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Author: disoriented_llama
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It's been a while since I last wrote anything extensive on GME...

It's not that the DD is done, it never is.

But, I wanted to be sure of some things I have thought for a long time before I presented anything. I wanted to approach analysis of GME from a place of neutrality again. Without the pressures placed on the research process from the investor community that surrounds this stock. It was important for me to try to look at GME in a different light. A step back is sometimes necessary to improve objectivity.

To view GME from it's importance in the macro environment you need to shed a lot of false assumptions about it's relevance or potential as it is viewed by many who invest in it. Even for me, after all this time it is hard not to place GME on a pedestal. There is no doubt that it's behavior remains abnormal. Even when compared to other stocks in the basket like AMC, BBBY, etc... it outperforms in almost every metric since 2020. So the question I wanted to answer is, why?

What really makes GME different?

Is it idiosyncratic risk? Is it overleveraged naked-short positions? DRS? Retail interest?

I don't think any of this is true.

There are other stocks with retail interest. There is still zero evidence of outstanding short positions (barring derivatives like total return swaps that are unaffected by the current or future price of GME). Some stocks have greater ownership of their float by insiders and employees that continue to be shorted such as DDS. As for retail they'll jump into anything that is up 10% on the day and bag-hold it forever (DOGE, ATER, MMAT, BBIG, DWAC, etc..).

So I had to step back and look at what makes the basket of stocks that GME correlates with so different from all the stocks on the exchange and specifically of the stocks in the basket, why does GME outperform?

Part I: The Basket

So let's try to classify all the stocks in the basket based on some simple metrics.

This once would have been a simple task, the assumption was that they simply needed to be retail stocks that were shorted hard during the pandemic or long-term targets of predatory shorting. I no longer believe that to be the case.

These are traits found among almost all basket stocks:

* They have robust and liquid options chains (except KOSS & DDS, I'll explain later)
* They have relatively high implied volatility in those options (50%+)
* They have significant insider/retail/institutional ownership or smaller shares outstanding.
* They have a liquidity release mechanism, either ETFs or warrants
* They have larger numbers of FTDs per unit of volume traded
* Large trading ranges due to active index fund trading and wide bid/ask spreads.

This can be distilled even further down two primary factors...

1. Liquidity

2. Volatility

So let's discuss these primary drivers of basket stock price performance

I. Volatility

Contrary to popular belief, volatility is not based on directional trend in a stock. It is simply the amount a securities price fluctuates.

There are two types of volatility we will be talking about here

1. **Historic Volatility -** The annualized standard deviation of a past price movements. Plainly, the amount a stock moved around over the past year.
2. **Implied Volatility -** The markets forecast of future price movements. This is found in the pricing of options as a measure of risk. A security with no options has no implied volatility.

So basically Implied Volatility (IV) is the market makers measure of risk in the future based on their assessment of risk in the past. This allows MMs to price in risk on sold options to protect themselves from unforeseen price movements.

The other important thing about volatility is it influences the price of almost every asset in the market. Because of the esoteric nature of options contracts "right to exercise" but not "obligation to exercise", potential range of movement must be baked into each contract. This is why trading options is considered by many to be trading volatility.

So implied volatility becomes, over time, not a representation of risk in the market, but the cost of risk in the market. A product like any other to be bought, sold, and traded by market participants.

Most importantly for our purposes a product to be sold short.

So why sell volatility short?

Well first it is good to remember that owning equities is the same as being short volatility. Since price and volatility are inversely correlated by taking a position hoping for price improvement you are effectively short volatility.

Selling volatility short is essentially betting that risk in a market is priced too high. You disagree with the amount of risk being priced in and you short it. It's a non-directional strategy, so profitable regardless of the direction of the underlying price.

In a bull market volatility shorting can become severely overcrowded. As volatility is inverse price, it is a self-reinforcing position; markets are going up so IV is going down. All of these participants reducing the forward pricing of risk in the markets leads to asymmetry in the way the market is pricing risk.

