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Portfolio Management | Crypto Finance | ICO

DAN MOREHEAD (PANTERA CAPITAL) INVESTING IN CRYPTOS

IPO ANALOGUE

They say history doesn't repeat itself, but it does rhyme. ICO rhymes with IPO for a reason—the ICO thing is going to be very much like the 1990's IPO boom—just much bigger.

On CNN recently I debated one of a very rare breed of animal—an academic who is a bitcoin hater. (I was going to use the term "skeptic" but "hater" unfortunately seems to be the correct word.)

On the way to the studio I skimmed a few of Vivek Wadhwa's screeds against bitcoin. It's hard to know which title is my favorite:

- *"Why Bitcoin Is the Largest Ponzi Scheme in Human History"*
- *"The Bitcoin Bubble is Going to Burst. Let's Promote Viable Digital Currencies Instead."*
- *"Why Bitcoin Is the Most Dangerous Global Scam in 20 Years"*
- *"R.I.P. Bitcoin. It's Time To Move On."*

In them there are many unqualified statements like:

“Bitcoin will surely go the way of…Pets.com—into the oblivion of hyperspace.”

https://www.linkedin.com/pulse/rip-bitcoin-its-time-move-vivek-wadhwa

Inadvertently, the articles provide a perfect platform to highlight two massively important points on why investors should have exposure to bitcoin and the other disruptive blockchains.

I will admit right upfront that if your objective is to sell newspapers, solicit academic grants, or throw your banking competitors off the track, railing against bitcoin may be an entirely rational strategy. However, if your job is like mine—prudent management of peoples’ capital—it is irrational to have zero exposure to something that (1) might be the future payment rail of the world, (2) that might become digital gold, (3) that might replace Wall Street back offices, (4) that might enable billions of people in the developing world to improve their lives with bank-free mobile money—and so forth, as Use Case (n) $\rightarrow \infty$.

Bitcoin is the Miracle Whip of Finance.™

A rational investor should have one or two percent of their portfolio invested in the blockchain disruption.

- *“Doubt is not a pleasant condition, but certainty is an absurd one.”*—Voltaire, letter to Frederick William, Prince of Prussia, 28 November 1770

If you had a portfolio of IPOs—one was Pets.com and one was Amazon.com—it doesn't matter what the rest were. You made a great return.

That's the point. Even if bitcoin is actually Pets.com—and you own it in a portfolio of the 25 best tokens (such as in our Digital Asset Fund) and 25 well-chosen ICOs (such as in Pantera ICO Fund) you will probably do very well. That's even after we're down to a single-digit number of blockchains and 90% of the ICOs have gone to zero.

Some excerpts from the CNN debate:

SMERCONISH: *Vivek, you think the party is about to end. Make your case.*

VIVEK WADHWA, DISTINGUISHED FELLOW, CARNEGIE MELLON UNIVERSITY: *I think that it's the greatest scam of modern times. It's not digital currency. It died as digital currency two years ago. Now it's people like this saying, hey, hold on to it, trust us, it's this magical thing to increase in value, and it does because everyone is believing these people…They're going to lose their life savings while the rich people here in Silicon Valley and who are hyping it cash out just in time. This is what happened with the dot-com boom. Grandma, grandpa lost their life savings. History is repeating itself.*

MOREHEAD: *I did read your piece on the way to the studio, and it said "It's time to move on, Bitcoin will soon go the way of MySpace and Pets.com." I would say there is a chance—I am a trader, I can never be sure of anything as you are as a writer—when that piece was written two years ago a $100,000 investment in Bitcoin would be worth $4.5 million today.*

WADHWA: *Yes, it's being used for sending money across borders when you have corrupt officials in, you know, crooked countries sending it over to their bank accounts and so on. It's being used for crime and it's being used for speculation. It died as a digital currency…Bitcoin is never going to be a digital currency. It's simply going to implode before you know it, and regular people who trust you are going to lose their shirts.*

SMERCONISH: *Dan, will you respond? I've heard this not only from Vivek, but also from other critics of Bitcoin who say it is synonymous with an underground economy.*

MOREHEAD: *Yes. I think that's a silly thing to say. Bitcoin has a permanent paper trail of every transaction that has ever been done. That is a terrible feature for committing crimes. It's well known that the Silk Road guy was using Bitcoin. However, it's not well-known that there were two federal agents that went rogue and were extorting money from him and other people in the dark web, and it was a Bitcoin company—Bitstamp—that reported them to the authorities and they are both in prison because every single crime they committed was a permanent paper trail.*

If the government had the choice today to approve either cash or Bitcoin, there's no way they'd approve cash. Cash is great for crimes. Bitcoin is terrible.

WADHWA: *Again, these people saying trust me. The value is going to keep going up when they know it's going to crash in burn. We're in the year 2000 right now, it's January, the price is still going to increase most likely because they are going to cause people to buy it, and then it crashes and it goes to zero and people lose their life savings. Don't do it. Get out of it rather than losing everything you have. Yes, the price might increase, but more likely or not it's going to be zero before you know it.*

MOREHEAD: Yes, I'd say when people call it a fraud or Ponzi scheme, I don't think they've really read anything about it. A fraud is a deception *intended for personal gain. Bitcoin is an open-source piece of software. How can that be a fraud or deception? We can all audit it.*

Ponzi Scheme? Charles Ponzi invented his scheme by defrauding people for his own wealth. Satoshi Nakamoto hasn't taken a penny out of Bitcoin. He or she, whatever it is, has over a million Bitcoins worth $20 billion. I challenge you to find one CEO of one company in the world that has $20 billion net worth that has never filed a 13-F selling any of his shares. This is not for personal gain.

