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Small Bitcoin holdings in a portfolio can have an outsized positive impact on returns, says report

Recent research by a digital asset manager has said that small weights of Bitcoin can have an "outsized positive impact on risk-adjusted returns" relative to other alternative assets.

The report, published on September 8 by CoinShares Research, showed that an allocation of 4% Bitcoin in a traditional balanced portfolio with 60% equities and 40% bonds resulted in an improvement in annualised returns to 18.8% from 9.3%, while the Sharpe ratio, which indicates how good or bad returns have been relative to the risk taken on by the investor, was at 1.69 with the Bitcoin included and fell 15% for the base portfolio. A Sharpe ratio above one is considered to have a positive impact on a portfolio.

Meanwhile, CoinShares said it had diversified similar portfolios with 4% holdings in other alternative assets, namely gold, an index tracking social networking firms such as Facebook Inc (NASDAQ:FB) and Google owner Alphabet Inc (NASDAQ:GOOG), and the commodity markets CRB index, in order to compare their performance with the Bitcoin enhanced portfolio.

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The report highlighted that over a three year period "none of these other assets or indices offer the same diversification benefits".

"What also makes bitcoin stand out is its asymmetric return profile, that is, the upside it provided versus the downside. Despite bitcoin's volatility, a 4% portfolio weighting does not materially increase the maximum drawdowns (i.e. the maximum possible loss from peak to trough) relative to other assets, while its annualised returns are close to double that of the other alternatives", it added.

The report also said that even if Bitcoin had been added to a portfolio at its peak price in December 2017, which was followed by a steep decline in the price, it would still have enhanced portfolio returns with "a reduced, but significantly better Sharpe ratio".

"From the peak in December 2017, Bitcoin returns are currently -46%, it should therefore detract from the overall portfolio Sharpe ratio. Historically, this has been mitigated by quarterly rebalancing (returning the Bitcoin weight in the portfolio back to its original), helping limit the impact of Bitcoin volatility. We see similar results from monthly rebalancing, suggesting regular rebalancing has been an effective approach to moderate overall portfolio volatility", the CoinShare report said.

In its conclusion, the report said that Bitcoin's investment characteristics "have historically made it attractive both as a driver of returns and a portfolio diversifier".

"Compared to other common alternatives and diversifiers, Bitcoin delivers outsized positive impacts on returns, Sharpe ratio and diversification, even at very low allocation sizes. Given these benefits, Bitcoin may well be suited to fill the current gap in available diversifiers troubling investors and portfolio allocators, as well as help reduce the exposure to economic cycles", it added.

Bitcoin was up 1.7% at US$10,849 in late-afternoon trading in London on Tuesday.

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