 Atlas Pulse Gold Report
See the facts, trade the action and ignore the noise

The Atlas Pulse Gold Dial

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In this issue...

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• The impact of speculators – gold needs more buyers than sellers
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• Silver catch up – only gold has turned the corner
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• Ask Charlie – questions from Argentina
• Adam Cleary on Ethereum – a 32 bagger since last summer
• Satoshi Pay – a talk with the founder from Berlin

Welcome to Atlas Pulse. Making sense of the gold market, and a little on magic Internet money.

It looks as if gold has turned the corner. Conditions are improving but it’s not quite ready for a bull market. For that, it must beat the stockmarket. I’ll also show you how the recent short covering and fresh longs in the ETFS and futures explain everything – except that the gold price should be $40 higher than it is.

If you are patting yourself on the back for backing the gold rally, you might consider kicking yourself for not buying the second largest crypto currency, Ethereum. It’s up 32 times since October. I’ll also cover Satoshi Pay, a bitcoin payment system, which allows you to buy content over the web with no login, username or password. The revolution is underway.

Not quite a bull market for gold

Of the Atlas Pulse three criteria that determine a bullish regime for gold, we need easy money and a positive trend in multiple currencies. That’s done. The third criteria is that gold should be beating the stock market. That’s not yet happening.
This point is simple and logical. For when gold is beating stocks, investors sell equities and buy gold. That buying power is powerful, and as you will see in this issue, gold needs to attract plenty of buyers for the price to rise. That may seem obvious but not necessarily. Companies, for example, publish their results and the price responds to news before you can even trade.

As a result, equities are primarily driven by earnings; at least over the long term. Gold is driven by many factors, but in this issue, I will focus on investor demand. That's not booming because the gold trend versus equities hasn't yet turned up.

Gold versus the S&P 500 – past 20 years

This past gold bear market has lasted for 1260 days, which is relatively long by historic standards, but not the longest. That occurred between 1987 and 1993 and lasted for 1913 days. My observation is that any bear rally that exceeded 20% has led to the end to the bear market. Anything less than 20% has seen new lows. There is one obvious exception as highlighted in the table on the next page. In 1980, gold collapsed from dizzy heights and had a powerful counter rally of 48%. That's the exception. It was more of a crash from an exuberant high and therefore the beginning of a bear market. That occasion saw a strong counter-rally during a period of extreme volatility. My 20% rule is merely an observation.

It’s not a law set in stone, nor is it intended to be. Despite that, many commentators have adopted it as common law – just like the 20% bear rule from equities to define an equity bear market. That rule is hopeless and always has been. Atlas Pulse readers know that the gold 20% turn rule was first published on these pages.

Since 2011, all the bear rallies in gold haven’t managed a 20% move until recently. If we say the low was approximately $1,050 in December, then a 20% rally implies a close above $1,260 would mark the turn. Gold has exceeded $1,260, but hasn’t managed to stay there for long. It seems as if the $1,260 is an area of resistance that may take time to break through.

The 20% rule has a good history of being the line in the sand. A bull hasn’t necessarily followed, but the price has not made a new low following a 20% rally during a bear market. The table overleaf gives you facts and figures of past gold bear markets.
Gold – past bear market statistics since 1970

