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Confusions of the Masses as the Underlying Reasons of the Financial Market Abnormalies with A Focus on the GameStop Case

Financial markets have always been unique indicators of the psychologies of the masses ever since they were established. In the fields of social science such as finance, it is very compelling to conduct research via experiments due to their nature of being determined by the psychologies and behaviors of the whole society and not the individuals. Scientists in those fields are mostly implementing different methods of scientific research and one of the most important method is the one so-called "natural experiments"[1]. Scientists use this method to examine the consequences of the cases/experiences or determinants of some significant incidents in those fields. This method focuses on the consequences of specific events to understand the determinants/reasons underlying the discussed phenomenon or *vice versa*[2]. In the finance field, one of the most remarkable examples of this type of research conducted is an old book called "Confusions of the Confusions", written by José Penso de la Vega in 1688. In his book, which is also considered as the first book on stock markets and one of the oldest in the modern economics, he discusses investors' behavior which has the most powerful impact on determining the prices of stocks in the stock market. In this paper, similar to the referred book, we are going to focus on the stock market phenomenon with the widely known name "GameStop Event" in order to understand the main psychological reasons underlying the case.

How it happened: In recent years, the financial markets have witnessed phenomena that deny traditional economic theories and models. We can briefly summarize it as that a group of individual investors on Reddit's investing forum conspired for a massive increase which is called a "short squeeze" in financial terms[3], in other words, causing the stock price of GameStop to increase rapidly, despite all of the fall expectations and the "shortage investments" on the stocks market price[4]. The origin of this event goes back to one post on Reddit's investing "subreddit" named r/wallstreetbets. Reddit user Keith Gill also known as the "DeepFuckingValue" shared a post referring to GameStop's share and claimed that stock is strongly undervalued due to put options and short selling of institutional investors and he shared his insights about the share and the Company. Other Reddit users who were also connected sentimentally with the Company GameStop, believed that it was an injustice to the Company and decided to start a campaign on social media which went viral and grew like a snowball. However the institutional investors had very strong reasons to believe the value of the stock of the Company would decrease, people who decided to buy stock of the Company without any reason but to demonstrate their fierce hostility to the institutional investors[5], led the Company's market share to skyrocket from 5 dollars to 81 dollars in couple days. The rapid increase in the price of the stock has almost led constitutional investors to bankruptcy and caused remarkable fluctuations in the whole market but especially in stocks usually known as the "Meme Stocks" which also include the stocks of Tesla, Nokia and the Virgin Galactic as the most remarkable ones.

If we want to understand the social behavior underlying this incident, we must know some important informations and insights about behavioral finance. Traditional financial theories, such as the Efficient Market Hypothesis, state that asset prices reflect all available information and the financial markets are driven by rational actors. However, the GameStop incident challenges this insight by demonstrating that markets can be influenced by collective behavior far above rational behavior. One of the most important insights into understanding investors' behavior is the loss aversion theory. It states that people are tended to take more risks to prevent losses rather than gainings[6]. It shows us why the vast majority of the investors who invested upon the decrease in the stock price, have rapidly closed their financial positions which led to a rapid increase in stock price in a way that called "short squeeze". Behavioral finance, which incorporates psychological insights into economic models, provides a more consistent framework for understanding such phenomena. Key concepts such as herd behavior, overconfidence, and social proof are crucial to explaining the rapid and irrational fluctuations observed in the GameStop case.

Mass Confusion and Herd Behavior: The rapid increase of GameStop's stock price can be attributed to mass confusion and herd behavior. Retail investors, many of whom lacked professional financial expertise, were driven by a mix of speculative greed, anti-establishment sentiment, and the fear of missing out (FOMO)[7]. Social media platforms exacerbated this behavior, creating echo chambers where bullish sentiments were amplified, and dissenting voices were drowned out. The collective belief in the possibility of quick profits led to irrational decision-making, where stock prices were driven by emotional stimulations rather than fundamental valuations. Undoubtedly, herd behavior is one of the most important phenomena in the financial markets. Prestigious finance Professor Aswath Damadoran from New York University who is also known as the "Dean of Valuation", demonstrates some of the investors' mentality by referring to the famous Lemmings' experiment/case[8]. He uses this metaphor to show investors who are blindly following the herd and ending up with big losses just like the lemmings who kill themselves by following the flock[9].

Social Proof and Overconfidence: The GameStop event also highlights the role of social proof and overconfidence in financial decision-making. Social proof, the psychological phenomenon where individuals mimic the actions of a larger group, was evident as more investors joined the buying frenzy, encouraged by the successes of early movers such as Keith Gill, the person who started this rally himself, who earned almost fifty million dollars in a relatively short period. Overconfidence is also a significant behavioral finance concept that was prevalent as many retail investors believed in their ability to outsmart institutional players. This overconfidence, fueled by success stories that they have seen in the same investing subreddit and the supportive community environment, led to a self-reinforcing cycle of buying that inflated the stock price beyond rational expectations[10].

Conclusion: In the GameStop case, we have a magnificent example of how financial markets can reflect irrationalities of human behavior and the social psychology of the societies, which in a way that against traditional economic/financial theory that assumes financial markets are efficient and driven by fully rational actors. We tried to emphasize the reasons such as overconfidence, social validation, and herd instinct. In order to understand what actually led to these sudden irrational movements of GameStop's share prices, we are obliged to mention those behavioral finance concepts.

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