Wall Street falls amid GameStop frenzy

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Since the Fed injected trillions of dollars into the financial markets following a crisis last March, Wall Street has risen to new record highs in what has been increasingly seen as a speculative bubble on the way to bursting.

In recent days, the market frenzy has taken a new turn with a so-called “short squeeze” that has seen the shares of companies whose business models are in severe trouble, possibly putting them on the road to bankruptcy, escalate by hundreds of percentage points.

The exemplar of this phenomenon has been GameStop, a US firm selling video games, consumer electronics and gaming merchandise with more than 5,000 stores internationally. At the start of the year its shares were trading at around $19. Yesterday they had risen to more than $330, an increase of 1,500 percent, taking the market value of the company to more than $20 billion.

The cause of the rise is a speculative frenzy among so-called retail traders on a Reddit messenger platform to buy a call options which pay out when the share price rises. A call option is not the purchase of the share itself but the right to buy it, at a fraction of the cost of the share itself, once a “strike price” is reached. This enables the making of profit when the call option is exercised as the share price continues to rise.

The operation has been organised by targeting hedge funds that have shorted GameStop. Shorting involves borrowing shares and then selling them in the expectation that their market value will fall, buying them at the lower price and then returning them to the lender, reaping a profit on the transaction.

The Reddit message platform has been used to target shares that have been shorted by hedge funds, forcing the fund to buy at the higher price in order to cover itself, leading to a further boost in the price of the targeted stock.

One user on the Reddit platform posted screen shots showing how he had turned $50,000 worth of GameStop call options into nearly $23 million this year. Others have posted similar gains, with users of the platform urging others to keep taking out options to buy the stock.

This coordinated action forced the hedge fund Melvin Capital to exit its bet against GameStop, having reportedly lost about $3.75 billion in its shorting operation since the start of the year. One post on Reddit gloated: “We are better at being irrational than Melvin is at being insolvent.”

Other companies, which have been subject to shorting, have also been targeted. Shares in the cinema group AMC, which this week had to organise rescue financing because of the downturn in revenue caused by the pandemic, were up by 300 percent at one point yesterday.

The phone company Blackberry, whose long-term position was hit by the introduction of the iPhone and other smart devices, also saw its shares surge. The retailer Express, which had been severely hit, saw its shares more than double in value.

The frenzy is extending to Europe with the *Financial Times* reporting that some European stocks have been touted as “the next GameStop.”

Shares in the heavily shorted British education publishing company Pearson rose 14 percent yesterday to reach their highest level in 16 months.

The market frenzy has raised concerns in the Biden administration. The White House press secretary, Jen Psaki, said it was “monitoring the situation.” The fear is that such are interconnections within the financial system and the elevated level of debt that significant losses by hedge funds on the wrong side of increasingly frenzied Wall Street trades can set off a chain reaction.

The GameStop phenomenon is the most egregious expression of the speculative bubble which has been fueled by the US government and, above all, the Fed, especially since last March and could be a sign that the financial "chickens are coming home to roost."

Steve Sosnick, chief strategist at Interactive Brokers, told the *Financial Times*, "What we've seen over the last few trading sessions borders on madness. You could always get crazy things going on individual stocks, but when you see it metastasising through a whole range of other stocks, that's a sign of real froth."

He likened the action of the so-called retail traders to an ant colony. "Each individual may not be able to move much, but if you have enough of them, they can move a remarkable amount," he said.

The market madness, however, did not begin in the last few days. It is the outcome of the decadeslong growth of financial parasitism, accelerated by the interventions of the Fed since the onset of the pandemic resulting in the injection of more than $3.5 trillion into the system, coupled with a commitment to keep interest rates at virtually zero for the indefinite future.

In his press conference Wednesday, Fed Chairman Jerome Powell denied that the Fed was behind the massive run-up in stock prices, declaring, "I think the connection between low interest rates and asset values is probably something that's not as tight as people think because a lot of different factors are driving asset prices at any given time," Powell said. No one, least of all Powell, believes this statement.

The provision of essentially free money has led to a situation where previous metrics, in particular, the price earnings ratio for a company, which to some extent determines investment in its stock, have been all but junked.

Tesla, which makes only a small profit and has seen its shares rise by 964 percent since the start of 2020, now has a price earnings ratio of 209.

According to Daniel Kozlowski, chief investment officer at Plaisance Capital, "Some companies have now moved to infinite valuations, by any mathematical expression.

"Every ladder is leaning against the same wall—interest rates and quantitative easing. If interest rates rise, there will be a real reckoning," he said.

The Fed has been at pains to reassure the markets that there will be no upward movement in interest rates or any pullback of its asset purchasing program, currently running at $120 billion a month, seeking to squash concerns there might be some form of "tapering."

The statement of the Federal Open Market Committee yesterday, following its regular two-day meeting, said the Fed's bond buying program would remain until "substantial further progress" had been made securing economic recovery and reiterated its commitment to "adjust the stance of monetary policy if risks emerge."

In other words, if there is a major fall on Wall Street, the Fed will be on hand with still further injections of money.

It is too early to say yet, but that time may be coming closer following yesterday's significant downturn. Despite the Fed's declaration of support, Wall Street had its worst result since last October. The Dow fell 633 points, or 2.1 percent, while the S&P 500 dropped by 2.6 percent, wiping out all the gains it had made so far this year.