



A SHORT GUIDE

**TO UNDERSTANDING
BITCOINS**

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Introduction

Bitcoin is a digital monetary system. Instead of “dollars,” the unit of currency is referred to as a “Bitcoin.” ***Like traditional money, bitcoins can be used to store and transfer value among other bitcoin users within the bitcoin community.***

Bitcoin is considered a cryptocurrency. The currency utilizes cryptography for management and creation of the currency.

There is a bitcoin protocol, which resides primarily on the internet. It’s possible to utilize the protocol on your smartphone, computer, tablet, and other computing devices. It’s easily accessible to anyone with common available technology.

Essentially, anything that can be done with conventional currencies can be done with bitcoins. It’s possible to buy and sell goods and services, give money to other individuals or organizations, or even provide credit to others. Bitcoins can be bought, sold, and exchanged for other currencies.

Bitcoin is considered by many to be the ideal currency. It’s secure, free from borders, and very fast.

Bitcoins are virtual. There are no physical bitcoins to be found anywhere in the world. The bitcoins are merely an

idea to convey value. All that's required is that other bitcoin users accept the same premise.

Interestingly, bitcoins are a peer-to-peer system. There is no central authority, computer server, or control point.

History

As with the founding of Facebook, the history of bitcoin is a little fuzzy, but these are the high points:

1. **In 2008, someone named “Satoshi Nakamoto” published a paper titled, “Bitcoin: A Peer-to-Peer Electronic Cash System.”** To the best of anyone’s knowledge, the author’s name is an alias. It has even been suggested that several people wrote the article.
 - The premise combined the previous technologies and philosophies of HashCash and b-money. ***The idea was to create an electronic monetary system that was completely decentralized.***
 - The primary innovation was a global accounting process that would take place every 10 minutes. This would allow the entire network of users to reach a consensus regarding the previous 10 minutes of transactions worldwide. The advantage of this process is the elimination of users double spending their currency.

- Previous attempts and electronic currency dealt with the double-spend issue by clearing transactions through a centralized clearing system. This is considered a weakness because a centralized location could be hacked.
2. **The actual bitcoin network was launched in 2009.** The first issuance of bitcoins was 50 coins. The value of the coins was negotiated by the users at that time.
 3. **The first notable transaction was 10,000 bitcoins for two Papa John's pizzas.** The transaction was indirect and did not include Papa John's as one of the involved parties. The first bitcoins weren't worth much!
 4. **There has only been one significant exploited vulnerability.** In 2010, 184 billion bitcoins were created. The transaction was quickly noticed, reversed, and the flaw was removed from the system.
 5. **By the beginning of 2013, over 1,000 merchants were accepting bitcoins as payment.** Many charities also began accepting bitcoins for donations. The Internet Archive gave employees the option to receive their salaries in the form of bitcoins.

6. **Bitcoins have ranged in value from less than a penny to over \$1,200. The value of a bitcoin is very volatile.** The value in November 2015 was roughly \$400. Who knows where it will be in a few months?
7. **The first government seizure of bitcoins occurred in June of 2013.** The DEA seized 11.02 bitcoins as part of a raid and listed the bitcoins as a seized asset.
8. **Also in 2013, Vancouver, Canada became the location of the first bitcoin ATM.** The ATM allowed the purchasing of bitcoins.
9. **Many larger companies are now accepting bitcoins.** These include Overstock, Zynga, and several Las Vegas casinos. There is even a bitcoin financial product on the U.S. Commodity Futures Trading Commission.

Bitcoins have a somewhat shady history. If you recall, the infamous Silk Road drug website relied on the use of bitcoins. **However, the use of bitcoins is becoming more accepted, and even mainstream companies are now getting involved.** Even the US stock market has investment options for those interested in bitcoins.

"I do think Bitcoin is the first [encrypted money] that has the potential to do something like change the world."

- Peter Thiel, Co-Founder of Paypal

The Advantages of Using Bitcoin

Bitcoin is a unique currency. It's completely virtual. **Bitcoin is unsupported by any central bank or other authority.** It's not the official currency of any country. Yet all of these are both advantages and disadvantages. Whether or not bitcoin is an advantage for you is dependent on your situation.

