The Big Read Bitcoin

‘Digital tulip’ or new asset class? Bitcoin’s bid to go mainstream

The cryptocurrency’s embrace by Elon Musk and America’s oldest bank suggests it is starting to win institutional acceptance

Robin Wigglesworth in Oslo and **Eva Szalay** in London FEBRUARY 12 2021

Elon Musk is not like most multibillionaires. The first oblique hint that Tesla’s eccentric chief executive was contemplating another audacious, market-shaking move came via a risqué, Yuletide social media message.

On December 20, Musk tweeted a cartoon image depicting himself as a devout monk trying to live a “normal productive life”, gazing at a woman in a provocative pose with “bitcoin” plastered over her posterior.

The meaning of the bawdy tweet became clearer this week. On Monday, Tesla announced that it had spent $1.5bn of its cash reserves buying bitcoin, and would soon start accepting payment for its electric vehicles in the digital currency. It sent a frisson of excitement running through the world of cryptocurrencies.

Adding to the frenzy, BNY Mellon — America’s oldest bank — on Thursday said it would start holding and transferring cryptocurrencies for asset management clients, while Mastercard announced it would soon support “select cryptocurrencies” on its network, allowing more stores to accept them as payment. Even Miami’s mayor trumpeted plans to get the city to buy bitcoin.

The Evobits crypto farm in Cluj-Napoca, Romania. Bitcoins are 'mined' through an energy-intensive network of computers around the world © Akos Stiller/Bloomberg

The flurry of announcements sent the price of bitcoin — which was only invented by an unknown cryptographer in 2008 — to a new high of $48,277 on Thursday. Despite dipping on Friday, that brings its 12-month gain to 358 per cent and means that the 18.6m bitcoin currently "mined" through an energy-intensive network of computers around the world are currently worth $877bn in total. That is twice the value of JPMorgan, America's most valuable bank, more than eight Goldman Sachs', or about a third of the entire FTSE 100.

Analysts and investors say the main driver of bitcoin's frenetic recent rise has been fears that central bank stimulus to dampen the economic damage of Covid-19 will ultimately ignite inflation. But the hope of its proponents is that the string of direct and implicit endorsements from pedigreed financial institutions and companies will now help drag the volatile cryptocurrency into the mainstream.

"We are potentially at the birth of a new asset class," argues Duncan MacInnes, a fund manager at Ruffer, a traditional, conservative UK investment group that raised eyebrows when it placed a $600m bet on bitcoin last year. "Bitcoin is emerging from the shadows, being co-opted by establishment institutions and becoming a legitimate alternative asset for investment portfolios."

A flurry of announcements sent the price of bitcoin to a new high on Thursday © Anthony Stanley/Avalon

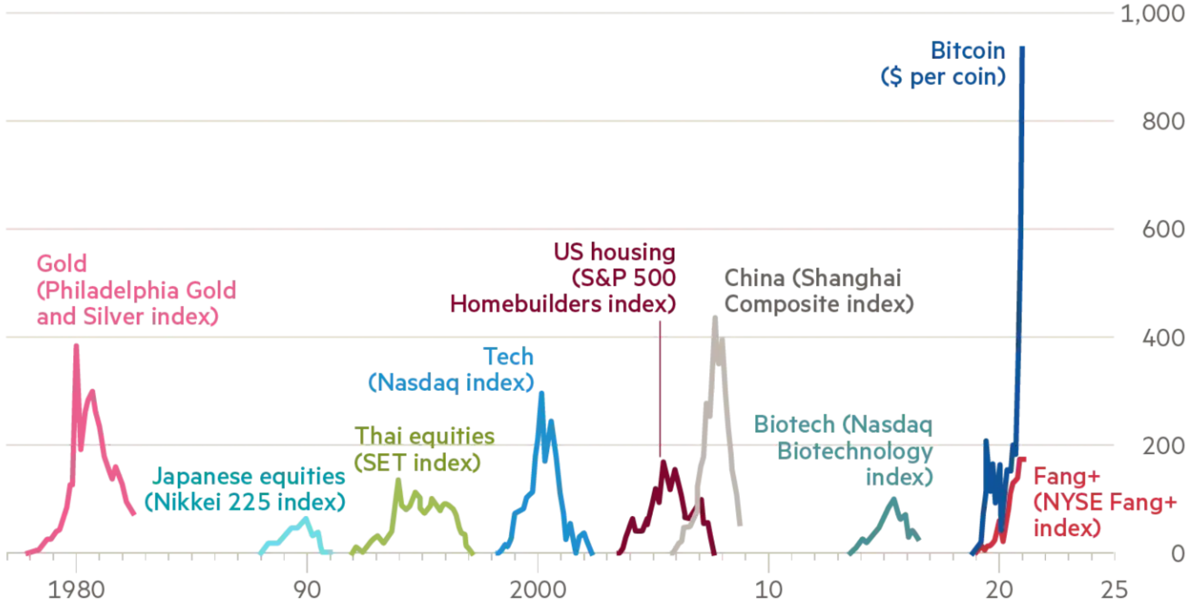
Nonetheless, idle fascination, indifference, scepticism, weariness and occasional mockery remain the primary responses of the mainstream finance industry, where many doubt that bitcoin will ever play even a minor role. Cryptocurrencies and their supporting networks have yet to yield any meaningful, concrete uses — despite hefty hopes and ample funding in recent years — and bitcoin enjoyed a similarly wild upswing in 2017, only to subsequently plummet 80 per cent from its peak.

