Opinion Bitcoin Markets

Eric's Decembe Thoughts

The wheel is in motion and cannot be stopped.

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Market research 101

What we’ve witnessed during the last few months is just how amenable high-profile investors appear to be to the bitcoin pitch. An analogy I keep coming back to is that of a focus group—you take a small sample and expose them to a certain idea or concept, and you study their reactions. If the focus group members are representative of a larger demographic, the group's reactions can be expected to reflect the views of that larger demographic.

The results are now in; the pitch is working.

So far, our focus group is still but a nibbling, early majority. As time progresses, more and more allocators will be exposed to the bitcoin pitch. The more data we have, the more we learn about the pervasiveness of the argument and can begin to reason about what the outcome will be. Bit by bit, we're leaving the hypotheticals behind and are transitioning into a world where we can make judicious assessments of where bitcoin is going.

Sonata in ₿, Allegro

In my November thoughts, I talked about the psychological impact of the bitcoin price surpassing its last peak, a.k.a. the "*second nudge effect*".

Between Nov 25-Dec 15 we struggled to cleanly push past the psychological $20,000 threshold, and even dipped to a low of $16,200 for a moment. Quite contradictory, this occurred amidst one of the most concentrated bullish news flows we've ever had. A recap:

- Nov 20: BlackRock (world's largest asset manager) CIO Rick Rieder reveals that he views bitcoin as a contender to gold
- Nov 24: Pendal Group ($73.6bn AuM) starts investing in bitcoin futures
- Nov 29: Guggenheim's Macro Opportunities Fund ($5.3bn AuM) reserves the right to allocate up to 10% in Grayscale Bitcoin Trust
- Nov 30: AllianceBernstein's ($631bn AuM) Bernstein Research recommends that bitcoin can comprise 1.5% to 10% of portfolios
- Dec 2: BlackRock CEO Larry Fink: "Bitcoin can possible 'evolve' into a global market asset"
- Dec 4: MicroStrategy Inc. buys another $50m worth of bitcoin
- Dec 9: MicroStrategy Inc. offers $550 million worth of convertible senior notes and plans to use the net proceeds to buy bitcoin
- Dec 10: MassMutual ($235bn AuM), a U.S. life insurance company, buys $100m worth of bitcoin
- Dec 15: Ruffer ($27.4bn AuM) confirms a bitcoin exposure of ~$745m, around 2.7% of the firm's AuM

(Graphic by Vetle Lunde, Arcane Research)

Riffing on the previous month's symphony analogy, we've indeed entered a briskier, more lively part of the first sonata.

I don't think I've ever seen anything quite like it for bitcoin. The fact that we still dipped to $16,200 in the midst of this was a godsend, and a rare opportunity for anyone wishing to leverage up. In my own accounts, I've been buying options, futures and gone long on margin—for the first time in years.

Where are we going, anyway?

Giving an exact price call for a new bull cycle is, in my opinion, rather baseless guesswork. The peak will entirely depend on just how intense the hysteria gets at its climax. It's more a-kin to trying to guess how viral a meme will go—even if you think it's the best meme you've ever seen, there's no way you can reliably tell if it will reach 50 million people or 250 million people, and there's really no way to tell if bitcoin will reach $50,000 or $250,000 either.

Of course, that doesn't mean you can't apply fundamental analysis, although with limited precision and no clear timeframe.

Using gold as a framework to value bitcoin is probably the most common methodology around. That's where the Winklevii get their Case for $500k Bitcoin from, as does Guggeinheim's $400k prediction, as do many others. The calculation just divides the value of all the gold in the world with the bitcoin supply. These aren't exactly next-year projections though, they could very well take 5 or 10 years or more to play out.

While I've found myself wanting to nitpick those projections since they essentially batch all forms of gold (jewelry, investment gold, central bank reserves, electronics) into a single bucket and should probably be adjusted somewhat downward, I'm inclined to agree with the method on a conceptual level.

But at the same time as it's an optimistic projection, it's also quite conservative. Gold today is a remnant of something that used to be the basis for money, but has since then largely fallen out of grace with society. According to a 2019 survey, only 12% of Americans hold gold. *Most* people don't hold gold. *Most* people prefer stocks or real estate to preserve their wealth. Gold is a niche asset.

I'm reluctant to accept the idea that *if* bitcoin over time reached a similar asset size to gold, and *if* people learned to get comfortable with it, it'd merely stay as that of a niche, store-of-value alternative.

