IMPERIUM CAPITAL

momentum

Global Matters Weekly

22 February 2021

Coin toss

– **Andrew Hardy, CFA**

Digital gold or "index for money laundering[1]"? Fiat currency hedge or irrational mania? Bitcoin divides opinion more than most, but the bulls are in the ascendency at present and the 12-year old cryptocurrency is gathering many new followers as a result. Its 6-fold increase in price in the last year has been the driver; creating a FOMO (fear of missing out) effect whilst also increasing the size of its market, which reached $1 trillion over the weekend, to a level where institutions begin to consider it more seriously. While we expect that cryptocurrencies will become more mainstream over the coming years, we've never held Bitcoin in portfolios, nor do we have any plans to include it. I'll provide a few thoughts around this here.

Bitcoin cannot reasonably be considered as a reliable store of value, at least not yet. After twelve years of existence and accelerating adoption, its prospects for longer-term success are growing, but there's still every chance that it gets overtaken by other cryptocurrencies or technologies in time, or that increased adoption forces regulatory action by governments around the world. Indeed, the existence of so many competing digital currencies also undermines one of the key arguments made in support of Bitcoin: that of truly fixed supply. Amidst such huge uncertainty its price has proven to be exceptionally volatile as it can only be viewed as a speculative asset for now, which cannot compete with far more established asset classes like gold and inflation linked bonds for reliability in a portfolio context.

There have been some well publicised first-time buyers in recent months, including the UK asset manager Ruffer and Elon Musk's Tesla, but like with so many holders they've only invested a very small percentage of their cash. Very few businesses or portfolios have substantial allocations at this point, nor is it being widely used for transactions. Bitcoin and other cryptocurrencies still have a very long way to go before becoming at all entrenched. Energy consumption is one of the areas where on the face of it Bitcoin remains strikingly uncompetitive, especially in an increasingly environmentally conscious world, with estimates that the average energy required for just one transaction is equal to that of around 500,000 Visa transactions[2], due to the electricity used in 'mining' the coins.

This latest surge in price has come over a period when the value of many other risk assets have also soared, when there have been several other signs of exuberance in markets, and for Bitcoin has been accompanied by very high turnover, all of which hints at the gains having been driven by speculative forces. Bulls argue this reflects rising fears of fiat currency debasement, due to central banks pumping liquidity into markets, but if that was the case one would expect to see a rapid increase in inflation expectations also being priced into other markets. Monetarist economic theory supports higher inflation and currency devaluation in time, but actual results of over twenty years of unconventional monetary policy in Japan – which have failed to ignite inflation and led to a stronger currency – highlight it's by no means a given.

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It was just over one year ago when most risk assets began a pandemic induced plunge. When Bitcoin bottomed a few weeks later around the end of March, at the same time as most equity markets, it had fallen over 70% from its previous high. If one believes in Bitcoin as a diversifier and store of value, one must question why it had so few friends back then but is so popular now at many multiples of that price. When there are no fundamental characteristics – assets, cashflows, recurring demand etc – to base price estimates around, or a management team to discuss the way forward with, it's easy to lose confidence during times of crisis, and be shaken out of a position, something holders need to consider given the huge volatility that is likely to persist in its price. In contrast, there are many other companies linked to accelerating digital and virtual activity who have seen their share prices leap higher at a similar rate since then, several of which we and many other investors did have the confidence to add to around the market lows, because it's possible to build confidence in a fair value range.

Of course, there are many valid arguments in favour of investing in Bitcoin, but it's clear to me that becoming a buyer today requires a massive leap of faith. All investments come with a degree of risk and require one to take a view on future scenarios, but in the case of Bitcoin it is much harder to know how it will perform in any environment or build confidence in estimates of long-term value. While cryptocurrencies are likely to become more mainstream, it is by no means assured that Bitcoin would be the long term winner; there have been many examples in recent decades where the earliest pioneers in new technologies eventually saw most of their market share taken by new competition. We will follow the maturing cryptocurrency markets closely and be on the lookout for appropriate investment opportunities, but for now we are very comfortable watching from the sidelines and instead focusing our attention on the myriad other technology related opportunities around the world.

