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ADVISORS

# THE INVESTMENT CASE FOR BITCOIN

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## OVERVIEW

Investors are currently facing the biggest challenge in a generation: how to generate investment returns in an increasingly complex environment:

- + The U.S. government is dramatically increasing the money supply, devaluing the dollar and generating fears of inflation.
- + Bonds and fixed income securities, which have traditionally been up to 40% of an investment portfolio, are yielding close to nothing.
- + Public equities are close to all-time highs, leaving investors to worry about much-anticipated corrections due to the actual status of the economy.

## WHAT IS BITCOIN?

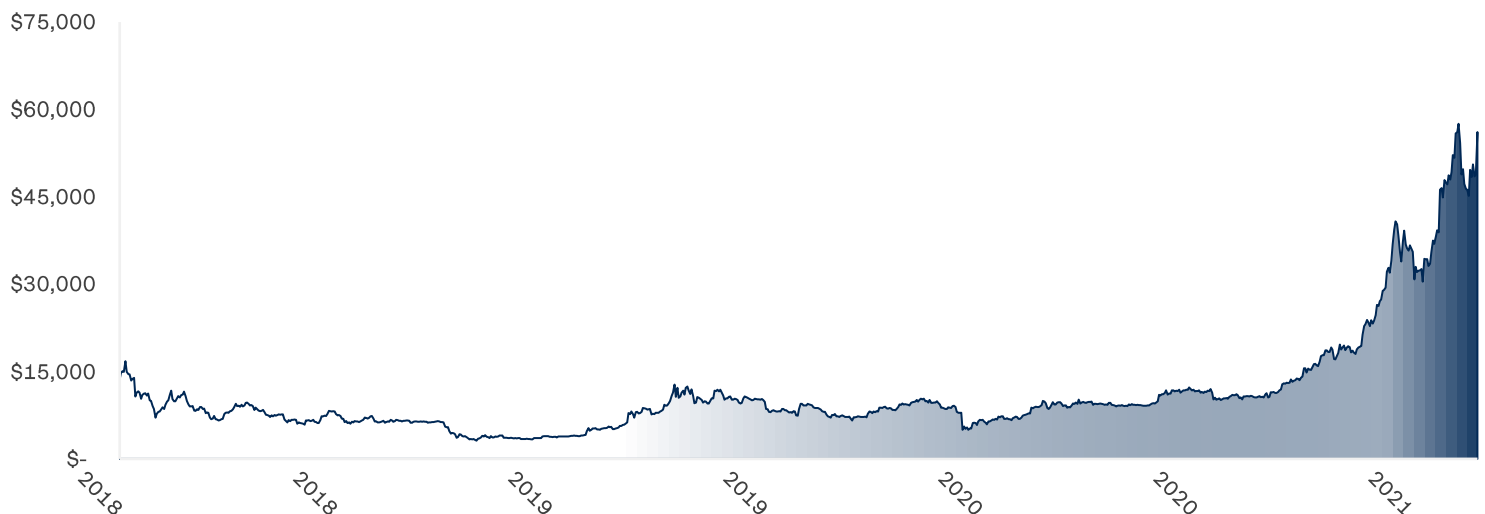
Bitcoin was launched in 2009 as a digital currency that enabled users to transfer value between one another through the internet without the need for a central intermediary such as a bank or credit card company. As the asset grew over time, more and more investors discovered bitcoin's attractive qualities that include scarcity, seamless transferability, durability, divisibility and decentralization.

Bitcoin is a new asset that can best be described as an *emerging store of value* that is disrupting other store of value assets including gold, fiat currencies, and financial assets. Bitcoin has retained its purchasing power, has a strong adoption rate, and is as liquid as a large cap equity. Bitcoin is currently in price discovery where investors are learning about bitcoin's store of value qualities, built-in network effects, and global adoption. Bitcoin has not yet reached its fair market value which we believe is in the trillions of dollars. As bitcoin adoption continues, volatility will decrease, and bitcoin could eventually be used as a global medium of exchange. **The investment case for bitcoin has three main investment drivers:**

1. Bitcoin continuing to take market share from gold as an alternative store of value.
2. Macro environment as a catalyst for demand due to quantitative easing and low interest rates.
3. Strong demand outlook for retail and institutional investors searching for an inflation hedge and growth asset.

