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THE BIG SECRET ON WALL STREET

Get Out of the Dollar with Bitcoin Bonds

- *Protecting Yourself Against a GlobalAssets*
- *Why Wealth is Shifting to Real Assets*

FROM THE DESK OF PORTER STANSBERRY

SPECIAL REPORT

Note: Due to the run up in the price of the Bitcoin Bond, we are no longer focusing on this security. You can still access this report as the information is a demonstration of our work. Please call customer-care concierge Lance James and his team so we can replace it with another report at 888-610-8895, or internationally at +1 443-815-4447.

Bitcoin Bonds

Bitcoin offers an escape hatch from the coming global "Minsky Moment" when central banks go bust, taking fiat currencies down with them. In this report, we're introducing the ultimate low-risk way to invest in one of the world's most volatile assets.

No one had ever seen anything like it.

In the spring of 1928, a young stockbroker did something no one on Wall Street had ever done before. Or has since.

The broker told his clients to get out of debt – entirely.

At the time, that meant selling all their stocks. Back then, in the 1920s, virtually all investors in the stock market used margin loans. By looking out for his clients' best interests – and telling them to get out of stocks – the stockbroker was essentially shutting his own business down.

And he didn't stop there. He also warned his clients to completely avoid owning any corporation that was financed, in any way, with debt.

Here's what he wrote:

> *We think you should know that, with few exceptions, all of the larger companies financed by us today have no funded debt. This situation is not the result of luck but of carefully considered plans on the part of the management and ourselves to place these companies in an impregnable position.*
>
> *The advice we have given to important corporations can be followed to advantage by all classes of investors. We do not*

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urge that you sell securities indiscriminately, but we do advise in no uncertain terms that you take advantage of present high prices and put your own financial house in order. We recommend that you sell enough securities to lighten your obligations or, better still, to pay them off entirely.

He repeated this advice month after month for more than a year, until the market crashed in the fall of 1929.

It saved the fortunes of his clients.

It also cemented his reputation as a wise and honest financier who cared deeply about the welfare of his clients – even more than his own firm's profits.

The young broker's name was Charles Merrill.

His reputation for excellent advice and selfless integrity created so much brand value that his firm, Merrill Lynch, went on to dominate the retail brokerage business for the next 70 years. The company's network of brokers gave it unmatched stability on Wall Street, allowing it to grow into a leader in investment banking.

And eventually… even into mortgages.

In 2003, Stanley O'Neal, the firm's first outside CEO and the only man to lead the firm who hadn't started his career as a retail broker, led Merrill Lynch to invest heavily in subprime mortgages. A firm that was built upon a legendary reluctance to invest in indebted companies was destroyed by investing in the worst credits Wall Street ever created.

Ironically, it was Merrill Lynch's reputation for caution, and its robust core business, that enabled it to borrow heavily and to invest billions in subprime mortgages.

It's in this way that financial stability often leads to instability.

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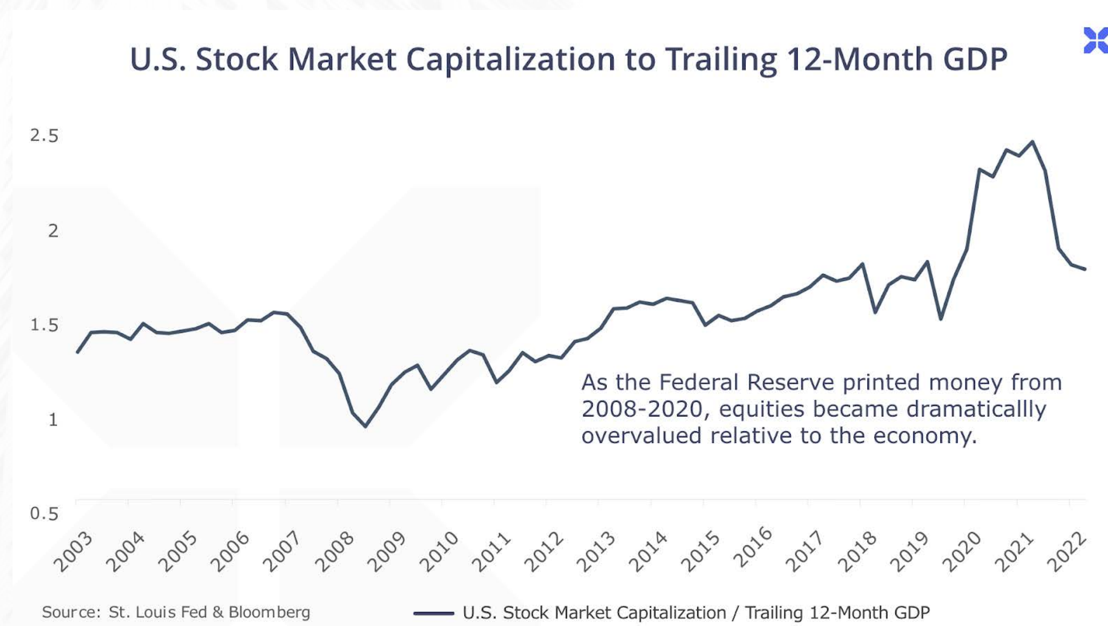

Bill Bonner, our long-time business partner and an underappreciated economic genius, explained the cycle to us this way:

Financial innovations always appear brilliant, at first. But they soon are taken to excess and become a farce. Eventually the farce leads to a tragedy.

We've seen many brilliant financial innovations become a farce.

General Electric's AAA credit rating – the highest possible and granted only to a small handful of governments and companies – allowed it to supply credit to millions of American consumers. It helped people buy their first electric appliances in the post-World War II baby (and building) boom. This was good for the consumer and great for GE's bottom line, propelling it to become the largest publicly traded company in the world by 2000.

GE's credit innovations were, at first, a brilliant asset for the company. These innovations were the foundation for the company's incredibly stable earnings. For 80 quarters in a row the company met or beat its earnings forecast. The company's CEO, Jack Welch, would become famous (and rich, with over $400 million of total compensation) thanks to GE's remarkable growth.

But by the time Welch retired, the company's accounting was a farce, as was revealed in subsequent SEC investigations. Likewise, most investors didn't realize

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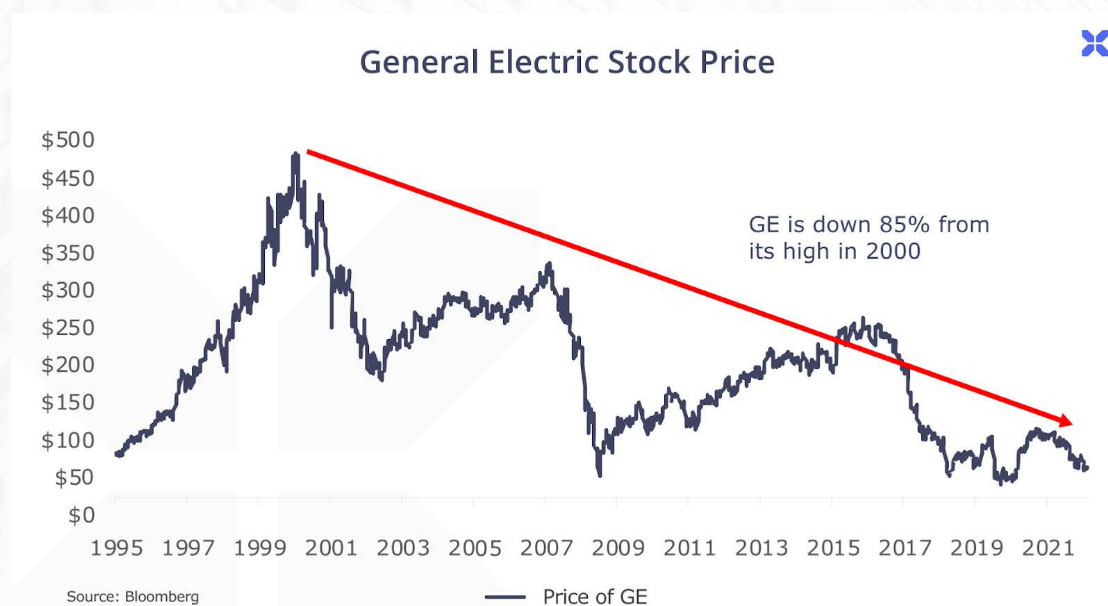
the company's earnings were no longer powered by safe lending to homeowners. Instead, GE began to maximize the earnings power of its credit rating by borrowing huge sums of money (over $100 billion in overnight loans) to invest in high-yielding, risky credits – like private-label credit card debt and foreign mortgages. GE's AAA rating was a farce.

