**Game Stop & Short-Selling Interim Commentary**

A few of our clients have inquired about Game Stop and a few other companies experiencing huge volatility.

The first thing to understand is that ***we have no direct exposure to Game Stop (or AMC, Bed Bath & Beyond, airlines or the other "short-selling" candidates***).

We may experience some tangential volatility—but it will not impact the underlying business models or the ability to produce sales, cash flow or earnings from any of our businesses.
As we have explained with all of our clients---***we hold extremely rare and valuable businesses with incredibly high abilities to produce sales, cash flow and earnings***. However, despite the incredible value associated with these businesses---they can still be impacted by volatility in other places in the financial markets.

For this reason, ***if we take a position in a given business—it is ALWAYS based upon where we think that business will be in 10 or more years***.
A ten year holding period allows us to absorb volatility in the markets and increase the odds of a positive outcome over a decade or more.

**What Is Short-Selling?** Short selling involves borrowing shares of stock from a broker or custodian, selling the stock, then hoping the price goes down so you can buy the shares you need to return to the lender, while pocketing the difference. If you have to pay more to buy the shares to settle your debt, you've lost money.

Short-selling exposes an investor to potentially unlimited losses since there's no absolute upper limit to a stock's price.

Additionally, a stock's price can remain above the company's true value longer than many short sellers can keep their nerve, or even remain solvent.

Here are comments from Warren Buffett on the matter at the 2001 and 2006 Berkshire Hathaway annual shareholders meetings.
Warren Buffett: Short selling is "tempting" but it's "ruined a lot of people" - YouTube

Regarding the current situation with Game Stop. It is a deteriorating business that is posting losses while increasing debt. We don't know if it will go out of business or not. However, we know it is an asset we don't want to own. As such, it is easier to avoid it.

It has been widely reported that several large hedge funds have "shorted" Game Stop assuming they would be able to buy the shares back later at a lower price.
As Mr. Buffett explained in the link above, this is a risky strategy.

The collective "short positions" dwarfed the total amount of shares that are actually available to trade on a daily basis. ***Not only is this illegal, but it has severely exposed the short sellers to a "short-squeeze."***

A short-squeeze occurs when traders with a short position are forced to cover their shorted stocks. ***This forces them to go from being rabid sellers to panicky buyers***. Simple economics of Supply and Demand dictates that the equilibrium price then has the ability to skyrocket upward as the "shorted" positions are covered.

It has also been widely reported that all of the pressure to induce a "short squeeze" occurred due to some average amateur retail investors that are sharing commentary on Redditt message boards like WallStreetBets.

Up until this point, we are in agreement.

However, ***there is NO WAY on God's Green Earth that we have seen this type of volatility merely by the trading activity of some average people*** at home buying a 100 shares of Game Stop here and there.

**Rather, we believe these things are at work:**

1) High Frequency Traders (another type of very sophisticated institutional trader) use extremely complex algorithms (math models) to read articles, headlines and message boards to sniff out emerging trends.
2) The high frequency traders saw the amount of "shorted" stock and employed a strategy to expose the shorts and force them to cover the short positions….of course with the intent of making a bunch of quick money in the process.
3) The high frequency traders are the ones with large enough fire power to create this kind of volatility. As such, we are witnessing two differing types of hedge funds battling it out.
4) The traders involved are most likely using immense amounts of leverage (either borrowing on margin or using put and call options…or both) to magnify the impact of their bets. This leads to tremendous volatility.

Let me repeat this…..***there is NO WAY that average retail investors on some message board are causing this type of volatility***.

The "little guy" is being described as the hero of a David vs. Goliath battle. Although Goliath may collapse in the process….it is other Goliath's that are operating behind the scenes to make this happen. Furthermore, these large funds/traders have large amounts of liquidity and/or large amounts of leverage in the process. This will increase the amount of volatility even more.

Our fear is that Greed has taken hold and innocent (naïve) retail investors are now going to pile into this trade and try to make some quick money. As they do, there will be some who are incredibly harmed in the process.

**No matter how much we study this—we cannot determine what will happen next. As such, the disciplined thing to do is to stay away and avoid this type of lunacy**.

We welcome any questions or comments you may have.

*Dave, Warren, Jon and Nate*