AMSA

Are Cryptocurrencies a Worthwile Long-term Investment?

Cryptocurrencies

Asset Team – May 2022

Tommaso Borghesi

www.amsa-network.com

AMSA

Index

Introduction

Cryptocurrencies have been around for over a decade now and are being traded by over one hundred million people daily on various exchange platforms (Howarth, 2022). Since Bitcoin's foundation in 2009 by a group of programmers known as Satoshi Nakamoto, the virtual coin has exponentially increased in value, and so have the hundreds of other coins which followed on later, such as Litecoin in 2011 (Reiff, 2022; Levy, 2022). Although the cryptocurrency market has skyrocketed over the years to reach an exorbitant market capitalization of about 2.1 trillion dollars in 2021, with numerous multinationals aiming to exploit the blockchain technology and seize the metaverse opportunity, cryptocurrencies are still seen by many as a "bubble" market and hence not a worthwhile long-term investment (Mitra, 2022). This is because despite the exponential surges in price of Bitcoin and its successors, the cryptocurrency market is still greatly led by investors' beliefs and emotions rather than an intrinsic value provided by the asset (Green, 2022). Hence the term "bubble" for such a market, which is expected to burst by many in the coming years due to multiple reasons which will be analysed in the following sections.

This report will shed light on and evaluate cryptocurrencies' potential strengths and weaknesses, with the aim to infer whether the asset might be a worthwhile long-term investment or is otherwise destined to collapse in the coming years.

Section 1: Crypto Strengths

Corporations investing in crypto

The rise of the cryptocurrency market over the past decade has not only been triggered by retail investors alone. In fact, its growth was contributed by numerous renowned multinationals that are currently investing into the asset to secure future competitive advantage over competitors due to the numerous opportunities provided by the digital currencies. To illustrate, cryptocurrencies enable companies to reach new demographic consumer segments who believe in the asset. Many customers value cryptocurrencies as they enable for more transparent transactions due to the blockchain technology which permanently encrypts and stores payment data (Deloitte, 2021; NDTV, 2021). Hence, adopting this new payment system helps corporations attract new consumers who prefer the latter over transacting with traditional fiat currencies, thus providing an additional incentive for these customer groups to purchase the organisation's products. Similarly, other companies adopt the asset to spur awareness of its revolutionary technology among its workforce to trigger profitable future innovation and development among the firm (Deloitte, 2021). Additionally, some firms hold

crypto coins, rather than cash, as an alternative current asset in times of high inflation (Deloitte, 2021).

Among the corporations which have already invested in the asset are giants operating in the gaming, fashion, FMCG, and even music industry. For instance, fast moving consumer goods industry giant Unilever has recently announced its collaboration with SAP to ensure better traceability of its palm oil supply chain (Unilever, 2022). The British multinational is planning to adopt SAP's Green Token, a crypto token which allows companies to source transactions of suppliers' raw materials used in the production of their products (Greentoken, 2022). The token uses cryptocurrencies' blockchain technology to reliably store data on transactions of an organisation's entire supply chain (Greentoken, 2022). By adopting the asset, Unilever (as many other companies worldwide) aims to add value to the firm's operations to gain competitive advantage thanks to the blockchain technology. In Unilever's case, this collaboration would result in minimising deforestation due to traceability of palm oil production. The Unilever collaboration with SAP is an example of how large organisations are attempting to embrace the potential of cryptocurrencies to their own benefit. Such collaborations not only contribute to a general positive sentiment over cryptocurrencies for the public but provide positive signals as to the yet uncertain future of the asset.

