



Advisory services offered through Luxon Asset Management

Bitcoin, Block-chain, and Cryptocurrencies

I. Bitcoin and Block-chain explained

Bitcoin is a digital currency based upon a technology known as Block-chain. They are related, but distinct concepts. To understand bitcoin, we have to first talk about Block-chain technology. Block-chain, at its simplest, is a publically distributed ledger system. Unlike the banking system, which relies on a central authority (such as the Federal Reserve or a bank) to verify transactions, block-chain technology is decentralized and relies on a giant public accounting ledger to record, verify, and maintain ownership of something. While Bitcoin is the most high profile example of this, the technology could eventually also be used for traditional banking, credit card, and securities transactions.

Once mature, this technology could rapidly speed up routine financial transactions. The IBM Institute for Business Value and The Economist Intelligence Unit estimate that 65% of banks will have adopted block-chain technology by 2020, independent of Bitcoinⁱ.

Bitcoin, in turn, is a digital currency based upon Block-chain technology, and otherwise known as a cryptocurrency. It is by far the market leader with \$190 Billion in Market Cap as of 12/4/2017 – however over 1300 other cryptocurrencies exist.ⁱⁱ

II. Risks

We see three main risks to Bitcoin and other cryptocurrencies:

- 1) **Regulation** is probably the biggest danger to Bitcoin. Former SEC commissioner Joseph Grundfest, now at Stanford, puts it bluntly: “the most obvious way for regulators to go after initial coin offerings would be to label them as securities and punish them for not registering with the authorities.”ⁱⁱⁱ If bitcoin loses the ability to trade with other major world currencies, such as the US Dollar, British Pound, Euro, or Chinese Renminbi, it could quickly become irrelevant. Cryptocurrency’s propensity for illegal activity, such as money laundering and drug transactions, make is especially vulnerable to strict regulation.^{iv}
- 2) **Banks eventual replacement of Bitcoin.** If banks are able to implement Block-chain technology effectively, they could end up replacing Bitcoin’s market purpose, especially if Bitcoin begins to be regulated by mainstream financial bodies.
- 3) **Classic market bubble.** Even without the development of the above items, Bitcoin is subject to the classic boom / bust characteristics of a speculative bubble.

III. Possibilities

- 1) **Bitcoin** will begin trading on traditional futures markets this month^Y. This could legitimize its use and market leading position.
- 2) **Market regulators and institutions** embrace and approve Bitcoin, making it a legitimate worldwide means of interchange.

IV. Should I invest in Bitcoin?

It's our view that Bitcoin is firmly in the world of speculation – not investment. That doesn't mean we think Bitcoin will go up, down, or sideways – we actually have no idea what direction it will go.* It does mean we consider Bitcoin highly unpredictable and therefore unsuitable as an “investment”.

This information is provided for educational purposes only and should not be construed as an offer to buy or sell any security.

**Past performance is not indicative of future success.*

ⁱ “Coming in 2017: “Live” Blockchain Deployments Promise to Accelerate Payment Processing Services and Trade Finance”, American Express Content, <https://www.americanexpress.com/us/content/foreign-exchange/articles/blockchain-to-accelerate-payment-processing-services/>

ⁱⁱ <https://coinmarketcap.com/all/views/all/>

ⁱⁱⁱ NYTimes: Initial Coin Offerings Horrify a Former S.E.C. Regulator, Business Day, https://www.nytimes.com/2017/11/26/business/initial-coin-offering-critic.html?rref=collection%2Ftimestopic%2FBitcoin&action=click&contentCollection=timestopics®ion=stream&module=stream_unit&version=latest&contentPlacement=3&pgtype=collection

^{iv} UK government mulls Bitcoin regulation, BBC News, <http://www.bbc.com/news/technology-42223577>

^v CBOE and CME battle for bitcoin futures bragging rights, Financial Times, <https://www.ft.com/content/e535b17c-d8ea-11e7-a039-c64b1c09b482>