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<tr>
<th>Date</th>
<th>Start</th>
<th>End</th>
<th>Length in days</th>
<th>Gold/S&amp;P ratio</th>
<th>Gold Fall</th>
<th>Silver Fall</th>
<th>XAU Fall</th>
<th>Date new low</th>
<th>Number of days to the new low</th>
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<td>254</td>
<td>63%</td>
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<tr>
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<td>20</td>
<td></td>
<td>18.6%</td>
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<td>10.4%</td>
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<tr>
<td>Turn</td>
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<td>25/09/84</td>
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<td>16.9%</td>
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<tr>
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<tr>
<td>s</td>
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<td>10/11/84</td>
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<td>1913</td>
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<td>03/06/88</td>
<td>65</td>
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<td>9.0%</td>
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<td>11/09/91</td>
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<tr>
<td>Turn</td>
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<td>1500</td>
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<td>13</td>
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<td>24/10/07</td>
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<td>1.8%</td>
<td>62.3%</td>
<td>25/05/99</td>
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<td>05/10/99</td>
<td>39</td>
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<td>35.1%</td>
<td>8.8%</td>
<td>30.2%</td>
<td></td>
<td>bull market followed in March 2001</td>
<td>16</td>
</tr>
<tr>
<td>Turn</td>
<td>25/08/99</td>
<td>05/10/99</td>
<td>39</td>
<td></td>
<td>35.1%</td>
<td>8.8%</td>
<td>30.2%</td>
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Table note: There have been six bear markets since the 1970s. You can see that a 45% price fall is relatively normal. As is a 68% drop in the Gold/S&P ratio. I like that this last bear was so uniform. Silver down 72% with the miners even worse. It feels like the job has been done.

The impact of speculators

At the year-end, there were 19.2 million ounces (Moz) of short positions in the gold futures market that were held by speculators. They were betting on the price falling. On the other side, there were 18.8 Moz held by bullish speculators that hoped the price would rise. Finally the ETFs held 47.2 Moz of physical gold in the vaults.
The shifts this year have been huge and not dissimilar to what we saw during the credit crisis. The shorts have rushed to buy 8.1 Moz in order to close their shorts. The longs have bought 11.8 Moz taking the total to an impressive 30.6 Moz. Finally; the ETF investors have added 8.7 Moz. That took iShares by surprise as they had to suspend the IAU ETF because they hadn’t applied for enough shares from the SEC. That’s was poor planning on their part.

A look inside the gold market – past decade

Chart note: The red line shows the speculative shorts in the futures market in Moz. These have halved as the short squeeze ensued. The blue line shows the longs, which have risen by 50%. The ETF holdings have grown more modestly, but it’s still been a significant move. The gold price is shown in gold (LHS).

Generally speaking, the short sellers move quickly because the have to. Their horizon is days and weeks. The longs are more measured (weeks and months) whilst the ETF holders behave more like investors (months and years). Naturally the physical buyers are ultra long-term investors as they rarely sell. Putting it all together, the investor interest in gold has jumped from 47.4 Moz to 75.4 Moz – a rise of 28 Moz in a short space of time. It’s a three-month record move.

Record inflows into the gold market – 3 month rolling periods since 2006

Chart note: The chart combines the longs, shorts and ETFs. The black line shows the change in the number of million ounces of gold held by investors and speculators. Over the past decade, we have never seen such high inflows over a three-month period. Wowzer.
What about the physical market? What about the central banks? Surprisingly, they don’t seem to matter much compared to investor flows. Changes in investor interest explains 80% of the move in the gold price. When they buy, it rises, and when they sell, it falls. It’s as simple as that.

**Investment demand drives the gold price – past decade**

![Chart note: The black line shows the combined investor interest in gold. That is the longs less the shorts in the futures markets plus the ETFs. The number of ounces (millions) is shown on the right axis. The price of gold is shown on the left. The R squared between the two lines is 80%.](#)

If 80% of what is happening is simply a matter of investor demand, that may seem a little depressing. Surely there’s more to the gold market than just greater fool? Fortunately there is. For example, and as I have shown in previous months, there’s also a high correlation with long-term real interest rates and inflation. Investors, for whatever reason, inherently know this and normally buy gold for the right reasons. That is they buy into easy money and sell into tightening.

Whilst the R squared between investor flows and the gold price is 80%, the other number is that 59,020 ounces of investor holdings correspond with a $1 move in the gold price. If there are 75,306 Moz of gold held by investors, it follows that the gold price ought to be 75,306,000 / 59,020 = $1,276 at the time this chart was printed. The price was $1,233. That means gold was $43 cheap according to this model.

