

The Conventional Investor's Guide to Bitcoin

Is the currency worth owning?



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Outside the Mainstream

The column is written for those who invest in conventional securities, such as stocks and bonds, but who have not added Bitcoin to their portfolios.

If you fit that description, you have plenty of company. Although more than 100 million Bitcoin wallets exist, most of those accounts are small. In spring 2020, reported cointelegraph.com, only 800,000 Bitcoin wallets held as much as one coin, which equals just over \$50,000 at today's rates. In contrast, about 15 million households had investable assets of greater than \$1 million.

In other words, few wealthy individuals hold substantial stakes in Bitcoin. The same holds for smaller accounts; say, for the employee who has an \$80,000 401(k) plan, a mutual fund in an IRA, and some cash at the bank. At this stage in its development, most everyday investors do not own Bitcoin, at least for purposes other than transactions.

A Speculative Nature

It may be that Bitcoin's outsider status is appropriate. Cryptocurrencies are mirages--polite fictions that possess no intrinsic value. Perhaps long-term investments that underlie key purposes, such as generating retirement income, should consist of something more tangible, such as assets that generate cash (as with stocks and bonds), or securities that are supported by government bodies.



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Perhaps. On the other hand, although gold bullion does exist, its primary worth derives neither from its decorative or industrial uses, but instead because it stores value. Whenever somebody wishes to sell gold, there are always buyers. In other words, the metal is treasured because it is treasured. Such a belief does not appear to be substantially different from the faith accorded to Bitcoin.

At this point, many will pass on Bitcoin, preferring investments that have stronger theoretical underpinnings. That is understandable. However, for those who remain interested, because they care more about assets have performed than underlying explanations, Bitcoin offers two possibilities for portfolio improvement.

Possible Benefits

The trivial path is by increasing returns. By “trivial,” I do not mean immaterial. Far from it. Owning an asset that gains 1,000%, as Bitcoin has done over the past two years, is the most important trade that one can make. But of course, recognizing such opportunities is much, much easier said than done. The chief investment officer of Guggenheim Partners claims that Bitcoin is worth \$400,000. If you agree with him, buy Bitcoin. Lots of it.

The sounder reason, for those not gifted with the blessing of prophecy, is to improve portfolio diversification. Bitcoin is not perfect at the task. Sometimes it moves distressingly in line with other assets; for example, when stocks nosedived during March 2020’s COVID-19 panic, so too did Bitcoin. However, Bitcoin mostly marches to its own drum. If it continues to do so, it will be a valuable diversifier.

In this respect, Bitcoin resembles gold, which is also volatile (although less so than Bitcoin), and which also is only loosely correlated with stocks and bonds. Each asset is also regarded as a hedge against rising inflation, although Bitcoin's inflation-protection properties are entirely theoretical, since inflation has been dormant since Bitcoin was invented. Still, gold and Bitcoin fulfill similar roles.

For those who desire the hedge, a market-weighted solution would be to own one part Bitcoin for every 10 parts gold, because Bitcoin's market capitalization is \$1 trillion, while the 6 billion ounces of existing gold (that is, gold that has been mined, as opposed to that which rests in reserves) is worth \$10 trillion. However, a 50/50 split would be a more practical application. Placing 2.5% each into gold and Bitcoin would yield a 5% portfolio hedge.

Buying Tips

The best way for U.S. investors to own Bitcoin is not through a mutual fund or exchange-traded fund. That is not because such funds would fail at the task. Quite the contrary. If they existed, they would likely be ideal. However, citing concerns about the marketplace's youth and instability, the SEC has not approved the creation of any registered Bitcoin funds.

(The Commission currently is reviewing an application for VanEck Bitcoin Trust, which is vying to become the first Bitcoin ETF. VanEck currently runs an exchange-traded note that mimics a Bitcoin index, Vectors Bitcoin ETN, but despite their similarities in name, ETNs are quite different from ETFs.)

That leaves two main ways for U.S. investors to own Bitcoin. One is directly, by purchasing the currency on an exchange, then storing it in a wallet. This is the cheapest path for long-term owners, because although both Bitcoin exchanges and wallets levy transaction fees, there are no holding charges for static accounts. On the flip side, if direct Bitcoin investors lose the passwords to their wallets, they may end up forfeiting their investments. That doesn't happen with mutual funds.

The indirect approach is to buy shares in Grayscale Bitcoin, which is a grantor trust (not a registered fund) that holds Bitcoins. Accredited investors may buy from the trust itself, at net asset value, while ordinary investors must buy shares that the accredited investors have made available on the secondary market. Owning Grayscale eliminates the password concerns. However, as the

trust carries a 2% annual expense ratio, this option is costly for long-term owners.

In summary:

1. Somewhat to my surprise, Bitcoin is here to stay.
2. Those who are comfortable with its wobbly theoretical foundation, and who are inclined to hedge with gold, may wish to add Bitcoin to their portfolios.
3. The cheapest route for buy-and-hold investors is to purchase Bitcoin directly, rather than through Grayscale Trust. But if so, store that password in a safe-deposit box!

Edit: My apologies, I forgot about Osprey Bitcoin Trust, which launched last month. It is an improved version of Grayscale's Trust, as its expense ratio is 0.49%. As with Grayscale, Osprey is available at NAV to accredited investors only, meaning that unaccredited investors will likely pay a premium when the shares are in demand.

Note: For a related commentary, albeit with more detail, see Amy Arnott's article, "Does Your Portfolio Need Bitcoin?"

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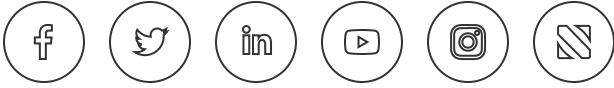
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