Speculation Becomes Consensus: Bitcoin's Rise and The Coming Crypto Economy

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Section I: Introduction

With a historical timeline that only stretches back to 2008, and use cases that are at times difficult for even the initiated to explain, the crypto market is still regularly discussed, ridiculed, and dismissed by critics who often mistake their confusion for conviction. This is not particularly surprising, because regardless of merit, Bitcoin and blockchain technology mean nothing to the individual who perceives they have no need for either. One of Bitcoin's most influential advocates, MicroStrategy CEO Michael Saylor, whose company now owns more than 90,000 BTC, was a skeptic as recently as 2019. In a recent interview with *Nomad Capitalist*, Saylor asserted that prior to the central bank response to COVID19, he simply did not "need" Bitcoin.

For Saylor, the actions of central banks around the world throughout 2020 forced him to examine things differently. With a monetary supply expanding by roughly 15% per year, both organizations and individuals must deal with the challenges of a deflated fiat currency. While Saylor's interest in Bitcoin originated because of its value as a possible hedge against inflation, his thorough investigation of Bitcoin and the technology that makes it work, has turned him into an evangelist:

"It's digital gold designed with all of the attributes that we love about gold with none of the liabilities."

As the CEO of a publicly traded company, Saylor sees Bitcoin as a financially prudent way in which to store his reserves. While he is surely interested in the larger crypto ecosystem at least as an observer, he has no need of picking winners and losers in the crypto market outside of Bitcoin. He is what is known as a "Bitcoin Maximalist," and while that position is not without merit, the maximalist position brings a degree of risk for crypto investors while also potentially limiting returns.

This paper is an attempt to give investors a better sense of the entire financial market by examining three aspects of the crypto market that should be understood prior to investing meaningful resources.

First, narratives matter. This is true for traditional markets, and it is true for crypto. This has never been more apparent than today, with social media and global information flow being constant. Secondly, there are implications to adhering to a maximalist position as opposed to exploring the larger crypto ecosystem. This is of particular importance for anyone looking to truly hedge against global uncertainty across all markets. Finally, while volatility within markets is often used as a pejorative term, it currently equates to opportunity within the crypto market.

Section II: The Power of the Narrative

As of early 2021, the prevailing narrative surrounding Bitcoin is the one that Saylor and other advocates have often used when describing it: digital gold. For many, that narrative makes a great deal of sense, as it is descriptive and meaningful without having to really get into the technical details. With a fixed supply of 21 million, Bitcoin has the potential to become the purest market in the world, where supply and demand, at least in the long term, is allowed to operate efficiently, without undue influence by any one entity.

If one accepts the idea that Bitcoin is digital gold, it becomes quite tempting to assume that the second biggest cryptocurrency must be digital silver. With a market cap of around $150B, Ethereum is the solid number two currency today, but to think of it as digital silver would be to completely miss its utility. A better narrative for Ethereum would be “digital oil” as it potentially represents the power that will move ideas, currencies, and almost anything else in a truly digital landscape.

The common practice of social media “de-platforming” demonstrates how powerful narratives are. Whatever your political persuasion, it should be obvious that when one owns the narrative, one owns nearly everything. The “digital gold” narrative that Bitcoin currently owns means its role as a true store of value is its to lose. The Ethereum narrative of digital oil is a little less lucid, though if de-platforming continues to be exercised by Big Tech, one can expect Ethereum’s narrative to begin centering around its value as a decentralized platform impervious to shut down simply because a clandestine group of fact-checkers didn’t like a post.

The idea that narratives matter can be seen with Tesla’s soaring stock price, especially when compared to their competitors. Tesla is Elon Musk, and a guy who builds rockets can certainly build a car, right? Few today can name the CEO of GM or Toyota. Everyone knows Musk. While his car company might not be profitable yet, his cars are more than cars, they are statements. They are stories. Tesla owns the narrative.

The Golden Upgrade

With retail investors, Wall Street firms, and corporate treasuries all becoming comfortable with the idea of Bitcoin as digital gold, it is important to understand what the implications of such a construct are. To do that, one must first understand that Bitcoin truly represents an invention, the invention of “digital scarcity.” One of the hallmarks of our current digital age has been the ease with which we can replicate e-mails, invoices, books, anything. While this ease of reproduction has a great many advantages, it represents quite a problem with monetary transactions. Bitcoin’s use of blockchain technology and proof of work consensus protocols, solved the “double spend” problem. This meant that a bitcoin could be sent from peer to peer with confidence that it was not a counterfeit currency.