**Please remember, it’s just a model.**

Atlas Pulse has lots of models and approaches the gold market from numerous angles. I’ve covered the AP bond model in detail in recent months and that places a fair value for gold in the $1,150 area. *(That is since I recalibrated the model to make it more bullish).*

This AP Investor demand model is telling us that in order to forecast the gold price, we could do worse than forecast investor behaviour. I believe this is why the trend of the gold / S&P 500 ratio is so important. You know there’s buying power ahead if gold is beating stocks. If it isn’t, we can’t be so sure that future flows will come.
A commentator recently wrote a tongue-in-cheek forecast for $36,000 gold (the book Dow 36,000 in 1999). I read another piece justifying gold at $5,000. According to the AP Investor demand model, for $5,000 gold, they’d need to be 219 million ounces purchased in the ETFs. For $36,000, they’d need to be 2,049 million ounces bought. Naturally, I’d expect the relationship to shift as gold moved to higher prices (a 59,020 divisor wouldn’t hold much past $2,000 per ounce).

The annual supply from the mines is forecast to be 95 million ounces in 2016, meaning that investors currently hold 9 ½ months of mine supply. At $5,000, this would require 2 ¼ years supply and at $36,000, 21 years supply. Obviously I’m overstating things as highlighted in bold. In any event, it puts into perspective how much gold needs to be bought to justify these fancy numbers.

Silver lags

I haven’t said much about silver and the gold to silver ratio is worth a mention. It recently touched 85 which is high given the 20 year average has been 61.5. Silver is now cheap versus gold but the trend hasn’t yet turned in silver’s favour. If the ratio returned to it’s 20 year average, the silver price would be over $20 per ounce.

Silver is cheap relative – since 1970

Chart note: The gold silver ratio is simply the gold price divided by the silver price. At 80, that means 80 ounces of silver has the same value as an ounce of gold. The rally in silver has done a little more than gold from distressed levels. Many expected more.

The link between gold and silver is essentially linked to investors’ appetite for risk. This relationship has strong links with credit spreads (additional cost of borrowing for lowly rated companies or countries versus the risk free rate). The thought is that with the ECB chucking €80 bn at the bond market each month, spreads ought to tighten. They are slightly, but the fundamentals don’t justify improving credit conditions at this point in time. It appears that the market has doubts. So far, the silver price hasn’t broken out of its five-year bear trend-line although it’s on the cusp.
Can silver break through the trend line?

Chart note: The peak in silver occurred just under five years ago. The bear has probably ended, but it’s surprising how it still hasn’t broken out with all the recent excitement. Maybe it will.

Whilst investor demand explains 80% of the move in gold prices, the same isn’t true for silver. Indeed, there is no statistical link between investor interest and price post 2012. The price of silver collapsed from $48 to $13 despite zero net selling by investors. That can only mean one thing. There has been no shortage of silver on this planet whatsoever.

Investment demand does little for silver – past decade

Chart note: The investor flows explained much of the silver price movements up until 2012 but since then, there has been a disconnect. Investors own nearly one billion ounces of silver. Despite that, and a recent 250 million ounce spending frenzy, the price hasn’t moved by much. The market needs to tighten before we can get excited – so do credit spreads.
I have been very bearish on copper and mentioned it on several occasions as a sell. Following the collapse, the priced has bounced, along with oil and everything else, but I continue to read about stockpiling in China. Unlike gold, and to some extent silver, the trend remains negative and the rally is part of the recent momentum crash in financial markets. I’ll get to that in a moment. Copper is most likely being propped up by dark forces. I’d steer clear.

The momentum crash

A number of hedge funds have been destroyed this year. They are victims of the crash in the momentum effect. That is the normal process whereby good stocks, with good fundamentals, happily chug along. The bad stocks, with bad fundamentals, do poorly. No surprise there and academic research suggests that the systematic gap between good and bad is around 5% per annum – until it isn’t. When it’s disrupted, we call it a momentum crash.

