SAFETY ▪ STRENGTH ▪ STABILITY
UNIT TRUST CORPORATION
ADVISORY SERVICES DEPARTMENT

Newsletter

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CRYPTOCURRENCY

The world is evolving, and technology has caused a massive shift in everyday activities. People communicate with each other, work, shop for goods and services and even the method of payment, have all changed. It has evolved from cash to debit and credit cards to even contactless payment methods where customers can pay for items with a smartphone. In this vein, there is a newer payment system emerging – cryptocurrency.

Cryptocurrency can be defined as a digital currency whose transactions are verified and records are maintained by a decentralized system, rather than the oversight of regulators. It is encrypted using cryptography which is a secure form of communication that allows only the sender and intended recipient to view its contents. Intended to provide enhanced security and safety, it uses advanced coding to store and transmits cryptocurrency data between wallets and to public ledgers.

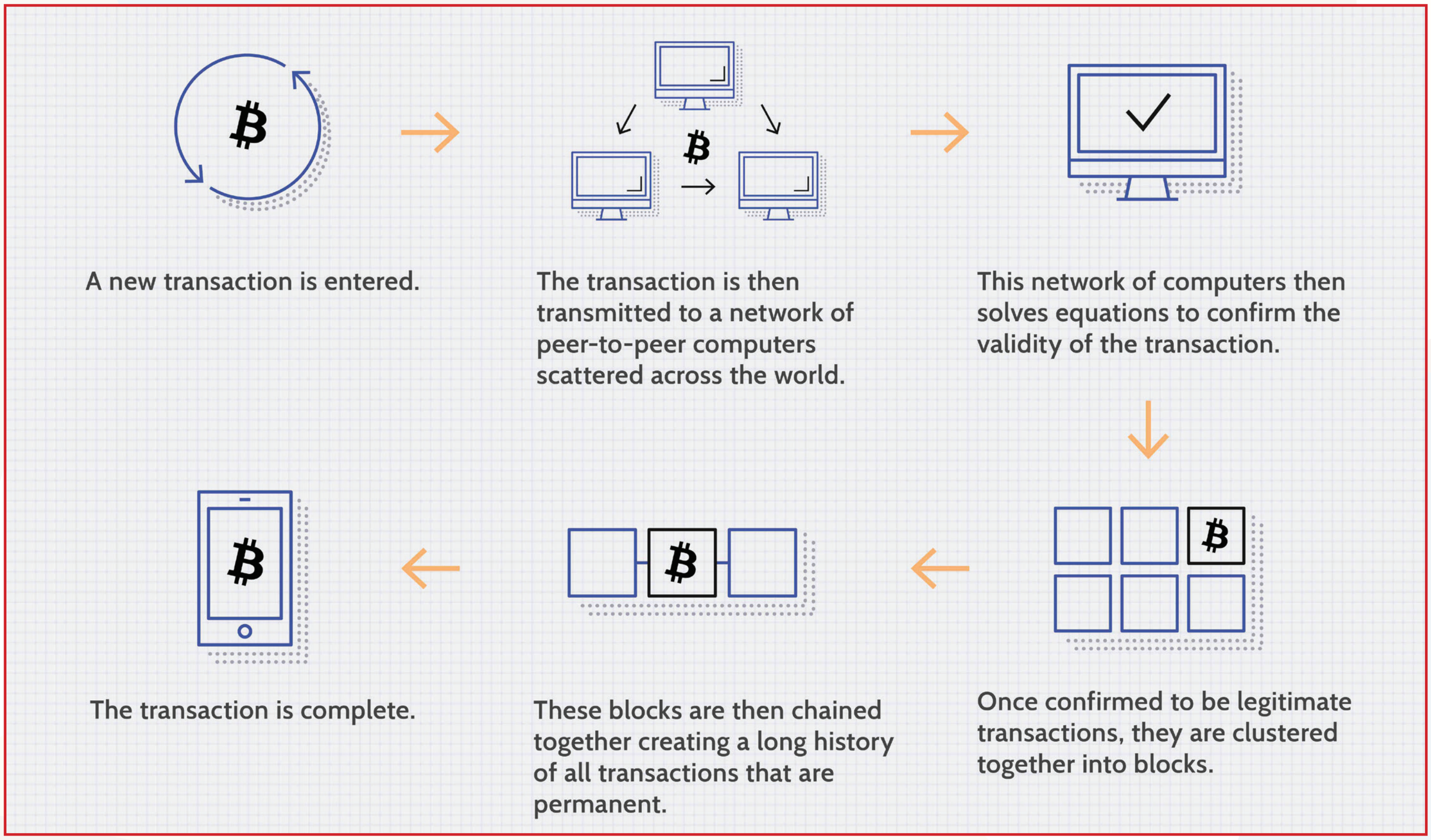
Unlike physical money that exists in the real world and can be exchanged from hand to hand, cryptocurrency is purely digital. Individuals and businesses transact with the coin electronically on a peer-to-peer network. Payments are recorded as digital entries to an online database that describes specific transactions. As security is an essential element of cryptocurrency, transactions usually require a two-factor authentication process. For instance, a username and password to start a transaction and an authentication code that's sent via text to your personal cell phone.

