IDIOSYNCRATIC RISK

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A fugazi, spotted in its natural habitat.

HAPPY NEW YEAR!

It is with great pleasure that I am able to write for you, dear reader, the very first lines of issue number one of volume TWO of *Idiosyncratic Risk*, our investment newsletter for the month of January, in the year 2021. Like many of you, I'm sure, I am imbued with a palpable sense of relief every time I have occasion to recall that, by some happy accident of the calendar, or the inexorable march of time, it is no longer last year.

Of course, 2020 was not uniformly and unambiguously bad. (Neither for this author, nor for everyone else). Antrim Investment Research was founded early in 2020, and only moderately inconvenienced by the coronavirus pandemic. The excellent early reception the firm has received from institutional investors has enabled me to focus exclusively on the aspects of my investment practice and experience that are most differentiated and valuable to my institutional clients: the identification and elucidation of a moderate number of well researched and articulated short ideas.

Neither has 2020 been particularly trying or troubling for one of the newest classes of "investor" in financial instruments, the bitcoin "hodlers." A single bitcoin could be exchanged for $7,251.28, as recently as December 31st, 2019, but trades today at an astronomical price of $33,002.54. The coin closed the year on a blistering rally, having appreciated nearly 280% in the final three months of the year, after gaining "only" 48% over the first nine.

And as usual, there is a wealth of things that can be written about bitcoin. Little of it is actually useful. Bitcoin is, like gold, silver, fiat currency, denarii, ducats, or doubloons, a medium of exchange. That it exists entirely in a digital format, and that its supply growth characteristics are fixed by the recursive nature of the algorithm that both produces the distributed ledger for the currency and controls the issuance of new coins, lends it some credibility as a hedge against a host of geopolitical risk factors including, but not limited to, the prospect of rampant hyperinflation resulting from the competitive currency debasement that has become the defining monetary policy for the world's largest and most important economies.

But bitcoin is not a wholly apolitical asset. There are political risk factors that affect the demand for the coin itself, from time to time. Most famously, in January of 2018 there were rumors that rampant speculation in cryptocurrency amongst the younger generations of South Korea might lead to a government restriction or outright ban on cryptocurrency trading, that precipitated a plunge in the price of the high-flying coins. That same year, Bitcoin would go on to lose over 80% of its value before recovering.

Crypto-currency bulls, rather than focus on the "FUD" (**f**ear, **u**ncertainty, and **d**oubt), surrounding the potential for governments to execute restrictions or bans on trading in the currency, however, tend to point to regulatory restrictions already in place that have prevented more widespread adoption of crypto currency as an asset class for institutional investors. In the United States, for example, the SEC has repeatedly refused to allow registration of a bitcoin-backed ETF, which is seen as a gating factor for allowing more widespread adoption of crypto currency as a financial asset amongst luddites, as well as for institutional investment managers regulated by the investment company act of 1940. As the thesis goes, a tremendous amount of pent-up demand for bitcoin among institutional investors exists, that might be tapped once a suitably liquid instrument is created that tracks the price of the currency.

In recent months, this argument has gained in force after a public software company, Microstrategy (Nasdaq: MSTR) announced the intent to purchase up to $1B in bitcoin as part of the company's revised treasury reserve strategy. On December 21st, 2020, the company announced that they had completed the acquisition of approximately 70,740 bitcoins at an average price of approximately $15,964, and a total investment outlay of $1.125B. Two weeks later, the company's expectation that "bitcoin will provide the opportunity for better returns and preserve the value of our capital over time," has been well met. Microstrategy's bitcoin holdings amount to over $2.4B USD, in total.

Where the "pent up institutional demand" argument falls flat, however, is in the execution of any realistic institutional investment allocation to an asset class the diminutive size of the market for bitcoin. Even in December 2020, *after* the tremendous price rally the coins have staged over the preceding year, the total market capitalization for the entire bitcoin marketplace, globally, is a mere $350 billion U.S. Dollars. There are a number of popular arguments in favor of bitcoin as an investment taking the form of, "should bitcoin displace 'X' as a medium of exchange, its value would have to increase by 'Y'!" All are putting the cart firmly before the horse.

Comically small allocations to bitcoin from institutional investors have an enormous impact on the price of the underlying. Grayscale Bitcoin Trust, a closed end fund that holds bitcoin for qualified investors, now has $10.8B in assets under management, up from $1.9B at the end of 2019, as asset flows into the ARK family of "innovation" ETFs, and specifically into the ARK "Next Generation Internet ETF," have, in turn, resulted in flows into the GBTC. (ARK is GBTC's largest investor). As a result, Grayscale has purchased over 70% of all the bitcoin mined during 2020.

The relative lack of liquidity in the bitcoin marketplace brings us to the "point," of this letter (if there is one), which is to say, dear reader, please stop listening if ever a market pundit or investment analyst attempts to ascribe some fundamental justification to, or draw some macroeconomic conclusion from, the price movement of bitcoin. The speaker would only be wasting your time. One of the fundamental underlying assumptions of the "efficient market hypothesis," as it is applied to a well-functioning market for investment securities, is that the marketplace is liquid and comprised of many rational buyers and sellers. You do not have to believe that bitcoin-believers are irrational in order to understand that the very first requirement of an efficient market is still not met – there are not yet enough bitcoin for the market to absorb even small changes in its participants' portfolio construction without dramatic volatility.

