Fiduciary Financial Group

Diversification: A Case For Adding Bitcoin Exposure

In June 2017, we published a newsletter about Bitcoin and its rise. At the time (6/29/2017) BTC was priced at $2,565. It now trades at $9,059/coin, an increase of 253%. In contrast, the S&P 500 has returned (with dividends) about 32% over the same period.

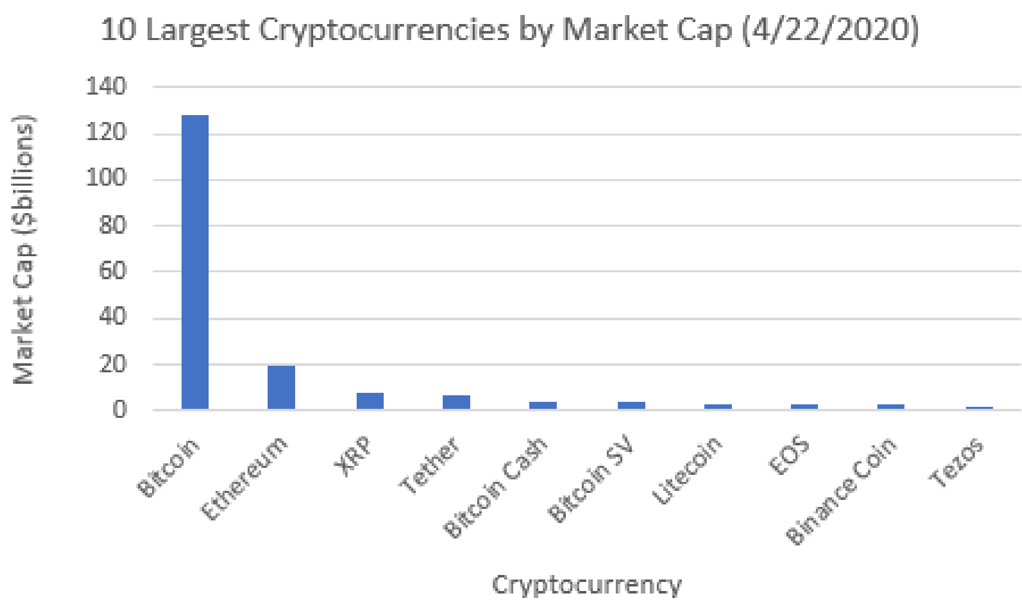
Bitcoin			SPDR S&P 500 ETF Trust (SPY)		
$10,000	→	$35,886	$10,000	→	$13,171
June 29, 2017		June 29, 2020	June 29, 2017		June 29, 2020

In June 2017, we did not feel we could broadly recommend an investment in cryptocurrency to all clients given its high-risk nature, lack of community acceptance, and insufficient barriers to entry with countless other cryptocurrencies launching. That spring and summer of 2017, we did recommend Bitcoin individually to clients in several instances – to those whom we felt could embrace the uncertainty and the macroeconomic and technological concepts behind our confidence in cryptocurrency's efficacy. Grasping these concepts is definitely helpful in having confidence in the future of Bitcoin and its viability as an investment even during times of *extreme price volatility.*

As Bitcoin went on to reach ~$20,000 a coin just 6 months later (a near 500% increase) we got skittish, letting the topic of Bitcoin drop and we have not published any newsletters about it since. We had lost our faith in suggesting the asset class after such a rapid rise with the absence of any real justifiable reason for this spike beyond speculation. We received calls from random people on the internet who had read our blog and asked us to buy Bitcoin for them. Let us be clear: we NEVER get random people off the internet asking us to book orders for them. It is usually a surefire signal that it is time to run for the hills! The only other example of this in recent history was Canadian marijuana stocks in 2019. Countless folks approached us about buying stocks in these companies. Since mid-2019, the big ones – Cronos Group, Aurora Cannabis, Canopy Growth, Aphria, etc. – have all plummeted.

Today, the risks in Bitcoin are still real and we appreciate them as we always have. While still a "hot topic" we are passed the Bitcoin hysteria that was 2017 and over the last 18 months, it has priced fairly consistently between $5,000-$10,000 per coin. The key risks of Bitcoin that we have identified are:

1. *New cryptocurrencies are launching all the time as it is very easy to create new "coins". Some are far more practical in their structure for use as a currency than Bitcoin. This illuminates weak barriers to entry in the cryptocurrency space which exposes Bitcoin to extreme downside risk.*
    - Having said this, Bitcoin still represents more market value in dollar terms than the next 9 largest cryptocurrencies combined as indicated by the following chart. A key element of value in currency is widespread acceptance… the so-called "Network Effect". Bitcoin appears to be winning on that front, at least compared to its other crypto peers.