USA winner beat losers the majority of the time – since 2001

![Chart showing performance of stocks over time]

*Chart note: The chart shows the past winners in blue and the past losers in red. That is simply the best and worst performers over the past year. The black line is the S&P 500. All charts are total return. The winners are calm whilst the losers are volatile. The losers rally and crash harder. Buy and hold the winners. Trade the losers.*

A momentum crash sees everything turned on its head. The biggest ones follow bear markets but can happen at any time on a smaller scale. The biggest occurred in 1932, and 2009 was memorable as well. There was also a big one in emerging markets in 1998. It’s amazing how many professional investors have little understanding about this concept. Quite simply, it’s one of the most important behavioural traits in finance. I write about it in *The Fleet Street Letter.*

It’s simply a matter of mean reversion. The good stocks are good, but not that good. The bad are bad, just not that bad. When the gap between them becomes too wide, investors remind themselves that everything has a fair price. The bad are too cheap and the good, too dear. The relationship snaps and it’s always fast and furious.

What follows is a major rotation within markets. The winners change shape. Some previous investment themes that have been fashionable will peak and cease to perform. Some distressed
areas will recover over the longer-term. It’s important to observe those changes, particularly during the momentum crash.

For example, some emerging markets are showing signs of improvement, but not all. If you would like to know which ones, then invest in a subscription to *The Fleet Street Letter*.

**Winners versus losers – since 2001**

![Chart](chart.png)

*Chart note: The winners generally beat the losers and that’s why this line rises most of the time. The momentum crash occurs when things go into reverse. The recent crash is relatively modest compared to 2009 or even 2003 (post bear rallies). Despite that, some hedge funds have been caught short.*

Having managed a global equity momentum fund from 2005 to 2009, I am one of the world’s leading experts on this subject having had practical experience. I discovered the momentum crash in 2009 the hard way and that’s what makes me an expert on this subject. There are many indicators that help to forecast these events and I follow them closely. Each week, I put 3,200 global stocks though a mincer. The outputs give you a radar of what’s working and what’s not in financial markets. I find the models invaluable.

**Ask Charlie**

*Send me your questions and I’ll find the answers. atlaspulse@gmail.com*

**Rob from Buenos Aires wrote.** You use cap to fees ratios to assess value of bitcoin, and infer in writings that most of the fees come from mining. But mining volumes fall over time as it gets harder to mine, eventually reaching zero. Does that mean this measure only has temporary usefulness? Or are there loads of other fees from general transactions in the bitcoin economy included in the figures, which should grow over time?

**Answer:** Bitcoins come from mining. Fees come from transactions. I discovered the link two years ago and it has been very accurate in forecasting bull and bear markets. The fees are the best measure of the size of the network for the simple reason that is the only credible way to measure economic activity. Transactions could be small. Output volume (number if bitcoins changing
hands) overstates the reality considerably because it doesn’t take into account the ‘change’ that is returned to the payee. The latest reading from the AP model using the network to fees ratio, suggests a bitcoin should be worth around $700 (currently $415).

However, the block size debate has skewed the data. As the block size approaches the 1 MB limit, people are paying higher fees to prioritise their transactions. I’m comfortable with that $700 target but would highlight the current distortions with my model until the block size is raised.

I don't understand your logic of calling bitcoin a *digital asset* instead of a *crypto currency*. Digital - ok, and I get that crypto might attract unwanted government attention. But crypto also stresses the security aspect of the network, which is essential for adoption by new people.

Much more crucially, if bitcoin isn't a currency then it's pointless. Taking away that word robs it of its primary or even sole purpose in life. And you wouldn't want to call it a *digital currency*, as we already have plenty of that. In any case, the market for words will win. *Crypto currency* is the accepted term, so it seems to me you have a battle against overwhelming odds, which you’re unlikely to win! It’s the charge of the Litecoin brigade. Keep up the good work.

