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R&R Weekly Column
By Brunello Rosa

Market Lilliputians At War Against "The System"

Last week, media attention was attracted by the epic fight between day traders and the giants of Wall Street. That story is largely known now. Thousands of retail investors, organising themselves on platforms such Reddit and trading on online exchanges such as Robin Hood, have been purchasing the shares of the moribund company GameStop (considered a sort of "Blockbuster" for gaming), a company that funds such as Melvin Capital, which specialises in equity long/short strategies, had been heavily shorting in previous months.

With the price of the stock rising from $17 per share on January 4th to $347 on January 27th, those funds were scrambling to purchase the stocks they needed to cover their short position. But the extent of the bet was such that those shares did not exist, resulting in their prices being pushed up at the speed of light. Eventually, regulators such as the SEC decided to intervene, to calm a market dynamic that was becoming uncontrollable, with retail investors prevailing against hedge funds and Melvin Capital closing its short position and needing to be rescued by its competitors. As the theory says, to be successful a speculative attack needs coordination among the agents involved in it, and a coordinated signal that suggests when the attack should start. The Reddit community had both.

Taking sides in an issue of this sort is hard. One could feel sympathy for the market Lilliputians revolting against the giants of Wall Street, and especially the millennials behind this movement. Nevertheless, the coordination of actions in this way is dangerously close to market manipulation. Hedge funds do not attract popular sympathy, especially hedge funds that short the equities of struggling companies and so can result in the bankruptcy of businesses that might have otherwise survived. But this very strategy – shorting – is also the one instrument that market participants have to signal inefficiencies in the management or unviability of business models.

As for the regulators, they are supposed to be the guardians of the market but tend to act too late, when the damage has already been done. Often, during severe market corrections, some regulators also ban short selling altogether, leaving the impression that market forces should be left free to act only if they push market prices up (the so-called Bernanke Put – now the Powell put).

In the end, it does not really matter who is the good guy in this story, and who is the felon. The real question is what this episode signals, and what the lessons are that must be learnt. It seems to us that this "Reddit army" is following the tradition of fight-the-system/anti-globalisation movements that started with the Seattle WTO protests at the end of the 1990s (remember Naomi Klein's "No Logo"?) and continued with protests such as Occupy Wall Street. One could even claim that the entire crypto-asset movement (net of its abundant scams, illegal activities and manipulation) was originally a way to disrupt "the System".

So, there is a *fil rouge* that connects all these protest movements in their "rage against the machine", represented in dystopian movies such as The Matrix franchise. But one needs to be careful here. History teaches us that most revolts and revolutions aimed at democratising the system end up with autocratic regimes or even ferocious dictatorships. Even the mother of all revolutions, the French Revolution of 1789, ended up with Napoleon's empire and eventually the "restoration" of the Congress of Vienna.

The revolutions of 1848 (the year in which the Manifesto of the Communist Party by Karl Marx was published), which led to the temporary fall of many absolutist monarchies in Europe, similarly ended up with the election of Napoleon III to become the President of France. He too later became Emperor and an absolutist ruler. On a much smaller scale, the anti-globalisation sentiment prevailing among the middle- and low-income classes in the United States was eventually channelled by a plutocrat from New York: Donald Trump.

The lessons to learn here seem to be the following: 1) Social malaise due to the restriction and loss of job opportunities induced by the pandemic is leading people to find other sources of income perceived as rapid and safe, such as day stock trading. 2) Central bank liquidity, issued to help banks survive and sovereigns monetise public debts, is making one-way bets too widespread in the markets, thanks to the perceived "Bernanke put". 3) The financial system seems more de-anchored from economic fundamentals than ever, increasing the chances of all sorts of distortions and manipulations occurring, which can end in devastating market crashes. 4) The revolt of the people by way of coordination through electronic platforms is a signal of the underlying social malaise that, though exacerbated by the pandemic, originated decades ago with the decoupling of salary and productivity growth and the beginning the globalisation process. 5) These events are further confirmation that politics, markets and geopolitics these days are taking place first and foremost within cyber space. Politicians around the world should take note of these events, if they do not want to see this revolt exiting the computer screens and taking to the streets.

Our Recent Publications

- Emerging Markets Outlook: Economic Recovery In H2-2021, Liquidity To Support Financial Markets, *by Alessandro Magnoli Bocchi and Fawaz Sulaiman Al Mughrabi, 28 January 2021*
- Preview: FOMC Looking Through the Soft Patch, *by Nouriel Roubini and Alessandro Magnoli Bocchi, 25 January 2021*
- Flash Review: Federal Reserve Remains On Hold While Sounding Cautiously Upbeat, *by Brunello Rosa, 27 January 2021*
- **GEOPOLITICAL CORNER:** Britain After Brexit: The World Did Not End, But A New One Began, *by John C. Hulsman, 26 January 2021*

Looking Ahead

The Week Ahead: US And EZ Unemployment Expected To Stay Unchanged, With Bank of England Remaining on Hold

In the US, in January the non-manufacturing PMI is expected to increase to 57 (*p:* 52.2), while unemployment is expected to stay unchanged at 6.7%.