BLOCKCHAIN

Most cryptocurrencies use blockchain technology to record transactions. Even though it seems complicated, blockchain at its core is quite simple; it is basically a type of database that is essentially a digital ledger of transactions.

An additional benefit is that this system inherently makes an irreversible timeline of data as only when a block is filled does it become a part of this timeline. See Figure 1 for an outline of the process.

Figure 1: The Transaction Process



Source: Investopedia

CURRENT MARKET

The cryptocurrency market has evolved erratically and at unprecedented speed over the course of its short lifespan. According to CoinMarketCap, a cryptocurrency data and analytics provider, more than 10,000 different cryptocurrencies are traded publicly. The total value of all cryptocurrencies, by market capitalization (the price of the virtual currency times the number of coins in the market), as at September 24, 2021, was approximately $1.9 trillion (see Chart 1) — down from an April high of $2.2 trillion.

Chart 1: Total Cryptocurrency Market Cap

Source: CoinMarketCap

The list of the most valuable cryptocurrencies is always changing, just like the list of the most valuable publicly traded companies. Since cryptocurrencies tend to be more volatile than blue-chip stocks, how cryptocurrencies rank in value can change quickly. There are a few consistencies at the top of the list, though.

The 10 largest trading cryptocurrencies as at 24 September 2021, by market capitalization are shown in Table 1.

Table 1: Top 10 Largest Trading Cryptocurrencies

CRYPTO CURRENCY	MARKET CAPITALIZATION
Bitcoin	$799.3 billion
Ethereum	$341.8 billion
Cardano	$71.5 billion
Tether	$68.7 billion
Binance Coin	$59.2 billion
XRP	$43.6 billion
Solana	$41.3 billion
USD Coin	$30.4 billion
Polkadot	$30.4 billion
Dogecoin	$27.5 billion

Source: CoinMarketCap

BITCOIN

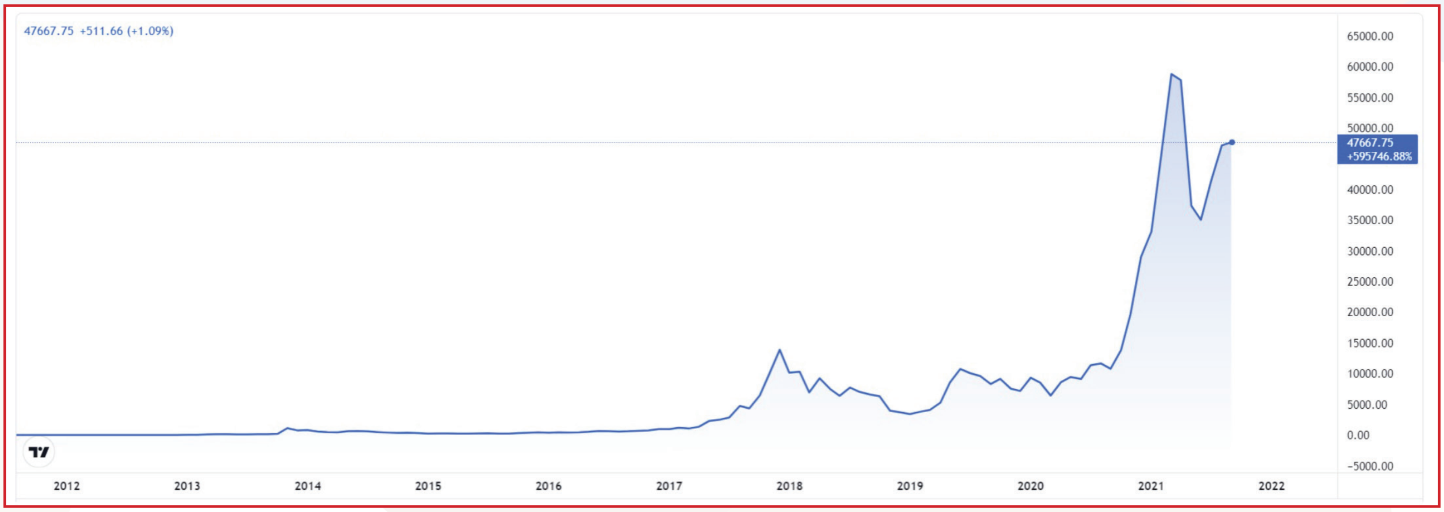
The oldest and most well-known cryptocurrency is Bitcoin. It was first proposed in a 2008 white paper published by an unknown person or group of people using the name Satoshi Nakamoto. Nakamoto begins the paper by stating that "Commerce on the Internet has come to rely almost exclusively on financial institutions serving as trusted third parties to process electronic payments. While the system works well enough for most transactions, it still suffers from the inherent weakness of the trust-based-model". Further, the existence of a trusted intermediary increases transaction costs, "cutting off the possibility for small casual transactions."

