WARNING: You Should NEVER Short Meme Stocks!

Description

Hedge funds have been losing a lot of money shorting meme stocks in 2021. In addition to the $2 billion they lost shorting **GameStop**, they're now getting rolled on **AMC Entertainment Holdings** (NYSE:AMC).

According to a *Reuters* report, short-sellers have lost $512 million on AMC stock so far. The report does not say that hedge funds are the majority of those short, but it appears likely given two facts:

1. Most non-hedge fund pooled vehicles (e.g., ETFs) aren't allowed to short.
2. Hedge funds like **Mudrick Capital** are among the biggest shorts in AMC shares.

Given this, it's almost certain that hedge funds are losing colossal amounts of money on AMC and other meme stocks. And what's true of hedge funds is even truer of retail investors. If you're a retail trader, you can lose unlimited sums of money on short sales just like Melvin Capital and Mudrick Capital, but unlike them, you're unlikely to get a bailout. In this article, I will make the case that short selling is extremely risky and that shorting meme stocks is even riskier than shorting the average stock.

Why shorting is so risky

Shorting in general is risky, because the potential losses are unlimited. To short a stock, you

1. Borrow the stock;
2. Sell the stock; and
3. Buy it back and return it.

If you short a stock and it goes up, the potential losses are unlimited. For example, if you borrowed 10,000 shares of a $2 stock and had to pay them back at $100, you'd be staring at a $980,000 loss. That is, the $1 million the shares are now worth minus the $20,000 sales proceeds. If AMC hits $100 like many investors predict, then this is the scenario its short-sellers will be looking at.

Meme stocks in particular are even riskier

If shorting stocks is risky, shorting meme stocks is even riskier. That's because these stocks' prices don't follow their fundamentals, and, therefore, it's quite possible for them to go up, even when they look like they "should" go down.

As an example, let's consider **BlackBerry** (TSX:BB)(NYSE:BB). BlackBerry is a Canadian technology stock that got taken up by Reddit, just like AMC and GME. In its most recent fiscal year, BlackBerry saw its

- Revenue decline;
- Earnings come in at -$0.56 per share; and
- Gross margin decline.

These are all pretty bad results. In fact, even BlackBerry's software and service revenue — previously its strong suit — declined in 2020. Given this, you'd expect its stock to decline. Yet it's actually up some 35% for the month of June and 98% for the year. Clearly, Reddit is sending this stock to the moon. So, while it might look like a tempting short target, it could easily defy what fundamentals would predict — particularly if Reddit stays interested.

Foolish takeaway

As the events of 2021 have shown, shorting stocks is very risky. Whenever you short a stock, you run the risk of unlimited losses. If you short a meme stock, that risk is even greater, because these stocks have the potential to rise dramatically in a short period of time. Overall, it's best to not short meme stocks. No matter how good your analysis is, WSB's 10 million members have more buying power than you do.

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1. Investing
2. Tech Stocks

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2. NYSE:BB (BlackBerry)
3. NYSE:GME (GameStop Corp.)
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