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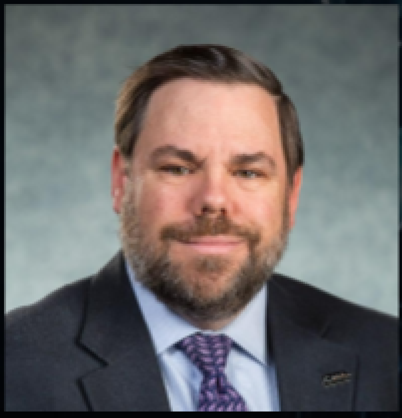
Virtual Event Series

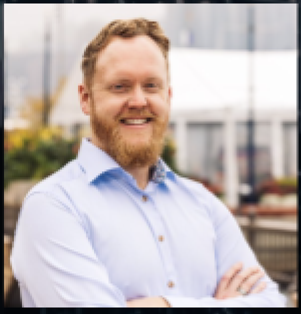
Dot.com vs Crypto... Bubble?

Guest Speaker:



Keith Black
Managing Director
FDP Institute

Hosts:



Kenny Estes
CEO & Founder
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Ayla Kremb
COO & Co-Founder
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DiffuseTap: Dot.com vs Crypto… Bubble?

Last time on DiffuseTap, Keith Black, Managing Director of Financial Data Professional Institute, talked to us about the parallels between the dot com bubble and crypto, where the high yields in crypto are coming from, and what the dot com bubble says about the future of Bitcoin.

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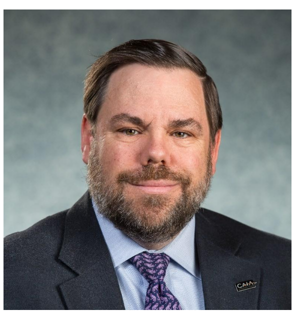
DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas)… straight from your armchair like a boss.

Meet the Speaker



Keith Black is the Managing Director of the FPD Institute. With over 30 years of experience, he has designed alternative investment portfolios for corporate and public pension clients, totalling over $600 million. Keith has written books and articles (like this piece on the "bubble"), and sits on the editorial board of the CFA Digest, Journal of Alternative Investments, and Journal of Investment Consulting. LinkedIn: @keith-black

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KENNY ESTES: You're here today to hear from Mr. Keith Black. Keith, do you mind briefly introducing yourself?

KEITH BLACK: Thanks, everyone. My name is Keith Black. I'm with the FDP Institute, which stands for Financial Data Professional. In FDP, we have an educational program that teaches about artificial intelligence and machine learning applications in financial markets. Prior to that, I spent 11 years at CAIA Association, where we have 12,000 members in 100 countries around the world who have studied alternative investments, including hedge funds and venture capital, as well as real assets.

AYLA KREMB: Beautiful. Today, we're going to talk about how this may or may not be a bubble. How did you get into the whole comparison of dot come versus crypto as a bubble? When did you start thinking about this?

KEITH: What's interesting is I'm probably invested in crypto because I wasn't invested in the dot com bubble. I saw people make and lose a lot of money in the dot com bubble. I had FOMO at the time because I didn't take advantage of it, and I felt vindicated when things came down. But I didn't want to miss it this time. I put about 3% of my assets in crypto about two years ago, and thankfully, it's at about 10% now. It's been quite a ride learning about all things crypto over the last couple of years.

KENNY: It's quite often that people go with the analogy that crypto is just the new dot com bubble. What similarities do you see? What do you think are the similarities and differences between now and then?

KEITH: I was closely following it 25 years ago. In around '97 to '99, we saw a tremendous number of companies enter into what we now know as Web 2.0. There was a lot of speculation and a lot of hype. The idea was that any company can simply add ".com" to their name or say they built a website, or are going into e-commerce, and you'll see an immediate increase in their stock price between 50% to 300% in a matter of hours or days.

There was a tremendous amount of money going into web2 with the promise of shutting down the brick-and-mortar world. The idea was that since we had all these websites, nobody was ever going to buy clothes in a store again. Everyone's going to get it online. That came true for books, music, and travel. But at the end of the day, 25 years later, we see that e-commerce still has a 5 to 25% share in many products, and less in many services..