By the early 2000s, as it piled into ever-riskier debts, like long-term care insurance, GE was well on its way to becoming a tragedy. The company would have certainly gone bankrupt in 2008 under the weight of its bad debts were it not for a $140 billion government-led bailout. With total debt of more than half a trillion dollars, GE, at its peak, was the 10th largest borrower in the world.

Even today, more than a dozen years after the crisis, the company limps along and continues to sell its best businesses to repay its enormous debts. (Editor's note: Porter recommended shorting the company, saying it could never earn enough to finance its debts, over a decade ago, in July 2011.)



A Synchronized, Global "Minsky Moment"

Hyman Minsky was an academic economist who studied under Joseph Schumpeter at Harvard.

Schumpeter taught that capitalism's dynamism was defined by "waves of creative destruction," a description that profoundly influenced Minsky's theory of credit.

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Like Bill Bonner taught us, Minsky's research showed how the financial system would trend from periods of stability, towards excess, and then instability. In short, there's a process of creative destruction in banking too. New technology and other innovations enable more stability and therefore, more credit. But eventually the growth in credit surpasses its ability to be serviced reliably, and the so-called "Minsky Moment" occurs – a crisis strikes.

At these times, Minsky believed, the role of the central bank was paramount.

Ben Bernanke, the recent winner of the Nobel Prize in economics, and head of the U.S. central bank from 2006-2014, was a Minsky disciple. His studies of the Great Depression while the head of Princeton's economics department convinced him that allowing banks to fail was the critical error after the crash of '29 that led to the decade-long Great Depression. The Nobel committee cited his work from the mid-1980s about the hidden costs of allowing banks to fail.

We are about to learn the hidden costs of not allowing banks to fail.

We believe that financial innovations and efforts to promote financial stability lead, inevitably, to more instability. Bailing out banks doesn't eliminate Minsky Moments. It simply postpones them by allowing still-greater excesses to develop.

Therefore, we suspect that the central bank-led global economic stability that's existed since around the introduction of the Euro, and which accelerated dramatically after the global financial crisis and the European sovereign debt crisis, is going to lead, eventually, to the biggest Minsky Moment in history.

And now, we are certainly well into the "farce" stage of the play.

Central banks have gone from supporting sovereign credit markets and mortgage markets, to buying junk bonds and equities. The size of their buying has gone to levels completely unimaginable before the global financial crisis, with the Federal Reserve's balance sheet increasing 10-fold in just over a decade.

The scope of the central banks' manipulations of the markets created something that should never exist in capitalism – negative interest rates.

The impact on the real economy has become a farce too. The past decade has seen income inequality soar as the money supply grew at much faster rates than productivity, sending asset values soaring relative to wages. Artificially low interest rates enabled both sovereign borrowers and corporate borrowers to afford vastly more credit.

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Likewise, ultra-low interest rates led investors to take on far more risks, which in turn bolstered the number – and valuations – of speculative unprofitable firms to unprecedented and absurd levels. There were, at one time, more than 150 unprofitable "unicorns" worth more than $1 billion each.

Perhaps the most flagrant farce has been the creation of thousands of alternative "crypto-currencies" with little or zero utility that became worth billions overnight.

A Farce with Devastating Real-World Consequences…

The most dangerous impact on the real economy, though, has been the effect on resources and energy.

If unlimited amounts of capital are available, at virtually zero cost, then virtually any energy infrastructure project can be financed (at least on paper) – even projects that don't work.

As a result, over the last decade $3.8 trillion has been spent on "renewable" energy infrastructure globally, in a quest to make our environment better. Meanwhile, the mix of fossil fuels in global energy consumption has declined by just 1%, from 82% to 81%.

What has increased, dramatically, is the carrying costs of our electrical grids. What has also increased, dramatically, is the instability of power grids, all around the world. This winter will reveal just how much time and money has been wasted on energy investments.

That's going to cause a very significant rise in social and political unrest. People

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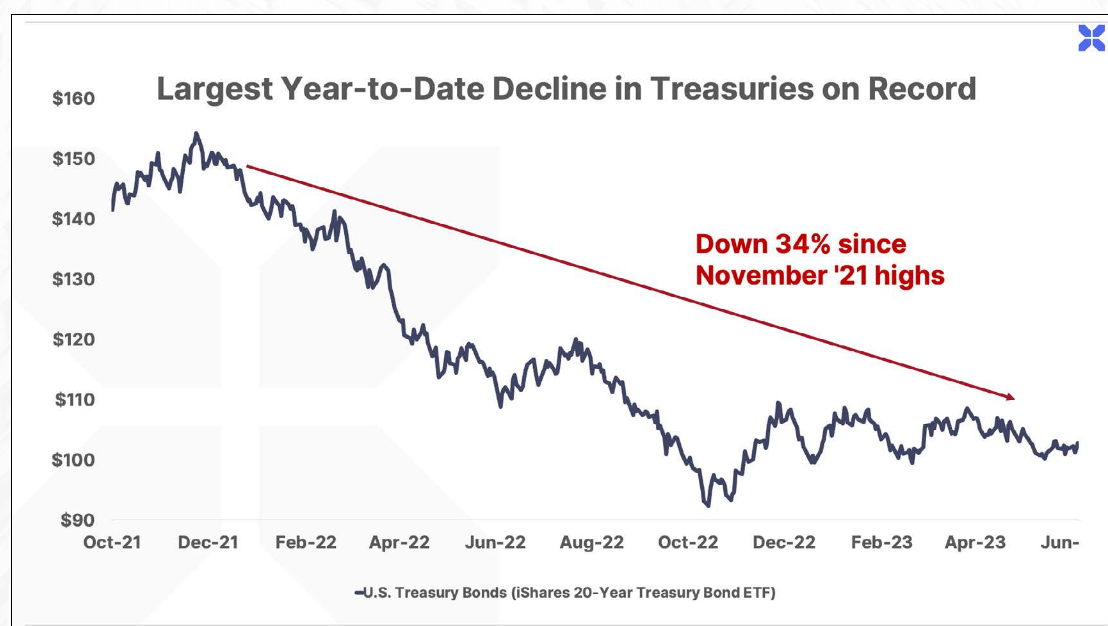
are going to die because of the instability of the power grids. And there's going to be hell to pay.

And that's not the only big problem.

The ongoing collapse in long-dated British sovereign debt and the British pound is, we suspect, the first stage of the greatest financial tragedy in modern times. It will not be the only sovereign credit that's destroyed this year. Constant maturity U.S. long bonds are down over 30% from November 2021. That's virtually unprecedented.



The losses in the world's bond markets are going to wreck a lot of banks, a lot of pension funds, and a lot of insurance companies. The collapse in paper currencies is going to make it very difficult (read: impossible) to rein in inflation without wiping out trillions in equity valuations.

