Mariner
WEALTH ADVISORS

Decoding Digital Assets:

Are They Right for You?

If you've been wondering whether digital assets fit with your overall investment strategy but have questions, we'll break down the basics of what you need to know. Above all, we recommend you work closely with your wealth advisor who can help you decide if it's appropriate to allocate a small portion of this speculative asset class to your portfolio.

Above All, Diversify

As with any investment, it's important to diversify your portfolio across asset classes to help weather market and economic fluctuations as well as to consider your risk tolerance, what your goals are and how long it will take to reach them.

What Are Digital Assets?

Digital assets can include coins, tokens, crypto, cryptocurrencies and more. What all of these terms refer to is an asset that features ownership, governance and transference confirmed through a blockchain technology.

Blockchain

Blockchain is the technology on which all digital assets are built. It is a software that, using consensus mechanisms (think voting) and encryption (think information security), allows parties to reach agreement on a transaction history without the need for a trusted intermediary such as a bank. It is this technology that makes it possible for a string of ones and zeros to be unique and therefore valuable.

Bitcoin

Bitcoin was the first digital asset and the first application of blockchain technology. It was launched in 2009 as "peer-to-peer electronic cash system" that "allows for online payments to be sent directly from one party to another without going through a financial institution."[1] In effect, as long as two parties agree on the value of bitcoin, they can use it as a medium of exchange instead of dollars or other fiat (paper) currencies.

A unique element of bitcoin relative to fiat currencies is fixed supply: there can only ever be 21 million bitcoins issued, and even the issuance pace is programmatic and predictable.

This is obviously a very different policy than any other fiat currency and has resulted in bitcoin being held primarily as a "store of value" by speculators who believe its value will rise over time. Bitcoin remains the largest and most widely held digital currency, presently representing approximately $800 billion of value and approximately 40% of all digital asset value.[2]

"Ethereum" and All the Rest

The rise in the value of a bitcoin from zero in 2009 to greater than $40,000[3] has catalyzed the creation of thousands of digital assets. As of September 2021, there were approximately 12,000[4] digital assets in circulation. While all are based on blockchain, each individual digital asset intends to serve a unique function. Many are "cryptocurrencies" that act as a form of money amongst users.

There are also classes of "cryptocommodities" that allocate digital commodities (such as compute power, or storage) and "cryptotokens" that allocate digital finished goods (such as access to a game or media site). Ether, or Ethereum, the second largest digital asset by value,[5] allocates access to the Ethereum network, a "virtual computer" that runs programs and executes contracts on the blockchain. Given the widely varying functionality, liquidity, technical aspects, and governance structures of each of the digital assets, prospective investors need to be sure to understand the risk and return profile of any digital assets in which they are deploying capital.

What is the "Bull" Case?

The bull case for digital assets has two main tenets. The first: As central banks print more fiat currency to finance ever-larger fiscal deficits, the value of fiat will fall in real terms, and investors will increasingly allocate to bitcoin and other digital assets to store their purchasing power. The second: as blockchain disrupts more and more industries, the underlying digital assets that allocate these blockchains will increase in value (i.e., Ether), and bitcoin will become the "reserve currency" of the blockchain economy the way the dollar is the trusted intermediary for the analog economy. For digital assets with more supply constrained[6] issuance policies, the increased demand will result in significantly higher U.S. dollar prices of the digital assets over the long term.

What is the "Bear" Case?

The bear case for digital assets has several tenets, but mainly boil down to the speculative nature of the asset class, the lack of claim on any real collateral and potential government intervention. Indeed, digital assets are highly speculative and have historically demonstrated significantly more volatility than even equity markets. Coincidentally the recent year-plus run-up in digital asset values has occurred simultaneously with a broader rally across all risk asset markets. Furthermore, digital assets are not securities and, in fact, largely operate outside the reach of traditional contract law.

The universe of thousands of lesser-known digital assets is rife with examples of "tokens" created for no true utility purpose other than speculation. The potential for total loss of principal investment is significant, especially amongst the smallest, most volatile and dubiously conceived digital assets. As for regulatory risk, it's plausible that federal regulators could take a more adversarial view toward digital assets as a threat to the federal government's ability to tax, spend and control monetary policy. Any negative regulatory developments could have very negative consequences for the values of digital assets.

Are Digital Assets Appropriate for Your Portfolio?

In short, the appropriateness of digital assets as part of your portfolio depends on you and your wealth plan. The volatility, risk of loss, and technical complexity of digital assets are not appropriate for everyone. In general, an investor with a very long investment horizon, low liquidity needs, high risk tolerance, and a willingness to understand the asset class will be a more appropriate candidate for investing in digital assets as part of a broader asset allocation.

On the other hand, an investor with a short investment horizon, high liquidity needs, a low risk tolerance, and a lack of full understanding of the risks of the asset class is less likely to be a fit for investing in digital assets. Even for those who understand digital assets, we generally advise only small allocations. As with any speculative investment, a good rule of thumb is not to invest more than you are willing to lose.

Consult With Your Wealth Advisor

As you learn more about digital assets and have questions about whether they would be a fit for your portfolio, please reach out to your wealth advisor.

At Mariner Wealth Advisors, our in-house investment team works alongside your advisor to offer advice on digital assets. Together they can assess your financial picture and offer recommendations on appropriate assets classes for your specific financial situation. We're here to help you navigate how to invest your portfolio to help you achieve your goals.

For more information visit: marinerwealthadvisors.com

Sources:
[1] "Bitcoin, a Peer-to-Peer Electronic Cash System"
[2-5] CoinMarketCap.com, as of Sept. 22, 2021
[6] Issuance policies vary widely by digital asset

The investment characteristics of virtual currencies, crypto-currencies, and digital coins and tokens ("Digital Assets") generally differ from those of traditional currencies, commodities or securities. Importantly, Digital Assets are not backed by a central bank or a national, supra-national or quasi-national organization, any hard assets, human capital, or other form of credit. Rather, Digital Assets are market-based. A principal risk in trading Digital Assets is the rapid fluctuation of market price. The value of client portfolios relates in part to the value of the Digital Assets held in the client portfolio and fluctuations in the price of Digital Assets could adversely affect the value of a client's portfolio. There is no guarantee that a client will be able to achieve a better than average market price for Digital Assets or will purchase Digital Assets at the most favorable price available.

There is no assurance that the virtual currency market, or the service providers necessary to accommodate it, will continue to support Digital Assets, continue in existence or grow. Further, there is no assurance that the availability of and access to virtual currency service providers will not be negatively affected by government regulation or supply and demand of Digital Assets. Currently, many of the companies providing Digital Assets custodial services fall outside of the SEC's definition of "qualified custodian", and many long-standing, prominent qualified custodians do not provide custodial services for Digital Assets or otherwise provide such services only with respect to a limited number of actively traded Digital Assets. The regulatory schemes possibly affecting Digital Assets or a Digital Asset network may not be fully developed and subject to change. It is possible that any jurisdiction may, in the near or distant future, adopt laws, regulations, policies or rules directly or indirectly affecting a Digital Asset network. It is also possible that government authorities may take direct or indirect investigative or prosecutorial action related to, among other things, the use, ownership or transfer of Digital Assets, resulting in a change to its value or to the development of a Digital Asset network.

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