
LISTEDRESERVE

MoneyBits

Curb your enthusiasm

When traders load up on derivatives, it can often be hard to know if they are preparing for good or bad news.

Take what happened last Friday, when open interest in Bitcoin futures hit an all-time high at CME Group — and exceeded the amount at crypto-market leader Binance. Many took that as a sign that investors expect the Securities and Exchange Commission to approve an exchange-traded fund investing directly into Bitcoin soon. But futures and options can be used to go short or long. And some traders are, in fact, piling into the futures because they worry the ETF could get rejected by the SEC, says Giovanni Vicioso, global head of cryptocurrency products at CME. “I think it’s uncertain what’s going to happen, market participants need proper tools to hedge against that risk,” he told Bloomberg.

It is uncertain; but ... the missing thing from this article is the CME is the more highly regulated exchange that houses activity from blue chip participants. Given the activity at Binance in the past few weeks it is hardly a surprise that CME volume has overtaken Binance.

It might be that traders are betting that the ETF gets knocked back; it might also be that activity over bitcoin from institutional investors is getting the green light at more and more institutions. For sure, some of them will go short.

While we are on the topic of going short; if you are a sophisticated investor who wants to short bitcoin; *note it is not the same as gold*. You can short mountains of gold knowing that the counterparty most likely does not have the ability or security measures to call you on your short and take physical delivery. Unless you have a private Fort Knox, you are closing the position before expiry. Taking delivery of bitcoin (any amount) costs about \$4.

I have the view that this is not yet well understood in financial markets and somebody, who is short, will learn a very expensive lesson.

The new threats

What do you do all day? Investors ask that with surprising frequency. In the early days I was miffed by the question because it was so direct; I now think of it differently. It’s a good question, because what are we doing all day? Are we reading the right things? Are we talking to the right people? Are we taking the right amount of risk?

Our principle consideration though is what are the bad things that can happen? How do we protect ourselves from those bad things, or if appropriate, exploit them?

Many of our top macro concerns when we first launched five and a half years ago have actually happened since. They were:

1. What if mining gets banned?

We viewed this as profoundly dangerous because attacks on mining generally cause asset sales, forcing price down (creating opportunity too). Also, mining bans provide a huge disincentive to future mining investment which potentially threaten the security model.

In early 2021 when China banned mining it was a serious issue. Bitcoin dropped 40% at the time and the hash rate on the network fell by half. It was no casual ban, the country responsible for the most network hash did it so it was an absolute worst case scenario.

What we did not expect at the time was the resilience of the network. Mining hash returned almost entirely within 6 months and has been on a biblical charge ever since with an overwhelming amount of investment in the mining network.

2. What if a major exchange collapses?

2022. FTX. A story well told but the price collapse that it precipitated (some 65%) was enormous and painful. There were two lessons here. Firstly, counterparties in this sector must be carefully selected. Secondly, do not leave assets on exchanges. We knew that pre-FTX, we know it now.

The damage this one did though still resonates. Retail interest remains at all-time lows because a lot of (mainly Americans) lost a lot of money to Sam Bankman-Fried.

The recovery from the most famous exchange collapse [Mount Gox](#) in 2014 took at least two years; the same will be true of FTX.

3. What if bitcoin gets banned?

It hasn't and it won't. But subtle road blocks are everywhere now. For example in Australia if you bank with Commbank they will limit the amount you can send to a bitcoin exchange each month. In America it was more radical with outright attacks on banks that supported the sector culminating in the collapse of Silicon Valley Bank.

This risk remains alive but the attacks will be increasingly subtle and well thought out. I expect them to fail because people's demand for bitcoin will ultimately be reflected in political opinion and the political will to attack bitcoin will die with the antiquated US Senators that lobby for it.

So, our focus is shifting to newer risks.

1. Fiscal discipline in the US

There is a less discussed threat to bitcoin and the whole sector which is that the US government gets its act together and spends less than it earns. They introduce fiscal discipline and a genuine capital market that allows the market to price risk as opposed to having that risk priced by the Federal Reserve. This strategy would be incredibly painful short term for the US because many, many projects would fail and their financial markets would come under extreme pressure. Even so, they remain capable of it if there is sufficient political will.

