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SMART AND STEADY

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What is Bitcoin really?

By the time this edition of The Weiss Report reaches your eyes, you've almost assuredly heard about Bitcoin. Rather than get hysterical about the highs and lows, our goal in this edition is to discuss Bitcoin as a potential asset in an investment portfolio. To do that, we will discuss what Bitcoin actually is, we will identify the characteristics we look for in any investment and whether Bitcoin applies, and lastly we will discuss some of the risks that are inherent in cryptocurrency investing.

Without getting too technical, Bitcoin was started in January 2009 when Satoshi Nakamoto mined the first block of bitcoins. There is some debate about whether Nakamoto is a real person or whether it is a name used by a group of people, but it is undisputed that the first 50 bitcoins were mined at that time. Over a period of time, Nakamoto reportedly mined over one million bitcoins and turned over control of the system to another programmer.

While the origins of Bitcoin are a bit murky outside of the facts above, there is less of a debate about what Bitcoin is. Bitcoin is one of many forms of cryptocurrency. These forms of currency are meant to act as a digital cash system without a central entity (bank). A central entity essentially keeps track of the currency to make sure no one is double spending. Cryptocurrencies aim to make that central entity unnecessary by being a peer to peer database where everyone can read every transaction – thereby making sure that double spending cannot occur.

This is about as deep into the origins and philosophical aspect of Bitcoin as we will go. Certainly deeper conversations can be had about the issue and we welcome readers to contact us for more.

Part of the difficulty in discussing the investing value of Bitcoin is that it doesn't fit well into what financial professionals identify as an investment. There is no backing of the currency, like gold or a government note. It isn't like a stock because there is no company of which ownership is shared. With a stock, things like earnings matter – for Bitcoin there is no comparable thing. As shown by the wild fluctuation, there is legitimate question about its viability as a storer of value.

Bitcoin also lacks many of the regulatory features that we take for granted in "regular" investing. Outside of the newly offered futures contracts, Bitcoin is illiquid compared to stocks and bonds. There is no recourse for buyers, there is no government entity to turn to when an investor is wronged. There are also concerns about hacking and price manipulation. There are even many stories of Bitcoin fortunes being lost when a laptop dies or other computer calamity.

So if Bitcoin doesn't have any of the characteristics that investors generally look for, why is it so popular?

At this point, the excitement surrounding cryptocurrencies can generally be segmented into two different groups that are motived by two specific personality traits. The first, and perhaps more obvious, is greed. As the price of bitcoin increased at a rapid rate, a large number of people saw dollar signs in their eyes. They believed that bitcoin would be their "gold rush". As more and more casual followers put money down, the price continued to go up. Word spread like wildfire on social media attracting more people. The fear of missing out on a "once in a lifetime opportunity" continued to be too strong for many.

The other personality trait involved in the cryptocurrency boom is curiosity. As with any aspect of technology, some have a desire to be involved as soon as possible. These early adopters tend to float from new idea to new idea and take pride in being among the first to embrace new technology or ideas. Many of bitcoin's early adopters refer to themselves as "hodlers", which is a misspelling of holder, as they intend to hold their bitcoin no matter what happens to the price. This is another differential between cryptocurrency and the broad stock market. Many holders of cryptocurrency are not acting like investors, but more like collectors.

Cryptocurrencies are not inherently bad. The technology is fascinating and there may be legitimate uses as a currency in the future. However at this time, we categorize bitcoin and other cryptocurrencies as a gamble, rather than an investment. We just generally do not recommend using investment money for gambling purposes. We welcome deeper questions and discussion regarding cryptocurrency, please feel free to contact the office any time.

Portfolios:

In portfolios that we manage by discretion we have seen that the strategic change from individual stocks to more broad based investment products has been a good one. The overall stock market was up every month in 2017 and we see that as a positive sign for both the overall market and for the portfolios we've crafted for clients. In most portfolios managed by discretion, we are gearing for more growth opportunities in 2018 while diminishing our individual fixed income exposure.

Enclosures:

For our first enclosure, Lenny Weiss provides some observations he's had after 40 years in the industry. While he likes to joke that he "knows" things because of his gray hair, it is certain that his experience has yielded wisdom. He is very happy to be able to share that wisdom with our readers.

Our second enclosure is a brief history of market bubbles. While discussing cryptocurrencies, it is very difficult to avoid talking about bubbles. Because we wanted our primary piece to be about cryptocurrency's nuts and bolts, we wanted to provide some contextual understanding of some of history's largest bubbles.

