What Bitcoin and Pepsi teach us about human nature

Published 3 June 2024

Pierre Debru
Head of Research, Europe

Key Takeaways

- Bitcoin is exhibiting very interesting characteristics as a portfolio diversifier, from low correlations and high growth potential to elevated information ratio
- Institutional investors are currently failing to dissociate their subjective misgivings about the asset (anchored in initial misconceptions) from the objective characteristics of the asset

Remember the Pepsi Challenge? For readers too young to have encountered it, the Pepsi Challenge is a marketing stunt organised by Pepsi, mostly in the 1970s and 1980s. Pepsi representatives would set up a stand in shopping centres or public locations and present two white cups to bystanders. One cup would contain Pepsi-Cola, and one would contain Coca-Cola. People would then be encouraged to test both colas and select the one they preferred without knowing which is which. While most people instinctively think they preferred Coca-Cola, a majority chose Pepsi in the challenge.

Despite the Pepsi Challenge's grand success in boosting Pepsi's brand recognition, it was a bittersweet victory. The challenge failed to translate into a significant sales surge for Pepsi-Cola. People, it seemed, were unwilling to let go of their loyalty to Coca-Cola's brand and switch to what the challenge seemed to indicate was a cola better suited to their taste.

Investors' behaviour around crypto investing has much in common with the Pepsi Challenge.

The crypto challenge

Let's imagine our own crypto challenge, where we would describe the quantitative characteristics of bitcoin to multi-asset managers without naming the asset we are talking about. Armed with the data collected over the last 11 years or so, we would be able to list that:

- This asset beat large-cap and small-cap equities, Treasury, investment-grade, and high-yield bonds, as well as gold, REITS, or infrastructure, in nine out of the last 12 years[1].
- The correlation of the asset calculated over the last 11 or 12 years with all the asset classes above was lower than 25%[1].

- The volatility of the asset is 69%, but thanks to its low correlation, adding 1% of it to a 60/40 portfolio (60% MSCI All Country World, 40% Bloomberg Multiverse) would have added only 0.07% of volatility and 0.5% of max drawdown[1].
- This 1% addition would have improved returns over the last 11 years by 0.67% per year, which is an outstanding Information ratio of 0.96[1].

We will then ask those investors if they think this asset would be worth adding to their current portfolio and if it is worth investigating further.

There is little doubt that, considering the purely quantitative measures listed above and how they compare with existing diversifiers currently used by investors in their portfolios, such an asset would attract many positive and enthusiastic answers. The correlation with equity and fixed income is lower than commonly used assets like commodities, gold, or REITS. The return potential is well above all other often-used asset classes, and the information ratio aligns or betters most active strategies or hedge funds.

Negative cognitive bias and misconceptions

And yet, contrary to retail crypto ownership, institutional investors' current crypto ownership remains very small, even if it has recently grown thanks to the “wake-up call” that was the approval and launch of spot bitcoin ETFs in the US.

In the same way that consumers, while confronted with tangible proof of their preference for Pepsi, stuck with Coca-Cola, institutional investors continue to disregard the new asset class that is crypto, dismissing all the accumulating research on its strong potential as a source of growth and diversification.

The asset class and Bitcoin, in particular, continue to carry the stigma of many disproven and often contradictory misconceptions, such as that it is only useful for criminal activities and, simultaneously, that it has no real-life use case. Those misconceptions are creating a psychological bias for many investors that stops them from recognising what are now hard-to-contradict facts:

- Bitcoin is not the latest new thing. It has been around for more than 15 years. It is older than Instagram, WhatsApp or Uber and has survived multiple “crypto winters” that, according to critics, were the start of the end
- With a market cap of almost $2 trillion, cryptocurrencies represent about 1.5% of the total market cap of liquid assets. It is now of a similar size to staple institutional investments like high-yield bonds, inflation-linked bonds or emerging markets small caps
- The neutral position for a multi-asset manager is to invest 1.5% of its portfolio in bitcoin and crypto (since it is their weight in the market portfolio). Not investing in cryptocurrencies is taking a negative asymmetric risk against the space and taking an active bet against the asset class. This is not something that can be done without careful thinking and deliberations. Find out more in our blog.

Warren Buffett famously said, “What the human being is best at doing is interpreting all new information so that their prior conclusions remain intact”. On the contrary, investing is about trying to strip out emotions

and biases and stick to the facts. It is long overdue that the investment world applies this principle to cryptocurrencies.

Sources

[1] Source: Bloomberg, WisdomTree. From 31 December 2013 to 30 April 2024. In USD. Based on Daily Returns. The 60/40 Global Portfolio is composed of 60% MSCI AC World and 40% Bloomberg Multiverse. You cannot invest directly in an index. Historical performance is not an indication of future performance and any investment may go down in value.

Important Risks Related to this Article

Important Information

Marketing communications issued in the European Economic Area ("EEA"): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as "WisdomTree" (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

For professional clients only. The information contained in this document is for your general information only and is neither an offer for sale nor a solicitation of an offer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and affer seeking independent investment, tax and legal advice.

The application of regulations and tax laws can offen lead to a number of different interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and affer seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.