Twitter Thread by Dr. Ellie Lockhart is the protagonist

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OK, I guess I have a thing to say about the stock market. I have done kind of what these Reddit folks are doing with it, in that I have invested in the stock market when I was not at all rich, using parts of my paycheck that it probably wasn't wise to risk. I don't now. (thread)

But, like, it worked out okay for me. I even shorted some stuff. I didn't coordinate with anyone or whatever, but I don't think on the individual level the stock market is *inherently* malicious. If you're privileged, you're going to be exposed to it (through 401ks, etc.)

And I don't think it's wrong for people to try to make money off of it outside of the 401k/retirement context that's socially normal, *especially* if they're desperate like I was. There *are* strategies that you can use that, while risky, aren't exactly like gambling

Like, gambling is risky in a different way. You are always working with a fairly consistent set of probabilities in gambling, and they're never in your favor (outside of grey area gambling like between friends, where you could hypothetically actually still card count)

Anyway, like, on shorts: I don't think they're evil. I think they're dangerous. For an individual, a short always carries a small risk of individual bankruptcy. There's USUALLY not even a huge upside to them; they're not mystical or magical, they're basically reverse "longs"

So the deal with shorts for retail investors is, they're a loan, and the currency is shares. Your lender is your broker (Robinhood or TD Ameritrade or Schwab, for most people). As a retail investor (aka not rich af)you are required to have significant collateral in cash or stocks

That's sort of the actual reason it's "cool" that someone (unfortunately, bigots) is "sticking it" to a hedge fund shorting things, apart from the fact that that hedge fund made a colossally bad move that deserves to be punished (which I'll explain in a second)

See, for anyone, if you buy $1000 in stocks, normally - which is all most investors can do, bc they aren't approved for the more complex transactions - you've just incurred the theoretical possibility of making any hypothetical amount, or of losing $1000

This applies to any "long" stock transaction: you will never lose more money than you put in, unless it's in fines for financial crimes. You may lose, it's even likely, but you probably won't even lose it all.

Unless, of course, you invest, normally, in something like Gamestop

Last year it was JC Penney. Retail chains that are headed for bankruptcy get cheap fast. For an individual investor, to short them seems REALLY appealing, and here's why:

All shorts, but especially the more normal kind, have infinite downside, and one guaranteed upside.

Let me describe a normal short, that you'd need to be a fairly serious investor with the ability to take risks (aka at least "normal person rich") to do, but which is what hedge funds are more *supposed* to do:

You short Tesla. It's a terrible company and it's gonna crash and burn. It's also extremely volatile, and can vary hundreds of dollars in a day right now. But you would not be making a terribly unwise bet, as someone with several multiples of $800 to burn, to bet El*n will fck it

Now, on volatility: if you have less than $100K or so invested, you have a very limited legal permission (in the US) to engage in "day trading," which is the "exciting" thing where you buy and then sell at a few cents a share more and you win

Basically, if you buy a stock as a regular investor, many of the easily accessible brokerages will require that you hold that stock until the next morning; some require 7 days. This is supposed to encourage buying stocks you believe in and not taking a lot of risks

In practice it just allows individual investors to get screwed by big companies doing exactly what this hedge fund was trying to do. But anyway, if you've been invested for a few weeks or so, your brokerage will let you do SOME day trading.

It's important to save that normally though, because below $100K (or some similar number) in the US, you're limited legally to three day trades a week. Meaning, you can, for instance, take advantage of Tesla's volatility, but not as much as someone with more invested.

The "long" way to make money from Tesla is to note when Tesla is dipping, and if you feel reasonably confident it's going to climb above where it is now today, and you haven't done three day trades already, you buy it and sell it as soon as it's worth a bit more.

Importantly,while this may make or lose you a lot of money, to your broker, it's Tuesday: they basically don't even change anything except a line in a database,they effectively still hold those shares.They can take them back from you at almost any time,ESPECIALLY if you day trade

The other trap that retail investors have been placed in by both the federal government and the financial industries has to do with "margin," which is a kind of credit that's similar but not identical to what you use to short sell, and with closing transactions.

