

Bitcoin: Horrible Currency/Great Investment
By Jonathan Burklund



Introduction

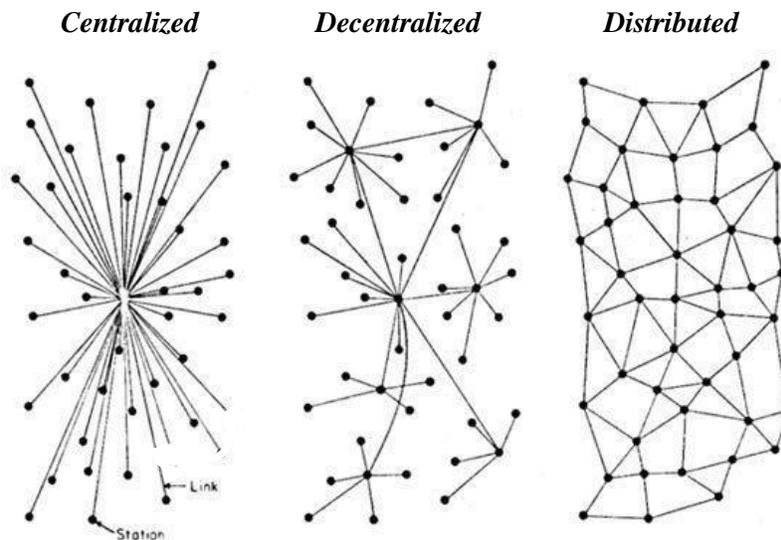
Interest in cryptocurrencies (“Crypto”) has accelerated over the last year as evidenced by several factors, including: Bitcoin’s steep price increase; Tesla’s \$1.5 billion purchase; the placement of Bitcoin’s price movement on CNBC’s main screen; and Skybridge’s announcement of a dedicated Crypto fund. This article provides: (i) an overview of Blockchain (the technology that enables Crypto), (ii) a history and description of Bitcoin, and (iii) my opinion of Bitcoin as a storehold of value.

What is Blockchain?

Blockchain is a public ledger shared by all users enabling universal information distribution. The “block” represents the store of information and the “chain” represents the cryptology required to secure the information so that users can transact directly with each other.

Currently, data is controlled by a “trusted institution.” For a member to access the public ledger, it interacts only with the trusted institution. Theoretically, the trusted institution has the computing power to secure the information and prevent bad actors. On the other hand, blockchain enables two willing participants to transact with each other in a system that is based on cryptographic proof, thereby eliminating the need of a trusted third party.

Blockchain works by distributing data to all parties. The following chart compares the current centralized and decentralized systems to a distributed one.



Centralized: A centralized data system has a one central node which is represented by the hub at the center of the spokes. The node is operated by a “trusted third party” and each user communicates only with the node. The banking system provides the best example of such a system. When I want to pay my PSE&G bill, I notify my Chase Bank to send the payment to the utility. In turn, the bank notifies the utility that my balance is sufficient to pay my bill. There is no way for me to communicate directly with PSE&G. HOWEVER, this model does require PSE&G to be a Chase customer as well.

Decentralized: A decentralized system is like a centralized one except that there are several nodes. Users can communicate with their own node and the nodes are able to link together. So, it does not matter if PSE&G is a customer of Chase, Citi, or Joe’s Bank. Ultimately the relationships of the nodes connect so that I can pay my utility bill on-line. Again, I am not able to pay PSE&G directly.

Distributed: A distributed system has no central information clearing location, but each individual user can communicate with all others without a “trusted third party.” In this system, I would be able to make my payment to PSE&G directly. The system provides my payment with a distinct hexadecimal identification called a “hashtag.” Through this system of cryptology (the “chain”), the PSE&G is assured that my payment is valid. This transaction is then validated by other users to ensure that I am not a bad actor.

