

Convexity Maven

A Commentary by Harley Bassman

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“Tulips for the Masses”



**“Let me issue and control a nation's money and I care not who writes the laws.”
Mayer Amschel Rothschild - 1790**

As I am no longer accruing a W-2 statement, it is unclear if I should declare myself unemployed or retired. But until I make that decision, I enjoy keeping myself sharp; so I accepted a meeting with a gentleman focused upon the nexus of alternative investing and venture capital. When I noted that Google, Amazon, and Facebook were not only similar to Gilded Age monopolies (and mark my words, they shall meet the same fate as Standard Oil), but also more dangerous to personal privacy than the NSA, he called me a “dinosaur”.

I presume this was the flippant Generation-X version of the Millennial’s retort of “you just don’t get it”; but truth be told, I took it as a compliment. After all, the

dinosaurs ruled the planet for over 150 million years and may well have developed opposable thumbs if not for an errant meteor resetting the clock. This would be in contrast to the human experience of a mere few hundred thousand turns of the sun.

Thus, I will state for the record that aside from Trump slowly ripping the fabric of acceptable social behavior, what is most bothersome to me is the frequent calls I receive from otherwise respectable people suggesting that bitCoin (or other "crypto-currencies") are a fine haven for my assets.

Recall the core of my Mantra [<http://www.convexitymaven.com/themavenmantra.html>], "It is never different this time"; and so it is.

Either Bitcoin (capital "B") is an investment in the BlockChain technology – *a decentralize public ledger that can act as a peer-to-peer electronic cash system*, or, bitCoin (capital "C") is a *store of value that can act as an alternate currency*.

If it's the former, count me in; except for the small detail that buying bitCoin is not an equity investment in Bitcoin - I do not have partial ownership of a patented or trademarked process where I am entitled to a share of its future dividends or retained earnings. Thus, it must be the latter – participation in an anonymous unregulated savings and transactions account that is independent of the current (political) fiat monetary system that undergirds the Global Economy.

Let's take a step back and consider why there might be such an interest in bitCoin as an independent alternate currency; keeping in mind that nearly every great fiction is wrapped around a grain of truth.

Saving the debate as to whether it was a mistake to let Lehman collapse (I think Paulson was right, but the contra-thought is well founded), the FED was the last line of defense available to calm the global whirlwind of a combined bank run and liquidity trap.

Thus, the creation of Plan A: *Increase monetary velocity via financial repression (ZIRP and Asset Substitution) to create inflation, depreciate nominal debt, and de-lever both the public and private economies of the United States.*

$$M * V = P * Q = GDP$$

The FED pumped over \$4 Trillion (M) into the system, yet velocity (V) declined in an off-setting manner. The underlying fundamental of Plan A was to increase monetary velocity as the happy by-product of accelerated asset velocity.

Through what I would call *Force Majeure* finance, the FED pressured investors out of safe assets (Treasuries and MBS) and into riskier ones. Such a pity that instead of increasing monetary velocity, their actions briskly elevated the nominal price of stocks, real estate, and a certain da Vinci painting.

[Note: When historians examine the key factors supporting Donald Trump's victory, they will likely focus upon Hillary Clinton and James Comey, but the ghost will be the various FED policies that exacerbated income disparity.]

Such a clever idea was Plan A that it was mimicked by other Central Banks so that perhaps in excess of \$20 Trillion of fiat currency (~\$14 Trillion in the G-4) has been materialized since the Great Financial Crisis.

I will not apologize for being a UChicago trained monetarist; and indeed, I do also believe in efficient markets (although it may just take longer than your patience allows). As such, it is a certainty that fiat currency cannot be manufactured at a rate faster than the growth of the overall economy without inflation. If it were the case that sometime in the past a kingdom had freely distributed the currency of the realm to its citizens at such a pace without ruinous inflation, I am sure it would have been recorded in the history books.

It is an appreciation for the ultimate denouement of Central Bank currency debasement, as well as a general fear of Government (NSA, currency controls, general capriciousness), that has fed the stampede to bitCoin (and other crypto-currencies).

bitCoin is trying mightily to check all the boxes of what defines "money":

- 1) Its supply is controlled or limited,
- 2) It is fungible/uniform – this is why diamonds cannot qualify,
- 3) It is portable – this is why land cannot qualify,
- 4) It is divisible – thus art cannot be money,
- 5) It is liquid – this means people will readily accept it in exchange.

