SHEPHERDING NEW HERDS: EXPLORING THE REALITIES OF RETAIL INVESTMENT AND ENGAGEMENT

- Retail equity investment increased sharply in 2020
- Growth stimulated by ease of trading via neobrokers and higher disposable income
- New generation of retail investors driven by innovation, sustainability and noise
- Retail preference for disruptive tech stocks driving development of thematic ETF strategies
- Issuers will need to consider wider engagement with both the retail and ETF audiences

At its fundament, investing as an individual in the equity markets has been driven by herd mentality. You select your herd or herds based on your investment objectives, the investment products available to you and the level of capital you have. You might be a stock-picker, controlling your own investment destiny at one end of the scale, or rely on a financial advisor and/or institutional fund manager to do the heavy lifting for you at the other end, but whichever way you are ultimately seeking the best possible returns at the right risk profile.

In recent years, more and more tools have been made available to allow individuals to assert a far greater control over their own investment portfolios, be that through the advent of electronic brokerages, social trading platforms, neobroker solutions or exchange-traded products. This has allowed for a more dynamic form of retail investment that is able to respond more quickly to capital market trends, and indeed to effectively initiate trading patterns in cases where large numbers of individuals act in tandem to drive inflows into a stock or strategy. In essence, this is a modern community of several different herds, fluent in the new media of trading and in prime position to lead and capitalise on the rise of a more "viral" form of investment.

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Social trading meets viral ideas

To be clear, social trading and viral investing as bare concepts are nothing new, even if the infrastructure itself has changed. Individual investors have been passing on "hot" tips and recommendations to each other for many years. Long before social trading, there was peer-to-peer idea sharing through word of mouth, then as the internet age took hold, via investor community message boards. The inception of e-brokers and social trading more than ten years ago then gave the amateur investor greater facilities to act on the investment ideas generated by peers, commentators and, latterly, through social media channels.

As momentum has gathered, and neobrokers have emerged offering low or zero commission structures, adding a further appeal to the "do-it-yourself" retail investment process, so retail trading has thrived. Fast forward to 2020, when unprecedented levels of retail investor trades were seen [1] as the appeal of certain stocks and strategies and the ease (and lower cost) with which these could be accessed, combined with greater levels of disposable income available to many during the COVID-19 lockdowns and the continual low interest rate environment.

Bringing that behaviour into sharper focus is the role social media can play in perpetuating trading spikes in a particular stock or financial instrument. This has recently grabbed headlines, but while such events amply demonstrate that a critical mass of retail investors can materially move a needle over and above where traditional trading patterns usually sit, these are ostensibly short-term events that serve to detract attention from the wider trends of retail investing.

A big, thematic explosion

So, what are those wider trends? Recent trading activity has highlighted several key themes that appeal to retail investors. On the short-term side there is the sudden, GameStop-style trading motivated initially by activism, counterweighting short-selling activity, but in the end a means to making rapid capital gains through the critical mass factor, but these cases are isolated. Much more so, the modern retail audience has two fundamental and divergent yet inter-related investment motivations: innovation and sustainability.

The innovation motive has manifested itself in a heightened retail interest towards several of the more disruptive technology stocks, with investors seeking to capitalise on moving early into the next tech "unicorn". This has demonstrably increased the focus towards investing directly and away from comparatively stodgy active and passive mutual funds [2].

It also leaves room for newer funds that are looking to occupy this disruptive space. Moreover, this breed of "challenger" funds has an opportunity, and competitive compulsion, to build profile through social media presence rather than more traditional reputation-building through performance. Those that have a particularly dynamic approach can thrive in their appeal to this audience that is focused on innovative trends. A fast-growing example is thematic funds, where the narrative of investing in disruptive businesses that stand to gain the most from underlying macro trends has a broad appeal to those with the appetite for high risk – high reward strategies that strongly reflects the pace of technological growth and immediacy of megatrends that they have grown up with. However, many of them also have sustainability at their core.

ARK Investment Management is a thematic ETF provider managing roughly $50 billion in total assets and operating on the premise of open and crowdsourced research and long-term, sustainable progression. Its five ETFs saw inflows more than double in 2020 and these delivered substantial returns to its investors across the range [3]. Its flagship ARK Innovation ETF saw its assets double in just the last quarter of 2020, recording by far the largest inflows of any of the approximately 150 thematic ETFs globally. It pales into insignificance compared to the multi-trillion-dollar-managing "big three" index fund and ETF providers, Vanguard, BlackRock and State Street, yet leads them all in a tangential but increasingly relevant area: social media. ARK has more followers on its Twitter account than any of its behemoth counterparts. ARK founder Cathie Wood's latest two posts on YouTube have received over a million views each. Interviews with Larry Fink barely reach twenty-thousand views.