Additionally, the paper states that the trusted intermediaries are pressured to gather as much information about the parties as possible in order to control transaction costs. Hence, Nakamoto sought to create a coin that completely removed any trusted central authority and replace trust with cryptographic proof. This system would have the added benefits of having low transaction fees, low latency (time to make transactions), and pseudo-anonymity.

Bitcoin can be accepted as a payment for goods and services or bought either from other people or directly from exchanges/vending machines. These Bitcoins can be transacted via software, applications, or various online platforms that provide wallets to store your private keys to Bitcoin or another cryptocurrency. Another way to obtain Bitcoin is through mining. Miners compete to solve computational puzzles and are awarded Bitcoin whenever they add a new block of transactions to the blockchain.

Introduced to the public on 3 January 2009, Bitcoin traded for less than a dollar until February 2011. The first purchase using Bitcoin was recorded in May 2010, by Laszlo Hanyecz, a computer programmer from Florida. He purchased two pizzas with the agreed amount of 10,000 Bitcoins, which would be equivalent to over $400 million in September 2021. However, since then Bitcoin has been accepted more widely. US online retailer Overstock.com, WordPress, Dell, and Universal Store at Microsoft all except the digital currency. Additionally, Wikipedia accepts donations in Bitcoin and Google has an inbuilt conversion rate so you can easily find out how much your Bitcoin is worth.

Chart 2 – Bitcoin Traded Value/Price 2011-2021



Source: TradingView

Due to Bitcoin's nature, its price is not influenced by the typical factors that affect traditional currencies such as monetary policy, inflation rates, and economic growth measurements.

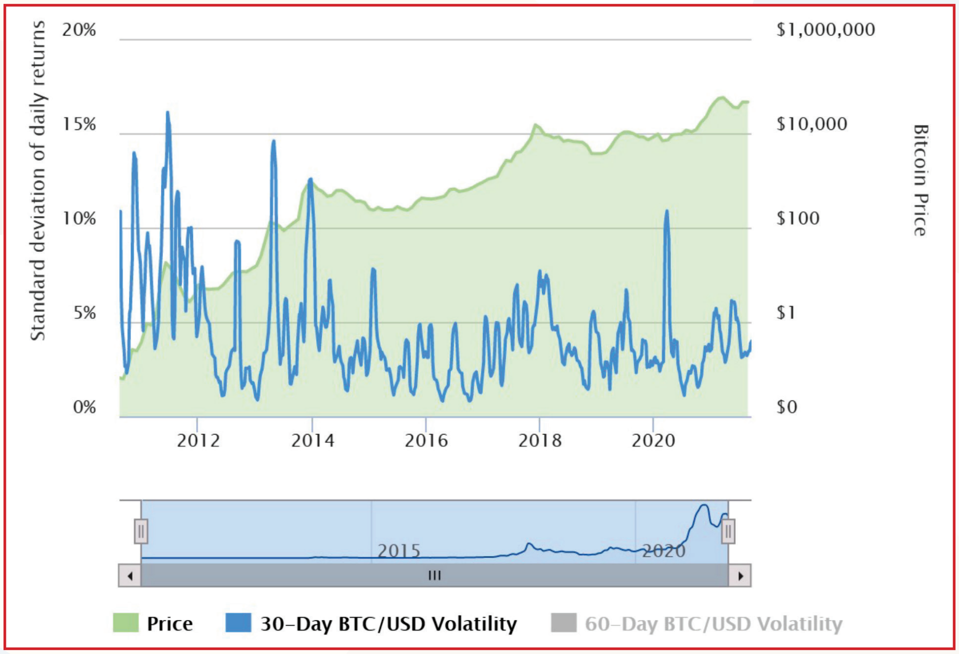
Bitcoin's value largely depends on its supply and the market's demand for it. New Bitcoins are created at a fixed rate which was designed to reduce over time. For example, as shown in Chart 2, growth slowed from 6.9% (2016), to 4.4% (2017) to 4.0% (2018). As a result, there may be times where the demand for Bitcoins increases at a faster rate than the supply, which can push the price upwards.

