FRMO Corp. Q1 2020 Conference Call

Tuesday, October 20, 2020

Thérèse Byars—Corporate Secretary

Good afternoon, everyone. This is Thérèse Byars speaking, and I'm the Corporate Secretary of FRMO Corp. Thank you all for joining us today.

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Today's discussion will be led by Murray Stahl, Chairman and Chief Executive Officer, and Steven Bregman, President and Chief Financial Officer. They will review key points related to the 2021 first quarter earnings.

A summary transcript of this call will be posted to the FRMO website in the coming weeks.

And now I'll turn the discussion over to Mr. Stahl.

Murray Stahl—Chairman & Chief Executive Officer

Thanks, Thérèse, and thanks, everyone, for attending. What I'll do today is point out some items on the income statement, point out some items on the balance sheet and give the audience some of the customary information, which is ever-growing, that they usually ask for. I'll highlight some things that we're up to that I think you'll find interesting, and then we'll turn it over for questions. I should tell you that I haven't seen the questions in advance. I have not the slightest idea what they are, but I have a feeling they're going to be very interesting.

So, with that, let's start with the income statement. The first thing you'll observe is a lot of big negative numbers and a lot of big positive numbers. If you can guide your eyes to the net income loss for the most recent three-month period, what you'll see is comprehensive income attributable to the company of roughly $182,000. So, what does all that mean? It means that our investment in Texas Pacific Land Trust (TPL) from May 31st to August 31st declined precipitously. But since we consolidate Horizon Kinetics Hard Assets (HK Hard Assets), a lot of that is not actually attributable to us. So, you back that out.

On the other hand, we had a fair amount of appreciation in our investment in the South LaSalle Fund, our vehicle for holding our seats in the Minneapolis Grain Exchange (MGEX). The Minneapolis Grain Exchange is in the process of merging with Miami International Holdings, otherwise known as MIAX. MIAX started its life as primarily an options exchange, and on September 25th, began operating a real-life equities exchange. For almost a month they've been operating an equities exchange called MIAX Pearl and it's getting to be a pretty big outfit. So, those are some of the income statement highlights.

On the balance sheet, the first thing I direct your attention to is that net income for the quarter is only $182,000 of net income—well, those are the GAAP rules. But if you'll turn your attention to shareholders' equity attributable to the company, on May 31st, it was a bit less than $115 million. Now we're up to $116.2 million. That's the shareholders' equity attributable to ourselves as shareholders—all of us, collectively, on this call, and the other FRMO shareholders.

I believe the record shareholders' equity for FRMO is roughly $127 million. We've been through an oil price crash, we've been through a global pandemic, and a lot of other things in the last six months. And our thesis was that we were prepared for some gruesome things. Well, I leave it to you to look at the share price of TPL and some of the other things that happened, and this is where we are: $116.2 million in shareholders' equity, down from a record $127 million. So, all things considered, for a global pandemic and a worldwide depression, I have to say not so horrendous. I wouldn't want to experience it again—you're never really prepared, but we were reasonably prepared for this sort of thing.

The other points are statistical, so I will just read you some numbers, if I may. We're always asked the question: What is our direct and indirect ownership of Texas Pacific Land Trust? In sum, as of the most recent period, it works out to 52,534 shares as of September 30th, so it doesn't exactly correspond with the August 31st number. I thought I'd give you the most recent. And then the next question we normally get is, What is the quantity of GBTC? GBTC stands for the Grayscale Bitcoin Investment Trust. That share quantity—also, incidentally, as of September 30, 2020, so it doesn't exactly correspond—is 560,831 shares.

The next thing we are normally asked involves direct coin ownership. Now, these are coins that we own directly and also some coins we own indirectly through the private partnerships. First, direct, and then the indirect. These are our pro rata interests: direct bitcoin, 66 coins. Now, that is rounded. Normally, we give you the decimal points, but maybe it's better this way because it changes every day in the up direction. So, 66 coins. Litecoin, again, coins that we mined ourselves, 536 coins. Ethereum, 35 coins. Ethereum Classic, 662 coins. And Zcash, 52 coins.

Indirect ownership via the private partnerships: Bitcoin Cash, 91 coins. Bitcoin SV, 91 coins. The Grayscale Ethereum Classic Investment Trust (ETCG)—we had some Ethereum Classic coins in the funds, and we contributed them for shares of the Ethereum Classic Investment Trust, of which we own 1,546 shares. And then we had some bitcoin cash, which we contributed to the Bitcoin Cash Investment Trust, of which we own 1,375 shares. We also have XRP, otherwise known as Ripple Investment Trust: 448 shares. We have the Zcash Investment Trust, with 542 shares. And we happen to own indirectly through the funds 209 coins of Bitcoin Gold. Bitcoin Gold, you might recall, is one of the forks of bitcoin that occurred several years ago, and we ended up collecting Bitcoin Gold which we never sold, so that's our pro-rata ownership.