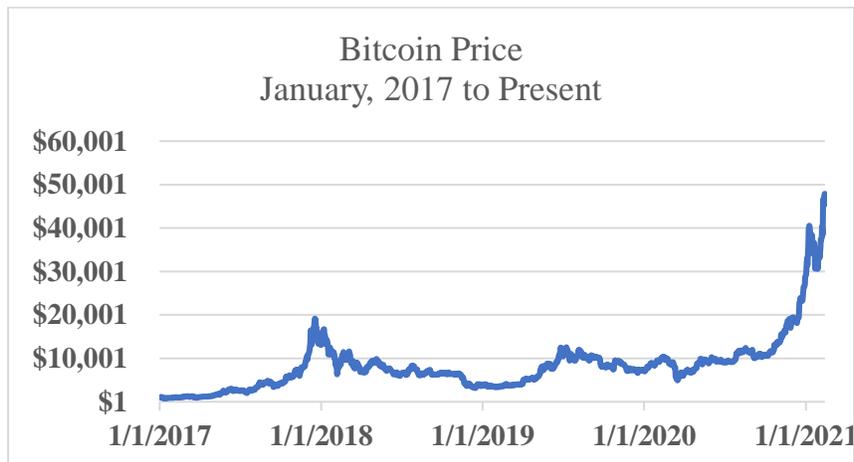


Potential of Blockchain in the Healthcare Industry: Potential applications of Blockchain to the healthcare industry are exciting and can dramatically improve care while reducing costs. Presently, the healthcare industry is plagued by decentralized systems. A particular managed care company, as the “trusted third party,” is the keeper of patient data who are members of that payor network. But the payors, as a rule, do not link with each other. So, if patients seek healthcare services within their payor’s network, generalists and specialists should be able to access all patient data. BUT, if patients travel out of their networks, their information will not follow them. In this system, patients are required to inform

treating doctors of their health history. They may not inform the doctors of all their pre-existing conditions or prescriptions. As a result, they can be at risk for improper treatment and potentially unnecessary hospital visits.

On the other hand, if all doctors were connected through a distributed system, patient records would be updated constantly and accessible to all doctors in all markets. Thus, healthcare providers would have access to complete current information required to properly treat patients, thereby improving outcomes, and ultimately lowering costs.

Bitcoin Background



In 2009, Satoshi Nakamoto detailed the concept of Bitcoin in a white paper entitled: *“Bitcoin: A Peer-to-Peer Electronic Cash System.”* The paper proposed an online cash that would allow payments to be sent directly from one party to another without transacting through a financial institution. *Investopedia* defines “Bitcoin” as:

“Bitcoin is a type of cryptocurrency. There are no physical bitcoins, only balances kept on a public ledger that everyone has transparent access to. All bitcoin transactions are verified by a massive amount of computing power. Bitcoins are not issued or backed by any banks or governments, nor are individual bitcoins valuable as a commodity.”

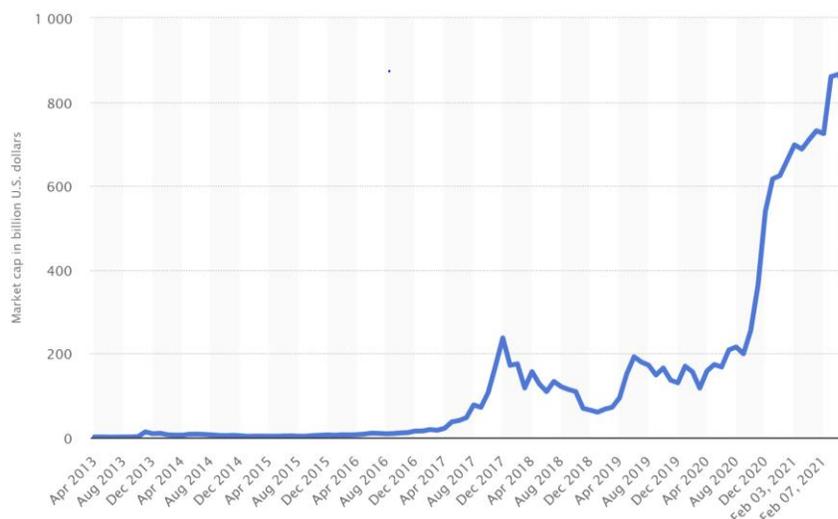
The supply of Bitcoins is limited to 21 million coins, of which approximately 18.6 million are in circulation. Bitcoins are produced through a process call “mining,” in which operators are rewarded for validating blocks of transactions. The block reward is halved every 210,000 blocks (or roughly every 4 years). In 2009, it was 50. In 2013, it was 25. In 2018 it was 12.5. And in May of 2020, it was halved to 6.25. It is estimated that the final block of Bitcoin will be issued in 2140.

Why will it take another 19 years for the remaining 3.6 million Bitcoins (17.1% of the total) to enter circulation? Two reasons: First is the rule of halves described above. The other related to the computing power required to mine the asset. In 2009, there were fewer computers mining fewer transactions. Presently, there are millions of rigs mining millions of transactions, requiring a vast amount of computing power and electricity. As a result, the difficulty level of mining has increased from one in 2009 to more than 13 trillion (yes, with a “T”) in 2021, slowing the mining process.

What does this mean? The supply of Bitcoin will be limited for the foreseeable future.

