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Resurgent cryptocurrencies

As cryptocurrency again makes headlines (and breaks out to new highs), it's a good time to revisit a simple checklist to help investors weigh the pros and cons of entering the space.

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A THREE PART CHECKLIST FOR EVALUATING CRYPTO

- **Why am I buying it?** Said simply, FOMO (fear of missing out) is not an investment strategy. And while I've heard some plausible cases for owning digital assets, "because the price is going up" is not one of them (though, predictably, investor interest does tend to spike during bull markets). Bitcoin remains largely unproven as a currency and flopped as an inflation hedge, so the most interesting case is as "digital gold" – a fungible store of value with a fixed supply, but with portability and divisibility that a big hunk of metal can't offer. Ultimately, the question is whether bitcoin offers a case as a long-term portfolio diversifier – something with returns uncorrelated to other assets (stocks, bonds, real estate, etc.) and with a positive expected return. As of now, that answer remains murky to me (why should Bitcoin be expected to have a positive return? What is its intrinsic value?). But it also seems clear that's not how it is being used anyway. Per Coinbase, the median time users hold Bitcoin before selling it or sending it to another account is just 89 days. Risky (and even speculative) assets could feasibly have a place in someone's portfolio, but there's a meaningful difference between investing and gambling – and we aren't in the business of gambling.

- **Do I understand it?** A commonly repeated Warren Buffet maxim is to "never invest in a business you cannot understand." There are over 23,000 cryptocurrencies in circulation, each with unique code and functionality (which, in most cases, isn't much at all). Even Bitcoin, the most popular, remains vexing – again, is it a currency, digital gold, a lottery ticket, or something else entirely? The bar for investing hard-earned dollars into an asset should be extremely high. Past that, there are important ancillary items outside of the investment case that must be understood and considered: the tax implications, the security of the storage vehicle, the manipulability of the markets, the potential for new regulation, etc. Now, in fairness, most investments face these questions – but crypto is still new, and many of these items are either in flux or unanswered for now. As the size of the investor base grows with time, expect the regulation and taxation questions to come further into government focus.

- **Is the volatility manageable?** Cryptocurrencies are ubiquitous today, but they're still relatively new. And partially because of this, their volatility is well-above most more traditional investments. Bitcoin has seen four crashes of 50% or greater since 2017 alone (and two of 80%+); the S&P 500 has had fewer since World War II. Stomaching the pain of market crashes is one of the most difficult parts of investing. Cash balances spiked following both the Covid-19 crash and 2022 bear market, leaving trillions on the sidelines for both subsequent recovery rallies. And while one might expect the volatility of crypto to moderate somewhat as institutional adoption grows, without a clear use case or widely utilized valuation method, we should expect the volatility to remain high. This is especially true when compared to financial assets like stocks and bonds (whose cash flows can be used to estimate a value) or commodities with economic worth (like crude oil or copper). How will most investors handle the next 85% crash, especially if the answer to question #2 is a "maybe" at best?

In the end, while Bitcoin is intellectually interesting and while returns have been outstanding, there should be a high bar to clear for investing our money into something. To me, it is not clear that Bitcoin or other cryptocurrencies have cleared that bar, and the longer-term investment case is still a question mark. But at a minimum, this list offers a starting point.

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