PRIVATE WEALTH MANAGEMENT

CIBC WOOD GUNDY
BALLARD MUDGE FINANCIAL GROUP

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GAMESTOP CANADA EH?

To understand the Wall Street Bets "investing" forum on Reddit, a popular online message board, you have to imagine an online Frat house and the Bro culture that goes with it. Contributors speak of buying the popular target company names and holding on for dear life (HODL) so long that they have diamond hands -- or holding on to an investment position so tightly that their grip could turn coal into diamonds. The goal is to make enough profit to order chicken tenders or "tendies" in the group's parlance. All of this is framed in Rocket Ship emojis to emphasize their expected returns and screen shots of their trading account balances to prove their claims about the positions they hold. It sounds like a world where testosterone meets Covid-19 boredom meets discretionary spending not being spent on travel, restaurants or actual fundamental based investing.

Despite first impressions, there is actually a lot going on. The target companies of their fandom tend to be nostalgic favourites that have fallen on hard times as technologies change. Companies like Blackberry, video game retailer GameStop, and movie theatre chain AMC Theatres have recently been targets of the group.
More importantly, the targeted companies are also always being bet against by larger investors. For Example, Melvin Capital Management LP and other large hedge funds had borrowed shares of GameStop and sold them in the market betting that they could buy them back in the future at a cheaper price to earn their profit. This "short sale" then became the basis of attack for the Wall Street Bets crowd. Seeing the short position, the Wall Street Bets traders bought the GameStop shares or options, which then quickly started to gain value.

Like any situation where you borrow money, the lender will want to make sure that you are able to pay back the loan. For instance, if you obtain a mortgage to purchase a house, the lender will make sure that you have a reasonable income to cover its cost.

As GameStop's share price climbed, the amount of money Melvin Capital and others needed to buy back the shares grew along with it. The lenders of the shares got nervous and demanded that these firms post more collateral or begin reducing their positions. However, it is important to remember that since Melvin Capital had borrowed shares and sold them to create their short position, they actually had to go into the market and buy more shares to reduce their position. This rebuying contributed to their problem further. This phenomenon is known as a "short squeeze" and reportedly led Melvin Capital to realize a loss of 53% in January 2021 alone. Whether Melvin Capital can make it through this drastic loss remains to be seen.

Canada has a much different investing landscape than the United States. While we do have some national and international champions, the majority of our companies tend to be smaller than American ones. Canadian market speculation recently appears to be centered around junior mining, energy, cryptocurrencies and cannabis companies. Also, the options markets are much less developed and remain with far lower volume of shares traded.

Is a similar event possible in Canadian markets? Could the same level of retail trading cause short squeezes here?

I started thinking about this while watching live as Computer Modelling Group, a heavily shorted company in the Canadian Focused Equity Portfolio that I manage, climbed from $4.71 per share at the new year to $6.74 per share on February 9th. This 43% increase in price corresponded with just a 20% increase in oil prices, a main driver of their share price. Was there just renewed interest in the company or were the people who bet against the company worried about the possibility of a short squeeze?

Computer Modelling Group Ltd is a software company that assists energy producers in the task of modelling their underground energy reservoirs to assist in the extraction of energy. Apparently, some people don't think its future is very promising and are betting against it. At the end of September 2020, there were 2.9M shares sold or +/-3.7% of the company. This number has trended down to 838k recently (7/15/2021) or +/- 1%[1]. Sure enough, someone was significantly reducing their position.

Where this gets interesting though is that there is often a very low volume of shares traded. Over the summer months,

[1] Information Courtesy of Thomson One

the daily trading volume for company has dropped to 27k shares per day. It would take 31 average summer trading days for the short seller to be able to cover their now reduced position if they were able to buy all of the shares that traded.

While there are no options traded on Computer Modelling Group's shares and it is difficult to get a warm and fuzzy nostalgic feeling about oil reservoir modelling software, any uptick in retail interest or a substantial company buyback could indeed make this a dangerous situation for the short seller. There is no guarantee that shares will be available to buy back when the short positions need to be unwound. It then comes as no surprise that investors have begun to unwind their position.

Sincerely,

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