Bad Habits: Meme Stocks, Short-term Options and SPACs.

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When Ed Sheeran released the song *Bad Habits* in the Summer of 2021, he might as well have been describing investor behavior as it coincided with a surge in speculative investment behavior. At the time *Bad Habits* came out, retail investors were piling into low-quality meme stocks, short-dated options and overhyped SPACs. Sound familiar? In 2025, and accelerating in July, we have seen a revival of these market behaviors. In this paper we will discuss the current environment as it relates to the appetite for each of these investment vehicles, we'll note the impact on more fundamentally sound opportunities in small and microcap stocks, and outline what investors can do to stay disciplined in the face of this market volatility.

It is like déjà vu all over again. In 2021, we wrote extensively about meme stocks in our paper The Rise of Retail Investors and the Birth of Meme Stocks (September 2021). The advent of meme stocks was driven by a confluence of social media, government stimulus and changing demographics that led to profound changes in market participation by retail investors and the associated stock behavior. In the current environment we are hearing echoes of the 2021 rally in the form of short-squeezes on less liquid, heavily-shorted stocks and a sharp 'junk rally' in low-quality stocks driven by retail investors. In 2021 the story revolved around names like GameStop and AMC, driven by nostalgia, their popularity on social media and championed by viral personalities like Redditt trader Roaring Kitty. Internet personalities embraced war metaphors and framed the purchases as an effort to support nostalgic firms and battle big hedge funds. The resurgence of meme stocks is in part a function of the aggressive risk-on market environment after tariffs were delayed in April. At their core, meme stocks and related anomalies are more representative of trading-driven market manipulation that long-term investors would be well served to avoid, as opposed to a thoughtful long-term investing strategy. Thankfully, our managers have avoided being tempted by the recent risk-on trade, instead staying focused on quality companies with improving fundamental prospects, which we think they will be rewarded for over time.

Meme stocks: donuts, half pipes and home buyers. While A.I. and cryptocurrency gathered investment headlines early in the year, meme stocks made a dramatic resurgence in early July. A subset of these stocks, labeled DORK. stocks, gained fame for their recent dramatic price swings. The stocks in the group included Krispy Kreme Donuts, Opendoor, Rocket Technologies and Kohl's. As an example, Opendoor was up 439% in a month. Among the four stocks, only Kohl's is profitable, although the company has seen dramatic sales declines in recent years, is loaded with debt, and saw the CEO resign in May for ethics violations after four months on the job. Other names have reached meme stock status, including GoPro, which makes action cameras used in extreme sports. The stock was recently up 57% in a day, despite declining sales, negative cash flow, negative earnings and a heavy debt burden.

In the end, meme stocks are about weaponizing liquidity and herd speculation in an effort for retail investors to feel like they are taking control of their own destiny, while also punishing large investors who short beloved stocks. Additionally, the meme stock phenomenon is a byproduct of technology available and the simple pursuit of profits through market manipulation. There has been a democratization of markets through low-fee trading venues that additionally 'gamify' investing. As a result, there is no shortage of activities that provide direct hits of dopamine in the quest for quick dollars. An investor can buy a stock or option and get virtual confetti on their phone to celebrate. It is not a stretch to note the parallels between sports betting, which has exploded in popularity and availability and how people are using investment apps. Speculation is as old as investing, but market access and the tools available to engage in speculation have notably expanded and continue to develop at light speed.

Options are fueling the fire. Short-dated options have become another accessible tool for speculation embraced by retail traders and some hedge funds. These products have seen strong demand in an environment with unpredictable market movements. In any given day, trade policy or other announcements can create intraday volatility leading to an increase in option buying. Large market swings create the potential for highly lucrative, albeit highly risk trades. Zero days to expire (0DTE) options have exploded in popularity despite representing a highly speculative and volatile investment. For context, according to CBOE Global Markets, in May 2025, over 60% of the S&P 500 options volume was in these one-day bets. Investors can buy 0DTE options on their phone with Robinhood or other brokers like Webull, Interactive Brokers and SoFi. This phenomenon is recent, as Robinhood only rolled out access to these vehicles in January of 2025. By buying call options that are close to their expiration date, traders are seeking to benefit from the high volatility in the option price. Not only can they be a speculative investment, but options are also a tool for buyers of meme stocks to use to punish short positions and push stocks higher. The process is known as a "gamma squeeze" where traders purchase call options, forcing the market maker to hedge the position and buy the stock. For highly-shorted positions this can create additional pressure to purchase shares by investors covering their shorts. On July 14, for example, when Opendoor rose 120%, there were over 2 million call contracts traded. (Source:

Bloomberg) In the end, 0DTE options are a highly volatile speculation and leverage tool that can result in a total loss, or conversely the trader can gain many multiples of a stock price's movement. They are cheap, volatile and have increasing liquidity, making them easy for retail traders to access - particularly in a bullish, risk-on environment. Short-dated options are the antithesis of what our managers look for in sound fundamental investments, but it is important to understand how they are affecting broader stock prices and pushing index returns.

