Why We Currently Don't Buy Bitcoin—Or Any Other Cryptocurrency

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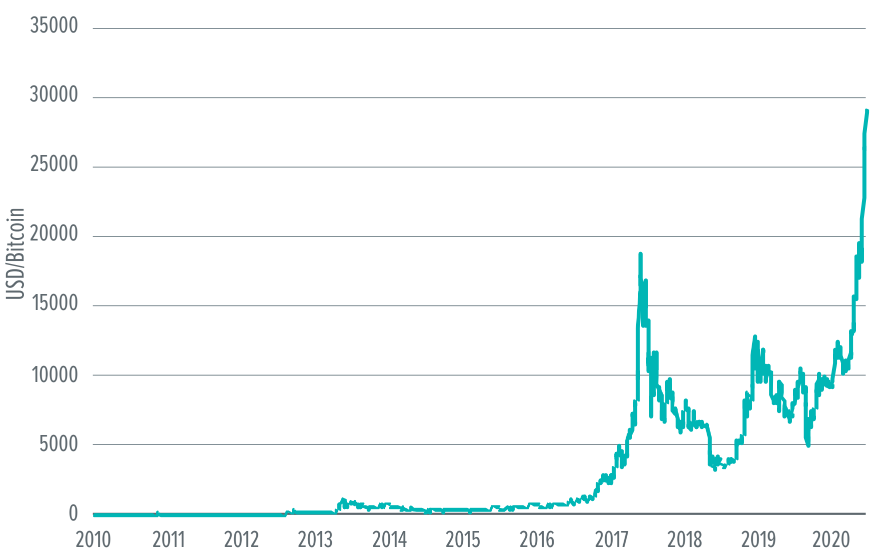
Snapshot

- Investor interest in cryptocurrencies has increased exponentially as bitcoin recently surpassed its all-time high.
- Dramatic action by global central banks and governments to combat the COVID-19 pandemic has led to a massive increase in government debt, boosting interest in traditional "hard" stores of value such as silver and gold.
- The finite nature and lack of state sponsorship have been tailwinds to bitcoin in these unusual times; however, cryptocurrencies remain generally in their infancy. Extreme volatility and sky-high regulatory risks make the asset class a highly speculative investment and not an appropriate strategic holding in a goals-based investment portfolio.

Cryptocurrencies, a digital media of exchange originally designed in response to the global financial crisis, are once again grabbing headlines. After a gain of more than 1000% in 2017, their combined market value fell close to 80% over the next 12 months. Recently however, bitcoin has rebounded substantially, surpassing its all-time high, and investors are once again questioning the potential role of cryptocurrencies in a broad investment portfolio (Exhibit 1).

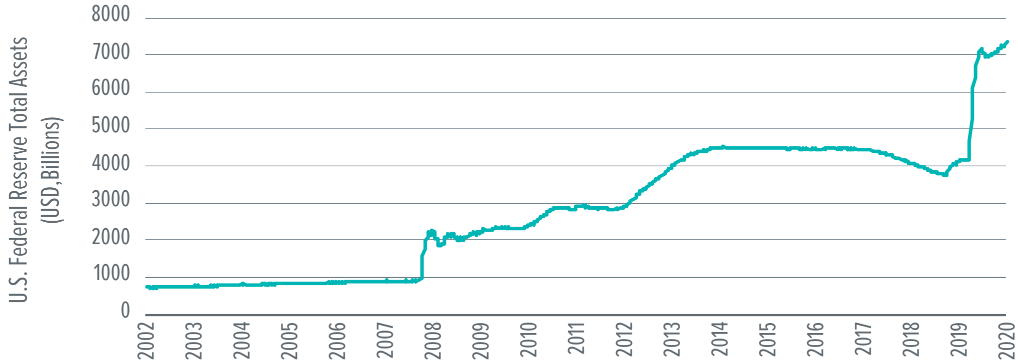
Exhibit 1: Bitcoin Surpasses 2017 Peak



Source: Bloomberg. Data spans 19/7/2010-31/12/2020.

As COVID-19 wreaked havoc through 2020 on the global economy, monetary and fiscal policy authorities responded with stimulus measures that far eclipsed responses during the global financial crisis. For example, over a three-month span in 2008, the U.S Federal Reserve (Fed) added $1.3 trillion of assets to its balance sheet. By comparison, in the three months following the first mandated COVID-19 shutdowns, the Fed added roughly $3 trillion in assets to a balance sheet that now tops $7.2 trillion (Exhibit 2).

