



PWM Weekly Observations

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Bitcoin is Flying – Should I Care?

Bitcoin has taken off again, reaching new highs and grabbing headlines in the financial news. We have taken notice and we've been discussing Bitcoin's place, if any, in a portfolio. Some of our readers have likely traded and/or still own Bitcoin or one of the other digital currencies, so we felt it timely to focus on the concept of Bitcoin and other digital currencies and provide our perspective on what is happening and why. There are plenty of divergent opinions on the topic and this is ours.

What is Bitcoin?

Bitcoin is difficult to define so we went to Investopedia, which defines Bitcoin like this:

“Bitcoin is a digital currency created in January 2009 following the housing market crash. It follows the ideas set out in a whitepaper by the mysterious and pseudonymous Satoshi Nakamoto. The identity of the person or persons who created the technology is still a mystery. Bitcoin offers the promise of lower transaction fees than traditional online payment mechanisms and **is operated by a decentralized authority, unlike government-issued currencies** (our emphasis).”

“There are no physical Bitcoins, only balances kept on a public ledger that everyone has transparent access to, that – along with all Bitcoin transactions – is verified by a massive amount of computing power. Bitcoins are not issued or backed by any banks or governments, nor are individual Bitcoins valuable as a commodity. Despite it not being legal tender, Bitcoin charts high on popularity, and has triggered the launch of hundreds (now thousands) of other virtual currencies collectively referred to as Altcoins.”

The idea that someone could go out and create a new, independent money is rather astonishing, but that is exactly what may be happening as Bitcoin acceptance grows. The definition above is helpful in understanding Bitcoin, but in our view leaves too much to be desired. Any economics text will tell you that money has three basic functions: 1) Medium of exchange; 2) Unit of Account, and 3) A Store of Value

Money as a Medium of Exchange: This implies that money must be widely accepted as a method of payment. I might consider my baseball card collection as valuable, but I would have difficulty paying for my groceries with baseball cards. Those cards are not an acceptable method of payment.



Money as a Unit of Account: You can think of money as a yardstick; the device we use to measure value in economic transactions. The only way to compare two different items of value would be in terms of dollars.

Money as a Store of Value: If I earn \$25 today, can I hold onto it and spend it next week, next month, or even next year with little, if any, degradation in value? If I can, then I have a good store of value.

The dollar is currently the world's reserve currency because it best fits all of these criteria, particularly the last. There are other currencies, but they all have some limitation compared with the dollar. If that ever changes, the dollar will lose reserve currency status.

There are now over 5,000 altcoins in existence, but Bitcoin gets the bulk of the attention, primarily because it was the first, and is still the largest digital currency. Recently, PayPal announced that it will accept Bitcoin as payments on its platform for transactions, which means that as a medium of exchange, Bitcoin has become easier to use and is acting more like money as events like this happen. However, Bitcoin has been a poor store of value as the price has been like a roller coaster, hitting a high of about \$19,000 in late 2017, followed by a low of about \$3,200 in late 2019, and now back at its high. These rapid changes in value create problems when accepting Bitcoin as payment. Imagine getting paid in Bitcoin one day, only to have Bitcoin decline by 15% the next day, as happened this week? You might be reticent to accept Bitcoin again. While some will benefit from the price swings, it is a zero-sum game. For every 'Bitcoin winner' in the payment system that gains from appreciation, there has to be a loser on the other side of the transaction, so this volatility naturally creates as many dissatisfied users as satisfied users.

Is it Possible for Currency to be Independent of Government?

The bigger question that we see is whether there can be a place for a currency that is independent of any government. If you live in a country with a very weak currency (Venezuela, as an example) Bitcoin, along with gold and dollars, can be very attractive alternatives to a local currency that depreciates massively every day due to runaway inflation. In fact, Bitcoin might be even more attractive because dollars and gold are hard to find in Venezuela, while Bitcoin, as a digital asset can be more readily available, assuming you have internet access. Another advantage Bitcoin enjoys is divisibility. If you use dollars, you need to make change, which can be very difficult in Venezuela. Gold is even harder to divide. As a digital asset, Bitcoin is easily divided into very small pieces and therefore can be a preferred currency in places like Venezuela. In fact, you can buy pizza with Bitcoin in Venezuela ([See this link](#)). And here in the U.S., a new credit card is now offering rewards in Bitcoin, rather than in miles or cash. This time around, the rise in Bitcoin value has caught the attention of large investors, both institutional and individual, which has added to the Bitcoin credibility. Many will take comfort in that, but our perspective is that large institutions and individuals are as susceptible to financial bubbles as anyone. Just take a look at past bubbles.

