All the Ways the GameStop Roller Coaster Could End

It could crash. It could coast. It could hook hedge funds to Reddit. And it could change Wall Street forever.

By ALEX KIRSHNER

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The siege by Reddit’s WallStreetBets community on institutional investors betting against the stock of video game retailer GameStop is now the stuff of internet and market legend. A loosely organized movement of amateur traders has made GameStop’s stock one of the most traded equities on the planet, and one of the most discussed ever.
The gambit to buy stock of GME in huge numbers anddrive up the price has made some
Redditors and their allies life-changing money. A stock that cost $2.57 in the early days of
the pandemic rose to around $30 in mid-January and $380 by one point on Wednesday.

Early Thursday, the online trading platform Robinhood halted new acquisitions of the stock
as the price kept going up past $400, inspiring an immediate class-action suit and
widespread outrage among the Redditors and other retail investors, including Ja Rule.
Shortly after the stoppage, the stock took its steepest drop of the week, plummeting from
nearly $500 at one point in early trading to under $150 after markets opened. The stock
then went back up over $250, then back down to around $200, and could remain on a roller
coaster interminably. After all, the Redditors have yet to publicly surrender.

On the other side of the coin are short sellers, mainly institutional investors such as hedge
funds, that had borrowed the stock, sold it, and hoped they’d buy it back at a lower price.
Instead, short sellers on GameStop had lost $24 billion by trading’s close on Wednesday,
according to financial analytics firm S3 Partners Redditors involved in the plan have
described doing it both to make a profit and make a point to Wall Street elites they dislike.
“It’s sort of Occupy Wall Street by the trading desk instead of by Zuccotti Park,” says David
A. Kirsch, a University of Maryland associate business professor and co-author of a book on
bubbles and crashes. “That’s real. It’s a social movement. It’s organized market action.”

So now that we’ve seen what’s possible when a horde of amateur investors squeezes Wall
Street, what will happen next? Will GME’s rocket ride continue? Will it crash hard? And who
will be left holding the bag? Some possibilities.

**The Stock Will Plummet More ... or It Won’t**

“You’re asking me to be like an oracle of the future,” says Campbell Harvey, a Duke
international business professor who also works as a partner and adviser to large funds.
“The answer’s kind of unsatisfactory for you, but all these scenarios are possible.”

Whatever happens, the episode marks the widespread discovery of a new frontier where
the internet and the stock market intersect.

The focus will remain for at least a while on GameStop. Nobody thinks GME got this
expensive because a brick-and-mortar video game retailer turned around its business
overnight. There’s been widespread skepticism that the stock price could stay high. But that
isn’t the same thing as a clear prediction it will fall forever, or do it soon. “Nothing is certain,”
Harvey says. “And one thing that people often don’t understand is a bubble is just a
deviation from fundamental value. A bubble can be permanent.”

GameStop lost $470 million in 2019 and announced hundreds of store closures in 2020,
another year for which it is also likely to report a big loss. By the company’s underlying
numbers, the stock shouldn’t be worth nearly what it is now. But assets can trade durably
above where they “should” for long stretches. One reason it happens is “the presence of
noise traders in the market,” explains Anastasia Fedyk, an assistant finance professor at
the University of California, Berkeley. In this case, Redditors and those joining them—
whether they’re institutional investors riding the wave or people who learned of the story
on Twitter—have made a lot of noise.

“An investor may see that there’s a bubble, there’s a mispricing, either a bubble in a positive
direction or maybe something’s underpriced. They put on a position that would sort of bet
toward closing this gap. And if enough investors are doing that, the gap will close,” Fedyk
says.

That would make the stock crash back to around where it was before this episode.
“However, if there are enough investors in the market that are acting in the opposite
direction or acting randomly, the bubble can persist, and in fact, the people who are sort of
trading against the bubble may get squeezed out of the market.”
Options trading, where someone can pay up front for the right to buy a stock at a certain price by a certain date, can speed up this process. Those trades can mean a rapid profit if a stock rises well past the option strike price, as has happened for many GME owners. (Imagine having an option to buy 100 shares of the stock for $15 each while the stock is worth $300.) They also mean a total loss if the stock doesn’t exceed that exercise price.

The heavy media attention on GameStop has probably helped the stock too, according to Fedyk, who’s devoted much of her career to studying the effect of the news on the market. The existence of the article you’re reading right now could be a good thing for GME, because if you’re learning about GME on Slate (hi), you’re more likely to be a retail investor than an institutional one, and thus more likely to bet on the stock’s success than its failure.

