Regions Wealth Podcast

Episode 43: Understanding Cryptocurrency: What to Know Before You Invest

Mainstream interest in Bitcoin and other types of cryptocurrency has skyrocketed. As of 2021, one in six Americans say they've invested in, traded, or used some form of cryptocurrency. This growth has left many traditional investors wondering if investing in cryptocurrency is right for them. In part one of this two-part series on cryptocurrency, Assistant Vice President and Operations Analyst Michael Moorefield joins us to discuss the basics of cryptocurrency: the pros, cons, and what individuals need to know before deciding to invest in crypto.

Episode Transcript

Sarah Fister Gale, Host:

Welcome to Regions Wealth Podcast, the podcast that tackle's life challenges with financial experience. I'm your host, Sarah Fister Gale.

Mainstream interest in Bitcoin and other types of cryptocurrency has been on the rise in recent years. According to Pew Research, 16% of Americans say they've invested in, traded or used cryptocurrency as of 2021. This growth has left many traditional investors wondering if investing in cryptocurrency is right for them. Joining me remotely is Michael Moorefield. He's an assistant vice president and operations analyst at Regions Bank. Michael, thanks for joining us today.

Michael Moorefield, Assistant Vice President and Operations Analyst:

Thank you for having me. I'm looking forward to the discussion.

Sarah:

So, Michael, as you know, this is part one in a two-part series on cryptocurrency. In this episode, we'll be discussing the basics of cryptocurrency as an investment: the pros, cons, and important considerations. We've taken some frequently asked questions and have developed a character who needs your help. Let's listen.

Josh:

"Hi, I'm Josh, and I'd like to get your take on cryptocurrency as an investment vehicle. I know it's been around for years, but I suppose I didn't pay it much attention until quite recently. A few years ago my teenage son took all of the money he inherited when my dad passed and purchased a few different types of crypto and several NFTs. At the time, my wife and I were

absolutely livid. And it shocks me to say this — his returns? They've been solid. Granted there have been a few exceptions, but overall, I can't figure out if it's pure luck, if it's good timing, or what, and my wife and I are kind of waiting for the other shoe to drop."

Sarah:

So we'll dive into Josh's question in the next section, but first let's start with some background for those who might be relatively new to this topic. Can you give us a primer on cryptocurrency? What are they and how long have they been around?

Michael:

Sure. So cryptocurrencies are digital currencies that operate through a decentralized network and are not dependent on any centralized authority like a bank or a government. They've been around for just over 12 years. And have grown to a market cap nearing $2 trillion as of recording.

Sarah:

So at a very high level what are the main or most common types of cryptocurrency?

Michael:

So there are several different types of cryptocurrency. We have store value coins, such as Bitcoin. The most popular and the currency that most people would be familiar with. Then outside of store value coins we have transaction tokens. These are slightly lesser known coins like Litecoin and Bitcoin Cash. And those are gonna differ from Bitcoin in that rather than being bought to hold like an investment or like a store of value, people are gonna buy transaction tokens in order to make faster, quicker transactions between peers. Their blockchain operates at a much quicker pace than the Bitcoin blockchain does, so it makes the transfer of wealth much more efficient than what the Bitcoin blockchain does.

In addition to transaction tokens we also have platform tokens. The largest platform token that most people are gonna be familiar with is Ethereum. Ethereum is the second largest cryptocurrency and there's a lot of people who see Ethereum kind of developing into the new internet. I know that's kind of hard to wrap your mind around and, could be a bit abstract to think about a cryptocurrency being thought of as a new internet, but that kind of plays into the whole, if you're interested in the space and you're thinking about investing to really dig in and understand what you're investing in, because there's a lot of potential for Ethereum and the Ethereum blockchain. In addition to platform tokens we also have utility tokens. Utility tokens allow access to the functionality of corresponding protocols. So a good example of that would be Chainlink and the LINK token. In order to utilize the functionality of the Chainlink protocol you have to pay in LINK tokens. It's kind of a way to bootstrap their protocol, bring in money to help fund further development and things of that nature. Outside of utility tokens we have stable coins such as USDC and Tether.

They're gonna be some of the more widely known and widely used stable coins. Personally, I struggle to count stable coins as cryptocurrency because they're pegged to underlying government issued currency. But when you are getting into some of the more decentralized aspects of the developing financial world, stable coins are gonna be a very, very important part of the ecosystem, but just know that they do differ from other cryptocurrency types.

Sarah:

So, Michael, we talk a lot about cryptocurrency as an investment. What is the difference between cryptocurrency and traditional currency like the dollar?

Michael:

That's a great question. And something that a lot of people struggle with. Really, we need to take a step back and, and really look at the differences between the two, and that will help gain some perspective about the future of both of them and will allow people to make their own opinions.

