Market Note

What Happened to Bitcoin?

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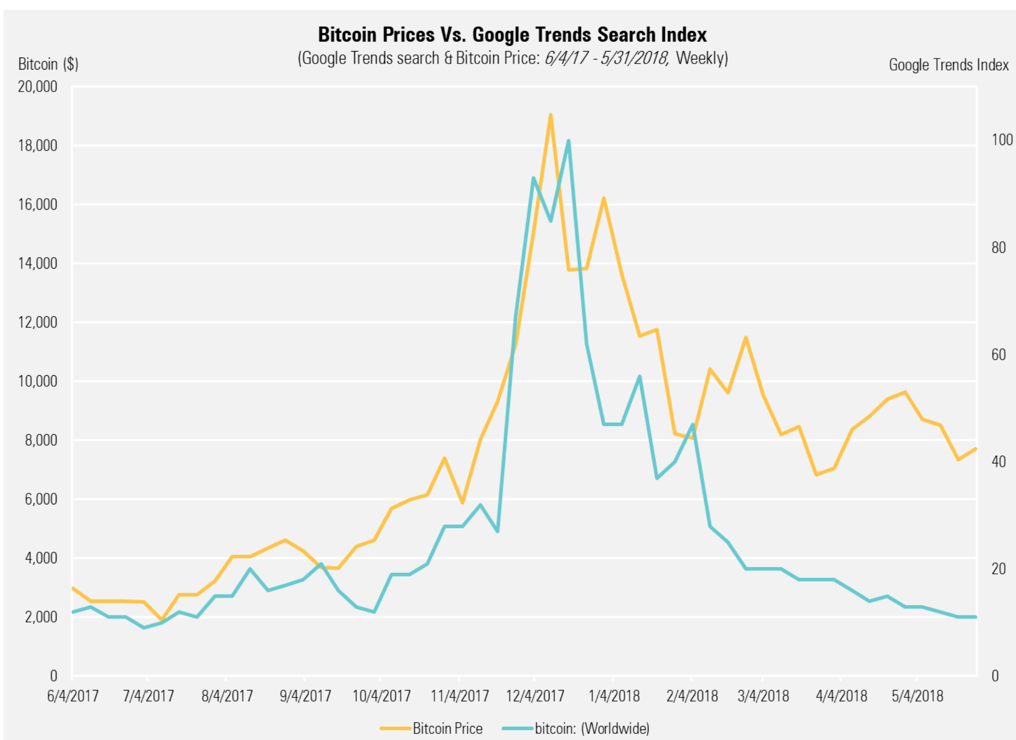
Summary

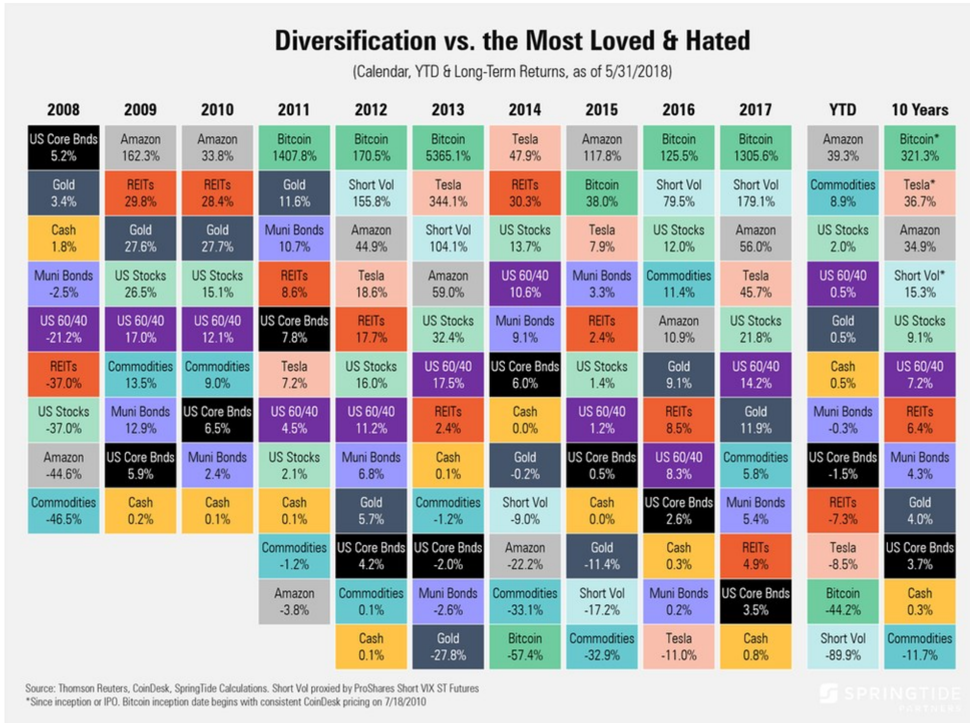
- Bitcoin and other digital assets remain polarizing among investors, garnering many diverse viewpoints of what the technology can or cannot become.
- Although average bitcoin returns remain strong, median investor returns from the point of widespread retail adoption have not.
- The digital assets or cryptocurrency/token space is a lot bigger than just bitcoin, but bitcoin remains the flag-bearer and still commands a dominant share.
- We continue to watch and perform due diligence on multiple funds and individual investments in the cryptocurrency and broader digital assets space.

