



ANDREW BURGER, PORTFOLIO MANAGER

DOLLAR FOR... BITCOIN? ISSUES OF A MAINSTREAM CRYPTOCURRENCY

BY ANDREW BURGER, PORTFOLIO MANAGER

Our business allows us to understand what is top-of-mind for affluent families and institutions—a great source of ideas and topics we can investigate and research. One such topic is cryptocurrency, which is a focus of many asset allocation discussions. Specifically:

Should I be allocating assets or excess cash to a Cryptocurrency – Bitcoin or the like?

Will the U.S. dollar be replaced anytime soon?

The prevailing thesis for most long-term crypto investors is that the underlying technology can be a replacement to fiat currencies such as the U.S. dollar. However, while transactional cryptocurrencies such as Bitcoin may provide answers for some of the questions that some investors express about fiat currencies, we do not believe that the U.S. dollar is at risk of being replaced by a cryptocurrency any time soon—if ever. Our belief is based upon the volatility of cryptocurrencies, the limitations that would be placed on conducting effective fiscal and monetary policy, the criminal activities made possible by crypto, socioeconomic misconceptions related to the transition to a crypto economy, and the energy required to run a crypto economy.

CLEARSTEAD CONTINUES TO BOLSTER TEAM WITH NEW TALENT

We are pleased to announce that we have added talent to the Private Client and Reporting & Operations teams with Bryse Cirjak and Ben DeHaan, respectively.

Bryse Cirjak joined Clearstead as a Senior Planning Associate. Bryse previously worked at PNC Wealth Management as a Wealth Strategist. He holds a Bachelor's degree in Finance & Marketing from The University of Findlay and is a Certified Financial Planner.

Ben DeHaan joined Clearstead as a Performance Analyst. Ben recently received a Bachelor's degree in Business Management from Palm Beach Atlantic University where he graduated Summa Cum Laude and received the Rinker School of Business Class of 2021 Outstanding Graduate Award.

These changes underscore the firm's commitment to building its investment consulting practice, promoting the next generation of leadership, and maintaining a rigorous investment process.

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Although discussions about cryptocurrency have increased during client meetings, Clearstead does not currently recommend any individual cryptocurrency. In its current forms, cryptocurrency is highly speculative, and investors should approach it with that in mind. This article is meant only to provide alternative perspectives for your consideration and discusses the roadblocks to any of these assets replacing the U.S. dollar.

“Cryptocurrency” has seemingly become a catch-all for the entire ecosystem of digital assets and so we will add some definitions to hopefully add some clarity to the situation¹.

- Cryptocurrency - A digital currency in which transactions are verified and records maintained by a decentralized system using cryptography, rather than by a centralized authority.
- Digital Dollar/Currency - Digital money, or digital currency, refers to any means of payment that exists purely in electronic form.
- Crypto Assets - Private digital assets that use cryptography and are designed to work as a medium of exchange. They can act as a currency (relatively stable value) or an asset (with fluctuating value).
- Stable Coin - Cryptocurrencies that attempt to peg their market value to some external reference like the U.S. dollar or gold.

The multitude of different crypto assets leads to confusion, so for that reason, and because this is the nature of most questions about the subject, we are limiting this discussion to Bitcoin being referred to as a transactional currency such as the U.S. dollar.

VOLATILITY OF CRYPTOCURRENCY

The exact reason that Bitcoin is a popular speculative investment is one of the primary factors why it cannot become a popular means of conducting transactions for goods. As shown in the trailing 1-year price chart below, Bitcoin has moved rapidly to both the upside and the downside. It reached an all-time high price of \$63,729 leading up to Coinbase's Initial Public Offering in April 2021 and then lost roughly half of its value since then.



Source: Coindesk.com.

For informational purposes only. Past performance is not an indicator of future results.

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LIMITED QUANTITY OF CRYPTOCURRENCY UNITS

One unique feature and possible benefit to Bitcoin as a currency would be the limited supply of units outstanding. There are only 18.7 million bitcoins in circulation and, even after mining the remaining Bitcoins, there will only ever be 21 million Bitcoins in existence. This limitation could be seen as a solution to hyperinflation or possible abuse of the ability to create or print additional dollars, which would add or remove liquidity on demand.

