

Fleet Street invasion

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Today I would like to share with you some insight from Charlie Morris, the editor of *The Fleet Street Letter*. Charlie knows the City like the back of his hand, and has a unique perspective on the financial system that I've not encountered in any else before.

Sailing global markets as a fund manager for almost two decades, there's not much he doesn't know about when it comes to financial instruments. In light of this, readers of *The Fleet Street Letter* often ask him his opinion on cryptocurrencies, a term which Charlie actually despises. Requests for his view on the subject grew so great that he decided to write a full issue on them, which he prefers to class as "digital assets". I share with you part of his briefing below.

Valuing bitcoin

When bitcoin was initially described to me as electronic gold, there was some truth in that, as there is a limited supply. Knowing that there will never be more than 21 million bitcoins means that your investment won't be inflated away. Indeed, bitcoin's inflation rate is 4.2% per annum and we know that it will fall in the future on a pre-set path. That has given people confidence that there is scarcity and the potential for future value.

While the supply side is known, the demand side is another matter. The price has been directly proportional to the amount of value that is transferred across the bitcoin network. In other words, if \$1 billion worth of bitcoin changes hands each day, a price of \$3,500 per bitcoin should be expected – according to my calculations that I won't bore you with. If it dropped to \$100 million, the price would drift down towards \$350. And if people stopped transacting, it would soon become worthless.

Could bitcoin rise to \$1 million? Yes, it could. All that is needed is for the network activity to rise 300-fold from current levels. That's entirely possible as the network remains youthful and most people don't use it at all. In this sense, by examining demand trends, bitcoin isn't gold as its value hinges on the vibrancy of the network that connects people. No network activity would mean no value. And if the mainstream used it in abundance, we'd soon be talking about trillions of dollars of value.

Electronic money

You might think that electronic money already exists, but it doesn't. Internet access and payment systems have merely allowed us to access our bank balance in real time and make transfers in a more efficient manner. Electronic money is taking it a stage further. It would enable you to use the pound, but without your bank. The Bank of England would issue the pound in a controlled manner, and people would be able to store it in a software wallet without the need for a bank. An e-pound and a paper pound would have the same value.

The raison d'être is that banking services are expensive. The consumer doesn't notice unless they switch into foreign currencies, but the retailers certainly do. It is not uncommon for retailers to be charged 2% of each transaction, which in aggregate, is a huge amount of money. An electronic pound or dollar would negate much of this, as the transaction could potentially take place with virtually no friction. That would be considered progress by the majority. This might appear to be fanciful, yet it is possible, whereas just a few years ago, it wasn't.

Digital assets are not currencies

An e-pound is a pound delivered by supercomputers rather than on paper or via your bank. The pound is of course a currency. It is issued by the central bank, generally pays interest and can be used to pay taxes. In the UK, the pound is extremely stable. It is only in other countries that volatility becomes apparent. And even then it averages around 8%, which is much less than gold or the stockmarket. The volatility of the pound relates to the broad prospects for the British economy, of the relative value or interest rate differentials between two countries.

Inflation varies over time, sometimes due to internal factors, and at other times, external. We tolerate and accept inflation because in our own country, our currency has near zero volatility over the short term. Instead, we know it will decline in value over the long term. And that's why we invest in assets.

If digital assets, which sadly have become known as cryptocurrencies, were actually currencies, then they might resemble some of the points made above. They could be issued by a central authority, and they could pay potentially interest (currently they don't). Yet for digital assets to be currencies, they would have to represent cyberspace in some form or another. Perhaps they will in time, but my analysis suggests that they don't, and won't. They are merely independent networks whose value is directly related to their adoption and utility.

Extreme volatility

Utility is important as it leads to value-driven buyers. That means a steady stream of buyers that need a constant supply. An example might be a supermarket that needs food or an airline that needs fuel. The inclusion of value-driven buyers makes a market more stable, as when the price falls, demand rises which keeps the market in balance. A market absent of value-buyers becomes extremely volatile and that's where digital assets are today.

A new asset class

My vision is that digital assets are a new asset class. That might not seem like a bold statement, but it is. Consider how rarely a new asset class comes into being. Most attempts are just the old ones recycled and dressed up as new. A good example was hedge funds which proved to be correlated to risky assets during the financial crisis. Another is emerging market debt, an asset class that is forever being reinvented and repacked for pension funds; and it dates back centuries. Infrastructure is just odd-shaped property, and so on.

Digital assets are truly different and offer investors something new. They are not linked to the price of bonds or stocks. They don't care about traditional currencies or the price of commodities. Their value is linked to the networks they build and their only link to the outside world is the price of electricity. Consider that mining bitcoin is an energy-intensive activity.

Imagine a world where bitcoin and Ethereum are joined by dozens of other impressive digital networks, all beaver away doing useful work. The result would be a surge in value on a scale never seen before. This space is currently worth around \$130 billion. And if it went mainstream, it could surge by multiples of that. And that's why I believe this is a new asset class; it is genuinely different from what has ever been before.

If you like Charlie's analysis, there's a lot more where that came from. And if you're interested in learning more about the digital asset or cryptocurrency space, [click here](#).

Have a great weekend!

Until next time,

Boaz Shoshan
Exponential Investor