It's not an existential threat to bitcoin but it would slow progress. It would imply a genuine competitor had been born for monetary premium. A currency that actually might hold its value because it is not made up from thin air whenever it is needed.

I view this outcome as highly unlikely. US interest payments now exceed their defence budget, enormous spending cuts are required now to stop the deficit growing. Can that really happen in an election year? Will it happen in any year? I don't see it, but the risk exists.

2. Weaponisation of an ETF

This I see as more likely. Imagine the year is 2029, Bitcoin has just crashed 40% to \$650,000. The US public is crying out for support from the government as lender of last resort because of the damage done to pension funds etc. in the US.

The USG announces a bitcoin fork. The software is forked (which means copied and a separate version is operated) and Bitcoin_USG is born; the maximum supply is still 21 million but the US Government announces that it has the ability to intervene in the market when it drops.

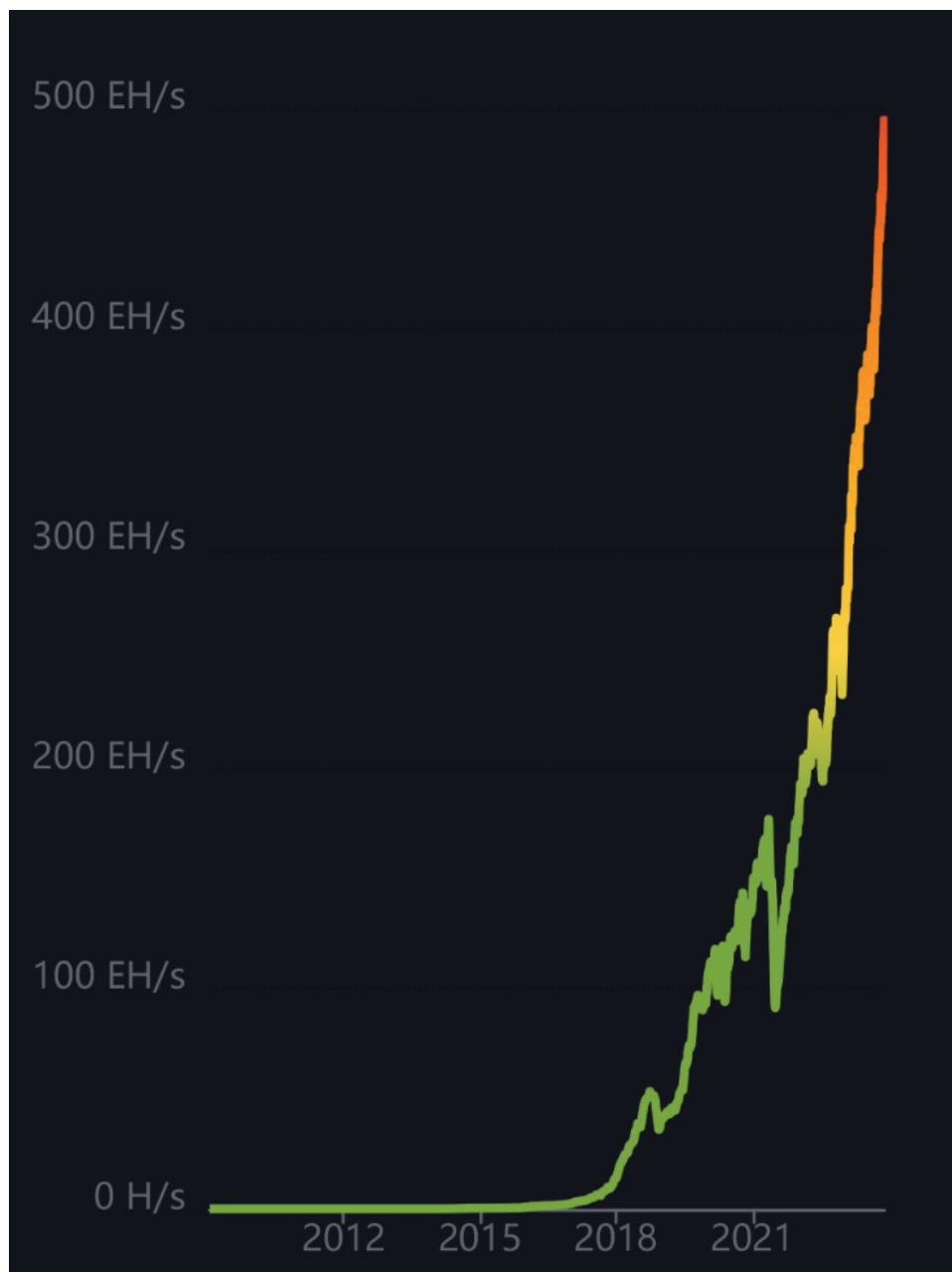
Note that forks in bitcoin are common. The most famous in 2017, Bitcoin Cash, was initially quite successful (and damaging to bitcoin).

