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Cryptocurrencies: Myth vs. Reality

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Cryptocurrencies: Myth vs. Reality

Valuing the market of cryptocurrencies has raised both excitement and fear in popular discussion, with concerns about its legitimacy heatedly debated across the financial world. The cryptocurrency market has grown to 2,042 separate currencies, and despite rampant speculation about the future, current research provides little insight to a market approaching \$217 billion in market capitalization. The purpose of this research is to examine how the 67 largest cryptocurrencies by market capitalization respond to events, determine if cryptocurrencies behave individually or as a collective asset class, and what factors influence cryptocurrency valuation.

On January 16, 2018, the price of Bitcoin fell by 17%, erasing \$40 billion in market value after China's ban of popular cryptocurrency exchanges. The market response of cryptocurrencies to shocks can illuminate important characteristics about its value: is it primarily speculative or a rational valuation of blockchain technology? By examining the response of various cryptocurrencies to shocks, we also eliminate some of the mystery surrounding what roles cryptocurrency may play as a currency, technology, or an entirely new entity. Just as past evidence shows that formerly snubbed financial technical analysis has predictive ability because so many people are convinced it does (Lo, et al. (2000)), cryptocurrency may be a viable investment if enough people believe it will be.

This research further delineates whether cryptocurrencies move as a homogenous asset class, uncorrelated individual assets, or some combination. By looking at the majority of the market, we are also interested if smaller cryptocurrencies move independently of larger ones. The existence of a threshold where behavior normalizes in response to news and economic events indicates a credible market with considerable liquidity.

As the cryptocurrency market develops, results from this research aims to explain the mysterious, speculative environment surrounding the technology, and illustrate the true financial motivations and possibilities of a frequently misunderstood industry.

References:

Lo, A. W., Mamaysky, H., & Wang, J. (2000). Foundations of technical analysis: Computational algorithms, statistical inference, and empirical implementation. *The journal of finance*, 55(4), 1705-1765.

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