We face a global synchronized "Minsky Moment," in which, because of soaring inflation (mostly related to soaring energy costs), the stabilizing impact of the world's central banks is no longer available. The global economy now faces a complete reset of interest rates, sovereign debt loads, and corporate debt loads without the "cushion" of central bank largesse to soften the collapse.

What will happen? Michael Burry, of Big Short fame, says he thinks "the mother of all crashes" is en route.

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Where to Put Your Money Ahead of the Debt Crisis

Our bet remains that, given a big enough panic, the world's central banks will blink. We believe that, sooner or later, the only sustainable path for the developed world's economies is a mixture of higher inflation rates, and massive social benefit restructuring.

In the U.S., for example, there is no legitimate way for our federal government to finance its $31 trillion (!) in debt.

The yield on short-dated Treasuries (i.e., 2 years or less in maturity) that the government relies upon to finance the majority of its debt is now around 5%. The last time government bonds sustained that level of interest was in October 2008, before the global financial crisis. The total debt load then? Less than $10 trillion. Assuming inflation remains sticky and the Fed keeps the Fed Funds rate at 5% or higher, it will cost something like $2 trillion per year just to pay the interest on government debt.

In 2019, total federal tax receipts were $3.46 trillion. They're currently estimated to be $3.7 trillion in 2020. Paying more than 50% of tax receipts in interest alone is completely untenable… never mind the trillions in unfunded liabilities of Social Security and Medicare.

These facts, more or less, are mirrored across the major economies of the developed world. Thus, like Michael Burry, we believe the scope of the coming crisis is far, far bigger than virtually anyone yet realizes.

That's why we have written you this letter. Like Charlie Merrill in his time, we believe the world's economy is on the precipice of a debt crisis unlike any that's ever happened before. For at least the next 5-7 years, investors who flee debt and leverage, and who own high quality, unencumbered equity, and especially energy, will do best.

We also believe that investors will do well to divest themselves of the U.S. dollar and instead, make a long-term move towards alternative currency.

Global Currencies in a Race to the Bottom

Given the unrelenting pressure on sovereign governments to finance unsustainable debts with inflation, all signs point towards widespread currency devaluation going forward.

In 2022, the Japanese yen has collapsed by 16%, the British pound has shed 12% of its value, and the Euro is down 9% against the U.S. dollar along with similar

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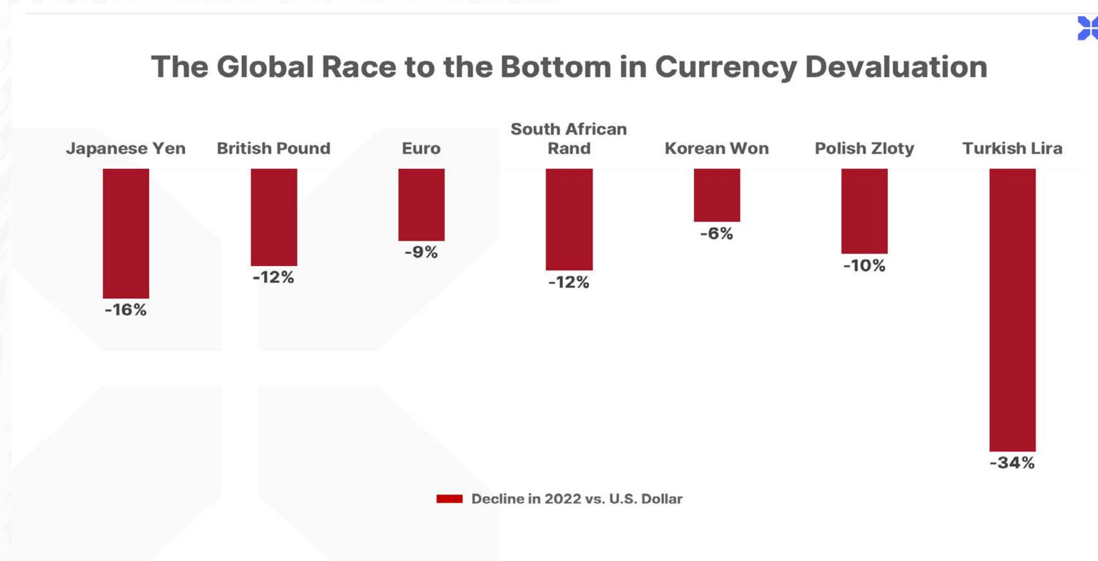
declines in currencies of other major economies, like South Korea, Poland and South Africa:



For now, the U.S. dollar reigns supreme. A big part of this divergence is due to the aggressive monetary tightening campaign by the U.S. Federal Reserve. Other factors include the global energy crisis that is spiking energy costs for economies with less energy security, like Europe and Japan.

Finally, there's the U.S. Dollar's role as global reserve currency – providing a safe haven that investors traditionally flee into amidst economic and financial distress.

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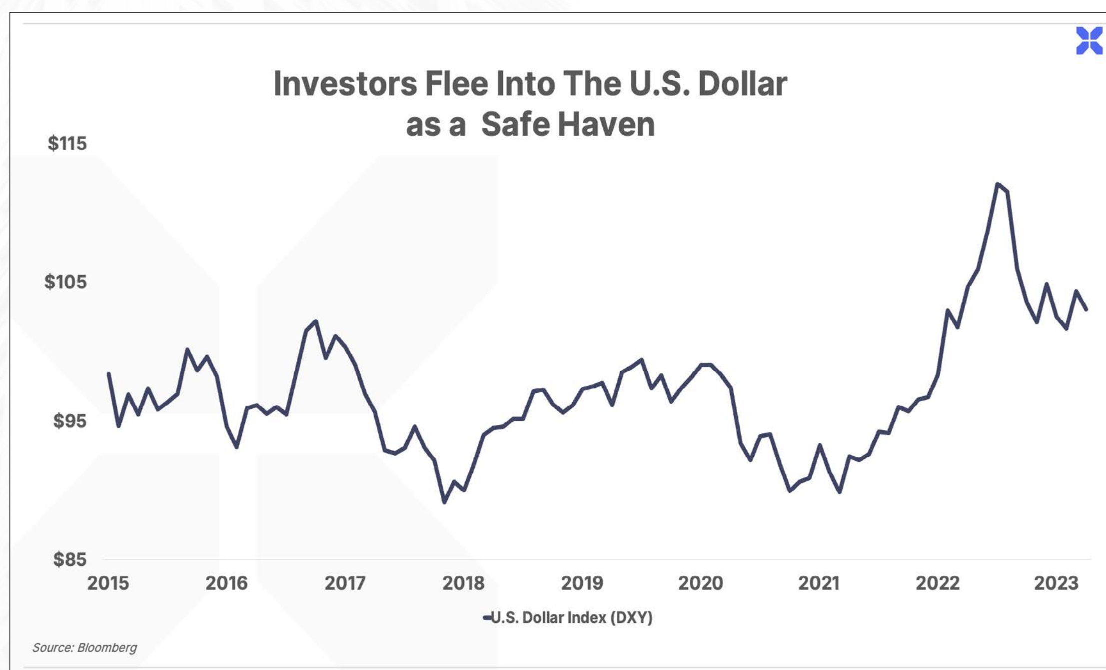

These factors have all combined to temporarily prop up the U.S. dollar's value on a relative basis. But zooming out beyond these short-term factors, the bigger picture is clear: the United States is the largest debtor nation in world history.

And thus, our future seems certain: paper money systems are unblemished by historical success. There are zero historical examples of any debtor nation with over 100% of GDP in debt that didn't inflate away its obligations.