So, you have fiat currency, government backed currency such as the US dollar and that's exactly what it is. It's government backed, right? It is a currency that is issued by a government and is supported by that government's ability to tax its citizens. That's where the strength of the US dollar comes from as well as roughly 50% of all international trade agreements are paid in US dollars because of the strength of the US government.

Cryptocurrencies are not associated with government at all. Not associated with the US government, not associated with any international government. They are built and housed on a decentralized platform. They are developed by groups of people all around the world that have the desire to build and work out developments for the cryptocurrency that they're working on. So through a decentralized network, a decentralized platform, you have the development of a decentralized currency.

So on one hand you have fiat currency, which is backed by a single entity being the government that issued it, and then on the other you have a decentralized currency, being a cryptocurrency, that has many very, very, very small individual players that as a group make the backing and support for that currency.

Sarah:

So at some point do you think we'll be able to use Bitcoin or another cryptocurrency as a day-to-day currency?

Michael:

Absolutely. And ultimately, that comes down to merchants just desiring to receive Bitcoin, right? We haven't reached that point just yet because there's still a lot of uncertainty. They want the consistency that traditional finance has offered. We're moving in the direction where merchants will want to receive cryptocurrencies in the future. We're not there yet, but they absolutely can receive them now if they wish to.

Talking about Bitcoin as legal tender, El Salvador decided to go ahead and approve Bitcoin as legal tender. So now El Salvador has two currencies as legal tender, the United States dollar and Bitcoin. There's been significant adoption of Bitcoin and Bitcoin payments in El Salvador. Now to keep things in perspective, you know, we hear about El Salvador being its own standalone nation. Taking Bitcoin on as legal tender. It sounds amazing. And in my opinion, it is. But for perspective, El Salvador's GDP is about a fifth of that of the state of Mississippi, which is one of the lowest GDPs in the United States. So it's a great headline. It is a move in the direction towards Bitcoin as a currency. However, still a long way to go for true adoption. That being said, other countries in Latin America, South America, and some smaller ones over in Europe and the Middle East are interested in rolling out similar plans.

Sarah:

Oh, that's exciting. And interesting if only symbolic move in the use of crypto as a currency. Let's talk about cryptocurrency from an investment standpoint. When we're thinking about the regulatory environment, how does cryptocurrency differ from traditional investment vehicles like stocks?

Michael:

Sure. So stocks are gonna be regulated by the SEC and futures contracts, similar to options. Option contracts are gonna be regulated by the CFTC. Right now no regulatory body and nobody in government really at this point knows who has jurisdiction over cryptocurrencies. Both the SEC and the CFTC are both jockeying for jurisdiction. So right now it's kind of an arms race between the two as to, you know, who gets to regulate Bitcoin. But what's unfortunate is that this uncertainty about how it's regulated and who is regulating it has led to a lot of confusion, misunderstanding, and it puts cryptocurrencies into a gray area as to how it's going to be regulated moving forward, right? If anything, asset markets - they don't like uncertainty. And right now it's very uncertain as to how they're gonna be regulated and even who is gonna regulate them in the future.

We're waiting on the executive order that the Biden administration issued a few months ago to receive the comments back from other government agencies looking into environmental impact, financial innovation studies, how it could be used here in the United States, how it's being used overseas. How it's being used in El Salvador. And once all those comments come back, the Biden administration and the treasury will review them and start to put together a more unified, structured regulatory response to how cryptocurrencies are gonna be regulated in the future.

So I think everybody in the space is looking forward to that. There might be a bit of anxiety there. But definitely looking forward to having some solidified guidance as to what this space can look like, what it should look like, and what it will look like based on how regulators understand it now and expect it to develop into the future.

Sarah:

So it sounds like regulations are inevitable. It's just unclear what the timeframe will be, right?

Michael:

Absolutely. Crypto has been around for over 12 years now. It seems like at the beginning nobody thought that we would make it this far. And now we've made it this far and the space is just exploding. So now we're seeing a mad scramble to one, understand where we are now. Understand where the space is developing into the near future. And then trying to put a regulatory framework around all of that. And that's not an easy ask of anybody.

Sarah:

And how will regulations help investors to think about this space or to gauge whether or not it's an appropriate investment for them?

Michael:

So you know as a consumer, if it's not regulated there's probably not gonna be any form of consumer protection. So definitely something to keep in mind: if it's not regulated, you are at some type of additional risk from any investment. So as an investor if regulation is gonna be good, it's gonna work to your benefit as long as it's not overregulation. Which because of what crypto stands for is absolutely a potential risk for the crypto market.

Sarah:

Let's talk a little bit about NFTs. At a very basic level for someone who has no background knowledge whatsoever, what is an NFT?

