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Bitcoin: All Hope and no Judgement

November was a mixed bag for stocks around the world, with the US continuing to move higher, whereas Europe and emerging markets slipped back. The S&P-500 has now notched up a new all-time high in every month this year except March, and with the Dow Jones closing above 24,000 for the first time recently there is undoubtedly a sense of celebration building. Trump's successful tax cuts are central to this but there is good news emanating from Europe with very strong economic confidence data, especially in Germany. Elsewhere, bonds were flat, whilst oil continued its rally, moving beyond $60 a barrel for the first time in over two years and sterling, recovered another 1.8% against the dollar.

We don't make reference to bitcoin in our major stock market/ asset class return tables overleaf, but maybe we should. For the record, its price (measured in US dollars) was up 51% in November and is now up 1,200% over the last 12 months and 2,462% over the last 24 months. Unsurprisingly, this has been a popular subject of conversation over the last few weeks and one that we need to address.

But first a little background and in order to grasp the concept it is important to understand the context of its origins. Although its roots date back much further, it formally emerged in the wake of the 2008 financial crisis and the collapse of Lehman Bros. The still-anonymous 'inventor' was most probably a consortium of coders, dissatisfied with the failings of the global financial system and keen to provide a solution. The damage is obvious when banks go bust and customers lose their life savings through no fault of their own, but it is government policy that has the greatest impact on the value of money. This is exemplified by hyperinflation in Zimbabwe, deflation in Japan and the value of sterling dropping post-Brexit.

So what if it were possible to hold an asset that could be used as a medium of exchange for goods and services, that did not rely on banks and could not be devalued by the actions of a short-termist, incompetent government. Essentially this is what bitcoin offers. It is a non-physical, digital asset that is moved directly between counterparties (peer to peer), without the need for a middleman (banks). In principle it has no prospect of being subject to hacking or counterfeit issues, because this is dealt with by the technology embedded in the so-called blockchain. Its supply is strictly controlled by a set of unbreakable rules (which is what makes it a cryptocurrency) and as a result it is not possible to issue more units at will. In nearly all the recorded examples of currencies that had to be scrapped, the central cause was a failing government that liberally printed money, thus creating hyperinflation. As faith is lost, the value of the notes and coins vanishes. It is not too far-fetched to suggest that this could be the ultimate fate of the US dollar and as we have mentioned before, Lionel Schriver describes how this might arise in The Mandibles, a gripping novel about a bloodless world war in the near future and highly recommended as a last minute stocking-filler.

The currency was first described in an academic paper entitled Bitcoin: A Peer-to-Peer Electronic Cash System and the concluding remark was that 'we have proposed a system for electronic transactions without relying on trust'. This isn't just trust in the banks, we interpret this to mean trust in the system. Users will never have to even think about what might go wrong, because nothing ever will. A slightly circular philosophical concept maybe, but so far so good; with no legitimate reports of sytem failure to date, there is nothing to distrust.

Having now read through the entire paper several times, one salient point pops out. The term bitcoin is mentioned only once, which is in the title. Could it be that the authors took the view that bitcoin itself was likely to fail, but the concept would eventually work? If the principles in the paper were to have lasting power it wouldn't help if references were constantly made to a defunct project.

So if bitcoin is to become established and to have longevity, it can only come from building public trust. At the moment the media would have us believe that it is just drug dealers that are interested and although this may be a drawback, it actually provides further evidence that the concept is working.

However, one should not leap to the conclusion that bitcoin is a scam. Investment firm Fidelity in the US is taking the subject very seriously to the point where employees can buy coffee in bitcoins in the company canteen. But the hype has attracted its fair share of swindlers (bitconmen?) and some of the brokers seem plain dodgy.

So, the big question - is bitcoin a buy? From an investment perspective, our answer is 'no' on the basis that we cannot calculate with any confidence what its future fair value is likely to be. This is the same reason why we avoid gold and precious metals. We acknowledge that the price could shoot up, it could go up another tenfold from here, but we can't explain what a reasonable value would be. Indeed we couldn't explain why it would be justified at a tenth of the current price and neither can the Nobel prize winner in economics Robert Shiller. Our view is that buying bitcoin is all hope and no judgement.

