Will the upcoming ‘halving’ event lead to another surge in bitcoin?

SHIRLEY WON
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Bitcoin’s appeal for investors is its low correlation to other assets in a portfolio because it’s fundamentally different from a stock or traditional investment.

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The price of bitcoin soared by 1,800 per cent to almost US$20,000 in late 2017 before its epic bust. Following more wild swings, the price of the cryptocurrency has climbed to about US$10,000 – just days before an event that will slash new supply of bitcoin in half.

Decentralized crypto assets are still in their infancy and prone to hyper-volatility. Nonetheless, institutional and higher-net-worth investors are starting to pay attention to bitcoin for portfolio diversification.

“We look at it as digital gold,” says Arthur Salzer, chief executive officer and chief investment officer at Toronto-based Northland Wealth Management Inc., a family office and advisory firm. “It’s a valuable addition as an alternative asset like private equity, private real estate and private debt. We also own physical gold through a Canadian fund."

Bitcoin is the leader with 69 per cent of the market value of all cryptocurrencies followed by ether – now trading at more than US$210 – with 9 per cent. First created in 2008, virtual bitcoin tokens are generated by miners using computers to solve complex math problems. They compete to add "blocks" of verified transactions to the public blockchain ledger and get rewarded with new bitcoins.

Around May 12, an event called the "halving" will take place in which miners' bitcoin rewards will be reduced by 50 per cent. This event, which occurs every four years, controls inflation and will eventually limit bitcoin to 21 million in circulation. Bitcoin's price surged after these events in 2012 and 2016.

This event should be a catalyst for a strong rally, says Mr. Salzer. "There's a market cycle that has followed halvings. It creates interest and probably investment demand – be it real or emotional."

When the price of bitcoin plunged after surging in the 12 to 18 months following previous halving events, "we would reduce our positions on the way up to get back to target exposures [for clients]. You need to constantly rebalance this asset," he says.

Northland's clients may have a 2.5- to 10-per-cent exposure to bitcoin depending on risk tolerance, Mr. Salzer says. They hold it through The Bitcoin Fund (QBTC.U-T), a closed-end fund run by Toronto-based digital asset manager 3iQ Corp. The firm bought the fund for its clients through a private placement for accredited investors. It went public in early April and now trades at a premium to net asset value.

As bitcoin has an asymmetric return profile – the upside potential is greater than downside – a tax-free savings account is the best place for this digital asset, Mr. Salzer says. "We are neutral on registered retirement saving plans given the tax consequences upon withdrawal."

His outlook stems from spending 18 months researching the benefits and risks of bitcoin. He met with major U.S. investors and investment firms involved with bitcoin, including a unit of Fidelity Investments that was created in 2018 to offer cryptocurrency trading and custody services to institutional customers.

Bitcoin's appeal is its low correlation to other assets in a portfolio, Mr. Salzer says. Still, its price sank below US$4,000 at one point on March 12, when stocks and gold were also roiled amid COVID-19 fears. Bitcoin's crash was due partly to investors raising cash to meet margin calls, but its price has more than recovered, he says.

Martin Lalonde, president and portfolio manager at Gatineau, Que.-based Rivemont Investments Inc., also sees bitcoin as an uncorrelated asset to other investments – even though that wasn't the case in March.

"In times of crisis, most assets will behave the same way," says Mr. Lalonde, who manages Rivemont Crypto Fund, which is available to accredited investors. "I don't think [bitcoin] will continue to do so in the future. It's fundamentally different from a stock or traditional investment."

Although he's bullish on bitcoin over the medium to long term, he's unsure if its price will skyrocket after the upcoming halving as it did in 2017. This event has been anticipated, so it may be priced in, he says. "Markets are forward looking."

Rivemont's crypto fund was launched following client requests, but the firm only got regulatory approval in late 2017.

"We had wealthy clients who were interested in bitcoin but didn't want to have problems with personal wallets and getting hacked," Mr. Lalonde says.

He recently raised his fund's weighting in bitcoin to 95 per cent, while the rest is in ether, the currency used in the Ethereum blockchain network. "We are still the only actively managed cryptocurrency fund in Canada," he says. In the past, the fund has also owned other crypto assets, such as litecoin and Zcash.

Mr. Lalonde says it's important to be able to move into cash or other cryptocurrencies because bitcoin has been so volatile, with 80-per-cent price declines in the past, and it is not clear whether it will remain the leader. "Some people say it's really worth US$100,000. Others say it's not worth anything."

Another crypto fund available to accredited investors is 3iQ Global Cryptoasset Fund. It Initially invested 50 per cent in bitcoin, 35 per cent in ether and 15 per cent in litecoin, and is rebalanced periodically.

Given the differences between bitcoin and ether, there's room for both in an investment portfolio, says Stefan Coolican, president of Toronto-based Ether Capital Corp. (ETHC-NE), a technology company with investments in ether and in Ethereum-related businesses.

Bitcoin is seen as a digital commodity like gold that can be a hedge against inflation, but ether is the currency used for transactions on the Ethereum blockchain, which includes smart contracts, Mr. Coolican says.

"With ether, you are investing in this venture-capital type platform where people try to build businesses and Web applications on the Ethereum network. You get exposure to the upside on all those businesses and applications because they need ether to transact in whatever they do."

Toronto-based Purpose Financial LP and its founder Som Seif own about nine per cent of Ether Capital, which is listed on the NEO Exchange. The stock provides a way for investors to get easy exposure to ether because it represents about 75 per cent of the firm's assets, Mr. Coolican says.

The coming halving is “potentially bullish” for bitcoin if demand stays the same when supply is cut – and it can affect ether too, he says. “Historically, ether is seen as a levered bet on bitcoin. If bitcoin goes up 10 per cent, ether may go up 20 or 30 per cent. Ether was created in 2014, so it’s earlier stage and more speculative [than bitcoin].”