PRUDENTIAL **INSIGHTS**

Prudential Investment Managers

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Risky business? What you should know before investing in cryptocurrencies

Cryptocurrencies (cryptos) such as Bitcoin, Ethereum, Dogecoin and Binance Coin, have become more than just buzzwords in the investment world, but remain somewhat shrouded in mystery compared to traditional investments. The headlines of high returns can create a fear of missing out (FOMO) even if you don't fully understand what you might be missing out on. And as we've written in the past, FOMO should never be a motivating factor behind any of your investment decisions.

What are cryptos and how do they work?

On a high level, cryptos are digital assets that exist on a network or digital ledger known as a blockchain, which enables transactional data to move safely among many computers. Like other currencies, cryptos can be traded, but they exist outside of central banking systems. Due to their popularity and ease of access, cryptos have become more than just a speculative investment vehicle, with many using the digital currency as a means to pay for online transactions across geographical regions.

What are some of the key differences between cryptos and stocks?

Investing in cryptos is quite different to investing in the stock market. For example, buying stocks means owning a share in a listed company, which can be done directly via regulated stock markets or unit trusts, such as those offered by Prudential.

Cryptos, on the other hand, are purchased as individual tokens, which are essentially units of currency. These are either stored or traded digitally and are valued purely on the basis of supply and demand - they have no real intrinsic value *per se*. The value of stocks, however, is based on the market's perception of several measurable and quantifiable factors, including the value of the company's assets, its financial performance, its competitive environment, and its future growth and cash-flow prospects.

Both cryptos and stocks are dynamic, with values changing daily, and each comes with different motivations for investing. Stock market investing is based on the anticipated growth of a company, and its ability to generate returns for investors through either capital appreciation or dividend payments. Buying cryptos can be for the purpose of generating returns, but also to make payments where this type of currency is accepted.

Be aware: Cryptos are not regulated

While cryptos have gained traction and earned favourable returns for investors, there have also been significant losses and scams involving these currencies. In South Africa, cryptos are not yet regulated by the Financial Sector Conduct Authority (FSCA) or any other local regulatory body, which means there is limited recourse if something goes wrong. While there are registered cryptos available, these assets are currently in review and regulation is expected to follow soon. Unit trusts, by comparison, are very well regulated, making them a much more secure way to invest.

Should you invest in cryptos?

At Prudential, we do not invest our clients' money in cryptocurrencies. However, as with other unlisted investments, it should depend on your investment objectives and risk tolerance. If you are younger, far away from retirement and can handle the risk, they could possibly have a place in your portfolio. Each crypto should be analysed on its own merits, with input from someone who has done research in the field. However, they shouldn't be your primary source of returns, particularly given their high levels of volatility.

Unit trusts offer lower risk by comparison, and most have a long history of inflation-beating returns. Plus they are better regulated and historically have been a successful way to save for short, medium, and long-term financial goals.

If you're interested in adding a good-quality unit trust to your investment portfolio, try our Fund Selector tool to help you assess which Prudential fund is best suited to your investment objectives, time horizon and risk profile. The Prudential Equity Fund, for example, is suited to investors with a long-term view and higher risk tolerance, compared to the Prudential Balanced Fund, which invests in multiple asset classes, giving it a lower risk profile compared to a typical equity fund.

Whichever option you choose, Prudential's funds are structured on a risk-conscious basis and are well diversified to generate returns for investors under a wide variety or market conditions. Cryptos, meanwhile, are a single asset class and offer investors less downside protection across different market cycles.

While the above offers a broad outline of the main differences between cryptos and unit trusts, if you are considering adding cryptos to your investment portfolio it's important to understand the full extent of the risks involved. We recommend speaking to your financial adviser before making any changes to your investment's asset allocation, to make sure that you stay on track to reaching your long-term investment objectives.

For more information, please feel free to contact our Client Services Team on 0860 105 775 or email us at query@prudential.co.za.