What to make of Cryptoculture in 2018

With Bitcoin briefly touching $20,000 in early December -- a nearly 20-fold climb from the beginning of 2017 -- yet retreating back to as low as $9,000 in 2018, many have wondered if they too should be allocating a portion of their portfolio to bitcoin or other cryptoassets such as Ethereum and Litecoin. Similarly, so-called initial coin offerings, security-like investments for new cryptoassets and blockchain-like endeavors have captured investor attention -- as well as regulatory scorn.

For households who are weighing getting into cryptoassets, here are some guidelines:

Avoid the temptation to go all in. Investments in bitcoin and similar assets should be considered only as a portion of your alternative investment portfolio -- alongside where private equity, hedge fund and commodity investments might live. There are many factors that may cause an investor to take pause. First, there are no verifiable metrics for valuing the assets, as one would a traditional security. Also, with more than 1,500 types of cryptoassets (a number that is growing daily), each with their own utility, it is difficult to maintain a true understanding of the marketplace. Cryptoassets are not as accessible as many other types of assets, as one cannot go through a traditional brokerage account, or simply to their banker. Finally, speculators have discussed the possibility of a "bubble" and the question of if or when cryptoculture may go downhill.

Understand if and why cryptocurrencies belong in an investment portfolio. Some have invested in bitcoin because they believe cryptocurrencies will soon replace fiat currencies. Others just want to buy something that is going up in value. But even among the purists and opportunists, there is no denying that cryptocurrencies are incredibly volatile. It may be appropriate to pare down the risk in other parts of the investment portfolio if cryptocurrencies are going to take up a significant portion of one's alternative allocation.

Keep track of buys and sells. The term "cryptocurrency" is something of a misnomer as the Internal Revenue Service views bitcoin and similar cryptocurrencies as property, meaning that any gains and losses from dispositions will have to be reported for tax purposes. Even when bitcoin is used to make payment, which could potentially be a taxable event as well, it is important to have documentation of its original cost basis. Since these cryptoassets are not held in any traditional brokerage accounts in the U.S., there is currently no 1099 issued, so investors must keep track of documentation themselves.

Store cryptocurrencies responsibly. There have been several reports of bitcoins lost due to hacking as well as user error. Before diving into this asset class, one should learn protocol around storing and moving cryptocurrencies. Many exchanges have been hacked, which is why some people choose to store their cryptocurrencies on an external hard drive. Unfortunately, some who have done that forget the "key" for accessing their coins. Remember: bitcoin has no customer service rep or bank, meaning there is no one to call for help when there is a problem, or no recourse for lost or stolen assets.

Monitor regulatory developments. In the last few months, the Securities and Exchange Commission has published guidelines for investors looking to get into this space. Cryptocurrencies may be new, but the reality of scammers looking to defraud investors trying to get into the next new thing is not. The last few weeks of 2017 saw several companies "rebrand" themselves as bitcoin and blockchain-oriented despite having no prior experience in the area. Similarly, companies have turned to launching so-called ICOs as a way to raise capital. Unfortunately in this nascent area, the laws have not yet fully kept up with the technology, which creates a risky situation for investors. It is important for investors to stay vigilant and ask questions of any investment that seems too good to be true.

As with any financial choice, it is important to research the proposed investment fully, while also recognizing that understanding an investment's risks does not necessarily protect from other types of risk. For more information or to discuss a specific situation, contact your Anchin Relationship Partner or Jonathan Kraes, a manager in Anchin Private Client, at 212.840.3456 or info@anchin.com.

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