

December 2017 Issue 4

Dear client,

While preparing for the holidays ahead and the festive season, we also need to take some time to reflect on the past year.

Just as 2016, this year was full of interesting news, ranging from the Gupta-saga and the state capture to Jacques Pauw's new book and the ANC leadership battle, not to mention the Springboks!

In this newsletter we take a in-depth look at Bitcoin that has now increased from around \$800 to \$16 000. Will Bitcoin become the new world currency or is this just another fad?

There is also an article on artificial intelligence, something that will have an increased impact on our lives as time goes on.

Its important to remember that our world is constantly changing. At My Brokers is our commitment to continue walking this road hand in hand with our clients.

My Brokers want to wish you and your family a Merry Christmas!



Let us take the bull by the horns together next year and make a success of it!

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WHAT'S ALL THE FUSS AROUND BITCOIN? **OLD MUTUAL MULTI-MANAGERS**

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The price of Bitcoin has increased by a staggering 50 000% over the past five years (yes, you have read that correctly) from \$12 to almost \$6 000 attracting rising interest from investors. However, the price of Bitcoin has also suffered several sharp declines over this period and is clearly very volatile.

We are not going to pretend to be experts on this rapidly emerging technology, but there are some very important investment principles to consider (the first of which is to avoid investing in something you don't fully understand, even if it has made other people a lot of money).

What exactly is Bitcoin?

Bitcoin is the best known of the so-called cryptocurrencies (although it is only one of thousands). According to its creator, Satoshi Nakamoto (probably a pseudonym), Bitcoin is a "purely peer-to-peer version of electronic cash" allowing online payments "to be sent directly from one party to another without going through a financial institution".

It relies on an emerging technology known as blockchain, a digital, decentralized and public ledger.

Blockchain advocates regard it as a more efficient, cheaper, guicker, safer and transparent way of transacting, compared to traditional banks. Transferring money is one of many applications of blockchain technology.

Processes which place a cost on enforcing trust (such as transferring money, exchanging derivatives, enforcing legal contracts and verifying audits) can be made significantly more efficient • Rapid price increases completely divorced using blockchains.

Can Bitcoin replace traditional currencies?

Economics textbooks ascribe three characteristics to a currency: A means of exchange, a unit of account, and a store of value. Bitcoin (and its cousin cryptocurrencies) tick the first box but the second two are questionable.

We are very far from a point where companies or individuals measure their income and expenses in Bitcoin (and since Bitcoin's value is expressed in dollars, it is the dollar that would remain the unit of account). Its volatility

means that it is unlikely to be seen as a store of value. Moreover, currencies are backed by a lender of last resort (the issuing central bank) to step in when trust between market participants and liquidity evaporates. With Bitcoin, the trust lies in the fact that transactions are cryptographically protected. The fact that there is no central authority backing Bitcoin and that it is largely outside government reach is seen by its fans as a plus. But who will step in if trust in Bitcoin has been breached?

The global financial crisis showed not only the importance of authorities stepping in to put out fires, but also the inherent instability of unfettered markets revealing that financial activities need a form of regulation. The US dollar remains the world's reserve currency because of the strong US legal system, the backing of their government, the credibility of the central bank (the Fed) as lender of last resort as well as the very deep, liquid and open capital markets where dollar assets can be traded.

Is Bitcoin a bubble or the real deal?

There is no standard financial definition of a bubble, but broadly speaking it has the following four elements which are all present:

• A compelling story, usually of a revolutionary new technology. (e.g. railroads, automobiles, the internet) or an almost infinite new source of demand (Chinese demand for commodities) or a severe supply restriction (peak oil).

from any measure of intrinsic value.

• A frenzy of euphoric speculative activity, attracting non-professional investors. Overexuberance can very easily turn into fear and therefore prices can re-rate extremely quickly.

The availability of cheap credit.

The lesson of the 1990s internet bubble (and earlier iterations) is that although the hype of the new technology was justified – the internet has transformed our homes, businesses, and social connections - investors were simply

prepared to pay way too much for IT companies. For instance, Microsoft's share price took 16 years to regain and surpass its December 1999 level despite the widespread use and profitability of its software. Too much good news was priced in. A different example: smartphones are ubiquitous today, but buying shares in Blackberry, the first smartphone maker, would have been a terrible investment (Blackberry's share price fell from a peak of \$319 in June 2008 to \$24 today).

How Blockchain ledgers work

Currently, a transaction between two parties typically involves two ledger entries, one at party A's bank and then one at party B's bank. With blockchain technology, the transaction appears simultaneously and publicly on both parties' ledgers for verification, making it quicker and more transparent while eliminating the need for a central authority to guard against manipulation. All transactions are cryptographically (but not centrally) confirmed, stored and protected.

Why all the hype?

The hype is driven by three factors: firstly, as mentioned above, the more the price of Bitcoin rises, the more attention it attracts. Secondly, it does appear to be a fundamentally useful technology. Thirdly, post the global financial crisis, many have lost faith in the traditional financial institutions and in the central banks that manage the system. Bitcoin is seen as an alternative that is outside of government control and interference.

What are the risks?

The first main risk is simply valuation: Bitcoin's price surge means anygrowth will have to take place off an already-high base. The second risk area is a regulatory one. The more widespread cryptocurrencies are used, the more likely governments are to step in to limit tax evasion, money laundering, bypassing of capital controls (a big issue in China), and all manner of illicit activities.

