

## Should you be selling your stocks right now?

FISHER INVESTMENTS\*

If you have a \$500,000 portfolio, you should download the latest report by *Forbes* columnist Ken Fisher's firm. It tells you where we think the stock market is headed and why. This must-read report includes our latest stock market forecast, plus research and analysis you can use in your portfolio right now. Don't miss it!

[Click Here to Download Your Report!](#)

Dow Jones Reprints: This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit [www.djreprints.com](http://www.djreprints.com)

- [See a sample reprint in PDF format.](#)
- [Order a reprint of this article now](#)

WEEKEND INVESTOR

# Should You Invest in Bitcoin?

*Is it just the latest in a long line of speculative manias, or could it have staying power?*

By JOE LIGHT

Nov. 22, 2013 6:08 p.m. ET

What is a [bitcoin](#) worth?

For the growing band of people who follow the virtual currency, the answer is self-evident: The price of a [bitcoin](#) this week surpassed \$780, a record.

On Jan. 1, you could have bought a bitcoin for merely \$13.50. At Friday afternoon's price of about \$730, that bet would have grown about 54-fold.

The bitcoin phenomenon, and the technological innovation that made it possible, is interesting—but for investors large and small, the more pertinent question is whether they should buy the virtual currency or avoid it.

Unlike traditional money, bitcoin exists only online. To create, or "mine," the currency, computers guess solutions to complex math problems and send them to other computers on the bitcoin network. (More on that below.)

As time goes on and more coins are mined, it becomes more difficult to create bitcoins. Right now, about 12 million bitcoins have been found, with about 9 million yet to be discovered.

Once created, bitcoins can be traded on currency exchanges or used as money to purchase goods and services from merchants that accept it.

Its limited supply has made bitcoin attractive to people worried about inflation, while its anonymous nature makes it a favorite among those making illegal transactions.

On Monday and Tuesday, bitcoin's strengths and weaknesses were discussed in Congress, with U.S. Senate committees hearing testimony from federal officials who attempted to explain how bitcoin worked, what its legitimate uses are and why it has been attractive to criminals.

Even Federal Reserve Chairman Ben Bernanke weighed in, writing in a letter to a Senate committee that bitcoin and other virtual currencies "may hold long-term promise, particularly if the innovations promote a faster, more secure and more efficient payment system."

Yet some economic historians are already comparing bitcoin fever to legendary manias of the past.

Larry Neal, a professor emeritus of economics at the University of Illinois, is in the midst of writing a textbook on the history of international finance. He says he's thinking of including a passage on bitcoin and how it embodies investors' struggle for returns.

"Where's the backing that would persuade random strangers to accept this?" says Mr. Neal, who in his book "I Am Not Master of Events" wrote about a currency bubble in 18th-century France that ended with investors losing most of their money.

But on the flip side of the coin are investors such as Raoul Pal, a former hedge-fund manager and founder of the Global Macro Investor, a macroeconomic research service. This month, Mr. Pal issued a research report to his subscribers that concluded with the words: "Trade Recommendation: Buy Bitcoin."

Mr. Pal admits there's a likelihood that bitcoin ends up being worthless. But there's also a chance, he says, that it ends up taking over at least part of gold's traditional role as a store of value.

Other bitcoin proponents believe it could become an integral part of the remittance market, since bitcoins can be sent to relatives abroad with lower fees and less hassle than traditional money-transfer services.

If it replaces some or all of gold's role, given the limited supply of bitcoins relative to that of gold, the potential upside for bitcoin is huge, possibly hundreds of times the current price, Mr. Pal says.

In other words, a small amount of bitcoin is a kind of lottery ticket. It will probably be worth nothing, but if it's worth something, it could be worth a lot.

That gives individual investors two legitimate choices. The safest, and least expensive, route: "Just ignore the whole thing," says Mr. Neal.

