ROCKEFELLER
ASSET MANAGEMENT

MONTHLY Market Review

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Rise of the Alt Currencies

Bitcoin going parabolic;
Priced off pie-in-the-sky promises

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As the calendar turns to the final month of 2017, investors have a lot to be thankful for. The global equity market has notched 14 consecutive months of gains, while long bond yields remained anchored in spite of above-trend growth in major parts of the world economy. Growing optimism over the passage of the tax reform bill drove up the S&P 500 Index by nearly 3% in November, though it remains to be seen if the ball can cross the goal line. Investors also cheered the nomination of Fed Governor Jerome Powell as the next Chairman. The former investment banker is viewed as market friendly and represents policy continuity. Solid U.S. economic data pushed Treasury yields higher, with the two-year yield hitting 9-year highs. However, the U.S. dollar gave up some of the recent gains. The British pound and the euro rallied with progress being made on the Brexit negotiation. In the commodity complex, crude oil prices surged on OPEC's and Russia's agreement to extend production cuts to the end of 2018, but base metals were mixed on China's further tightening. The month also featured some unusual transactions. Veolia, a BBB-rated French utility, issued 5-year bond at a *negative* yield of 0.026%. Leonardo da Vinci's "Salvator Mundi" was sold for a record $450 million. This painting was auctioned off for a mere £45 in 1958 (about $700 today) when it was believed to be the work of one of his students. It was later sold for just $10,000 in 2005. For those who missed out on the Renaissance master's work, the consolation prize could have been Bitcoin, which rocketed up from $6,377 at the end of October 2017 to over $11,000 on November 28th before settling at $9,653 by month end.

Equity Markets Indices[1]	10/31/2017 Price	11/30/2017 Price	MTD Change	YTD Change
MSCI All Country World	497	505	1.8%	19.8%
S&P 500	2575	2648	2.8%	18.3%
MSCI EAFE	2003	2020	0.9%	20.0%
Russell 2000®[2]	1503	1544	2.8%	13.8%
NASDAQ	6728	6874	2.2%	27.7%
TOPIX	1766	1792	1.5%	18.0%
KOSPI	2523	2476	-1.9%	22.2%
Emerging Markets	1119	1121	0.2%	30.0%
Fixed Income				
2-Year US Treasury Note	1.60%	1.78%	18	59
10-Year US Treasury Note	2.38%	2.41%	3	-3
BarCap US Agg Corp Sprd	0.95%	0.97%	2	-26
BarCap US Corp HY Sprd	3.38%	3.44%	6	-65
Currencies				
Australian (AUD/$)	1.31	1.32	-1.2%	5.1%
Brazil Real (Real/$)	3.27	3.27	0.1%	-0.4%
British Pound ($/GBP)	1.33	1.35	1.8%	9.6%
Euro ($/Euro)	1.16	1.19	2.2%	13.2%
Japanese Yen (Yen/$)	114	113	1.0%	3.9%
Korean Won (KRW/$)	1120	1088	3.0%	10.8%
US Dollar Index (DXY)	94.55	93.05	1.6%	9.8%
Commodities				
Gold	1271	1275	0.3%	10.6%
Oil	54.4	57.4	5.6%	6.9%
Natural Gas, Henry Hub	2.77	2.94	6.2%	-20.1%
Copper (cents/lb)	310	304	-2.1%	21.2%
CRB Index	188	189	0.9%	-1.7%
Baltic Dry Index	1522	1578	3.7%	64.2%

SOURCE: BLOOMBERG

'Tis the Season to be Thankful

The Thanksgiving tradition supposedly harks back to the 1621 harvest celebration among the colonists and the Native Americans at the Plymouth Plantation. However, it did not become a national holiday until 1863, when President Lincoln proclaimed the *final* Thursday in November as a day of "Thanksgiving and Praise to our beneficent Father who dwelleth in the Heavens." In August 1939, President Roosevelt abruptly declared that the Thanksgiving holiday that year would be switched to November 23. Just like this year, the last Thursday in November 1939 fell on the 30th. FDR was worried that a late start to the Christmas shopping season would adversely affect the economy, which was already in the throes of the Great Depression.

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FDR's move triggered much outcry from the Republicans; some derided the earlier holiday as *Franksgiving*. The political divide led 23 states to follow FDR's proclamation while 22 states still celebrated Thanksgiving on November 30th, 1939; three states actually gave holidays on both dates (Alaska and Hawaii did not gain statehood until 1959). In the following two years, FDR again brought forward the date of Thanksgiving. This issue was finally resolved in late 1941, when a joint resolution of Congress designated the fourth Thursday in November as Thanksgiving Day.

Personally, I gained a deeper appreciation for Thanksgiving since my daughter left for college; it's a holiday that she has no excuse not to come home for. This year, I was especially looking forward to the holiday since my daughter turned 21 ten days earlier. I had to inform her that she was now legally in control of what used to be an UTMA (Uniform Transfer to Minors Act) account. It was time for a father-and-daughter talk on dollars and cents as well as responsible stewardship of money.

