The Crypto Factor

Does crypto hold any currency among US advisors?

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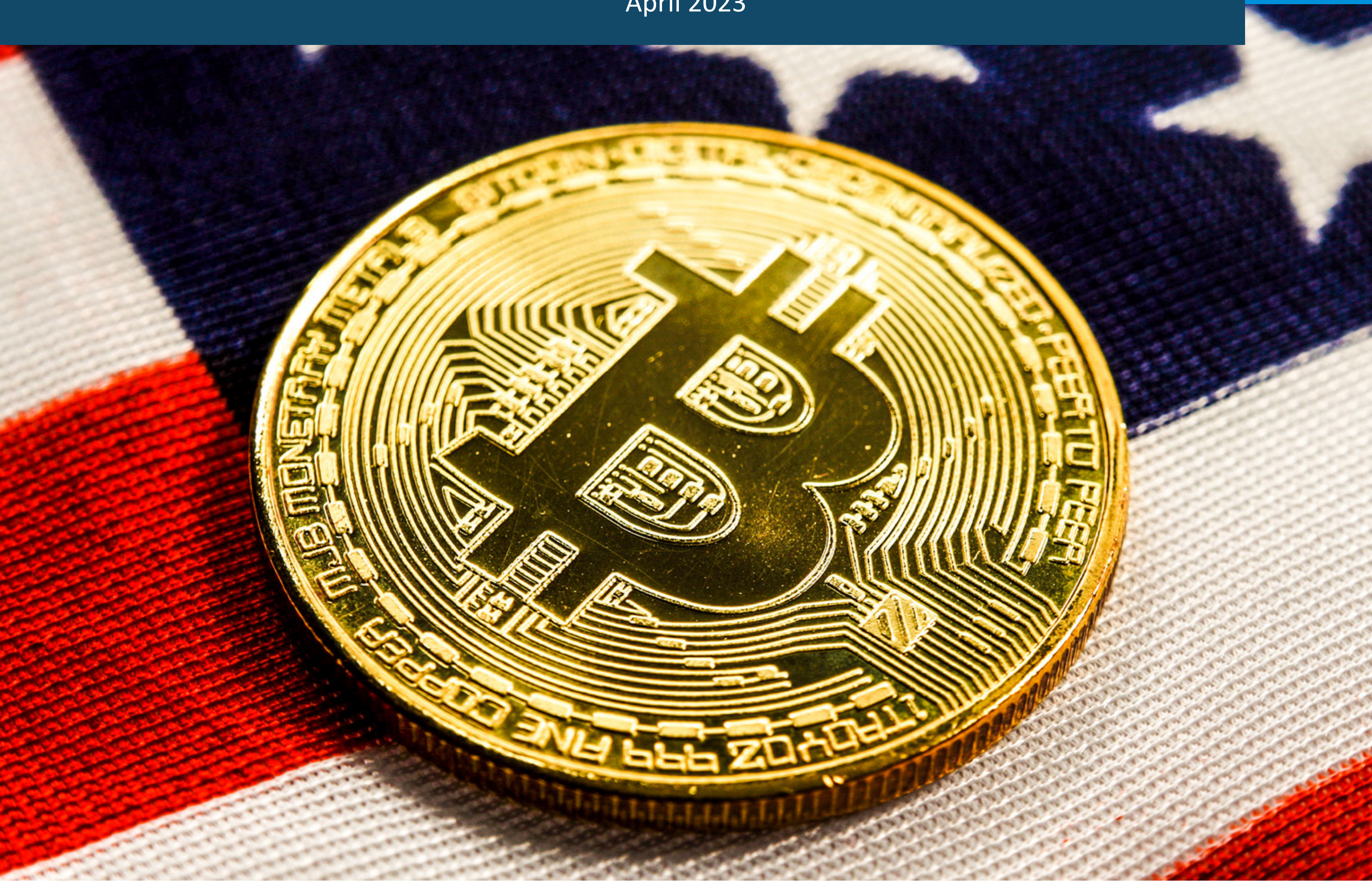

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Key Insights

1 US advisors have a negative outlook on the cryptocurrency sector. Only one in 10 (10%) think cryptocurrencies will outperform the S&P 500 in 2023. And less than one in 10 (8%) say the cryptocurrency downturn — or 'crypto winter' — is over. In addition, more than a third (37%) of advisors think the crypto bull market of 2021 will never be repeated.

2 Just one in eight (12%) advisors say they are seeing increased client interest in cryptocurrencies. The lack of investor appetite is linked with the turmoil of 2022 and, in particular, the high-profile failure of the FTX exchange. Indeed, seven in 10 (69%) advisors say the FTX collapse has reduced client demand for cryptocurrencies.

3 Furthermore, advisors are bracing for new waves of crypto turbulence over the coming months. Seven in 10 (70%) think there will be more cryptocurrency failures in 2023. And ominously, more than a quarter (26%) say there will be a cryptocurrency collapse on a greater scale than FTX this year.

4 Just 6% of advisors agree that cryptocurrencies have a role to play in client portfolios. Even fewer (5%) think cryptocurrencies act as an inflation hedge. And less than one in five (18%) agree crypto will be more attractive when interest rates fall.

5 The regulatory environment is also deterring advisors from the space. Seven in 10 (70%) say they will not recommend cryptocurrencies to clients due to increased regulatory scrutiny.

6 Complexity is another reason why advisors are not recommending digital currencies. More than a quarter (26%) say they don't understand cryptocurrencies.

7 Advisors point to scams/fraud and uncertain regulations as the biggest risks of investing in cryptocurrencies. And they see the biggest potential benefit as the prospect of high returns.

