How Cryptos Are Changing the Way We Think About Money

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OK, it's time to start taking cryptocurrencies seriously.

And no, not because they're making people a fortune. You know that. We've been talking about it all year. Many cryptos are up 1000% this year alone. Some are up even more than that.

Since that's common knowledge, I'm guessing if you haven't taken the time to understand the market yet, it's because a) you have no interest or don't understand quite what the fuss is about, or b) you feel like you've missed the boat.

I think you'd be wrong on both fronts there. I'll come back to that shortly. Today, I want to ignore the profit potential side of things altogether – that's obvious to everyone – and explain why it's vital you understand what's going on with cryptocurrencies *even if you never intend to buy one.*

Let me explain.

#1: Cryptocurrencies the most important disruption of the monetary system in half a century

It's worth remembering that what we consider to be a "currency" has changed radically over the centuries.

Generally, these changes happen very quickly, during times of social upheaval, crisis and even revolution. I think we're living through one of those times today. More on that in a second.

Today most people would describe a currency as a government issued, state controlled, unbacked fiat currency.

OK, most people wouldn't say that, because most people don't spend a lot of time considering exactly what money is or where it comes from. I'd argue that in itself is a consequence of our current monetary system. In every nation on the planet, money is what the government decrees it to be.

That's the post 1971 world. Money comes from the state. It can be created or destroyed at will by a central bank. Its rate of interest is strictly controlled. And it is unconnected to any real asset.

But it wasn't always so.

Before that (1944-1971) money – or at least the dollar, to which most other currencies were lined – was backed by gold. It had a connection to something real.

Prior to that, virtually all currencies were backed by something real, in one way or another. Gold and silver were most common. But tin, copper, land and government bonds have all been used as part of the "backing" of a currency.

That created a different lens through which to view any given currency. It introduced an element of choice on the part of the user (you) – if not all currencies are created or backed equally, choosing which one to use and accept is a much more important task.

It was closer to what you might call a free market in currencies. Yes, currencies are traded freely today. But they're all fiat. The choice is fairly moot. None of them have any intrinsic value. Choosing the dollar over the euro is choosing one piece of paper over the other.

And the differences weren't just between nations. Any bank could issue its own currency. You had a choice about what to use and accept, based on your view on the issuing banks' solvency.

It all sounds way too technical and boring today, doesn't it?

But that's the point – the modern monetary system exists in its current state largely *because people have stopped thinking about what money really is.*

At least that's how it's been for a long time. Where once it was an integral part of life, the average person today doesn't give serious thought to whether a currency is trustworthy, valuable or stable. It simply is.

A nice side effect, if you're a central banker: all that paper money helped fuel massive borrowing and economic growth through the last 40 years. When the economy is growing, the stock market is going up and people have jobs… people don't spend a lot of time worrying about the currency.

But something changed in 2008.

The Global Financial Crisis brought that system to the brink of collapse. Central banks around the world responded by printing vast amounts of money. That had the effect of a magician revealing the sleight of hand by which his tricks work.

It made people wake up and start asking what money really is again.

It's no surprise Bitcoin was invented in the days after Lehman Brothers went under. Trillions of dollars of bailout money suddenly appearing – out of thin air – was the perfect wake up call for people to start thinking seriously about currencies again. Maybe not all currencies should be government issued and unbacked?

I think that idea took root unconsciously in people's minds in 2008. In the decade since, during which central banks around the world have warped what money "is" even further, that idea has grown… morphed… and found a natural outlet.

The first outlet was gold and silver, both of which exploded after the crisis. As people questioned fiat currency… they turned back to traditional monetary metals, controlled by no government and unprintable.

Cryptocurrencies are the next logical step in that process.

Make no mistake: this is a huge disruption. We're moving away from a world where a currency is a piece of paper issued by the state… and towards a free market where there are hundreds of different and viable choices.