America's history of printing away its obligations began in 1690, with our first colony, the Massachusetts Bay Colony. The most recent example was in 1971, when President Richard Nixon cheated our foreign trading partners and creditors. He repudiated the Bretton Woods agreement, which required the U.S. to settle its foreign debts in gold. Nixon, much like Sir William Phips, assured the public the measure was only "temporary." Nixon also claimed, laughably, that the accompanying wage freeze and 10% import tariff would "increase jobs."

The next decade saw the first substantial decline in real wages in American history. It was the beginning of the hollowing out of the middle class, as inflation sent asset prices higher, while the average standard of living fell.

And it is about to happen again.

There is no question in our minds that U.S. politicians will tap the printing press to

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paper over America's unsustainable debt burdens. That's why we believe investors should take advantage of the temporary strength in the U.S. dollar to diversify into alternative stores of value.

This includes sound money, like gold and silver, which will soar in value against rapidly depreciating fiat currency in the coming years. Other tangible assets, like commodities, will also appreciate for the simple fact that governments can't print things like copper, as we explained in our previous issue.

One Asset Has the Most Upside from a Global Currency Devaluation

It's more than just a store of value. This decentralized, digital monetary network allows seamless monetary transfers to anyone around the globe with the click of a button. It's a peer-to-peer transfer mechanism, which means it exists outside the scope of governments and central banks, making it the most legitimate international, reserve currency.

If you think this sounds like Bitcoin, you're right. We're not in the business of hiding behind misleading descriptions here at Porter & Company.

Given the absurdity of many crypto "currencies" (we're as fed up with "Dogecoin" as you are...) you may be surprised to see us recommending Bitcoin in this letter. We believe that Bitcoin is, at present, the best alternative to the U.S. dollar as a world reserve currency. And we think, more and more as this crisis builds, enormous amounts of value from around the world will seek to own it and mine it.

In our eyes, Bitcoin is the ultimate form of money. It's a currency of pure energy.

But the investment we're about to show you isn't merely Bitcoin – it's something better.

The New Global Money

Unlike fiat currencies, Bitcoin runs on software – not decrees from central bankers and governments.

Bitcoin was born in the wake of the last financial crisis, first defined in an anonymous whitepaper, published on October 31, 2008. The paper laid out the dire need for a globally available, decentralized and non-inflationary currency.

The solution came in the form of the Bitcoin network, which was launched as an open-source software protocol in 2009. Bitcoin registered its first series of transitions at pennies on the dollar, and went on to become the best performing

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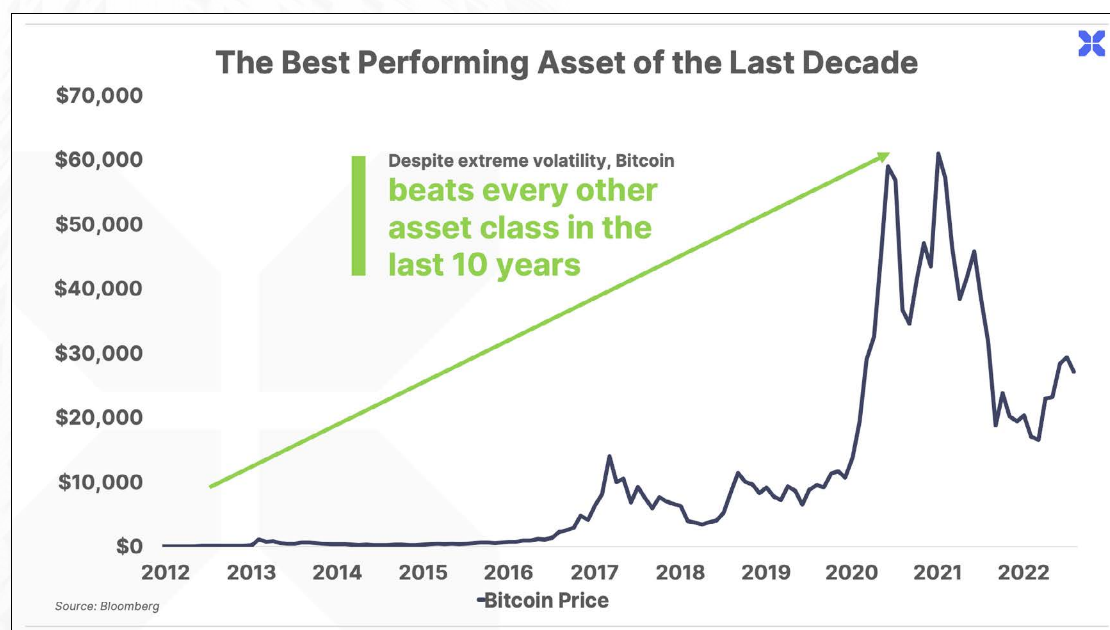
asset class of all time – undoubtedly fueled by the record volumes of global monetary expansion during the last decade:



The Bitcoin protocol ensures that only 21 million coins will ever be created. That makes it immune from currency devaluation, and eliminates the silent theft of purchasing power through inflation that plagues sovereign currencies.

Beyond providing a source of stable money, Bitcoin also allows seamless, secure peer-to-peer transactions with anyone around the world at the click of a button. Often referred to as the "internet of money," Bitcoin's decentralized nature eliminates interference from governments, thereby eliminating the threat of censoring transactions and currency devaluation.

This censorship-free feature has never been more important in today's world of "cancel culture" when financial institutions like Paypal threaten to financially punish those who engage in "thought crime":

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Bitcoin achieves all of these critical monetary features through its elegant software protocol that makes the network stable, self-regulating, and ultra-secure.

Here's how it works...

Every Bitcoin transaction is digitally encrypted onto a decentralized network, known as the blockchain. The blockchain is essentially a public ledger, maintained through a network of thousands of "nodes". At each node, high-powered computers — known as miners — keep track of every Bitcoin transaction. These miners compile real-time Bitcoin transactions into data blocks.

When a given data block fills up, the miner adds it to the pre-existing block series. This process forms a chain of continuous transaction blocks, hence the name "blockchain". Here's a diagram showing how individual transactions get added to the Bitcoin blockchain:

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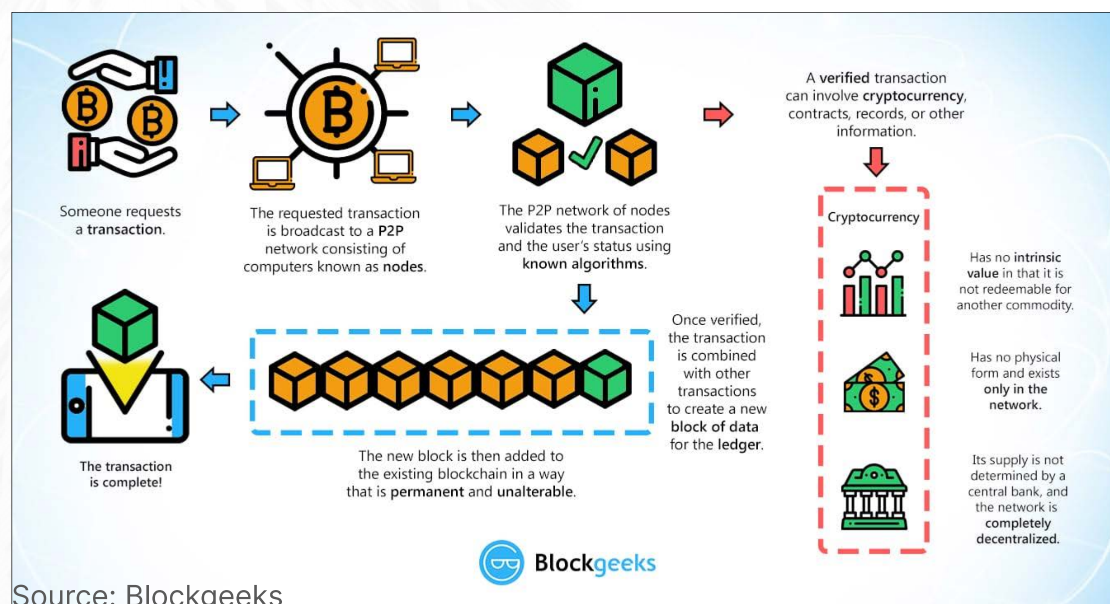

Source: Blockgeeks

The blockchain was designed as a self-regulating network, with built-in incentives for computers around the world to compile and keep track of every transaction. In exchange for lending their computing power to the Bitcoin network, miners are rewarded with entries into a lottery for each data block they create. The number of actual Bitcoins awarded in these lotteries declines over time, ensuring that the total number of Bitcoins approaches a hard limit at 21 million coins.

