Fresh Invest: Crypto as part of an investment strategy
Season 2, Episode 4 Transcript

Alex Lieberman, Co-founder and Executive Chairman of Morning Brew Hey, everyone, I'm Alex Lieberman, co-founder and executive chairman of Morning Brew. This is season two of Fresh Invest, your favorite investing podcast sponsored by Fidelity Investments and powered by Morning Brew. There's a good chance today's topic is the whole reason you've been tuning in to Fresh Invest. We're going to discuss the pros and cons of investing in cryptocurrency.

Alex [If I had to pick one question the Morning Brew audience asks most frequently, it's probably this: Should I invest in crypto? If so, how, and which one or ones should I invest in? It's on everyone's lips and Tweet Decks, and there's a lot to consider. There's certainly upside to be gained in crypto. The price of Bitcoin soared past a jaw-dropping 64,000 this past April. And as we covered in episode three, crypto has gone from a techie obsession to fairly mainstream in recent years.

Alex But crypto also has downsides, for reasons we'll get into in this episode. And because there's so much to keep in mind, we're turning to our friend at Fidelity, Jurrien Timmer, who is director of Global Macro.

Alex Welcome, Jurrien.

Jurrien Timmer, Director of Global Macro at Fidelity Thank you very much. Thanks for having me, Alex.

Alex So could you start by introducing yourself and talk a little bit about your philosophy on crypto investing?

Jurrien Yes. So I'm the director of Global Macro at Fidelity, which is a fancy way of saying I look at the big picture, but from a traditional investment point of view. So I'm fairly new to the crypto space. I kind of went down the rabbit hole last December. And until that point, I was strictly operating in the 60/40 world of stocks and bonds and other asset classes as well. But generally where most investors would be invested. And I've been at Fidelity 26 years. I've been in the business 36 years.

Alex And out of curiosity, you said it was last December that you started going down the rabbit hole. Just talk a little bit about the experience. What have you come to learn about or think about this Wild West of Bitcoin and crypto?

Jurrien Yeah, you know, it was a wild ride. I mean, the parallel has been used with a lot of people that crypto is kind of internet 1990s. The internet stuff was a sideshow for many people, especially in my industry, because these companies back then were not in anyone's benchmark. They were not on the S&P 500. But then it gets bigger and then companies start getting added and it becomes part of the landscape.

Jurrien And I think a similar situation has been with crypto, at least from my perspective. I'm in front of a lot of clients doing events. And again, when it's sort of out there in the distance and it's a couple of crypto punks doing this stuff, but it really doesn't apply to the general audience, there wasn't really that need to get involved. But then, of course, Bitcoin starts going up. Everyone starts asking questions. And I felt the need to have an opinion.

Jurrien And as you well know, it's hard to have an informed opinion on crypto without doing the work. You can't just kind of read a few articles for an hour and say, OK, I'm ready to go. It takes a pretty deep dive. And so, last December happened to be the time that I'm, like, OK, I'm going to do it. It was over the holiday period, over, you know, Christmas, New Year's. So it was kind of a slow period in the market.

Jurrien And I did not come up for air for two weeks. I could barely sleep. I was so obsessed with it because, you know, you're peeling the onion, you learn things and it's, like, I want to know more. And so I came out of this, in my view, with a decent understanding about what Bitcoin is. So that really was limited to Bitcoin because you got to start somewhere. And it's been just drinking from a firehose ever since. And I just last week did my kind of deep dive on Ethereum. But as quickly as I'm learning, the landscape evolves even quicker.

Alex And so, for a lot of people who try simplifying what Bitcoin is or can be for investors and just for citizens, they'll explain it as a digital version of gold, a digital gold. Can you expand on why that comparison is made, and if you think it is a fair comparison for Bitcoin?

Jurrien Yes, I do think that's a fair comparison. And it's interesting — when I went down that rabbit hole, I thought it was all going to be very hard to quantify and grasp because it's such a futuristic thing. And as a history geek, I was very pleasantly taken into another direction, that in understanding the value proposition of Bitcoin, specifically as a hedge against monetary inflation, if you will, I went basically a thousand years into the past —

Alex Yeah.

Jurrien And looked at, you know, what is money? What role did gold play? How did gold evolve after we went from the gold standard to Bretton Woods to the fiat currency system. And so I found this very interesting parallel where the past and the future kind of meet. And I think of it as the crypto space, obviously, in general, is about network effects. You know, Metcalf's law, the blockchain, a whole new, decentralized way of doing business in the world, including in the financial industry, but other areas as well.

Jurrien And Bitcoin, of course, rides that platform, but it's built in scarcity — makes it more than that. So comparing Ethereum to Bitcoin, for instance, Bitcoin is much scarcer, but it's deemed less scalable, and then Ethereum is more scalable, but less scarce, although Ethereum 2.0 is trying to change that a little bit.

Jurrien But what's interesting is that I looked at gold. Gold used to be money, and gold would go up and down with inflation, but it didn't do anything more than that. And then in 1971, when the U.S. went off the gold standard, gold kind of came of age, if you will. It grew up and it went on its price discovery path during the 70s. And it was a wild ride, just like Bitcoin's ride has been wild. Gold went up 20-fold with very large drawdowns.

