Hard Money?

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Introduction

Cryptocurrency has been a concept since the early days of the internet when visionary coders believed in the potential for digital funds to be transferred seamlessly. Today, we are witnessing the realization of this vision, decades later. The current market for cryptocurrencies has the potential to fulfill this transformative vision or serve as a stepping stone towards its ultimate realization. As participants in this market, our role is to navigate and trade to the best of our ability and knowledge.

This report aims to provide general knowledge about the cryptocurrency market and highlight important considerations when dealing with the most volatile and wealth-consuming asset class, particularly in the post-Great Moderation era.

Relevant History

The history of Bitcoin comes before the technological boom, in the 1900s, where economists contemplated the idea of currency as tokens of value independent of the state, which laid the groundwork for Modern Monetary Theory (MMT). The concept emerged that currency is essentially tokenized debt issued by the state, and entities engaged in international transactions often relied on hard money, such as gold, silver, and commodities, for settlement. This understanding aligns with the principles of metallism (which is the economic principle that the value of money derives from the purchasing power of the commodity upon which it is based) and commodity money, which form the basis of Austrian economics and its perspective on domestic and international payment systems built upon tangible assets.

The divergence between MMT (Neo-Chartalism) and Austrian economics/Crypto believers stems from the conflicting viewpoints on how ledger money operates through debt-based fiat and metallism. This ongoing tug-of-war between these two schools of thought shaped the economic landscape from the 1900s to the 2000s.

The pivotal shift away from the gold system occurred when Kissinger negotiated with the Saudis (and the rest of the OPEC cartel) to peg their oil exclusively to US dollars, compelling them to invest their excess wealth in US Treasury Bills at a 7% yield during that time. This arrangement effectively rehypothecated oil multiple times, aligning it with the prevailing international dollar-based financial system of the 1970s. This pivotal moment led to the era known as the Great Moderation, and the best asset growth in human history.

Given the context provided, we can now appreciate the emergence of Bitcoin during the depths of the Great Financial Crisis (GFC) in a broader light. Following the dot-com boom and the subsequent turmoil in the financial system during the GFC, Bitcoin emerged as a decentralized means of transacting digitally, free from reliance on banks and intermediaries. The conservative approach adopted by banking and investment institutions, along with increased regulatory scrutiny and liquidity dependence, provided an opportunity for Bitcoin and the wider crypto ecosystem to serve as a volatile yet semi-illiquid form of ledger money, facilitating risk lending and borrowing at lower rates compared to traditional banking channels. This phenomenon gave rise to the financial game theory concepts of "halving" in Bitcoin and "burning" in Ethereum.

In summary, the birth and evolution of Bitcoin, along with the broader crypto ecosystem, can be seen as a transformative response to the challenges and opportunities presented by the Great Financial Crisis. Their success paved the way for the rise of retail and wholesale Central Bank Digital Currencies (CBDCs) and governments are recognizing the influence and impact of cryptocurrencies, driven by the principles of Neo-Chartalism, on the future of money and finance.

Market Overview

Name: Bitcoin (BTC)
Description: BTC is the native token for the Bitcoin ecosystem, and the progenitor for the modern crypto ecosystem. There is the halving of the token emission every 4 years that changes the stock to flow of Bitcoin, and its evaluation.
Source code: https://github.com/bitcoin/bitcoin
Whitepaper: https://bitcoin.org/bitcoin.pdf
Overview: https://coinmarketcap.com/currencies/bitcoin/
Market cap: $502,032,750,313
Price: $25,875.75
Website: https://bitcoin.org/

Name: Etherium (ETH)
Description: Etherium is the native token for the Etherium ecosystem, and it is the base layer for the multilayered crypto ecosystem through Defi smart contracts. The change of Proof of state from Proof of work makes the token have a deflationary nature if activity on-chain increases.
Source code: https://github.com/ethereum/go-ethereum
Whitepaper: https://github.com/ethereum/wiki/wiki/White-Paper
Overview: https://coinmarketcap.com/currencies/ethereum/
Market cap: $209,185,252,844
Price: $1,738.97
Website: https://www.ethereum.org/

Conceptualization & Recent News

The current conceptualization of Bitcoin and Ethereum is a result of combining the pioneering technological advancements of the Cypherpunks, the inherent qualities of precious metals and cross-currency functionality from Metallism, and the evolution of Neoclassical economics influenced by notable thinkers such as Ricardo, Hayek, Milton, and Rand. This amalgamation of ideas has been further shaped by decades of economic repression, culminating in the modern economic landscape we witness today.

The evolution of cryptocurrency can be traced back to the use of gold as a form of value and currency exchange. Gold, due to its rarity and its ability to serve as a medium of exchange, became the benchmark for determining wealth in relation to other assets. This historical precedent explains various significant events, such as the Greeks using silver as their primary currency to resist the Persians, Trajan seizing Dacian gold mines to strengthen his military gains, Heraclius resorting to melting down gold from churches and various sources to finance his war against the Sasanians, and the Spanish accumulating massive amounts of silver from the New World, leading to the transfer of wealth to the Dutch and the British (thus shaping modern politics & culture through the trade weighted dollar for Spanish silver being the backing for the US dollar).

