NFT Madness

“Am I dreaming? Has the world gone mad – or have I?”
– English writer, H.G. Wells

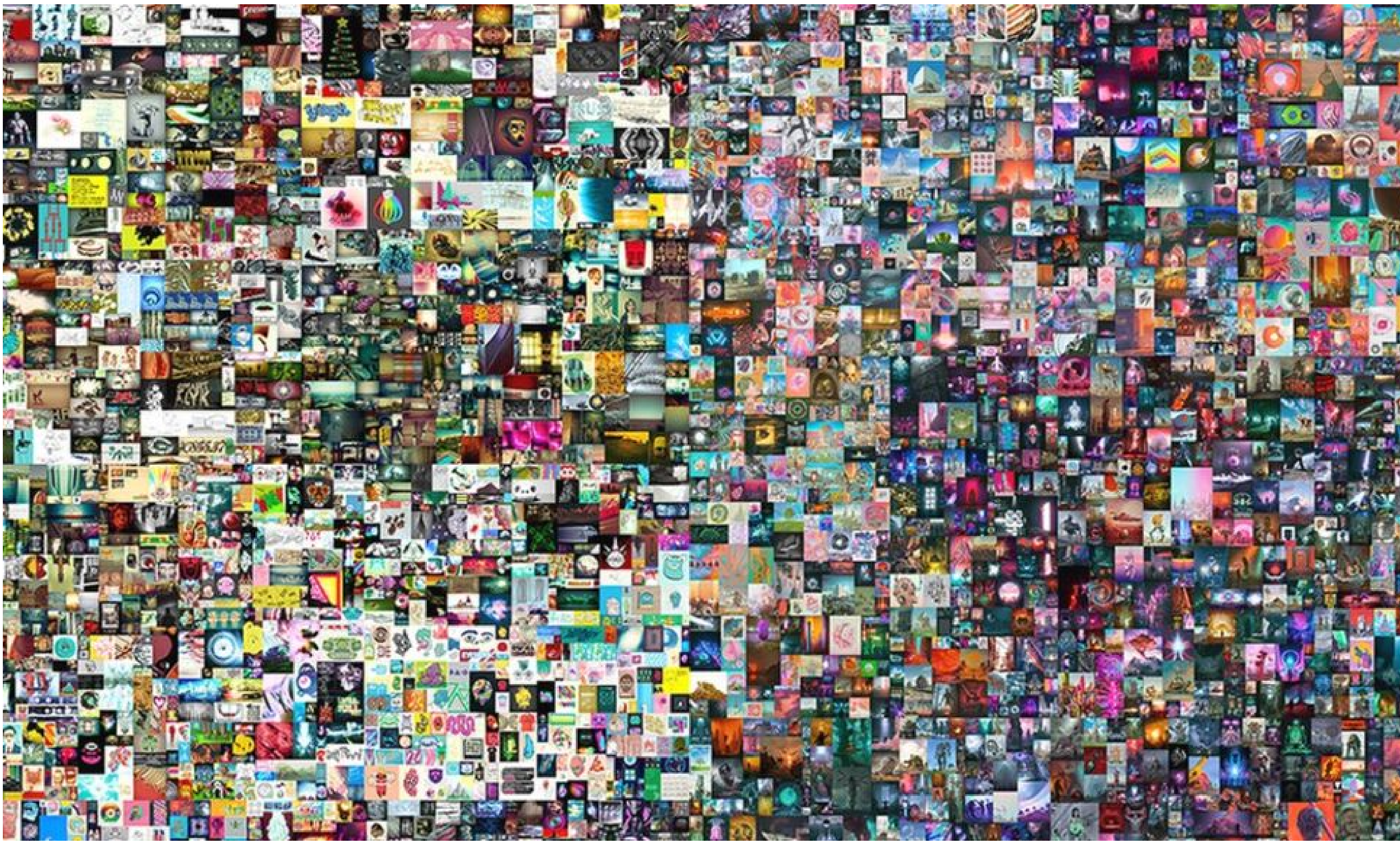
Since the first NCAA Division I Men’s Basketball Tournament was played in 1939, college basketball fans from across the sports world have had the chance to indulge in a yearly event that is now affectionately referred to as ‘March Madness’. Coincidentally, the term was first used in 1939 by an Illinois high school official, Henry V. Porter, about the very popular high school basketball tournaments played in the Midwest. Through the years, use of the term ‘March Madness’ gained in popularity, particularly in Illinois, Indiana, and other parts of the Midwest; however, during that period the term was used exclusively in reference to state high school basketball tournaments.

In 1982, the first NCAA Division I Women’s Basketball tournament was played. The same year, fans across the nation began associating the term ‘March Madness’ with the NCAA Tournaments when CBS sportscaster Brent Musburger, who had worked for many years in Chicago before joining CBS, popularized the term during an annual broadcast. (As a sidenote, the NCAA has credited former Seattle SuperSonics exec Bob Walsh of the Seattle Organizing Committee for starting the March Madness celebration two years later in 1984. Unfortunately for Pacific Northwest sports fans, the region has only produced one NCAA Division I Men’s Basketball champion since the tournament started in 1939, although Gonzaga is the odds-on favorite in this year’s competition.)

