# Nervous opening expected for Wall Street

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The key questions that will be uppermost when Wall Street opens today are whether the speculative frenzy in GameStop and other companies, whose shares have been shorted by hedge funds, will continue, and whether the downturn in the broader market, evidenced by significant falls at the end of last week, will deepen.

The two phenomena are interconnected. There are fears the surge in shorted stocks, which has resulted in a 1600 percent rise in GameStop shares since the start of the year, coupled with rises in others, such as AMC, up by 300 percent, is a sign that the Wall Street bubble may be about to collapse.

As the *Financial Times* noted: “The frenzied trading of the past week has fuelled concerns that a speculative bubble … could trigger a sharp market pullback.”

The reason is that the GameStop frenzy is only the most egregious expression of the speculative bubble that is Wall Street as a whole.

The surge in GameStop and other targeted companies represents the complete divorce of the market value of their shares from the underlying economic reality. GameStop, a retailer of video games, had seen its revenues halved in the last 10 years and then experienced a 31 percent fall in sales in the first nine months of last year. But its market value as a result of the speculation makes it a $25 billion company.

What could be called the “GameStop strategy” involves buying up the shares of companies that have been “shorted” by major hedge funds. Shorting is a process in which a hedge fund borrows the shares of a company, sells them in anticipation they will fall—a result which can result from the shorting action itself—and then buys the shares at the lower price, returns them to the original holder, making a profit on the deal.

But if the share price rises, as has happened with the targeting by retail investors of shorted stocks using a Reddit platform, the hedge fund has to buy the shares at a higher price, thereby making a loss.

The extent of the losses by the hedge fund Melvin Capital, a significant shorting player, as a result of last week’s GameStop surge, is now being revealed.

According to a report in the *Wall Street Journal*, Melvin, which had previously been regarded as successful, started the year with about $12.5 billion on hand, but lost 53 percent in January. It now has capital of around $8 billion, which includes $2.75 billion of emergency funds injected into it by two other funds, Citadel and Point72 Asset Management.

The extent of the losses at Melvin, together with the possibility that other hedge funds could also lose large amounts, has sparked the concern of the Securities and Exchange Commission, the Wall Street regulator.

In a statement issued on Friday, the SEC said it was closely monitoring and evaluating the extreme volatility of a number of the stocks.

The statement began with an assurance that the “core market infrastructure” had proven “resilient” under the impact of the “extraordinary” weight of last week’s trading volumes, but then added:

“Nevertheless, extreme stock price volatility has the potential to expose investors to rapid and severe losses and undermine market confidence.”

The concern of the SEC is not the fate of the hundreds of thousands of small retail investors and individual stock market players who have been caught up in the frenzy. It fears that if there are further major losses by hedge funds, defaults on debts and a major sell-off, this could set off a crisis.

No doubt the SEC has in mind the experience of 1998, when the bankruptcy of the hedge fund Long Term Capital Management, threatened the entire market, prompting a rescue operation by the New York Federal Reserve.

The speculation in GameStop and other shorted stocks is not only the result of the activity of retail investors.

Long-time hedge fund operator and noted short seller Jim Chanos told the *Financial Times* that the events of the past 10 days were “surreal,” unlike anything he had witnessed in his 40 years in finance.

He poured cold water on the claim, widely circulated on Reddit and on other platforms, that the speculation hitting hedge funds was “sticking it to the suits,” noting that besides some retail investors “a bunch of hedge funds have made a lot of money.”

On Thursday, an angry social media storm arose over the decision by the sharebroker Robinhood, the main firm through which the retail surge has taken place, to suspend purchases of GameStop shares and other shorted stocks with the claim that this was the result of intervention by major hedge funds to protect their positions.

While it cannot be ruled out that Robinhood was leant on, the real reason for the suspension in trading appears to be that the brokerage firm could not finance the increased volume of deals. Share trades pass through a clearing-house before they are finalised, in a process that can take as long as two days.

