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

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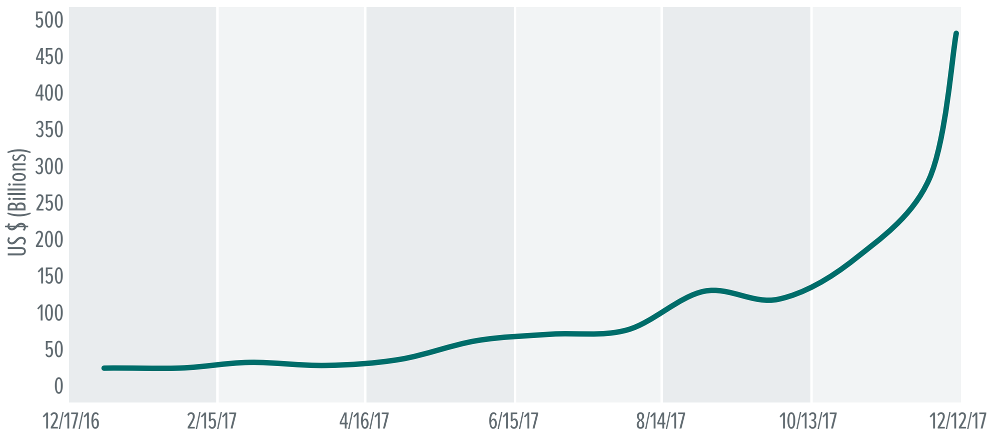
Snapshot

- Cryptocurrencies are difficult to justify as an investment since they don't satisfy the basic prerequisites of traditional investing.
- While the fair value of traditional investments can typically be estimated based on forecasted earnings, forecasted income or assets, the fair value of cryptocurrencies is anyone's guess since they neither generate earnings nor are backed by assets.
- We believe the high-risk nature of the cryptocurrency market makes it an unsuitable investment choice when it comes to meeting important financial life goals, particularly for investors who cannot afford the high risk of permanently losing money.

Cryptocurrencies, digital media of exchange originally designed in response to the global financial crisis, are intriguing from an investment perspective. From the beginning of 2017 until now, their combined market value has risen by more than 1000% (Exhibit 1).

Exhibit 1: Cryptocurrency Market Takes Off



SOURCE: www.quandl.com, SEI (as of 12/12/2017)

Speculation, Not Investment

While everybody wants an investment that gains 1000% in a year, cryptocurrencies do not satisfy the basic prerequisites that define traditional investments such as stocks, bonds and real estate—which we traditionally think of as assets with return potential. Stocks provide a claim on the expected future earnings of a company that can be realized as dividend payments or price appreciation. Bonds produce periodic interest payments and, under normal circumstances, return the investors' principal at maturity. Real-estate investments provide rental income and the potential for price appreciation.

The fair value of these traditional investments is typically estimated based on forecasted earnings, forecasted income or assets. However, the fair value of cryptocurrencies is anyone's guess since they neither generate earnings nor are backed by assets.

So while the dramatic and accelerating growth of cryptocurrencies may seem attractive, the only underpinning of this appreciation is the willingness of one investor to pay more than the previous investor. What happens when that stops?

The Real Value of Cryptocurrencies

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 they can't get from conventional banking and payments systems. Meanwhile, corporations, entrepreneurs, venture capitalists, and even central banks and government institutions are more interested in the underlying technologies driving cryptocurrencies.

Many organizations 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 centralization and third-party verification, which would cause them to become more similar to the systems they were designed to replace.

We are confident that our underlying investment managers have the tools to identify companies that may be affected by blockchain-related trends. Should viable cryptocurrency-related investments arise, it will be because the fundamental value of the business case can be cited.

Our View

The cryptocurrency market is just beginning to mature and the supportive value of digital coins remains difficult to price. We view them as speculative instruments at best and possibly worthless at worst, making 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 or blockchain-driven enterprises in a strategic investment portfolio. The recent introduction of derivatives on certain cryptocurrencies is an interesting development, but hardly one on which to build a solid investment case.

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