Is cryptocurrency a store of value for the current crisis?

Even prior to the arrival of the current world health pandemic, many cryptocurrency believers have been confident in crypto's ability to securely serve as a safe haven… a dependable defense against random chaos. Did cryptocurrencies reassure investors during this crisis? Is Bitcoin Gold 2.0 or Tulip 2.0?

Claude Mabille, August 2020

FINATIC
ICT & Finance Solutions

Topic - Is cryptocurrency a store of value for the current crisis?

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Chapter One – Introduction

The Coronavirus outbreak has stumbled the global economy and resulted in a record economic slowdown. In fact, in a recent press release, the World Bank refers to the pandemic driven 2020 recession as the worst of its kind since World War II (The World Bank, 2020). A quick look at the traditional markets such as equities, commodities, forex, and their respective 12-month historical charts confirm this. The steep decline since January 2020 reminds us of 2008 recession, which was caused due to Lehmann Brothers and sudden currency issuance by governments across the globe. Back then, Satoshi Nakamoto came up with a form of digital asset called the Bitcoin, the first successful cryptocurrency which has steadily grown in value, since its first issuance in 2009.

As the pandemic driven recession has had a clear impact on the traditional markets, there is a sheer need to find more stable options. Gold is a highly dependable store of value but that’s not enough because diversification plays a significant role in the success or failure of an investment strategy. Therefore, most seasoned individual and institutional investors have been on a lookout for alternative investment options, largely for the sake of diversification. After all, diversification of investment portfolio lays down the cornerstone for a sound investment strategy. Now, this is where cryptocurrencies come into the picture and help fill in the gap.

At this juncture, it is worth highlighting that investors considering cryptocurrencies as a potential diversification option are looking at it from an entirely different perspective. They are on a lookout for a store of value, which is quite different from the reason why cryptocurrencies came into existence. So, in this paper, we shall evaluate the genesis of cryptocurrencies, market size, market manipulations, its qualification for the ‘store of value’ status, and more.

Chapter 2 - What Makes Cryptocurrencies a Reliable Investment Option?

Cryptocurrencies are no longer the new kid on the block, as they have been around for over a decade and proved their mettle by outperforming most other types of traditional assets (Cointelegraph, 2020). Since its initial release in the year 2009 by Satoshi Nakamoto, Bitcoin has earned the trust of the masses, forcing governments to classify it as an asset. Let us now analyze some of the key traits of Bitcoin, which makes it a reliable investment option.

Bitcoin is now treated as an Asset

Although countries like China, Vietnam, Bolivia, and certain others refuse to legitimize Bitcoin, countries such as the US, Canada, Australia, and European Union do not frown at it (Investopedia, 2019). In fact, the Internal Revenue Service (IRS) in the US now requires crypto investors to make full disclosure in Form 1040 and has laid down guidelines for the same (IRS, 2020). Similar regulations have been enacted in several other countries by amending the classification of 'Asset' in their tax legislation.

Accepted as a mode of payment

Besides being treated as an asset by the Governments, Bitcoin and other cryptocurrencies are now accepted as a valid payment method by mainstream businesses. A few to mention are Microsoft Store, Overstock, Namecheap, KFC Canada, and Subway (Tuwiner, 2020). So, bitcoins are now trusted as a valuable asset that can be used instead of fiat currencies, which are regulated by the concerned government authorities.

Not Regulated by those with Vested Interests

Unlike fiat currencies and stocks, cryptocurrencies are not regulated by lawmakers and their policies. Neither are these issued by any single person or entity, which makes it free from corrupt practices. On the contrary, Bitcoin runs on a peer-to-peer network without any centralized server or control which ensures higher transparency with no potential for manipulation. Also, unlike the US Dollar, which is issued by the US Authorities or the GBP, issued by the UK Government, the Bitcoin is not issued by any particular authority. The absence of a central server, issuance authority and regulatory agencies together ensure that Bitcoin remains free from the clutches of those with vested interests.

No Intermediaries

Every time you make a monetary transaction, you end up paying a commission to intermediaries such as banks, stockbrokers or other financial service providers. This is greatly reduced when you make use of cryptocurrencies, which translates into enormous savings. So, cryptocurrencies are a unique investment avenue that does not require the investor to lose out on earnings in the form of brokerage, commission, or transaction charges.