In the crypto space, we can see the same kind of speculation, the same kind of Etrade ads. Crypto ads are exactly the same as the dot com ads 25 years ago. We see people wanting to get rich without doing the due diligence and without seeing what they're really investing in.

AYLA: If you think of the risk factors in the dot com bubble, there was some kind of semblance of a real business, where you have a relationship to it. That's different from a stable coin, which is a lot more esoteric to wrap your head around. If you had to outline the risk factors in each of these markets, and the public's ability to assess risk factors in each, how would you compare and contrast when people are getting in over their head in crypto faster than they were in the dot com bubble?

KEITH: The promise of crypto is building web3, and taking control of our own destiny, both controlling our own financial life and our data life. But at the end of the day, what we saw in the dot com bubble is that there was a tremendous rise in the NASDAQ, from '97 to March of 2000. From March of 2000 into October, the NASDAQ lost more than half its value, $1.9 trillion, and there was a lot of overcapacity in the space.

There were companies that were purely speculative and said they were in web2, but they didn't really have a competitive product. What ultimately popped that dot com bubble was that in the long run, all of these companies were going to want to take market share from the brick-and-mortars, but they didn't have enough money to make it to the end of the year 2000, let alone to make it to the long run.

And so, when we look at crypto, the vast majority of the 18,000 coins out there are going to zero. A lot of these are inherently speculative, like Doge and Shiba Inu, which are basically just pets.com. People say they're a joke, but as of the other day, they're trading at $25 billion between them, even if there's no utility. And so, what we need to do is do our due diligence and figure out who has a business model, who has the assets, and who doesn't. There will be thousands of coins that will be worth zero in the long run. But let me know when you want me to tell the good news of the story.

KENNY: Well, we're going to do one more bad news. Doge is a fork of Bitcoin itself. If we're making the argument that Doge is just pets.com, and is eventually going to zero, would you extend that argument to Bitcoin, the coin with the identical source code?

KEITH: It's a matter of trust, and it's a matter of the number of network users. We see that for better or worse, Michael Saylor, Elon Musk, and Jack Dorsey have pretty big corporate stakes in Bitcoin. They've raised the bar in claiming that this is a corporate treasury asset, or a store of value. People like the code that limits Bitcoin to 21 million coins outstanding. And we see that Doge has 132 billion coins outstanding and many meme coins have billions in supply outstanding. But ultimately, it comes down to supply and demand.

Bitcoin has that limited supply of 21 million, and people believe, at least as of now, that Bitcoin is a store of value. As long as it's held in those corporate treasuries, there's probably enough trust to sustain the demand. The idea is that every four years, the rate of block creation in Bitcoin slows down, and that's going to reduce the supply. If the demand grows consequently, Bitcoin could be a store of value.

AYLA: On the positive side of things, how do you see this going forward? Because after the big dot com crash, people regrouped and the Internet turned out to not be such a bubble after all. How do you think crypto is going to move forward? Maybe you could pocket several coins in one part of the conversation, and everything else on the other end.

KEITH: The NASDAQ lost $1.9 trillion from March to October of 2000. One of those companies was Amazon.com, which a couple of weeks ago was worth $1.9 trillion. But also, out of this came eBay and Broadcom and Priceline. A couple years later, Google and Netflix came. And so, even though the vast majority of dot coms did go to zero, what we saw 20 years later was that promise did exist. But it's concentrated in a very small number of projects.

If you think about the business model of Amazon versus Priceline, or Broadcom versus eBay, and then Google and Netflix a couple years later, every one of those is completely different. Certainly, they use the pipes of web2 to deliver their products. But we need to understand what the business models of these cryptos are. If in web2 it was "winner takes all", we can also think of crypto the same way. Seeing how Google and Amazon turned out, we can say that some of the biggest companies five years from now could be crypto companies. But it's going to be a relatively limited number of crypto projects that are going to have those hundred billion dollar values.

KENNY: We were talking about values, and Ainsley sent me a DM. In the dot com era, there was not necessarily a lot of cash flow. A big part of the issue was that these were pre-revenue products. And in a lot of cases, the valuations they had were not supportable. Do you see the same thing playing out here? And do you see that there is an intrinsic value to some of these tokens above and beyond just future cash flows? Do you think we're in a new economic paradigm?

