Rochester Wealth Strategies

439 S Main St, Suite 250
Rochester, MI 48307
(248) 434-6550

Bits & Pieces About Bitcoin

By Mike Skoric, CFA

One of the hottest assets in 2024 after a disappointing last couple of years is Bitcoin, the hard-to-define cryptocurrency that's already up around 50% in 2024 and over 100% over the past year. Crypto investors that go back longer have witnessed similar periods of irrational exuberance and performance by Bitcoin and occasionally other asset classes, only to be disappointed later. But could this time be different, and if so, how? To help answer these questions, it is helpful to consider the probable factors driving this recent outperformance.

A key driver has been the long-awaited SEC approval of spot Bitcoin ETFs on January 10th of this year. This came after a long list of disappointing prior approval attempts and SEC rejections dating back to 2013. Suddenly, there were 11 approved applications that the investing public could choose from, including ones from Wall Street behemoths like BlackRock and Fidelity – adding an extra layer of perceived legitimacy for the evolving asset.

Initial bullish estimates were that these funds might draw as much as $100B in assets in just the first year. After less than three months, this does not appear to be at all unrealistic given that just the largest two of the recently approved ETFs alone have accumulated over $20B in assets. Furthermore, the strong recent performance of Bitcoin could result in more retail investors wanting to "join the party" as well as institutional managers allocating at least modest positions. In fact, total assets in the eleven ETFs, including ones that were converted to ETFs, already exceed $50 billion, which is almost half of gold ETF assets that have been around for almost two decades.

The second likely performance driver has to do with the Bitcoin "halving" process which happens approximately every four years. A key part of the bullish thesis on Bitcoin is its supply scarcity which in theory should make it a good store of value and an inflation resistant asset. Bitcoin is limited by the original program to no more than 21 million tokens of which 19.6 million have already been issued. The way new tokens are created is by rewarding Bitcoin miners for validating blocks of transactions. For the last four or so years these miners were rewarded with 6.25 tokens, but that figure will be cut in half in April of this year, to 3.125 tokens. Historically this halving has often led to periods of stronger performance due to the simple laws of supply and demand, which should result in higher Bitcoin prices. It is reasonable to expect that some or even most of the price benefit from the upcoming halving is already priced in as investors have been anticipating this and probably initiating or adding to existing positions, but more near-term gains are also likely.

Lastly, there are the common reasons we often hear as being key motives to invest in Bitcoin. This includes its perceived inflation-fighting qualities in a world with increasing national debt levels and decreasing confidence in "fiat" national currencies. There are also fears of future global conflict with numerous current geopolitical hotspots and outright wars. Many would argue that this reasoning would warrant some small exposure to an asset that is still in many ways outside the scope of government control and with the mentioned limited supply feature.

At Rochester Wealth Strategies, we remain cautious in our approach towards Bitcoin and the broader cryptocurrency space. With any emerging asset, especially one with no cash flow (which is usually the basis for the valuation of most assets), there must be significant due diligence. If Bitcoin is gradually viewed as an alternative to gold, then it could provide one somewhat reasonable basis for valuation. At the same, though, we do feel that supply and demand is a powerful market dynamic. While we don't want to be overly optimistic, we are attracted to the favorable risk-reward ratio that we have witnessed for much of the last fifteen years and that alone makes Bitcoin worthy of out serious analysis and consideration.

All said, we attempt to reach a comprise by currently employing a very modest allocation to Bitcoin, and only for our most aggressive clients. As we gain more clarity on the use of Bitcoin overtime, we will reconsider the scope of its use in client accounts.