

Twitter Thread by Carlos E. Perez



Carlos E. Perez

@IntuitMachine



The interview with CNBC of @chamath is a much watch because there is so much insight hidden underneath.

There are many things that caught my attention. The one thing was the abstraction that hedge fund strategies are all 'momentum' plays. What it seems to imply is that the marshaling of resources at an opportune time drives the future behavior of a stock.

From basic physics, we know that momentum is mass times velocity. So any 'momentum' tactic employs the variation of mass, velocity or both. Wrt stocks, mass is money and velocity is speed of trade.

We cannot argue that there are benefits of scale associated with having more money. Also, high-frequency trading has shown the value of high-speed trading. So in an abstract sense, market manipulation can involve a kind of momentum play.

The objective of stock trading is to buy a financial instrument at a low price and sell it at a higher price. The purpose of a momentum play is to front-run the decision process of other traders such that one acquires the assets before a decision is made.

There are two basic tactics at play here. One is to act faster than other participants. The second is to ensure that one's action sets up the future lucrative scenario where one can consummate one's trade.

It is necessary to find that greater fool. In the case of shorting a stock into bankruptcy, finding the greater fool is taken out of the equation. A company that declares bankruptcy unilaterally wipes out the worth of its stocks. Stock owners have no choice in the matter.

This is what hedge funds that short attempt to do. Of course, the problem with shorting is that it is the opposite of exchanging money to own an asset. A short is instead a commitment to buy back stock at a later time. A short, requires assets in a margin account as collateral.

But shorting is like pushing against a string. It's different from going long that is like pulling a string. Someone with infinite cash can buy up all the stock that is available, hence pushing its price up until the limit where you've bought all the stock.

As the GME debacle shows, apparently you can short over 100% of the stocks available. This isn't really possible. What is happening is that the hedge fund is making a commitment to buy over 100% of outstanding stock. This works if the company goes bankrupt.

What happens then if the trade goes in the wrong direction. The loses has no limits. It is the scenario where a hedge fund is obligated to acquire all the stock (and more) of the company. The limit is when the hedge fund runs out of money.

But what happens to the short commitments when the hedge funds runs out of money?

The commitments can only be closed by covering (i.e. buying) back the shares, but this is impossible! You cannot buy more than 100% of something. So how did a hedge fund close its position without impacting the market?

They paid someone to take on their previous commitments. In other words, someone else is short.

The thing about markets is that there are many kinds of commitments (that we call derivatives) that allow one to make money in any way that the market moves. You can make money even if the market does not move!

Money is made in wall street by having a crystal ball or being able to manipulate the behavior of the market so it leads to your expectations. Like every game, manipulation is a kind of deceptive strategy.

Games like Go and Chess don't have deception as a component. That is because all information is transparent and available for both players. In contrast, game-like Poker and Stratego have an element of deception. Deception is necessary in games that have info that is private.

@chamath in the interview reveals the true source of unfairness in the markets. The reality that hedge funds are colluding in their plans to manipulate the markets. This can be fixed if we take his suggestion. That is, the positions of hedge funds are made public for inspection.

The curious thing is that decentralized finance (see: cryptocurrencies) have transparency. Anyone can mine the blockchains to see the various commitments that are being made.

A problem that gold bugs have always complained about the commodity markets is that fictitious supplies of gold are sold in the market and are only resolved to reality at the closing of the contracts.

We saw this in 2020 where people bought oil contracts and upon the closing of the contract (i.e. the delivery) found out that they didn't have the storage to acquire the supply. There was a mad rush to pay people to acquire oil (hence negative price).

With cryptocurrencies, you can't sell a coin that you don't have. The other fascinating thing about cryptocurrencies is that new supply is created all the time due to mining. For Bitcoin and Ethereum there is constant 24x7 inflationary pressure. This leads to its robustness.

Decentralized finance has the robust characteristic that the rules are difficult to game. Now we see hedge funds short \$GME make a Trumpian play. That is to stop the count! They are going on TV to make the case that regulators step in and call the game in their favor.

If you can't win the game, you can at least try to rig the referees! As people like Trump has shown, the rich have always played this game of favoritism where their rules are different from the rules everyone else plays.

Completed here: <https://t.co/Ulywmt4evY>