Part 3: The Notorious SBF

And other acrimonious acronyms (FTX, BTC and ETH)

TL;DR:
- **FTX/Alameda blowup; makes the case for DeFi's proven value**
- **Bitcoin/Ether aren't dead; a hedge against currency debasement**

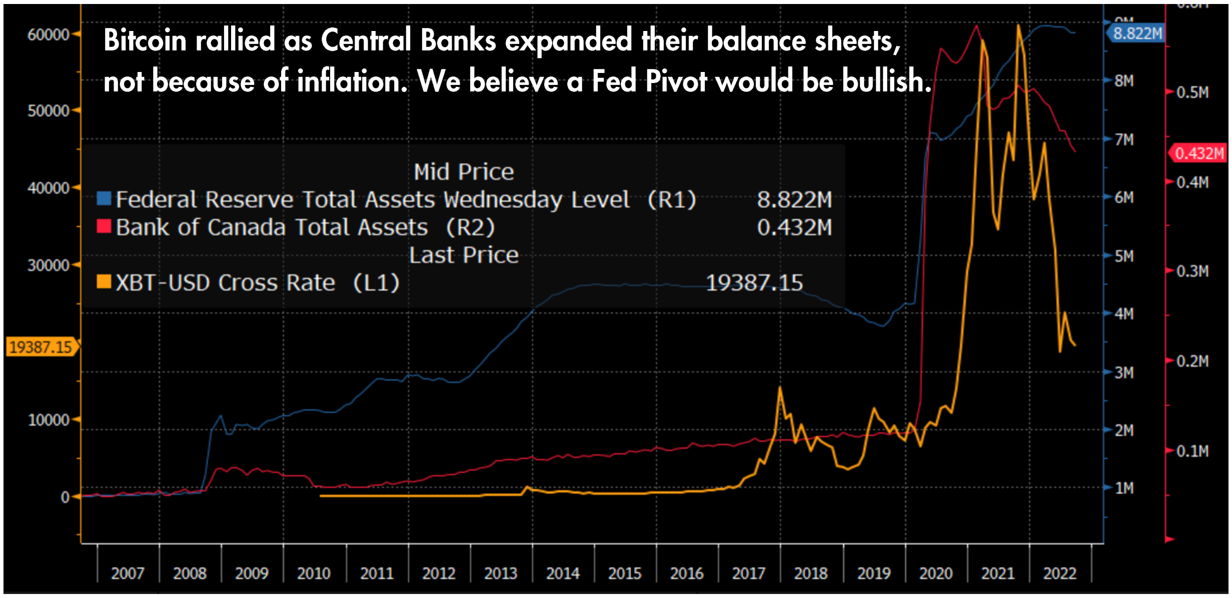
In Part 1, What a Difference a Month Makes, I covered our strategies. In Part 2, we talked about the Race Against Time. And now we've arrived at the topic of the hour.

Ether madness:

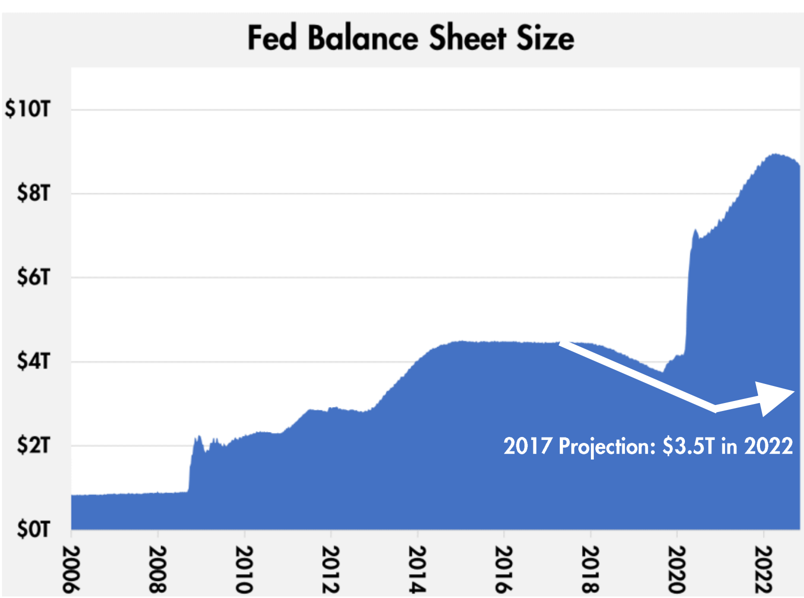
No discussion of potential currency debasement would be complete without a mention of cryptocurrencies, very much on investors' minds this week with the implosion of Alameda Research and the FTX exchange, seen until now as the blue chip prop fund and exchange of the space. With author Michael Lewis of "The Big Short" and "Liar's Poker" fame on the case, it won't be long until we have a tell-all book and movie to expose what in my view is going to be a story of horrible malfeasance in which customer funds were misappropriated to shore up proprietary positions (ala MF Global) and subsequently lost.

