

GOLD AND BITCOIN



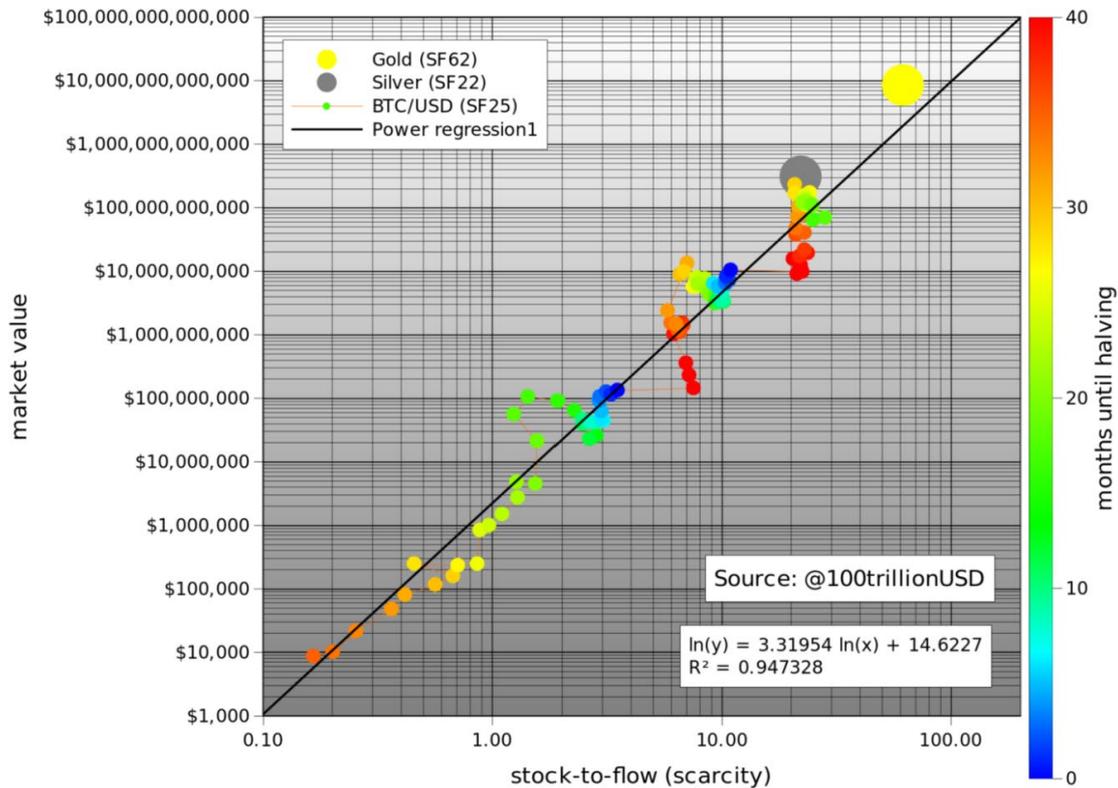
To crypto enthusiasts, Bitcoin’s function as a global currency with no central organisation controlling supply makes it valuable. The question for financial investors, is how valuable? The dominant valuation methodology for bitcoin at the moment is the stock/flow model, popularised by Plan B, and freely available here [Modeling Bitcoin Value with Scarcity | Medium](#). The idea is that scarce assets will have value. The scarcer the asset, the more valuable it will become. To try and model scarcity, Plan B looks at precious metals. The note was published in March 2019. The key column is the 3rd one, which takes the stock of the metal and divides it by its flow or supply

	Stock (tn)	Flow (tn)	SF	supply growth	Price \$/Oz	Market Value
gold	185,000	3,000	62	1.6%	\$ 1300	\$ 8,417,500,000,000
silver	550,000	25,000	22	4.5%	\$ 16	\$ 308,000,000,000
palladium	244	215	1.1	88.1%	\$ 1400	\$ 11,956,000,000
platinum	86	229	0.4	266.7%	\$ 800	\$ 2,400,000,000

Source: Plan B, data as at March 2019

Bitcoin supply is programmed to fall by half, every four years, which naturally boosts the value of bitcoin in a Stock/Flow model. Using the precious metal terms above, Bitcoin starts like platinum, with large flow and small stock, and ends like gold with large stock and small flow. Visually, Plan B shows this with the below chart. The key point to remember is that there will only be 21 million Bitcoin ever produced, which implies flow will be trending towards 0, and hence Bitcoin will trend towards infinity. Few understand this.

