# Manager's Report June 2017

Joshua Pierce, CAIA, CFP®
Director of Research
Portfolio Manager
Baystate Wealth Management
200 Clarendon St, 25th Floor
Boston, MA 02116
jtpierce@baystatefinancial.com

## Bitcoin: Interesting, Fascinating....Relevant?

In a month where risk markets continued to rise, and did so in a relatively calm and quiet manner, it seemed that investors found themselves looking for interesting topics of discussion. For the month, the US stock market, as benchmarked by the S&P 500, rose by roughly 1.4%. And the global stock market, as benchmarked by the MSCI All Country World Index (ACWI), rose by roughly 2.3% in the month of May. It is as if this market is simply boring, or investors are just content with the slow and steady rise, so there is a thirst for topics of interest.

What seems to have filled that need for intellectual stimulus is not necessarily the Comey dismissal and the investigation to follow, but instead bitcoin and its consistent rise in price. In fact, bitcoin is being discussed both near and far, through questions from my mother to the international music superstar Pitbull, who referenced his not owning bitcoin as one of his biggest financial "misses." Regardless of one's view of the cryptocurrency, it is without a doubt one of the more interesting topics in financial markets, at least in theory, and may even be the wave of the future. (For full disclosure, we at Baystate Wealth by no means view bitcoin as an investment theme, but instead an interesting topic for discussion around the future of blockchain technology and currencies in general.)

### Bitcoin – Then & Now

Bitcoin, the most well-known of the numerous cryptocurrencies being cultivated and traded, is up over 400% in the last 12 months. This has the cryptocurrency trading at levels around $2,500 per one U.S. Dollar as of early June. As you may recall, back in the spring of 2014, I used this space to detail the somewhat complex and confusing world of bitcoin. For the purposes of review, below are some key excerpts:

> Bitcoin, with a capital "B", is a consensus peer-to-peer network created to facilitate transactions using digital currency. The unit of currency is transacted through the consensus network called bitcoin, with a lowercase "b". Bitcoin, the unit of currency, may be used in internet-based transactions between a producer (seller) and a consumer (buyer).

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(*Editorial comment: One would think it would be more easily digested as a new form of currency and means of transacting had the creators had the foresight to give unique names to both the currency and the exchange. Presumably this would have reduced confusion and thus created two distinct new forms of technology in the eyes of the technological layperson. Therefore, for the purposes of this report, going forward, both "Bitcoin" and "bitcoin" will be used to describe the unit of currency, unless otherwise noted.*)

The idea of bitcoin, both the transaction technology and the currency, was conceived sometime around 2007-2008 by an anonymous computer software engineer. In 2009 the currency was officially launched and became available to all who want to get involved. In fact, one of the biggest myths around bitcoin is that it is only available to a few individuals. This belief is inaccurate. In the early years of the currency's existence access was limited to those individuals with time, interest and access to the necessary resources (i.e. computers). Now, anyone can access the currency and transact rather seamlessly through online providers. These online providers act as both an exchange and a virtual "wallet" for any individual interested in the technology. Further, bitcoin ATMs seem to be popping up all over the place, including locations in Vancouver, Boston, Austin, and Seattle. Plans for additional locations, such as Los Angeles and New York seem to be in the works as well.

When originally writing this piece on bitcoin, my interest was piqued on all aspects, including its history, philosophical views of the cryptocurrency, the trading of it, and of course owning it. So, I opened a bitcoin trading account, also known as a "virtual wallet." After some initial checks and balances, I deposited the necessary funds from my bank account into my virtual wallet to purchase one bitcoin at a price of roughly $580. And I took a deep breath, as if I had entered the dark side. For the immediate days to follow, I checked to see if my bitcoin was still there, and each day my wallet was available and my one bitcoin was accessible.