In this way, Bitcoin mimics the gold standard. Gold mining became progressively more difficult and expensive over time, as the industrial revolution and new discoveries eliminated many sources of gold. Today, as computing power radically increases through time according to Moore's Law, Bitcoin is designed to become progressively more difficult to mine. Thus, Bitcoin is designed to match increases in computer power, in the same way that the earth's natural geology caused gold's relative scarcity.

It's said that an ounce of gold has always been worth a fine men's suit. That was true 2,000 years ago and it's true today, despite massive increases in productivity. That's because gold became relatively more scarce as humans figured out how to mine it ever more efficiently throughout the scientific and the industrial revolution.

The same is true with Bitcoin – but with one very important difference. Bitcoin's "productivity curve" isn't predicated by industrial (mining) technologies, but instead by the incredible, almost miraculous, advances seen in digital technologies. Bitcoin is a currency that's designed to be stable relative to advances in computing. And that means its value has soared relative to other currencies.

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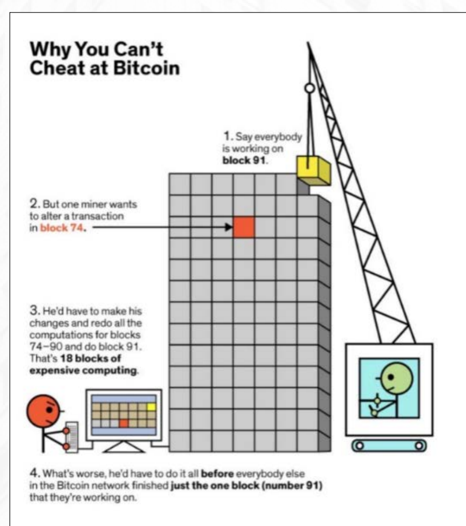
The Bitcoin protocol uses several mechanisms to ensure security and integrity of the blockchain. This includes the fact that 50% of the network nodes must approve each data block before adding it onto the blockchain. This prevents a bad actor from creating false transactions in real-time.

That's because in order to create a "false" version of the Bitcoin ledger, a bad actor would need to rewrite the entire blockchain history with the new false version, as explained in the following graphic:



The end result is a secure self-regulating decentralized network, governed by a series of rules that eliminates the need of any central authority. That's what makes Bitcoin the ultimate candidate for global reserve currency – a neutral asset that exists outside the realm of sovereign governments and banking cartels.

Bitcoin is the people's money. And more people are using it each day.

So far this year, more than 17 million transactions have been settled in Bitcoin. But we're still very early in its adoption, and therein lies the big upside case to much higher prices...

Bitcoin's Unlimited Upside Potential from Growing Global Adoption

Over the last decade, Bitcoin has transformed from a fringe speculative vehicle into a mainstream financial asset. Today, big banks like Goldman Sachs, Citi and JP Morgan are now dealing in Bitcoin. And Fidelity — one of the world's largest asset managers with $12 trillion in assets — now offers Bitcoin investments in its 401k retirement plans.

This growing adoption is how Bitcoin went from a standing start in 2009 to a more than $1 trillion asset at its peak last year. And yet, we're still in the early innings of this story. Remember that the ultimate bull case for Bitcoin is its ascendance to become a global reserve currency.

In that context, the potential addressable market for Bitcoin is the global M2 money supply, defined as currency in circulation plus overnight deposits, savings deposits, and money market funds. These are all sources of currency that could

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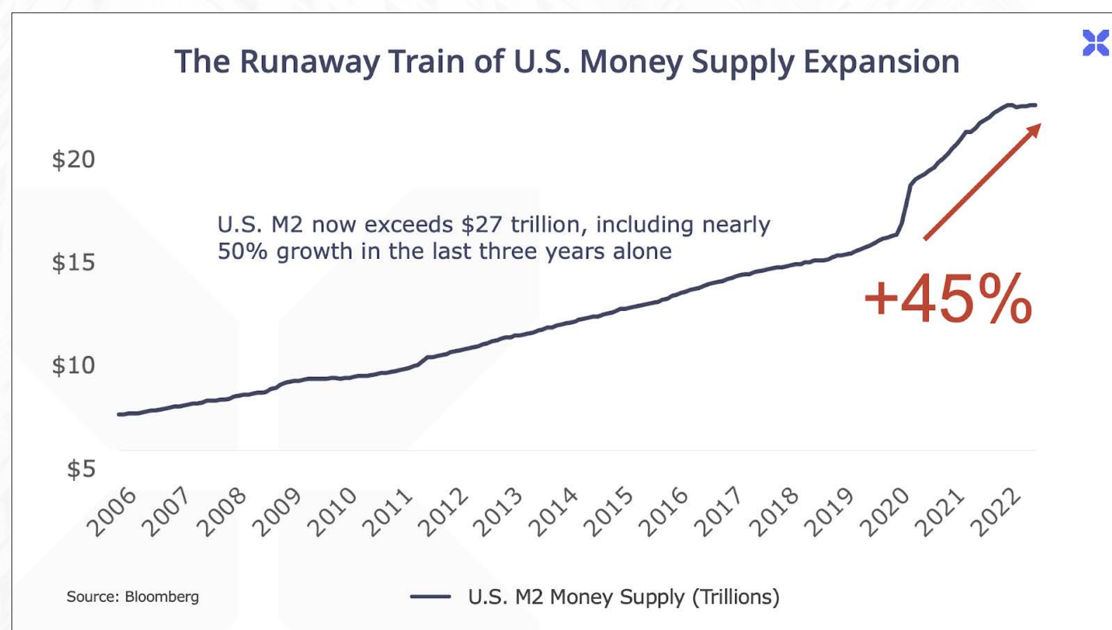
flow into Bitcoin if investors lose confidence in fiat currency and begin looking to Bitcoin as an alternative store of value.

In the U.S. alone, the M2 money supply is over $20 trillion and growing – including nearly 50% growth since 2020 alone:



Globally, the M2 money supply is nearly $100 trillion. Meanwhile, the total size of traditional asset classes is in the hundreds of trillions of dollars.

