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Moon or ฿omb?

Has the bull began his run?

By Boaz Shoshan

Imagine…

12 May 2020:

Following the success of the Houthi drone attack on Saudi Arabian oil facilities, a sophisticated global terror group repeats the attacks, but at huge scale.

Deploying a fleet of weaponised drones around the globe, the group simultaneously attacks oil production facilities in the US, Russia, and the Arabian Peninsula.

Though casualties are kept to a relative minimum and some of the drilling facilities manage to defend against the drone attacks, the effect to the commodities market is huge: half the world's oil supply is taken down in a matter of hours.

The price of oil doubles overnight.

Source: pikrepo.com

Imagine…

12 May 2020:

In a cunning move to please the conspiracy theorists in his base in the run-up to the US presidential election, Donald Trump signs an executive order for a full and public audit of the US's gold reserves.

Without giving his administration time to react, camera crews from news networks large and small are granted access with a heavily armed guard to Fort Knox, the Philadelphia Mint, the Denver Mint, the San Francisco Assay Office, the New York Federal Reserve and the Bullion Depository at West Point.

But while the mainstream journos are impressed with the bars on display, shrewd observers swiftly realise that while there is plenty of gold on display in the vaults… *there's half as much as there should be.*

And it's not just the US government's gold that is missing. The New York Fed, entrusted with thousands of tonnes of gold from foreign governments and international organisations, is similarly missing more than half what it claimed it held.

The story sweeps the world. Gold bug conspiracists rejoice. Trump promises justice will be done against the deep state insiders responsible. And the gold price doubles.

Ok, so I may be getting a little imaginative with my metaphors here, but I think you get the gist. It's a basic dynamic that anyone can understand: if the supply of something gets cut in half, while demand remains the same, the price of it doubles.

Now I'm afraid I have no advance knowledge of a global oil attack, or a sudden gold shortage as described above, occurring on 12 May this year.

But I do know of another commodity that *will* have its supply cut in half that day…

And while it's relatively easy to imagine how oil and gold would spike on a supply shock, this commodity is considerably misunderstood…

The halvening is happening

Bitcoin.

So many feelings accompany that word, and vary vastly depending on who you ask (and often how old they are).

Optimism, devotion, confusion, scepticism, outright hatred – they're all in there.

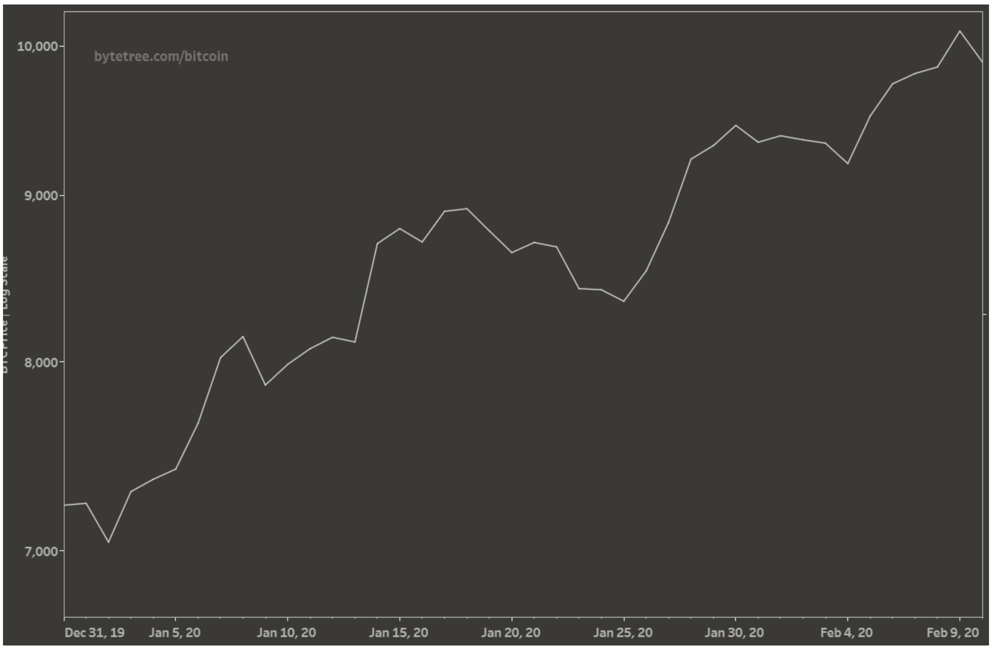
It's a bit like the mix of emotions stirred by gold – but more so.