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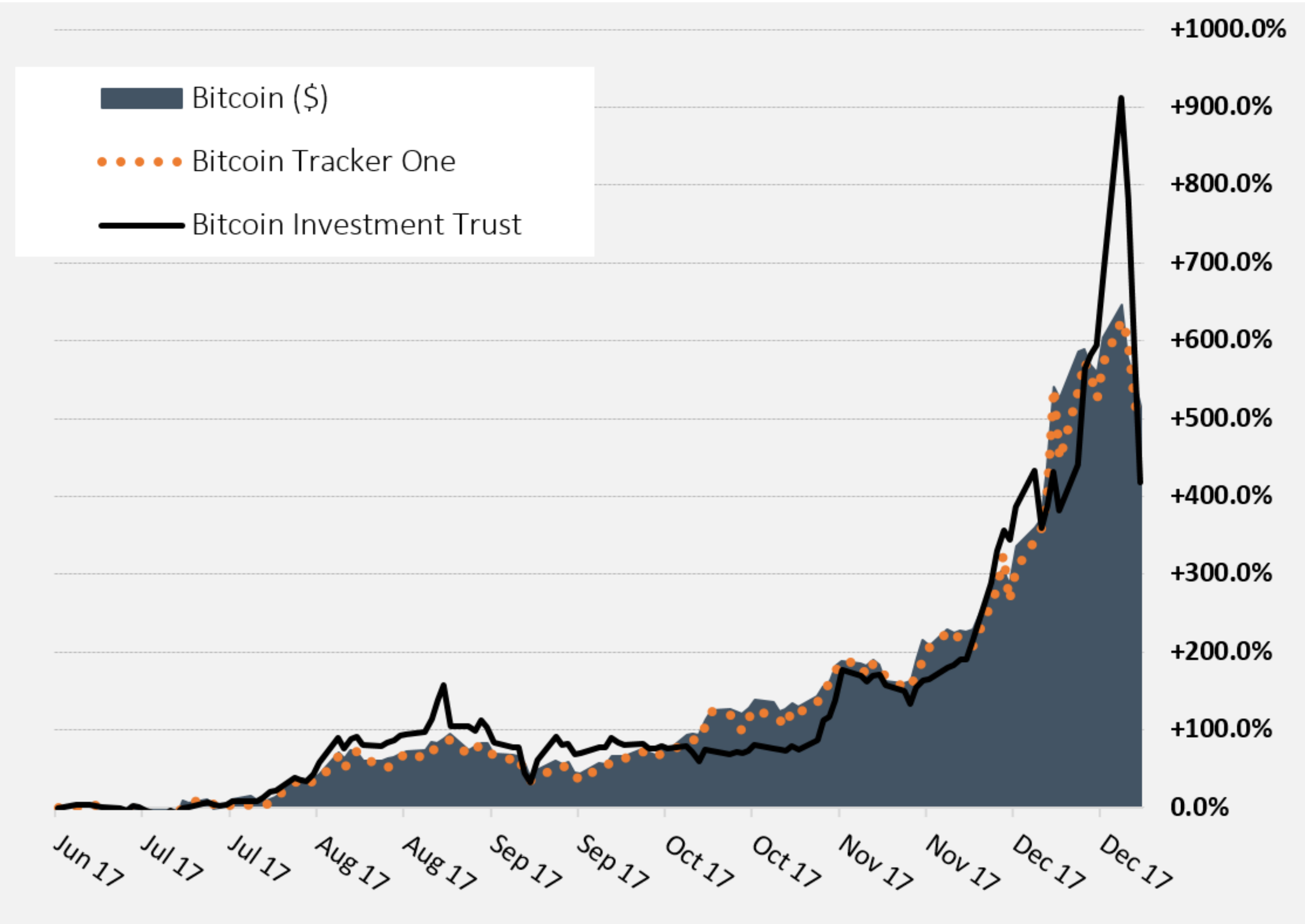
The method that we have been employing to accommodate clients requesting bitcoin exposure has been to buy a fund that tracks the price (orange dotted line in the chart below). For the more agrressive there is also an investment trust that seeks to do the same thing but it can trade above (or below) its intrinsic value. If the hype soars, then the holder potentially gets a boost of seeing the fund trade at a premium and as the chart shows this has been significant recently. It can go the other way and investors should be aware that these strategies carry risks beyond the fluctuating value of the underlying bitcoin price.

Martin Lewis, the consumer finance expert from moneysavingexpert.com has a similar message to us but he, too, doesn't go as far as saying 'don't do it'. If you want a punt, by all means, go ahead, but don't put in more than you can afford to lose, highlighting a key difference between investing and gambling. You won't lose nearly everything by investing in the Fidelity Asian Values fund for example, but you just might with bitcoin. Indeed, we wouldn't want to stop anyone taking an each way bet on Nigeria to win the World Cup next year, just don't cash in your ISA in order to do so!



