

Summary

- Cryptocurrency is a subset of the digital assets sector.
- The US approved 11 Bitcoin ETFs in January this year, and approved trading in options in Bitcoin ETFs in September.
- US pensions in Wisconsin and Michigan have invested small proportions of their funds in Bitcoin ETFs.
- Some argue that Bitcoin, in spite of its inherent volatility, can provide valuable diversification for pensions.
- Others say that it is the 'wild west' of investment and amounts to little more than speculation.
- Still in its infancy, time will tell how the story of cryptocurrency plays out.



Cryptocurrency: Diversification opportunity, or risky business?

Sandra Haurant considers the arguments for and against cryptocurrency investment and what opportunities may develop for this new asset class

Cryptocurrency is defined as: “Any form of currency that only exists digitally, that usually has no central issuing or regulating authority but instead uses a decentralised system to record transactions and manage the issuance of new units, and that relies on cryptography to prevent counterfeiting and fraudulent transactions,” by Merriam Webster. To which many would say, what’s cryptography? The same dictionary replies: “Secret writing; the enciphering and deciphering of messages in secret code or cipher,” and “the computerised encoding and decoding of information.”

Perhaps it’s not surprising, then, that the world of cryptocurrency can feel so secretive, a space that has its own vernacular, an area that seems to generate a plethora of negative headlines.

In one high-profile scandal, the 2022 fall of one of the biggest crypto exchanges, FTX – put simply, a bureau de change for cryptocurrencies – landed CEO, Sam Bankman-Fried, in jail for 25 years for fraud (at the time of writing, he was reportedly sharing a cell with Sean ‘P Diddy’ Combs, who is facing

charges including sex trafficking, which he denies). Caroline Ellison, Bankman-Fried’s former adviser, ex-girlfriend and prime witness in the case against Bankman-Fried, has just been sentenced to two years for her role in the crimes.

A controversial area, then, cryptocurrency is a subsector of the broader digital assets sector, which also includes non-fungible tokens (NFTs), asset-backed tokens and tokenised real estate. And it’s a big space. According to the UK’s Financial Conduct Authority, more than 20,000 cryptocurrencies existed at the start of 2023.

The scope of scarcity

Cartwright senior investment consultant and head of digital assets, Glenn Cameron, says: “My professional opinion on the matter is with that cryptocurrencies, in the best cases, and there’s a handful of them, you could think of them as sort of technology start-ups. But I would say in the vast majority of cases they are just outright scams.”

There is, though, a notable exception to this, in the form of Bitcoin, argues Cameron. “It’s a completely different

kettle of fish,” he says. “There’s a hell of a lot of noise here, and there is signal in the noise and the signal is Bitcoin.”

What makes Bitcoin stand out, says Cameron, is its finite nature. In nation-state currencies like the pound and dollar, more notes and coins can be minted as and when the powers behind them decide to. There will only ever be a fixed number of Bitcoins – once the maximum number (21 million) is reached, no more will be created. In that sense, according to Cameron, Bitcoin is comparable with gold – there is only so much of it in the world. Its scarcity, he argues, is what makes it valuable.

Moving to mainstream?

In January this year, the US Securities and Exchange Commission (SEC) approved 11 Bitcoin exchange-traded funds (ETFs) in the States, although it framed its approval carefully. In a statement at the time, chair Gary Gensler said: “Importantly, today’s Commission action is cabined to exchange-traded products (ETP) holding one non-security commodity, Bitcoin. It should in no way signal the Commission’s willingness to

approve listing standards for crypto asset securities. Nor does the approval signal anything about the Commission's views as to the status of other crypto assets under the federal securities laws or about the current state of non-compliance of certain crypto asset market participants with the federal securities laws."

Gensler went on: "While we approved the listing and trading of certain spot bitcoin ETP shares today, we did not approve or endorse Bitcoin. Investors should remain cautious about the myriad risks associated with Bitcoin and products whose value is tied to crypto."

