A Little Bit(coin) in your Portfolio

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True wealth

BITCOIN AND cryptocurrencies in general have seen some intense media coverage in recent times, so I thought in today's edition we discuss cryptocurrencies.

What are cryptocurrencies?

Cryptocurrencies, such as Bitcoin, emerged around 1999 at the peak of the dot com boom. Unlike traditional currencies – there is no physical currency - no paper or metal, there is no central bank issuing any currency or any one nation that stands behind it. Cryptocurrencies are basically digital codes made by computers and stored in a "digital wallet."

Now, while most people have heard of Bitcoin, there are more than 8,000 cryptocurrencies in circulation as of January 2022!

Bitcoins can be earned in several ways – you could buy them using good old traditional money or mine them. Mining involves the use of powerful computers to solve highly complex mathematical puzzles – so not everyone's cup of tea for sure.

What drives its value?

Cryptocurrencies have been under intense media coverage. The basic premise around these digital currencies was that the age of the traditional currencies was over. However, this has not quite materialised.

The price of Bitcoin is tied to supply and demand. Although the supply of Bitcoin is (artificially) limited, that shortage will more than likely be circumvented by so many other new cryptocurrencies being launched.

Should you consider including Bitcoin in your Portfolio?

It is important, as with any investment decision, to link it back to your goals. As an example, let us consider the three most common investor goals and how crypto relates to these:

Investors would like a positive expected return i.e., grow wealth. Whilst Bitcoin value has increased it is important to remember Bitcoins do not give you future claim to income or cashflows. If you own a Bitcoin today, then you will own the same one Bitcoin years from now. Your wealth generation outcome is dependent on the value of Bitcoin increasing and not due to any underlying income/growth generation.

Reduce uncertainties of the outcome i.e., help them move forward on their financial journey with greater certainty. Unfortunately, crypto/Bitcoin has proven to be a very volatile asset and as such unlikely to dampen volatility in an investor's portfolio it could in fact increase it.

Liquidity function i.e. cash funding goal. Cash gives you the confidence of the value that you have will remain to be able to meet your short-term needs but given the volatility with cryptocurrencies where the price movements of 10-20% daily are not unheard of, crypto, unfortunately, does not offer that safe haven of holding value, that provides confidence to investors that they can utilise it to fund their short-term goals.

While it is a hot topic, I think investors must truly be aware and consider if this is appropriate for their situation. As James Oliver so succinctly put forward on HBO's Last Week Tonight1 when talking of cryptocurrency:

"Everything you don't understand about money combined with everything you don't understand about computers."