But love it or loathe it, the supply of BTC will be cut in half ("weather permitting") on 12 May – and this will have an impact on the price, one way or another.

You don't need to be a crypto-nut to read this issue. I'm not here to convert you. That's this guy's job.

You should read this either as a speculator (you don't need to like what you're speculating on), or simply as a spectator. The built-in halving dynamic is entirely unique to the crypto asset class, and what we will see occur in May is an historic event.

In our 2020 Predictions Pack, I predicted that this year could be as big as 2017 was for cryptocurrencies, but you had to watch the bitcoin price for confirmation of it.



Bitcoin price (USD) year to date. Source: ByteTree

So far, so good.

In this issue, we'll delve a little deeper into the bitcoin market, and the potential for a cryptomania to rival, or even exceed that of 2017.

Bitcoin was among our "Stealth Wealth" portfolio of assets in one of our first reports when writing for this monthly publication, for its benefits as a scarce asset without counterparty risk, and which can be held, and even traded, without any electronics involved. But we're looking at it from a different angle today.

First, a brief overview: this is how I perceive bitcoin. It's not a rival to gold, it's a beautiful modern twist on a practice that is thousands upon thousands of years old…

…continued overleaf…

The magical ledger

The term "bitcoin" is somewhat deceptive, as the term encompasses not just the asset itself, but the entire system by which it is created, stored, spent and recorded.

It'd be like if the terms "pound sterling", "GBP", or the symbol "£" meant not just pound coins, notes, and sterling bank deposits… but also the Royal Mint, the Bank of England, HM Treasury, every private bank that accepts it, and all the payment systems that are entwined on top (Paypal, Stripe, etc).

It'd be like if the word "copper" not only referred to the metal, but also to the system by which it is mined, refined, transported and hedged against by those that rely on stable pricing of it.

So I'll zoom out a little and tell you how I see bitcoin.

"Bitcoin", in its entirety, is just a book, a ledger.

It's like one of those dusty great tomes you see used by a bookkeeper in films, TV series and video games, to manage a company or family's finances. Think "Victorian accountant".

But this ledger, having been put online and with some cryptography added in, has taken on near magical properties.

This ledger is available to anyone with an internet connection. It's even possible for people without one to use it, provided they transact with somebody who does.

It's not only open to anyone to pore over and examine either – *anyone* with a connection can open an account within it (known as an "address"), in seconds. (You can open one here in a jiffy – you just need to move your mouse as randomly across the screen as you can.)

The number of pages in this ledger is in theory limitless – there's no real limit to the number of transactions it can remember.

And the number of accounts that can be created may as well be limitless – the ledger has the capacity for 2 to the power of 160 of them (a truly unimaginably large number).

But there is a limit on one thing: the number of units that can be allocated within it: there's only room for 21 million of them to be allocated within it. There will never be more than ₿21,000,000 held by all the accounts within the ledger.

However, as small as one 100 millionth of ₿1 can be paid from one account to another. This spending effect is as simple as reducing the amount from one account and adding it to another – all within the pages of the book.

Most importantly: *this ledger never displays incorrect information.* It cannot be fudged, fooled, corrupted or cheated. The figures within cannot be scrubbed out, written over, or deceptively smudged.

For it's not a Scrooge-like character who solely writes in the ledger. Anybody who wishes to move money from their account to another submits it to the bookkeepers, who aggressively compete *against* one another to prove beyond all doubt which transactions are valid before the others do. Anyone with a computer can aid the bookkeepers' efforts, but if you want to make a living out of it, you need to be serious – it requires serious energy to maintain an immutable ledger.

