



SPECULATIVE MADNESS OR SMART PLAY

DOES BITCOIN BELONG
IN WEALTH PLANNING?

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BITCOIN HAS BEEN on a tear lately, up nearly tenfold since the beginning of 2016, when a single “coin” could be had for just over \$400. By mid-September 2016, Bitcoins were trading well north of \$4000 — and investor interest has become feverish as returns dwarf all other assets. Even a rumored move by China to shut down all three of its Bitcoin exchanges could only dent Bitcoin’s rise, chopping prices from a high of nearly \$4700 per Bitcoin to just over \$4000. Investors who missed the steep climb — most of them, in what is still a very new, untested asset — are on the phone asking financial advisors how they can get into this hot new vehicle.



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Mark La Spisa, CFP®, managing advisor and president of South Barrington, IL-based Vermillion Financial Advisors Inc., says that he first heard the term “Bitcoin” about five years ago when a retired financial planner who had become a client asked him about it. At that time, he knew nothing about the crypto-currency, which had only been created two years earlier in 2010. These days he’s getting a lot more calls about Bitcoin, and not just from his most sophisticated and knowledgeable clients.

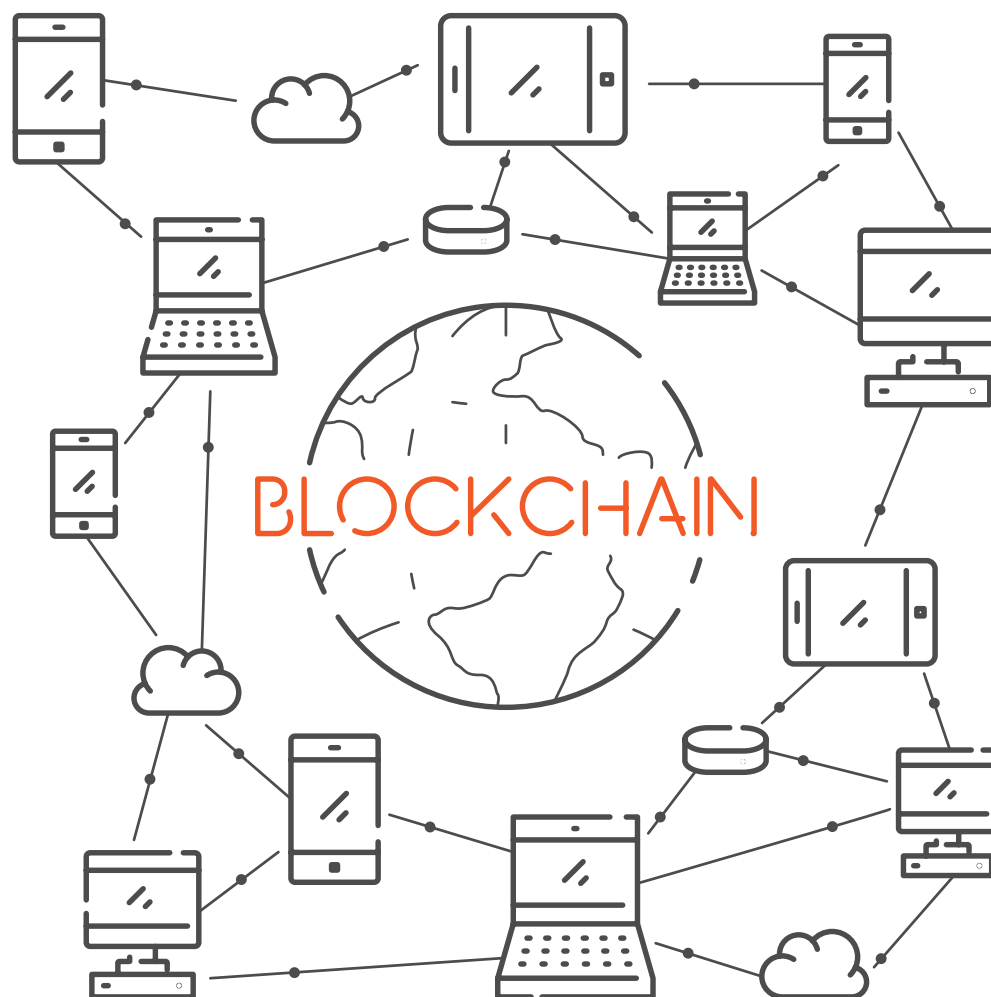
“Anything that becomes hot, anything where there’s a lot of money being made in it, becomes something that people become interested in,” La Spisa explains. “But as more money jumps into Bitcoin, the more there’s pressure to regulate it. At some point in time, it doesn’t keep on going up like it did in the past.”

