



## Market Commentary: Value, Trust, Bitcoin & Human Ingenuity January 2024

I remember visiting my uncle's house in the early '90s and watching with fascination as my cousin, 15 years younger, played a Sims game.<sup>1</sup> She was tending to a virtual garden and partaking in a bunch of other dreary acts that most adults would not want to re-enact in their spare time, no less on a computer. Simoleons (AKA SimCash) were used to purchase items in this virtual world. One can, for example, purchase a Swan Throne,<sup>2</sup> which is a virtual toilet for your virtual world. Simoleons is a currency issued by the creators of Sims that the players trust and interact with given its perceived value<sup>3</sup> within the Sims virtual world. This is conceptually similar to the US dollar—or any widely-used currency-- which is trusted and valued by its users. Will Bitcoin specifically, or cryptocurrency generally, replace either or both?



### Perceived Value

The value of things is generally not static, relying on many factors, some direct and others indirect. The price of eggs, gas, and apples changes regularly over time and even among different stores. Calculating a cash flow of \$5,000 for the next 10 years would be assessed a different initial value today as compared to five years ago, when risk-free interest rates were materially lower. A component of the initial value is the risk that the contra party would indeed pay you the agreed upon \$5,000 a year - with that risk also assessed different values, at different times, based on a number of considerations.

In the case of the Swan Throne, if the Sims producers greatly limited the availability while increasing the promotion of this mighty throne, they may have been able to markedly increase its value, a synthesis of economic theory related to supply - demand and elasticity. Some participants may come by their Simoleons through playing the game, while others may partake in a currency exchange by converting US Dollars to Simoleons.

<sup>1</sup> Mythic Quest is a real fun comedy based on a design group within a company that produces a very successful MMO (Massively Multiplayer Online) game - I highly recommend it. While I believe the world may be sick/over it, they also happened to totally land 2 Covid episodes.

<sup>2</sup> [Most Expensive Items In The Sims 4 \(gamerant.com\)](https://www.gamerant.com/most-expensive-items-in-the-sims-4/)

<sup>3</sup> Or at least the potentially immeasurable pleasure of purchasing a Swan Throne which the Sims producers are "giving away" at a mere 5,000 Simoleons.



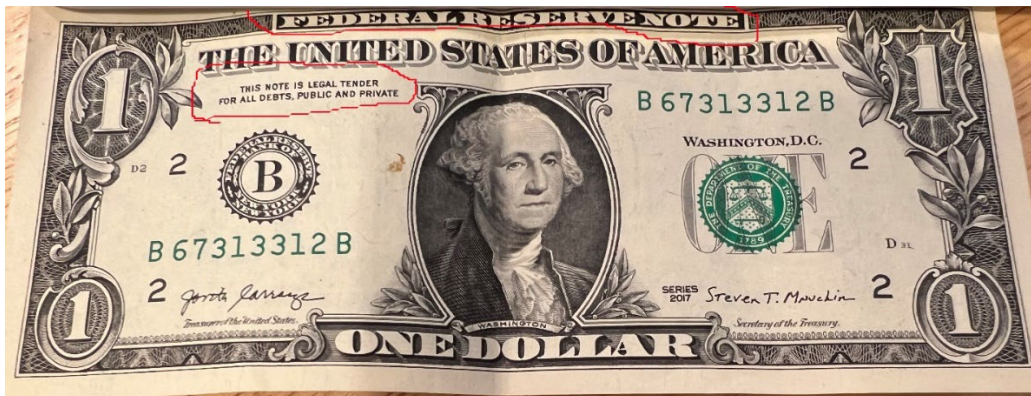
In the investing world, participants use their US dollars to purchase items they believe will pay them a stream of income via coupons or dividends and/or potentially increase in value based on a number of beliefs. Participants also sometimes purchase items simply to store their wealth for a variety of reasons. Gold has been one type of storer of wealth that has stood the test of time for maintaining a level of value and being reasonably exchanged for other goods and services globally. It's been a form of currency at many points in history.

## Trust

Simoleons are digitally created. The Sims producers can unilaterally change the price of everything on their system and greatly affect the value of Simoleons. Or conversely, everyone can decide that Sims games are dumb and simply leave the virtual world resulting in Simoleons becoming worthless.

The US dollar is printed on presses and without the “backing” of the US government it is worthless. It could also become close to worthless if the US government made some poor decisions leading to the decline in the value of a US dollar.

We (collectively, mostly) trust in the full faith backing of the US government that the US dollar has value and therefore use it in our daily life to exchange for many products and services where those respective proprietors accept it. It is very convenient!





I enjoy highlighting how lucky we are to live in the United States. We have discussed our enviable geography, abundance of food, energy, commodities and so on. We also have some of the best governance in the world within our political and financial systems – which we constantly challenge.

