HEADSPACE

JUNE 28, 2024

Roaring Kitties and the Emergence of "Finfluence" Risk

EXECUTIVE SUMMARY

- Research suggests that "finfluence" – a term the North American Securities Administrators Association incorporated into the regulatory vernacular in 2022 in reference to investing by retail investors in response to postings and information sharing on social media – is likely an underappreciated risk. The scope of "finfluence" risk can be multidimensional, with the potential to impact not just individual investors, but broader market participants and systems as well.
- In an effort to administer sound risk management and compliance practices, investment managers should engage in an intentional assessment of the potential impact and severity of "finfluence" risk as it relates to their specific business model, client types, and investment strategies' compositions.
- If "finfluence" risk to a firm or its clients is present to one degree or another, mitigating measures could include: enhancing client risk disclosures; designing and employing portfolio management mitigation techniques; periodically monitoring social media platforms; or providing client education on "finfluencers" and "meme stocks," among other potential measures.

BACKGROUND

This past month, you've no doubt been getting LinkedIn and email feeds on one or more topics that are top of mind for all investment managers to one degree or another (e.g. the 5th Circuit's vacating of the Private Funds Rule, the SEC's potential re-proposal of its AI rule, various enforcement actions, etc). I'm right there with you. However, I couldn't help but also follow the reemergence of Keith Gill (a.k.a. "TheRoaringKitty") that occurred in May and persisted into this past month. Given that what transpired received sparse coverage in the usual risk and compliance newsfeeds – GameStop stock adding roughly $9.6 billion in market value in two days with short-sellers losing $1 billion, [1-2] plus a maelstrom of media attention based on "TheRoaringKitty's" June return to social media after a three-year hiatus (*The Wall Street Journal* alone published 16 articles in a nine-day period on his reemergence [3)] – I thought the broader topic of "finfluence" was worth examining.

After reading the articles *The Wall Street Journal* was publishing, I couldn't help but ask two sets of questions. First, is the broader "finfluence" phenomenon a potential risk warranting assessment by investment managers? Or put in simpler terms (and quoting an old David Letterman bit), "Is this anything?" Second, what, if anything, can and should investment managers be doing to reasonably address "finfluence" risk? What follows are my thoughts.

IS THIS ANYTHING?

Ample data and scholarly commentary on "finfluence" warrant it being treated as a potential risk that should be taken seriously.

During the 2021 GameStop craze, some maintain that the market actually functioned normally in response.[4] Indeed, some argue "it's a stretch to think that extreme market movement in a few, relatively low-capitalized companies will have any major effect on the broader market."[5] However, there seems to be enough evidence and counter-views to support the notion that "finfluence" risk should not be brushed aside by investment managers. Some of the more noteworthy evidence and views include the following:

- 37% of Gen-Z investors in the United States and 38% in the United Kingdom cite social media influencers as a major factor in their decision to invest.[6]
- Investing-related social media forums such as Reddit's WallStreetBets have over 13 million members.[7]
- As of 2021, retail trading volume had reached that of mutual funds and hedge funds combined, growing from roughly 15-18% of all trades in early 2020 to 30% of all trades by early 2021.[8] Relatedly, 2024 data shows that retail investors make up a significant ownership percentage of even large capitalization companies, approximately 41% of Apple and 34% of Pfizer for examples.[9-10]
- In addition to the GameStop events in May this year, the SPAC that purchased Truth Social rose from a low of $16.90 on January 12, 2024, to a high of $71.93 on March 27, 2024, due to support from former President Trump's supporters – representing more than a 425% increase in value despite having a 2023 revenue of $4 million that resulted in a $58 million loss.[11]
- Certain commentators maintain "finfluenced" retail trading presents potential systemic risk, including heightened speculation prompting broad market selloffs and reduced liquidity,[12] as well as heightened transaction costs and reduced market efficiency.[13]
- Cerulli reported last month that rallies in "meme" stocks in particular not just exceed the stocks' underlying fundamentals, but also lead to sector-wide bubbles.[14]
- The US Federal Reserve Board has posited that social media may not only increase risks for individual investors but also increase risks across the entire financial system, primarily because existing risk management systems may not be calibrated for the increased volatility that can result from such investor behavior as that seen in a GameStop event.[15]

With the increased use of social media as a source of investing information and galvanization for retail investors, it doesn't seem inconceivable that, should a similar craze occur with a stock or set of stocks with even higher capitalization than GameStop, a significant market event could arise. Granted, investment managers probably don't need to worry about the likes of Taylor Swift purposefully disrupting markets anytime soon (Taylor has approximately 95 million followers on X; TheRoaringKitty has approximately half a million by comparison). However, at its core, "finfluence" is simply an aggregated movement of ordinary individuals who have the technological means to communicate, share information, and act on it – and in an incredibly swift way (pun intended).

