January 29, 2018

Consilience Market Notes:

Bitcoins, Cryptocurrencies and Tulip Bulbs

First, an update: Our *Global Macro Indicators** are as follows for the 8 asset classes we invest in for our clients:

Global Equities – **Positive,**
Global Bonds – Negative,
Commodities – Negative,
Gold – Neutral,
Hedge Fund Strategies – Neutral,
U.S. Dollar – Negative,
Real Estate – Negative,
Cryptocurrencies – Negative.

Now to this week's report:

Nobel-prize winning economist Robert Shiller, compares the rise of Bitcoin to the tulip craze in the 17th century.

In the 17th Century, tulips became such a prized commodity that they were being traded on Dutch stock exchanges. And many people traded or sold possessions in a bid to get in on the action. But it all came to an end as a sudden drop in prices sparked panic selling. Tulips were soon trading at a fraction of what they once had, leaving many investors in financial ruin.

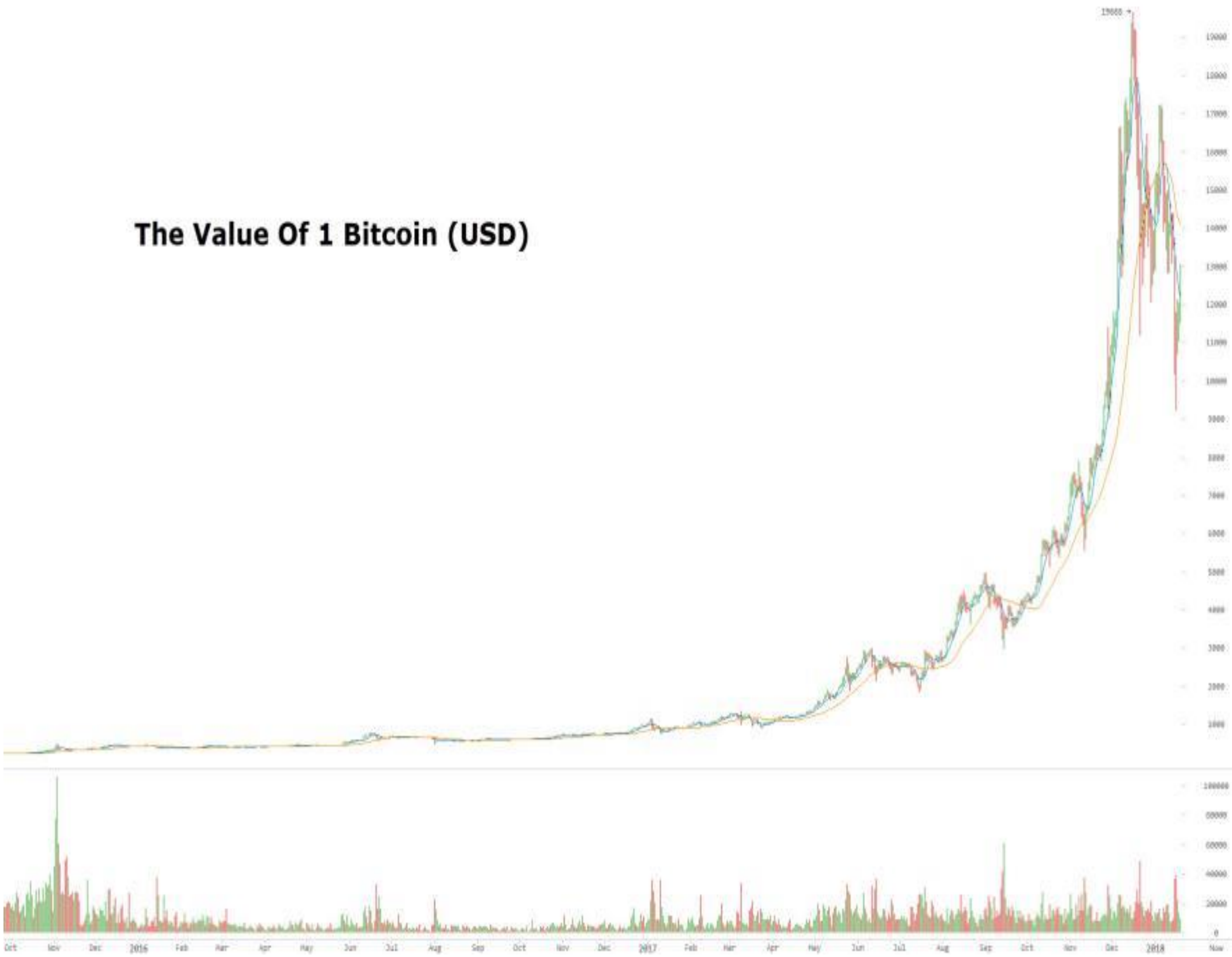
Is there a difference between the current Bitcoin euphoria and the 17th century tulips?

