Retail investors and media psychology

Ross Dahlke

Method	koRpus	stringi
Word count	1150	1132
Character count	7538	7537
Sentence count	54	Not available
Reading time	5.8 minutes	5.7 minutes

Abstract

Introduction

Financial markets were recently upended by massive short squeezes of a cadre of stocks including GameStop, AMC Entertainment Holdings, BlackBerry, and Nokia. The recent events saw historic fluctuations in the prices of these stocks. Individual investors made tens-of-millions of dollars, often with leveraged positions. What is particularly unique about these events is that they were triggered by retail investors. These retail investors, bolstered by financial stimuli and an abundance of free time due to the COVID-19 pandemic, organized collective behavior actions on an internet forum, the Reddit subforum r/WallStreetBets.

Media commentators quickly offered various perspectives on the events. Is this class warfare? A populist movement? Just some bored, lonely young men trying to make money? There is a deep pool of academic literature that explores the psychological motivations of retail investors and personal finance more broadly. For example, ________. In addition, there is a small, yet robust and powerful set of research on the impacts of media on financial markets. However, I am interest in the media psychology component of financial decisions. I am interested in how media impact financial markets in-so-much-as how the media effects, and is driven by, individual investors.

More broadly, my research investigates how individuals enter and participate in complex systems. In this case, the totality of the financial markets are beyond comprehension. Investors, particularly small, retail traders, are unlikely to ever fully understand the complex system of global finance. Yet, they do. And as is increasingly common, participants are coordinating activity in order to alter the systems that they participate in. As it pertains to retail investors, I ultimately want to know both *why* they participate in the markets, and more importantly, *how* they participate in the financial markets. What is the media ecology that individual investors are exposed to or seek out? How do novice traders come to trust the financial investment advice of various media outlets, communities, or individuals? What do people do after they lose their life savings in GameStop stock? How much time do retail investors devote to trading financial securities?

COVID-19 and Retail Traders

The COVID-19 global pandemic has spurred a rise in retail investors that rivals the boom of retail investors during the internet bubble after the rise of discount stock brokerages. At the center of the rise in retail investors is Robinhood. Robinhood is a smart phone app and stock trading platform that offers free trading of stocks and other securities. While other trading platforms have since adopted free trading, Robinhood created and maintained a significant following by being the first to offer free trading, it's gamified user interface, and a target demographic of young, new investors. With Robinhood easing barriers of entry for new investors, financial stimuli from the government due to the pandemic, and newly-found swathes of free-time, these retail investors grew in size and influence during the pandemic.

Retail investors now routinely account for 20% of stock market activity (Pagano et al. 2021) These retail investors on Robinhood significantly impact financial markets, particularly during COVID (Pagano, Sedunov, and Velthuis 2020). Users of Robinhood increased the amount of money they invested on the platform during the pandemic (Welch 2020). Robinhood traders primarily engage in both momentum and contrarian strategies where they invest in stocks that have already demonstrated rising price momentum and “buying the dip” where they buy stocks that have recently fallen in price, respectively (Pagano, Sedunov, and Velthuis 2020). In other words, Robinhood investors did not panic during broad market turmoil during COVID-19 and often used price drops as buying opportunities. However, in aggregate they do not produce an alpha, or “beat the market” by producing larger-than-average returns (Pagano et al. 2021). Their trades ultimately mostly produce noise in financial markets (Pagano et al. 2021). If all Robinhood investors do is create “noise” in the markets, then the noisiest they’ve been is when GameStop stock rose dramatically in early 2021.

GameStop

In January and February 2021, a handful of stocks experienced an extreme “short-squeeze” which effectively sky-rocketed the prices of these stocks that was caused by decentralized retail investors acting in concert (Lyócsa, Baumöhl, and Vŷrost 2021). The largest movement was seen in GameStop which took most of the attention of the saga. Many investors, both individual and institutional, gained and lost significant sums of money. For a full recapping of the sequence of events, I recommend _________.

The GameStop saga provides support for the principle that market forces tend to make markets fair, “where fairness is defined as investors ‘getting what they pay for’ rather than investors ‘beating the market’ ” due to the apparent misvaluation of GameStop and other stocks by institutional investors (Macey 2021). On the other hand, the events also cast doubt as to whether the SEC is achieving its stated goal of maintaining fair, orderly, and efficient markets" (Macey 2021).