With the creation of digital scarcity, moving value over the Internet became possible. While gold has for centuries been seen as a great store of value over time, it has been severely hampered by its inability to serve as a store of value across space. It is difficult to move gold bars from Milan to Miami. Bitcoin, as money made for the Internet, need not concern itself with clearing customs, or any of the myriad hassles typically associated with moving large amounts of value across large geographical areas.

The second major upgrade of Bitcoin over gold is its superior divisibility. Each of the 21 million bitcoin that will ever come into existence can be divided into 100,000,000 "satoshis," named after the creator of Bitcoin. Each of these satoshis have their exact proportional value to one full bitcoin. In other words, one can own, use, and transact with fractional shares of bitcoin that are easily denominated in native currencies. Gold has always had a problem with subdividing, from unscrupulous rulers who shaved off a bit for their own treasuries, to the modern practice whereby there is a significant markup on anything smaller than an ounce of gold. Should gold manage to reach $2000 an ounce, one could expect to see a tenth of an ounce trading for about $250. The removal of this markup for a fractional share gives bitcoin the ability to be used for transactions that no one would consider conducting with gold.

Section III: Maximalists as Minimizers

Cameron Winklevoss, co-founder of crypto exchange Gemini, said at a 2020 conference:
"But we're definitely not maximalists in the sense that we only believe and love Bitcoin. We hold a lot of Bitcoin. We want Bitcoin to work. We hope it works. We also hold Ether and other cryptocurrencies and we're very bullish on Ethereum and the DeFi (decentralized finance) projects that have been built on top of Ethereum and much of what's going on there. We're long the space."

Cameron, along with his twin brother Tyler, originally gained notoriety for having been the "other guys" involved with the creation of Facebook. Having settled out of court for $65M, the Winklevoss twins have been proponents of Bitcoin nearly from its inception. As stated above, they are not maximalists though, and in fact, it would be strange if they were, because as owners of a crypto exchange, their business is about far more than just Bitcoin or Ethereum.

One of the more outspoken Bitcoin maximalists is stock trader and analyst Max Keiser, who came into Bitcoin around 2013. It is important to note Keiser's entry into BTC, because in early 2013, BTC was trading well below $100. It would climb to nearly $1000 by December. If you took a considerable position in Bitcoin back in 2013, you would be a very wealthy person today. Keiser can afford to be a maximalist.

To better understand the maximalist position, it is important to understand what is known as a "fork.". A fork occurs when there is disagreement among network developers and the disagreement cannot be solved in a way that keeps all developers on the same code base. Back in 2017, Bitcoin's rapid gain in popularity led to problems with scaling, or the inability to efficiently handle continued growth in usage. This resulted in high transaction fees, and many within the Bitcoin community were concerned that increased fees would make it less a digital cash system, and more a reserve currency.

Unable to reach a compromise, a “hard” fork took place in August of 2017, and “Bitcoin Cash” was born. As of early 2021, it trades at around $400. If you are looking to purchase a cup of coffee with a cryptocurrency, or to move money from one person to another with super low fees, Bitcoin Cash might be a good option for you. While many competing cryptocurrencies claim to have superior technology, scale better, or have lower fees than Bitcoin, such claims are highly contentious, and thus far, the market has clearly chosen Bitcoin in terms of both price and adoption.

While Bitcoin is positioned as the base layer for the entire crypto ecosystem, that does not mean that there are no other coins providing utility. It is a big space, and Bitcoin does not solve every use case. As developers have put a premium on security, Bitcoin’s price has surged as a true “store of value.” It may eventually become more of a day to day currency, as its technology is actually built on that concept, but for now, it will let its “Cash” cousin be used for buying a cup of coffee.

Perhaps the principle reason behind the “winner take all” mentality within the crypto community specifically, and the greater market in general, is because regardless of coin type, everything is currently categorized as a “cryptocurrency,” which can be more than a bit misleading. While Apple and Facebook are both tech companies, to assert that they are interchangeable would be foolish.