Again, if you use TD Ameritrade (frex) to trade, and you buy shares of basically anything that isn't intensely obscure (and they may not be able to get you shares of obscure stocks, not worth the trouble) they know they will get the money they're owed, and you will too

That's because you're not making a deal with some other stock trader in an alleyway or something, you're telling one T-SQL database to talk to another T-SQL database. You buy Adidas stock, TD or whoever has tens of thousands of shares on hand and they just deed some to you

You sell Adidas, someone makes a buy - and sometimes it's your broker. It could also be another brokerage, a hedge fund, a securities-backed whatever, some obscure financial instrument, *or* another individual investor working through a brokerage.

Point is, whoever is buying your shares is good for it, and the transaction is guaranteed

but, bc of the way it USED to work, where someone might not deliver the physical stock certificates, there's a 3 day waiting period before sold stock becomes US dollars

If you are using an app like Robin Hood or the basic levels of TD or Schwab, you just have to wait 3 days before you can access that money. You're fine, you will get it, but you can't immediately turn around from your Adidas sale and buy Tesla with that money

It's really stupid, because there's only extreme edge cases, most of which involve major fraud not on the consumer investor end, where you would not receive your money, and in any case, that's a risk these banks can easily swallow on the scale you operate on

Which is why when you invest a certain amount, usually $2500 or so, you are often offered a margin account, and that's where the federal regs - which are obviously designed to benefit the big banks against individuals - kick in to screw you, and your broker helps them screw you

A margin account is often a dangerous idea but not for the reason you probably think. It's a loan, which you can use to buy somewhat more stock than you have in actual cash value at that moment (and you can take out a loan against your securities too) - but that's not the danger

The issue is how the transactions you make get ordered. See, the feds got convinced at some point that individual investors are *dangerously irresponsible* and need to be *protected* - notably not going after actual gambling or whatever - through, of course,massive possible fines

I forget the exact technical details of how this works, and I want to note it DOES apply to the big banks and is the only reason this hedge fund is screwed, but that's just another reason the GameStop situation comes off as a freedom fighter sort of thing

To explain how this works, let me switch to the Gamestop situation for a moment. So, GameStop is still f*cked. They are going to go out of business. Remember that a business gains very little from their stock price unless they own a lot of their own stock,and GS certainly doesn't

Given this, you'd think the hedge fund would be fine, given how a short works.

Oh! That reminds me. How the short works: so you have a line of credit, related to your amount of assets, which for a hedge fund is *huge* and for a regular investor is not huge.

When you short shares as an individual, you tell your brokerage to, instead of selling you a bunch of shares of Walmart that they have in their stores, sell those shares at the current market price.

In 3 days, you get that cash, and since you can only short with margin/credit, you're immediately given that money in your account, so if you think Wal-Mart has peaked but an oil fund is about to climb, you can sell Wal-Mart now, and buy a bunch of the fund

As an individual investor you are putting yourself at significant risk of penalties by doing this, because you don't technically have any of this money. You've just incurred a debt equal to however much you'll be paid for the shorted shares, AND what you buy with them

Now, when you "go long" in this hypothetical oil fund, you cancel out the debt, by acquiring those shares as assets - as long as you're right that the oil fund goes up. If you're wrong, and Wal-Mart goes up and oil goes down, you don't just lose money, you may risk lawbreaking

You won't go to jail, but to bring you back in compliance, your broker can be required to, basically, update their database to reposess or sell your shares, buy the shares you're short (bc you owe them shares, not money), and pay you whatever is left - even if it's a BAD TIME

A hedge fund has a huge advantage in this sort of thing, because they literally use their huge amounts of money to "hedge their bets." They're also limited, just like an individual investor, in terms of how much they can "leverage" their "actual" assets but they have so much more

I believe you are essentially allowed to have a combined short and margin balance of (cash + current value of long stocks)x1.5 as an individual, but the hedge funds have higher limits. They certainly just have more money.

