PGIM
India Mutual Fund

To Crypto or not to Crypto

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Dear Investors and Distribution Partners,

Hope you and your family members are safe and doing well. India continues to go through the challenge of dealing with the second wave, though things are beginning to look better. Hopefully, as the second wave of COVID recedes and the vaccination numbers improve, life will be back to normal albeit in phases.

In my previous communication, I had written about portfolio "co-morbidities". The idea was to highlight that diversification is the key to have a successful financial journey. The essence of diversification is creating a portfolio of uncorrelated assets. If we look at the uncorrelated or low correlation asset classes available to the Indian investors, they would broadly fall into seven categories viz: Equity, Debt, Gold & Precious metals, Commodities, Real Estate, Currency & Alternative Investments. Alternate Investments are a legitimate asset class. Like all other asset classes, alternate investments are not a monolithic bloc but have diverse options like Private Equity, Venture Capital, Hedge Funds, Art, Antiques, Wine, and the new kid on the bloc -Crypto Currencies, to name a few.

Whenever there is debate around alternate Investments, I see people having very strong opinions. Proponents believe alternates are the future. Those who do not believe say all the alternates are in fashion due to easy money made available by global central banks. I believe that the reality is somewhat in between. Alternate investments are a legitimate asset class and have proved to be uncorrelated even during the crisis of 2008 while valuations could be a function of easy money. Does it mean that every individual should take exposure to an alternate asset class they can get access to? No.

Alternative Investments are a very high-risk reward category. Not only do they require deep expertise they also need a mental frame to accept that the entire investment could technically go to zero. We keep hearing about investors who made a fortune by investing in "Google" but can we ignore the investment outcome for those who invested in search engines like Aliweb, Excite that preceded Google but are nowhere on the scene. Seasoned investors make multiple investments in the given space with a clear understanding that if lucky, one out of them would be the multi-bagger, while most would be reduced to zero value as the mortality rate is very high. Cryptocurrencies are in the same class. We are witnessing some large institutions taking exposure to them. I don't want to opine on the merits or demerits of Crypto, but I would like to put the issue in context of asset allocation.

Within the seven asset classes mentioned above, alternate investments typically need high ticket sizes. Though these days everything can be made available in a unitized form including crypto. That explains why it's all a rage among the public. If the investor wants to invest and diversify within the alternate space the portfolio has to be reasonably large. Assuming that the portfolio is large enough and can achieve diversification, how much should be the allocation to Alternate Investments? From a behavioral perspective the allocation should be such that even if the investment value reduces to zero, the investor should not lose a peaceful night's sleep. The technical answer would be maybe around 5%. Long-term investments of NPS have a cap of 5% to AIF exposure for instance.

Bottom line is that if you count yourself as an investor (and not a speculator), you can look at alternate investments for a risk appropriate portion of your portfolio. That can mean Crypto or if you have a good eye, investing in an upcoming artist. Who knows, may be the new craze of "Non Fungible Tokens" for an original work could be that multi bagger down the line.

Stay invested stay safe.