Jurrien And it was a coming of age story because it went from being money to being an asset class. And I think Bitcoin is kind of in that mode where it's a teenager coming of age and teenagers are full of promise, but they can also wreck your car, right? So it's kind of of that volatile price discovery mode.

Jurrien But I think that is Bitcoin's promise for the typical investor. I mean, it has promise for a lot of other applications as well. But I think for most typical investors, in a world where real rates are negative and we have a lot of financial repression and a lot of monetary inflation, we all know the story about the Fed and other central banks. I think that's kind of its use case for most people right now.

Alex Yeah, and you bring up as a history buff, how it was a really pleasant surprise to see kind of, like, that Bitcoin is very much part of a longer story of the history of money. And I remember having that experience as well. I think the book I was reading was "The Bitcoin Standard," and it was basically this long education, not just about Bitcoin, but on the history of money and how the downfall of money has often been, when you see inflation of it, it loses its value, and money is generally defined across time, space, and scale.

Alex And I think to your point that the interesting thing with Bitcoin is because there's 21 million Bitcoin, because it's easily divisible, because there will never be more than 21 million, it could have wealth preservation properties similar to gold. That said, there's still a lot of risk with Bitcoin and I'd be interested to hear your thoughts from a macro perspective. You assess this new asset class, but specifically Bitcoin. Where do you view the biggest risk to the asset right now?

Jurrien Yeah, it's a great question. And by the way, there are some really great bits in that book, you know, about the history of money.

Alex Yeah, oh yeah.

Jurrien Really, really good stuff. But yeah, you know, I view the risks more as what are the obstacles to widespread adoption, especially institutional adoption. And so one that people have mentioned, of course, is the regulatory risk. And I think the older and bigger Bitcoin becomes, the more contained those risks are, because it's too big to just regulate out of existence. And also, once you're past the on and off ramps of U.S., you know, fiat dollars to stablecoins to Bitcoin, it just becomes harder to regulate.

Jurrien And my sense is, and I know my colleagues at FDAS, Fidelity Digital Assets, agree with that, is that regulation actually, I think, done the right way, of course, would be good for the space because it would legitimize the space. So if you're running the pension fund of a large corporate pension plan, once it starts getting regulated, if it's done the right way, it will have passed a checkpoint, if you will.

Jurrien The other obstacle has been ESG consideration. And this is a widely polarizing [chuckles] subject. The hardcore Bitcoiners swear up and down that it's only wasted energy that is used and it's very ESG-friendly. Other people will take the other side. But I think that's an issue that is kind of going away on its own. When China banned the Bitcoin mining, that kind of started to resolve itself.

Jurrien And to me, there's no question that the bitcoins that were mined in China were not all dirty, but certainly there was parts of it. And we saw that news event happened, I think it was in May where a large coal-fired power plant in China went down, and all of a sudden the hash rate collapsed for a few days. So, it's hard to not draw, you know, connect the dots on that front.

Jurrien But with China banning mining and with institutions obviously being very ESG-minded, I mean, you can't even get in the door these days as an investor or as an issuer of securities if you're not on the right side of history on this. So I think that's an area where the whole space will just move in the right direction just because the potential buyers will demand it.

Alex Yeah. So there's so much good stuff there. The one callout I want to make is where you talked about regulation and actually, if done properly, regulation can be a positive thing. Because I think a lot of people get very scared about regulation, assuming that entire countries are going to ban Bitcoin and it'll crush the network effects and, like, so much of the value prop. But I think to your point, regulation actually can be a good thing to make it feel more approachable, because there's actual structure and governance around something, especially if you want institutional investors to get involved.

Alex How should retail investors think about if and how much exposure to Bitcoin they should have in their portfolio? And also, how should they know when they've done enough of the work to make an intelligent investment like this?

Jurrien Yes, it's a great question and [laughs] I've done a lot of thinking about that. And I would say — and actually, my 24-year-old daughter was just over for dinner last night. She's a nurse, and she's, like, I want to learn more about crypto, what should I buy? And I told her, you need to do the homework. Don't buy it just because it's going up — that is the worst reason to buy anything. And that's not limited to crypto.

Jurrien But it's a question of, again, through the lens of a 60/40 old-timer, I guess I should call myself, where on this spectrum would Bitcoin live? And so, if you have the crypto space and you have Ethereum and the network stuff, that kind of belongs on the extreme of the 60 side. That's like a venture capital type of investment.

Jurrien Bitcoin on its own, if it's a digital gold, if that's how you see it, to me, that goes on the 40 side of the 60-40 spectrum, because we're in an era right now in a regime of negative real rates. And I liken it a little bit to the 1940s World War II — the debt-to-GDP went up a lot because the U.S. mobilized the economy to enter World War II, and the Fed was tasked with keeping rates below the inflation rate and absorbing that debt.