### FIGURE 1: BITCOIN PRICE FROM 2018 TO 2021

Source: Bloomberg



## BITCOIN VS. GOLD

### Similarities to Gold

Bitcoin has very similar qualities to gold, which is why investors view it as both an emerging store of value and macro hedge.

- + **Non-sovereign:** No government, central bank or organization can manipulate or print more bitcoin.
- + **Scarce:** Bitcoin has a hard cap supply of 21 million and bitcoin's scarcity increases over time.
- + **Non-correlated:** Bitcoin has a very low correlation to traditional assets which can help reduce exposure to economic cycles and make it an attractive addition to an investor's diversified portfolio.



**Non-Sovereign**



**Scarce**



**Non-Correlated**

### Advantages Over Gold

Bitcoin has key advantages over gold which is why we are seeing many institutional investors and smart money allocate capital to bitcoin over gold. Bitcoin's major advantages include:

- + **Digital:** Bitcoin is a digitally native asset which will only increase in value and adoption as the global economy becomes more digitized. Bitcoin has future utility as a global payment and settlement network that gold does not have. Millennials understand this which is why bitcoin is a top 5 holding of millennials.
- + **Network Effects:** Bitcoin has built in network effects similar to Facebook, Instagram and Uber which is how bitcoin has a viral loop that has helped it grow to over 120 million users. We believe that bitcoin users could reach 1 billion by 2026. Gold does not have a built-in network effect.
- + **Higher Upside:** While bitcoin has store of value qualities like gold, bitcoin also has an opportunity to gain a large amount of market share in the market for stores of value (gold, Global M2, real estate, and financial assets). Bitcoin is a growth and technology investment that is taking market share from these incumbents.



**Digital**



**Network Effects**



**Higher Upside**

## MACRO ENVIRONMENT

### Fundamentals

The biggest hurdle investors face when trying to understand bitcoin is the fact that there are no fundamental metrics such as cash flow, P/E ratios, or book value. This is because bitcoin is the first technology and asset that is competing in the market for store of value assets.

Bitcoin's fundamental metrics are different than these traditional investments. Bitcoin's fundamental metrics include user adoption, valued stored on the network and daily transactional volume:



**120 Million**  
120 million bitcoin users



**\$1 Trillion**  
Over \$1 trillion dollars of investor wealth is stored in bitcoin.



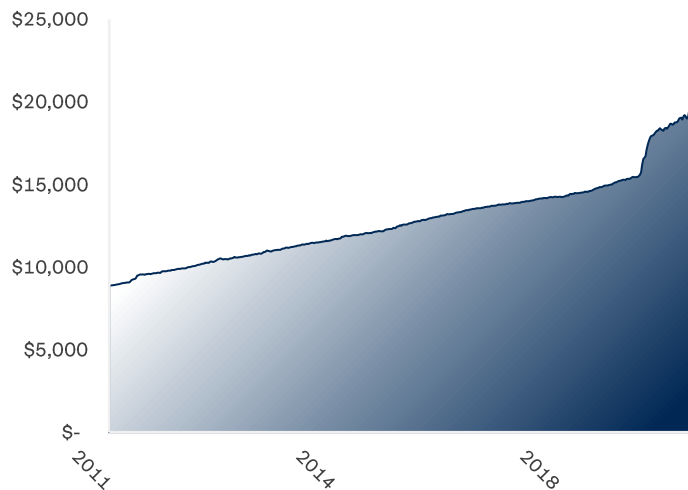
**\$50 Billion**  
Daily transaction volume on the bitcoin network

### Monetary Stimulus

Central banks throughout the world are engaging in quantitative easing to combat the economic issues resulting from the COVID-19 epidemic. This has led to investors looking for assets that can benefit from this monetary stimulus and increased uncertainty. The Fed has printed over 35% of the U.S. Dollar in existence since March 2020. While central banks are engaging in quantitative easing, **bitcoin is programmed to quantitatively tighten**. Bitcoin has a fixed supply schedule of 21 million programmed in the Bitcoin network's code that no central bank, government or organization can change. There is currently 18.5 million bitcoin in circulation and only 2.5 million (12%) will be minted over the next 120 years. Bitcoin's incremental supply rate decreases by 50% every four years.

