What's the Deal with GameStop and How is it Impacting the Market?

Equity markets dropped across the board last week. The pullback erased all gains seen earlier in January and resulted in a monthly loss of more than 1% for the S&P 500.

We recently discussed the possibility of earnings not meeting the lofty expectation set by the markets over the past few months. The move straight up in stock prices since the beginning of November was due for a pause (at a minimum), and a retracement in the event earnings did not really shine. The tech sector is especially vulnerable on this front and its current leadership is a threat to other sectors if it begins to crack. Thus far, 82% of companies have beaten their fourth quarter estimates and that still has not been enough to propel markets higher. This tells us that those earnings improvements were already factored into prices and it is going to take something extraordinary to move us higher right now.

In addition to the overbought technical conditions, we saw some extra volatility due to the short squeeze initiated by an aggregate of retail traders on the Robinhood platform. In a nutshell, a lot of small retail traders got together and plotted a coup against hedge funds that had shorted some weak companies. GameStop was the most notable, but others have also been involved. The idea was pretty simple - and it worked. All of these individual traders bought as much stock as possible in these heavily shorted companies. This caused the price of the stocks to rise dramatically and resulted in the hedge funds having to cover their short positions. For those of you who are unfamiliar with these terms, to short means to bet that the stock will go down. Hedge funds do this by borrowing shares of the stock from a broker at its current price and immediately selling those shares. The hedge fund then buys the shares later at a lower price to give back to the broker and makes a profit on the difference in the price at which the shares were borrowed and sold and the lower price at which they were bought and returned to the broker. During the time in between, the hedge fund must pay interest to the broker on the value of the borrowed shares. The act of buying back the shares is called covering the short position. In essence, the Robinhood traders knew that if the price rose high enough, hedge funds would have to cover their positions to prevent the potential for catastrophic losses. To cover their positions, the hedge funds had to buy the stock, which simply caused the price to go even higher. The higher it went, the greater the number of hedge funds that had to throw in the towel and cover, thus creating a vicious cycle of ever higher prices. Robinhood traders simply watched the price move higher and higher and the big money was forced to keep buying the stock. I suspect some traders made a fortune from this… and good for them. They were smart enough to see a legal opportunity and took advantage of it. I don't fault someone for thinking outside the box and taking a chance, if they can afford to be wrong. The other indirect issue that all this buying and shorting caused is that the hedge funds who were trying to hang on and not cover their short position were forced to increase their cash positions to satisfy their margin loans with the brokers. To do this they sold their winning positions to lock in profits and raise cash. Many of the positions sold were shares of Apple, Amazon, Netflix and the like. The selling of these shares put additional pressure on the markets as these huge stocks pulled down the major indices. At the end of the week, we saw some moderate losses and got some real entertainment from a bunch of little guys winning the first round against the heavyweights. We will keep an eye on this and report back as we learn more about all the players involved and see how this shakes out over the next few weeks. Let us not forget that at the end of the day, a company is worth whatever its earnings are relative to a risk-free rate of return. All the technical and mechanical gyrations in the world will not make GameStop (or any company) worth any more or less than what its earnings say.

Despite an increase in volatility and overbought market, corporate earnings are trending in the right direction.

Last week's commentary can be found [here](#).

G. Chadd Mason
CEO, The Cabana Group

Cabana Asset Management
Ranked #2 Fastest-Growing Firm in the U.S. in *Financial Advisor* magazine's 2019 ranking and survey.

Cabana Asset Management
Ranked #1 Fastest-Growing Firm in the U.S. in *Financial Advisor* magazine's 2018 ranking and survey.

IMPORTANT DISCLAIMERS

This material is prepared by Cabana LLC, dba Cabana Asset Management and/or its affiliates (together "Cabana") for informational purposes only and is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The opinions expressed reflect the judgement of the author, are as of the date of its publication and may change as subsequent conditions vary. The information and opinions contained in this material are derived from proprietary and nonproprietary sources deemed by Cabana to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. As such, no warranty of accuracy or reliability is given and no responsibility arising in any other way for errors and omissions (including responsibility to any person by reason of negligence) is accepted by Cabana, its officers, employees or agents.

