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SHANE WATKINS: Tracking crypto — even if you don't believe in it

Financial market participants need to educate themselves on this asset class

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Picture: DADO RUVIC/REUTERS

Jamie Dimon, the CEO of JPMorgan, likes to disparage bitcoin ("If you're stupid enough to buy it, you'll pay the price ...").

The second-largest cryptocurrency ethereum, which launched in 2015, is now worth the same as JPMorgan. The total value of the cryptocurrency market has grown from virtually nothing a decade ago to more than $2.6-trillion.

Broader acceptance and adoption have driven spectacular price appreciation in the asset class. The two largest crypto assets, bitcoin and ethereum, are now together worth $1.6-trillion. Bitcoin itself is worth a fraction less than two of the biggest and best companies in the world, Apple and Amazon. Ethereum's value is equivalent to that of Tencent.

Even if you don't invest in crypto or believe that it's a new and exciting asset class, these developments are worth tracking.

Bitcoin is the largest and best-known cryptocurrency. It was first introduced in 2008 by a pseudonymous individual called Satoshi Nakamoto. The "coins" are generated through a competitive process of computers solving complex equations. This is known as "bitcoin mining". Bitcoin miners receive bitcoin as a reward for completing and securing "blocks" of verified transactions which are added to the blockchain.

Every four years the number of coins available as a reward for miners declines by 50%. Only 21-million bitcoins will ever be created, hence the scarcity value. There are about 18.5-million coins in issue and the last coin will be mined in about 2140.

By "mining" for new coins, the miners act as the auditors to ensure the legitimacy of all bitcoin transactions and thereby maintain the bitcoin network and open ledger. This computer network is generally accepted to be the most powerful computer network in the world.

The technology driving all crypto assets is "decentralised blockchain", which is the record-keeping technology behind the bitcoin network. In the words of the founder of Morgan Creek, Mark Yusko: "It is a powerful computing network that is going to become the base layer protocol for *the internet of value*." His view is that bitcoin can easily reach $250,000 per coin, which will be equivalent to the current market value of gold.

There are two main types of cryptocurrencies — those used as a store of value or for transactional purposes (such as bitcoin), and those crypto assets that facilitate decentralised finance (so-called DeFi) such as ethereum.

To a degree, bitcoin is displacing gold as a store of value. More disruptively, leading projects in the DeFi space have the potential to replace traditional financial models. Financial transactions are currently routed through our traditional banking system. DeFi completely circumvents the banks. There are numerous financial models that are at risk of being disrupted by crypto applications.

What is the investment thesis for bitcoin, the largest cryptocurrency? Only 1.5% of the world's population have any exposure to bitcoin and this number is growing by 100% a year. The maximum number of coins is limited. Provided the adoption of bitcoin increases with limited additional supply, then price appreciation is assured.

Why adopt bitcoin as a store of value over gold? In many respects bitcoin is a superior asset. It is divisible, transportable, recognisable, has no storage costs and better security than gold at much lower cost.

A criticism of bitcoin is its impact on the environment because of its electricity consumption, estimated to be equivalent to the total electricity usage of Denmark. Proponents of bitcoin argue that gold mining itself is hugely energy intensive and damages the environment more by polluting from gold treatment plants and mine-dumps. Recently bitcoin miners have been moving to green energy sources.

Many traditional finance players have begun to embrace crypto assets. S&P has launched bitcoin futures, Goldman Sachs has launched a crypto trading team and UBS is looking to offer bitcoin to high net-worth clients.

Many US corporates (most notably Tesla and Microstrategy) have invested in bitcoin on their own balance sheets and a companies have announced that they will accept bitcoin as payment for services or products. PayPal and Square now offer users the ability to buy and sell using bitcoin. The CME has launched bitcoin futures.

There are numerous bitcoin ETF's globally and the new chairperson of the SEC, Gary Gensler, appears to be a crypto proponent. Talking to CNBC he said: "It's a digital, scarce store of value, but highly volatile." Recently the CFO of Bridgewater Associates, the world's largest hedge fund, resigned to join a bitcoin-focused firm, New York Digital Investment Group. Momentum in crypto is increasing.

In SA, the FSCA does not specifically prohibit institutional investors from investing in crypto assets but a circular discourages investment. Clearly there are elements of a bubble and some crypto assets are likely to implode. But survivors in this new asset class are going to change the way we invest and transact.

Given the rate of adoption of crypto assets, financial market participants need to educate themselves on this asset class and make a conscious decision on whether to participate.

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