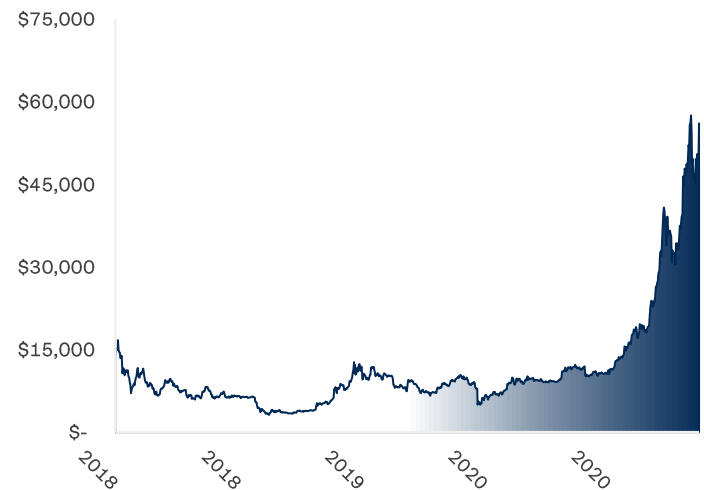
**FIGURE 2: M2 MONEY STOCK**

Source: St. Louis Fed (\$ in billions)



**FIGURE 3: BITCOIN PRICE**

Source: Bloomberg



Paul Tudor Jones stated in a May 2020 investment memo that he believes we are living through the "Great Monetary Inflation" and that bitcoin will be the best performing asset in response. This divergence is why investors are moving their wealth and capital to bitcoin.

Source: <https://woobull.com/>, St. Louis Fed, <https://www.coindesk.com/price/bitcoin>

## INSTITUTIONAL DEMAND

### The Smart Money Has Arrived

Bitcoin initially launched in 2009 but did not come on most institutional investor's radar until 2017 when the price of bitcoin went from \$1,000 to \$20,000. Over the past four years, these institutional investors have conducted the investment diligence on the emerging store of value and have determined it is a suitable investment for their portfolios given the institutionalization of the market structure, regulations, and custody. This includes macro investors, university endowments, insurance companies, public companies, energy companies, pension funds, and wealth management firms. There are many other institutional investors that are actively allocating to the emerging asset that have not yet made their bitcoin investment public. This technology and market is still in the early stages.

#### Who's In?

**Paul Tudor Jones**

CIO, Tudor Investment Corporation

**Peter Thiel**

Co-founder of PayPal and Palantir

**Elon Musk**

Founder of Tesla and PayPal

**David Swenson**

CIO, Yale Endowment

**Jack Dorsey**

Co-founder of Square and Twitter

**Marc Andreessen**

Founder of a16z

**Chamath Palihapitiya**

Founder of Social Capital

**Ric Edelman**

Founder of Edelman Financial Engines

**Abigail Johnson**

Chairman & CEO of Fidelity

#### Quotes

*"The Bitcoin story is very easy, it's supply and demand. Bitcoin's supply is growing at around 2.5% a year, and **the demand is growing faster than that** and there's going to be a fixed number of them."*

**Bill Miller**

Investor, Mutual Fund Manager

*"At the end of the day, the best profit-maximizing strategy is to own the fastest horse. If I am forced to forecast, **my bet is it will be Bitcoin.**"*

**Paul Tudor Jones**

CIO of Tudor Investment Corporation

#### Financial Institutions



**Morgan Stanley**

**MassMutual**

Source: <https://www.coindesk.com/>, <https://www.institutionalinvestor.com/article/b1mmvg200ctr0/Wall-Street-s-Crypto-Cold-War>

