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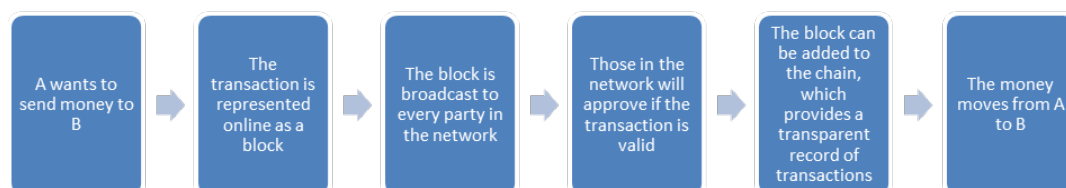
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For thousand years, physical tokens have been used as means of payment, where a direct exchange of sellers' goods and buyers' tokens allows them to achieve an immediate and final settlement. Nonetheless, this option was not possible when the two parties are not present in the same location (e.g. e-commerce), necessitating the usage of digital tokens. Alternatively, in a digital currency system, cryptocurrency, the means of payment is simply a string of bits.

### Cryptocurrency Stages:



*The blockchain is a decentralized ledger, or list, of all transactions across a peer-to-peer network. In fact, Bitcoin and other cryptocurrency rely solely on blockchain technologies. Using this technology, participants can transfer value across the Internet without the need for a central, trusted third party. Transactions are not anonymous, but they are pseudonymous, where a transaction record is generated, but identifying information is encrypted and no personal information is shared.*

### So What Is Bitcoin?

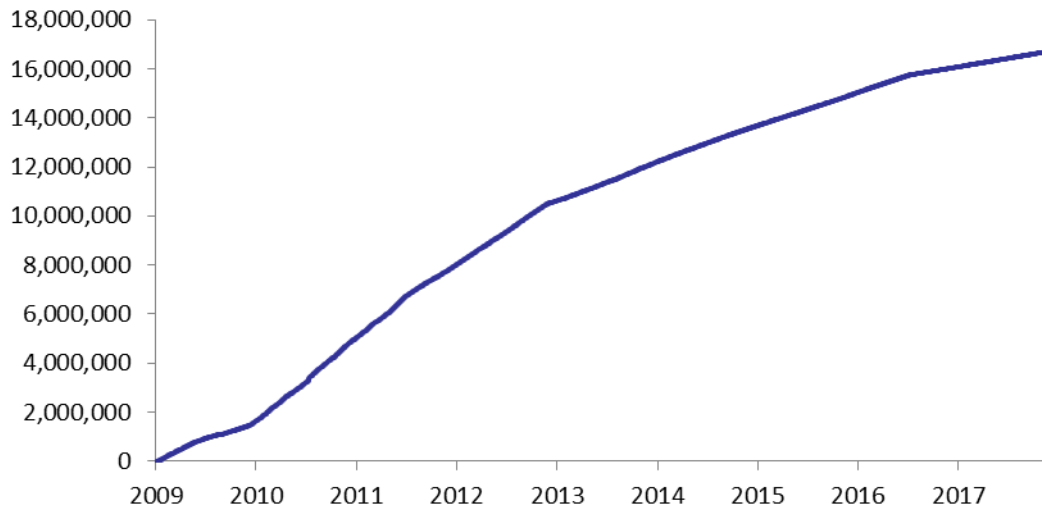
Bitcoin is a cryptocurrency, intended to take power out of the hands of the government and central bank, and put it back into the hands of the people, as seen in the view of its creator. In 2008, a programmer under the pseudonym Satoshi Nakamoto published a paper describing digital currencies. A year later, the inventor launched the software that created the first Bitcoin network and cryptocurrency. Nowadays, there are three ways one can get Bitcoins: buy them on an exchange platform, accept them for products and services, or mine them.

New bitcoins are engendered by a competitive and decentralized process called "mining". This process involves that individuals solve the code to create more bitcoins, and are then rewarded by the network for their services. Bitcoin miners are processing transactions and securing the network using specialized hardware and are collecting new bitcoins in exchange.

Due to Satoshi Nakamoto's schemes, Bitcoin will never experience inflation, as the total number of Bitcoins in circulation will reach a maximum of 21 million, by the year 2140. In fact, mining becomes more difficult as more miners join the fray since the code gets tougher as supply increases. Every four years, the number of Bitcoins released in relation to the previous cycle gets reduced by 50%,

along with the reward to miners for discovering new blocks. There are currently about 16.74 million Bitcoins in circulation.

### Bitcoin Supply



Source: Blockchain.info

As such, Bitcoin and other cryptocurrencies can be regarded as safe haven investments, for they do not lose their value based on inflation and are not subject to national government restrictions. Consequently, Bitcoin is showing its strength as a refuge against inflating national currencies.

Nonetheless, digital currencies are considered as properties for tax purposes; hence one would record capital gain or loss when disposing of virtual currency. As such, income would be taxable even if paid in cryptocurrency. Business transactions in bitcoin are subject to all the normal rules for sales tax, withholding, and information reporting.

As for the major threat of bitcoin, according to Bloomberg, 40% of bitcoin is held by almost 1,000 people. Hence, given the fact that bitcoin is a digital currency, there's no prohibition against market manipulation, causing a push in prices followed by a crash in a minute. Other threats include fraud and security risks. Bitcoin exchanges are entirely made online and, as with any digital system, are at risk from hackers; moreover, despite the fact that Bitcoin uses private key encryption to verify owners and register transactions, scammers might tend to sell false bitcoins.