What Happened to Bitcoin?

Talk to 10 different investors and you will get 10 different opinions of what bitcoin is and what it is worth. To some, it is a revolutionary censor-resistant store of value akin to digital gold. To others, it is nothing more than a clever, modern-day Ponzi-scheme. For better or worse, the "market" (there is undoubtedly a lot of price manipulation so we use that term lightly) has decided that one bitcoin is worth about $6,400. That's 56% less than at the start of the year and 67% less than its all-time high of over $19,500 in mid-December. Paradoxically, the cheaper bitcoin has become, the less people have been interested in buying it. Buy high, sell low thinking is rampant. Having never experienced a true long-lasting bear market or even sideways volatility, most bitcoin investors can be forgiven for thinking momentum is the only way to invest.

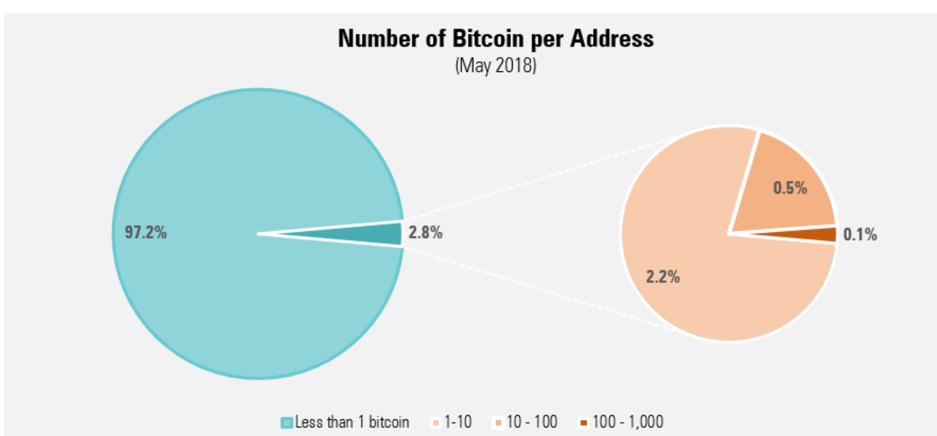


The chart below shows the recent volatility in the context of the last decade and other asset classes. There is still plenty of fuel here for bitcoin bulls, especially early adopters. Bitcoin has seen significant declines before and bounced back stronger than ever. To be fair, for early investors bitcoin has also still outperformed any other asset we know of. (We started bitcoin's performance three years after it was technically launched given limited awareness and use prior to that.)