Our third enclosure comes from Raymond James and provides a quick look at what the firm is thinking. Called the Investment Strategy Quarterly, we try to include this as an enclosure in each Weiss Report. It allows readers to see a snapshot of themes, economic expectations, and tactical outlook.

The Weiss Report
Volume 21 Number 1
Enclosure #1

Market Observations After 40 Years

By: Leonard A. Weiss

After 40 years of observation, I thought I had seen enough of the up and down cycles to claim I had seen it all. Then, something happened in 2017 that not only had I never seen, but had never occurred in the prior 99 year history of the New York Stock Exchange (NYSE). The stock market appreciated in all 12 months of the year. This occurrence was unprecedented!

In these 40 years, I have seen major bull and bear markets. I believe I have learned the difference between conditions that cause bull market corrections and what conditions cause bear markets.

There was a time when financial information was limited to the well connected, and now there are multiple 24-hour cable news networks dedicated to the markets available to everyone. Then of course there's the Internet, where just about everything one wants to know is available in a nanosecond.

I'd like to make some observations about how markets have changed, but mostly how they have not.

In 1977, a one percent fluctuation constituted eight points on the Dow. Today one percent translates to 240 points. One percent is still one percent, but, the media seems focused on points. So when the market rises or falls 150 points in one day, they present this as a major move. We want our readers to understand that a 150-point fluctuation in a day is more of a yawn to us than a dramatic move. We urge all readers to convert their thinking from points to percentages. It will help us all keep the markets in real focus.

The next observation I'd like to make is that market sentiment and its affect on markets have changed very little in 40 years. The easiest way to see this is to understand that at market extremes, greed and fear still dominate markets. In parabolic up moves, it seems everyone thinks the markets will go up forever, and when a waterfall decline occurs, fear grips investors and they conclude the market will never rise again. When the rising market peaks of 1987 and 2000 were achieved there were no bears, and when the waterfall declines of 2000-2002 and 2007-2008 there were no bulls. I really believe that at market extremes, greed and fear rule the times. In this context, little has changed in 40 years.

Taking this point further, it is complacency that drives greed and pessimism drives fear. For these 40 years, I have been told that bull markets need to "climb a wall of worry" to continue rising. This may be true because for every buyer there must be a seller. At market tops, it's perceived that no one is bearish which dries up normal selling. Markets generally rise in a straight line with no sellers and then collapse like a house of cards.

The same is true about waterfall declines. As markets drop, fear builds so quickly that it seems no one is willing to buy which accelerates the decline forcing a point of maximum fear and a market bottom.

Most bull market corrections are caused by events that causes sharp but usually short down drafts, and then the bull markets resume their climb. An example of this came in April 1981 when President Reagan was shot. For about an hour no one knew if he was alive or dead. During that time the markets sank until news was released that the President was alive and would recover.

In 1990, Saddam Hussein invaded Kuwait threatening Mideast oil supplies. This caused a sharp correction as energy prices rose sharply, since almost 65% of all oil we were using was imported. But after a few weeks, it was obvious that the U.S. lead coalition would drive Hussein out, and normalcy would return.

The last example I will use was the "Brexit Scare". Most analysts were certain that the British would vote to stay in the Eurozone in June of 2016. When the vote went the other way, the market sold off sharply for 3 days! Then the market settled down and recovered the lost ground.

In Summary: We remain bullish on stock prices for 2018. There is sufficient pessimism in our opinion for a Wall of Worry to exist.. While markets seem to rocketing higher by points, they are not running up out of control based on the percentage gains. There have been many years in the last 25 when an individual year's annual gain exceeded 2017. Last, corporate profits are rising not falling, and the yield curve is not inverted. With the above in mind, we see little chance of recession, or a secular bear market this year.

We always have to warn about events that can and probably will jolt markets, but we believe events that cause downdrafts in stock prices should not be a predecessor to a secular bear market.

A Brief History of Bubbles

In conjunction with our discussion of Bitcoin, we thought our readers should know that the craze surrounding cryptocurrency is not unique in history. In this piece, we will touch on a few of the many speculative bubbles that formed and in time collapsed leaving significant financial carnage in their wake.