KEITH: In the dot com bubble, we made up a lot of metrics. The price of "eyeballs" was something that people talked about back in the day. But if you look at tokenterminal.com, they'll give you the 12-month revenue of different cryptos. And then, they'll give you the price-to-sales multiples, which includes what the revenue has been to miners and stakers and liquidity providers. Over the last 12 months, you will see that it's been $7.2 billion in Ether, $1.6 billion in Uniswap, $620 million in Bitcoin, $450 million in Sushiswap, and $310 million in Compound.

There are billions of dollars of fees going through these projects. They're clearly not worth zero. You could put a price-to-sales multiple on it or you could use a DCF model to do a traditional valuation, and you will realize that ETH is worth a lot more than than zero.

AYLA: That is certainly worth a lot more than zero. Hopefully it will remain that way. What do you think is going to happen to the innovation in this space given the meltdowns, like the one that we just had? Money is flowing out of the system, and trust is going down quite a bit. What do you think is going to happen to new projects coming online, especially those really good projects with proper risk management and collateralization? Do you see them getting off the ground and being meaningful over the next six to nine months?

KEITH: We really need to do our due diligence on these crypto projects. We need to figure out which projects are good and bad. We need to see if people are managing these like they're managing companies, what the utility of their projects are, and whether they're looking at recreating a traditional business or building a completely new business. For example, Aave and Compound are borrowing and lending, and Binance and Uniswap are recreating securities exchanges.

We also need to see whether the coin is designed well, whether they have the right security and the right custody, whether the code is audited or auditable, whether they have a good white paper and a good business plan, and whether they've got the right team. And then, we need to see the size of their network. How many people hit their website? What's the total value locked? How many people follow them on Twitter or discord, or telegram? What does the code look like on GitHub and how many developers are contributing? Are they trying to recreate a brand new blockchain? Are they just going to go with something popular like an ERC 20 token? And are they going to focus on the functionality of their DAP rather than creating their own layer one?

KENNY: Makes sense. That actually ties to a slightly tongue-in-cheek question around due diligence. Do you think that a lot of the speculators and investors in crypto are able to do due diligence? How much expertise do you need to do that yourself?

KEITH: Some of it is relatively straightforward. You could easily look at tokenterminal.com and see the flows that are going through each protocol. You can see the total value locked. You can see everything from the revenue to the miners, stakers and liquidity providers. Everything in crypto is open source. You could easily do your homework by looking at the number of wallets, and the increase in the number of wallets. However, a lot of people might not have the sophistication or the background of an experienced public equity investor, or an experienced venture capital investor.

You could draw a parallel here by thinking of crypto as just like publicly traded venture capital, wherein every one of these crypto projects is a startup project. We know that startups are prone to failure. Some of them are spectacular successes, but not every venture project gets funded. So, we need to take the mindset of a public equity investor or a venture capital investor and do our homework in these projects.

But clearly, there are a lot of people in this space who are driven by social media, who are buying the coin of the day they see on TikTok, which probably didn't come from a lot of due diligence.

AYLA: Very good point. One of the questions that popped up here is about a CBDC. Are we actually not ready for it? Should we park this whole project of CBDCs for a while? Or do you think that there's still value in it but the approach has been flawed thus far, and therefore both governments and private entities should still invest resources and energy to build it out?

KEITH: It's interesting that the Bitcoin white paper came out just a few weeks after the demise of Lehman Brothers. And then, the first block was printed in early 2009. The very first Bitcoin block had a message about bank bailouts. Thus, this entire space was designed to be a bit libertarian and decentralized. We really did not want to be pinned down to one bank, or one government, or one brokerage firm.

But at the end of the day, the way this could be playing out is this entire industry can be owned by JP Morgan, Visa, and the U.S. Fed. That certainly wouldn't sit well with the decentralized pioneers who started this. The U.S. Fed came out with a white paper talking about CBDCs just a few weeks ago, and they said they were open to the idea, but they seem pretty concerned about two different areas. One area they were concerned about was the spread between the yields on stable coins and bank accounts.

