Gold and Bitcoin – birds of a feather or chalk and cheese?

Introduction

In 2017, a precious metals fund made headlines by investing in Bitcoin[1], explicitly subscribing to the idea that Bitcoin was a form of digital gold. This narrative gained significant traction in 2021 due to ETF flows out of gold and a bumper year for cryptocurrencies. Bitcoin broke through the psychological US$1 trillion market-cap barrier while cryptocurrencies broke through the US$3 trillion value level. Markets connected the two stories and suggested that the baton was being passed from gold to Bitcoin, from an old store of "rainy day" value to the new kid on the blockchain.

This narrative link had, in fact, been around for some time. A lineal precursor to the Bitcoin project was Nick Szabo's theoretical Bit Gold mechanism dating from 1998[2] (a decade before Bitcoin went live). Szabo stated, "*I was trying to mimic as closely as possible in cyberspace the security and trust characteristics of gold, and chief among those is that it doesn't depend on a trusted central authority.*" This decentralisation characteristic is the clearest and most cogent link between the two monetary comparisons with which this article concerns itself. However, the connection has potentially been overplayed by cryptocurrency enthusiasts, in our view.

Misled by the numbers

The market cap increases and relative flow information behind recent narratives are notable. However, context provides a more balanced picture:

(1) Gold ETF flows were indeed negative in 2021, as ETFs lost 173 tonnes of holdings. However, for context, overall demand from all sectors was positive at 4,021 tonnes. Some softening in ETF demand is also put into context by a huge 2020, which saw 874 tonnes of new ETF demand.[3]

(2) US$3 trillion may have been an impressive threshold for cryptocurrencies to breach, but it contrasts with an estimated US$418 trillion of available household wealth.[4] Our calculation, which uses an above-ground gold stock of 205,238 tonnes[5] and year-end 2021 prices, suggests the value of gold is much higher than all cryptocurrency stock, at an estimated US$12 trillion.[6]

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[1] CNBC: https://www.cnbc.com/2017/11/24/a-gold-fund-is-investing-in-bitcoin.html

[2] The Genesis Files: With Bit Gold, Szabo Was Inches Away From Inventing Bitcoin - Bitcoin Magazine: Bitcoin News, Articles, Charts, and Guides

[3] Source: World Gold Council, Gold Demand Trends Full Year 2021 | World Gold Council

[4] Source: Credit Suisse, Global wealth report – Credit Suisse (credit-suisse.com)

[5] Source: World Gold Council, How Much Gold Is in the World | Above-Ground Gold Stocks | Goldhub (end 2021)

[6] Using a 31 December price per troy ounce of US$1,822, converted to price per metric tonne of USS$58.6 million (source Thomson Reuters Datastream)

Correlation ≠ Causation

Other recent narrative strands have attempted to link Bitcoin and gold as the “same plays”. However, we argue the resemblance is superficial at best:

(1) Both Bitcoin and gold have performed well at the same time in recent years. While their respective success has something to do with the destiny of the US dollar, it has not been for entirely the same reasons:

a. In 2020-2021, the US government implemented a “helicopter money” policy, directly sending three rounds of stimulus cheques to most American adults. As this money was only partly used for everyday expenses, with a substantial amount finding its way into financial assets, many in the investment community predicted that Bitcoin would be a beneficiary. The crypto press[7] widely quoted a survey by Mizuho Securities in the run-up to the third round of stimulus, suggesting that around 40% of recipients would invest at least some of their payment, while 60% of incremental investment flows would go into Bitcoin. In retrospect, a 2021 report into the first round of stimulus by the Federal Reserve Bank of Cleveland[8] found that stimulus-related flows *did* impact Bitcoin trading volumes significantly, with a spike in trades of the same size as the stimulus cheques (US$1,200). While the direct impact of these three stimulus rounds may have been modest, the narrative was very successful and institutional flows piled in on top of retail money (2019-2020 saw an 806% increase in investment in digital-asset vehicles).[9]

b. Central banks, particularly in emerging markets, have been diversifying their balance sheets away from the US dollar by purchasing gold as well as other currencies. There have been net gold purchases for 12 consecutive years – by complete coincidence, the same length of time that Bitcoin has been trading. During this period, 5,692 tonnes of gold have been added to their balance sheets (for a total of 34,592 tonnes or 16.8% of all gold ever mined).[10] Central banks have generated sustained metronomic demand for gold, which has encouraged investors. While it is evident that the Bitcoin and gold stories have both been running in parallel and both relate to US dollar dynamics, they are far from identical!