Now the interesting part. Imagine US ETFs control 40% of the bitcoin by that date; when the fork happens they receive the new coin and announce that they will only buy Bitcoin_USG in future. Bitcoin crashes and Bitcoin_USG soars. The new coin is only available to wallets that have fully KYC'd and have registered a digital identity with the government thanks to software changes the fork has introduced. The marketing for this will be around 'safety'. This bitcoin is 'safe' and has no terrorists or Chinese Canadians making more money than us.

In the short term this could work. It would propel USG coin forward and seriously dent Bitcoin. It would not work long term though because the changes to the code the government would be required to make would fundamentally alter the proposition of the asset and crucially there would be no guarantee that miners and users would support the fork.

So what do we do all day?

We think about the bad and terrible things that could happen to the asset class so that when they come along, we have at least thought about them and can react.



What metric is there that measures the pace of change of technology? There are a few and technologists would point to the computer processing speed as the ultimate measure.

I would propose another, the bitcoin mining hash rate (of course I would).

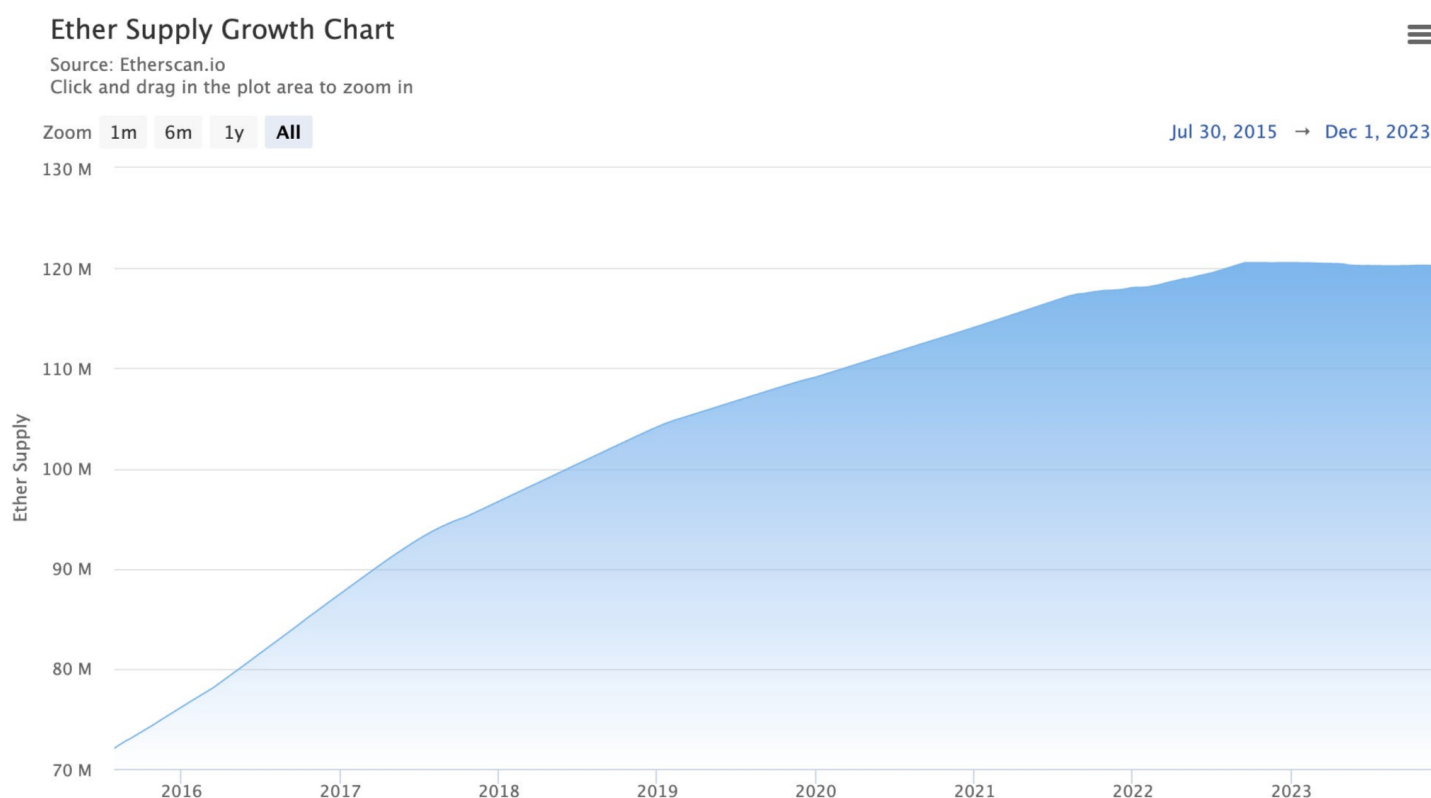
If you believe that we have reached a technical exponent because of the level of capability of machines then this measure might be for you. The bitcoin network now collectively computes 500 EH/s which is the equivalent of 100 billion of the latest Apple M3 chips.