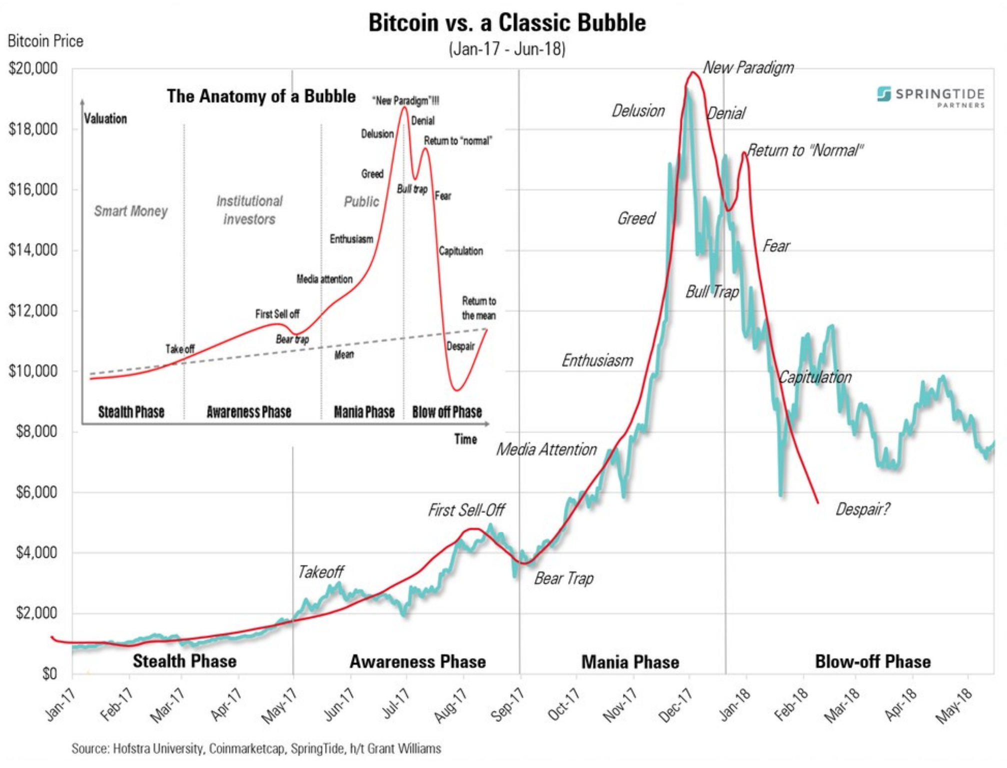


Although average bitcoin returns remain strong, median investor returns from the point of widespread retail adoption are not. By our calculations, the median investor bought in at over $9,000 (based on our estimates of the volume-weighted price using Coinbase wallets).

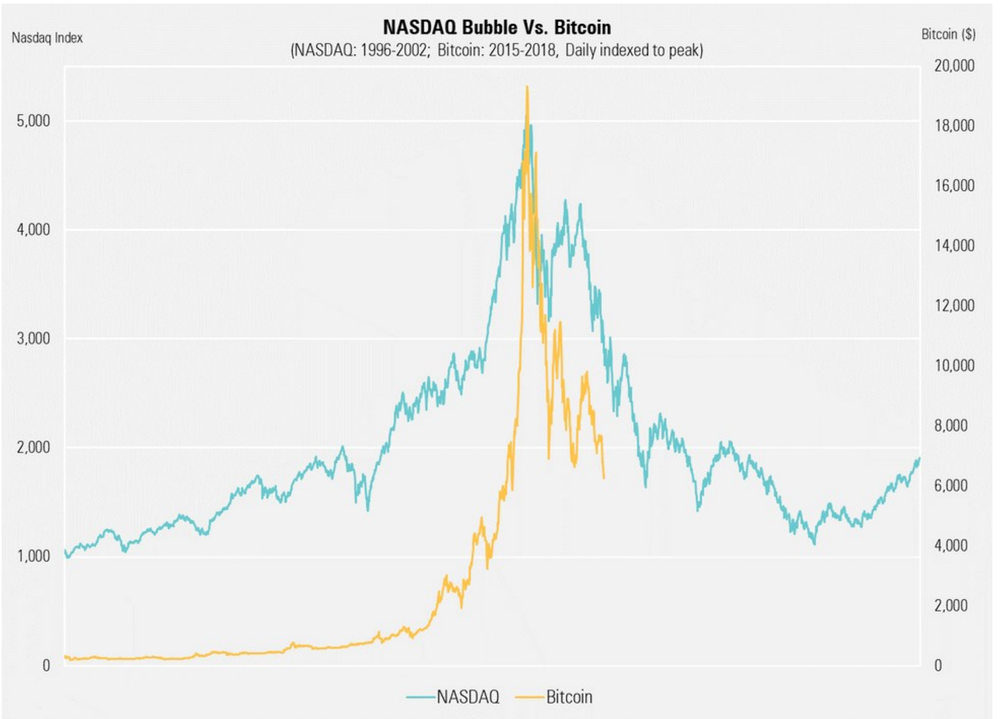
The average experience of bitcoin investors has therefore likely been negative with a small minority who got in early having made a substantial amount of money at the expense of late entrants, not unlike Ponzi scheme economics. The majority of bitcoin investors are probably underwater, but considering the fact that 97.2% of bitcoin wallets hold less than 1 bitcoin, hopefully it is not by much.



