How much should a neutral investor allocate to cryptocurrencies?

Published 7 March 2024

Pierre Debru
Head of Research, WisdomTree Europe.

Key Takeaways

- Cryptocurrencies already represent 1% of the Market Portfolio, i.e. the portfolio that simulates the totality of all liquid assets accessible to investors
- The neutral position for a multi-asset manager is to invest 1% of its assets in Bitcoin and cryptos. Anything else is either an overweight or an underweight and requires strong knowledge and conviction
- With a 1% investment, investors would be taking a neutral stance on the space, ready to benefit from potential upside and managing the risk by limiting the downside risk to a single percent.

- Related Products WisdomTree Physical Bitcoin, WisdomTree Physical Ethereum, WisdomTree Physical Crypto Mega Cap Equal Weight Find out more

With the launch of regulated spot bitcoin Exchange-Traded Funds (ETFs) in the US, cryptocurrencies have made another step toward full institutionalisation. With regulated investment vehicles available across the world, it is now virtually impossible for investment professionals to dismiss the asset class as a whole. Like for any other asset class, it is now necessary for investors and portfolio managers to develop their own views and assign an “underweight” or “overweight” rating to Bitcoin, Ethereum and the rest.

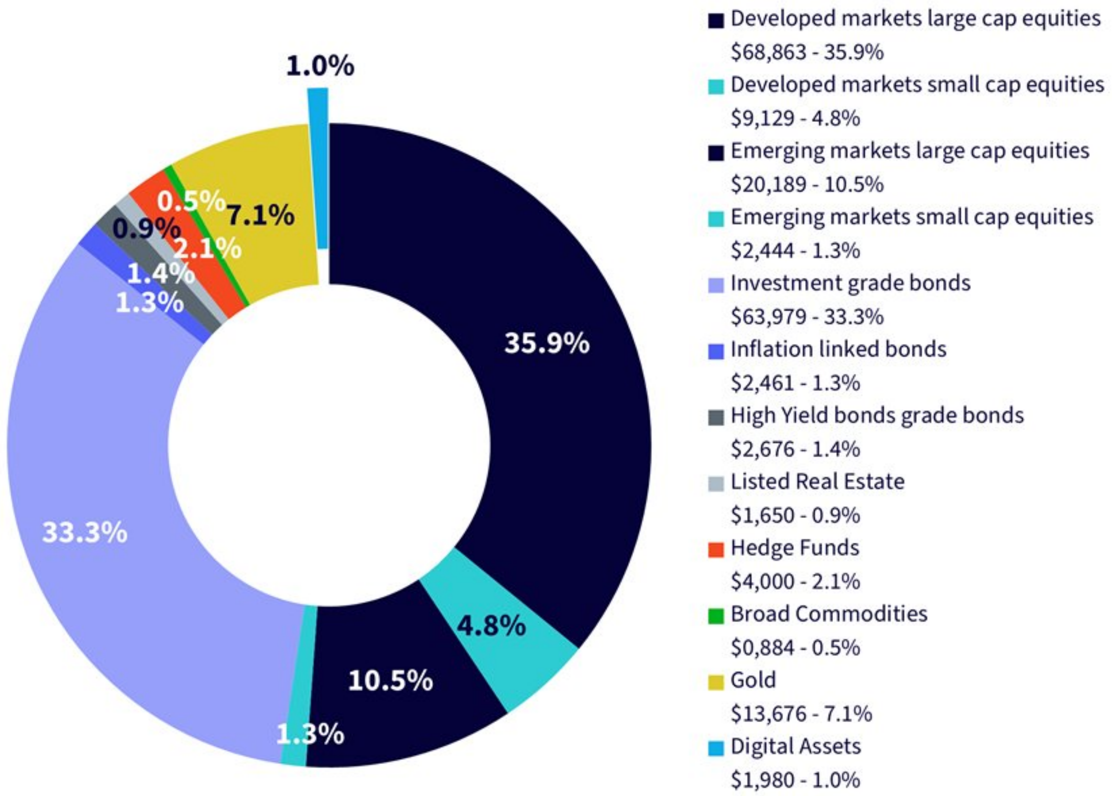
1% in cryptocurrencies is a neutral allocation

As cryptocurrencies are such a young asset class and because many investors are still relatively unfamiliar with them, it would be easy to think that the neutral positioning is 0% investment and that anything above zero is an overweight. But this is not the case.

A good assessment of the neutral positioning of an asset in a multi-asset portfolio is to look at the market portfolio, i.e. the portfolio that simulates the totality of all liquid assets accessible to investors. Figure 1 showcases the current market portfolio.

The total market cap of liquid assets sits at around $191 trillion. With a market Cap of almost $2 trillion, cryptocurrencies represent about 1% of that. This market is now of a similar size to high-yield bonds, Inflation-linked bonds or Emerging markets small caps.

Figure 1: Today’s market portfolio



Source: Bloomberg, WisdomTree. As of 16 February 2024. Market caps are shown in US Dollars billion. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investment may go down in value.**

In other words, nowadays, the neutral position for a multi-asset manager is to invest 1% of its assets in bitcoin and crypto. 1% is the rational choice for investors in the absence of a strong, supported investment thesis that would support a disappearance of the crypto space. This is a safe position that allows one to benefit from the continued growth of the space in positive scenarios and that allows one to cap losses (at 1%) in more negative scenarios.

Not investing in cryptocurrencies is taking a negative asymmetric risk against the space

By not investing in digital assets, investors are, by definition, taking an active bet against the asset class. To do so, they would need a strong and clear investment thesis to support that underweight.

A short investment is an asymmetric investment in which the asymmetry works against the investor. They have a capped upside since the asset can only lose 100% and an unlimited downside. So, the risk for a portfolio manager to underweight an asset is a lot larger than to overweight one, as the asymmetry works in favour of the investor in a long position. This is why, investors tend to consider that the conviction and the backing of an underweight need to be stronger than for an overweight.

With highly volatile assets like cryptocurrencies, this is even more important to consider. In the last 12 years, Bitcoin has been the best asset class in nine of them. Furthermore, in six of those nine years, the returns were more than 100%1. So, the asymmetry would have really been positive for an overweight investor and really negative for an underweight one. Those oversized returns are not a thing of the past either. Bitcoin returned 157% just last year2.

Conclusion

Looking purely at the characteristics of cryptocurrencies, it is clear that they can bring value to a multi-asset portfolio. With their growth potential, their diversification credentials and ease of investment through regulated investment vehicles, it is becoming increasingly hard for investors to ignore them. With a 1% investment, investors would be taking a neutral stance on the space, ready to benefit from potential upside and managing the risk by limiting the downside risk to a single percent.

For more information on the impact of adding small amount of crypto currencies in a multi-asset portfolio please see our latest research paper on the subject.

Assets used

Sources

1 Source: Bloomberg, WisdomTree. From 31 December 2013 to 31 December 2023. In USD. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investment may go down in value. See info about asset used at the end.**

2 Source: WIsdomTree, Bloomberg. 31 December 2022 to 31 December 23. in USD. **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 oer for sale nor a solicitation of an oer 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 aer seeking independent investment, tax and legal advice.

The application of regulations and tax laws can oen lead to a number of dierent 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 aer 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 oering 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 ailiate, nor any of their respective oicers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.