Yes and no.

First the "no." Cryptocurrencies are dissimilar because the concept is based on sustainable and evolving technological foundations. In essence, they are currencies without a government or central bank… The first experiment in organic currencies.

They fulfill the needs of a very complex system, precisely because they have no owner and no authority that can decide on its fate. They are owned by “the crowd,” its users.

But, many will point to the exponential rise in value as evidence that they are a mere passing fad, and similar to the tulip, it will suffer the same fate.



The brokerage firm, Morgan Stanley, recently sent a research note to their clients suggesting that the real value of bitcoin might be ... $0. That's zero dollars. (Bitcoin is currently priced at $11,038 aa I write this report.

They’re not alone in their negative view of Bitcoin and the other major cryptocurrencies.

Bank of America/Merrill Lynch recently banned their roughly 17,000 financial advisors from buying bitcoin/cryptocurrency-related investments for their clients.

J.P. Morgan Chase’s chief executive has not only called it a fraud, but also said that if any of his traders bought or sold bitcoin, he would “fire them in a second.”

Wells Fargo CEO Tim Sloan said, “I'd probably rather own a [U.S.] dollar than a dollar of bitcoin."

Are these warnings justified or might these institutions have an ulterior motive? I believe they do. Due to the fact that these cryptocurrencies exist outside of their control, they can severely disrupt longstanding oligopoly of the banking system's financial power.

Integral to the banking system's implanting monetary policy are the Central Banks, i.e., Fed, European Central Bank, Japanese Central Bank, Peoples Bank of China etc. and the large money center banks which include J.P. Morgan, Bank of America/Merrill Lynch and Wells Fargo.

Some even wonder if monetary policy is even achievable for a global market that includes a large component in cryptocurrencies!

Today, there are over 1,000 cryptocurrencies and their combined value is approximately $600-800bn, or 1% of global money in circulation. If there is a reason to believe their future growth is sustainable, it can be summed up in one word: blockchain.

Blockchain technology is also known as distributed ledger technology... distributed in the sense that there are complete copies of their database (or ledger) scattered around the world.

This, in contrast to companies, governments, and individuals who historically keep their records in one centralized database. The risk has been and is that centralized databases can be manipulated… records can be changed, hard drives can fail, data can be lost, and the records represent only one party's view of any given transaction.

In the world of blockchains and distributed ledger technology, the exact opposite is true. The transactions recorded on the ledger represent a transaction that takes place between the parties involved and is confirmed by the blockchain network via a consensus.

The value and utility that a well-designed blockchain provides is immutability, secure transactions, privacy, transparency and thus, the reduction or potential elimination of fraud.

This is in contrast to the centralized systems we depend on to conduct transactions. But as we've learned, these intermediaries are not at always trustworthy.

It wasn't long ago when the LIBOR scandal uncovered that many of the most "trusted" financial institutions in the world were manipulating interest rates for their own benefit, and of course at the expense of others.

