BUSINESS

Road to Retirement: Crypto millionaires, are you missing out?

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In a recent CNBC survey of millionaire millennials, nearly half of them reported having at least 25% of their assets in cryptocurrencies, such as Bitcoin and Ethereum. While surveys vary, most indicate that millennials are 300% more likely to own cryptocurrencies than those over age 55. Although I am not aware of any studies, I expect that very few baby boomer millionaires hold 25% of their wealth in cryptocurrencies, as nearly half of Millennial investors report they do.

So, are cryptocurrencies the road to riches? Are younger investors on to something that older investors just can't see? Or are older investors avoiding the next investment bubble by sticking to the "boring stuff." My sense is that both generations of investors can learn something from the other.

Many younger investors are drawn to cryptocurrencies. It is a new and unique asset class. Yet, it will take many years to figure out if crypto assets have staying power, or if they'll go the way of the pet rock. My gut sense is they probably do have staying power, but the market is likely to change enormously.

It's like the early days of the internet when people saw its rough potential, but its ultimate success was a roller coaster. Many early leaders faded away, and companies that nobody heard of suddenly rocketed higher. It was tough to pick the eventual winners. For the foreseeable future, cryptocurrencies will likely exhibit similar behavior, where winners and losers are extremely hard to predict. Success will be based more on the luck of the draw, than on an investor's ability to fundamentally assess which asset will win in the long term.

Now, younger investors with a longtime horizon and a greater tolerance for risk may find this market very attractive. It is true that cryptocurrencies have minted many millionaires, but those who lost big betting on crypto don't garner many headlines.

For instance, over the last 24 months, the price of Bitcoin has gone from about $12,000 to $5,500, then up to $65,000 and back down to $30,000. That's quite a lot of volatility for two years, and those dramatic swings can create some big losses.

Older investors tend to prefer stocks as their primary wealth builder. While older investors may feel more comfortable with stocks, individual stocks can exhibit the same kind of volatility as individual cryptocurrencies.

By way of example, we'll look at the price of United Airlines stock over the last two years, which is part of the S&P 500 stock index. It was worth about $94 a share in 2019, dropped to $20 a share in 2020, and recently traded at about $55 a share. It actually had a larger peak-to-trough percentage decline than Bitcoin did. There are many stocks that exhibited similar behavior over the last few years. Moreover, the stock market in general is prone to falling 50% or more at times. Does that mean the risk is similar in both markets and younger investors aren't taking more risk with crypto?

In my humble opinion, cryptocurrencies are substantially riskier than stocks, even though they may exhibit some similar volatility and trading patterns. The reason is that the stock market is filled with companies that are essential to our daily lives and the operation of the global economy. Although the value is never clear, clearly there is value in a diversified portfolio of companies that are important to the economy.

But with cryptocurrencies, we don't yet need them to run the global economy. If they disappeared tomorrow, for the most part our economic lives would go on just as they did before. Thus, today they clearly have less value and potential staying power.

Because of all the uncertainty around cryptocurrencies, it would be smart for some younger investors to show caution and take a lesson from older investors. But because the world changes and cryptocurrencies have huge potential, many older investors could take a few pointers from the younger crowd.

Ultimately, the right answer between crypto vs. traditional assets depends on your individual risk profile. But there is one important lesson we can apply to the debate, and that is investors should diversity.

While estimates of the total global stock market value change daily, a ballpark figure is about $110 trillion. Cryptocurrencies are worth about $1.3 trillion. If you wanted to diversify based on the value of crypto vs. stocks, you might allocate 1% of your equity portfolio to cryptocurrencies. That might not sound like much, but if crypto grows 10x as many believe it will, then it would become a larger part of your portfolio. And if it outright fails, as others believe it will, it's only 1% and won't do much damage.

It is tempting to invest a lot of money into something you think will make you rich. But getting rich and staying rich are not the same thing. Diversification (into the established and the new) and patience (get rich slowly) are the fundamental building blocks of wealth management. Investors both young and old should stick close to them.

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