Title: Gamestop Big Picture: The Short Singularity Pt 2
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Disclaimer: I am not a financial advisor. This entire post represents my personal views and opinions, and should not be taken as financial advice (or advice of any kind whatsoever). I encourage you to do your own research, take anything I write with a grain of salt, and hold me accountable for any mistakes you may catch. Also, full disclosure, I hold a net long position in GME, but my cost basis is very low (average \~$45/share with my later buys averaged in), and I'm using money I can absolutely lose. My capital at risk and tolerance for risk generally is likely substantially different than yours.

First, thank you everyone for the comments and questions on [my first post on this topic](https://www.reddit.com/r/investing/comments/l5l413/gamestop_big_picture_the_short_singularity/). Given the traffic and sheer volume of questions, I figured writing another post would be better (and actually something I can manage).

I wanted to focus this post on a few common themes I saw in the comments to the first post, as well as questions people were asking me directly, and related themes I saw on other posts and subs that I believe would be informative for this sub.

First, a simplified recap of the 1/27/2021 trading day as I saw it. The following is my interpretation of events, and may include personal opinions, assumptions, and outright errors. Apologies for the length, but I hope this helps some of the newer traders thinking about jumping into the water with these sharks. I honestly don't think that you should, but you make your own decisions. I'll just try to help provide some information to help if I can.

Euro Market Hours: Retail Euphoria & The Setup

After-hours and Euro market activity rockets the stock in an essentially unbroken streak from \~$146 to $365. GME long social media is going ballistic.

Volume is too low. There is no sell-side pushback. Allowing consolidation at these prices would be a major setback for the short-side, yet they are doing nothing on volume they could easily push back.

I smell a rat. This is too easy.

5am Eastern: Fear, Uncertainty, Doubt (FUD)

If you ask most retail market participants about how quants with their algorithms, hedge funds with their trading strategies, sophisticated experienced traders, etc., conduct their operations, you will probably get responses about sophisticated programs and high frequency trading, fundamental analysis, risk hedging strategies, lots of math, etc. That is largely true, but it is critically incomplete. The most successful hedge fund managers also deeply understand that beneath the surface, the primal forces driving markets are fear and greed, and they know how to best leverage information asymmetry to play other investors--and especially retail investors--like fiddles.

As retail sentiment reaches fever pitch, Andrew Ross Sorkin gets a call from Melvin Capital just before the start of CNBC's Squawk Box, by far the most-watched pre-US market show and files a [breaking news alert](https://www.youtube.com/watch?v=1HYBo5teFTU) at the start of the show.

(Paraphrasing) Melvin Capital is out. They didn't go bankrupt but they came close and took a huge loss. Congratulations WSB, you've won and you've burned the house down, and now that the shorts are out this whole thing is going to crash and burn all the retail investors you dragged along with you.

"[Who's going to be left holding the bag](https://youtu.be/1HYBo5teFTU?t=146)?... uh, the thing that concerns me most, at this point, is whether **some of these investors will actually start to get out today**\--they'll look at this and say 'we won the game'--if that's winning, uhh unclear, you know, where the finish line is, uh in that regard, but uh, as much pain as they may have uh, created for Melvin Capital for example, umm, **my-my great anxiety at this point is the number of-of retail investors that have been jumping into this uhh.. in literally the last 24 hours who very well may get hurt, uh, far more, and lose far more than some of the hedge funds that were involved, uh in this**. Um, let's just show you where we are now..."

"**Where are the regulators**.. and is this just the beginning?"

Meanwhile, as if it had been choreographed and rehearsed, the Squawk Box team are outraged--absolutely outraged at what is going on, while a big graphic of GME price crashing off a cliff dominates 2/3 of the screen and social media is flooded with messages and posts skillfully crafted to stoke the fear.

In WSB, other subs, and other social media sites, dozens of bots start posting bogus messages purporting to mock the retail investors with messages like "Thanks for the free gainz retards!".