While the bitcoin was accessible, out of the gate its value fell from my original purchase price to a low of roughly $400. My immediate thought was that my experiment quickly lost $180. That sell-off was short lived, although the price volatility was surely constant. After a brief stint above my original purchase price, the cryptocurrency hit a "bear" market of sorts, touching lows around $225. While holding this currency, friends and colleagues would ask with a smirk "do you still own that voodoo currency?" or "hey, how is your bitcoin working out for you?" And, as the bear market in bitcoin drew out, interest on a national level all but disappeared.

I took the ribbing in stride; however, my frustration from the experiment hit its peak around August of 2016, and I had to sell. In fact, my thought was: "Why do I even own this stupid thing?" Of course, the timing of my exit is almost exactly the starting point for the currency's massive run to its current levels above $2,500. A classic capitulation trade – based on emotion and frustration, not on data or analysis. In fact, the sell decision was driven largely by the fact that I wasn't sure why I owned it in the first place as I had no way of truly analyzing a fair value for the cryptocurrency.

Bitcoin now, relative to 2014, seems to be more mainstream and quite obviously higher in price. At the time of my writing in 2014, there were only a few retail outlets that accepted bitcoin as a means of transaction. Now, by some accounts, there are hundreds of companies accepting the cryptocurrency. What is more relevant than the number of companies accepting bitcoin for transactions, is the types of companies on the list. These companies include Microsoft, Dell, Expedia.com, Intuit, DISH Network, Subway and Overstock.com to name a few. While this is only a sampling of the companies, it is to say that commerce is becoming more open to new ways of transacting business.

In addition to some retail acceptance, in 2015 and 2016, by some accounts there was $575 million invested in bitcoin-related deals across more than 200 different venture capital firms. And in 2015, the U.S. Commodity Futures Trading Commission formally announced that it considers bitcoin a commodity and not a currency, thus giving the commission some oversight. Further, just recently, Japan declared the cryptocurrency as an officially recognized form of payment. This is much different than how the currency (or commodity) was viewed back in 2014. Back then, most central governments denounced the currency as a "black market" payment system. Which was not unfounded as this was, and may still be, the case for those looking to launder money or conduct transactions without any form of tracking or regulation. (As an aside, the best example of how bitcoin can be used without tracking or regulation may be in the case of WikiLeaks and its financial blockade back in 2011-2012. This was the time when WikiLeaks was releasing government secrets, so financial institutions attempted to choke the group financially by not allowing their customers to send funds in the form of a donation to support WikiLeaks. These institutions included Bank of America, Visa, MasterCard, PayPal and others. Thus, WikiLeaks founder, Julian Assange, resorted to accepting bitcoin as donation and did so without any issue.)

## **Is bitcoin a Solution?**

There is no question that bitcoin is far away from being considered as mainstream, and thus nowhere near full adoption as a currency. In fact, bitcoin appears to trade more like a "commodity" with speculation playing a larger role than its fundamental value. Bear in mind, however, that the value of bitcoin is in two forms: (1) the bitcoin as a commodity or cryptocurrency; and (2) Bitcoin (with an uppercase "B") as the technology of the creation and transfer of currency. Again, the primary discussion here is around bitcoin the cryptocurrency. It is my belief, with everything known today, that the U.S. Dollar, the Euro, the Yen, the Pound and, by some arguments, the Chinese Yuan, will most likely remain the core currencies for my lifetime. However, it is inarguable that the technology wave and the millennial generation (as well as the generations to follow) will embrace new technology at a faster pace than prior generations. Part of this could very well include challenging contemporary thinking on central banks, transactions, and currencies well beyond what any of us traditional thinkers could imagine.

While I would still classify bitcoin as interesting, maybe even fascinating, that thesis is challenged with every tick up in price and trading volume. It is interesting that the skeptics who questioned its viability have seemingly been silenced, or maybe they simply capitulated. And, it is fascinating to see the explosive rise in price, without a fundamental, or at least widely understood reason. That said, whether bitcoin is or will be relevant to currency markets or capital markets in the aggregate, remains to be seen. Though it does seem that the blockchain technology behind the transaction and trading of bitcoin appears here to stay, at least in some form if not its current. Of course, the lack of regulation/oversight could prove challenging and it seems that the fate of crypto will be dependent on the integrity and security of the derivative wallets and exchanges behind it.