[1] 1 Larry Fink, Blackrock CEO. October 2017.
[2] 2 Statista data, provided by Deutsche Bank. February 2021.

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The Marketplace

- Global equities returned -0.4% last week whilst global bond yields rise.
- The Pfizer-BioNtech vaccine is reported to be 89.4% effective in preventing Covid-19 infections according to an Israeli study.
- Brent crude oil rose 0.8% to $62.9 a barrel.
- Gold fell -2.2% to $1784.3 per ounce.

Market Focus

US

- US equities retuned -0.7% last week.
- The flash Markit US composite PMI came in at 58.8 versus 57.7 expected -the highest reading in nearly six years.
- The retail sales report for January came in at +5.3% month-on-month, well above the +1.1% advance expected, and the strongest monthly rise since June 2020. The approval of stimulus payments is seen as a key driver.
- The US 10-year treasury yield rose to its highest level in nearly a year, currently standing at 1.38%.
- US industrial production rose by a stronger-than-expected +0.9% in January (vs. +0.4% expected), although the previous month's reading was revised down three-tenths.
- The January PPI reading in the US was much higher than expected, rising +1.3% (vs +0.4% expected), while the core reading rose +1.2% month-on-month (vs +0.4% expected).
- Weekly initial jobless claims for the week ending February 12th hit a 4-week high of 861k (vs. 773k expected)- the previous week's reading was also revised upwards by +55k.

Europe

- European equities returned -0.2% last week
- Euro Area composite PMI rose +0.3pts to 48.1 (broadly in line with 48.0 expected) in February. The Manufacturing PMI printed at 57.7 (vs 53.4 expected). Services came in lower, with Germany falling to 45.9 and France to 43.6.
- Eurozone core bond yields rose last week, with the German 10-year bund reaching its highest level since June 2020 at -0.32%
- Mario Draghi's new government in Italy won a huge confidence vote in the lower house last Thursday with a 535-56 vote. This came after a big victory in the Senate the previous day.

UK

- UK equities rose 0.9% last week.
- Sterling climbed past $1.40 for the first time since April 2018, making it the best performing major currency this year. The pound has benefitted from the UK's strong vaccination rollout.
- The CPI reading for January surprised slightly to the upside with a +0.7% reading (vs. +0.6% expected).
- The flash composite PMI reading for February rose to 49.8 from 41.2 in January (vs. 42.6 expected). The Manufacturing PMI came in at 54.9 (vs 53.1 expected).
- Retail sales plunged -8.2% in January (vs -3% expected) led by non-essential retail stores being closed due to ongoing lockdown measures.
- The UK government is preparing plans to test millions of citizens for Covid-19 amid a cautious easing of lockdown measures. Every UK adult has been promised a first vaccine jab by the end of July.

Asia/Rest of The World

- The benchmark Global Emerging Markets index returned -1.4% last week.
- Japanese equities returned -0.3% last week.
- Chinese equities fell by -0.4%.
- Japan's manufacturing PMI re-entered expansionary territory to 50.6 (vs. 49.8 last month). The services PMI fell slightly to 45.8 (vs. 46.1).
- China urged the Biden administration to take steps to "build up goodwill," including removing tariffs and sanctions, as Beijing continued to put the onus on Washington to repair their fractured relationship.

Past performance is not indicative of future returns.

Source: Bloomberg. Returns in local currency unless otherwise stated.