[This is an example of expanding risk in short volatility positions with the S&P; 500 and the VIX. When the risk\/reward flips the asymmetric tails collapse.](https://preview.redd.it/b9pv3pwludf91.png?width=2349&format;=png&auto;=webp&s;=4f2c68f33daef889c5fdccdcdae0d9044c6e6e81)

This happened to volatility sellers in 2018 in an event known as "Volmageddon" and again in 2020's "COVID Crash". Risk in the market is currently not appropriately priced...

II. Liquidity

The market liquidity is a feature of a market where an asset can be purchased or sold quickly with minimal change in price. There should always be ready and willing buyers and sellers. It is one of the key components of market efficiency. The most liquid asset is cash, because it can be traded for items or assets at face value, immediately. This is where the term liquidate comes from; to turn into cash.

For stocks and options this liquidity can be visualized in it's bid/ask spread. Highly liquid and frequently traded stocks will be able to be bought and sold with relatively little change in price. This will be represented in their bid/ask spread (order book). The same is true for options. This effect is fully realized when trades are executed in the market.

In an illiquid market the efficiency breaks down. Sold stocks will demand a discount from buyers (buy the dip...) since the risk of carrying the asset demands a higher return on investment (MOASS). Buyers and sellers in this market are at odds both striving to get more from their investment due to the increased risk of trading it. This is what drives the wider spread.

Illiquid markets also have less depth, fewer buyers and sellers want to participate so there is less alignment in pricing due to the spread the further the stock moves from the price it started meaning buyers need to take on more risk or seller need to more steeply discount in order to efficiently participate.

This can be a hard concept to grasp, think of liquidity like the flow of water. A wide, deep river will move millions of gallons of water a minute but the surface is calm. Whereas a shallow rocky river will still move water but it's surface will be turbulent and chaotic.

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III. Illiquidity vs. Risk

So now that we understand these concepts we can apply them to the basket of stocks we have been watching for over a year. Since the markets on these stocks are less liquid, they present a greater amount of risk to participants. The people making these markets price this risk into the options for these securities. So we end up with what I will call **Gherkin's Law.**

>**Gherkin's Law**
>
>I. Liquidity is inverse volatility.
>
>II. Liquid markets have low volatility.
>
>III. Illiquid markets have high volatility.

Illiquid markets by nature of their high volatility attract buyers and volatility sellers and they remain until their position is either no longer profitable or they are forced out (like the earlier S&P; 500 examples). These two factors of liquidity and volatility will lay the groundwork for what I will discuss in the next part of this DD.

Part II: Damming the flow

So if you understand the risks of selling volatility, you want to do it in an environment were it is profitable but your position is not at risk of competing with larger entities. Many short volatility sellers had already been burned in 2018/20, and were more wary about diving back into those high-risk macro environments.

Enter the basket stocks.

These low interest illiquid environments are perfect for volatility sellers. They generate volatility naturally due to their illiquidity and their volatility makes them unattractive to large institutional investors, but more attractive to traders who are seeking the higher risk/reward environment they present.

This group of assets is the perfect playground for these Volatility Funds, Market Makers and Authorized Participants. With any two of these three types of participants you can start to control the flow of liquidity and generate volatility.

Back to the water metaphor once again, think of this asset and participant structure like a hydro-electric dam. The market makers and ETF authorized participants acting as operators controlling the flow of liquidity and the volatility funds sell the energy created.

[Flow of cash into less liquid markets](https://preview.redd.it/zf49zf5gvdf91.png?width=1484&format;=png&auto;=webp&s;=116b37cce7c74b16a3a4ac53e951f4f3cb455972)

By manipulating the flow of liquidity into these small volatility prone assets they can ensure 2 goals.

