

# Bitcoin is a little less “cryptic”

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## Bitcoin’s Veil of Secrecy Slips a Bit

As controversy continues to swirl around Bitcoin, fans should be aware that the so-called cryptocurrency has recently become a touch less cryptic. Most prominently, the U.S. Department of Justice recovered \$2.3 million of the \$4.4 million Bitcoin ransom that Colonial Pipeline paid in May for relief from a crippling cyberattack.

The federal law enforcement officials attributed their success to a recently created Ransomware and Digital Extortion Task Force. In previous incidents, investigators were able to trace ransom payments made in Bitcoin, but not to unlock the cryptocurrency wallets in which the ransom payments were stored. This time the Justice Department team managed to obtain the required digital key by some undisclosed means. One possibility is that a cryptocurrency exchange cooperated with the FBI or responded to the agency’s subpoenas. If that happened, the implications would be transformational in the battle against ransomware.

In a somewhat similar vein, the FBI and Australian police recently nabbed 800 alleged criminals who unwittingly used an encrypted app devised by the law enforcement officials. The sting operation was assisted by a paid collaborator who had previously sold encrypted devices to organized crime members. Operation Trojan Shield (known as “Special Operations Ironside” in Australia) resulted in the seizure, among other items, of more than eight tons of cocaine, 250 firearms, and over \$48 million in cash and cryptocurrencies.

## **Still Holding Its Place in the Spotlight**

Recent financial market events highlight Bitcoin's continuing hold on the investing public's imagination.

MicroStrategy plans to sell \$1 billion of common stock and use the proceeds for general corporate purposes that include buying Bitcoin (BTC). The website [cryptobriefing.com](http://cryptobriefing.com) commented that the company's huge BTC investments have turned its shares into a "pseudo-Bitcoin ETF." Indeed, MicroStrategy stock has closely tracked the cryptocurrency's price in recent months. The price correlation in the current quarter (through June 14) is 91%.

The software company's proposed stock offering follows close on the heels of a \$500 million nonconvertible bond sale to fund Bitcoin purchases. Unlike buyers of the software company's earlier convertible bond sale made for the same purpose, holders of MicroStrategy's "straight" bond will not obtain anything like a direct play on the cryptocurrency's appreciation. On the other hand, they will be less directly exposed to Bitcoin price declines. That could prove to be a benefit, considering the roughly \$284.5 billion charge on losses related to fluctuations in the digital asset's price that MicroStrategy announced shortly before launching the nonconvertible offering.

Fascination with Bitcoin also focused attention on a Sunday, June 13 price jump of 9%. On that day, Elon Musk reversed course a second time to say Tesla would, after all, accept the cryptocurrency in payment for its electric vehicles "[w]hen there's confirmation of reasonable (~50%) clean energy usage by miners with positive future trend." Previously, Musk had canceled plans to accept Bitcoin, citing concerns about the vast energy consumption associated with minting the digital coins.

## **The Central Bank Digital Currency (CBDC) Challenge**

Notwithstanding Tesla's renewed willingness to accept Bitcoin for big-ticket purchases that can run over \$100,000, it remains unclear that any crypto will ultimately become a

full-fledged medium of exchange. On June 10, though, El Salvador became the first country in the world to adopt Bitcoin as legal tender.

While Bitcoin and other cryptocurrencies have made some strides toward wider adoption, they face a longer-term competitive challenge from central bank digital currencies (CBDCs). China is in the forefront of this development. CBDCs have both advantages and disadvantages for users, relative to cryptocurrencies.

CBDCs offer the advantage of providing a safety net of reliable governance. They retain the privacy feature, but subject it to the issuing country's laws and regulations. CBDC users do not enjoy the anonymity offered by cryptocurrencies, but on the other hand, neither are they likely to experience the extreme volatility exhibited by Bitcoin. For example, Bitcoin plunged by 47% versus the dollar between April 15 and June 8, 2021. The People's Bank of China plans strict controls over the digital yuan to prevent disparities with the value of conventional forms of the currency.

### **Investment Prospects**

The "store of value" label remains tenuous for Bitcoin in light of the extreme price variability described above. Proponents argue that swings of such magnitude will cease as Bitcoin ownership becomes more widespread within the population. That may prove correct but for the time being, at least, investors should continue to view Bitcoin as a volatile asset and avoid excessive concentration in it.

For risk-tolerant equity clients, we are currently providing modest portfolio exposure to crypto assets. In lieu of direct ownership of Bitcoin, we use selected stocks that are significantly correlated with Bitcoin and have additional investment merits. More aggressive clients may wish to allocate a percent or two of their total assets to crypto assets by opening crypto wallets outside our management.

We do not see a role for Bitcoin in income-oriented accounts managed by Lehmann Livian Fridson Advisors or Livian & Co. Crypto assets generate no current income. To



achieve the important objective of inflation protection, we rely instead on gold, typically with an allocation of 3% to 4%.