The Big Short Tantrum

New player on the street

Abundant central bank liquidity boosting financial assets' upside and government stimuli in the form of blank checks have both contributed to a significant growth of individual investors' trading volumes in the US over the last twelve months.

The growth of trading volumes by individual investors seems to have led to large speculative upside in numerous stocks and is now the source of new risks in the market on the long and short side of books.

The Tesla precedent

The first large "Short Squeeze" likely related to significant retail flows actually started before the more recent Covid investment boost, when Tesla was identified as being at the crossroads of nascent thematic plays in the fields of disruptive innovation, autonomous driving and electric vehicles. As the EV front-runner and given the current welcome transition to lower emission vehicles, it was natural for Tesla to record historically strong appreciation of its stock in the last two years. What is more unnatural is the level of valuation it now trades at, retail flows helping to contribute to the stock incredible upside and short squeeze of the stock (the stock was multiplied by more than 20, while shares shorted went from more than 200M in May 2019 to 56M shares shorted mid-January).

The Tesla "Short Squeeze" was the first victory claimed by individual investors against hedge funds across social networks. We could probably see there the genesis of a high Short-Interest targeting philosophy which only progressed in the last months in the US market.

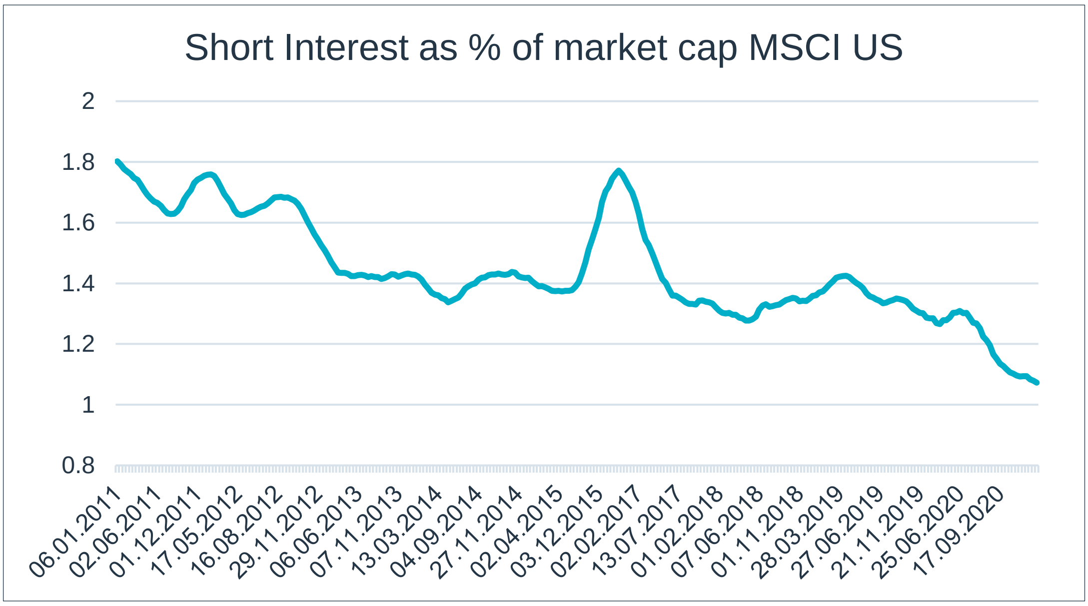
The Gamestop squeeze

The Gamestop event of January was for now the most extreme illustration of the threat current developments pose to functional Equity markets. Gamestop was in recent months subject to very significant investor flows, alimented by social networks advertising the extremely high Short-Interest position (at some points more than 140% of float). It was followed by large coordinated purchases of the stock, which led the stock from a level of $4 end of July 2020 to $483 intraday on Wednesday January 28th. Other high Short Interest US stocks seemingly targeted the same way with significant trading volumes and large upsides in the last weeks were AMC Entertainment, Naked Brand Group, Nokia, Bed Bath & Beyond and BlackBerry.

Deleveraging across the board

This environment has led to abyssal losses for some concentrated hedge fund managers, to forced deleveraging of some market participants, and a large reduction of exposure by Long/Short Equity funds globally.

In an environment of historically high economic uncertainty and Equity valuations not seen since the 90's Tech Bubble, we are probably witnessing close to a capitulation by the market on the strategy of short selling. Recent risk-on thanks to the vaccine and the January turmoil have led to historically low levels of Short Interest in the US and globally, after high Short Interest names had an historical out-performance.