The fear is almost palpable coming through my monitor. People start trying to sell, then start asking why their market sell orders won't go through while they're watching a practically vertical dive on the GME chart next to Joe Kernan as he says "If you think there's speculation in crypto \[...\] and-and-**now they're looking for the next mark, right**? They'll-they'll find another Gamestop, once they're done with Gamestop, but **in the meantime, there's gonna be BLOOD**".

Congratulations Squawk Box--you beautifully played your part in engineering peak, nigh-hysterical fear among the less experienced retail investors, and basically shouted "FIRE!!!" in the market equivalent of a locked theater. I truly believe your feelings were sincere, and you truly do have concern for the retailers who have been and will be hurt in all of the volatility, but that made your actions all the more effective in driving many try to lock in losses. C'mon, you can do better--I've seen you do good work and am thankful for what you did getting good info out during the peak of the pandemic--please do some investigation before spreading only one side of the narrative handed to you by financially conflicted parties. You have analysts doing your background research--any of them could tell you the short interest in GME would take more than an entire trading day to unwind even if the buy-side of every single transaction that day was to close a short position and no new short positions were initiated. Also, any of them could tell you that it's unlikely Melvin Capital held 100% of all short interest in GME. Melvin leaving is not equal to all shorts being covered--and you didn't even get confirmation that Melvin actually covered! Get them to say it themselves on air rather than carrying their water and letting them ride on your reputation and providing cover from an SEC stock manipulation investigation.

Most retail brokerages don't open pre-market trading until around 7am. All those people could do was watch their positions bleed as GME plummeted over the remainder of the next 2 hours, hitting the floor of $182, nearly 50% down from the peak about 3 minutes before retail brokerages open pre-market trading.

Wow. I have to hand it to the short-side hedge funds. Some of your traders must have studied drama for their undergrad or something--that is almost perfect timing.

Almost, but not quite.

Pre-Market Tears... of Joy and Relief

The engineered crash was probably intended to run right through the open of retail pre-market, with the idea of getting panicking retail to sell into the low liquidity environment for more violent downward price moves without the benefit of Limit Up/Limit Down halts, causing a stampede for the exits. Man, how many hours did you guys spend thinking this strategy up? I'm honestly impressed.

Two minutes prior to pre-market open, however, some deep conviction, deep pocket players, understanding the market mechanics and fundamentals behind the recent wild ride in GME started raking in the shares at discount prices they probably never thought they'd ever see again during this campaign. I'm sure tears of joy were shed, as they realized floor-to-close of regular trading gains of nearly 100%.

Whoever you are, well played.

I would note here that those people could easily have waited for the engineered crash to drain the blood of the fearful retailers who would have punched out, which would have allowed them to lock in greater share volumes at even lower prices, but they stopped the crash early instead. I don't know if that was their intention, but a lot of retail people were probably saved because of that.

With the almost literally last-minute reversal, price rode green candles upward through the retail pre-market open, and many who would have despaired and punched out to lock in losses instead white-knuckled through the chop and held, with very bullish action through to the market open. Those who survived the day--good on you, I know it couldn't have been easy.

Chamath

Let's let the man [speak for himself](https://www.youtube.com/watch?v=1iYh_mc26SU) (and speak up for retail). Well worth spending 30 minutes to watch if you have the time. I have to give Scott Wapner credit--he asks tough questions and he repeatedly brings on guests that he know will go toe-to-toe with him with the gloves off to ensure that there is a good, vigorous debate representing diverse viewpoints. Be on the right side of history big boy, lol.

Skirmishing continues at lower volume than the last 2 trading days. Bullish patterns everywhere--buying up on high volume, straggling down on low volumes. Liquidity is running out. Short-side is rationing, saving ammo for the end-of-day push.

Shenanigans, End of Day, More Shenanigans

At various points throughout the day, levers are pulled to flush retail positions out by margin calling profitable accounts across many of the retail brokerage firms, changing margin requirements with no notice.

Short-side attacks coincide with ominous warnings on news media about potential regulator action, short-side touts spreading FUD across mainstream media.

