The GameStop Trading Rally: Understanding Investor Behaviour in a Changing World

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The recent frenzy surrounding GameStop shares has been attributed to retail investors who decided to collectively take on hedge fund short sellers. This has been fuelled by various factors including social media sites like Reddit and Twitter and zero-cost trading apps like Robinhood. It has also encouraged retail investors the world over to take similar action, with a subreddit called Bursabets being set up to be the “Malaysian version” of WallStreetBets, the forum that initially triggered the GameStop surge.

In October 2020, ICMR released a paper entitled *Enhancing Financial Literacy in a Digital World: Global Lessons from Behavioural Insights and Implications for Malaysia*. Traditional economic theory has often posited that individuals are rational beings who make choices to maximise a utility function, using the information available and processing this information appropriately. Yet behavioural research has shown us that this is not true even with so-called “perfect information”, individuals often act inconsistently or against their own best interests due to other psychological and behavioural factors.

In that paper, we had discussed how the advent of digitalisation could play a huge role in changing the ways investors behave in the capital market, but that it could be a double-edged sword for better or for worse. This recent GameStop rally is proof that this is already happening, and that the intersections between investor behaviour and digitalisation can be consequential.

The changing landscape

Many critics have labelled the GameStop rally as “irrational exuberance”, in a large part due to the fact that the stock rally did not appear to be on any underlying fundamentals – GameStop sold physical copies of games in retail stores, and had been struggling with net losses and falling revenue amidst pandemic store closures and increased digital competition.¹ The “irrational” behaviour underpinning the GameStop rally is not new – we have seen retail investors create huge fluctuations in the market, from the Dutch Tulip Mania in the 17th century, to the more recent dotcom bubble of the 1990s. What makes this recent episode different is how it reflects the intersections between a changing landscape and investor behaviour:

1. Increased market participation via app-based investing

Robinhood’s zero-fee trading model that pioneered in 2013 opened the doors to investing for many retailers, and disrupted the industry by forcing many other traditional brokerages to go down the zero-fee route as well. The low cost, convenient account opening, no minimum account balance, and easy-to-use app interfaces provides a low barrier-to-entry into the equity

market for retail investors. Robinhood now has more than 13 million users, 3 million of which signed up in the first four months of 2020 alone as the COVID-19 pandemic forced people around the world into lockdown. While Robinhood is not the sole trading platform involved in this saga, they have remained the market leaders in zero-cost online day trading in their mission to “democratise finance”.

Behavioural research has suggested that people are inclined to overvalue free products – there tends to be a disproportionately large increase in demand when a product becomes free even if the price drop is relatively low.\(^2\) People tend to fear making a bad deal and suffering a loss, but “free” eliminates this fear. In this context, zero-fee trading may encourage investors to take more risk than they usually would as their opportunity cost lessens.

The gamification of investing apps has also raised concerns that it makes investing too fun and too easy, to the point that investors do not seriously consider the risks they are taking (back in 2015, NBC News had called Robinhood “Charles Schwab meets Candy Crush”).\(^3\) In fact, Massachusetts securities regulators had filed a complaint against Robinhood in December 2020, arguing that the gamification of the app exposed investors “to unnecessary trading risk”.\(^4\) Regular emoji-laden notifications, in-app prompts, and celebratory falling confetti after completing a trade creates a positive reinforcement that encourages impulsive trading, not unlike the one-click checkout and “reward coins” that are a feature of many e-commerce platforms.

While zero-fee trading has not yet arrived in Malaysia, the advent of digital-only brokers has brought down the cost of trading in the equity market, and this had led to an increase in retail participation, particularly during the pandemic. From March 18 to June 30 2020, Rakuten Trade had activated almost 50,000 new accounts, with 80% of customers below 40.\(^5\)

### 2. Social media as a collective movement

Social media platforms have played a large part in the GameStop rally, with members of Reddit group WallStreetBets collectively taking action to purchase the shares, pushing GameStop’s price higher and effectively squeezing short sellers. This has been further fuelled by activity on other platforms - GameStop shares jumped another 45% in after-hours trading after Tesla CEO Elon Musk tweeted about it along with a link to the WallStreetBets subreddit.