In the EZ, December's unemployment rate is expected to remain unchanged at 8.3%, while retail sales are likely to rebound to 0.8% m-o-m (*p:* -6.1%).

In the UK, the Bank of England is expected to leave its policy stance unchanged.

The Quarter Ahead: Delayed Vaccine Distribution To Weigh On Global Growth; Central Banks To Remain Dovish

In the US, President Joe Biden's USD 1.9tn relief plan - which includes proposals for: *i)* additional direct checks; and *ii)* a higher federal minimum wage – is likely to be approved by Congress, thanks to a democratic majority in both the House and the Senate.

Still in the US, throughout 2021, the US Fed is likely to maintain its loose policy stance, even as economic growth accelerates.

In the EU, a slow rollout of COVID-19 vaccines has been blamed on: *1)* the European Commission – the institution leading the purchase agreements - for not securing enough doses; and *2)* the EU's medical agency "*for taking too long to approve jabs that had received the green light elsewhere*".

In China, the army sent 26 military aircrafts into the south-western corner of Taiwan's air defense zone, to simulate missile attacks on a US aircraft carrier, according to US intelligence.

Last Week's Review

Real Economy: DM Economic Recovery Remains Fragile; Global Vaccine Distribution Slows

In the US, in Q4-2020 q-o-q GDP rose by 4.0% annualized (*c:* 4.2%; *p:* 33.4%), as consumption was hampered by the: *i)* withdrawal of fiscal support; and *ii)* resurgence in coronavirus infections. In December: *i)* 'durable goods orders' decelerated to 0.2% m-o-m (c: 0.9%; *p:* 1.2%); while *ii)* 'nondefense capital goods orders excluding aircraft' – a closely watched proxy for business spending plans – rose by 0.6% m-o-m (*c:* 0.6%; *p:* 1.0%). December's 'PCE price index' rose to 1.3% (*c:* 1.1%; *p:* 1.1%) while 'core-PCE prices' – the Fed's closely watched inflation gauge – rose to 1.5% (*c:* 1.3%; *p:* 1.4%).

During its first meeting of 2021, the US Fed left the 'target range for federal funds' rate unchanged at 0-0.25%. The QE monthly program was also maintained at: *i)* USD 80bn of USTs; and *ii)* USD 40bn of MBS. In a post-FOMC meeting statement the Fed declared "*the pace of the economic rebound"* (…) *"has moderated in recent months, with weakness concentrated in the sectors most adversely affected by the pandemic"*. According to the Fed Chairman Powell: *i)* nearly half a million jobs were shed by the leisure and hospitality sectors in December; and *ii) "the economic recovery hinges on vaccination progress"*.

In the EZ, January's 'economic sentiment indicator' fell by 0.9 pts to 91.5 0 (*c:* 89.5; *p:* 92.4), driven by: *i)* sliding 'confidence in retail trade'; and *ii)* smaller-than-expected reductions in 'services confidence' and 'consumer confidence'.

In Japan, December's retail sales fell by -0.3% y-o-y (*c:* -0.4%; *p:* 0.6%), driven by lower purchases of general merchandise and fuel.

Financial Markets: Volatility And Trading Volumes Rose, Equities Fell; USD Up, As Safe Haven

Market drivers: Retail investors supported a few "*short squeezes*", driving heavy price fluctuations in selected stocks.

Global equities closed lower w-o-w (MSCI ACWI, -3.6%, to 643). In the US: *i)* the S&P 500 Index posted the worst week since October (-3.3%, to 3,714); and *ii)* total trading volume hit a record high of 23bn shares - a significant increase from the y-t-d average daily volume of about 14bn. In the *EZ*, European shares fell (Eurostoxx 50, -3.4%, to 3,481) amid worries about a slowing economic recovery, due to: *i)* the still-raging COVID-19 pandemic; and *ii)* delays in the distribution of vaccines. Going forward, risky assets are likely to be supported by: *1)* the global recovery; and *2)* accommodative fiscal and monetary policies.

Fixed Income: w-o-w global bonds remained flat (BAML Global, 0.0% to 297.8), as well as USTs (0 bp, to 1.09%). Going forward, government bond yields are likely to remain at low levels.