What are we working on? A couple of interesting things. Number one, in 30 days, we at Horizon Kinetics are going to launch an ETF. It's the first time we've ever launched an ETF, and the theme is going to be inflation-oriented investments. We're doing it for a couple of reasons. Number one, we think we're going to have some inflation. We could be wrong about that, but we think that's coming.

Secondarily, whether we're right or wrong, and that's merely a forecast, the popular indexes have moved so radically away from any inflation beneficiaries that inflation beneficiaries as a portion of the index, or the popular index, is fairly de minimis. So, the world needs a product like that. And then it's actively managed, as opposed to passively managed.

Why actively managed as opposed to a passively managed ETF? Even though I haven't seen the questions, I have a feeling I'm going to get one about this. So, forgive me if I might be answering part of it in advance, but the thing about the indexes is—and we've written about this many times—in the fullness of time in any index, something's going to be the best investment and it's going to be the biggest position just by appreciation. Every index ultimately gets top-heavy. The issue becomes, if you're passive, well, you have to accept that. And if you accept it, the first question is, are you even diversified? Meaning that if your best investment is too good, in a way, it's a little bit of a curse because you may not want to be that concentrated. It's one thing to be concentrated because you chose to; it's another thing to be concentrated because it happened to you.

In the case of an index like the S&P 500, it's concentrated in technology stocks, obviously, and it may well be that that continues for a very long time. But is that something that people really want and desire? Another way of looking at the same phenomenon is, instead of looking at the biggest investments in the S&P, look at the smallest. Then ask yourself the question: How many positions in the S&P are one basis point in size? How many are two basis points in size? If you look, you will observe a shocking number of such positions. Now, obviously, if an investment is only a couple basis points in size, it could go bankrupt any day and be worthless by the close of business, and still have no material impact on the value of the S&P 500.

But if you look at the companies themselves in terms of their revenues, their total assets, how many people they employ, what relationships they have with other companies, and so on, you would then see something else. If those companies—de minimis though they are in the index as weights—were to actually go bankrupt, it might have a de minimis impact on the index, but it'd be disastrous for the global economy and even more disastrous for the U.S. economy. What does that mean? That the index—as a matter of definition, if you look at it that way—is no longer diversified in the sense that it doesn't reflect the economy; it just reflects the best performing stocks. But the purpose of the index is to be diversified *and* representative of the general economy, not to be a super-charged vehicle with the best companies that ever existed on the planet. They may be the best companies, but it's gotten away from indexation.

I believe we have to bring indexation back to where it was, and we need to bring diversification back to where it needs to be. It's almost bizarre for me to be saying this, but I don't think you can move back to a classically diversified position without adding active management. So, we're launching this ETF and it's the first one we've ever done, and I think we're going to do others in the fullness of time.

The other thing I'd like to say is that subsequent to September 30th, FRMO is investing $2,700 to try to build our own cryptocurrency mining machine. Obviously, if we fail, it's only $2,700. We're going to give it a try, and I actually believe we can do it. And if we do, it opens up a different kind of opportunity for us in the world of mining. I think we've gotten a lot of experience just through the last couple of years. We've learned a lot and, if we could pull it off, it would greatly raise our return on invested capital. It would also have implications for our investment in Winland Holdings. As you probably know, we bought some more shares of Winland. We're up to a 28.39% ownership.

Winland itself, now with its mining, has, as of this reckoning—this is September 30th, again—2.9898 bitcoin. We can round it up and call it 3. Our proportional ownership, if this is even important to you, is 0.8488 of a coin. So, if you want to add nearly one bitcoin on a look-through basis, you can do that. I don't know if it's going to change your calculations, but there it is. Anyway, if we could develop a mining rig assembly capability, it would dramatically raise our returns on capital, not just for ourselves but for Winland as well, because we're both going to be mining and it's worth a try.

With that, I'll ask Steve: Do you want to add anything to what I just said in terms of the outline?

Steve Bregman—President & Chief Financial Office

No, not so far. I find this very engaging.

Murray Stahl—Chairman & Chief Executive Officer

Okay, good.

Steven Bregman—President & Chief Financial Office

I'll listen some more.

Murray Stahl—Chairman & Chief Executive Officer

Great. And now, Thérèse, if you'd be kind enough to read the questions?

Questioner 1

What is the look-through ownership for FRMO shareholders of MGEX and the pending transaction with Miami International Holdings?

Murray Stahl—Chairman & Chief Executive Officer

So, two things there. Let me give you the numbers first. As I said before, the vehicle via which we own shares in the Minneapolis Grain Exchange is South LaSalle, which owns 110 seats of the total 402 seats. That means South LaSalle owns 27.36% of the entirety of the Minneapolis Grain Exchange. As of September 30th, FRMO owns 29.91% of the South LaSalle Fund. So, you could multiply the 110 seats by .2991. I know it won't give you a round number, but that's, on a look-through basis, how many seats we own in the Minneapolis Grain Exchange.