“For the average person, if they want to speculate and they want to use it as fun money or they want to take a small part of their assets and buy Bitcoin, that’s probably fine,” says La Spisa, “but there’s no financial advisor that I know that’s going to take 50% of a person’s money and buy Bitcoins with it. It still comes back to the basic principles: diversification, proper asset allocation, things of that sort, and the challenge is that with any investment, if a client doesn’t understand it, they should stay away.”

Bitcoin basics

What’s to understand? Plenty. First, Bitcoin is a digital, peer-to-peer currency that is created by vast networks of computers (in a process called “Bitcoin mining”) but is not controlled or tracked by any sovereign government. It was invented just after the global credit meltdown by a shadowy figure named Satoshi Nakamoto, whose November 2008 paper Bitcoin: A Peer-to-Peer Electronic Cash System laid the groundwork for Bitcoin’s creation. A Bitcoin network issued its first Bitcoins in 2009.

Because bitcoins don’t have any physical form that can be checked for authenticity, it’s important to assure investors that their holdings are genuine and not counterfeit. Bitcoin uses a digital ledger known as a blockchain technology to track how bitcoins are created, bought



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and sold. The blockchain keeps a record of every time a bitcoin is traded, verifying each transaction and embedding information about it in the digital footprint of the bitcoin. This prevents people from using bitcoin twice or making their own counterfeit bitcoin.

Bitcoins can be bought online through a number of exchanges, using bank transfers, credit cards or payment services like PayPal. There are even a few Bitcoin ATMs.

Once you've bought a Bitcoin, you are assigned a Bitcoin address, a string of 30 or more characters that identifies you as the owner of your currency. These numbers are publicly viewable, but it's difficult for governments and other interested parties to figure out which account belongs to a given individual. As a result, in the early days, Bitcoins were widely used for illicit transactions such as drug deals and tax evasion.

Bitcoins are still not widely accepted as currency, though there are some online exchanges that facilitate payment for goods and services in Bitcoin.

Incorporating Bitcoin in a diversified portfolio

No one is looking to Bitcoin to replace major asset classes like stocks or bonds in portfolios, nor do most investors plan to place the majority of their money in it. The cryptocurrency is too volatile and untested for that — and remember, since Bitcoin is essentially backed by nothing but the belief that other investors will eventually buy it — it has no intrinsic, fundamental worth.

Yet some wealthy investors have found a place for Bitcoin within their overall strategy, as David Berger, chairman of the Digital Currency Council, notes. “Wealthy investors have been flocking to Bitcoin,” he explains. “As the former CEO of the Institute for Private Investors, the leading peer network for ultra-high net worth investors, and the

Chairman of the Digital Currency Council, the leading professional association in the digital currency economy, I've examined the asset class for countless wealth investors. In almost every instance, there is a portion of their portfolio that is appropriate to allocate to bitcoin or other digital assets.”

“Investments in Bitcoin should be made with risk capital, similar to an investment in an early stage venture. The asset class is volatile and will likely have a binary outcome for investors. That said, it also has relative liquidity when compared to an investment in an early stage venture,” says Berger.

That seems reasonable to La Spisa, as long as an investor understands what he or she is getting into and can withstand losses. “Some investors have a propensity to take that risk. They're just wired that way. They enjoy taking that risk and they have the wherewithal in order to withstand bad investments. For them, sure. I don't think there's anything wrong with it,” he says. “But if I took your mother's or your grandmother's money and I put an allocation of even 10% into Bitcoin and that goes bad and they don't have that money anymore, that's a problem.”

