The Bitcoin Chimera

It has been hard to avoid the media hype around Bitcoin, and if we were to believe certain pundits it seems that Bitcoin is set to become the new reserve currency of choice. Whilst it may be an attractive idea, given its decentralised nature, there are some issues, in particular its great volatility and non-universal acceptance, which make it more akin to an asset as opposed to a reserve currency.

In fact, Bitcoin has been making headlines with its extreme price fluctuations. After reaching a record high price of $19,666 on the 17th of December 2017, it has since seen its value slide. During the current holiday season it has failed to fully recover from its wild swings in value with its current figure sitting at $15,249 as of the 26th of December. Such spells of volatility mean that cryptocurrency are highly speculative and unsuitable as long term savings products.

Morgan Stanley recently commented that the true value of Bitcoin is potentially 0. Bitcoin's value is fundamentally dependent on the network effect, therefore "if nobody accepts the technology for payment then the value would be 0." Among the top 500 eCommerce Merchants only 3 currently accept Bitcoin, a shrinking figure from 5 last year. With the recent peak values of Bitcoin, what do these "successes" mean if there is no merchant acceptance alongside it or wider market acceptance (beyond it being a tool for speculation)?

Bitcoin is therefore best viewed as a speculative high risk, high reward investment – a far cry from what it was originally intended to be. Furthermore, it is hard to ascertain the intrinsic value it holds, compared to – for example – Gold. At a surface level both are similar. Gold faces mistrust from governments and currency printing, the reality is similar for Bitcoin where there is no central bank in charge of the currency. However, the value of Bitcoin fluctuates more than Gold. However, given the physicality of Gold and its historic eminence, at least it is easier to comprehend its intrinsic value. Not only does Bitcoin lack the physicality but also suffers from a lack liquidity putting it at a disadvantage. Indeed during its peak-value the most popular US exchange Coinbase suspended buying and selling as it was unable to process the high traffic and there were warnings of delays of up to 10 days. A way to counteract this is to effectively bid a high transaction fee for miners to prioritise your transaction during periods of high demand. But during moments such as when the price of Bitcoin reached peak value, you would effectively be attempting to outbid every user in the world attempting to cash out and be included in the next block which would diminish your returns.

Exchange services are also particularly vulnerable to attacks from hackers. In addition to exchange sites such as Coinbase and GDAX going down multiple times as a result of increased activity. Other traders such as Bitfinex reported it had been under sustained DDoS attacks. South Korean crypto exchange Youbit had been hacked in April earlier this year which resulted in 4,000 Bitcoins being stolen, as a result of the 17% loss in assets the service filed for bankruptcy. The vulnerability and unreliability of these exchange services increase the risks of using Bitcoin as a means of investment.

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