

GameStop Mania: A Confrontation between Retail Investors and Wall Street

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Abstract: In early 2021, the meteoric rise and dramatic collapse of GameStop's stock captured global attention, as retail investors united via online platforms to confront Wall Street short-sellers. This paper explores the GameStop short squeeze as a complex interplay of behavioral finance, social media influence, and market dynamics. It examines how Reddit's r/WallStreetBets community leveraged collective action, emotional contagion, and information cascades to drive GME's price from under \$4 to \$483, defying conventional valuation metrics. Key psychological mechanisms such as herding behavior, overconfidence, and confirmation bias were amplified through online interaction, leading to unsustainable price surges. The study also highlights how institutional players adapted and intervened in response, and how trading platforms like Robinhood introduced controversial restrictions. This unprecedented market event not only challenged traditional assumptions about investor rationality but also highlighted the disruptive capacity of decentralized online communities. The case emphasizes the need for regulatory frameworks that can adapt to the rapid pace of information diffusion and emotionally charged trading environments. As digital platforms continue to empower retail participants, understanding the psychological and structural drivers of such episodes becomes essential. The GameStop phenomenon reveals deep-rooted vulnerabilities in modern financial markets and underscores the need for updated market supervision, investor education, and trading platform accountability. Ultimately, it is not merely a story of speculative frenzy, but a pivotal case illustrating the evolving power of online-driven collective action in financial markets. Future market stability may depend on a balanced integration of behavioral insights, real-time surveillance, and equitable trading access to ensure resilience against similar speculative surges.

1. Introduction

In early 2021, GameStop's stock price surged from under \$4 to a staggering intraday peak of \$483, before crashing by 80% within just four days. This sudden and extraordinary market movement was not driven by traditional valuation metrics or company fundamentals but by a collective wave of retail investors rallying against Wall Street hedge funds accused of malicious short-selling. The phenomenon ignited global attention and became a financial and social media sensation. But in this zero-sum battle between the bulls and the bears, who truly came out ahead?

This paper investigates the GameStop saga, not merely as a market anomaly but as a striking manifestation of modern retail investor behavior amplified by online communities. It explores the underlying forces that drove the stock's meteoric rise and violent collapse—such as short squeezes, gamma squeezes, and behavioral biases[1]—through the lens of behavioral finance. The study aims to shed light on the evolving role of social media in financial markets and the growing power of loosely coordinated retail collectives.

2. Case Background

GameStop Corp. (GME), founded in 1984 and headquartered in Texas, is the world's largest video game retailer. It went public on the New York Stock Exchange in 2002 and operated over 5,000 stores across ten countries, selling digital and physical gaming hardware, software, and accessories. Once dominant in its field, GameStop began to face existential challenges around 2010

with the rise of digital downloads and online gaming platforms such as Steam, Nintendo Switch, and Xbox Live. Game developers increasingly bypassed traditional retail channels in favor of direct digital distribution.

As a result, GameStop's sales and profits declined sharply. By 2019–2020, its financial condition had severely deteriorated, with revenues falling and losses mounting. The company's stock had plummeted by over 90% from its peak. During this period, discussions around GameStop began to emerge on Reddit's r/WallStreetBets[2] (WSB), a forum known for its aggressive and highly speculative investment style. The community's YOLO (You Only Live Once) mindset encouraged all-in bets, often using options and leverage.

On April 3, 2020, a Reddit user known as ElderHedgehog (EH) posted on WSB highlighting that over 84% of GameStop's float had been sold short. This raised alarm bells among users, many of whom saw an opportunity to trigger a short squeeze. The forum, which harbored deep mistrust of Wall Street hedge funds, began rallying behind GME.

From April to July 2020, GME's price hovered between \$2.57 and \$6.47. In July, another user cited data suggesting the short interest had surpassed 100% of the float due to naked short selling and systemic leverage in the market. This revelation intensified bullish sentiment.

