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Cryptocurrencies making waves

Rising interest in cryptocurrencies

While COVID-19 dominated every conversation in 2020, it was also the year when cryptocurrencies started to become more popular with both retail as well as institutional investors. Recent data trends revealed that "crypto" searches on Google soared to an all-time high in February 2021, far exceeding the previous peak in early-2018. Elsewhere on Twitter, total tweet volumes devoted to cryptocurrencies were also 181% higher in January 2021 compared to a year ago.

Bitcoin going institutional

In addition, there are a handful of anecdotal examples of rising institutional interests in cryptocurrencies. For instance, PayPal has announced that its users in the U.S. can buy, sell and hold four cryptocurrencies, including Bitcoin, Ethereum, Litecoin and Bitcoin Cash. Furthermore, Tesla announced in February that it bought USD 1.5 billion worth of Bitcoin, while Morgan Stanley became the first large U.S. bank to offer its wealth management clients access to Bitcoin funds.

Another way to gauge institutional activity is via Grayscale's Bitcoin Trust (GBTC) – a publicly traded open-ended fund investing in Bitcoin. Notably, its assets under management (AUM) rose by more than 10 times to nealy USD 30 billion (as of 18 May 2021) from the start of 2020, wherein Grayscale highlighted that the growth was largely due to institutional investors, particularly the hedge funds.

Figure 1: Bitcoin price history (USD)

Source: Bloomberg I 19 May 2021

Renewed concerns on recent price volatility

The above developments suggest cryptocurrencies are no longer a niche topic and fast becoming mainstream. In fact, Bitcoin, burst into the limelight when it surged to more than USD 60,000 in March 2021 compared to just less than USD 10,000 a year ago (Figure 1). However, market concerns on Bitcoin's historically high price volatility yet again resurfaced after the cryptocurrency plunged to as low as USD 30,000 on 19 May. Notably, the decline came after a move by Chinese regulators to ban financial institutions and payment companies from providing services related to cryptocurrencies. Tesla CEO Elon Musk's earlier announcement suspending the acceptance of Bitcoin for vehicle purchases out of concern that "rapidly increasing use of fossil fuels for bitcoin mining" did not help.

Attributes of cryptocurrencies and findings

The massive growth of cryptocurrencies and digital assets owe their appeal, in part, to various attributes or "labels" (Figure 2). The section below discusses if some of these attributes are apt for cryptocurrencies as an investment, taking into consideration the volatile price dynamics.

1) <u>Is it a speculative risk-on asset?:</u> Possibly. Bitcoin and equity price moves were positively correlated over the past 12 months and could remain so in the near term. Still, this relationship likely arose due to the flush global liquidity of late and may ease as stimulus measures taper off.

2) <u>Is it a haven asset?:</u> Unlikely. Despite frequent claims that Bitcoin is a haven asset, this characteristic appears to be lacking. Notably, lockdown fears and economic recession in March 2020 led to a liquidity crunch and aggressive sell-off in Bitcoin, which occurred alongside broader equity declines.

3) <u>Is it an inflation hedge?:</u> Unlikely, especially against lukewarm inflation. Due to the scarcity of cryptocurrencies, the hedging effects may be more significant in instances of large inflation shocks, although there is little evidence to prove its effectiveness as a hedge given its short history.

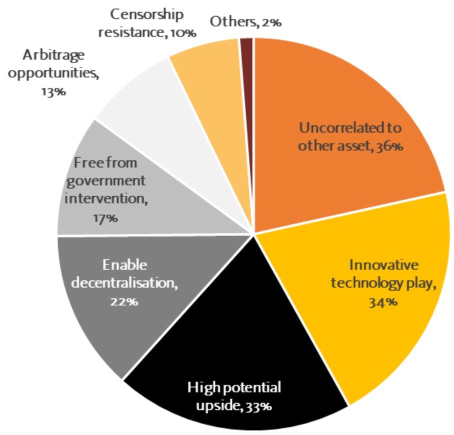
4) <u>Is it a replacement for the U.S. dollar and other fiat currencies?</u>: Unlikely. Major central banks are also looking to launch their own digital currencies. However, investors should note Bitcoin's emerging negative correlation with the U.S. dollar and concomitant positive correlation with other currencies (e.g. ASEAN) and the FX implications of including Bitcoin in investment portfolios.

5) <u>Is it an effective portfolio diversifier?:</u> Unlikely. For now, the price swings of cryptocurrencies are very much tied to risk-assets as well as developments in mass adoption, regulations and technology. Nevertheless, they could be more effective as a portfolio diversifier should the positive correlation with risk-assets (including equities) fade over time.

Conclusion

No doubt, cryptocurrencies including Bitcoin are becoming more mainstream as an investment. Nevertheless, the main argument for cryptocurrencies is still their highly speculative nature for trading gains as of now. In our view, they do not serve as an effective portfolio diversifier nor inflation hedge, and the heightened price volatility also limits their usefulness as a haven asset and/or a store of value. In addition, we cannot ignore the potential regulatory tightening as well as environmental concerns related to cryptocurrencies. As such, we would continue to urge investors to exercise extreme caution when investing in cryptocurrencies.

Figure 2: Appeal of Digital Assets



Sources: The Institutional Investors Digital Asset Survey, 2020 Review Fidelity Digital Assets, Maybank FX Research & Strategy

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