In terms of MIAX, you might recall that even though we had a few shares already, we actually got the bulk of the MIAX shares we currently own by exchanging the Bermuda Stock Exchange for MIAX shares. You'll observe, when you look at the notes in the financial statements, our carrying value for our investment in MIAX is $4.33 million. Obviously, we could theoretically take some cash as part of the deal, but we don't want it; we want MIAX shares. So, we're tendering all our seats for MIAX shares. Assuming this deal closes in due course—I don't know if it'll close by November 30th, it's possible, but it should be closed by the end of the year—then by February 28th, we're going to have a lot more MIAX on a look-through basis. So, I hope that answers that question.

Questioner 2

I have a series of others, and some cover that same topic. But first is, "What is the current ownership percentage of FRMO in South LaSalle," which you answered. South LaSalle has acquired additional seats after the end of the quarter. Will these purchases increase the exposure of FRMO in MIAX in any way?

Murray Stahl—Chairman & Chief Executive Officer

Well, it doesn't and the reason is because the South LaSalle Fund took in more money and so we were using that money. FRMO itself did not, during the quarter or subsequent to it, invest more money in South LaSalle. It's just that South LaSalle happens to own more seats. On a pro rata basis, we have the same number of seats.

Questioner 3

South LaSalle is a hedge fund. Is the investment of FRMO in South LaSalle subject to management and/or performance fees, and does that differ from other LPs?

Murray Stahl—Chairman & Chief Executive Officer

So first of all, South LaSalle is not a hedge fund, because it only owns one asset other than some cash; it owns the Minneapolis Grain Exchange. It's just a partnership that exists to hold seats of the Minneapolis Grain Exchange. We ourselves don't pay a performance fee. There are clients who are in the fund for whom, if this is a successful investment, there would be a performance fee. So, that performance fee would be collected by Horizon Kinetics, and I guess we would participate via our interest in Horizon Kinetics.

Questioner 4

Horizon Kinetics recently filed a prospectus for an actively managed ETF. Can you talk about HK's strategy with active ETFs going forward?

Murray Stahl—Chairman & Chief Executive Officer

I referred to this a bit earlier—the first one is the inflation ETF. Believe it or not, I think there are something like 1,700 ETFs in the United States. I just looked this up the other day, and I actually don't believe the number, but my source is the World Federation of Exchanges. You can look it up, and maybe I read the wrong line, but I don't think so. Globally, there are well over 15,000 ETFs. That's a big number. And I believe there's only one ETF that we could find that you can argue is a beneficiary of inflation. So, why is it a big deal? Because unlike other assets in the world of ETFs, it's very hard to passively define an inflation beneficiary. Let me elaborate on that.

Most ETFs are either in an index like the S&P 500, the NASDAQ 100, Russell 3000, or something like that, where the definition of membership is just being part of the index. There's no stock selection involved; there's no analysis. If the S&P says you're part of the index, then you're part of the index, whatever the inclusion criteria are. Regarding inflation, it's different because the functional problem is if there were inflation, would the expenses go up faster than the revenues? If so, then you're not an inflation beneficiary. Or would the revenues go up faster than the expenses? In that case, you would benefit from inflation. But how do you know in advance without doing some analysis? And even if you do some analysis, it's not easy to do.

The basic problem for most companies is that their biggest expense is the people. I'm making up a number for illustrative purposes—this is by no means a forecast—let's just say the inflation rate were 10%. If a company were producing a certain product, is it possible the company could raise its price by 10%? Of course, it is possible. Could the company then say to the employees, the inflation rate is 10%, therefore, I will grant a 10% across-the-board salary increase, so everyone can deal with inflation? Yes, of course.

However, the oddity is if the company did that, the employees would actually not keep pace with inflation. I know that sounds arithmetically strange, but why is that? It's because we live in the world of a progressive tax system. If an employee makes X, whatever X happens to be, and wages rise by 10%, then they happen to be in a higher tax bracket and, therefore, the after-tax income wouldn't rise by 10%; it would rise by something less than 10%. The only way to remedy that is for the company to increase wages by more than 10%. But if the company does so, it would not be a beneficiary of inflation; it would be hurt by inflation.

Then you could say, well, why can't the company raise the price of its product by 11%, 12%, 13%, or 14%, or some other number? Of course that's theoretically possible for a given company, but it's not possible in the aggregate. Because if every company raises their prices on their goods and services more than the rate of inflation, that would no longer be the rate of inflation, by definition. The sum total, weighted of course, of all the price increases would be the new inflation rate.