[i] (see endnote)

2. *Security risks associated with Bitcoin are real. Coin thefts/hacks from digital exchanges have resulted in permanent and significant loss of wealth.*
    - *This threat is still prevalent and supports the need for careful due diligence in identifying and selecting a reputable exchange with significant resources devoted to security.*

3. *Bitcoin's current viability as a world currency used in daily commercial transactions is weak due to its limited capacity for processing high volumes of transactions. For instance, BTC can only process 7 transactions per second as compared to Visa, which records an average of 1,700 transactions per second.*[ii] (see endnote)

4. *Bitcoin's extreme price volatility (at least currently) makes it difficult for large organizations to adopt it for use in commerce. A key ingredient to a viable currency is price stability and Bitcoin lacks that at this point.*

5. *New governing bodies may move to try and outlaw Bitcoin from its jurisdictions due to the threat it poses to traditional, government run currencies.*
    - *This has already happened in China, Russia, Vietnam, Bolivia, among other countries.* [iii] (see endnote)

These are real risks, but we now feel that absorbing them via modest cryptocurrency exposure is justified given a very real paradigm shift:

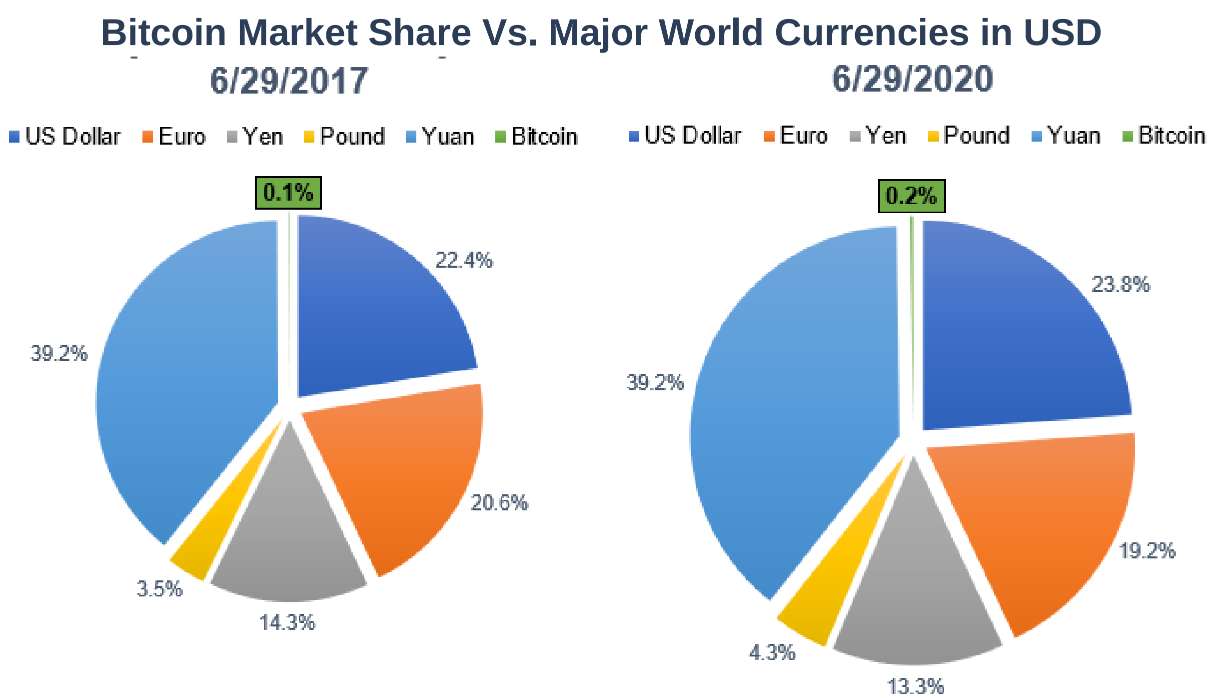
- **The aggressive Central Bank monetary policies of Quantitative Easing, Troubled Asset Purchases, and Zero-to-Negative Interest Rates once thought to be "short-term" responses to the Great Recession, appear to be difficult to reverse and most economists now expect them to be here for the foreseeable future.**
    - **Example - In 2008, the FED was buying failing mortgage bonds. Today in the USA, we are seeing the FED not only buy mortgage bonds, but it is also backstopping failing junk-rated corporate bonds. The Bank of Japan has taken it a step further buying exchange traded funds (ETFs) that hold Japanese stocks.**

