



Industry Perspectives

July 2018

Bitcoin – Global Currency or Speculative Bubble?

Overview

- ▶ Bitcoin has made many headlines in the past year without a full understanding of the potential downfalls of the cryptocurrency.
- ▶ There's a "near zero" chance of Bitcoin overtaking the U.S. dollar as the world's dominant currency.
- ▶ We believe there are far more negatives than positives to Bitcoin and consider it a speculative bubble.

"Similar to the way the Federal Reserve prints new dollars out of thin air, new Bitcoin are also created artificially and distributed to miners over time."



Despite vast publicity in the media, many people don't fully understand exactly what Bitcoin is in nontechnical terms. Many investors also question whether Bitcoin is riding a speculative wave that could soon collapse.

First, Bitcoin (and other similar cryptocurrencies like Litecoin, Ethereum, or Ripple) is not an actual coin but instead is a digital token with no physical presence and no backing by any country's central bank or government. Bitcoin can be sent electronically from one Bitcoin owner to another, anywhere in the world.

A transaction takes place when a transfer of funds is initiated between the Bitcoin addresses of the sender and recipient. Addresses are heavily encrypted making the transactions anonymous. Unlike centralized payment networks such as Visa or PayPal, which solely keep track of their users' transactions and balances, the Bitcoin payment network is decentralized. All Bitcoin digital tokens and transactions are stored, moved, and simultaneously verified across a massive network of 10,000+ connected computers. The record keepers (known as miners) operating these computers continuously and independently update the chain of Bitcoin ownership. Each miner shares with all others something akin to a digital accounting ledger for all Bitcoin at that time. This system is known as Blockchain.

New Bitcoins are created as miners are paid in Bitcoin for their computer costs and services. The amount of Bitcoin growth per year is limited and pre-determined by the founder's original design that there would be no more than 21 million total Bitcoin in circulation (some 17 million currently outstanding). Similar to the way the Federal Reserve prints new dollars out of thin air, new Bitcoin are also created artificially and distributed to miners over time via a speed- and accuracy-based lottery system (computer-based).



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Bitcoins are essentially like having money stored in the cloud. This digital money is stored in wallets, and you access the rights to them when you exchange Bitcoin addresses with vendors, individuals, etc. Bitcoins can be purchased and sold online using a credit card from companies such as Coinbase.

In summary, the often written advantages of Bitcoin as a possible global currency include:

- the anonymity of transactions,
- the speed and potential lower cost of transactions,
- its global reach, and
- the diversity and transparency of its Blockchain payment system.

POTENTIAL DOWNFALLS OF BITCOIN

In our opinion, the negatives and potential downfalls of Bitcoin are numerous relative to the U.S. dollar. Some of the limiting factors to Bitcoin becoming a legitimate global currency include:

- lack of market depth and liquidity,
- lack of price stability (see graph below),
- numerous countries unwilling to accept Bitcoin as a legal currency,
- the majority of Bitcoin transaction value has gone toward speculative trading rather than commerce,
- in a growing world economy it is impractical to cap the amount of global currency outstanding, and
- in a security-conscious world it makes no sense to favor a currency which can be moved across the globe anonymously.

“In our view the ability of Bitcoin to unseat the U.S. dollar as the world’s dominant currency is near zero in the medium term.”

Current statistics speak to the high degree of confidence in U.S. dollar value and stability.”



Around \$580 billion of U.S. bills are used outside the country. That’s 65% of all dollars.



More than 1/3 of global gross domestic product (GDP) comes from countries that peg their currencies to the dollar.



More than 85% of foreign exchange trading involves the U.S. dollar.