Transparent Transactions

The absence of a centralized server and the use of Distributed Ledger Technology, which synchronizes a large database ensures that everyone knows what is happening. Since the detailed record of transactions and modifications to the ledger are publicly visible, it ensures higher transparency. In other words, you never know what the bank is doing with your money as the Ledger remains accessible only to the Bank and its employees. For instance, you do not know how much of your deposits are being invested in equities, bullions, or bonds. That is not the case with a distributed ledger, which is not maintained by any individual or institution.

Immune to Credit Card Frauds

As cybercrimes continue to surge, authorities across the globe are trying to bring in legislation to enforce data privacy and cybersecurity laws through amendments to existing laws or enactments such as the General Data Protection Regulation (GDPR). However, it cannot be denied that these laws are at its nascent stage and need to evolve in order to accord better protection to the concerned citizens. This becomes a challenge because most regulatory bodies are designed to regulate a particular sector. For example, the Financial Conduct Authority (FCA) regulates Financial Service Providers in the UK, which makes sense because an estimated 25% of all reported cybercrimes target banks and financial institutions (Forbes, 2019).

However, it cannot be ignored that credit card cybercrime statistics are at an all-time high (CSOOnline, 2020). This requires the monitoring of all entities that accept online payments. However, regulatory bodies like the FCA have no control over e-commerce or online consultation service providers that cannot be specifically classified as Financial Service providers. As such businesses also accept online payments, they need to be regulated and compelled to follow certain predefined security measures. The Payment Card Industry (PCI) is a global organization that has been working in this direction. However, as the compliance of Payment Card Industry Data Security Standard (PCI DSS) is not mandatory under various nationwide regulations, it lacks enforceability.

As financially motivated cybercrimes are at an all-time high, none of the credit card or personally identifiable details are safe, and the reason for it is the need for its disclosure. Every time you make a purchase with your credit card, you end up revealing your credit card number and other details, which makes you vulnerable to cyberattacks. This is not the case when you make use of cryptocurrencies to make payments. Since it serves both as an investment and a reliable and safe mode of payment, investing in it is a lot safer than keeping money in your bank account. Plus, the ROI is much higher than what you can earn through a savings bank account.

Faster International Transactions

Cross-border investments become a whole lot easier with cryptocurrencies. This is mainly because it eliminates the need to go through the tedious process of international transfers. So, if you invested $50,000 in Bitcoin but now want to invest a part of it in crude oil in another country, then you can use cryptocurrencies to make quick transfers and gain better control over your investment portfolio.

From the abovementioned, it is clear that Bitcoin, once perceived to be a high-risk investment is now being looked upon as a reliable investment option and a potential store of value. The reason for this is the ongoing pandemic-driven recession and the frequent trade wars, which makes equities and commodities risky to invest in.

So, is Bitcoin a safer option? Is it immune to trade wars and other forms of market manipulation? And most importantly, does it qualify to be a store of value? This is something that we shall analyze in the following chapters. In doing so, we shall evaluate the current market size of cryptocurrencies, current investors, risk assessment, security, and more. Finally, we shall evaluate the steep changes in Bitcoin's price chart and figure out if the cryptocurrency market is free from price manipulation and trade wars.

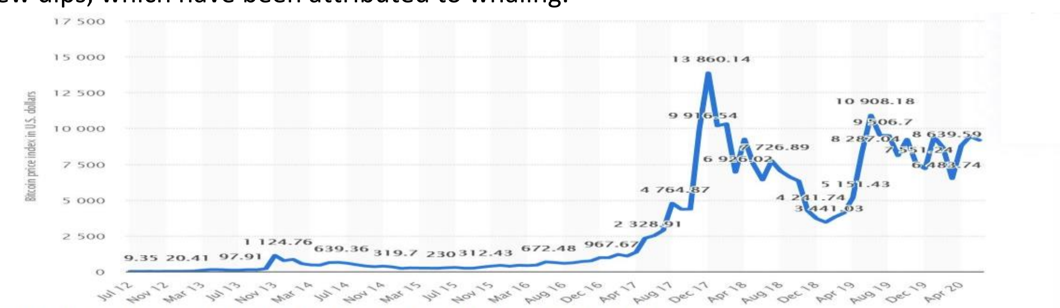
Chapter 3 - Market Size of Cryptocurrencies

As the cryptocurrency market has come into existence since slightly over a decade, you may wonder if investing in it makes any sense. Particularly, if you are unaware of its enormous size and future potential. So, let us start by determining the market size of cryptocurrencies. The only way to do this is by calculating market capitalization, which can be determined by multiplying two key metrics — the total number of a particular asset (cryptocurrency) in circulation and its currently traded value. This is similar to how the market capitalization for equities and other assets is calculated.

