ODDO BHF

MARKET VIEW

JUNE 21ST, 2021

Bitcoin: Technological innovation or pure hype?

Jan VIEBIG,

CIO Private Wealth Management

Laurent DENIZE,

CIO Asset Management

Disruptions often begin with a ground-breaking idea. In 2008 Satoshi Nakamoto proposed a decentralised, electronic payment system. Nakamoto designed a peer-to-peer network that would store transactions between participants in a public distributed database and summarise them in data blocks. The chain of transactions is called the “blockchain” and is operated by a large number of participants using open-source software and decentralised network nodes.

So-called “miners” verify the transactions, gather them into transaction blocks and encrypt them using a code called a “hash”. This process is called “proof-of-work” and consumes a large amount of computing power and, hence, energy. Miners are compensated for their work with bitcoins. The number of bitcoins is capped at 21 million. Currently, about 19.1 million are in circulation. The last bitcoin is expected to be mined in 2140. Multiplying the number of outstanding bitcoins by bitcoin’s high-water mark (reached on 15 April 2021) of USD 63,410, works out to bitcoin assets worth about USD 1.2 trillion.

According to economists, a speculative bubble occurs when asset prices have come unhinged from their fundamentals. And, indeed, the bitcoin price chart is reminiscent of the 17th-century tulipomania, with its price soaring from less than 10 cents in July 2010 to more than USD 60,000. Bitcoin-mania is spreading very fast, especially among young, cosmopolitan people, driven by its promises of wealth, technological progress and independence from bureaucrats.

Unlike equities, bonds and real estate, bitcoin possesses no fundamental intrinsic value. Equity investors own a portion of a company, whose value depends on its projected cashflows. Bitcoin’s value cannot be determined using any valuation model. Price increases are based solely on the hope that the number of bitcoins will be capped and that more and more buyers will drive the price up.

Bitcoin’s huge price run-up has been driven in recent months primarily by its increasing acceptance by large companies (see Chart 1). Service providers such as PayPal allow US users to trade bitcoin through their PayPal account. Larry Fink, CEO of Blackrock, the world’s largest asset manager, recently changed his mind on bitcoin and now believes that it could develop into a “great asset class”. In February 2021 Tesla boss Elon Musk sent the price soaring with his announcement that Tesla had bought USD 1.5 billion in bitcoin and would now accept bitcoin as a means of payment. In May 2021, Musk then announced that Tesla would no longer do so, on the grounds that mining consumes too much energy and that coal, rather than renewable sources, is often used to generate that energy.

The facts that bitcoin mining is an energy-intensive activity and that mining activities are located overwhelmingly in coal-intensive China, is not news. Cambridge University researchers publish the “Bitcoin Electricity Consumption Index”. Based on their calculations, bitcoin mining uses more than 133 terawatt-hours per year in power. That is more than the energy consumed individually each year by Sweden, Ukraine, Norway and Argentina.

ODDO BHF
12, boulevard de la Madeleine - 75440 Paris Cedex 09 France - Phone: 33(0)1 44 51 85 00 - Fax: 33(0)1 44 51 85 10 - www.oddo-bhf.com
ODDO BHF SCA, a limited partnership limited by shares with a capital of €70,000,000 - RCS 652 027 384 Paris - approved as a credit institution by the Autorité de Contrôle Prudentiel et de Résolution (ACPR) and registered with ORIAS as an insurance broker under number 08046444.
www.oddo-bhf.com

This raises the issue of what social benefits bitcoin has to offer. Bitcoin is called a cryptocurrency. According to economists, viable currencies must have some clearly defined features. These are: a means of payment, a measure of value, and a store of value. Any currency that doubles or halves in value within a few weeks fails as an efficient means of payment, measure of value or store of value. Bitcoin is far too volatile for such uses (see Chart 2).

Many officials are skeptical. ECB president Christine Lagarde, for example, called it a "highly speculative asset, which has conducted some funny business and some interesting and totally reprehensible money laundering activity". The World Bank recently declined to support El Salvador's plan to introduce bitcoin as legal tender, citing environmental concerns and a lack of transparency. The head of the Bank for International Settlements (BIS), Augustín Carstens, was even more forthright in an interview with the German weekly Der Spiegel: "Bitcoin is good for just two things – speculation and ransom payments."