This quick overview demonstrates the value of liquidity provided by gold in both local commerce and international trade. However, gold was primarily used for large transactions and expensive goods. Within nations, silver and IOUs (I Owe You) representing gold held in vaults were more commonly used. This is where the concepts of bimetallism and banking, particularly IOUs and accounting, became integral to human society. Throughout history, there have been instances of trading both metals and electrum (a mixture of silver and gold) in ancient Egypt, the use of clay tablets for orders in the Late Bronze Age, the practice of using food as a form of debt, the use of tally sticks in China and the UK (starting from the 12th century during the Great Bullion Famine), and so on. The existence of bimetallism and records of funds and transfers allowed for a longer time horizon for consumption and production, with the average citizen having a weekly perspective and rulers having a yearly perspective based on harvest cycles.

We now move to Ricardo's ideas for modern capitalism and the concept of marginal propensity to consume (MPC) and save (MPS). Ricardo's ideas, which significantly contribute to modern capitalism, consist in three key areas:

1. The concept of rent
2. Central Banking & ratio of government debt to gold
3. Free trade and the competitive advantage

Understanding the marginal propensity to consume and save is crucial, as it directly impacts individuals' investment choices and overall capital accumulation for both nations and businesses. MPC represents the percentage of disposable income individuals use to purchase goods and services, while MPS is the remaining amount (DI - MPC) allocated to savings. Inflation primarily affects the lower and middle class, as their nominal DI remains stagnant, and tapping into savings only provides temporary relief. Therefore, changes in Dollar-denominated liquidity significantly influence the movement of cryptocurrencies like Bitcoin and Ethereum. MPS directly affects the extent to which individuals allocate their savings into crypto, while MPC influences the rate and amount of investments made by the average individual.

The concept of free trade played a pivotal role in increasing societal productivity and the availability of goods. This resulted in a lower MPC as prices adjusted, leading to a virtuous cycle of consumption and economic growth. However, this cycle can be reversed when either the Central Bank, leveraging Ricardo's idea of using gold to stimulate the economy, or the Business cycle becomes overleveraged.

It is worth noting Ricardo's concept of rent, which finds relevance in the utilization of virtual land in Ethereum and staking. The law of rent, as proposed by Ricardo, entails that when an individual utilizes someone else's land and gains economic benefits, a portion of the surplus should be paid to the landowner (renter). This payment compensates the renter for the time, risk, and opportunity cost associated with allowing others to utilize their private property. This concept of rent also applies to various activities such as utilizing liquidity pools (LP), engaging in NFT lending, and utilizing NFTs in games.

From here, we can discuss the intellectual suppression of Hayek, Milton Friedman, and Ayn Rand, who are proponents of Neoclassical economics, under the influence of Keynesian and New Keynesian economic theories that currently govern many governments. Keynes made significant contributions to economics, such as the concept of the natural/neutral rate of interest (R*), the money multiplier (which determines the amount that can be lent into the economy under a fractional reserve system), the foundations for Bancor and the reserve system, and adjustments to promote free trade.

However, Keynes also left a legacy that allowed governments to view recessions solely as consumption issues requiring fiscal policy stimulus, leading to increased inflation and sacrificing long-term productive capacity for short-term economic gains. This approach also led to the adoption of models like Dynamic Stochastic General Equilibrium (DSGE) and the use of the Taylor rule to set inflation targets, while perpetuating the belief in the Phillips curve. The negative aspects of Keynes' legacy have gradually impacted society since the post-World War II era, with increased financialization and reliance on the Eurodollar system, which has become highly leveraged through US dollar debt. Moreover, major Western economies have focused on perpetual stimulation through debasement.

These DSGE models and the Phillips curve have blinded modern economists to the importance of the money supply, money velocity, and economic history. Consequently, they have further fueled Neoclassical economics, which underpins the rise of cryptocurrencies. The end result is that the lower and middle classes suffer from the erosion of their savings, declining birth rates, and increasing detachment from the ruling elite. Alan Greenspan, who created the "fed put" and influenced Bernanke's implementation of the fed inflation rate in 1997, acknowledged the challenges of predicting money demand and the indirect link between the short-term interest rate and spending and prices.

In summary, the Federal Reserve and most major economists lack a comprehensive understanding of the factors influencing the supply and demand of money. Their reliance on setting the federal funds rate in the short term and inflating the money base through fiscal spending poses significant risks.

