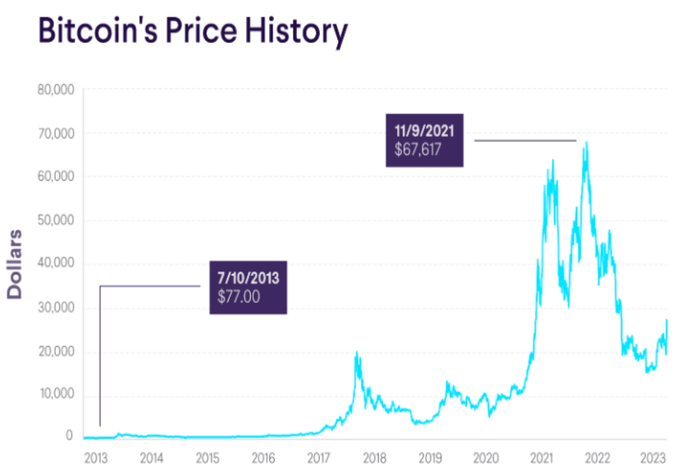
The Two Big Challenges with Investing in Bitcoin

Bitcoins don't generate cash and you need to have (almost) perfect timing

If you've been watching bitcoin prices lately, you already know they made a spectacular run in 2023. In fact, a single bitcoin was valued at over $42,000 at the end of 2023, having started the year north of $16,000 – for a staggering gain of over 160% in a single year.

To put things in perspective, bitcoin values were in the $300 – $400 range for much of 2015 and about $5,000 when the pandemic started in March 2020.



Those who invested in bitcoins years ago are likely rejoicing. But, should you add bitcoin to your retirement portfolio?

What is Bitcoin?

Bitcoin is a crypto-currency traded online and used by businesses around the globe. In fact, one of the most attractive advantages of bitcoins is that it can cross borders easily – facilitating international trade.

But for the purposes of investing, bitcoins are no different from any other currency or commodity.

In other words, bitcoin can be lumped into the same category as the U.S. Dollar, the Euro, the Japanese Yen and the Swiss franc as well as gold, wheat, oil, corn and uranium.

As such, at any given time, bitcoins are worth whatever the market says they're worth (meaning whatever someone else will pay). While this isn't necessarily a problem in itself, investing in bitcoins does come with two very big challenges.

Challenge #1: Not Generating Cash

When you invest in bitcoins – or any other commodities or currencies – you are investing based on price appreciation potential alone – meaning you are only rewarded if the price goes up relative to the U.S. dollar. So an investment in bitcoins is very different from conventional investments found in your retirement portfolio – stocks and bonds – in that those conventional investments offer the chance to generate cash.

Think of it this way: when you invest in a stock or a stock fund, that means you own a slice of a business (or businesses). And businesses exist to make money. As an "owner" of that business, you are entitled to a slice of that money. And that money is either used to reinvest in the business, which further increases the value of your slice or it's paid out as a dividend.

No matter which occurs, that stock generates cash – which makes those who own shares more money. Similarly, bonds distribute cash too, usually twice a year. So as a bond holder, you usually get back your original investment plus cash during the holding period.

That is not at all the case for bitcoin, gold, or other commodities. Those type of “investments” do not generate cash at all. Instead, investors can only hope that they rise in value with the price of inflation.

Further, it costs money to get into bitcoins because you must "buy" them and you won’t be able to buy them at the value you see posted online. You will have to pay a little bit extra, otherwise the person selling you the bitcoins has no incentive to do so.

Challenge #2: Getting the Timing Perfect

In many respects, with investments like bitcoin, you really have to get the timing right. And as most of us know, the vast majority of individual investors can’t do that with stocks.

Should you maybe consider investing in bitcoins as you would a lottery ticket (it only costs $1 and you might win huge)? That’s probably hyperbole, but you might consider limiting your investment in bitcoins to an amount you can afford to lose – and that’s not a good idea when constructing your retirement portfolio.

Your retirement portfolio should contain low-cost, diversified investments that aren’t quite as volatile as bitcoin or other currencies and commodities. And your retirement portfolio should be part of your long-term investment strategy.