Be prepared to lose your dough if you gamble on the bitcoin boom

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As a licensed financial planner I am getting many inquiries from clients of all ages about cryptocurrency, especially bitcoin.

Five years ago bitcoin was trading at $540 per coin and today it is closer to $75,000 in local currency. To put this price increase into perspective, if you bought 18½ bitcoin five years ago for $10,000, today it would be worth almost $1.4m.

As an adviser I find any asset exhibiting those types of returns simply cannot be ignored. And even if it is not recommended, it should be considered: this is what I am tell my clients.

But first, is cryptocurrency something that financial planners can actually advise their clients on? All financial planners in Australia are required to be representatives of an Australian Financial Services Licensee (AFSL) and hold the relevant authorisations from ASIC, such as authorisation to advise and deal in cash, shares, managed funds, derivatives and so on.

So with cryptocurrency only becoming popular in recent years, does your financial adviser, or anyone who provides cryptocurrency buy and sell recommendations and advice, need to be licensed?

ASIC has provided guidance on initial coin offerings (ICOs) which is basically a capital raising/crowdfunding activity to launch a new coin, and says the same principles apply to all crypto assets.

An ASIC spokesman also says: “There are potentially thousands of crypto assets out there that could be a financial product. In short, it’s up to the relevant crypto intermediary, issuer, etc to determine if the crypto asset is a financial product and then comply with the relevant obligations.”

In reality the legal situation is that cryptocurrency can be deemed to lie outside the range of “financial products” and consequently it’s open season as far as advice is concerned.

Jamie Lumsden, solicitor director at The Fold Legal says: “Cryptocurrency is not separately regulated as a financial product — nothing says cryptocurrency is a financial product in the same way life insurance or shares are. As long as the token is not a financial product, there are no restrictions on advising on them.”

Based on Lumsden’s view — which is mirrored by many others in legal circles — financial planners are able to discuss cryptocurrency with their clients.

From my perspective, assessing cryptocurrency is no different to any other investment: the risk and return metrics need to be carefully considered.

Although a $10,000 bitcoin investment in 2016 may have made you a crypto millionaire today, there have been massive swings in the bitcoin price in recent years. If you invested in December 2017 when it hit an all-time high of $25,000, 12 months later your investment would have dropped by 80 per cent in value to less than $5000.

Bitcoin and all other cryptocurrencies are inherently risky as they hold no intrinsic value.

However, this is not dissimilar to fiat currencies such as the Australian dollar, which is accepted because people feel confident they will always be able to exchange physical currency for goods and services. The dollar is not backed by any physical assets either.

We can only expect cryptocurrencies to continue to produce significant and sharp price swings until there is a more stable trading market. What this means is that if large companies start to accept bitcoin in exchange for goods and services, cryptocurrency will mature from its historically speculative investment past to a more stable global currency.

Already in Britain, you can purchase a BMW using bitcoin and in the US you can pay your AT&T phone bill using bitcoin, and Tesla plans to accept payment on its vehicles in the near future.

The second driver in the stabilisation and longevity of cryptocurrency may come in the adoption of the underlying technology that drives different coins.

But back to the average Australian who has probably heard of cryptocurrency but not done anything about it.

My advice to clients is simple: invest only what you are prepared to lose.