FX: w-o-w, the USD traded higher against other currencies (DXY, +0.4%, to 90.584; EUR/USD +0.7%, to 1.217), largely driven by a deterioration in risk appetite; however, as the markets normalize, the USD downward trend is likely to resume.

Commodities: Oil prices rose (Brent, +0.8% to 55.9 USD/b), as China – the world's second-biggest oil user – reported its lowest daily rise in COVID-19 cases, bolstering hopes of a pick-up in demand. Gold fell (0.3% to 1,846 USD/Oz.), as the US Fed kept its monetary policy unchanged without hinting to any more stimulus – supporting the USD as the preferred short-term safe haven asset.

Farah Aladsani *contributed to this Viewsletter.* *The picture in the front page comes from this website*

Abbreviations, Acronyms and Definitions

a	*Actual*	*LN*	*Northern League, Italy*
AKP	*Justice and Development Party, Turkey*	*M5S*	*Five Star Movement, Italy*
ann.	*annualized*	*m-o-m*	*Month-on-month*
ARS	*Argentinian Peso*	*mb*	*Million barrels*
avg.	*Average*	*mb/d*	*Million barrels per day*
bn	*Billion*	*MENA*	*Middle East and North Africa*
BoC	*Bank of Canada*	*MHP*	*Nationalist Movement Party, Turkey*
BoE	*Bank of England*	*mn*	*Million*
BoJ	*Bank of Japan*	*MPC*	*Monetary Policy Committee*
bpd	*Barrels per day*	*NAFTA*	*North-American Free Trade Agreement*
bps	*Basis points*	*NATO*	*North Atlantic Treaty Organization*
BS	*Balance sheet*	*OECD*	*Organization for Economic Cooperation and Development*
c	*Consensus*	*Opec*	*Organization of Petroleum Exporting Countries*
C/A	*Current account*	*p*	*Previous*
CB	*Central bank*	*P2P*	*Peer-to-peer*
CBB	*Central Bank of Bahrain*	*PBoC*	*People's Bank of China*
CBK	*Central Bank of Kuwait*	*PCE*	*Personal Consumption Expenditures*
CBT	*Central Bank of Turkey*	*PE*	*Price to earnings ratio*
CDU	*Christian Democratic Union, Germany*	*PM*	*Prime minister*
CNY	*Chinese Yuan*	*PMI*	*Purchasing managers' index*
CPI	*Consumer Price Index*	*pps*	*Percentage points*
DJIA	*Dow Jones Industrial Average Index*	*pw*	*Previous week*
DJEM	*Dow Jones Emerging Markets Index*	*QCB*	*Qatar Central Bank*
d-o-d	*Day-on-day*	*QAR*	*Qatari Riyal*
DXY	*US Dollar Index*	*QE*	*Quantitative easing*
EC	*European Commission*	*q-o-q*	*Quarter-on-quarter*
ECB	*European Central Bank*	*RE*	*Real estate*
ECJ	*European Court of Justice*	*RBA*	*Reserve Bank of Australia*
EIA	*US Energy Information Agency*	*RRR*	*Reserve Requirement Ratio*
EM	*Emerging Markets*	*RUB*	*Russian Rouble*
EP	*European Parliament*	*SWF*	*Sovereign Wealth Fund*
EPS	*Earnings per share*	*tn*	*Trillion*
EU	*European Union*	*TRY*	*Turkish Lira*
EUR	*Euro*	*UAE*	*United Arab Emirates*
EZ	*Eurozone*	*UK*	*United Kingdom*
Fed	*US Federal Reserve*	*US*	*United States*
FOMC	*US Federal Open Market Committee*	*USD*	*United States Dollar*
FRB	*US Federal Reserve Board*	*USD/b*	*USD per barrel*
FX	*Foreign exchange*	*UST*	*US Treasury bills/bonds*
FY	*Fiscal Year*	*VAT*	*Value added tax*
GCC	*Gulf Cooperation Council*	*VIX*	*Chicago Board Options Exchange Volatility Index*
GBP	*British pound*	*WTI*	*West Texas Intermediate*
GDP	*Gross domestic product*	*WTO*	*World Trade Organisation*
IMF	*International Monetary Fund*	*w*	*Week*
INR	*Indian Rupee*	*w-o-w*	*Week-on-week*
IPO	*Initial public offering*	*y*	*Year*
IRR	*Iranian Rial*	*y-o-y*	*Year-on-year*
JPY	*Japanese yen*	*y-t-d*	*Year-to-date*
k	thousand	*ZAR*	*South African Rand*
KSA	*Kingdom of Saudi Arabia*	*2y; 10y*	*2-year; 10-year*