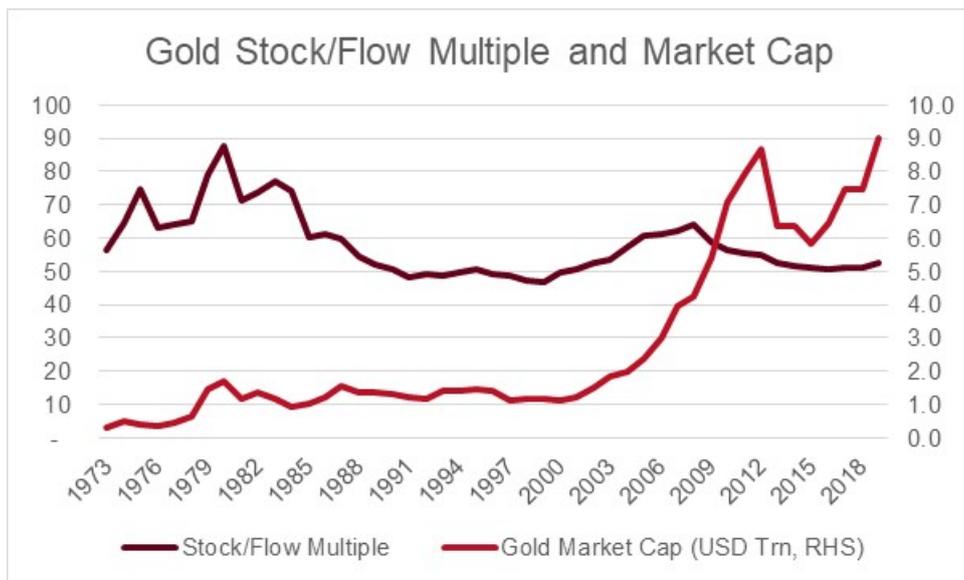
Why Bitcoin has Value: Scarcity



Charts made with gnuplot and gnumeric

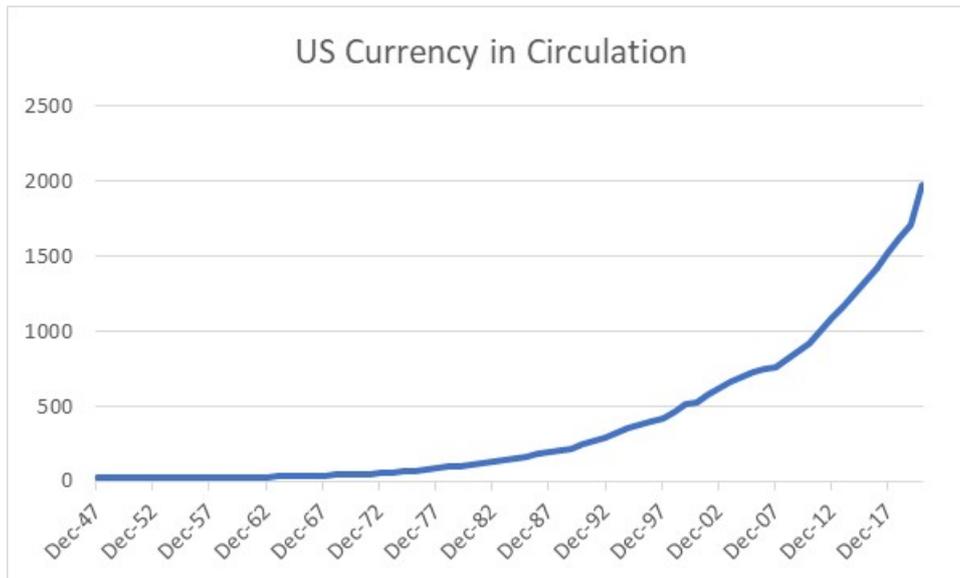
Source: Plan B, data as at March 2019

While the Plan B Stock/Flow model is elegant and intriguing, Stock/Flow models do have a history of failing. The relationship between the stock/flow multiple of gold, and its market cap seems to be spurious over time. From 1980 to 2000, despite having a