As of July 2020, the cryptocurrency market is worth 271.76 billion dollars with Bitcoin taking the lead, followed by Ethereum and Tether. Out of all the cryptocurrencies available, Bitcoin's market cap is by far the highest with a whopping 169.10 billion dollars. It is followed by Ethereum, yet another popular cryptocurrency that enjoys a market capital of 26.5 billion dollars (Top 100 Cryptocurrencies by Market Capitalization, 2020). Let us now analyze two key factors — stable growth and higher ROI — that make cryptocurrencies a good choice for investors, which would have a direct impact on the crypto market's overall growth.

Stable Growth

As can be seen from the below image, there has been a stable growth in the value of Bitcoin, with very few dips, which have been attributed to whaling.



Bitcoin Quarterly Price Chart - July 2012 to April 2020

On the whole, cryptocurrencies appreciate in value at a more stable pace than most other forms of investments such as equities and regulated currencies due to its decentralized architecture. Those who invest in equities or regulated currencies are well aware of how deeply these assets fluctuate during certain events.

For instance, stock prices are subject to fluctuations caused due to triggers such as economic setbacks, trade wars, and internal manipulation. On the other hand, the regulated currencies such as the US

Dollar, Euro, GBP, etc… also are influenced by the global economy, international trade relations, and several other factors. None of that happens in the case of cryptocurrencies, which have been stable despite the coronavirus outbreak when compared to other forms of traditional assets. Nevertheless, there have been times when cryptocurrencies have been dumped by whales, which we shall discuss in the subsequent chapters.

Higher ROI

Bitcoin continues to generate higher ROI than most other traditional forms of investments. For the sake of clarity, let us compare it to Tesla's stock price and compare the historical appreciation of the two assets. Both Tesla and Bitcoin were newly listed assets back in the year 2012, with the Bitcoin trading at $9.35 and Tesla's stock trading at a humble $32 per share.

At present, the Bitcoin is well above $9000 and Tesla continues to trade at $1500 per share on NASDAQ (NASDAQ, 2020). So, if someone invested $9.35 in a Bitcoin back in 2012, then that investment would now be worth well over $9,000 US Dollars. However, if the same person chose to invest in Tesla's stock, then that person would have to invest $192 to generate assets worth $9000.

TESLA HISTORICAL STOCK PRICE (BI ANNUAL)

As you can see in the above image, Telsa is far behind Bitcoin when it comes to generating returns on investment (ROI) and the same goes for other popular stocks such as Microsoft, Amazon Inc., and Facebook Inc (NASDAQ, 2020).

Bitcoin's value is likely to increase in the near future because it has been constantly attracting the attention of venture capitalists and other institutional investors. This is mainly due to the instability caused due to the pandemic driven global recession, which has led to an increased interest in cryptocurrencies.

Let us now move on to different types of investors and find out how their actions influence the cryptocurrency market.

Chapter 4 - Cryptocurrency Investors

Ever since Bitcoin was first released back in the year 2009, the cryptocurrency market has grown at a rapid pace. At present, both individual and institutional investors look at cryptocurrencies as a reliable investment option. With that said, let us find out more about the various types of investors commonly found in the crypto market.

Average Investor
The average investor is a millennial or a Gen Z who has some clue of what cryptocurrencies are but is not in a position to make a complete analysis before investing. However, the investor is eager to start investing in the cryptocurrency space and does so relying on the news or tweets available.

Informed Investor
An informed investor, as the name implies, is an investor who is fully capable of making an informed decision based on market conditions and price movements. However, due to limited capital, this investor's portfolio is limited and not very large in size.

Institutional Investor
This refers to larger investors such as Goldman Sachs or Venture Capitalists that invest large sums of money on behalf of their investors.

Whales
The term 'Whales' is used to identify investors with very high holdings of a specific cryptocurrency. For instance, some of the largest investors in Bitcoin include the Winklevoss twins who head Gemini Capital, Dan Morehead of Pantera Capital, Michael Novogratz who is a Partner at Goldman Sachs, and Barry Silbert who heads the Digital Currency Group (Investopedia, 2020). These are all referred to as whales because their actions can have a serious impact on the cryptocurrency markets.

