

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

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## WisdomTree

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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 scalability protocol, which is built on top of the Bitcoin network.

The Lightning 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 Lightning 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 5,5083.

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.

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