Today, this wealth is mostly concentrated in stocks, bonds, and real estate. Bitcoin's current $400 billion market capitalization is a rounding error compared with these traditional stores of wealth:

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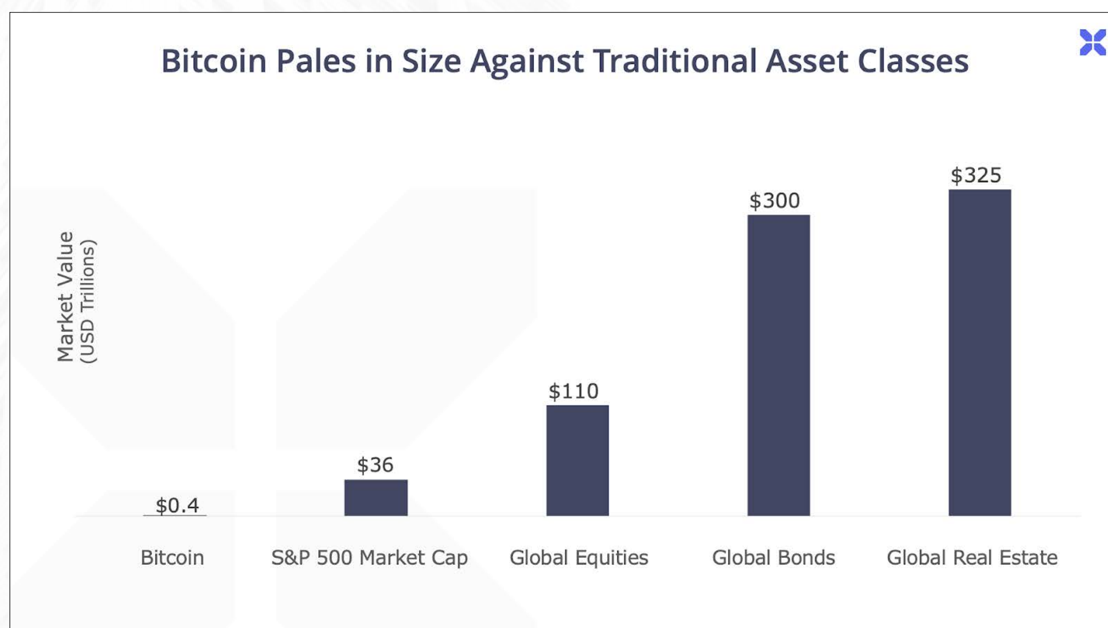

When you consider the ramifications of just 1-2% of global money supply or total wealth finding its way into Bitcoin, it's conceivable that the market could soar from its current $400 billion into the tens of trillions, pushing the price of Bitcoin from $20,000 to millions of dollars per coin.

The bottom line: in a world where overly-indebted governments around the globe issue endless new supply of fiat currency to inflate away their obligations, more and more of those currency units will flow into alternative stores of value, like Bitcoin. And if the global investment community begins diversifying even a small portion of their wealth away from traditional investments into Bitcoin, there's simply not enough supply to meet demand at today's prices.

Given Bitcoin's hard supply cap at 21 million coins, a scenario where trillions of dollars flow into the asset class, the conclusion is clear — much, much higher prices. As global central banks, including the Fed, return to their familiar playbook of cutting interest rates and expanding the money supply to deal with unsustainable global debt burdens, we see Bitcoin reaching new all-time highs and hitting $100,000... and that could be just the beginning of the next leg higher.

With Bitcoin prices recently falling from a high of $65,000 to around $25,000 today, we believe now is the time to get ahead of this trend. But instead of simply buying Bitcoin, we've identified a unique investment vehicle that will offer exposure to higher prices, while also providing protection against a downside scenario where Bitcoin prices fall in half from here.

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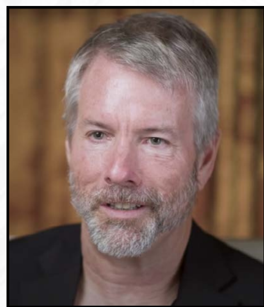
There are a number of Bitcoin ETFs and funds that allow you to "buy Bitcoin" via your brokerage account, but you are always faced with potential losses if the underlying takes a hit. The opportunity we've identified here is the only way to profit off Bitcoin no matter whether it goes up or down.

How to Profit Off Bitcoin No Matter Which Way It Moves

Microstrategy (NASDAQ: MSTR) is the largest independent, publicly traded business intelligence and analytics company…that's also the largest public holder of Bitcoin. How did a software company end up becoming one of the world's biggest Bitcoin holders?

To explain, we must start with the company's founder and executive chairman – Michael Saylor.



When he was younger, Michael Saylor wanted to be a fighter pilot — a byproduct of growing up on Air Force bases around the world, following his father's career as an Air Force chief master sergeant. A medical issue prevented Saylor from becoming the next Air Force Top Gun, but he went on to become a true maverick of corporate America.

After graduating from MIT with a dual major in aeronautics and astronautics, Saylor worked for chemical company DuPont. There, he developed computer models to predict changes in supply and demand trends for DuPont's key products. Saylor quickly saw a better way to do the job, and convinced his boss to issue a $250,000 contract to build his own computer models as an independent contractor.

The DuPont contract provided the seed capital for Saylor to launch Microstrategy in 1989, when he was just 24 years old. The company's business model was built on providing innovative data mining solutions, drawing upon the often disorganized but useful data spread across a company's corporate database.

Microstrategy developed software for predicting things like which McDonald's franchise locations would earn the most money, or whether a given store would sell more Big Macs or Fish Filets at any given day or time. This information could help a major corporation like McDonald's save millions by optimizing its promotional schedules, as well as saving money on logistics and staffing.

McDonald's was sold on the idea, and in 1992 offered Microstrategy its first major

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deal with a $10 million contract. Microstrategy went on to double its revenues in each of the next four years. The stock price soared, boosted by the ebullience of the dotcom bubble, making Saylor a billionaire by 1999.

Shares came back down to earth in March 2000, when the company announced it would restate its financials for the previous two years. The stock found a bottom after the company settled with the Securities and Exchange Commission (SEC) in December 2020, with Saylor and other executives avoiding an admission of wrongdoing.

Today, Microstrategy is a mature business, offering enterprise analytics and services to help companies make smarter, data-driven decisions. This includes one-off solutions, as well as the more comprehensive Microstrategy platform, designed as a "software as a service" cloud-based offering. The company's customer base spans across industries, including the manufacturing, retail, financial, technology, healthcare and other sectors.

Microstrategy's revenue is split roughly in half between software solutions and product support/service. It enjoys a sticky customer base – with 95% of its contracts renewing in its most recent quarter. The business is slow-growing but stable, with revenues over the last five years averaging about $500 million per year, and is expected to earn about $100 million in operating cash flows next year. We estimate their core software business alone is worth around $1 billion.

But the real upside case for Microstrategy comes from one of the boldest Bitcoin bets of all time.

How Saylor Transformed Microstrategy into a Leveraged Bet on Bitcoin

Everything changed for Microstrategy and Michael Saylor in the wake of the COVID-19 pandemic.

With global governments and central banks launching the most aggressive monetary and fiscal expansion of all time, Saylor became convinced that Bitcoin offered the ultimate safe haven against fiat currency debasement. Accumulating and holding Bitcoin has become a major strategic priority for Microstrategy, and the company's conviction remains resilient despite the volatility and recent declines in Bitcoin prices.

In a Wall Street Journal interview earlier this year, MicroStrategy's chief financial

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officer Andrew Kang explained that “there are no scenarios that I’m aware [in which] we would sell.” He went on to explain how the company’s shareholder base supports the Bitcoin strategy, noting Microstrategy hasn’t received any pushback from investors or pressure to sell, noting that “our investors are very much aligned with our strategy.”

This shareholder support has been a key factor underpinning the company’s Bitcoin accumulation strategy since August 2020, when Saylor announced that Microstrategy would begin replacing its treasury cash with Bitcoin. Since then, Microstrategy has not only converted the company’s $500 million cash pile into Bitcoin, but it has also issued $2.2 billion in low-cost debt to accumulate roughly 140,000 Bitcoins since then.

Before going any further, it’s important to appreciate exactly how Saylor was able to make an all-in bet with a public company. First, Saylor is Microstrategy’s largest shareholder with approximately 2 million shares, and over 70% of the voting power. Saylor isn’t just gambling with other people’s money – he has huge skin in the game here.