Bitcoin performance during inflation and the Ukraine Crisis

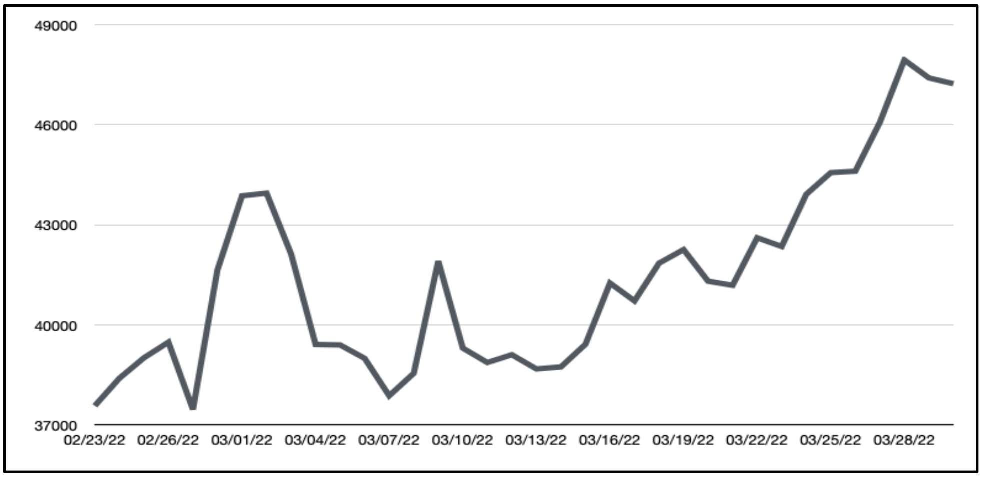
Cryptocurrencies are also believed by many to be a hedge against negative economic conditions such as inflation, and potential unforeseen geopolitical disruptions affecting the stock market. To this end, people who believe in the blockchain technology and its hedging properties, diversify their portfolios by holding cryptocurrencies for the long term.

One reason why Bitcoin might be less impacted by inflationary periods is because of the coin's fixed supply. Namely, unlike traditional fiat currencies which are somewhat regularly issued by governments, Bitcoin's supply is limited to 21 million coins (Hayes, 2022). This implies that, while other currencies may suffer the effects of high inflation rates, digital currencies will most likely resist devaluation more successfully as no additional ones will be printed or released (Hollerith, 2022).

Moreover, Bitcoin has proved to be (at least at the beginning stages) a safeguard against the recent Ukraine crisis which started with Russia's invasion on the 24th of February. When compared to Russian equities' performance between the end of February and March 2022, Bitcoin shows a clear opposite trend. Figures 1 and 2 respectively show the daily closing price fluctuations of Bitcoin and the iShares MSCI Russia ETF (an ETF tracking the results on an index composed of medium-large Russian equities) (BlackRock, 2022). More specifically, Figure 1 shows prices between the 23rd of February and the 28th of March 2022, whereas Figure 2 is between the 2nd of February and the 8th of March 2022.

*Note that the two timelines do not coincide as the New York Stock Exchange suspended trading of the Russian ETF on the 4th of March due to war-related political reasons (iShares, 2022).

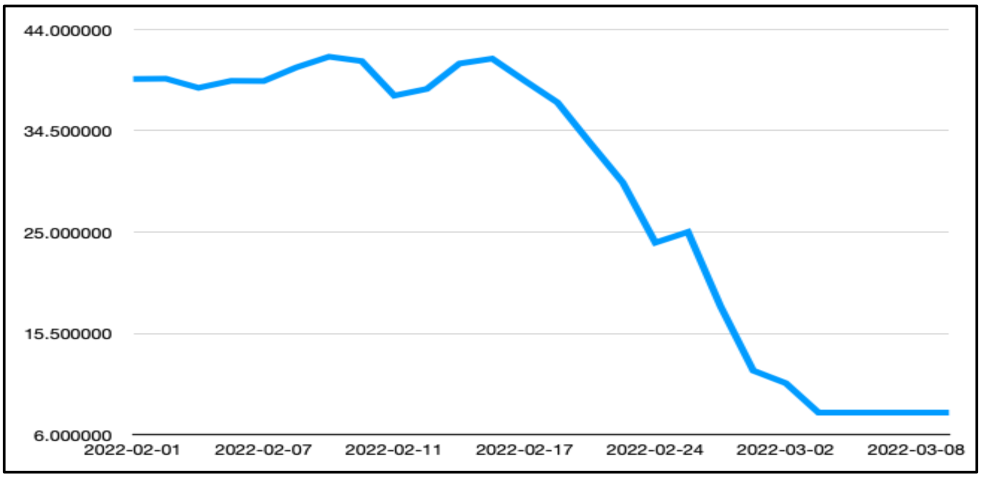
Figure 1: Bitcoin price fluctuations between 23rd of February 2022 and 28th of March 2022



