HBKS® Wealth Advisors

Should You Invest in Cryptocurrencies?

By Mark E. MANLY, CRPC, MBA
Financial Advisor

BECAUSE OF VOLATILITY — their extreme movements in terms of value — cryptocurrencies represent more risk than most investors want in their portfolios. But like many investment options, there are nuances that deserve examination.

According to Warren Buffet's first rule of investing, "If you don't understand it, don't invest in it." As defined by Investopedia, a cryptocurrency is "a digital currency that is created and managed through the use of advanced encryption techniques known as cryptography."

Clear as a bell, eh? Or maybe not. What is missing is the intended use — that is, a cryptocurrency is an exchange medium for goods and services, a substitute for traditional currencies. But if we already have money like the U.S. dollar, what advantages over traditional currencies do cryptocurrencies offer?

The most obvious advantage is in how it is created, using encryption, which is a means of securing digital data via an algorithm and a password, or "key." The key makes it extremely difficult to counterfeit a cryptocurrency, so it is resistant to fraud.

The record keeping for cryptocurrency uses encryption as well, which creates a high level of security for the users: transactions are transparent to the participants, making identity theft extremely difficult. This kind of public ledger is also referred to as a "transaction blockchain."

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Blockchain is what gives cryptocurrencies real value. All you need is a smart device and Internet access to make payments and money transfers instantly. You become your own banker.

Since conventional banks are not part of the transaction, access to the system is easier than, for example, a bank online solution. Accessibility becomes "democratic."

And very importantly, the account is owned solely by you.

All these characteristics of cryptocurrencies sound attractive — but the devil is in the details. It is extremely difficult to establish a "fair market value" for a cryptocurrency. When Bitcoin was first introduced in October 2010, the value was estimated at about one-eighth of a U.S. dollar. But by spring the following year, it was worth a whole U.S. dollar. Over the next six years the value grew in fits and starts to its all-time high of $19,783.06 on December 17, 2017. Then, dramatically, over the next week its value dropped by about a third, to below $14,000. On September 20, 2019, Bitcoin traded at $10,038.207, and the trend remains anything but stable.

National currencies like the U.S. dollar are more stable because even though they too are "fiat currencies" (a currency without intrinsic value that has been established as money by an agreement rather than backed by an asset like gold), the U.S. government guarantees it — hence the phrase, "backed by the full faith and credit of the United States of America." Other nations make similar declarations for their currencies, and their relative values fluctuate based on trading in regulated currency exchanges.

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That is what Bitcoin and others cryptocurrencies lack. The users desire ease of use — and in some cases the associated anonymity — and lower costs since they have cut out the banks and regulatory agencies that help rationalize normal currencies. Some users would argue that, using the financial crisis as an example, the banks and regulatory agencies are ill-equipped for that job, and they are better off letting science and math dispassionately control the show.

As a financial advisor, I argue that although cryptocurrency technology has great promise, it is, as of yet, far from foolproof and will continue to be prone to extreme volatility until the related issues are resolved. But if you are determined to dabble in this investment, do so with the understanding that a positive return is far from guaranteed.

FAST FACTS ABOUT CRYPTOCURRENCIES

Definitions:

From Investopedia, a **cryptocurrency** is "a digital currency in which encryption techniques are used to regulate the generation of units of currency and verify the transfer of funds, operating independently of a central bank." Also, "a decentralized digital or virtual currency that uses cryptography for security, making it difficult to counterfeit." Also, "a medium of exchange designed for the purpose of exchanging digital information."

Decentralized cryptocurrencies (such as Bitcoin): currencies that provide an outlet for personal wealth that is beyond restriction and confiscation.

Sources:
https://economictimes.indiatimes.com/industry/banking/finance/5-reasons-why-you-should-go-for-cryptocurrency/articleshow/61184608.cms

https://blog.blockport.io/what-are-cryptocurrencies/

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More Cryptocurrency-related Terms:

- **Fraud-proof:** When cryptocurrency is created, all confirmed transactions are stored in a public ledger. All identities of coin owners are encrypted to ensure the legitimacy of record keeping. Because the currency is decentralized, you own it. Neither government nor bank has any control over it.

- **Identity Theft:** The ledger ensures that all transactions between "digital wallets" can calculate an accurate balance. All transactions are checked to ensure the coins used are owned by the current spender. This public ledger is also referred to as a "transaction blockchain". Blockchain technology ensures secure digital transactions through encryption and "smart contracts" that make the entity virtually unhackable and void of fraud. With security like this, blockchain technology is poised to impact nearly every segment of our lives.

- **Instant Settlement:** Blockchain is what gives a cryptocurrency value. Ease of use is why cryptocurrency is in high demand; you need only a smart device and an Internet connection, and instantly you become your own bank making payments and money transfers.

- **Accessibility:** There are over two billion people with access to the Internet who don't have rights to use traditional exchange systems. These individuals are clued-in for a cryptocurrencies and are putting them in high demand.

- **The individual as owner:** There is no other electronic cash system in which your account is owned by you.

Mark E. Manly, CRPC, MBA

Financial Advisor

Mark Manly serves as a financial advisor in the Fredonia, New York, office of HBKS® Wealth Advisors. In addition to providing support for the principals in the Fredonia office, he provides personal financial planning, protection planning, retirement income planning strategies, education funding and wealth preservation strategies for his clients.

His career in financial services began in 2007 at A. G. Edwards which merged with Wachovia Securities the following year. In 2009, Wachovia was acquired by Wells Fargo advisors. Mark then joined Cadaret, Grant & Co. in 2011 where he was a financial advisor and later served as the General Securities Principal at the ClearPlan Financial Inc. branch.

Mark earned his Bachelor of Arts in sociology and education from the State University of New York at Geneseo and his MBA from Saint Bonaventure University.