Any smart financial institution will hold certain things - including, yes, gold, bc it's *one* of the more stable commodities, but also, like, toilet paper manufacturers and debt owed by the US government - to make sure they pretty much always have enough solid assets to leverage

So here's the thing about shorts and hedge funds. If I was a large (250K invested or so) individual investor or a hedge fund, I would absolutely short Tesla... for the long term (not to be confused with going long on Tesla, which means owning Tesla)

I would say "Ford Motors is worth ten dollars, and I have seen 100 Fords this week in the pandemic. Tesla Motors is worth ~800$ and that makes no f*cking sense bc I have never seen a f*cking Tesla, and even if I lived in El*n's neighborhood I'd still see more Fords"

So I would make the bet that whatever the nerds are selling Tesla for right now, even if it goes on to double or whatever, it will come crashing down in four or five years, when someone gets burned alive or El*n blows himself up in a rocket or Ford makes a perfectly good electric

But this bet would require holding a TON of stable assets so you don't end up in a margin call if Tesla goes up and up and up. You can only short Tesla long term if you are loaded, it's safer to just day trade it like I said if you are smaller time

So anyway, though, Tesla is a perfectly good contrarian short for a hedge fund. So is GameStop, to a point. Because even more obviously, Gamestop is doomed.

BUT

Remember that a long has potentially infinite upside, finite downside (you pay $800/share, you lose 800xshares, maximum, but it could go up any amount) and a long has finite upside (the amount you get paid in 3 days), infinite downside (it could, again, go up any amount)

So I mentioned last year around this time JC Penney was going under. It made an attractive short, and I tried to short it several times. The risk was incredibly low - after all, what was going to happen? JC Penney discovers fusion energy?

But because it was so obvious that JCP shares were headed for 0, there were effectively no buyers. I think I was able to do it once, made maybe $5 off of a few thousand shares that I bought back at fractions of cents lower.

Eventually the consumer brokers stopped allowing shorts of JCP, bc the market was all sellers and they might not have felt it prudent to buy any more shares to hold for shorting. But the big companies can, I guess, still short these companies? It's weird to me

So again, it seemed really safe bc it was hard to image an out for Gamestop. I am stunned they'd put all their eggs in one basket like that anyway though. Gamestop, like JC Penney last year and presumably now, is what they call a "penny stock."

Federal regulations and brokerages also strictly regulate the use of margin and shorting with penny stocks, which mean stocks under one dollar and especially stocks that have dropped near a few cents or even under a cent. Big banks presumably can work around, but *why*

Normally to buy a stock like that you would have to pay in settled cash that you have on hand - and then you can take advantage of microscopic variations that can lose or make a lot of money, but you also have the risk of not being able to find a buyer, or even close your shorts

So basically, I don't know how, before the Reddit bros with their cash accounts entered the scene, the hedge fund was able to buy enough GameStop to put themselves into a margin call, much less insolvency. I have to assume they absolutely failed at basic investing concepts

Like, if you're an individual investor like the Redditbros, it's your choice if you want to risk it all on crazy stonks. Your choice, and weird federal regulators'. But if it's your JOB, at a HEDGE FUND, you know your job is to HEDGE: to make sure at

WORST you SLIGHTLY lose money

What that means is that you, again, need a bunch of assets that are *probably* safe. If you're an "aggressive" fund, stuff that's trendy can do that - pharma stocks, for instance. You're still gonna need some toilet paper or weapons companies though.

The idea that they made an investment in a penny stock that then accelerated to normal-company levels - I mean, that's something they have to account for. This is extreme but *hedge* literally means balancing that. For that massive instability they should have had stability

my conclusion to this thread is that the stock market is amoral, most of the "protections" that exist for "individual investors" are actually punitive and designed to favor hedge funds,and that regardless of the Redditbros' horrible,it's hilarious these rules tripped a hedge fund