



Why Social Media Sentiment Moves Markets

Trace | July 2026 | Internal research — not an offer of securities

Executive Summary

Markets have always traded on information, but the structure of information has changed. Price-relevant beliefs now form, spread, and collapse on social platforms faster than traditional research processes can observe. Trace exists to trade that gap. Our core claim: collective sentiment is a measurable system, its shifts follow characteristic decay patterns, and the market prices those shifts with a lag that can be systematically captured. This paper traces the evolution of market information, explains why narratives move prices, takes the limitations of sentiment seriously, and describes how Trace converts the idea into a disciplined process — three buckets grounded in entropy logic, a mandatory seven-point Entry Gate, and dated decay windows that make every position falsifiable.

The Evolution of Market Information

For most of market history, edge meant information asymmetry — proximity to the floor, the speed of the wire, analyst access. Regulation FD, electronic disclosure, and the internet compressed that asymmetry until, by the 2010s, fundamental information was effectively a commodity: available to everyone, at the same time, at zero cost. What was not commoditized was interpretation. As raw information lost scarcity value, attention shifted to the layer above it — what other participants believe, how strongly, and how that belief is changing. Social platforms industrialized this layer: feed algorithms select for emotional intensity, repost mechanics create measurable propagation chains, and retail order flow responds to those chains directly. The meme-stock episodes of 2021 demonstrated that a narrative propagating through social channels could overwhelm fundamental anchors for weeks — and that the phenomenon was observable in advance by anyone measuring the propagation rather than the fundamentals. Fundamentals define a security's long-run gravitational field; sentiment defines its trajectory over the horizons where most realized volatility actually occurs.

Why Narratives Move Markets

A narrative is a compressed explanation that tells a large number of independent actors what to do next. That compression is its market power: a story coordinates buying and selling among participants who share no other communication channel, and prices move when coordination changes. Trace formalizes this with an entropy framing borrowed from statistical mechanics. When opinion about a security is dispersed across many independent views, the sentiment system is high-entropy and prices are stable. When a narrative takes hold, opinion collapses into a few shared configurations: entropy falls, positioning correlates, and the security becomes energetically loaded. The subsequent move — melt-up, air pocket, post-earnings gap — is the system relaxing back toward higher entropy. Sentiment shocks are low-entropy states, and low-entropy states decay.

The tradable structure follows from the decay physics. **Micro-trends** are sharp spikes — a viral headline, a binary catalyst — that decay in days and demand instruments that live entirely inside the spike. **Short-trends** are narrative regimes that build and exhaust over weeks to months. **Long-trends** are permanent reorganizations of collective belief that reprice a baseline over quarters and years. Each bucket has a distinct entropy signature, decay window, and correct instrument. Mismatching duration to bucket is not a style choice; it is a category error, and the most common way a correct thesis becomes a losing position. None of this requires sentiment to be irrational: narrative flows are real flows, and their propagation and exhaustion leave measurable signatures before the price move completes. The edge is not predicting what people should believe — it is measuring what they are coming to believe, and knowing the timescale on which that belief decays.

The Limits of Sentiment: A Balanced View

A framework that cannot articulate its failure modes is marketing, not process. First, sentiment is a conditional signal: it explains price action best where retail participation and narrative intensity are high, and over long horizons fundamentals reassert themselves — which is why every Trace position carries a dated window and claims validity only inside it. Second, reflexivity and crowding: as more capital reads the same social exhaust, signals decay faster and reversals sharpen, and publicized shorts against popular themes acquire counter-narratives that make squeezes violent — Trace's concentration checks exist because superficially distinct positions can share one crowded factor. Third, manipulation: social data is adversarial data, and a process that cannot distinguish organic from manufactured propagation systematically buys other people's exits. Fourth, timing precision: sentiment identifies regimes more reliably than dates, so a directionally correct thesis expressed through instruments that expire before the window closes still loses — the near-dated option on a long-trend thesis is the canonical error. Finally, the manager is a sentiment system too; the answer is procedural — written kill conditions, a mandatory pre-trade gate, and the standing rule that a failed check ends the discussion. Conviction is not an override.

The Trace Investment Perspective

Trace is a sentiment-driven, short-biased strategy built on the premise that narrative extremes are the most reliably mispriced states in modern markets — and that the decay of euphoria is the strategy's home terrain. Every idea, without exception, passes a seven-point Entry Gate before capital is committed: bucket logged; decay window logged with dates; instrument duration verified against the window; a specific kill condition written; the idea confirmed as a sentiment trade the engine can actually read rather than a rates or momentum trade in costume; concentration checked at single-name and shared-factor level; and structure checked for vega and theta fit. Any failed check means no order. Exits follow the same discipline: positions close on thesis completion or kill-condition trigger, not P&L milestones. The track record under construction is therefore not merely a return series — it is an auditable log of a process behaving the same way on good days and bad ones, which is the asset prospective partners are actually underwriting.

