THE BUSINESS TIMES

BT businesstimes.com.sg

Wednesday, September 21, 2022

INSIGHTS FROM CFA SOCIETY SINGAPORE

Digital gold or fool's gold: Crypto as a hedge for equity risk

Despite crypto enthusiasts' claims, correlation data casts doubt on Bitcoin's ability to serve as a safe haven

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CRYPTO enthusiasts often claim that digital coins and tokens are uncorrelated with equities and can provide a safe haven amid stock market crashes.

The assumption is that crypto assets will act like so-called digital gold, serving as a hedge against equity risk, and help investors ride out such downturns.

Such bold claims beg for examination, especially amid what looks like a bear market for stocks.

So, we explored how crypto has performed during previous crashes. In particular, we isolated the major panic events over crypto's short history and studied the correlation between this new asset class and some of its more traditional peers.

In 5 times over the last 5 years, the S&P 500 fell 7.5 per cent or more.

In each of these instances, we measured how correlations changed between gold and the S&P 500, Bitcoin and the S&P 500, and Bitcoin and gold.

We examined the correlations between other cryptocurrencies and gold and the S&P 500 as well, but found the results were qualitatively similar.

So we used Bitcoin as a proxy for crypto in general.

Clear takeaway

The correlation between gold and the S&P 500 came in as expected.

Outside of major downturns, gold and the S&P 500 have just a slight positive correlation of 0.060.

Yet, when the S&P 500 plunges, so does its average correlation with gold, which drops to -0.134.

The takeaway is clear. Gold does offer some protection in down markets and lives up to its status as a perennial hedge.

The same cannot be said for Bitcoin – or crypto in general.

Outside of equity market downturns, Bitcoin and the S&P 500 have had a slight positive correlation of 0.129. Amid the last 5 stock market contractions, however, the correlation between Bitcoin and the S&P 500 jumped to 0.258.

Indeed, in only 2 of the past 5 downturns did the correlation turn negative. On the other hand, true to its reputation, gold exhibited a negative correlation with the benchmark index in 4 out of the last 5 crashes.

But what about Bitcoin and gold? How has that relationship changed during recent panics and downturns?

In rising equity markets, Bitcoin and gold have a slight positive correlation of 0.057. Amid stock market crashes, the correlation rises only slightly to 0.064.

Close to zero correlation

So, whatever the state of the equity markets, the correlation between gold and Bitcoin is pretty close to zero.

Based on our data, crypto certainly does not act like digital gold. In times of panic, the correlation between crypto and the stock market actually increases.

Whatever its proponents may say about its utility as a hedge against market downturns, crypto has served as more of an anti-hedge, with its correlation with the S&P 500 rising as stocks plunge.

That said, given the lack of correlation between gold and crypto, the latter may add some diversification benefits to a portfolio.

Nevertheless, the overall verdict is undeniable: When it comes to hedging equity risk, Bitcoin and cryptocurrencies are more fool's gold than digital gold.

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Crash correlations

Gold and S&P 500

		CORRELATION
First crash:	Jan 26 to Feb 7, 2018	–0.073
Second crash:	Sep 21 to Dec 28, 2018	–0.077
Third crash:	May 6 to Jun 6, 2019	–0.407
Fourth crash:	Feb 20 to Mar 28, 2020	0.241
Fifth crash:	Jan 1 to Mar 11, 2022	–0.356
Average correlation during crashes		**–0.134**
Average correlation outside of crashes		**–0.060**

Bitcoin and S&P 500

		CORRELATION
First crash:	Jan 26 to Feb 7, 2018	0.814
Second crash:	Sep 21 to Dec 28, 2018	–0.025
Third crash:	May 6 to Jun 6, 2019	–0.583
Fourth crash:	Feb 20 to Mar 28, 2020	0.588
Fifth crash:	Jan 1 to Mar 11, 2022	0.493
Average correlation during crashes		**0.258**
Average correlation outside of crashes		**0.129**

Bitcoin and gold

		CORRELATION
First crash:	Jan 26 to Feb 7, 2018	–0.194
Second crash:	Sep 21 to Dec 28, 2018	0.107
Third crash:	May 6 to Jun 6, 2019	0.277
Fourth crash:	Feb 20 to Mar 28, 2020	0.275
Fifth crash:	Jan 1 to Mar 11, 2022	–0.179
Average correlation during crashes		**0.057**
Average correlation outside of crashes		**0.064**

Source: CFA Society Singapore