Shattering the competitive equilibrium: Is bitcoin the new crossbow?

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Key Takeaways

- New technology creates opportunities for first movers and risks for late entrants. Crossbows, digital photography or cryptocurrencies can only be ignored at incumbents' peril.
- A neutral allocation to cryptocurrencies would have allowed most balanced multi-asset funds to gain on average, 2 deciles on their peer groups. Yet, most managers do not invest in the asset class.
- By underweighting cryptocurrencies, multi-asset managers are leaving money on the table. In 2023, they created a negative contribution of -3% versus the market portfolio by ignoring the investment-changing landscape.

Technological progress is not a choice; it is a necessity. Our only option is between leading the way and being dragged forward.

How did a weapon "unfit for Christians" end up dominating Europe's battlefield for more than three centuries?

The medieval crossbow appeared in Europe around the 10th century. In light of the state of the warfare at the time, focused on set-piece encounters of a few expensively kitted out knights supported by disposable local levies armed with spears and bows, they were a game changer. They could level the playing field by allowing the levies to take down the knights while remaining at a safe distance, thanks to its armour-piercing capabilities. It required almost no training, and it was comparatively cheap, allowing belligerents to field many arbalists compared to the incredible expenditure needed to train and support knights and horses.

Despite those advantages, crossbow adoption faced many institutionalised challenges. The most famous being a papal edict from Pope Urban II highlighting its "brutality in war," as well as a subsequent edict from the Second Lateran Council in 1139 decree that declared the device "Hateful to Gold" and unfit for use by Christians and that those who used the crossbow against them would be placed under penalty of anathema.

Were those edicts successful? Of course not! As the saying goes, "We don't stop progress". The crossbow was too big of a game-changer. As long as everyone was playing by the rule, the status quo could remain, but as soon as it was deployed on a battlefield, the opponent had no choice but to deploy it as well or to

face horrible and swift defeat. And so, the crossbow became ubiquitous until the 14th century when it was replaced by the next innovation: longbows and their extended reach.

Why did I spend five minutes talking about crossbows? Because this story teaches us two things about technologies that can offer an edge in competition:

- No amount of barrier or wilful thinking will stop its eventual adoption, and ubiquitous adoption is only a question of time
- The adoption timeline is very much in the hands of the first movers. Once the technology is first deployed, all actors are forced to adapt and adopt it instantaneously or face an unsurmountable disadvantage

What do cryptocurrencies and crossbows have in common?

Blockchain technology has the potential to disrupt many sectors and industries over the short to medium term. Focusing on one of its applications, cryptocurrencies, and on one sector, multi-asset investing, disruption is happening as we speak.

Multi-asset funds and strategies tend to be a huge chunk of an asset manager's business, and competition is fierce to dominate league tables every year. At the end of the day, a good showing one year will help flows next year. Multi-asset managers use a variety of tools to try to differentiate themselves and outperform competitors. They try to develop better Strategic Asset Allocation using more asset classes or innovative diversifiers, be more accurate on their tactical calls for different assets, or find outperforming star managers to express their allocations.

Overall, investing is complex, the resulting league table remains quite tight, and every bps counts. Looking at all the “moderate allocation” multi-asset funds in Europe (which represent more than 3000 strategies in total), 2% extra performance in a year is usually enough to move a fund from the 50th percentile to the 25th or to move it from the 25th to the 10th.

Figure 1: Yearly performance differential between European-domiciled moderate allocation funds

	Extra performance needed to move from the top half to the top quartile in the league table	**Extra performance needed to move from the top quartile to the top decile in the league table**
2011	2.3%	2.3%
2012	2.5%	2.3%
2013	2.9%	2.2%
2014	2.3%	2.2%

2015	1.7%	1.8%
2016	1.8%	1.9%
2017	1.9%	2.2%
2018	1.7%	1.2%
2019	2.4%	2.3%
2020	2.7%	2.5%
2021	2.4%	2.4%
2022	2.3%	2.5%
2023	1.9%	1.9%
Average	**2.2%**	**2.1%**

Source: WisdomTree, Morningstar. From 31 December 2010 to 31 December 2023. Performance in USD. All European domiciled strategies in the EAA Fund EUR Moderate Allocation and EAA Fund EUR Moderate Allocation Global peer groups are considered. Historical performance is not an indication of future performance and any investment may go down in value.

Enter a new asset class: cryptocurrencies. As discussed in Bitcoin in Multi Asset Portfolios, the addition of 2% of Bitcoin to a 60/40 portfolio would have added 1.3% of annualised performance over the last 10 years[1] while adding only 0.2% of volatility and -1.2% of drawdown to the portfolio. This translates into an Information Ratio[2] that is basically unheard for an asset allocation decision. Even if we only focus on 2023, bitcoin returned 157%. An allocation of 2% to bitcoin would have basically added 3% to the return of a multi-asset portfolio, dramatically changing its positioning in league tables.

In other words, by deciding to allocate 2% of a portfolio to bitcoin, a multi-asset manager could easily move up 1 or 2 deciles in the league table. Looking at 2023 specifically, a fund in the 40th percentile would have jumped to the 10th percentile.

No crypto allocation is an underweight

The kicker is that contrary to many multi-asset managers' beliefs, a 2% allocation to cryptocurrency is not an aggressive bet toward a new and untested asset. Cryptocurrencies are now almost 15 years old, and their market cap hovers around 2 trillion. In other words, they represent 2% of the Market Portfolio, so 2% is, in fact, a neutral allocation. Not investing in crypto is a massive underweight and the most consequential allocation decision that most multi-asset managers are currently taking without even thinking about it. It is an allocation decision that cost them 3% of performance in 2023 alone. As soon as one manager starts

allocating, the landscape will shift dramatically, and reputation will be built or destroyed. It is now high time to decide if managers want to lead or be dragged kicking and screaming into the future.

[1] Source: Bloomberg, WisdomTree. From 31 December 2013 to 28 June 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.**

[2] Amount of extra return per unit of risk added

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