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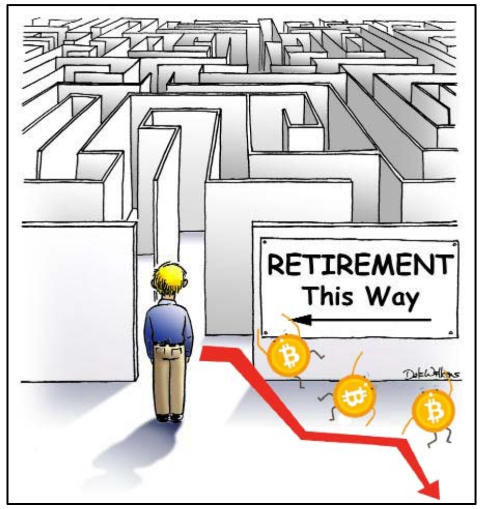
Cryptocurrencies are NOT investments

Navigating the Retirement Maze



'The value of crypto is just based on what one person decides how much another person will pay for it."

-- *Bill Gates, Microsoft co-founder*

As I worked late one evening last month, I occasionally glanced at my phone app that shows current pricing for precious metals, stock exchanges, and cryptocurrencies ("cryptos"). The US exchanges were closed, but cryptos trade 24 hours a day. This particular evening, prices were falling as though pushed off a cliff. The slide has continued. Since last fall, $1.5 trillion of cryptocurrency valuations have evaporated.

Ouch. A year ago, people were telling me how much they had made on cryptocurrencies, though none of them has stepped forward this year with similar claims. Crypto prices have been on a roller coaster the past several years, mostly downhill since last November.

I wrote a column about cryptocurrencies four and a half years ago, and my opinion of them hasn't changed. They are, in my view, the *Seinfeld* of currencies: "Currencies about nothing." At least Seinfeld made me laugh. Cryptos have me rolling my eyes at what passes for arguments for their existence unless you are laundering money from an illegal activity. They are nothing more than an encrypted number stored out in cyberspace, and if the "vault" gets hacked and the number stolen, say goodbye to your ownership of those cryptos. Bill Gates' quote at the beginning of this article is spot on, what I refer to as the "Greater Fool Theory."

Unfortunately, cryptocurrencies are now being touted as an "alternative investment" to investors by people and institutions that should know better. Thus, my focus today is on the suitability of cryptos as part of investment portfolios.

What is an investment?

Investopedia.com defines an investment as "an asset or item acquired with the goal of generating income or appreciation." Most people would agree that the goal of an investment is to generate a return commensurate with the risks inherent in that investment.

Three critical parameters of an investment are its return, its risk (i.e., potential loss), and the time frame over which one could expect to achieve the return. Sometimes these properties are easy to define, such as with a bank Certificate of Deposit: a promised return of 1.5 percent per year for two years, and extremely low risk if the investment is under $250,000 and thus guaranteed by the Federal Deposit Insurance Corporation. As investments get more complex, so, too, does estimating their return, risk, and timeframe.

Most of the time, projected return and risk measurements come from historical data for particular investment classes. Typically, the longer the timeframe, the more reliable the estimate. For example, the S&P 500 stock market index has returned an average of around 10.5 percent per year since its inception in 1957. The index consists of shares in businesses that have grown their sales and income over the years, which accounts for much of the return. From a long-term investment perspective, one could expect similar stock market returns.

However, there is a considerable shorter-term risk, as the annual return of this index has swung between gains and losses of up to 37 percent.

Cryptos as an investment

There is much historical and current data on stocks and the companies that issue them that help predict whether a particular stock or group of stocks are suitable investments for a given time frame. Audited company financials, industry metrics, share price history, and economic indicators all factor into determining an investment's potential risk and return. Both Federal and private entities help ensure that the financial data reported by companies are reliable.

For cryptocurrencies, there is… umm… nothing of the sort. They aren't regulated by any government entities (though that may change in the near future), have no laws requiring their issuers to provide guarantees, and have no legal protection against theft. They have only been available on exchanges since 2010 and thus have a short history, can be created by anyone (Google the phrase to find the instructions), have no regulations governing their issue and trading, and can disappear with no recourse possible by their owners.

My Crypto "Hall of Shame"

As much as it pains me to watch novice investors invest their limited means in cryptocurrencies, what really rankles me is the institutions and individuals who should know better than to tout cryptocurrencies as legitimate investments to novice investors. Fidelity Investments has begun offering cryptocurrencies in their 401(k) accounts. Numerous celebrities have been pitching cryptos in commercials. (Thank you Larry, Matt, Tom, and Giselle for your well-compensated Super Bowl ad endorsements.) All of the major financial institutions on Wall Street offer the ability to invest in cryptos. Why? To quote the investment bank rep in the movie The Big Short: "This is Wall Street, Dr. Burry. If you offer us free money, we ARE going to take it..."

Then there is the founder of a large Registered Investment Advisory who has decided to dedicate the remainder of his career to convincing other investment advisors that allocations of cryptocurrencies in client portfolios reduce risk and increase potential gains. (I sat through the presentation. I wasn't convinced.) His arguments sound less credible after the recent collapse in crypto prices. I wanted to ask him about his financial stake in his new crypto-touting company, but I never got the opportunity.

Good investing should be boring

A solid investment strategy is one to which you can safely contribute during your employment years, and as you approach retirement, ratchet down the risk in your portfolio. Your assets should be allocated across a range of investment classes in case one of them implodes, which happens from time to time. Good asset diversification has been shown to reduce risk while not sacrificing return. So, shoot for boring but appropriate investment allocations in your portfolios. Steady growth with reduced angst is a good combination. People have done this for years without cryptos. There is no need to use them now.

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