(2) Both gold and Bitcoin are “mined”. Mining analogies are warranted in a process sense. Neither a prospector panning for gold, nor a Bitcoiner with an ASICs rig (an array of microchips) knows whether they will discover, respectively, a gold nugget or a “block

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[7] Source: Bitcoin News Mizuho Bank Survey Says $24 Billion in US Stimulus Checks May Be Used to Buy Bitcoin – Bitcoin News

[8] Source: FRB Cleveland Uncovering Retail Trading in Bitcoin: The Impact of COVID-19 Stimulus Checks by Peter Zimmerman, Anantha Divakaruni: SSRN

[9] Source: CoinShares. CoinShares Weekly Digital Asset Fund Flows Report

[10] Source: World Gold Council How Much Gold Is in the World | Above-Ground Gold Stocks | Goldhub

reward" in a given month, and both are putting in the work to help achieve their rewards that can be quantified in energy. Both are quoted as having finite supplies, providing some reassurance that inflation will remain constrained. The main flaw to this argument though is that the limit of 21 million Bitcoins "set in stone" by Satoshi Nakamoto, the originator of the blockchain, can be changed whenever the developer community decides to do so, albeit this is currently disincentivised. The prospect of adding new gold sources – for example, asteroid or seawater mining – is extremely unlikely.

(3) Both have prices that tend to be quoted in US dollars and are used for larger transactions. Bitcoin is used for larger transactions, mainly because of a weakness – transaction times are too long and the transaction cost to transaction size ratio makes it uneconomic for small day-to-day payments processing. Bitcoin's inherent volatility relative to leading currencies like the euro and US dollar also makes it less practical for everyday expenses. In contrast, gold's role in international settlements has centuries of history.

Bitcoin and gold – four key differences

(1) Gold is a metal, Bitcoin is a technology. As a technology Bitcoin is "hackable" and subject to substitution by a wide array of competitors, including the more dynamic Ethereum as well as emerging third-generation cryptocurrencies. Gold has unique chemical properties that continue to find new uses – lateral flow testing being a recent example.

(2) Environmental emissions are much higher for Bitcoin than gold. Each Bitcoin transaction on the blockchain requires significant energy consumption; gold emissions are much more of a one-off hit. Put simply, reassigning the ownership of a bullion bar in a vault is not energy intensive.

(3) In terms of track record, the Bitcoin network is just 13 years old, while evidence of gold being used as a currency dates back to 550BC.

(4) Mass psychology or, in other words, there is no "Bitcoin wedding anniversary" – judging by relative tenures, Bitcoin would mark a quarter year compared to gold's 50 years. Gold is baked into our turns of phrase, our bedtime stories, our celebrations and ceremonies. It is a formidable incumbent as a store of value that exists outside the immediate control of governments. Super Bowl LVI with its dizzying assortment of crypto-advertising attempted to change this, but the marketers have their work cut out.

Conclusion

The argument that gold and Bitcoin are birds of a feather is a well-worn one but frays under closer scrutiny and the weight of recent events.[11] Bitcoin trades much more like a “risk on” asset. As such, it is hard to argue that both serve the same purpose in an investment portfolio. The comparisons are chalk and cheese, in fact: gold is an age-old, loose monetary hedge, while Bitcoin is a speculative, technological joyride. We do not see it as a replacement for gold. However, we would argue that Bitcoin, in particular, but also blockchain and digital assets in general, may fulfill other portfolio uses – for example, in transforming asset management processes, as sources of alpha, convex plays or diversifiers.

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[11] An equity market stutter in January (-9.0%) saw gold and treasuries stand relatively still (-0.9% for both) and bitcoin plummet (-18.2%). Sources: Refinitiv and Coinmarketcap, dates 4 – 27 January 2022. Equities represented by the MSCI World (Net) Index, bonds by Bloomberg US Treasury, all figures quoted in dollars

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