So, the only kinds of companies that really work in this circumstance are those that have relatively low people expenses in relation to their revenue. But not all of them work. You have to do a certain amount of analysis and that requires active management. Therefore, the ETF strategy, at least primarily, is that there are certain contingencies, and inflation is just one of them, for which one could arguably assert that one would like to be prepared. You might or might not think there's going to be inflation, but very few people would assert that the probability of it is zero. Now, maybe the probability is 1 out of 100, or 1%. If that's true, a person who actually believed that might say, well, I'll put 99% of my money in the S&P 500 and I'll put 1% of my money in inflation beneficiaries. That would be a reasonable diversification of assets. And maybe they believe the probability is 2%, or 2 out of 100, in which case, they'd change their asset mix accordingly.

So we think there's a market for it, just because of the rise of indexation. That represents a concentrated variable that has a market for other contingencies, which can't be provided for—it's impossible—on a passive basis, and must be provided for on an active basis. That gives you an idea of the ETF strategy. And we've got other strategies soon to be launched, so stay tuned.

Questioner 5

The next has two parts and it's also related to that. Can you give some insights into how different active ETFs are structured, such as portfolio confidentiality and transparency? Will the Horizon Kinetics active ETFs be materially different in structure than, for example, those of GAMCO (with ActiveShares) or Ark Invest?

Murray Stahl—Chairman & Chief Executive Officer

In terms of an ETF, we don't really need any confidentiality. What we're doing is pretty open. It's the result of research. There's nothing proprietary there, other than the analysis we do, just like the companies. And we basically share it with anyone, in any event. I don't think we're going to need any unusual secrecy arrangements. It's going to be pretty open and honest with people and I can't imagine we're going to have trillions of dollars in it. If we ever did, maybe we'd seek another arrangement. But we're going to have enough money to execute exactly what we want to execute, whenever we feel like executing it. So, there's no reason to hide, and we're not going to. Everything's going to be transparent.

Questioner 5 (cont.)

And did you want to mention anything about how it's structurally different from GAMCO's ActiveShares or Ark Invest?

Murray Stahl—Chairman & Chief Executive Officer

Every ETF has slight nuances, and we're using something slightly different, but it's just not material. There's nothing proprietary, there's nothing unique about it—no patents, no proprietary technology. Everybody uses a slightly different methodology, and we'll use ours, and it'll be pretty well disclosed once we're out there.

Questioner 6

Does FRMO still have plans to move from Pink Sheet listing to an OTC markets listing?

Murray Stahl—Chairman & Chief Executive Officer

In the last six months or so, given what we went through, it wasn't our top priority. But eventually, we'll get around to that. It just isn't something we're working on right now.

Questioner 7

Any thoughts to a stock buyback? I know it's been discussed as a possibility in the past.

Murray Stahl—Chairman & Chief Executive Officer

Well, last quarter we actually bought back a little stock. The problem is that for us, because we're a closely held company, I don't think a stock buyback is going to affect our valuation, because the valuation is really set by the handful of people who trade it. All it means is we're going to have less cash to do things with. And opinions of the handful of people who trade it are not going to change if we bought back 5%, 10%, or 20% of the float. We're not going to get an entirely new base of shareholders.

It might be very different if the bulk of our shares were in the float, but I don't believe a share buyback is going to have any material impact on valuation. Or put it this way: you could say that there'll be fewer shares outstanding and maybe we'll get more appreciation on the assets, though with less cash. In that sense, there could be an improvement, but then our shares would be less liquid, and the next complaint is going to be what it's always been: What are you going to do to improve the liquidity of your shares? I don't know that I want to go down that road in a meaningful way. Although, having said that, we bought some shares back last quarter.

Questioner 8

How has the recent Bitcoin halving affected the mining business? Has the profitability been lessened?

Murray Stahl—Chairman & Chief Executive Officer

The profitability is not lessened. The issue in the mining business is basically to buy machines with your excess cash flow. Lately—and this is entirely my fault—I have not been buying the machines. I've kept cash in reserve. You can argue that I should've been buying more machines, but I didn't for a number of reasons.

One is not just because of the tariffs, but there was a lot of disruption in just getting delivery because of the pandemic issues. The idea of laying money out and getting delivery four months later—because a machine only lasts so long—that's four months of its productive life. That's not a trivial amount of time, because eventually there'll be another halving that affects profits, so each month of productivity makes a difference. I didn't like that idea at all.

And secondarily, I thought there was an opportunity to actually build our own machines. If we could build our own, we could get the parts fairly quickly, like in four to six days. We have the room, we own a building, we could buy a lot of parts if we really had to. We've got storage. We can take our time and we're not risking a lot of capital. It could be a lot more profitable than buying machines.

If it's not, and it turns out to be a failure, we risk hardly any capital and we can go back to buying machines. Because eventually, like all pandemics, this pandemic will have an end. At that point, we might get the equipment quicker and maybe one day we won't have to pay the 25% tariff, which affects profitability. So, basically, you're paying more for every machine. Now, I'm ignoring the shipping costs. It's one thing to get it shipped from the Far East, it's another thing to get the parts shipped when they can be found locally. That's what we are doing, at least in the short run.