Source: Yahoo Finance, 2022

As shown by Figure 1, Bitcoin has experienced a somewhat constant and gradual rise in price starting from the Russian invasion of Ukraine in late February through the whole of March. The cryptocurrency roughly rose from trading for 37000 to 47000 US dollars. This 27 percent price increase in about one month is not an outstanding number for Bitcoin, due to cryptocurrencies' incredibly volatile nature. However, when compared to equities which were directly affected by the crisis, this price increase acquires more significance.

Figure 2: iShares MSCI Russia ETF price fluctuations from 2nd of February to the 8th of March 2022



Source: WSJ Market, 2022

When observing Figure 2, on the other hand, one can clearly notice the opposite trend experienced by the Russian MSCI ETF. Not only does the graph show how heavily Russian equities have suffered due to the Ukraine invasion, but it highlights how sudden and severe the drop in value was. Unlike Bitcoin, the iShares MSCI ETF fell from about 39 US dollars in February to 8.06 US dollars by the 4th of March (price at which the security is still quoted today, due to its suspension since that date). This makes for a tremendous price decrease of just under 80 percent, which might have been even more pronounced had the security not been suspended.

Section 2: Crypto Weaknesses

Unpredictability of Cryptocurrencies

Although most cryptocurrencies did indeed outperform Russian equities during the initial phases of the Ukraine crisis, the asset did also experience a gradual downturn in April itself, with Bitcoin alone falling by 17.3 percent (Mondovisione, 2022). Nonetheless, it is not entirely clear whether such a fall may be strictly related to the Ukraine crisis or a mere negative sentiment towards the market. This is due to the asset's extremely volatile nature, making it almost entirely based on the current supply and demand for the coins (Duggan, 2022). Namely, when the cryptocurrency market value rises, it is usually caused by investors' positive sentiment about it (and vice versa) since, as argued by investing guru Warren Buffett, the asset has no intrinsic value associated with it (Tanaya, 2022).

As a result of such sentiment-driven prices, cryptocurrencies are usually known to experience severe surges and plunges as shown by figure 3.

Figure 3: Bitcoin price fluctuations between July 2017 and May 2018

Source: Mitchell C., 2022

The graph shows Bitcoin's performance between July 2017 and May 2018. The arrows trace the main spike in price, followed by a severe fall in about two months' time. Figure 3 clearly illustrates how sudden and unpredictable cryptocurrencies price changes are, especially in the long-term. It is easily observable how the price rarely (if ever) stabilises for a somewhat relevant period. The asset rather rises and falls with no clear long-term tendency instead. Such an unpredictable and erratic nature does not allow for thorough fundamental analyses which are usually carried out by investors seeking long-term positions. Similarly, cryptocurrencies do not even pay dividends or coupons, unlike equities and bonds, which might make them even less attractive for a long-term investment plan as they *"don't add value"* throughout the investment holding period (Livemint, 2022).

Threat to banks and governments

In addition to cryptocurrencies' unreliability, other (perhaps more political) aspects have led multiple investors, including the previously mentioned Warren Buffett, to refuse to invest in the asset for the long-term. The American renowned investor has often claimed not to trust the asset due to the absence of a tangible value associated with its purchase (Livemint, 2022). But, most importantly, pointed out how it may not have a bright future ahead of it due to bank and government regulations: *"there's no reason in the world why the United States government […] is going to let [another currency] replace theirs"* (Tanaya, 2022). In fact, some countries are pondering ways to tackle the potential mass adoption of cryptocurrencies, while others have already banned them completely. For instance, countries like China, Egypt, and Qatar have banned the use of the asset by prohibiting cryptocurrency exchanges (Quiroz-Gutierrez, 2022). On the other hand, Russia, Australia, and other European nations are planning to regulate crypto by developing their own digital currencies (through national banks and governments) to tax and undermine the already existing ones which are currently unregulated and decentralised (Buchholz & Richter, 2022). Therefore, due to these concerns, investors may be sceptical about the asset's long-term future.