The problem is that we cannot think of one time in recorded history where money that was not somehow backed a governmental entity was the norm. That raises the question of whether Bitcoin can ever become anything more than a collectable, because governments always demand control of currency and they would be very hard pressed to give up that control. Bitcoin has existed as a semi-underground currency for years now, we suspect largely because the use of Bitcoin has not been perceived as a threat to central banks and the underlying technology (blockchain) is considered extremely important, especially in the financial community.

But, central banks around the world are experimenting with digital currencies – digital dollars, euros, yuan, etc. and they are well on their way to becoming reality. The rise of digital currencies from government could eventually eliminate the need for cash and allow governments to track and tax much of the economy that is currently hidden in cash transactions. From that perspective, most altcoins, including Bitcoin, provide complete anonymity and could be increasingly perceived as devices to circumvent government scrutiny and therefore become the hubs for illicit activities. This would be an easy excuse to regulate these altcoins with much greater vigor as time passes



([See this link](#)). The anonymity feature also makes theft an issue. Bitcoin depositories have been hacked and Bitcoin stolen, with little or no recourse for the rightful owner because of this structure.

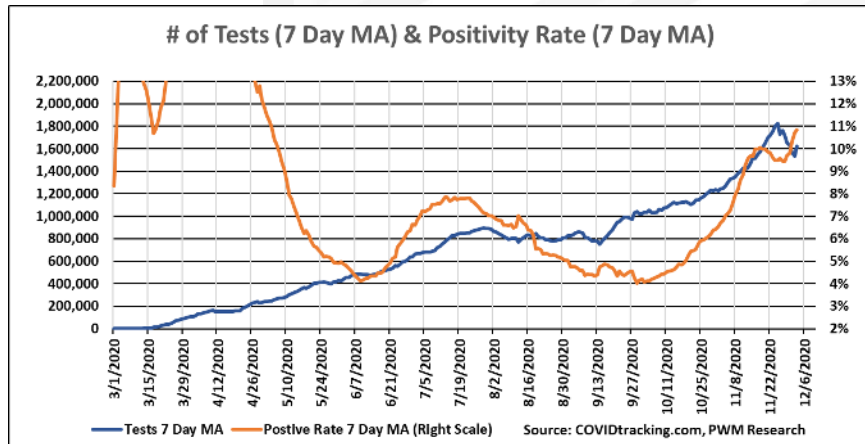
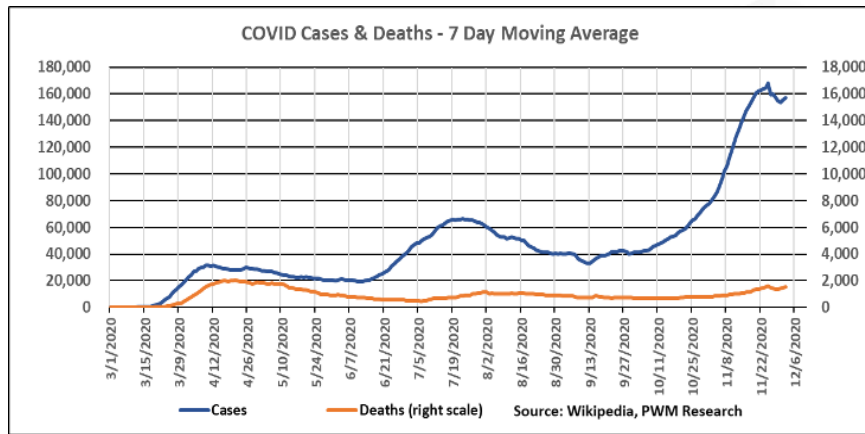
The efforts to take Bitcoin main-stream, like PayPal is doing, also increases the odds of government regulation. Any increase in acceptability of Bitcoin as a currency, degrades governmental money, digital or otherwise. As central banks develop their own digital currencies, they will insist on them dominating the financial landscape, raising the distinct possibility that Bitcoin can become a regulatory victim of its own success.

In our opinion, there are too many fundamental uncertainties to consider Bitcoin as a permanent part of an investment portfolio at this time. We can see no realistic avenue for Bitcoin to be accepted as currency by government, which implies that Bitcoin and other altcoins are probably limited to their value as a collectible. For any collectible, scarcity is a critical requirement and the total supply of Bitcoin is limited to 21 million. Once 21 million are 'mined' in existence, there will be no more Bitcoin created.

