

Killer B's! Bitcoin, Bankers and Blockchain



Jamie Dimon, CEO of JP Morgan, quotes from October 13, 2017:

- “Bitcoin is a great product if you are a criminal.”
- “People who purchase Bitcoin are stupid.”
- “Governments like to control their economies, currencies.”
- “Governments are going to crush Bitcoin one day.”

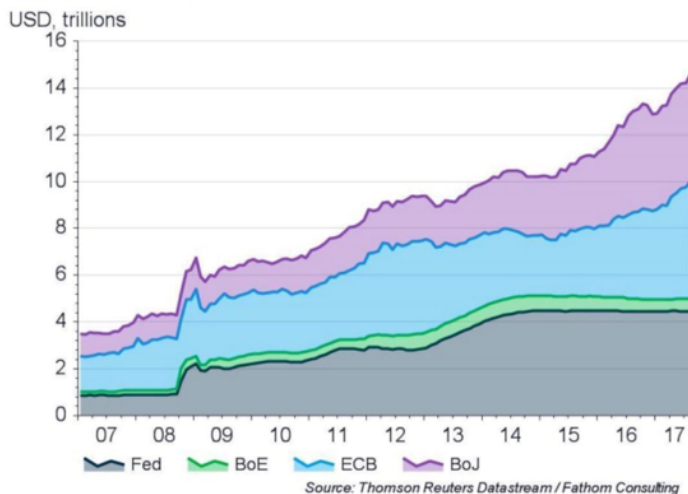
And my very favorite comment of his from September 14th:

- “You can’t... invent a currency out of thin air & think that people who are buying it are really smart.”

Meanwhile central banks have printed roughly \$12 Trillion in currency out of “thin air” since 2009 to prop up the banking system, AND the entire basis of the fractional reserve banking system is creating money “out of thin air” through issuing loans.

So, I’ve decided to tackle a brief

Central bank assets



explanation of Bitcoin in this report, along with why bankers hate it so much. In addition, however, I am including a description of blockchain technology, because it is very likely to be revolutionary in many aspects of internet security and property transfer in the future.

Bitcoin:

So, what is Bitcoin? Wikipedia defines Bitcoin as “a worldwide cryptocurrency and digital payment system called the first decentralized digital currency, as the system works without a central repository or single administrator.” (Source: <https://en.wikipedia.org/wiki/Bitcoin>) The unique aspect of Bitcoin that has attracted many followers globally is that there will only be 21 million “coins” created. The theory is that this maximum number will continue to support the value as more people adopt Bitcoin as a method of payment. This is in stark contrast to our current monetary system, in which central banks truly do create money from “thin air”, and there is no theoretical limit to the amount that they can conjure up. Another unique aspect of Bitcoin is its security. It uses “blockchain” technology, which I’ll touch on later, which is a very efficient, verifiable and secure method of exchange. It also bypasses the banking system in its current form.

Bankers:

So, why do many bankers (Central Banks in particular) have a hard time with Bitcoin? This answer is quite simple, and much easier than understanding blockchain technology. Banks need deposits, or reserves, to stay “healthy”. There are reserve requirements around the world that banks must meet, and if they fall short of these requirements, they need to raise new capital through issuing bonds or attracting new deposits. If people begin to flock to a new alternative currency, because perhaps they dislike what is happening to their currency, it makes it increasingly difficult for banks to maintain the required capital. This could become especially important during a debt crisis in a country. Due to hyperinflation that is occurring in Venezuela, it is very difficult to pay for anything because the currency loses value so quickly, and there is not enough currency to go around. Simple tasks, such as buying lunch at a restaurant (for those who can still afford to do so), are nearly impossible. However, by using an alternative currency, such as Bitcoin, the task is simplified and the transaction is seamless.

<https://www.theguardian.com/technology/2016/dec/16/venezuela-bitcoin-economy-digital-currency-bolivars>).