stock flow multiple of 50, its market capitalisation remained at USD 1 trillion.

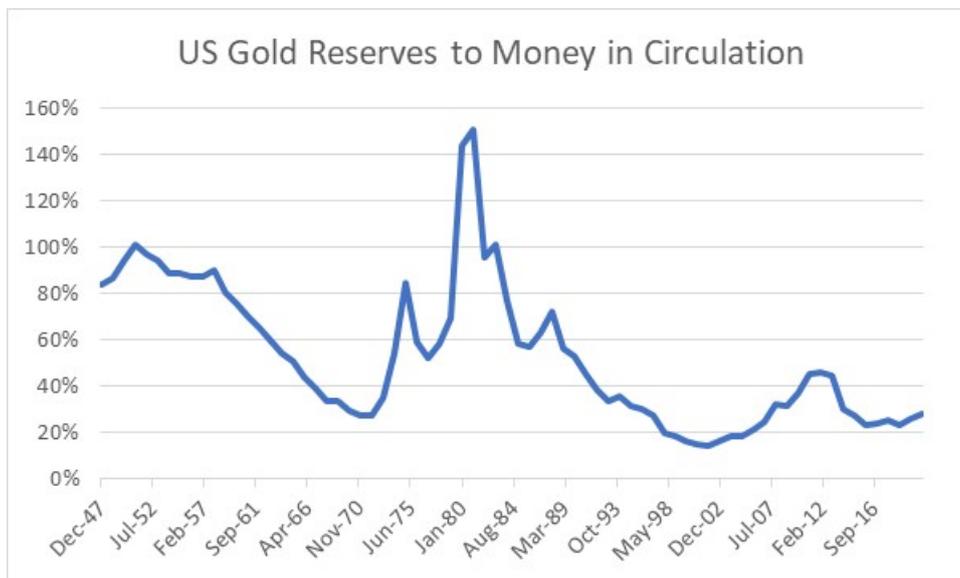


Source: World Gold Council

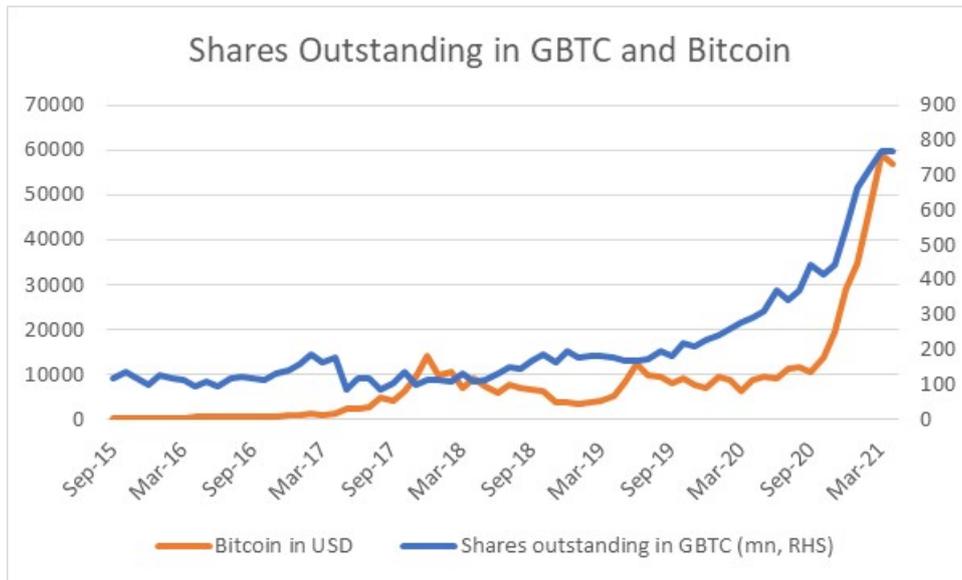
Alternative valuation models for gold tend to link gold directly to the number of US dollars in circulation. It goes without saying the US currency in circulation has seen exponential growth, which explains why you very rarely meet a bearish gold investor.