La Spisa adds that clients who seek out wealth advisors typically need more help with protecting their assets than wildly speculating in digital currencies. “The other thing you've got to think about is, who is the typical client that hires a financial advisor? And I don't know what your experience has been, but I've been doing this for almost 30 years and I typically find that clients tend to start hiring a financial advisor or an investment advisor around the age of 50. And that means they're in the home stretch of retirement. Speculation in most cases is not a high priority in the investment portfolio,” he says.



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An advisor's fiduciary responsibility may also constrain his or her ability to handle Bitcoin on behalf of clients, as recent guidance from the DOL has focused attention on non-traditional assets. La Spisa, a fiduciary for more than 30 years, says that advisors can sell unusual assets like Bitcoin, but they have to be careful. "Yes, I can do it. The issue is that I have to use full disclosure," he says. "If a client comes to me and says Mark, I want to buy x, y and z, as a fiduciary, my responsibility is to educate them, to make sure that they're aware of the pros and cons of it. If at the end of the day, they want to instruct me to buy something for their benefit, I can help them. That's not a problem. If I'm trying to charge a fee for my services, I'm doing something, that's where it's going to get a little bit complex."

Asked if Bitcoin is the kind of asset that wealthy individuals might buy behind their advisors' backs — and, in some cases, without their approval — La Spisa admits that it is hard to get some clients, particularly, self-made entrepreneurs to tamp down on their risk. "The toughest person to convince to become my client is the guy who was self-made, an entrepreneur, and created a business, created some real wealth running his business for the last 20 or 30 years," he says. "I come to him and say, hey, let's diversify you and get you out of your company stock and let's set up this nice plain vanilla, boring type of portfolio. And they go, what? I'm not going to be making 25% returns anymore? It's hard. It's a hard sell to get them to think about financial planning, and that they're at a different stage of life and that they may not be wanting to speculate in their 60s, 70s and 80s."

Currency or asset class?

Even the most seasoned institutional investors have had a hard time determining exactly where Bitcoin fits in the spectrum of investable assets — whether it is simply a currency, a store of value like gold, or an investment asset like stocks or bonds. For instance, in his July 26th investment memo, Howard Marks, the co-chairman of Oaktree Capital, originally dismissed Bitcoin, writing that "Serious investing consists of buying things because the price is attractive relative to intrinsic value. Speculation, on the other hand, occurs when people buy something without any consideration of its underlying value or the appropriateness of its price, solely because they think others will pay more for it in the future."

By September, however, Marks reconsidered, admitting that in its lack of intrinsic worth, Bitcoin was much like the dollar and other currencies, "Fiat currencies have value simply because of the faith in the governments that issue them. If enough people believe in it, why can't faith in Bitcoin suffice?"

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Morgan Stanley's currency team also considers Bitcoin primarily a currency, but explored its gold-like properties as a hedge against inflation and political uncertainty as well. Yet in a doomsday scenario, how much value can a digital currency retain, since it after all requires an internet connection to access? "Over millennia, gold has demonstrated its ability to endure and preserve value under all circumstances. By contrast, bitcoin's global platform literally requires the lights to stay on," Morgan Stanley's analysts concluded.

The value of scarcity

The jury is still out on how Bitcoin will perform, long-term, and whether it will most resemble the dollar, an ingot of gold or some sort of synthetic derivative. It is clear, though, that most people are buying it as a speculative play, based purely on the idea that limited supply and growing demand will push prices further upward. "In my opinion, the bitcoin price will continue to rise as it becomes more useful and scarce," says the Digital Currency Council's Berger. "That said, timing this market has proven extremely challenging and volatility is the rule, not the exception. I don't care to share an opinion on market timing, but the long term investor should focus on the fundamental trends — which are indeed positive."

How positive? A recent article in CoinTelegraph pointed out that Bitcoin production has been capped by its creators at 21 million — and there are currently roughly 35 million millionaires in the world. "That's right--there will never be enough Bitcoins in existence for every millionaire in the world to own even a single one," the author concluded.

