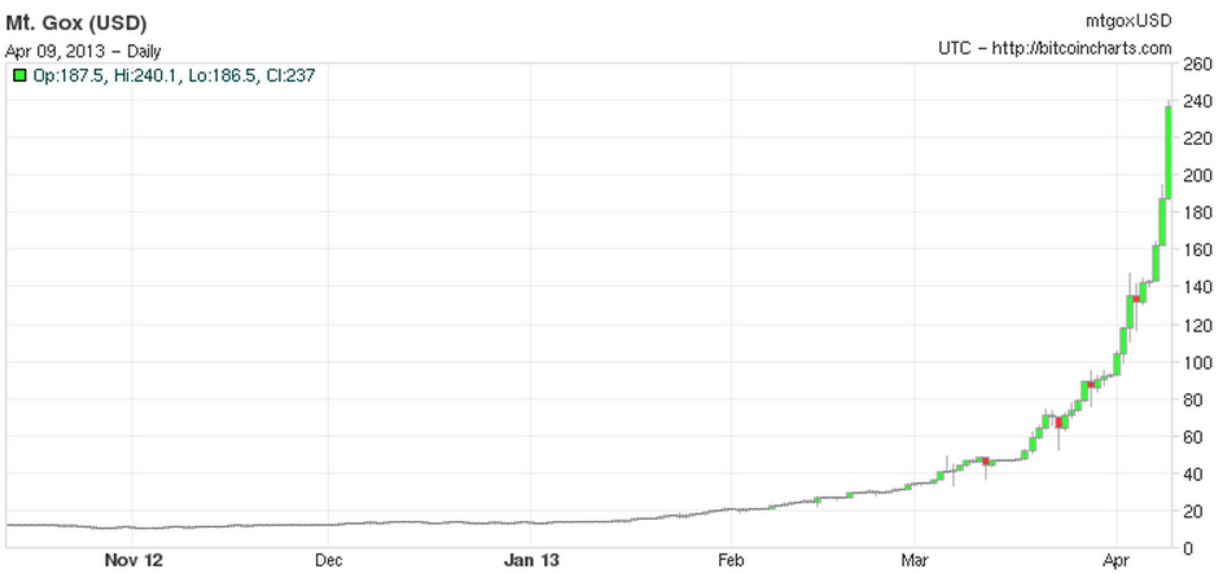
April 2013

Learning About Bitcoin

What is the number one performing currency year to date? It is a digital currency called Bitcoin and ever since the EU told Cyprus to force losses on bank depositors,, it has been going parabolic. As you can see from the six month chart below, Bitcoins have gone from $20 to $240 in only two and one half months!



The enormous rally in digital currency. Source: Mt Gox

When I look at how long it is taking for Germany to get their gold back from the US, the events in Cyprus, and the insane printing from Japan, I can only scratch my head on why gold and silver are down this year. Perhaps the fear trade has gone into Bitcoins as Europeans do whatever they can to flee the fractional reserve Ponzi banking system. Their use and the number of articles I have seen written about them has skyrocketed this year.

I am watching the phenomenon from the sidelines right now and don't own any and have no plans to open a Bitcoin account. I also find it darn close to impossible for me to be able to buy anything that has gone up 11 times in the last 2.5 months. I do, however; love freedom and think free markets in currencies, business, ideas, religion, and culture benefits the mass of society.

Although I like the concept of an internet currency, it certainly can come with Risks. As we know governments don't like competition and they could do all sorts of things to discourage its use like call them collectibles and tax the gains at 28%. It is also too early to know if Bitcoins will be accepted by the masses. After all, a Bitcoin is not backed by anything except trust, just like the world's paper currencies. At this stage, Bitcoins aren't widely accepted for payment. Lastly, currencies should not fluctuate as much as Bitcoins do and until the exchange rates stabilize, it is hard to imagine Bitcoins truly competing with Fiat currencies.

Since it is an electronic currency, it could be vulnerable to manipulation. Security incidents such as website and account compromises could trigger major sell offs. Other fluctuations in how units are issued could cause much larger exchange rate fluctuations. Currently anyone who puts money into Bitcoins should understand the risk they are taking and consider it a high-risk currency.