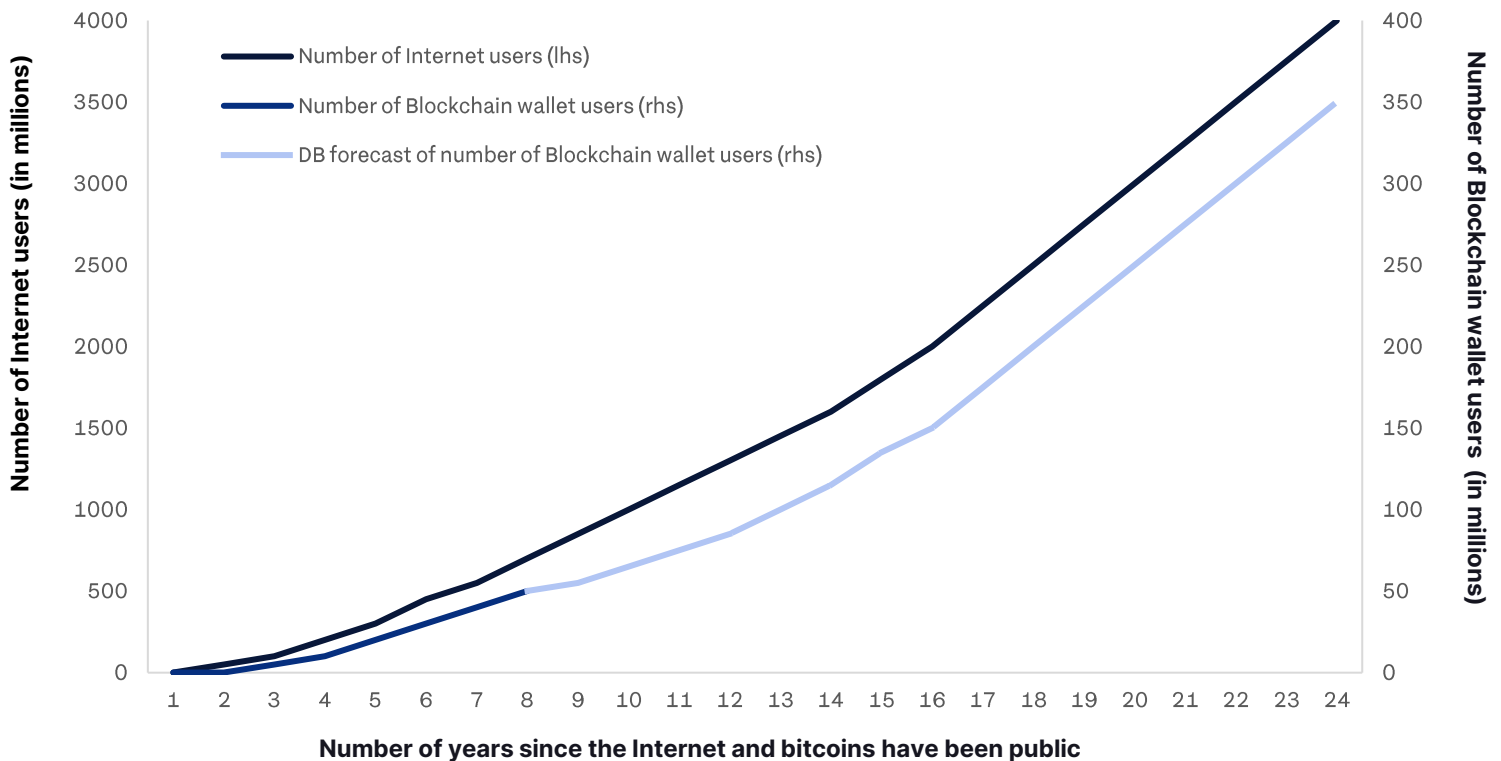
# BITCOIN ADOPTION

## Adoption Curve Similar to the Internet

Bitcoin has grown from only a few hundred users in 2009 to over 120 million users today. This is the same number of users that the internet had in 1997 and why bitcoin analysts continually state that we are still in the early innings of this emerging asset class. Adoption is being driven by a few different factors. The first is institutional investors in the US who are looking for both a defensive and offensive alternative investment. Bitcoin is a global asset that trades in over 200 countries around the world. Bitcoin is being adopted in various countries where the local currency is volatile such as Argentina, Venezuela, and Turkey. Investors are also adopting bitcoin in countries with authoritarian governments. Bitcoin is extremely portable, and an investor could easily move \$100,000 of bitcoin out of a country. This would be near impossible with \$100,000 of gold.