Short-side's rationed insufficient shares to make meaningful progress on the last tick of regular trading. This is key, as prime brokers of highly levered players pay a lot of attention to the status of accounts at the end of regular trading each day.

After hours it looks like more retail traders are dumped out of their profitable portfolios due to margin change requirements--right into the abyss of super-low after-hours volume. Had their brokers at least liquidated their accounts toward the end of the main trading day into meaningful trading volume they would have gotten much better returns. Dumping them into no volume means the last few accounts took massive losses vs mark to end of trading day market price. Thank, you brokerages, for protecting those people from themselves. Hopefully they took lower profits vs being dumped into the red.

Some people see the diving ticker and panic again.

One thing that was particularly irritating to me is that people were all over CNBC multiple times a day, making outrageous claims of how retail traders were slamming risk into the market via leveraged trades even as the retail brokers changed their policies in realtime to disallow use of any margin in accounts holding GME, and dumped those retail traders out of their positions. I knew what kind of volatility to expect, so I had maintained a net cash position in my account ever since buying, just in case something like this happened--thank goodness.

Technical Analysis for the Day

I wish this sub would allow charts, but I'll describe instead.

On the daily chart, RSI has been in an ascending channel since April '20(!), and rocketed to 98+(!!!) at the end of the trading day. Price is dislocating wildly higher every day for the past 4 days into descending volume.

My read of the chart is that it shows massive buy-side dominance into worsening sell-side weakness and lower liquidity. I read this as mind-meltingly, parabolically bullish, and something that would not be possible if not for the distortion of the supercritical mass of short interest, and I guess this is what a short squeeze looks like when you have access to all the data retail fintech can provide. The technicals tell me to expect massive volatility, but also that this is possibly the most asymmetrical risk environment imaginable.

I feel bad for the retail shorts that I know were out there. I saw a few posts about people taking short positions because Andrew Left got on TV and told them GME is going bankrupt, it's going back to $20, and he's an expert unlike you reddit amateurs, and by the way about 30 other experts followed and backed him up over the past few days. For this reason I'm glad that many of the retail brokerage firms have disallowed shorting GME and other volatile names. I hope they got out before their accounts got obliterated.

Lessons Learned

I wondered what kind of things you might see when billions of dollars were on the line, and I have to say that the short-side guys know how to go all-in and pull surprise after surprise out of the hat. They are good at manipulating people, letting them build up euphoric feelings only to slam them in the face with nonstop fear. They do it in media, and they do it in sudden price-crushing rushes, slamming the ticker down to try to get weak hands to fold. As I stated earlier, I am trading deep in the money, on capital I can afford to lose, and even I can't avoid feeling it. I honestly don't know how some of you trading on borrowed money meant for next month's rent can handle it.

The short-side players are running out of ammo, but they don't just go toe-to-toe in the market--they'll blanket media and even flood your discord server, message board, and social media with well-coordinated bot attacks. You will face those moments of stark terror--they are good getting people to feel fear. If you're thinking of getting into this trade--please understand that before deciding whether to jump in. You might not think that a stock that's been going basically vertical could leave long-side casualties on the field, but believe it--fear and volatility can get you to zero your account (or worse!) in any environment.

FAQs from the First Post (comments and messages)

(answers are my opinions only--do not take as financial advice. I've consolidated common themes.)

* **I'm afraid I'm missing out on a unique opportunity to make returns that could change my life trajectory in a positive way. Should I buy in at this point?**

First, each person decides on their own what trades they choose to make. However, I will say this: Fear is giving you this anxiety. Maximum FOMO is when you see green candles going up until the fear makes you punch the buy order in. Maximum despair and fear of life-altering losses hits peak during deep downward price movements, making you punch out to avoid losing your entire position. Fear makes you buy high and sell low. HFT houses are full of algorithms designed to exploit fear through the price movement, and find gaps in your risk mitigation strategy (e.g. stop-loss hunting algorithms, etc.). If fear is driving you to trade, I urge you not to swim in low-liquidity waters with sharks who specifically make their money exploiting fear.

