The only cryptocurrency I'd consider buying

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Hint: It's not bitcoin.

(Photo: Getty Images)

As we look back on 2017, it'll likely be remembered by investors as the year of the cryptocurrency.

Prior to the advent of virtual currencies, the stock market had been the undisputed king of consistent wealth creation, unless you were lucky enough to defy the odds and win the lottery. The 7% annual returns from the stock market, inclusive of dividend reinvestment, provided a rough doubling of your invested capital about once a decade.

But since the year began, we've witnessed the aggregate value of all cryptocurrencies rise from a market cap of $17.7 billion to $248 billion as of Nov. 22. That's about a 1,300% gain in less than 11 months. The stock market would take decades to match this type of return, and it's rightly put virtual currencies like bitcoin, Ethereum, bitcoin cash, Ripple, Dash, LiteCoin, and Monero -- to name a few -- on investors' radars.

Four reasons 2017 belongs to virtual currencies

The catalysts behind the rise in virtual currencies appear to be a mixture of four tangible and intangible factors.

First, we're seeing clear excitement about the future of blockchain technology. Blockchain is the digital decentralized ledger that underlies virtual currencies and records transactions without the need for a financial intermediary. This burgeoning technology makes altering logged data practically impossible since most blockchains are open-source networks. This added level of security, along with the ability to settle transactions in real time, could make blockchain an attractive technology for the financial services industry.

Second, weakness in the U.S. dollar throughout much of the year has sent some investors scurrying to cryptocurrencies. When the dollar weakens, it devalues the cash that investors may be holding on to. Traditionally, investors would seek to deploy some of this cash into gold, as gold has been used as a currency for centuries, and its scarcity makes it a suitable store of value. However, with some digital currencies, like bitcoin, having a cap on the number of coins that can be mined, they are also viewed as scarce and thus perceived to be a store of value.

News-driven events have served as a broad third catalyst. Announcements like Japan accepting bitcoin as legal tender and 200 companies in the Enterprise Ethereum Alliance (https://www.fool.com/investing/2017/07/27/9-brand-name-companies-that-have-joined-the-enterp.aspx?&utm_campaign=article&utm_medium=feed&referring_guid=9a1e83ee-cfda-11e7-92a9-0050569d32b9&utm_source=usa-today) testing out a version of Ethereum's blockchain in small-scale and pilot programs help validate the existence of virtual currencies.

(Photo: Getty Images)

Lastly, momentum has helped carry digital currencies higher. Until recently, virtual currency trading has been dominated by the retail investor, who's known for being far more emotional than institutional investors. It's likely that retail investors have seen these mammoth gains and simply not wanted to miss the boat. This buying has probably played a role in pushing cryptocurrencies to record highs in 2017.

The one cryptocurrency I'd consider buying

However, 1,000%+ gains within a year are bound to draw some criticism from skeptics (myself included). Personally, there's not one cryptocurrency I'd buy right now following their monstrous moves higher. But there is one I'd consider buying should it significantly drop in value -- and it *isn't* bitcoin!

Bitcoin might be the virtual currency I'd suggest avoiding the most. Its investors seem more enamored with the potential uses of its coin as a means of payment rather than its underlying blockchain, which is where the bulk of the value lies with cryptocurrencies. Bitcoin did wind up enacting a modest upgrade to its blockchain four months ago that wound up pulling some information off of the network in order to boost capacity, shorten settlement times, and lower transaction costs. The move was clearly made to lure in enterprise clients to test out its blockchain, but I'm not convinced that its first-to-market advantage will hold for much longer.

One of the under-the-radar issues with virtual currencies and blockchain technology is that the barrier to entry is exceptionally low. There's nothing to prevent competitors from developing new blockchain technology, which could perform better than the leading virtual currencies.

(Photo: Getty Images)

If I were to consider buying a virtual currency, it would be Ethereum. Even though Ethereum has had its share of gaffes (https://www.fool.com/investing/2017/11/16/280-million-reasons-to-avoid-investing-in-ethereum.aspx?&utm_campaign=article&utm_medium=feed&referring_guid=9a1e83ee-cfda-11e7-92a9-0050569d32b9&utm_source=usa-today), and it could face many of the same competitive risks as bitcoin described above, Ethereum's blockchain incorporates a unique feature known as smart contract applications (https://www.fool.com/investing/2017/09/22/ethereum-may-very-well-leave-bitcoin-eating-its-du.aspx?&utm_campaign=article&utm_medium=feed&referring_guid=9a1e83ee-cfda-11e7-92a9-0050569d32b9&utm_source=usa-today). These protocols help to facilitate, verify, and enforce the negotiation and compliance of a contract, making things more efficient and secure for enterprise customers. The inclusion of smart contract applications is a big reason why Ethereum currently has 200 organizations, including some brand-name companies, testing out a version of its blockchain. This, I believe, gives Ethereum's blockchain an edge over its virtual peers.

What remains to be seen is if Ethereum will utilize its coins, known as Ether, to potentially speed up transaction times at some point down the road. The answer will likely depend on whether other fiat currencies become more popular with enterprise and retail consumers. If so, utilizing Ether as a means to change instantly from one fiat currency to another might be of use and solidify Ethereum's blockchain as the go-to for businesses.

The key word here is "consider"

While I favor Ethereum far and away more than any other cryptocurrency, the word to focus on here is "consider." Though I believe Ethereum's blockchain to be superior in attracting enterprise customers, I still believe there's far too much risk to consider investing in digital currencies at the moment.

(Photo: Getty Images)

Aside from the minimal barriers to entry described above, the regulatory environment is also a double-edged sword for virtual currencies. Whereas bitcoin has been given the green light as legal tender in Japan, and it'll be listed on **CME Group**'s futures trading platform before the end of the year, it's also been shut out of China. Just three months ago, China announced that it'd be closing its domestic cryptocurrency exchanges and ending initial coin offerings. For every new door opened for cryptocurrencies, it seems another closes.

There's also the very real concern that investors have once again overshot (https://www.fool.com/investing/2017/10/19/the-reality-all-bitcoin-and-ethereum-investors-nee.aspx?&utm_campaign=article&utm_medium=feed&referring_guid=9a1e83ee-cfda-11e7-92a9-0050569d32b9&utm_source=usa-today) with regard to their enthusiasm over blockchain. If we look back, we're faced with numerous instances of new technology hitting the market and investors bidding up the companies behind these products, only to have them crash hard just years later. Genome mapping, 3D printing, and even the advent of business-to-business commerce via the internet took years to really catch on, and most of the companies in these spaces were pummeled after exponential short-term gains. A similar fate could await cryptocurrencies if blockchain technology isn't adopted immediately, which this writer doesn't see happening.

Long story short, keep your eyes on projects involving Ethereum's blockchain, but stay safely on the sidelines for the time being.

Sean Williams (http://my.fool.com/profile/TMFUltraLong/info.aspx?&utm_campaign=article&utm_medium=feed&referring_guid=9a1e83ee-cfda-11e7-92a9-0050569d32b9&utm_source=usa-today) has no position in any of the stocks mentioned. The Motley Fool recommends CME Group. The Motley Fool has a disclosure policy (http://www.fool.com/Legal/fool-disclosure-policy.aspx?&utm_campaign=article&utm_medium=feed&referring_guid=9a1e83ee-cfda-11e7-92a9-0050569d32b9&utm_source=usa-today).

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