My stable coin of choice is Gemini coin, or Gemini dollar, which is now paying 6.9%. I thought that 19.5% yield on a stable coin was a little too aggressive, as seen in Terra USD. I didn't want to go there. The Fed says there are two main risks of a stable coin. One is that it will drain money from the banking industry. If everybody wants to make a 7% yield instead of a 1% yield, the cost of corporate credit and the cost of mortgages could substantially increase if a lot of money comes out of the banking sector.

They're also concerned about the CBDC draining assets from the banking system. In a flight to quality scenario, if we believe the Fed is a better credit risk than than our local bank, we might be draining assets from our local bank as a crisis approaches. The Fed seems open to it. They think that there are some financial inclusion angles of a CBDC. We can pay tax refunds and social security payments in the CBDC. But we do have to worry about the systemic risks of it as well.

KENNY: You mentioned Gemini's US dollar paying about 6.9%. Obviously, a 19.5% yield is not super stable, but 6.5% is surprisingly close to the true inflation rate. Do you think what's going on here is that we're getting higher yields because the Fed is keeping the traditional finance yields artificially low?

KEITH: On Eric Golden's podcast Web3 Breakdowns, Episode 15 discusses "How crypto offers 10% yields" with Matt Ballensweig from Genesis. His idea is that Gemini is paying me 7%, and they're taking my money and loaning it to hedge funds at 10%. And then, hedge funds are investing it in arbitrage trades that earn maybe up to 13%. That way, I'm getting only half the yield, and the other half goes to Gemini as a prime broker/lender and the hedge funds.

If bitcoin is trading cheap in Japan and expensive in Korea, people who have the pipes to do that can earn arbitrage profits. And for most of the last two years, there's been contango in the Bitcoin futures on the Chicago Mercantile Exchange. The futures were trading about 100 basis points a month rich to spot Bitcoin. You could buy the Bitcoin, sell the futures, and pick up 100 basis points each month.

The idea was that traditional banks don't want to loan to crypto players and crypto hedge funds. So, we, as liquidity providers, need to enable these arbitrages to hedge funds. However, Efficient Markets theory tells us that the more money and the more time is invested in arbitrage, eventually those arbitrages go away.

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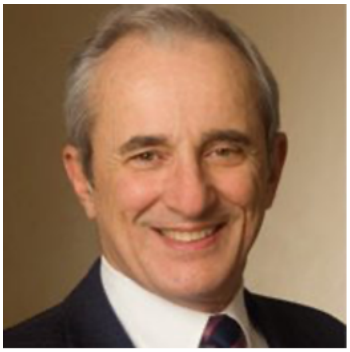
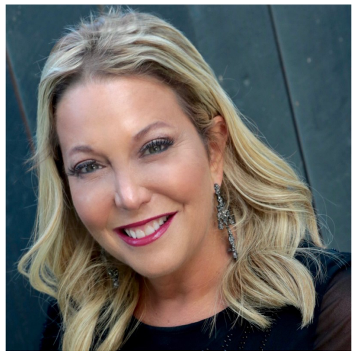


Dennis Chookaszian

Corporate Director, CME Group

DiffuseTap: Institutional Grade Governance

Sharing his decades-long expertise on corporate governance, Dennis talked about how to avoid a co-partnership going sour, the problem with overly idealistic CEOs, and the importance of keeping your board in check. Read on

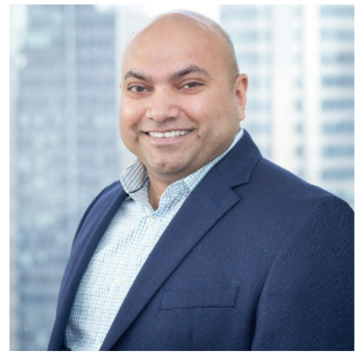


Susan Brazer

CEO & Founder, LionShare Media

DiffuseTap: Media Metaverse 2022

Susan described the 2020 digital media landscape; the evolution of media distribution; how converging, emerging technology points to the metaverse; and the prospect of having an open, decentralized, and free Web 3.0 marketplace. Read on



Raj Mukherjee J.D.

VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes Decoded with Binance.US

Raj explained the complexities of the US crypto tax landscape, how he built a dynamic tax information system for Coinbase and Binance from scratch, and how investors can profit from crypto without getting caught in a taxation mess. Read on

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