Bitcoin, said hedge fund billionaire Ray Dalio in a recent interview with CNBC, is becoming a sort of ‘digital gold’.

Although the world’s flagship cryptoasset has some way to go before it matches gold’s millennia as humanity’s most coveted metal, its supporters point to the hard cap on the number of bitcoins that can ever be minted as the ultimate inflationary hedge.

Data this morning showing UK inflation rocketed to a decade-high 4.2% in October has increased the pressure on asset allocators to incorporate inflation protection measures into portfolios. This followed last week’s data from the US revealing inflation shot up to 6.2% last month, its biggest surge since November 1990.
The price of bitcoin jumped 2% on 10 November following the US inflation shock to hit a record high of $68,000. However, it has since crashed back to below the $60,000 level on the back of intense volatility on 16 November, which saw $400bn wiped off the value of the crypto markets, which had touched $3tn in the previous week.

With regards to bitcoin’s long-term prospects, those who have endorsed its potential have broadened significantly in the last 18 months from the meme-touting message-board masses to some of finance’s most august institutions such as Fidelity and JP Morgan.

Closer to home, inflation hawk and leading multi-asset house Ruffer took a significant position this year, although the speed at which it then cashed in that bet had as much to do with riding momentum as the inflation protection that the house was keen to tout.

Surveyed at a recent Citywire event, more than a fifth of delegates admitted to being at least crypto-curious and would consider buying a regulated product based on real or synthetic bitcoin exposure.

So could bitcoin earn a place as an inflation hedge?

In an analysis last month, JP Morgan said the perception that bitcoin is an effective hedge against the debasement of traditional currencies was the primary reason for its recent surge to a fresh record high.
While the investment bank is not totally sold on bitcoin’s protective quality, it noted in its analysis that ‘the re-emergence of inflation concerns among investors has renewed interest in the usage of bitcoin as an inflation hedge.’

**History lessons**

Another sceptic is Rathbones’ head of multi-asset investments, David Coombs, who said crypto is yet to earn its place in a multi-asset fund, although he stressed that this was due to its short track record rather than any negative conviction.

‘Cryptocurrency has not been around very long – so historically there is no precedent here,’ Citywire + rated Coombs said. ‘And if we go back over the decades for other asset classes [such as art or vintage cars] that have tried to fit into this bucket, they have often blown up.

‘When you have a huge black-swan event, suddenly people do not want to buy pictures or cars, because there is no confidence in anything. So, all those assets that people thought were uncorrelated – actually, they are not during a normal economic cycle, but they are during black-swan events.’

Indeed, a paper published in May by authors including Man Group strategy adviser and Duke University economist Campbell Harvey called ‘The best strategies for inflationary times’ examined bitcoin’s price movement during the coronavirus crisis. It found that – if anything – it was heavily correlated with the US equity market.

‘While theoretically, bitcoin should have a zero-inflation beta and zero market beta, reality is different,’ they said. ‘For example, in March of 2020, at the height of the Covid-19 crisis, investors began to reduce risk. The stock market dropped 34%, gold dropped 12%, and bitcoin plummeted 53% as investors poured money into safe-haven US Treasuries.

‘Our analysis shows that unexpected high inflation is negatively related to US equity returns. The correlation of US equity and bitcoin returns suggests that bitcoin may not deliver positive real returns in periods of unexpected inflation.’
Another concern raised by the authors is that bitcoin is more than five times more volatile than the S&P 500 or gold, potentially making it an 'unreliable hedge', given that some other research has gold to also be an unreliable hedge in the short term due to its volatility.

Florian Ginez, associate director of quantitative research at WisdomTree, said there was not enough data for him to make an investment decision based on the idea of bitcoin as an inflation hedge. Instead, he views it as a diversification tool.

'It is not something where you can look at the data, do an analysis and come to a conclusion based on actual behaviour,' Ginez said. 'I definitely do not think it is a stupid narrative that bitcoin has similarities with gold, and from that perspective, it may behave as a hedge against inflation. But to me, this is a very hypothetical scenario.'

**A game-changer?**

Still, not everyone has been reluctant to make claims about bitcoin's use as a hedge against inflation. Among those making bold claims about its use in this role are Nigel
Green, the founder of DeVere Group, which launched a crypto trading app four years ago.

Earlier this month, Green claimed the move to hawkishness among central banks would lead bitcoin to never-before-seen success.

‘This climate will boost bitcoin and other cryptocurrencies as, with their provable limited supply cap, they are an intrinsically deflationary asset class.’

Comments

PhilipJMilton

This is one argument against cryptocurrency in that there is nothing beneath the bonnet to inspect, nothing to check, nothing to value and frankly, very limited usage as well. They are not ‘assets’, ‘currencies’ nor ‘investments’. They are too volatile to demonstrate many of the properties suggested. These things do not have State backing nor tax-raising powers. They rely purely on the collective faith of the participants. At least, say, with Tesla shares, there is a real company underneath the stratospheric share valuation so even if the shares dropped by 90%, there is still Mr Musk and still the assets in the Company and hopefully a profitable trading business in the end too. That said, even if that company was then valued at ‘only’ $100billion and not over $1trillion as it is now, many investors may still say it is far too much when considering prospects and the fundamentals.

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