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Hello and welcome to this Friday's Dividend Cafe. I am your host, David Bahnsen, and today we are going to thoroughly address the subject of Bitcoin, something that I have been meaning to write about more extensively for a very long time, and there's just a lot of reasons why I've sort of never gotten to it.

I certainly address it quite frequently. It often results in rather me getting a plethora of feedback from people who are really critical of my position on the matter. And that's certainly okay. I welcome descent. Our feelings at The Bahnsen Group about Bitcoin, and about other cryptocurrency investment, if you will, do not come as a result of limited research or inquiry. It comes as a result of extensive inquiry and deep dive into the subject, and rather than continue to do piecemeal explanations here and there, and comments on TV interviews and things like that, I thought it might behoove us to just devote a whole Dividend Cafe to it.

So we're gonna dive in today and look a little more extensively about why we do not own Bitcoin or adjacent investments to that space at The Bahnsen Group. I'm gonna start with just a little context historically and use this word stability. Sometimes you'll hear people talk about the inherent instability of the stock market or the inherent instability of the US dollar, the instability of our own world financial system, the instability of monetary policy, of government spending. There's a lot of issues in the world that are unstable, and I think that there's some merit to all those cases, although we do our best to define what those various instabilities mean and put it in a context. I don't, I don't know that people who use that language are always doing that.

Regardless, we can accept at face value that there are certain instabilities that exist in the world. I think the non-sequitur of the matter becomes rather apparent, though, when we look at the reality of Bitcoin, and I'm gonna do something that I think a lot of the opponents of Bitcoin or bears or skeptics or critics would not do, and I'm gonna be willing to discount a whole lot of the kind of troubled history and focus on more recent years.

But if we do want to look at a more totality, first of all, in the most immediate of history, as I'm sitting here talking, when I wrote the Dividend Cafe this morning, Bitcoin was at $88,145, and exactly two months ago today, October the fifth (I'm recording and writing here on December the fifth), Bitcoin was at $122,549. So you have a drop of 28% in two months, not the end of the world. Where it goes from here is anyone's guess, and I think that Bitcoin could very easily see $70,000 soon and it could very easily see $170,000 soon. There is absolutely no point of view on that from my vantage point.

But what I would like to say is that the underlying price of Bitcoin is speculative, and the argument that some will then come and say, no, no, no, it's a medium of exchange, or it's a future medium of exchange, and that that is where the underlying value case comes from, is very problematic. It undermines the first argument, first of all, that the price should be permanently escalating, to make a second argument that this is going to be a medium of exchange. But I'm gonna spend some time today talking about why the medium of exchange is problematic.

I don't bring up a 28% drawdown in the last two months to make an argument for or against anything. Stocks can and have had 28% drawdowns even in only two months. It doesn't happen very often, but when you look at COVID, I believe we dropped 34% in 31 days. When you look at the 1987 Black Monday period, when you look at the financial crisis, there's been about three times where you could have that level of drawdown in that quick of a period. And then there's been more times in my own adult professional career lifetime where it's dropped more than that, but over a longer period of time.

When I talk about stocks, we are talking about risk assets, and I want you to hear all of these descriptions. Risk assets in the stock market, they are volatile units of ownership that represent volatile claims on volatile profits from volatile companies. In other words, this is exactly what it is meant to be, not a medium of exchange. Stocks are not meant to transact in goods and services. They reflect an underlying volatility, and that is the entire functionality of public equity ownership.

If the value proposition of Bitcoin is supposed to be an underlying anti-fragility substitution of the US dollar as medium of exchange, store of value, et cetera, then this hyper volatility becomes a real problem. And again, the 28% in two months does not capture the reality of volatility.

Now, when I said I'm gonna do something gracious and discount the 10 years from 2011 to 2020, I will, and I'll say why I am going to in a moment. But you look back in 2011, there was a 94% drop. It went from $32 to $2 as there were some hacking concerns and drama at Mount Gox and some other stuff. You can Google it if you wanna understand it more. But again, it's easy to discard that because it was a long time ago. The prices then were so low, it was ancient history. Fair enough.

You had an 87% drop, a different one, in 2014, and again, at that point it went from, oh, about 1100 to 100 something in that range. And that was also different. There were regulatory concerns going on then that are different now. Okay, fine. You had an 84% drop, a different one in 2017–20 going into 2018. And again, at the time there was talk of Korea banning Bitcoin, of Japan banning Bitcoin. I think that's reasonably off the table now.

There were more hacking issues going on then, and maybe you think that stuff is in the rearview mirror. I'm not gonna formulate an opinion as to whether or not the hacking concerns are totally gone. It's a little hard for me, to be honest with you, to understand how they could be. But I'll just take it at anyone's word that they don't necessarily have the same concerns.

