Cryptocurrencies vs. Other Asset Classes

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Are cryptocurrencies potentially useful portfolio diversifiers? In their November 2017 paper entitled "Exploring the Dynamic Relationships between Cryptocurrencies and Other Financial Assets", Shaen Corbet, Andrew Meegan, Charles Larkin, Brian Lucey and Larisa Yarovaya apply a battery of tests to analyze relationships: (1) among three cryptocurrencies; and, (2) between the cryptocurrencies and conventional asset classes. They consider cryptocurrencies with market values over $1B at the end July 2017: Bitcoin, Ripple and Litecoin. They consider equities (S&P 500 Index), bonds (Markit ITTR110), commodities (S&P GSCI Total Returns Index), currencies (U.S. Dollar Broad Index), gold (COMEX close) and S&P 500 implied volatility (VIX) as conventional asset classes. Using daily data for Bitcoin, Ripple and Litecoin and for conventional asset classes as specified during April 29, 2013 through April 30, 2017, *they find that:*

- Cryptocurrencies are highly volatile compared to conventional asset classes. In particular, cryptocurrencies are highly sensitive to changes in regulation, existence/effectiveness of an exchange market and technological/hacking failures.
- Cryptocurrencies are largely isolated from all other asset classes. It therefore appears that external financial market conditions are less important for cryptocurrency pricing than are internal issues of design, operation and clearing.
- Cryptocurrencies are substantially interconnected. For example, Bitcoin price affects Ripple and Litecoin prices, particularly during Bitcoin price surges. In view of the isolation of cryptocurrencies from other asset classes, this interconnectedness suggests speculation.
- Findings suggest that cryptocurrencies can be useful as a portfolio diversifier, and can offer investors a safe haven.

In summary, *evidence suggests that cryptocurrencies comprise a new asset class, potentially (but with considerable risk) useful as a diversifier of*

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conventional asset classes.

Cautions regarding findings include:

- The available sample is short, arguably encompassing a time of cryptocurrency market immaturity.
- As noted, cryptocurrency values exhibit high susceptibilities to perturbation by regulators.
- As noted, cryptocurrencies may be illiquid, especially during crises.

See also “What Kind of Asset Is Bitcoin?” and “Bitcoin Return Distribution”.

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