Bitcoin Collapses: Should Investors Buy the Dip?

Description

Bitcoin took a serious tumble this morning, as the price of each token dropped 24% in a matter of hours. The cryptocurrency has now wiped off US$500 billion (CA$600 billion) in aggregate market value. This could have an impact on investors who hold cryptocurrency, Bitcoin mining stocks, and digital asset exchange-traded funds (ETFs).

It could also be an opportunity for new adopters and long-term investors to add more exposure. Here's a closer look at what's happening.

Why is Bitcoin falling?

There could be a number of different reasons for Bitcoin's sudden dip over the past few weeks, but three reasons seem to stand out. For one, Elon Musk's criticisms seem to have highlighted the fact that the cryptocurrency is still intensely energy intensive. Each transaction and block creation takes up a monumental amount of energy, which has a broad carbon footprint.

Meanwhile, Chinese regulators announced a slew of new measures to crack down on the industry. Yesterday, China banned financial institutions and payment companies from providing services related to cryptocurrency transactions. State authorities also warned citizens against speculative investment activities in the sector.

Finally, investors seem to be more risk averse this year than in 2020. High-growth tech stocks have been steadily losing value for much of this year. Investors are clearly pessimistic about the outlook for tech stocks. Since there's considerable overlap between digital assets and tech investors, this sell-off seems to be a broader trend in global capital markets.

How long could this last?

At this point, it's impossible to say how long this correction could last. But a look back at Bitcoin's history could give us some indication.

During the 2017 hype cycle, Bitcoin's value inflated 20-fold in a matter of months. When investor sentiment swung the other way in 2018, the price collapsed. Bitcoin's value would gradually dive lower for the next three years.

In other words, we could be facing a prolonged draw down and an extended period of low Bitcoin prices. This could also apply to all other cryptocurrencies, since the correlations between digital assets are still relatively high.

The best strategy

For long-term Bitcoin investors, extreme volatility and destructive drawdowns are nothing new. Despite its recent crash, Bitcoin's value is still 340% higher than last year. Over the past decade, it remains one of the best-performing asset classes in the capital market.

If you're a long-term investor with an appetite for risk and technical understanding of Bitcoin's potential, this may be a great time to add more exposure. **Purpose Bitcoin ETF** (TSX:BTCC) could even allow you to add BTC to your Tax-Free Savings Account (TFSA). Dollar-cost averaging into this asset class could be an excellent strategy.

However, mitigating risk by diversifying your portfolio far beyond cryptocurrencies is also essential.

Bottom line

Bitcoin has had a stellar run, which seems to be ending now. This could be an opportunity for long-term investors with the right risk profile. Good luck!

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vraisinghani