I'm ignoring, because the drama of these 80 and 90% drops were so severe, that there were also 50% drops in 2013, 56% drops in 2012. You know, it was a pretty volatile decade. But look, many could come and say, hey, you had—I wanna get this right—98%, 56, 83, 50, 84% drops, and yet here we are, still over 80,000. That's a pretty good argument for a certain resilience if you really held on through this whole period. Obviously it's been extraordinary.

But what I wanna do is just focus on the last five years and say, even in a more mature and more modern system, we get a little bit more revelation about what it is we're actually dealing with. And I think it's helpful to unpack that.

The world shut down, and as everyone knows, in March of 2020, I mentioned that the stock market itself dropped 34% in about a month. Well, what did Bitcoin do, that again is being touted as this sort of anti–financial system asset, this anti-fragility, this store of value? It dropped 50% in that same month.

I think that what we now have seen—the chart of the week today at DividendCafe.com, I just have recently used the same chart, I've used different versions of it in the past—but this is where I began to understand that some of my first-decade criticisms of Bitcoin had now evolved into a just different revelation altogether, which is, it really does function and exist, for good or for bad, as a very high beta, highly correlated asset in conjunction with tech stocks and with other risk-on asset classes. Sometimes the shinier the better, and so there may be some merit to that, but it is a very different investment thesis than what is often presented.

What you saw then after the COVID moment, this high correlation with Nasdaq, high beta relationship with the stock market, was a 53% drop in May of 2021, as all of a sudden there started being these external concerns about the environmental elements of Bitcoin mining, the power usage. There were regulatory fears in China at the time. But then it went up to 65,000 by the end of 2021.

So now you look at that price at the end of ’21, its peak to the trough price today over a four-year period, 65,000 to 88, 89,000. It's up about seven and a half to 8% per year over four years. That's certainly not bad. It's not lost money. But the annualized return in that period is far, far less than people would probably think it is based on the way it's discussed.

But of course, the major reason for that is that it went into ’22, from late ’21 into late ’22, with another 77% drawdown, and in 2022, the NASDAQ dropped 30%. The S&P dropped 20. So you just simply had this really leveraged relationship to risk assets, then at that point combined with a whole lot of grift, a whole lot of fraud, a whole lot of shenanigans that most investors don't really wanna be associated with.

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So some bad guys went to jail, some people have been pardoned recently, but my point is that 2022 saw some entire exchanges collapse, a lot of underlying leverage, various adjacent-to-the-Bitcoin-story things unwind, and you had this big drawdown. And then that's where now the bullish case people say, well look, after that nightmare of 2022, it then appreciated substantially, and here we are.

You know, it's now come back and, after the election last year, went all the way up to 125,000 as people were saying a strategic Bitcoin reserve was coming, and the Trump administration has been so friendly and such a proponent of deregulation in the crypto space. We have a chart, and hopefully they can put it up on the video here now, but you basically see the kind of lifetime of Bitcoin, where you see big moves up and what are really big moves down along the way through the 2010 to 2020 period.

But in the grand scheme of where the chart is now on a linear scale, it may not look that bad, but those were, as a percentages, you know, major, major drops. So there's this really high volatility and really high timing mechanism. What is it we're always talking about with something that has high volatility, high timing requirements? These are the types of financial instruments that exist for trading and speculating, and to the degree that someone fancies themselves good at trading or good at speculating on Bitcoin, then they may want that to be part of their investment thesis.

It'd be impossible to look at the chart and the underlying fundamental mechanism that Bitcoin is and not say that this is a vehicle that traders could either do really well with or really poorly with. It's just simply not what we do as investors in things that have intrinsic value.

I agree that there's been a lot of drama and challenge and difficulty and volatility in the last five years, and that the Bitcoin price is still higher than it was, and that you could call that resilience if you want. But I also agree that there's a significant amount of uncertainty, instability, speculation that doesn't necessarily foster a great deal of confidence in the future.

And I don't think this is simply a matter of a war shock test where one's perspective is just gonna kind of be depending on your point of view here. I think that one is right and one is wrong. I think that the resilience people see in the price being where it is, despite all of this up-and-down drama, speaks to the hope, the speculation, the leverage that's embedded in the asset, and that those things can last for minutes, months, maybe even years, and yet they just are not, and never have been, the foundation of our own investment decisions.

I think that there is an embedded uncertainty and instability that doesn't provide the characteristics we would want to see.