But for the more daring: Buy one or a fraction of one, or a handful of bitcoins, with money that's set aside for speculation and can be lost, says Mr. Pal.

Here's a guide to how bitcoin works, how it's performed as a speculation so far and why it might not be a terrible idea to buy a tiny stake.

### *The Bitcoin Network*

An anonymous cryptography expert or group going by the name "Satoshi Nakamoto" released bitcoin on the Internet in 2009.

Unlike traditional currency, which is issued in digital and physical form by governments, bitcoin exists only online and is maintained by a decentralized network of computers, called "miners," which create new bitcoins and verify transactions. Anyone can become a miner using his home computer, though now miners tend to use specialized computing systems that can cost thousands of dollars.

The miners attempt to guess solutions to increasingly difficult math problems, while recording bitcoin transfers in the process, for which they're awarded bitcoins. As more miners enter the network, competition to find solutions also increases, and as more bitcoins are created, the potential payoff falls. The system is designed so that the total number of bitcoins won't exceed 21 million.

Once a bitcoin is created, it can be sent between users using digital addresses and stored in virtual "wallets," which have passwords that guard access to the bitcoins. If the passwords are lost or stolen, the bitcoins are lost forever.

Investors can also purchase bitcoins online through websites such as Slovenia-based Bitstamp.net, San Francisco-based Coinbase.com and Tokyo-based Mt. Gox. In addition, a number of alternative digital currencies have sprung up, with names such as litecoin and peercoin, though none is remotely as popular as bitcoin.

For now, relatively few mainstream merchants—including dating site OkCupid and blogging platform WordPress.com—take bitcoins for goods or services, though the number is growing. Many merchants use services that, for a fee, immediately convert bitcoins into dollars.

Some merchants say they like bitcoin because they don't have to pay hefty credit-card transaction fees. Investors worried about inflation like the fact that the supply of bitcoins can't be manipulated by a central authority. Criminals like that transactions happen anonymously.

Lately, speculators have liked it because, well, bitcoin's price in U.S. dollars has grown exponentially in less than a year.

The whole thing reminds some observers of the tulip-bulb mania that struck the Netherlands in the 1600s.

Reliable data for tulip prices is scarce, but in 1637, a speculator bought a "Semper Augustus" variety of tulip bulb for 5,500 guilders, according to data provided by Peter Garber, a strategist at Deutsche Bank who has studied the period.

At the time, the same amount of money could have bought about 45 oxen, according to Mr. Garber.

In the same way, bitcoins are only worth something as long as other investors or merchants say they are. That's led some to compare bitcoins to gold as a "store of value."

"It's as if there was an effort to create gold that wasn't gold," says Peter Rodriguez, an economist at the University of Virginia. "The longer they persist, the more that people will have faith in them as a legitimate store of value."

Others are less optimistic.

With gold, there are also uses in jewelry and industry, says Campbell Harvey, a finance professor at Duke University who has researched gold's role in a portfolio.

"Gold's value can be overstated at times, but it has a use," he says. "Bitcoin is nothing like that."

### *Bitcoin as an Investment*

So what does bitcoin look like as an asset class right now, and how should investors treat it?

If it's an asset class, it's an incredibly volatile one.

According to an analysis of bitcoin prices performed for The Wall Street Journal by Mr. Harvey, between late 2010 and Wednesday, bitcoin's return in U.S. dollars had an annualized "standard deviation" of about 139%. That means it was roughly 7½ times as volatile as gold and more than eight times as volatile as the S&P 500.

Since last Friday, when bitcoin cost \$411, the price of a bitcoin has fallen as low as \$387 and risen as high as \$782, according to CoinDesk.com, which averages bitcoin prices across multiple exchanges.

Marie Brière, an associate professor at Université Paris Dauphine in France, calculated that between July 2010 and July 2013, bitcoin had an annualized return of more than 370% with 175% volatility. She found that its returns had a weak but significant correlation with gold and inflation-linked bonds, supporting the notion that some investors see bitcoin as an inflation fighter.