We are also seeing the millennial generation adopt bitcoin as their trusted store of value. Millennials are the first digitally native generation, and they understand the power of digital technologies and digitally native assets. A recent Charles Schwab study showed that bitcoin is a top five holding among millennials. As \$68 trillion is transferred to the millennial generation over the next twenty years, we believe a percentage of that capital will be allocated to bitcoin which will continue to be a strong demand driver. If bitcoin follows a similar adoption curve to the internet, we believe bitcoin could reach 1 billion users by 2026.

**FIGURE 4: ADOPTION RATES OF CRYPTOCURRENCIES AND INTERNET**



Source: Charles Schwab, Deutsche Bank forecasts, InternetWorldStats.com and Blockchain.com. We measure "adoption rate" by the number of users adopting internet and bitcoins since they went public. [https://www.dbresearch.com/PROD/RPS\\_EN-PROD/PROD0000000000504589/The\\_Future\\_of\\_Payments\\_-\\_Part\\_III\\_Digital\\_Currenc.pdf?&undefined&reaload=ZeafjOp4xasQemg~AntQmiLgtLovOnGIYgtRiwXKJTjzhX9GnNSzGzGK6Tur94nDtST9dhqB4fb68famNBibQ==](https://www.dbresearch.com/PROD/RPS_EN-PROD/PROD0000000000504589/The_Future_of_Payments_-_Part_III_Digital_Currenc.pdf?&undefined&reaload=ZeafjOp4xasQemg~AntQmiLgtLovOnGIYgtRiwXKJTjzhX9GnNSzGzGK6Tur94nDtST9dhqB4fb68famNBibQ==)

## INVESTMENT RISKS

### Custody Risk

Bitcoin and other digital currencies are bearer assets, meaning that whoever is in possession of them owns them. Therefore, the single biggest concern for investors is that bitcoin and other digital assets are custodied in the most secure manner. The top-tier digital asset custodians use NSA security and encryption protocols to secure the client's bitcoin. The digital asset custodians and other crypto industry participants strive to provide the fullest protection possible, but there is always the possibility that theft, whether by machine or by human. As new technology contributes to even better safety protocols and digital custodian balance sheets continue to grow, this risk declines every day. Eaglebrook mitigates custody risk by implementing even higher levels of security procedures including multi-factor authentication, biometric access, and disabled withdrawals of bitcoin (only USD can leave your account and go back to your bank or brokerage account).

### Adoption Risk

While bitcoin has a similar adoption curve to the internet, there is a risk that adoption decreases due to various factors including competitive digital assets, regulatory concerns, and volatility.

The emerging asset's investment thesis and narrative drives its value and bitcoin has been fortunate enough to have multiple things fuel its adoption and demand growth over time including:

- Being an independent, non-sovereign, and scarce asset that utilizes blockchain technology.
- Having global investors consider it a store of value in the form of "digital gold".
- Making its way on to corporate balance sheets as a hedge against potential inflation and currency devaluation during a time of fiscal and monetary expansion.

### Regulatory Risk

Bitcoin has been classified by the SEC as a commodity and not a security. It is always possible that an extreme event, like the U.S. government banning bitcoin, can happen. But the U.S. has legal crypto exchanges, corporate entities have bitcoin on their balance sheets and native, and digital asset companies are going public. There is regulatory "risk" that many digital assets become classified as securities, but then they would fall into an existing environment that includes the S.E.C., broker/dealer licenses and investor protections that are already put in place.