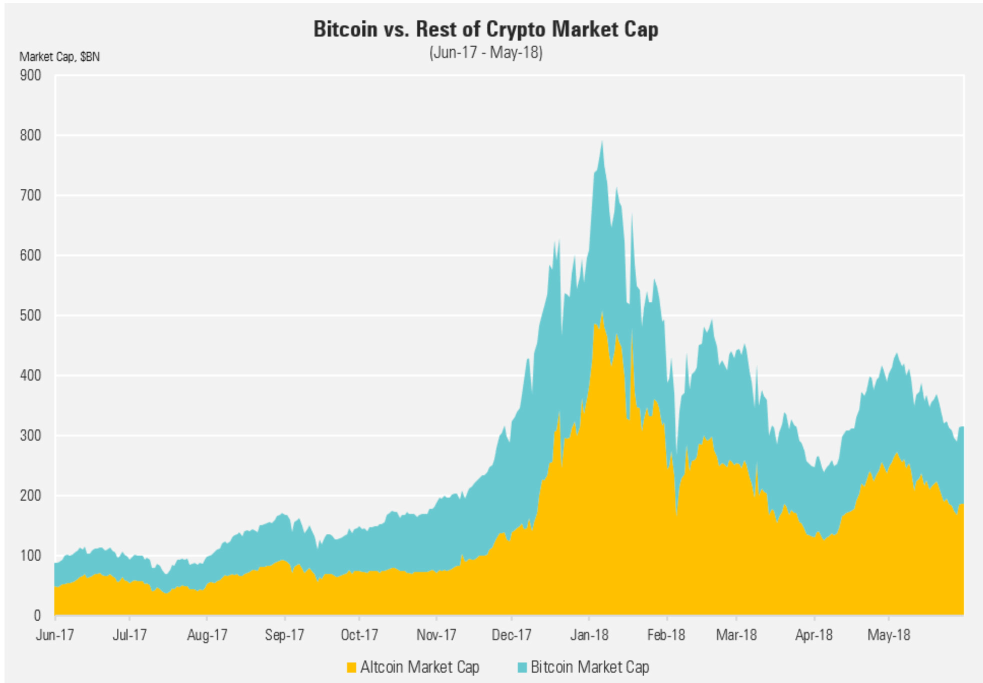
With the benefit of hindsight, between Thanksgiving and the end of the year, bitcoin exhibited all the signs – media attention, enthusiasm, greed and "new paradigm" type thinking – of a classic speculative bubble. Below is a comparison that had held incredibly well through February but has since decoupled. Maybe we need to see a further declines into the despair area before this chapter in bitcoin's history is complete… maybe not.



Bubble or not, bitcoin does have a certain symmetry with another classic bubble from history, albeit on a more exaggerated scale and condensed time-frame.



The digital assets or cryptocurrency/token space is a lot bigger than just bitcoin, but bitcoin remains the flag-bearer and still commands a dominant share. The Bitcoin Dominance Index measures bitcoin's share of the total cryptocurrency space, which has dropped over the last 5 years. Not only has bitcoin's dominance waned but the top 10 cryptocurrencies have dropped from 96% of the total market to around 65% today. The total space is worth about $300 billion, down over two-thirds from the start of the year.