Questioner 9

You have discussed the depressed shipping sector in a positive light many times over the last several years. Container ship rates just hit a five-year high and are still increasing. Any update or thoughts on the sector regarding this promising development?

Murray Stahl—Chairman & Chief Executive Officer

Well, it is a five-year high, but it's only because the five years that preceded it were so low. So, it's higher than it was, but nowhere near what it could be. You could say it's improving to a modest degree. Basically, there hasn't been shipbuilding for five years, and even if it were to start tomorrow—I just can't imagine it would start tomorrow—but even if it did, it would take years for those ships to get to the market. Every ship is getting older every single day. And eventually they get scrapped. They're just no longer efficient. There are changes in regulations, there are changes in fuel consumption laws and whatever. So, it's an improvement.

The sector is very far from having the profitability that it could theoretically have. Having said that, and having been through a number of these cycles, once it actually gets to an acceptable level of profitability, that happens just unbelievably rapidly, once it commences. If you look at the Baltic Dry Index, it's improved, but it's nowhere near what it could be. So, though we're still waiting for the big profitability, I'm glad to see it's improved.

Questioner 10

I believe you have stated in the past that FRMO's initiatives in the mining of bitcoin had the potential to be more profitable than investing in the currency directly. It's difficult for the typical investor to see how this could be achieved. Could you explain the optimal mining potential and project the kind of return that this would result in?

Murray Stahl—Chairman & Chief Executive Officer

Let's put it this way: theoretically, you have two ways get bitcoin. You can buy it in the open market or you can mine it, which means you get the machines, put them in a hosting facility and do what needs to be done. That's a lot of work. So, if you got exactly the same result, I don't know why anybody would go and do the mining. It would be pointless. You might as well just buy the coins. But if no one did the mining, you couldn't have bitcoin. There's got to be a profit.

The question (and the problem) is how much profit there's going to be. In the world of all cryptocurrencies, just like in all businesses, there's what you call the rent-seekers. There are all sorts of intermediaries along the way. There's the mining pool operator that pools all your hash rates. Not yours, but all the other people, so you can get a modest daily payment instead of great big one but maybe only once a year. Kind of like everyone teaming up to buy a lottery ticket. There are the people who host and therefore are selling electric power. There are the people who do repair work, and so on and so forth.

You've already heard one example of the things we've been doing, which is investing a limited amount of capital to go around all the intermediaries. We want to get to the point where we're doing everything ourselves, including building the machines, hosting, doing everything. In order to do that, we basically had to spend some time learning how to do all those various things, like how do you buy electric power more cheaply? What are the optimal times to operate during the day? When you host, there's only one option: to run the machines 24/7. But in the world of buying power, there are times during the day when power is cheaper. So, you learn it might be better if you had control over the whole operation, to operate the hosting facility only part of the day and that it could dramatically improve the profitability. Or the other idea I alluded to earlier: What if you built your own machines? That would be a lot cheaper than if you buy the machines from someone else, and so on and so forth.

So, over the last couple of years, we've been developing expertise and doing this mining thing better and better. And for those experiments, we haven't used any client money; we only used our money. And I can't tell you that every experiment was successful. When you experiment, it doesn't always work out. But it's been better, I have to say, than we had any right to expect, and it's a learning curve like for everything else.

So, assuming we're successful in everything, what will the rate of return ultimately be? The honest answer is: I don't know. I can just say I wouldn't do it if I didn't believe it's going to be far higher than simply buying the bitcoin, even though we've obviously bought a lot of bitcoin.

There's another thing to think about in this regard, and it might be a minor point, but it's worth stating again. I have this theory that mint coins ultimately are going to be worth much more than ordinary purchased coins. Why is that true? Because ultimately, I believe Bitcoin—and the other ones as well—is going to be a regular means of transaction and it's going to happen via banks. Banks, because for the Know Your Client rules, it's going to be very, very difficult to prove that money is untainted unless you had a coin with no record on it; that it went through no hands.

I believe there's going to be a business one day in which a bank leases mint coins. So, FRMO now has 66 bitcoins in all, and hopefully one day we'll have a lot more. They've never been traded. We can prove beyond any doubt that we made those coins, and that they have never been traded. The provenance is known. If we leased those coins out to a bank and they can only be used by that bank's clients, the bank's transactional activity will correspond to its Know Your Client rules and it can comply with all Treasury Department regulations. We'd get a fee for doing that. In other words, we'll still own our coins because they're our property, just like if you leased a piece of land or an office building, it's still your property but someone else is using it and you get a rent. The difference is, unlike owning a piece of real estate, we have no operational expense. Whatever operational expense there is in transferring those coins hither and yon, that's borne by the bank and we just get a fee. Therefore, we would get a fee, which would probably be some percentage of the market value.

