CRYPTO CASH MACHINE

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Crypto Cash Machine

By Michael Carr

I'M a crypto skeptic.

I've never owned bitcoin, and I don't recommend it to anyone.

There are just too many problems with this asset class to consider it a sound investment right now.

That doesn't mean I think all cryptos are going to zero. I just think they're more likely to be a sideshow to the current financial system than a complete rewrite of money as we know it.

However, that doesn't mean that we can't make money on crypto.

On the contrary, it's possible to exploit the volatility of crypto with trading strategies, and make good money doing so.

Here's why I'm telling you this…

I spotted a golden opportunity to innovate bitcoin trading last year.

It came about when the SEC approved the first-ever futures-backed bitcoin ETF to trade on public markets.

That ETF is the **ProShares Bitcoin Strategy ETF (BITO)**, and it's what we're going to trade in *Precision Profits*. This ETF was the first bitcoin investment vehicle that lets you trade options. That got my attention.

Because of my crypto-agnosticism, I was able to step back with a cool head and study the crypto market without being misled by the hype.

And so, I got to work creating a trading system that would give us the best odds at making money trading it.

The product of that work is why you're here today.

You can access a full primer on my trading system **right here**.

This report is more about the supplementary research that I came across when building my system.

After carefully examining what crypto enthusiasts tout these assets to be — I realized that crypto will never live up to their expectations.

In this report, we'll look at some of the misleading claims about crypto that compel many investors to make the costly mistake of owning it.

The truth is, bitcoin is the perfect asset to trade in the short-term with an active strategy, just as we do here in *Precision Profits*. But it's a miserable asset to buy and hold. You'll learn why in this report.

Plus, I'll reveal state-of-the-art behavior pricing models that perfectly articulate why crypto — and bitcoin especially — is so easy to exploit using my newest system.

I'm using the latest Nobel Prize-winning technology for analyzing bitcoin's price data. Most investors today continue to use Buffett's value thesis from 50 years ago. I'm using ideas from the last 10 years about how markets really work, using science rather than outdated theories.

Fair warning: this is a highly technical deep dive into the way crypto moves, and why it does. It's intended for those who really want to understand this asset class and why it doesn't work as a dependable buy-and-hold investment.

To be clear, this report is not required reading for using my bitcoin options strategy. But if you are curious about what I've uncovered and are prepared to tackle some of my most challenging research to date, read on…

Busting Crypto Myths

First, let's dispel some of the most common crypto myths.

According to SoFi.com, some of the benefits of crypto are:

1. Transactions can be made "easily"…

2. At low cost…

3. And in a manner more private than most other transactions.

Let's see how true these claims really are, starting with #1.

To complete a cryptocurrency transaction, I need to do a few things first.

I can either open an account with an app like Coinbase, or create a "wallet." There are hardware wallets, software wallets, even wallets that are just a string of characters written on a piece of paper. Here's an example of a bitcoin wallet address: **3FZbgi29cpjq2GjdwV8eyHuJJnkLtktZc5**.

To use this address, you need to either remember the string, open up the wallet on your smartphone or desktop, or connect a physical hardware wallet to a computer before you can make any kind of transaction.

Then I need to find a vendor willing to accept the crypto I have. To initiate the transaction, I have to copy their wallet address (which looks about as complicated as the one above) and enter it into the recipient field.

That's all possible — but let's be real. It's nowhere near as simple as using a credit card.

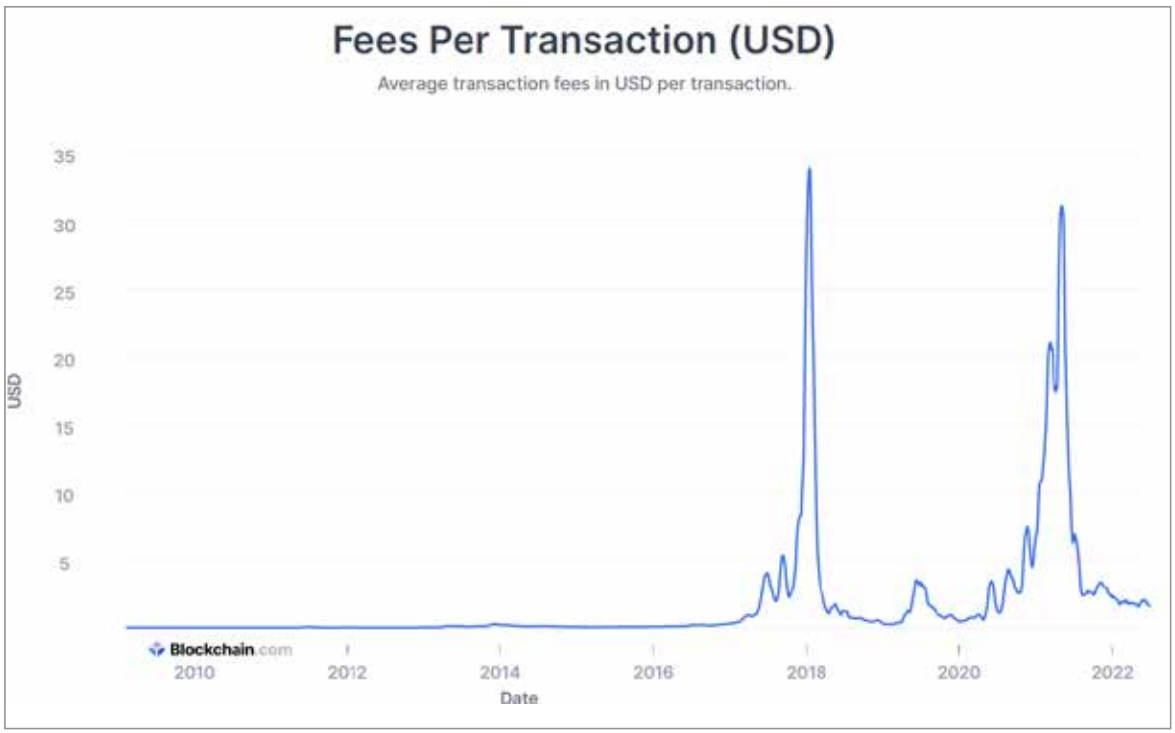
Myth #1 — ease of use — is bunk.