Now, another thing, I guess, that speaks to this—I consider a rule of thumb in a lot of investing decisions—is that the more loud and outspoken, impassioned an advocate may be that wants you to know just how dumb you are for not getting it, that's usually, I think, a sign of a very insecure investment thesis. There is absolutely no reason on God's green earth for someone holding onto something of great value for them to need everyone else to know what incredible value it is. To the extent they're still buying it, you would think they'd want it to be as low as it could be for as long as it could be, knowing that they're eventually gonna have to see this price go way higher ’cause of this wonderful thing they're holding onto.

But the difference is, you need people to know how dumb they are to not own something if it isn't worth anything until they believe it's worth something, that the self-fulfilling prophecy of their own confidence in it is what gives it that boost. And we have a word for things like this.

That is, I think, one of the reasons why people who hold assets of high internal rate of return—if nobody in the world believes that the dividends from the profits of a particular company are meaningful, but I own it and I'm receiving those dividends—I don't really need to care what anyone else believes about it. And yet, if the only way I'm gonna receive profit on the investment is if somebody else believes it, then it incentivizes me to have to go become a zealous evangelist for something in order to get the self-fulfilling prophecy of that promoted return.

This, I think, is a very important distinction. Internal rates of return don't require cheerleading.

Now fundamentally, I would argue that if I believed I had secret knowledge—or not-so-secret knowledge, but just knowledge that was not agreed with by the masses—about the ability of a Bitcoin to appreciate over time, and I was just continually buying more, I would not want anyone to believe the story. But this is fundamentally different, and I think that rule of thumb is important.

But when we get to the resilience argument, I want to be clear that we understand how incredibly embedded in the culture the factor is that has actually created this resilience, and I refer to it as speculation, because I think that there is a genuine price resilience in something like Bitcoin because of the sociological phenomena that is undergirding it.

Whether you're talking about meme stocks, whether you're talking about DraftKings, whether you're talking about fantasy football—which can be just good-natured fun at someone's workplace—but the sort of casino dynamic in a lot of our financial markets and in our culture that crypto is very much a part of has muddied the boundaries, muddied the distinction between entertainment, gambling, investment, and created this sort of synthesized picture where a lot of these compartments are not really as distinct from one another as you would think.

And I don't mind the existence of entertaining gambling. I understand that there is a real sense in which a lot of what we refer to as gambling is no longer just a sideshow. It's a fundamentally legitimate economic activity, even if there's gonna be real big losers and winners in it. But what I think we've seen is this vast increase in that dynamic in the culture become a substitute for an asset class, where it is all related to a sociological phenomena that really is the interplay of entertainment and gambling done in the context of investing. And yet I'm not sure that we are properly compartmentalizing these things.

Now you say, well, wait, don't belittle it. Don't infantalize what's going on here. What about the blockchain? This is a legitimate technological innovation, and that's what a lot of us are advocating for. But again, I would argue that the price of Bitcoin and the efficacy of distributed ledgers are two entirely different stories. I think you could be a blockchain bull, or at least a blockchain hopeful, and be a Bitcoin bear, in theory, or at least a Bitcoin skeptic. I don't think that's co.

Now look, even blockchain technology, I don't know how honest people would not say it seems to have underdelivered so far or overpromised. That could very well change. But I think that there's a cost and complexity around that decentralization that has not been overcome, and it's very difficult for it to scale well. And there's certain business processes where I think blockchain is gonna be a very appropriate utility.

But let's just call that a "to be determined." It has not yet reaped the dividends many thought it would, but maybe it will. But again, that speaks to an operational efficacy in various business functions that may or may not prove useful; that does not speak to the concept of Bitcoin as an underlying investment or store of value.

Now, one of the arguments I used to make in Bitcoin skepticism I'm a little less committed to now. And that is, I used to say, if this thing were true, that it was going to disintermediate the world's fiat money system, that it was going to undermine the establishment banking system or governments or central banks, then they would just crush it like a bug. And whether it was China or whether it was the US or whether it was State Department, Treasury Department, the power could undermine this in a second, and this idea that no, they wouldn't be able to, you would just literally have this kind of substitute financial system that existed on a distributed ledger, I've always thought was an absurd idea in real life.

And yet I still, of course, believe that. My argument basically used to be that it's either no threat to the financial system, in which case the ownership thesis is highly questionable, or it is a threat to the financial system, in which case the ownership thesis is even more highly questionable.

But no, I don't think that the regulators or governments are looking to squash it like a bug. I don't think they are looking to suppress it. I think that, many years now into this, they see what has gone on, the role it plays as a very useful and much more deeper-in-liquidity vehicle for trading and speculation and entertainment and gambling and so forth than previously thought.

And as a matter of transactional functionality, it is almost exclusively used in the world of criminality. But for real-life intermediary, real-life unit of account, real-life medium of exchange, it is highly, highly limited. And so, for that reason, I'm not as worried about governmental intrusion shutting it down as just the fact that the ownership thesis itself, I think, really does amount to something limited to the world of trading and speculating.

