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Elston Insights

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Bitcoin: the first trillion dollar wipe out

- Bitcoin is not an appropriate asset for retail portfolios
- It is an instrument for speculation, with no intrinsic value
- Understanding a bubble is possible. Timing its end is not.

A great technology, a lousy asset

In discussions with financial advisers, our position has consistently been that whilst blockchain is undoubtedly a breakthrough technology, Bitcoin is not an appropriate asset for retail investors' portfolios.

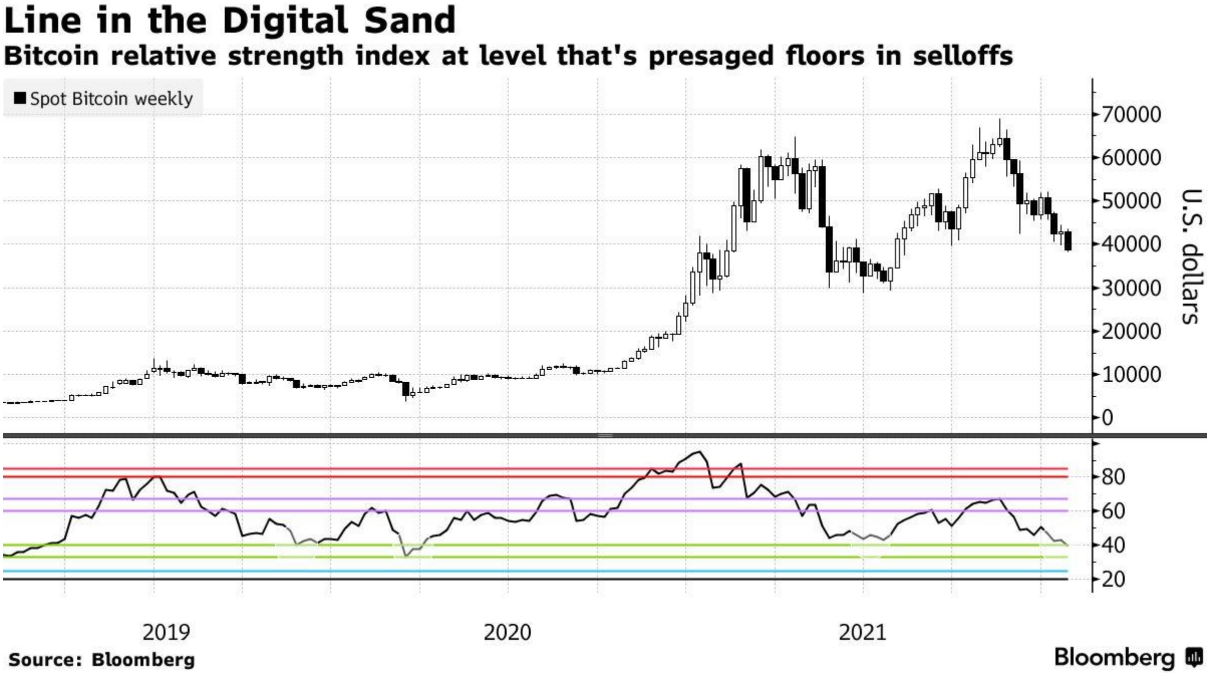
It is speculative, has no intrinsic value and will not be adopted by Governments as a recognised means of exchange (i.e. currency). Governments will indeed create their own digital currencies linked to the pound or dollar, as different means of delivering money. So yes digital money will happen. It just won't be Bitcoin. There is no precedent in history where Governments cede their monopoly of money supply and currency to something – or someone – they can't control. Bitcoin is therefore a speculative asset, like betting on the price of a "dot com" business that had no business or income in the 1990s, or of a tulip bulb in the 17th century.

In light of rising interest rates that is taking some of the "froth" out of markets, this more "boring", middle-aged and unevangelical view of Bitcoin looks like it has the potential to be vindicated. Bitcoin price level is -50% off its peak, and implies that almost $1 trillion dollars has been "wiped out" in value as the price plummeted to $38,000 last week.

A complex pyramid?

The scale of this wipe out reveals the extent to which some have made money at the expense of others in what could be perceived as a complex digital pyramid scheme, that has been semi-professionalised with the creation of a futures market (there were options on dot com shares too, remember?). Similar to actual pyramid schemes, you don't want to be one of the last ones out. So hats off to those who made money along the way and got out. They've had a lucky ride. But that luck will be funded by the misery of others' losses.

The FCA is right to keep the ban sales of cryptocurrency derivatives and exchange-traded notes to retail investors. We hope they will hold their nerve in face of intense lobbying. They have a consumer protection mandate, and sometimes consumers need protection from themselves. But sadly many won't have listened.



Long-term view on Bitcoin

Our view is that whilst day-to-day Bitcoin is worth whatever buyers and sellers are willing to pay each other to trade their respective greed and fear, its long-run intrinsic value Zero. The same cannot be said of shares or bonds. Their intrinsic value is linked to earnings and dividends (shares), and interest income and term (bonds).

Bitcoin enthusiasts see it as a replacement to Gold as a "real asset" inflation-hedge within portfolios. We disagree. Gold & Precious metals have retained intrinsic value over millennia as a store of value, means of exchange or adornment which you can touch or wear – despite generating neither earnings (like shares) nor interest income (like bonds).

Implementation options

Would you bet AGAINT Bitcoin? Whilst it may be tempting to "short" Bitcoin (e.g. via a spread-betting account), this is as risky as buying it, because the trading patterns of Bitcoin are unpredictable, you could be in a position of losing money in the near-term for longer than you can maintain it, even if a short position is proven correct in the long-run. Furthermore, the level of volatility is such that you would be required to post substantial margin and keep adding margin if the price moves against you. So the best thing to do about Bitcoin, in our view, is to follow it for interest only, but as an "investment" – to ignore it. Understanding a bubble is possible, but timing its end is not.

For those seeking exposure to the blockchain ecosystem, this can be done by investing in a blockchain focused ETF such as Invesco CoinShares Global Blockchain UCITS ETF Acc [London Ticker: BCHS] which tracks an index of *"global companies from developed and emerging countries that are or will be part of the blockchain eco system*", including HIVE BLOCKCHAIN

TECHNOLOGIES, BITFARMS, and chipmaker TAIWAN SEMICONDUCTOR MANUFACTURING, or First Trust Indxx Innovative Transaction & Process UCITS ETF Acc [London Ticker: BLOK]

Summary

So whilst we are positive on real assets as inflation hedges, Bitcoin isn't one of them. It's not *really* real, and it's not really an asset.

Henry Cobbe, CFA

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