Does cryptocurrency have a place in retirement plans?

Should defined contribution retirement plan portfolios include cryptocurrency? The short answer is: Not yet. We believe it's too soon to take a chance on this volatile new investment option, but that could change over time.

Cryptocurrency, whether it be Bitcoin, Ethereum, Tether or any other form, is one of the newest and most mystifying concepts in the financial industry. While investors in all age groups have bought cryptocurrency in one form or another, it seems to have the most appeal for younger generations. According to Pew Research, 43% of men ages 18 to 29, and 31% of all people 18 to 29 have used some kind of cryptocurrency. Many investors within this demographic experienced unprecedented gains in 2021, becoming "crypto millionaires."[1]

Cryptocurrency is rapidly becoming more accessible to both retail and institutional investors. Charles Schwab, one of the largest brokerage firms, began trading its first crypto thematic exchange traded fund on Aug. 4, and Crypto.com, one of the largest cryptocurrency exchanges, has now opened its services to institutional investors.

Given the momentum and interest in cryptocurrencies, more investment firms will likely begin to offer and participants will expect similar services. But what exactly is cryptocurrency and what is its role in an investment portfolio?

In its simplest form, cryptocurrency is "**A digital, encrypted, and decentralized medium of exchange.** Unlike the U.S. Dollar or the Euro, there is no central authority that manages and maintains the value of a cryptocurrency. Instead, these tasks are broadly distributed among a cryptocurrency's users via the Internet."[2]

Cryptocurrency operates on a transactional system based on "cryptographic proof," in which all transactions are recorded and verified on a ledger known as a blockchain. While many cryptocurrencies use their own forms of blockchain, the most common are Bitcoin's and Ethereum's, known as Ether.

[1] Dellatto, M. (2022, April 21) Crypto's Super User: Young Men. 43% Of U.S. Males Aged 18 To 29 Have Bought The Currency. *Forbes.* https://www.forbes.com/sites/marisadellatto/2021/11/11/cryptos-super-user-young-men-43-of-us-males-aged-18-to-29-have-bought-the-currency/?sh=4e77fbee349a

[2] Ashford, K. and Powell, F. (2022, June 6) What is Cryptocurrency? *Forbes.* https://www.forbes.com/advisor/investing/cryptocurrency/what-is-cryptocurrency

While Bitcoin is the most well-known cryptocurrency, other forms exist, such as stablecoins. Stablecoins' values are pegged to another financial asset in attempt to reduce volatility.

To purchase cryptocurrency, one typically creates an account with a cryptoexchange, such as Crypto.com, Coinbase or FTX. These exchanges allow for the purchase and sale of a variety of cryptocurrencies for a fee. Other avenues for purchase include traditional brokerage platforms such as Robinhood.

The year 2021 was historic for cryptocurrency. Bitcoin experienced a nearly 60% gain, trumping the S&P 500's return of 28.71%. However, Bitcoin's performance was miniscule compared to other tokens. Ethereum saw gains of 398.3%, while Solana, a crypto with a notoriously fast blockchain, saw gains over 11,000%.[4]

To put this into perspective, an initial $10,000 investment in Solana on Jan. 1, 2021, would have yielded $1.12 million by the end of the year. For many younger investors who do not trust traditional financial systems and revere technological innovation, 2021's gains were a resounding changing of the guard from centralized to decentralized finance.

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In 2021, investors lauded Bitcoin for its historically low correlation to equity markets. This low correlation can be a valuable diversifier for investors who are attempting to reduce their portfolio's equity market sensitivity. According to NASDAQ, "For almost all of 2021, Bitcoin remained within a range of minus 0.2 to 0.2 when compared to the S&P 500, gold, the U.S. dollar, and bonds. A value of between the range of minus 0.2 and 0.2 indicates they are largely uncorrelated."[3]

However, as volatility began to spike in the final quarter of 2021, the correlation of Bitcoin to equity markets also spiked as it reached 0.6, indicating moderately strong correlation. The shift in correlation in recent months has led to additional questions over Bitcoin's place as an independent, uncorrelated, alternative asset class.

Investors tend to hold crypto because of perceived value. Some individuals view Bitcoin as an inflation hedge, due to its inherent scarcity. This is because unlike central bank currency, which can print and increase the money supply, the number of Bitcoins is fixed at 21,000 tokens.

However, this "inflation hedge" thesis has not held true. As of June 30, 2022, Bitcoin had given up almost all of its gains from the previous year, declining 57.39%, while inflation continued to rise with June's report showing a 9.1% year-over-year increase.[4]

Coins that experienced larger gains in 2021 have seen even larger drawdowns than Bitcoin. Ethereum and Solana have experienced eye-watering losses in 2022, at -70.42% and -80.34% respectively.

Stablecoins, a perceived less volatile crypto with ties to other financial instruments, also faced losses. TerraUSD, the third largest stablecoin, which is pegged to the U.S. dollar, experienced a very sharp decline in May.[4]

Investors within TerraUSD were uneasy about a 20% yield offered by a lending platform, Anchor, to buy TerraUSD and lend it. This coupled with TerraUSD's unique approach to stabilizing the coin, using an algorithmic approach rather than fully backed reserves, led to a bank run on the coin. The losses caused a systemic meltdown

[3] Fulton, R.J. (022, June 14) Is Bitcoin Correlated to the S&P 500? NASDAQ. https://www.nasdaq.com/articles/is-bitcoin-correlated-to-the-sp-500

[4] Bloomberg, "Crypto". *Bloomberg*. https://www.bloomberg.com/crypto. Accessed July 22, 2022.

within the broader crypto market, leading to losses of $400 billion of market capitalization.[5] As of June 30, TerraUSD declined 91.84% YTD, with a price of just .082, a far cry from the .995 price it offered in early May prior to the meltdown.[4]

The meltdown significantly harmed the reputation of cryptocurrency, and institutional investors were not immune from the crash. According to *The Wall Street Journal*, "A $5 billion retirement fund serving Houston firefighters said last October it had put $25 million into Bitcoin and Ether. Since that announcement, both cryptocurrencies have fallen more than 50%."[6]

Based on its correlation to equity markets in recent periods, the argument for cryptocurrency being a diversifier is in question. Moreover, given cryptocurrency's short lifespan compared to traditional investments, it's relatively untested. At this time, in our view, cryptocurrency does not provide the diversification benefits necessary to be included in defined contribution plan investment menus.

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However, despite these apparent shortcomings, Crypto continues to become increasingly popular and may become more accessible in the future through retirement plans, with Fidelity offering Bitcoin as of April.

Crypto's place within retirement plans has prompted uncharacteristically stern messaging from the Department of Labor.

For more information regarding crypto's place within defined contribution plans, please visit the [TruePlan website].

[5] Chow, A. (2022, May 17) The Real Reasons Behind the Crypto Crash, and What We Can Learn from Terra's Fall. *Time*. https://time.com/6177567/terra-ust-crash-crypto

[6] Gillers, H. (2022, Aug. 14) Public Pension Systems Join Those Stung by Crypto Crash. *The Wall Street Journal*. https://www.wsj.com/articles/public-pension-systems-join-those-stung-by-crypto-crash-11660425848