FOREX TRADING

HOW SHOULD I TRADE CRYPTOCURRENCIES?

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Founded in 2010, we now have global presence in over 90 countries, with main offices in the separately regulated markets of Australia, Cyprus, New Zealand and the United Kingdom.

We believe that sound investment and trading decisions begin with a strong grounding in financial education. Our goal is to make this available to everyone - and this free eBook is part of that commitment.

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SHOULD I BELIEVE THE HYPE?

FOREWORD

It's fair to say the cryptocurrencies phenomenon shows no signs slowing. It's a trend that has caught the imagination of investors and first time retail traders.

For instance, at the time of writing, we've seen Bitcoin breakthrough $17,0000 threshold. That's a staggering price considering one Bitcoin was worth approximately $1,000 at the start of 2017.

However, f you're thinking of investing in cryptocurrencies, you might be wondering whether you should buy the 'physical' cryptocurrency, or trade cryptocurrency CFDs. This eBook will help you make an informed decision.

Patrick Latchford
CEO, Blackwell Global Investments (UK) Limited

EXPLORING THE BASICS

WHAT ARE CRYPTOCURRENCIES?

The cryptocurrency movement started with an entity known as Bitcoin. Many describe this as a 'digital currency' that is free from a single authority, whether that be a central bank, government or private company.

Other cryptocurrencies have followed suit. These digital currencies are often described as 'decentralised'. This simply means that no organisation owns the cryptocurrency.

For example, Bitcoin was created as a 'peer-to-peer' digital currency. Specifically, Bitcoin transactions aren't stored on one central server owned by an organisation. Rather, Bitcoin transactions are shared between all Bitcoin users on a public ledger.

The transaction mechanics of cryptocurrencies also rely on peer-to-peer coordination. The 'buyer' and 'seller' simply create a digital file, which contains their respective wallet keys, along with the transaction amount.

Cryptocurrencies use cryptography (hence the 'crypto' prefix) to keep transactions safe and secure. Once a transaction file is created, they are typically verified by people known as miners. Miners are essentially community curators - they use computer software to verify transactions before sharing them to a public ledger.

Like traditional currencies, cryptocurrencies exist to facilitate the purchase of goods and services.

In recent times, cryptocurrencies have become popular with investors too. The reason for this is that cryptocurrencies like Bitcoin have 'caps'. In the case of Bitcoin, there are approximately 17 million (of a maximum 21 million) in circulation. If we follow the laws of supply and demand, we know the value of Bitcoin will increase as its supply falls.

POPULAR DIGITAL CURRENCIES

THE TOP FIVE CRYPTOCURRENCIES

In addition to Bitcoin, there are many other cryptocurrencies that exist. Each cryptocurrency has distinguished points of difference relating to decentralisation and mining.

Below is a summary of the world's most popular cryptocurrencies:

Bitcoin: This cryptocurrency currently accounts for nearly half of the entire digital currency market. A major factor driving the popularity of Bitcoin is the limited availability of these coins, since its creator limited it to a maximum of 21 million units. This means the Bitcoin's value is likely to continue rising as long as more people buy it. It's this dynamic that will encourage people to hold it for the long term, as opposed to spending it to purchase products.

Ethereum: The second most valuable cryptocurrency after Bitcoin, Ethereum is a programmable blockchain that allows developers to build all sorts of distributed apps and technologies. This platform, first envisaged by a 19-year-old Bitcoin programmer, enabled many companies to raise hundreds of millions of dollars in funding for their Ethereum-based projects. Although the currency has faced some scaling issues, developers of this platform are working to resolve this. The currency is likely to adopt a new and more efficient 'Proof of Stake' transaction verification system.