Many think a repeat is now brewing. Bank of America's latest survey of fund managers indicates that bitcoin is now considered the most crowded trade in markets, and some government officials and policymakers have begun to warn about what they see as a pure, distilled example of mania.

"The recent spike in their prices looks less like a trend and more like a speculative mania — an atmosphere in which one high-profile tweet is enough to trigger a sudden jump in price," Tim Lane, the Bank of Canada's deputy governor, noted in a speech this week.

Bitcoin: 'the mother of all bubbles'?

% change from trough



Sources: BofA Global Investment Strategy; Bloomberg

New gold dream

Little divides opinion in the finance industry as vociferously as bitcoin. It is more likely to provoke crimson-faced arguments and broken friendships than politics, sports or even year-end bonuses.

Supporters say bitcoin is a sophisticated, secure, decentralised digital asset completely free from government control, with a capped supply — it was designed in such a way that there can only ever be 21m bitcoins in existence — that ensures it is a powerful protection against currency debasement or authoritarianism.

In fact, many proponents argue that bitcoin will play the role that gold did in previous eras, as the central, dominant reserve currency in a wider ecosystem of digital assets. Scott Minerd, global chief investment officer of Guggenheim Partners, posits that given the market value of all gold globally, each bitcoin could ultimately be worth as much as $400,000.

Bitcoin detractors liken the cryptocurrency to a ‘digital tulip’, a reference to the infamously frivolous 17th century Dutch tulip bulb mania © Art Heritage/Alamy

Detractors, meanwhile, ridicule the progressively outlandish price predictions brandished over the years by bitcoin proponents. They see the cryptocurrency as little more than a “digital tulip”, a reference to the infamously frivolous 17th century Dutch tulip bulb mania.

To them, bitcoin is at best the tip of an iceberg of speculation unleashed by low interest rates. At worst they consider it an environmentally destructive, quasi-pyramid scheme with no real utility outside financing illegal activity. Or as one wag once bitingly described bitcoin: “Imagine if keeping your car idling 24/7 produced solved Sudokus you could trade for heroin.”

For sceptics, the endorsement of various celebrities — the actress Lindsay Lohan this week tweeted “bitcoin to the moon” next to a rocket ship emoji — only adds to the perception of bitcoin and other cryptocurrencies as fundamentally vacuous, and dominated by feckless promoters rather than serious financiers.

Believers: Lindsay Lohan this week tweeted ‘bitcoin to the moon’ © Gareth Cattermole/Getty/MTV

Scott Minerd of Guggenheim says that each bitcoin could ultimately be worth as much as $400,000 © Lucy Nicholson/Reuters

Nonetheless, the rising intrigue that bitcoin is now generating even in some traditional citadels of mainstream finance is undeniable. Thus far most of the interest has come from investors such as family offices and hedge funds, but people in the industry say curiosity is starting to spread.

“One of the most interesting evolutions of the market has been the tone when institutions talk about crypto,” says Chris Zuehlke, a partner at DRW, a huge Chicago trading firm, and global head of the company’s cryptocurrency arm Cumberland. “In just three years bitcoin went from people asking ‘what is it?’ to ‘how do I trade it?’.”

Analysts say the biggest driver behind the recent burst of investor interest is the uncertain post-pandemic macroeconomic environment. Central banks have committed to keeping interest rates low even if inflation does pick up, while government borrowing has ballooned. Meanwhile, equity markets have reached record highs.

This raises thorny questions for institutional investment portfolios mostly predicated on a judicious mix of stocks and bonds to generate diversified, balanced returns over time. Gold has been a big, obvious beneficiary, but some analysts and investors now think bitcoin has a role to play alongside the millennia-old store of value.

