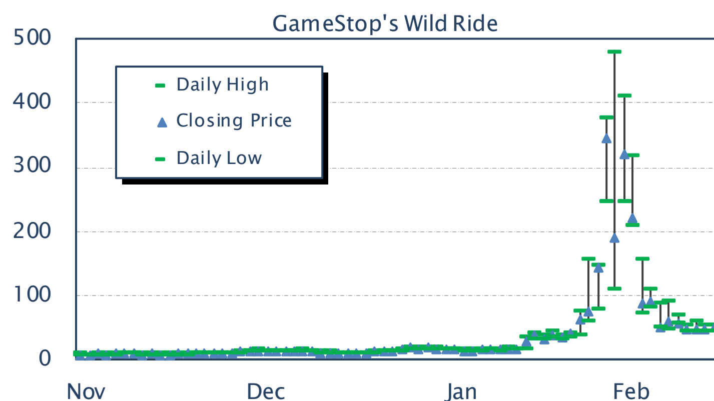
FEBRUARY 2021

INVESTMENT UPDATE

There's plenty of chatter surrounding the activities of a semi-organized group of internet vigilantes who have taken a sudden interest in the US stock market. No doubt you've read about the stunning run-up and inevitable collapse of the stock prices of companies like GameStop and AMC Entertainment, among others. The stories read, at least at first glance, like a bunch of kids running amok, going after Wall Street for fun and profit. It's a narrative that could—and perhaps should—be filed away with other crazy stories about past asset bubbles, which ultimately become what we now call "teachable moments."

Yet there's a kernel of importance in this story that might be worth pursuing after all; it involves the power of the collective to effect change—not necessarily by storming the gates of the castle, but by slowly eroding the foundation of the castle, little by little. The real story, it seems to us, is not this particular Reddit community "getting their lulz," but a bigger shift that's going on between two classes of investors: retail and institutional.



The conventional wisdom claims that retail investors operate at the mercy of institutional investors; that retail represents "dumb money" compared to the sophisticated tools, resources, and experience that professional money managers bring to bear. Retail investors, we're told, are reactive, not disciplined; they are perpetually late to the party, so much so that a high bullish retail sentiment measure is a well-known "sell" signal on Wall Street. Those who make markets in stock options typically don't even hedge small options trades that come through retail channels, as the market maker is more than happy to take the other side of an option trade initiated by a retail investor (the opposite of what would happen with a large institutional order). In short, retail investors, like Rodney Dangerfield, don't get any respect.

If the past year has taught us anything it's that the world, as we might have known it, can get turned upside down overnight, with shocking and unexpected results. The pandemic has put millions out of work, while bringing massive changes even for those of us lucky enough to have maintained steady employment. The lines between "work life" and "home life" have become blurred for many, while entertainment options now center around what can be done at home. Meanwhile policymakers have been pumping billions of dollars every week into the global economy to keep the wheels of commerce spinning. People have both too much money and not enough. Both too much free time and not enough. We are frustrated and bored.

Against this backdrop, is it any surprise that individual stock trading has made a strong comeback? While it's hard to get exact numbers on trades placed by individuals, there's plenty of evidence that the record level of stock trading volume over the past few months is being driven by a sharp increase in retail trading. Average trading volume has jumped from 7 billion shares per day in 2019, to 10.9 billion in 2020, to more than 14 billion so far in 2021. When we look at online brokers (where many individual trades are placed), the growth is even bigger; the largest e-brokers set a record in December with 6.6 million shares trading per day, but that exploded to 8.1 million in January. Brokerages, both online and traditional, are reporting record numbers of new accounts being opened over recent months.

Springing up to serve these new investors are made-to-order brokerage firms offering commission-free trading for stocks and ETFs, including Robinhood Markets, Inc., whose premium Robinhood Gold service also provides easy margin trading. This platform had proven very popular with Reddit's now-infamous "WallStreetBets" community, where trading strategies and stock picks are exchanged, along with plenty of memes and other internet-era folderol, by its millennial-heavy demographic. Unfortunately, that goodwill evaporated quickly when Robinhood restricted trading in late January on GameStop and other stocks, as Robinhood told regulators that they had insufficient capital to clear the volume of trades on its platform amid market turmoil and wild price swings.

At the heart of the GameStop trade was the idea that institutional managers (in this case, at least one high-profile hedge fund) had built up massive "short" positions (bets that GameStop's stock price would go down). The monetary value of these shorts was huge—bigger, in fact, than the market value of all of GameStop's stock, which made the short holders vulnerable to a run-up in the stock's price. If investors bought the stock *en masse*, there could

be a sudden spike in GameStop's price, as the owners of those short positions would all be heading for the door at once. Again, it's the size of the unwinding that had the potential to create a gigantic "short squeeze," as closing out short positions requires you find a buyer for your securities, and it can be difficult to find a buyer for billions in stock options that are losing money.