This solution, while simple, however, removes several steps that make fiscal and monetary policy a malleable process and effective tool to address economic challenges, both foreign and domestic. As shown throughout this most recent economic downturn related to the COVID-19 pandemic, the government made use of the fact that additional dollars could be effectively distributed through programs that ultimately supported the economy during a period where it was most in need. Therefore, a finite number of Bitcoin would mean that, come the next financial crisis, we will have given up our preferred tool to support and stimulate the economy in its time of most dire need.

DECENTRALIZATION AND ANONYMITY MAY POSE SYSTEMIC RISKS

The decentralized nature of cryptocurrencies means that transactions are difficult to trace. Because of its budgetary constraints and lack of manpower, the U.S. Internal Revenue Service has a hard enough time collecting taxes from gains created through sales of appreciated cryptocurrencies. If every transaction were moved to a crypto platform, both the senders and receivers of cryptocurrencies could be anonymous. A crypto asset holder could then store their assets on what is called a Cold Wallet (transferring Bitcoin onto a flash drive or similar device, therefore making it inaccessible from a network or computer). Cold Wallets and the ability to remove the currency from the accessible system are some of the reasons that many criminals and hackers use crypto assets to accept payments for ransom or illicit goods. For example, it was reported that the recent cyberattack on the Colonial Pipeline was settled with a payment of 75 Bitcoin (\$4.4mil equivalent).

POSSIBLE SOCIOECONOMIC RESTRUCTURING

With increasing disparity across the socioeconomic hierarchy, many people look to cryptocurrency as a possible solution or “fresh start” to the current imbalances of our economic system or a way to redistribute wealth. However, the demographic profile that owns the most Bitcoin is affluent, white males².

If we were to transition from the U.S. dollar to Bitcoin, the limited amount available for the entire country to convert would inflate the value of each Bitcoin significantly and result in only a few benefiting via their current holdings. This leads us to believe that the Federal government would likely create their own cryptocurrency (or digital dollar) rather than adopting one that is already in existence. This belief strikes down the underlying thesis of many cryptocurrency investors that Bitcoin could easily replace the U.S. dollar and would limit the possibility of a major redistribution of wealth in the process.

ONGOING ENERGY REQUIREMENTS FOR COMPUTATION

Bitcoin derives its functionality from using collective memory of every computer that is in the asset’s mining system. This is the basis of Blockchain Technology. A transaction is created and sent out to every other computer on the system and, once the transaction is recorded among 51% of the network, it is considered a “verified” transaction. Eventually the transaction is confirmed across the entire network. This process happens every time a Bitcoin or partial Bitcoin changes hands.

The average daily number of Bitcoin transactions has been well over 500 million since January 2021, and with each transaction being processed across every computer on the system, the energy demands are significant. To give you an idea of how significant the energy demands are, below is a comparison of the energy required to complete 100,000 traditional transactions and the associated transactions of just 1 Bitcoin (Exhibit 1). The energy consumption is estimated to have reached 130 Terawatt hours per year at its current run rate (Exhibit 2). If you compared Bitcoin’s energy demand to the usage of entire countries, it would rank 30th, above the energy usage of Norway and The UAE (Exhibit 3). Now, consider how much energy would be required to run the entire U.S. economy on a cryptocurrency.