* **I am a regular investor holding broad ETFs or mutual funds for my retirement. I do not actively trade, but I am concerned that what's happening here might impact the broader market, and maybe even my retirement account. Have you thought of that while you're having all this fun? What about systemic risk?**

You may be surprised to hear that I, and likely many others have thought quite a lot about these things. In fact, I hold about 75% of my capital in the same type of boring IRA and 401(k) accounts you're talking about, and I maybe rebalance them a few times a year and don't even check the balances regularly otherwise.

As for what kinds of impacts there may be--in all honestly, no one knows. Specifically, no one knows because no one knows exactly what the levered hedge funds involved hold, how they trade, etc. The massive short interest in GME is basically a deliberately engineered market distortion that is now blowing off, and distortions blowing off are always scary, and can spell financial damage or disaster for the unprepared.

That, however, is part of the market. To paraphrase Dr. King and Keynes, the arc of the market may be long (and longer than you can remain solvent), but it bends toward efficiency, given the right conditions. The US stock market is pretty good in this respect.

Now I won't deny that these hedge funds are run by smart people, but they occasionally get either arrogant or too clever for their own good and get caught. In GME they essentially voluntarily engineered themselves into a short squeeze entirely on their own while no one was even looking. In fact, the only way the trade works is if no one ever finds out and GME quietly goes bankrupt. In the meantime, a legitimate fundamentals-based turnaround story came to light and just lit the fuse. They're crying now about being cornered, but they walked into that corner themselves, then dug themselves in so deep that the only way out was GME bankruptcy, and sat there for a year just assuming GameStop would go bankrupt while no one was paying attention and they'd take their free money and walk. If this doesn't make sense, and you have a free 20 minutes and tolerance for mild profanity, I suggest you watch this video: https://www.youtube.com/watch?v=4EUbJcGoYQ4

Anyway, That being said, market "corrections" are aptly named, even if painful, because they are, in essence, corrections of various distortions in the market. The longer they go uncorrected, the harder, faster, and more drastic the move when it does happen--with usually worse consequences (see the 2008 financial crisis, which was a distortion 10+ years in the making before blowing off).

* **It looks like maximum gains on this trade would have started if you bought in at $4. Should I be looking for names at <$4 to find another opportunity like this? I heard some people made a lot of money on Hertz. Is this like Hertz?**

I have no idea. I wasn't looking at Hertz at the time. Obviously it's different in that GME is not going bankrupt despite what some people on the news might say (honestly, I don't understand their apparent conviction on this given most of them profess to not even know any details about Gamestop).

The sense I get is that some people realized that many stocks had their prices artificially suppressed by the pure panic in the market at the time, and were likely to bounce back. Stocks crushed down to penny stock land could easily bounce back multiple hundreds of percent just by moving back up by $1, and if you had a good reason to think they'd survive, that's a pretty good deep value trade.

Some people seemed to jump on that bandwagon with the mistaken idea that you should basically just scan all stocks for things <$5 today that used to be >$20 or whatever and assume the 90+% drop will result in a bounce off the floor, even if it's a "dead cat" bounce on the way to $0. DO NOT TRY TO TRADE THIS.

The theory is that a $100 stock that drops to $10 on its way to bankruptcy could bounce back to $15 first—a return of 50% if you time the floor and the bounce perfectly. In practice almost everyone who tries this loses all their money much sooner rather than later.

By the same token, people who "know" a company is heading to bankruptcy get their accounts wiped out when they short something on margin right as it hits a floor on the way down, get margin called on the bounce, and subsequently join the company in insolvency as they end up owing their broker more than they put in. Being right in the end is cold comfort at that point.

* **Could Gamestop just issue shares to bail out the short sellers?**

I guess it could, speaking entirely theoretically. That being said, consider the following:

They've already filed to issue $100mio worth of shares, or 500k shares using $200/share as a price assumption. I don't know if they've begun to execute on that.

That was just to give them the runway required to take bankruptcy completely off the table.

As you note, at these prices, using stock to finance a turnaround is absolutely feasible.

