KLINT FINLEY BUSINESS 05.27.17 7:00 AM

BITCOIN HAS COME ROARING BACK—BUT SO HAVE THE RISKS

ALEX DOUBOVITSKY/GETTY IMAGES

THE BITCOIN BOOM is back. This week, the digital currency leapt to record heights, peaking at nearly $2,800 before tumbling back down to around $2,400—by far the most dramatic run in its history.

While bitcoin didn't maintain its record price for long, it's been trading feverishly this year, breaking the $2,000 threshold just last week. Other "cryptocurrencies" like Ripple and Ether (the medium of exchange on the decentralized network Ethereum) have also soared.

"People are piling in. I think it's fear of missing out," says Campbell Harvey, a professor of finance at Duke University.

The big question is whether a crash is coming or whether cryptocurrencies have hit their stride. Should investors cash out now while the getting is good, or buy more now before the price climbs even higher? So far, when it comes to bitcoin, the only real rule is volatility.

Bitcoin has crashed before. In November 2013, bitcoin jumped from trading at about $200 to more than $1,200. It was trading at less than $600 within three months and took until March of this year to hit $1,200 again.

"This is highly speculative, you need to be prepared to lose everything," says Harvey. He says that's true for stocks too, but that bitcoin is more volatile than practically any other type of asset, including the stock market. Cryptocurrency is still a young technology, and it still faces many challenges, not the least of which is a potential schism within the bitcoin development community.

But there's reason to be optimistic about the future of bitcoin and other cryptocurrencies, says Adam White, head of the institutional trading arm at bitcoin exchange startup Coinbase. The 2014 crash was triggered by the collapse of the exchange Mt. Gox. Exchanges have become more stable since then, White says, and regulators are starting to adopt common-sense policies to protect consumers.

And while prices have risen and fallen in recent years, the overall trend is upwards. That makes investing in bitcoin and similar digital currencies attractive, especially at a time of political uncertainty and economic unease. Last year, Coinbase—which clearly has a horse in this race, since it makes money facilitating cryptocurrency trades—commissioned a study that compared bitcoin to other financial assets. The research found that while bitcoin is indeed extremely volatile—far more so than real estate, oil, or stock—the rewards are unusually good for the risk. The Sharpe Ratio is a measure used by investors of how risky an investment is compared to its typical returns. According to the report, cryptocurrencies have a surprisingly high Sharpe Ratio—better than any other asset class, including bonds and US equities, depending on the timeframe.

But Harvey still urges caution. Even assuming the Coinbase study calculated the Sharpe Ratios correctly, there's still very little history to base the calculation on. "For stocks and bonds, we have 100 years of data," he says. Bitcoin, on the other hand, only came online in 2009.

Still, when you're looking at the sorts of returns bitcoin has provided recently, any amount of risk will look good. "But do you really expect to keep seeing returns of 200 to 300 percent?" says David Yermack, a New York University professor of finance. "You'd have to have all the wealth in the world in bitcoin to keep that up." In other words, past performance is not indicative of future results.

That's not say that cryptocurrencies are necessarily a bad investment, so long as you know the risks. Just don't count on the price to keep rising forever. All gold rushes come to an end one day.