Methodology:
CoreData Research surveyed 250 US financial advisors in February 2023. Respondents included Registered Investment Advisors, independent broker-dealers and wirehouse advisors.

Background

Crypto volatility

The first few months of 2023 have been a rollercoaster ride for cryptocurrencies and an apt illustration of their extreme volatility. By the end of February, Bitcoin – the flagship cryptocurrency – had gained more than 40% on a year-to-date basis. The strong rebound fueled hopes that digital currencies were finally emerging from the long, dark "crypto winter" of 2022 — a year which saw Bitcoin plunge nearly 65%.

But any crypto euphoria was short-lived. By March 10, Bitcoin was nearing a two-month low as a mini banking crisis with ominous echoes of the 2008 financial disaster saw cryptocurrencies come crashing down. In fact, some $70 billion was wiped off the valuation of the cryptocurrency market in less than 24 hours, according to CNBC.

The crisis was triggered by the collapse of crypto lender Silvergate Capital, followed by the failure of tech start-up lender Silicon Valley Bank (SVB) and the crypto-friendly Signature Bank, New York. The collapse of SVB was the biggest bank failure since 2008, fueling fears about contagion risk.

But just days after the selloff, cryptocurrencies were rallying once again as the US government stepped in to protect depositors at SVB and Signature Bank. Meanwhile, HSBC agreed to acquire the UK arm of SVB.

The dramatic episode, which may have long-term repercussions, demonstrates both the volatile nature of crypto and its impact on the wider financial system. The failed banks all had varying degrees of exposure to crypto. Signature and Silvergate were the major US lenders for crypto firms, while SVB counted crypto startups and digital asset firms among its core clients. Just days before Silvergate shut down, key crypto players Galaxy Digital and Coinbase Global cut ties with the lender owing to concerns about its viability.

Experts fear the demise of these crypto lenders could impair cryptocurrency liquidity and especially that of Bitcoin. The crisis has also exacerbated concerns about stablecoins which have recently come under the regulatory microscope. USDC – one of the most liquid US dollar-pegged stablecoins – temporarily lost its peg following the regional bank crisis.

The failure of Silvergate and Signature Bank also demonstrates the ongoing fallout from the FTX scandal. The collapse of Sam Bankman-Fried's exchange in November 2022 during the height of the crypto winter sent shockwaves throughout crypto land which are still being felt today.
Of course, the macroeconomic environment, and in particular bond losses from rising interest rates, was another factor in the collapse of Silvergate and SVB. In addition, Fed rate hikes have dented demand for risk assets including cryptocurrencies and tech growth stocks.

Crypto evolution

The turmoil surrounding these crypto-exposed regional banks comes as digital currencies become increasingly ingrained into the financial fabric amid the ongoing shift to a cashless society. Indeed, more than 15,000 businesses worldwide now accept Bitcoin payments, according to Zippia.

Meanwhile, the sector continues to innovate and evolve amid the constant drumbeat of technology. Non-fungible tokens (NFTs), the metaverse and decentralized finance (DeFi) offer new applications and new possibilities which could not have been imagined when Bitcoin arrived on the scene back in 2009.

The entry of institutional investors into the crypto market – previously the preserve of retail investors and day traders — also appeared to lend the sector a semblance of credibility. In 2022, BlackRock partnered with Coinbase to offer its institutional clients access to Bitcoin in a deal that seemed to mark the arrival of crypto on Wall Street.

Crypto has also extended its reach from the corporate to country level, with El Salvador becoming the first nation to adopt Bitcoin as legal tender in 2021. And Ukraine was able to raise millions of dollars in Bitcoin and Ethereum donations to fund its war effort after the Russian invasion. These developments come as governments increasingly see a role for digital currencies in the future financial system. But countries are also grappling with how to best regulate cryptocurrencies as they seek to balance the desire to innovate with the need to protect consumers.

Proponents of crypto argue that digital currencies provide a hedge against inflation and economic uncertainty and also offer a better long-term store of value than fiat currencies. In addition, they point to the fact that leading cryptocurrencies including Bitcoin and Ethereum have seen astronomical price rises over the last five years.

But the fact remains that cryptocurrencies have been one of the most volatile investments over recent times. Bitcoin, for example, has failed to complete a full calendar year without recording an annual gain or loss of at least 60% since 2015.

Conclusion

This study's findings show advisors are approaching cryptocurrencies with extreme caution in the wake of the collapse of the FTX exchange which has significantly dented client demand. Advisors also expect more crypto failures in 2023. These concerns, alongside increasing regulatory scrutiny, complexity, and fear of scams, are conspiring to deter advisors from the sector.

In addition, many cryptocurrencies have a very short track record, rendering any meaningful comparisons with other assets problematic. Cryptocurrencies are also difficult to value as they don't represent an ownership interest in an entity and don't generate interest or dividends.

Ongoing crypto volatility also poses a major challenge for advisors and investors. Ultimately, investing in digital currencies represents a high-risk bet. Cryptocurrencies should therefore be rigorously researched and, if used, limited to small holdings in diversified portfolios. Investors could make big gains from crypto, but they could also suffer huge losses. So whether the crypto winter extends into a crypto ice age or blossoms into a crypto summer is anyone's guess. And that's just the point – trying to predict the crypto seasons is a futile and potentially hazardous exercise. Advisors should therefore be very wary of putting client money into these speculative investments.

CoreData

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- Deep understanding of industry issues and business trends
- In-house proprietary industry benchmark data
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- Rolling benchmarks

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