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Wall Street's temporary pain could provide an opportunity

◆ The Reddit crowd's attack on short-selling hedge funds could force them to unload some of their favourite stocks to cover margin calls.

◆ The move could create significant temporary volatility given the weight of some of the most-crowded trades.

◆ Technology names, widely owned by institutional investors, could take a temporary hit as a result of this.

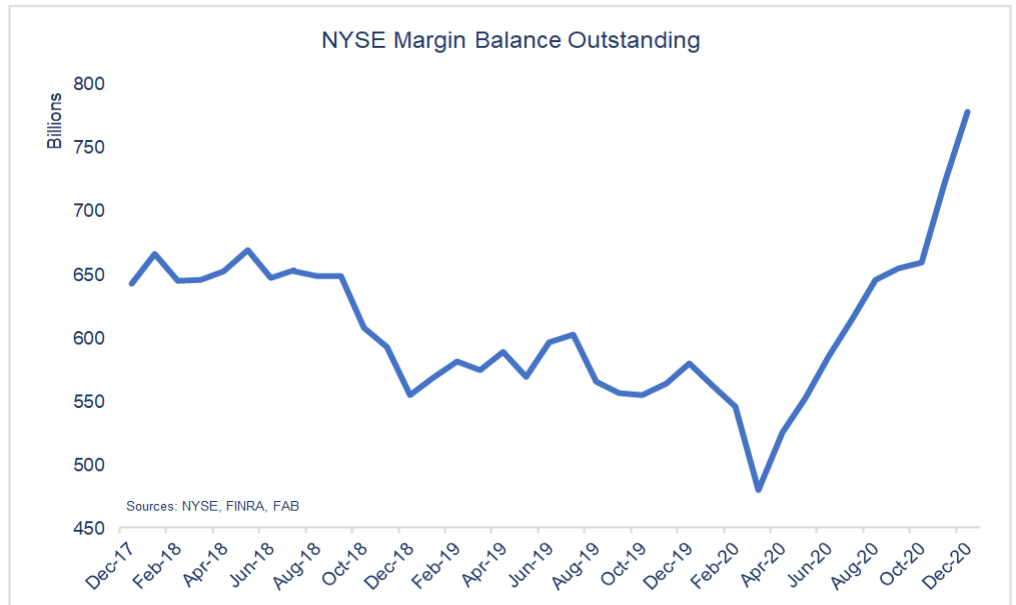
◆ This would create a short-term opportunity to get more exposure to equity markets at slightly lower prices.

◆ The FAB AAC is overweight in equities, IG and EM bonds, and gold, and is underweight alternatives.

About a year ago, investors were watching the rise of the so-called 'Robinhood crowd', a reference to the brokerage app which made newcomers to the stock market in the US feel like they were gaming while trading. The phenomenon has taken a whole new dimension and the moniker has gained deeper significance.

Scores of retail traders, spurred by social media forums, have driven heavily-shortened small-cap stocks into a breathtaking rally. In the process, some hedge funds have racked up billions in losses. Many others, including Carson Block's Muddy Waters, have closed their short positions in a hurry, reportedly at deep losses.

The danger here is that, to cover their shorts, some of these hedge funds have to sell their favourite stocks to raise cash to close other positions.



In a short-sale, the investor borrows stock of a company which it expects to drop in price and sells it. The investor has to return the borrowed stock later, but if the bet goes well, it will be cheaper to buy it back when it is time to return the stock, and the investor can book the profit.

The trouble is when the trade goes wrong. In this case, investors sometimes buy the stock to repay the borrowed shares before it rises further, and because of that pressure the stock price goes even higher. This is called a 'short-squeeze'.

The investor covering the short, however, has to raise cash from somewhere to buy the stock. Many times, this may have to be done by selling some of the stocks about which the investor is bullish. This is probably happening right now.

If this is the case, there could be a temporary correction in the market, particularly in technology stocks. In other words, a fire-sale.

The outstanding margin balance on the NYSE is at the highest in at least a decade

This was evident yesterday as the NASDAQ 100, which contains some of the most-loved stocks, was the worst-performing major benchmark in the US. Some of its biggest components were among the big losers, such as Google's parent Alphabet Inc., Amazon and Netflix.

Such big names moving down so fast, and dragging the indices with them, could trigger stop-loss orders from some funds and add short-term downside momentum. At some point, however, the downward spiral stops, and reassured investors are likely to seek those stocks that they like again, especially if they can now buy them even cheaper. For those who may have been wary of adding exposure to equities because of the recent rally, the current sell-off offers a great opportunity to do so.

Investment Strategy Update

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