Bitcoins have several advantages over conventional currency:

1. **Bitcoins can't be physically stolen.** There is nothing physical to steal. In theory, however, someone could force you at gunpoint to send your bitcoins to someone else.
2. **It's possible to avoid taxes.** The onus is on the taxpayer to be honest about bitcoin transactions. There are many disagreements regarding the government's ability to track bitcoins through the system. Most of the investigative activity regarding bitcoins is centered on major crimes, such as drug trafficking.
3. **Bitcoins are extremely flexible.** You can pay anyone in the world at any time. Holidays, exchange rates, borders,

and the time of day are irrelevant. ***Bitcoins have far greater flexibility than any other type of currency system.***

4. **There are no transactional costs.** As there is no central authority, transactional costs are unnecessary. All of the computers on the system, including your own, are doing the heavy lifting. There's no one else to pay. You could send your child a million dollars' worth of bitcoins without it costing a single penny. Try doing that with your local bank or PayPal.
 - However, providing a small transactional fee will guarantee that payments are processed more quickly.
5. **Privacy is maintained.** Your personal information isn't required as part of the transaction. There's no risk of identity theft. The entire process is encrypted. Keep in mind that it's not entirely anonymous. All transactions are recorded and posted for anyone to view. However, your name isn't publicly associated with your transactions.
6. **Transactions cannot be reversed.** This is good news for merchants, but may be a disadvantage for consumers.
7. **The bitcoin code is open source.** There are no secrets, other than the identities of the parties involved in the transactions.

It's easy to see why bitcoins are useful in certain situations. You have a greater degree of privacy and a lack of transactional costs. **Bitcoins can be used at any time and on any day.** You can still make or accept a payment on Christmas day at 2:00 AM.

"[Virtual Currencies] may hold long-term promise, particularly if the innovations promote a faster, more secure and more efficient payment system."

- Ben Bernanke, Chairman of the Federal Reserve

Disadvantages of Bitcoins

There's a little bad news, too. Bitcoins have certain disadvantages. ***The lack of governmental regulation and the limited supply of bitcoins creates challenges.*** In addition, considering the total number of retail establishments, only a small percentage of them accept bitcoins.

Consider these disadvantages:

1. **The value of bitcoins is very volatile.** The number of bitcoins is limited, and demand can vary from one day to the next. So the value of a bitcoin can change very quickly. ***It's possible to earn or lose a tremendous amount of value very quickly.***
2. **Bitcoins are not widely accepted at this time.** While the number of merchants and individual users is increasing, bitcoins still are an uncommon form of currency. Bitcoins are becoming more mainstream all the time, though. The Federal Reserve Board reports that the number of bitcoin users is doubling every 8 months.
3. **It's possible to lose your bitcoin wallet and all of your bitcoins. *It's crucial to keep a backup of your wallet file.*** A hard drive crash, virus, or corrupted file will cause your

bitcoins to become permanently orphaned. You can never get them back. No one else can ever possess them, either.

4. **There's a lack of buyer protection.** If you pay for a product prior to receiving it, there's no recourse if the product isn't delivered. However, there are third-party escrow services that can protect buyers. If you're paying in advance with bitcoin, you may want to use one of these services.
5. **Bitcoins make it easier to commit crimes, including fraud.** The anonymity of bitcoin makes it attractive to those engaged in illegal activity. However, cash is still more widely used in illegal activities than bitcoins.

It's important to consider how the disadvantages of bitcoins dovetail with your situation. ***It's easy to lose all of your bitcoins if you're careless.*** You can also lose a lot of money quickly if the demand for bitcoins drops sharply.

Bill Gates: "[Bitcoin] is a techno tour de force."

Charlie Munger: "I think it's rat poison."

Warren Buffett: "I think either Charlie or Bill is right."

<http://video.foxbusiness.com/v/2359385547001/>

May 6, 2013

Liquidity of Bitcoins

The bitcoin system is capped at 21 million bitcoins. Currently, there are roughly 14,800,000 bitcoins in circulation. There is a lot of speculation about what will happen to the value when the 21 million-bitcoin limit is reached.

