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Modern Tulips

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The Dutch tulip mania in the 17th century saw the price of tulips rise precipitously before crashing back down to earth. Generally considered to be one of the first ever recorded asset bubbles in history, it remains unclear what precisely was the catalyst that precipitated the scramble for the flowers.

Wealth certainly played a part. Holland in the 17th century was awash with surplus wealth created by its successful trading economy and repatriation of wealth from its colonies created the economic environment in which those who had access to the wealth could indulge in tulip mania. At its peak, a single bulb cost just over £100,000 in today's currency.

A digital tulip was recently sold for about £20,000. Not quite the level of an actual tulip during peak mania in the 1630s, but absurd enough to make one question the rationality of the markets. The aphorism that "a rising tide lifts all boats" is not quite accurate in describing what the increase in money supply and low interest rates has done to the markets. Quantitative easing (QE) has indeed been the tide that has lifted all boats. But the lowest quality and most speculative assets, the equivalent of leaking dinghy's that can't even carry their own weight, have been, unintentionally, given solid rocket boosters.

This digital tulip, and other such absurdities are called NFTs (Non-Fungible Tokens). They are the latest trend emerging from the bizarre primordial soup of cryptoland.

For something to be fungible, it has to be interchangeable. Gold, cash, bitcoin, stocks, bonds, and commodities are all fungible. One kilogram of gold is identical and holds the same value as another kilogram of gold. One pound sterling in your account is equivalent in value to another pound sterling. Non-fungible items on the other hand are unique. A traditional example is unique trading cards. Beanie babies (limited edition toys popular in the 1990s) and artworks can also be non-fungible.

NFTs can be anything digital. They are primarily used to sell digital art. An NFT is essentially some data stored on a digital ledger (the blockchain) which says that a digital asset is unique and non-interchangeable (i.e. non-fungible).

So what's the downside? You can download the same image of the tulip that someone else paid £20,000 for. Anyone who buys a Monet, Basquiat or Rembrandt painting can enjoy it as a rare physical object with some subjective beauty but with digital art, a copy is indistinguishable from an original. There is simply an entry in a ledger somewhere that says who owns the image of the tulip.

Charles Mackay's classic – Extraordinary Popular Delusions and the Madness of Crowds, perfectly describes the situation in Holland during the Tulip bubble.

"Many individuals suddenly became rich. A golden bait hung temptingly out before the people, and, one after the other, they rushed to the tulip marts, like flies around a honey-pot. Everyone imagined that the passion for tulips would last for ever, and that the wealthy from every part of the world would send to Holland, and pay whatever prices were asked for them. The riches of Europe would be concentrated on the shores of the Zuyder Zee, and poverty banished from the favoured clime of Holland. Nobles, citizens, farmers, mechanics, seamen, footmen, maidservants, even chimney sweeps and old clotheswomen, dabbled in tulips."

Similar beliefs as the one above are strongly held by many people with regards to NFTs and the wider cryptocurrency market. And so far, prices have been going in only one direction – up. The contemporary NFT buyers are the modern equivalent of the tulip speculators, and at least some of that surplus wealth has been fuelled by QE.

When will the NFT bubble collapse? This is impossible to answer. Markets can remain solvent longer than one can remain rational. And central banks all over the world have created exceptionally solvent markets. However, one thing that history consistently teaches us is that buying anything just because the price has gone up is not an investment strategy.

As the legendary investor Sir John Templeton once said: “The four most dangerous words in investing are: ‘this time it’s different.’”

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