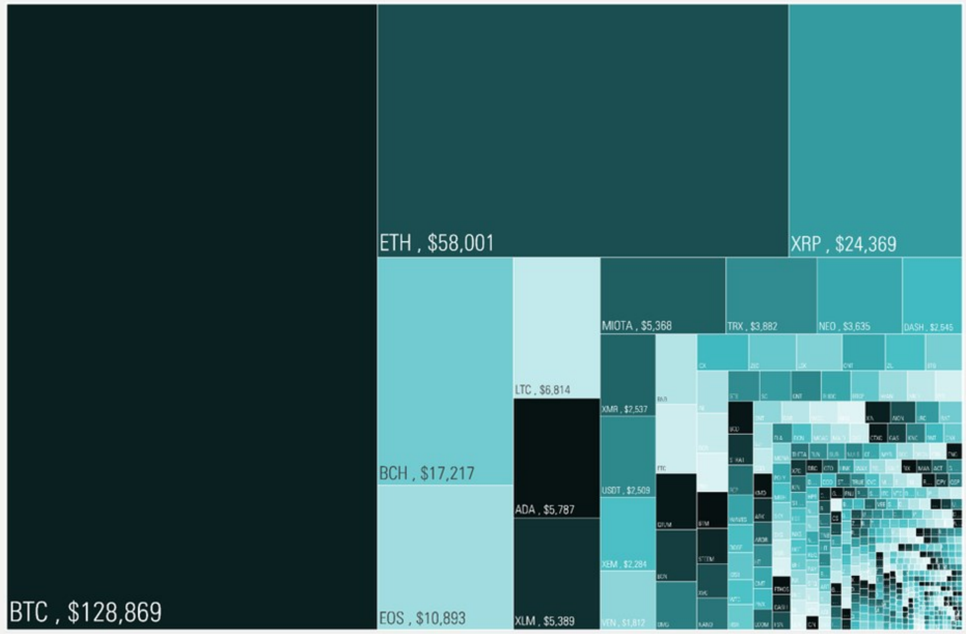
The overall crypto market is also highly fragmented and is getting more so by the day. The hype of last year attracted a lot of capital and with it a lot of new coin offerings, most of which were launched by profiteers and con-artists. There are so many blatant scams in the crypto space it would be impossible to list them all. Our favorite (although technically not a scam… in fact, perhaps the most honest person in all of crypto) is Useless Ethereum Token (UET). At launch it was made very clear that this token would have no value and the proceeds of the offering would be unapologetically used to buy the founder a T.V. He raised over $150,000 for his efforts. Good work if you can get it.

There is a lot of fraud, but we are still reluctant to write off the entire space. While we have been unable to find any direct tokenized use-cases with a clear path to profitability that we were comfortable investing client capital in, there are blockchain-based projects being built that have potential. There are also "blockchain-inspired" projects like Corda that show real promise and appear to be scaling. Ironically, most of the applications currently in use (that we are aware of) are effectively private ledgers run with oversight by a centralized "authority" (sometimes selected at random), which is sort-of the opposite of what bitcoin was originally envisioned to be.

The tree map below shows the break-down of the crypto market by capitalization. Less than half of the over 1,600 unique cryptocurrencies currently listed on coinmarketcap.com are visible on the map.

