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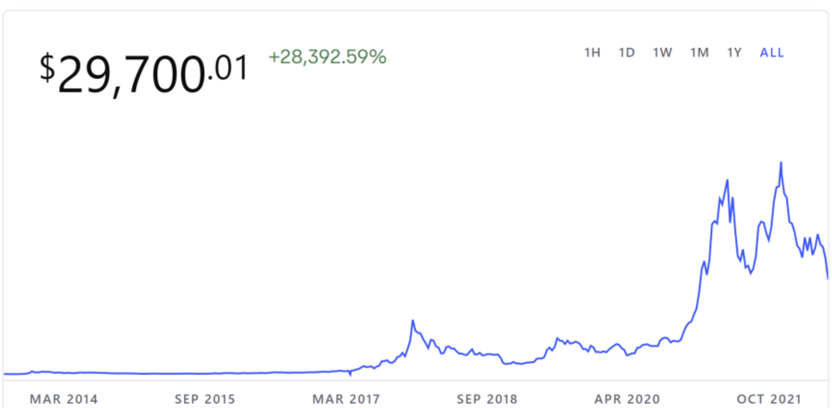
Cryptocurrency or Kleptocurrency?

With the price of bitcoin off more than 50% from its all-time high and down 30% since the end of March it is obvious that its promise as either an alternative non-correlated asset, or a currency alternative, has failed on both counts. And beyond bitcoin, the particularly egregious violator of these promises, is cryptocurrencies' youngest offspring, "stablecoins". And the irony in all this, is the fact stablecoins were invented to pretty much guarantee a stable price (1 to 1 to the US $ for example), thus overcoming the shortfalls of traditional crypto currencies.

As the next couple of charts show, Bitcoin and TerraUSD stablecoin, respectively, the one that was supposed to maintain its dollar value (TerraUSD) is actually down more than the pure crypto (Bitcoin). What went wrong?

Bitcoin



Source: https://www.coinbase.com/price/bitcoin

Source: https://coinmarketcap.com/currencies/terrausd/

Stablecoins were meant to fix their value to currency, such as the US dollar, so that investors could get the benefits of blockchain technology (anonymity, liquidity, privacy etc), without the volatility. If something sounds too good to be true, then it probably is. When markets get stressed and the typical balance of buyers and sellers goes out of whack, the issuer of the stablecoin must step in and unwind these positions to redeem investors. Unlike bitcoin whose support (or lack thereof) comes directly from the market, stablecoins must be supported by the issuer – they simply don't have deep enough pockets to meet the liquidity calls – a classic run on the bank.

For those that aren't too young to remember, this is what brought George Soros to fame and material wealth. In the early 1980s the Bank of England was attempting to keep the value of the British Pound pegged to a European Exchange Rate Mechanism (ERM). While the Bank was able to absorb some selling pressure without violating the peg, time and money was against it. Mr. Soros was able to capitalize by shorting the Pound and reaping millions when the Bank of England gave up on the ERM peg. So even though there's ample historical precedence on why pegs are hard to keep, even by deep pocketed, money printing central banks, stablecoin investors were willing to wager "this time is different". Turns out it wasn't.

So, with the demise of stablecoins, should investors revisit pure cryptos, such as Bitcoin? We don't think so for several reasons.

- **Cryptos lack asset value.** Unlike stocks, which have underlying assets (with a computable book value) or earnings; or Bonds that offer interest payments and a par value at maturity; or commodities that have a natural demand for consumption as well as replacement costs; or currencies that represent real economies with GDP, purchasing power parity calculations, and poor or good fiscal policies; or even gold that has had a natural store of value for thousands of years; crypto currencies: 1. Have zero underlying asset value or economic use. 2. The mining of new coins is so modest that mining costs are immaterial to its value. 3. A bit coin price of $10,000, or $30,000 or $100,000 is just as overvalued or undervalued as one wants to believe it is.

- **Cryptos cannot be shorted.** While counterintuitive, the lack of shorting is a significant drawback to cryptocurrencies' liquidity. When buyers go on strike, the absence of a "short interest" (amounts already previously shorted) means that there's no natural buyers when there's significant selling. In established financial markets, it's most often short covering that helps stem the selling tide, as the greed of the shorts looking to lock in gains, offsets the fear of the longs desperate for liquidity. Furthermore, investors have figured out that shorting issuers or market makers of cryptos (such as TerraUSD or Coinbase), they can squeeze them, forcing them to unwind their natural long positions in crypto, adding further pressure to cryptos.
- **Market capitalization of cryptos is non-sensical.** Similar to established financial assets, crypto currencies have a market capitalization (the value of all outstanding units combined based on the most recent trade). But to cryptos this makes little sense. All assets' market capitalization is a function of the "last trade". In established financial assets one can compare this market capitalization to its assets or earnings potential (as mentioned previously). With cryptos, all you have is a popularity rating. Bitcoin has the largest market capitalization among cryptos, at around $600 billion (down from over $1+ trillion a few months ago). Etherium's market capitalization is "only" $282 billion). But what do these numbers really mean? Absolutely nothing. One would never be able to buy all Bitcoin at this price (say to take it "private"), nor sell all Bitcoin at this price. Telsa (TSLA) for example has a $828 billion market capitalization. We can debate whether that is too high or too low, but at least an investor can actually have an opinion, relative to their belief for the outlook of the company. Cryptocurrencies are only worth what the next sap is willing to pay. Their market capitalization is vaporware.
- **Volatility guaranteed.** While we are experienced enough to know there are no guarantees when it comes to investing, the volatility of cryptos is probably an exception. For all of the previously mentioned reasons we believe cryptos are made to be pure speculative plays. Outside of nefarious entities that wish to move capital around the world anonymously and are willing to risk significant capital loss, we see no reason for cryptos to be considered as an investable asset. Even what could have been their strongest appeal, that of lack of correlation to established financial assets, is proving to have been incorrect.

While we have never been fans of cryptocurrency as a viable investment vehicle, nor store of value, we have been intrigued by its potential as a transaction medium. Yet, as the above discussion on market capitalizations implies, the world's interest in these seems to have purely been speculation. We don't know where cryptos go from here, but we do know they'll be going there without us. We continue to have no interest in something sold as a currency that appears to only promote speculation and the risk of massive risk of capital. Just like kleptrocracies often pretend to be democracies, we could be similarly be witnessing cryptocurrencies proving to be nothing other than kleptocurrencies.

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