But blockchain networks are different. And with their creation, tt's no longer impossible to imagine the replacement of dollars and other "fiat money" with open sourced, radically decentralized, deeply encrypted and self-regulating transactions in digital units of exchange that are "mined" rather issued by central banks.

What about their perceived lack of value? Many of us have had a difficult time understanding what can drive a cryptocurrency from pennies to tens of thousands of dollars in a relatively short period of time.

It's important to keep in mind that currencies do not have intrinsic value 'per se,' but rather trade on perception of value.

But, unlike fiat currencies, cryptocurrencies are more difficult to inflate. Remember that the synchronized central bank stimulus policies have pumped trillions of dollars, yuan, yen and euros into the global financial markets over the past nine years.

Why is this important?

Because, regardless of how long it takes… historically, the seductive temptations allowed under a fiat monetary system eventually catch up with governments, and their currencies devalue or totally collapse in value!

Here are just a few examples of currencies that are now worthless…

Yugoslavia -- 10 billion dinar, 1993

Zaire -- 5 million Zaire’s, 1992

Venezuela -- 10,000 bolívares, 2002

Ukraine -- 10,000 karbovantsiv, 1995

Turkey -- 5 million lira, 1997

Russia -- 10,000 rubles, 1992

Romania -- 50,000 lei, 2001

Central Bank of China -- 10,000 CGU, 1947

Peru -- 100,000 intis, 1989

Nicaragua -- 10 million córdobas, 1990

Yugoslavia -- 10 billion dinar, 1993

Did you know that since the Federal Reserve's creation in 1913, the dollar has lost 95% of its purchasing power!

Bitcoin emerged in the shadow of the financial crisis, when the reputations of the financial and economic policy community was at a post-1930s low. It is designed for a world where confidence in major fiat currencies is waning.

The intellectual breadth and audacity are breathtaking. The ability to think through ex ante how a new, decentralized currency asset could be constructed and maintained is remarkable.

But the big question is: Can these cryptocurrencies reach a level of critical mass necessary to become a serious currency in the global marketplace?

Quite possibly!

It has been reported on by CNBC that Amazon has secured three new domain names related to cryptocurrency, sparking speculation that the e-commerce giant could be preparing a move into the cryptocurrency space.

Amazon may not only be gearing up to accept cryptocurrencies as a means of payment, but may even be on its way to creating one of the world's largest cryptocurrency exchanges… a move that not only would lend credibility to bitcoin but one that could also create the necessary additional demand for bitcoin itself.

In conclusion, I would like to share a few excerpts from Paul Vigna's book,
The Age of Cryptocurrency: How Bitcoin and Digital Money Are Challenging the Global Economic Order.

If we've learned anything since the arrival of the Internet, it's that technology does not wait for us to catch up... Individuals and governments who haven't paid significant attention to new technologies have been in for a nasty shock.

We believe bitcoin, and more specifically the breakthroughs that have made it and other cryptocurrencies particularly effective tools for monetary exchange, have the potential to be an important force in finance.

It is intended to operate outside the traditional banking structure and allows people to send digital money directly to each other — peer to peer, as the concept of middleman - free commerce is known.

The collective brainpower applied to all the challenges facing bitcoin and other cryptocurrencies is enormous. Under the open - source, decentralized model, these technologies are not hindered by the same constraints that bureaucracies and stodgy corporations face.

Imagine how much wider the use of cryptocurrency would be if a major retailer such as Walmart switched to a blockchain - based payment network in order to cut tens of billions of dollars in *transaction costs off the $350 billion it sends annually to tens of thousands of suppliers worldwide.*