Then the critical question is whether Bitcoin is a highly valued collectable like [fine art](#) is for the very wealthy, or something more like [baseball cards](#), which have a dedicated collector community, or something like tulip bulbs 400 years ago in The Netherlands. ([See this link](#) for an explanation).

The bottom line is that we believe there are enormous hurdles that Bitcoin must yet navigate to truly become main stream. That, of course, does not mean it has no place in a portfolio, but it does imply that Bitcoin should be relegated to small positions in speculative accounts for those so inclined, not a core portfolio component, at least not yet.

Latest COVID Stats (without comment)





What We're Reading

[America's Greenest Energy Giant Isn't Trying to Save the Planet](#)

[The Surge in Global Biotech Innovation](#)

[Peak Oil Is Suddenly Upon Us](#)

[If You Left the Market, Don't Wait to Get Back In](#)

[The FDA's Political Inoculation](#) (WSJ, subscription required)

[The latest coronavirus relief proposals don't include \\$1,200 stimulus checks](#)

[New York State Assembly Gets New Class of Progressives](#)

[Hedge funds, not hipsters, may be powering bitcoin's second big rally](#)

[COVID Vaccines - Emerging Markets Could Benefit](#) (Barron's, subscription req'd)

[The 'everything rally': vaccines prompt wave of market exuberance](#)

Markets This Week

And the last shall be first.... Energy rebounded along with the stock market and led the way in a week where only Utilities and Homebuilders posted material declines. Interest rates began to tick up again, accounting for the broad weakness in Treasury markets. Higher Treasury rates did not, however, translate fully in credit markets as High Yield debt actually rose about half a percent on the week.

US Equities	1 week	YTD	Fixed Income	1 week	YTD	Sector Breakdown	1 week	YTD
S&P 500 (SPY)	1.69%	16.56%	20+ Yr. Treasuries (TLT)	-3.14%	15.88%	Consumer Disc. (XLY)	-0.15%	27.18%
Dow (DIA)	1.17%	7.99%	Barclays US Aggregate (AGG)	-0.57%	6.45%	Info. Technology (XLK)	2.82%	38.90%
NASDAQ (QQQ)	2.19%	44.27%	Intermediate Municipal (MUB)	-0.13%	4.19%	Financials (XLF)	1.79%	-3.91%
Russell 1000 Growth (IWF)	1.61%	34.21%	US Corporate Bonds (LQD)	-0.72%	9.39%	Health Care (XLV)	2.82%	11.94%
Russell 1000 Value (IWD)	1.87%	1.97%	Barclays US High Yield (HYG)	0.50%	2.65%	Utilities (XLU)	-2.15%	-0.79%
Vanguard Mid-Cap (VO)	2.00%	16.36%				Industrials (XLI)	0.44%	11.28%
Vanguard Small-Cap (VB)	2.03%	14.93%				Energy (XLE)	4.55%	-28.77%
						Materials (XLB)	0.10%	18.86%
International Equities	1 week	YTD	Commodities	1 week	YTD	Consumer Staples (XLP)	1.05%	9.49%
MSCI EAFE (EFA)	1.16%	5.94%	Commodities (PDBC)	0.03%	-11.87%	Comm. Services (XLC)	2.06%	25.76%
MSCI Emerging (EEM)	1.62%	13.99%	Gold (GLD)	2.70%	20.59%	REITS (VNQ)	1.80%	-4.48%
						Homebuilders (XHB)	-2.05%	25.70%

The table above is an analysis of the weekly and year to date returns of various markets/sectors that we follow (More RED = worse performing markets/sectors; More GREEN = best performing markets/sectors). Source: IEX Trading & PWM Research.

Retirement Planning:

[The Pros and Cons of Dividend Stocks for Retirement Savings](#)

Dividends can provide a steady stream of cash without having to dip into your principal.



Estate Planning:

[Top Estate Planning Considerations for Closing Out 2020](#)

The end of the year can be a convenient time to reflect on major life changes and plan for the future.

Tax Planning:

[U.S. appeals court skeptical of ending cap on state and local tax deductions](#)

A federal appeals court in Manhattan appeared skeptical of arguments by four Democratic-leaning U.S. states to overturn the cap on federal deductions for state and local taxes.

Health:

[Vaccination cards will be issued to everyone getting Covid-19 vaccine](#)

The Department of Defense released the first images of a Covid-19 vaccination record card and vaccination kits.

Entrepreneur:

[Making the most of virtual conferences](#)

Almost like being there...

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