The Short Squeeze…

'Reddit Traders vs Hedge Fund Shorters' – Watching from the sidelines.

Last week saw a group of amateur retail traders go up against institutional hedge funds which, in the case of several funds, quickly became a battle for survival against deliberate targeting of their short positions in some US stocks.

These day-traders used Reddit and other online message boards to coordinate and focus their combined buying on stocks with normally low daily trading volumes, and high short interest. (A short is when an investor borrows and sells an asset, expecting it's value to fall; subsequently buying the asset back at a lower price to return to the original owner).

It is worth noting here that if an investor buys an asset, the worst outcome is 100% loss. However, 'selling short' can be much riskier.

If the asset more than doubles in price, the 'short' investor must still buy back the asset, potentially costing many times its original sale value.

If a hedge fund is short and the stock price rises, this can force the fund to 'cover' their short, which involves buying the stock back, further pushing the price up, forcing other short investors to cover, pushing the price up even more.

This cycle is called a 'short squeeze' and last week saw a coordinated attack on short investors to generate short squeezes in a number of usually low-profile stocks.

GameStop Corp. GME (an otherwise non-descript US video game retailer), described as 'similar to Blockbuster Video' was one of these targets.

Initially the attack worked, forcing funds to unwind short positions and pushing the share price up from its open on Tuesday of $88.28 to $469 by 10am on Thursday of last week.

This was followed by a 44% decline later on Thursday, as some retail investors took profits and new shorts were opened by other institutional funds joining the fight, and forcing the price down.

At the time of writing (Tuesday morning 2nd. February, the price had fallen to $225). This extraordinary pattern of trading was mirrored in other stocks last week, such as AMC Entertainment Holdings Inc, (AMC), BlackBerry Ltd, (BB), Express, Inc. (EXPR), Koss Corporation, (KOSS), and others as the conflict between institutional short sellers and retail traders spreads.

Hedge fund Point72 Asset Management has declined 10% to 15% in in value the last couple of weeks, while D1 Capital Partners, one of last year's top-performing hedge funds, is down about 20%. Melvin Capital had also lost 30% by Friday, so these managers are taking big losses trying to cover their short positions.

As interesting as this might be, it is something Strategic Expat will avoid, and I would advise all investors to do the same.

Speculative trading is just what it sounds like, speculation, a high risk activity and very little in common with investing.

(A bit like tightrope walking really!)

Pick your battles carefully! ... This is a fight to steer well clear of.