In general, the US stock market is very liquid. You can quickly sell most stocks, bonds, or mutual fund shares at the going rate without concern. There's always someone willing to buy from you or sell to you, provided the price is right.

Given the limited number of bitcoins and users, it's not as easy to sell your bitcoins if you wish to cash out. Even if you can find a buyer, even relatively modest transactions can create volatility in the price for a bitcoin.

▶ How Bitcoins are Created

Bitcoins are created through a process called “mining.” The first computer to solve a puzzle receives a certain number of bitcoins. ***Unfortunately, there are many other computers competing against yours.*** And you probably don't have a computer that can compete.

Mining bitcoins is extremely challenging. There are companies with powerful computer networks designed to solve the puzzles. The typical home user has no chance of winning.

When a puzzle is solved, bitcoins are created and awarded to the owner of the winning computer. The number of bitcoins provided decreases as the number of bitcoins in circulation gets closer to the 21 million-bitcoin limit.

With an adequate computer, the puzzles take approximately 10 minutes to solve. The winning solution requires quadrillions of operations per second. The difficulty of the puzzles can increase or decrease to match the current environment. Winning computers now utilize dedicated circuits rather than software to solve the puzzles.

Most of those competing spend more on electricity than they win in bitcoins!

"The currency of universal values make brands innately sharable."

-Simon Mainwaring

How to Sell Your Bitcoins

There are several options for selling your bitcoins. The process can be quite simple or a little more complicated, depending on the method. More options are becoming available as bitcoins become more popular.

Selling bitcoin online:

1. **There are websites that offer direct trades.** A few examples include *Coinbase*, *LocalBitcoins*, and *BitBargain*. Most direct trade sites require you to register as a seller. This means you have to reveal your identity. The website will post your wish to sell your bitcoins and buyers can accept your offer.
2. **Exchange trades are another way to sell your bitcoins online.** You'll still have to identify yourself, but exchange trades require less work on your part. You list the number of bitcoins you wish to sell and your desired price. When someone else places a purchase order that matches your requirements, the exchange will complete the transaction.
 - Most exchanges charge a small fee of roughly 0.2%.

- Many investors choose to store their bitcoins on exchanges, since their only interest in bitcoins is speculative. While the bitcoin system is essentially hack-proof, this isn't true for the exchanges. ***You could lose all of your bitcoins by storing your funds on an exchange site that gets hacked.***

3. **Peer-to-Peer trading marketplaces can also be used to sell your bitcoins online.** The most popular sites are Brawker and Purse. Instead of selling your bitcoins for a more conventional currency, you can exchange your bitcoins for products you wish to purchase. Consider this example of peer-to-peer trading:

- Mary posts her Amazon wish list to the trading marketplace, along with the desired discount. The discount can be up to 25%.
- John wishes to buy Mary's bitcoins and is agreeable to her terms. He will then purchase the items and have them delivered to Mary's address.
- When the goods have been delivered, Mary will then notify the marketplace and the bitcoins will be released to John. The exchange takes a small fee, and everyone is happy.

- It's also common for the purchaser to purchase a gift card instead of purchasing the goods directly.

The advantage of selling online is convenience and safety. The websites do the heavy lifting for you. ***There can be a fee for using these websites, but it's minimal.*** Selling online is the most popular option for unloading bitcoins, but it's not the only option.

You can also sell your bitcoins in person:

1. **Selling your bitcoins in person can be the simplest solution.** All that's required is to scan a QR code on the other person's phone and accept your cash payment. Nothing could be simpler.
2. **Agree on the price.** The common practice is to make use of one of the bitcoin exchanges to determine the price. There are apps available to determine pricing.
3. **Attend bitcoin meet-ups.** At *meetup.com*, you can find others interesting in bitcoin. It can be a great place to buy and sell bitcoins.
4. **Be safe if you're dealing with cash.** A public place is much safer than an abandoned warehouse. ***You're not doing anything illegal, so stay visible.*** Bring along a friend,

too. If possible, sell your bitcoins to a friend or family member.

