Does CRYPTO Belong in Your Portfolio?

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Don't be fooled by the constant stream of articles about cryptocurrency. It's true that cryptocurrencies have become more popular, and more numerous, including Bitcoin, Dogecoin, Ethereum, and more than 9,000 others.

They're still not mainstream— "everyone" isn't investing in cryptocurrencies. But are they a new asset class? Should you include cryptocurrencies in your portfolio?

No. And no.

OK, that answer sounds pretty categorical. Let's be more precise: the enormous majority of individuals and households should not hold cryptocurrency as an investment. It's every bit as suitable as currency speculation with all the intrinsic value of a non-fungible token (that is, not suitable at all with zero intrinsic value).

Are cryptocurrencies the newest asset class, another tool for greater diversification?

No. They're a new kind of cash—much less stable than the US dollar—but not a new asset class. It's very like having currency from a country you've never heard of. Or perhaps something like when exchange-traded funds entered the world of investments (but, unlike ETFs, just a lot less useful [well, pointless] for the enormous majority of us).

In the type of large portfolio (not yours) where it makes sense to stockpile some euros, pounds, rupees, or yuan, it might make sense to have some cryptocurrency. The rest of us should stick to investments in the kind of assets that have been around for centuries, like stocks, bonds, real estate, and cash—legal tender issued by the authority of a sovereign government. Here's why.

What cryptocurrency really is

Money of any kind only works because groups of people agree to believe in it. (See Jacob Goldstein's book Money: The True Story of a Made-Up Thing.) All money, including the kind issued by governments, isn't valuable in itself. It's an agreed-upon or accepted representation of value.

In this respect, cryptocurrency is similar to government-issued currency—it has value because numerous people agree it has value. What is different is that everyone who owns cryptocurrency receives a distributed ledger containing all the data tracking every transaction ever made by anyone in that specific cryptocurrency, and how much they have (or had) at any time. You just can't identify who each individual is in the real world because everyone's identity is hidden behind a unique string of characters, kind of like an account number.

Where does cryptocurrency get its value?

Cryptocurrency, like legal tender, derives its value from how much you can exchange it for in goods or services. When we talk about how many dollars you can get for a bitcoin, it eventually boils down to how much bitcoin you'd need (compared with how many dollars) for a loaf of bread, a car, or a vacation.

The enormous swings in the value of cryptocurrencies stem from the fact that it's less certain how much cryptocurrencies can buy. Like the value of Beanie Babies rocketing upward and then crashing, the value changes based on what the community as a whole thinks it can get if it tries to sell (for example) one Bitcoin or Dogecoin.

There's an important similarity to another recent development, the emergence of non-fungible tokens (NFTs). An NFT is a computer file that's identified as being unique, even though it can be copied identically many times. It gets its value, if any, from the tag that identifies it as unique. How much value? As much as the next buyer is willing to pay for it (the same influence that has caused used car prices to skyrocket during the pandemic). If no one else believes it's worth paying for, its value is zero.

Why isn't cryptocurrency as good as a stack of dollar bills? Because many fewer people believe in its value. So, if you wouldn't speculate on the value of yen or euros, you certainly shouldn't speculate on the value of cryptocurrency.

Is cryptocurrency a fad?

We don't believe cryptocurrency is going away any time soon. In fact, it's likely to continue to be accepted by more and more people. And the technology that makes cryptocurrencies work—a distributed ledger of all transactions that can only be added to, and not otherwise edited, using blockchain technology—is already being used by businesses in ways that have nothing to do with cryptocurrency.

One of the major selling points of cryptocurrency is that it allows users to keep transactions private. ("Crypto" derives from Latin and Greek roots for hiding and concealment.) While there are obvious unlawful applications—ransomware criminals, for example, may only release computer files back to you if you pay in cryptocurrency—it's harder to see any essential application for people who (per our consistent recommendations) avoid committing felonies.

Cryptocurrencies and the technologies behind them aren't worthless. But cryptocurrencies are inherently speculative—they're not suitable for investing. "Investing" in cryptocurrency is applying the wrong tool for the job for almost all of us. I wouldn't use your doorstop as an investment any more than I'd use a mutual fund to keep your door open.

Investing without cryptocurrency

Anything with the promise of making a lot of money in the short run has at least commensurate risk. To make money with cryptocurrency, you'd need to be very good at timing the market (people are notoriously bad at that) or very lucky. Will a small number of people make enormous fortunes in cryptocurrency? Of course. Many, many others will lose substantial sums of money.

Investments should be boring. They're not about getting rich quickly, but building wealth slowly—very tortoise-like. And of course, most of us don't need to beat the market to succeed at investing.

Don't be seduced by articles claiming that cryptocurrency is a new asset class—it's not. It's a relatively new asset and, very much like speculating in sovereign currencies, it's marked by risks that outweigh the benefits. Like many other assets, cryptocurrency has no role in strengthening the financial security of individuals and households. Anything cryptocurrency can be relied upon to do in an investment portfolio, there's an alternative that's far less speculative that can do the job better.

If you're curious or you want to be a part of the trend, take the money from your entertainment budget, and consider it already spent at the time you buy cryptocurrency. And just like a bet at a casino, don't consider it part of your portfolio.