“This environment creates a huge need for two things: assets that have a plausible case for delivering positive, real returns; and assets that can still offer diversification,” argues Inigo Fraser Jenkins, an analyst at Bernstein, the Wall Street research house. He had previously declared that cryptocurrencies such as bitcoin had zero role to play in the portfolios of institutional investors, but late last year changed his mind, and now thinks they should be taken seriously.

While Fraser Jenkins concedes he can count the number of clients that have started to dabble in bitcoin on one hand, he is confident that the “direction of travel is towards more institutional adoption”.

Bitcoin proponents say it could play the role that gold has done in previous eras, as the central, dominant reserve currency © David Gray/AFP/Getty

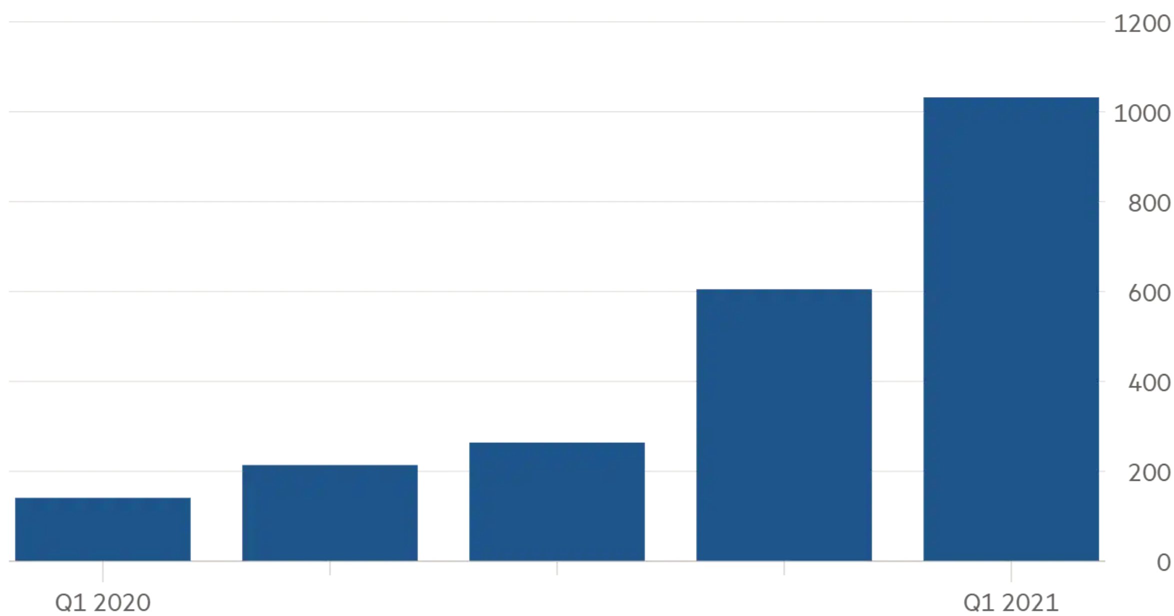
Viability test

For MacInnes at Ruffer, the rapid maturation of the crypto industry also played a major role in his change of heart. Rather than an odd bunch of "bros" and "computer geeks", he discovered that it is now populated by alumni of prominent investment banks, hedge funds and consultancies, with many crypto companies professionalised and formally regulated. "It's grown up," MacInnes says.

Ruffer cashed out some of its bitcoin profits this year, selling $650m worth, but is still holding on to about $900m of the cryptocurrency. "What bitcoin was, and what bitcoin is today, are both different from what we think bitcoin has the potential to become in the future," MacInnes argues. "We think we're at the foothills of this long trend of financialisation and institutional adoption."

Cryptocurrencies just surpassed $1tn in value

Total market capitalisation of major cryptocurrencies ($bn)



Source: BofA
© FT

MacInnes concedes that there is a risk of stricter regulation, controls or even outright bans, but cautions that the window for governments to act without disastrous results is narrowing, given the rapid growth of the industry. "There's an enormous, tidal wave of institutional adoption. If governments want to stand in the way of this, it has to be soon, or it is going to be too late, as we'll be in too deep," he says.

