Sprott | Special Report
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Cryptocurrencies Fail to Prove their Mettle

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Bitcoin's Fall from Grace

The reports of gold's death at the hands of cryptocurrencies seems to have been greatly exaggerated. I can't say that I'm surprised. We've warned investors about the instability of the cryptocurrency market and the false equivalency with gold, including in several posts over the past two years. In April 2018, we published *Cryptocurrencies, Solid Gold or Just a Flash in the Pan?*

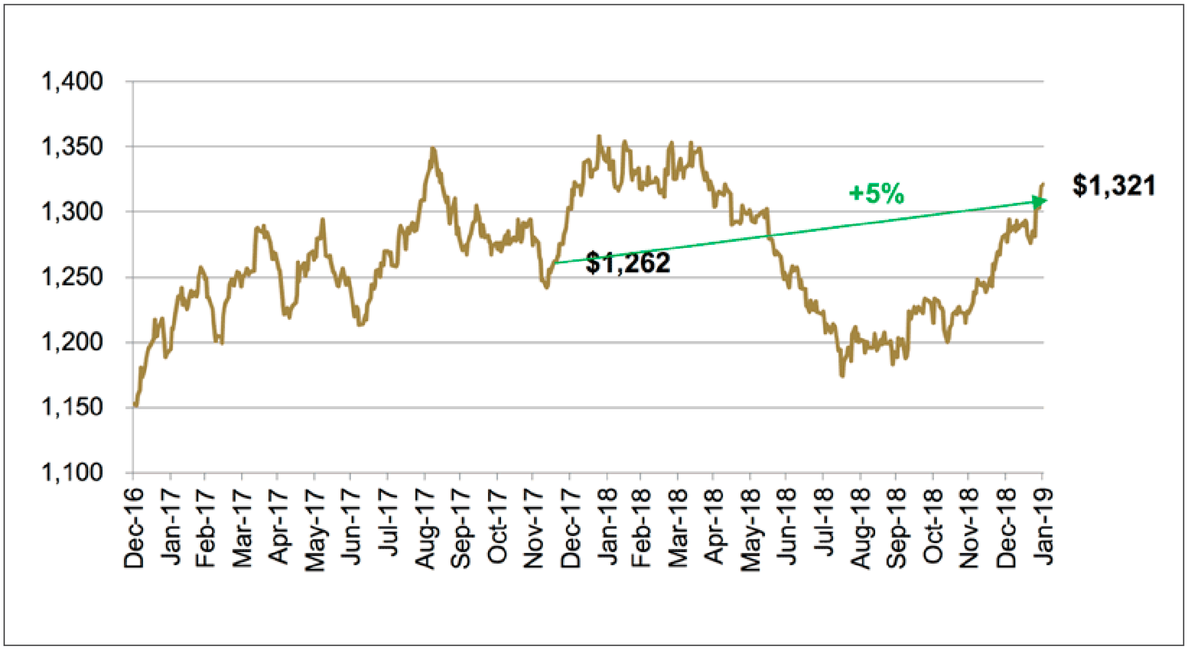
Since reaching a high on December 14, 2017 ($18,674), the price of Bitcoin had fallen by a staggering 82% at the end of January 2019 ($3,417 as of 1/31/19). During the same period, the price of gold[1] rose from approximately $1,262 an ounce to $1,321, a gain of 5%. Bitcoin's market capitalization has plummeted from $120 billion to $61 billion and is dwarfed relative to the over $7 trillion in value in the above-ground gold supply.

Given cryptos' 2018 rout, this is an opportune time to reflect on our earlier thesis and recent developments in the cryptocurrency market.

Figure 1: Bitcoin's Rise and Fall (12/30/16 – 1/31/19)

Source: Bloomberg.

Figure 2: Price of Gold (Per Once; 12/30/16 – 1/31/19)



Source: Bloomberg.

Cryptos: New Gold or Fool's Gold?

If we rewind to early 2018, Bitcoin and cryptocurrencies were all the rage, dominating media headlines and creating an investor frenzy, just as Bitcoin's price began to fall sharply. Cryptocurrency bulls were boldly pronouncing that Bitcoin was the new "digital gold" that would succeed gold bullion as the alternative to fiat currencies. Amid this hype, many investors ignored the precious yellow metal.

