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Do cryptocurrencies have a place for value-oriented investors?

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What's the value of Bitcoin? Or better, what makes it valuable? Is it because many people think it's valuable? Is it valuable because it's cool and we expect other people, especially those in the online community, to believe it's valuable? Does the dynamics of investor demand matter as much as fundamentals?

In a recent paper, Xavier Gabaix, the Pershing Square professor of finance and economics at Harvard University, and Ralph Koijen, the AQR capital management professor of finance at the University of Chicago's Booth School of Business, argue "prices move because people do things independently of fundamentals." In the paper, they explain that the amount of money entering the markets can have a large impact on share prices regardless of fundamentals. They do, however, conclude that, in the long run, prices return to fundamentals.

But what is the fundamental value of Bitcoin? Moreover, without knowing the fundamental value of Bitcoin, we won't be able to make buy and sell decisions.



investor view of cryptocurrencies improving, finds survey

isn't. It fails the three key functions of money: store of value, unit of account and medium of exchange. Bitcoin is extremely volatile, very illiquid and unable to handle a large volume of transactions.

Bitcoin isn't an asset like real estate or a stock because it doesn't generate cash flows or expects to generate any cash flows. It isn't a bond for the same reason. It also has no inherent value, unlike precious metals. Gold, for example, is perceived to be valuable because it has certain unique characteristics and attributes. It's the best electrical conductor, it's one of the most malleable metals and is widely used in tools and jewelry. Bitcoin, you'll note, isn't any of these things.

Also, Bitcoin has no stable correlation with other markets like the stock market. For example, the correlation coefficient between Bitcoin returns and the returns of S&P 500, NASDAQ, Russell 2000 and the S&P/TSX are two per cent, negative three per cent, negative five per cent and four per cent, respectively, none of which are significantly different from zero. And so, Bitcoin can't be used as a hedging instrument. Despite the bull market of 2018 and 2019, its value collapsed.

Heavy regulation by governments and recent comments by Jerome Powell, chair of the Federal Reserve, weaken Bitcoin's value proposition. Many central banks have announced they intend to launch their own cryptocurrencies, which may steal any legitimate thunder Bitcoin actually has, leaving room only for illicit activity that governments will clobber down. And hostile government policies against Bitcoin increase the cryptocurrency's vulnerability and reduce its attractiveness.

Every generation must learn things the hard way. It's now the turn of millennials, who love everything digital. It's time to learn the risk of fads, be they digital or analog. Unfortunately, since about 50 per cent of millennials have already invested in Bitcoin, this may end in disaster.

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