What has driven bitcoin growth since 2019 and will it become more mainstream?

Published December 13, 2023

WisdomTree
Contributor

Bitcoin has experienced its fair share of ups and downs since launching in 2009. At almost 14 years old it's easy to be blown away by its meteoric rise, but for most European institutional investors, bitcoin has only really been an investable asset since 2019 when spot ETPs became available. Over this period, bitcoin has produced a 49% compound annual growth rate and risen from $7,710 to $38,000[1]. To understand the future direction of travel for bitcoin, we need to look back at some of the most important drivers behind its adoption.

Figure 1: Bitcoin price performance

Source: Wisdomtree, Bloomberg. Performance period is November 2019 to November 2023. Historical performance is not an indication of future performance and any investment may go down in value.

Bitcoin was created as a global peer-to-peer payment system or a global medium of exchange to enable the transmission of value across the world, at a low cost and without an intermediary, such as a bank. To fulfil the promise of a global payment system, the Bitcoin network needs to be able to process a large number of transactions in seconds at very low fees. A solution to achieve these goals is the Bitcoin Lightning Network, a layer 2[2] scalability protocol, which is built on top of the Bitcoin network.

The Lighting Network promises to transmit millions of transactions per second versus the original Bitcoin network, which can only handle 3—7 transactions per second globally. The Lightning Network was originally proposed in 2015, the mainnet was launched in 2018, and since then, the network has steadily grown.

The Lightning Network uses the Bitcoin blockchain to open and close individual connections or "channels", which link one user to another. The actual transactions are moved off-chain which enables the Lightning Network to bypass the Bitcoin network's transaction fees and wait times. Therefore, the Lighting Network is particularly suitable for situations where multiple small transactions are made with the same counterparty. Suitable application areas could include micropayments and remittances.

In the past four years, we have seen a steady increase in both the number of Lightning Networks' channels and in bitcoin that has been locked into the Lightning Network. The number of channels has increased with a compound annual growth rate (CAGR) of 23% from 31,142 channels to 71,246 channels and the number of bitcoin (BTC) locked in the network at a CAGR of 61% from 830 to 5,508[3].

While using bitcoin as a global peer-to-peer payment system is still possible, in this use case, it is facing competition from tokenised currencies, also called stablecoins. Their benefit is that the value of asset-backed stablecoins is stable, but they are centralised, which means they have an issuer so users are exposed to counterparty risk. Bitcoin is decentralised and does not have a counterparty.

Figure 2: The number of BTC locked in the Lightning Network

Source: WisdomTree, Glassnode. Historical performance is not an indication of future performance and any investment may go down in value.

It is possible the next stage of the internet will be based on decentralized ledgers, micropayments and a token-based economy. Currently, the large technology companies control access to different databases, whether it's Amazon, Apple or Google. The promise of web3 is that real-world assets and financial assets will be tokenised and users will be able sell and buy these items recorded on blockchains directly with each other. This new world of commerce would most likely need new ways of handling transactions, keeping records and maintaining property rights. Cryptocurrencies, and particularly bitcoin as a payment system, could be well suited for this new token-based economy.

Another driver for the price of bitcoin has been its adoption as "digital gold", an uncorrelated asset and a long-term store of value. Institutional investors often buy gold to hedge against a variety of risks. As bitcoin is a non-sovereign asset and not dependent on any central bank's money printing it could be suited for this purpose. It has a 21 million bitcoin supply limit, which was hard-coded into the Bitcoin blockchain when the network was conceived. The Commodity Exchange Act in the US and the Securities and Exchange Commission, named bitcoin a commodity.

Typically, the price of commodities is determined by supply and demand. In the next six months, the price of bitcoin could fluctuate as the supply of new bitcoin awarded to miners is cut in half in an event called "bitcoin halving."

Where next for bitcoin?

The launch of spot bitcoin exchange-traded funds (ETFs) in the US could be price positive as the ETF issuers would need to buy bitcoin at the same time supply is reduced.

The ability to use bitcoin in corporate treasuries and as collateral could be other factors supporting the long-term adoption of bitcoin, particularly as the volatility of the asset decreases. We have seen an increasing number of large banks start to offer custody services for crypto. One step further would be the decision to offer financing and allow bitcoin to be used as collateral for loans. Then, other financial services, such as bitcoin-backed bonds or insurance pools, could follow suit.