Now let's talk about the transaction fees.

Fees are relatively low, but only sometimes. They vary significantly over time, and according to blockchain.com, they can rise or fall suddenly.

This isn't how a credit card or cash works, and it isn't a model consumers or businesses can accept in the long run. Waiting to make a purchase when fees are low is something I'd wager very few people would be willing to accept.

Here's a look at the drastically fluctuating fees since 2010:



You can see that the average cryptocurrency transaction fee has been anywhere between several pennies to $34 over the last 12 years.

And this is an average across all of cryptocurrency. Some fees, paid in cryptocurrencies like Ether (ETH), can reach well into the hundreds if not thousands of dollars during times of network congestion.

So while fees are *sometimes* low, when considering these massive spikes, I don't think we can genuinely say they're always lower than a traditional credit card transaction.

That's Myth #2 out the door. So let's talk Myth #3: Privacy.

Privacy in crypto is debatable.

While all addresses are represented by random strings of numbers, anyone can see the activity of these addresses at any given time. So, people can't see your name. But they can see everything you're doing with your money.

In a way, crypto is actually the LEAST private way to transact currency there is.

Sure, the banks don't necessarily see what you're doing with your money when you use crypto. At least, not automatically. They can if they want to, just by searching a blockchain explorer like **blockchain.com** or **etherscan.io**.

And criminals who think crypto is anonymous clearly haven't thought it through very hard. When Colonial Pipelines was hacked, the FBI **recovered** the bitcoins paid as ransom relatively quickly, just by tracking where they went through the websites I just mentioned.

That's Myth #3 busted.

So, none of the "crypto bros" arguments hold up to actual scrutiny.

Then… what IS crypto good for?

One thing: Trading.

Here's why…

Uncovering the Driver of Bitcoin's Volatility

The biggest problem with using crypto for payments is the volatility.

When prices are rising, holders are reluctant to spend. And vice versa — sellers are reluctant to accept payment in crypto when prices are falling.

But the whole reason anyone honestly wants to be involved in crypto is ultimately to speculate on its wild upside moves. If volatility collapses, traders would lose interest and the whole experiment would fall apart.

So any value that can be derived from Bitcoin is inextricably linked to its volatility. And since volatility is not suitable for accepting payments, we arrive at a classic Catch-22.

My full analysis indicates the crypto market isn't serving a true economic purpose at this time, at least not in the way Bitcoin believers hope or claim it might.

While fees and prices can fluctuate, one thing stays the same — Bitcoin is constantly in motion. That makes it worth trading.

The question for me then became: Where does Bitcoin's volatility come from, and can we expect for it to continue over the long run?

Economists with the National Bureau of Economic Research (NBER) did some work on that question. The NBER is the organization responsible for determining when recessions start and stop. It has close ties to policymakers, and its interest in crypto is most likely research for central banks considering issuing their own digital currencies.

Its research showed "many of the known characteristics in the equity market also form successful long-short trading strategies in the cross-section of cryptocurrencies. In particular, three factors —cryptocurrency market, size, and momentum — capture most of the cross-sectional expected returns."

In layman's terms, this confirmed my own research that there were similarities between the crypto markets and stocks. Here are three of them:

- The market factor indicates that cryptocurrencies tend to move together. The majority of them will be in a bull or bear market at the same time.
- The size factor tells us smaller cryptocurrencies will have the biggest moves. They also carry the most risk. This is true for stocks, as well. But just like in the stock market, most traders stay with large caps because the potential returns are large, and the risks are lower.
- The momentum factor means that it should be possible to develop a trading system to apply to crypto markets.

This research also validated my ideas about where prices in the market come from.

In the stock market, academic researchers and fundamental analysts believe the price of the stock represents its fair value, which is determined by a discounted cash flow analysis.

In simple terms, the stock's price is the present value of all the cash the company will generate in the future. This is what Warren Buffett has been using for 50 years.

These models are widely used, but more recent research has shown that there's another factor driving pricing. One that's more important in understanding how to profitably trade crypto today.

