

See bitcoin as a lottery, not an investment

Apart from returns, an investment must have fundamental value, transparency, regulation and market-driven demand-supply. Bitcoin falls short on these

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A tea seller in Mumbai's newest corporate hub claims to have bought 4 bitcoins, at Rs1 lakh each, in May 2017. He is already sitting on a handsome profit, given the price of Rs13.64 lakh per bitcoin—as per Coinome as on 19 December. However, he says he will wait till next year when the price would be around Rs15 lakh a bitcoin. On being asked how he knows for sure that the price will move to that level, he responded with an assured, “*Aap dekhna* (you’ll see).”

New Delhi-based Ashish Kharkia, 33, who is an assistant vice president in a multinational financial services company, heard about bitcoin 3 years ago. He is disappointed that he didn't get in then. “I heard about bitcoin through word-of-mouth. One of my friends had invested in bitcoin 3-4 years ago. Another friend has also put money in it. I then explored bitcoin and other cryptocurrencies. I invested just 3 months ago,” said Kharkia. He doesn't want to invest too much and feels that cryptocurrencies are something that can burst any time. “I will keep my bitcoin investment limited and won't over expose. However, I won't stay away from it,” said Kharkia.

In between these two extremes there are many others who have chosen to ride the bitcoin rally. Some started early and are sitting on a large profit pool. Others are getting in now amongst all the noise and space

bitcoins has captured. Quick money and wealth creation are two reasons cited by some of the people who have bought bitcoins, and are holding on.

If you are tempted to bite the bitcoin bullet now, ask yourself, “What is driving this urge?” On the other hand, if you have already indulged in this trade, know what you have bought. Have you invested in a cryptocurrency, a financial asset or a commodity?

Many experts across the globe have called the bitcoin rally a bubble. We won't know if they are right till it bursts. Meanwhile, it helps to evaluate whether your bitcoin trade was based on logic, greed or just herd behaviour.

Herd behaviour?

This is not the first time people have rushed after a trade in the hope of quick gains. A similar phenomenon was seen in the 17th century too, when the well-documented tulip mania occurred in what was then the Dutch Republic. More recently, the subprime asset mania saw many bankers chasing an asset whose underlying value simply collapsed in 2008. In India too, the plantation investment schemes of early 1990s were another mania that many investors fell for. The boom in information technology (IT) stocks in the 2000s, the infrastructure stocks' rally in 2007, to name a few cases from India, were also irrational trades chasing high returns. In all these instances, demand increased rapidly leading to prices rising but—without the support of fundamentals and quality—they eventually collapse.

According to Tarun Birani, founder and director, TBNG Capital Advisors, “It (bitcoin rally) seems to be a classic case of herd mentality. We saw it with gold when prices were rising sharply in 2008-10. It's happened in real estate. To those who haven't bought, it looks like a lost opportunity and they too want to get in.”

However, most investments—even if done following a herd or chasing quick returns—have an underlying asset that has some value. It could be physical property, a useable commodity or stocks of listed companies. In these cases, it is clearly identifiable that value erodes where there is dearth of quality or where visibility of future earnings has deteriorated. So far, in case of bitcoin, people are simply chasing returns and not real value, as it is still unclear where it derives value from.

According to Prakash Lohana, a Vadodara-based certified financial planner and life planner, “Some years ago, people got carried away with investing in art, and now paintings from unknown artists are lying unsold with them. In case of bitcoin, too, the lure of quick gains shuts down the rational logical mind, which we then have to try bringing back on track.”

Lohana feels this happens because people tend to have a bias for ‘recent returns’, and when they see others scoring profits they too want to try it before it's too late.

It's also ease of access. Bitcoins is available on digital platforms and setting up an account to start trading is easy, and without any explicit regulatory control. However, most bitcoin exchanges in India do ask you to do a full Know Your Customer process, where you have to provide your Permanent Account Number, bank details and Aadhaar number.

Bitcoin as investment

Before making any investment, it is important to understand what you are buying.

“Unfortunately, in the short-term and near-term, bitcoin has lost the core purpose of currency. Nobody is using bitcoin to buy anything. People are getting into bitcoins only to invest and hold. With limited supply and whole world getting into it, bitcoin is, arguably, rising a lot more in value than it deserves to. We don't know where it is going to settle,” said Kunal Nandwani, co-founder and chief executive officer of uTrade Solutions, a multi-asset trading platform.

According to Coinmarketcap.com, there are over a thousand cryptocurrencies currently. The basic question is, do you understand the functionalities of these cryptocurrencies?

But the big question still remains: is cryptocurrency an investment? An investment is backed by logic, not euphoria. Its price is derived by a rationale, such as a rise or fall in its profits or sales or credit profile. Sheer demand or the lack of it can drive prices up or down, but sentiments have to be linked to logic and real events. Its features—and the way it works—should be transparent. Last, there should be a redressal mechanism: a platform to handle your grievances, if any, and a time-bound system to resolve those grievances.

Nandwani says, bitcoin doesn't tick all these investment boxes. "Does it check the traditional investment boxes, not in my view. One of the rules of investing is, you should understand what you are investing in. Today, I don't think majority of the people even understand why bitcoin was invented. It was meant to decentralize the whole financial system. (Whereas) the biggest reason everyone is getting into bitcoin is due to fear of missing out."

While greed can pay off sometimes, financial products also require regulation for fair trades.

According to Suresh Sadagopan, a Mumbai-based certified financial planner, "Many people intuitively understand that what has gone up so fast isn't normal and some have even burnt their fingers in earlier bubbles in equity and real estate. These are people who are not interested in the bitcoin rally. One has to consider that there is no valid redressal mechanism. Tomorrow if the price crashes to \$5, where will the investors—who haven't been able to sell—go? What is the logic?"

It makes a valid investment product when aspects like fundamental value, transparency, regulation and market-driven demand-supply dynamics come together. Everything else is more akin to gambling. Some will make money even in a gamble. But there is a chance that many who follow in blind hope will lose out.

So far, bitcoin doesn't tick any of the investment boxes. And if it is a gamble, the downside is more than just price and capital. However, despite its risks and downsides, bitcoin is not illegal. "Bitcoin may not be legal tender but it is not illegal. The advantage is that bitcoin is more traceable than cash," said Nishith Desai, founder of Nishith Desai Associates.

However, as of now there is no regulation on cryptocurrencies. "The industry is looking to adopting self-regulation. The bitcoin-trading community is willing to be regulated. Since it is approached more as a commodity, Securities and Exchange Board of India (Sebi) would be the appropriate regulator to regulate bitcoin," said Desai.

Though there is no regulation, tax experts have made it clear that you have to pay taxes on gains from selling bitcoins. "Bitcoin prices have gone up significantly. If you have made a gain, you have to pay tax on it whether you are an investor or a trader," said Gautam Nayak, a Mumbai-based chartered accountant.

An investment either serves the purpose of regular returns or long-term growth. Quick short-term profits are made from trading. In case of bitcoin, there are too many unanswered question and until it begins to tick some of the investment boxes, it will remain a gamble.