Bitcoin is an internet commodity. It was meant to be transmitted over the internet. The reason why gold is such a failure (yes, a failure), in my view, is because there is no easy way to transact with it. While attempts to re-"currencify" gold have been made such as e-gold, e-gold didn't transfer much more than $2bn per year at its peak. Bitcoin did more than ten times that in a single *day* this week.

As soon as people become comfortable with storing their wealth in bitcoin, they will quickly learn to take advantage of bitcoin's transactional layers to transfer that wealth around. That will undeniably allow bitcoin to proliferate way beyond the status of gold.

So, what is bitcoin's end target?

Some optimists believe that bitcoin can swallow a vast portion of the $40 trillion of global narrow money in circulation. Those who have thought more deeply about the subject sometimes conclude that it is the $100 trillion of global broad money that better approximates bitcoin's total addressable market, since a fixed-supply currency would in and of itself be able to emulate many of the savings vehicles typically included in the broad money definition. But that analysis too misses the point of just how unsuccessful today's money is as an asset class compared to what it could be.

The money we have today, is money in its most weakened form. Quite literally, people who hold plenty of cash these days can't stop thinking about how to get rid of it and what to allocate it to, since their wealth otherwise loses value over time. There's a lot of wealth that *could* comfortably sit in money balances which simply doesn't today.

That's why we have such spectacular asset bubbles in equities and real estate (~$100 trillion and $250-300 trillion respectively) since these assets have a reputation for preserving and amplifying one's wealth. In a world of hard money, where the money you own would grow in value at the rate of GDP rather than deteriorate, *these* are the asset bubbles that bitcoin would chew from.

Now, what that translates into as a unit price of bitcoin, I dare not even pen (I don't want a low-grade news site to pick this up and exclaim "Arcane Research predicts $XX,XXX,XXX per bitcoin!"), but you can easily do the math yourself.

Other thoughts

It seems that what's on a lot of people's minds right now is when the next "altcoin season" will start. Everyone remembers how bitcoin's dominance fell from 65% to 32% in the span of a month last time it hit $20,000 and how 2017 paved the way for altcoins to outperform bitcoin by orders of magnitude.

One the one hand, I must contrast that with how it occurred in an environment where bitcoin transactions with fees as high as $20 weren't getting cleared from the mempool, and how retail investors were the sole group dominating the speculative element of the cryptocurrency market.

Whereas now, in the last 24 hours, transactions paying as little as 1 sat/byte (5-10 cents for a regular transaction) have been processed, and institutional investors are the ones leading the charge. Further, crypto derivatives have since quite some time eclipsed spot volumes, indicating a more sophisticated slant as to who's moving the market.

I can also imagine that there's a slight dampened interest to go all-in on "DeepBrainCoin" as your main financial bet this time around when it's written all over the press that the financial elite are pretty much exclusively plowing their crypto capital into bitcoin.

On the other hand, I must be careful here as to not over-intellectualize. Retail "dumb money" still plays an enormous role in the crypto market, and altcoins rallied at multiple occasions in 2017 even without bitcoin fees reaching problematic levels.

Those who follow me know I pay a special interest to "Crypto TikTok". I do this unironically to track how crypto memes fare when they're powered by the most refined virality engine in the world. The results so far have only gone to show that the most simplistic biases and fallacies are still alive and well in the retail cryptosphere, and TikTok looks like it's shaping up to become a giant amplifier for that.

It would also be unfair to say that the current story is all about bitcoin. Among all the new crypto-entrants we've seen in the news this past month, there was one item that stuck out: the Alan Howard-backed institutional-focused investment firm, One River Asset Management, acquired a $600 million stake in bitcoin **and ether**—a stake they're looking to increase to $1 billion by early next year.

This is, in all fairness, not unreasonable given that DeFi is perhaps the greatest crypto growth story of 2020. On top of that, the CME Group have announced that they're aiming to launch an Ethereum (ETH) futures product in February next year. I don't think there's any point in denying that Ethereum will continue to play a major role alongside bitcoin for the foreseeable future.

What about the Mnuchin KYC rule?

There are plenty of better voices to hear on this subject than mine. I recommend reading the threads by Jeremy Allaire, Cynthia Lummis and Jake Chervinsky if you haven't already, as well as Coinbase's response and Coin Center's quick take. Although I find the trend troubling (albeit expected), I don't foresee any material market impact coming out of this proposal.

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