The very nature of social media capitalises on individual’s social preferences to enhance peer group messaging, while leveraging on the large amount of time spent on social media to build an accessible contact point. Social media platforms have also famously harnessed algorithms

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designed to keep people engaged amidst limited attention spans. This makes investors more susceptible to misinformation and herding behaviour, particularly if there is an overreliance or belief in influencers or even other forum participants. There is a tendency on social media for people to only post about their wins and not losses, which can bolster overconfidence and amplify the herd mentality. Behavioural research has also shown that investment decisions of community members have a casual effect on an individual’s decision making - this could also amplify the “Fear of Missing Out”, particularly if one sees peers making profits from stock trades. For example, FinTok and StockTok are growing corners of TikTok (as of Feb 2, the #fintok tag on TikTok has garnered 158.1 million views, with #stocktok boasting even more at 539.4 million views). While some of these content are educational, many also use the platform to talk about their stock picks and show off six-figure incomes that they have made via day trading.

The positive feedback loop within social media platforms also creates a sense of community and belonging, which could be particularly attractive during a pandemic when many people feel physically and emotionally isolated. In the case of GameStop, fellow members on WallStreetBets have urged and encouraged each other to buy and hold, and have created their own lingo and culture reinforcing the sense of community fighting against a common enemy. It also underlines the psychological idea of loss aversion or sunk cost fallacy, where people continue to pursue a loss-making course even if it is not sustainable as they have already committed a significant amount to it.

3. Enhanced access to information

Technology and connectivity have also narrowed the information gap between retail investors and traditional institutional investors. Mobile apps that provide aggregated research makes it easier for individual investors to obtain analysis that might have previously been limited to industry players; decentralised social media communities allow for sharing and exchange of knowledge at unprecedented speed (WallStreetBets boasted more than 5 million members even prior to the GameStop saga).

Technology also means that both information and capital are now borderless even at a retail level. The creation of BursaBets highlights how ideas from the US can influence behaviour in Malaysia, even though the dynamics of both markets are very different. However, the difference in regulatory structure (short-selling remains regulated in Malaysia) and market fundamentals meant that an attempt by investors in BursaBets to drive up the price of rubber glove shares did not succeed, underscoring the role that regulation and market context can play in shaping outcomes. Nonetheless, it is important to note that many retailers now have access to online trading platforms globally, even if they may not be regulated within their own

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jurisdiction. This was highlighted in May 2020, when online investment platform eToro stated that Malaysian investors accounted for over 11% of their Asia Pacific customers, despite the Securities Commission warning that eToro was not licensed or registered in Malaysia.\

4. Millennials and Gen Z as a new class of investors

As millennials (born between 1981-1996) progress in their careers and Gen Zs (born between 1997 to the mid 2000s) enter the workforce for the first time, they are emerging as a new class of investors shaping the market. A study showed that more than half of millennial and Gen Z investors said they’ve been trading more often since the Covid-19 pandemic began, compared with just a 30% increase for the general population. Further, more than half of Robinhood customers were opening their first brokerage account, with the median customer age being 31 years old. This is line with what is happening in Malaysia, where 64% of CDS account openings on the Bursa Anywhere app has been by investors aged 25-40. These numbers make sense especially in the context of investing online during a pandemic – millennials and Gen Z are digital natives who grew up with technology, and are comfortable conducting every part of their daily lives digitally, even investing.

