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Bitcoin Cash Commentary (October 2017)

Bitcoin Cash and the Fork: What is it?

Cryptocurrency itself is a new term, and the term fork as it relates to a cryptocurrency requires explanation. In order to understand a fork, one must first understand the concept of a distributed ledger, or blockchain, upon which bitcoin and other cryptocurrencies are based. The blockchain contains all of the transactions that ever happened to that particular cryptocurrency. A transaction can only be added to the chain with an encrypted digital signature.

The chain, or distributed ledger, exists in a multitude of copies, unlike the more common central database used by a bank. Thus, not only would a criminal need the correct digital signatures, also known as private keys, to corrupt the system, the criminal would also need to simultaneously attack and alter every copy of the blockchain. This is why the blockchain is secure.

However, the system, being distributed, works on consensus. Everyone must use the same computer code that created, or is, the cryptocurrency. If someone changes the code without the consent of the other members, a transaction could be processed on one copy of the distributed ledger that would not be represented on all of the other copies. From that point in time, there would exist an altered version of the blockchain. These two versions are then said to have forked. In other words, there begins a deviation from what was previously a common history.

Bitcoin experienced such a fork on August 1, 2017. The dispute between two factions centered on the carrying capacity of the system. Specifically, in this instance, the dispute was over the size of a block, since it is generally agreed that some adjustment must be made to accommodate the ever-increasing number of bitcoin transactions. A block is simply the term used to describe the most recent series of bitcoin transactions that have been accumulated into a discrete group for confirmation as legitimate, then to be added to all the preceding blocks of the blockchain ledger. Thus, the common way of looking at this matter is that there are now two currencies: Bitcoin and Bitcoin Cash.

Bitcoin Cash is being treated as a so-called “fork” in the same manner as that of Ethereum and Ethereum Classic. Ethereum faced a hard fork because there was no consensus on whether to stay with the original ledger (blockchain) or shift to the new ledger, a discussion necessitated by the discovery of a flaw in the blockchain code and how to respond to it. However, Ethereum is qualitatively different from Ethereum Classic. Ethereum’s blockchain is mutable, which means that it can be changed by consensus. This is a major philosophical distinction vis-à-vis Ethereum Classic, in which the blockchain is immutable. Secondly, Ethereum and Ethereum Classic have different monetary policies. Without changing these factors, it would be impossible to merge the two blockchains.

What’s the Difference Between bitcoin and Bitcoin Cash?

Bitcoin and Bitcoin Cash are different insofar as block size and transaction processing speed. However, both coins have the same monetary policy and the same policy with regard to immutability. The two coins are qualitatively identical in terms of value. There are now two currencies in which the users agree on the concept of fixed issuance to the level of 21 million currency units and no more issuance beyond that point.

The blockchains are now different, as of August 1, 2017, due to different ownership, even though both had identical ownership profiles on July 31, 2017.

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In U.S. currency, the $1 coin, the 50¢ coin and the $2 bill never became popular and clearly have a different ownership profile than the $1 bill. Nevertheless, the purchasing power of all these are identical. Similarly, although Bitcoin Cash has not become popular, its purchasing power and, therefore, its intrinsic value should largely be a function of monetary policy and inflation rate, not profitability.

Why Does Bitcoin Cash Trade at a Discount to bitcoin?

- It has not attracted miners, since its difficulty rating is unstable and it is not clear how much money, if any, a miner can earn by validating transactions.
- China eliminated cryptocurrency exchanges in September 2017, thereby forcing Chinese investors to sell bitcoin and Bitcoin Cash prior to that date. There is a large universe of bitcoin buyers. There is not yet a large universe of Bitcoin Cash buyers.
- This is because most exchanges have chosen not to support Bitcoin Cash.[1] These exchanges will not execute a purchase order for Bitcoin Cash. Indeed, many will not even hold Bitcoin Cash in wallets and are forcing sales.
- Custodians such as Xapo[2] are refusing to support Bitcoin Cash, and all Bitcoin Cash must either be sold, removed, or converted to bitcoin from Xapo's cold storage[3] by mid-December, forcing yet more sales. Thus, for the next month or two, there will be relentless selling of Bitcoin Cash by small holders. It is gradually being accumulated by big holders.[4] Eventually, the selling will abate.
- Once forced selling ceases, one will be able to measure the willingness of large investors to value the coins based on purchasing power. Using current prices of the Bitcoin Cash relative to bitcoin, if the thesis of similar intrinsic value is correct, one might be able to make a return of 15x or greater[5].
- Bitcoin Cash, once accumulated by several large owners, will, in our opinion, find some use as a medium of exchange. Perhaps this might form the basis of a cryptocurrency futures contract for institutional investors. Perhaps it can be the basis of an international money transfer application for banks, inasmuch as a small number of banks could purchase much of the available supply and, in effect, create a semi-private blockchain.
- Bitcoin Cash should be regarded as more akin to a corporate spin-off in the world of equities than a fork in cryptocurrency. In the days before spin-offs were as broadly recognized as they are today, there was usually a 5-6 month period of time until a bona fide ownership base was established. In the case of Bitcoin Cash, more than 2 months of this process has already elapsed.

[1] For instance, Coinbase and Xapo do not currently support Bitcoin Cash.
[2] Xapo will not support BCH (Bitcoin Cash) in any way after December 14th, 2017. Users will have until that date to decide if they want to sell or withdraw their BCH. If users do nothing with their BCH by that date, then Xapo will automatically sell any remaining BCH balances for BTC and credit the corresponding value in BTC to the customer's wallet. Coinbase users will not be able to retrieve their Bitcoin Cash until January 1, 2018.
[3] An offline method – that is, not connected to the internet – of securely storing cryptocurrencies.
[4] Source: bitinfocharts.com
[5] As of October 11, 2017.

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