Cutting-Edge Price Models Point to Sentiment

Nobel Prize-winning economist Robert Shiller recently **demonstrated** that the way investors *feel* about a company can determine the direction of its trend.

Another economist, Hersh Shefrin, has created a pricing model based on that insight. In *A Behavioral Approach to Asset Pricing*, Shefrin showed that for a single investor, the fair value of a stock can be defined by the following equation:

$$\gamma(\chi_t) = \varrho^t P_1(\chi_t) \,/\, \frac{\omega(\chi_t)}{\omega(\chi_0)}$$

In this equation:

- $\gamma(\chi_t)$ is the price of χ at time *t*;
- ϱ^t is the expected utility the investor assigns to the probability that the price of χ will equal γ at time *t*;
- and ω is the expected growth in consumption of χ at time *t* or *0*.

For a market, this equation must be solved for all investors and potential investors who are involved in that market. This is largely an academic exercise, but it has important real-world implications.

To solve the puzzle for cryptocurrencies, I realized that typical investors in these markets tend to believe that the growth in expected consumption of crypto services over time is large.

Mathematically, that means that as $\frac{\omega(\chi_t)}{\omega(\chi_0)}$ approaches infinity, or some other large number, the value of $\gamma(\chi_t)$ would fall to zero.

This conforms to the reality of the crypto markets. If crypto becomes more widely accepted and used in everyday transactions, it's volatility will decline. And as the volatility declines, the potential gains will decrease.

Market participants either don't want this, or ignore the ramifications of widespread acceptance.

However, this scenario is unlikely to happen because there isn't as significant demand for crypto as there is for money. Some transactions might use crypto, but it's not going to replace debit or credit cards in the foreseeable future.

In that regard, crypto is a solution in search of a problem that doesn't exist. There's simply no real problem with Visa and MasterCard.

Since crypto isn't going to replace money at the grocery store anytime soon, we can simplify the pricing model.

The term $\frac{\omega(\chi_t)}{\omega(\chi_0)}$ can be reduced to 1. That recognizes the fact the consumption at time *t* will be equal to the consumption at time *o*, and crypto acceptance will remain steady (and negligible) in the long run.

This is good for us. It means that volatility will stay high, and increase our odds of trading it profitably.

Under that assumption, the equation becomes:

$$\gamma(\chi_t) = \varrho^t P_1(\chi_t)$$

Now the expected value of the cryptocurrency (the left side of the equation) is equal to the expected utility the investor assigns to the probability that the price of χ will equal γ at time *t*.

If the investor assigns a high utility to higher prices, this factor will be high, and the price of the cryptocurrency will be high. This roughly means if an investor believes the price is going up, they are willing to pay more for the cryptocurrency.

Instead of fundamentals like cash flow, the value of cryptocurrencies is based solely on how much the traders in the market believe the crypto should be worth.

This leads us to the next equation. The market price of the cryptocurrency reflects the accumulated sum of the sentiment of all investors in the market, or:

$$\gamma(\chi_t) = \sum \varrho^t P_1(\chi_t)$$

This equation can be rearranged and simplified to a variation of one of the most popular equations in the world, $E = mc^2$.

Here, E $(\gamma(\chi_t))$ is the expected price: *m,* $(\Sigma P_1(\chi_t)$, is the probability an investor in the cryptocurrency assigns to a future price, and *c,* $(\Sigma \varrho^t)$, is sentiment. In this equation, sentiment is squared because shifts in sentiment have a profound impact on the expected price.

Let's say an investor is bullish. They expect the price to double. Their belief is based on something, likely something they read or heard from another investor. If they assign a high probability to that event, they will buy aggressively. If they assign a low probability, they may hold and not buy new amounts.

The market price is the summation of all these actions taken by all investors in the market. The more they believe prices will rise, the more they will buy, or at least not sell. And that should drive prices up.

When sentiment turns bearish, investors stop buying. Without buyers, the market stalls or falls. The more it holds steady or declines, the more nervous investors become and the more bearish sentiment becomes.

In simple terms, the price of bitcoin or any other cryptocurrency depends solely on ***sentiment***. Bitcoin goes up and down simply because people believe it can go up and down. It has no fundamentals, or any real value for that matter.

And that's why it's the perfect thing for us to be trading in the short-term, instead of buying and holding.

The only way to quantify sentiment is with technical analysis— just as we do here in *Precision Profits*. This gives our bitcoin strategy the ultimate advantage.

We simply don't need to turn to anything else but technical indicators on charts to predict bitcoin's next move.

As the NBER research showed, the best technical analysis indicator is momentum, and there are many ways to measure it.

Precision Profits's bitcoin strategy uses several types of momentum indicators. This makes it the optimal strategy for tracking bitcoin's price moves. (For more info on those, access my *Bitcoin Profit Blueprint* report **right here**.)

Regards,

Michael Carr
Editor, *Precision Profits*

P.S. As always, I invite your feedback on my research. If you have thoughts or questions about this report, don't hesitate to write me at **PrecisionProfits@Money&Markets.com** with everything on your mind. I'll look to feature your questions and observations in a future update.

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