As leaders in precious metals and real asset investing, we at Sprott could see the telltale signs of a speculative bubble in assets that lack real, intrinsic value. Bitcoin's rise and subsequent fall harken back to the early 2000s dot-com bubble when once exciting new internet ventures suddenly were seen as irrational business ideas and investor hysteria. From Pets.com to Kitty Coins (and the 679 other coins that are now residing in crypto heaven, according to Deadcoins.com), the parallels are abundant.

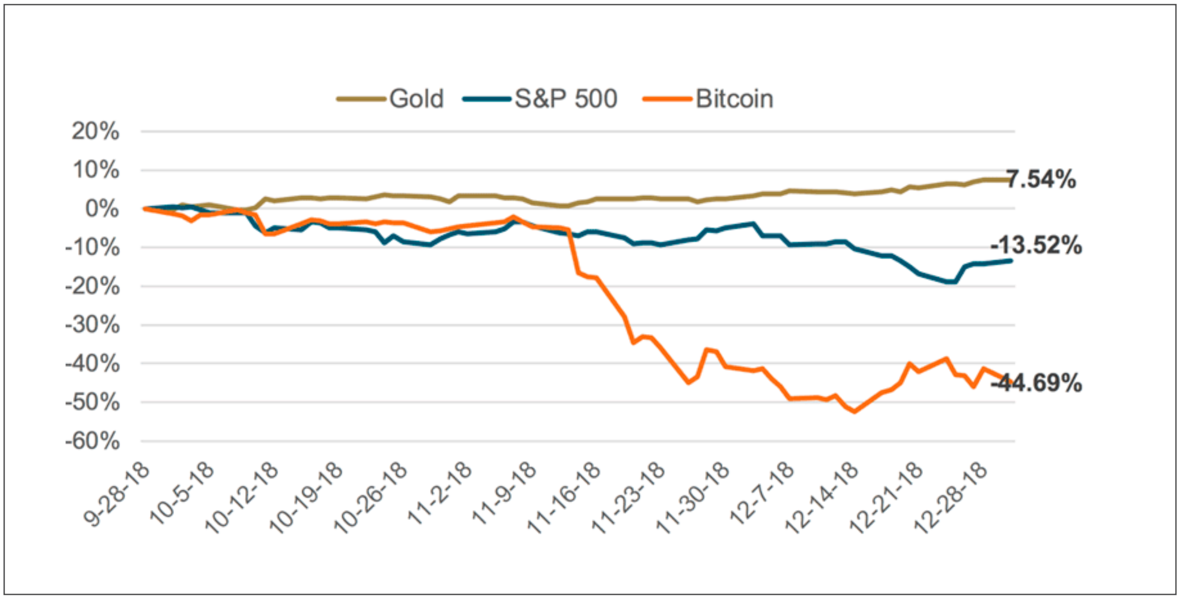
While exciting (by definition) when we're in them, market bubbles pop as soon as psychology shifts and investors flee. Bitcoin was the perfect candidate for a market bubble: **With zero underlying intrinsic value, Bitcoin's value is driven purely by sentiment.**

Also, the presence of a shocking number of bad players in the cryptocurrency space has badly damaged investor confidence. The SEC has focused most of its efforts on stopping initial coin offerings (ICOs), which too often seem designed to scam investors. Greater oversight should help the cryptocurrency space in the long-term, but it has also culled out speculative value in scam coins—there are currently 182 scam coins listed on Deadcoins.com.

Why Cryptocurrencies Struggle

We continue to argue that cryptocurrencies lack gold's key benefits: they are not an effective store of value that can help investors protect their wealth. The fourth quarter of 2018 was a difficult time for financial markets and offers a telling snapshot of the relative protection provided by Bitcoin versus physical gold. For the three months, U.S. equities (as measured by the S&P 500 Index[2]) lost 13.52% while gold gained 7.54%. At the same time, **Bitcoin lost 44.69%, acting the part of a risky asset precisely when most investors sought safe havens.**

Figure 3: Gold Outperforms in Q4 2018



Source: Bloomberg.

