Want to Retire Rich? Why Bitcoin Could be Your Biggest Mistake

Description

Investors are always trying to find assets that offer high return potential, as well as low correlation to the economy. The idea in doing so is to not only generate high rewards, but to do so in a variety of economic circumstances.

Such assets are difficult to find, with them often becoming less popular among investors during periods of strong economic growth.

Bitcoin was previously mooted as such as asset, with it apparently having low positive correlation to the wider economy. However, following a decline of over 80% in the 12 months after it reached a record level in December 2017, the virtual currency appears to be exceptionally volatile and highly dependent upon investor sentiment.

High volatility

While there are a range of assets that display high levels of volatility, Bitcoin’s performance over the last couple of years has been akin to a ‘rollercoaster ride’. Having surged from $1,000 at the start of 2017 to reach almost $20,000 by the end of the year, it plummeted by over 80% within one year. Although it has subsequently made a partial recovery, it still trades around 60% down on its all-time high.

For an investor who bought at any point in the last couple of years, their experience of holding Bitcoin is likely to have been full of ups-and-downs. There are likely to have been periods of joy, and times of despair. While having a limited amount of capital in such as asset may not cause too much stress for investors, investing sizeable portions of a portfolio could lead to a difficult experience due to the exceptional volatility that Bitcoin is likely to exhibit.

Since Bitcoin’s price is determined solely by demand and supply, rather than there being any fundamentals that are present in other assets, a fall in its price can take place without clear reason. This could lead to increased fear among holders of the virtual currency, when the same situation in other assets such as stocks may lead them to increase their investment due to it offering a wider margin of safety.

High correlation

With its dependence on investor sentiment, Bitcoin is arguably more positively correlated to the wider economy than other assets. Its performance over the last couple of years provides evidence of this, with it falling heavily in line with weak investor sentiment during 2018, and then posting improved performance as global stock markets have increased in price during 2019.

As such, its risk/reward opportunity may be less favourable than other assets. Certainly, it could perform well in a rising market, but as its performance in 2018 showed, a decline in investor sentiment may lead to significant falls that erase most, if not all, of its gains. Therefore, investors who are looking to buy an asset today with the view of it delivering sustainable growth over the long run may find that Bitcoin offers an uncertain long-term outlook.

By contrast, the stock market has a diverse range of companies that may offer sustainable growth over the long run. While volatility may be high during challenging periods for the economy, in the long run owning a range of stocks could offer less volatility and higher rewards when compared to Bitcoin.

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