The Node: Hard Money and a Dovish Fed

Fed Chairman Powell was praised for his clear policy forecasts yesterday. What might it mean for bitcoin, which means different things to different people?

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Yesterday, U.S. Federal Reserve Chair Jerome Powell confirmed the central bank
would maintain its easy money accommodations. Interest rates will remain near zero and an asset-buying program will remain in place. The economy will be allowed to run hot. This is despite mounting inflation concerns in financial markets and among a minority of Fed members.

This has some asking, what does it mean for bitcoin (BTC, +1.39%)? Bitcoin is the world’s first decentralized monetary system. It exists as a foil to the U.S. dollar, with a stable issuance rate and a hard capped supply. Its price is wholly dependent on what other people are willing to pay for it. And, over the past year, there are a number of sophisticated investors willing to pay quite a lot for it.

Bitcoin has gained a place within the larger financial firmament. To some extent, it has become an indicator for the economy itself – a way of indirectly measuring inflation worries or the willingness for investors to gamble on risky assets. But bitcoin’s place is far from fixed, and there are a number of conflicting views of how a “hard money” world will react to a dovish Fed. Here’s a quick and dirty rundown.

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Bitcoin is often discussed as an alternative store of value, particularly an alternative to gold. This seems to be the predominant view among Wall Street bigwigs and tech companies that came into the crypto economy in recent months. The purest distillation of this idea comes from Michael Saylor, who is directing his internet boom-era tech company, MicroStrategy, to bet big on bitcoin.

“I want something that I could put $425 million into for 100 years,” Saylor told CoinDesk in September. In this scenario, bitcoin is a place to park wealth, which would otherwise be eroded in an inflationary environment. Following Powell’s address, the U.S. dollar fell while would-be inflation hedges like bitcoin and gold rose.

Currently, “long bitcoin” is the second-most crowded trade in the financial market, according to Bank of America’s latest monthly investor survey. But this doesn’t indicate that all bitcoin holders are in it for the long haul.
In fact, a separate investor report out from Bank of America cast doubt on the “store of value” belief. Commodity strategist Francisco Blanch wrote that bitcoin's main utility was as a speculative asset. Looking at bitcoin's price history, he found, contrary to popular belief, bitcoin has mostly underperformed as an inflation hedge.

“Looking year by year, we find that bitcoin has been positively correlated with CPI inflation in five out of the nine past years, with the largest correlations in 2014 and 2018 ... However, when looking at correlations with inflation surprises since 2011, we find that bitcoin has among the lowest co-movements, lagging most asset classes such as commodities, TIPS, and EM FX in particular,” the report read. (I was unable to find the original document.)

Some believe that bitcoin could grow into its role as an inflation hedge, almost by
sheer will. That phenomenon is called the “Tinkerbell Effect,” named after the fairy in “Peter Pan,” where something may be more likely to occur if enough people believe it will happen.

Still, some think bitcoin’s 12-year life is too short to make any solid predictions on how it will perform. Cam Harvey, senior adviser to Research Affiliates and a professor of finance at Duke University, told Bloomberg as much. He also said that even if bitcoin is viewed as a store of value, that couldn’t tell you much about the short term. Gold has held its value for millennia, he said, but is prone to wild fluctuations.

Bitcoin, too, is volatile. It’s for that reason some investors are loading up on the asset as a way to diversify their portfolios. That’s the opinion of Deutsche Bank analyst Marion Laboure, who said bitcoin is not going anywhere but will likely remain unstable (primarily due to shallow liquidity.)

Instead of a gold alternative, Laboure imagines a world where bitcoin trades like Tesla stock. The comparison isn’t out of balance, Tesla’s sky-high valuation is based on the idea that electric vehicles will become standard. Bitcoin’s price at least partially reflects the possibility it becomes a global monetary standard.
Powell has been praised for his ability to cut through “Fedspeak” and give a clear indication of how the regulator will respond to the economy. Whether inflation picks up or not, the policy seems clear. Meanwhile, bitcoin is many things to many people.

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