Rathbones
Look forward

Review of the week

1 February 2021

Like birds in the sky

When the going gets weird, the weird turn pro. The GameStop upheaval on Wall Street is part of the ongoing democratisation of finance. Ignore its effects at your peril.

The democratisation of finance has been a big, steady trend of the past few decades. It hasn't been one great jolting shift, but the concurrent slide of many different parts of the industry.

Digitisation and cutthroat competition led to massive falls in the cost of trading shares, making it dramatically easier and cheaper to trade assets online. And not only stocks, but other assets that ordinary investors have typically been barred from: direct loans, options and highly levered bets on price movements (contracts for difference or CFDs).

There has been the expansion in ETFs, a cheap way to invest for even those with small amounts of money, that increased the number of potential investors out there. We've had peer-to-peer lending and crowdfunding platforms that allowed individual investors to invest in smaller projects that they believe in, or that offer more enticing returns than traditional markets. These have increased the types of assets that ordinary investors can explore. And then there are the retail investment platforms that have popped up online offering everything from stocks and funds to riskier fare like options and CFDs.

And yet, despite all these changes that allowed punters to access financial assets like never before, investing struggled to hit the mainstream. Most people, while investors through their pensions, hadn't a clue about how to even get started with putting money in the markets. And if they did, most were cagey, with mistrust of 'finance' running high, especially following the great recession. Until now. All it took was a whole bunch of government cheques, a pandemic that locked people away and a financial environment that offers zero return in the bank. Now everybody seems to have an opinion on GameStop, an ailing American videogame retailer whose share price has been rocketing recently, wiping out hedge funds and making many retail investors rich (and likely making a few more poor as the price crashes again).

Democratisation is never clean. It is tumultuous and it is messy. Always has been - that's half the story of democracies. It is a progressive and decentralising political force that transfers power from the old guard to the new. And the new guard tends to be more numerous and more powerful than anyone realised. Democratisation is intrinsically decentralising. And like everything in this century, its effects on markets have been amplified and distorted by social media.

When the going gets weird …

The spike in the price of GameStop was driven, essentially, by a crowd-sourced 'buy' recommendation on an internet discussion forum. A few members of this Reddit group, called WallStreetBets, saw that investors who were 'short' GameStop (i.e. betting that the share price would fall) had borrowed more shares in the company than actually existed. WallStreetBets members saw that these investors, mostly hedge funds, were susceptible to a 'short squeeze': When the share price rises, everyone who is short the stock has to either put up more cash to their broker to show they're good for the money or buy the stock to get out of their short. If they buy, that pushes the price higher, causing more of the short investors to buy, creating a feedback loop. It becomes like musical chairs because, as we noted before, these short investors need to buy more shares than there are to go around. And if they don't get a chair they're bankrupt, so they all start buying at any price and the stock explodes.

Once a bit of momentum got going, word spread rapidly on Twitter, TikTok and Facebook. Like a murmuration of starlings, investors from all over the world swooped as one on 'game-ified' investment platforms that seem more akin to gambling apps. GameStop's shares jumped the better part of 1,000% in a few days. This isn't the first time that retail investors have helped a stock defy gravity, either. Last year, shares in car rental giant Hertz soared despite the inconvenience of it being bankrupt. The company actually managed to sell tens of millions of dollars of newly issued shares to investors with a prospectus that said the shares were worthless. This week, after another WallStreetBets tip about silver, the metal's price soared to an eight-year high. I can't think of any investment bank research desk whose 'buy' recommendations have that much clout …

We are seeing what happens when amateur investors move into turf that used to be the domain of the professional few. As per usual, weird things occur. A great and crazy man once said, "When the going gets weird, the weird turn pro." And so you have hedge funds haemorrhaging money while hobbyist investors make out like bandits. That's the market, nothing wrong with that. But it has scared many professional investors. And given many retail investors a false sense of skill or security. It pays for all investors to be aware of these new phenomena and the effect they could have on their own investments. One particular effect of all this, we believe, is the potential for grassroot investor campaigns targeting companies that raise the public's ire. That could be because they are recalcitrant polluters, they are shovelling large paycheques to their executives, or treating employees or customers poorly. Democratisation will mean the values of the many will be brought to bear on the few.

The gravity of trade

One month on from Brexit, the government has announced it is planning on joining the Trans-Pacific Partnership. The pithily named Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) is a free-trade network of 11 nations, including Australia, Japan, New Zealand, Canada and Mexico.

If the UK is successful in joining it would be the only member that doesn't have a coastline on the Pacific Ocean. This is funny, and only slightly irrelevant. It is good news that the UK is trying to smooth trade with other countries, that should mean better competition in British markets and lower prices for households, and greater markets for our producers. However, these nations are, in the main, very far away from our shores. And that does matter in trade. The gravity model of trade shows that countries tend to trade more with those closest to them, for obvious reasons. Trying to offset stymied trade with near neighbours by making connections with others much further away is extremely difficult.

As for those near neighbours, the European Union is having a tough time with its vaccine rollout at the moment. Vaccine companies are struggling with overwhelming global demand and a shortage of raw materials, something we should all be keeping an eye on. The bloc reports its fourth-quarter GDP growth this week. It is expected to be grim reading, with the annual growth rate declining to -5.4%. Across the Atlantic, the US reports nonfarm payrolls and the unemployment rate on Friday. The jobless measure is forecast to remain at 6.7%.

UK PMIs – surveys of business mood, upcoming orders and hiring intentions – are due this week as well. Obviously, in the middle of another lockdown, these will be gruesome. The same goes for new car sales. One resilient bright spot is the housing market. It continues to hold up well as people rush to complete before the end of the stamp duty holiday on 31 March. The Bank of England meets Thursday to discuss monetary policy; no change is expected.

Given these generally tumbling economic indicators and the slow progress of many inoculation programmes, it's been a choppy couple of weeks for stock markets. Investors are realising once again that it won't be all plain sailing and that there's still a long way to go before most people in most countries have two shots in their arm. Markets will continue to see-saw between optimism and worry in the meantime.

Julian Chillingworth
Chief Investment Officer, Rathbones

Rathbones
Look forward

rathbones.com

rathbonefunds.com

Important information

Any views and opinions are those of the author, and coverage of any assets in no way reflects an investment recommendation. Past performance should not be seen as an indication of future performance. The value of investments and the income from them may go down as well as up and you may not get back your original investment. Fluctuations in exchange rates may increase or decrease the return on investments denominated in a foreign currency.