This issue can more meaningfully be thought of as “competitors or complements.” Ethereum really is a complement to Bitcoin, not a competitor. While the Bitcoin blockchain can process smart contracts, the overhead and complexity needed to support them introduces security risks and limits scalability. It is into that “gap” that Ethereum has positioned itself, emerging as the primary “smart contract” offering, not really needing to compete with Bitcoin, but at times even enhancing its utility. Even Bitcoin Cash could be seen as a complimentary offering, as there is power behind the Bitcoin brand and it is focused on smaller transactions. There will be countless cryptocurrency losers, but it would be foolish to expect only one winner.

Crypto Categories

Massari, one of the leading intelligence providers within the crypto economy, provides dashboard type analysis for hundreds of cryptocurrencies. While this crypto space is constantly evolving, Massari has broken the crypto economy into the following categories for quick reference:

DeFi (Decentralized Finance)	Smart Contract Platforms	Decentralized Exchanges
Currencies	Stablecoins	Lending
Exchange Tokens	Web 3.0	Derivatives
Privacy Coins	Interoperability	Asset Management
Data Management	File Storage	Gaming

While it is beyond the scope of this paper to analyze all of these categories, this breakdown by Messari is quite helpful in demonstrating that crypto is far more than Bitcoin, though all of these categories, and the coins and tokens within them can trace their origins back to it. While the open source nature of Bitcoin's protocol has led to numerous imitators, to see the entire crypto space as nothing but Bitcoin knock-offs would be to miss the larger crypto narrative entirely. For example, Filecoin is a protocol that seeks to replace standard, cloud based storage options with a decentralized offering that allows users to pay miners to store and retrieve their data using the FIL token. Filecoin's competitor is Dropbox or Google Drive, not Bitcoin.

While recognizing that the crypto economy is more than Bitcoin, it is special. In a talk entitled, "The Number Zero and Bitcoin," Robert Breedlove compares the invention of Bitcoin to the invention of zero. In this talk, he points out that in regards to zero, "the discovery of nothing begins to change everything." As moderns, we struggle to think of financial accounting without zeros, but the zero is still relatively new in regards to human history, and while it technically represents nothing, its importance as a placeholder, as that point between positive and negative, cannot be overstated.

Just as the concept of zero will never be replicated, Breedlove asserts that Bitcoin won't either. While it may take some time for Breedlove's sentiment to be proven right or wrong, Bitcoin is the thing by which other currencies are compared. Like six zeros after a 1 make you a millionaire, what a currency is in relation to Bitcoin has a great deal to do with what makes it valuable. From transaction speed and size, to one's monetary supply, nearly every cryptocurrency has meaning in its relationship to Bitcoin. While Bitcoin should have pride of place in nearly any crypto portfolio, the use cases that Bitcoin has spawned means that value will be created in other areas of the crypto economy, though in many instances, those other areas are likely to be good for Bitcoin as well.

Section IV: The Upside of Volatility

Because no one living today has ever experienced the adoption of a completely new form of money, or the rise of a new way to interact with money, it becomes easy to dismiss the volatility of Bitcoin's price as something that will prevent it from becoming money in any sort of a traditional sense. Volatility in such a nascent space is not only to be expected, but is in fact required. While retail demand for Bitcoin is still largely driven by speculation about future adoption, the driving force behind current institutional demand is because Bitcoin is already serving as a store of value. Millions of traders debate the role that Bitcoin will play in the global economy by betting for and against it in cryptocurrency markets. They thus drive a process of knowledge discovery in this market. As demand shifts from speculation to adoption, the price will stabilize.

One of the reasons that gold continues to be such a stable store of value is due to its limited supply. It is not easy to get gold out of the ground, and therefore, the world's gold supply only increases by about 2% annually. As mentioned previously, gold's "somewhat" fixed supply has made it a great store of value over time, but its history is not without volatility. One need only examine the drastic price changes in Spain after the discovery of the New World to realize that gold is not in and of itself "non-volatile."

The price shocks in Spain that came with gold discoveries in the New World are still debated by economic historians today. Where Bitcoin has most improved on the sound money principles of gold is in the pre-programmed supply of new Bitcoin that can come into the system. There will never be a discovery of new Bitcoin, so whatever volatility does exist within the Bitcoin market today and in the future, is all about demand. Since Bitcoin's rise in 2020 was based largely on its utility as a store of value, if it emerges as a true medium of exchange, natural network effects will take hold and it will increase in value. This is how free markets should work.