In August, investor Ryan Cohen, the founder of Chewy.com and a major individual Apple shareholder, disclosed that he had purchased 9 million shares of GME at an average price of \$8.43. He publicly announced plans to revitalize GameStop and transform it into an e-commerce rival to Amazon. His involvement caused GME stock to surge 24% in a day and 67% over the course of the month.

3. Case Development and Escalation

Following Ryan Cohen's investment, discussions around GameStop intensified on Reddit. Retail investors began promoting the idea that GME was an ideal candidate for a short squeeze. A short squeeze occurs when heavily shorted stocks rise in price, forcing short sellers to cover their positions by buying the stock, which drives prices even higher. Many WSB users advocated buying and holding shares to trap institutional short-sellers, amplifying the rally. Though publicly portrayed as a retail uprising, some analysts noted that institutional investors were also participating behind the scenes, capitalizing on the retail frenzy.

By December 2020, GME had risen to \$18.84—a more than fourfold increase since July. Despite the price surge, short interest remained unusually high, reaching up to 138% of float. Hedge funds like Melvin Capital, managing over \$12.5 billion, and other short-focused institutions continued to bet against GameStop, believing the price rise was purely speculative and unjustified by fundamentals.

On January 11, 2021, Cohen joined GameStop's board alongside two Chewy executives, signaling a more hands-on role in the company's transformation. This further fueled bullish sentiment. GME jumped 12.72% that day and continued climbing over the following week. On January 19, short-seller Citron Research released a video arguing GME would fall back to \$20 due to overvaluation. The backlash from WSB was immediate and fierce; retail investors perceived the video as both dismissive and misleading. The post ignited even more buying.

GameStop shares began spiking on seemingly trivial news—such as the company adopting Microsoft cloud services—jumping 44% in a single session. Short interest remained above 100%, and the massive open interest in call options set the stage for a gamma squeeze.

On January 22, GME surged 51% to close at \$65. This triggered the so-called “gamma squeeze”: when deep out-of-the-money call options become in-the-money, market makers must hedge their exposure by buying the underlying stock. As delta and gamma increased, market makers were forced to purchase massive quantities of GME, sending prices even higher. On the following Monday, the highest strike price was \$115; by Tuesday it had risen to \$200, but by Wednesday the stock already hit \$380, forcing further hedging in a feedback loop.

January 25 saw trading halts triggered by extreme volatility, as retail enthusiasm and market mechanics pushed GME to an intraday high of \$159. Institutional short-sellers, including Melvin

Capital, attempted a counterattack via a short ladder attack to suppress the price. Meanwhile, some long-position institutions began exiting their trades, leaving retail investors exposed. The trading volume reached 180 million shares—2.5 times the total float. Despite heavy losses, Melvin Capital received \$2 billion from Citadel and \$750 million from Point72 in emergency funding to stay afloat.

On January 26, ex-Facebook executive Chamath Palihapitiya joined the fray, announcing he had bought \$125,000 in GME call options, declaring support for the retail crowd. The stock soared 92.71% to close at \$147.98. That evening, Elon Musk tweeted “Gamestonk!!” along with a link to the Reddit forum, sending after-hours prices soaring another 50%.

On January 27, GME opened above \$300. Media outlets reported that Melvin Capital had fully closed its short position, suffering a 53% loss. Citron also announced it had exited its GME shorts, admitting 100% losses. GME closed that day at \$347.51, up 134.84%. That evening, Discord shut down the WSB server, citing violations unrelated to the stock market, which only fueled further outrage.

4. Regulatory Shock and Collapse of the Bubble

On January 28, a seismic event shook the global financial market: Robinhood, a commission-free broker[3] favored by retail investors, suddenly restricted buying of GameStop shares—users could only sell, not buy. The GME ticker was even unsearchable within the app. Institutional investors, however, faced no such limitations. Robinhood’s CEO, Vladimir Tenev, later justified the move as necessary to protect the platform and its clients.