### Bitcoin: a Currency or a Commodity?

The question remains on whether the bitcoin is a commodity or a currency, yet the official answer depends largely upon geographical location and political influence. Money has 3 main functions: means of exchange, unit of account, and store of value. Bitcoin lacks the store of value since it is very volatile and has limited means of exchange as few companies and countries are accepting it. Moreover, Bitcoin has few to no similarities with traditional money, where it lacks the primary attributes of conventional fiat currencies:

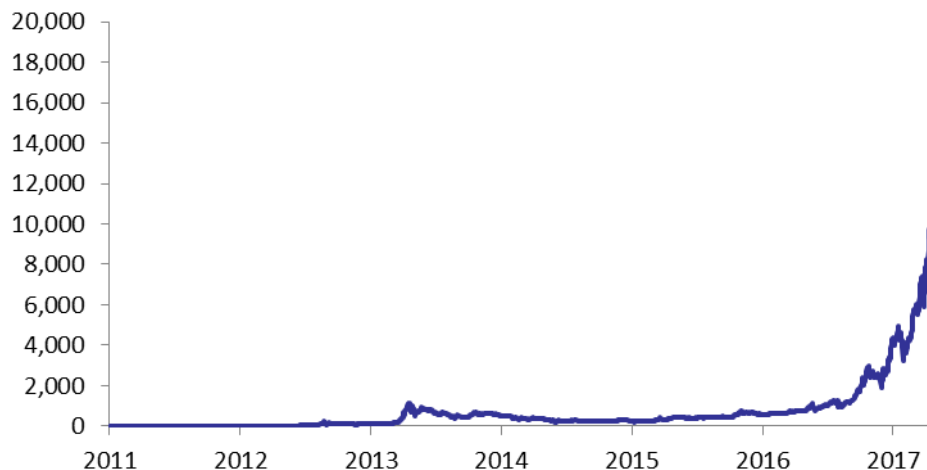
- **Physical form:** bitcoin is considered a line of computer code and offers no physical presence.
- **Central bank/ governmental recognition:** Bitcoin exists in the online environment, thus it's not under the control of a central banking authority and no government officially recognizes the value of Bitcoin.

- **Indefinite supply:** Bitcoin has a finite supply of 21 million. Bitcoins can't be printed, only Bitcoin miners can add supply to circulation.

Consequently, one of Bitcoin's largest opportunities is that cryptocurrencies could potentially become large players in the commodity market. When compared with gold, Bitcoin has several key characteristics in common of which scarcity and finite supply. However, unlike gold, bitcoin has no intrinsic value as its underlying asset is an algorithm and cannot be used as a store of value. Also, as is the case with most commodities, the price can fluctuate wildly based on many other external factors.

### What's Driving the Price Up?

Bitcoin Price



Source: Reuters

Bitcoin's growing popularity among merchants is boosted by several unique advantages: "

- **Low transaction costs:** Without any intermediaries needed to facilitate transactions, fees are minimal.
- **Security:** Blockchain technology ensures the integrity of transfers.
- **Speed:** Bitcoin is a streamlined peer-to-peer form of direct payment."

Moreover, Wall Street's growing embrace of the bitcoin has been the recent key driver of the surge in its price. The price surge came after the bitcoin futures launch gave investors exposure to the bitcoin market. The Chicago Board Options Exchange, CME, and NASDAQ declared the launch of futures markets for bitcoin. However, this could work against the price of the cryptocurrency, leading to less actual bitcoin changing hands, leading to less demand. The digital currency still suffers from political pressures, as seen through the 20% weekly decrease in bitcoin's price after China's ban on cryptocurrencies.

### A Bubble?

The main reasons behind bubbles tend to be driven either by new technologies or by new financial innovations. Bitcoin, can be considered both a new technology and a major financial innovation. Nonetheless, bitcoin acts differently than stocks or bonds; with no interest or dividends paid, it's difficult to derive bitcoin's intrinsic value. Usually, the uncertainty of valuation is one of the major issues in bubbles.

During the 2008 financial crisis, Dr. Jean-Paul Rodrigue, from the Department of Economics and Geography at Hofstra University in New York, described a four-stage model for the value of an asset during a bubble: Stealth, Awareness, Mania, and Blow-off. In details, the stealth stage is where only investors realize opportunity for future appreciation; the awareness stage is where many investors realize the momentum of the asset, hence increasing demand and pushing prices up. The mania stage can be depicted as the stage where all the public notices the prices, hence driving prices at all-time highs. Finally, the last stage describes the fall of prices at a faster rate than their increase, and the bubble bursts.

As seen below, the bitcoin price could be mirroring the classic bubble model, and may now be in the third stage. Bitcoin Stages according to the model:

- The Stealth Stage (2010-11): early adopters invested in the cryptocurrency, mining bitcoins for themselves
- The Awareness Stage (2013-2015): bitcoin earned the media's attention and has also been featured in the Wall Street Journal
- The Mania Phase (2016-present): prices rose exponentially with more countries and firms accepting bitcoin as a legal form of payment



Bitcoin is carving itself a niche market. In fact, most developments in the technological and financial fields inflate into speculative bubbles as investors and traders assume that the value of these new assets will grow indefinitely. However, it is possible that the future holds a place for cryptocurrency

as a major currency solution, with Bitcoin paving the way for these currencies to gain momentum. The reality that European and American markets are exploiting digital currencies denotes true validity.

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