Michael:

NFTs are very, very interesting. And personally, I'm very excited for this space's development over the next few years. So NFT stands for non fungible token. Essentially what that means is that it is a one of one type asset. The way that I think of NFTs is like a receipt. It represents digital ownership of an item. So when you buy something you receive this token that says you own this specific item. So you can tokenize a painting if you wanted to. And you could throw that painting onto the blockchain and create a token it's called tokenization. And that token represents ownership of that real life painting. So if I own that painting and I want to sell it to somebody down the street or somebody comes to my auction to buy my painting, I could hand them the painting but the receipt that they would receive for it would be that token on the blockchain that would then get passed to their wallet.

So if anybody ever asked, who owns that painting? They could look on the blockchain and see that that person holds that token, so they're the rightful owner that painting. That way if that painting were ever stolen, that token would never be moved. They could look into your wallet and see that you actually are the true owner because you still hold the ownership token.

Now, today we're not doing anything at that level, right? I think that's kind of where NFTs are gonna move to in the future. Right now I see the NFT market very, very similar to the baseball card market. Just ultra high evaluations for, you know, suspect art, I guess you could say. I know art is in the eyes of the beholder but, you know, that's gonna be to the individual investor to determine if that value's actually there or not. But it is definitely a fun area to keep an eye on. And I think, like I said earlier, in the near future over the next five, 10 years, I think NFTs have the potential to replace all receipts. I don't think we'll receive a paper receipt in the future, I think we'll receive a digital receipt in the form of an NFT showing complete ownership of everything that we buy. It's something to keep an eye on.

Sarah:
- I always think of NFTs as an investment vehicle, but based on what you've just said, it sounds like there's real potential in the technology itself. That's fascinating. I know we've already covered a lot of ground, but let's pause here and listen to a bit more of Josh's question.

Josh:
"I'd like to get your take as a professional. While my wife and I definitely won't be going all-in on something like NFTs, I am *curious about adding cryptocurrency to our portfolio. Obviously, from a risk tolerance standpoint, my son is in a very, very different place than we are. While we have a very moderate risk appetite, we can withstand some loss without jeopardizing any of our long-term goals. I know you probably can't get into specific recommendations or anything like that, so I guess my question is this: is cryptocurrency something that you're seeing more serious investors add to their portfolio? And if so, what factors should I be considering before taking that leap? And are there any tax implications I should be aware of?"*

Sarah :

So that's a lot of questions. Michael, in your day to day work are you seeing more interesting cryptocurrency from serious investors? And how does cryptocurrency fit into a traditional portfolio?

Michael

So we're definitely seeing more interest in cryptocurrency. Especially, when we see the price of Bitcoin going up. Funny enough it gets a little bit quieter when the price is going down, but over the years we have seen an uptick in the number of questions coming in around cryptocurrency. How does it fit into a traditional portfolio? It only fits into a portfolio that is willing to take on maximum amount of risk. Cryptocurrency and Bitcoin are incredibly volatile assets. So anybody that is risk averse in the least bit should not come anywhere near this space. And even those that are willing to take a significant amount of risk and withstand significant amounts of volatility should limit their cryptocurrency exposure to one to 5% of their total portfolio value.

Sarah:

Is that true of all cryptocurrency or are there certain types of cryptocurrency that might be better suited for someone with a slightly lower level of risk tolerance?

Michael:

So I get this question a lot. When you're talking about risk and cryptocurrency, are some riskier than others? Yeah, absolutely. Are some more volatile than others? Yeah, absolutely. But even the least volatile and the least risky are still risky enough and volatile enough that if you're not prepared for that immense amount of volatility and risk, it could destroy your portfolio. Or at least your ability to sleep at night. So, you know, understand what you're investing in before you invest in it. Know why you're investing in it before you're investing in it. And if you are not willing to withstand 50% declines in a one to two day period, which is absurd, then cryptocurrency, regardless of which currency you invest in, is just not for you, unfortunately.

Sarah:

Okay. Let's talk about the taxes. While we can't get into the nuances of taxes, Josh raised a really good question, is cryptocurrency taxed?

Michael:

Oh, it's absolutely taxed. The IRS is sorting to crack down on investors who didn't believe cryptocurrency was taxed. The IRS is now starting to headhunt a little bit for those people and take in the taxes that are past due. So absolutely cryptocurrencies are 100% taxed. The tax code is a little unclear at this point as to exactly how they're taxed. Highly recommend you consult with your tax professional before making any investment, one, to make sure that they're comfortable with their ability to, file your taxes that include cryptocurrency transactions. But also to make sure that they fall in line with your tax plan and, and your investment plan as a whole.

Sarah:

That makes sense: consult your tax professional *before* making any investment. So to wrap this up, let's listen to the final portion of Josh's question.