Jurrien So in that kind of framework, the Fed's kind of doing something similar. So it is holding interest rates below the inflation rate, which means that the 40 side of a 60-40 portfolio is losing purchasing power. And so in the old days, gold would fill that need. And it still can, of course, and it still does. But if Bitcoin is a new form of gold and silver as a protector of purchasing power, that's how I would think about where I would own Bitcoin in a diversified portfolio.

Alex So just for our listeners who haven't heard the 60-40 paradigm before, can you just quickly share, like, actually how to think about that? And what is the 40-bucket versus the 60-bucket?

Jurrien That's a great question. So I should have specified that. But 60/40 is kind of a model — and for some it's 70/30, others it's 50/50 — but the idea is you have the majority of the portfolio in stocks or growth assets. So stocks are the tried-and-true anchor in any portfolio because they are a play on growth and they are somewhat of a hedge against inflation, not like super-high inflation, but they are hedge.

Jurrien So historically, stocks have returned about 11% per year. Inflation historically has been about 3. So the real return has been well above zero. So they have performed well above inflation. Over the past 20 years, we've been kind of in this disinflationary era where every time there's a shock that causes the stock market to correct, bond prices go up and bond yields go down. So the 40 has been a really good insurance policy against shocks to the 60.

Jurrien And until the current — kind of the last 10 years out of the 40 — you would get a double whammy. You would get nice income, 5%, 6, 7% yields, and you would get that negative correlation against stocks. So you had kind of a win-win that protects your portfolio and earns income. Now the income part is gone. So it's just the insurance part. But that's the 60-40. So you want to have enough in there to protect from shocks in the 60s, but not too much because the 60 is what drives the return over the long run.

Alex Yeah, makes total sense. So I want to talk a little bit about kind of like these arbitrary price points for Bitcoin. You often see headlines in The Journal, a bunch of business media, where when Bitcoin slips below a key price point, like 30,000 or 40,000 right now, or it gets above 50,000 or 60,000, there's a ton of both conversation and momentum around it.

Alex Do these arbitrary price points actually mean anything? Should retail investors be focused on them? Should they be thinking about them as places to enter into potential buy-and-hold trades? How do you think about these kind of arbitrary round numbers?

Jurrien Yeah, it's interesting because we have the same conversation in the stock market, of course. And I always try to remind our investors, our clients, that we should focus on value, not price. The price of something is just the price of something. You can buy a car for 10,000 that is a great car, or you can buy a car for 100,000 that's not a great car. So it's the value that we should focus on.

Jurrien And, so same with the S&P. The S&P may be at 4,000 or 3,000 or the Dow is at 30,000, but how much are we paying for each dollar of earnings is really the question. And so for Bitcoin, it's the same thing. But it's easier said than done, because it is a new asset and how do we value it? And so 40,000 or 30,000 or 50,000 is kind of a meaningless number if you don't put it in the context of what its value is. And so that's always going to be a tough thing in terms of a new asset that's going through price discovery.

Jurrien But for Bitcoin, we have the supply model start to flow, we have the demand models, Metcalf's law, you know, historical S-curves. We can look at internet adoption or mobile phone adoption in decades ago, and we can kind of draw those curves and to see where Bitcoin is along those curves. And so that's how I think about it.

Jurrien But, you know, it's human nature to anchor ourselves to these round numbers. And for instance, 30,000 ended up being very good support during this decline. And it so happens that that was exactly the level that my demand model said it should have been at the first place. So the 64,000 was an overshoot against that curve. But that's how I think about it.

Jurrien But it's hard, right? And so, you know, now that we're back at 50, it's like an anchor. So that's how we keep score, right? It's like a birthday or an anniversary. It's, like, you keep score that way so people can't be faulted for it. But ultimately, it's the value, not the price that matters.

Alex Absolutely. So today's question for you, Jurrien, is could you explain as briefly as possible why crypto tends to be more volatile than, for example, something like the S&P?

Jurrien Because it is a brand-new asset class going through price discovery, just like gold was in the 70s. Gold just sat there for centuries and then it came into its own. And price discovery, by definition, is a period of volatility because you don't know at that point — like, again, back to the 1990s, how do you know if something you're buying is the [indistinct].com or an Amazon, right?

Jurrien And so we're in that Wild West phase where we don't know what the regulatory risks are. We don't know whether adoption will take place at an institutional level. And so it's par for the course and it's, by definition, volatile. And over time, the return profile will slow down and the volatility profile will slow down. The Sharpe Ratio, which is the ratio of return to volatility, may very well stay the same, but the numerator and the denominator will kind of quiet down and grow up.

Alex Yep, absolutely. So really exciting time, but a really early time. It's early in the life cycle, this asset, which has caused it to obviously be more volatile than a more mature index or asset, something like the S&P. Jurrien, thank you so much for joining me today.

Jurrien Great. Thank you, Alex. Great to be here.

Alex And thanks to everyone for joining us today. I hope you feel like you now have a stronger grip on the various forces shaping the world of crypto and what to know before you possibly get involved. I personally think this is the biggest shake-up in the world of finance in the past decade. Could you imagine trying to explain something like Ethereum or Bitcoin in 2011? I can't.

Alex I really appreciate you listening today. See you same time, same place next week to talk SPACs with Fidelity professional John Gagliardi.

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