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Digging into the Bitcoin Craze

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Bitcoin has been getting *a lot* of publicity lately. It's wild daily percent changes are being discussed on nearly every financial media outlet. "Bitcoin Storms Wall Street" was the cover article recently in Barron's. There's even a story of a British man who may resort to digging up a landfill because, in 2013, he threw away his hard drive that stored over 7,500 Bitcoins. While 2017 has become the year of Bitcoin, there is no clear definition of what exactly Bitcoin is. Jamie Dimon, CEO of JP Morgan Chase, considers it a "fraud" and Warren Buffet called it a "mirage"; yet, it's so popular that the Chicago Board of Options Exchange ("CBOE") server crashed on December 11th after the first Bitcoin futures contracts were made available for trading.



Matt began his career in the financial services industry in 2010 as a Junior Research Analyst at a boutique money management firm. In short order, he worked his way up to Investment Strategist, helping to manage assets across five portfolio strategies. His passion for the industry has earned him the right to use the Chartered Financial Analyst (CFA), Certified Financial Planner™ (CFP®) and Chartered Market Technician (CMT®) designations. Matt is driven by building sound relationships with clients.

Matt graduated with a B.A. in Finance with a specialization in Environmental Studies in 2009 from Michigan State University. He is a member of both the CFA Institute and the Market Technicians Association.

What is Bitcoin? Objectively, Bitcoin is a cryptocurrency, meaning a digital asset designed to be utilized as a medium of exchange. It was invented by Satoshi Nakamoto, likely a pseudonym. He/She is completely anonymous and has not been heard of since 2011. Nakamoto's goal is to have a completely decentralized digital currency with no need for

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institutional control, such as the role central banks play in traditional currency. The result was an algorithm in which a set number of bitcoins are "mined" by powerful computers solving mathematical puzzles. The formula states that only 21 million Bitcoins, in total, will ever be mined. Currently, the total supply of Bitcoins is shy of 17 million and counting.

Bitcoin are nonphysical in nature, so they must be held in digital wallets (or in the case of the man who is willing to unearth a landfill, on hard drives). Transactions are untraceable to specific individuals, as a person's bitcoin wallet address and private key are secretive in nature. As you can likely guess, these qualities make bitcoin conveniently attractive to dealings involving illicit activities. Bitcoin was the preferred medium of exchange on Silk Road, the notorious website that was brought down by the Feds in 2013.

The subjective answer to the question “*What is Bitcoin?*” lies beyond money laundering. I highly doubt even criminals would be willing to deal with the extreme volatility that Bitcoin exhibits on a daily basis. It’s not uncommon for Bitcoin to rise or fall by 25% a day. Some will view Bitcoin as a hedge to currency inflation brought upon by central banks who print money. Another subset of people will like the inconspicuousness and the ability to transport currency across borders and avoid transaction costs when exchanging currencies. Others will view trading Bitcoin as a way to make a quick buck through speculation. There are also the skeptics who assign no value to Bitcoin, citing concerns of Ponzi and Pyramid Schemes.

Valuation is an even trickier subject. Bitcoin has no industrial applications, produces no cash flow and lacks convenience. At the same time, Bitcoin’s supply is controlled and is gaining some acceptance as a potential store of value. To a certain degree, valuation is dependent on a person’s subjective definition of Bitcoin. The market is set somewhere between the “ultimate hedge against central bank currency debasement” and “frenzied speculation”. It’s hard to argue that we are not seeing telltale signs of an asset bubble, while at the same time Bitcoin is gaining legitimacy

with sovereign countries and established financial organizations such as the CBOE.

If Bitcoin doesn’t sound risky enough, it should be noted that before Facebook, there was myspace.com. Right now, Bitcoin has the first-mover advantage, but a new cryptocurrency can be created at any time, and currently there are over a thousand other cryptocurrencies available over the internet. Some other cryptocurrencies such as Ethereum, Ripple and Litecoin pose a true threat to Bitcoin dominance, touting better organization and structure. It’s undeniable that we are in the early stages of cryptocurrencies as a potential asset class, and as they attract more acceptance from the mainstream there will be increased competition to Bitcoins’ “market share”.

We hope this sheds some light on the phenomenon that is Bitcoin. While there is much more out there in terms of complexity and information, we hope this primer will at least help you navigate some conversations with friends, family or co-workers. No matter where your opinion falls on Bitcoin, just be happy that a) you didn’t throw out a hard drive worth \$100 million, and b) you are not contemplating digging through a landfill to find it.

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