
Flexibility in Practice: How We Handled GameStop

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GameStop has been front and center in the financial news on account of the stock's significant price volatility over a few weeks. And that has put it top of mind for many clients, as we've been fielding questions on how GameStop's volatility was handled in our portfolios. This incident serves as an opportunity to highlight how Dimensional's investment process is built to handle developments within markets, given that many of our portfolios held GameStop in January. GameStop's rise and fall in price was extreme, to be sure. But our process is built to react systematically to the changes in stock prices that happen every day.

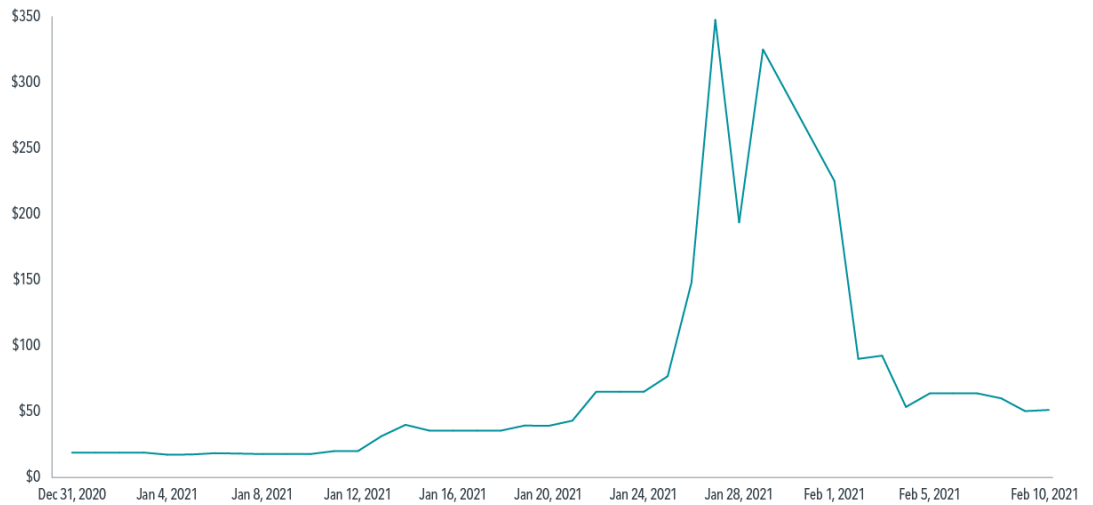
Our goal is to increase expected returns and manage risk in our portfolios so that we can deliver better outcomes for our clients. Therefore, it naturally follows that we should use all the information we have about expected returns, and—given that market prices change every day—we believe a daily process is essential to efficiently using this information.

Size, relative price, and profitability contain information about expected returns. By late January, GameStop had increased in size and relative price rather dramatically. Our investment process is set up to respond to new information about securities and their expected returns on a daily basis.

Exhibit 1**Market Prices Can Change Rapidly**

Closing price of GameStop (GME) from December 31, 2020–February 10, 2021

At its closing peak on January 27, 2021, GameStop had a market capitalization of \$24.2 billion, making it larger than over 200 of the constituents of the S&P 500 Index and as large as Whirlpool and American Airlines combined.¹



Past performance is no guarantee of future results.

In USD. Stock price data from Bloomberg L.P.

We evaluate stocks daily using many variables to assess long-term and shorter-term expected returns. As the price of GameStop climbed, it quickly moved out of the small cap and value space, becoming a large cap stock. For a dedicated small cap portfolio, we consider that exposure to a large cap stock no longer fits the intended asset class of the portfolio. Importantly, our daily process allows us to consider that in real time as prices change.

In contrast, an index-tracking approach does not have the same flexibility to respond to price changes; by design, an index will wait to respond until its next periodic reconstitution date. Small cap indices holding GameStop quickly saw it become the largest index holding as the stock price increased and generally continued to hold it as the price fell.

Exhibit 2**Focus on Higher Expected Returns Requires Flexibility**

Daily implementation helps maintain a consistent focus on higher expected returns as security prices change

	Weight in GameStop (basis points)	
	December 31, 2020	January 31, 2021
Dimensional US Small Cap Portfolio	5	0
Russell 2000 Index	4	72
Dimensional US Small Cap Value Portfolio	17	0
Russell 2000 Value Index	9	149

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After peaking, GameStop's subsequent fall in price put it in the low profitability growth space of the small cap market, which we exclude across our equity portfolios due to low expected returns. Our daily process allowed us to again respond quickly. By February 3, we had completely sold GameStop from all Dimensional portfolios.

Before the sharp price increase in January, GameStop had been a high revenue earner in our lending program over the previous year due to its high cost to borrow. As we do for all stocks held in our portfolios that lend securities, we work to maximize the revenue received, which we believe benefits the portfolio's overall return.

The cost to borrow a security also contains information about expected returns. We take that information into account when making trading decisions. In addition, we look to avoid purchasing stocks at loan for high fees, as the expected returns on such stocks are low. Dimensional's portfolios stopped buying new shares as the information from the high borrowing rate on GameStop indicated a lower expected return.

This example highlights how we implement our daily process each and every day. However, what we did with GameStop is not unique to this situation. We regularly use new information about expected returns in a flexible manner to maintain consistent exposure to higher expected returns. GameStop is a case in point of how quickly prices can change and the importance of a robust implementation process that can be nimble and respond systematically.

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GLOSSARY

Profitability is a company's operating income before depreciation and amortization minus interest

expense scaled by book equity.

Relative price refers to a company's price, or the market value of its equity, in relation to another measure of economic value, such as book value.

Market capitalization is the total market value of a company's outstanding shares, computed as price times shares outstanding.

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