Instead of trying to write original material related to Bitcoins this month, I encourage you to read the Wikipedia entry on Bitcoins:
http://en.wikipedia.org/wiki/Bitcoin

and listen to one or both of these excellent interviews on Bitcoins:
http://twobeerswithsteve.libsyn.com/episode-117-a-bit-about-bit-coin

or

http://www.youtube.com/watch?v=yi2WgeJ73IE

As governments go deeper and deeper in debt, I think they will continue to default on that debt via currency debasement. People who hold wealth need to try and stay one step ahead of the money printers. I don't know which competing currencies will win, but I do think you need to be aware of the Bitcoin story. This could become a major development in world finance.

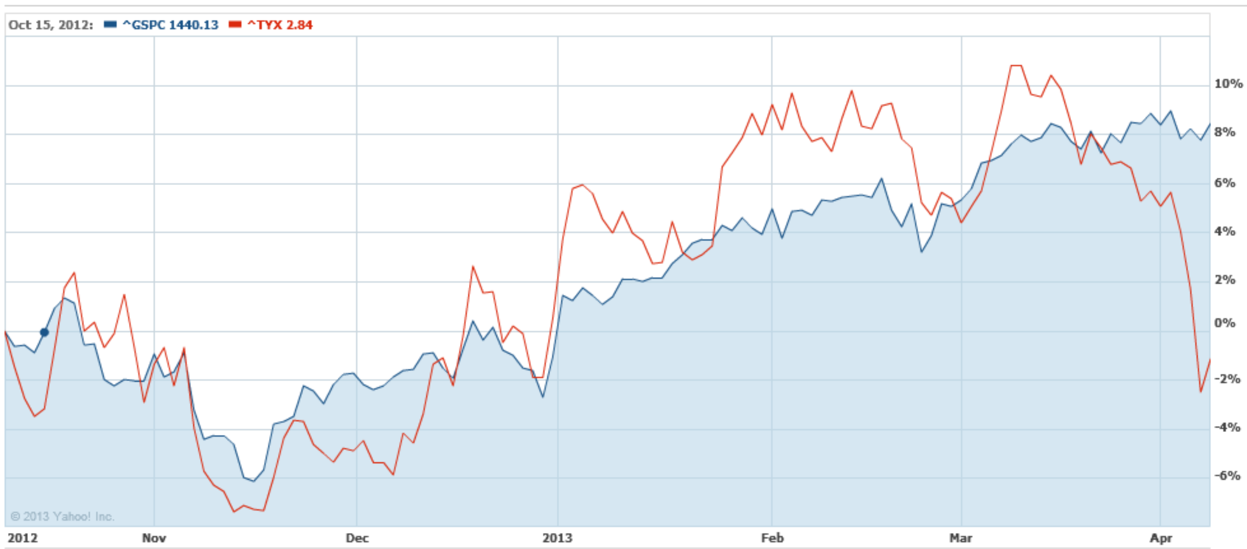
Markets
After an explosive move from the November 16, 2012 low, the S&P 500 has been in a sideways correction for the last month. So far this correction has been met with heavy buying and we haven't even seen two down days in a row. Bernanke and his pals at the other major central banks can be patted on the back for much of this rally.

What has me currently puzzled is the relationship between the 30 year bond and the US stock market. As you can see from the 5-year chart below, the yield on the 30 year Treasury bond (red line) was highly correlated to the S&P 500 (blue line) until the Summer of 2011. Europe looked like it was about to explode that Summer and I can see why stock markets dropped around the world and investors traded their European bonds for US Treasuries. In December of 2011, the LTRO program was announced and the world relaxed again. Since then, the US stock market has rallied strongly and the yield on the 30 year has not bounced back like stocks. When stocks were at the their all time highs in October 2007, the 30 year Treasury bond was trading for around 4.4%. Today it is 2.9%.

I believe the positive correlation between US stocks and 30 year yields should eventually come back. The chart below is telling me that either the US stock market has gone up too much and needs to correct or Treasuries are way too expensive (yield is too low) and investors are going to lose a lot of money in bonds as yields rise back up to around 4.4% where they should be at this point in the recovery.

Who is wrong, the stock market or the bond market. 5 year chart courtesy of Yahoo Finance.

Below is a six month chart of the S&P 500 compared to the yield on the 30 year Treasury. Here you can more clearly see how much the yield has dropped on the 30 year Treasury while the S&P 500 has managed to trade sideways for the last month. We haven't had much of a correction in stocks since the November 16, 2012 low. Some investors that have rushed into Government bonds are clearly expecting a drop in stocks.



The recent disconnect shows up more clearly on the 6 month chart. Source: Yahoo Finance.

Domestique Capital LLC
4601 Old Shepard Place
Ste. 117
Plano, TX 75093
214.556.8904 phone
www.domestiquecap.com