I don't believe it's an argument for something to say, they're regulating it less now. You know, the Trump administration came in and said, we're putting a crypto-friendly guy at the SEC. We're putting less ex rules on the exchanges. We're gonna allow for more leverage, more borrowing, more this or that around the regulatory apparatus of it. That could be a good thing. It could marginally help those who transact in the world. But you're now talking about the bars around something, not the thing itself.

It was similar to that idea of the strategic Bitcoin reserve, people saying, well, the government buying it with borrowed money to have this minuscule reserve in the grand scheme of things, it doesn't speak to the underlying value of it. And in fact, I think the way it went about happening seemed a little silly to a lot of people. But nevertheless, it did push price up at the time as it seemed to be an argument for speculators. And now, of course, it's far lower in price than it was when the reserve fund was first announced.

I think that, as I get closer to wrapping this up, what I wanna say is that we at The Bahnsen Group have always had a philosophy about productivity, and I would like you to think about a world in which you woke up tomorrow and there was no more Bitcoin, and how your life would be different.

I'll use Apple, Microsoft, and Google as examples ’cause there are three such massive companies and they're not in our dividend portfolio. But the fact of the matter is that very few people could imagine their life without the technology that the Apples, Microsofts, Googles of the world.

But I would say let's even go past those companies. I made a list of just some of the goods and services that come out of the major companies we own in the dividend portfolio, and I think that most people would say if they woke up tomorrow, not only without Google, Apple, Microsoft, but they woke up tomorrow without diapers, paper towels, electricity, medicine, Tylenol, routers, servers, gasoline, credit cards, pet food, cereal, ATM cards, cosmetics, oncology, water, coffee, restaurants, hotels, natural gas pipelines, wireless service, streaming.

The profits from our investments come from the usefulness of the investment. Our investment thesis comes from the profits of the companies that do useful things, and then more specifically, the sharing of those profits in the form of dividends with us. I don't think that there is a person who would be impacted if crypto disappeared tomorrow. I mean, I know those people that make a market in it or trade in it, but I mean societally, it's hard to think of a way in which our collective wellbeing would be worse off, and that to me is an important point of view about the investability of something.

My essential argument here is that what I'm most describing about Bitcoin is its feature for traders and speculators: high volatility, highly questionable apparatus around it, leveraged traders. Sometimes there's kind of unseemly actors involved. There is this sort of wild west scene that makes it a great place for people to either play and have fun or to go with real grownup money, speculate and trade, and either do really well or really poorly.

But all of those things that could be a feature to that world are a bug to The Bahnsen Group, where the fundamental volatility of it that is so conducive to trading and speculating is the antithesis to a medium of exchange and the antithesis to the underlying value or productivity argument. So one has to pick the lane as to what their ownership thesis is.

As a stable medium for settling transactions, Bitcoin is anything but. As an anti-fragile alternative to risk assets, something that can counter financial instability, it's proven to be anything but. It's proven to be far more volatile than the assets it is intending to be a substitute for.

But as a speculative trading vehicle, it's been really good—and of course bad for others—but what it is, when it's really good for some and bad for others, is zero sum. And we do not do zero sum. Our investment arguments, always and forever, our investment case, always and forever, goes beyond zero sum and is wealth additive, wealth contributory, productivity enhancing out of usefulness.

And so I will tell you that, having studied this as long as I can, as deeply as I can, that from the varying different and often contradictory arguments that enthusiasts might make, I cannot get behind any of them. And yet I'm totally behind the idea that a trader or speculator may make a bunch of money, but it becomes very timing sensitive and very, shall we say, unpredictable. And that is outside of what we do or want to do.

I will not be regretful if Bitcoin hits $200,000. I will not be celebratory if Bitcoin hits $20,000. What I will be is keenly focused on an investment philosophy that is centered around productive assets. That's what we want to help achieve financial goals for our clients around, and therefore we feel very strongly that our position of agnosticism around this shiny object has been the right one and will continue to be.

With that said, I always do welcome feedback. I have a very strong hunch I know what a lot of the feedback will be, but that's what the control-D buttons are for, my friend.

Thank you all for bearing with me. I do hope you'll look at some of the charts and some of the arguments articulated at the written DividendCafe.com.

In the meantime, I'm gonna try to beat this little cold I'm fighting, give a speech here in San Francisco this weekend, and head back to the Newport Beach office for the entirety of next week, where I look forward to actually being in one office for a whole week. And I wish you all a very, very good weekend.

Love this time of year and hope you're doing well. I do thank you for listening, watching, and reading the Dividend Cafe.