1. That there will be volatility to short and interested buyers due to the wide range of price fluctuations .
2. That the position will not be at risk. Since control of the timing and volumetric flow is under their stewardship, the position is actually very stable even though to outside speculators it may appear high risk.

In essence these funds are able to create a perpetual volatility machine inside each of these small/mid-cap equities. Guaranteeing a product to sell.

I have [discussed in the past](https://www.reddit.com/r/Superstonk/comments/sy36q8/wycking_off_for_opex_confluence_of_datasets_and/) the flow of shorting and FTDs between GME and ETFs. Through this process funds with the proper liquidity rights (MMs and APs) can achieve absolute control of a small illiquid market.

I'll try to outline the process here using GME's chart as a visualization may help in understanding this better.

[If you ever wondered why GME goes up so quickly on such high volume and down on low volume...this should help explain it. Without going too in depth with the cycles, I'll say that the only events that generate liquidity and IV in GME are ETF FTD periods and OPEX events. Until now, I'll explain in due course.](https://preview.redd.it/tpvoe4oa8ef91.png?width=2461&format;=png&auto;=webp&s;=63ee68dd0d0066ea999d0aaeb62c9d0bd19e1ceb)

So when you look at price/volume/volatility overlaid in this manner you can start to see how this controlled release of liquidity Is extremely advantageous to volatility sellers. By blocking the flow of liquidity they can short the underlying and it's volatility almost risk-free until the volatility stagnates. Then they start all over again.

* **Step 1: Short the stock and sell volatility**
* Effect: Price drops/IV drops
* **Step 2: Offset short positions in ETFs**
* Effect: FTDs on the stock are pushed out to the following quarter allowing covering at the bottom of the short cycle.
* **Step 3: Hedge the incoming upside move**
* Effect: Protects the short equity/volatility position from the liquidity release.
* **Step 4: Cover all FTDs and short positions from the previous cycle (OPEX).**
* Effect: Introduces a large surge of liquidity resulting in a massive move in IV and allows short positions to start back at Step 1.

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Many of these actions are done with large swaps across multiple assets at once. Using combinations of volatility, total return, and entropy swaps they can ensure that they remain profitable across each cycle of covering and shorting. This strategy is underlying hundreds of assets across multiple sectors. It is profitable and effective.

[https:\/\/www.bloomberg.com\/news\/articles\/2022-03-15\/citadel-securities-opens-up-after-record-7-billion-windfall](https://preview.redd.it/i5weyxpalef91.png?width=656&format;=png&auto;=webp&s;=f10efa2be2903cf3b19b8ad54757d683ac405a02)

[https:\/\/www.afr.com\/wealth\/investing\/susquehanna-the-poker-aces-playing-a-key-hand-in-the-us5-trillion-etf-market-20181122-h186s2](https://preview.redd.it/yibpod1slef91.png?width=751&format;=png&auto;

=webp&s;=66444d5a0ba62f43882dbd0c386a80df3a81df25)

Short Volatile risk three years before "Volmageddon"

https://www.globalvolatilitysummit.com/wp-content/uploads/2015/10/Short-Volatility-Positioning-A-Cause-for-Concern-Barclays.pdf

Barclays Strategy for shorting "meme" stockshttps://www.docdroid.net/5gM68EW/barclays-us-equity-derivatives-strategy-impact-of-retail-options-trading-pdf#page=2

So I haven't answered the question, what makes GME different?

Well as a company nothing... I know. But that is the rub of this whole thesis, GME really isn't any different from any other stock in this basket or in it's sector. Cohen, NFTs, DRS, MOASS, Dividend...etc.

None of it matters.

The only things that matter are volatility and liquidity.

But something about GMEs liquidity that ***is*** ***vastly*** different from the other stocks in the basket. The participants in GMEs markets do not behave the way they are supposed to. They are an aberration, a risk. Exactly what these positions seek to avoid.

Part IV: When the Levee Breaks

So there are two ways this seemingly perfect strategy can break down.