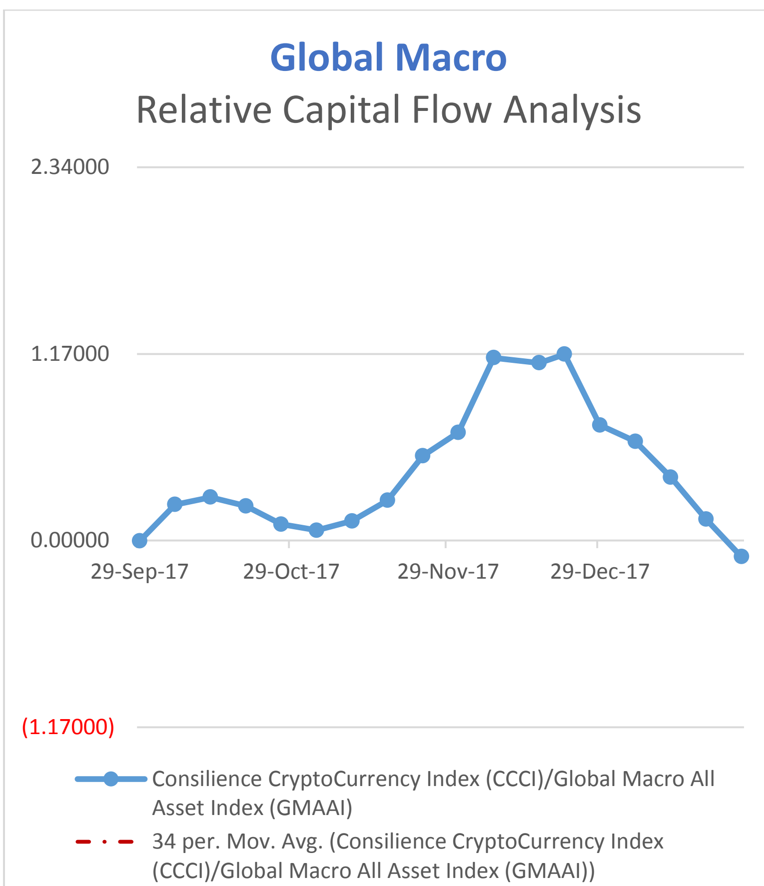
If suddenly the entire world starts using a money where governments can't just print extra money because they feel like it, needed competition and discipline [will be] forced upon it. Costs will come down, commerce and economic activity will grow along digital lines that transcend the lines on a map, and the world will seem even smaller than it already does.

So… Is there a difference between the current Bitcoin euphoria and the 17th century tulips? Consider the following:

Virtually every major bank had by the second quarter of 2015 established a task force looking at cryptocurrencies and blockchain technologies.

At *Consilience Asset Management*, we have created a cryptocurrency index and quantitative model to enable us to track the future of Bitcoin and other major cryptocurrencies. As shown in the following chart, this model is based on our core investment indicator, *Relative Capital Flows*.

A brief description of this process is presented at the conclusion of our report. But as shown here, the movement of capital is displayed as moving positively or negatively (above or below the zero line) and the horizontal delineations represent extremes in those flows.



The metric of 1.17/-1.17, equal 3-standard deviations of above or below the zero line.

These levels represent extremes in investor behavior and provide evidence of attractive buying and selling opportunities. Our current reading is negative as the capital flow trend is declining and negative (below zero).

