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# 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 <u>previous post</u>, 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."

# 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.

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