The third risk area is competition: it is often argued that Bitcoin's price is supported by its limited supply (that has to be "mined"), but there is virtually no limit to the amount of competing cryptocurrencies. Blockchain technology will likely reshape global financial (and other trustbased) processes, but this is no guarantee that Bitcoin will maintain a leading position (remember MySpace came before Facebook, eBay was dominant before Amazon, Hotmail used to be more popular than Gmail and at least five major search engines came before Google's domination).

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cryptocurrencies available. Traditional institutions will not stand by if their lucrative core business areas are under threat, and many are already making big investments in new technologies, including blockchains. Many major global banks, multinationals, governments and leading universities have been building blockchain-based systems and applications across a variety of valid use-cases. These institutions have both resources and client bases which exceed the current reach of Bitcoin.

Will my funds invest in Bitcoin?

No, firstly because Collective Investment Schemes may not, at this stage, invest in cryptocurrencies. But more importantly, while blockchain might turn out to be a game-changing technology, the speculative nature of Bitcoin means that we cannot reasonably build conviction in future price expectations. Fiat currencies can be assessed by their fundamentals (economic growth, inflation, monetary policy and governance), but Bitcoin's intrinsic value is almost impossible to pin down.

While supply is known (limited coins are created at a rate that can reasonably be assessed by mining 'hash' power and transaction rates), demand varies widely – hence creating the characteristic volatility we see in the Bitcoin price – and is subject to the risks discussed above. Also, since Bitcoin pays no interest, future returns depend entirely on price increases, instead of compounding income over time.

In summary, it is an exciting technology, but not an exciting investment opportunity.

There are already cheaper, faster, more efficient and more anonymous



Ons beskik oor ons eie Facebook-blad, volg ons gerus en lees lekker saam.

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Artificial Intelligence (AI) Overhyped or the next revolution in asset management? Old Mutual

This year saw the advent of the first fully Alpowered, daily traded ETFs, with some viewing this as heralding a shift into a new investment paradigm, autonomous learning investment strategies (ALIS).

What's new about these investment processes is that the technology learns and adapts as it goes along based on the information and enormous data sets the algorithms have access to and on which they are basing their investment decisions and solving problems. All with no human input.

As in other fields of AI, this has raised the spectre of Singularity – a much-vaunted future state when computers could potentially have superintelligence that surpasses our own and which could, it is feared, ultimately put humans out of business.

But have we truly crossed the AI Rubicon or is this all just a matter of hype?

For many, the AI milestones that have been achieved over the last five years, have set us up for the greatest technological revolution in history over the next decade – and the investment industry will undoubtedly be at the centre of this.

But artificial intelligence and talk of technological revolution has been around for a while. It was first talked about in 1965 when a British mathematician and cryptologist brought up the concept of an intelligence explosion. Then in 1993, a sci-fi writer and computer scientist said that within 30 years we would have the means to create superhuman intelligence.

There are many definitions of AI but Forbesdon't even needmagazine contributor David Thomas puts itto code in, you ofmost succinctly: "Artificial intelligence is athe AI and, throwbranch of computer science that aims to createout the pattern.intelligent machines that teach themselves".out the pattern.

There are different levels of AI, with each level becoming more sophisticated and autonomous in the tasks computers can do without human intervention. There is machine learning (or structured learning), which is the ability of computers to learn and improve at tasks with experience. Then there is deep (or unstructured) learning, when a computer uses algorithms that adapt to new data and thus trains itself to perform tasks. The best known examples of deep learning are IBM Watson and driverless cars.

Inevitably, the advances in AI have spurred robust debate about what impact AI will have on the investment world.

To get a balanced perspective, it's worth considering why AI is developing so rapidly.

Al advances have primarily been made possible by the sharp decline in the price of graphics processing units (GPUs) in recent years driven by gaming. This has enabled AI to access immense amounts of data of all types (numerical, image, voice), which are being made available from companies such as Google, Facebook and Microsoft.

Cloud-based hosting has also provided access to extremely strong AI platforms. For instance, you can use IBM or Google's AI platforms to take advantage of work that they have already done and build on top of this.

Why is this important?

It allows for quick-to-market implementation when you have enough data to teach your algorithm.

With so much data being made available, you don't even need to come up with a hypothesis to code in, you can throw mountains of data at the AI and, through deep learning, it will figure out the pattern. Platforms are cheap/free, so the barriers to entry are low. The main barrier is access to enough rich data.

Notwithstanding the increasingly fast-paced innovation we've seen and the growing excitement about the potential of AI, it is not likely to be an investment panacea – and it's premature to think that fundamental qualitative investment professionals will no longer have jobs as a result of AI.

Instead, some of the things the investment industry needs to be thinking about are:

If you pick the incorrect data, you will get the incorrect result (which will come in as the correct result, but is based on the wrong information).

An algorithm learns as time goes by, but it cannot determine an upcoming black swan event unless it has a previous black swan event to have learnt from.

Al is very good at doing one thing well, but not at integrating many things into a "supersolution". For instance, you can use Al to determine what the market may do using machine readable news as a factor in an investment portfolio, but you are not able to just "ask Al to come up with a portfolio" and let it just figure it out.

More important for the investment industry is to consider how can we use AI to improve portfolios, how we can we use AI to take the repetitive, grudge work out of our jobs in order to concentrate more time on the hard thinking work and how we use AI to augment what we do, as opposed to worrying about it replacing what we do.

In other words, it is not human versus machine; it means human and machine is better than human alone.