“Retail investors can choose which stock to hold a long position in, out of thousands of stocks. So having that one stock highlighted by media, or by social media in this case, can really drive up the attention, and it can only go in one direction. Retail investors that look at the news and see that stock can buy, or they can not do anything. They don’t tend to sell,” Fedyk says.

Of course, those predicting the stock will tank—whether to its 2020 level or somewhere else—have reason to feel confident. Despite having a loyal fan base, a lot of customer data, and a big game trade-in business, GameStop remains a struggling mall retailer trying to sell easily downloadable video games out of physical stores during a viral pandemic.

Lots of talking heads and actual experts consider lots of stocks to be overvalued. But they’re not all alike. For instance, Tesla’s stock price says the company was worth more than $800 billion after trading closed on Wednesday, despite Tesla having a small share of the car market and suspect earnings. But Tesla has a CEO, Elon Musk, who has inspired his own cult following and convinced millions that he and his company are revolutionary. GameStop doesn’t have anything like that, even though a famous activist investor, Ryan Cohen, helped kick off its current run.

Though Musk helped juice GME himself this week, it’s not clear how GameStop will justify a market capitalization (that is, its total value based on stock price) of more than $24 billion after Wednesday. Or even something in the teens of billions, where it fell to Thursday morning.

"At least a company like Tesla has a story," Kirsch says. "I don’t buy it, but they’ve got a narrative for why the company is worth something. Every time something threatens that narrative, they have a chief executive who’s able to recast it. As soon as we come to some sort of denouement, he takes the ball and throws it down the field, so, gotta go chase it. It’s very hard for me to see how the GameStop narrative gets you to $25 billion. If it’s just literally these Reddit people buying and buying and buying, at some point they run out of money."

Or they pull out because they’re bored or risk-averse.
“We know that investors in general, retail investors in particular, like to close their winning positions and take gains, so I think all of those factors may speed up the convergence between GameStop’s market value and underlying value,” Fedyk says. “On the flip side, there’s still maybe enough remaining people joining in that they can make it last longer.”

**GameStop Itself Probably Won’t Benefit**

It will be hard for GameStop to turn its stock boom into material improvements to its core business that might make a big price more durable. The increased price means the company’s shareholders can pay for college, buy themselves yachts, or just feel good about making a few bucks. But it’s not like the company itself collects a toll every time someone buys a share.

GameStop could “float” more stock to the public, basically offering more people a piece of the company, and use their purchases to raise money to grow its business. But that, according to Harvey, could send a “bad signal” about the stock to current shareholders and drive the stock price down on its own.

“When does a company want to offer stock to the shareholders?” Harvey says. “It’s when it’s overvalued. And when does the company want to buy back? When the stock is cheap.”

Perhaps GameStop could offer some of its stock to a company it wants to acquire—maybe one that specializes in streaming video games, to bring GameStop further out of a brick-and-mortar age and into a digital one. “But if I’m gonna be acquired with this stock, I’m gonna be pretty nervous about it,” Harvey says. By the time the deal closed, the price might have cratered.

Ultimately, the company itself capitalizing on the stock growth will be hard unless this bounce goes much higher or lasts considerably longer.

“I definitely don’t have a very strong prediction about how quickly the stock price will converge back, whether it will converge back in full,” Fedyk says. “But I do think it will decline in the somewhat near future, and capitalization on really short-term movements is, I think, much more difficult for the firm.”

**This Will Change Investing**

Whatever the stock does, the effect of this entire bizarre story will reverberate widely, touching countless people who had nothing to do with Reddit’s bout against Wall Street.

It’s at least possible that government regulators will step in and try to make it harder for groups like r/WallStreetBets to throw their weight around to such dramatic effect. But none of the experts I spoke to could figure out what argument a regulatory agency might make against the Redditors’ actions. Perhaps the Securities and Exchange Commission could halt trading of GME for a short time, as it’s occasionally done in hectic situations in the past, and that might send the stock back to Earth. Or trading platforms could break the momentum themselves, as Robinhood appears to have tried to do when it stopped letting users buy the stock on Thursday. TD Ameritrade also restricted GME transactions, though traders apparently found ways to keep buying the stock for a few hours before a dive began.

“I don’t see how the currently written rules would lead to anything,” Fedyk says of possible regulatory action.

Some of the dynamics with the GameStop run-up are novel, but publicly pushing a market position is not. The only “new” things are that it happened on Reddit and not in a press release, on TV, or at a conference, and that the people getting so much attention were ostensibly not professionals.

