

DEMELZA HAYS

BITCOIN OR GOLD?

WHY NOT INVEST IN BOTH?

Bitcoin has frequently been called “digital gold”. But what are the differences when investing in the crypto currency compared to the precious metal?

The rules of the Bitcoin software were originally designed to replicate the traits of gold that make it uniquely suited to be money. However, Bitcoin represents an entirely different asset class, with different risks and different benefits. Over the past six years, the correlation between gold and Bitcoin has been low and slightly negative. Therefore, investors can successfully diversify fluctuations in the price of gold by investing a small part of their capital in Bitcoin. Instead of choosing

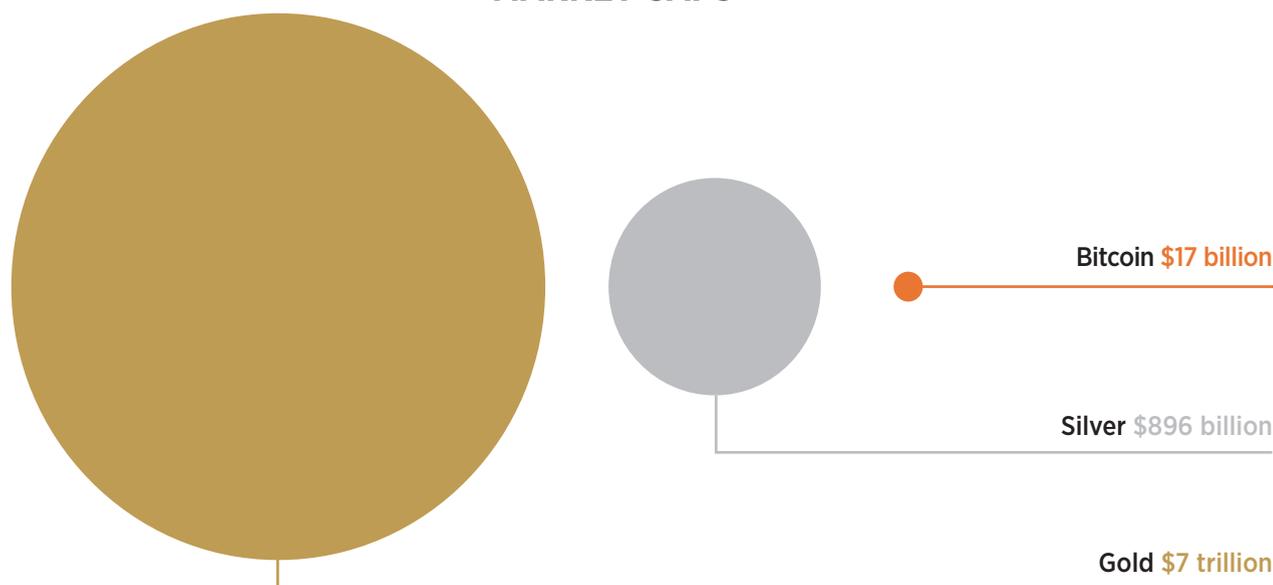
between gold or Bitcoin, the obvious investment strategy is – and has always been – diversification.

The zero and negative interest rate policy of various central banks as well as the global war on cash have pushed more investors into the realm of alternative investments. Gold and Bitcoin are outside of the control of the government, and can therefore provide a “safe haven” during times of significant fiat currency dilution. This is why the demand for Bitcoin is going up in countries that are demonetising their fiat currencies, such as India

and Venezuela. Following the demonetisation of the 500 and 1.000 rupees banknotes in November of last year, the price of Bitcoin on India’s largest Bitcoin exchange, Unocoin, shot up to \$818 while American exchanges quoted the exchange rate as \$709 per Bitcoin. Similarly, Surbitcoin, Venezuela’s largest Bitcoin exchange, saw an increase from 450 accounts in 2014 to over 85.000 in 2016.

However, Bitcoin is much more than just “digital gold”. Bitcoin is also a global, affordable, transparent and nondiscriminatory payment network.

MARKET CAPS



Source: Demelza Hays, Incrementum AG

As money, Bitcoin has three main advantages and four main disadvantages in comparison to gold.

• **Fast clearance and settlement of transactions:**

Bitcoin offers immediate clearance because anyone can make an account at any time without any identification documents. Today, over 125,000 merchants worldwide accept Bitcoin. In contrast, a Google search for merchants that accept gold as payment leads you to a few dusty goldbug forums that discuss ways to make gold great again.

• **Low shipping costs:** Transaction fees for “shipping” Bitcoin from one account holder to another ranges from free to forty cents regardless of the amount of Bitcoin being sent. What matters for a payment network and a medium of exchange is how quickly you can put the media to use. In this sense, gold is slow money. The physical aspect of gold is awesome, until you try to stuff it into your USB port in order to send it to someone across the globe.

• **Low storage costs:** Storing Bitcoin amounts to storing a large string of numbers that represent digital data. Online, paper, and brain wallets are completely free of charge. Hardware wallets can range from €15 to €240; however, this is still a fraction of the cost of storing physical gold. Fees for a safety deposit box range from €25 – €500 per year depending on the bank and size of the box. Storing gold at home is also an option. Home storage ranges from free to €10,000 depending on the quality of the vault. Insurable home storage systems typically start around €1,000.

Bitcoin’s four drawbacks compared to gold are as follows:

• **Risk of a 51 percent attack:** This is when one miner or mining pool gains a majority of the power on the network. Volatility in the price of

Bitcoin during the past few weeks has stemmed from this risk. A Bitcoin miner is an individual or group of people that run a version of the Bitcoin software on a hardware device specifically designed for mining Bitcoin called an application-specific integrated circuit (ASIC). Mining is the process of adding new transactions to the Bitcoin database of previous transactions. The debate between big blockers from the Bitcoin Unlimited (BU) camp and little blockers from the segregated witness (SegWit) camp amounts to what version of the Bitcoin software should be run on the hardware devices. The most popular software being run by miners, Bitcoin Core, has a data cap of 1 MB per block of transactions. A new block of transactions is mined approximately every 10 minutes, which equates to a limit on the new data that the network can



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record of 1 MB every ten minutes. The BU miners want to raise this limit while the SegWit camps want to decrease the data size of each transaction. Last week, the president of the largest Bitcoin mining pool, who is a proponent of Bitcoin Unlimited, threatened that “[a 51%] attack is always an option.”

• **Risk of changes in regulation:** In Europe and in the US, the regulatory outlook is bleak. At the beginning of this month, the SEC rejected the Winklevoss Bitcoin ETF, and the European Union’s 4th Anti-Money Laundering Directive (AMLD) argues for stricter monitoring of cryptocurrency users, miners, exchanges and wallet providers.

• **Reliance on internet, electricity, and hardware devices:** Without internet, the speed of broadcasting a transaction to all of the nodes across the network would decline steeply. The increased latency would result in more forks of the Bitcoin network because miners would build blocks with an incomplete list of recent transactions. Similarly, Bitcoin’s proof-of-work mining is estimated to cost \$400 million in electricity and hardware per year.

Even though Bitcoin has been called “digital gold”, comparing Bitcoin to gold is like comparing apples to oranges. Bitcoin and gold represent two distinct asset classes – and should be treated as such by investors. The 2017 outlook for both of these classes is positive because they are both deflationary monies that allow investors to counter expansionary fiat currencies and artificially low interest rates. However, buyers beware: a growing body of academic research recommends only 2–4 percent of a diversified portfolio should be in Bitcoin compared to up to 20 percent that may be invested in gold. 