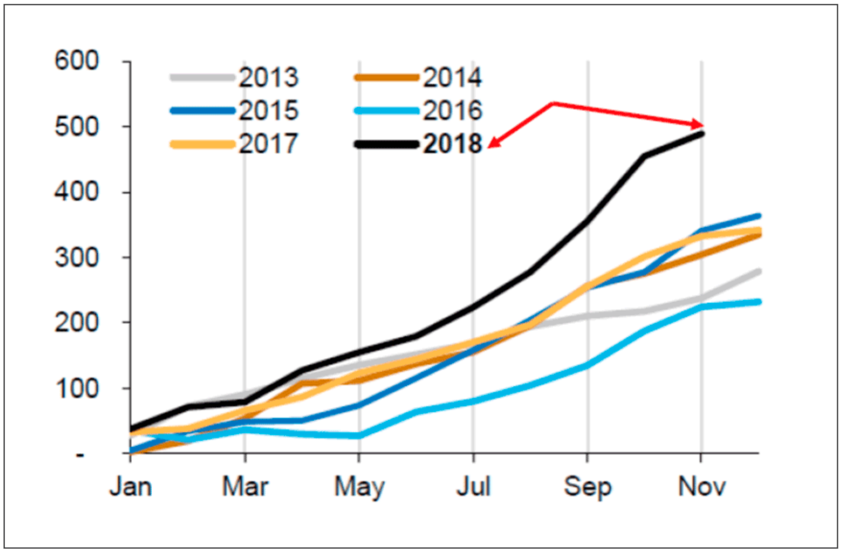
Gold did what it typically does in a market calamity: Gold held or rose in value. Despite all of the hype and euphoria about "digital gold," for investors looking for safety with low-volatility, uncorrelated assets, there is no substitute for the real thing.

Gold Remains a Stalwart

Gold, along with silver, have been alternatives to fiat currencies, and in fact predate them, for millennia. It's hard to refute their staying power. Gold and silver have a level of credibility that is essential in any financial asset, something that Bitcoin and other cryptocurrencies have clearly not earned.

The world's central banks agree. In 2018 alone, central banks collectively added more gold to their reserves than in 50 years, according to the World Gold Council.

Figure 4: Central Banks Increased 2018 Gold Buying by 74% YOY



Source: Macrobond, Macquarie Strategy, January 2019.

Gold is an Immutable Store of Value

Countries have trusted gold to be part of their currency reserves for centuries, given its proven track record as a reliable, immutable store of value. For the same reasons, individuals and institutions choose to hold gold and silver as part of their investment portfolios to protect wealth and diversify their portfolios. When things go wrong in the financial markets, history has shown that investors can rely on precious metals to help offset portfolio losses.

In practice, gold is also an inherently safer investment, regardless of cryptocurrencies' theoretical promises of security and anonymity. When you store your gold and silver in a secure physical vault, there is little chance of theft. In most cases, the vault will insure against losses (as does the Royal Canadian Mint where precious metals bars representing the Sprott Physical Bullion Trusts are stored).

This is not the case with cryptocurrencies. **A report from CipherTrace estimates that US$1.7 billion in cryptocurrencies were stolen in 2018.** Most of these thefts were by hackers who nabbed coins directly from the exchanges. While crypto advocates value the fact that cryptocurrencies are bearer assets—meaning no personal ownership information is recorded and the holder is presumed to be the owner, no matter how they came to acquire them—there is a real risk of losing or having digital coins stolen.

Gold has No Equal

At Sprott, we are optimistic about blockchain technology as a means to securely record and track provenance and ownership of real assets and do believe that cryptocurrencies might make sense in specific portfolios. We've invested in several blockchain-based technologies including VaultChain™ Gold and Silver, Emergent Technology and OneGold, a marketplace for digital precious metals.

But there are fundamental limits to cryptocurrencies as assets. **Gold, on the other hand, will continue to serve as the preeminent store of value and as a safe haven investment, we believe. It has no equal.**

More Sprott Insights on Cryptocurrencies

Cryptocurrencies, Solid Gold or Just a Flash in the Pan? – April 2018
Cryptocurrencies: New Gold or Fool's Gold – October 2017
Why Cryptocurrencies (Bitcoin) are Unlikely to Usurp the Role of Gold – July 2017

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About Sprott

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1 Spot gold is measured by the XAU: The ISO 4217 standard code for one troy ounce of gold, considered as a currency.

2 S&P 500® Total Return Index represents 505 stocks issued by 500 large companies with market capitalizations of at least $6.1 billion, and reflects reinvestment of dividends. This Index is viewed as a leading indicator of U.S. equities and a reflection of the performance of the large-cap universe. The TR Index represents dividends reinvested.

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