This material may contain 'forward looking' information that is not purely historical in nature. Such information may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader. Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy. All investment strategies have the potential for profit or loss. All strategies have different degrees of risk. There is no guarantee that any specific investment or strategy will be suitable or profitable for a particular client. The information provided here is neither tax nor legal advice. Investors should speak to their tax professional for specific information regarding their tax situation. Investment involves risk including possible loss of principal.

Cabana LLC, dba Cabana Asset Management ("Cabana"), is an SEC registered investment adviser with offices in Fayetteville, AR and Plano, TX. The firm only transacts business in states where it is properly registered or is exempted from registration requirements. Registration as an investment adviser is not an endorsement of the firm by securities regulators and does not mean the adviser has achieved a specific level of skill or ability. Additional information regarding Cabana, including its fees, can be found in Cabana's Form ADV, Part 2. A copy of which is available upon request or online at www.adviserinfo.sec.gov/.

The Financial Advisor Magazine 2018 Top 50 Fastest-Growing Firms ranking is not indicative of Cabana's future performance and may not be representative of actual client experiences. Cabana did not pay a fee to participate in the ranking and survey and is not affiliated with Financial Advisor magazine. RIAs were ranked based on percentage growth in year-end 2017 AUM over year-end 2016 AUM with a minimum AUM of $250 million, assets per client, and growth in percentage assets per client. Visit www.fa-mag.com for more information regarding the ranking.

The Financial Advisor Magazine 2019 Top 50 Fastest-Growing Firms ranking is not indicative of Cabana's future performance and may not be representative of actual client experiences. Cabana did not pay a fee to participate in the ranking and survey and is not affiliated with Financial Advisor Magazine. Working with a highly-rated advisor also does not ensure that a client or prospective client will experience a higher level of performance. These ratings should not be viewed as an endorsement of the advisor by any client and do not represent any specific client's evaluation. RIAs were based on number of clients in 2018, percentage growth in total percentage assets under management from year end 2017 to 2018, and growth in percentage growth in assets per client during the same time period. Visit www.fa-mag.com for more information regarding the ranking.

Past performance is no guarantee of future results. All investment strategies have different degrees of risk and the corresponding potential for profit or loss. Asset allocation and diversification will not necessarily improve returns and cannot eliminate the risk of investment losses. "Target Drawdown" is merely a descriptive term used to describe the general strategy and objective of the portfolio, it is not a guarantee, nor should it be construed to suggest safety or protection from loss. There is no guarantee that portfolio performance will remain consistent with the targeted drawdown parameter. While risk tolerance and targeted "drawdown" are identified on the front end for each portfolio, Cabana's algorithm does not take any one client's situation into account and there is no guarantee that Cabana's strategies will be suitable for any investor. Investors and advisors should not simply rely on the name of any portfolio to determine what is suitable. It is the responsibility of investment advisors to determine what is suitable for their clients. Cabana manages assets on multiple custodial platforms. Performance results for specific investors will vary based upon differences in associated costs and asset availability.

Cabana claims compliance with the Global Investment Performance Standards (GIPS®). GIPS® is a trademark of the CFA Institute. The CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. To receive a GIPS Report and/or a firm's list of composite/pooled fund descriptions please email your request to info@thecabanagroup.com.

The COVID-19 health epidemic has had substantial global economic impact on financial markets. As of March of 2020, restrictions to travel and business spanning the economy for activities not deemed essential have been imposed throughout the United States. These restrictions have caused unprecedented volatility and uncertainty in capital markets and have negatively impacted the economy. It is unknown how severe the impact to the economy and capital markets will be if the epidemic persists for an extended period of time. The epidemic may have a material adverse impact on Cabana's investment advisory business including, but not limited to, the performance of our portfolio strategies.

For additional information regarding our services, including performance disclosures, please visit https://thecabanagroup.com/disclaimers/.

CABANA