

Taking Bitcoin to the stockmarket won't do much for its risky image

Written by The Conversation

Since its [inception in 2008](#) digital currency Bitcoin has attracted critics who argue it's inherently risky. The latest push to create an exchange traded fund (ETF) in order to make trading it easier, suggests attitudes to it haven't changed. But some risks associated with a Bitcoin ETF is just like any other asset that becomes tied to investors and the stockmarket.

The US Securities and Exchange Commission (SEC) has already [rejected an application](#) to create an ETF for

[Bitcoin](#)

. But there are two other proposals - (

[SolidX](#)

&

[Grayscale](#)

) still before the commission.

Bitcoin is intended to act like currency in that, once you have a Bitcoin, you can use it to buy goods. It's much the same as using electronic payments from a bank.

Like a currency too, it has its own exchange rate and can be traded for other currencies. It has a [history of wild price fluctuations](#) as investors have in turns bought it with enthusiasm and sold it when spooked.

The push for Bitcoin ETFs is not only the result of [more](#) and [more](#) money flowing into these funds, but also because ETFs make it much easier to invest in types of non-traditional assets like Bitcoin.

Why a Bitcoin ETF?

Buying and selling Bitcoin directly is a [complicated](#) , multi-step process. You need to have a Bitcoin wallet to store Bitcoins, you need a private key to access the wallet, and it needs to be connected to a Bitcoin exchange somewhere around the globe for you to actually buy or sell. This is all very technical and beyond the capacity of a lot of investors.

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Buying or selling a Bitcoin ETF would be much simpler.

An ETF is a managed fund that is listed on a stock exchange. Think of it like a basket or a holding company.

In the case of a Bitcoin ETF, it would “hold” a certain amount of Bitcoin depending on the rules it has set up. Investors can buy into it through the stock market, just like you would any public company. By buying shares in the ETF you have essentially bought a “share” of the Bitcoin it holds.

ETFs like this are popular because they are more transparent and (usually) cheaper than comparable funds. While the average management fee for a [US equity managed fund is 0.68%](#) per annum, an ETF can charge as low as 0.05% per annum. This would mean a difference in return of A\$207 for a A\$1000 initial investment over 30 years time.

These low management fees are for traditional ETFs - the ones that hold bonds or shares. This is not necessarily so for some of these more complicated ETFs.

Bitcoin ETFs, for example, are not looking to be so cheap. Bitcoins aren't as easy to manage as shares or bonds, they require secure storage and insurance from loss.

The proposal from [Grayscale](#), for example, aims to charge 2% per annum. For someone with an initial investment of A\$1,000 in this ETF, this would mean a huge difference in returns. We calculate you would receive about A\$811 less over 30 years than if you bought Bitcoin on an exchange and stored them on your computer (less the Bitcoin transaction fee).

Because they are listed on the stock exchange ETFs are also very “liquid” - they are easy, cheap and fast to buy and sell. This means it is easier to [get in and out](#) of an ETF than it would be to buy or sell units of actual Bitcoin.

ETFs disclose their holdings every day. This is the mechanism that ensures the total value of the ETF does not deviate too far from the market price of whatever it holds.

The risk in a Bitcoin ETF

There are risks to a Bitcoin ETF that extend to even traditional asset ETFs, like stocks and bond ETFs.

One drawback is that if the Bitcoin ETF becomes extremely popular there are inherent dangers that could reduce the benefits to investors. [Movements in the ETF may influence movements](#) in the underlying Bitcoin price.

This “tail wagging the dog” effect may mean Bitcoin prices no longer relate to fundamental demand, but rather investor demand. There may also be [reduced diversification benefits](#) of Bitcoin.

Investors may seek out Bitcoin to get variety in what they invest in, to try a non-traditional asset. But as a Bitcoin ETF becomes more correlated to stock market returns due to investor demand, a lot of that benefit will disappear entirely.

When this happens Bitcoin returns will go up, together with stock, as investors enter the market, and vice versa when investors leave. There is also potential for investor demand to cause bubbles (where the price becomes overinflated) due to the ease of trading the ETF.

The same risk of being tied to investors [has also been discussed in the context of commodities](#), with a suggestion they're to blame for a recent commodity bubble (although [this is disputed](#)). The argument is that as commodity investment took off with the introduction of commodity indices, so too did prices despite these investments being simple buy hold strategies. The same pattern could happen with Bitcoin ETFs as they become an everyday investment in the average portfolio.

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