Bitcoin:

In my view, this situation merely strengthens the original case for the iconic application of blockchain. Many readers of this letter remember hearing about Bitcoin from me in early 2012, when I started talking about the dangers of Central Bank balance sheet expansion, its potential for catastrophic inflation, and how Bitcoin represented a hedge against that. You may even have received one of the dozens of one-bitcoin coins I gave out at conferences that winter. I was quite a bit early on that inflation call. But I might have been right in the end. I believe that ten years on, we are seeing the sorry result of Central Bank decisions made in 2008 and 2009, and that Bitcoin then as now remains an outstanding hedge against fiat debasement. It's not a hedge against inflation, however. Inflation causes Central Banks to get serious about reducing the money supply, as they are doing right now, and that's bad for crypto.

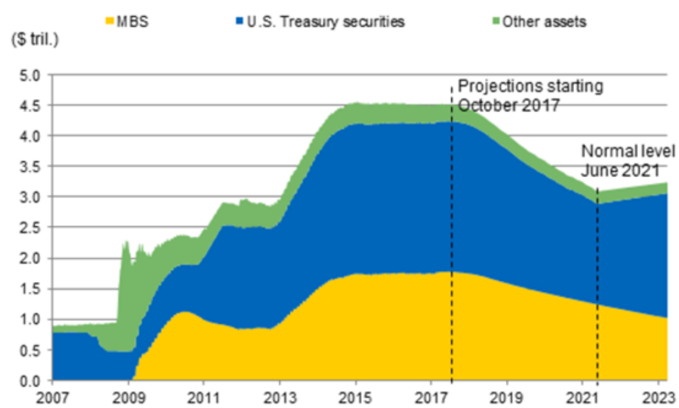


As you can see in the chart above, Bitcoin rallied to its highs just about to the point when Central Banks stopped expanding their balance sheet. In my view, Bitcoin will resume its rally as soon as they start expanding it again. And the next time, it may be the $160-200 Trillion in U.S. unfunded liabilities from Social Security, Medicare and Medicaid that need to be paid out via printed money on top of $30 Trillion of our current National Debt plus perhaps $50 Trillion in new printing to stop the next recession. What will it feel like to be 100% invested in fiat at that point? And there you have my case for equity upside protection, Bitcoin up 10-50X, collectibles, hard assets, inflation-protected investments with pricing power etc. as critical portfolio components looking ahead.



It's also interesting to look at how challenging it has been to predict the future path of the Fed. While the Central Bank is currently chipping away at its almost $9 Trillion balance sheet, it's well worth remembering that, as seen below, the best laid plans of economists can go sadly awry. Only five years ago, in 2017, as noted here, S&P projected based on Fed forecasts that the Fed Balance sheet would be $3 Trillion by the end of 2022, instead of its current level of over $8 Trillion. And if we get more balance sheet expansion, that should be bullish for hard assets and for Bitcoin, just as it was from 2009 to 2021.

Chart 3 - Projection of Federal Reserve Balance Sheet Normalization



Sources: St. Louise FRED, Federal Reserve Bank of New York, and S&P Global calculations.

Defi:

The collapse of FTX, Alameda, and so many more firms this week clearly demonstrates the value of DeFi. Through all the catastrophic deleveraging events of last summer, and also last week, the major DeFi protocols continued to operate, completely transparently, available to all. Want to know the reserve status of AAVE, Maker, or Compound? It's right there for all to see, 24/7. No need to take Sam Bankman-Fried's word (or that of his CEO) that they would never, ever, use client assets to shore up losses in their hedge fund.

And with the possible mortal blow to Alameda-backed Solana, it now looks like the old standby Ethereum might be the big winner. During the high-volume days in the middle of last week, 5000 Eth were burned by the protocol, giving Ether a deflationary monetary policy, remarkable in this day and age. Ethereum burned $5 million a day, the Fed printed $8 Trillion in two years. Ponder that. Will we be trading cryptocurrency futures in our funds? You bet.

Warm regards,

Roy Niederhoffer

President

PS Lisa Ferrero and I will be in Europe from December 5-9. If you'd like to set up an in-person meeting to discuss our Smart Alpha, Diversified Macro or Emerald Programs, or have a conversation about your thoughts on 2023, it would be my pleasure. Alternatively, we'd love to catch up on Zoom before year-end.

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