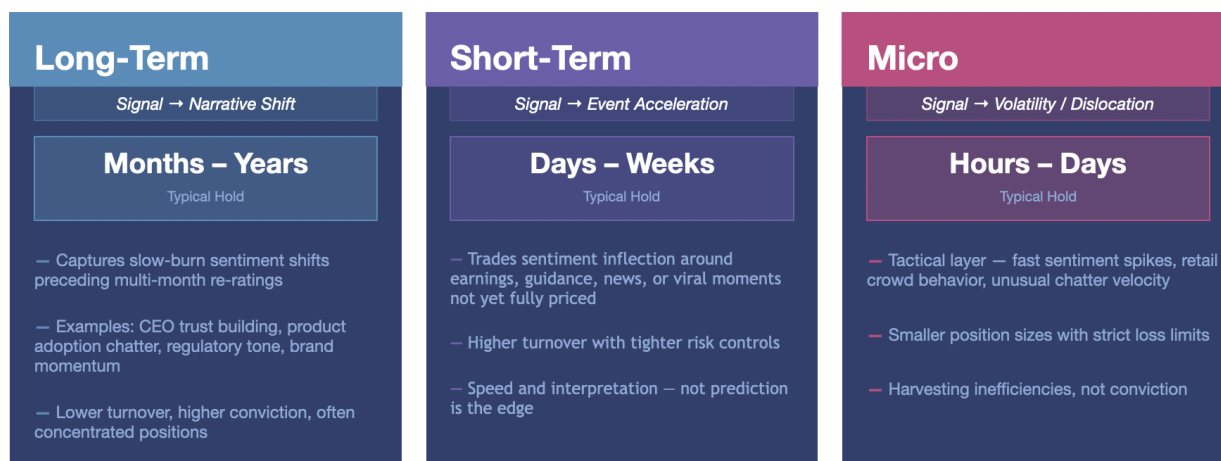
Snapshots from the current incubation book, summarized at the level of setup and lesson; full trade logs with gate checks and dated windows are maintained in the fund's performance documentation.

Name	Bucket	Sentiment setup	Outcome and lesson
MSTR	Short-trend	Leveraged crypto-proxy euphoria at a sentiment extreme; opinion crowded into one reflexive narrative.	Puts closed at a large gain on thesis completion. Exit when the decay window closes, not when the P&L feels finished.
RIVN	Short-trend	Deteriorating EV narrative with persistent cash-burn pessimism.	A dilutive offering changed the sentiment regime; position substantially covered on the event. Kill conditions are written in advance and executed mechanically.
INTU	Short-trend	AI-adjacent enthusiasm on a mature franchise; exhaustion signals emerging.	Buyback announcement plus exhausted downside sentiment marked the thesis complete. Sentiment trades end when the narrative stops propagating.
NFLX	Micro-trend	Binary earnings catalyst with dispersed pre-print positioning.	Held only through the catalyst date with a mandatory post-event exit. Catalyst trades are dated positions; time is part of the thesis.

Two patterns recur: the profitable exits were thesis-complete exits, closed because the narrative finished decaying rather than because a price target printed; and the costly episodes cluster around duration mismatch and delayed kill-condition execution — which is why both are hard-coded into the Entry Gate.

A Roadmap for Trace-Branded Visuals

Because the edge is conceptual, communication depends on visuals that make the physics intuitive in seconds. The existing library establishes the language: an animated three-curve signal-decay chart (micro, short-term, long-term windows), a sentiment-cycle bell curve animation, and concept spheres for data exclusivity, signal decay, and manipulation risk. The roadmap extends this in three phases. Near term, ahead of the incubation close: investor-deck integration — a one-slide entropy explainer pairing $S = k \ln W$ with plain language, a three-bucket taxonomy graphic, and an Entry Gate flowchart. Medium term: the case snapshots become annotated price-and-sentiment overlay charts marking the logged window and kill condition on the actual price path, turning the audit trail into marketing material. Longer term, on the institutional platform: a live sentiment-dashboard aesthetic for quarterly letters and the eventual data room. Every asset passes the same test the trades do — one idea, one window, one honest claim.



From the Trace asset library: the three-bucket signal taxonomy — each bucket with its own signal type, holding period, and risk posture.

Conclusion

Social media did not make markets emotional; it made emotion observable — timestamped, quantifiable, propagating through measurable networks. Narratives coordinate flows, flows move prices, and the formation and decay of narratives follow patterns regular enough to trade, provided the trader respects their timescales. Trace's contribution is not the observation that sentiment matters — that is now consensus. It is the discipline wrapped around it: a framework that assigns every narrative a bucket and a decay window, a gate that refuses any trade it cannot fully specify, and an exit doctrine that ends positions when theses complete rather than when emotions do. Sentiment moves markets. Process is what lets a fund harvest that movement without being moved by it.

We are not trading noise—we are trading behavior at scale.