Bitcoin vs. Rest of Crypto Market Tree Map

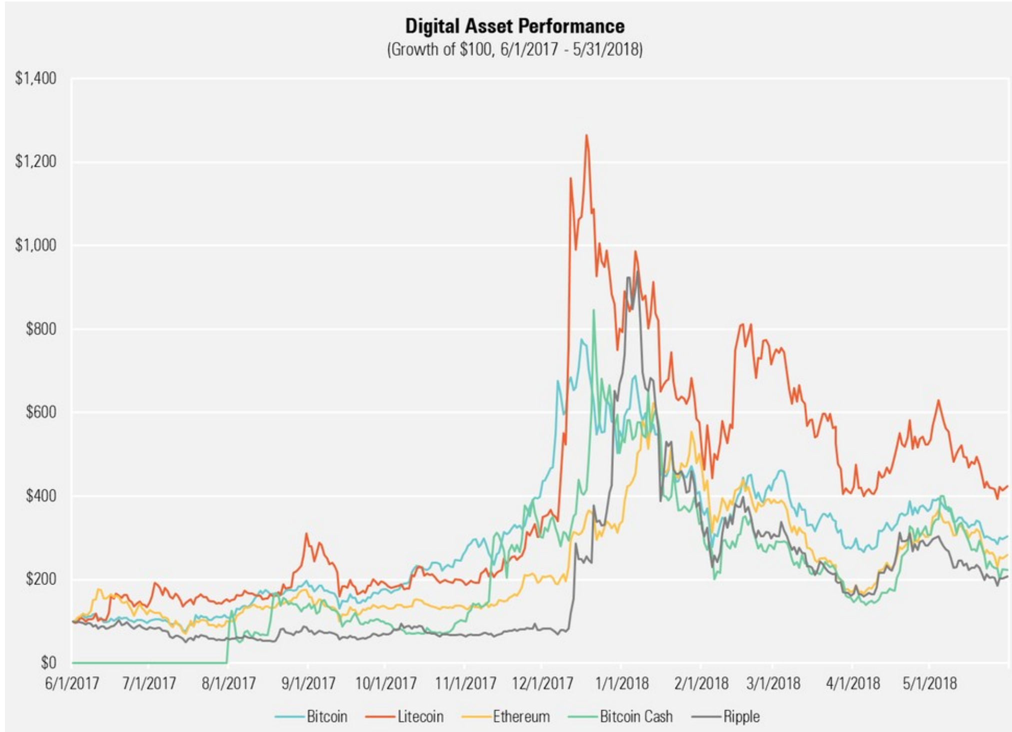
(May 2018, Not Float Adjusted)



Bitcoin and Ethereum remain the top two contenders. That is important because network effects in any blockchain-based digital asset suggest winner-take-all market dynamics will manifest over time. At least that is how it is supposed to work. During the highest transaction volume period last year, high traffic (partly related to people breeding and trading digital kittens… true story) overwhelmed the bitcoin and Ethereum networks and exchanges and both transaction costs and times soared.

At the peak, round-trip transactions in bitcoin took longer than 30 minutes and cost up to $60. Daily price volatility averaged more than 5%, more than twice the volatility in crude oil and eight times that of the S&P 500. That may not seem unreasonable to anyone who has been forced to deal Forex at a third-world airport or for a Venezuelan citizen facing a devaluation of their entire life-savings, but for a currency pitched by many as frictionless and efficient, it was embarrassing. As the inefficiency of the space became apparent, many mainstream retailers that had begun to accept bitcoin, reversed course and stopped (though many like Overstock and Expedia still do).

Looking at just the top 5 cryptocurrencies/tokens, we can see that bitcoin’s recent performance has been average and Litecoin has led the pack. Litecoin is an open source peer-to-peer payment system based on bitcoin, but pitched as the “silver” to bitcoin’s “gold”. It solves for the slower speeds of bitcoin transactions by substantially improving on bitcoin’s block generation time. Ripple is a competing currency exchange and remittance network to bitcoin that validates transactions through a common ledger managed by an independent network (as opposed to the decentralized, global and open proof-of-work protocol used by bitcoin). In our experience bitcoin diehards really dislike ripple (often called the “banker coin”) because of its backing by a few large financial institutions. Ethereum is a decentralized platform for applications (called “smart contracts”) that can run independently using the Ethereum network as a validating party effectively cutting out unnecessary middlemen.



We continue to watch and perform due diligence on multiple funds and individual investments in the cryptocurrency and broader digital assets space. To date, we have not been able to get comfortable with any direct investments but are considering several digital assets or digital asset infrastructure funds focused on scalable applications with definable markets and specific use-cases. We view allocations to the space as call options and will size them as such (lots of upside, but risk of total loss). Some of the froth we warned about in Crypto FOMO has been washed out, which we view as a promising development.

Sincerely,

The SpringTide Investment Team

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