

I've Seen This Movie Before: A Warning to Crypto Speculators

December 9, 2017

By: Direk Khanijou

I calculate the motions of heavenly bodies, but not the madness of people.

– Isaac Newton on the South Sea Bubble

The Tulipmania. The Mississippi Scheme. The South-Sea Bubble. The Nifty Fifty. The Dotcom Bubble. The U.S. Housing Bubble.

These are some of the great speculative episodes of the past.

What's interesting is that humans get smarter in all kinds of ways but not more rational. History has shown that we will always oscillate between fear and greed. It's just the way we are wired.

To understand the folly behind cryptocurrencies you need to understand human nature and financial history – not Blockchain. I am a big believer in studying history because it helps with pattern recognition. On this topic, there are several time-tested quotes:

Those who cannot remember the past are condemned to repeat it.

- George Santayana

The farther back you can look, the farther forward you are likely to see.

– Winston Churchill

We learn from history that we do not learn from history.

– Georg Wilhelm Friedrich Hegel

What has been will be again, what has been done will be done again; There is nothing new under the sun.

– Ecclesiastes 1:9

Not to know what happened before you were born is to be a child forever.

– Marcus Tullius Cicero

My favorite writer on human foibles is **John Kenneth Galbraith**. Serious students of investing ought to read his excellent book 'A Short History of Financial Euphoria.'

Here are some passages from the book:

The more obvious features of the speculative episode are manifestly clear to anyone open to understanding. Some artifact or some development, seemingly new and desirable – tulips in Holland, gold in Louisiana, real estate in Florida, the superb economic designs of Ronald Reagan – captures the financial mind or perhaps, more accurately, what so passes. The price of the object of speculation goes up. Securities, land, objets d'art, and other property, when bought today, are worth more tomorrow. This increase and the prospect attract new buyers; the new buyers assure a further increase. Yet more are attracted; yet more buy; the increase continues. The speculation building on itself provides its own momentum.

...Then there are those, superficially more astute and generally fewer in number, who perceive or believe themselves to perceive the speculative mood of the moment. They are in to ride the upward wave; their particular genius, they are convinced, will allow them to get out before the speculation runs its course. They will get the maximum reward from the increase as it continues; they will be out before the eventual fall.

...And thus the rule, supported by the experience of centuries: the speculative episode always ends not with a whimper but with a bang.

...Those involved with the speculation are experiencing an increase in wealth – getting rich or being further enriched. No one wishes to believe that this is fortuitous or underserved; all wish to think that it is the result of their own superior insight or intuition. The very increase in values thus captures the thoughts and minds of those being reward. Speculation buys up, in a very practical way, the intelligence of those involved.

...The first is the extreme brevity of the financial memory. In consequence, financial disaster is quickly forgotten. In further consequence, when the same or closely similar circumstances occur again, sometimes in only a few years, they are hailed by a new, often youthful, and always supremely self-confident generation as a brilliantly innovative discovery in the financial and larger economic world. There can be few fields of human endeavor in which history counts for so little as in the world of finance.

...Uniformly in all such events there is the thought that there is something new in the world.

...The rule is that financial operations do not lend themselves to innovation...The world of finance hails the invention of the wheel over and over again, often in a slightly more unstable version.

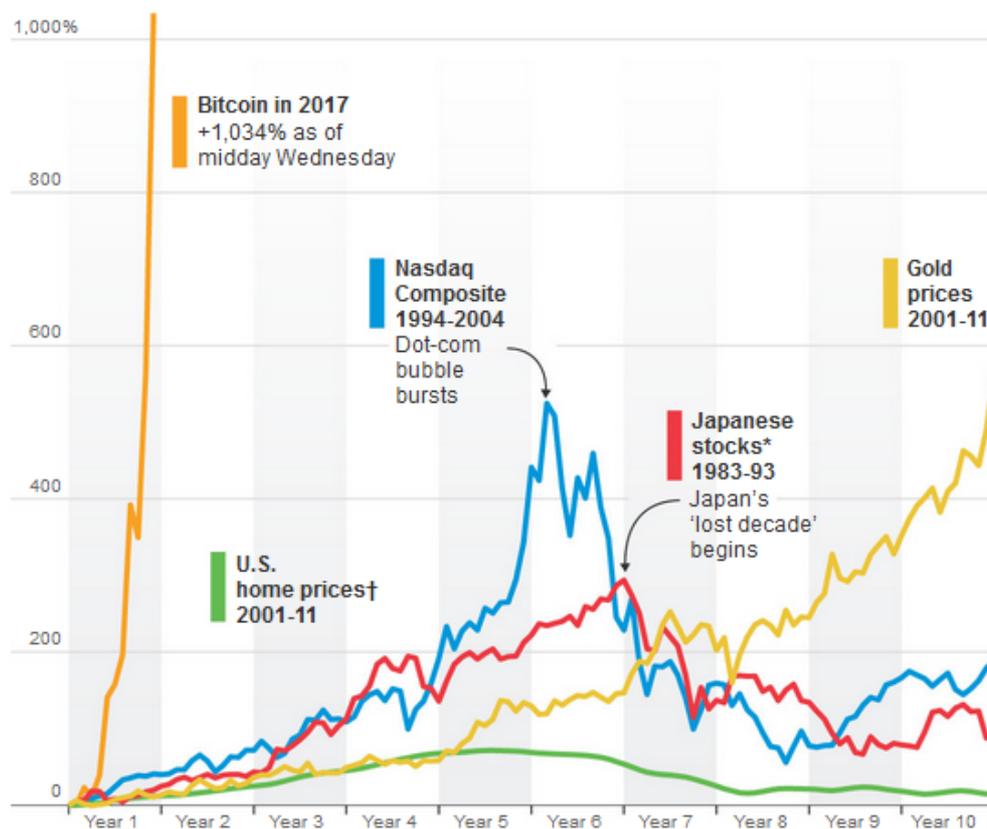
Bitcoin

The price of one Bitcoin has increased by more than 1,000% this year.