Research has shown that millennials and Gen Z care deeply about social justice and community issues – more than 75% of respondents to the Deloitte Global Millennial Survey 2020 said the pandemic had highlighted new issues for them and made them more sympathetic towards people’s needs. The same number said they were now motivated to take positive action to improve their own lives, and that of their community. At the same time, millennials and Gen Z are getting increasingly disenfranchised by businesses and leaders, with the number of respondents who think businesses can be a “force for good” dropping by 25% from three years ago. The survey also reaffirmed findings that millennials have no qualms starting or stopping business relationships based on factors that reach beyond personal experiences, like the environment, unequal pay, or business’ political stance. Behavioural research has shown that social identity and strong preferences for social values can powerfully affect decision-making, to the extent that individuals derive utility from it.

As a generation who grew up in the aftermath of the Global Financial Crisis and now the pandemic, many millennials and Gen Z feel that they have lacked opportunities at the expense of large institutions profiting. Conversation on WallStreetBets highlight that, at least for the

14 Deloitte (2020) The Deloitte Global Millennial Survey 2020: Resilient generations hold the key to creating a “better normal”
initial participants of the GameStop frenzy, a key underlying motivation was to rally against a system perceived to be championing Wall Street elites amidst increasing inequality. The idea that small retail investors could band together against large institutional investors is particularly attractive due to frustration of a “K-shaped” recovery, where over the past year the stock market and investors have been earning profits while the “small guy” suffered the economic impact of the pandemic.

The role of policymakers

Digitalisation and the way it changes investor behaviour is inevitable and need not be dangerous. As ICMR had discussed in our previous papers COVID-19: Rethinking Long-Term Savings for Greater Financial Inclusion in a Changing Economy and Enhancing Financial Literacy in a Digital World: Global Lessons from Behavioural Insights and Implications for Malaysia, digitalisation of the capital market can increase opportunities for long-term savings and asset accumulation, deliver more relatable financial education content, and provide tools for better money management. The presence of retail investors also provides liquidity and diversity in the market. As such, rather than limiting access, the aim for policymakers should be on ensuring that investors understand the risks they are taking, while also taking a broader long-term view on how the capital market is evolving.

Financial literacy remains key, but the traditional means of financial education will no longer suffice. The conventional understanding of investors as rational beings imply that consumers fail to act in their own interests due to information asymmetries or misinformation. As such, ensuring consumers are informed is the appropriate way to correct the markets’ failure, and many financial education programmes that seek to impart skills or knowledge therefore implicitly assume that this will lead to positive changes in financial behaviour.

However, with our current understanding of human behaviour, we now know that there are deeper psychological triggers behind investors’ decision-making process. As businesses exploit these behavioural loopholes to target consumers and investors, it is imperative that policymakers too do the same. This could include harnessing data points for more targeted and segmented investor outreach, collaborations with social media influencers, working with industry players on tools that can encourage long-term savings and investing, as well as using behavioural insights as a measurement tool to evaluate policy effectiveness.

Part of being able to design effective policy includes understanding the needs and wants of the target market. With two generations of digital natives now investing in the capital market, it would be naïve to dismiss their preferred communication channels and methods, even if it may seem unconventional. As highlighted by public policy think tank CATO Institute, “that investors are corresponding in memes and emojis instead of memos and Bloomberg chats doesn’t mean that anything fishy is going on.” Instead, policymakers would need to be more proactive rather than reactive to the changes in the digital and cultural landscape, especially as decentralised platforms...

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and access to information and markets will only get tougher to regulate. Understanding millennial and Gen Z investors is an area in which ICMR is hoping to do further research on this year.

Finally, what is happening in the financial markets can be seen as a reflection of deeper frustration about the wider economy. Similar to social justice and political movements that have harnessed this energy over the last few years, retail investors are starting to retaliate against what is perceived to be widening inequality and unethical profiteering in the capital market. While the GameStop rally might have started in the US markets, the impact of this will reverberate around the world. This will require greater reflection on the role of the capital market in enabling financial inclusion, the responsibility towards shareholders vs stakeholders, and how the capital market can address deep-seated structural issues.