He's contributed bitcoin to the world as an open source piece of software—with no patents—so people can move money more cheaply around the world without paying all the data and payments monopolists.

SHIFT TO INSTITUTIONS?

Although I have spoken about bitcoin since 2013, in hindsight it was premature to discuss this topic with institutional investors. Their typical objectives were either related to a mismatch in liabilities or an uncertainty in producing excess returns (alpha) over common benchmarks.

Truth be told, there was no incentive for a perceptive institutional portfolio manager—even one who bought BTC or ETH for his or her personal account—to argue in favor of allocating crypto to an institutional portfolio.

Today, however, the perceived risk-reward relationship is rapidly shifting towards institutional involvement—and for compelling reasons.

First, the market has grown over ten times in size since this time last year, and is now large enough to warrant an alternative asset class designation by even the largest institutions.

The proliferation of investable assets across a variety of sectors and industries allows for the construction of a diversiPed portfolio of protocol tokens and blockchain equity—without apprehension from one year ago.
Although such an investment is now viable, why would large and established institutions consider digital assets in the first place? Precisely for the reasons that always motivated their allocations—to match liabilities and generate alpha.

As a hypothetical, consider this:

Yale University endowment ($27.2bn) is one of the most forward-thinking institutional investors. Imagine they allocated 1% to the blockchain asset class last year. To keep things simple, let's say they put half in Bitcoin and half in Ethereum. $136mm in each—not a huge number. The crypto markets now trade $20bn a day.

That tiny exposure—just 1% of the portfolio—would have returned enough to send 214,512 kids to Yale.

Past returns clearly do not guarantee future performance. This hypothetical simply illustrates our central theme—blockchain is an astonishingly asymmetric trade. If you're wrong, the portfolio is out 100 basis points. If you are right, you may change your financial standing materially.

Understandably, there were other reasons why institutional investors have been circumspect about blockchain. Market regulators in the US and elsewhere only hinted at the status of certain tokens, leaving the market without clearly defined rules of the road. Additionally, tokens warehoused on exchanges with questionable security threatened to embarrass institutional investors should they turn out to be hacking victims. However, it seems the SEC may soon rule on the security status of tokens and that Wall Street banks will soon begin to trade cryptocurrencies. Their counterparties will need custody, and so we expect the largest Wall Street custodians to soon offer their services to investors.

We expect forward-thinking institutional investors to begin investing in blockchain equity and tokens soon.

Soon the risk of NOT being involved will out-weigh the risk of having a small allocation.

Allison Nathan: *So it doesn't concern you that the vast majority of even a well-diversified cryptocurrency portfolio will likely go to zero?*

Dan Morehead: *I wouldn't think of it that way. I had a fun debate on CNN recently with Vivek Wadhwa of Carnegie Mellon University, who once wrote a paper titled, "RIP, Bitcoin. It's Time to Move On." And he argued that bitcoin is the Pets.com of this era. But a portfolio of investments in early internet companies could have included much more than ventures like Pets.com; it could have included an Amazon.com. Even if 90% of cryptocurrencies are going to zero, I think you can craft a portfolio that will have some losing assets, but also a couple of truly transformative winners.*

Allison Nathan: *Even if all of that is the case over the long term, do you think it is reasonable to expect another major correction in the cryptocurrency space? Many would argue it is a bubble that has started to burst.*

Dan Morehead: *I do not believe this is a bubble. Cryptocurrencies are clearly very volatile. Anything that can go up 10 times in six months can easily go down 50% in a week. I have no idea where it's going to be in the short run. But it's very difficult for me to believe that we are in the midst of a bubble given that almost all institutional investors have zero exposure to it. That said, I do expect a substantial wave of institutional investor flows into the space over the next 18 months.*

Allison Nathan: *What is the fair value of bitcoin?*

Dan Morehead: *It's difficult to put a precise number on it, but I believe it is much higher than today's price, with the risk- reward substantially skewed to the upside. If I had to take a really big-picture view of the terminal value of bitcoin, I think it's roughly a half a million dollars per bitcoin. How do I calculate that? By taking into account some of the markets that bitcoin will disrupt. For example, bitcoin disintermediates the transfer of money across borders, so you could take the value of correspondent banking and the value of remittances. Bitcoin could also be a very strong competitor to the credit card companies, so you could take some fraction of their market capitalization. Bitcoin is, again, a very good store of wealth, so you could take some share of the roughly $8tn market cap of gold and other stores of* *wealth. And lastly, bitcoin is similar to a currency, so it could take some market share from fiat currencies, which amount to around $100tn of global money supply.*

On top of those known use cases, there are others that we don't even know about yet. When you have a new technology like TCP/IP or bitcoin, you might not appreciate the incredible disruption that could follow. In the early '90s, I could understand selling books on the internet, but I had no idea that Uber or Snapchat would exist.