IS THIS REALLY FOR INVESTMENT MANAGERS TO DEAL WITH?

The combination of availability of information, regulatory expectations and industry norms relating to compliance and risk management practices, continued regulatory interest, and use-cases of "finfluence" risk mitigation strategies suggest investment managers can and should examine how the risk may or may not apply to their own shop. If applicable, investment managers have potential ways to respond to and manage such risk.

•. ***Risk forecasting using publicly available shorting information.*** With respect to "meme" stocks in particular, one historic characteristic has been they have been heavily shorted prior to gaining momentum.[16] The degree to which a stock is and has been shorted is publicly available on a variety of websites such as *The Wall Street Journal* and MarketBeat.com, as well as periodic reports issued by stock exchanges such as the NYSE and Nasdaq. Relatedly, with the SEC's adoption of Regulation SHO, another data point became publicly available that could serve as an indicator of which securities may be more vulnerable to "finfluence" risk – the Threshhold Securities List. The Threshold Securities List is a publicly available list of securities that have been marked as "failure to deliver" for five or more consecutive business days. The List is intended to identify potential instances of market manipulation by short sellers. Because short selling was a major driver of the 2021 GameStop craze, the Threshold Securities List could serve as another data repository for stocks that may be susceptible to turning into "meme" status. GameStop, as well as other commonly known "meme" stocks such as AMC and Bed Bath & Beyond, have ended up on the List at various points.[17]

•. ***Risk disclosure using publicly available prior "finfluence" event information.*** The SEC's Division of Corporate Finance has also attempted to equip the public with information about securities issuers who may have experienced or are experiencing a "finfluence" event. Specifically, the Division of Corporate Finance has issued disclosure guidance to securities issuers that are attempting to raise capital during periods with: recent stock run-ups or recent divergences in valuation ratios relative to those seen during traditional markets, high short interest or reported short squeezes, and reports of strong and atypical retail investor interest (whether on social media or otherwise).[18] Investment managers could review whether such information is available for securities in their portfolios, and if so, determine whether corresponding risk disclosure is warranted in documents such as Form ADV, Prospectuses, and SAI's, among others. This potential step is analogous to when investment managers updated the same disclosure documents based on similar information public companies reported regarding potential business impacts from the Russia-Ukraine conflict and Brexit.[19- 20]

•. ***Monitoring social media to address and forecast "finfluence" risk.*** WallStreetBets, Spiking, TradingView, and eToro are a but a few venues where real-time investor sentiment can be gleaned. Analysis by the CFA Institute indicates that independent predictive monitoring of potentially "finfluenced" events is possible through the form of monitoring discussion activity on social media forums such as these. In one study, the CFA Institute monitored certain social media platforms with defined parameters for what level of attention to a particular stock indicated achieving or trending toward meme status (unfortunately, the exact parameters were not shared).[21] Additionally data sources such as Thinkum Alternative Data, YOLO Stocks, Meme Tracker, and Quiver (TrendSpider) provide insights into social media discussions surrounding certain investments that may be in or nearing the throes of a "finfluence" event or state.

• ***Designing and integrating "finfluence" risk mitigation strategies into portfolio management practices.*** Certain investment managers have employed techniques that suggest risk mitigation at the level of portfolio management can be designed and implemented effectively. For example, Counterpoint employs what it deems a "Meme Stock Factor" in its Counterpoint Tactical Equity Fund (CPAEX).[22] Counterpoint's "Meme Stock Factor" is calculated as a stock's average daily trading volume over the last month (which represents the level of investor interest in a stock) divided by the stock's total market capitalization (which represents the company's relative size and importance).[23] The technique segments stocks into "High Attention" and "Not High Attention," with the former having higher than 5% of their market cap as recent daily turnover, and the latter having lower than 5% market cap as recent daily turnover.[24] "High Attention" stocks over the long run have a negative expectation, and thus, Counterpoint uses the classification system as a way to forecast future returns and risk.[25]