This situation has led to a splintering of the Neoclassical synthesis (the post-Keynesian order) and a divide between Neoclassical economists, such as Hayek, Friedman, and Rand, and more popular modern economists. The inherent self-perpetuating cycle introduced by Keynes has contributed to this division. Classical economists' attempts to dissuade citizens from constant consumption by encouraging saving and borrowing against future efforts have been misunderstood by many, leading to nominal confusion and the vilification of these economists. As a result, they have found common cause with the Cypherpunks of the 1980s, sharing a common enemy in state-mandated control. Although their efforts to reintroduce balanced budgets, establish fully reserved banks, and reintroduce gold and silver as currency in the USA were unsuccessful, this alliance, along with the Occupy Wall Street movement, laid the intellectual and catalytic groundwork for the emergence of Bitcoin and eventually the wider crypto movement.

Bitcoin was originally conceptualized with the principles of gold, gold mining, and gold settlement in mind. This is evident in the need for a liquidity sink in crypto that requires effort (CPU mining) to obtain and can be used to settle transactions. However, Bitcoin lacked a benchmark to determine wealth until other cryptocurrencies emerged. This broader range of cryptocurrencies allowed more people to understand the power and immutable trust of blockchain technology, particularly when faith in traditional currencies wavered.

Ethereum was initially developed to explore the vast capabilities and advancements of blockchain technology. Its purpose extends beyond being a mere cryptocurrency and encompasses facilitating advanced financial transactions, real-world applications, and interoperability. As a result, Ethereum possesses qualities akin to silver in a Bimetallism market, offering a versatile and valuable asset, while also serving as a robust ledger for various rollups within its ecosystem.

What to look out for in order of priority

Supply side

1. Halving of token emission for Bitcoin, and Etherium burning
2. Exchanges being created or destroyed/hindered both either Countries or Chains
3. Whales moving in or out of exchanges
4. Projects locking or unlocking their treasury of BTC/Eth
5. More momentum to buy or Capitulation

Demand side

1. Sovereign or major institutions utilizing on-chain function
2. Crypto regulation
3. Dollar denominated based liquidity and change on Dollar denominated use
4. Interest rate/Policy changes
5. Excess currency & incremental currency of the masses

Endogenous events that changes all calculations above

1. Developed nations actually implementing retail CBDC's
2. Permanent fracturing of investment & supply chain markets (which includes energy)
3. Debt write off of pensions, sovereign debt, and dollar denominated loans
4. America balkanizing officially
5. Target 2 Liabilities actually affecting Eurozone economy
6. Oil spiking to $120 per barrel to a $150 per barrel
7. Quarterly & Yearly rebalancing of traditional markets
8. US defaulting on debt
9. Triple and Quad witching of traditional markets

Key Takeaways

The emergence and evolution of cryptocurrencies, particularly Bitcoin and Ethereum, have been driven by a combination of technological advancements, economic theories, historical precedents, and societal factors. These digital assets have provided a transformative response to the challenges and opportunities presented by the Great Financial Crisis and the shortcomings of the traditional financial system.

Cryptocurrencies have amalgamated the principles of decentralized digital transactions, the concept of value independent of the state, and the qualities of precious metals as mediums of exchange. The rise of Bitcoin and the wider crypto ecosystem has opened new avenues for decentralized finance, risk lending and borrowing, and innovative financial concepts such as "halving" and "burning."

Furthermore, the understanding of concepts such as the marginal propensity to consume and save, rent, and free trade has influenced individuals' investment choices, capital accumulation, and the development of virtual economies within the crypto ecosystem.

However, the current financial landscape, governed by Keynesian and New Keynesian economic theories, has led to a lack of comprehensive understanding of money supply and demand, contributing to economic imbalances and risks. This has further fueled the rise of cryptocurrencies as an alternative to the traditional financial system.

Moving forward, there are several factors to consider in the cryptocurrency market. On the supply side, the occurrence of halving events and token burning, the establishment or hindrance of exchanges, and the movement of whales and project treasuries will impact the market dynamics. On the demand side, the adoption of cryptocurrencies by sovereign institutions, regulatory developments, changes in dollar-denominated liquidity, and shifts in interest rates and policies will play significant roles.

Additionally, there are endogenous events that can have a profound impact on the calculations and dynamics of the cryptocurrency market. These include the implementation of retail Central Bank Digital Currencies (CBDCs), geopolitical and economic shifts, debt write-offs, and market rebalancing.

As participants in the cryptocurrency market, it is crucial to monitor these factors and adapt to the evolving landscape. By staying informed and making well-informed decisions, individuals can navigate the cryptocurrency market to the best of their ability and knowledge, taking advantage of the potential opportunities while being aware of the inherent risks associated with this volatile and rapidly changing asset class.

Resources

Below you can find the list of sources, divided by sections, that have been used to compile the report:

Introduction:

https://en.wikipedia.org/wiki/Chartalism
https://cejsh.icm.edu.pl/cejsh/element/bwmeta1.element.cejsh-ca40fb25-3824-423a-85e2-b7e8d047d3f5/c/05.pdf
https://www.brookings.edu/research/alternatives-to-the-feds-2-percent-inflation-target/

Market Overview:

https://coinmarketcap.com/coins/

Relevant news and conceptualization:

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What to look out for in order of priority:

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Key Takeaways:

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