5. **There are websites available to help you find local bitcoin buyers.** The most popular website is *localbitcoins.com*. Buyers and sellers are rated based upon their previous transactions.

There are several ways to sell bitcoins, from established online platforms to local meet-ups. ***Selling your bitcoins can take some time, depending on the current demand in the marketplace.*** Remember to be safe when dealing with cash. A public place is the preferable option.

“Right now Bitcoin feels like the Internet before the browser.”

- Wences Casares, global tech entrepreneur

▶ **How to Purchase Bitcoins**

The options for purchasing bitcoins are similar to those for selling them. You’re just on the other side of the transaction. Follow the same methods and do your research to ensure you’re paying a fair price.

How You Can Get Started

Now that you know how to purchase and sell bitcoins, you may wonder how to get started. ***There's little to be done once you have the software on your electronic device.*** The software is referred to as a wallet.

Get started with bitcoins in just a few minutes:

1. **Create a bitcoin wallet.** There is a variety of wallets available for different platforms: mobile, web, and desktop. Different wallets have different features. Be certain to understand the features and choose your wallet wisely.
2. **Secure your wallet. It's important to back up your wallet regularly. Remember, if the file is lost, your bitcoins are lost forever, too.**
 - Encrypt your wallet. Encryption ensures that no one can use your wallet without knowing the password, including you. Use a password that you can remember.
 - **An offline wallet is safest.** If your wallet is stored offline, only those with physical access to the storage

location can gain access to your wallet. Online storage is inherently more risky.

3. **Keep all software up to date.** Just as with any other type of software, bugs can appear from time to time. Keep your software up to date and you'll always have access to the latest features.

4. **Obtain bitcoins.**

- Buy bitcoins from an exchange.
- Accept bitcoins as payment for a good or service.
- Purchase bitcoins directly from another party.

That's all there is to it. ***There are countless online resources available to fill in the details.*** There are also many physical books on the subject. Much of the necessary information will depend on the wallet you choose. You can quickly learn all you need to know to use bitcoin as a currency.

"Virgin Galactic is a bold entrepreneurial technology. It's driving a revolution and Bitcoin is doing just the same when it comes to inventing a new currency."

- Sir Richard Branson

Bitcoins as an Investment

Investing in bitcoins is becoming more popular. **Many millionaires have been created through the buying, holding, and selling of this currency.** It's also possible to lose a lot of money. Bitcoin is becoming more mainstream every year, and even Wall Street is taking an interest.

There are two primary ways to invest in bitcoin at this time:

1. **The Bitcoin Investment Trust.** If you want to invest in bitcoins but leave the decisions to the experts, this is one option. Other similar investment options are popping up. You don't have to worry about maintaining a bitcoin wallet or make decisions about when to buy or sell.
2. **Invest directly in bitcoins.** This is very similar to investing in any other currency. The low volume of bitcoins ensures significant volatility. From mid-September 2015 to early November 2015, bitcoin prices nearly doubled!
 - If you have a strong stomach, it's possible to make a lot of money with bitcoins. However, it's questionable whether there is any way to make accurate predictions

about the value of bitcoins. There are many websites claiming the ability to predict bitcoin prices. None, however, has a proven record of accomplishment.

- ***Many experts consider investing in bitcoins to be similar to gambling.***

Currency investing is always exciting and rarely predictable. Bitcoin investing is even more so. ***It's definitely not the place to put your entire nest egg.*** However, if you're bold and stay informed, bitcoin is one way to invest with high risk.

*"Bitcoins can be traded or used for purchases,
but only with those sellers who will accept them.*

*Because it is a system independent of external meddling,
there can be no sudden devaluation of Bitcoins through
the actions of governments."*

- Kurt Eichenwald

Conclusion

Bitcoin is a unique currency and community. The users of bitcoin are often attempting to avoid the prying eyes of others. It appeals to conspiracy theory types. **However, bitcoin is also growing into a respectable and acceptable form of currency.** Larger companies and banks are becoming more accepting of and interested in bitcoin.

Consider your own situation and determine if bitcoin makes sense in your financial life.