Clearing-houses require that brokerages post collateral for their trades in case there is a default. Because of the increased volume of its deals, Robinhood was forced to obtain a cash infusion of more than $1 billion. Lenders included JP Morgan Chase and Goldman Sachs.

In a series of interviews explaining the suspension, Robinhood CEO Vlad Tenev said it was "not negotiable" for the firm to "comply with our financial requirements and our clearing house deposits."

The Depository Trust and Clearing House Corp has not provided details of how much money individual firms are required to supply to cover their trades, but on Friday it was revealed that the total capital it required to be placed under its jurisdiction had increased from $26 billion to $33.5 billion.

In a statement, the DTCC said that the frenzied trading in stocks, such as GameStop and the movie chain AMC, "generated substantial risk exposure at firms that clear these trades ... particularly if the clearing member or its clients are predominantly on one side of the market."

Under normal circumstances the activities of the DTCC pass unnoticed, in the background. But in times of great turbulence, calls for increased money to be placed with it as collateral can have a major impact. In reporting on this development, the *Financial Times* noted that, during the market crisis in mid-March, one US bank was required to find $9.6 billion in the course of an hour to finance derivative trades.

Cutting through the hype on social media that the surge is some kind of rebellion or even a "revolution" against the titans of Wall Street and a movement to "democratize finance," the essential reason can only be found in the most fundamental feature of the entire financial system.

This is the divorce between the market value of shares and other financial assets, and the underlying real economy. This process, which began 40 years ago, was accelerated first by government bailouts and the provision of ultra-cheap money by the Fed, after the 2008 crisis, and was given a further boost when the government and the Fed injected trillions of dollars into the financial system as a result of the market crisis in mid-March last year.

Since then, amid the worst economic contraction since the Great Depression and the loss of millions of jobs, Wall Street is up more than 66 percent, with stocks such as Tesla, which returns only a relatively small profit, escalating by 900 percent. The escalation of the stocks of companies that are either in bankruptcy or on the road to it, was first seen immediately after the Fed's March intervention, when the stocks of the car hire firm Hertz spiked 900 percent after it had filed for bankruptcy.

In an editorial last week entitled, "The Reddit Wolves of Wall Street" the *Wall Street Journal* referred to the present situation as one of "high financial drama." It then offered a reassurance to its readers and to itself that: "This may be a new example of the power of social media, but it isn't a crisis of capitalism or the stock market."

The editorial went on to point to the underlying driving force of this speculation.

"The government body that should come in for more introspection is the Federal Reserve. The central bank may be feeding the asset frenzy as it holds interest rates near zero and crushes the long bond yield curve so it doesn't send accurate price signals. As investors search for yield they move into commodities, real estate, junk bonds, foreign currencies – and stocks."

But that analysis only raises another question, which the WSJ does not care to probe. Why does the Fed not end this policy which, as the editorial implicitly acknowledges, can only lead to a disaster?

The short answer is that it is incapable of doing so. It is locked into the escalation of financial assets by the injection of ever-greater amounts of money, because to end it would bring about a collapse of the financial house of cards with devastating economic and financial consequences.

That, by any definition, signifies a crisis of capitalism. The fact that the WSJ raises this prospect, only to immediately rule it out, is a sure sign that it smells the odour of death wafting up from the open grave of the system it so strenuously defends.

But the ending of the capitalist profit system, no matter how deep its crisis, will not come about automatically. Rather, its death agony will result in social destruction and the eruption of the class struggle, for which the ruling class is making its preparation through the cultivation and development of fascist forms of rule, as revealed by the events in Washington of January 6.

The capitalist system is caught in the coils of an ever-tightening crisis. But it can only be overturned, and a higher form of socio-economic organisation developed, through the conscious political struggle by the working class to take power in its own hands—a struggle for which the crisis on Wall Street must provide further impetus.