

On Bitcoin

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Most of the articles written on Bitcoin tend to be at the extremes. They are either written by sceptics who believe bitcoin is worth \$0 (or possibly less than \$0 because of its net negative environmental impact) or by the true believers who are confident its price will only continue to rise as more people convert to the faith.

Bitcoin is more of a commodity than a currency. Even though it is called a cryptocurrency, its extreme volatility makes it almost impossible to transact with for day-to-day needs. In many ways, bitcoin might be considered more like gold than any currency. A form of digital gold.

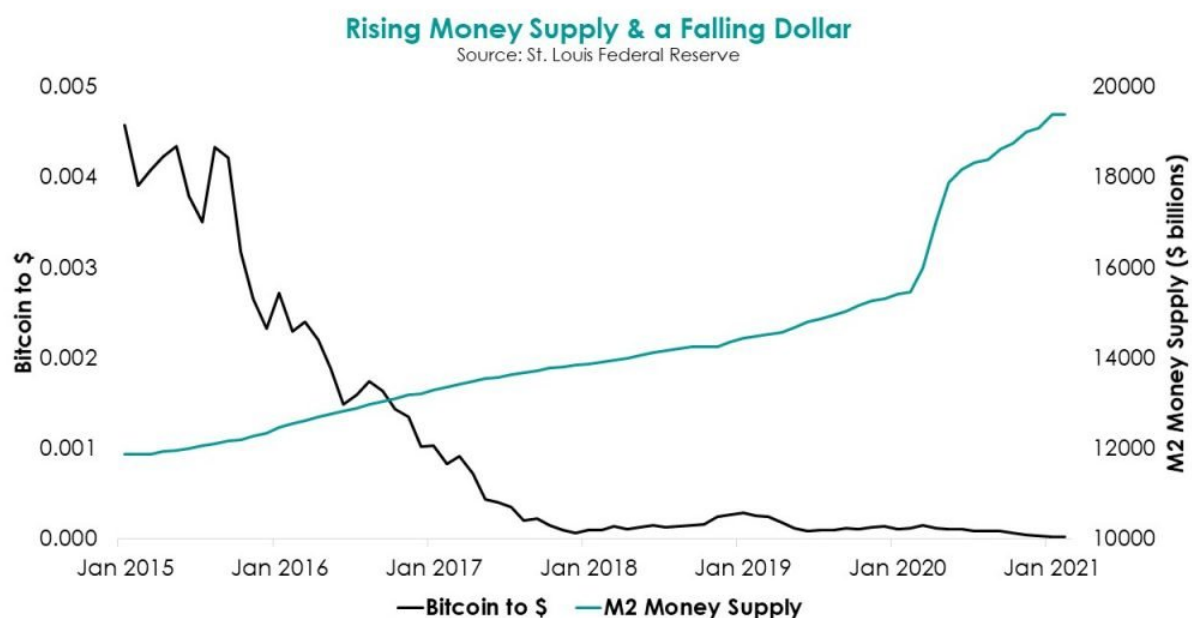
Sceptics say bitcoin has no intrinsic value and they are indeed correct. However, what is the intrinsic value of gold? The shiny metal currently sells for about \$1700 an ounce. Is that cheap or expensive? One could justify a price that is half or double what gold currently trades for based on one's biases. Gold bugs believe gold is grossly undervalued while gold sceptics will ignore it all together and invest in more productive assets.

Gold produces no dividends or cashflow, so it not possible to measure its relative value on the criteria used to estimate the cheapness or dearness of investment assets which confer an entitlement to a stream of interest or dividends. Its industrial uses are limited as well – only about 7-10% of all gold reserves by weight are used industrially. And most of its industrial applications have come after the industrial revolution. For thousands of years prior to the industrial revolution, gold has been used for jewellery, for the adornment of palaces and religious artefacts, and a store of value, including as the medium of coinage and as reserves underpinning the value of fiat currencies. People stored it in vaults and speculated on its value – limited tangible utility, just like bitcoin.

What we see is that gold continues to have a value for many in the 21st century despite its limited utility and absence of a yield. But behind this lie millennia of conventions which have conferred value on gold for other qualities. Gold is not a ubiquitous metal; it is scarce, and supply is controlled by those who own the mines which it comes from. There are perhaps parallels here with bitcoin. What bitcoin lacks is the provenance of gold as a convention across human history. For some, the physical nature of gold will be more compelling than the dematerialised, digital existence of bitcoin, which hangs on the integrity of the blockchain and encryption keys. What if they turn out to be the greatest Ponzi scheme of the modern age?

Gold's usefulness as a hedge ironically arises from its relative uselessness. Its limited industrial use means that gold prices are not tied to the growth of the global economy. Gold is a counter-cyclical asset precisely because it is not industrially significant, unlike other metals such as copper and aluminium. Similarly, bitcoin's intrinsic disconnection with any discernible economic condition is a necessary, but not sufficient, requirement for a good hedge. There is a large element of faith propping up the price of bitcoin and this faith has not been tested through thousands of years, unlike gold.

It is possible to have a nuanced view on bitcoin without veering into the extremes. Perhaps the most interesting fact about the rise of bitcoin is to reframe it as a decline in faith of traditional fiat currency. Most bitcoin charts show the price of dollar against bitcoin (i.e. how many dollars it takes to purchase a bitcoin). However, inverting the chart to show how much bitcoin it takes to purchase a dollar shows a 99% fall in the dollar.



Whether a sceptic or believer, perhaps the one thing to take from the rise of bitcoin (which may well be temporary) is the decline in faith of traditional currencies as the supply of money (M2) has rapidly increased over the last few years.

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