The graph depicts more than just speed though. To keep growing it needs technological adoption of new monetary technology. The other key element of bitcoin mining is energy efficiency, every model of a miner is better and better in that regard using less energy per calculation.

So raw tech speed, plus human adoption of technology, plus massive leaps in energy efficiency. I think it's a good proxy for the progress of the species and is perhaps a reason for profound optimism.

ETH Supply

Our Managed Fund has slowly increased its weight towards ETH in Q4. There are a number of reasons for that, one is the likelihood that the ETF focus moves from Bitcoin to Ethereum, the second is the developing yield curve on ETH that results from its staking rewards. The other is more simple, supply.



The mechanism of Ethereum's mining model changed in 2021 when it moved to proof-of-stake. We wrote about that extensively at the time, one of the results of that meant that Ethereum's supply curve might ultimately become deflationary; it now has.

As the market heats up you cannot really avoid using Ethereum. It drives around half of the USDt supply, its smart contracts are behind a lot of the NFT market. A large proportion of people doing anything non-bitcoin in the sector will need ETH in 2024.

So the thesis here is unambiguously this. There is much less ETH available than in the last cycle and likely more people that will need it. Accordingly, we believe the probability it will rise in price is better than average; so we are buying more of it.

Euro-Trash



The [results](#) of the European Survey on banknotes are in. You might recall we covered this some months ago. 22,000 people participated in the survey and this will guide the ultimate outcome. I say guide because the results were adjusted a bit as the ECB explains:

For the Kantar Public survey, all questionnaires completed in less than 90 seconds (as happened in a total of 151 cases) were attributed to “speedsters” (the term used to describe respondents clicking through the questionnaire at speed without taking the time to read the questions) and removed from the final data.