To save a few keystrokes, I will stipulate that bitCoin may soon check all of the above. I will also allow that its one-year realized volatility of 81% will decline by enough to qualify it as a "store of value". [For comparison, the actual USD volatility versus: EUR = 7.5%, JPY = 8.6%, GBP = 9.0% and BRL = 14.2%]

What mitigates bitCoin's advancement beyond being a nifty on-line global gambling token, is that by definition, **true success in becoming an accepted global currency would literally be an Act of War** no less lethal to a nation than a nuclear strike by North Korea.

The transformative moment for humankind was when we started to work together; first as a family, then a village, community, city, state, and finally as a nation. At each step along the way, currencies were created to allow the exchange and store of value. If this did not exist, synergy and growth would not be possible. As a contemporaneous example, fishermen might only seek minnows since the time and investment to capture a whale would not be economic via direct transaction barter.

As much as language, ethnicity, and religion have historically bound a nation, I would suggest that a common currency was also important. And as nations become more heterogeneous, it may well be the case that currency is the definer of nations. Hence the creators of the European Union chose to use money as opposed to politics as the binding agent for a unified continent.

Such is the power of a currency that we often refer to the Chairperson of the Federal Reserve as the second most powerful person in the country; which may seem strange to other nations where control of the currency is held at the top.

Restrictive capital controls exist in China as Xi Jinping uses the cudgel of corruption to become the most powerful mandarin since Mao; and last year Narendra Modi of India canceled most of the cash in the country to gain greater control of the economy. Last month, Crown Prince Mohammad bin Salman of Saudi Arabia invited many of its billionaires to the Ritz Hotel for an indefinite stay (check-out requires a check), and certainly Russia has little interest in permitting asset transfers by oligarchs not friendly to Vladimir Putin.

Before you wave your hand at the unenlightened, consider that our politics have become the most nativist since Smoot-Hawley passed. Our President has dropped out of Paris and TPP, and perhaps soon NAFTA. Many in congress would like to rein in the independence of the Federal Reserve. And rest assured that those wearing MAGA hats have no interest in a currency not fronted by a dead American hero and reversed by a federal building.

So, it is extremely unlikely that U.S. Government would sanction as legal tender the use of an anonymous alternate currency it cannot control or tax. And while bitCoin abusers in the U.S. may be taken to court for tax evasion, I will leave it to your imagination how other nations might react to such maneuvers.

I am especially vexed by the various investment vehicles being offered, many of them with Hedge Fund cost schemes. There are no tools to divine value since there are no underlying economic fundamentals to analyze: No Purchasing Power Parity, no trade balances, and no inflation. Perhaps these funds will be structured like CTAs that rely upon momentum and charts; but if that's the case, let's just be clear that crypto-currencies then exist purely for speculation.

Then there is ICO (Initial Coin Offering) investing, which rhymes with the IPOs (Initial Public Offering) two decades past. The small problem here is that if I am wrong on every preceding aspect, then eventually there will only be a SINGLE crypto-currency, since that is most efficient. Hence, the NYSE eventually clobbered the AMEX, Philly and P-coast exchanges. It is also why there tends to be only one "reserve currency" at a time for global trade. If such is the case, the only reason to buy an ICO is for the "flip" after issuance, a game that is likely to be as non-transparent for ICOs now as it was for late 1990's IPOs.

As much as I would love to offer you a multi-colored chart of the [price of bitCoin](#) overlaid versus [NKY in 1989](#) and [NASD in 2000](#), I will not since it would divert you from the salient point: The problem with crypto-currencies is NOT that they are in a bubble, it is that they are fundamentally untenable in a world of nation-states, and that said nations are presently shifting to a more authoritarian preference.

I will admit I am open to the notion that I am completely wrong-headed and I simply do not have the imagination to appreciate a changing landscape; as such I will never short bitCoin. Moreover, I will not consider suggesting a "top" in bitCoin (or the SPX) until the (net) Central Bank spigot is closed, which respected research indicates will not occur across the G-4 until early 2019.

With the VIX at 10, traders are twitching and risk managers are napping; so I have no problem with you flipping a few crypto-currencies in the same size as you might play cards in Las Vegas.

As long as the music is playing, I am sure that someone will want to dance.

Your comments are always welcome at: harley@bassman.net

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