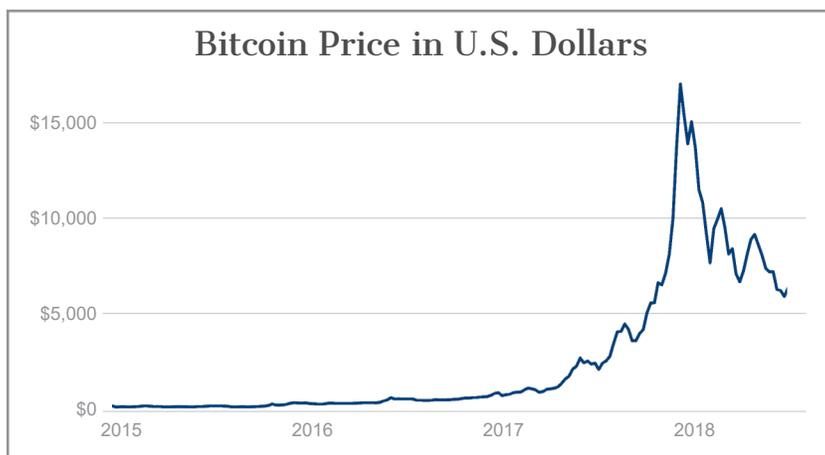


39% of the world’s debt is issued in U.S. dollars.



64% of all Central Bank foreign exchange holdings are in U.S. dollars.

Source: worldbank.org



Source: Coindesk.com. January 1, 2013 through June 30, 2018.

History of Bitcoin Prices

The first Bitcoin was mined January 3, 2009. From 2009 until 2011, the price of Bitcoin barely rose above \$1, until it hit its first “bubble” in July 2011 rising to \$31, before dropping back to \$2 by December 2011.

By November 2013, the price of Bitcoin had slowly risen to above \$1,000 then underwent a period of extreme volatility through early 2017.

The peak price reached \$17,900 on December 15, 2017 and has dropped significantly ever since, settling at \$6,400 as of June 30, 2018.



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Perhaps most important is the perceived value of the guarantee and backing of the dollar by the U.S. government. Although the U.S. completely severed its ties to the gold standard in the early 1970s, the U.S. dollar is still backed by the full faith and credit guarantee of the U.S. government. For many countries this would mean very little, but U.S. GDP has grown 44 out of the past 50 years. The S&P 500 Index has grown at 10% per year pace over the same period. Tax revenue and government owned assets have grown substantially. Thus, the government backing is recognized globally as having real value.

Unlike the dollar and other country-backed currencies, Bitcoin has no government or asset backing whatsoever. While we acknowledge some of Bitcoin's positives, we view there are far more negatives. We believe the price appreciation of Bitcoin is a temporary situation driven by pure speculation. New buyers are entering the market simply because it is going up. This situation, like other bubbles, is not sustainable because Bitcoin has no real underlying value. As that reality sinks in, traders are likely to take their losses and switch to other trading vehicles. If trading volume shrinks materially, the price of Bitcoin could drop to near zero. ◀

For questions or to speak with a relationship manager about adding any of the 10 Buffalo Funds to your portfolio, contact:

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Past performance is not a guarantee of future results. Index performance is not illustrative of fund performance. One cannot invest directly in an index. Please call 800-492-8332 for fund performance.

The S&P 500 Index is a capitalization-weighted index of 500 large capitalization stocks which is designed to measure broad domestic securities markets. It is not possible to invest directly in an index.

None of the Buffalo Funds invests in Bitcoin or any other cryptocurrencies. As of 3/31/18 Visa was held by the Buffalo Dividend Focus Fund (2.60%), Growth Fund (2.08%), and Large Cap Fund (2.88%); no Buffalo Funds held Paypal.

Fund holdings and sector allocations are subject to change and are not recommendations to buy or sell any security.

Mutual fund investing involves risk; Principal loss is possible. The Funds may invest in smaller companies, which involve additional risks such as limited liquidity and greater volatility than larger companies. The Funds may invest in foreign securities which will involve political, economic and currency risks, greater volatility and differences in accounting methods. This risk is greater in emerging markets. The Funds may invest in lower-rated and non-rated securities which presents a greater risk of loss to principal and interest than higher-rated securities. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities.

The Funds' investment objectives, risks, charges, and expenses must be considered carefully before investing. The statutory prospectus contains this and other important information about the investment company and may be obtained by calling (800) 49-BUFFALO or visiting buffalofunds.com. Read carefully before investing.

Kornitzer Capital Management is the advisor to the Buffalo Funds, which are distributed by Quasar Distributors, LLC.