There are, however, a few things to consider:

1. They have a fiduciary responsibility to their shareholders. They need to be able to justify how issuing even more shares is ultimately beneficial for the company and shareholders. “Because our stock price is high right now” is not typically a compelling reason, though maybe these circumstances are an exception to that rule given the extremity of the price.
2. While a healthy balance sheet would be an improvement, debt is usually cheaper than equity when it comes to financing a company’s activities. If they can secure solvency with the $100mio stock issue already authorized, and leverage the healthier balance sheet and insanely improved market cap to instead borrow what they need to restructure, especially in this ultra low interest rate environment, that would be better for the company and shareholders.
3. They can’t just make a snap judgment to do so. It takes time, board approvals, regulatory paperwork that is public, etc. There is a lot of work and potential risk in this process—particularly for this company.
4. Even if they did this, the incredible total volume of short interest being squeezed means that in practice it would be hard for the share issue to change the trajectory of the stock. The main effect might be to terrify some retail longs into bailing out of their position depending on how the news is presented to them.

* **_______ securities pricing theory/model means short interest has no impact on a security's price, short positions can be held infinitely so there really is no obligation to cover, so the thesis behind the short squeeze trade is invalid, etc. Mathematically long and short positions are the same thing.**

That may be true in some ideal theory assuming you are trading in some kind of mathematically ideal market using very specific assumptions, but you’re trading in a real market that includes things like counterparty risk, regulatory and contractual limits on ability to borrow (at least in theory--Hello SEC, threshold securities list??), interest cost, etc. that make trading in an real market different. I'll build on Box by saying all models are wrong, but some are useful--*within the bounds of certain assumptions.* The situation playing out now tells you that the short interest of GME is wildly outside the bounds of whatever models the hedge fund people are using to model position risk.

You can, in theory, infinitely roll your debt forward if you can continue to find willing lenders and are ok paying interest forever. Maybe this works out to be mathematically preferable to a squeeze to infinity.

But, step away from pure theory for a moment. We don't even have to look at empirical evidence in real markets. All we need to do is build a stochastic model of an equity market sophisticated enough to model margin limits and dynamic account balances tied to securities being traded as they are in real markets and you’ll see the probability of continuing to carry a short position converges to 0 over time. The only question is which happens first: you cover proactively, the underlying company goes bankrupt (and you cover for $0 less interest paid to borrow the stock), or you’re margin called and forced to cover with potentially unlimited downside. Take bankruptcy off the table as we have in the case of GME and you have one of two choices--get out or eventually get squeezed out. There is no such thing as infinite ability to roll borrowing forward in real markets, and if your risk models assume that I feel sorry for you.

* **Is this illegal? Will the SEC step in somehow?**

I am not a lawyer. I do not give legal advice. And, honestly, I have no idea. I can't think of any securities regulation that at least I may have violated, but I also don't have the ability to lobby the SEC on international news.

* **So what will happen next?**

I don't know, and most likely anyone who tells you they know is kidding themselves. All I see is a good fundamentals-based position I bought into at a reasonable but bullish valuation followed by the most bullish chart I've ever seen from a TA perspective. I have theories, but there are doubtless other people better qualified to opine on that.

All I can say is if you're in the trade, strap in and prepare for a wild ride. If you're watching from the sidelines get out the popcorn. The rate at which liquidity is disappearing means whatever is going to happen will happen soon (assuming the SEC doesn't step in with an extended pause in trading to bail out the hedge funds).

Thank you for reading, and good luck with your trades.

Update from Original Draft, 1/28 Pre-Market

We're seeing tons of retail brokerages limit trading on GME to only allow selling, even when current positions and intended trades would be cash only?

Wow, I mean it kind of occurred to me in some sort of theoretical, abstract sense that somehow limiting large swathes of retail to sell-only was actually better than a general 2-way trading suspension, but who knew the short-side people could actually get retail brokers to do something so bonkers?? I guess you really do find a way to try basically anything when you're about to lose that much money.

edits to fix formatting issues