But immutable it remains. The ledger has been around for 11 years, and though totally digital with no master, the ledger has never been compromised. And there's a hell of an incentive to do so – currently $185 billion, not including all the money that could be made shorting the rest of the crypto world once you've broken bitcoin.

This is one of the biggest, most open jackpots on the planet for any budding hacker – crack the ledger, and you can do whatever you like with the accounts therein. Considering how vague the law is on bitcoin, you might not even need to hide your identity.

But if you've got even close to the computing power to attempt such a feat and can afford the vast amount of energy required to try and break it… why not become a bookkeeper, and reap the rewards that are to be had in securing the ledger – freshly written units within it?

A ledger that anyone with internet can access, and transfer value through (and other data for that matter), that is distributed all around the world and updated in real time, with no master and unbreakable…

The sci-fi author Arthur C. Clarke famously declared that any sufficiently advanced technology is indistinguishable from magic. Bitcoin, to my eyes, gets very close to this.

… but what about the halvening?!

Alright, so now we're past the nature of bitcoin, let's get to what's going to happen in May.

Here's how the 50% reduction in supply will take place – no drones or presidential decree required.

The job of a bitcoin miner, the aforementioned "bookkeeper", is to bundle up outstanding bitcoin transactions, verify that they are real and not fraudulent (specifically, that no BTC has been spent twice), and then add them in a batch as a "block" to the ledger – known as the blockchain. For this, they are rewarded with fees, paid by those making the transactions – but also, more importantly, with uncirculated BTC.

For every block of transactions a miner successfully adds to the blockchain (beating all the other miners to it), that miner receives "new" BTC. But the quantity of uncirculated BTC they receive is halved every 210,000 blocks of transactions.

To begin with, they received 50 BTC for every block they mined. But a decade and 615,000 blocks later, the bounty awaiting cunning miners has been halved to 25 BTC, and then 12.5 BTC.

And on 12 May, that's set to be cut again to 6.25 BTC. It should be noted that 12 May is an estimate of how long it'll take for the next 14,000 odd blocks to be mined, using the average block mining time since BTC has been created.

Should a miner suddenly increase their efficiency (quantum computing for example is constantly referred to as a future nuclear advantage that a miner will inevitably develop), the halving, or the "halvening", could come a lot sooner. But all being well, it'll be 12 May we see the grand cleaving in supply.

This constant reduction of BTC supply every 210,000 blocks (which until now has taken roughly four years) is why it's estimated it'll take 120 years to mine the total 21 million BTC allowed by the protocol – *while 98% of all BTC will have been mined by 2030.*

The cover of this month's issue was created by Christina Hess for a company in Austin, Texas, called cryptoart.com. It's called "Moon or Bomb", and sums up the conflicting arguments made by crypto investors on what halvenings really mean for BTC – will the price rocket to the moon, or bomb?

(If you're hardcore, you can order a print of it with a special in-built feature that allows you to store your bitcoin within the actual image.)

This "sudden scarcity" dynamic is a very bullish concept if you believe in bitcoin's inherent value as the ledger I described above. But let's take a look at the last halvening to see how it affected the BTC price.

The last halvening, back in 2016, appeared to be a "buy the rumour, sell the news" event to begin with, with the market rising in expectation by almost 50%, but then selling off slightly after it had occurred.

