Seed Weekly

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seed investments

Bitcoin, A Speculation and Warning!

Before I begin, I would like to clarify the difference between three financial concepts –

<The Background>

- Investing : Purchasing monetary assets with the expectation that they will provide income and / or profit in the future.
- Speculation : As above, but there is hope of gain and risk of loss with no firm evidence.
- Gambling : As above, but with uncertain outcomes where the risk of loss outweighs the risk of gain in the long run.

Bitcoin is a digital currency, aiming to do away with some of the challenges posed when purchasing goods or items online.

1. Middleman - Everything we buy today must go through a bank or intermediary, who in turn take a cut for providing us with trust.
2. Balance verification - We trust middlemen to verify balances and so avoid what is known as the “double spend” problem.
3. Scarcity - Central banks print money and devalue people's money as a result. (Don’t keep it under the mattress).

With bitcoin, all users on the network verify transactions at the same time, solving the first two problems. This means that no single user or institution can force or decline a valid transaction. Neither can they control (or manipulate) the flow of value - not even cross border. Bitcoin has a finite supply, with an estimated 21 million bitcoins in issuance to be reached by around 2040. With governments or institutions being unable to “print” or “produce” bitcoin and thereby devaluing purchasing power (as with traditional money), true scarcity is achieved. That is why they call bitcoin a “deflationary currency”.

Did I mention “fraction of the cost” transfers? This is because there are no middlemen. For example, bitcoin to the value of R16 bn has been moved within a couple of hours at a cost of only R 1,900.

Whether bitcoin will become the "digital gold" of the internet is anyone’s guess – and only time will tell.

Speaking of time, global adoption has been on the slow side. Albeit not too slow; there are currently 6,755 cryptocurrency ATM’s worldwide. South Africa is home to seven bitcoin ATM’s, with three of these stationed in the Western Cape (two in Cape Town and one in Stellenbosch).

<The Speculation>

I would like to share a speculative idea with you, but please read the warning below and treat this as speculation - not investing - and only use money you are prepared to lose.

I am not giving advice here

Bear with me as I explain the speculation via an analogy.

Let us imagine for a minute we are back in the sixties and operating under the gold standard. Now, let us further assume that for some reason, other than a change in gold prices, the gold miners' profit halves. Be it regulation or difficulty of unearthing gold - it does not matter.

In a scenario like this, what will happen to the miners, the price of gold and the general price level? Well, let us use some basic supply and demand principles to see if we can arrive at a rational conclusion. Who are always first to move? Speculators of course! Those that “know” what is about to happen will step into the market and start buying gold, putting upward pressure on the gold price even before anything has happened.

What are the miners to do? First, they could lay off some variable costs... but versus the fixed cost of setting up mines, this would only save them in the short run. The miners who haven't reached economies of scale will start to shut down production and sell some, or all, of their assets in the medium to long term, including their unearthed gold inventory. This may typically put short term downward pressure on the gold price.

Bitcoin, A Speculation and Warning!

With less mining infrastructure and/or miners able to sell gold, supply decreases. This in turn puts upward pressure on the gold price and this is what the speculators have bargained on. The higher gold price brings an increase in purchasing power for holders and thus also deflationary pressure on the general price level.

In another digital reality, the above analogy is far from unreal. It is time (again) for the bitcoin halving. The halving means that the computer “miners” that facilitate bitcoin transactions will have their income cut in half for doing the same work. The current estimated date for this to occur is on the 11th / 12th of May 2020.

As in the above analogy the speculators have already begun speculating and possibly explaining the recent rise in the price of bitcoin ($6,300 to $10,000). Once the halving happens in May, miners' profitability will decrease resulting in the probable closure of some of them. With less supply and the same or higher demand, we should see the price increase, ceteris paribus. This will not happen overnight and should play out over a couple of months to a year.

<The Warning>

Watch out for bitcoin scams!

These scams take various forms; Malware scams, fake bitcoin exchanges, Ponzi schemes, fake bitcoins and for the more tech savvy, ICO scams.

For now, I would like to focus on the one that four people I personally know have already been caught in, totalling almost R 250,000 in destroyed personal wealth. These are fake bitcoin exchanges.

These crooks pose as some celebrity on social media, or present themselves as internet adverts, promising to make the reader tons of money "just like they made" with bitcoin. By clicking on the advert, you are redirected to a seemingly legitimate exchange, with actual live pricing.

The first way they catch speculators is with the belief knowledge that the layman does not know how to manage this risk, especially when it comes to leverage. They go all in, thinking they are buying bitcoin, unaware that if the market moves against them just enough, they could lose their entire account balance. Especially with a leverage of 200 times.

Lastly, these "exchanges" make it near impossible to impossible to withdraw your funds.

Usually the reader can scroll to the bottom of the webpage and see the address of the business. They are most often incorporated in a country (or island) with loose financial regulations and very little regard for protecting an investors’ wealth. Qtek.IO is a common example.

Be careful of these adverts! No good can come from them.

<The Way/s to Buy Bitcoin>

There are two main types of wallets in which to store your bitcoins, namely, cold and hot wallets.

Cold wallets refer to where the bitcoin address and private key (password) are stored in a location NOT connected to the internet. This can be paper or a piece of hardware like the Trezor or Ledger Nano. If you go to one of the ATM’s mentioned above, you input your Rands and they provide you with a paper wallet. Or you provide them with the paper wallet, and they provide you the Rands. The hardware wallets save the function of the paper wallets on a USB-drive-like device, and come with software to aid in transfers to and from the device to any other bitcoin address.

Hot wallets, on the other hand, refer to where the bitcoin address and private key are saved on devices, websites or exchanges (any location connected to the internet).

Bitcoin, A Speculation and Warning!

Having a combination of both seems like the safer and more efficient way of speculating on bitcoins.

Opening an account by a trusted exchange such as Luno (local) or Kraken (offshore) is straight forward. Depositing and withdrawing Rands is easy and works reliably (for a fee, of course). Both exchanges can and do send bitcoins to another bitcoin address within minutes. This is where a cold wallet comes in handy (safe storage of bitcoin).

<The End>

I really wanted to end with an economics joke, but there was not enough demand.

The Real End,

Evan Smit *B.Com*

Business Analyst

Bitcoin, A Speculation and Warning!

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