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CRYPTOCURRENCIES – ANOTHER **LESSON IN BEHAVIOURAL FINANCE**

The wild swings in cryptocurrencies alone attracts attention globally, but it's also writing history – at least within behavioural finance.

In February 1637 the futures market for tulip bulbs in the Netherlands collapsed. The price of the most sought after tulip bulbs had risen to a level equivalent to 10 years of salary for a skilled craftsman. One of the most expensive tulip bulbs, Viceroy, could allegedly be purchased and be used as payment for say, 12 full-grown sheep or a 1,000-pound cheese. The bull market for tulip bulbs had prevailed in the Netherlands for more than 2 years. Some estimates of price developments for the period show a sixty-fold price increase before the market collapsed.
When I touch that story, it is not surprising that I combine it with those cryptocurrencies that had exploded in price, where Bitcoin is the most well-known. When discussing the new electronic currencies, these are often compared with the dramatic rise in prices for tulip bulbs. But the market for tulip bulbs almost 400 years ago was more sophisticated than many are aware of. Therefore, it is more than just a comparison of the price developments that gives reason to consider the lesson dated almost 400 years back.

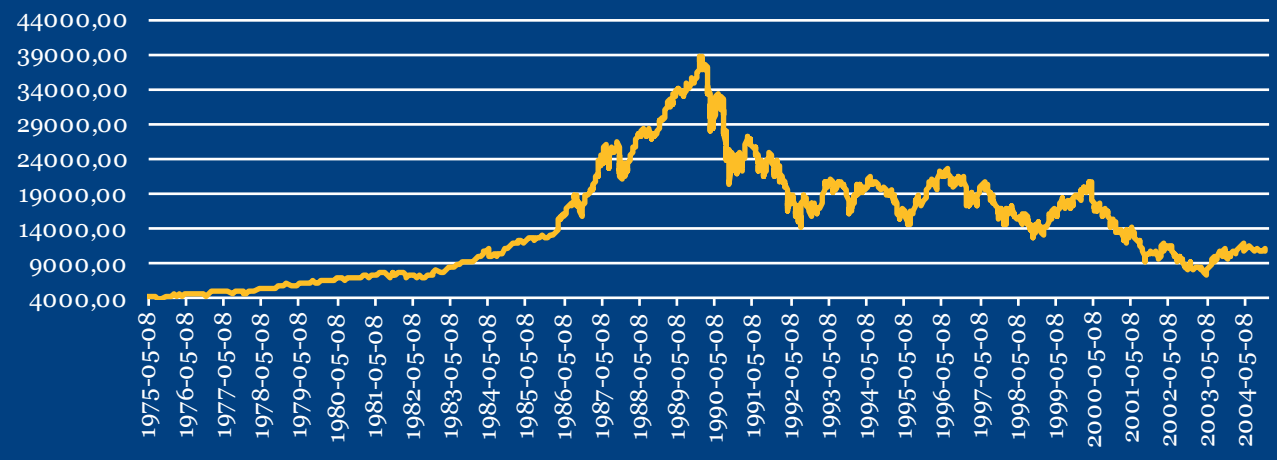
My company is not involved in advisory about cryptocurrencies as I do not consider these as financial investment opportunities that can be dealt with in a rational way. On the other hand, the investor behaviour that surrounds the cryptocurrencies are both fantastic and exciting, and from a professional view, I since long find it interesting to participate in the debate about cryptocurrencies.
I always find new investment opportunities exciting to have a look at, but of course, it also means that a certain share of new ideas will be rejected. Therefore, I have noticed some disappointment about my professional assessment of cryptocurrencies as investment objects. However, I do not neglect what currently happens with cryptocurrencies and whatever happens to Bitcoins and the fellow mates in the future then it goes into the history books, like back in February 1637.

The market for tulip bulbs was a futures market with physical delivery where the contracts were even drawn-up by lawyers. The trade was so widespread that the stock exchanges in a large number of Dutch cities traded tulip bulbs. Before the tulip bulb market meltdown, the one-time gold even made its way to be traded on the London Stock Exchange.When a bubble bursts, the trigger can be anything. In this case a buyer of tulip bulbs on the exchange in the city of Haarlem could not fulfil his contract. It was apparently the one tiny event that caused the whole Dutch tulip market to collapse where prices fell by 99 pct. It all happened within a few days and it was followed by a year-long recession in the Dutch economy.