Although most of these investors now manage sizeable portfolios under the name of an entity, they did start off as individual investors. At present, these are the Movers and Shakers of the cryptocurrency ecosystem due to the enormous size of their holdings. However, they would soon have to compete with large institutional investors because the pandemic-led recession has shaken the global economy and forced institutional investors to look for other options.

Now that you have an understanding of the type of investors that exist in the cryptocurrency space, let us delve deeper into cryptocurrency market manipulation.

Chapter 5 - Market Manipulation and Whaling of Cryptocurrencies

Market Manipulation haunts every type of market, whether it is Equities, Bullion, Fiat Currency, or Commodities. This involves using various tactics to manipulate the prices of the assets so that a very specific goal is achieved. On the whole, it refers to a specific tactic or a bunch of tactics employed for the purpose of price inflation or deflation of a particular asset. Every market is subject to manipulation by those who either hold a majority of a particular asset or bring together a group of others who do.

In the Equities market, this occurs in the form of pumping and dumping, or bear raids which refers to planned short selling or some other tactics used to reach a specific goal (NASDAQ, 2018). Similar activities are observed in other markets across the globe, so it comes as no surprise that quite a few people now suspect such activities in the cryptocurrency space. Primarily, the sharp price movements of Bitcoin have brought about this kind of market sentiment in the cryptocurrency ecosystem. Before we assess this theory, let us understand how internal manipulation takes place in the cryptocurrency market and how it can be detected.

How are the Crypto Markets Manipulated?

In the cryptocurrency landscape, there are five major strategies used for market manipulation. Let us now discuss one at a time.

Pump and Dump

This is the most common market manipulation technique, which begins with the crypto whales coming together in order to follow a very specific game plan, which involves strategically well-planned moves. It begins with price manipulation through sudden purchases, which forces average investors to believe it to be a lucrative investment opportunity.

As the sudden pumping of money artificially inflates the price of a specific cryptocurrency, it deceives the average investor into believing it to be an upward trend. So, the average investor brings in additional liquidity and buys the cryptocurrency at a much higher price. Once this sort of demand has been created, the whales start dumping or selling their positions at a much higher price, which although profitable for the whales, is unfair to the average buyer.

Market Making

Market makers are professionals responsible for market making, which involves placing strategic buy and sell orders on the same asset. It is worth mentioning that their activities are not illegal but essential to generate liquidity. In fact, quite a few stockbrokers act as Market Makers to help keep the market liquid. Basically, a market maker strategically spreads bids and asks on a position to make a profit from the difference. While this is not illegal, investors may mistake it for institutional investments and make the wrong investing decisions. However, that can be easily avoided by tracking, what is often referred to as the Market Maker's volume. It can be detected by observing very similar volume bars with no major price increase in a cryptocurrency.

Algorithms

Primarily, an algorithm is a software program that is designed to perform certain actions when predefined standards are triggered. This is again not illegal but works to the disadvantage of an average investor because bots are much faster than their human counterparts and can make firm emotionless decisions. So, you are not competing solely with humans but also with advanced bots that perform high frequency buy and sell actions.

To put things into perspective, let us take a hypothetical situation and assume that the price of Ethereum has been going down for some time and you wish to buy it when the price hits a low of $150. You are definitely not alone contending for the $150 price level and there are several others who wish to buy at that very level.

This is where high-frequency bots wipe off average investors by making transactions within milliseconds, which is humanly impossible. You must have heard about the bad bots that grab all the Black Friday discounts from popular eCommerce portals, only to sell them at a higher price. The high-frequency bots do the same thing with stocks, depriving the average investor of a potentially lucrative opportunity.

Washed Trading

This technique is often used by exchanges to show higher trade volumes and attract investors to generate more commissions. It has always been there in the traditional markets and is now seeping into the crypto markets also.

Whaling

The distribution of crypto assets is often uneven, resulting in some entities holding large proportions of a crypto asset's total supply. Such entities are called 'whales' because they have the potential to cause sudden and massive price moves. Blockchain transactions from such whales are worth monitoring especially if the funds are sent to an exchange as this can be an indicator of imminent large price movements.

Whaling is the market manipulation by whales, which includes collective actions that misguide and misinform an average investor. Basically, the whales come together and employ tactics such as price suppression and range-based trading. Once they have scooped up the profits, they buy back the particular cryptocurrency at a much lower rate. To get more clarity on whaling and to be able to detect it in the near future, you need to understand two major market manipulation strategies — price suppression and range-based trading.