I. **Liquidity Can Overwhelm the System.**

The timed release of liquidity means that they must open their position to risk once in a while in order to rebalance and generate volatility. These massive surges of liquidity attract risk-seeking speculators. While retail isn't capable of overwhelming their hedges other institutions can. In a bull market there is no desire to go to war with another fund as the market is rife with opportunity. In a bear market however when opportunities are drying up and funds are more aggressively seeking profits and exposed risk the chances are higher. If institutions were to pile into these liquidity releases the protective hedges can be overwhelmed.

[When the hedges collapse...](https://preview.redd.it/06dbcrxnaff91.png?width=1639&format;=png&auto;=webp&s;=ec1f35448102f7c02a076140c02b383f7249fcd1)

II. Liquidity Can Run Dry

Since the system relies on synthetic liquidity and the underlying stocks have smaller free-floats. FTD creation is inevitable. This is a bit more complicated so I will try to break it down.

* When the system is running perfectly ETFs allow for the shifting of FTDs to a high-liquidity environment. As opposed to settling them directly on the stock which would drive volatility. That wouldn't be ideal for someone short volatility.
* The generation and subsequent offsetting of these FTDs means that the liquidity release becomes necessary to the trade. In bear markets many of these large ETFs can become overcrowded as institutions across the market seek to hold short positions. Over time this position shift can lower the amount of creation per day these volatility funds have access too.
* If the end of a cycle is reached and there is no liquidity to be released the fund is now staring down a massive pile of obligations. Without sufficient liquidity in the underlying stock trades begin to experience a higher fail to volume ratio.
* Eventually the fail-to-volume ratio can overwhelm the ability to clear them. Trades begin creating more FTDs than they are satisfying. This feedback loop creating obligations that cannot be cleared without a

massive influx of liquidity (squeeze). This is what happened on GME back in January 2021.

[Ryan Cohen dried up the liquidity in 2021, we are drying it up now.](https://preview.redd.it/nliyubrklff91.png?width=600&format;=png&auto;=webp&s;=6fc2d29a1f8c8437fa7ff1fcadceaed8703c6fd9)

This low-liquidity environment in the current bear market is already becoming a contagion. It's only a matter of time.

https://preview.redd.it/on1f7q9wmff91.png?width=1921&format;=png&auto;=webp&s;=d453fbc00a9d24bc3b47ab3848d4df40750e5425

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https://preview.redd.it/r5j6zzzcnff91.png?width=1920&format;=png&auto;=webp&s;=3afe9fd37d76e7542967353b454ab29930e93654

These stocks are all way more illiquid than GME or BBBY, but the fuse is lit.

\-Gherkin

>“It is perfectly obvious that the whole world is going to hell. The only possible chance that it might not is that we do not attempt to prevent it from doing so.”■ **J. Robert Oppenheimer**

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[As always feel free to check out the livestream from 9am - 4pm EST on YouTube](https://www.youtube.com/channel/UCYmgi8psSbIWiSR2tefHbug)

Our join the community discord https://discord.gg/9ZDgRU7hFk

As always the information will be available here on reddit as well.

You are welcome to check [my profile](https://www.reddit.com/user/gherkinit) **for links to my previous DD**

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Disclaimer

** Although my profession is day trading, I in no way endorse day-trading of GME not only does it present significant risk, it can delay the squeeze. If you are one of the people that use this information to day trade this stock, I hope you sell at resistance then it turns around and gaps up to $500.* ■

**Options present a great deal of risk to the experienced and inexperienced investors alike, please understand the risk and mechanics of options before considering them as a way to leverage your position.*

**This is not Financial advice. The ideas and opinions expressed here are for educational and entertainment purposes only.*

** No position is worth your life and debt can always be repaid. Please if you need help reach out this community is here for you. Also the NSPL Phone: 800-273-8255 Hours: Available 24 hours. Languages: English, Spanish.*