MONEY TALK: Why bitcoin is going bananas

#currencies #technology #investing

Tim Boreham

02:12pm February 12 2021

A bitcoin ATM inside a tobacco shop in New York. (Getty)

What's the most 'real' asset in these virus-ridden times – an intangible line of computer coding, a lump of yellow metal or the bundles of cash rolling off central banks' (digital) printing presses to fund trillions of dollars of stimulus spending?

Increasingly, many large investors are seeing the former – cryptocurrencies – as legitimate stores of value.

In the space of what feels like a few months, 'cryptos' have gone from being the preserve of geeks and millennial speculators, to an institutional asset class alongside blue-chip shares and gilt-edged bonds.

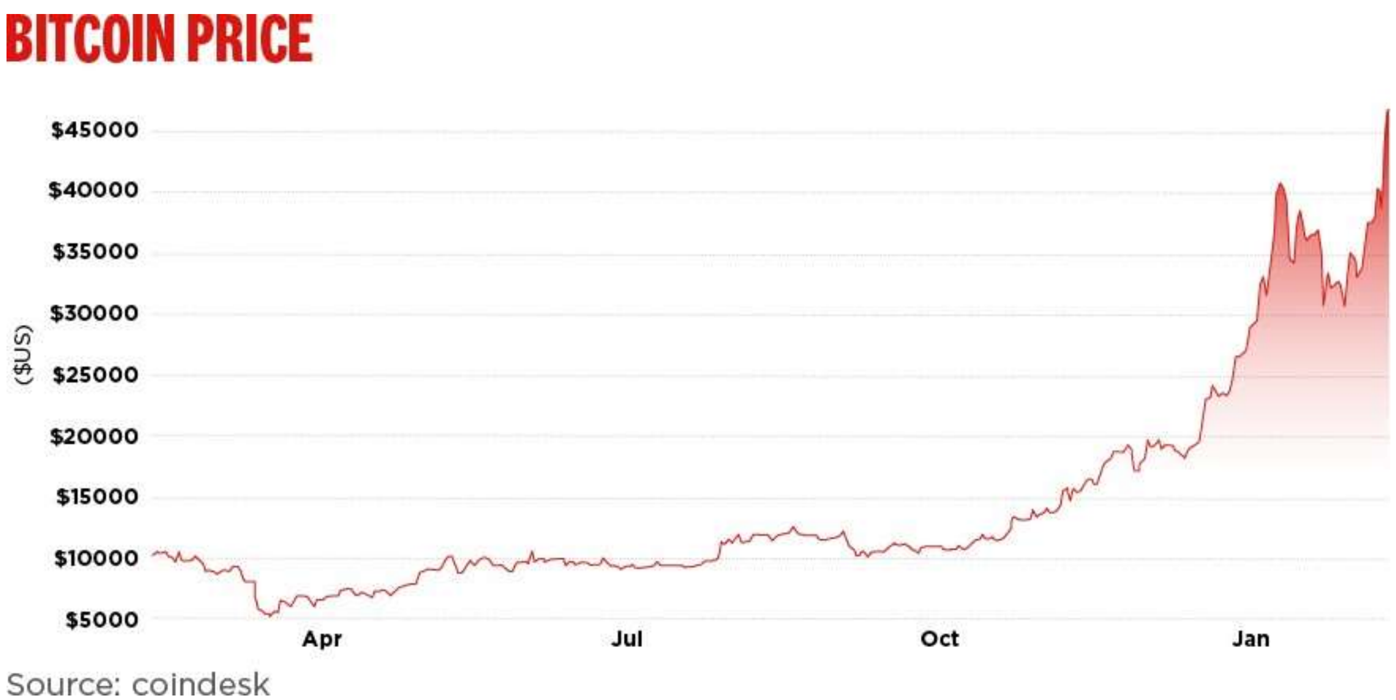
Blackrock, the world's biggest fund manager, says two of its funds will trade in derivatives of bitcoin, the most widely traded crypto and a proxy for the sector. Grayscale recently bought $US600 million of bitcoins in one day, while Coinbase – the largest cryptocurrency exchange in the US (which is backed by Reinventure) – is reportedly on the cusp of floating with a valuation in the tens of billions of dollars.

As for the punters, they continue to lap the story up: a quarter of Australians own or plan to own cryptocurrency by the end of this year, according to a survey released this week by Finder. Almost half of the 1004 respondents were attracted to potential price appreciation, but 19 per cent were keen to diversify their portfolio and 12 per cent wanted to hedge against inflation.

However, critics warn that if something looks like a bubble, it probably is a bubble.

The price of bitcoin, the most popular among thousands of cryptos, has soared almost 400 per cent over the last 12 months as it attracted more interest from large investors. This week, bitcoin surpassed $US47,000 ($61,000) after it emerged Elon Musk's Tesla had made become the latest corporate to dive in with a $US1.5 billion investment.

Five years ago, bitcoins fetched around $US380.



The second most popular crypto, etherium, (97 per cent of crypto inflows went into bitcoin last year) also trades at a near-high of $US1760 ($2285) as futures contracts this week began trading on the CME Group's derivatives exchange.

Meanwhile, the S&P 500 Index, the measure of the world's top stocks, has edged up 17 per cent over the last 12 months. And gold, the traditional safe harbour, is also 17 per cent in US dollar terms and steady in Australian dollar terms.