Price Suppression involves the use of certain tactics to suppress the price of a particular cryptocurrency. As a result, there is a sharp decline in the trading value of a cryptocurrency. It could be Bitcoin, Ethereum, Ripple, or anything else. However, in most cases, Bitcoin is targeted as it has the largest market cap in the cryptocurrency ecosystem. This was earlier felt in September 2019 when there was a sharp fall of about $1000 in the price of Bitcoin (Story from Markets, 2019).

Range-based Trading involves the trading of a cryptocurrency within a predefined range, which leads the regular investor to believe that it is what their crypto is worth. Alongside, the whales continue to buy from panic-stricken common investors who end up selling their positions only to see a price spike in the near future.

It is a myth that Bitcoin whales are only responsible for accidents. Whales control the markets with both bear traps and bull traps. If they cause the bear trap, they can get investors to sell early. If there is a Bull trap, they can push investors to buy crazy. Thus, Bitcoin whales play with traders' psychology. Fear or FOMO causes investors to make wrong decisions.

Bitcoin whales leading to market crash in less than 5 minutes.

Chapter 6 - Frauds

Over the years, there has been a considerable increase in the number of cryptocurrency frauds, which includes deploying creative tactics to deceive cryptocurrency investors into transferring Bitcoins to scammers and cyberattacks being launched on popular cryptocurrency exchanges. In fact, within the first quarter of 2020, scammers have stashed away $24 million in Bitcoin (Coin Telegraph, 2020). However, identifying frauds and avoiding them in the cryptocurrency ecosystem is much easier than it is in the case of traditional credit cards or bank accounts. With that said, let us now discuss some of the most talked-about cryptocurrency frauds and their impact.

Impersonation of Celebrities

One of the key strategies used by scammers in 2020 is the impersonation of celebrities such as Elon Musk, Barack Obama, Bill Gates, and several others (BBC, 2020). This worked extremely well because who would not trust Bill Gates if he ever claimed to repay $2000 for every $1000 in Bitcoin? However, as a seasoned businessman and a highly lauded intellectual, Mr. Gates does not make such tall claims. The same goes for Barack Obama. So, who was it? Cybercriminals who hacked the Twitter accounts of several celebrities only to scam crypto investors and steal their Bitcoins.

The Vaultage Solutions Scam

The Vaultage Solutions scam has affected close to two thousand South African investors, leading to a loss of about 227 million South African Rands. Willie Breedt, the Head of Vaultage Solutions has now been declared bankrupt by a South African High Court, which means the investors will not be able to recover their investments. Trouble began in the last quarter of the year 2019 when Bitcoin prices dipped, and the cryptocurrency was trading somewhere between $6,600 and $7,200 (Bitcoin.com, 2020).

The Binance Mess

Binance, one of the most reliable cryptocurrency exchanges in the world lost $40 million in Bitcoin around May 7, 2019 (Binance, 2019). The attackers used a combination of cyberattack techniques such as phishing, malware injection, etc… to gain unauthorized access to certain high-profile accounts held by Binance. Subsequently, the miscreants made away with 7,000 Bitcoins from the Maltese cryptocurrency exchange. However, Binance's CEO Zhao Changpeng promised to make good the losses of those affected by this attack.

Besides the abovementioned, there are several other types of frauds that are associated with Bitcoin solely due to the fact that it is used as a mode of payment. That includes ransomware attacks, DDoS attacks, and certain other forms of cyberattacks. However, we have only touched upon the Bitcoin frauds, which have impacted cryptocurrency investors. Now that you have a fair idea about some of the biggest cryptocurrency frauds, let us move further and find out more about the rules and regulations that govern cryptocurrencies.

Chapter 7 - Regulatory Measures

Bitcoin was created to be an unregulated mode of payment, which is not controlled by governments or agencies. Since no single authority regulates it, none can control cryptocurrencies but can only impose restrictions on its citizens.

Is Bitcoin Legal?

The answer to this question depends on who is asking because while bitcoin is legal in most developed countries, there are others that are yet to accept it. For example, Bitcoin is legal in the United States, Canada, the United Kingdom, and several others. However, in Asia, it has only received acceptance in Japan, while India and China continue to impose restrictions on its usage.

