Cryptocurrency or Fiat Currency? Volatility or Debasement? Choose Your Risk. (October 2017)

Choose Your Retirement and Estate Risk: Volatility or Money Debasement?

Most observers consider cryptocurrency to be a technological innovation. Certainly this is true. Yet some technologies actually change the way society is structured, and cryptocurrency is arguably such an innovation. One would think that this would be self-evident in the investment world, yet cryptocurrency is not accepted even as a legitimate investment.

This lack of acceptance is because modern portfolio theory defines risk as price volatility. Anyone observing cryptocurrency upon the most casual basis will immediately realize that it is far more volatile than even the most volatile equity segment. However, in a historical, rather than day to day or year to year context, the great investment issue has never been the control of volatility; it has been the retention of purchasing power or, stated differently, a defense against the erosion thereof. This is the contest of the unending efforts of governments—either with, or even without, the assistance of a central bank—to debase the value of money against the struggles of the citizenry to resist debasement.

The history of government monetary policy, domestic and foreign, recent and ancient, provides a mind-numbingly endless series of examples of currency debasement, all telling the same story.

- The Roman Empire provides 2,000 years of examples of successive debasements of their coins. For instance, during the 73 years between the end of the reign of Marcus Aurelius in 180 CE to the beginning of the Emperor Gallienus in 253 CE, the denarius silver coin was debased from 75% silver to only 5%, which was just a surface coating that would wear off. That is 93% depreciation, which works out to about 3.6% per year.
- Interestingly, in the U.S., in the 73 years from 1943 to 2016, the inflation rate was 3.67% per annum, which means that the dollar also lost 93% of its purchasing power. For most of that period, though, a U.S. citizen could earn a comparable yield on his or her savings from their bank deposits or treasury bills, so that purchasing power could be maintained if the cash was held within the financial system and not under the mattress or in the bookshelf. That has not been the case, though, over the past decade, since short-term interest rates have been kept near zero; money held in the system really is being eroded.

An integral part of that monetary history, though, are repeated examples of how certain items of fixed supply – that is, which were reliably scarce – have provided a remarkable degree of investment return. As we will see, though, that value creation might not be appreciation per se so much as the simple retention of value versus the depreciating currency in which that item is denominated.

This is in accordance with Sir Thomas Gresham's principle, now considered to be a law of economics, that bad money drives out good. This is why the Liberty dime, which has not been minted since 1945, can be had for about $72 each. This is a 72-year rate of return of 9.71% per annum. If silver coins were an asset class, they would compare quite favorably with any type of fixed income investment and most forms of equity. And this is despite the fact that the supply of silver is constantly increasing and is now priced at $17.50 an ounce; whereas, it traded in excess of $49 in 1980.

Or, there is a 1909-S Indian Head penny. Rare coin website CoinTrackers.com estimates its value, even if only in average condition, at $600. That represents a compound annual rate of return of 11.63%. In any case, it is far superior to the return of $1 from 1909 to the present.

It is simply astonishing that a 1909-S Indian Head penny, collecting no interest, could dramatically outperform every bond index or fixed income index within reason, as well as the S&P 500 Index. That Indian Head penny escaped the debasement power of the government, because it stopped being issued and, in an operation of Gresham's Law, individuals withdrew them from circulation and saved them for their scarcity value.

In a parallel manner, cryptocurrency essentially bypasses or renders obsolete the control of the value of money by central banks or governments. It is the veritable embodiment of the idea of social change as expressed by the inventor and social theorist Buckminster Fuller. Fuller stated that: "You never change anything by fighting the existing reality. To change something, build a new model that makes the existing model obsolete."[1]

Hopefully, if nothing else, a vigorous discussion of the merits of cryptocurrency or lack thereof will restore the focus of the investment debate from a study of volatility to a study of purchasing power.

[1] WikiQuote

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