One could liken this to the early stages of the internet. For those who may not remember the tech boom of the late 90's, because of the amazing innovation of the internet, there was a vastly accepted belief that the world will change with the internet and that everything will forever be different because of it. And while it is true that the internet changed the world in many facets, the root of its success was not singular in nature. Without doubt, the internet was successful because of its convenience factor, and frankly because it provided a solution, whether we all knew it at the time or not.

The internet, in a somewhat simplistic and accessible manner, allowed for greater information sharing. It filled the universal void of being able to get whatever one wants, be it information or a product, practically immediately with one click of the mouse. Imagine how crazy it must have sounded in the 1990s to suggest that you could order just about anything online and not have to go to a store! Or, better yet, one could communicate with anyone in the world and do it for free! Neither of those examples held true before the internet rage of the 90's. And, further, there were very few people at the time that could even imagine email or Amazon.com as being a reality let alone their eventual dependence on it.

This convenience offered by the internet satisfied a basic human desire for immediate results and a simpler way to transact and communicate. And, we jumped on exactly what the internet was and we continue to embrace it as its offerings continue to expand. It is important to note, that the history of the internet and its roots allowed for the service to expand at a relatively slow rate. Recall that the internet began with the exclusive use by the military. Eventually the service was offered to academic institutions, then eventually it was rolled out to the general public. This slow and multi-level rollout allowed for time to work out potential kinks and install some form of regulation and management of the service. Bitcoin has been thrown out to the public and the kinks are being worked out as it goes, and with that comes the heavy price volatility.

Getting back to the service and value offered by cryptocurrencies relative to that of the internet, it is not obvious what need or enhancement to everyday life cryptocurrency could offer on a mass scale. In fact, it seems these currencies are a form of technology that is challenging contemporary thinking and the establishment that exists for currency in general. At this point in time, most citizens of the world would not look to bitcoin to make their lives more convenient or as an enhancement of any kind. That said, there are some -- namely those backing Bitcoin-- who would say that eventually bitcoin, both the technology and the currency, will make life better. What "better" means is unclear and it is this lack of clarity that is holding bitcoin back, at least in terms of mainstream acceptance.

## **Where Does Bitcoin go from Here?**

Regardless of what you call the cryptocurrency or how you classify it, one cannot deny its growing popularity. The demographic of individuals involved with, or at least following, bitcoin range from a millennial trader or consumer, to government officials and Private Equity investors. And, its growing popularity may be best illustrated with the recent explosion of roughly 100 or so cryptocurrencies that are now available for trading. These relatively new cryptocurrencies trade under names like Potcoin, Earthcoin, Mooncoin, Bytecoin, and many others. With a growing list of "copycat" cryptos, one can't help but continue the analogy and liken this to the early internet days of the 90's. With every new crypto coming to market, it is hard not to recall the likes of Pets.com, the poster child for irrational exuberance and valuation in the tech boom of the 90's. This is not to say that these cryptos will not survive long, but it is to reference the history of Pets.com relative to that of Amazon.com.

So, while only time will tell what the effects of this massive rise in both interest and price of bitcoin will be, what is clear is that what was presumed a “voodoo currency” in 2014 is now, with every passing day (and move in price), gaining more and more interest. I for one will remain interested in and fascinated by bitcoin and cryptocurrency in general. Though at this point, I will do it from the sideline as an observer, curious to see how it all plays out, with an open mind to continue to learn more as the currency, the market, and the technology behind it mature with time and experience.

As always, please call on us if we can be of service.

Joshua T. Pierce, CFP®, CAIA
Director of Research, Baystate Wealth Management
200 Clarendon Street, 25th Floor
Boston, MA 02116
(617) 585-4578
jpierce@baystatefinancial.com
www.baystatewealth.com