To my surprise, as I was about to broach the subject of money after dinner, my daughter casually asked if she should put some of her own savings into digital money. "You mean bitcoin?" I replied with bewilderment to her first ever investment question. She said that many of her friends have been trading bitcoin, and some have made enough money to pay for overseas vacations. These kids, like my daughter, are liberal arts majors who dabble in the creative fields like music or film, and have never shown interest in finance or economics. Yet bitcoin was all the rage because its price just kept on going up. One was able to easily start trading bitcoin with just a few hundred dollars by downloading a bitcoin trading app. Since Bitcoin is not yet regulated, there are no long forms to fill out for account opening, and the app can be linked to one's bank account or even a credit card for funding. When I pontificated about bitcoin's lack of intrinsic value and the risk that traders would rush for the exit at some point, my daughter somehow concluded: "We gotta rush in before the craze is over."

A Work of Genius

When the pseudonymous Satoshi Nakamoto released the Bitcoin software as open source code in January 2009, two forces were set in motion – the introduction of the blockchain technology, and the rise of cyptographically secure alternative currencies that transcend national boundaries. Bitcoin is the first application built on the blockchain technology, which runs as a distributed public ledger that stores transactions on numerous networked computers so that records cannot be altered. Many believe that applications built on the blockchain technology have the potential to transform business models across industries. However, in spite of the hope and hype, the actual adoption of blockchain in traditional businesses has been rather limited to date.

The use of alternative or private currency is nothing new. During the Free Banking Era (1837-1863) in the U.S., there were roughly 8,000 types of money issued by banks, railroad companies, churches, etc. The federal government eventually exerted greater control and became the sole issuer of currency as the modern economy is fueled by credit growth, which is a function of money supply. No government would willingly give up the monopoly on the provision of currency.

The design of Bitcoin is a work of genius – the system is free of government control, anonymous, and new bitcoins are electronically "mined" at a decreasing rate, with the ultimate supply capped at 21 million bitcoins. To libertarians and anarchists suspicious of the Big Brother, Bitcoin offers the hope of a new world order free of governmental interference. To those engaged in the underground economy, Bitcoin's anonymity makes it ideally suited for illicit transactions and money laundering across the globe. Bitcoin's capped quantity appeals to monetarists who have been worried about fiat currencies' debasement through money printing.

In spite of these well-designed features, there is no way to gauge what a bitcoin is really worth. There is literally nothing tangible – no real assets, neither government nor private entities – backing up Bitcoin. The enigmatic Satoshi Nakamoto, now a billionaire with his estimated hoard of one million bitcoins, has disappeared from the scene since late 2010. A group of Bitcoin developers have been squabbling over its future as some inherent design weaknesses have surfaced. For example, the recording of every transaction on numerous distributed computers makes Bitcoin too slow to function as a practical payment system – Visa processes roughly 1,700 transactions per second; a Bitcoin transaction takes about 10 minutes to complete. This has led to a split in the Bitcoin community and the creation of a variant currency called Bitcoin Cash, which is designed for better performance at the expense of security. There was also a string of heists from Bitcoin exchanges – from Mt. Gox's loss of 850,000 bitcoins in 2014 (roughly $9 billion in today's value) to the recent $31 million theft from Tether Treasury.

Bitcoin proponents argue that the value of the digital currency lies in its network effect – its value is derived from more and more people believing it has value and pouring money in to drive up the price. They also point to the scarcity value – Bitcoins are capped at 21 million units. For example, if one believes the transaction and investment demand warrants a Bitcoin monetary base of $2 trillion in ten years, the target price for each of the 21 million bitcoins would be around $95,000. A 20% discount rate would peg the current value at about $15,000. Some argue that the Bitcoin market should be as big as the $7.8 trillion gold market, as bitcoins have essentially evolved into digital gold.

Such pie-in-the-sky valuations belie the fact that there are competing cryptocurrencies – I last counted 916 of them – being offered through the unregulated crowdfunding channel called Initial Coin Offerings (ICOs). Over the first nine months of 2017, more than $2.3 billion coin sales have been raised. While most of these cryptocurrencies will likely fall by the wayside, some may emerge as better alternatives to Bitcoin. Furthermore, the fact that Bitcoin Cash was easily spawned out of Bitcoin should give pause to those who believe in the capped supply argument.

Who Will Get the Last Laugh?

Bitcoin has so far managed to survive the slings and arrows from the so-called establishment. China banned bitcoin exchanges a few months ago. JPMorgan Chase CEO Jamie Dimon called bitcoin a fraud and Vanguard founder Jack Bogle said one should avoid it like the plague. Yet the price of Bitcoin could go as high as people's imagination would take them to as more newcomers jump on the bandwagon. The Chicago Board Options Exchange and the Chicago Mercantile Exchange now plan to launch bitcoin futures trading in a few weeks. Some view it as legitimization of Bitcoin for institutional investors. On the other hand, the ability to finally short the bitcoin futures could eventually pop the bubble. Waiting in the wings are the SEC, IRS, and other establishment institutions that will no longer be able to ignore the bitcoin phenomenon.

In the final analysis, an investment in bitcoin comes down to whether one is willing to suspend one's disbelief. Bloomberg News reported that even some doomsday preppers have stocked up on bitcoins for the post-apocalyptic world. Perhaps they should be reminded that virtual currencies will cease to exist in the absence of electricity and network providers. Just look at how cash became indispensable in Puerto Rico after Hurricane Maria destroyed the island's power infrastructure. Call me old-fashioned or incorrigible, but I'd rather have a few silver bullets and gold coins in the post-apocalyptic world. In my humble opinion, Bitcoin is a bubble. But for now, my daughter's instinct to rush in before the craze is over appears to have been correct. Timing is everything. ●

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