Conclusion: Horrible Currency/Great Investment

Bitcoin Market Capitalization
August 2013 to the Present



Horrible Currency: for the foreseeable future, Bitcoin will be a horrible currency for the following reasons:

Too Volatile: Over the last year, the dollar has traded in a range of .93 Euro to the dollar to .83, representing a 11% variance. In contrast, Bitcoin has traded in a range from 4,634 Euro per Bitcoin to 39,157, representing a 745% variance. Potential increases like this make it impossible for a shopper to use Bitcoin in any transaction. Since January 1, 2021, the price of the cryptocurrency has increased from approximately \$30,000 to \$47,000. If I purchased a \$100,000 Tesla with Bitcoin in January 2021, it would have cost approximately 3.3 Bitcoins. As of February 2021, those same coins are now worth \$155,100, meaning that I would have paid 55% more for my Tesla than I should have. Further, Tesla has no way to hedge this price volatility currently (though I expect Bitcoin options will become much more liquid in the future), creating significant accounting issues for the company.

No Central Bank Support: Most of the world's fiat currencies are supported by central banks. These institutions address macro-economic conditions by adjusting the supplies of currencies relative to their demands. In the case of Bitcoin, there are no such stabilizing influences. In fact, by the definition of Blockchain, there never will be.

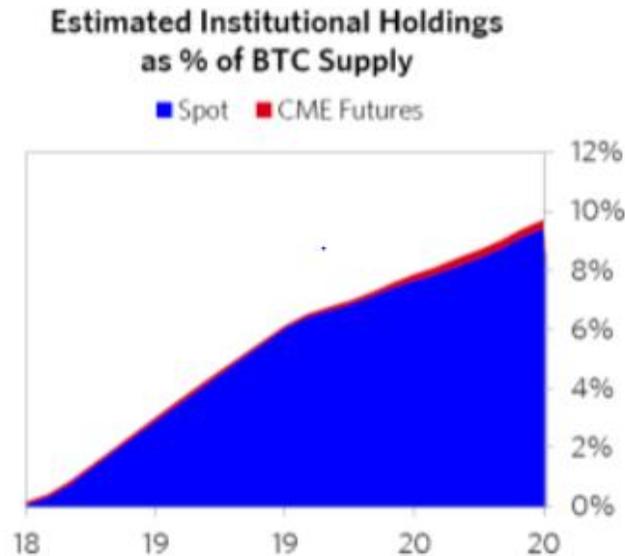
Potential for Bad Actors: The integrity of the Bitcoin system, or any blockchain system, depends upon the peer-to-peer network auditing transaction blocks and each node in the network checking the others' work. This process works if the trustworthy users control at least 51% of the computing power of the network. So, it is highly unlikely that system's integrity will be impaired. However, if the Department of Defense can be hacked, there is some risk of malfeasance.

While these risks are too great for a currency, they are acceptable for an investment with the characteristics of a growth stock.

Great investment: Anthony Scaramucci recently forecasted that the price of Bitcoin could be \$100,000 by the end of the year. I agree for the following reasons:

Supply/Demand Dynamic: As discussed above, the supply of Bitcoin will be limited unless the transaction auditors collectively authorize more coins. In the meantime, demand is, and will continue to be, skyrocketing for several reasons including increasing: (i) institutional demand (more on this below); and (ii) acceptance of Bitcoin as a payment method despite its volatility.

Institutional Demand: In an article entitled: “A Look at the Path for Bitcoin If It is to Become an Alternative Storehold of Wealth,” the authors shared a fascinating chart (below) showing institutional ownership has increased from 0% to 10% over the last two years.



As the market capitalization of Bitcoin (shown above) approaches \$1 trillion, its liquidity has improved significantly. As a result, it is easy to see that more institutions will join Skybridge in creating dedicated Crypto funds.

Bet on Blockchain: The potential for Blockchain is immense. Currently, the only “pure plays” in Blockchain is Crypto. As the “Kleenex” of Crypto, Bitcoin is in a great position to enjoy this trend.

Washington is currently struggling to determine how to regulate Crypto. Some believe that regulation presents a risk. I have the opposite view. I think that regulation will validate this market and encourage more investment.

What supports Bitcoin’s valuation? Earlier in my career, I advised early-stage biotechnology companies. These companies had no hope of near-term revenues and would spend hundreds of millions of dollars before shipping a single product. I learned that these companies were not valued on current results but on long-term expectations. The expectation of Bitcoin is that it will eventually become a generally accepted, stable, liquid currency. At that point, it will be a storehold of wealth. Until then, it will trade on the hopes of becoming so.

References:

- “Bitcoin: A Peer-to-Peer Electronic Cash System” by Satoshi Nakamoto
- “What I Think of Bitcoin” by Ray Dalio
- “A Look at the Path for Bitcoin if it is to Become an Alternative Storehold of Wealth” by Rebecca Patterson, Dina Tsarapkina, Ross Tan and Khia Kurtenbach
- “Bitcoin and Blockchain Basics” by Arthur T. Brooks
- “Blockchain Basics: A Non-Technical Introduction in 25 Steps” by Daniel Drescher