Deciphering Crypto Currency

Author: Lauren Borden

Something we've gotten a lot of questions about lately is cryptocurrency. Many people are curious about it, wondering if it's the next big thing, or simply don't even know what it is. A number of the questions we've gotten are about whether or not it's wise to invest in it or what returns someone can expect. In this blog, I'd like to dispel some of the myths surrounding cryptocurrency and identify some important risks that come with its market.

First, let's identify what cryptocurrency even is. Perhaps the most popular form of cryptocurrency is Bitcoin, which was introduced in 2008. The North Dakota Securities department defined cryptocurrency as "a medium of exchange that are created and stored electronically in the blockchain, a distributed public database that keeps a permanent record of digital transaction." [3] In simpler terms, that means that every single piece of cryptocurrency details every transaction of itself and all other pieces, then stores those records on an electronic "chain." Another question you may have is "How does it work? Why do people want it?" Ameer Rosic from Blockgeeks described the value of cryptocurrency in his article titled "What is Cryptocurrency: Everything You Need To Know [Ultimate Guide]." Rosic writes the following:

> "The Fiat-money [standard currency] on your bank account is created by debt, and the numbers, you see on your ledger represent nothing but debts. It's a system of IOU. Cryptocurrencies don't represent debts. They just represent themselves. They are money as hard as coins of gold."

This is different than your common bank with conventional currency. Let's say a hypothetical person in Huntsville, Alabama is worth one billion US Dollars. If they head to their local bank and close their account, they likely won't be able to actually receive one billion dollars in bills that day, or for a while. The actual money the bank is using for your account went to someone else's loans, insurance, or other things the bank could be using it for. Your account details what amount you're entitled to at any given time. This isn't the case with cryptocurrency. If the most recent transaction report reads that you have 20 Bitcoins, then you have exactly that, no questions asked. So, you can exchange your cryptocurrency for a variety of things, so long as whomever you're exchanging with agrees.

There are a number of reasons to be cautious from an investing standpoint. There is absolutely no regulation on cryptocurrency. Even though there are risks associated with investing in the stock market, at least there are regulations and insurance in place to protect investors. All transactions are from buyer to seller. Likewise, those transactions are irreversible. Miners (people who dedicate their computers to accounting in exchange for small fractions of currency) confirm transactions, and once it's done, it's done. It is entirely possible to make a transaction with a fraudulent buyer, because all cryptocurrency accounts are anonymous and secure. This means anyone buying or selling cryptocurrency needs to be wary of every transaction they make, because it could go south.

Oftentimes, the volatility of cryptocurrency is higher than almost all other indexes. According to Jay Adkisson of Forbes magazine, on December 28th, 2017 Bitcoin was trading at $15,433.73 and then in early February had dropped to below $10,000. [3] Furthermore, many economists don't trust the stability of cryptocurrency and predict a bubble. Adkisson writes, "Stock market crashes never bottom at zero, for the reason that at some point market fundamentals take back over and folks can see a return for their investments […] The problem with buying a Bitcoin is that it doesn't generate a return, but is simply an internet token that is used as an alternative to transfer money between its users (and for which they have to pay fees with each transaction). In other words, Bitcoin has no fundamentals, and will never have fundamentals." [3] That fact that cryptocurrency investment values are so dependent on consumers is a risk of its stability that all investors need to keep in mind. Also remember that cryptocurrency is newer compared to other markets and pretty unfamiliar, so it is difficult to predict any trends on what happens next. It is unpredictable in many senses.

Is cryptocurrency right for you? There's a lot of information on cryptocurrency, and a lot of opinions. Many people have had it change their lives for the better, while others for the worse. Before getting involved in cryptocurrency, it's important to evaluate what your investment strategy is as well as what you think works in conjunction with your goals. If you have money that you are willing to let loose in the cryptocurrency market, make sure that it doesn't impede your other financial goals. Speak with your advisor and decide if it's right for you.

Information on cryptocurrency is hard to digest, but we've provided some resources below along with an informational video that can help investors recognize what it is and what it's used for. If you have any questions, call our office or send us an email and we'd love to help.

References

[1] Securities Commission Article http://www.nd.gov/securities/news/news-archive/securities-commissioner-reminds-investors-approach-cryptocurrency-caution

[2] Rosic, Ameer; What is Cryptocurrency: Everything You Need To Know [Ultimate Guide] https://blockgeeks.com/guides/what-is-cryptocurrency/

[3] Adkisson, Jay; Why Bitcoin Is So Volatile; February 9th 2018 https://www.forbes.com/sites/jayadkisson/2018/02/09/why-bitcoin-is-so-volatile/#6e0637e239fb

Resources

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