## Bitcoin (and Other Cryptocurrencies)

In 2008, there was not a lot of trust in the banking system of the US. It was a great time to introduce an alternative currency. Bitcoin was born.

Many cryptocurrency advocates point to the lack of governance in much of the world and therefore the need for a global currency (I might say we already have that and it's the US dollar!). They may be right in a perfect world, but systems generally need control of their issued currencies for a variety of reasons – both good and bad.

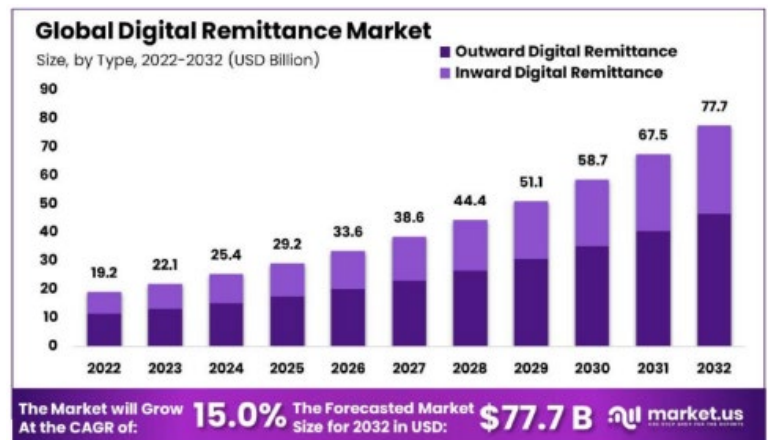
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## Global Remittance

Many people from poorer countries sacrifice a meaningful aspect of life by moving to and working in wealthier countries and then sending most of what they make back to their families. This is called remittance. It is viewed by economists as beneficial to poorer countries as it spurs consumer spending (by the recipient family using the remittance), increasing the GDP of the receiving country and thereby indirectly assisting all of the country's inhabitants. But it has historically been very expensive to send funds back home, with a recent IMF<sup>4</sup> report estimating a 7.5% average fee which comprises the transfer and exchange of a remittance.<sup>5</sup>

Crypto enthusiasts believe that using cryptocurrencies could lower this fee dramatically. I am only partially skeptical. Unless poorer country inhabitants can use crypto just like they use their nation's fiat currency (like in El Salvador, which recently made Bitcoin legal tender!) they still would incur a hefty exchange rate. In addition, I believe cryptocurrencies also have a transaction fee associated with them that is higher on a percent basis for lower transaction levels. Remittances are generally numerous and in small increments of value, so that could mean increased cost. All that said, the positives of **digital** technology, inclusive of blockchain and other innovations brought on by cryptocurrencies, should result in downward fee pressures – a net positive for the world!<sup>6</sup>

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<sup>4</sup> [How Do Transaction Costs Influence Remittances \(imf.org\)](https://www.imf.org/en/Publications/WP/Papers/2022/01/01/How-Do-Transaction-Costs-Influence-Remittances)

<sup>5</sup> [The Role of Crypto in Remittances: Revolutionizing Global Money Transfers | by Ulrik K. Lykke | Medium](https://www.medium.com/@ulrikklykke/the-role-of-crypto-in-remittances-revolutionizing-global-money-transfers)

<sup>6</sup> [Digital Remittance Market Size, Share | CAGR of 15.0%](https://www.market.us/digital-remittance-market-size-share-cagr-of-15-0)





The US, as an example, issues currency for the presumed good of its citizens (us!). And, because it has control of its currency, it can increase the supply dramatically to assist us at times of dislocation (Covid, for example) and reduce it at other times (such as to combat inflation). Countries without control of their money printing press have fewer options in maneuvering stressful periods – the difficulties of some of the southern EU states during the financial crisis (2008-09) is an example of this within modern, developed countries. For example, Greece, Italy, and Spain have limited control of the Euro).

Corporations also have an interest in controlling a created currency used within their platforms. Sims wants to control Simoleons just as does American Express insists on controlling its “points” for obvious reasons – both entities would be happy to have inflows but would be devastated by massive outflows where, all of a sudden, they have unanticipated obligations to third parties.

Sixteen years after its birth, crypto as a currency has not made it into the mainstream. Individuals simply do not use cryptocurrencies to transact.<sup>7</sup> They **DO** use cryptocurrencies either as a storer of wealth, similar to gold, or as a speculative investment with the thesis that it will either one day become a currency of choice<sup>8</sup> or, more realistically, a storer of wealth.

## Human (Crypto) Ingenuity

Regardless of what one thinks of cryptocurrency, the infrastructure and ecosystem supporting it arose pretty much overnight and have been impressive both in terms of innovations and in how quickly a parallel financial system has been built. Yes, there have been many high-profile frauds, and crypto can facilitate criminal activity, but unfortunately this happens in the regular financial world as well. Besides, the technology is still new, meaning it has not yet been as severely tested as has our modern financial system.<sup>9</sup> Nascent, exciting technologies attract bad apples as well as good ones! And this parallel financial system should put pressure on the traditional one to lower costs and further innovate, which is a positive for the world over. Further, the innovative validating technologies of cryptocurrencies, as well as the ability to digitally program contracts, provide many beneficial use cases.