If our costs were sufficiently low, the way you might look at it is this: Let's say, just for the sake of argument, we had 100 coins and it cost us $5,000 each. One day, a coin might be worth a million dollars. And let's say we get a 1% fee for leasing it to a bank. Well, 1% of a million dollars is $10,000. If we assume the cost basis is $5,000, the yield on cost would be 200%—we'd actually have a 200% return on the embedded capital and no ongoing expenses.

I personally believe it's going to happen. Now, those numbers are just for illustrative purposes. What if a bitcoin were worth $2 million? What if it were worth $10 million? Or $20 million? Imagine if it were worth $20 million a coin. It's not an outlandish number. And you get a 1% fee for leasing it. So, 1% of $20 million is $200,000. Your cost basis would remain the same, $5,000. Your return on capital would be astronomical.

Now, some people have written—this is not my idea, I'm just transmitting the ideas of others—about something called the bitcoin reserve. So, what is the bitcoin reserve? They define the reserve to be the coins that are custodied by the various so-called crypto exchanges. I'm involved in securities exchanges. They have a very precise legal definition and are subject to certain regulations, and the crypto exchanges are not exchanges in the way I think of it. They're really broker-dealers, but they call themselves exchanges, and they happen to custody the coins.

So, you could look at it this way, as some people do: the coins in custody are the liquidity reserve. If I wanted to buy a bitcoin, I would have to go to one of these exchanges, which I call brokers, and I'd put an order in for one bitcoin, and presumably the bitcoin would come from somebody who wants to sell it, where the coins are custodied. That's liquidity reserve.

In the last two-ish months, maybe a little longer, the bitcoin reserve—remember, this is the sum of all the coins that they have custodied in all these various exchanges—has been declining. I don't remember how much it declined by, but it's fairly substantial in a relatively short period of time. So, the world of supply appears to be shrinking, and the world of demand appears to be growing because there are Bitcoin funds starting all over the world and there are people getting introduced to Bitcoin and other cryptocurrencies as well. Like anything else, when supply and demand are in the right balance, the price usually goes up. A lot of people are very optimistic about it for that reason, and it could change upward in a radical way in the not-too-distant future. That's their basic investment thesis.

Questioner 11

What percentage of FRMO's cryptocurrency exposure is allocated to Grayscale? You gave us those numbers.

Murray Stahl—Chairman & Chief Executive Officer

Yeah, I gave you the numbers. So, obviously, the bulk of it is Grayscale—in the Bitcoin Investment Trust—and some of the smaller ones as well, like the Bitcoin Cash Investment Trust, and the XRP Investment Trust.

Questioner 12

Recently, Horizon Kinetics filed for an ETF. Will it be a standalone or are you considering a family of ETFs? And how will they be marketed against the large ETF families, so they could become largely held and potentially reach $1 billion or more?

Murray Stahl—Chairman & Chief Executive Officer

To begin with, as I mentioned, Horizon Kinetics filed for an ETF and, hopefully, if everything goes right, more or less 30 days from now—you never know exactly because you're dealing with the regulators—we will have an ETF. We wouldn't be doing it just to have one ETF. There are going to be other ETFs that will follow. I know you'd like me to tell you what they are, but I think we have some pretty good ideas. If it's a great idea, people with more resources could be listening to this call and they'll do the ETFs. It's not that I have any great secrets, but I don't think it's such a great idea to tell you what it is, although I would love to.

We've actually hired a couple of people who are going to market it. You never know how much money you're going to get, but the preliminary indications of what we believe we're going to get on the first day exceed my expectations. I'm not saying we're getting a billion dollars, of course. Everything we're going to do in all the ETFs will be unique. Anything we do is going to be different than anything anybody else has done before.

Questioner 13

Have you considered a crypto ETF and can FRMO participate?

Murray Stahl—Chairman & Chief Executive Officer

As far as a Bitcoin ETF goes, they actually just approved an ETF that owns nothing but bitcoin. I don't know that I'm interested in doing that, because ultimately that falls in the genre of passive. Eventually, a lot of people are going to figure out the technology of how to do it, and there'll be Bitcoin ETFs all over the world, and they'll be available for a handful of basis points. I don't think in the long run that's what we want to do.

Now, there are interesting things to do in cryptocurrency and I hope we're doing some of them. I'd rather devote my attentions in that direction rather than just going for a lot of AUM in a very short period of time that might deteriorate into a very low fee. I'm less interested in what I would call gigantism, which is what that is, and more interested in proprietary products. So, I hope we're moving in the direction—or I hope you agree we're moving in the direction—of proprietary things. So, a Bitcoin ETF is not on our to-do list right now.

Questioner 14

The next question has to do with inflation. At the conclusion of some recent commentary, a mention was made that there seemed to be signs that there was a transition of sorts going on into a more inflationary environment. Inflation headed to an "above trend" level. Also mentioned was an increase in interest rates, but your indication seemed to be that the increase would be muted. Can you comment on these descriptions?