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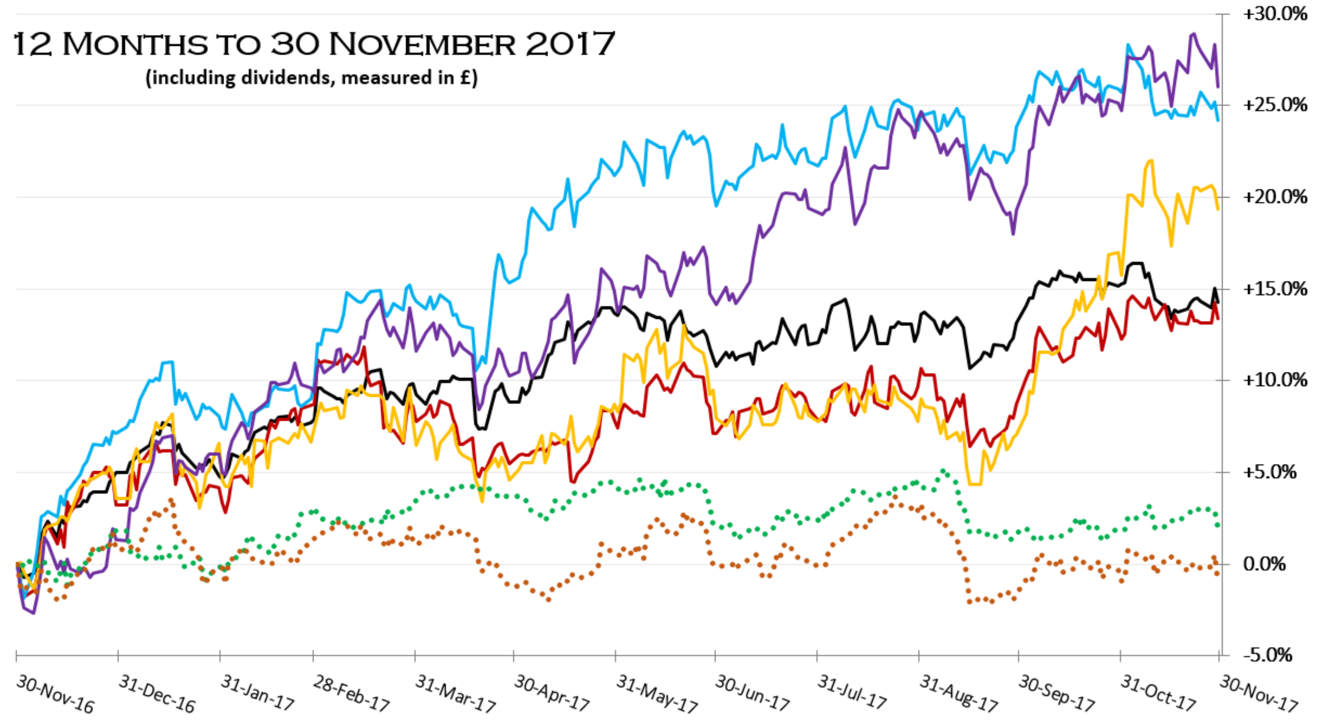
Index Returns

Index	Region/Asset Class	30 Nov 2017	1 Month Change	1 Year Change	2 Year Change
UK 100	UK	7,326.7	-2.2%	+8.0%	+15.3%
UK Mid Cap	UK	551.6	-2.0%	+10.7%	+8.6%
UK Small Cap	UK	5,771.0	-1.1%	+17.2%	+26.1%
Dow Jones Ind Avg	USA	24,272.4	+3.8%	+26.9%	+37.0%
S&P 500 Index	USA	2,647.6	+2.8%	+20.4%	+27.3%
NASDAQ Comp.	USA	6,874.0	+2.2%	+29.1%	+34.6%
Nikkei 225	Japan	22,725.0	+3.2%	+24.1%	+15.1%
Euro Stoxx 50	Europe	3,569.9	-2.8%	+17.0%	+1.8%
CAC 40 Index	France	5,372.8	-2.4%	+17.4%	+8.4%
DAX Index	Germany	13,024.0	-1.6%	+22.4%	+14.4%
Milan Index	Italy	22,368.3	-1.9%	+32.1%	-1.5%
MSCI Emg Mkts (£)	Emg Mkts	555.5	-1.7%	+22.6%	+60.2%
IBOVESPA Index	Brazil	71,971.0	-3.1%	+16.3%	+59.5%
MICEX Index	Russia	2,100.6	+1.8%	-0.2%	+18.6%
S&P BSE SENSEX	India	33,149.4	-0.2%	+24.4%	+26.8%
Shanghai SE Comp.	China	3,317.2	-2.2%	+2.1%	-3.7%
Hang Seng	Hong Kong	29,177.4	+3.3%	+28.0%	+32.6%
UK All Property	UK Property	7,060.8	+0.2%	+6.7%	+7.6%
UK Conv Gilts	UK Gilts	3,539.3	+0.3%	+2.2%	+9.4%
UK Index linked Gilts	UK IL Gilts	4,813.0	+0.6%	+3.8%	+21.0%
JPM Glob Agg. Bond	Global Bonds	791.6	-0.9%	-1.8%	+21.9%
iBoxx Non-Gilt	UK Corp Bonds	336.0	+0.0%	+4.9%	+12.9%
WTI Crude	Oil	57.4	+5.6%	+16.1%	+37.8%
LMEX	Base Metals	3,176.2	-2.6%	+13.5%	+48.1%
Gold Spot $/oz	Commodities	1,274.94	+0.3%	+8.7%	+19.7%
S&P Agri & Livestock	Agriculture	761.75	-1.5%	-4.1%	-10.0%
£1 = US$	Currencies	1.35	+1.8%	+8.1%	-10.2%
£1 = €	Currencies	1.14	-0.4%	-3.8%	-20.3%
£1 = Yen	Currencies	152.21	+0.8%	+6.3%	-17.9%

12 Months to 30 November 2017

(including dividends, measured in £)



Source: Albert E Sharp, Bloomberg®

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