diffusetap

Virtual Event Series

Risk Management in the Age of Bitcoin

Guest Speaker:

Greg Foss

Executive Director

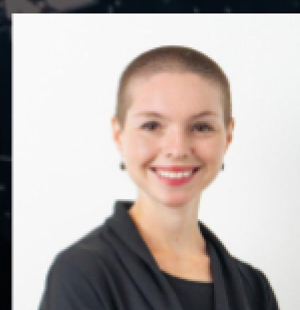
Validus Power Corp

Hosts:

Kenny Estes

CEO & Founder

Diffuse



Ayla Kremb

COO & Co-Founder

Diffuse

DiffuseTap: Risk Management in the Age of Bitcoin

Last time on DiffuseTap, Greg Foss, Executive Director of Strategic Initiatives at Validus Power Corp, talked to us about the great Fiat Ponzi, the imminent collapse of financial markets, and the role Bitcoin plays in hedging against it all.

Want to make friends from the Diffuse Fund Ecosystem? Email contact@diffusefunds.com.

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

Greg Foss is Executive Director of Strategic Initiatives at Validus Power Corp. He has 30+ years of experience in high-yield credit trading and analysis, both the sell side and buy side. As Managing Partner of Credit Strategies, he led a successful hedge fund team during the 2008 financial crisis. He was also a founding shareholder at 3iQ, one of Canada's largest digital asset managers.

LinkedIn: @greg-foss-a553ab32

About Diffuse®

We are an alternative fund platform offering differentiated investment products. From digital assets to VC funds and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds. For more information, visit www.diffusefunds.com.

KENNY ESTES: You are all here to hear from Mr. Greg Foss. So Greg, would you mind introducing yourself a little bit?

GREG FOSS: Hi Kenny, nice to meet you. Ayla, nice to see you again. Thanks for organizing this. My name is Greg Foss. I'm a Canadian, 58 years old. I spent my life as a credit risk manager in various positions on Wall Street and Bay Street. I started my career as a sell side proprietary trader in junk bonds. And then, I moved to hedge funds where I managed upwards of $5 billion in credit products through the great financial crisis and in successive years.

We were on the right side of famous trades, including being short in the U.S. subprime market. And then, I turned those trades around and bought some fairly convoluted structured products. But you're not here to hear about that story. I'm a risk manager that found Bitcoin in 2016, so shame on me for being a Bitcoin maxi. I believe in Bitcoin because it solves my biggest concern in life, which is the Fiat Ponzi.

I've spent my life in the Fiat Ponzi. The Fiat Ponzi is alive and well, and it exists because of the centralization of the control of the money printer. Every single fiat will fail. All you need to do to realize that is examine history. It doesn't happen overnight, but it happens in successive steps, like we've experienced. You need to insure yourself against that inevitability.

I've lived through five financial crises. Four are historical, and we're about to go into the fifth one right now. The four historical ones include when I got my start as a Latin American debt trader in the Brady Bonds solution in the late 1980s. I had come back from Cornell University to Canada and I worked for Canada's largest financial institution, the Royal Bank of Canada, which was insolvent. It doesn't matter whether you're Canadian or international. Every single global financial bank was insolvent in the late 1980s because of Latin American debt. That is part of the problem with the Fiat Ponzi.

Global banks only hold $4 to $6 of risk absorbing equity capital for every $100 of loan they make. How often do you think those loans lose more than $4 to $6 of their value? Trust me, it happens on a regular basis. The global financial system is regularly insolvent. It's just the mathematics of banks that are levered over 25 times to their equity capital base.

When I told the CFO of the Royal Bank of Canada in 1988 that we had a problem, he said "I know. Don't tell anybody." Now, if you want to put your future in the hands of a Fiat Ponzi without any insurance against that collapse, go ahead. But smart risk managers will own insurance against the inevitable collapse. And that's how I like to look at Bitcoin.

Bitcoin is the most perfect technological and math protocol that has ever been advanced to solve the Fiat Ponzi. Having lived through the great financial crisis in 2008, I can assure you that the world was very close to ending. We were making a lot of pretty good trades, but I was so distraught over the reality of the fiat collapse that we were not having any fun. We were actually doing well. I can only imagine what it was like to sit in a risk chair where you are getting carved in half, and realizing that the Fiat Ponzi was ending.

In 2008, we were very close to a collapse. The Fed came out with the Troubled Asset Relief Program, or TARP, which was a $700 billion program that rescued the subprime markets. We've just done four times of that in global central banks, and Canada has led the pack. I'm not sure if this is a Canadian centric podcast or not, it doesn't matter. It's only mathematics. You need to have protection against that final collapse of fiat, which will happen. It happens all the time. It just doesn't happen to G7 nations.

There are 160 fiat currencies in the world that fail on a regular basis. But the G7 currencies don't fail on a regular basis. That's until the next financial crisis, which is the one that is going to cause a failure of a G7 nation. It likely won't be the US dollar. It will likely be the Canadian dollar, unfortunately, because we don't matter.

Canada is a rounding error on the global stage. We have a buffoon as a prime minister, a CEO who won't admit that budgets do not balance themselves. He believes that budgets balance themselves, and that shows in his monetary policies. I think that Justin Trudeau is mathematically challenged. He's admitted as much.