Murray Stahl—Chairman & Chief Executive Officer

Let me do the interest rate question first. Other than irrelevant increases, I don't think the world can afford an interest rate increase. An increase of a few basis points in rates is irrelevant, so we're going to disregard that. But let's just say, for the sake of argument, rates went up by 1% across the board. I'm not forecasting. I'm just using it as an illustration. The total debt of the United States of America—that's not the federal debt, that's every piece of debt that everybody owes, everything from a federal bond to a credit card loan, to a student loan, to a municipal bond, to a state bond—comes to a total of $84.4 trillion. How do I know that? The National Debt Clock, or the U.S. Debt Clock as it's called sometimes, gives that information.

The total interest paid right now annually on that $84 trillion is $3.859 trillion. So, what do you pay it from? You can only pay it from the GDP. The GDP of the United States is roughly $19.7 trillion, maybe $19.8 trillion. Let's say we're at $19.8, which I don't even think it is, but let's say it were. So, I take $3.859 trillion and divide by $19.8 trillion. That means roughly 19.5% of the U.S. GDP, or national income, is used to pay interest. So, what if that number, $84.4 trillion – remember, the total debt of everything and everybody—even though I personally don't even have any debt really, and a lot of people don't. So, that makes it is even worse because it's concentrated in only a portion of the country's hands. Well, what's 1% of $84.4 trillion? That's $844 billion. So, take $844 billion divided by $19.8 trillion, and you get to see it moves the needle a lot. Now, I could've made it a 2% or 3% or 4% interest rate increase. But whatever number you want to use for your rate increase assumption—and remember, that $84.4 trillion is constantly, I mean every hour of every day, growing—you'll collapse the economy. People won't be able to pay the interest. It just cannot be done.

So, that's not going to happen. There are only a certain number of other things that can happen. Scenario number one: people can be reasonable and stop collectively accumulating that kind of debt. Unfortunately, I don't see any evidence of that. I wish it were true, but it's simply not. That number is going up incredibly rapidly and it's not only—and maybe not even primarily—for consumption purposes. For example, there's a $5 trillion private equity sector. All it really is, is leveraged equity. The way you enhance returns is by cheap debt. So, a lot of people try to enhance moderate returns by debt leverage because it's cheap. That's part of the problem. And the only brake, theoretically, is for the central bank to raise interest rates. That's the second possibility. But for reasons I stated before, they're powerless or unwilling, whichever descriptor you want to use, to do that. So, it's going to be a problem.

So that's two possibilities, and now we have the third possibility: That the debt is going to have to be monetized. Not just the federal debt, but the state debt, the local debt, even different kinds of private debt. And it is happening, because you saw the Federal Reserve invest in private partnerships run by the Treasury and it's buying every kind of debt you could possibly imagine. So, the debt is being monetized, but understand that the only way it can be monetized is by printing money, the money to buy that debt. It's already happening.

The only question is, what is the rate at which it's going to continue? Will it accelerate or not? I personally think it will, just because I watch the debt numbers accelerating. You won't stem the problem that way unless you accelerate the government's debt purchases along the way, and you can't accelerate the purchases without creating more money. The more money you create, the more inflation you're going to get because that's basically the definition of inflation—that the amount of money available is rising faster than the goods and services that are available. So, if you believe in the law of supply and demand, you'll get inflation.

That's what I ultimately see happening, and I think it's already happening. That's why FRMO's position is the way it is. That's why we have hard assets, that's why we have a hard assets portfolio, that's why we have cryptocurrency, and that's why we're doing the inflation ETF. We really believe that's going to happen. And I think a lot of people will come to see that. No guarantee I'm right, but that's the way we see it.

Questioner 15

Can you talk about your strategy at the RENN Fund and how it is developing?

Murray Stahl—Chairman & Chief Executive Officer

Basically, there are many types of investments that would be better off in a closed-end fund format. The problem with a closed-end fund is they all seem to go to discounts to net asset value. It's very hard to ask people to put up capital, and for them to see it, even if it's successful as an investment, go to a discount to net asset value.

That being said, there are some interesting holdings in the RENN Fund. I'll point to two of them. One, we have a very big tax loss carryforward which we're looking to utilize, and you would think that's worth something. Secondly, when we got control of the Fund, it included an investment called Petro-Hunter Bonds, and we put out a press release on this I think today. Theoretically, the bonds were worthless, but they're not worthless, and we actually got a fairly big payment on that a couple weeks ago. And we might get more payments. There are a lot of assets that you can do a lot of things with in a closed-end fund format that you really can't do in an open-end format, and we'd like to find ways to make the fund bigger. We're working on a lot of stuff. I obviously can't say what they are, but we're working on them.