Going one step further, Saylor offered existing shareholders an exit if they weren’t on board with his all-in Bitcoin bet. Shortly after announcing the new corporate strategy to acquire Bitcoin, Microstrategy initiated a Dutch auction to acquire stock from existing shareholders. In a Dutch auction, securities are priced via bids from shareholders, rather than a predetermined price from the seller. In hindsight, any Microstrategy owners who parted with their shares in the auction at $140 made a big mistake. Microstrategy’s stock went parabolic over the next six months, appreciating by nearly 10-fold, before coming back down to earth more recently at around $280 per share.

And therein lies the opportunity today.

Today, Microstrategy sports a market capitalization of $3.6 billion. If we assign a valuation of $1 billion to its core software business, based on a 10 times multiple to next year’s cash flows, that implies a valuation of $2.6 billion to its 140,000 Bitcoin holdings — or roughly $18,500 per Bitcoin.

That’s a discount of about 25% to Bitcoin’s current trading price of around $25,000.

Alternatively, consider that if the market was pricing Microstrategy based on the full value of its $1 billion software business and roughly $3.5 billion in Bitcoin holdings, then the shares would be trading at around $350 instead of $280.

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One way to capitalize on this opportunity would be to simply buy Microstrategy shares at their discounted valuation. But here's why we're not recommending that today.

Recall that Microstrategy took on $2.2 billion in debt over the last two years to fund its Bitcoin buying spree. And while that debt is low cost — with a weighted average interest rate of less than 2% — the market is pricing in the risk of this elevated debt load as a risk to owning Microstrategy shares. That's because in the event of default, Microstrategy shareholders will likely take the biggest hit, since the company's debt holders must get paid first (more on this later).

That's why we are not recommending shares of Microstrategy today. Instead, we believe the best risk-to-reward opportunity lies higher on the company's capital structure. It's a place where few individual investors know to look.

Bitcoin Bonds!

The security we're recommending today is the Microstrategy 2025 Convertible Bond (CUSIP: 594972AC5). The bond trades around $950 and we recommend buying up to $1,000.

A convertible bond is a hybrid security that acts like both debt and equity.

Generally, investors in a corporate bond have limited upside — the best-case scenario is that the company pays the bond off in full at maturity, while paying out interest along the way. The attractive feature of bonds is that they sit at the top of the capital structure in the event of default and bankruptcy. That means bondholders get paid first from any proceeds of a bankruptcy liquidation or reorganization, before a single dime goes to the equity holders (i.e., owners of common stock).

Stockholders sit below bondholders in terms of priority of payouts in the event of default and bankruptcy. But in exchange for taking this greater risk, they participate fully in the upside from a successful business. As earnings and cash flow grow, there's no limit to the gains in a company's share price.

Convertible bonds strike a balance between these two vehicles. They sit ahead of equity holders in the claims on the company in the event of default – providing more downside protection versus owning stock. And convertible bondholders can also participate in the upside from higher share prices, because of their "conversion" feature.

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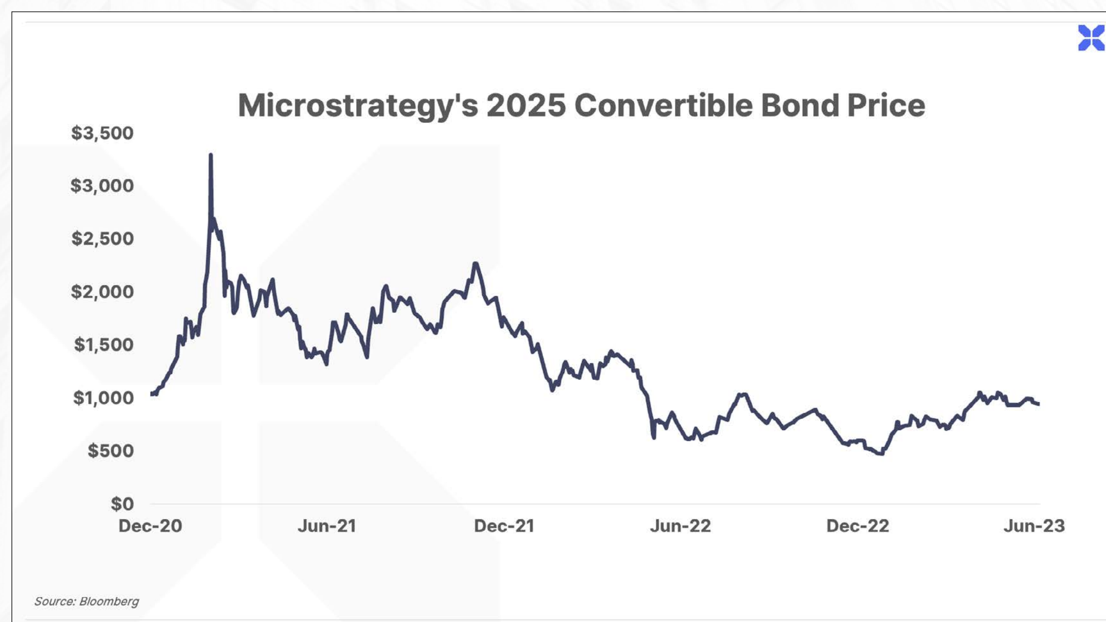
Here's how conversion works...

Each convertible bond comes with the option for bondholders to convert a specific quantity of bonds into stock, at a designated stock price — known as the "conversion price." As the bond approaches the maturity date (i.e., the date upon which the company is required to repay bondholders), a trading window opens up during which the bonds can be converted into shares at the conversion price.

In the case of the Microstrategy 2025 Convertible Bonds, the maturity date is December 15, 2025, and the conversion window extends from June 15, 2025 - December 14, 2025. During this period , convertible bond holders have the option to convert each $1,000 par value bond into Microstrategy shares at a price of $397.99. (Par value simply refers to the face value of the bond at issuance.)

These bonds trade actively in the open market, where prices started at their par value of $1,000 and have since fluctuated from as high as $3,000 to as low as $750, settling in at $950 as of June 14:



These prices reflect the market's expectations for the intrinsic value of the convertible bond based on the conversion feature. Since the par value of the bond is $1,000 and the conversion price is $397.99 each bond can be converted into 2.51 shares of Microstrategy stock – a number known as the "conversion ratio".

You can use this conversion ratio to determine the intrinsic value of the convertible

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bond, based on the Microstrategy share price. For example, if Microstrategy shares trade at $796 – or double the conversion price – then the $1,000 par value bond is worth $2,000 (excluding future interest payments).

Microstrategy's 2025 convertible notes also come with a modest coupon payment of 0.75% per year. This amounts to $7.50 per $1,000 in par value bonds of annual interest payments. This interest is paid out in semi-annual increments on June 15th and December 15th each year. If purchased today, the total coupon payments through the bond maturity on December 15th, 2025 would amount to $18.75 per $1,000 in par value bonds.

These factors converge in three scenarios where Microstrategy shares could trade between now and the conversion window in 2025. Given the stability in Microstrategy's core software business, the major driver of the company's economic fortunes, and thus the value of its convertible bonds, will be driven by the price of Bitcoin.

Let's consider three potential scenarios, based on a baseline, bear, and bull case for Bitcoin over the coming years.

The Baseline Scenario of Flat Bitcoin Prices

In the baseline scenario, we'll assume a $20,000 Bitcoin price, or roughly in the middle of its recent trading range between $15,000 and $30,000.. This would make Microstrategy's holding of 140,000 Bitcoin worth $2.8 billion. Plus, assuming a value of $1 billion on the core software business, this implies a total value for the business of $3.8 billion.