“There’s a long history of talking out trades,” Harvey says. “Some people take a position, and then they talk it up in the media. This is nothing new. This has gone on for perhaps centuries.”
(Harvey does hope, however, that it becomes standard for stockbrokers who lend out stocks to short sellers to be required to give a piece of their fee to the stockholder: “Think about it, right? You’ve gotten an extra house, and you’ve got a manager for it. They take care of the house. They rent it out. And you don’t get any money for it? It’s your asset. Come on.”)

Absent new regulation of behavior that’s gone on for generations, Kirsch envisions that the market could increasingly look like a zero-sum fight between fancier institutional investors and internet-aligned forces trying to profit and punish them. Kirsch views both the Redditors and the short sellers as market manipulators who might scare off someone sitting at home trying to make a few trades on a platform like Robinhood or TD Ameritrade.

“When markets are being manipulated, as they clearly are, it’s very hard for true average investors seeking to avoid being caught up in these events to know how to react,” Kirsch says. “So if we push regular investors out of the market, that’s a bad thing. The market just ends up being short sellers and millions of Reddit counterattackers; we’re not going to have a very stable market structure.”

For the time being, this dynamic only exists among a few fringe stocks. But that doesn’t mean it won’t cause ripples elsewhere or affect the confidence of one of those “true average investors.” Investment banks and large funds will remain in the market but may have little choice but to pay more credence to guerrilla trading coalitions that form on social media. That’s not just to prepare for battle but to get ideas or even decide to join a position lots of forum users take out.

“Maybe they will try to scrape more social media sites,” Fedyk says. “I know institutions are scraping Twitter in addition to traditional media. Maybe now they’ll do text analysis of Reddit as well.”

**There Will Be Winners and Losers No One’s Noticed Yet**

That big funds are already using machines to keep close tabs on online discussion is suggestive of something else we’re likely to learn about the GameStop fracas in the months ahead: that this was not entirely a David vs. Goliath battle between Redditors who believed in GameStop and hedge funds who wanted it to die. It’s true that the short positions against GameStop were likely overwhelmingly from big funds, but it’s almost certain that plenty of their big-fish peers joined the side of the internet army. It’s possible they even helped foment it.

“I have no doubt that this is not just a retail phenomenon,” Harvey says. “We’re just focused on the hedge funds that are shorting. There’s more hedge funds that are momentum traders. So I have no doubt that there are many institutional investors that have greatly profited from this momentum trade.” A momentum trader buys in the direction the stock is moving.

Many of the Reddit investors are stereotypical “little guys.” Some have reaped windfalls, like a 25-year-old former line cook who turned $4,000 into nearly $70,000. Others will join or get out at the wrong time and suffer crushing losses.

“There will always be winners and losers,” Kirsch says. “My fear is that the way public stock markets tend to work, it’s usually little guys who are the losers. These big hedge fund players, yeah, it sucks to have to close a short position and recognize losses and be written up in the Wall Street Journal and tell your [investors] that you lost some money, but their holdings are up substantially in 2020. Their houses in the Hamptons are still spacious and comfy and well-staffed.”

Rich people staying rich is close to a sure thing. Rich people know this, and they’ll probably continue to short stocks, despite some speculation this week that large investors would stay away from short selling for fear of winding up on the wrong side of a Reddit-like throng.
“I don’t think that this is a particularly uniquely discouraging situation, especially given that we’ve had kind of flash crashes and completely incorrect market reactions in the past, and I don’t think trading behavior has gotten any more cautious,” Fedyk says.

Not everything about GameStop’s moment of intense market fame will be transformative. Some of the effects may not be clear for years. But no matter the future of r/WallStreetBets, which briefly went private on Wednesday and had its Discord community banned for hate speech, the precedent is set that obsessives gathered on the internet can pool their power and be a market force. That will outlast the pandemic, which has created a whole new class of retail traders that didn’t exist before spending a year inside with nothing to do.

“They’ve kind of grouped together, and in doing that, they’ve got essentially the power of a large hedge fund,” Harvey says. “Think of it as a decentralized hedge fund. A hedge fund is very centralized. You’ve got a portfolio manager that is making the decisions. And now, with WallStreetBets or other forums, you’ve got retail investors coming together and acting in a correlated way. Not completely in unison, but in a correlated way, and effectively executing the power of a large institutional investor. And that, we have never seen before.”

The traders have already expanded their efforts to other stocks in situations that resemble GameStop’s, with significant success. They have massively inflated the price of another heavily shorted stock, movie theater chain AMC’s, and have shown no sign of stopping.

In Harvey’s view, a regular person on Robinhood can’t do anything to give a hedge fund or bank even a slight headache. Thousands or millions are a different story.

“The playing field becomes much more level,” he says. “I think it’s a big mistake to brush off the influence of the retail investor. A big mistake.”