Some Bitcoin critics assert that large Bitcoin holders, or "whales" could conduct a major sell off, thus affecting supply. In the short term, this is true, but in the long term, this would be nothing but good, allowing new investors or users the opportunity to get into the market at a lower price point. This practice, known as "buying the dip," is something that smaller crypto investors have been doing for years now. By examining the market on a daily, even hourly basis, they have increased their positions in particular currencies, not lamenting volatility, but taking advantage of it.

With its fixed supply, Bitcoin, like gold, is likely to see less volatility over time, especially as global adoption continues. In the meantime, volatility represents one of the principal reasons for managed crypto portfolios. While there will likely be nice returns for anyone who simply buys and holds some of the bigger cryptocurrencies, a managed portfolio that takes advantage of narrative, scope, and volatility of the entire landscape is likely to produce greater returns with even less risk.

Speculative Volatility

In The Bitcoin Standard by Saifedean Ammous, it is claimed that "a theoretically ideal money would be one whose supply is fixed, meaning nobody could produce more of it." At present, one could argue whether the "ideal" that Ammous references could actually be agreed upon by today's central bankers and global financial institutions. It is difficult to discern whether the rampant monetary expansion taking place on a global level is being done reluctantly, or with genuine optimism for a positive future outcome.

While understanding the motives behind central bank actions represents a super power we don't claim to have, we do believe it can be asserted that Ammous is correct. A fixed supply would be ideal, because it would remove one half of the supply and demand equation that makes price discovery typically so difficult. In watching the rise of Bitcoin, it seems disingenuous for detractors to use "volatility" as the reason for eschewing the potential power of crypto in general, and Bitcoin in particular. Bitcoin seeks to reduce long term volatility with its rigid, cannot be manipulated, supply cap. Bitcoin detractors seem to be saying they would be comfortable with a manipulated supply if that would keep the short term volatility in check at the expense of long term value retention.

Bitcoin has been crafted as an agnostic concept, to decry its strict monetary supply in the hope of reducing short term volatility is to miss the entire point of what makes something, anything, valuable: scarcity.
That investor speculation has been a significant factor in Bitcoin's rise is not a question. With every passing day though, that speculation becomes based more and more on concrete realities like network effects, sound money

principles, and the deep-seated need for purchasing power to be retained from one day to the next. What detractors have failed to see, is that speculators within the crypto space often become adopters, advocates, and evangelists. These speculators now represent some of the most educated investors in the market today, and they are actively helping create a very different financial future, and not just as cheerleaders, but as active market participants. For example, because of the decentralized nature of the crypto market, holders of certain crypto assets can become liquidity providers within specific markets by loaning their crypto. This increases market liquidity, dampens volatility, and is another expression of how the crypto economy lends itself to free market principles.

Section V: Conclusion

To successfully balance risk and return in the crypto economy demands one understand the power of the narrative, the impact of the maximalist position, and the necessity of volatility in the short term. While these three areas apply to the overall market, their impact on the crypto market are currently much more magnified based upon its place as an emerging market, where the rules, regulations, and opportunities are only just now coming into focus. The challenge then becomes how to ensure a risk adjusted return.

Bitcoin already has an exceptionally high Sharpe ratio; however, given its meteoric rise from zero, the Sharpe ratio becomes a somewhat tortured statistic. A broader, more macro understanding of the entire market allows one to view blockchain as a technology stack - one that could be incredibly useful and provide a substantial net value to society. This will disappoint people hoping to apply a PE ratio or some other fundamental measurement since these are already so skewed in traditional equity markets (TSLA stock recently topping a PE of over 1600). It is a very reasonable approach to simply compare the growth potential of blockchain and crypto markets to more traditional FANG stocks - and in this scenario the blockchain market has substantially more upside potential.

At the time of this paper's initial publication, Bitcoin has surged to a market cap of $1T. While this represents something of a psychological barrier that Bitcoin has crossed, what is more significant for investors is this means it is now roughly one tenth the size of the world's gold market, a figure that grows almost daily. Yes, there will be corrections along the way. Yes, there will be crypto projects that fail miserably because open source software allows for almost anyone with a keyboard to try something new, and yes, the crypto narrative still has its detractors. Nevertheless, blockchain technology, and the crypto economy that it powers, has moved beyond speculation, and should be a part of any intelligent investment strategy.

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