But the ride has been far from smooth, with cryptos experiencing frequent sharp corrections.

So why are even staid investment institutions embracing cryptos?

JPMorgan's analysts say the big end of town has been getting more involved in cryptos ever since the listing of CME bitcoin futures in December 2017, leading to the "gradual maturing" of the market. Between mid-October and late January, they say $US3bn of funds flowed into the Grayscale bitcoin Trust – a company that buys bitcoin on behalf of investors – as $US7 billion gushed out of gold exchange traded funds.

Tyler Winklevoss, co-founder of the Gemini crypto exchange, believes bitcoin is “better at being gold than gold”. Cryptos, he says, are superior to the lustrous metal in terms of not just scarcity, but durability, portability, divisibility, ease of storage and the degree of difficulty involved in counterfeiting.

The rarity factor of bitcoin comes about because they are produced by the dark art of “mining”, which involves networks of independent computers solving complex cryptographic puzzles to generate a bitcoin “reward”. The process, however, consumes vast electricity (one reason why the remote but energy-rich Arctic Circle has become an unlikely hub for bitcoin “extraction”).

While the amount of gold is limited to the pace of mining, only 21 million bitcoins can be mined given algorithmic limitations. Currently, around 18 million have been produced, with an astonishing street value of more than $US900 billion. Ray Dalio, the founder of hedge fund Bridgewater Associates, dubs bitcoin “one hell of an invention”, a perfect foil against the “debasement of fiat money”.

“The last bitcoin is set to be mined in 2140, so it will be another century until all bitcoins are mined into existence,” says Simon Peters, an analyst at multi-asset investment platform eToro.

He adds debate continues to rage as to whether bitcoin is a better store of value than gold, as it is only a very new asset class. Opinions also differ on whether it should be considered a commodity given the few obvious use cases on one hand, but similarities with gold in being considered a store of value.

“(But) whether an investor prefers bitcoin or gold, the idea is the same. Investing in either of these assets could be a great way to protect you from inflation and a reduction in purchasing power over the years to come,” Peters says.

While the use of cash is waning and inflation fears are elevated amid never before seen stimulus programs, certainly not everyone is supping the cryptocurrency Kool-aid.

The head of the Bank for International Settlements, Agustin Carstens in January warned that bitcoin could “completely crash”. Similarly, Gabriel Makhlouf, a European Central Bank governor, warned that crypto investors “need to be prepared to lose all their money.” In typical blunt style, legendary investor Warren Buffett has described bitcoin as “rat poison”, a “mirage” and a “gambling device”.

When his clients ask about cryptos – and it’s not that often – Adelaide financial adviser Theo Marinis stresses that bitcoins remain in the realm of speculation, not investment.

“You can make a lot of money and you can lose a lot of money,” he says.

Marinis adds that “without doubt”, physical currencies eventually will disappear, to be replaced by some form of cryptocurrency.

“But I don’t necessarily think it’s bitcoin,” he says. “That’s because it’s not controlled by anyone. It’s all built on trust.”

Melbourne-based adviser Adam Stanley has fielded a few queries from younger clients, but none has invested.

“We do not recommend clients buy crypto currency,” says Stanley, an executive director of Pitcher Partners Investment Services. “We are not able to get any comfort on valuations and the volatility has been extreme, making it difficult to recommend for client portfolios.”

It seems agreement between the crypto bears and bulls may still be some way off – and don't expect the debate to quieten down.

"Maybe both," said investing guru Stanley Druckenmiller last week when asked if bitcoin was the "mother of all asset bubbles" or something more "genuine or lasting", in a video published by Goldman Sachs.

"It could be a new asset class; the answer is I don't know."

The views expressed are those of the author and do not necessarily reflect those of the Westpac Group.

The information in this article is general information only, it does not constitute any recommendation or advice; it has been prepared without taking into account your personal objectives, financial situation or needs and you should consider its appropriateness with regard to these factors before acting on it. Any taxation position described is a general statement and should only be used as a guide. It does not constitute tax advice and is based on current tax laws and our interpretation. Your individual situation may differ and you should seek independent professional tax advice. You should also consider obtaining personalised advice from a professional financial adviser before making any financial decisions in relation to the matters discussed.

Tim Boreham

Tim has been a business journalist for more than 30 years, working for The Australian, Business Review Weekly and the Melbourne Herald. At The Australian he covered banking for seven years and authored the Criterion investment column for more than a decade. Tim is now a freelance business writer and has founded The New Criterion as a separate weekly column. He also writes a column on biotechnology stocks for Biotech Daily and the online small caps website Stockhead.

Financial Strategies (SA) Pty Ltd trading as Marinis Financial Group
T 08 8130 5130 | F 08 8331 9161 | A 49 Beulah Road, NORWOOD SA 5067
E admin@marinisgroup.com.au | W marinisgroup.com.au
ABN 54 083 005 930 5067 | AFSL No: 326403

Disclaimer:

Performance data quoted represents past performance and does not guarantee future results.

The information in this article is general information only. It is not intended as financial advice and should not be relied upon as such. The information is not, nor is intended to be comprehensive or a substitute for professional advice on specific circumstances. Before making any decision in respect to a financial product, you should seek advice from an appropriately qualified professional on whether the information is appropriate for your particular needs, financial situation and investment objectives.

The information provided is correct at the time of its creation and may not be up to date; please contact Marinis Financial Group for the most up to date information.