Her paper, which was co-authored by Kim Oosterlinck and Ariane Szafarz of the Université Libre de Bruxelles in Belgium, concluded that a small allocation to bitcoin—perhaps 3% of a well-diversified portfolio—could improve one's risk-return trade-off.

But that study was conducted when bitcoin was merely four years old, and even Ms. Brière says investors will have to wait and see which, if any, of bitcoin's characteristics persist.

"I'd be very cautious. Is this a bubble or not? That's very hard to determine at this point," she says.

And yet some firms are already trying to make it easier for investors to get involved.

Cameron and Tyler Winklevoss, of Facebook fame, have filed with the Securities and Exchange Commission to launch an exchange-traded fund, called the Winklevoss Bitcoin Trust, that holds bitcoins. In an email from their lawyer, the Winklevosses said they are working with the SEC to finalize the proposal and hope to launch next year.

SecondMarket, a platform for investing in private assets, has already launched a private fund called the Bitcoin Investment Trust, which holds bitcoins. It charges 2% yearly in management fees and is open only to accredited investors, which for a single person means more than \$200,000 in income or \$1 million in assets, excluding a primary home.

SecondMarket CEO Barry Silbert says the trust, which is available in certain self-directed individual retirement accounts, has gathered \$36 million in assets as of Thursday.

He says that some family offices have made investments and seem to treat it as a small part of their gold allocation or their "risky alternatives" allocation, which includes investments such as hedge funds.

Bitcoin "has a binary outcome," says Mr. Silbert. "There will either be a total loss of principal or a very, very high return."

### *What to Do*

Bitcoin's all-or-nothing nature probably means that investors shouldn't treat it as they would a normal asset class at all and instead think of it as they would a "tail-risk option"—one that pays off only if an extremely unlikely event occurs, says Mr. Pal, the former hedge-fund manager.

Again, in layman's terms, that essentially means that bitcoin is like a lottery ticket. Taking a tiny risk won't damage a portfolio if bitcoin goes bust, but will have a sizable impact if it takes off.

What could that payoff be? And what's the chance of success?

Unfortunately, there's no way to know either answer. Mr. Pal believes that if investors do tie bitcoin's price to that of gold, one bitcoin could be worth \$1 million. He says that even using a "conservative" estimate of \$200,000, the price of bitcoin, at under \$1,000, seems to factor in only a slight chance of the coins being equated to gold.

Mr. Pal says he thinks the probability is much higher. As a result, he's put a small slice of his portfolio—between 1% and 2%—into the coins.

"There's no basis to be sure what bitcoin's value will be or if it will even have a value," says Lawrence H. White, an economist at George Mason University, adding that he thinks its value is probably more closely tied to its role in the remittance market than as a gold substitute.

Take note: Bitcoins aren't useful as a way to avoid taxes—legally, at least. This summer, the Government Accountability Office said that income earned through virtual currencies is taxable. Some issues remain to be clarified, such as whether gains should be taxed in the same way as those from commodities or a collectibles.

There are many places where an investor can buy a bitcoin—or even a fraction of one, including Bitstamp and Coinbase. The minimum purchase at Coinbase is 10 cents.

Investors should think of bitcoins as a long-term speculation rather than a short-term trade or a long-term investment, says Mr. Pal. If you decide to take the risk, you shouldn't base your buying and selling on the gyrations of the market or invest more than the tiniest fraction of a portfolio that can be completely lost.

As bitcoin mania unfolds, the currency might turn out to be merely a speculative bubble that bursts as investors lose interest, akin to tulips in the 1600s. But by risking very little, at the very least, an investor might be part of a story that's still told nearly 400 years later.

**Write to** Joe Light at [joe.light@wsj.com](mailto:joe.light@wsj.com)

---

Copyright 2013 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our [Subscriber Agreement](#) and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit [www.djreprints.com](http://www.djreprints.com)