These programs all create the REAL risk of widespread fiat currency debasement. Some exposure to Bitcoin (among other non-traditional assets with intrinsic value independent of the US Dollar, Euro, Yen, etc.) should be considered by most clients in light of this new paradigm.

It Is All Relative…. Let Us Dig In…

In June 2017, we looked at the money supply of 5 of the world's largest currencies – US Dollars, Euros, Yen, British Pounds, and Chinese Yuan in their respective regions (USA, Eurozone, Japan, UK, and China). At the time, the total collective value of these currencies in their regions (expressed in dollar terms) was roughly $60 trillion. Bitcoin's value on the other hand, was less than $50 billion, or less than 1/1000th of the value of the money in these major markets.

Now, less than 3 years later, the collect value ($ terms) of these same 5 currencies has eclipsed $75 trillion in the same 5 regions. The "currency pie" is getting bigger. Bitcoin's market value is now ~$155 billion. While the 3-fold increase in Bitcoin's market value might seem unsustainable at first glance, let us look at its "currency market share" aka "slice of the currency pie" again which quickly debunks this argument. ~$155B in Bitcoin today still only represents 0.2% (2/1000ths) of market share against "the big 5 currencies"… ($150B / $75T) in their regions. If we expand the market size to include the money supplies of these currencies outside their boarders as well, the total is closer to ~$90T alluding to the market share of Bitcoin being even less significant. **The moral of the story?** *If governments around the world continue to print more money and increase the size of the "currency pie" while Bitcoin's supply remains finite in quantity (21 Million coins in all), BTC can increase in value by many orders of magnitude in dollar terms and still not make up meaningful currency market share. Look at the charts of Jun'2017 vs Jun'2020 below.*



Conclusion

We feel this "currency pie growth" trend will continue and provides a strong argument for some exposure to the world's leading cryptocurrencies - namely Bitcoin, Ether, and possibly a few others.

Government's around the world are running out of tools to address rapidly expanding debt levels. If history is any guide, continued debt monetization is the path out of our debt problems as it does not look like the European Union, United States, Japan, China, etc. have the capacity to repay these debts barring an expansion of their respective money supplies.

We believe, that in addition to diversifying your portfolio across stocks, bonds, and commodities spanning the globe, a small exposure to cryptocurrencies (possibly 1-2% of financial assets) and gold (possibly 3-7% of assets) to mitigate currency weakness may be warranted despite the significant risks.

There are several avenues for adding digital currency exposure, or at the very least blockchain exposure to your portfolio. We will list some options below. *Before making any investments in this space, we highly recommend having a discussion with us to better understand the significant risks involved.*

- *Online cryptocurrency exchanges:* These websites facilitate the direct purchasing of Bitcoin and other digital currencies. Some of the most well-known include:
    - Binance
    - CoinDesk
    - Gemini
    - Robinhood
    - Kraken

- *Venture Capital / Hedge Funds / Private Equity*: These options are typically only available to accredited investors with $1M or more in financial assets.
    - Digital Currency Group
    - Polychain Capital
    - Pantera Capital
    - Galaxy Digital

- *Exchange Traded Investments:* These options are available through traditional brokerage accounts. The leader in this space is "Grayscale Investments" which offers:
    - GBTC – Bitcoin Investment Trust
    - ETCG – Ethereum Investment Trust

Book an appointment now to review your portfolio:

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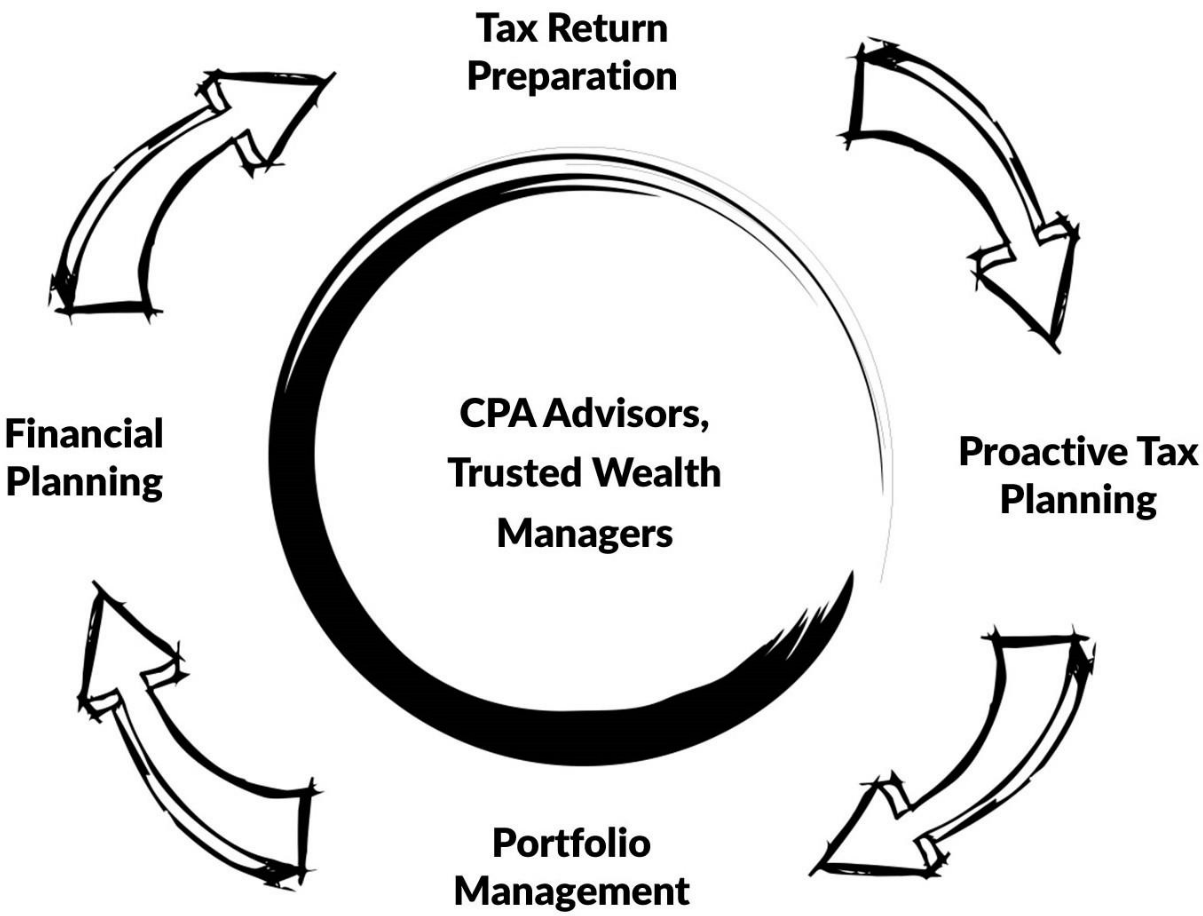
Disclosure:
Investing involves risk including the possible loss of principal. Cryptocurrencies carry additional, unique risks apart from traditional stock & bond brokerage investments. As always, consult with your investment advisor about the pros and cons of these investments before taking any action. The specific platforms, investment vehicles, funds, etc. that are referenced above are provided for informational purposes only and are not intended to be recommendations made by Fiduciary Financial Group to the reader. Investing in cryptocurrencies should also be done only after assessing your own personal tax situation with your tax professional.

Citations:

i Bagshaw, Rick. "Top 10 Cryptocurrencies by Market Capitalisation." Yahoo! Finance, Yahoo!, 22 Apr. 2020, finance.yahoo.com/news/top-10-cryptocurrencies-market-capitalisation-160046487.html

ii Transaction Speeds: How Do Cryptocurrencies Stack Up to Visa or PayPal?" accessed June 29, 2020, https://howmuch.net/articles/crypto-transaction-speeds-compared

iii Bajpai, Prableen. Countries Where Bitcoin Is Legal & Illegal. Investopedia, 9 May 2019, www.investopedia.com/articles/forex/041515/countries-where-bitcoin-legal-illegal.asp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Portfolio
Management
Financial
Planning
CPA Advisors,
Trusted Wealth
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