

Bitcoin, other forms of cryptocurrency are here for the long haul

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It seems like everybody's talking about Bitcoin these days, and for good reason. Blockchain and the decentralized ledgers that support cryptocurrencies like Bitcoin, represent a significant technological breakthrough. Furthermore, over the past couple years there have been few investments which have performed better, leading many to ask if it's too late to invest.

Before investing in cryptocurrency, here are some things you should consider.

Cryptocurrency is designed to function like cash to help facilitate asset transfers. Like a printed dollar bill, cryptocurrency can be held and exchanged anonymously. Unlike cash, cryptocurrency only exists in digital form and must be accessed via password protected electronic accounts. But because it exists only in the digital world, cryptocurrency can be exchanged much more quickly, cheaply, and safely than cash which helps explain its rapidly rising popularity.

Since the technology behind Bitcoin is so disruptive, the world is in the midst of a high profile debate over what to do with it. Some countries, like China, have already decided to launch their own cryptocurrency, and declared Bitcoin, and all other forms of decentralized cryptocurrency, illegal. On the opposite end of the spectrum, El Salvador recently adopted Bitcoin as legal tender.

Bitcoin has existed for more than a decade, and during that time has developed somewhat of a controversial reputation. Given its ease of transportability and anonymity, Bitcoin has become popular with drug dealers and is the currency of choice for ransomware thieves. Bitcoin also threatens the livelihood of the very profitable and politically powerful banking and credit card industries.

As much as investors love the idea of a world no longer exchanging dirty physical currency, they're much more concerned about the huge and rising amount of energy required to run the servers that update and maintain Bitcoin. It is estimated the amount of electricity needed to "mine" Bitcoin is currently equivalent to the annual electrical consumption of Greece. It is these environmental concerns that reportedly caused Elon Musk to rethink his strong endorsement of Bitcoin.

In the U.S., Federal Reserve Chair Jerome Powell announced it'll be just a matter of days before he releases a position paper for public comment on the creation of a U.S. Government-backed Central Bank Digital Currency (CBDC), which will directly compete with Bitcoin.

All this means it's becoming increasingly evident that digital currency is the future. The real question now is which type of cryptocurrency will prevail: a decentralized version like Bitcoin, or the kind issued by central banks and backed by governments. It seems reasonable to assume that financial regulators will have a say in how this debate is decided. Gary Gensler, who up until recently taught a course on cryptocurrency at MIT, and is the newly seated Security and Exchange Commission Chair, went on record recently stating he doesn't see much future for Bitcoin.

But while financial regulators may want to clean up the "wild west" of the current cryptocurrency craze, the privacy features remain a significant driver of demand for decentralized cryptocurrencies like Bitcoin. It is highly likely any CBDC will be viewed by many as traceable and therefore not as anonymous as Bitcoin or hard currency.

In the short-term, the price of Bitcoin has clearly been the beneficiary of a world awash in trillions of dollars of government stimulus – note the unexplainable appreciation of Dogecoin, a cryptocurrency literally set up as a joke with a current market value in excess of \$26 billion. Without all of the pandemic-induced government stimulus, cryptocurrencies would likely be trading at much lower levels.

Because of the transactional efficiencies and consumer protections they offer, it seems increasingly likely that CBDCs will eventually dominate the cryptocurrency market. This will lessen the appeal of the decentralized cryptocurrencies and hard currency, but I suspect both of those forms of currency will be with us for many years to come because of their promise of anonymity.

If you're considering making an investment in Bitcoin, or any other cryptocurrency, approach it as you would any other highly speculative investment. Keep the position at less than 5% of your liquid holdings, and only earmark funds you can easily afford to lose. Also remember, when you invest in anything truly speculative, it is normally advisable to do so with taxable money in a taxable account. That way, if your gamble blows up in your face, at least you are able to deduct the loss against income and other taxable gains and recoup some of your loss.

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