Answer: Sir, you are right and I am wrong. Your case is well made and I agree with you. Besides, the term *digital assets* has been hijacked by a corporation. My fight is over. Crypto currencies it is.

**Ethereum**

I’ve mentioned Ethereum on several occasions. It is the main challenger to bitcoin and the greatest tragedy is that I never bought it.

![Ethereum Chart](chart-note)

*Chart note: The chart shows the price of Ethereum in US dollars. It was 43 cents on 22nd October 2015. It recently touched $14.*

That’s a *32 bagger in just 4 months.*

I’ve asked my friend Adam Cleary, who is a true guru on these matters, to tell you more about Ethereum.
Ethereum – the challenger emerges

Since the beginning of 2016, Ethereum has seized the imagination of the crypto currency space, with the price of its crypto currency, the ether, rising from $0.95 at the beginning of this year to $13 at the time of writing. At this price Ethereum has a market cap of just over $1bn and has stormed into second place in the crypto currency rankings, outstripped only by bitcoin.

Ethereum was originally funded by a crowd sale in August 2014 when it raised $18.4m in bitcoin. A punter contributing 1 bitcoin worth $600 to the crowd sale received 2,000 ether – an effective price of $0.30 per ether. These 2,000 ether are today worth $26,000 – a 43x return and a good trade in anyone’s book.

Ethereum is commonly explained as being Bitcoin 2.0 – a next generation bitcoin. But actually what differentiates Ethereum from bitcoin is that it doesn’t set out to be primarily a currency and payment system, but rather a computing platform.

Put very simply, Ethereum is a world computer that you can’t shut down, that enables contracts and transactions to be executed automatically without human intervention. The ether crypto currency acts as the fuel to power the engine of this computing platform. Ether is consumed by miners for accessing resources of the network. The more ether a user holds, the more "gas" they can pump into the computational engine of the Ethereum virtual machine.

What Ethereum plans to facilitate is a network of interconnected devices where machines can transmit money and data in a manner that dwarfs the efficiency of human input. Ethereum could enable entirely new industries to be created whilst traditional business models, particularly in finance where providers act as middlemen, could increasingly become obsolete.

Ethereum today is where bitcoin was in 2012 when the first bitcoin light wallets emerged. It has untested infrastructure and needs to build its credibility and broaden the network effect with developers actually building applications as opposed to speculating in the price of ether. By extension if you think you have already missed the rally consider this: the price of bitcoin was $13 in December 2012 (the same price as ether today) – a year later in November 2013 it was $1,000 – a further 77x return. Maybe there is still time to board the train...

In the crypto currency world Ethereum may be to Bitcoin what Google was to Yahoo! in search engines. Or it may be the digital oil to bitcoin’s gold. Either way an allocation to Ethereum looks like a must have for any crypto currency enthusiast – given the vibrant momentum of this emerging challenger.

Adam Cleary is an entrepreneur, digital currency investor and investment manager. As the founder of Bullion Bitcoin Adam was the first person to put gold on the bitcoin blockchain – creating a gold backed currency called Bits of Bullion. As an investor Adam has been building giftaff.com – an online platform that enables the sale of gift cards for 40 digital currencies – which is currently finalising a second round of fundraising. Adam also runs a regulated investment management firm, Cavenham Capital Limited, which advises investors on digital currency investment.

If you are interested in investing in the digital currency space you can email him at: adam.cleary@cavenhamcapital.com
Satoshi Pay

I recently met Meinhard Benn, the CEO and founder of Satoshi Pay. It is a fintech company focused on nano-payments. It enables you to buy content over the Internet using bitcoin – and potentially other crypto-currencies in the future.

Meinhard was born in East Germany and used to cycle past Mutti’s house as a child. He was 12 when the Berlin Wall came down and soon after, discovered computers. He took to them like a duck to water and is a self-taught hacker.