Blockchain is an innovative and disruptive technology, but, owing to environmental concerns, its use cannot currently be recommended. That leaves bitcoin as a vehicle for speculation. Those who enjoy huge volatility in exchange rates and can ignore sustainability issues may want to buy bitcoin. But because of its high volatility, bitcoin is certainly not suitable for long-term investment by risk-averse investors.

Chart 1: Demand from large institutions drives bitcoin to more than USD 60,000 in spring 2021

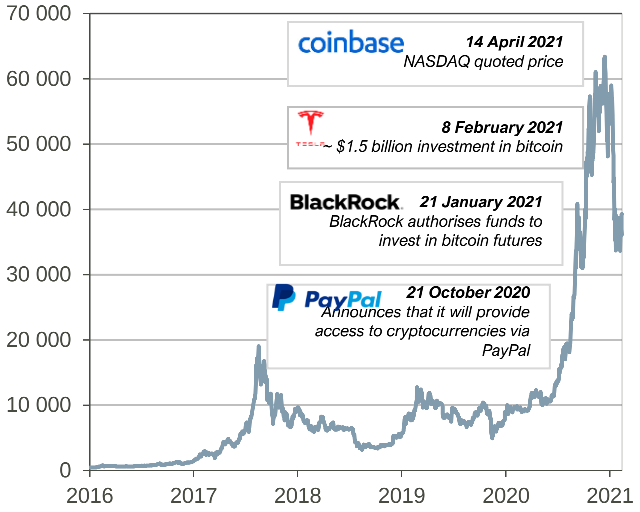
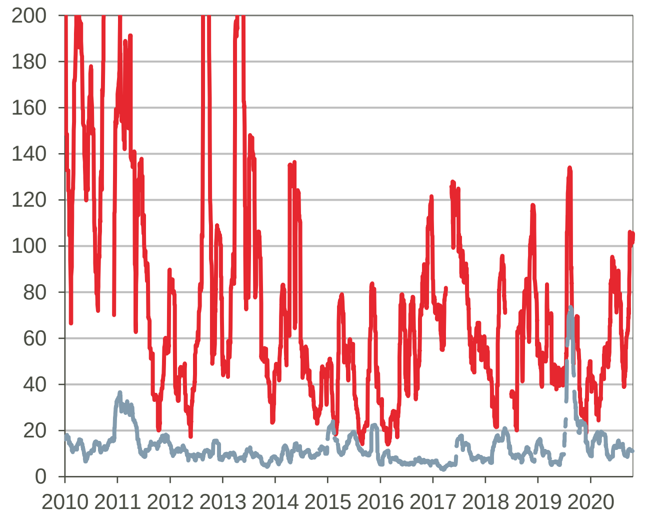


Chart 2: 30-day volatility is many times higher for bitcoin (red line) than for the MSCI World (blue line)



Disclaimer
This document has been prepared by ODDO BHF for information purposes only. It does not create any obligations on the part of ODDO BHF. The opinions expressed in this document correspond to the market expectations of ODDO BHF at the time of publication. They may change according to market conditions and ODDO BHF cannot be held contractually responsible for them. Any references to single stocks have been included for illustrative purposes only. Before investing in any asset class, it is strongly recommended that potential investors make detailed enquiries about the risks to which these asset classes are exposed, in particular the risk of capital loss.

ODDO BHF
12, boulevard de la Madeleine - 75440 Paris Cedex 09 France - Phone: 33(0)1 44 51 85 00 - Fax: 33(0)1 44 51 85 10 - www.oddo-bhf.com
ODDO BHF SCA, a limited partnership limited by shares with a capital of €70,000,000 - RCS 652 027 384 Paris - approved as a credit institution by the Autorité de Contrôle Prudentiel et de Résolution (ACPR) and registered with ORIAS as an insurance broker under number 08046444.
www.oddo-bhf.com