ARK's herd, and the community of thematic funds like theirs, is sizeable, and is rewarded with healthy performance, defying the brickbats in some quarters that warn against a less seasoned investor audience becoming overexposed to volatility [4].

Building herds through the grapevine

Peeling back the layers, ARK's high returns have been driven to no small extent by the large proportion of their funds invested in Tesla. If we think (in crude terms) of our Venn diagram of key factors driving new retail investment, where those factors are innovation, sustainability and noise, Tesla straddles all three perhaps better and certainly more successfully in terms of size and influence than any other stock. Add in the Elon Musk factor, with his status as a primary influencer of investment behaviour [5] but also a highly effective communicator of his company's investment story to non-professional investor audiences, and it is easy to see how quickly a specific but large retail herd can mobilise around his stock.

Again, here there are precedents – Steve Jobs et al – but against the current backdrop of ubiquity in social media, Musk's influence has resonated, and not just in a Tesla-centric way but also in his influence over other trends and ideas. This was clear in the acceleration of the frenzy around GameStop immediately following his tweet linking to the Reddit r/wallstreetbets boards, and even two months on from GameStop's initial spike, his sonorous endorsement reverberates; GameStop is still by far the most discussed stock on social media [6]. And, it may well be the most overvalued, at least in the traditional sense of measuring intrinsic valuation, a measure by which Tesla itself continually confounds the received wisdom.

The rapidity of the speculative reactions to Musk and others has also caught the attention of other capital market disruptors. Shareholder activist research is increasingly being circulated through social media, inviting an "open-source" style of debate and attracting comments from across the investment spectrum, professionals and amateurs alike. By association, this can help to mobilise a larger, more diverse audience towards a cause and raises the prospect of shareholder revolts with a deeper retail backing, especially where emotive topics, such as leadership remuneration, director nominations and environmental issues, are at the core.

A new breed of engagement?

The implication from this is that there is a spotlight to be shone on issuers in their The implication from this is that there is a spotlight to be shone on issuers in their communications to retail investors and an expectation of greater direct engagement. However, on a practical level, approaching large and disparate groups of amateur investors bound together by key influencers and acting on short-term opportunities would be arduous and quite possibly fruitless. There is also a more fundamental fact to consider: GameStop, Tesla and other retail investor trading favourites tend to be US-based issuers.

It is reasonable to state that direct retail investment into public equities has been historically, and remains, a much more critical driver of valuation in the US than in Europe. Recent proportional breakdowns of individual investor asset allocation [7] shows half the amount allocated to public equities in Europe as in the US. US retail puts more money into public equities than any other asset type; European individuals are far likelier to pool capital into cash savings accounts or pension funds. Moreover, US retail equity investment tends to be dynamic, while European equity ownership amongst individuals tends to be static, albeit that the tide is turning due to the increased traction of neobrokers and social investing. Nonetheless, approaches will naturally differ between the regions. On both sides of the Atlantic, however, more structured investment products are proving increasingly popular.

Which brings us back to ETFs. The emergence of thematic, impact and ESG and sustainability-focused players within the space, as evidenced across the board with the rising number of funds and sizeable inflows, speaks to an investor audience that is, despite the occasional stellar short-term gains, focused on the longer game. Thematic and ESG investing is also growing rapidly outside the ETF market, but the advantages to ETFs of low management fees, full transparency on stocks invested in and the openness of their investment strategies is appealing to a newer and younger investor audience, that may be less seasoned in the capital markets but that generally demands a responsible, sustainable and accountable investment style. This makes the rapid growth of these strategies an investment megatrend to watch and, in turn, opens up the question of wider engagement between ETFs and issuers. In contrast to the large array of index-tracking ETFs, where engagement is mostly confined to voting and stewardship duties, several recently-launched thematic, ESG and impact ETFs are being managed actively, and this raises the prospect of greater day-to-day interaction with issuers.

This is likely to bring with it an expectation of a much more specific investment proposition that will require more forensic detail to be given on growth plans and sustainability, depending on the specific fund. In the end, understanding and responding to the expectations of this audience effectively could open up new investor opportunities largely financed by a retail audience that values the long-term and is keen to support the future growth and/or sustainability journeys of these companies.

We will be exploring the fast-growing ETF dynamic further in our forthcoming paper focused on building active engagement with passive audiences.

These new herds may be moving fast, but the opportunity for issuers to capture them could be gathering momentum too.

References:

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6 Reddit (r/wallstreetbets): Most discussed stocks of the week: 14-20 March 2021

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