To put this in perspective, the Dow Jones Industrial Average, in its biggest year, in 1915, went up 82%.

Vertical Ascent

Bitcoin's 1,034% run-up this year compared to decade-long trends in other historically huge market moves



*Tokyo Stock Price Index †Case-Shiller Home Price Index

Sources: CoinDesk (bitcoin); FactSet (Nasdaq, Japanese stocks, gold); Thomson Reuters (home prices)

This is the way I look at Bitcoin.

As of this writing, the market capitalization of Bitcoin is about \$230 billion which is about the same as Procter & Gamble.

Ask yourself: would you rather own all the Bitcoins or Procter & Gamble? I am confident that Procter & Gamble will still be around in 20 years. Also, whatever the currency we decide to adopt, people will always be willing to trade a portion of their current income for goods and services. This isn't going to change.

It seems that most people are aware of the dangers of speculating in cryptocurrencies. However, many are behaving like Chuck Prince (former CEO of Citigroup) who in 2007 said 'But as long as the music is playing, you've got to get up and dance. We're still dancing.'

What is speculation?

SPECULATE, v. To gamble with a SECURITY, an irony lost on most speculators, who call themselves "investors" even though they have done little or no research on the asset they are trading. Speculation, generally buying whatever has been "hot" in the hope of finding a GREATER FOOL.

– Jason Zweig, *The Devil's Financial Dictionary*

Serious investing consists of figuring out what income producing assets are worth and then trying to pay a lot less for them. Speculation, on the other hand, is about trying to predict the future direction of prices. While speculation can be a lot more fun, **Warren Buffett** has joked that ***A bull market is like sex. It feels best just before it ends.***

Today, speculating in cryptocurrencies seems like an easy, lazy, no-brainer way to make money. But be warned: speculation is most dangerous when it looks easiest. In the long run, it is better to be wrong for the right reasons than right for the wrong reasons.

Cocaine Brain

Research in neuroscience reveals that our brains are pattern seeking and are designed to perceive trends even when none exist. After an event occurs just two or three times in a row, the brain automatically anticipates that it will happen again. If it does repeat, the natural chemical dopamine is released which floods our brain with soft euphoria. This intoxicating prospect of making money is addictive and can arouse the same parts of the brain that are stimulated by drugs – our 'cocaine brain'.

One of the consequences of dopamine-induced pleasure is that we become gullible. Financial journalist **Walter Bagehot** is famous for saying: *All people are most credulous when they are most happy.* **Warren Buffett** agrees: *Nothing sedates rationality like large doses of effortless money.*

THE WALL STREET JOURNAL

Home World U.S. Politics Economy Business Tech Markets Opinion Life & Arts Real Estate WSJ. Magazine

MARKETS

Bitcoin Mania: Even Grandma Wants In on the Action

The digital currency has gone from tech curiosity to mainstream topic, leading its value to jump more than 10-fold in 2017

Just like 1999

In 1999, many money managers, MBA students, and other high IQ people knew with great certainty that dot-com stocks were grossly overvalued – yet they participated. I believe the main reasons were envy and fear of missing out. A similar story is playing out today with cryptocurrencies. **Mark Twain** was right: *History does not repeat itself, but it does rhyme.*



katyperry
Berkshire Hathaway

Follow

katyperry nbd just asking Warren Buffett his thoughts on cryptocurrency

Load more comments

coreyskute Incredibly huge fan would love a shoutout of my gear check it out here https://www.forudesigns.com/shop/Women/Platform_Shoes/2187620

revboostjr @nataliapaca you know.... NO BIG DEAL

diggatetbebeyim0 diggat et bebeyim



241,714 likes

NOVEMBER 29

Log in to like or comment.

It is a bubble, there is no question about it...It's just an amazing example of a bubble.

- Robert Shiller, Nobel-winning author, and Yale professor

I could care less what bitcoin trades for, how it trades, why it trades, who trades it. If you're stupid enough to buy it, you'll pay the price for it one day. I've also told people that it can trade at \$100,000 before it trades to zero.

- Jamie Dimon, CEO of JPMorgan Chase

Avoid bitcoin like the plague. Did I make myself clear?

- Jack Bogle, founder of Vanguard Group

Further Reading

1. A Short History of Financial Euphoria by John Kenneth Galbraith
2. The Great Crash of 1929 by John Kenneth Galbraith
3. Extraordinary Popular Delusions and the Madness of Crowds by Charles Mackay
4. The Crowd: A Study of Popular Mind by Gustave Le Bon
5. Irrational Exuberance by Robert Shiller