Oaktree's Marks also weighed in on the scarcity argument, noting perhaps tongue-in-cheek that if one-third of the \$14 trillion in U.S. money supply were held in Bitcoin, the total value of the asset would rise by 60 times from current

levels (which would result in an eye-popping Bitcoin price of over \$250,000 — enough to pay for four years of Harvard with a single coin). Yet he notes that no other currency has ever appreciated in this manner, even though there is also a finite (though large) supply of American dollars and French Francs and Japanese Yen. He points out further that other digital currencies are popping up everywhere including 11 with market caps over \$1 billion. What's to stop this market from fragmenting? What will Bitcoin be worth if it's just one of many digital currencies, even if it remains the leading brand?

"Scarcity has been the point of Bitcoin since the beginning, that there is a finite supply, and now you've got demand," says La Spisa. "You've got to remember, there's nothing backing it. You've got as much backing to air as you do to this. The only reason that it's valuable is if demand goes up and there's no supply."

Indeed, JP Morgan Chase CEO Jamie Diamond recently compared Bitcoin to historic investment mania, telling participants in a Barclays Banking Conference that "Bitcoin will eventually blow up. It's a fraud. It's worse than tulip bulbs and won't end well" and saying he'd fire any trader stupid enough to trade in the currency.

Still, despite some naysaying, investment firms have been moving to where the money is. New firms are springing up to trade, store and manage the currency. Bitcoin funds have been launched by established players like Van Eck Securities. In 2015, 13 of the world's leading financial services companies, including Bank of America, BNY Mellon, Citi, Deutsche Bank, Morgan

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— Jamie Diamond





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DECIDING IF BITCOIN IS RIGHT FOR YOUR CLIENTS

All this points towards more volatility ahead for what has always been a risky, speculative asset. Advisors and their clients considering Bitcoin should consider these factors when deciding whether or not to invest:

■ **How much can I lose?** Bitcoin has no inherent value. It's price is based solely on how much people are prepared to pay for it. As a result, investors need to be comfortable with the possibility of losing part or all of the money they've invested in Bitcoin. It should make up a small part of most portfolios — no more than the investor can afford to lose.

■ **How carefully should I be prepared to monitor my investments?** Bitcoin prices can change quickly. Clients who invest in it should be aware of pricing trends — and ready to act on sudden moves. This is not like a utility stock that you can buy and hold for decades. It's an investment that needs to be monitored. Hands-off investors should probably stay away.

■ **How comfortable am I with sudden price movements?** The news that China was restricting trading knocked nearly a \$1000 per coin off the price of Bitcoin in a single week, a move that could easily unsettle more conservative investors. The risk with any speculative investment is buying high on the hype and then selling on downward volatility. Make sure your clients are willing to weather temporary downturns.

■ **When should I get out?** As the Wall Street adage goes, "Trees don't grow to the sky." Smart investors will think ahead about how much appreciation is enough — and when they'll be willing to take some or all of their money off the table. If your clients want to dabble in Bitcoin, talk to them about systematically withdrawing assets at pre-determined price points, a kind of dollar cost averaging in reverse.

Stanley and Toronto Dominion Bank, joined R3, an industry-spanning group to explore how to integrate blockchain technologies into mainstream banking and investment. The group now has more than 70 members.

New rules in the offing?

Bitcoin has, up to now, been almost entirely unregulated. It was invented, remember, to allow people to complete financial transactions without government oversight.

Yet many market participants expect government entities like the SEC and central banks to eventually seek to regulate this underground market.

What form these regulations might take, and how effective they might be in a decentralized, global peer-to-peer market, are as yet unknown but important factors in the future performance of Bitcoin.

YOUR PARTNER IN SOPHISTICATED WEALTH PLANNING STRATEGIES

No one knows how high Bitcoin prices will go, or if the current surge reflects real value or is simply another in a long line of speculative bubbles. Yet if your clients are asking you about sophisticated, non-traditional investment vehicles like Bitcoin, you need to be able to provide them with sound, prudent advice, taking into consideration not just the portion of their wealth that they intend to allocate to these strategies but their total financial portfolios. Premier Trust is an advisor-friendly trust company with deep experience in serving wealthy clients. We can help you navigate your clients' most challenging wealth planning issues by providing you with full trust company capabilities, while maintaining full control of customer accounts and relationships. A relationship with Premier enables your firm to access the best of both worlds — the continued control of client relationships that advisors would enjoy if they set up their own trust companies, plus the cost-efficiency and sophisticated capabilities of using a dedicated third-party provider.

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