Are cryptocurrencies fool's gold? Experts weigh in

April 27 2021, by Peter Ramjug

Bitcoin rose to an all-time high of $65,000 in mid-April before a recent swoon. It started the year below $30,000. Credit: Matthew Modoono/Northeastern University

Up, up, and up they go.

The sky's the limit on prices for digital currencies such as ether, dogecoin, and the most popularly traded one, bitcoin. What's driving the latest eye-popping valuations? It's a mix of speculation and an ever-expanding appetite for risk for investments that differ from traditional stocks and bonds, say Northeastern researchers who study cryptocurrencies.

"It's impossible to know for sure" what's behind the latest mania in e-coins, says Ravi Sarathy, a professor of international business and strategy at Northeastern. But he thinks that the pandemic may have hastened the shift to an internet currency.

"Clearly COVID hastened the rate at which people lived on the internet," Sarathy says. "More and more commerce is happening online and people are always on Zoom, so it's not that surprising to see these valuations as more people start paying for their e-commerce purchases with digital currencies."

Big tech companies like Facebook and Google manufacture relatively few, if any, physical products. "Almost all of their products are purely digital, existing on the internet," adds Sarathy, who expects to publish a book next year on blockchain, a secure means of trading bitcoin and other cryptocurrencies. "So it is a comfortable step for users to also accept digital currencies."

The digital ledger underlying bitcoin and other digital currencies, also known as e-currencies, can also be used in a variety of other applications, including banking, finance, identity verification, and supply-chain tracking. It even has the potential to trade in the rapidly burgeoning market for digitized content known as non-fungible tokens.

The digital artist known as Beeple made news last month when he sold a piece of art for $69 million in hard legal tender, a record for a digital

work of creativity.

Bitcoin has been on a tear, rising to an all-time high of $65,000 in mid-April before a recent swoon. It started the year below $30,000. Dogecoin, created in 2013 as a parody of the cryptocurrency frenzy, has surged to record highs, reaching 45 cents in mid-April, up from less than 1 cent to start the year. Tesla's Elon Musk recently tweeted his support, "Doge Barking at the Moon."

Ether, which runs on a blockchain called Ethereum and is particularly suited for business transactions, has rallied to an all-time high. The currency is different from the more well-known bitcoin.

"Think of bitcoin as digital gold, whereas for Ethereum you can think of it as a public computer that anyone can use to transact online," says Alex Mirran, who graduated Northeastern in 2018 with a degree in finance and entrepreneurship, and now runs a data management software startup, GalaxyX.

Today, over 50 distinct blockchain systems support more than 7,500 crypto assets that enable all forms of digital records and transactions, including contracts, documents, and securities, according to Coinbase, the trading platform that recently made its Nasdaq stock market debut.

The company was valued at a whopping $86 billion on its first day as a publicly traded company. Professional basketball star Kevin Durant of the Brooklyn Nets and rapper Nas were early investors. "Long crypto forever," Nas tweeted.

Its shares have since fallen, lopping off billions in value and underscoring the crypto market's volatility.

"People say whatever the market is willing to pay is the valuation, so

right now if it is willing to pay $86 billion then that's the valuation," says Sarathy. "Of course, it could be different six months from now."

If history is any guide, it will. Cryptocurrencies are notoriously volatile, which makes it difficult for most investors to see them as real currencies. "There's really nothing behind them," says Jeffery Born, a finance professor at Northeastern. "There's no there there."

Born has been teaching about investments since 1999, when tech companies were going public at a rapid rate and saw massive valuations despite a lack of tangible assets. Their stock prices eventually crashed back down to earth, a scenario Born predicts for the crypto market.

"Ultimately I was proven right then and I fear that I will be proven right again," he says, comparing the excitement to the Dutch tulip craze of the 17th century, one of the most famous market bubbles and crashes of all time.

That doesn't mean the e-coins lack perceived value to investors, counters Sarathy. "They're hoping to replace money," he says. "If people agree that something can be exchanged for value among a certain group, it becomes money."

But the main reason that people have it is as an investment, and most of the limited supply (a maximum of 21 million bitcoins can be created) is held in the hands of a few, he says.

And, Sarathy points out, money is traditionally used to exchange goods for cash. "If I go to buy a cup of coffee, I could theoretically use bitcoin if the grocery store had an app, but very few mainstream commerce companies accept bitcoin as a means of payment," he says.

But that's changing. Major payment apps such as Square and Paypal

enable even smaller merchants to accept bitcoin, and their large volume allows them to hedge against volatility for their clients, Sarathy adds.

Tesla, the electric car maker, is one that does take bitcoin. "For now, you can use Bitcoin to buy Tesla products in the continental U.S. We plan to expand into more markets in the future," the company says on its website.

But Northeastern's Born thinks the company quickly converts the e-currency for actual cash. "I would be stunned to know that Tesla keeps bitcoins more than a day," he says.

Digital coins make for compelling business stories on TV, the professor points out, but in reality, investors are shelling out actual legal tender in exchange for no promises, Born says. "They don't guarantee anything, they don't guarantee it will ever be used in anything, and they don't guarantee it will ever have any future value."

Provided by Northeastern University

Citation: Are cryptocurrencies fool's gold? Experts weigh in (2021, April 27) retrieved 27 April 2024 from https://techxplore.com/news/2021-04-cryptocurrencies-gold-experts.html