Twitter Thread by Cory Doctorow #BLM

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There is no shortage of takes about what's going on with Gamestop (and other surging stocks), Robinhood and Reddit's r/wallstreetbets, many of them contradictory - at least on the face of them. But I think it's possible for most of these takes to be right. Here's how.

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First you need to understand the underlying mechanics of the story. Stock markets are fundamentally a way of making bets, including bets on the outcome of other peoples' bets, and bets on the outcomes of THOSE bets.

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All this complexity creates lots of exploitable opportunities. Some of these opportunities are considered legitimate and are given respectable names like "arbitrage." Others are considered illegitimate, and are called disreputable things like "stock manipulation."

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A hypothetical Martian observing all this through a telescope could not tell you which kinds of bets were honest and which were dishonest, because the difference isn't about any objective standard, but rather, about power.

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The strategies of powerful people are legit, while the strategies of their would-be dethroners are not legit. Sometimes, even outright frauds are OK if they're done by people with enough power.

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If your scam pays out quickly enough, you can sometimes parlay the resulting cash into retrospective legitimization, so even the strategies of the out-group can end up being retconned as legit, if they're successful enough.

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That's why Amway isn't illegal: Betsy DeVos's father-in-law was simultaneously the boss of Amway and head of the US Chamber of Commerce, and Gerry Ford was his Congressman, who was then elevated to president in time to legalize its business model.

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To understand the Gamestop rise, you have to understand a couple of different kinds of bets.

"Shorting": this is a bet that a stock will go down. There's a complicated backstory to how you make this bet, but it doesn't matter.

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The thing to know here is that shorting a stock can make you rich...if the stock goes down. But if the stock goes up, you lose money. There's not really any limit to how much you can lose here.

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Every time the stock goes up, the shorts have to pony up more money to keep their bet alive (in the hopes that it will go down again later), or they have to take their losses, pay out the winner of the bet and surrender any chance of winning later.

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Shorting isn't just a bet on someone else's failure - it's a way to fund bullshit-detection. If you know (or suspect) that a company is lying about its prospects, you can bet against it.

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Shorts fund a lot of research into defective products and scammy businesses, because they win when bad companies are exposed and their stocks go down. Some of the scary security research you read about bad IoT software is funded by shorts.

12/

That's why habitual bullshitters like Elon Musk HATE shorts. Musk leads a cult of credulous worshippers who buy whatever he's selling. Shorts make bets that Musk's cultists will get deprogrammed. Musk uses this to sharpen his cultists' resolve: "they want us to fail!"

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"Options": many different bets get lumped in as "options" but for the purposes of this discussion, buying an option means buying the right to buy stocks later. The people who sell you the option usually go out and buy the stock right away so they'll have it to sell.

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"Front-running": Cheating. Front-runners insert themselves into transactions by spying. If I know that Alice is buying a bunch of Bob's shares, I can snap them up a millisecond before Alice gets there, mark them up, and sell to Alice at a profit.

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"Retail investor": An "average joe" who buys stocks from a brokerage like Robinhood.

"Institutional investor": Hedge funds, private equity funds, pension funds, index funds, investment banks, etc. Whales and sharks.

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"High-frequency trader": A bot. Someone (usually an institutional investor) who uses an algorithm to buy and sell shares very quickly. HFTs might buy a stock and sell it less than a second later (when they're front-running, for example).

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With that all out of the way, here's what seems to be going on. Reddit's r/wallstreetbets is a "retail investor" forum of average joes, many of them angry at the scammy, evil stuff that the big institutional investors get up to.

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Their grievances are mixed: some are angry that big investors have figured out how to destroy good businesses for money. Some are angry because ONLY big institutionals get in on the action when that happens and average joes are locked out of those plays.

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They are stuck at home, have little to spend their money on, and - critically - have access to "trading platforms" like Robinhood that let them buy and sell stocks without any fees (institutionals often have sweetheart deals like this, but average joes used to pay to play).

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They're getting together to make money and to punish their enemies. The easiest enemies to punish are shorts, because if they push up a stock even a little, the shorts get pounded for millions of dollars.

