Brockenbrough

Crypto Finally Finds a Seat at the Table **Mid-Quarter Commentary**

Quoting Paul Volcker, the heroic former Fed Chairman who tamed inflation in the 1980s, "I wish someone would give me one shred of neutral evidence that financial innovation has led to economic growth—one shred of evidence." He was no fan of ever-increasing financial complexity, generally condemning it as Wall Street's obsession with self-enrichment at the expense of financial stability. Amen! Crypto must have Mr. Volcker violently thrashing in his grave. I had well and truly hoped crypto would go the way of fake meat: annoyingly on the menu but rarely ordered. How naive. There's a proverbial gold rush going on here, with an endless army of prospectors laying claims, digging holes and peddling get rich schemes. Even the President has a coin. I'm skeptical.

There's literally an entire industry, nascent ten years ago, trying to figure out what, beyond speculation, crypto might be good for—the perfect solution looking for a problem. I should have known that they'd eventually figure out a way to make us use it. They call it Stablecoins. And as the name implies, issuers have devised a way to make a crypto coin stable. They financially tie the value of the coin to the value of the dollar or some other stable asset. I'll spare you the details, but there are well-established financial tools for tying the value of one thing to another. A stablecoin tied to the dollar will always reflect the value of a dollar…according to the folks issuing dollar-linked stablecoins.

So where is this going? Earlier this year both Amazon and Walmart revealed they are exploring stablecoin payment systems to bypass traditional card payment networks like Visa and Mastercard that charge them fees that they'd like to pay less of. As I understand it, you'd have a digital wallet (an account) containing money (crypto coins, maybe dollars too) and you'd use this 'money' to exchange for Walmart stablecoin and then make purchases at Walmart, perhaps other places too. Of course, this future transaction wouldn't be as cumbersome as my explanation. I imagine it'll be as simple to you as tapping a card is now, perhaps even more so. The accounting is managed by a blockchain, a distributed, unalterable ledger. (Google it if you want more info.) In fact, the whole crypto ecosystem was/is made possible by the invention of blockchain. The use of stablecoin and blockchain infrastructure to facilitate cheaper and faster transactions outside of the traditional banking system is growing rapidly and there are other uses in the works too: titles, inventory, stock trading— any transaction involving specific ownership. Walmart and/or Amazon could just be experimenting, but this Stablecoin thing is happening. Of course, as with all financial innovation, it will take some time to determine what risks, if any, this new architecture presents, but that won't slow the roll-out.

Why am I writing about this now? The adoption of stablecoins likely spreads a patina of legitimacy over the entire crypto universe that I believe is undeserved. And with Bitcoin flirting with new highs, the dollar in a weakening trend and every new Congress passing bills that add trillions to the deficit, I'm concerned about crypto speculation getting out of hand. After all, true Bitcoin believers are convinced it will replace the dollar. It was probably invented to replace fiat currencies. Unlike dollars and yen and euros, you can't conjure more of it. Bitcoin is capped at 21 million coins. Crypto disciples hold dearest a dystopian vision of runaway debt and a collapsed dollar. They fervently believe Bitcoin is the future of money, but I believe it would be an epic financial disaster. Why? Because tens of trillions of dollars of debt would be at risk with a perpetually falling dollar and the concomitant rise in inflation and interest rates. And that's why I believe we will eventually make the tough choices necessary to avoid disaster, leaving Bitcoin without a purpose. What then? What price would you pay for something that serves no purpose and has no intrinsic value? In any case, I believe Bitcoin is not the future of money. As the late sage Charlie Munger, Warren Buffet's right-hand man, said a few years ago, "it's rat poison."

But it surely is sweet smelling bait, and between now and then, the speculative boom in crypto, including Bitcoin, probably continues. What to make of the White House embracing and tangentially profiting from a technology designed to replace the dollar with possible apocalyptic financial repercussions? And there are now big public companies principally in business to issue debt and equity to buy Bitcoin, levering their balance sheet to Bitcoin at ever higher prices with the avowed goal of never stopping. Does this all sound like business as usual? No. Does it make sense that tokens with ownership rights to precisely nothing can increase in value, without limit? No. In my opinion it's a classic mania and it's not over, maybe not even half over. More people will be sucked in; more companies will join in. Few are deaf to the sirens' song of a sure thing. The history of investment manias and bubbles is rich and goes back centuries. They say even Sir Issac Newton lost a fortune when he panic-bought into the late stages of the South Seas stock bubble back in 1720. Buyer beware.

I'll offer an alternative, admittedly the one in which I've spent my career: how about a diversified, well-positioned basket of public companies? You own a growing cash flow stream, receive a growing dividend check and benefit from a shrinking share base (most buy back their shares over time, increasing your ownership). And those companies have experienced management teams, prepared to deal with whatever economic circumstance we face. You'll have to settle for getting rich slowly, but you won't end up poor. I believe Paul Volcker would approve.

Richard H. Skeppstrom II serves Brockenbrough as Managing Director and Chief Equity Strategist. He manages two of our investment products and writes most of our investment commentary. Richard joined the firm in 2016 and has 30 years of experience in the investment management industry.
