

Portfolio Advisor

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Decrypting cryptocurrencies

Cryptocurrencies – particularly the most widely known, Bitcoin – have existed since an unknown entity by the name of Satoshi Nakamoto released a white paper laying out the parameters of the Bitcoin digital token. Since then, Bitcoin’s price has risen and fallen – often dramatically – in value over the last decade, surging as much as 5,400% in 2013, and falling as much 75% in 2018. More recently, investors have driven up the digital token’s value by approximately 800% year-over-year*, leaving many to wonder: what are cryptocurrencies, and how do they work?

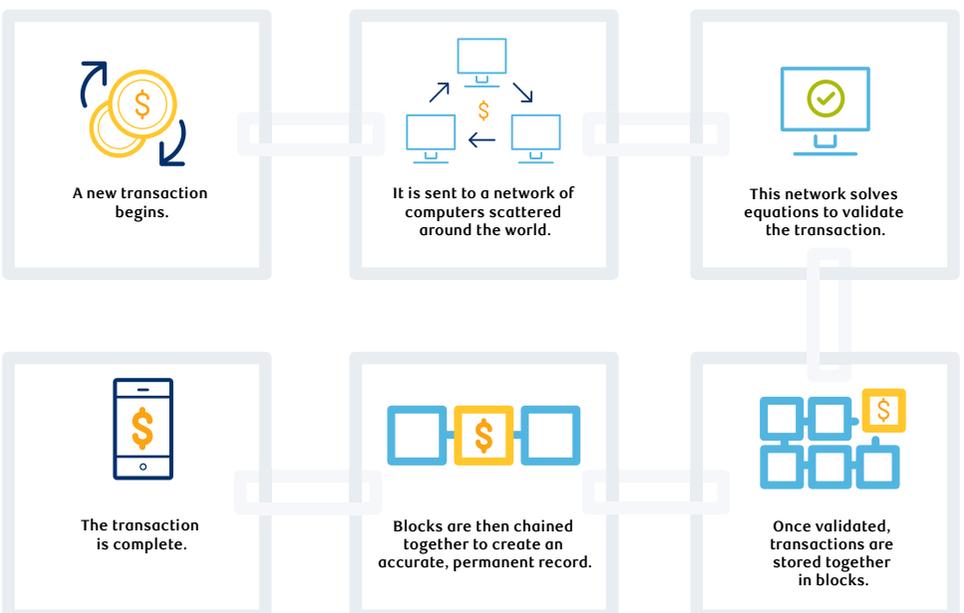
A token by any other name

It’s important to note that Bitcoin and its cryptocurrency peers are not actually currencies, at least not by traditional definitions. Yes, they can be used to purchase some goods and services, but these tokens are only virtual, not physical. Importantly, they are not issued by a government, country or central bank – instead, they are issued by private corporations, referred to as exchanges, such as Bitcoin Inc., Ethereum, Coinbase and XRP. In fact, Bitcoin and its peers are designed to bypass banks and other financial institutions, providing a decentralized, anonymous and global (non-country or region-specific) payment form. They cannot at this stage be deemed a store of value either (for instance the way gold might be).

Blockchain technology – a look under the hood of cryptocurrencies

Cryptocurrencies may or may not survive in the face of global central banks deciding to issue their own digital currencies. After all, will people trust a private corporation to act as a backstop to a functional currency, versus a central bank? However, the technology that underpins them – called “blockchain” – may well have a bright future, whether or not cryptocurrencies become more broadly accepted.

In essence, blockchain is a virtual chain of transactions that are linked together as a “block.” As cryptocurrency transactions are generated, they are added to the chain as a new “link.” Bitcoin itself uses a massive global network of decentralized computers to store this “chain of blocks.” Each of these computers is called a “Bitcoin miner,” and they verify every transaction in the blockchain.



Source: *What is cryptocurrency?*, RBC Global Asset Management (March, 2021).

To date, the Bitcoin blockchain has never failed, has never been compromised or hacked, and successfully processes over \$2 billion a day in transactions. And how this blockchain technology may be leveraged for other purposes is a source of great interest – some of the current applications include secure medical data sharing, digital identification and copyright protection. This technological innovation explains much of the excitement that surrounds cryptocurrency.

Wait-and-see approach

New financial instruments are periodically developed and accepted over time and as they prove their usefulness and value. But for now, Bitcoin and other cryptocurrencies remain highly volatile and speculative. As a result, we encourage investors to exercise extreme caution, and we do not currently provide any investment advice or solutions related to cryptocurrency.

*Source: Bloomberg L.P. Return from April 20, 2020, to April 16, 2021.