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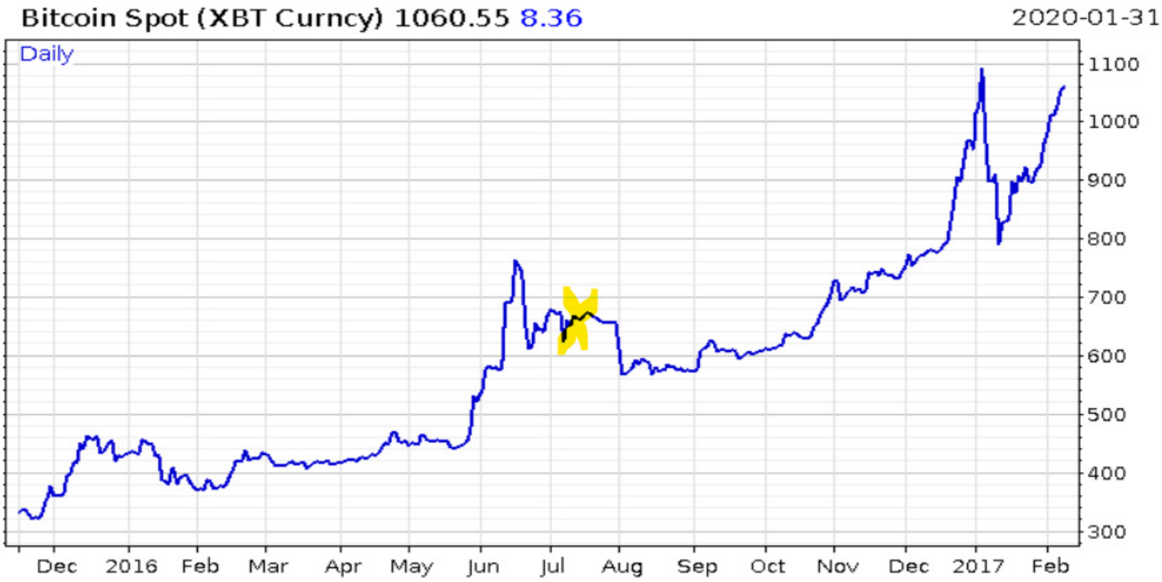
But as you can see on the right-hand side of the chart however, by the end of the year BTC had more than doubled:



The last halvening indicated in yellow. Perhaps the Brexit referendum triggered some buying in June? Note the chart mostly covers the year 2016, hence why the numbers at the right are so low.

Source: FullerTreacyMoney.

So what will happen this time around in May?

Some folks believe that as the reward for mining BTC is going to decrease, that this will actually disincentivise mining and the security of the network will decrease, and cite the rise after the halvening in 2016 as the result of increased awareness of the asset. I strongly disagree.

I think this built-in supply shock dynamic is deeply underappreciated by investors, as it is a mechanism they are completely unused to. This halvening and future halvenings will gain ever more hype and fanfare as the sheer scarcity of this asset becomes more clear in time.

But there's one thing that's required to keep the BTC market running at the pace it has so far in 2020.

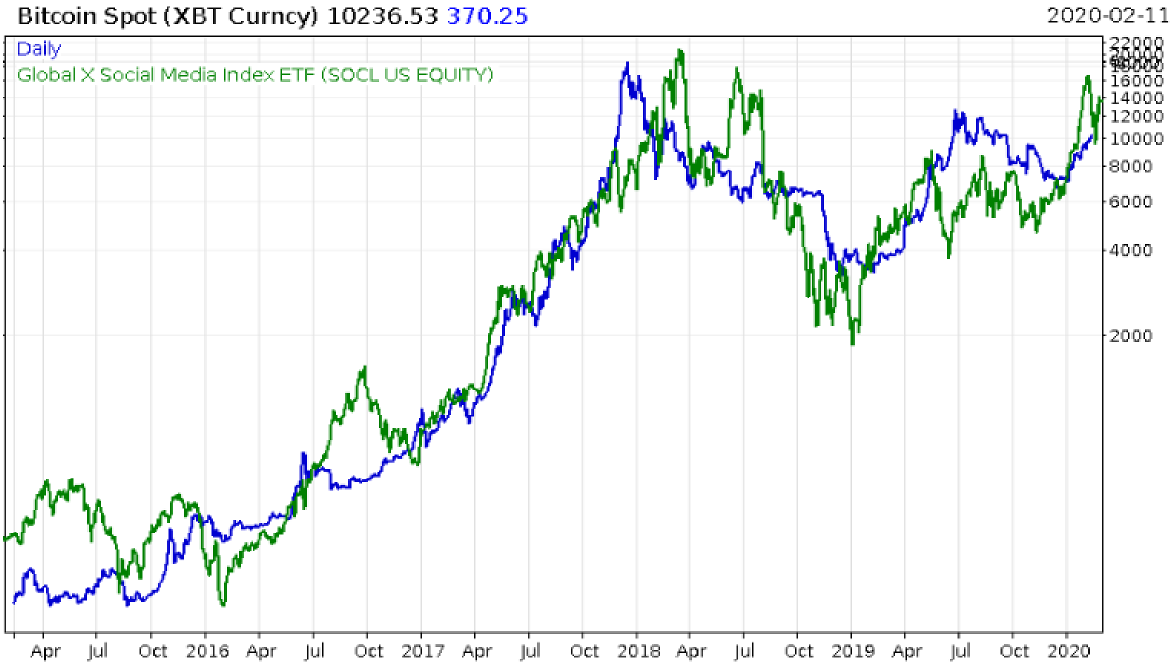
Some folks believe BTC is an uncorrelated asset – that it behaves differently and out of step with stocks, bonds, commodities, etc. This is often used to try and get the institutional money on board with the idea.