The decision was prompted by clearinghouse requirements: due to heightened volatility, margin requirements soared to 100% for long positions and 300% for short positions. Multiple brokers followed suit, severely curbing retail participation while leaving institutions relatively unimpeded. This action ignited widespread outrage. Global retail investors began purchasing GME through local brokers in a show of solidarity. The event became a symbol of class warfare: retail investors versus Wall Street.

On January 28, GME peaked at \$483 before closing down 44.29% at \$193.60. On January 29, most brokers lifted restrictions, and the stock rebounded 67.87% to close at \$325. However, over the weekend, market enthusiasm cooled. By February 2, GME dropped 60% to close at \$90. The bubble had begun to deflate.

In the aftermath, the U.S. Congress held multiple hearings[4] to investigate potential market manipulation, structural flaws, and the role of social media. Key figures from hedge funds, retail platforms, and regulatory bodies were questioned. The hearings aimed to assess the need for regulatory reforms and to understand how a loosely coordinated group of retail investors had disrupted Wall Street’s playbook.

5. Case Analysis: A Behavioral Finance Perspective

The GameStop saga exemplifies retail-driven herding behavior and the powerful psychological forces behind collective decision-making in financial markets. Investors on Reddit’s r/WallStreetBets were not acting in isolation but were heavily influenced by social proof and emotional contagion. What began as scattered posts evolved into a massive coordinated movement.

This case displays a classic “information cascade[5],” where individuals rely on the observable actions of others rather than independent judgment. As more people bought GME, new participants interpreted this as validation, reinforcing the trend in a self-fulfilling loop. Rational analysis gave way to group psychology, driven by narratives of rebellion and justice.

Cognitive biases like overconfidence, confirmation bias, and optimism fueled the irrational enthusiasm[6]. Many investors disregarded valuation metrics and fundamental data, making decisions based on peer encouragement or social media hype. Emotional trading further inflated prices, creating extreme volatility and systemic fragility.

The media amplified this frenzy, while social interaction—both verbal and non-verbal—became a dominant decision input. Ultimately, this collective behavior led to a price bubble that was

unsustainable due to the lack of intrinsic support. Once early institutional participants exited and momentum waned, the bubble collapsed, leaving many retail investors exposed.

The GameStop episode underscores how behavioral biases, institutional asymmetries, and regulatory gaps can interact to generate extreme market events. It challenges assumptions about rational markets and highlights the evolving influence of online investor communities. Understanding these dynamics is essential for future market design and investor education.

6. Conclusion

The GameStop episode represents a watershed moment in modern financial history, where the convergence of social media, behavioral finance, and retail investor enthusiasm challenged the dominance of institutional players. Far from being a mere anomaly, the event exposed systemic weaknesses, regulatory blind spots, and the emotional undercurrents that often override rational analysis in financial decision-making.

From a behavioral finance perspective, the case highlights several critical dynamics: the emergence of herding behavior among retail traders, the role of social proof in reinforcing collective actions, and the susceptibility of investors to cognitive biases such as overconfidence, optimism, and confirmation bias. These forces created a feedback loop that drove the stock far beyond its intrinsic value, culminating in a bubble driven not by fundamentals, but by narrative momentum and emotional fervor.

Moreover, the role of digital platforms—both trading apps like Robinhood and social networks like Reddit—was central in shaping investor behavior and market outcomes. The unilateral trading restrictions imposed by brokers revealed significant asymmetries in access and control, undermining trust in financial systems. Institutional actors eventually recalibrated their positions, but many retail participants suffered substantial losses as the bubble collapsed.

The event also triggered important regulatory and political discussions. Congressional hearings signaled a recognition of the shifting dynamics in equity markets and the influence of retail investors. While some view the GameStop saga as a populist victory, others caution against the risks of emotionally driven trading and misinformation in decentralized environments.

In conclusion, the GameStop phenomenon serves as a powerful reminder of the complex interplay between psychology, technology, and market structure. It calls for more inclusive financial education, better regulation of trading platforms, and a deeper understanding of how collective behavior can reshape traditional power dynamics in capital markets.

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