Given the type of information that is available, along with certain use-cases of risk management and disclosure approaches, it would seem worthwhile for investment managers to assess whether "finfluence" represents meaningful risk to the manager and its clients. After all, it appears certain mitigation measures may be taken. Additionally, regulatory expectations and industry norms require sound risk management program practices to be active, continuous, and periodically refreshed,[26] and regulatory interest on the topic of "finfluence" was expressed by at least one SEC Commissioner earlier this month as part of the SEC's Investor Advisory Committee meeting.[27] Accordingly, it would seem prudent to evaluate whether the risk is applicable, and if so, the particular nature and severity of it relative to the investment manager and its clients.

WHAT COULD INVESTMENT MANAGERS DO?

Although I don't think investment managers need to overreact to "finfluencer" or "finfluence" risk, there are several potential steps they could take depending on the nature of the risk relative to their particular business model, client types, and investment strategies' compositions.

Potential steps for investment managers can include:

- Documenting "finfluence" risk in internal investment risk inventories and frameworks
- Periodically monitoring social media platforms for increased attention to certain securities
- Designing "finfluence" risk mitigation portfolio management strategies
- Enhancing risk disclosures
- Providing investor education on risks tied to "finfluencers" and "finfluence"

Whether an investment manager chooses to take one or more of these steps should be considered in light of the manager's specific business model, client types, and investment strategies' compositions. An investment manager may reasonably decide that none of the steps suggested for consideration are needed. However, at least engaging in a thoughtful evaluation of the potential risk "finluence" poses to a manager's particular business and clients would be in line with regulatory standards and sound compliance and risk management best practices. That seems well worth the exercise.

Thanks for reading.

ENDNOTES

[1] "'Roaring Kitty' Came Out Of Hibernation. Is The Meme Stock Craze Back?," Hannah Miao, *The Wall Street Journal,* May 14, 2024

[2] "GameStop Short Sellers Lost Almost $1 Billion in Monday's Monster Rally," Yun Li, *https://www.cnbc.com/amp/2024/05/13/gamestop-short-sellers-have-already-lost-1-billion-from-mondays-monster-rally*, May 13, 2024

[3] The following is intended as a representative list of published articles and their pace of publication:

- "Keith Gill's Reddit Account Shares New Screenshot Showing No GameStop Stock Sales," Hannah Miao, *The Wall Street Journal,* June 3, 2024 (6:29 pm ET)
- "Who's Roaring Kitty? The Man Driving GameStop up, Again.," Video, *The Wall Street Journal,* June 3, 2024 (6:29 pm ET)
- "E*Trade Considers Kicking Meme-Stock Leader Keith Gill Off Platform," AnnaMaria Andriotis, *The Wall Street Journal,* June 3, 2024 (6:39 pm ET)
- "Meme Stock Latest: GameStop Falls; 'Roaring Kitty' Holds Firm; E*Trade Raises Questions," Quentin Webb, *The Wall Street Journal,* June 4, 2024 (11:03 am ET)
- "Who Is Keith Gill? The Meme Lord Is Back," Gunjan Banerji, *The Wall Street Journal,* June 4, 2024 (4:33 pm ET)
- "GameStop Burned Andrew Left in 2021. He's Betting Against the Stock Again.," Hannah Miao and Greg Zuckerman, *The Wall Street Journal,* June 5, 2024 (5:45 pm ET)
- "'Roaring Kitty' Schedules Livestream Video for Friday," Hannah Miao, *The Wall Street Journal,* June 6, 2024 (1:30 pm ET)
- "GameStop Shares at $100? Some Traders Say Yes," Gunjan Banerji, *The Wall Street Journal,* June 6, 2024 (4:23 pm ET)
- "Keith Gill's GameStop Trades Pose Conundrum for Market Cops," Alexander Osipovich, *The Wall Street Journal,* June 6, 2024 (4:51 pm ET)
- "Ouch. Traders Pounced on Ultra-Bullish GameStop Bets ahead of Livestream," Gunjan Banerji, *The Wall Street Journal,* June 7, 2024 (12:31 pm ET)
- "GameStock Shares Plummet Nearly 40%," Podcast, *The Wall Street Journal,* June 7, 2024 (4:39 pm ET)
- "GameStock Stock Halted Multiple Times during Roaring Kitty Livestream," Video, *The Wall Street Journal,* June 7, 2024 (6:11 pm ET)
- "Keith Gill's Riotous Return to YouTube Had Beer, Charts and a GameStop Pep Talk," Gunjan Banerji, *The Wall Street Journal,* June 7, 2024 (6:24 pm ET)
- "GameStop Drops Surprise Earnings Report into Renewed Hubbub around Its Stock," Denny Jacob and Sarah E. Needleman, *The Wall Street Journal,* June 7, 2024 (6:29 pm ET)
- "Keith Gill's Reddit Account Posts Portfolio Update Showing an Unchanged GameStop Position," Hannah Miao, *The Wall Street Journal,* June 10, 2024 (4:54 pm ET)
- "GameStop, Cashing in on 'Roaring Kitty' Effect, Raises over $2B from Stock Sale," Quentin Webb, *The Wall Street Journal,* June 12, 2024 (6:01 pm ET)

