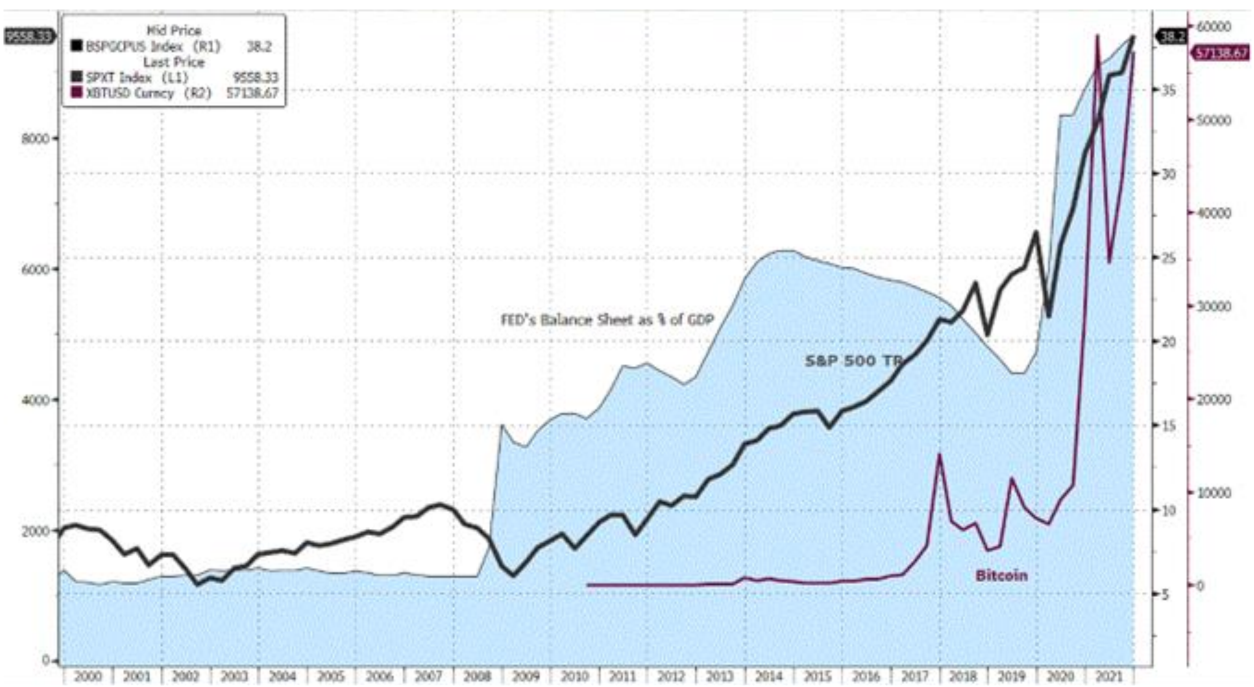
Lynx
Investment Advisory

Central Bank Balance Sheets, Asset Prices and Crypto

The Quantitative Easing era, which began in the aftermath of the 2008 financial crisis and received a shot in the arm (no pun intended) with the COVID-19 global health crisis, has fueled values across asset classes. While the rise in asset prices could be attributed to greed among some people, in other cases, it is driven by the fear of missing out.

In the United States (see chart below), the Fed's balance sheet as a percentage of GDP has surged from 5%, which was the norm before 2008, to 38% as of November 30, 2021. A portion of the balance sheet's increase results from making cash available to banks at a low rate to facilitate lending. Another is the consequence of buying assets directly and funding the surging fiscal deficit. That phenomenon is not just confined to the United States; the Bank of Japan and, more recently, the European Central Bank have joined the fray. The quantitative easing has fueled two things: first an increase in asset prices, and second, inflation. Here we will focus on the first i.e., the increase in asset prices specifically Bitcoin or Cryptocurrency.



Source: Bloomberg, Lynx Investment

Over the last few weeks, we have only met "geniuses" who cannot wait to share how smart they have been in picking their stocks and making a killing in Bitcoin or some other Crypto. Spoiler alert - the bull market makes every investor look like a "genius".

As the chart shows, the quantitative easing era, which began in 2008 due to the financial crisis, has been followed by a big bull market in stock prices. While the current rise in the stock market is driven by actual earnings, unlike the dot.com bubble, we can certainly make the case that the valuation of the equity market is expensive and stretched. However, it is the rise of cryptocurrencies led by Bitcoin in the aftermath of Covid that is of particular concern. Huge money flows have led to an exponential rise in Bitcoin's price especially since April of 2020. Many Bitcoin investors do not realize that they are putting money in a largely unregulated area with a lot of opaque corners which, like every bubble, will burst at some point.

Nial Ferguson in his book *Ascent of Money- A Financial History of the World* describes the fate of bubbles more elegantly.

"Perennial truths of financial history. Sooner or later every bubble bursts. Sooner or later the bearish sellers outnumber the bullish buyers. Sooner or later greed turns to fear."

Fortunately, after burning their hands during the housing financial crisis of 2008 and threatening the entire financial eco-system, banks have generally stayed out of the Crypto world. This also means that if the prices of Crypto crash, the Fed is unlikely to intervene as there is no existential threat to the financial system as in 2008. The lack of regulation in Crypto and the fact that it may not pose an existential threat to the system means that the small and big retail investors in Crypto will be holding the bag when and if access to cheap money is curtailed. While Blockchain technology and Crypto may have a role in developing more innovative financial tools that can better track the flow and settlement of transactions, the exponential price increase seems unwarranted.

We at Lynx believe that the better way to invest in Crypto markets is by investing in both a diversified set of semi-conductor related stocks and gold. It might not get you exponential returns but may help you meet your financial goals and save you during downside volatility.

We look forward to hearing your comments, thoughts, and questions, so please do not hesitate to call us.

Yours faithfully,

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