At the end of the day, it will have contagion effects to all markets in the world when any currency fails. Turkey is in trouble. It's a G11 country. Argentina has also failed four times in my career. And so, you need protection against that. In my opinion, Bitcoin is credit default insurance on a basket of sovereigns. It's the cheapest and best asymmetric trade opportunity I've ever seen in 35 years of managing risk.

AYLA KREMB: I'll hop in with some questions. I understand the point you made about the Fiat Ponzi, but maybe you could also dig into some of the other Ponzi things we've observed within the crypto environment. Everybody watched Terra collapse a few weeks ago. I understand that Bitcoin is your drug of choice, but if you look at the entire crypto ecosystem, how do you assess what happened with Terra?

GREG: That's a great question. Offline, I can share with you some insights I had on the actual collapse. But the reality is, if you look at it just on the surface, Luna was the Fiat Ponzi designed digitally. Luna token was the debt, and Terra was the currency. They printed more debt to defend the peg until the crisis of confidence caused a run on the bank. There is no amount of printing that will solve that Ponzi fee. It is exactly the same thing that happens when global investors lose confidence in the debt of a nation.

The bank run is the same that happens with Luna token as it goes to distressed levels. Canada has printed more money on a per capita basis than any other G7 nation. Yet, we still maintain a triple A credit rating compared to the United States' double A plus credit rating. But to understand the risks, don't look at the credit ratings. Look at where Canada trades in the credit default swap markets.

It didn't take long for me to look at Luna and see that this was just the Fiat Ponzi set up digitally. It was ingenious. Do Kwon was full of hubris, much like central bankers tend to be full of their own hubris, and pretended that he was smarter than the other people in the room. When, in fact, he fell prey to an age-old problem when people lose confidence in your currency and your debt, which we saw with the Luna token when it all came crashing down.

So, be very careful where you are allocating your capital in these alternative digital assets. I am not anti other digital assets as much as I am pro Bitcoin. But Bitcoin is the only purely decentralized application. There is no Do Kwan in Bitcoin. There is no Vitalik in Bitcoin. There is no centralization in Bitcoin. All other digital assets have a level of centralization.

KENNY: I'm curious. Bitcoin obviously has a fixed supply that's predetermined. But on the other hand, Ethereum has actual underlying utility. How do you view Bitcoin versus Ethereum?

GREG: I think that I think Vitalik is too centralized. I think proof of stake is like equity. You can buy your equity votes. I don't buy it. I'm proof of work over proof of stake. But at the end of the day, I'm not out to have a fight with Ethereum holders. But if you ask Vitalik what the total supply of Ethereum is, his answer would be "well, it's difficult."

But no, I don't want to know the difficulty, sir. I want to know the exact supply of your currency. If you can rug pull me by changing the supply of your currency, I don't care about how it can solve the Fiat Ponzi, because that's exactly what central bankers do. They can't tell you how much Fiat Ponzi they can print. They just keep printing it until it doesn't work anymore.

I also see this thing people commonly talk about. What about the environmental impact of proof of work models like Bitcoin? That is fun. To start with, Bitcoin solves environmental problems. I'm part of a company that takes Bitcoin miners to flare gas sites that are otherwise venting or flaring gas into open wells in the world. We can mine Bitcoin within 16 hours, setting up mobile units.

Bitcoin actually stabilizes electricity grids and makes things like renewable resources or renewable energy sources viable. That's because you can mine Bitcoin when the sun is shining. There is no demand in the power grid because the sun generally shines when people don't need to use the grid. They're all at work and need to use the grid when the sun isn't shining. Proof of work is necessary to secure the system, and that's what allows Bitcoin to provide more security over proof of stake models like Ethereum.

AYLA: Maybe we could talk a little bit more about the other coins aside from Bitcoin. We talked about tether in the prep for this conversation, and you mentioned that Evergrande was going to be the Ponzi equivalent of tether. What do you think is going to happen to tether in the future?

GREG: Tether definitely has exposure to commercial paper and probably has exposure to junk-rated commercial paper like Evergrande. But if you believe their disclosure, 85% of their assets are held in liquid U.S. Treasury securities and other high rated assets. That means if it falls from a peg of 100 cents on the dollar down to 85 cents on the dollar because they value all that commercial paper at zero, that's not the same as a run on Luna, which absolutely goes to zero.

That's because there is an algorithmic stable balancing. There were no assets backing Luna. Luna was programmed as an algorithmic stablecoin, whereas tether is backed by assets. Some of them are safer than others. But at the end of the day, if there's a problem with tether, there's a way bigger problem with the Chinese Communist Party and their exposure to real estate.

I think people overthink things very often. We need to understand that the true leverage in tether is only to this commercial paper. It's not a bank that's levered 25 times to Evergrande. The real problem with tether would be the commercial banks that have all the exposure to Evergrande on a 25 times levered basis, not on a one-to-one levered basis. And so, if there is a problem in tether, then we have way bigger problems in the global financial system.