Bitcoin's price fluctuates for various reasons, including media coverage, speculation, and availability. With negative press, some Bitcoin owners panic and sell their shares, driving down the price and vice versa with positive press. Also, when the volume of Bitcoin sold on the market increases, the price decreases. As more institutions adopt Bitcoin as an investment and medium of exchange, its price increases. Historically, Bitcoin has been quite volatile. Unexpected changes in market sentiment can lead to sharp and sudden moves in price.

In recent times, the factors that influence the price of Bitcoin have changed considerably. Starting in 2017, when Bitcoin gained mainstream attention, regulatory developments have heavily impacted its price. Each regulatory pronouncement can either increase or decrease the price depending on whether it is positive or negative. In November 2019, when China accelerated a crackdown on cryptocurrency businesses, Bitcoin's price sank to an all-time low. A similar effect was seen in 2017 when South Korea made a move to regulate cryptocurrency trading.

In May 2021, Elon Musk said that Tesla, the electric carmaker had suspended vehicle purchases using Bitcoin, citing environmental concerns over the so-called computational "mining" process. This is where high-powered computers are used to solve complex mathematical puzzles to enable transactions using Bitcoin. As a result, Bitcoin prices experienced sharp declines and lost close to half their value in a matter of weeks. The digital currency's annualized 30-day volatility reached 116.62% on May 24, its highest since 10 April 2020 (see Chart 3).

Chart 3: Total Cryptocurrency Market Cap



Source: Highcharts.com

Volatility is not the only risk associated with owning cryptocurrency. They are also unregulated and susceptible to errors and hacking. In August 2021, more than US$600 million was stolen in what is considered to be one of the biggest cryptocurrency robberies. Reports state that hackers exploited a vulnerability in the Poly Network, a platform that looks to connect different blockchains so that they can work together. Luckily, in this instance, hours after the hack, the attacker started returning the funds – first in small amounts and then in millions.

Investing in cryptocurrency can be quite risky but at the same time, it also has the potential to earn high returns. It also has the added benefit of diversification as cryptocurrencies such as Bitcoin have historically shown almost no price correlation with the US stock market.

Investment Check List

Even though cryptocurrency is considered, by many experts, to be one of the riskier investment options, especially given the fluctuation in prices, it can be a good addition to your portfolio. If you're planning to invest in cryptocurrencies, it is important to fully understand them. These tips can help you make educated choices.

1. **Research Exchanges**

   Cryptocurrency exchanges are platforms that allow you to buy and sell digital currencies. According to Bitcoin.com, there are over 500 exchanges to select from. You need to ensure that you are selecting the one that you are most comfortable with – do research, read reviews and talk to people currently invested before you make your final decision.

2. **Understand Storage**

   If you buy cryptocurrency, you have to store it somewhere. It can either be stored on an exchange or in a digital wallet. There are numerous options for wallets, each with its own benefits, technical requirements and security. Similar to exchanges, it is important to investigate your storage choices and select the one best for you before investing.

3. **Diversify Your Investments**

   Diversification is an important aspect of any good investment strategy, and it holds true when you're investing in cryptocurrency. When you are now starting out, it may be helpful to select one currency to see if you're comfortable, but as you progress and continue to invest in cryptocurrency, it is best to do the necessary research to select from the numerous options and spread out your investment.

4. **Prepare for Volatility**

   The cryptocurrency market can be quite volatile, so you have to be prepared for the ups and downs that can cause dramatic swings in the price. If you know that your investment portfolio or mental well-being can't handle that, cryptocurrency might not be a wise choice for you.

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