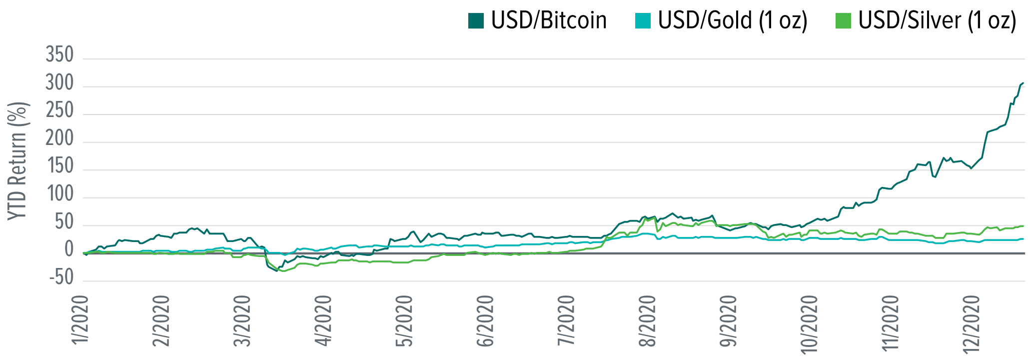
Exhibit 2: Federal Reserve Balance Sheet Runs Higher



Source: St. Louis Fed. Data as at 23/12/2020.

Throughout the first half of 2020, growing economic uncertainty and a weakening US dollar (due to the growing debt to GDP position of the US) drove investor interest in traditional "hard" currencies such as gold silver. Following the US election in November, bitcoin in particular rapidly appreciated on the prospect of additional fiscal measures, as well as positive vaccine news, both of which raised the spectre of inflationary pressure (Exhibit 3).

Exhibit 3: Bitcoin Returns Race Past Gold and Silver



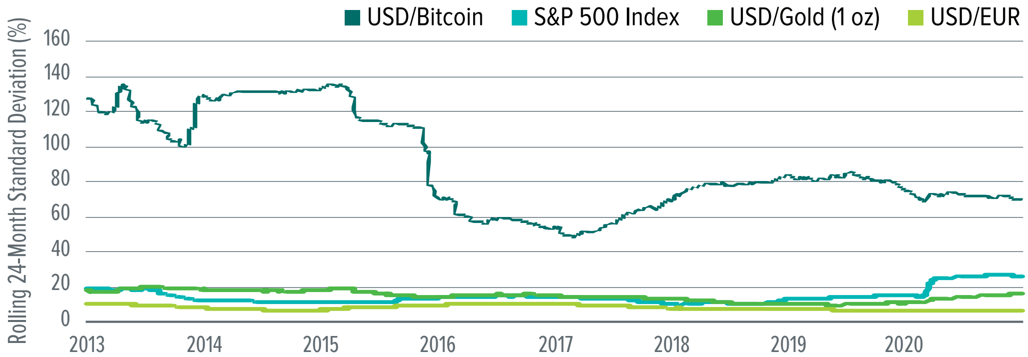
Source: Bloomberg. Data as at 31/12/2020.

As technology disruptors, cryptocurrencies and blockchains, or the public digital ledgers where cryptocurrency transactions are recorded, do appear to have promise. The digital assets tend to attract individuals seeking a degree of privacy that they cannot get from conventional banking and payment systems. Meanwhile, corporations, entrepreneurs, venture capitalists and even central banks and government institutions are more interested in the underlying technologies driving cryptocurrencies.

Many organisations are looking at how this technology can be used to improve operations and business outcomes. Their aim is to create a direct, secure and verifiable person-to-person system for payments that would be entirely private and digital, thereby removing traditional third-party intermediaries like banks. Whether this leads to actual paradigm shifts or just fosters marginal enhancements to businesses remains to be seen. Ironically, wider acceptance of these technologies may require more centralisation and third-party verification, which would cause them to become more similar to the systems they were designed to replace.

As can be expected given the nascent currency or technology, cryptocurrencies can exhibit extreme levels of volatility. Bitcoin, the most widely followed cryptocurrency, has exhibited realised volatility in excess of 100%, far exceeding that of the S&P 500 Index, gold or the euro. (Exhibit 4).

Exhibit 4: Bitcoin a Volatile Store of Value



Source: Bloomberg. Data as at 31/12/2020.

The cryptocurrency market is just beginning to mature, and the supportive value of digital coins remains difficult to price. We view them as highly speculative instruments, which makes them an unsuitable investment choice for pursuing important financial life goals—particularly for investors who can't afford the high risk of permanently losing money. In our view, it is far too early to consider including cryptocurrencies in a strategic investment portfolio.

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