KENNY: Fair enough. Going back to Bitcoin, the correlation between Bitcoin and the S&P 500 seems to be pretty high these days. Certainly higher than I presume you, as a Bitcoin maxi, would like. Why do you think that is? And is that going to persist in the long term?

GREG: First of all, Bitcoin is only 13 years old. I always like to say "zoom out", but let's examine the here and now. There are definitely big algo funds in New York that are trading Bitcoin as a risk-off, risk-on asset that is correlated to the NASDAQ. They have big money to make that correlation stick until it doesn't. In my opinion, Bitcoin is actually a long volatility asset, which means it is an insurance product.

When you own Bitcoin, you actually own credit insurance. And therefore, the value of Bitcoin is actually increasing as other risk assets are decreasing. It's just that these algos haven't figured it out yet, because they're programmed by 24-year old Ivy League students who don't know anything coming out of school. They just build themselves a program and correlation, and have a lot of money to defend that correlation.

They also have an instrument called cash settled futures, and a cash settled futures ETF in New York called BITO, which allows them to develop a record short interest on Bitcoin. The open interest on Bitcoin is at a record short level, and that's fine because it's a cash settled product. All of these things, in my opinion, will solve themselves over time. It all starts with education as to what Bitcoin really is.

But when you have big money on Wall Street, they can move markets in ways they want. However, I believe that over time, as education increases and the fidelity research report gets out in the hands of more people that believe Bitcoin is the only crypto that matters, more people will understand what Bitcoin is as an insurance product. Consequently, more people will realize that other digital assets are much more like the securities that trade on the stock exchange.

AYLA: One more question here from the audience. In terms of an average Joe investing in Bitcoin as part of their portfolio, how much do you think somebody should put in Bitcoin versus other altcoins, and versus all the other asset classes?

GREG: What a great question. I pitch one simple mandate. If you own zero Bitcoin, you are taking more risk than if you own a proper portfolio allocation. And as in every portfolio, the right risk level is dependent on the person. I own 40% of my portfolio in Bitcoin and Bitcoin-related assets. I don't own and would never advocate owning 100% in Bitcoin.

But the beauty of an asymmetry return or asymmetric investment opportunity like Bitcoin is that you don't have to own 100% in order to achieve the upside and the benefits of owning Bitcoin. My price target on Bitcoin is over 2 million US dollars in today's dollars. The market is basically telling me I have a less than 2% chance of being right. And while I'm not 100% certain that it will go to $2 million, I'm sure that it's way higher than 2%.

That's like going to the horse track and knowing a horse is way better than the 80-to-1 odds that the last Kentucky Derby winner won the Kentucky Derby. If you play the probability analysis, do good credit and research, and study expected value analysis, you will realize that Bitcoin is the best asymmetric return opportunity you've ever seen. In that vein, you need to own more than zero. That is the right answer.

Forty percent is probably not the best decision if you haven't done thousands of hours of research like I have, to get to the level of confidence that I have. That being said, the wrong answer is zero. If you agree with me that you should own at least 10% of your portfolio in digital assets, I would hope that at least 5% of that was allocated to Bitcoin. The other 5% can be whatever you want it to be, but make sure that Bitcoin makes up a good portion of your exposure because Bitcoin is the insurance against the Fiat Ponzi.

Some of these other digital assets will succeed. I can even start a bigger firestorm and say I believe the ones that do succeed will find their way to layer three Bitcoin protocol. But I don't want hate mail. I love Bitcoin and I do believe it will solve the Fiat Ponzi. I also believe that the most secure blockchain in the world will attract successful applications that up until now are built on other more centralized blockchains. That remains to be seen. It's an opinion, please don't send hate mail. I'm just trying to solve the Fiat Ponzi. I'm not trying to get into an argument over what particular blockchains are better for different use cases.

KENNY: I love it. I agree with a lot of what you said. I think if you're managing a portfolio and you don't believe that crypto is on the efficient frontier at this point, your head is squarely buried in the sand. It's just not a tenable position anymore. But if that 2 million price target you have plays out right, that's a 67-to-one return from where we are right now. Even if you don't have a big portfolio allocation, you're going to really see some upside there.

GREG: Right. You could also change your portfolios as the information changes. The biggest problem with Peter Schiff is, he just has remorse that he actually didn't buy Bitcoin at 10 bucks. And now, for the last hundred or thousand fold increase in price, he's been saying, "See, I told you it would go from $70,000 down to $30,000." What an arsehole. At the end of the day, he's giving very poor investment advice to people that actually believe he has experience. He is a horrible risk manager. Don't manage your portfolios like Peter Schiff. When the information changes, change your risk allocation accordingly.

All I can tell you is that the adoption curve for Bitcoin is now better than the Internet and cell phones. Fidelity uses that research to base their price target of Bitcoin of over a million dollars per Bitcoin by the year 2030. The difference between Fidelity's price target and my price target is that I don't give a time. I'm just highly confident Bitcoin will achieve my price target within my lifetime. And if not within my lifetime, within the lifetime of my kids, because that's who I own Bitcoin for. It's for my children.

Thank you for downloading this DiffuseTap event transcript.

Sign up for upcoming sessions and check out past features and event transcripts.

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

JOIN US