

Executive Summary

This paper investigates the different theories and explanations aiming to explain the GameStop short squeeze in January 2021. On January 28, 2021, the shares of video-game retail company GameStop (“GME”) rallied to an intra-day record price of 483 U.S. dollars, the stock traded below 20 U.S. dollars for most of 2020 in comparison. GameStop was known to be heavily shorted and was frequently mentioned on the social-media platform Reddit. On that day, January 28, several zero-commission trading platforms that facilitated most of the trading in GME, restricted trading in GME shares and options. This move sparked wide outrage among the public as some small money investors were locked out of their gains, and the share price cratered. The United States Securities and Exchange Commission (“SEC”) thereafter launched an investigation into the happenings around the GameStop short squeeze. This paper, thus, aims to find agreements and disagreements between the SEC Staff Report on GameStop and academic research. On top of that, possible blind spots are addressed.

In the first section, textbook-like short squeezes are characterized including the factors initiating and driving a squeeze. An exemplary short squeeze is also described: the unexpected surge of Volkswagen (“VW”) shares is illustrated with an emphasis on the underlying causes. In this case a release of Porsche’s takeover plan triggered the short squeeze. Also, a gamma squeeze is described as GME experienced high levels of options trading activity.

Next, the paper gives an overview of the SEC staff report focusing mainly on market structures, novel brokerage platforms, the new generation of market participants and the various financial data points. Among those, trading volume, option contract trading and short interest are closely examined as well as the accounts participating in the frenzy. Further, the actions of brokerage platforms and settlement agencies are studied. Their decisions ultimately led to essentially trading restrictions and crumbling share prices. On the topic of regulatory actions though, the report does not argue for urgent policy actions since markets successfully passed the test of extreme market volatility.

Chapter 4 focuses on the different theories explaining the GameStop short squeeze. Firstly, the SEC’s perspective is portrayed. The commission finds that a combination of the following factors induced the short squeeze: short interest, retail investors trading heavily on zero-commission platforms and settlement agencies. Secondly, this section also presents the different lines of argumentation laid out in academic papers. Those are grouped in two baskets: retail investor actions, sentiments and coordination, and market contagion and regulatory implications. The first group of studies find effects of (social) media engagement, and

sentiments on GME trading. On top of that, evidence on trading behavior including performance of retail investors is laid out. The second line of research focuses on transmission effects of the GameStop short squeeze, whereby other heavily shorted stocks also experienced high volatility. The findings, though, are contradictory. Moreover, enhancements to the current regulatory environment are presented that revolve around transparency, shortened settlement cycle, *payment-for-order-flow* and market liquidity.

Lastly, an analysis summarizes the various argumentations. In doing so, this part of the paper summarizes the unique aspects of this short squeeze such as widespread participation, media coverage and market implications. Furthermore, the aspects of the short squeeze on which researchers agree are described. Both the SEC and multiple research groups conclude that relentless retail investor-induced buying, high short interest in GME, coordination over social media and clearing agencies all fueled the short squeeze. None of those are however found to be dominant, rather a mix of factors caused the short squeeze. Besides its relevance, the SEC report is found to be flawed in areas of market health, regulatory implications, and impact of retail investors in comparison to evidence provided by researchers. Some findings in academic papers are however contradictory, in particular in areas of transmission effects and retail trading impact towards the end of January 2021. Some blind spots in academic work published so far are also identified that mainly revolve around options trading and the missing examination of institutional investors. In that regard, the paper proposes further investigations in what might have been a fight between institutional investors rather than small versus big money.