Crypto ETFs? Look Before You Leap

Investing in cryptocurrencies just got a lot easier. But beware. Crypto remains a highly volatile and speculative investment.

The SEC recently approved 11 applications to create ETFs that track the price of Bitcoin.

The long-awaited approval of crypto exchange-traded funds (ETFs) came on January 10, when regulators gave the go-ahead, allowing a number of large financial companies to offer funds that invest in Bitcoin. The move lends regulatory legitimacy to an asset class that has had a wild ride and often been dismissed as purely speculative.

Up to now, investing in cryptocurrencies involved creating digital "wallets" with private and public "keys." Buying or selling then took place through specialized exchanges, such as Coinbase. But the ETF structure makes crypto investing much easier. ETFs trade on an exchange, like stocks, and prices are continuously determined on the exchange. That means they can be traded throughout the day at real-time prices. It also means that investors can use ETFs in certain investment strategies, such as selling short and buying on margin.

A Checkered Past

Prospective investors in a crypto ETF should first consider cryptocurrency's spotty history. Long-term investors have had a very bumpy ride. In addition to huge daily swings, prices have undergone multiple boom and bust cycles. In 2017, for example, Bitcoin started the year priced under $1,000, topped $19,000 in December, then tumbled below $7,000 two months later. In 2020, it went from about $7,200 to $29,000 by year-end. Prices then plunged, then skyrocketed to over $65,000 in November 2021, only to plummet below $17,000 a year later.[1] And crypto prices took a major hit after FTX, a leading crypto exchange, filed for bankruptcy (the so-called "crypto winter"), bringing down a number of crypto lenders with it. Although prices have since rebounded, anyone buying in today should be prepared for a rough ride -- and possible loss of all or part of their invested funds.

Risky Business

As Bitcoin's price history amply illustrates, crypto investing is speculative and involves a high level of risk. Unlike a stock, whose value is driven ultimately by the company's sales and earnings, cryptocurrencies produce no revenue or profits. They trade on momentum or the latest news. Because their volatility precludes them from functioning as a viable currency, they are now used more as a speculative gamble or inflation hedge.

The long-term outlook for crypto is equally speculative. Some prophesize that cryptocurrencies represent the future -- that all government-backed currencies will eventually be replaced by crypto, whose prices will soar to new heights. Others see them as a giant Ponzi scheme destined to eventually collapse. Still others see a hybrid future where some transactions continue to be done in cash and others in cryptocurrency, whose prices will slowly climb as usage expands.

Whatever your own outlook, if you are considering investing in a crypto ETF, be wary. Don't invest money that you will need to depend on later. And be prepared for a wild ride. Also stick to well-established fund providers. Above all, talk to a trusted financial professional before investing.

[1]Source: Yahoo Finance.