With the 2021 NCAA Division I Basketball Tournaments nearly complete, another ‘madness’ has enveloped the world over the past couple of months: NFTs. Now, readers might be sitting behind their computer screens scratching their head, either because (1) they’ve never heard the acronym before in their life or (2) they’ve read about the NFT phenomenon and are utterly perplexed by it. I’m confident that at least some of our readers fall into the second bucket because after speaking with a handful of very astute investors, I received the same dumbfounded look from each one of them when I asked them for their thoughts on the NFT mania.

To simplify the concept as best I can, NFT stands for “non-fungible token” and provides unique proof of ownership over a digital asset (think digital art, a digital coupon, a video clip, or even a tweet). NFTs are encrypted using blockchain technology (see All-In On Blockchain?) and are a one-of-a-kind piece of code, verifying authenticity and ownership, that is stored and protected on a shared public exchange (i.e. a distributed, de-centralized ledger).

The space has gained immense buzz over the past few months, catapulting those three little letters into the mainstream when a visual piece of art titled “Everydays: The First 5000 Days” was the first NFT-based work of art to go on auction at Christie’s in March. The final price tag? Over $60 million for the lucky (or perhaps, unlucky) bidder, which anointed its creator, Beeple, as one of the top three living artists in the world by price after Jeff Koons and David Hockney.



While the digital art community has been the biggest beneficiary of funds that have poured into NFTs lately, in theory, the scope for NFTs extends to anything that is unique and needs provable ownership. Mike Winkelmann, also known as Beeple, even said this in an interview with CNBC:

> “As soon as I saw it, I saw it as this massive, massive potential for this as a platform for digital ownership of a bunch of different things, not just art…Moving forward, I think this will be seen an alternate form of asset class.”

Which leads one to wonder: are NFTs so revolutionary that they will set the standard for ownership of digital – and even physical – assets moving forward? Or is this simply another example in a long list of recent illustrations that the world has gone mad?

When the Physical and Digital World Collide…

One thing that has become apparent over the past decade is the growing connectedness between the physical and digital world. VR (Virtual Reality) and AR (Augmented Reality) products have made it possible to explore new universes and to see the existing world in new ways. Video conferencing and the cloud has made it possible to work and operate businesses from home, turning virtually (no pun intended) any place with an internet connection into an office. Digital wallets have made it possible to pick up groceries without a physical wallet, and digital currencies have made it possible to buy and sell physical goods without the need for fiat currencies.

As these worlds have collided, it has enabled innovators and entrepreneurs to push forward and develop seemingly limitless value from simple strings of code. Cryptocurrencies are an obvious example of this phenomenon. But entire online universes have been created where people pay thousands or millions of dollars to own unique bits and bytes. For example, it was recently published that Mars House, the world's first digital NFT home, sold for more than $500,000. This digital home has zero utility in the physical world – its owner cannot sleep under its roof, cook in its kitchen, swim in its swimming pool… you get the idea. Despite this, somebody paid nearly twice the median price of a physical home in the United States to own that unique piece of code. Further, even though the buyer has proof of ownership of the digital home, the asset can be shared and viewed on the internet by nearly anyone with access to the internet. In contrast, someone that owns a physical home must invite somebody into that home for them to gain access.

Which, again, begs the question…is this a case of the world gone mad or is it the new frontier? In many respects, it depends on who you ask. A close friend of mine who is a very early adopter and who encouraged me to buy cryptocurrencies in the early 2010s recently told me that he believes "this is like bitcoin on day one." Other blockchain enthusiasts I've spoken with take a more reserved approach. On the other hand, seasoned investors that I've reached out to quite frankly don't know what to make of the phenomenon. One company recently hosted a virtual event on LinkedIn titled "Demystifying Non-Fungible Tokens" which speaks both to the topical nature of NFTs and the fact that the technology is extremely early and still highly perplexing to the mainstream.

While much of the media has focused on the seemingly absurd price tags that some people are paying for purely digital assets (i.e. the artwork from Beeple, the world's first digital house, or even Jack Dorsey's first tweet which fetched over $2.9M last month), there is a greater connection between the physical and digital worlds that must be considered when coming to a conclusion on NFTs.

Specifically, the "tokenization of assets" refers to turning any asset, either real or virtual, into a digital token that provides proof of ownership without the need for a central third party or intermediary. Ernst & Young published a very detailed overview of how this technology will play out in the real world, concluding:

> "The process of tokenization creates a bridge between real-world assets and their trading, storage and transfer in a digital world. The corresponding basis is built by using Blockchain technology…A digital token can thereby be described as a piece of software with a unique asset reference, properties and/or legal rights attached. Non-fungible tokens (NFTs) represent assets and items which are unique, irreplaceable, and non-interchangeable. The attributes which are represented by NFTs can vary, comprising unique serial numbers on the one hand but also more dynamic information like location, size or consistency of the product itself on the other hand… As most of this world's assets are unique in their representation, NFTs will play an increasingly important role in ushering in the next era of the digital economy and supporting enterprise adoption of Digital Ledger Technology /Blockchain to digitally represent their assets."

Conclusion

Focusing attention on click bait (i.e. headlines on the internet with a "wow" factor) such as 'Long-dormant MoonCats project rides NFT mania to the moon' would lead any logical person to believe that NFTs are another case of the world gone mad. But digging deeper and looking beyond that myopic view, NFTs should really be seen as another bridge between the physical and digital worlds. However, since the technology is still in its infancy, it will likely take years for news of practical applications to drown out the noise created by manic buyers itching to ride the next big bubble to the Moon…or Mars.

Michael Johnston
Tech Contributor