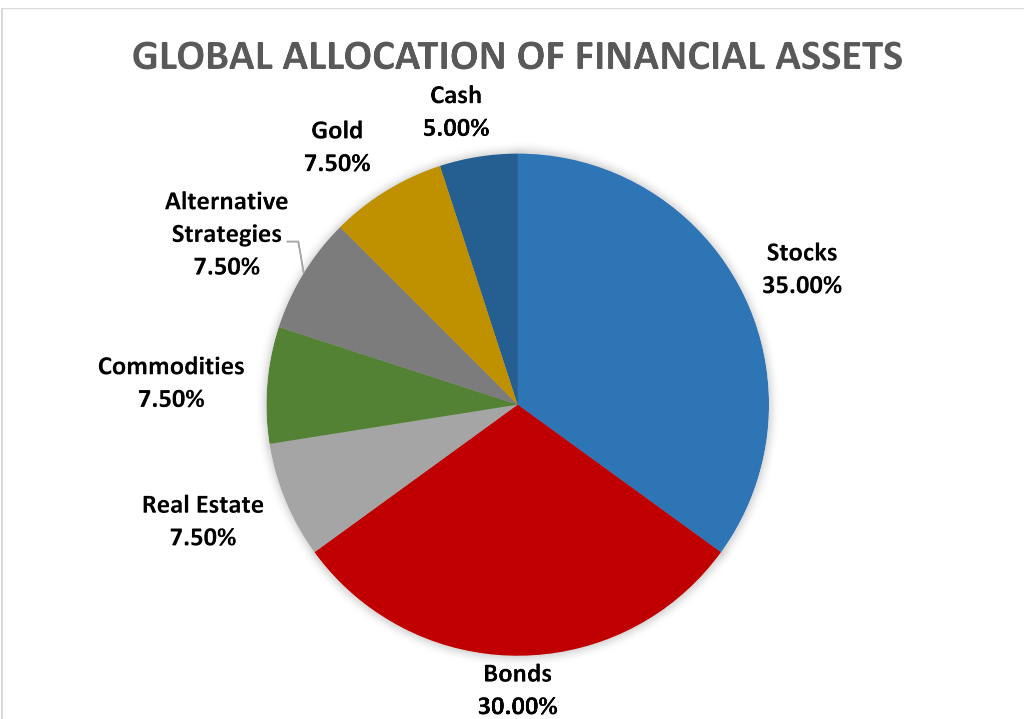
The ability to properly anticipate change is predicated upon a detached analysis of fundamental information, applying that information to imagine a plausible world different from today's, understanding how new data points fit (or don't fit) into that world and adjusting accordingly.

Although this will be no easy feat, our answer at *Consilience Asset Management* is to employ a discipline that we believe circumvents the effects of these uncertainties and disparities between the above noted risks and actual market action. Ultimately, it will be the forces of supply and demand that will drive prices of financial assets higher or lower, regardless of the fundamental, geopolitical or economic circumstances.

The cornerstone of our process is our *Global Macro Capital Flow Model.*

In this model, we monitor the movement of capital among the approximately $225 trillion of tradable global financial assets. Here, market trends can be identified regardless of their driver; debt, geopolitical, economic or other…

Below is a picture of the distribution of the world's liquid investment assets as a percent of the $225 trillion total…



Source: BIS, Thompson Reuters, World Bank, World Gold Council, Financial Analysts Journal, (January 2014).

By measuring the capital flows of each of these categories relative to the total, both favorable and unfavorable investment trends are identified.

At *Consilience Asset Management*, we employ this process in deploying client assets.

A more complete description of our model and process can be found on our website: www.consilienceassetmanagement.com under the tab **"Our Process."**

Based on this, the ratings for each of the seven asset classes (along with this month's addition of cryptocurrencies as an eighth class) that we monitor are included each month at the beginning of this report.

And although we are not calling for an end to the current bull markets for stocks, and we are closely monitoring the exciting developments in cryptocurrencies, we are cognizant of the challenges inherent due to the structural changes noted in this report, as they could have a huge impact on the current supply/demand dynamics in the global marketplace.

As such, we realize that these are clearly challenging and unprecedented times and therefore it is important for the astute investor to be nimble and pay close attention!

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Roger Faulring is an Investment Adviser Representative (IAR) with and offers Investment Advisory Services through United Advisors Services, LLC ("UAS"), an SEC Registered Investment Adviser (RIA). UAS and Consilience Asset Management are not affiliated.

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*Our *Global Macro Tactical Strategy* seeks to identify favorable investment opportunities among seven primary asset classes. Capital is rotated to the specific markets in an effort to control risk by underweighting or eliminating exposure to markets that exhibit elevated risk.

Our *Relative Capital Flow Model* is the cornerstone of our tactical allocation decisions and is augmented by our Behavior, Economic, Monetary and Stability indicators.