SPAC revival? In 2025, through June 25, we have seen 61 companies raise over $12.4 billion through SPACs. According to SPAC Analytics, SPACs accounted for 2/3 of IPO volume and 40% of proceeds during this period. This market revival is the highest since 2021 but remains far off the pace of issuance for that year when SPACs raised over $162 billion in 613 listings. The current resurgence speaks to the sentiment driven market this year. In their essence, SPACs are companies formed to raise capital through a quick IPO. The end purpose is investing the money raised by merging with or acquiring a private company. There is generally a maximum of roughly two years to make an acquisition. Many SPACs in 2021 had celebrity sponsors who helped them raise capital, but by 2022 the market for SPACs crashed as interest rates rose and many SPACs failed to find target companies. In the end, most SPACs were overhyped and the market was oversaturated with too many chasing too few deals. Looking back, most SPACs turned out to be poor investments, with estimates that 2/3 of SPACs that had an IPO in 2021 never completed a merger. In fact, the average one-year return on SPACs that did successfully 'deSPAC' (successfully found a merger) in 2021 was -64.2% according to research by Jay Ritter, a finance professor at University of Florida. The results have been similarly poor each year since. That said, a positive effect was a surge in the number of small and microcap public companies. To this day, our investment managers continue to sift through the companies that survived for fundamentally sound investment opportunities.

Characteristics of market leadership have supported more speculative activity. We would characterize the market environment since the tariff pause in early July to be a 'junk rally'. During that time negative earners and poor-quality stocks have led the market, with non-earning stocks leading stocks with earnings by over 13% in microcap and 9% in small cap. In large cap, stocks without earnings have led by around 6%. Additionally, down the cap, spectrum stocks with the lowest price, often correlated with low quality, have won since the tariff pause. Lastly, the highest valuation stocks have led in all market cap ranges. Notably, in our experience, junk rallies led by the lowest quality stocks tend to be more short-lived and tend to broaden into more fundamentally driven environments. It is no surprise that most fundamental investors have struggled in this environment. We have seen many outstanding investment managers underperforming their index, with quality growth managers particularly hard hit.

Exhibit 1. Non-earners have led since tariff pause April 9 – July 29, 2025

Index	Non-Earners	Positive Earnings	Difference
Russell Microcap	34.0%	20.9%	13.1%
Russell 2000	24.2%	14.9%	9.3%
Russell 1000	23.5%	17.2%	6.3%

Source: Acuitas Investments; FactSet; Russell Investments

Small / Microcap Leadership To understand where the fuel for the euphoria came from we need to look back earlier in the year. When "Liberation Day" tariffs were announced on April 2, 2025, the global stock market witnessed the largest decline since the COVID-19 pandemic. Days later, on April 9, the Trump administration announced that it would pause tariff increases, leading to a V-shaped market recovery and the largest one-day recovery for the S&P 500 since 2008. By June, peak uncertainty had given way to peak euphoria with the S&P 500 and the NASDAQ recording record highs, but importantly microcap stocks led the market by a wide margin. The Russell Microcap Index was up 26.4% over this period compared to the Russell 2000 and Russell 1000 Indexes, up 17.7% and 17.4%, respectively. Despite the strength during this period, small and microcap stocks still lag large cap year-to-date and over the past year, meaning valuations remain compelling despite their recent strength.

Exhibit 2. Microcap Wins Since Tariff Pause

Index	4/9 - 7/29	YTD	1-Year
Russell Microcap	26.54	2.68	5.95
Russell 2000	17.69	1.33	1.73
Russell 1000	17.39	8.99	18.33
Magnificent 7	24.57	6.47	29.46
DORK	38.81	0.28	-29.21

Source: Acuitas Investments; FactSet; Russell Investments

We think we are early in a shift to a small- and microcap-led market, as we see a host of catalysts that set up well for small and microcap leadership, including the prospect for declining rates, deglobalization, an improving IPO market, and a robust M&A environment. Additionally, we continue to believe that valuation matters and as we have covered in detail in our quarterly commentaries, microcap stocks remain extremely cheap relative to large cap. Our investment managers do not participate in short-dated options, rarely invest in SPACs and definitely don't chase low-quality meme stocks. We believe these are views that will be rewarded over time, but haven't been rewarded in the last couple months. After 2021, the meme stocks, like most SPACs, performed very poorly and we continue to believe that allocating to the most experienced investment managers who focus on fundamentals and attractive characteristics and that we vet through deep due diligence offer the most compelling way to access small and microcap markets. We continue to believe that these markets are in the early innings of a recovery versus large and mega-cap stocks and we look forward to the market distancing itself from the most speculative periods.

Disclosures

Past performance is not a guarantee of future returns. Investing in securities involves risk of loss that investors should be prepared to bear. Investments in small and microcap companies may be less liquid and prices may fluctuate more than those of larger, more established companies.

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