Bubbles often have a similarity where graphic one shows the well-known ten-fold rise of stock prices in Japan until 1990. The famous dot.com bubble was actually only a five-fold rise for the Nasdaq stock exchange as a whole before the dot.com bubble blew up in 200o / 01 (graphic 2). Nevertheless, there are also differences in bubbles which in all fairness should be mentioned in connection with for example, Bitcoins. In the short-term, the number of tulip bulbs was reasonably known due to cultivation and transport time limitations i.e. the market was predictable. But in the long

***Graphic 1*:**

DEVELOPMENT IN NIKKEI 225 (1975 TIL 2004)



Source: FRED, Fed St. Louis , USA

run, the number of bulbs was infinite, which should have limited the price increases. The number of Bitcoins is said to be limited to 21 million, which buyer's must believe in, though this would be a significant difference to the tulip bulb market.

The two worrying parallels that I see is, firstly, what could be understood as a legitimisation for smaller investors when something is traded on a regulated exchange. For Bitcoins, this move was taken on December 17th last year when the giant CME Group opened to trade Bitcoin futures on their exchange. Secondly, in a futures market, the liquidity and the size of the underlying asset is a risk factor. I argue it's important to be aware of the size of the underlying market in this case.

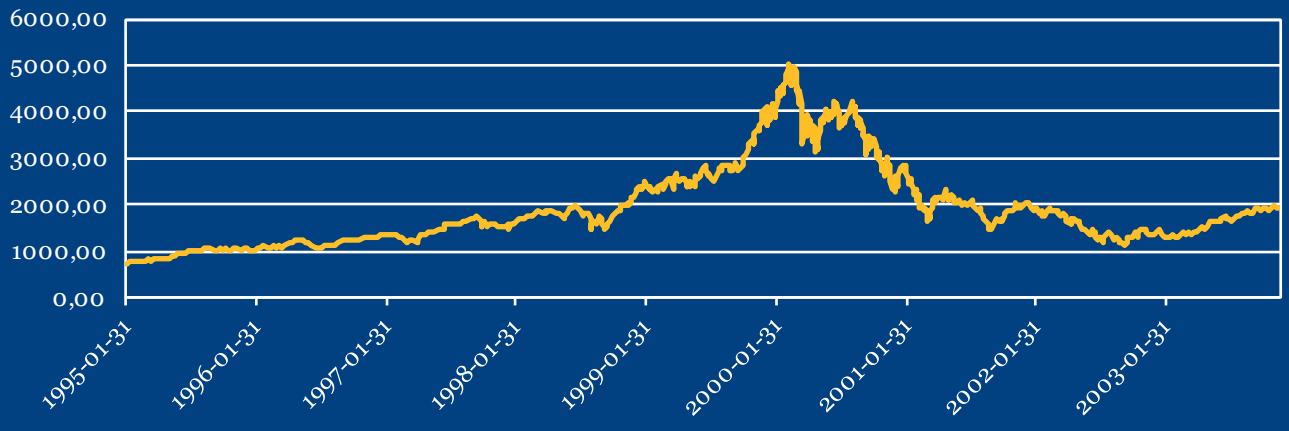
It's no surprise that trading in cryptocurrencies, including Bitcoins, has attracted many in Asia. The reason is that investors in that part of the world are more oriented towards momentum-driven trading, thus to jump on a trend. In Europe, for example, a bigger share of investors are value-focused where considerations about the correct valuation of an asset weighs heavier in investment decisions. The fact that Asian investors have a strong participation in the market is an indication of high short-term activity which also generates leveraged investments. I have noticed that 50 and 100 times leverage is not impossible. These factors must be included when assessing how stable, or liquid, the underlying market is. The factors that I mention here for certain contribute to an unstable market - like in the Netherlands in 1637.

However, the blockchain technology that all cryptocurrencies are based on will create changes of disruptive dimensions throughout the financial industry. All kinds of contracts, claims, documents etc. can be converted into a digital blockchain code. It will revolutionise and rationalise the financial sector where the ultimate step is when cash is defined by single digital codes based on the blockchain technology. This development is amazingly fascinating, and it seems to generate the view among some people that Bitcoins for this reason should have a particular value - however, my assessment is that there is no rationale justifying this. Some arguments for an increasing price on Bitcoins are based on the expectation that an increasing number of payments will be made in the digital currency. But transactions are traditionally not something that supports a currency's value. It is quite marginal- where the U.S. dollar is the best example as the world largest transaction currency. The long-standing assessments that I have knowledge of predicts that the transaction status for the U.S. dollar means a few pct. for the market value of the greenback.

Concerning the true cryptocurrencies, my assessment remains that some people collect rare stamps, and some may collect rare digital currency blips in the future. This is where personal behaviour, financial behaviour and investment philanthropy begin to set the price, and not a rational consideration. And as always, any pricing is solely based on the buyer's interest in an item - but right now it does not matter as long as the neighbour is ready to pay more than you are ...

***Graphic 2*:**

DEVELOPMENT IN NASDAQ (1995 TIL 2003)



Source: FRED, Fed St. Louis , USA

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