BITCOIN: IT'S TIME TO SEIZE THE OPPORTUNITY

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The current global economic climate is a concern for investors. Trade-restructuring, high levels of liquidity, systemically-low inflation, inverted yield curves, negative-yielding bonds, historically tight employment markets, and significant leverage at both consumer and government levels are just some of the factors that suggest we are in a world where monetary and fiscal policies could tenably be argued by those at opposite ends of the spectrum.

This has polarised opinion as to the effectiveness of 'money', whether that be in policy setting, or investment decisions, and this, in turn, has contributed to a slow erosion of confidence in traditional investment principles. At the same time, the demand for accountability has increased, as has the desire for the democratisation of value determination.

Given this backdrop, it is unsurprising that Bitcoin has gained credence over the last decade, after the whitepaper for the cryptocurrency was published [1] at the peak of the Global Financial Crisis. It is the lack of trust in the current financial system, and the subsequent nostalgia for a sensible monetary system that is giving credence to Bitcoin – its inherent structure is designed to address the shortcomings of traditional currency management.

In this paper, we look at the evolution of Bitcoin, examine its value relative to other assets, and explain why now is the time for investors to consider exposure to the cryptocurrency within their portfolios.

LACK OF TRUST IN CENTRAL BANKS

Ever since the world has moved away from the Bretton Woods Agreement [2], the power with which central bankers had been bestowed has grown enormously. Accountability is encapsulated in the confidence that investors place in monetary policy; it is a pure trust-based system. Although allowing for such flexibility has permitted rigid economic systems to become both nimbler and more dynamic, it has also led to numerous bankruptcies in lesser developed countries such as Brazil, Argentina and Venezuela. This has begun to sow seeds of doubt wherever excess policy persists, even within developed nations.

Take the US for example. The US dollar is under the remit of the US Treasury – which issues money and debt and is responsible for overall fiscal health.

1 Published in October 2008.

2 In 1944, the Bretton Woods Agreement established a new global monetary system. It replaced the gold standard with the US dollar as the global currency.

The Federal Reserve is considered an independent central bank. It has a mandate to meet certain metrics on inflation and employment by adjusting interest rates. It also has another tool that it has taken advantage of since 2008: quantitative easing. This is a method of reducing interest rates by purchasing bonds (mostly US treasuries) in the open market.

This 'independent' central bank, however, is headquartered in Washington DC, has its governors appointed by the President of the United States, and also frequently engages with the Treasury. In all practicality, the central bank works with the government. This raises many questions over conflicts of interest, market manipulation, and what an independent central bank means – all of which have been glossed over in the interests of promoting economic health.

For a start, there is no fail-safe mechanism to prevent the US Treasury from issuing more debt while the Federal Reserve reduces interest rates, creating cheap financing for the government. One could argue this has already happened. But to challenge this paradigm would involve betting against US debt, and because two-thirds of this debt is owned by everyone that is not the Federal Reserve, to do so would mean betting against your own holdings. This systemic construct is the stigma now pinned to the US dollar, whereas in the past, the dollar was frequently referred to as the 'Reserve Currency.'

If we look at Europe, where a single monetary policy shackles various fiscal policies, often of disparate economies, the situation is equally concerning. The European Central Bank (ECB) has the ability to purchase sovereign debt of member nations, and it has used its power to almost the full capacity permitted, driving down front-end yields to negative levels in Germany, and to near-zero levels in countries such as Portugal, Ireland, Italy, Greece and Spain – often referred to as the 'PIIGS'.

It's a similar situation for many other G20 economies. Central banks have become buyers of all kinds of debt, severely inflating their balance sheets without true accountability. It appears that the world is willing to believe that such 'blackhole' accounting somehow trumps (pun-intended) the zero-sum game of sound economics.

BITCOIN: AN ALTERNATIVE TO TRADITIONAL MONETARY SYSTEMS

Bitcoin solves many of the problems associated with today's monetary systems. It is not a financial instrument designed by a sovereign institution whereby it could serve any ulterior motives; it has been created as an alternative to traditional payment networks, by the public, and it is a declaration of the democratic determination of value as its very existence undergoes a continuous vote-of-confidence.