Ripple: Released in 2012, Ripple is different from other digital currencies, since it does not use a public ledger (blockchain) to establish consensus for transactions. Instead, it uses an iterative consensus process that is faster than the Bitcoin network. Since Ripple's structure doesn't require mining, it reduces the usage of computing power and minimises network latency. But as discovered by another rival network, this can expose the entire network to attacks, making it unsafe. Ripple, however, has found favour with various financial institutions, including Japan's large banks, to test a public ledger (blockchain) and possibly implement it in the future.

Bitcoin Cash: This recently introduced cryptocurrency has become highly popular largely because of support from the Bitcoin mining giant ASICs. A new and revised version of Bitcoin, Bitcoin Cash aims to do away with the SegWit feature of the original Bitcoin, which makes for cheaper transactions.

New Economy Movement (NEM): This cryptocurrency is different from others, since it works on 'Proof of Importance', rather than 'Proof of Work' or 'Proof of Stake' features to verify a transaction. The 'Proof of Importance' algorithm tracks a user's transactions to determine how important that user is to the overall NEM economy.

HOW TO TRADE DIGITAL CURRENCIES

TRADING CRYPTOCURRENCIES

So how can you 'trade' cryptocurrencies? Well, you essentially have two options:

First, you can actually buy the physical cryptocurrency itself. This is essentially an investment, where you buy an asset in the hope that its value appreciates over time.

Secondly, you can trade a cryptocurrency CFD. This gives you the ability to speculate on the future price of the cryptocurrency without actually 'owning' it.

We'll explore both of these options in detail using the world's most popular cryptocurrency - Bitcoin - as an example.

WHY BUY BITCOIN?

Clearly, Bitcoin has attracted the attention of investors and traders, beginners and experts, believers and sceptics.

No other asset in history has recorded such jaw-dropping growth, with Bitcoin prices skyrocketing from around $400 in January 2016 to above $4,000 by August 2017, only to cross $17,000 in December 2017.

Moreover, Bitcoin is among the most volatile assets, offering attractive opportunities to enter and exit the market within a matter of hours. Other cryptocurrencies could follow suit too.

Needless to say, if you time your 'buy' correctly, you could stand to make a significant profit. However, you first need to decide whether to buy physical Bitcoins or trade in Bitcoin CFDs.

HOW TO BUY PHYSICAL BITCOIN

If you'd like to purchase and store physical Bitcoins, the first step is to create a wallet.

This is pretty much like opening a bank account for fiat currency. You can use the wallet to receive Bitcoins, store them and transfer them to others. You can either have a wallet installed on your own computer or mobile device, or have it hosted with a third party.

You will also need a Bitcoin address to identify the wallet and a private key to make transactions. The cryptocurrency can be purchased from an online exchange for a small fee structure. Other cryptocurrencies work in a similar fashion. However, there is a risk when buying physical Bitcoin. Namely, you are essentially backing the cryptocurrency to appreciate in value - and are tied to its extreme price fluctuations.

CONSIDER CONTRACTS FOR DIFFERENCE

If you are risk-averse, trading CFDs (Contracts for Difference) is a viable option when it comes to cryptocurrencies like Bitcoin.

CFDs essentially give you the power to speculate on the future price direction of an asset. In the case of Bitcoin, this is very useful, as you could place trades that profit from both price rallies (buy) and falls (sell).

Another advantage of choosing to trade CFDs is leverage. You can hold larger positions than you would if you were to buy the cryptocurrency itself. This means that there is the potential for higher profits too. However, the risk is that the losses would also be higher if your predictions fail to play out. So, just like any other form of speculative trading, success lies in being able to accurately predict price trends.

Trading CFDs is also faster. When trading Bitcoin CFDs, you don't need to wait for an order to be filled or for the currency to even be transferred to your account. You are trading a contract, which can be executed immediately.

WHICH OPTION IS BETTER?

There is no single correct answer to this. If used appropriately, both methods could bring you remarkable results. This is particularly true of the cryptocurrency market, where the potential for growth is impressive, while volatility is high.

What you need to remember is that each option is suitable for different types of market cycles and, therefore, should be chosen accordingly.


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