



## ***The Bitcoin Craze***

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By Dan Timotic, CFA  
Managing Principal &  
Portfolio Manager

Over the past year or so, everyone has heard about Bitcoin and its amazing run to levels nobody could have imagined. Naturally, people are interested in this phenomenon and have been asking questions about it. In full disclosure, I do not own any of it nor do I plan on owning any of it in the near future. I am by no means an expert in cryptocurrency, but I am an expert in investment management. As a fundamental analyst, I rely on the analysis of corporate balance sheets, macroeconomics, cash flow statements, fiscal & monetary policy, valuations, etc., in order to make investment decisions. Cryptocurrencies have none of that. So, why am I writing an article on the subject? Because over time, there have been many fads that have driven investors to greed and resulted in great disappointments. I'm not saying that cryptocurrency is a fad, but it is important to put things in perspective and understand what you are doing with your money. And more importantly, what the risks could be.

I'm sure by now you've heard about cryptocurrencies taking over the world. After all, the media has consistently run coverage on the subject. It is nearly impossible to go a single day without some mention of Bitcoin and the other "currencies." Some pundits talk about these "currencies" replacing real global currencies, as if all of the major economies and governments would simply sit idly by as their home currency is threatened. While the blockchain technology has merit, the fact that investors are speculating on Bitcoin and others is concerning. I don't know whether Bitcoin is worth \$1 or \$1,000,000, but neither do many of the other experts. Why? Because there is no fundamental way to value a speculative, unregulated investment that is being driven by an idea.

Some of you may be old enough to remember the dot com bubble of the late 90s early 2000s. Back then, everyone was convinced that fundamentals no longer mattered, and valuations were justified because of the growth projections of untested tech companies. We saw valuations explode to levels that would make even the most optimistic people scratch their heads. Analysts continued to make recommendations without regard to the silly valuations these companies were demanding. Any company that had an online presence was expected to do well. One of the most famous failures of the time was Pets.com. After raising about \$82 million from its IPO in early 2000, it shut its doors in November of 2000. That's right. Less than a year after its IPO the company folded, proving once again that valuations and cash flow matter. Here is a chart of the Nasdaq Composite during the tech bubble:



Back to Bitcoin. While the blockchain technology is proving to be impressive for a variety of reasons, I am concerned that people are confusing the technology with the currency. For a currency to be viable, there are certain requirements. The currency must be backed by something. Some will argue that the U.S. dollar isn't backed by anything, but the fact that there is the full faith and credit of the United States supporting the currency is something. The currency must also be readily acceptable and stable. If you're a retailer selling goods, you cannot afford to accept currency that is illiquid and volatile. While Bitcoin has run up to extraordinary levels, the price fluctuation has been staggering. At the end of 2017, Bitcoin ran up to almost \$14,000. It continued its rise for the first few days of the year, rising to just over \$17,000 by January 6<sup>th</sup> and falling back down to under \$8,300 by the close on February 8<sup>th</sup>.

If you are a local retailer accepting Bitcoin, imagine what would happen to your margins if you sold a product for \$17,000 and didn't convert the Bitcoin quickly enough. Your entire profit margin would have been wiped out.

So, what's been driving this crazy market? In my opinion, it's the continued promotion by the media over something that seems to attract viewers and increase their ratings. Speculation and greed also play a big role. Some pundits claim that it's different this time and this technology will take over the world. I remember people saying the same thing about Japan and the entire tech bubble. Apparently, valuations and fundamentals only matter after a crash. I'm not saying this too will end in the same way the tech bubble did, I'm just saying that people need to be aware of the dangers in listening to people that may have an ulterior motive in promoting this currency.



The reason I decided to write this article is not to cast doubt on blockchain technology or the potential validity of cryptocurrency. I wrote this article because the average investor needs to understand that history is littered with investment opportunities that were supposed to exceed all laws of mathematics. If someone wants to play around with cryptocurrency, it's their money and they have a right to do what they want. I'm just trying to explain the risks and hopefully educate investors enough, so they don't find themselves in a very bad place. Many times, investors get caught up in the most recent hype and ignore anything that conflicts with their idea. Whenever someone invests money, they put that money at risk, and they should be very careful to understand why they are investing. Investors cannot control their return, but they can control their risk.

I will conclude with this. There was a tea company called Long Island Iced Tea Corp. based in Hicksville, NY whose business was selling non-alcoholic drinks. The company had a net loss of nearly \$4 million in the third quarter and lost over \$11 million for the nine months ending September 30, 2017. On December 21, 2017, it announced they were changing their name to Long Blockchain and the shares skyrocketed over 250% immediately. What changed? The company still lost money, but investors poured in, so they wouldn't miss out on another crypto play. I'll let my readers determine whether a name change justifies this type of reaction, but as an investment manager, I will go out on a limb and say that it doesn't. If you're interested in reading about another great, speculative bubble that ended disastrously, I suggest you read the story of the Tulip market in the 17<sup>th</sup> century.

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