With Bitcoin, we do not need to be concerned about oversupply, as supply of the asset is capped. Furthermore, supply up until a terminal point is self-regulating; if network economics prohibit the creation of new units at the same pace, then the supply schedule naturally slows. Additionally, there is full visibility – the blockchain attribute allows for immutable accounting and ensures that no provisions of the manifesto are violated.

The value of Bitcoin

For an asset to have 'value', it needs to have a number of key attributes. An asset that carries value must have some permanent traits that make it an attractive candidate as a unit of exchange. How does Bitcoin compare then to the monetary assets it seeks to replace?

Comparing value exchange and storage in today's world, Bitcoin ranks well, while at the same time retaining its independent qualities. In a post-Bretton Woods world, where central bank policy has been marred by suspicion, a trust-less solution is making its own case.

While gold has stood the test of time, and the US dollar is backed by the might of the US Government, Bitcoin holds its own, as shown in Figure 1.

FIGURE 1. BITCOIN VERSUS GOLD AND FIAT CURRENCY

Traits of Money	Gold	Fiat (US dollar)	Crypto (Bitcoin)
Fungible (Interchangeable)	High	High	High
Non-Consumable	High	High	High
Portability	Moderate	High	High
Durable	High	Moderate	High
Highly Divisible	Moderate	Moderate	High
Secure (Cannot be Counterfeited)	Moderate	Moderate	High
Easily Transactable	Low	High	High
Scarce (Predictable Supply)	Moderate	Low	High
Sovereign (Government Issued)	Low	High	Low
Decentralized	Low	Low	High
Smart (Programmable)	Low	Low	High

Source: https://cryptonews.com/guides/why-do-bitcoins-have-value.htm
Historical performance is not an indication of future performance and any investments may go down in value.

THE EVOLUTION OF VALUE

The appeal of an investable proposition, however, changes with time and is subject to how the dominating generation of a certain time gears its worldly perceptions. Once an asset deemed to be of value becomes commoditised and succumbs to commonality, ubiquity and the lack of uniqueness stagnates its marginal appeal. Some new attribute, a renewed confidence, or a new product altogether forces an evolution that resets the inertia around a different vision of value.

Technology is a striking example of this. One can purchase a smartphone from a specific manufacturer yet within two years most of its features may be obsolete. Unless that manufacturer is able to portray most of the smartphone's original features as necessary, the market will move on, possibly to a new product from a new manufacturer altogether.

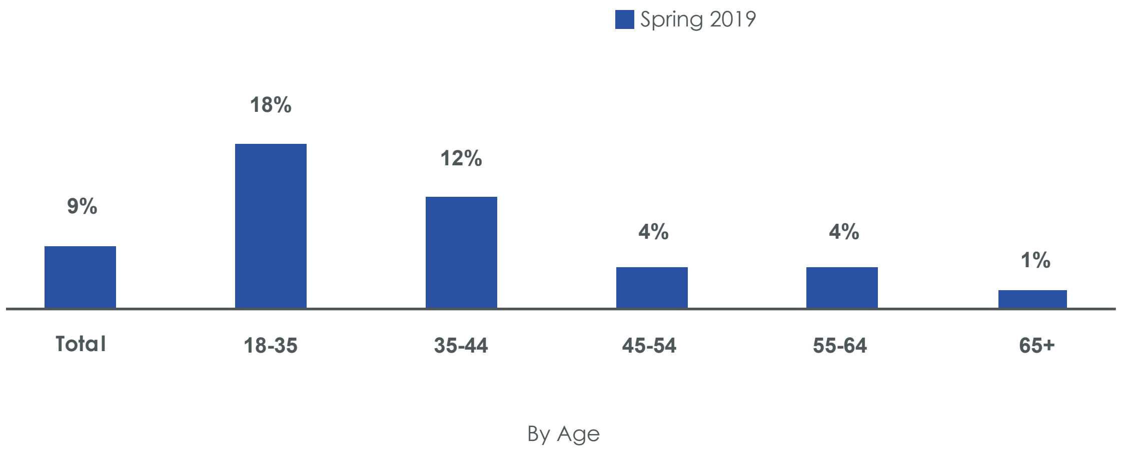
In economics, the shift isn't always easily detectable. But look at how the concept of value has evolved over the years. In the past few years, the emphasis has shifted from "what profits do you make?" to "what profits will you make?" to "what profits are you capable of making?" For example:

+ In the year **1995**, an asset with a **Price-to-Earnings ratio of 15** was considered 'fair value' and investable: oil stocks, big pharma
+ By the year **2005**, an asset was investable if it had **revenue**. Proof of profits was deferred to the future: Amazon
+ By the year **2015**, an asset with a large **subscriber-base** was deemed attractive. Monetisation (revenue) was given a pardon until the future: Facebook, Snap, Twitter, Uber
+ By the year **2025,** it is likely that value will accrue in increased efficiencies in **network activity**: the cryptocurrency narrative

Investments into network operators (nodes) and activity represent a new economic reality that ascribes importance to the processing of data and information. This is where the concept of value is appears to be heading. While mainstream investors are still trying to determine how to assess the virtues of Bitcoin, young investors and iconic financial institutions understand the evolution of value and are busy becoming a systemic part of the Bitcoin ecosystem.

Indeed, millennials are very clear about their intentions when it comes to the role Bitcoin will play in their portfolios. Whether it be due to the financial exclusion exacerbated over the past 10 years, or the faith in a new governance of economics, their focus on Bitcoin is obvious.

FIGURE 2. BITCOIN OWNERSHIP RATES



30 April 2019. Source: https://medium.com/blockchain-capital-blog/bitcoin-is-a-demographic-mega-trend-data-analysis-160d2f7731e5
Historical performance is not an indication of future performance and any investments may go down in value.

WHY NOW?

Having looked at the conditions that gave rise to the need for Bitcoin and its subsequent popularity, as well as its proliferation among younger investors and its legitimacy amongst forward-thinking institutions, the real question for the opportunistic investor is: why now?

To answer this question, consider its core traits:

- Non-governmental, decentralised ownership
- Full transparency, auditability, and immutability
- Requires resources to create (computing power) and process
- Rewards creators and processors
- 10+ years of existence and technological efficacy
- Capable of making peer-to-peer cryptographically secure payments

Apply the filter of the current global economic backdrop and it becomes apparent that at the very least, Bitcoin deserves a spot in the global macro toolkit. Any forward-thinking investor should become familiar with Bitcoin, and consider an allocation to the asset, however small, within their portfolios.

But how does one become comfortable with the value of an asset that has no precedent or benchmark?

Bitcoin has seen a meteoric rise in price over the past five years, raising questions about its fair value. Yet if we discount the effect related to the speed at which modern-day markets discount the future, the thought process shouldn't really be too different from that involving a new valuable commodity, or even a currency.

It is probably worthwhile looking at it in components, although the whole is likely to be greater than the sum of its parts. On one hand, we have a commodity with limited supply and fixed parameters around mining economics and computational power. On the other, we have network effects at play, where security and value accrue with greater usage.

Affecting both components are network upgrades (soft/hard forks) , increased financialization (derivatives), and to an extent, regulatory acceptance.

As we have illustrated in our upcoming piece, even multiple iterations of the above all point to a materially higher fair value price for Bitcoin from its present-day levels of around $10,000.

And while not all of these attributes will be the driving price-determinant at every point in time, it's undeniable that scarcity, the most prominent of concerns, is becoming a headline-grabber in these early days of the ecosystem. With only 21 million Bitcoins ever created – a third of which are believed to be permanently lost – and the scaling back of production in the near future (the production rate will halve in 2020), it is not inconceivable that we will see a supply shock issue just as institutions are gearing up their interest.

In conclusion, the uncertainty and excesses within the global economic backdrop, paired with a demand for financial prudence and egalitarianism, means that there are numerous tailwinds that will serve to channel capital, at least at the margin, away from traditional investment options to the benefit of Bitcoin. For this reason, now is the time for investors to seize the Bitcoin opportunity.

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