March 6, 2021

Is Crypto Becoming Mainstream? | Part III – The portfolio manager's view

IS CRYPTO BECOMING MAINSTREAM?

Welcome to the third article in our focus series, that asks whether crypto can become mainstream. In the previous post, we highlighted the obstacles that could prevent crypto from becoming an alternative form of money. Now, we look at the potential role crypto could play inside investment portfolios.

Part III

THE PORTFOLIO MANAGER'S VIEW

"to include or not to include, that is the question."

For portfolio managers the fundamental question is the eligibility of cryptocurrencies in their asset toolboxes.

Can crypto be a store of value? Without any cash-flow, how to value these assets analytically? This should sound familiar to most commodity investors who will also know that this does not mean that a quantitative approach doesn't exist. The problem is that cryptocurrencies do not have a value anchor with real values (like real assets). You cannot calculate any fundamental intrinsic value (its price could be anything or nothing at all, its value is whatever the markets say it is), but you can still look at the impact of a Bitcoin allocation in the context of multi-asset portfolios. In a recent article, Pierre E Mendelsohn [1] made the calculation around the inclusion of Bitcoin within a portfolio context. The portfolio optimization, calculated using different methods and objectives, ends up between 0% and 2.6%. Unsurprisingly, in front of the observed volatility, under a minimum variance objective, the allocation ends up at zero.

These calculations demonstrated that a limited allocation to Bitcoin helped increase the risk/return trade-off in the portfolio (with best results in the last 5 years, not so much anymore on a shorter timeframe), but it also increased drawdowns by a very significant proportion for unprepared investors. As stated in Mendelsohn's article, historically, Bitcoin was an uncorrelated asset class which brought a measurable diversification benefit to multi-assets portfolios. The point is then that **correlations are not stable**. Recent months showed higher correlations to other assets (especially US equities and gold).

The article concluded by stating the obvious that "going forward, Bitcoin will attract further interest only if it can remain uncorrelated to traditional assets and, therefore, continue to bring an observable diversification benefit to multi-asset portfolios. If so, and this is not a small if, we would expect it to gradually become less volatile as it becomes more widely accepted."

Stay tuned for our next article which will tie up everything we have discussed thus far, while asking: What next for crypto?

Footnotes:

1. Pierre Mendelsohn is the founder and CEO of Alpima. The referred article is "To include or not to include, that is the question". Simulations were based on a USD denominated portfolio articulated around 10 highly liquid sub-asset classes and adding BTC to it. The observation period was from July 2012 to January 2021.

Disclaimer

All financial data and/or economic information released by this Publication (the "Publication"); (the "Data" or the "Financial data and/or economic information"), are provided for information purposes only, without warranty of any kind, including without limitation the warranties of merchantability, fitness for a particular purpose or warranties and non-infringement of any patent, intellectual property or proprietary rights of any party, and are not intended for trading purposes. Banque Internationale à Luxembourg SA (the "Bank") does not guarantee expressly or impliedly, the sequence, accuracy, adequacy, legality, completeness, reliability, usefulness or timeless of any Data. All Financial data and/or economic information provided may be delayed or may contain errors or be incomplete. This disclaimer applies to both isolated and aggregate uses of the Data. All Data is provided on an "as is" basis. None of the Financial data and/or economic information contained on this Publication constitutes a solicitation, offer, opinion, or recommendation, a guarantee of results, nor a solicitation by the Bank of an offer to buy or sell any security, products and services mentioned into it or to make investments. Moreover, none of the Financial data and/or economic information contained on this Publication provides legal, tax accounting, financial or investment advice or services regarding the profitability or suitability of any security or investment. This Publication has not been prepared with the aim to take an investor's particular investment objectives, financial position or needs into account. It is up to the investor himself to consider whether the Data contained herein this Publication is appropriate to his needs, financial position and objectives or to seek professional independent advice before making an investment decision based upon the Data. No investment decision whatsoever may result from solely reading this document. In order to read and understand the Financial data and/or economic information included in this document, you will need to have knowledge and experience of financial markets. If this is not the case, please contact your relationship manager. This Publication is prepared by the Bank and is based on data available to the public and upon information from sources believed to be reliable and accurate, taken from stock exchanges and third parties. The Bank, including its parent,- subsidiary or affiliate entities, agents, directors, officers, employees, representatives or suppliers, shall not, directly or indirectly, be liable, in any way, for any: inaccuracies or errors in or omissions from the Financial data and/or economic information, including but not limited to financial data regardless of the cause of such or for any investment decision made, action taken, or action not taken of whatever nature in reliance upon any Data provided herein, nor for any loss or damage, direct or indirect, special or consequential, arising from any use of this Publication or of its content. This Publication is only valid at the moment of its editing, unless otherwise specified. All Financial data and/or economic information contained herein can also quickly become out-of- date. All Data is subject to change without notice and may not be incorporated in any new version of this Publication. The Bank has no obligation to update this Publication upon the availability of new data, the occurrence of new events and/or other evolutions. Before making an investment decision, the investor must read carefully the terms and conditions of the documentation relating to the specific products or services. Past performance is no guarantee of future performance. Products or services described in this Publication may not be available in all countries and may be subject to restrictions in some persons or in some countries. No part of this Publication may be reproduced, distributed, modified, linked to or used for any public or commercial purpose without the prior written consent of the Bank. In any case, all Financial data and/or economic information provided on this Publication are not intended for use by, or distribution to, any person or entity in any jurisdiction or country where such use or distribution would be contrary to law and/or regulation. If you have obtained this Publication from a source other than the Bank website, be aware that electronic documentation can be altered subsequent to original distribution.

As economic conditions are subject to change, the information and opinions presented in this outlook are current only as of the date indicated in the matrix or the publication date. This publication is based on data available to the public and upon information that is considered as reliable. Even if particular attention has been paid to its content, no guarantee, warranty or representation is given to the accuracy or completeness thereof. Banque Internationale à Luxembourg cannot be held liable or responsible with respect to the information expressed herein. This document has been prepared only for information purposes and does not constitute an offer or invitation to make investments. It is up to investors themselves to consider whether the information contained herein is appropriate to their needs and objectives or to seek advice before making an investment decision based upon this information. Banque Internationale à Luxembourg accepts no liability whatsoever for any investment decisions of whatever nature by the user of this publication, which are in any way based on this publication, nor for any loss or damage arising from any use of this publication or its content. This publication, prepared by Banque Internationale à Luxembourg (BIL), may not be copied or duplicated in any form whatsoever or redistributed without the prior written consent of BIL 69, route d'Esch ı L-2953 Luxembourg ı RCS Luxembourg B-6307 ı Tel. +352 4590 6699 ı www.bil.com.