



Should institutional investors be looking at cryptocurrencies?

In the 15 years since the launch of the Bitcoin network, the original cryptocurrency has climbed from negligible worth to its current price of £47,700 – albeit a bumpy ascent – as investors have been drawn to the digital asset as a store of value not linked to inflation measures.

Although Bitcoin was designed as a digital currency to be transferred peer-to-peer via the internet without the need for a third party, such as a bank, the limited supply of Bitcoin (only around 21 million Bitcoins can ever be sourced or ‘mined’) precipitated price fluctuations driven by speculative investors.

Large scale investors remained dubious of Bitcoin and the newer cryptos on the block for some time – in 2018 BlackRock CEO Larry Fink described Bitcoin as "an

index of money laundering” – but institutions are now more receptive to crypto as an asset class.

According to a survey conducted by Fidelity Digital Assets in 2023, over 50% of institutional investors canvassed agreed the asset class has longevity, while 65% of investors plan to buy or invest in digital assets (of which cryptocurrencies are one) in the future, and more than a quarter said their perception of digital assets had improved over the past year.



Early movers

Fidelity Digital Assets itself was launched in 2018 on the back of client demand as a subsidiary of Fidelity Investments, a self-pronounced “early mover in the digital asset space”, while the early 2020s marked an inflection point as institutional investors began to allocate to cryptocurrencies, largely as a head against inflation in the face of central banks cutting interest rates.

Indeed, 2021 marked a U-turn for BlackRock as the asset manager added bitcoin futures to two of its funds. Since then, the asset manager behemoth has gone on to become the largest institutional Bitcoin holder, accruing over \$21bn in assets in its recently launched Bitcoin ETF - one of the fastest-growing ETFs of all time, demonstrating the growing confidence of traditional finance in crypto.

However, Martha Reyes-Hulme, research analyst at Fidelity Digital Assets, cautions that when approaching digital assets, it's important investors research and understand cryptocurrencies, their unique characteristics, their risks, and their volatility.

“While volatility has skewed to the upside, it can also translate to meaningful drawdowns depending on allocation and holding period,” Reyes-Hulme says. “Investors should also be selective about custodial solutions and well informed about the regulatory classification of their investments.”



Regulatory frameworks for cryptocurrencies are still evolving, with governments around the world building out new rules, but it's clear the implementation of comprehensive regulation will be paramount to the continued adoption of cryptocurrencies.

To this end, Chantal Bradford, head of business development and institutional sales at Deribit says compliance has been a priority for the crypto trading platform over the past 18 months.

“We are in the process of applying for a MIFID licence and now have our ISO27001 [the international standard for information security management to help avoid security breaches],” she says.

In January this year the US Securities & Exchange Commission (SEC) greenlighted the sale of ETFs linked to the spot price of Bitcoin, while in March the FCA announced it would consider applications for cryptoasset-backed Exchange Traded Notes (cETNs) targeted at professional investors to be listed on exchanges. At the time, the FCA said it is “collaborating with government, international partners and industry to develop the UK's cryptoasset regulatory regime and lead international standards in this space.”

Bradford said this has prompted “an inflow of assets into the crypto ecosystem,” but added there is still a lack of regulatory clarity surrounding crypto derivatives, which she said would drive a higher level of institutional adoption of crypto.



A digital future

Duncan Moir, senior investment manager at abrdn, notes that conversations with institutional investors have progressed over the past few years from questions regarding the function of blockchain to how to access cryptocurrency, signifying the change in investors' appetite.

Taking the view that almost all investments could be converted into digital assets using distributed ledger technology (DLT) over the next decade, abrdn has made strategic investments in a bid to help shape the development of a digital future. An example of this is abrdn's investment in Archax, which allows institutional investors to access blockchain-based digital assets and acts as a bridge to the traditional capital markets.

"In 2022 we made a material investment in Archax – the first and only FCA cryptoasset registered

exchange," Moir says. "We think they're going to lead the way both in the UK and in their market when it comes to regulated digital securities growth because they've gone with a regulation-first approach."

Redington CIO Pete Drewienkiewicz is less sanguine on the outlook for cryptocurrencies but says the investment consultancy has exposure to Bitcoin and "a handful of well-established currencies that seem likely to gain broad adoption" via systematic managers who trade baskets of cryptos from a momentum perspective.

"We've had some exposure for a couple of years now but it's a fraction of the portfolio. We can benefit from cryptos going up and down, so as long as we catch the trends we're happy with that for now."



Portfolio risk

However, Drewienkiewicz questions whether cryptocurrencies are a good fit for pension funds and liability-driven investments.

"Pension funds' and insurance companies' liabilities are intrinsically linked to the official measure of inflation, which takes them to the side of the conversation around crypto," he says.

"Everyone seems to believe you should hold crypto as protection for your currency being debased. But if your currency is being debased in a way that is showing up in the inflation numbers then you can just hold inflation-linked bonds. If your currency is being debased in a way that is not showing up in inflation

numbers, is Bitcoin the correct asset to protect against that? Every time there's a risk market sell off it seems that Bitcoin sells off, and that's not how we'd expect an asset offering protection to behave."

Conversely, Cartwright investment consultant Glenn Cameron is a proponent of professional investors allocating to Bitcoin, although he posits that Bitcoin is incomparable to the other ~30,000 cryptocurrencies in the market.

"If you add up the value of all the other cryptocurrencies, they're not collectively worth as much as Bitcoin, which has got about \$1.3trn stored in it now. And many of them are scams," Cameron says. "Bitcoin is objectively ●●●

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verifiable because of the technology it uses. Unlike other crypto, it's based on digital ledgers that are immutable."

Cameron notes that the State of Wisconsin Investment Board is the largest pension scheme in the US to allocate to Bitcoin and says Cartwright is assisting a pension scheme that will be the first British pension scheme to make an allocation to Bitcoin.

He continues: "We're not going to pension schemes or any other type of institutional investor and suggesting they bet the farm on Bitcoin. We're saying it makes sense to have a 2% to 5% allocation to Bitcoin to reduce the risk of the portfolio and increase the expected returns. Bitcoin has uncorrelated returns: the drivers of its investment performance is different to anything else."



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