<https://www.forbes.com/sites/realspin/2017/02/03/why-venezuelas-currency-crisis-is-a-case-study-for-bitcoin/#279b8aa19b29>)

In Europe, short term interest rates are still negative. Larger depositors actually have to pay interest to a bank to hold their money so that the bank can in turn go out and risk that money making loans and keeping the “spread”. That doesn’t appeal to many people. Europe has taken steps to ban cash by getting rid of the 500 Euro note, which makes it more difficult to store cash in large quantities. I’ve seen this move to eliminate cash around the globe, with Sweden taking the lead (<https://www.weforum.org/agenda/2017/09/sweden-becoming-cashless-society/>). Eliminating

cash, and ensuring all transactions are digital forces money into the banking system. This serves “the system” in two ways. First, all transactions are recorded and governments can ensure they collect proper taxes. Second, when money is forced into the banking system through the elimination of cash, it adds to bank reserves and “props them up”. I’m all for healthy banks, but the negative side effect is that during a future crisis, banks may likely enact negative interest rates (this is the European blue print, and has been discussed at Bank of England meetings, as well as in the U.S. at the central bank meetings in Jackson Hole). Having no alternative to keeping money in banks, such as hoarding cash, allows banks to basically tax citizens without allowing a vote. Not too democratic, and not to my liking.

Bitcoin threatens the “establishment” by giving citizens an option rather than being forced into their governments’ currency. At various times over the course of the past year, China has halted Bitcoin trading due to capital flight. Other countries have banned Bitcoin outright. Some, however, such as the U.S. thus far, have tolerated its existence. I see a move by Central Banks toward bitcoin related technology. In fact, one report discussed the International Monetary Fund (IMF) using blockchain technology for their Special Drawing Right (SDR), which is a likely frontrunner to replace the U.S. Treasury as the preferred central bank holding asset. (<http://www.reuters.com/article/china-currency-sdr/imfs-special-drawing-rights-should-go-digital-china-c-bank-researcher-idUSL3N13C14720151117>). The problem with governments moving toward blockchain however is that the attractive part about Bitcoin currently is the scarcity, or maximum number of coins that can be printed. As we all know from economics, scarcity creates value! While Central Banks could use the technology in their transactions, they likely would not adopt maximums regarding issuance.

Blockchain:

What’s the big deal about blockchain? For a deeper dive, please click the link from MIT (<http://mitsloan.mit.edu/newsroom/articles/blockchain-explained/>). On a topical level, blockchain is a decentralized network that records transactions and attaches a “ledger” to it using “cryptography and game theory”, and does not require secure networks like those we are used to. It is essentially a way to keep records of most any kind. Because of the decentralization, a chain is not controlled by one source, thus can not be “hacked”, as can occur in current transactions. Beyond the technology of how these blocks are formed and attached to transactions however, the more interesting piece of the technology, to me at least, is how it can be applied.

Blockchain does not require third party intermediaries to process, so it is virtually free and eliminates “toll takers”. Future applications could include stock and bond transactions, title / land ownership transactions and many other contract transactions, in addition to items where privacy is of importance like electronic medical records. In addition, transactions such as selling energy to the electrical grid or to purchasers directly could be possible. There are many other ways, many not even imagined yet, as to how blockchain will change the use of the internet.

Summary:

While I can understand why people use cryptocurrency, it is nearly impossible to determine what the eventual digital currency standard will be. My personal belief is that it may become too great a threat to global governments and banks, possibly during the next economic crisis or downturn. When governments perceive they are losing too many assets to alternative currencies, they will likely ban their trading, as has already occurred in certain countries. In addition, if people are trying to protect against catastrophic events, such as the power grid being hacked, or an EMP from a North Korean missile, Bitcoin won't provide much use as it requires power and a working internet to use.

I do believe that banks have woken up to a technology that will likely change the way they do business in the future, and will greatly improve efficiencies and reduce costs. We're at the beginning of this process, but I've heard a lot about the promising ways that banks could adopt blockchain technology.

In general, I believe this could be the beginning of a significant change in the way we use the internet and deal with information security and property transfer transactions. There will undoubtedly be new businesses that will assist companies in adopting and modernizing their existing infrastructure to implement these changes. We will be looking for ways to capitalize on these changes for our clients as opportunities in different industries present themselves.

Very sincerely,

Brian Prichard & Your Team at 44 North Financial Partners

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