Not all of them will pan out. That's obvious. But some will. Perhaps bitcoin is one of them. It certainly seems that way. No one forced so many people to buy into it. No one told them they had to use bitcoin over dollars or pounds. They bought it because they saw value in an alternative.

One day they may decide otherwise and move into something else. But I doubt we'll get back to a world where currency is purely government issued for a long time. We're closer to the days of private banks and financial institutions issuing their own currencies, except the issuers are programmers building algorithms.

What happens next?

Well, I think we're seeing the network of users explode now. For cryptos to become genuinely important in the financial system we'll need to see that continue a good while longer. The fact that increasing numbers of retailers are accepting bitcoin is a sign of that trend intensifying. The next big one is Amazon. If Amazon starts accepting bitcoin – and there's evidence to suggest that will happen very soon – bitcoin will make a giant leap towards the heart of the traditional financial system.

Or it may be another cryptocurrency. Or it may be more than one. Once established, we'll see a battle royale between traditional fiat currencies and cryptos. People will use what they trust most. I have my own ideas on what will happen then… write to me with yours at nick@southbankresearch.com.

#2: They're part of the Battle of the Century: free markets vs central banks

Imagine a world where you could pay your debts, get paid and buy almost anything you like with bitcoin.

Or you can use pounds (in this country).

How do you think the state would respond to that? If printing money and manipulating interest rates had a real impact because people had a choice about what currency to use?

I can't see Mr Carney being too pleased.

Any limitations to a Central Bank's power are bad news. So I can't see bitcoin being officially "allowed in". All that means is you'd need pounds to pay your taxes. Every other piece of business could, in theory and if enough people trusted the network, be conducted in bitcoin.

That threatens the very basis of the state's power. My guess is that very soon somewhere in the world a government will wake up to that fact… and try to ban bitcoin.

What do you think will happen? If a government, terrified of what true competition would mean, tries to impose its will on a burgeoning free market in cryptocurrencies?

I'll tell you: the market will shoot up harder and faster than anything we've seen so far.

It could happen. The US government banned gold in the 1930s, in order to manipulate the price of the dollar. That's how the Treasury filled Fort Knox – by confiscating the gold.

Did it destroy gold as an asset? As a store of value? No. Because people valued gold precisely for its quality as a non-government controlled, international currency. The same goes for bitcoin. Though I don't know what the digital equivalent of Fort Knox is.

#3: They're an entirely new asset class – which doesn't happen often

Cryptocurrencies are best described as "the internet doing money", as Charlie Morris put it at our Tech Symposium in May.

The internet has changed everything else about how we live our lives and conduct business. It was only a matter of time before it did money.

And in doing so it has created a new asset class. Yes, we can compare bitcoin with other currencies, because it'll ultimately compete with them on a global stage. But like gold, it has qualities that make it distinct from other currencies.

So do all cryptocurrencies. Rather than deriving their value from physical scarcity (gold) or trust in the government (fiat currency), their value comes from the size and safety of the network. Right now that value is soaring.

New asset classes don't come along very often. And people find it hard to get their around at first. Imagine you'd never heard of a publically listed company before. The idea of owning a "share" in a company that may or may not exist or make money next year would feel strange at first. But over time we come to accept and understand these things.

The same goes for cryptocurrencies. They're new and strange. But they're worth understanding. You might compare them to small caps – they have similar qualities, in the sense that they're highly volatile and you don't need a lot of cash to get started. But they're small caps on steroids. Cryptos have made 80 times the return of small caps in 2017. And you can jump in with £50 odd.

To me, that's compelling. Any genuinely new asset class is worth understanding and owning, even in a small way. Given you only need pocket change to claim a stake, it just makes good sense (to me) to own some.

Which, by the way, is why I'm so excited that we've published our new book on cryptocurrencies this week. It's an entry level blueprint to understanding and getting set up in the world of cryptocurrencies. The best part? I've found a way of offering you a free copy. Hundreds of people have already taken me up on that offer. You can grab yours now by clicking here.

Have a great weekend,

Nick O'Connor

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