NEUBERGER | BERMAN

CHARLES KANTOR
Kantor Group/Long Short Team

The Reddit Phenomenon

Recent events illustrate the power of collective wisdom, powered by technology and “boredom”.

Below is a text exchange that transpired Wednesday evening with my daughter, who is a freshman at college and, thankfully, was unaware that buying GameStop (“GME”) was a “thing”. Following my unsuccessful attempt to articulate what was going on, and why a spike in GME shares meant that all other stocks would be down, she hung up on me. Five minutes later we had the following text exchange:

- **Daughter:** “Wait I researched the stock market thing”
- **Daughter:** “I get it now”
- **Daughter:** “It is a rebellion against wall street organized by Reddit”
- **Me:** “Correct”

Over the last few weeks, we’ve seen unprecedented volatility within specific stocks in the market highlighted by the Reddit phenomenon. Simply put, retail momentum trading and headlines have been driving catastrophic losses for various hedge funds that are short stocks with high short interest (e.g., GME, AMC, BBW, BBBY, EXPR); meanwhile, the “Reddit stocks” have enjoyed sizable gains…for now.

What is the Reddit phenomenon?

In our opinion, it is the power of collective wisdom facilitated by the digital revolution, supported by "boredom" and enabled by new technology platforms (and the concurrent impulsivity that these platforms help facilitate). Not surprisingly, we have received countless incoming emails and calls with the common question being, "are you short GameStop?" As always, our goal is to be as transparent and thoughtful as possible for you all—and as such, the simple answer to that question is "no", but we'd actually suggest that the proper answer is "yes". How can that be? Well, specifically:

1. We have no *direct* short exposure to GME.
2. We *all* have *indirect* exposure to GME.

So what do we mean by "indirect" exposure? Simply put, the "GameStop dynamics" are reverberating far beyond that specific stock or its corresponding sector. The first derivative and appropriate question would be, about how much exposure do you have to other highly shorted stocks? Unfortunately, that question, too, is relatively subjective based on what is defined as "highly shorted". Nonetheless, there has been clear correlation amid some highly shorted stocks and even select ETFs that have exposure to GME and others. But perhaps even more important, there is the "de-grossing" impact, which *impacts both short AND long stock positions.* So let us explain de-grossing at a very high level. It largely works as follows:

- When hedge funds are short a stock that moves against them, the stock position gets *bigger* as a percentage of their portfolio.
- At that point, risk management protocols often kick in and they are forced to cover the short.
- Once a stock gets covered, that brings the hedge fund's net exposure longer.
- If a hedge fund does not want to change its net exposure, it will sell down long positions to balance the book (which itself may be levered, serving to exacerbate the issue).
- The resulting effects of covering shorts and selling longs brings about "de-grossing", or forced selling, to meet margin calls in a disorderly market, which we witnessed this past week.
- Here again, the power of collective wisdom plays a role. All professional investors de-gross at the same time. That is what they are trained to do.

This "de-grossing" and forced selling to meet margin calls has been fast and furious as many hedge funds have moved from one side of the boat to the other, at breakneck speed. All of these trading dynamics are led by a changing market structure with lots of "crowding" in longs and shorts and further provoked by technology (ease of trading), transparency and communication, as well as the overall macro backdrop.

We believe this phenomenon is technical and *NOT fundamentally* driven. In other words, the short-term share price movement is not related to any "new news" about the company, its employees, its customers or, most importantly, its future cash flows, in our view.

After all, in a typical "functioning" capital market, the GME management and board would have several options to capitalize on the appreciated share price and larger market capitalization of the company. For example, management might consider issuing new equity for general corporate purchases or to acquire another company. In our view, however, what we consider to be an unnatural appreciation in the GME stock takes these types of options largely off the table—whether due to regulatory scrutiny or a target company rejecting the equity as a currency.

The bottom line? We understand the fragile market structure that we are operating in today, and we believe in having a very strong risk management process. Numerous long positions sold off from the de-grossing, but we believe that will prove to be a temporary phenomenon. Poorly positioned companies do not tend to outperform over extended periods of time; similarly, quality, well-run companies do not tend to underperform over the longer term. We continue to focus on beyond privileged and resilient companies with strong management teams, significant business moats, gaining market shares, and mission-critical products and services. And, unfortunately, while we believe that no one can credibly time the end of this market volatility (and we stand by our belief that guessing market direction in the short term is a random walk), as fundamentally driven investors, we stand by our belief that the "E" (earnings) will be the ultimate driver of the "P" (the stock price) for our underlying investments.

NEUBERGER | BERMAN

Neuberger Berman
1290 Avenue of the Americas
New York, NY 10104-0001

www.nb.com