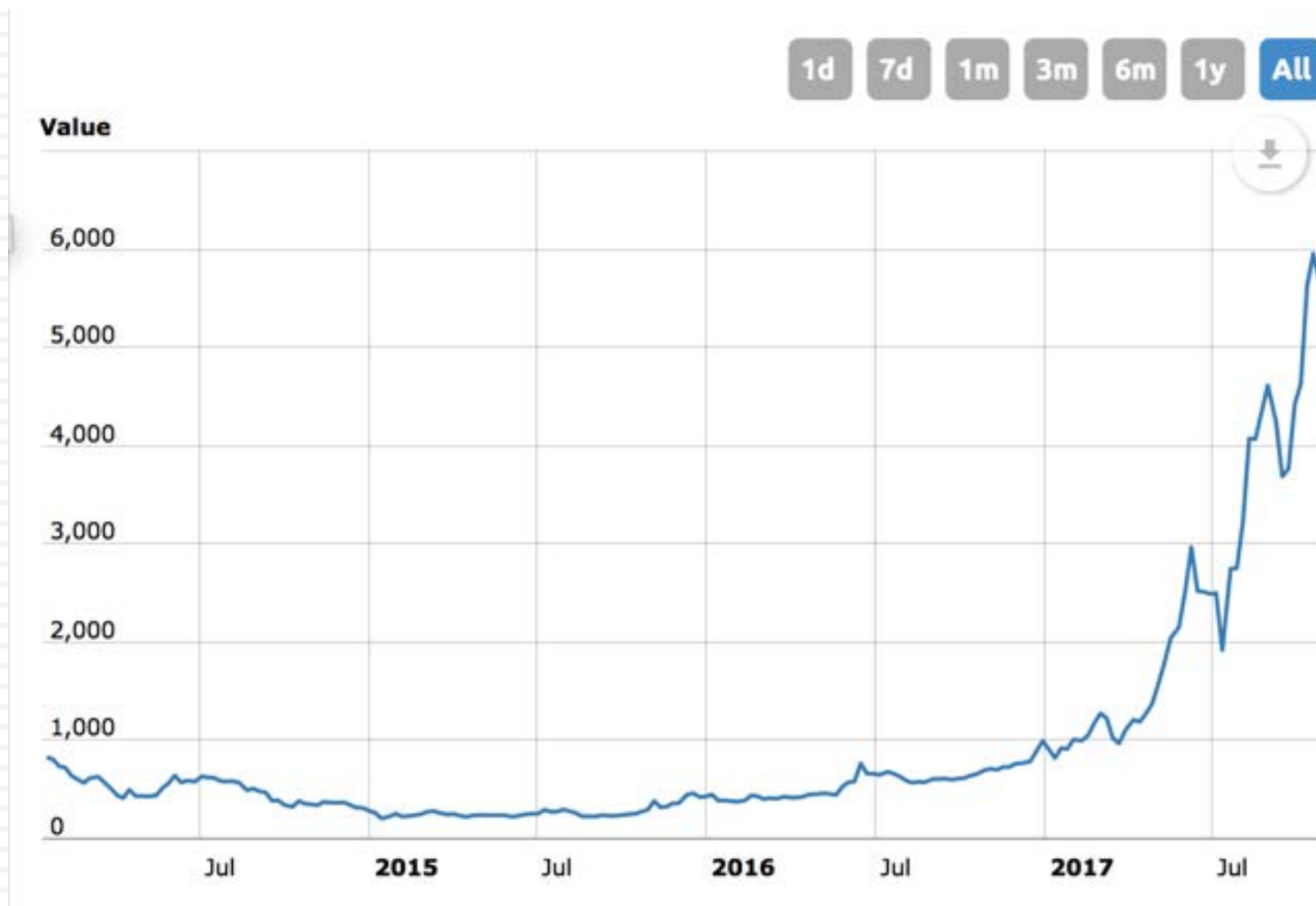




THE BITCOIN BOOM: ASSET, COMMODITY, CURRENCY OR COLLECTIBLE?

Value vs. Price, Trade vs Invest

To Infinity and Beyond: Bitcoin's Boom Continues



Classifying Investments

1. Cash flow generating assets: Generate cash flows now or are expected to do so in the future. Can be a fixed cash flow claim, a residual claim or a contingent claim.
2. Commodities: Used as raw material to meet another need (energy, food etc.).
3. Currencies: Measure of cash flows, medium of exchange or store of value.
4. Collectibles: May have aesthetic or emotional value but derives its pricing from its scarcity (supply) and the perception of others that it is wanted.

Value versus Price

	To value	To price
Assets	Can be valued based upon expected cashflows, with higher cashflows & lower risk = higher value.	Can be priced against similar assets, after controlling for cash flows and risk.
Commodity	Can be value based upon utilitarian demand and supply, but with long lags in both.	Can be priced against its own history (normalized price over time)
Currency	Cannot be value	Can be priced against other currencies, with greater acceptance & more stable purchasing power = higher price.
Collectible	Cannot be value	Can be priced based upon scarcity and desirability.

