All that glistens...

Unless you have been living under a rock for the last ten years you will be aware of the excitement and controversy that surrounds cryptocurrencies such as Bitcoin. Investors have long worried about the debasement of national currencies through expansionary monetary policies and the resulting erosion in purchasing power through inflation. This is one reason why growth assets such as equities form the core part of most long-term portfolios since they offer exposure to economic growth (through company profits) and a partial hedge against inflation (companies can and do pass on cost increases by raising the price of their goods and services). Fears over the debasement of currencies were heightening by the huge expansion in money supply that resulted from bond purchases, otherwise known as Quantitative Easing (QE), by central banks during and after the Global Financial Crisis of 2008. In fact, inflation did not materialise at that time but that did not stop investors from looking for alternatives to so-called fiat currencies.

For some the answer lay in a traditional store of value, gold. For others, technological innovation created new alternatives. In particular, the advent of so-called distributed legers (blockchains) based around replicated, shared, synchronised and encrypted digital data allowed for the creation of new digital currencies that did not rely on a central authority. Bitcoin was the first of these decentralised cryptocurrencies. Advocates of Bitcoin have highlighted the underlying algorithm which limits the total number amount of Bitcoin that can be created through computer 'mining' to 21m by c.2140. This it is argued creates scarcity value. It is certainly true that the price of Bitcoin has soared since its creation – rising from virtually nothing to a peak of over $60,000 this year before falling back to a mere $40,000 today. The price has been incredibly volatile and there is a good reason for this - it has no intrinsic value. No one can say whether the price today is expensive or cheap since there is no 'fair value'. There is extrinsic value, but this is purely in the eye of the beholder. The volatility of Bitcoin and its high transaction costs also seem to preclude its usage as an international currency (another argument put forward by proponents).

In some respects, Bitcoin is similar to gold but there are important differences since gold is tangible (and indestructible), can be worn as jewellery and has a long history of usage as a (relatively stable) store of value. We worry that those 'investing' in Bitcoin are relying on the greater fool theory (such as in the famous South Sea Bubble) and price momentum does seem to be the main attraction for many participants. We would also reject the scarcity value argument since there are basically an unlimited number of cryptocurrencies that can be launched (even spoofs as in the case of Dogecoin). We would also draw attention to regulatory issues. Governments can and do intervene in financial matters. They may seek to restrict the use of cryptocurrencies in order that monetary policy retains its ability to influence domestic monetary conditions. Such a move would not be unprecedented. For example, in 1933, the US outlawed private individuals from holding all but a very small amount of gold for precisely this reason. Another issue concerns the energy used when computers 'mine' Bitcoin. China recently announced that it would crack down on Bitcoin mining for exactly this reason. The decentralised nature of Bitcoin also means it is used by some for nefarious purposes as in the recent ransomware attacks where payment was demanded in Bitcoin. This might provide another reason for governments to clamp down on cryptocurrencies which would surely have negative repercussions for the Bitcoin price.

In conclusion, we do not see Bitcoin as an investible asset.

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