



Kimberlee Sipe Financial Advisor

*"Good Advice Does Not
Come in a Box"*



Issue XVIII—May 2014



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*Monitor your
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Keep in touch

919.747.9509
phone

Email:
[ksipe@capital-
invest.com](mailto:ksipe@capital-invest.com)
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919.831.2370

The Rise of Bitcoin

Is the virtual currency a fad, or the future?

Provided by Kimberlee D. Sipe

Mention "bitcoin" to assorted economists or investors, and you may trigger all kinds of associations. To some, it signifies an exciting new reality – a digital currency, with a payment system that could revolutionize finance. To others, it is a volatile commodity – propped up by hype, fraught with risk. It also refers to an open source software system, and a financially startling concept – currency production through the Internet.

You can't talk about Bitcoin without talking about bitcoin. Bitcoin with a capital B references the Bitcoin network that creates the digital currency; bitcoin with a lower-case b refers to the currency itself.

Where is bitcoin made? Online. All bitcoin is generated in cyberspace, and the process is interesting to say the least. The first step in making bitcoin is "mining", and mining takes math skills. A bitcoin "miner" (a computer user) tries to solve one or more math problems, with success resulting in shares of bitcoin. The more miners there are, however, the smaller fractional bitcoin shares become as no more than 21 million bitcoins will ever be created.¹

Once mined, a bitcoin can be sent to a miner's password-protected digital wallet. (If the digital wallet is hacked, the bitcoin is irrevocably lost.) A miner can use bitcoin to pay for goods and services at a small-but-growing network of online and brick-and-mortar merchants.¹

What is a bitcoin worth? Ask the free market – specifically, the commodities market. Look at the bitcoin charts at Coinbase.com, one of a few sites tracking historical daily settlement prices for bitcoin across various bitcoin exchanges. On July 6, 2013, a single bitcoin was worth \$69.31; on November 30, 2013, a bitcoin was worth \$1,126.82; on April 16, 2014, a lone bitcoin was worth \$516.61.²

Volatility and bitcoin go hand in hand. Since no central bank in the world issues bitcoin, it is only worth what investors are willing to pay for it. In the worst-case scenario, bitcoin plays out like the tulip bulb mania of the 1600s and investors eventually pay little or nothing for it. In the blue-sky scenario, bitcoin becomes a part of everyday life.

University of Virginia economist Peter Rodriguez neatly summed up the emergence of bitcoin in the *Wall Street Journal*: “It’s as if there was an effort to create gold that wasn’t gold. The longer [bitcoins] persist, the more that people will have faith in them as a legitimate store of value.”¹

Who dreamed up bitcoin? A mysterious person or entity going by the name of Satoshi Nakamoto. A white paper under that authorship floated the idea of a virtual currency and a network to create it in 2008. In 2009, “Satoshi Nakamoto” created the open source software system to generate bitcoin.³

In March, *Newsweek* claimed it had found Nakamoto hiding in plain sight, living quietly in a middle-class Southern California suburb – but the man they profiled, Dorian Satoshi Nakamoto, told the Associated Press that he had never heard of bitcoin until February 2014. Students and researchers at Great Britain’s Aston University claim that the author of the 2008 white paper is Nick Szabo, a respected academic theorist and George Washington University law school graduate who invented Bit Gold, a conceptual forerunner of the Bitcoin network.^{4,5}

For bitcoin to steal gold’s shine, it has to lose its dark side. If all of this sounds like something out of a dystopian science fiction novel, you aren’t alone in your skepticism. There is much that is exciting about bitcoin and its potential to streamline global finance, but there are also big question marks. As *Entrepreneur* notes, about 90% of bitcoin buyers are speculators. That is not the only detail about bitcoin that unnerves investors. The digitized anonymity of bitcoin transactions beckons to cybercriminals, who undoubtedly see bitcoin exchanges as upcoming grand prizes when it comes to hacking, phishing and malware.⁶

Where bitcoin has really taken off is China – in fact, that is where about half of daily global bitcoin trading occurred in 2013. But when the People’s Bank of China stated that bitcoin was dangerous, bitcoin values on the Mt. Gox exchange fell from \$1,300 to \$700 in 24 hours. (That exchange later filed for bankruptcy.) The PBOC maintains that it will not ban bitcoin.^{4,6,7}

Bitcoin prices skyrocketed in 2013, and they could fall just as dramatically through a variety of factors (hackers raiding exchanges, crackdowns in the PRC, imitators rising to steal its thunder). At this point, it is little wonder that many regard bitcoin as a speculative play for the long run.

Kimberlee Sipe, Financial Advisor may be reached at (919) 747-9509 or by email ksipe@capital-invest.com
Please visit her website at www.InSightInvestPlan.com

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Citations.

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