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The cryptocurrency moment: Return considerations for a new asset class

From the Field

Key Insights

- Digital assets have recently become accessible to mainstream investors, but there are some considerations for making allocations to this new asset class.
- A wide range of conditions typically are required for investing in digital assets, but formulating a long-term return expectation is particularly critical.
- Unlike traditional assets, the mere adoption of digital assets and their potential for adding economic value do not in themselves imply a return expectation.

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Cryptocurrencies, or "digital assets," (DAs) first appeared on the radar screens of professional asset allocators about five to eight years ago. Many analysts have spent the subsequent years asking whether DAs have any real economic value. How can we be sure that bitcoin is not a form of fraud, like a Ponzi scheme?

At T. Rowe Price, we also began asking similar questions a few years ago. We now believe that DAs do have merit as an asset class and should—generally speaking—have a financial value that is "greater than zero."

The highly successful launch of several spot bitcoin exchange-traded funds (ETFs) in early 2024 has shown that traditional investor interest in DAs is substantial. The second Trump administration also seems poised to take a constructive stance. This means that different considerations are now rising to the forefront with this new asset class.

For us, the key question is whether the investment returns potentially available to passive DA holders merit their inclusion in diversified portfolios.

Toward a return framework

To merit inclusion in a traditional multi-asset portfolio, an asset needs to have an expectation of a positive future return. Here, we focus on the excess return above cash, which is the reward for accepting investment risk rather than simply holding cash as the risk-free asset.

We have decades of historical data showing that stock and bond returns have exceeded cash returns over time. We also have a solid theoretical foundation for why this should be the case. Both assets carry a return premium (the equity risk premium for stocks and the duration premium for bonds) that potentially rewards holders for accepting financial risk.

Consider gold as another example. Few will argue that the fair value of gold is zero. However, it is difficult to argue that its long-term, structural return should exceed cash (or inflation). Like all commodities, gold's return prospects are a function of supply and demand. One can have a positive or negative view based on those drivers, but to us there is no "evergreen" reason for gold to earn excess returns.

The case for "digital gold"

We are sympathetic to the "digital gold" thesis for owning bitcoin, which views DAs as hedges against financial collapse. In this event, one could expect after-inflation returns to be negative for most financial assets, including cash. An asset that merely kept up with inflation would have a return higher than cash. Like gold, bitcoin might fall into that category, thanks to its limited supply.

But this argument faces two challenges: First, the same thesis works for any real asset—so why not buy gold, art, or unimproved land? Secondly, it would be better to have reasons to invest in DAs that do not require betting on a financial collapse.

DA advocates also argue that widespread adoption of the digital gold thesis itself could generate attractive returns while the ongoing adoption cycle lasts.

Both arguments could be plausible reasons to consider DAs. However, they are less durable than the investment rationales underpinning traditional stocks and bonds.

Taking the next step

In sum, DAs have arrived at the "gold" stage. The next step in their evolution as an investable asset class will be the formation of a long-term return thesis. Consider how stock and bond returns are generated.

For traditional companies, we know where returns can come from. Stocks and bonds are bundles of contractual rights that entitle the owners to specific future cash flows from the issuers. Holders of common stock typically are passive owners who absorb economic risk in exchange for the profits, which can be passed to them via dividends, retained earnings, or share buybacks. Bond holders, meanwhile, have a prior claim on a previously determined cash flow via interest coupons and return of principal.

Why digital assets are different

To understand how owners of DAs are situated in comparison, we need to first understand two other constituencies.

The workers who operate the blockchain's consensus mechanism play the same role that a traditional company does for stocks and bonds. But software code and technology replace the company for the limited set of services that can be "produced" using the blockchain. In the case of bitcoin, the consensus workers are the miners who use customized computer equipment to find new blocks.

Next, there are the users. These are the network participants who submit new transactions to the blockchain. Users generally need to pay fees for these transactions, which accrue in the associated DA and are run through the blockchain.

Transaction fees are the equivalent of the revenues (costs plus profits) of a traditional company. The fact that users are willing to pay fees demonstrates that the network is generating real-world utility. Consider that over the 12 months ended in August 2024, slightly more than USD 1.3 billion in fees was expended on the bitcoin network to support a total transaction volume of USD 2.4 *trillion*.[1]

What about digital asset holders?

What about the third constituency, the holders of a digital asset? Despite the potential for the blockchain to create economically meaningful value, there is no general reason why passive DA holders should be compensated simply for holding the asset. The economic relationship between the parties in a blockchain is defined by software code, not contractual rights. With many DAs, there is no built-in mechanism for passive holders to participate directly in the value added by the protocol. This, in turn, means that many traditional forms of security analysis are off the table.

To develop an expected return thesis for DAs, we need to determine on a case-by-case basis whether passive holders should expect to participate in the value added by a blockchain network. The answer is likely to look different for different DAs.

Where digital asset returns might come from

What are some DA-specific frameworks that could provide an expected return thesis? We start with bitcoin because it is the largest DA by value and has a comparatively simple protocol.

[1] Coinmetrics. Data analysis by T. Rowe Price.

An investment thesis comes into view when we recognize that, unlike gold, bitcoin is used for real-world transactions. This means that monetary considerations unavailable for gold can be included in our analysis.

The programmatically fixed supply schedule for bitcoin means that growth in bitcoin transaction volume (measured in USD) necessitates a rising price for bitcoin. So, we can back into an expected return thesis for bitcoin if we can identify structural reasons for continued growth in the use of bitcoin for transactions. For example, a natural baseline would be to assume that bitcoin transaction volumes, measured in USD, grow alongside the economy itself. This return thesis is long term because it suggests that passive bitcoin holders could expect gains as long as the economy continues to grow.

Conclusion

The analysis above raises the question of whether DAs should be included in diversified portfolios. In our view, DAs do have economic value, but that value in and of itself does not imply an expected return.

To formulate a long-term return thesis for DAs, investors will need to determine whether passive holders should expect to participate in the value added by the blockchain. The answer is likely to depend on the DA, so this analysis will need to be conducted on a case-by-case basis.

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