The retail investors who caused the short squeeze organized on a subforum of the popular website of Reddit called “Wall Street Bets,” or r/wallstreetbets (Lyócsa, Baumöhl, and Vŷrost 2021). As a result, the GameStop saga is seen as battle between Wall Street and small, Robinhood traders who are upset at Wall Street. The members of r/wallstreetbets maintained a sense of unity and purpose throughout the events (Muzio 2021). Regardless of whether the organized behavior of r/wallstreetbets users is a political movement, hopeful acts of “sticking it to hedgefunds” or something else, they have demonstrated their power to move financial markets (Muzio 2021). However, retail investors as whole both bought and “shorted”–or bet that GameStop stock was going to go down–indicating that “the Gamestop frenzy was not a pure digital protest against Wall Street but speculative trading by a group of retail investors, in line with their prior high-risk trading behavior” (Hasso et al. 2021).

r/WallStreetBets

Wall Street Bets is a subreddit where investors talk about their stock trades. The group is known for their risky “YOLO” (You Only Live Once) trades (Muzio 2021). There is a particular language and meme culture that permeates from the group and potentially helps to create their culture of “degeneracy” (Boylston et al. 2021). For example, they celebrate people with “diamond hands” as those who are prepared to hold to their stocks for a long time and decry “paper hands,” those who miss out on profits by selling too a stock too early (News 2020). They maintain they are not “dumb,” but they are “retarded” or “autists.” Although these words are derogatory, they use it as a way to self-deprecate and build unity.

Information and Media

Efficient market hypothesis

Tetlock: 2011

Attention

Barber and Odean 2008

Engelberg 2008

Antweiler

Mass Media

Fang 2009

Wall Street Journal

Barber 1993

Lian 1999

Tetlock 2007

CNBC/ Mad Money

Keasler 2010

Karniochina 2009

Bolster 2012

Engelberg 2012

Peress 2014

Market efficiency in real time

New Media

Da 2011

Farrell 2020

Campell 2019

Social Media

Tumarkin 2001

Antweiler 2004

Echo Chambers

Cookson 2021

Heimer 2016

Jame 2016

Hailiang Chen

Crawford 2018

Bartov 2018 (sentiment)

Chawla 2016

Sanjiv 2007

Herding and Social Effects

Reddit's self-organised bull runs

Musciotto 2018

Ouimet 2020

Ivkovic 2007

Duflo 2003

Duflo 2002

Shiller 1989

References

Boylston, Christian, Beatriz Palacios, Plamen Tassev, and Amy Bruckman. 2021. "WallStreetBets: Positions or Ban." http://arxiv.org/abs/2101.12110.

Hasso, Tim, Daniel Müller, Matthias Pelster, and Sonja Warkulat. 2021. "Who Participated in the Gamestop Frenzy?" *TAF Working Paper No. 58* 58 (February).

Lyócsa, Štefan, Eduard Baumöhl, and Tomáš Vŷrost. 2021. "YOLO Trading: Riding the Herd During the Gamestop Episode." *ZBW - Leibniz Information Centre for Economics, Working Paper*. https://doi.org/http://hdl.handle.net/10419/230679.

Macey, Jonathan R. 2021. “Securities Regulation as Class Warfare.” *Columbia Business Law Review, Forthcoming*, February. https://doi.org/http://dx.doi.org/10.2139/ssrn.3789706.

Muzio, Tim Di. 2021. “GameStop Capitalism. Wall Street Vs. The Reddit Rally (Part 1).” *University of Wollongong Working Paper*, 1–13. https://doi.org/http://bnarchives.yorku.ca/673/.

News, Wallstreetbets. 2020. “Dissecting the Unique Lingo and Terminolgy Used in the Subreddit R/Wallstreetbets.” %22https://www.wallstreetbets.shop/blogs/news/dissecting-the-unique-lingo-and-terminology-used-in-the-subreddit-r-wallstreetbets%22.

Pagano, Gregory W., Clifton T. Green, Brian Roseman, and Yanbin Wu. 2021. “Zero-Commission Individual Investors, High Frequency Traders, and Stock Market Quality.” *Available at SSRN: Https://Ssrn.com/Abstract=3776874 or Http://Dx.doi.org/10.2139/Ssrn.3776874*, January. https://doi.org/http://dx.doi.org/10.2139/ssrn.3776874.

Pagano, Michael S., John Sedunov, and Raisa Velthuis. 2020. “How Did Retail Investors Respond to the Covid-19 Pandemic? The Effect of Robinhood Brokerage Customers on Market Quality.” *Finance Research Letters, Forthcoming*, November. https://doi.org/http://dx

Welch, Ivo. 2020. “The Wisdom of the Robinhood Crowd.” *NBER Working Paper Series*, September. https://doi.org/http://www.nber.org/papers/w27866.