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"FOLM" vs. "FOMO": How Do Gold And Cryptocurrencies Compare As A Portfolio Hedge?

- Carol Roth

In this informative newsletter, Carol covers the difference between "FOLM" and "FOMO" and how they relate to gold and crypto; the history of their respective social contracts; access; use cases; and more!

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“FOLM” vs. “FOMO”: How do gold and cryptocurrencies compare as a portfolio hedge?

As major global central banks put their respective countries further in debt and jeopardize the value of their currencies, people around the world are looking for ways to hedge the risks that this presents, as well as other portfolio risks related to the broader economic environment.

The rise and recent fall of cryptocurrency has many people asking what they should consider in terms of evaluating both gold and cryptocurrencies as a hedge.

Here are some things to consider.

The History of the Social Contract

Everything of value has value because of a social contract. When people agree and trust the value that something conveys, it is considered to have that value. And that value can fluctuate over time based on the number of people who agree and trust in that value, as well as the scarcity of and demand for the underlying item of value.

Gold has had an enormously long social contract backing its value. Its value has endured, according to researchers, for at least 5,000 years. That’s a very substantial track record, through all kinds of financial cycles. While the past never guarantees the future, it’s a pretty compelling data point.

Cryptocurrencies have a decade and a half track record or less, depending on the crypto. That doesn’t mean that one or more cryptocurrencies don’t have the opportunity to endure, it just provides less data on how it thrives or survives in different economic and geopolitical situations.

The Underlying Use Cases

One of the reasons that gold has had such a long social contract is that it has a variety of uses. It is used to signal wealth and luck in a variety of cultures globally. It can be used to make decorative jewelry or have more practical uses when melted and used in the creation of other goods. While the market capitalization of gold does exceed the underlying use value today, should geopolitical winds shift substantially, it could be put to work in other ways. This all makes gold desirable.

Cryptocurrencies are not malleable in the physical world. In the digital world, certain cryptocurrencies are programmable with data and smart contracts. When things are going well, those cryptos that have additional uses can be considered valuable for those use cases. If things are going poorly, it may be easier to meet your needs by using gold as an exchange mechanism.

Access

In terms of access, storage and related costs, gold and cryptocurrencies function differently. Gold is physical and tangible in nature, so you may need to consider storage or how to carry it with you, but in a worst-case-scenario, it may also be easier to access. And, storage is easier than you may think—one million dollars' worth (in today's value) of gold can fit into a shoebox!

Cryptocurrency isn't physical and is tethered to technology; if you are concerned about a bad scenario, whether it be weather or war, where you can't access technology, or if the providers of storage or exchange are down, that can impair your access and use of it.

Both crypto and gold are highly coveted today and require defenses. Cryptocurrency needs to be defended from cyberhackers, while gold must be protected in the physical world.

The storage of both has costs associated with them that relate to the kind of protection they provide.

Meeting the Currency Tests

Currencies have three tests that they need to meet: (i) a medium of exchange, (ii) a store of value, and (iii) a unit of account.

Gold has long been a medium of exchange. Although less seamless on a day-to-day basis than say a dollar-based transaction today, many individuals and entities- and even major governments- will take gold as a payment.

As discussed, gold also has a long history of a store of value, and has been remarkably stable over long periods of time. As a unit of account, while it can be used for settlement, it is usually priced in some other currency.

Cryptocurrencies have a much harder time meeting these tests. As a medium of exchange, their value is fairly limited today, although that may change, particularly for those cryptos that gain more traction over time. The prices for most major cryptos have been very volatile and they are not a unit of account (most frequently quoted in dollars).

While gold meets the tests better and can be used as currency, I would consider it more of a commodity, while crypto behaves more like an alternative asset, such as a collectible.

Also, many people getting into crypto are doing so because of "FOMO" or fear of missing out. The properties of cryptocurrencies make them speculative assets and should likely be treated as such in a portfolio. Gold holders usually are more concerned with "FOLM" or fear of losing money. That makes it more of a true hedging product. You can see this in the recent volatility in cryptocurrencies vs. gold.

What Do You Understand?

My father left me with a handful of foundational financial principles, and one of the key ones was never invest in something you don't understand. I am sure you know what a gold chain is, but do you know what a blockchain is? Gold and other precious metals are very easy to understand, but cryptocurrencies- even the most established- have a learning curve.

Cryptos may be worth investing some time to understand it better, but do your research before you allocate any substantial investment.

Legal Implications

Both gold and crypto, being decentralized and outside of government financial systems, are subject to legal threats. In the US, gold was recalled by the government under President FDR during the Great Depression, and individuals did receive compensation in exchange.

Today, the US government and other developed countries' governments seem to have more concern with cryptocurrencies, and are actively considering different legislations, and also competitive digital centralized currencies.

While neither are immune to laws, you have to decide which would be more difficult to access should the government "go rogue" or institute new laws.

Follow the Money

According to the World Gold Council data, in 2021 central banks around the world added almost 456 tons of gold to their reserves, some of that to replace fiat currency-based reserves. Many wealthy individuals have also been adding to their gold holdings.

Wealthy individuals have also been investing in crypto. Some countries are turning to cryptocurrencies like Bitcoin as well, but it seems to be countries that are struggling and looking for a "Hail Mary pass" solution vs. the more established and well-to-do countries around the world.

While this will shift as the economy shifts, I always like to look to what the wealthy and powerful are doing as a data point.

The Verdict

If you are seeking out speculative investments, crypto may be worth learning more about, but if you are looking for a risk-adjusted return and an asset that will perform more like a hedge or "insurance policy" in your portfolio, gold is a much better consideration for you today.

As more time passes, this information is bound to change, so, like other investments, you should revisit it periodically. Remember, nobody can predict the future and a slew of variables can change the course of history. One, both or none may be right for you, but these factors should help you as you do your research and diversify your portfolio based on your current holdings, your risk profile and your goals and objectives.

Many financial experts suggest having 5-10% of your portfolio in hedges like gold, even during better economic conditions, depending on your risk tolerance, objectives and current portfolio size and allocations. If you haven't added or updated your hedges, like gold, recently, talk to a financial advisor or specialist to review your portfolio and make sure that it is well positioned given your risk profile and objectives for the likely volatile times ahead.