INSIGHTS FROM CFA SOCIETY SINGAPORE

GameStop fiasco brings market's trust deficit into full relief

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By Rebecca Fender

The GameStop controversy has raised several questions: Was there market manipulation? Does market infrastructure need to change? Is the social media narrative now powerful enough to impact market pricing? PHOTO: REUTERS

JUST days after the release of the Edelman Trust Barometer titled "Declaring Information Bankruptcy", Wall Street experienced an information crisis firsthand, courtesy of Reddit and GameStop. The wild January ride has put a focus on investing versus speculation versus gambling, in the context of an environment where many betting outlets have been paused due to Covid-19, and technology has enabled free and fast access to markets.

This has attracted many new market participants. How will they fare in the long term? Will this democratise markets and make them more inclusive, so more people benefit from long-term value creation? Or will it lead to a different "investor class" that views investing as a new form of (sometimes very costly) entertainment?

The GameStop fiasco brought the market's trust deficit into full relief. Hearings are planned in the House Financial Services Committee and Senate Banking Committee of the US Congress. CFA Institute, a global association of investment management professionals, will be actively following these events, and we are engaging with various industry stakeholders about investor protection and ways to foster the integrity and transparency of markets.

But GameStop is just one aspect of a larger trajectory. In 2017, the Future of Finance team at CFA Institute introduced the fintech disruption and parallel worlds scenarios in Future State of the Investment Profession. We suggested that a quickening flow of disruption from technological innovation was likely and that mass disaffection related to antiglobalisation and populism could impact markets. Social media, we noted, has vast potential to both bring people together and to divide them.

For insight on these issues and the path forward, we interviewed Jon Stein, CFA, a member of the CFA Institute Future of Finance Advisory Council, for his views on the GameStop situation and the future of online financial platforms.

CFA Institute: *We're talking with a lot of investors about whether the GameStop situation was about manipulating the market, and a lot of questions remain. Does market infrastructure need to change? Is the social media narrative now powerful enough to impact market pricing?*

Jon Stein: It seems like the retail investor is having a moment, and it's the next logical step in what we've been seeing as far as social platforms discussing investing, the ability to trade on a phone for free, and investing tweets from influencers like Elon Musk, all combined with the use of social media as a tool to disrupt.

Social media was supposed to help democracy, but we are realising it may be breaking it. Is it the same thing with social media and finance? Today an individual retail investor can do the same thing that traders did via Bloomberg chat many years ago in relative secrecy, but now it is public, and the market reacts more quickly. As a result, we're going to have to think about regulations. (Note: The CFA Institute Standards of Professional Conduct states, "Members must not engage in practices that distort prices or artificially inflate trading volume with the intent to mislead market participants.")

CFA Institute: *Should we be regulating the steps in the settlement process? We don't want to regulate speech or prohibit people from investing, but we are concerned with investor protection.*

Jon Stein: The recent events haven't been terrible for the investor, but they haven't been good either. Trading for short-term benefit doesn't help society. These actions, however, are being taken by the same people whom politicians are generally trying to protect. These actions have been destructive of value and a waste of time – just like gambling is. So perhaps it should be taxed like gambling. It is fun, but it doesn't create value and is not a productive activity.

CFA Institute: *We had the same day-trading dynamic but with less sophisticated technology in the dot-com boom and the global financial crisis (GFC). Is it helpful for CFA Institute and other market advocacy organisations to continue to caution against the perils of day trading? Or does that just feed the perception of an exclusionary "establishment"?*

Jon Stein: CFA Institute needs to keep saying this because the reason markets exist is to raise capital. This speculative activity like we've seen doesn't further these ends.

To those who argue the system is broken, we should recognise that not all correlations between value and price are broken. You do have to give credit to Roaring Kitty – it was a great trade – but we need to encourage proper capital allocation. There shouldn't be crazy swings in price unless there is news.

How should we think about new speedbumps, since there are no transaction costs now? It need not be a flat-fee regressive tax but could instead be progressive. For example, at casinos you tend to have to pay taxes once your winnings exceed a certain amount. This reinforces the idea that as you go up in scale, you need to be more thoughtful.

CFA Institute: *Are you concerned about gamification and how some platforms use ploys to get people to trade against their own best interests?*

Jon Stein: It is happening more and more. Reporters don't write articles about the people who lose, only the US$40 million winner. Betterment and other major firms for retail investors won't race into this space though because it isn't good for the long-term brand when it ultimately goes wrong. Regulators will need to step in at some point.

You can check out the TechCrunch video I did with Vlad Tenev, the founder of Robinhood, back in 2016 to hear us talking about how we designed our business models. Just because something is online does not make them similar, and we have been very focused on alignment of interests with our investors.

There are examples of using gamification to benefit customers. Companies can use prompts and contests to encourage people to save more. It comes down to product design and the company's incentives.

CFA Institute: *It sounds like the "democratisation of markets" should really be about the "democratisation of value creation."*

Jon Stein: Yes, I completely agree. And just remember that just because something doesn't have a commission doesn't mean it is really free. Like eating at McDonald's: it might not cost you a lot of money today, but it will cost you in terms of your health.

You should want transparency, and if you aren't paying for something, you should be asking questions.

Rebecca Fender, CFA, leads the Future of Finance initiative, which is the thought leadership platform for CFA Institute.