The person touting the GameStop trade is a guy whose Reddit username is unprintable here, but who goes by "Roaring Kitty" on YouTube. He's the one who developed this thesis, screened companies for the highest short-interest-to-market-value ratios, and highlighted their upside potential. He found an audience online, including on Reddit, and began beating the drum on GameStop in mid-2019. What you might not know is that his real name is Keith Gill, and he's a CFA charterholder, formerly employed as a marketer for an investment arm of Mass Mutual. Mr. Gill is the literal poster child for today's internet investor/personality, but he's also a trained analyst with an institutional mindset and background.

Of course, the short sellers never saw the internet horde coming. Why would they take a meme-posting, cartoon-loving internet rabble seriously? If they had any warning at all, would they have taken steps to defend themselves against these "kids" sitting in their gamer chairs? And who could blame them? It's one thing to post theories, but quite another to put sums of money on the line. But that's exactly what the internet traders did, and in a period of ten trading days, heavy retail purchases of GameStop sent its stock price soaring from less than $20 per share to nearly $500, as short sellers lost billions in one of the more spectacular short squeezes ever seen.

In the wake of these trades, some have called for new regulations to protect the integrity of the markets. But what, exactly, should regulators do? Existing regulations don't limit, to any real extent, how individuals spend or invest their own money. And it seems to us that's exactly how it should be, provided that the public is not being fed false information by those who profit from doing so, and even then, laws and regulations penalize the provider of the information, not the consumer of it. Is there a case to be made that internet personalities like Mr. Gill, given their influence, have a responsibility to the public when sharing their investment strategies? That's a grey area, and one that's gained enough traction that disclaimers are now popping up on Mr. Gill's (and others') public profiles, encouraging people to do their own due diligence or otherwise seek professional advice (e.g., "the Roaring Kitty channel and live streams are for educational purposes only…").

Meanwhile, there's little sympathy for the hedge funds among the general public. That may be because the whole idea of profiting from a company's misfortune rubs folks the wrong way, or it may be grounded in an analysis of recent history; there is a strong case to be made that short sellers helped trigger the financial crisis by crushing the prices of brokerage and financial stocks, leading to the bankruptcy (or forced acquisition) of Bear Stearns, Lehman Brothers, and Merrill Lynch. Naturally, the hedge fund industry disagrees; an industry spokesperson recently claimed that "short sellers conduct in-depth research and analysis that can expose financial fraud and corruption." Of course they do.

Where does that leave us? Individual investors have been chipping away at institutions' advantage for a while now; they can transact at low cost just like the big guys, they have access to much of the same information as institutions, they can form a virtual "hive" and share data and information, much like teams of analysts do in a professional setting. They have made life much more difficult for short sellers and have proven that, at least in a handful of cases, they have the strength of their conviction and are willing to put their own money on the line to prove it.

Only time will tell if the balance of power will continue to trend in favor of the little guy, but it seems clear that some of these changes are here to stay. One big unanswered question is what will happen to retail enthusiasm when the bull market ends, and some of their newly-earned profits turn into losses. Most institutional investors will still be here; for the most part, these firms have deep enough pockets to survive the occasional downturn. Institutions hire people who are making careers of these jobs, with training, advanced degrees, continuing education, and professional reputations on the line. And while there are consumer protection groups that look out for individual investors, they are easily outmuscled by an investment industry with enough monetary resources and influence in Washington DC to keep the status quo intact.

As for Agincourt, we welcome more retail involvement in our markets. Despite recent advances, most individual investors don't have the time or inclination to develop and implement a truly disciplined approach to investing. Understandably, they look at investing as a (hopefully) profitable hobby, not a vocation. Unlike institutions, individuals don't typically focus or specialize in a certain market niche, which gives firms like ours a big advantage when they stray, uninitiated, into unfamiliar territory. We feed off of volatility—when markets get knocked sideways, it creates mispricing and confusion; institutional knowledge, passed down over the decades, gives professional investors a big head start when deciding and implementing a course of action.

At the same time, we hope to never be guilty of hubris; we appreciate the sheer size and power of the retail investor base, which has shown it has the potential to move securities' prices and generate big gains—and losses. And while the excitement generated by GameStop and the other "meme stocks" has faded, the broader stock market continues to set new records, churning higher every day, due at least in part to retail demand. Everyone with any money socked away in the stock market has benefited from their involvement.

So, thanks, retail investors, we love you— and, for the record, we never short sell anything!