I'm not convinced this is true. Maybe bitcoin will become an uncorrelated asset with a fiat price that runs on its own steam – but I don't believe it is *yet*.

While I'm a fan of the ideals ascribed to bitcoin, I'm a realist when it comes to what affects its fiat price.

While it was clear to me that bitcoin's last great run was highly correlated to the broader stockmarket (which I alluded to in December), there are some stocks it really trades tightly in line with. Over the last five years, bitcoin has shared an incredible affinity with tech stocks.

Charlie Morris over at *The Fleet Street Letter Wealth Builder* can be credited with this next chart. Here is bitcoin charted against an ETF full of Silicon Valley's finest. I've kept bitcoin performance on a log scale to rein in its exceptional performance:



Bitcoin price on a log scale (blue), charted against a social media ETF (green – no log)

It makes sense that bitcoin shares so much in common with the likes of Snapchat and Facebook – they are all, ultimately, network technologies. They're also all beneficiaries of central banks shovelling liquidity into the market, and victims of that liquidity being drained (like in 2018).

It's for this reason that I put a crypto bull run alongside my prediction for a stockmarket melt-up in that December predictions pack. Bitcoin is not yet mature enough to function and perform as an asset when the stockmarket is not in a good mood, or even better, drunk and heady at the bar.

While it would be nice to think that bitcoin would perform strongly on negative global economic performance, so far this has only really been the case when there's a calamitous event like socialism occurring in your own country, and your currency is taking the flak for it – cue Venezuela, which saw $305 million in local bitcoin transactions last year.

So the rally in stocks will need to be maintained to keep the tailwind behind bitcoin. But once again, we come to the halvening question. Remember, this time around there are an awful lot more people who know what bitcoin is than in 2016.

And for all the people who lost money after the BTC top in December 2018, the speculative desire for quick riches in the crypto market is still there.

According to one stunning YouGov poll in 2019, from a sample of 1,262 adults, it concluded that 81% of Americans were familiar with at least one type of cryptocurrency, and that one in five had purchased cryptocurrency in the last year.

Provided the coronavirus doesn't flip the stockmarket and usher in a recession, I believe the potential for cryptomania to return in force is strong.

If the spectre of the coronavirus departs, I reckon this will be a year bullish enough to rival its 2017 run.

It's here that we turn to some of the interesting narratives that have developed within the bitcoin community in anticipation of the halvening.