Trading versus Investing

	The Pricing Game	The Value Game
Underlying philosophy	The price is the only real number that you can act on. No one knows what the value of an asset is and estimating it is of little use.	Every asset has a fair or true value. You can estimate that value, albeit with error, and price has to converge on value (eventually).
To play the game	You try to guess which direction the price will move in the next period(s) and trade ahead of the movement. To win the game, you have to be right more often than wrong about direction and to exit before the winds shift.	You try to estimate the value of an asset, and if it is under(over) value, you buy (sell) the asset. To win the game, you have to be right about value (for the most part) and the market price has to move to that value
Key drivers	Price is determined by demand & supply, which in turn are affected by mood and momentum.	Value is determined by cash flows, growth and risk.
Information effect	Incremental information (news, stories, rumors) that shifts the mood will move the price, even if it has no real consequences for long term value.	Only information that alter cash flows, growth and risk in a material way can affect value.
Tools of the game	(1) Technical indicators, (2) Price Charts (3) Investor Psychology	(1) Ratio analysis, (2) DCF Valuation (3) Accounting Research
Time horizon	Can be very short term (minutes) to mildly short term (weeks, months).	Long term
Key skill	Be able to gauge market mood/momentum shifts earlier than the rest of the market.	Be able to “value” assets, given uncertainty.
Key personality traits	(1) Market amnesia (2) Quick Acting (3) Gambling Instincts	(1) Faith in “value” (2) Faith in markets (3) Patience (4) Immunity from peer pressure
Biggest Danger(s)	Momentum shifts can occur quickly, wiping out months of profits in a few hours.	The price may not converge on value, even if your value is “right”.
Added bonus	Capacity to move prices (with lots of money and lots of followers).	Can provide the catalyst that can move price to value.
Most Delusional Player	A trader who thinks he is trading based on value.	A value investor who thinks he can reason with markets.

What is Bitcoin?

- ❑ Bitcoin is not an asset, since it does not generate cash flows standing alone for those who hold it (until you sell it) and it is not a commodity, because it is not raw material that can be used in the production of something useful.
- ❑ The choice then becomes whether it is a currency or a collectible, with its supporters tilting towards the former and its detractors the latter.
- ❑ Bitcoin is a currency, but it is not a good one yet, insofar as it has only limited acceptance as a medium of exchange and it is too volatile to be a store of value.

Three Currency Pathways for Bitcoin

- The Global Digital Currency: In the best case scenario, Bitcoin gains wide acceptance in transactions across the world, becoming a widely used global digital currency. If that happens, it could compete with fiat currencies and given the algorithm set limits on its creation, its high price could be justified.
- Gold for Millennials: In this scenario, Bitcoin becomes a haven for those who do not trust central banks, governments and fiat currencies. In short, it takes on the role that gold has, historically, for those who have lost trust in or fear centralized authority. If this scenario unfolds, and Bitcoin shows the same staying power as gold, it will behave like gold does, rising during crises and dropping in more sanguine time periods.
- The 21st Century Tulip Bulb: In this, the worst case scenario, Bitcoin is like a shooting star, attracting more money as it soars, from those who see it as a source of easy profits, but just as quickly flares out as these traders move on to something new and different. If this happens, Bitcoin could very well become the equivalent of Tulip Bulbs, a speculative asset that saw its prices soar in the sixteen hundreds in Holland, before collapsing in the aftermath.

Reality Checks

- ❑ Bitcoin is not an asset class: To those who are carving out a portion of their portfolios for Bitcoin, be clear about why you are doing it. It is not because you want to a diversified portfolio and hold all asset classes, it is because you want to use your trading skills on Bitcoin to supercharge your portfolio returns.
- ❑ You cannot value Bitcoin, you can only price it: Any one who claims to value Bitcoin either has a very different definition of value than I do or is just making up stuff as he or she goes along.
- ❑ It will be judged as a currency: In the long term, the price that you attach to Bitcoin will depend on how well it will performs as a currency. If it is accepted widely as a medium of exchange and is stable enough to be a store of value, it should command a high price.
- ❑ You don't invest in Bitcoin, you trade it: Since you cannot value Bitcoin, you don't have a critical ingredient that you need to be an investor. You can trade Bitcoin and become wealthy doing so, but it is because you are a good trader.
- ❑ Good trader ingredients: To be a successful trader in Bitcoin, you need to recognize that moves in its price will have little do with fundamentals, everything to do with mood and momentum and big price shifts can happen on incremental information.

What next?

- Would I buy Bitcoin at \$6,100?
 - No, but not because I believe that it is over valued, since I cannot make that judgment without valuing it and as I noted before, it cannot be valued.
 - It is because I am not and never have been a good trader and, as a consequence, my pricing judgments are suspect.
 - If you have good trading instincts, you should play the pricing game, as long as you recognize that it is a game, where you can win millions or lose millions, based upon your calls on momentum.
 - If you win millions, I wish you the best!
 - If you lose millions, please don't let paranoia lead you to blame the establishment, banks and governments for why you lost.