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VIRTUAL ASSETS

At CFA Institute Asia-Pacific FinTech Month 2022, Matt Hougan, chief investment officer, Bitwise Asset Management, presented an overview of the cryptocurrency market and explained the basics of investing in virtual assets.

Subsequently, Joanne Murphy, managing director, Asia Pacific, Chartered Alternative Investment Analyst Association, moderated the panel discussion. The contributors included Marco Lim, managing partner and CSO, MaiCapital in Hong Kong SAR; I-Cheng Liu, vice chair and president, Pegatron Venture Capital in Taiwan; Raymond Tsang, associate professor of practice at the Chinese University of Hong Kong; and Bryan Venture, senior associate at New Zealand law firm MinterEllisonRuddWatts.

THE RECENT MARKET PULLBACK

At the macro level, virtual assets tend to perform well in markets where investors are comfortable with a higher level of risk. However, at the end of 2021, when central banks began to hike interest rates, all asset classes, including cryptocurrencies, were affected. Crypto platforms that were highly leveraged or had built up excesses during the bull market were more exposed to the subsequent volatility. However, despite the turmoil, the industry's fundamentals remain intact. According to Liu, "The best platforms should thrive, particularly those with solid backers." Market sentiment, while uncertain, also appears to fall along those lines, with the more established names continuing to find favour among investors.

DEFINING CRYPTOCURRENCY

There seems to be a fundamental misunderstanding about cryptocurrency, mainly because it is poorly named. "It isn't a currency in the traditional sense; it was never meant to replace any existing currencies or enable us to buy a cup of coffee," says Hougan. Instead, it allows real-world financial assets to exist virtually so they can be transacted over the internet. Blockchain, the underpinning technology, is one of the most significant breakthroughs of the past 20 years. It is accurate, updates in real time, and is not controlled by a single entity. Essentially, blockchain

- allows for the high-speed transaction of financial assets,
- can be programmed so that decision-making is automated, and
- creates proof of ownership without the need for third-party affirmation.

INVESTING IN VIRTUAL ASSETS

Hougan has identified several compelling reasons to invest in the asset class. These include potentially high returns, a low correlation with other asset classes, ample liquidity, and accessibility. However, retail investors may find it daunting given the numerous choices. This is because each is optimized for certain aspects of a virtual asset. “The primary goal of Bitcoin—the first to be developed—was to act as a secure store of wealth,” notes Venture. Others evolved along the way, and because they were pieces of code, they could be programmed to do ever more complex tasks. Hougan observes that “an easier way for retail investors to access the asset class would be through a fund rather than an individual cryptocurrency.” Even then, there are several suggested approaches to keep in mind, including the following:

- assume a long-term investment horizon,
- cap these holdings at around 5 percent of a portfolio, and
- remain disciplined and regularly rebalance (i.e., sell when valuations exceed your target or add assets when the reverse occurs).

AN EVOLVING REGULATORY LANDSCAPE

Regulators have been slow to catch up with this fast-evolving industry. Their current focus is chiefly to prevent money laundering, although some central banks are exploring ways to set up their own digital currencies, explains Venture. However, “more needs to be done before the necessary framework and boundaries are established,” suggests Tsang. This would afford investors a measure of comfort that’s on par with more traditional asset classes, such as equities and bonds. It also would require more granular detail in defining customer protection and regulating the custody of virtual assets, alongside other rules that mirror those that govern the real economy.

DIFFICULTIES IN DISCERNING VALUATIONS

“Given the industry is still in its infancy, assigning valuations remains challenging,” says Lim. Various analytical methods could be applied to each subclass, such as examining a crypto miner’s costs. But as these providers evolve beyond just mining, those asset valuation methods become inadequate. The panel suggested other ways to use the market as a tool for price discovery or artificial intelligence that would capture all the data points and determine what seems most appropriate. However, the consensus is that the process could take years to mature, even as the industry becomes more established. Meanwhile, professional investors confronting the issue now “must get creative in developing their own proxies to ascertain an asset’s value,” concludes Lim.