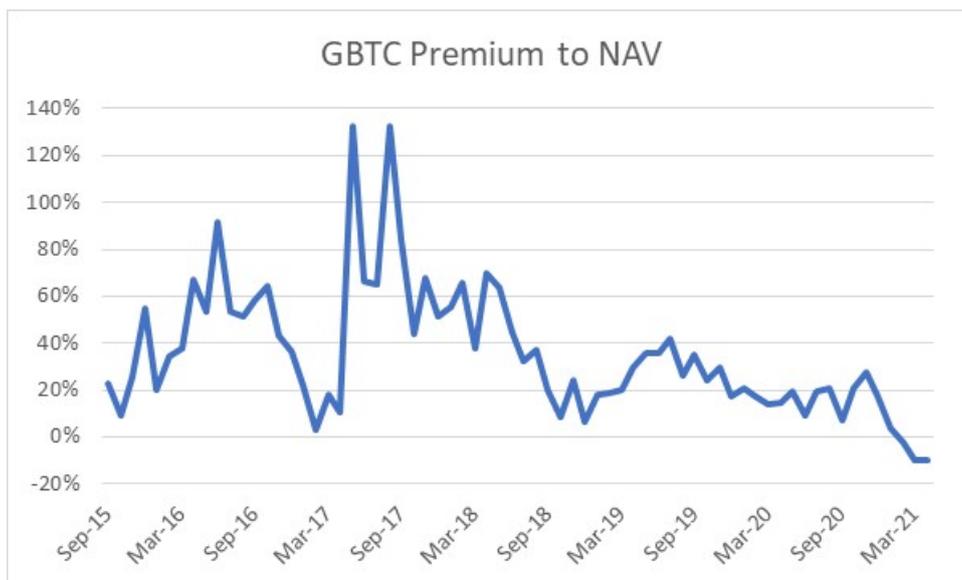
Until 1972, the US dollar was fixed to the price of gold. When we compare the value of US gold reserves value (reserves times gold price) and compare to US currency in circulation, we see that gold reserves covered all currency in circulation in 1952, and again in the late 1970s and 1980s. This leads many gold bulls to target a price of gold that would again make gold reserves equal money in circulation. This gives a current price target of roughly USD 7000 per ounce. This was the original Stock/Flow model. As can be seen below, this analysis has been wrong for 40 years now.



Stock/Flow models are tricky, and lack of supply has often been used as a reason to drive asset prices to very high levels. When I look at Bitcoin, I see some recent changes in the behaviour of the market that suggest liquidity has been a bigger driver of price movements. Shares outstanding in the biggest Bitcoin security (Grayscale Bitcoin Trust) has surged in line with Bitcoin.



At the same time shares outstanding has increased, the Grayscale Bitcoin Trust has moved from trading at a premium to a discount for the first time.



Bitcoin is a scarce asset by definition, but it was also an illiquid asset. That is no longer true. Will Bitcoin’s price now diverge from the Stock/Flow model, just like gold diverged from the money supply model in the 1980s and 1990s? Time will tell.

INFORMATION

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