For instance, you could have a smart contract where if a certain event occurs (e.g., Chiefs win the Super Bowl), a participant to the contract automatically receives a payment. This solves counterparty risk and can essentially get rid of the need for escrow accounts. For example, there could be a smart contract tied to a court decision or the handing over of a deed for a house.

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## Deep Thought of the Month: Deepfake!? Mind Control?!

During our recent **Advisor Summit**, I used some of my speaking time to attempt to scare the participants with amazing innovations that can also go wrong – which brings up the topic of regulation: How much do we want certain industries regulated?

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<sup>7</sup> To be fair, transactions do occur in crypto but it is very minimal relative to transactions using alternative means.

<sup>8</sup> For Bitcoin in particular which sharply created scarcity through the difficulty of “mining” a coin and a strict limit on overall issuance, adoption should result in an increase in value which creates some ponzi like characteristics. For those cryptocurrencies without scarcity built in, one should be hesitant in participating.

<sup>9</sup> Which means there will inevitably be more disasters in the crypto world.







Here is the article I referenced: [Mind-Decoding Technologies Raise Hopes \(and Worries\) \(undark.org\)](https://undark.org/2024/01/03/brain-computer-neurorights/)<sup>10</sup> highlights the existing capability of scientists to introduce artificial memories in mice. They could therefore most likely introduce them in humans in the not-too-distant future. It also highlights the **current capability to read human minds**. The positive is the capability to allow mind control for positive reasons such as allowing a fully paralyzed person to communicate. The negatives are dystopian nightmares similar to *Minority Report*,<sup>11</sup> where crimes are stopped prior to taking place by reading people's thoughts.



Jerry Tang prepares to collect brain activity data using an fMRI machine at the University of Texas at Austin. Using a large, expensive machine is a hurdle for widespread use of Huth and Tang's decoder. *Visual: Nolan Zunk/University of Texas at Austin*

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More relevant perhaps to this Commentary is the increasing ability to assume someone's identity—the recent Taylor Swift AI deepfake, for example, has captured international attention. While it is not inspiring (because why can't we all just be nice humans!), perhaps future posts will come with a level of authentication provided through blockchain technology that essentially verifies the author. Us non-famous world participants may not need it, but Taylor Swift certainly may be interested. She can use a private key in validating anything she puts her stamp of approval on, and the rest of the world can verify through a public key.

<sup>10</sup> <https://undark.org/2024/01/03/brain-computer-neurorights/>

<sup>11</sup> [Minority Report \(2002\) - IMDb](https://www.imdb.com/title/tt0211512/)

<sup>12</sup> <https://undark.org/2024/01/03/brain-computer-neurorights/>



## Summary

We wrote about Bitcoin this month as the SEC finally approved Bitcoin ETFs. The SEC has a mandate to protect retail investors, which it typically does by focusing on definitions of the product and risk disclosures, but this time it attempted to simply not approve. The issuers brought them to court and won. It marks yet another impressive mark for the growth of Bitcoin specifically and cryptocurrencies generally.<sup>13</sup>

Based on current trends, cryptocurrencies seem to have a path to be a storer of wealth, similar to gold, diamonds, and other hard commodities whose value is almost completely based on our assessment of it rather than the utility of the commodity.

But it has also introduced amazing technological innovations that hopefully will assist the world in its drumbeat forward in terms of health, wealth, and well-being. Due to these innovations, we believe cryptocurrencies, either directly or indirectly, will be a net benefit to the world in the long term and hopefully a positive for those invested in the actual cryptocurrencies themselves.<sup>14</sup>

***IMPORTANT DISCLOSURE:*** *The information contained in this report is informational and intended solely to provide educational content that we find relevant and interesting to clients of Fountainhead. All shared thoughts represent our opinions and is based on sources we believe to be reliable. Therefore, nothing in this letter should be construed as investment advice; we provide advice on an individualized basis only after understanding your circumstances and needs.*

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<sup>13</sup> There is also some interesting strategy at play among the issuers as Grayscale converted their expensive closed end fund to an ETF charging 1.5% while all other participants are closer to 0.25%. Grayscale knows (1) the entry level of their constituents so has an idea of paper gains and (2) most likely recognizes, given their head of product, that many investors are slow to move to the most efficient choice. One last note: It seems like all of the issued ETFs use the same underlying index which means moving from one ETF to another within 30 days would trigger a wash rule which does not allow the generating of a tax loss.

<sup>14</sup> Note that this is not a recommendation to invest or not invest in cryptocurrencies or other investments tied to them. We are focused here just on the potential positives and negatives of the impacts.

