Rodney's Take

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The Reverse 'Robinhood'

Kevin Costner ruined Robin Hood for me. When he played the lead in the 1991 film *Robin Hood: Prince of Thieves*, he didn't even attempt an English accent. I've heard stories of why he didn't, but the fact remains that during the entire film he was surrounded by superb actors such as Alan Rickman and Morgan Freeman who were in character, and here was this guy who sound like he just dropped in from Southern California.

But now there's a new Robinhood, a brokerage firm, and I'm a big fan, but probably not for a reason they would like.

The new version offers trading for free. As we all know, if you're offered something for free, like a search engine or a social media page, then *you're* the product, as in, your information is being sold. When it comes to the brokerage firm, they sell their trade flow, so the clients don't get the best execution, but hey, they saved $1.95 on the transaction, so that's awesome, right?

I don't care if people choose to trade on that platform or any other. I'm much more interested on what they trade, and as far as I can tell, Robinhood has introduced millions of people who used to spend their time playing video games to the world of options, where for the low, low price of just a few hundred dollars, a newbie investor can make a bet that a short-dated, out-of-the-money call option on Apple, AMD, Nvidia, or many other stocks will pay off at 3-, 4-, or even 5-to-1. Of course, there's always the possibility that those same out-of-the-money options expire worthless, but hey, if there wasn't risk, it wouldn't be gambling, er, investing, right?

The newly minted Robinhood crowd has been driving up the prices of equities, mostly high-tech names, by purchasing call options, which institutions on the other side have to hedge by purchasing the stock. We know that small investors are the culprits because single-option contract trades recently made up 12% of all volume, up from 6.5% at the start of the year, and 60% of all contracts purchased expire within two weeks, up from 45% in January. That reeks of new money looking for home runs.

For a while, they were rewarded, which has been very nice for the rest of us. As the option buyers drove institutions to hedge, they drove up the prices of the underlying stocks, which showed up as a lot of green in my investment account. But I must admit, I do like to take short-term trades, and I've been known to play the options market, which is where I've really become a fan of Robinhood investors.

This group has been gracious enough to pile into options and drive the time premiums to the moon. So far this year, implied volatility, which is what determines how cheap or expensive options are, has gone through the roof. That gives me and a zillion other people who like to play the other side of options the ability to sell the Robinhood investors what they want at a high price. In other words, I'm making a little money here and there by selling them options and pocketing the time premium. Of course, I hedge my positions. I'm way too old and have made too many mistakes to sell naked options.

All of this is fun and games until the underlying stocks favored by the Robinhood crowd hit a wall, much like Tesla, Apple, Nvidia, Shopify, and a number of other stocks did the week before Labor Day. Then there comes a reckoning, and we can only hope that the newest gunslingers lose only their premium paid, that they haven't sold naked options and left themselves open to very deep, very ugly, losses.

Robinhood is trying to add some safeguards to its trading systems, essentially flashing a message when investors trade options telling them to make sure they have a plan. Yep, that'll work.

Having their clients pay through the nose when trading options can't be what Robinhood intended when it set about "democratizing investing." Since many option sellers (unlike me) are professional investors who spend their days taking money from option buyers, the system would be better described as a "reverse Robinhood," where the brokerage firm has made it possible for the wealthy professional investors to consistently take money from those who are likely not-very-rich, novice investors.

Experience can be very expensive.

Rodney

Got a question or comment? You can contact us at info@hsdent.com.