As a result, while it is tempting to make the case that a meteoric rise in the price of bitcoin portends for a higher rate of inflation in the overall economy or speaks to uncertainty around the freedom of global trade and/or the exacerbation of the global populace's concern for privacy and individual liberty as central banks around the world ponder the introduction of their own digital currencies, one cannot, in good conscience. It remains a fact that the importance of all these factors combined pales in comparison to a simple statistic: weekly in-flows (or outflows, would that such a thing could occur) into the Grayscale Bitcoin Trust.

Those same inflows and outflows are entirely unpredictable and unrelated to any number of other macro-economic factors that the spectacular rise of bitcoin might be attributed to. And so long as that remains the case, it remains the opinion of this author that a rapid increase in the price of one of the most discussed financial assets on the planet, at present, however spectacular it may be, is entirely devoid of any fundamental significance.

Every bubble in history has shared the characteristics of the ongoing bitcoin bubble, to such a degree that any analysis of it, this time around, is almost pedestrian. Put simply: investment flows into securities and vehicles (GBTC, ARKW) with price inelastic demand for a float limited asset (BTC) have an unbelievably outsized impact on the demand for the underlying. Compare to the late 90s, for example, when tech-focused sector funds allocated inflows to float-limited tech IPOs based on scant, ephemeral, fundamental rationalizations.

But these characteristics also make bitcoin a poor proxy for inflation, or geopolitical risk, or whatever fundamental justification is required to explain its inclusion in an investment portfolio. The simple fact of the matter is that, like the USO, which utterly collapsed in April when it was forced to sell front month oil futures contracts into a market flush with supply, the Grayscale Trust and the Ark Next Generation Internet Fund will not act according to logical conclusions drawn from fundamental datapoints that articulate the fundamental case for bitcoin. They will act according to their mandate – which is buy when the flows come in and sell when the flows go out.

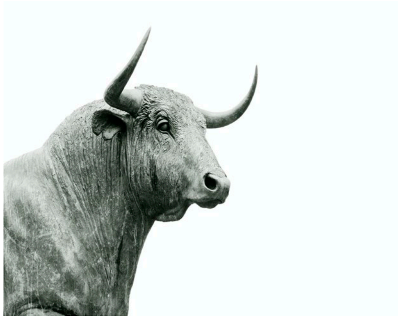
For many months, now, it has been the opinion of this author that the widespread introduction of an effective coronavirus vaccine should prove to be a tremendously inflationary shock to the macro-economy, to the extent that it is able to put service and hospitality workers back to work and get shoppers back in stores. Already fiscal and monetary stimulus has produced inflation in essential categories of goods and services immune from both the pandemic and the lockdowns it brought on. But what should that mean for so-called "inflation hedges," like bitcoin? Or Gold? In the case of bitcoin, investors inflation expectations will have zero bearing on the investment decisions of either ARKW or Grayscale.

Paradoxically, should the vaccine succeed in bringing part-time workers back to work and bring fiscal stimulus and extended unemployment benefits to their logical conclusion, it might also result in a rather abrupt reduction in the amount of day trading, "investment," and crypto-currency speculation that has fueled this year's rally. One wonders what fundamental reason will be given for a decline, should flows out of these products produce a decline in the price of bitcoin, at the very moment that investor's confidence in fiat currencies, globally, ebbs?

To paraphrase James Carville, "it's the flows, stupid."

PAST PERFORMANCE IS NOT A RELIABLE PREDICTOR OF FUTURE RESULTS

Recommendation	Date	Performance Since Recommendation
Short ACEL	October 1st, 2020	-9.4%
S&P 500	October 1st, 2020	+10.0%
Long LMND	August 3rd, 2020	+94.7%
S&P 500	*August 3rd, 2020*	+13.1%
Short TSLA Short GSX Long AKRXQ	July 1st, 2020 July 1st, 2020 July 1st, 2020	+237.9% -18.1% -100.0%
S&P 500	*July 1st, 2020*	+19.4%
Long MIK Short QSR Long MINM (formerly: ZMTP)	June 1st, 2020 June 1st, 2020 June 1st, 2020	+239.8% +11.7% +68.4%
S&P 500	*June 1st, 2020*	+21.6%
Long NLY Long AGNC Short SWKS	May 1st, 2020 May 1st, 2020 May 1st, 2020	+42.2% +33.3% +48.6%
S&P 500	*May 1st, 2020*	+25.9%
Long DESP Short KNSL	April 1st, 2020 April 1st, 2020	+125.4% +91.7%
S&P 500	*April 1st, 2020*	+43.2%



A Bull, in grayscale – get it?

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If you are coming across this, the tenth issue of ***Idiosyncratic Risk***, for the first time, welcome. I would always like to make new friends. If you find my views interesting or helpful, and if you'd be so kind, feel free to forward this newsletter along in your network to those who might also make use of its content.

I sincerely appreciate the friendship, support, mentorship, and camraderie I've experienced during my career in Investment Management and I would like to thank my friends and readers for supporting me, whether by forwarding this email and my contact information along in your network, or merely reading these pages and considering what I have to say.

Feel free to reach out with questions, criticisms, suggestions, and investment ideas if you've got any good ones.