Bitcoin: Don’t let the “greater fool” be you

Mickey Kim
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“Greed,” “Envy” and “Pride” are three of the “Seven Deadly Sins” inflating not only the current bubble in Bitcoin, but all of the bubbles that came before and will follow. As historian Charles Kindleberger wrote, “There is nothing so disturbing to one’s wellbeing and judgement as to see a friend get rich.”

Bitcoin started 2017 at $968.23 and recently hit $19,000, up about 1800%. Speculators believe it’s going higher and they’ll sell before the inevitable fall (i.e. the “Greater Fool Theory”).

Bitcoin was launched in 2009 by its creator, the pseudonymous Satoshi Nakamoto. It was designed as a digital currency providing a secure way to make online payments between parties anonymously and without the need for governments to issue currency or banks to process transactions (making it popular among libertarians and the end-of-times crowd).

There are currently about 16.7 million Bitcoin outstanding. Additional Bitcoin are created by “miners” who solve math problems that become increasingly complex. A key contributing factor to the bubble is the ***supply of Bitcoin is limited by design to an illiquid 21 million.***

Bitcoin is underpinned by “blockchain” technology, which is a secure, decentralized electronic ledger or list of entries that is maintained by various participants in a network of computers. Proponents say blockchain is a revolutionary concept that will eventually be adopted across financial and other systems, like healthcare.

Blockchain may be a brilliant innovation, but that says nothing about Bitcoin’s prospects as a widely-adopted currency or its fundamental value.

Currency has three roles, all of which Bitcoin fails. First, it must be a ***medium of exchange***. No buyer/seller is going to use/accept Bitcoin if it can rise/fall 20% within hours of a transaction. Second, a currency must be a ***store of value***, a useful place to keep savings. Third, it must be a ***unit of account*** for business accounts, debts and prices. Again, Bitcoin’s extreme volatility makes it a poor store of value/unit of account.

Bitcoin’s current value of $271 billion (greater than 488 of the S&P 500 stocks) is unjustified, but just like the dot-com bubble of the late 1990’s didn’t diminish the revolutionary impact of the internet, neither does the bubble in Bitcoin invalidate the potential of blockchain.

Bitcoin’s meteoric rise has also been fueled by the whiff of legitimacy from the decision of Cboe Global Markets and CME Group to offer futures contracts on Bitcoin. This will enable ***speculators*** to place bets (long-positive/short-negative) on Bitcoin by putting down ***less than 10 cents on the dollar***, which could lead to a contagion and catastrophe for Cboe/CME and its clearing member firms if a Bitcoin collapse leads to mass defaults.

Predictably, floodgates have opened with promoters singing the siren’s song of getting in on the ground floor of the “next Bitcoin” with an initial coin offering (“ICO”). This year 270 ICOs have raised $3.2 billion from investors, ten times the amount raised in 2014-2016. Most ICOs are not registered with the SEC and fewer than 10% back companies with an active product or service.

The SEC issued an Investor Bulletin on the inherent danger of ICOs in July https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-bulletin-initial-coin-offerings, but with financial luminaries such as boxer Floyd “Money” Mayweather, Jr. (Centra, Stox and Hubiits) and socialite Paris Hilton (Lydian) touting ICOs to their social media followers, what could possibly go wrong?