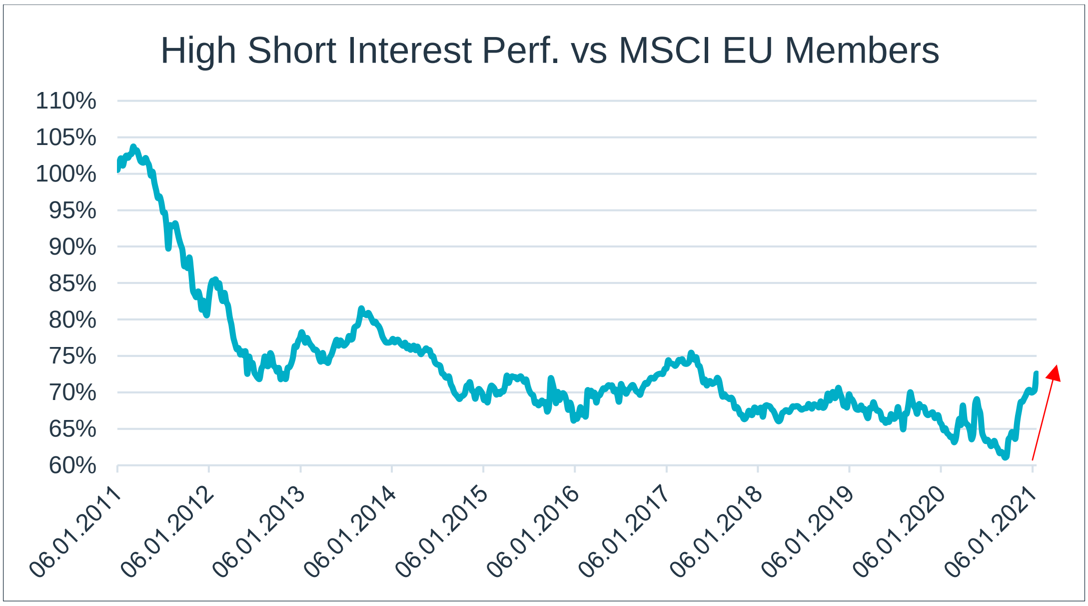


Source: RAM AI, Markit as of end January 2021

Short Tantrum in Europe

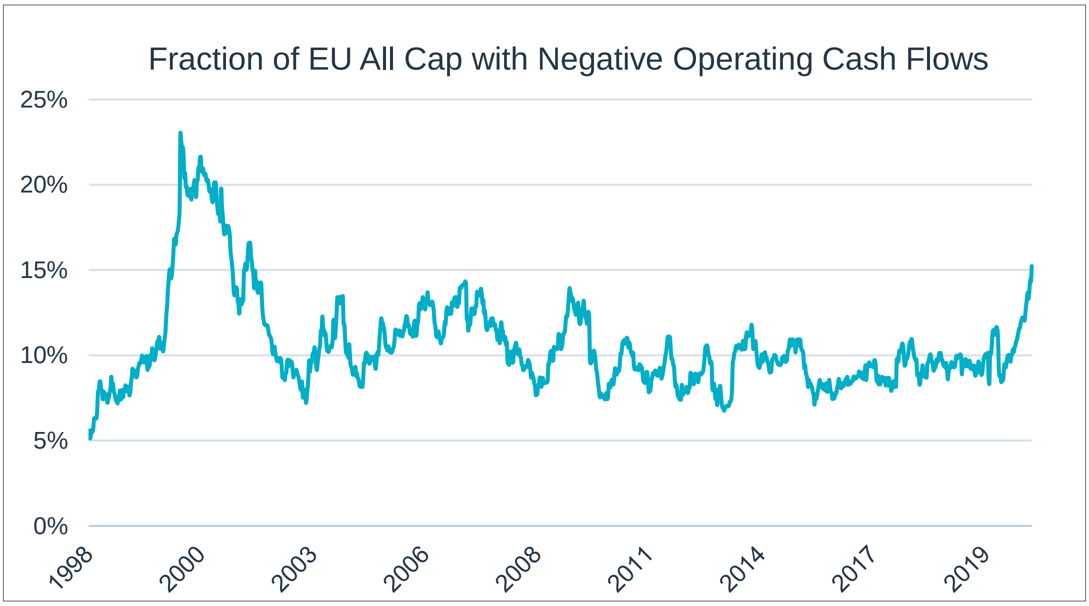
The recent market extremes in the US impacted European equities too, with a large number of high Short Interest stocks (among them growing ranks of zombie companies) out-performing significantly in recent months.

If we look at the 10% most shorted companies within MSCI Europe, these stocks out-performed the market by more than 3% in January and 14% since November. They are back in-line in terms of relative performance with other MSCI EU members to the levels they were trading at mid-2012, the year after the last previous European recession.



Source: RAM AI, Markit as of end January 2021

Additionally, to further illustrate the extreme moves in the market, the following chart shows the significant increase in the number of European companies with negative Operation Cash Flows.



Source: RAM AI, Factset Fundamentals, as of end of January 2021

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