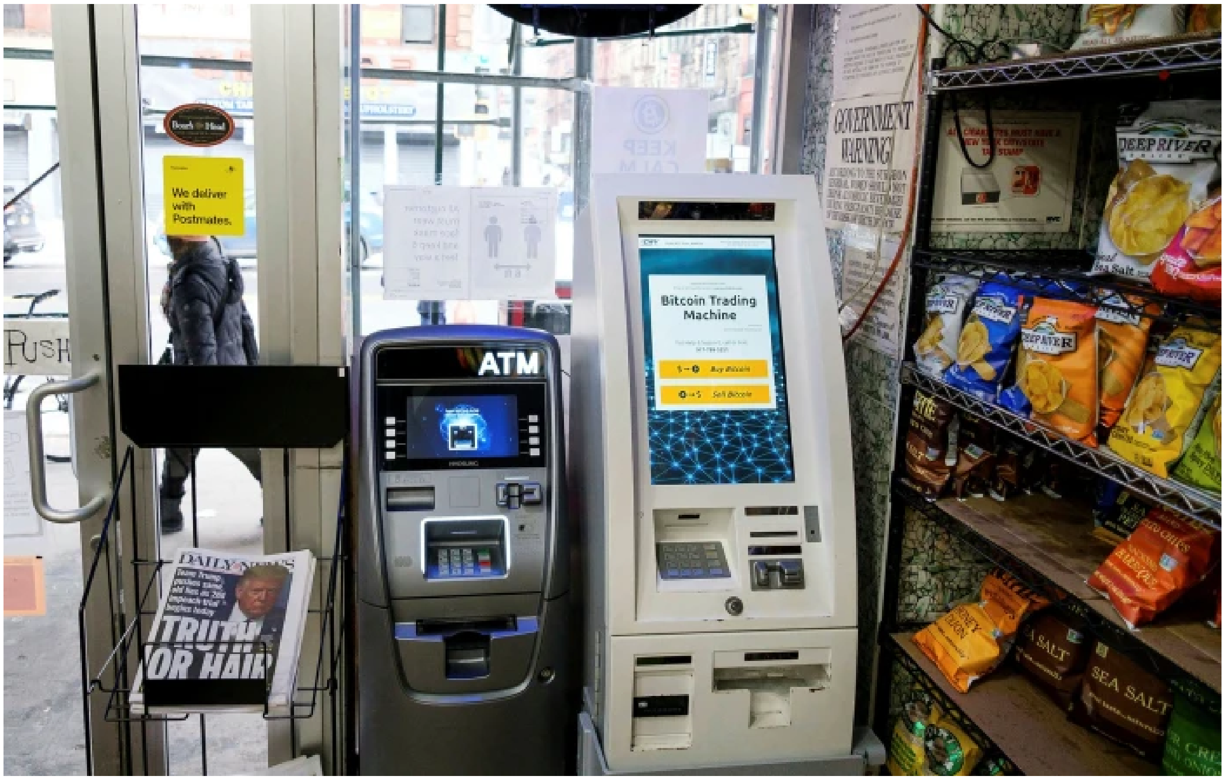
Nonetheless, despite the flurry of recent announcements there are few signs that bitcoin is becoming a viable currency — either as means of exchange or a true store of value, traditionally two of the main pillars.

A cryptocurrency mining farm in Norilsk, Russia © Andrey Rudakov/Bloomberg

Nikolaos Panigirtzoglou, an analyst at JPMorgan, points out that despite a rise in payments using the cryptocurrency since 2018, the overall volume remains vanishingly small. Costs are stubbornly high, at around $25 per transaction, and the wild volatility of bitcoin deters both buyers and sellers. Chamath Palihapitiya, a prominent venture capitalist, recently ruefully revealed that he used bitcoin to buy a $1.6m Lake Tahoe property in 2016 — the same amount of bitcoin would today be worth $128m.

Those kinds of swings mean that it is an "open question" whether more merchants or corporate treasurers will ever follow in Tesla's footsteps, notes Bryan Routledge, associate professor of finance at Carnegie Mellon University's Tepper School of Business.

The price of bitcoin has been explosive over the past year, but the volatility remains stomach-churning, which will put off many serious investors and virtually all corporate treasurers outside of Tesla, industry executives note. It is hard to claim to be a store of value when prices can often move around by 5-10 per cent in a day, they point out.



A Bitcoin automatic teller in a store in New York © Justin Lane/EPA-EFE/Shutterstock

Even financiers that have an open mind about the merits of bitcoin say they are sceptical that it will command a role in the portfolios of the investment industry any time soon. Krishna Memani, chief investment officer of Lafayette College's endowment, struggles to see how any major investment groups will adopt bitcoin to any significant degree for the time being. "I don't think we are there just yet and unlikely to be there anytime soon," he says.

Perhaps the best explanation for parts of the investment industry's current interest in bitcoin — and an indication of how durable it will ultimately prove — was made by the legendary hedge fund manager George Soros almost a decade ago.

"When I see a bubble forming, I rush in to buy, adding fuel to the fire," he admitted in a 2009 speech. As the hedge fund titan knew, riding a market mania can be immensely lucrative — provided one gets out before the reckoning.

Word on the street © Colm Fulton/Reuters

Letter in response to this article:

Don’t compare tulip mania with cryptocurrencies / *From Joseph von Zanten, Department of Political Economy, King’s College London, London WC2, UK*