One of the ETFs launched in January was BlackRock's iShares Bitcoin Trust (IBIT), which seeks to track the performance of the price of Bitcoin. Commenting at the time, BlackRock global head of digital assets, Robert Mitchnick, called the ETF "a natural progression of our efforts over multiple years," building on "the foundational capabilities we've established to date in the digital assets space".

IBIT quickly became the largest Bitcoin ETF with \$20 billion in assets by the end of May 2024, according to Nasdaq. More recently, in September 2024, the SEC approved listing and trading of options for IBIT on the Nasdaq, opening the door to the trading of derivatives in this space.

Piquing interest for pensions

If Bitcoin – and other cryptocurrencies – are known for one thing, it's their headline-grabbing propensity for growth. On 24 September 2014, one Bitcoin had a value of \$435. On the same date a decade later, that value was more than \$63,000.

But this also comes with great risk, of course. Cameron says: "If you take 100 per cent of your money, and you want to invest in something for six months, then Bitcoin is super risky." The falls can and do come fast and hard. But, he claims, in small doses within a large fund, invested over 10 years, Bitcoin can reduce volatility, thanks in large part to

its lack of correlation with the other asset classes typically held in pensions, namely equities and bonds.

Tobam founder and CIO, Yves Chouiefaty, agrees. "Pension funds are looking for diversification, obviously," he says. And for diversification, funds need a lack of correlation. "But also, from a US perspective, the US\$ debasement is leading pension funds' US\$ liabilities to decrease, as expressed in Bitcoin. This is also one of the drivers of the interest in Bitcoin."

"Despite some significant allocation [in Bitcoin], the interest is not yet mainstream; however, the trend is upward in US pensions funds"

And there is evidence that pensions are opening their doors a crack to these new asset classes, says Chouiefaty. "The interest in Bitcoin in particular is already rising, and allocations have already been allocated to Bitcoin. There is public information that some public pensions funds have allocated to Bitcoin."

He adds: "Despite some significant allocation, the interest is not yet mainstream; however, the trend is upward in US pensions funds." Indeed, the state pensions in Wisconsin and Michigan have taken this route, investing a very small proportion of their portfolios in Bitcoin ETFs. Small – but nonetheless significant, since the move marks a real shift in attitudes and one that proponents of crypto greeted with glee.

Risks without rewards?

For XPS Group CIO, Simeon Willis, cryptocurrency remains unappealing for pensions in the UK. "We haven't seen any interest from UK pension schemes in relation to cryptocurrency investment," he says. "Other than the odd conversation over coffee, in our

experience trustees are not enquiring about cryptocurrency."

Indeed, Willis says: "XPS Group is unwavering in our view that cryptocurrency is an unsuitable asset for institutional investment, on account of its speculative nature and highly questionable fundamental value. [...] Cryptocurrency is still the wild west of investing and I don't see that changing any time soon," he adds. "The investment case for crypto falls down in several areas. Aside from the well documented price risks involved, cryptocurrencies don't pay interest and can be thought of as equivalent to investing in physical cash. You don't find institutional investors investing in stacks of £50 notes."

Baby steps vs giant leaps

For Cameron and Chouiefaty, though, investing a relatively small amount in Bitcoin (as opposed to other cryptocurrencies) could pave the way for significant returns in the long term – but as the big pitfall of these asset classes is (very significant) volatility, it's perhaps crucial to begin with just a toe in the water. "Pension funds do not like volatility," says Chouiefaty. "In order to manage this pitfall they allocate smaller amounts. Typically, at Tobam we recommend for a pension fund having a 40/60 fixed income/equity allocation, to allocate approximately 2 to 4 per cent in Bitcoin."

He adds: "It appears that the US is once again the leading wagon for all crypto-related innovations and regulatory changes, and it would be disappointing to see the UK and Europe missing the boat and lose out on one of the most revolutionary inventions of the 21st century."

Nonetheless, Bitcoin is only 15 years old, still a new kid on the block. Only the future will show whether this divisive asset can deliver.

 **Written by Sandra Haurant, a freelance journalist**