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Exhibit 1

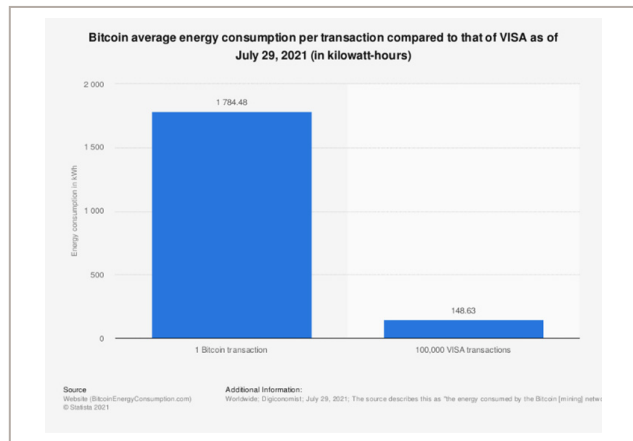


Exhibit 2

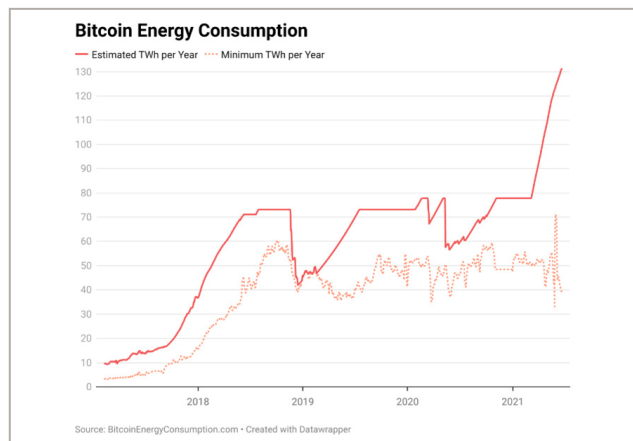
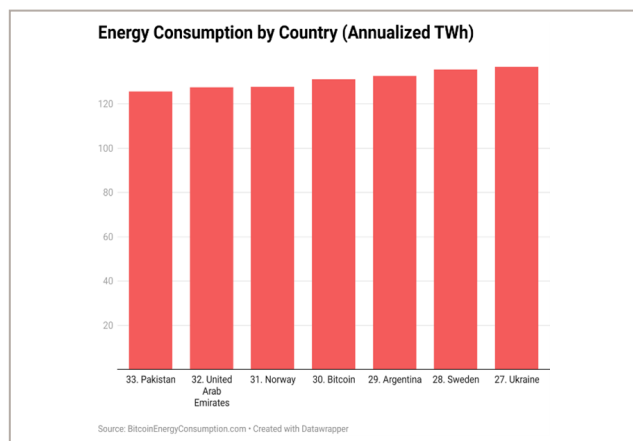


Exhibit 3



A TOUGH ROAD AHEAD

For these reasons, we believe there are major obstacles ahead of a cryptocurrency replacing the U.S. dollar. However, this is not a condemnation of Bitcoin or other cryptocurrencies as they may have future run-ups in price, resulting in gains from speculation. Crypto may very well be the future of currencies, but there are tough decisions and societal changes that need to be made before widespread adoption could occur for transactional means.

At Clearstead, we aim to provide additional considerations and ultimately outline the risks of investing in something like Bitcoin when the discussion arises with clients. The best approach is to discuss these risks and considerations with your advisor and weigh them alongside your financial objectives and needs.

Sources:

- (1) [Investopedia.com](https://www.investopedia.com/).
- (2) [Gemini.com/state-of-us-crypto](https://www.gemini.com/state-of-us-crypto).

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Performance data shown represents past performance. Past performance is not indicative of future results. Current performance data may be lower or higher than the performance data presented.

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MARKET BENCHMARK RETURNS

July 31, 2021		1M	3M	12M	YTD
US Large Cap	S&P 500	2.4%	5.5%	36.4%	18.0%
US Small Cap	Russell 2000	-3.6%	-1.5%	52.0%	13.3%
Developed Intl	MSCI EAFE	0.8%	2.9%	30.3%	9.6%
Emerging Intl	MSCI Em Mkt	-6.7%	-4.4%	20.6%	0.2%
Real Estate	NAREIT	4.0%	7.7%	34.5%	26.0%
Core Fixed	BarCap Agg	1.1%	2.2%	-0.7%	-0.5%
Short Fixed	BarCap 1-3Yr	0.2%	0.1%	0.4%	0.2%
Long Fixed	BarCap LT G/C	2.8%	7.3%	-4.2%	-2.0%
Corp Debt	BarCap Corp	1.3%	3.6%	1.2%	0.0%

Source: Bloomberg

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