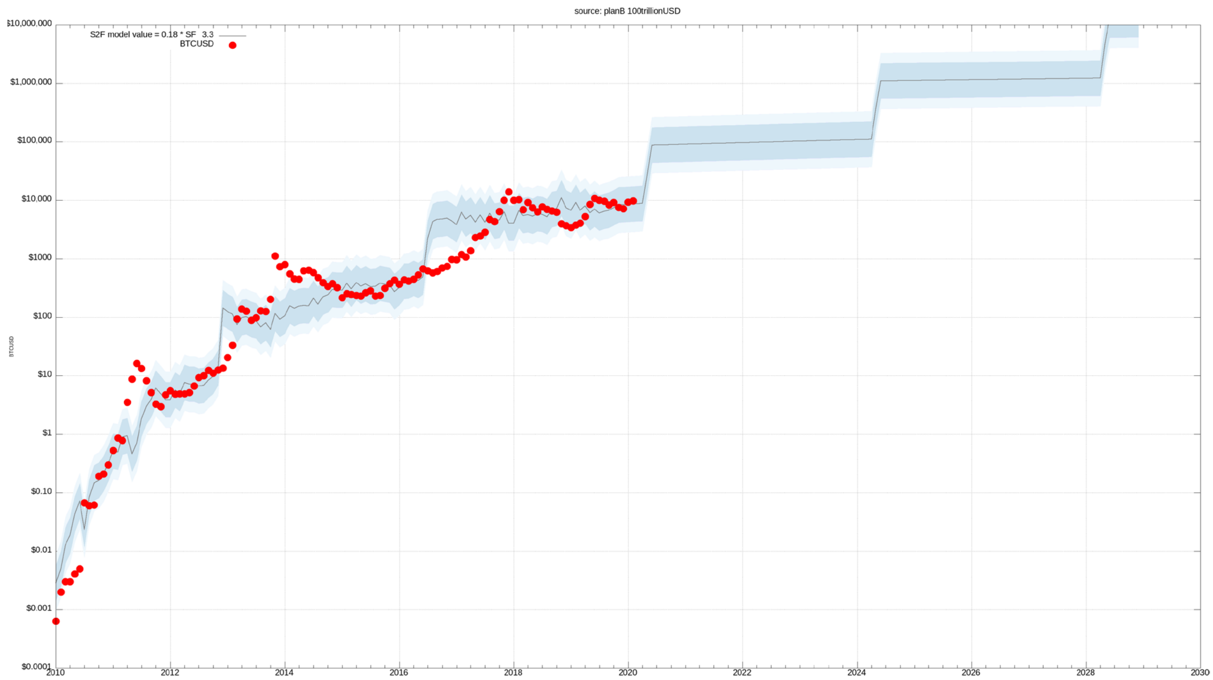
Of particular note is an anonymous Dutch asset manager who goes by the handle "Plan ₿", and wrote a viral blog post called Modeling Bitcoin's Value with Scarcity.

Key to his Mr. ₿'s thesis is the stock-to-flow ratio, or S2F. This is a measurement of the outstanding stock of something, relative to the new supply mined every year. This dynamic, he argues, is what

...continued overleaf...

has made gold so valuable over time as it has such a high S2F ratio that yearly output figures don't affect its overall price much and so its value remains fairly stable. But, according to Mr. Ƀ, bitcoin has an S2F ratio even higher than gold, and what's more, it moves violently higher whenever there's a halvening, as the flow is cut in two.

As a result, he's made the incredibly bullish prediction that after this halvening, the BTC price will average $100,000 until 2024. When the next halvening takes place that year, he argues the BTC price should average $1,000,000 until 2028, until the next halvening, and so on.



Red dots indicate bitcoin price so far (logarithmic scale), while blue channel indicates stock-to-flow valuation model.

Click to enlarge. Source: Plan Ƀ, on Twitter

As you can imagine, this theory has been music to the ears of many a 'coiner, and has been very widely shared and believed. It's got to the point where I think bitcoin whales may conspire to rig the price to make it appear more credible, so they can dump their bags of BTC on believers once the price has reached an adequate level for them.

I highly recommend you read his thesis for yourself. Take a look here – it's not long.

Our own Charlie Morris, who's been measuring and modelling bitcoin for years, doesn't buy it. He published a lengthy rebuttal to Mr. Ƀ, in which he rebukes the idea that halvenings create such massively higher values in such little time – you can read his full piece on it here.

You can probably guess which piece was more popular from the relentlessly bullish 'coiner community…

Ultimately, nobody knows what's going to happen in May – but it'll be fascinating to watch. I'm bullish on bitcoin for the simple supply-and-demand dynamics created by the halvening – and the easy-to-grasp bullish narrative that could take hold of market sentiment.