Since cryptocurrency is generally unregulated by government, we will not highlight bubbles that also saw significant involvement by government. Accordingly, we will not focus any space in this piece to the Japanese Asset Bubble of 1987-1992 or the U.S. mortgage/banking crisis on 2005-2009. Both of these bubbles/crashes saw government as a major player in their cycles.

The first known asset bubble was called "The Tulip Bubble" in Holland and collapsed in 1637. Tulips were introduced to the Dutch in 1593 by traders from Turkey. At the time they were unique because of their rare bright color. Their color patterns came in wide variety, increasing their rarity. Exotic tulips became the ultimate luxury accessory and status symbol.

People mortgaged houses and sold businesses to buy the bulbs and flowers. Prices rose to more than 10 times higher than a skilled worker's income. At one point, a single tulip bulb sold for up to $150,000 in today's currency. Bulbs were traded for land, livestock and was even considered an acceptable dowry for a bride. People were buying tulips and bulbs despite never seeing them. Near the end of this bubble, overpriced tulip bulbs rose 20 fold in one month. Needless to say, prices did not reflect the true underlying value of a tulip bulb.

In February 1637, with prices at staggering levels, a single bulb auction attracted very few buyers. Dealers began to liquidate their inventories which began the domino effect which collapsed prices in a short period of time. Banks failed, and individuals realized they had traded homes and other assets for a flower.

In the 20th Century there was another similar bubble. It was called "the Florida Real Estate Bubble" which collapsed in 1926.

It was the roaring 1920s and the economy was booming, and standards of living rose quickly. At the same time, Florida became a destination for people who didn't like the cold. Housing construction in Florida could not keep up with the newfound demand causing prices to unjustifiably double and even triple in some cases. News of anything rising is price so quickly attracted speculators.

Soon, money was flooding into Florida real estate and prices soared. In a short period of time, almost everyone in Florida was either a real estate investor or agent.

The growth around Miami was so maddening that the overutilized railroads began to embargo all shipments of building materials so food and medicines could be shipped. This embargo brought new building to a near halt. Then a strong hurricane hit Florida in 1926. At the time it was called the greatest hurricane in South Florida history.

Despite a roaring economy, it was becoming harder and harder to find buyers to sell to at the prices needed to make a profit. Then most saw the writing on the wall and began to sell. Panic selling ensued, and prices came down with a sickening thud. The bubble had burst.

The last bubble we will discuss most readers may remember: the Beanie Baby Craze of the 1990's. Many readers may still have Rubbermaid containers full of the adorable toys,

The primary exchange to buy and sell Beanie Babies was a then new online experience called E-Bay. At their price peak, Beanie Baby trading exceeded 10% of all E-Bay activity, and it was estimated that 60% of American households owned a Beanie Baby.

Today, surviving Beanie Babies are worth about 50 cents apiece, says Zac Bissonnette, author of the recently published The Great Beanie Baby Bubble: Mass Delusion and the Dark Side of Cute. The chances that any long-neglected collection secretly contains a toy that could sell for more than $10 are extremely low.

Our point here, is that over time, many items can be run up in price by speculators, manipulators and the craze of individuals to make a quick buck. The times change, the items involved change, but the ending is almost always the same: a price collapse and potential financial ruin to those who participated. This is why there is a phrase in Latin: Caveat Emptor which translates to Buyer Beware.

We believe that Bitcoin and other crypto currencies will suffer the fate that other asset bubbles suffered.

INVESTMENT STRATEGY QUARTERLY QUICKVIEW

JANUARY 2018

THEMES

Economic Outlook: A Positive View, with New Uncertainties

Economic fundamentals remained in good shape in 2017, with most sectors closing out the year with positive momentum. The job market has remained strong, helping to fuel growth in consumer spending and residential homebuilding. Business fixed investment has strengthened, reflecting a rebound in energy exploration and increased business confidence. The global economy has been picking up as well, supporting U.S. exports.

U.S. Equity Outlook: Staying Calm in the Face of the Bull

The somewhat arbitrary change of the calendar shouldn't alter the underlying forward-looking expectations for the stock market – or provide much new insight into future winners and losers. Yet, the arrival of another year does provide a fine excuse to pause and reflect on current conditions and examine the themes that investors should monitor as they gaze ahead. Since it's difficult to look forward without knowing the direction you've come, let's turn our attention to the past before proceeding to what may be ahead.

