Catching up on crypto

To say that the last few months have been a wild ride for cryptocurrency would be an understatement.

When I spoke with Dr. Lamont Black last June, Bitcoin was trading at around $33,000. As of late February, it was trading around $37,000. Before you start thinking that sounds like steady gain, consider that in 2021 bitcoin traded as low as $28,975 in June, reached an all-time high of $68,990 in November, then gave back more than 28% just a few weeks later. All the while, there have been fraud scandals and calls for greater regulation.

This seemed like a good time to catch up with Dr. Black again. A self-proclaimed "financial futurist," Dr. Black is an Associate Professor of Finance at DePaul University and the Academic Director for the school's Keeley Center for Financial Services. Previously, Dr. Black served as an Economist at the Federal Reserve Board of Governors in Washington.

We discussed the recent volatility in cryptocurrency markets, recent trends designed to provide more stability and the potential for non-fungible tokens, or NFTs. The following are highlights of our discussion.

An alternative investment

I've already pointed out Bitcoin's wild ride, but other cryptocurrencies have experienced similarly wild price swings. While Dr. Black said that is a cause for concern, his view is that volatility is bound to happen when dealing with an innovative, paradigm-shifting technology.

"I'm not surprised at all when I see this type of volatility," he said. "This is partly why I think cryptocurrency is shifting from a discussion around money to a discussion around investing. No one is buying pizza or coffee with bitcoins anymore. Many people are now buying crypto as an investment, so we need to shift the conversation from cryptocurrency to crypto assets. Then the discussion from a wealth management perspective is, should I own crypto or not?"

Gaming the system?

Dr. Black himself treats cryptocurrency as an alternative asset class. Just as he has a retirement plan and ETFs tied to the S&P 500, he invests in cryptocurrency as a potential way of earning additional gains. "As with most investors, there's part of me that still wants to beat the market," he said. "People think of alternative assets as derivatives, commodities, currencies, and now crypto is in that category. It's not the core, but it is adding some of that speculative investment that could potentially have more exponential growth relative to the U.S. stock market."

But inevitably there's the question of just how legitimate some of these investments are. A U.S. couple recently made global headlines for an alleged $4.5 billion Bitcoin laundering scheme. There's also concern around how much the largest holders of various cryptocurrencies manipulate the price. While that's less the case with larger players like Bitcoin, with smaller digital coins, the share of the top 10 holders can be as high as 80%. The worry is that easy money is being made by a handful of early movers, while the investors who come in later get caught in a more volatile experience.

Black pointed to "pump-and-dump" schemes in which the fraudsters drive the price up then quickly sell it in unison, sending the price crashing back down with smaller investors left holding the bag. Another scheme is called the "rug pull," in which a coin's founders abandon the project and run off with their investors' money. Nonetheless, Dr. Black doesn't see those misuses as a nail in cryptocurrency's coffin. The key, he said, is to be smart about where you make your investments, especially if you're new to the market.

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"I think it's too easy for people as they're learning about crypto to try and come up with one reason why it's a total fraud or a total scam and why you should never invest," he said. "Another analogy would be to look at the U.S. stock market. We have thousands of different stocks issued by different companies, and that's a good thing. In cryptocurrency, we also have large-cap and small-cap." This highlights the wide range of risk and return in this new market.

Central banks check the scene

Dr. Black says 2022 is the year when we figure out the intersection of cryptocurrency and traditional currency. He points to the heightened interest in central bank digital currencies, or CBDCs—a digital form of a country's fiat currency.

"The People's Bank of China already has a pilot program," he said. "The Federal Reserve recently released a white paper saying that they're exploring it here in the U.S. It's being explored in Sweden, India and Russia. Just about every central bank in the world is now asking this question because they recognize that we are moving toward cashless societies. So, this whole idea that the U.S. currency either exists in a bank account or on a piece of paper—that is going away. They're recognizing we need digital cash."

The difference is that while cryptocurrencies like Bitcoin are managed without government involvement, CBDC's would be highly regulated and highly managed. "The supply of the dollar will still be controlled by the Fed whether the currency is physical or digital, so that's not going to change," Dr. Black said.

Crypto meets the greenback

There's also the advent of stablecoins, which is a cryptocurrency pegged to a reserve asset, such as a fiat currency. In theory, it delivers the best of both worlds, offering the benefits of being cryptocurrency without the volatility. The two largest stablecoins are pegged to the U.S. dollar: Tether, has about $75 billion in circulation, while USD Coin, issued by a company called Circle, has about $27 billion in circulation.

Still, there are concerns. Tether has drawn the attention of regulators. In October, the company reached a $41 million settlement with the Commodity Futures Trading Commission on charges that it misled investors about its reserves being fully backed by the dollar and other fiat currencies.

"These both have a value of $1, but then the question is how do they maintain that peg?" Dr. Black said. "It's because of reserves in these accounts in which they hold cash and cash equivalents, and so a lot of the regulation in Congress right now is focused on stablecoins and whether banks should be allowed to issue stablecoins or not. That's because stablecoins are really at that intersection—they look a lot like money, and yet they're crypto, and so the regulators are trying to figure out if this is a threat. Should we shut it down or do we figure out how to regulate it?"

The NFTs are coming!

Many of the buzzwords being floated in tech circles, like the metaverse and Web3, are applications designed to be built on the blockchain. Within that context, you can own digital assets in the metaverse. This is why Dr. Black believes nonfungible tokens, or NFTs, are such a promising innovation.

"They're not just these cute images that people show off on social media because they think it's cool," he said. "It's a record of ownership of a digital asset which can now reside in this entire ecosystem called the metaverse. That is the future of the digital economy, and blockchain is going to empower that."

Black explained that NFTs fall into the category of crypto asset. An NFT is similar to a digital coin, but it's unique.

"The whole idea of cryptocurrency is transferability," Dr. Black explains. "I can have a bitcoin in my wallet, I can send it to your wallet. You could send it to somebody else. That's fungibility just like the U.S. dollar is fungible. Nonfungible tokens are inherently unique or scarce, and that's what makes them valuable. NFTs are traceable and trackable ownership of a unique asset. And that's incredibly powerful in a digital economy."

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Dr. Lamont Black is a recognized expert on cryptocurrency and blockchain who is a regularly invited speaker at conferences and in the media. His teaching on cryptocurrency at DePaul covers aspects of money and investing and has been featured in the Chicago Tribune. In his graduate course on blockchain, he works with business and computer science students to build real-world blockchain applications.

Dr. Black points to how Napster popularized digital music with MP3 files that can be copied at no cost, collapsing the music industry's revenue model. He said the future of music could be one where individual musicians sell their music using NFTs. "The proceeds go directly back to the artist, because now you have a clear record of ownership and sale using the blockchain," Dr. Black said. "I think that the applications and the use cases are incredibly telling and promising."

Beyond the hype of pieces of digital art selling for $69 million, Dr. Black points to potential new uses for NFTs for physical assets like real estate. Instead of using an expensive title company to record ownership of a house, an NFT could record ownership securely on the blockchain. "We're talking about an intersection of the digital and the physical," Dr. Black said. "I think it's just a matter of time before some of these applications start to build a bridge between them."

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