### Other Risks

There are some things that are almost impossible to forecast, yet present risk:

- Quantum Computing** – New forms of computing could be powerful enough to overcome the inherent protection offered by the cryptography of digital assets.
- Technical Risk** – New updates to bitcoin's core software code introduces a bug or flaw that causes the network to seize or fail. This has never happened in bitcoin's 12 years of existence and each day that the network functions is further validation that this risk is minimal.
- 51% Attack** – A group of humans or some form of entity could hypothetically gain control of 51% of all the computers on the bitcoin network, effectively giving it the ability to commit fraud by re-writing transactions on the blockchain. However, the cost, number of machines to control and amount of electricity needed would be staggering. And as the bitcoin network expands and grows every day, this risk also becomes less likely.

## INVESTMENT RECOMMENDATION

We believe bitcoin presents one of the best alternative investments in the current market environment and can be summed up as follows:



Bitcoin will **disrupt gold as a store of value** due to adoption by millennials, the resulting network effects and better utility than gold



The uncertainty created by continued monetary stimulus and quantitative easing is leading to **increased demand for bitcoin as an alternative to fiat money**



Bitcoin is **the only alternative investment** that allows an investor to play “defense” (safe haven, store of value) and “offense” (growth asset, price appreciation) at the same time.

We believe bitcoin’s asymmetric investment profile can generate attractive returns as adoption continues and the emerging asset takes market share from other stores of value.

Subject to each individual investor’s risk profile, **we recommend an initial low, single-digit allocation to bitcoin**, in line with other alternative investment weightings.

### DISCLOSURES

*Investment advisory and management services are provided by Eaglebrook Advisors, Inc., a registered investment advisor. Please see our Form ADV Disclosures and Privacy Policy in our website.*

*Price Volatility of Digital Assets – A principal risk in trading Digital Assets is the rapid fluctuation of market price. High price volatility undermines Digital Assets’ role as a medium of exchange as consumers or retailers are much less likely to accept them as a form of payment. The value of client portfolios relates in part to the value of the Digital Assets held in the client portfolio and fluctuations in the price of Digital Assets could adversely affect the value of a client’s portfolio. There is no guarantee that a client will be able to achieve a better than average market price for Digital Assets or will purchase Digital Assets at the most favorable price available. The price of Digital Assets achieved by a client may be affected generally by a wide variety of complex and difficult to predict factors such as Digital Asset supply and demand; rewards and transaction fees for the recording of transactions on the blockchain; availability and access to Digital Asset service providers (such as payment processors), exchanges, miners or other Digital Asset users and market participants; perceived or actual Digital Asset network or Digital Asset security vulnerability; inflation levels; fiscal policy; interest rates; and political, natural and economic events.*

*Digital Asset Service Providers – Several companies and financial institutions provide services related to the buying, selling, payment processing and storing of virtual currency (i.e., banks, accountants, exchanges, digital wallet providers, and payment processors). However, there is no assurance that the virtual currency market, or the service providers necessary to accommodate it, will continue to support Digital Assets, continue in existence or grow. Further, there is no assurance that the availability of and access to virtual currency service providers will not be negatively affected by government regulation or supply and demand of Digital Assets. Accordingly, companies or financial institutions that currently support virtual currency may not do so in the future.*

*Custody of Digital Assets – Under the Advisers Act, SEC registered investment advisers are required to hold securities with “qualified custodians,” among other requirements. Certain Digital Assets may be deemed to be securities. Currently, many of the companies providing Digital Assets custodial services fall outside of the SEC’s definition of “qualified custodian”, and many long-standing, prominent qualified custodians do not provide custodial services for Digital Assets or otherwise provide such services only with respect to a limited number of actively traded Digital Assets. Accordingly, clients may use non-qualified custodians to hold all or a portion of their Digital Assets.*

*Government Oversight of Digital Assets – The regulatory schemes—both foreign and domestic—possibly affecting Digital Assets or a Digital Asset network may not be fully developed and subject to change. It is possible that any jurisdiction may, in the near or distant future, adopt laws, regulations, policies or rules directly or indirectly affecting a Digital Asset network, generally, or restricting the right to acquire, own, hold, sell, convert, trade, or use Digital Assets, or to exchange Digital Assets for either fiat currency or other virtual currency. It is also possible that government authorities may take direct or indirect investigative or prosecutorial action related to, among other things, the use, ownership or transfer of Digital Assets, resulting in a change to its value or to the development of a Digital Asset.*





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