Warren Buffett's verdict on bitcoin: 'It will come to a bad ending.'

OPINION
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by **Roger Lowenstein**

The most chilling movie scene ever might be the final take of *Invasion of the Body Snatchers*. One by one we see the human race overtaken by aliens except for the hero, played by Donald Sutherland. We lose track of Sutherland's character for a moment - but when the camera finds him at the end, he mechanically raises his arm in a grotesque salute confirming that he, too, has lost his humanity.

I feel that way at times talking to people about bitcoin. One day, they laugh off bitcoin as a bubble, this generation's version of no-doc mortgages and liar loans. The next day, they exude a mystical calm, the fervour of the faithful.

In case you have been living in a cave or spending too many hours at an ATM that dispenses only central bank-denominated bills, bitcoin is a token invented by somebody unidentified, traded on a digital blockchain controlled by its users and not by the Federal Reserve, Citibank or Ron Paul.

It has been called (by naive journalists) a virtual currency, which it manifestly is not, as almost no one uses it to buy things. "Virtual commodity" is better. "Digital gold" is not quite right because gold is an element. You can find it on the periodic table, along with platinum and silver. There will not be more precious metals invented nor was gold invented. Of digital tokens about 1200 exist, and more may be created before the sun sets. According to a report by Goldman Sachs, because of the ease of minting (oops, bad metaphor) alternatives, bitcoin has, "hence no intrinsic value due to rarity [scarcity]".

The hoo-ha concerns the price, approximately $US1000 at the end of last year, $US9900 at the end of last month, and $US18,888 ($24,640) as of December 18. The speculative frenzy has gotten a shot in the arm from the Cboe (Chicago Board Options Exchange), which launched a futures contract last week. As if it were not speculative enough, people can now buy bitcoin in derivative form.

Investment writers, on days when they have no investments to write about, have claimed that futures will add "liquidity" to bitcoin and dampen "volatility". This is unsupported by experience. Every speculative vehicle from equities to mortgage securities has grown more, not less, volatile with the advent of public trading. Liquidity offers would be-sellers an exit ramp, but it is one of the enduring myths of investing that it ever promises an escape at yesterday's price.

The Commodity Futures Trading Commission, a federal agency, saw fit to sanction the bitcoin contract and also a second futures contract that will debuted last week. Bitcoin options are also in the works. According to the CFTC, "Futures markets allow commodities producers and consumers to engage in 'hedging' in order to limit the risk of losing money as commodity prices change."

On its website, the CFTC uses the example of a wheat farmer. By selling wheat futures, the farmer lays off his risk and, arguably, is able to support a bigger farm. Does the CFTC honestly believe this will occur with bitcoin futures? Or that they serve any economic purpose?What futures and options will bring to bitcoin is an accelerated (and leveraged) version of what the market already is-gambling. Since futures contracts are cleared by member firms, the possibility exists that a sudden move in bitcoin would force these firms to cover losses by selling other commodities-yen, pork bellies, whatever else they own, so says Andrew Wilkinson, chief market analyst at Interactive Brokers, which handled half the bitcoin volume on the opening day. In other words, a panic that began in bitcoin would not necessarily end there. Ask Lehman Brothers.

'There are basically two kinds of assets'

It has been said that when Wall Street embraces bitcoin, it will become institutional, as if this would protect it. It will adorn the wild gamble with the cloak of precision. Fundstrat Global Advisors, a New York research firm, has announced a "price target," as if the trajectory of a bubble could be divined. Devotees speak of a new "asset class". The term should be banned. "Asset classes" are a conceit of Wall Street, designed for marketing.

"There are basically two kinds of assets," elaborated Warren Buffett, who was in his office and not buying bitcoin the day I called. "One you look to the stream of income it will produce; the other you hope like hell that someone will pay you more for it." The second type is inherently speculative; it includes gold, although gold at least has value as jewellery. It most definitely includes bitcoin.

It did not start that way, bitcoin was devised in 2008 as a decentralised, peer-to-peer network that permitted transfer of ownership without the involvement of a third party (such as a bank). Coins were distributed to "miners" - computers that solved complex problems of increasing difficulty. Only 21 million coins could be created, of which more than 16 million exist now. Transactions are recorded in a blockchain impervious to hacking (although exchanges and other electronic user accounts have been burglarised time and again).

As an alternative payment network, bitcoin appealed to people in countries with capital controls and to money launderers and libertarian foes of central banks (of which the financial crisis spawned its share). Its launch signalled the emergence of a social digitocracy. People overly impressed by financial wizardry lately swoon over technocratic wizardry.

Whatever the cleverness, even the mathematical beauty, that went into bitcoin, its suitability as currency is dubious. Even if it were gold, gold (in its day) enforced an inelasticity in the money supply that led to depression. When the next financial crisis comes, societies dependent for liquidity on bitcoin miners would starve.

As a store of value - closer to what its mysterious creator intended - bitcoin suffers the fatal defect of volatility. Nor has it been much adapted in e-commerce, due to problems with security, fees, which are non-trivial and, again, volatility. Visa, by the way, can process payments ten thousand times faster.

Rather, bitcoin has found its purpose as a trading vehicle, a tulip. Its soaring price testifies to the general incomprehension that speculation is not investment. According to a convert, its intrinsic value derives, entirely, from scarcity. But scarcity (if indeed it is scarce) does not suggest any particular value - nor does it require that a thing be valued at all.

The young Japanese and Koreans, like the students at America's MIT, who are flocking to bitcoin, the people gulled by stories of overnight riches, document the continuing hold of the beauty contest mentality in investment markets. People are buying because others are buying, because it is going up.

What do you think they will do when it goes down? "I will say this," Buffett added, "it will come to a bad ending."

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