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If they can keep the stock up long enough, the shorts will give up and the average joes will collect their winnings. And the average joes are clever. They've figured out that they don't even have to buy the stocks to force the price up - they can buy cheaper options instead.

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An option is a bet. The people on the other side of the bet usually buy the stocks they sell options on. If I buy an option to buy a stock from you and then the stock goes up, you have to go out and buy the stock and sell it to me at a loss.

23/

If you're an option seller who thinks a stock will go up, you protect yourself by buying shares now.

Buying options is a cheap way to get someone else to buy a stock, which pushes the price up. If the price is going up, options sellers will snap up more stock.

24/

There's two prominent versions of the Gamestop story. The first is that r/wallstreetbets represents so many angry average joes that they can "move markets" by buying unlikely shares, like Gamestop or AMC, and confound the markets.

https://t.co/DRBbwJKfMN

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The second story is that r/wallstreetbets has figured out a hack. They inflict asymmetric pain on shorts (a tiny gain for average joes is a huge wound to the sharks). By buying options, they can eke out tiny gains for a fraction of the price.

https://t.co/g0FoiyU7cU

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But there's a THIRD story, and I think it's the most important one. That's @alexisgoldstein's account of what's going on with Robinhood and the institutional investors it's in bed with.

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Recall that all of this is only possible because Robinhood lets average joes buy and sell stocks for free. How can Robinhood give away a service that costs it money and still stay in business? (Hint: They're not making it up in volume).

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The answer is: surveillance. Robinhood partners with institutional investors and lets them spy on what the average joes are buying and selling. Sometimes, this is just "market intelligence" ("Hey, people like fidget spinners") but the main event is front-running.

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If you're paying Robinhood to tell you what assets its customers are about to buy, you can go out and buy them up first and sell them for a profit to Robinhood's customers.

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Or you can buy some of that asset up because you know its price will go up once Robinhood's customers orders are filled.

Or both.

31/

Citadel Securities is Robinhood's main institutional investor partner. Founded by billionaire Ken Griffin, they combine tech (high-frequency trading), an "asset manager" (they spend other peoples' money) and a "market maker" (they sell things like options).

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Citadel gets to see all those r/wallstreetbets buy orders before they're filled. They can fill some of those orders, making a profit. They can buy some of the same stock for themselves, making a profit. They can sell options, making a profit.

33/

A little bit of this profit comes at the expense of average joes: if there wasn't a front-runner marking up the stocks they buy, the average joes would pay a little less. But the average joes are still profiting from the destruction of the shorts.

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Citadel is merely taxing their winnings. The real losers here, though are Citadel's competitors, funds like Melvin Capital, who were seriously short on Gamestop and went bust thanks to all of this. Guess who bought Melvin at fire-sale prices? That's right, Citadel.

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So the third story goes like this: there are a lot of average joes. They're numerous, pissed and smart. They move a lot of money against shorts and make it go farther thanks to the force-multiplier effect of options.

36/

THEN all this activity is multiplied again by Citadel, a fund that is no better (and no worse) than Melvin or the other targets of the average joes' wrath. Citadel's bots are triggered by the average joes' activity, which turns kilotons of damage into gigatons.

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It's not clear whether the average joes know they're triggering Citadel's bots, or whether this is just Citadel's bet on frontrunning average joes paying off for Citadel. It's possible Citadel is the joes' patsy, and the joes are ALSO Citadel's patsies.

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It's also not clear whether Citadel - and its feuding cohort of competing finance-ghouls - can contain the storm. Maybe they profit off the average joes now, but the joes figure it out and turn their weapons on Citadel and the whole system later.

39/

Remember, the "legitimacy" of a financial strategy isn't determined by its objective decency, but rather by the power of the people who deploy it. If the average joes can attain respectability, they may be legitimized.

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But the road to legitimacy is rocky. Yesterday, the finance monopolist TD-Ameritrade halted trading on the stocks targeted by the average joes. Today, Robinhood followed suit. Maybe they fear that they can't control the monster they created?

https://t.co/xbvpra0AQC

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