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Hedge Funds Vs. WallStreetBets: Neither Side Is Solely To Blame

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Recently the wild swings in Gamestop's GME -16.1% stock have thrust a new breed of investor to the media spotlight. Along the way, we are seeing debates on multiple levels ranging from ethical to legal issues involving WallStreetBets, Reddit, hedge funds and the Federal Government. Individual investors are wondering if the system is working, or if it needs to be amended.

From a pure investment perspective, it is interesting that battle lines have been drawn between the hedge funds and the WallStreetBets investors—popularly known as the "big guys" versus the "little guys." This unfortunate polarization has driven me to ask how this has happened, and why. The "how" is a lot easier to answer. Combine the ingredients of free trading, ability to buy fractional shares and the proliferation of chat rooms for any topic, and no one should really be surprised about the mechanics of the situation. We should have seen this coming a long time ago. The "why" is far more complicated to answer.

From a pure investment perspective, hedge funds have carefully crafted an image of being the "smart money" in the Wall Street game. But how smart are they? Some are very bright; others not so. We have seen numerous accounts of big losses—or as they euphemistically say "drawdowns"—and irrational behavior when it comes to investment positions. (I personally remember a colleague deciding to reverse all his long and short positions because nothing was working. He panicked that the current positions were losing a lot of money for clients, so he made the longs into shorts and vice versa! The switch didn't work, by the way.) We also think hedge funds discover unfamiliar stocks that are undervalued. But a brief review of the top stocks most hedge funds own often lists the top names in the S&P 500 index. What's so creative about that?

As a society we tend to label investors we admire as "thinkers"–money managers that truly conduct comprehensive research on stocks before acting. These thinkers are rational, disciplined and have high conviction. When they establish a position in a stock, they are expecting a slow *crescendo* rise of valuation over time.

On the other hand, we label investors that take big unresearched risks based on rumors from various networks as "thugs." Thugs are impatient, tend to follow superficial trends and have very high turnover in their accounts. They do not usually spend a lot of time reading financial statements nor do they

act with fierce independence. Like “Axe” in the TV show *Billions*, thugs seek stocks that will produce a sudden *sforzando* of valuation in a short time.

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In the GameStop GME -16.1% debacle, many have tried to determine if the sides could be collectively labeled as thugs or thinkers, but that’s an overly simplistic explanation of what happened. It is very difficult to draw any collective conclusions about the Redditors that drove this issue into the foreground. And just as there are all types of hedge fund managers, there are all types of investors on WallStreetBets. It will be interesting to see if the Federal Government makes policy about future activity or if this phenomenon is simply a byproduct of social technology. I suspect the investment community will adapt to the collective voices of the “little guy” and add that as a new factor influencing the markets. And I’m fine with that. The arrival of WallStreetBets is an expansion of the investment community that makes our markets run democratically.

I also think there are thugs and thinkers on both sides of the field, and for that I am grateful. Thugs and thinkers make the investment world go around; it is pointless to imagine a world without both.

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