Most countries that impose restrictions on the use of bitcoins do so in order to curb the possible criminal activities that can take place. Since Bitcoins do not require the furnishing of tax details or pass other identification checks, it can be used for nefarious purposes such as drug trafficking (Investopedia, 2020).

Self-Regulation

Within the context of cryptocurrencies, self-regulation is the establishment of guidelines and a code of conduct for market participants to operate businesses within the ecosystem. Those guidelines span a broad spectrum, from knowing your customers (KYC) to maintaining transparency to ensuring security against hacks.

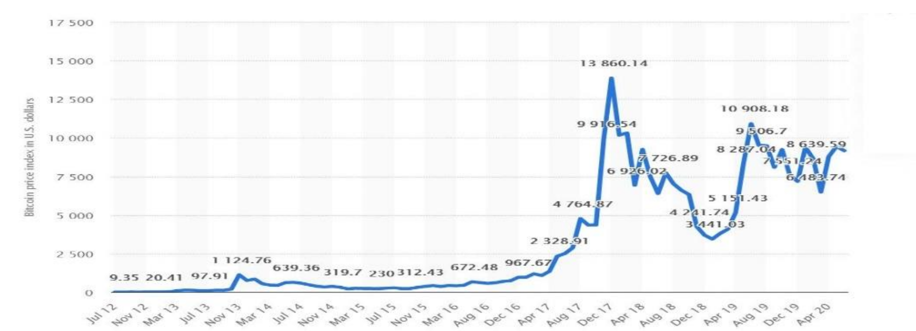
So, the unspoken rule is that cryptocurrencies remain a legitimate investment option for citizens unless the concerned authorities have specifically banned it within its territory.

Chapter 8 - Is cryptocurrency a store of value for the current crisis? | Let's Summarize

Bitcoin was designed to be a decentralized virtual currency by its creator, Satoshi Nakamoto, but not as a store of value that it has eventually turned into. The reasons for this are many, which we shall discuss later on. Let us first understand what is meant by the term 'Store of Value'.

Basically, Store of Value refers to an asset that does not quickly depreciate and has a longer shelf-life, which primarily means that it is not perishable in nature (Investopedia, 2020). A good example would be gold, which has been invested in for ages.

Now that we have Gold as a yardstick, let us evaluate if Bitcoin qualifies as a store of value. As Bitcoin is an intangible asset, there is no need to worry about its shelf life, so let us evaluate it on the basis of its quarterly prices.



Bitcoin Quarterly Price Chart - July 2012 to April 2020

As the chart clearly indicates, Bitcoin has mostly appreciated in value with very few lows. This clearly indicates that most long-term users have consistently earned profits. Therefore, Bitcoin definitely qualifies as a store of value. Let us now move further and analyze whether Bitcoin is the new Gold 2.0 or not.

Is Bitcoin the new Gold 2.0

Bitcoin was designed with an entirely different mindset, which was to ensure a decentralized and transparent mode of payment. The first issuance of Bitcoin in 2009 coincides with the period when the Lehmann Brothers, an investment bank filed for bankruptcy, causing a chain of reactions that eventually caused the global recession. Therefore, Bitcoin emerged as an alternate currency but some of its unique traits often compel investors to compare it to gold. So, let us evaluate some of those common traits based on facts.

Limited Supply

Just like gold, Bitcoin's supply is limited in order to overcome one of the major pitfalls of fiat money, which is its unlimited supply. There are only 21 million bitcoins that can be mined in total. In order to limit the number of Bitcoins in circulation, it was designed in a manner that its supply would be reduced by 50%, every four years. In a way, that makes it scarce and also valuable just like gold, a scarce natural resource.

Appreciation in Value

As we have seen in the historical chart that shows quarterly prices of Bitcoin, it has steadily increased in value without any long-term depreciation. This is very much how gold rates have been all along, making it a preferred store of value.

From all the details that we have evaluated, it is clear that every market is prone to market manipulation and the cryptocurrency market is no exception. So, to rule out investing in cryptocurrencies solely due to a flaw that exists in all markets is not right. Instead, investors need to focus on understanding and identifying indicators that help identify threats in the cryptocurrency ecosystem.

Finally, Considering the common traits between the two assets — gold and bitcoin — it would not be wrong to conclude that Bitcoin has transformed from virtual currency to a store of value. Particularly, in times of a global crisis, when traditional markets are too risky to invest in.

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