[4] "SEC Describes the GameStop Frenzy but Not What to Do about It," Matt Phillips, Matthew Goldstein & Ephrat Livini, *New York Times*, October 18, 2021

[5] "How Much Are Meme Stocks Really Moving the Market?," Jessica Matthews, *Fortune*, June 13, 2021

[6] "The Finfluencer Appeal: Investing in the Age of Social Media," Serena Espeute and Rhodri Preece, *Industry Future*, January 2024

[7] "WallStreetBets Trademark Lawsuit Against Reddit Dismissed by Court," Winston Cho, *The Hollywood Reporter*, January 17, 2024

[8] "Meme Investors and Retail Risk," Sue S. Guan, *Columbia Law School Blue Sky Blog*, May 26, 2022

[9] *https://wallstreetzen.com/stocks/us/nasdaq/aapl.ownership*

[10] *https://wallstreetzen.com/stocks/us/nyse/pfe/ownership*

[11] "Navigating Meme Stock Hype with a Thoughtful Investment Strategy," Gabriel Brenner, *https://abacuswealth.com/navigating-meme-stock-hype-with-a-thoughtful-investment-strategy/*, May 30, 2024

[12] "GameStop and the Reemergence of the Retail Investor," Jill E. Fisch, *ECGI Working Paper Series in Law*, April, 2022 (citing "Retail Trading Was Said to Be a Risk to Markets during the GameStop Saga, but the Archegos Blowup Has Reddit Users Pointing Fingers Back at Wall Street," Will Daniel, Markets Insider, March 30, 2021)

[13] GameStop and the Reemergence of the Retail Investor," Jill E. Fisch, *ECGI Working Paper Series in Law*, April, 2022 (citing *Meme Investors*, Sue Guan, January 3, 2022)

[14] "U.S. Retail Investor Education: The Behavioral Bias Revisited Issue," *The Cerulli Edge*, May 2024

[15] "Financial Stability Report," Board of Governors of the Federal Reserve System, November 16, 2021

[16] "What Are Meme-Stock Frenzies and Why Do They Fizzle?," Bailey Lipschultz, *Bloomberg*, June 18, 2024

[17] "What Is Regulation SHO and What Does It Imply for GameStop Stock?," Bernard Zambonin, *The Street*, February 23, 2023

[18] "Sample Letter to Companies Regarding Securities Offerings During Times of Extreme Price Volatility," U.S. Securities & Exchange Commission, Division of Corporate Finance, February 2021

[19] "Sample Letter to Companies Regarding Disclosures Pertaining to Russia's Invasion of Ukraine and Related Supply Chain Issues" U.S. Securities & Exchange Commission, Division of Corporate Finance, May 2022

[20] "SEC Disclosure Brexit Trends," Skadden, Michal Berkner, James A. McDonald, Brian V. Breheny, October 3, 2016

[21] "Meme Stocks and Systematic Risk," Derek Horstmeyer and Valerie Mayer, *Enterprising Investor*, August 9, 2021

[22] *https://counterpointfunds.com/meme-stocks/*

[23] *Id.*

[24] *Id.*

[25] *Id.*

[26] "U.S. Department of Justice, Criminal Division, Examination of Corporate Compliance Programs," March 2023

[27] "Remarks at the Meeting of the Investor Advisory Committee," Commissioner Mark T. Uyeda, June 6, 2024