TITAN INVESTMENTS

February 9, 2021

Your Own Worst Enemy

January saw a 162.5% return for GameStop (GME). Prior, GME had seen its share price fall 80% over the past five years as more consumers downloaded games directly rather than bought them from a brick and mortar.

Then two guys walked into the proverbial bar. First, towards the end of November, Ryan Cohen (Chewy founder) acquired almost 10% of GME shares. This was the initial catalyst that riled Reddit users' message boards. Next, Andrew Left (Citron Research founder) released a video on why GME was going to tank, saying these Reddit users "were suckers at this poker game." This provocation unleashed a barrage of buy orders that led to GME spiking from approximately $39/share to over $300 in a matter of seven days. The coordination of "Main Street" investors was incredibly impressive and even more so in the face of "Wall Street" perpetually downgrading GME.

This is where the GME situation begins to get complicated. Market mechanics are often overlooked by investors as most only think to buy shares of a given company. The idea of "shorting" is center stage in the GME story. Shorting is when Party A borrows a certain number of shares from a given broker (Robinhood), liquidates the shares, with plans to buy those shares back (cover) and return them to the broker. Further, the broker typically has full discretion on which shares are loaned out and liquidated; and there are no expiration timeframes with short sells. In sum, a short trade benefits if the share price moves lower.

Just over a year ago the entire company of GME was worth just shy of $300M. This is not large in terms of company size and instigated smaller hedge funds to short a significant portion of GME shares. In conjunction with the recent volatility, 142% of GME shares had been shorted as of Dec. 31. In other words, brokers have lent out more shares than exist on the market!

Situations like this could end badly for everyone given more than all the shares of GME have been loaned out. Reddit users seem to want hedge funds that shorted GME to go bankrupt. Short-positioned fund managers want the price to fall, which would hurt "Main Street" investors embolden to ride GME appreciation. However, everyone could lose in situations like these. Hedge funds were responsible for the bulk of the short position. If the hedge fund goes bankrupt, those borrowed shares will not be returned to the broker. The original owner has nothing to sell despite their account saying otherwise if those shares are not returned.

Ironically, a situation can quickly materialize whereby a higher share price for GME is a net negative for Reddit investors given it increases the chance of 3rd party bankruptcies and the inability to deliver shares. Thus, these Reddit users could end up becoming their own worst enemy.

All investors should take note of this situation as it raises accountability questions. Ask your investment manager, your "guy" or "gal," are you a broker or investment manager? Second, do the mutual funds or exchange traded funds I own, own GME? Third, can my shares be loaned out? Fourth, is your broker lending out shares it does not own? Fifth, what happens if this all goes south? Last, and this is more of a request than a statement: Show me the documentation that highlights your fiduciary duty to *me*.

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