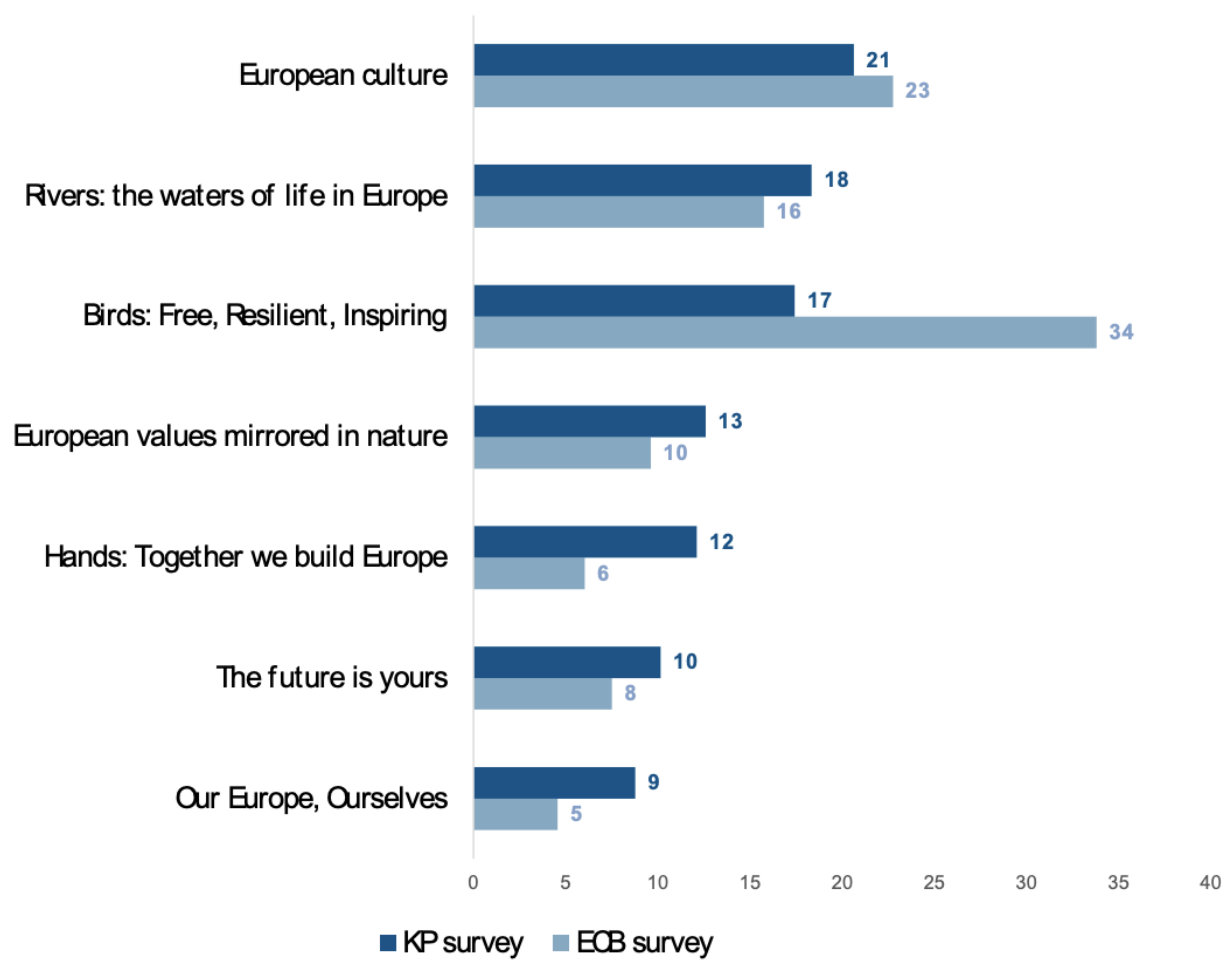
After the fieldwork, the Kantar Public survey team looked at the distribution of the population in each country. The following steps were followed in deciding the weighting approach to be taken for the survey.

1. Countries were first weighted according to gender, age, region and education population data.
2. In countries with a weighting efficiency below 70%, weights were trimmed so that the highest weights would be no more than three times the average weight.
3. For countries that still had a weighting efficiency below 70%, a simple weighting based only on gender and age was used.
4. A gross weight based on the population of each euro area country compared with the total euro area population, but excluding Bulgaria, was created.

Bizarrely then, if you completed the survey quickly in under 90 seconds. Your result was removed. No “speedsters” as the ECB called them.

Then adjustments were made based on gender, age and region as well as your level of education.

Weights were also “trimmed”. Weightings were then further adjusted, except for Bulgaria. And voila! The voice of the people; adjusted for race, sex, education and being Bulgarian emerged.



These adjusted figures resulted in the ECB declaring 'European Culture' and 'Birds' as the winners. To my eyes, birds came third in the public survey. Birds did not win and they should not be on the banknotes. But they will be.

All in all the survey was fun and meaningless and manipulated to derive the result a bureaucrat wanted under the guise of public demand. It is intensely revealing as far as I'm concerned that the ECB runs its surveys exactly like it runs its economic policies. Vague corruption, statistical fraud and regional bias all wrapped up in pretty marketing.

Birds for the win then.