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# Bitcoin valuation: Four methods

There are a number of sensible frameworks through which to view this evolution in money and finance

BEFORE diving into the Bitcoin valuation task, we must first acknowledge that this is no ordinary undertaking.

Unlike traditional assets such as stocks and bonds, Bitcoin lacks the typical characteristics required for traditional valuation methods. It doesn't generate cash flows, pay dividends, or otherwise offer yields, and thus may be more reminiscent of commodities, which are both cyclical in nature and notoriously difficult to value.

Nevertheless, there are a number of sensible frameworks through which to view this evolution in money and finance.

So, in response to the question posed by Franklin J Parker – "On behalf of the professional investment community, I am respectfully asking any crypto expert to put together some cogent, coherent concept of how to make 'buy and sell' decisions in a cryptocurrency portfolio" – here are four Bitcoin valuation methods that highlight different ways of exploring the cryptocurrency's worth and offer insights into this nascent yet powerful technology.

## 1. Compare it with the alternatives

One way to gauge Bitcoin's value is to determine what asset classes or securities it competes with and compare their potential value.

So, to extend our commodity metaphor, where does Bitcoin – so-called digital gold – stand relative to actual gold? Both are fixed-supply, counterparty-free assets, with rare and desirable monetary characteristics, and used by investors as long-term safe havens for capital preservation. Today, gold has a market capitalisation of roughly US\$11.5 trillion. If Bitcoin reached a similar market capitalisation, then the price per coin would exceed US\$500,000.

Of course, Bitcoin has something of a technological edge over gold. It is digital, decentralised, and free from government influence. So, if its market capitalisation reaches US\$11.5 trillion, why would it stop there? And is gold its only competition? Couldn't Bitcoin stand in for other financial collateral and store-of-value assets, such as global bonds or even residential property?

To be sure, definitive answers to these questions are elusive, but trying to find them can enhance our understanding of Bitcoin, Bitcoin valuation, and the crypto phenomenon more generally.



Unlike stocks and bonds, Bitcoin lacks the typical characteristics required for traditional valuation methods. It doesn't generate cash flows, pay dividends, or otherwise offer yields. PHOTO: BLOOMBERG

## 2. Base it on production costs

We hear all the time about the electricity and equipment required to mine Bitcoin. These associated expenses provide another means of determining the cryptocurrency's value. While estimates of these costs are highly variable and inevitably inaccurate, Cambridge University researchers have compiled some of the most reliable data.

Of course, Bitcoin is a store-of-value asset and an alternative monetary technology. But few users are pricing Bitcoin based on the latter quality. That's why Bitcoin production costs serve a purpose similar to those of gold: They set a floor on the price, which can help determine whether the underlying is undervalued.

Historically, Bitcoin's price has tended to bottom out at around its production cost, as in the second half of 2016, the first half of 2019, March 2020, and the second half of 2022.

By helping determine whether Bitcoin is undervalued, production costs are a critical input to its valuation. But since they can hardly quantify the upside price potential associated with Bitcoin's monetary premium, they are also a limited input.

## 3. Look at the US dollar

So, how do we value Bitcoin's monetary premium? As an alternative monetary technology, Bitcoin has to be assessed in the context of the prevailing monetary system: the US dollar. Real interest rates, money supply growth, and fiscal policy, among other factors, all influence Bitcoin's valuation.

Elevated real interest rates and constrained money supply growth are indicators of sound monetary and fiscal policy. They help gauge whether the authorities are protecting the value of the dollar. Such factors should constitute headwinds for Bitcoin prices. If policymakers are looking after the existing monetary regime, investors are less likely to look for an alternative.

Of course, monetary policymakers often adopt profligate measures that debase the value of the dollar. The quantitative easing (QE) and other monetary stimulus of the last 15 years created low and negative real interest rates, as well as rapid growth in the money supply. These were ideal conditions for Bitcoin and fuelled the