Josh:
"Also, the buying process is sort of mystifying to me. Admittedly, I'm not a very tech-savvy person. Let's say I wanted to purchase some Bitcoin — how do I get started? Also, I've been hearing a lot about cryptocurrency scams. How common are they? What precautionary measures should I take before investing in cryptocurrency?"

Sarah:

So Michael, if someone like Josh decides they'd like to invest in cryptocurrency, what is the step by step process? How do they go about purchasing it?

Michael:

So the first step is to find an exchange. And I believe there are roughly 600 exchanges worldwide. So there are plenty of options for any investor. It's really up to the investor to find the exchange that works best for them. So find the more common ones in your country. Compare the pros and cons of those exchanges. The most important should be the one that you're most comfortable with. The user experience that you feel comfortable with. The one that you understand what you're clicking on. Once you find a cryptocurrency exchange that you are comfortable with, then you want to figure out which currency you want to purchase or that you want to trade within that exchange. And I should say, not all exchanges are created equal. Not all exchanges carry the same tokens or currencies that all the other exchanges do. So there's a lot of due diligence that needs to go into finding the exchange that is gonna suit the needs that you have. But once you've found an exchange and you've confirmed that they have the tokens that you wanna trade, then for the most part they're very, very user friendly and straight to the point as far as how to transact. They make it very easy. From my personal experience, creating an account and buying currencies on the exchange that I use is very similar to a traditional stock brokerage account. You create the account, you find the securities that you wanna buy and it's a very simple one, two, three process.

Sarah:

So it sounds like there's a lot of education involved in investing, at least on the early end. Is this something that investors should be talking to their financial advisors about?

Michael:

Absolutely. If you have an interest in getting involved in cryptocurrency, it should absolutely be part of the conversation that you have with a financial professional. If you have a portfolio manager, definitely talk to them about this. See what kind of exposure your portfolio can allow for while staying within your risk boundaries. See how adding crypto exposure will impact the risk structure of your portfolio. Keep them aware of all of the coins and tokens that you're investing in. Get their opinion on the opportunity and see how adding additional risk at that time plays into expectations for future stock and bond market developments. Is this the opportune time to be taking risks? And how large of a position is adequate for your portfolio structure?

Sarah:

Josh also mentions that he's been hearing a lot about cryptocurrency scams. In our next episode, we're discussing this topic in depth with Ryan Owen. But at a high level, what precautionary measures should individuals take to protect themselves if they choose to invest in cryptocurrency?

Michael:

Well, first I'd like to say, I am very excited to listen to Ryan Owen's podcast. He is on top of his game. He understands this space. He's gonna have some great information and really, really looking forward to his episode. To answer your question directly, the best thing that you can do is just know what you're investing in. If you know what you're investing in and you truly know what you're investing in, then you're gonna be aware of how the system works, how cryptocurrencies work, your potential areas of risk as far as scams are concerned. You know, if you don't know what you're doing, if you don't know what you're investing in, you're probably gonna have some blind spots as to potential risks and potential scams. So it all comes down knowing what you're investing in, truly understanding the space, and not just gambling.

Sarah:

Excellent. Excellent. That's interesting perspective. So, Michael, at the end of each of these episodes we like to ask our guests for some key takeaways. What are some takeaways that you can share with those who might be thinking of about investing in cryptocurrency?

Michael:

Yeah. So I have two takeaways. And this applies to not just cryptocurrencies but the broader market as a whole, but specifically cryptocurrencies with the scams that are happening today and the amount of risk and volatility. The first, as I've stated a few times on this podcast: know what you're investing in. If you know what you're investing in, you're putting yourself in a much better position from a risk standpoint not just from volatility, but from scams as well. If you don't know what you're investing in, you're gambling. And we don't want that. We need to be informed investors. So understand the space and understand what you're investing in.

The second takeaway would be, know why you're investing in this space. So, yes, you might understand what Bitcoin is and other currencies, but you have to have a legitimate reason to be in it. Why are you there? And once you develop that why, you're gonna be able to withstand the volatility better. You're gonna be able to sleep at night when we get those 25, 50% pull downs. Because your why shouldn't change unless something fundamental changes. And with a good why, you change the perspective from price to the building out of this new environment of this new asset class. And it really helps put things into perspective and, and gets you away from the volatility of the asset class. So in summary, understand what you're investing in and understand why you're investing in it.

Sarah:

I love that. Thank you so much, Michael. This has been a really interesting conversation. That was Michael Moorefield, assistant vice president and operations analyst for Regions Bank.

Michael:
Thank you for having me. This was a lot of fun for me.

Sarah:

And thank you for listening. Don't forget to check back for part two of this series — we'll be chatting with Portfolio Manager Ryan Owen on the latest cryptocurrency scams, how to identify them, and steps you can take to protect yourself before making an investment. Visit regions.com/wealthpodcast to explore past episodes, or subscribe to Regions Wealth Podcast on your favorite podcast platform.