Outlook

Overall, blockchain technology is a revolutionary discovery and will probably continue to be adopted in the future for various applications. However, it is not yet certain how cryptocurrencies will be dealt with by nations. The cryptocurrency market is currently unregulated and decentralised in most countries, leading to effects such as money laundry, tax omission, and theft or manipulation of data (Lindwall, 2022). Moreover, concerns have been raised regarding the unsustainability of Bitcoin due to its mining process. Bitcoin-mining has been estimated to use about 120 terawatt-hours of energy per year (Kolbert, 2021). Such a figure can be compared to the annual energy usage of Sweden (Kolbert, 2021).

Therefore, due to these concerns, it would not be totally unreasonable to expect a disrupting revolution of the crypto market by governments in the following years. Countries may choose to continue to ban or restrict cryptocurrency trading as we know it today. Hence, a long-term investment in Bitcoin and other digital coins may not be a safe bet for retail investors.

Bibliography

Buchholz, K., & Richter, F. (2022, March 18). *Infographic: Where the world regulates cryptocurrency*. Statista Infographics. Retrieved May 12, 2022, from https://www.statista.com/chart/27069/cryptocurrency-regulation-world-map/#:~:text=Among%20those%20exploring%20the%20concept,issue%20their%20own%20digital%20currencies

The business benefit of using cryptocurrency. Deloitte United States. (2021, September 1). Retrieved May 11, 2022, from https://www2.deloitte.com/us/en/pages/audit/articles/corporates-using-crypto.html

CryptoCompare asset report: Bitcoin Falls 17.3% to 2022 low in April. Mondo Visione - Worldwide Exchange Intelligence. (2022, May). Retrieved May 12, 2022, from https://mondovisione.com/media-and-resources/news/cryptocompare-asset-report-bitcoin-falls-173-to-2022-low-in-april/#:~:text=Bitcoin%20Market%20Cap%20Falls%20by,closed%20the%20month%20at%20%2441%2C972.

Dow Jones & Company. (n.d.). *BTC to USD | bitcoin USD historical prices - WSJ*. The Wall Street Journal. Retrieved May 12, 2022, from https://www.wsj.com/market-data/quotes/fx/BTCUSD/historical-prices

Duggan, W. (2022, May 11). *Why is crypto down Today*. Forbes. Retrieved May 12, 2022, from https://www.forbes.com/advisor/investing/cryptocurrency/why-is-crypto-down-today/

Green, N. (2022, May 9). *The growing bitcoin bubble – is it worth the risk?* unbiased.co.uk. Retrieved May 11, 2022, from https://www.unbiased.co.uk/news/financial-adviser/the-growing-bitcoin-bubble-is-it-worth-the-risk

Greentoken by SAP. GreenToken by SAP. (n.d.). Retrieved May 11, 2022, from https://www.green-token.io/

Hayes, A. (2022, March 5). *What happens to Bitcoin after all 21 million are mined?* Investopedia. Retrieved May 12, 2022, from https://www.investopedia.com/tech/what-happens-bitcoin-after-21-million-mined/#:~:text=The%20Bitcoin%20ecosystem%20is%20still,million%20coin%20limit%20is%20reached.

Hollerith, D. (2022, April 5). *Crypto: Bitcoin is seen as inflation hedge for newcomers outside the US*. Yahoo! Finance. Retrieved May 12, 2022, from https://finance.yahoo.com/news/crypto-bitcoin-inflation-hedge-231009445.html#:~:text=Bitcoin%20is%20often%20touted%20by,supply%20of%2021%20million%20units.