Provided the stockmarket isn't affected by the coronavirus, and central banks keep injecting liquidity, I think we'll see a mania like 2017 all over again. What I can be sure of is that there'll be vast quantities of volatility wherever the price goes, delivered to the market in a way only crypto can provide: buyer beware.

With that in mind, in the last cryptomania the alt coins soared to absurd valuations, making many speculators ludicrously wealthy in very little time. It's my colleague Sam Volkering over at *Crypto Profits Extreme* who's the expert on this topic, but here are a few altcoins, or "alts" I'm personally keeping an eye on.

You should know that I am not interested in these coins for their fundamentals like I am for bitcoin (to use a crypto saying, I am a "bitcoin maximalist"). I'm interested in these because they have a strong narrative behind them, or with the last one here I think it *could* have a strong narrative behind it. And crypto prices are all about narrative: they're like the stockmarket unicorns which despite burning billions of investors cash, are still bid up because they have a charismatic CEO or a "cool" product. Imagine that, but on steroids.

During a crypto boom like in 2017, prices for individual cryptos behaved like viral videos, tweets, or blog posts. But instead of accruing millions of views, they accrued millions of dollars in market cap.

This is something I experienced not just by my ownership of bitcoin, but through my ownership of a crypto called Verge ($XVG), which I loaded up on at half a cent before it was suddenly valued above 24 cents when the mania was in full force just a month or so later. It was utterly absurd. But that doesn't mean the crypto market can't get that frothy again.

BUT PLEASE NOTE: I've said it before, and I'll say it again – if you want to invest in any crypto project, you should treat your holdings in the same way you do lottery tickets. The money you should be investing you should not only be prepared to lose, but to do so with a smile on your face. Crypto is the wildest market in the world, and it's utterly brutal if you get on the wrong side of it.

To end this issue, I'd like to give you a glimpse of what the BTC community is like, and how they view what's about to happen. It's a video called "The run of the golden bull" – you can watch it here.

It's full of tongue-in-cheek references about the crypto community ("NEETs" being a reference to folks Not in Education Employment or Training who just stay at home and trade crypto, for example), but it's a good reflection of just how invested some people still are in the project despite the endless declarations that bitcoin has died by mainstream commentators.

When the video was doing the rounds recently, many bitcoin enthusiasts asked each other, "Where were you when the bull began his run?"

We'll see in May just how far he's gone.

You can watch the countdown to the halvening here: bitcoinblockhalf.com.

Important Risk Warnings:

Front page image: Christina Hess at CryptoArt
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General - Your capital is at risk when you invest, never risk more than you can afford to lose. Past performance and forecasts are not reliable indicators of future results. Bid/offer spreads, commissions, fees and other charges can reduce returns from investments. There is no guarantee dividends will be paid.
Overseas shares - Some recommendations may be denominated in a currency other than sterling. The return from these may increase or decrease as a result of currency fluctuations. Any dividends will be taxed at source in the country of issue.
Funds – Fund performance relies on the performance of the underlying investments, and there is counterparty default risk which could result in a loss not represented by the underlying investment.
Exchange Traded Funds (ETFs) with derivative exposure (leveraged or inverted ETFs) are highly speculative and are not suitable for risk-averse investors.
Bonds – Investing in bonds carries interest rate risk. A bondholder has committed to receiving a fixed rate of return for a fixed period. If the market interest rate rises from the date of the bond's purchase, the bond's price will fall. There is also the risk that the bond issuer could default on their obligations to pay interest as scheduled, or to repay capital at the maturity of the bond.
Taxation – Profits from investments, and any profits from converting cryptocurrency back into fiat currency is subject to capital gains tax. Tax treatment depends on individual circumstances and may be subject to change.
The Financial Conduct Authority does not regulate certain activities, including the buying and selling of commodities such as gold, and investments in cryptocurrencies. This means that you will not have the protection of the Financial Ombudsman Service or the Financial Services Compensation Scheme.
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