ADVISOR PERSPECTIVES

Hundreds of Thousands of Tiny Buyers Swarm to Insolvency Stocks

June 10, 2020

by Sarah Ponczek, Vildana Hajric

Just in the last week, 96,000 people on the Robinhood investing app opened a position in Hertz Global Holdings Inc. The number of users holding Whiting Petroleum Corp. grew roughly 10,000 in the last 24 hours.

Two things the companies have in common: They've filed for bankruptcy protection. And each saw their shares double to start the week.

It's the same thing for Chesapeake Energy, as it prepares a potential filing. In the past, the court process usually wiped out equity shareholders. In this day and age, as small day traders salivate at any opportunity to get rich quick, a filing has apparently become a buy signal for many of them. There's evidence retail investor actions have become a decisive driver of price.

"Retail has a lot to do with it and I don't think you've seen institutional investors buying those kinds of stocks," said Christopher Grisanti, chief equity strategist at MAI Capital Management. "It's too much risk. I would call it catching a falling knife."

Shares of stocks in or on the verge of bankruptcy soar

The 2020 stock market has been full of peculiarities that nobody saw coming. The fastest drop for the S&P 500 into a bear market, followed by the fastest 50-day rebound in nine decades. Mom and pop scrambling to the right side of the recovery trade, while the advice of Wall Street legends falls flat. A health-care crisis forcing one of the deepest recessions, and in the midst of it, equities emerging unscathed.

In a market as bizarre as this, it seems only fitting that the next step would be a growing affinity for companies that can't pay their debts.

According to website Robintrack, which uses Robinhood's data to show trends in positioning but isn't affiliated with it, individual investors on the app have been flocking to bankruptcy-protected companies in droves. (The site says it downloads popularity data each hour for every stock directly from Robinhood via a public application programming interface, or API. A Robinhood spokesperson declined to comment for this story.)

Of course, interest in these stocks isn't flowing solely from Robinhood clients. But the app is a lens into retail interest, particularly among younger investors, because unlike other popular brokerages, it's possible to see holdings of its users in real-time. Some of the rallies in these shares may also be due to short covering.

Robintrack's data show 159,000 users now hold Hertz stock in some form. That's a record high, and up from 37,000 users a month ago. Over the last three days, the car rental firm has seen the largest surge in popularity on the platform. Right now, more users on the investing app hold bankrupt Hertz than do Netflix Inc.

Call it crazy, but don't call it dumb. In the three sessions through Monday, Hertz shares surged 577%, just weeks after the company filed for bankruptcy. Trading volume in the stock has surged to an average of 197 million shares a day in June -- more than 60 times what was typical in 2019.

Hertz

Chesapeake Energy has seen a similar turn. The oil company jumped 182% on Monday, and after markets closed, news broke that the firm was said to be preparing to file for bankruptcy. More than 20 million shares changed hands, the most turnover on record for the stock in a single day, Bloomberg data show. In recent days, Chesapeake's popularity with users of Robinhood ballooned to 38,000 -- a gain of 9,000.

Same with Whiting Petroleum, a shale driller that went bankrupt in April. The number of users holding shares of the company rose to a record 50,000 this week. On Monday, the stock surged 152%, and more than 104 million shares traded.

“It’s great that Vegas is open again, but who needs it when you have the stock market instead,” said Peter Boockvar, chief investment officer for Bleakley Financial Group. “After an incredible run since March, we now have clear froth in parts of the market. We know this level of speculation has coincided with a sharp increase in the activity of retail investors.”

Boockvar added the activity has been encouraged by a “zero rate” and “unlimited QE” environment, referring to the Federal Reserve’s quantitative easing measures. Ahead of the central bank’s decision Wednesday, he’s not the only one laying blame.

“In this tape, bankruptcies have become the flavor of the day,” said Michael O’Rourke, chief market strategist at JonesTrading. “At what point will Jay Powell and his colleagues at the Federal Reserve realize they have broken the market’s pricing mechanism? The bankruptcies are only a small part of the story.”

Bloomberg News provided this article. For more articles like this please visit bloomberg.com*.*