More volatility ahead for crypto assets

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The US Securities and Exchange Commission (SEC) this week approved the first exchange-traded funds (ETFs) that invest directly in Bitcoin, broadening access to the largest cryptocurrency for investors. Bitcoin is up 9.3% year to date, following a rise of 157% in 2023.

However, while the approval lowers investment hurdles and helps investors overcome technical challenges in storing digital assets, we remain unconvinced of the structural case for crypto assets fundamentally.

Crypto's application remains limited. We are skeptical that crypto assets can make significant inroads in meaningful and disruptive real world use cases. Many of the crypto-related innovations in the financial industry are currently being implemented using private, not public, blockchain technology. And even where public blockchains are being used, rising prices of native coins and tokens may ultimately undermine the success of the business through higher operating costs and increased competition through other blockchain solutions.

Cryptocurrencies can significantly raise a portfolio's volatility. Using Bitcoin as an example, just a 10% allocation in an otherwise balanced portfolio would have seen the cryptocurrency drive about 50% of the portfolio volatility, based on our analysis looking at the past 10 years. It raises volatility from a moderate risk to levels similar to an all-equity portfolio. In addition, Bitcoin's performance has a positive 0.31 correlation to global equities with a 78.8% annualized volatility, meaning it has tended to move in the same direction as the stock market with significantly higher volatility. Since 2014, there have been three major drawdowns surpassing 70% in Bitcoin from which it has taken an average of three years to recover. Bitcoin remains 30% lower than its November 2021 high.

Sustainability issue remains debatable in crypto assets. 2023 will enter the history books as the warmest year on record. Headlines around wasteful energy consumption might resurface and lead to renewed criticism about the proof-of-work algorithm used for crypto mining, especially if rising crypto prices draw in more miners thereby increasing energy usage.

So, we don't see crypto assets as a strategic investment, as the significant price swings make them more of a speculative trade for those who believe they can time the market. Longer-term investors, in our view, are better advised to focus on leading firms that deliver, enable, or use new technology for growth, gaining market share, or cutting costs in both public and private markets. We see opportunities in companies that apply and monetize artificial intelligence (AI) across software, internet, and semiconductor sectors. For more details, click here.