Although not an economic libertarian himself, he finds himself drawn into those circles and is a strong advocate of open source software. He had a laptop that used Linux software and an Android phone. He’s a true believer.

Satoshi Pay (https://satoshipay.io) was founded in September 2014 and is based in Berlin where there is a hub of activity in the fintech space. The company is incorporated in the UK and is backed by Coinsilium (COIN PZ) and Fast Forward (FFWD LN) which are both listed in the UK.

His dream was to enable online cash payments whilst declaring war on the username and password. Satoshi Pay allows you to deposit bitcoin and spend it on content offered by providers such as blogs, publishing companies, software providers, music or TV. It’s like have a coin-operated electricity meter on your browser.

The content providers can access the system via Word Press and although it’s early days, 112 companies have signed up and 7,371 users now have Satoshi Pay wallets. They live on your screen and you can buy content without logging in and leaving your details. The content providers pay away 10% of the revenue to Satoshi Pay whilst the users pay nothing.

To make the system more efficient, the transactions are only logged on the blockchain at the end of the day. That reduces the impact on the network and reduces transaction fees. In time, they will integrate credit cards so that customers don’t need to buy bitcoin. That means multiple spending possibilities with just one credit card transaction. This business is highly scalable and once people realise that the Internet can be monetised, it will flourish.

I believe that companies in this space have much to offer and will have an enormous impact over time. This will be tech bubble 3.0. When Bitcoin, Ethereum and what’s yet to come, catch on, there will be significant upside in this space. Satoshi Pay is a young innovator and doing great things to demonstrate what’s possible.

Fleet Street Letter

I signed up with Money Week as the new editor of the Fleet Street Letter in the autumn. We relaunched Britain’s oldest newsletter in January and investors are signing up in droves. Quite simply, I am doing my old job (Head of Absolute Return at HSBC) via regulated publishing rather than banking.
I have total freedom to make investment decisions and face few restrictions in what I can write about. It’s refreshing and satisfying. The people around me are highly professional and supportive.

When I was in fund management, a typical client used to pay over £10,000 per year for my services. An improved version of the same is now available for £150 – a number which is often discounted.

The Fleet Street Letter has a monthly thought piece, weekly market updates and trades - as and when. There are two portfolios called Whisky and Soda. Whisky is an equity portfolio encompassing country funds, global sector funds and UK stocks. Soda has lower volatility and is comprised of high quality assets. In a sense, Soda is a bond portfolio without bonds. You can mix the two portfolios according to your personal taste.

If you are too busy to follow them, Neil Sutherland from Sutherland IFA has stepped forward and offered his managed services. If that interests you, then get in touch with Neil at http://www.sutherlandifa.com or email info@sutherlandifa.com. He is regulated by the FCA.

Summary

Gold has turned the corner and as I write, the dollar is coming under pressure following the Fed’s dovish tone. Despite that, gold is at $1,264 and is stalling around the 20% resistance zone. In the short-term, and having seen record flows into the gold market, the market is possibly exhausted. I will be more bullish when gold is beating equities and the when $1,260 looks more like support rather than resistance. In any event, the bear appears to be done so we can celebrate that. Don’t overlook silver.

Don’t forget to sign up to The Fleet Street Letter. It’s rare in life that high quality can be so cheap. Thank you for taking the time to read Atlas Pulse. Please send me questions, praise, ideas or criticisms.

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Charlie Morris is the editor of the Fleet Street Letter, the Britain’s oldest financial newsletter, and the CEO of CCData.CC, an analytics platform for blockchains. He spent 17 years at HSBC Global Asset Management as the Head of Absolute Return managing a multi-asset fund range overseeing $3 billion. He is a familiar face in the financial media, often discussing the gold market. Prior to fund management, Charlie was an officer in the Grenadier Guards, British Army.

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