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Asset Class/Region	Currency	Currency returns			
		Week ending 19 Feb. 2021	Month to date	YTD 2021	12 months
Developed Market Equities					
United States	USD	-0.7%	5.3%	4.2%	16.8%
United Kingdom	GBP	0.9%	3.5%	2.8%	-9.8%
Continental Europe	EUR	-0.2%	4.7%	3.5%	-0.1%
Japan	JPY	-0.3%	6.6%	6.9%	18.2%
Asia Pacific (ex Japan)	USD	0.4%	7.5%	11.3%	35.9%
Australia	AUD	0.0%	3.1%	3.4%	-2.2%
Global	USD	-0.4%	5.5%	4.5%	17.3%
Emerging markets equities					
Emerging Europe	USD	0.7%	5.9%	3.4%	-7.0%
Emerging Asia	USD	0.2%	8.1%	12.8%	44.5%
Emerging Latin America	USD	-0.6%	5.2%	-1.9%	-11.2%
BRICs	USD	-0.5%	9.0%	13.2%	32.5%
China	USD	-0.4%	9.5%	17.6%	48.9%
MENA countries	USD	0.1%	1.8%	3.8%	5.6%
South Africa	USD	-0.3%	10.4%	13.4%	13.6%
India	USD	-1.2%	10.3%	7.9%	24.5%
Global emerging markets	USD	0.1%	7.6%	10.9%	32.4%
Bonds					
US Treasuries	USD	-0.9%	-1.5%	-2.7%	3.0%
US Treasuries (inflation protected)	USD	-1.4%	-1.8%	-1.5%	7.6%
US Corporate (investment grade)	USD	-0.7%	-1.3%	-2.5%	4.3%
US High Yield	USD	0.0%	0.9%	1.3%	7.1%
UK Gilts	GBP	-1.9%	-4.4%	-6.0%	-0.7%
UK Corporate (investment grade)	GBP	-1.3%	-2.2%	-3.4%	2.7%
Euro Government Bonds	EUR	-1.0%	-1.5%	-2.1%	0.3%
Euro Corporate (investment grade)	EUR	-0.4%	-0.4%	-0.5%	1.0%
Euro High Yield	EUR	0.1%	1.0%	1.5%	2.5%
Japanese Government	JPY	-0.3%	-0.4%	-0.7%	-2.1%
Australian Government	AUD	-1.1%	-1.6%	-2.3%	-0.6%
Global Government Bonds	USD	-0.9%	-1.5%	-2.8%	6.3%
Global Bonds	USD	-0.7%	-1.2%	-2.2%	6.8%
Global Convertible Bonds	USD	-0.1%	5.3%	5.3%	27.8%
Emerging Market Bonds	USD	-1.4%	-1.2%	-3.0%	0.5%

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Asset Class/Region	Currency	Currency returns			
		Week ending 19 Feb. 2021	Month to date	YTD 2021	12 months
Property					
US Property Securities	USD	-1.1%	4.4%	4.5%	-8.8%
Australian Property Securities	AUD	-3.2%	-3.2%	-7.1%	-22.3%
Asia Property Securities	USD	1.0%	5.3%	5.2%	-5.0%
Global Property Securities	USD	-0.5%	3.3%	2.3%	-7.1%
Currencies					
Euro	USD	0.0%	0.0%	-0.8%	12.4%
UK Pound Sterling	USD	1.2%	2.3%	2.7%	8.6%
Japanese Yen	USD	-0.5%	-0.7%	-2.0%	5.5%
Australian Dollar	USD	1.5%	3.0%	2.3%	18.0%
South African Rand	USD	-0.8%	3.6%	0.0%	2.1%
Swiss Franc	USD	-0.5%	-0.6%	-1.3%	9.8%
Chinese Yuan	USD	0.0%	-0.5%	1.1%	8.4%
Commodities & Alternatives					
Commodities	USD	1.7%	8.5%	13.1%	10.0%
Agricultural Commodities	USD	2.0%	3.4%	8.4%	28.8%
Oil	USD	0.8%	12.6%	21.4%	6.4%
Gold	USD	-2.2%	-3.4%	-5.8%	11.0%
Hedge funds	USD	0.1%	2.4%	2.4%	7.5%

Source: Bloomberg. Past performance is not indicative of future returns

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