International Outlook: Progress and Faith

One problem with being the first to slash interest rates and undertake a highly simulative central bank policy is that, if successful, you're likely to be the first to wind it all back. This is the scenario that U.S. policymakers are currently facing. Looking forward into 2018, further interest rate increases and a reduction of the Federal Reserve's balance sheet are highly likely. By contrast, other major global central banks are still expanding the size of their balance sheets and the likelihood of interest rate increases during 2018 in the UK, the euro zone, China, or Japan are still low.

For more information, refer to the full *Investment Strategy Quarterly.*

ECONOMIC SNAPSHOT

ECONOMIC INDICATOR

FAVORABLE	GROWTH
FAVORABLE	BUSINESS INVESTMENT
FAVORABLE	HOUSING AND CONSTRUCTION
FAVORABLE	REST OF THE WORLD
NEUTRAL	EMPLOYMENT
NEUTRAL	CONSUMER SPENDING
NEUTRAL	MANUFACTURING
NEUTRAL	INFLATION
NEUTRAL	MONETARY POLICY
NEUTRAL	LONG-TERM INTEREST RATES
NEUTRAL	FISCAL POLICY
NEUTRAL	THE DOLLAR

From Scott Brown, Ph.D., Chief Economist, Equity Research

TACTICAL OUTLOOK (6-12 months)

FAVORABLE	OVERALL EQUITY
FAVORABLE	NON-U.S. DEVELOPED MARKET EQUITY
FAVORABLE	NON-U.S. EMERGING MARKET EQUITY
FAVORABLE	ALTERNATIVE INVESTMENTS
NEUTRAL	U.S. LARGE CAP EQUITY
NEUTRAL	U.S. MID CAP EQUITY
NEUTRAL	U.S. SMALL CAP EQUITY
NEUTRAL	INVESTMENT GRADE INTERMEDIATE MATURITY FIXED INCOME
NEUTRAL	INVESTMENT GRADE SHORT MATURITY FIXED INCOME
NEUTRAL	MULTI-SECTOR BOND STRATEGIES
NEUTRAL	CASH AND CASH ALTERNATIVES
UNFAVORABLE	OVERALL FIXED INCOME
UNFAVORABLE	INVESTMENT GRADE LONG MATURITY FIXED INCOME
UNFAVORABLE	NON-INVESTMENT GRADE FIXED INCOME (HIGH YIELD)
UNFAVORABLE	GLOBAL (NON-U.S.) FIXED INCOME

The tactical asset allocation outlook above reflects the Raymond James Investment Strategy Committee's recommendations for current positioning. Your financial advisor can help you interpret each recommendation within this material relative to your individual asset allocation policy, risk tolerance and investment objectives.

RAYMOND JAMES®

INVESTMENT STRATEGY QUARTERLY QUICKVIEW

JANUARY 2018

CAPITAL MARKETS SNAPSHOT

EQUITY	AS OF 12/31/2017*	4Q 2017 RETURN**	12-MONTH RETURN
Dow Jones Industrial Average	24,719.22	10.96%	28.11%
S&P 500 Index	2,673.61	6.64%	21.83%
NASDAQ Composite Index	6,903.39	6.55%	29.64%
MSCI EAFE Index	2,050.79	4.23%	25.03%
RATES	**AS OF 12/31/2017**	**AS OF 9/30/2016**	**AS OF 12/31/2016**
Fed Funds Target Range	1.25 - 1.50	1.00 -1.25	0.50 - 0.75
3-Month LIBOR	1.69	1.33	1.00
2-Year Treasury	1.89	1.45	1.22
10-Year Treasury	2.41	2.31	2.48
30-Year Mortgage	3.91	3.83	3.08
Prime Rate	4.50	4.25	3.75
COMMODITIES	**AS OF 12/31/2017***	**4Q 2017 RETURN****	**12-MONTH RETURN**
Gold	$1,305.10	1.89%	11.65%
Crude Oil	$60.10	18.33%	5.61%

*Price Level
**Total Return

SECTOR SNAPSHOT

	SECTOR	S&P WEIGHT
OVERWEIGHT	INFORMATION TECHNOLOGY	24.0%
	FINANCIALS	14.8%
	HEALTH CARE	14.0%
	INDUSTRIALS	10.1%
	ENERGY	5.8%
EQUAL WEIGHT	MATERIALS	2.9%
UNDERWEIGHT	CONSUMER DISCRETIONARY	12.2%
	CONSUMER STAPLES	8.2%
	UTILITIES	3.1%
	REAL ESTATE	2.9%
	TELECOM	2.0%

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