Howarth, J. (2022, March 18). *How many people own bitcoin? 95 blockchain statistics (2022)*. Exploding Topics. Retrieved May 11, 2022, from https://explodingtopics.com/blog/blockchain-stats

Ishares MSCI emerging markets ETF | Eem - Blackrock. (2022). Retrieved May 12, 2022, from https://www.blackrock.com/us/individual/products/239637/ishares-msci-emerging-markets-etf

Ishares msci russia ETF: Erus. BlackRock. (2022). Retrieved May 12, 2022, from https://www.ishares.com/us/products/239677/ishares-msci-russia-capped-etf#:~:text=Bid%2FAsk%20Spread%20%2D-,On%20March%204%2C%202022%2C%20NYSE%20Arca%2C%20Inc.,the%20iShares%20MSCI%20Russia%20ETF.

Kolbert, E. (2021, April 22). *Why bitcoin is bad for the environment*. The New Yorker. Retrieved May 12, 2022, from https://www.newyorker.com/news/daily-comment/why-bitcoin-is-bad-for-the-environment

Levy, I.-I. (2022, February). Currency.com. Retrieved May 11, 2022, from https://currency.com/what-are-the-oldest-cryptocurrencies#:~:text=Litecoin%20was%20one%20of%20the,the%20second-oldest%20surviving%20cryptocurrency.

Lindwall, C. (2022, April 27). *Crypto has a climate problem*. NRDC. Retrieved May 12, 2022, from https://www.nrdc.org/stories/crypto-has-climate-problem#:~:text=Right%20now%2C%20most%20cryptocurrencies%20remain,taxes%20owed%20are%20often%20not

Livemint. (2022, May 1). *Warren Buffett doesn't believe in bitcoin, won't buy it even at $25. read here*. mint. Retrieved May 12, 2022, from https://www.livemint.com/companies/people/warren-buffett-doesn-t-believe-in-bitcoin-won-t-buy-it-even-at-25-read-here-11651420954800.html

Mitchell, C. (2022, May 11). *Blow-off top definition*. Investopedia. Retrieved May 12, 2022, from https://www.investopedia.com/terms/b/blowofftop.asp

Mitra, M. (2022, April 8). *The total value of the crypto market more than doubled in one year. what happens next?* Money. Retrieved May 11, 2022, from https://money.com/crypto-market-doubled-value-whats-next/#:~:text=In%202021%2C%20the%20crypto%20market's,now%20sits%20around%20%242.1%20trillion.

NDTV Profit. (2021, November 18). *How does blockchain technology ensure transparency in cryptocurrency trade?* NDTV.com. Retrieved May 11, 2022, from https://www.ndtv.com/business/how-does-blockchain-technology-ensure-transparency-in-cryptocurrency-trade-find-out-2614495#:~:text=The%20technology%20that%20enables%20it,that%20all%20transactions%20are%20transparent.

Quiroz-Gutierrez, M. (2022, January 5). *Crypto is fully banned in China and 8 other countries*. Fortune. Retrieved May 12, 2022, from https://fortune.com/2022/01/04/crypto-banned-china-other-countries/#:~:text=Egypt%2C%20Iraq%2C%20Qatar%2C%20Oman,China%20have%20all%20banned%20cryptocurrency.

Reiff, N. (2022, February 8). *Were there cryptocurrencies before bitcoin?* Investopedia. Retrieved May 11, 2022, from https://www.investopedia.com/tech/were-there-cryptocurrencies-bitcoin/#:~:text=Founded%20in%202009%20by%20a,technology%20and%20decentralized%20digital%20currencies.

Tanaya, M. (2022, May 2). *Warren Buffett gives his most expansive explanation for why he doesn't believe in bitcoin*. CNBC. Retrieved May 12, 2022, from https://www.cnbc.com/2022/04/30/warren-buffett-gives-his-most-expansive-explanation-for-why-he-doesnt-believe-in-bitcoin.html

Unilever PLC. (2022, March 24). *SAP, Unilever pilot blockchain technology supporting deforestation-free palm oil*. Unilever. Retrieved May 11, 2022, from https://www.unilever.com/news/press-and-media/press-releases/2022/sap-unilever-pilot-blockchain-technology-supporting-deforestationfree-palm-oil/

Yahoo! (2022, May 12). *Ishares msci russia ETF (Erus) Stock Historical Prices & Data*. Yahoo! Finance. Retrieved May 12, 2022, from https://finance.yahoo.com/quote/ERUS/history/