Based on the current share count of 12.9 million shares, that implies a fair value for Microstrategy of $295 per share. Since this is below the $368 conversion price, convertible bondholders would be incentivized to simply hold the bonds through maturity, and collect interest payments along the way.

However, these bonds trade at around $950 per $1,000 par value. This means that they stand to realize gains of 5% when they're repaid the full par value, plus another roughly 2% in interest payments. This reflects a total return of 7% by simply holding the bond through the December 2025 maturity date as shown below:

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Baseline Scenario for MSTR 2025 Convertible Bonds	
Bitcoin Price Assumption	$20,000
Value of MSTR Core Business (M)	$1,000
Value of MSTR's 140000 Bitcoin Holdings (M)	$2,800
MSTR Intrinsic Value (M)	$3,800
MSTR Share Count (M)	12.9
Implied MSTR Share Price	$295
$1000 Convertible Bond Value	$1,000
Total Interest Payments per $1,000 in Par Value	**$18.75**
Total Return on 2025 MSTR Convertible Bonds Purchased at $950	**7%**

So even if the price of Bitcoin goes nowhere, these bonds offer the potential to generate a very respectable 28% return over the next roughly three years.

Scenario #2: Bullish Bitcoin

Next, let's assume a Bitcoin bull case where prices reach $100,000 per coin by 2025. In this scenario, the Bitcoin component of Microstrategy's value surges to $13 billion, bringing the total market value to $14 billion.

First, though, it's important to note that when convertible debt converts into shares, the company's share count increases. In the case of Microstrategy's 2025 convertible bonds, $650 million in par value bonds were issued. Based on the 2.51 conversion ratio per $1,000 of par value bonds, this $650 million in debt becomes 1.63 million new Microstrategy shares upon conversion, for a roughly 12% increase in total shares outstanding.

With that in mind, the implied fair value per share of Microstrategy at $100,000 Bitcoin is $1,034 per share, and the $1,000 convertible bond becomes worth $2,597 (excluding interest consideration in the fair value). Adding in the interest component, and based on a purchase price of $950 per $1,000 par value in bonds, the total return is 175% in this bull case scenario, as detailed below:

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Bull Case Scenario for MSTR 2025 Convertible Bonds

Bitcoin Price Assumption	$100,000
Value of MSTR Core Business (M)	$1,000
Value of MSTR's 140000 Bitcoin Holdings (M)	$14,000
MSTR Intrinsic Value (M)	$15,000
MSTR Share Count (M)	14.5
Implied MSTR Share Price	$1,034
$1000 Convertible Bond Value	$2,597
Total Interest Payments per $1,000 in Par Value	$18.75
Total Return on 2025 MSTR Convertible Bonds Purchased at $950	175%

Scenario #3: Bitcoin Plummets

Finally, let's consider a bear case scenario — where the Bitcoin price falls by 50% to $10,000 per coin.

In this scenario, the value of Microstrategy's Bitcoin holdings would fall to just $1.4 billion. And assuming the same $1 billion valuation on the core software business, that would make Microstrategy's total intrinsic value equal to $2.4 billion, which is slightly more than its total debt of $2.2 billion.

So even in this downside scenario, Microstrategy's assets would exceed its liabilities, meaning the company would be able to repay bondholders at 100 cents on the dollar (importantly, note that this relies on the key assumption that Microstrategy's operating business is worth $1 billion).

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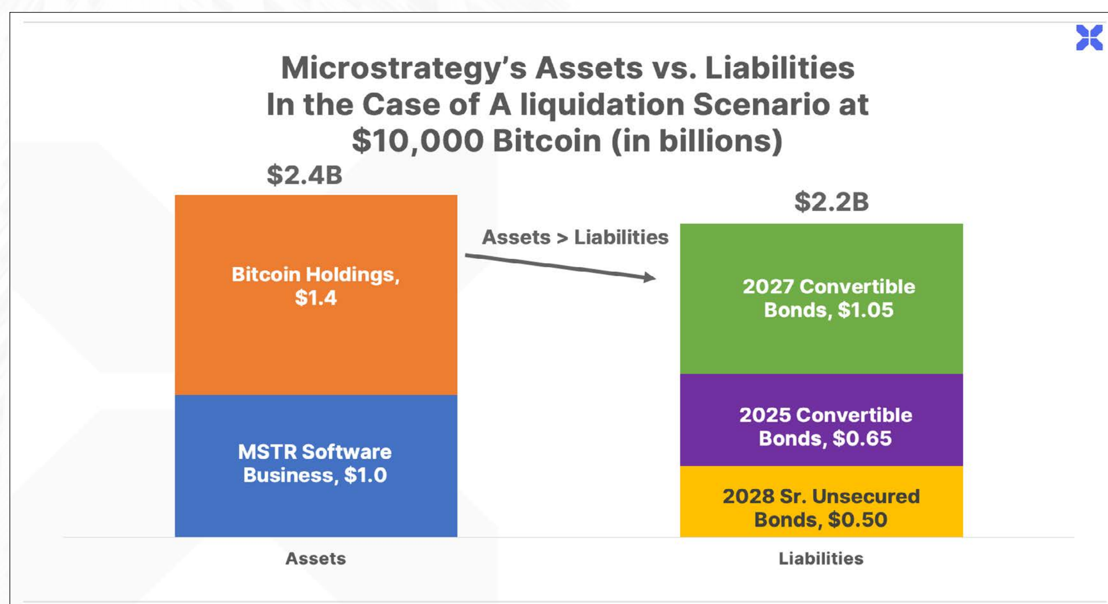

In other words, based on these assumptions, Bitcoin could fall by 60% from today's price of $25,000 and investors can still expect to earn a positive 7% return from the 2025 Microstrategy convertible bonds. This return would come from the 5% gain from the bond a repaid at par value, plus 2% in total interest payments earned along the way.

That's why we view this as a safer way to get exposure to a Bitcoin bull market – plenty of upside exposure to higher prices, with a margin of safety in case prices fall further from here.

As things stand today, Microstrategy's current annual interest expense is approximately $48 million per year. Based on an expected annual operating cash flow of around $100 million, Microstrategy currently generates enough cash flow from its software business to service its debt. The company also had $94 million in cash on its balance sheet as of March 31, 2023 – enough to satisfy the next 12 months of interest payments.

Finally, one last thing investors should consider is the potential for an early repayment when evaluating the prospects for Microstrategy's 2025 convertible bonds.

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Early Conversion Features Could Limit the Upside Scenario

The 2025 Microstrategy Convertible bonds have an early redemption feature, which could limit the potential upside scenarios. If Microstrategy shares trade at 130% of the $397.99 conversion price in any 20 of 30 consecutive trading days, the company can issue an early conversion notice on these bonds.

Plus, other triggering events can force an early conversion at par value, including a change in control of the company. For example, if Microstrategy was acquired, then the acquiring company would have the option of buying out the convertible debt at the $1,000 par value.

Finally, these notes are redeemable in stock, cash or a combination of the two. So if or when conversion is triggered, Microstrategy has the option of paying holders of the convertible notes in shares or the cash-equivalent of the shares upon conversion, or a combination of both. In each of these scenarios, investors still stand to earn a double-digit return, given that the bonds trade at a discount or roughly $800 per $1,000 par value.

When considering this range of potential scenarios, these bonds offer a unique risk/return proposition for getting exposure to Bitcoin with a “heads we win” and “tails we don’t lose much” investment vehicle.

Action to take: The MicroStrategy 2025 Bitcoin Bond **(CUSIP: 594972AC5)** is no longer an active recommendation. We recommended selling the position in November 2023 and recorded an 82% gain over 13 months in our model portfolio.

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