



## December 2017 – Bitcoin

***I do not understand where the backing of Bitcoin is coming from. There is no fundamental issue of capabilities of repaying it in anything which is universally acceptable, which is either intrinsic value of the currency or the credit or trust of the individual who is issuing the money, whether the government or individual—Alan Greenspan***

***Where There's Bubbles, There Could Be a Bath—New York Times Headline-January 14, 2018***

### Bitcoin and Bubbles

We had intended to have this letter address the question many currently seem to have which is: Is it time to get out? We have often addressed market timing, but we wanted to wait to see how the market was going to react to the recently passed tax reform legislation so we concluded it would be better to let some time pass to see what companies report as they account for their lower income tax rates. Accordingly, we decided to discuss this topic in more depth next quarter and devote this letter to a subject that many actually are calling about—Bitcoin. We believe that Bitcoin is far more likely to be a bubble now as opposed to stocks.

At this point it is almost impossible not to have heard about or been asked about Bitcoin --the mystical cryptocurrency that has taken the financial world by storm. And made all our friends' children wealthy beyond measure. Bitcoin's acolytes sing that it is the newest world-altering revolution in technology and finance and anyone who is not onboard simply does not "get it."

We feel it is times like these that we should go back to the basics and look at Bitcoin as we would any other investment asset and ask the same questions. The most of important of which being: "What is the intrinsic value of this investment?"

But let's put first things first. What is Bitcoin?

Wikipedia defines "Bitcoin as a cryptocurrency and worldwide payment system...the system works without a central bank or single administrator." Bitcoin should be contrasted to "Fiat Currency" as money without intrinsic value, but deemed to be: "money by government regulation."

Keeping on with our definitions, intrinsic value can simply be defined as how much something is worth and is a question that we spend a lot of our time everyday thinking about in regards to your investments. In a simple world you would sell any investment where you were offered a price above its intrinsic value and buy any that was offered to you at a price below. The question to follow would be why would the other person ever buy something for more than it is worth or sell something for less? The answer lies in a mix of psychology, market behavior, and human nature all at the same time.



In the long run market prices tend to be very rational, efficient, and fair. In the short-term, however, prices can behave very irrationally, very inefficiently, and very unfairly. We have seen it time and again where the price of an asset can vary wildly from what its intrinsic value can be calculated to be by any rational estimation. This short-term behavior is typically what gives rise to market booms, busts, bubbles, and crashes.

It is our opinion that we see a perfect example of this at play in the markets today in the form of Bitcoin and the other cryptocurrencies. The driving force behind their prices is good old fashioned speculation and is more akin to a win-lose game of finding the greater fool rather than investing in an asset because it has an attractive value. Stocks can be valued using the companies' future profits, and bonds and real estate using their future cash flows. Oil has value because of its utility as an energy source. Cash has value because it serves as a currency with the backing of a government. In simple terms, Bitcoin's current value is only what the next person is willing to pay you for it. Almost all governments are going to be more attracted to more transparent fiat money as opposed to an opaque system favored by terrorists and drug dealers.

Bitcoin is currently an inefficient, speculative, and, so far, a wildly volatile system. For example, on January 9, 2018 its dollar value was \$14,562.42. A year earlier it was \$835.73.

All such markets rely on people willing to use it as a way to conduct transactions. The problem with Bitcoin is that I can buy cup of coffee with dollars and its price will generally be the same the next time I want a cup of coffee. But what if I had borrowed \$1,000 in Bitcoin, and a year later it cost me over \$17,000 to pay that loan off. That would be some interest rate. It just won't do.

While cryptocurrencies, such as Bitcoin, have some use in current transactions, it won't work when time is a factor. Unless you have much more market predictability you would be just as well off buying a Powerball ticket or searching for that leprechaun who will give you a pot of gold.

(Note: This is all not to say that the technology behind Bitcoin and other cryptocurrencies does not have potential. We feel that there are many applications where it can and will add great value. But until those opportunities come to fruition and we are offered the opportunity to invest in them at an attractive price we will continue to have to wait and see.)

As always we are grateful for the opportunity to help you with your investments. Please let us know if you have any questions, comments, concerns or would like to get together.