There are other potential catalysts behind the adoption of bitcoin which, to us, appear further out on the horizon. These include bitcoin being used as legal tender in more countries (for example: El Salvador) and as a reserve asset. To become a reserve asset, bitcoin would have to mature and change in nature to become more stable in value, highly scalable and have a uniform global regulatory and legal framework. In addition, the energy consumption issues of bitcoin mining would have to be resolved.

[1] Bloomberg as of 28 November 2023.

[2] Layer 2 scalability networks move transactions off chain, roll them up and combine them back into a single transaction that's secured on the layer 1 blockchain, benefitting from its robustness and security.

[3] Source: Glassnode.

Related blogs

+ Institutional investment flows could ignite a new bull market in crypto

+ Crypto outlook: new flows needed to mark the end of the crypto winter

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. Past performance is not a reliable indicator of future performance. Any historical performance included in this document may be based on back testing. Back testing is the process of evaluating an investment strategy by applying it to historical data to simulate what the performance of such strategy would have been. Back tested performance is purely hypothetical and is provided in this document solely for informational purposes. Back tested data does not represent actual performance and should not be interpreted as an indication of actual or future performance. The value of any investment may be affected by exchange rate movements. Any decision to invest should be based on the information contained in the appropriate prospectus and affer seeking independent investment, tax and legal advice. These products may not be available in your market or suitable for you. The content of this document does not constitute investment advice nor an offer for sale nor a solicitation of an offer to buy any product or make any investment.

An investment in exchange-traded products ("ETPs") is dependent on the performance of the underlying index, less costs, but it is not expected to match that performance precisely. ETPs involve numerous risks including among others, general market risks relating to the relevant underlying index, credit risks on the provider of index swaps utilised in the ETP, exchange rate risks, interest rate risks, inflationary risks, liquidity risks and legal and regulatory risks.

The information contained in 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 in the United States or any province or territory thereof, where none of the issuers or their products are authorised or registered for distribution and where no prospectus of any of the issuers has been filed with any securities commission or regulatory authority. No document or information in this document should be taken, transmitted or distributed (directly or indirectly) into the United States. None of the issuers, nor any securities issued by them, have been or will be registered under the United States Securities Act of 1933 or the Investment Company Act of 1940 or qualified under any applicable state securities statutes.

This document may contain independent market commentary prepared by WisdomTree based on publicly available information. Although WisdomTree endeavours to ensure the accuracy of the content in this

document, WisdomTree does not warrant or guarantee its accuracy or correctness. Any third party data providers used to source the information in this document make no warranties or representation of any kind relating to such data. 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.

This document may contain forward looking statements including statements regarding our belief or current expectations with regards to the performance of certain assets classes and/or sectors. Forward looking statements are subject to certain risks, uncertainties and assumptions. There can be no assurance that such statements will be accurate and actual results could differ materially from those anticipated in such statements. WisdomTree strongly recommends that you do not place undue reliance on these forward-looking statements.

WisdomTree Issuer X Limited

The products discussed in this document are issued by WisdomTree Issuer X Limited (the “Issuer”). Investors should read the prospectus of the Issuer before investing and should refer to the section of the prospectus entitled “Risk Factors” for further details of risks associated with an investment in the securities offered by the Issuer.

Securities issued by the Issuer are direct, limited recourse obligations of the Issuer alone and are not obligations of or guaranteed by any of Swissquote Bank Ltd (“Swissquote”), Coinbase Custody Trust Company LLC (“Coinbase”), any of their affiliates or anyone else or any of their affiliates. Each of Swissquote and Coinbase disclaims all and any liability whether arising in tort, contract or otherwise which it might have in respect of this document or its contents otherwise arising in connection herewith.

The product discussed in this document is an unregulated ETP, approved to trade on the SIX Swiss Exchange in Switzerland, Euronext Paris, Euronext Amsterdam and the Deutsche Börse Xetra in Germany. Cryptocurrencies are a high-risk investment and may not be suitable for all types of investor. Prospective investors should be aware that the price of the underlying asset(s) by which the securities are secured can demonstrate higher volatility than other asset classes and consequently the value of the securities may be extremely volatile. You must ensure that the nature, complexity and risks associated with cryptocurrencies are suitable for your objectives in light of your circumstances and financial position.

For Investors in Switzerland: This document constitutes an advertisement of the financial product(s) mentioned herein. In Switzerland, this communication is only targeted at Qualified Investors. The prospectus and the key investor information documents (KID) are available from WisdomTree's website: https://www.wisdomtree.eu/en-ch/resource-library/prospectus-an d-regulatory-reports