Questioner 16

Now that the exchanges have been consolidated, MIAX, MGEX, and the Bermuda Stock Exchange, do you ever foresee a day when the entity becomes public? Also, what do you see happening with the BRIXX rollout on MIAX? The BRIXX is that commercial real estate index.

Murray Stahl—Chairman & Chief Executive Officer

Let's do the last part of it first. In a couple of years, the world of exchanges—this applies to every exchange, including MIAX—is going to be radically different than it is today. The way exchanges historically evolved is as follows: the exchange was a place for raising capital. Companies want to raise capital, people buy shares if they find them to be alluring investments, and then they trade. The exchange makes money from listing fees, from trading, obviously, and from selling the data. And investors put together portfolios of these companies. Some do it on a stock-by-stock basis, some do it on a macroeconomic basis, on the basis of believing that the economy is going to be good, or bad, or whatever.

The problem with that approach is that the securities, in general, no matter what they are, are highly idiosyncratic. So, what do I mean by idiosyncratic? I mean that what you think is going to be the performance over a short period of time, based on the variables you think are relevant, turns out not to be. I'll give you an example just in the FRMO case. Look at how much TPL, which is evident in our financial statements, declined between May 31st and August 31st. It's a lot. But if you look at the price of oil or natural gas on May 31st relative to where they were on August 31st or now even, they're higher, not lower. But how, then, can TPL go down that much?

In other words, if it was May 31st and we somehow had the *Wall Street Journal* of September 1st so we knew what the price of oil and the price of natural gas were going to be in three months, we would've thought that TPL would go up, but it didn't. You had perfect information about a future specific economic event, but your instrument for expressing that assessment gave you the opposite result. So, what does that have to do with MIAX? It has everything to do with MIAX and it has everything to do with every other exchange as well.

The new products coming out, and you'll see it in the index we refer to, but it'll be in many other indexes, work much differently. Instead of somebody saying, "I'm buying these stocks because I think the economy is going to be good, bad, or indifferent," you'll actually be able to make an investment based specifically on your forecast. You might say the GDP is going to be up 2% or 3% or something other figure, and if it is up that much or more and your analysis is correct, you'll get paid based on some pre-agreed upon formula. And if the GDP doesn't go up by that amount, or even goes down, you might have to pay in accordance with some prearranged formula. The idiosyncratic nature of investing will be radically different.

Once you have enough indexes like that, it should be fairly obvious that it makes conventional indexes completely obsolete. Why would you buy the S&P 500 because you think the economy is going to go up, if you can invest in the GDP figure itself? It's going to turn the world right back to active management. That's what's going to happen to the individual stocks, too. So, the new ways the markets are going to work are going to be very different. It's not that stock investing or options investing or anything else is going to go away, it's just not going to be indexed the way it is right now, because the current tools are just too idiosyncratic.

That being said, exchanges are going to be very different, and an exchange that owns a clearinghouse is going to be incredibly valuable because there are only three clearinghouses in the United States. One is owned by the CME, one is owned by the Intercontinental Exchange, and one is owned by the Minneapolis Grain Exchange. And I don't believe any more will be created, for the simple reason that it takes a lot of regulatory bandwidth to oversee a clearinghouse, because the operations are just so critical. And it's not so easy to do, by the way. It requires a lot of detailed work.

You can do the same thing with securities. The future for securities exchanges, basically, is that somebody's making an investment predicated upon a certain forecast, whatever it happens to be, and they have to put up money, and the money has to be held somewhere. Where is it going to be held? It's going to be held in the clearinghouse. So, that kind of business, from an exchange point of view, is fairly lucrative because it's tremendously scalable. I'm not saying there's ever going to be a GDP security, I'm just making it up as an example. Now, maybe somebody will get that idea and the next thing you know, there'll be a GDP security. It could happen.

Anyway, if they did obviously attract a lot of money, and a lot of money is deposited in the clearinghouse, the exchange business is a direct beneficiary, because it is an economy of scale business; the more throughput you have in the given operations, the more profitable it is. All the exchanges have that faculty, and they're all looking for trading products like that. That's the way exchanges are going to work in the future and that's what every exchange is looking to do. I don't think there are any exceptions in that regard. Obviously, some will be more successful than others.

Okay, that was our last question. In that case, all that remains is to do two things: one, Steve, would you like to give some concluding remarks? Do you have anything to add to what I said? Feel free to disagree with me.

Steven Bregman—President & Chief Financial Office

No, I don't think so. I'm good.

Murray Stahl—Chairman & Chief Executive Officer

Okay, he's good. Therefore, I hope you're all good as well. I'm pretty good. So, with that, I'd just like to thank you for your attention and thank you for your support. And, of course, we're going to reprise this in another three months. I hope you enjoyed the presentation and found it helpful. So, thanks everyone and we'll see you again in 90 days. Good afternoon.

Operator

Thank you, ladies and gentlemen. This concludes today's event. You may now disconnect your lines and enjoy the rest of your day.

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