Making Sense *of* Investing

BY JESSICA PERRONE

Jessica Perrone, Founder of HerFinIQ.com, is a Summit mom and experienced investor who's on a mission to empower women and teen girls through Financial and Investing Education. Each month, she will answer questions she commonly receives on how to invest.

Question:

Dear Jessica, My teen wants to invest in cryptocurrencies - what are your thoughts?
— Jennifer, Chatham

Thanks for writing in, Jennifer; it seems like where ever I go, people are asking me about Cryptos! In fact, just this week, even my plumber asked for my thoughts on Bitcoin!

Let's start with "What is cryptocurrency?" According to Coinbase.com, a popular cryptocurrency exchange platform, Cryptocurrency is "typically decentralized digital money designed to be used over the internet. Bitcoin, which launched in 2008, was the first Cryptocurrency, and it remains by far the biggest, most influential, and best-known. In the decade since, Bitcoin and other cryptocurrencies like Ethereum have grown as digital alternatives to money issued by governments."

Cryptocurrencies are not without risk, so when considering investing in Cryptos, a meaningful conversation for you and your teen to discuss is "Risk Tolerance." So let us break it down. What is Risk? Risk is defined as the possibility of something "bad" happening. To introduce the concept of risk to my teen investing class, I pose the question, "What is riskier, Walking in Park or Sky Diving?" Of course, there is always a "Smart Aleck" in the group that says "Walking in the park" because of the probability of stray baseballs hitting pedestrians... But for all purposes here, Sky Diving would be the riskier activity. Now let's apply this concept to investing. The Financial risk associated with loss of money is referred to as Downside Risk.

There is typically minimal downside risk if you have money parked in a traditional or high yield savings account earning interest. This is because the money you put in is the money you in the future can take out plus (hopefully some meager) interest. But, when it comes to Crypto, the assets are much riskier and, therefore, have the potential for more Downside Risk. Let's investigate this further.

Bitcoin is the largest Crypto by market cap, followed by, Ethereum, Tether, Binance Coin, and USD Coin. As recently as November 2021, Bitcoin reached all-time highs, trading at just over $67,000. If you happened to purchase Bitcoin back in July 2021, when the price was around $38,000 and then, in turn, sold your Bitcoin holdings in November, you were feeling pretty good about your 43% return on your investment! However, if you bought your Bitcoin in Nov. for $67,000 and happened to look at the value the last week of Feb 2022 and saw the value below $38,000, losing almost half your investment, you may have been pretty upset and stressed out!

These substantial price fluctuations are why Cryptocurrencies are considered to be on the high side of the risk spectrum. The vast price moves can quickly make or break a crypto investor or trader.

With that said, before investing in any Crypto instrument, I recommend doing a quick internal risk assessment and ask yourself...

1. If my crypto investment lost half its value, how stressed would I feel?
In my "Investing for Beginners" classes, to help women gauge their risk tolerance, we start with the simple question, "How would you feel if your investment account went down by -10%", then move on to -20%...-30%...-40% and ultimately -50%. Women with a low-risk tolerance can feel anxiety about losing as little as -10%. In contrast, women with a high-risk tolerance could emotionally handle a -50% drawdown (or loss) to their hypothetical investment accounts.

2. How soon do I need access to my invested funds?
Another component of an individual's risk tolerance is Time Horizon, or how soon you will need access to the amounts of money you have invested in an asset or investment account. People with a long-term Time Horizon have a higher risk tolerance, whereas individuals with a shorter Time Horizon have lower risk tolerance. For example, if your attitude towards the money you are investing in Crypto is similar to a fun Vegas wager where you say to yourself, "If this asset loses value, it is not the end of the world. I do not need access to these funds any time soon. I can wait for the asset to rebound" This would indicate a "Longer Time Horizon". Simply put, when an investment is in a down cycle, investors with a more extended Time Horizon can wait a longer time period for that asset to regain its value. And in turn, you have a higher risk tolerance.

The other side of the spectrum is a short Time Horizon or a need to access invested money in the near future. With a short Time Horizon, if the assets are in a downcycle, and the investor needs to withdraw funds immediately, they would have to sell the asset at a loss. For example, you are saying to yourself, "I will need access to these funds to pay my bills next month," and "I really can't afford to lose any money."

It can be fun and exciting to invest in Cryptocurrency. But there is also a level of risk involved. As with all investments, it is essential to do your research, but identifying risk tolerance is a big part of finding your investing comfort level. I hope I gave you a good starting point and if you have further interest in the subject, please check out my "Making Sense of Crypto" Workshop.

May The Markets Be In Your Favor,
Jessica Perrone

If you have any investing or money questions you'd like answered, please email me at hello@herfiniq.com