4 Things to Know Before Investing in Cryptocurrency

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Have you ever traveled to a different country? One of the first things you probably did was visit a bank and exchange your money for the local currency. A Benjamin can buy you a nice dinner in the States, but if you want to enjoy fine dining in Italy, you'll need some euros!

Investing in cryptocurrency is similar to exchanging your money in a new country. Bitcoin, Litecoin, and Ether are a few examples of "foreign currencies" that work in a very specific context within certain online communities.

Exchanging any type of currency is built upon *shared trust*. We value dollars and Euros because we know that we can purchase goods or services with them.

The question is, *can you trust cryptocurrencies*? And should you jump into the world of crypto investing?

WHAT IS CRYPTOCURRENCY?

Cryptocurrencies are digital assets people use as investments and for purchases online. You exchange real currency, like dollars, to purchase "coins" or "tokens" of a given cryptocurrency. There are many kinds of cryptocurrencies. Bitcoin is the most famous, but Ether, Bitcoin Cash, Litecoin, and Ripple are a few others. All sorts of big tech and finance companies want a slice of crypto pie. Even Facebook has created a cryptocurrency called Libra.

The word *cryptography* means the art of writing or solving codes. (Sounds like the setup of an *Indiana Jones* movie, doesn't it?) Each "coin" is a unique line of code. Cryptocurrencies cannot be duplicated, which makes them easy to track and identify as they're traded.

You've probably heard of people making (or losing!) hundreds of thousands of dollars by investing in cryptocurrencies. It feels like a modern-day gold rush. But cryptocurrencies have actually been around for about 10 years. The earliest cryptocurrency was Bitcoin, created in 2009 by an unknown person who goes by the name Satoshi Nakamoto.

HOW DOES CRYPTOCURRENCY WORK?

Cryptocurrencies are exchanged from person to person on the web without a middleman, like a bank or government. It's like the wild, wild west of the digital world. There's no marshal to uphold the law.

Here's what we mean: Have you ever hired a kid in your neighborhood to mow your lawn or watch your dog while you were out of town? Chances are, you paid them in cash. You didn't need to go to the bank to make a formal transaction. That's what it's like to exchange cryptocurrencies. They are **decentralized**: No government or bank controls how they're produced, what their value is, or how they're exchanged.

As a result, cryptocurrencies are worth whatever people are willing to pay or exchange for them.

Now hang with us. We're about to get techy! You store your cryptocurrency in a digital wallet—usually in an app or through the vendor where you purchase your coins. Your wallet gives you a private key—a unique code that you enter in order to digitally "sign off" on purchases. It's mathematical proof that the exchange was legit.

Cryptocurrencies operate on what is called blockchain technology. A blockchain is like a really long receipt that keeps growing with each exchange. It's a public record of all of the transactions that have ever happened in a given cryptocurrency.

What can you buy with cryptocurrency?

At this point, most people still see cryptocurrencies as an investment. But cryptocurrency spending could become popular as these currencies gain trust. There are online retailers, such as overstock.com, who accept cryptocurrencies. And of course, any two individuals who value the tokens can exchange them for goods or services.

Some major retailers, such as Whole Foods and Nordstrom, are experimenting with accepting Bitcoin as a valid source of payment.[1] But for the most part, cryptocurrencies are still on the fringe.

4 THINGS TO KNOW BEFORE INVESTING IN CRYPTOCURRENCY

Before you say good-bye to your dollars and hello to Bitcoin or Ether, there are a few things you need to know.

1. Cryptocurrencies are volatile. The value of cryptocurrencies goes through extreme ups and downs. In 2017, the value of Bitcoin swung between $900 and $20,000![2] Someone sneezes and the price drops! Investing in cryptocurrency is risky, to say the least. Of course, all investing carries a degree of risk. But you should always avoid *unnecessary* risks, especially when it comes to your hard-earned money. Don't play poker with your financial future.

2. There are lots of unknowns. There's still a lot that needs to be ironed out with how cryptocurrencies work. Think about it: Nobody even knows who the founder of Bitcoin is! Relatively speaking, only a small percentage of people in the world understand the system and know how to operate it. Ignorance makes you vulnerable. We always advise people that if you can't explain your investments to a 10-year-old, you have no business investing in them to begin with. You're setting yourself up to do something stupid.

3. Cryptocurrencies can be used for fraudulent activity. People who want to remain anonymous and avoid regulation from banks or the government will use cryptocurrencies to make shady deals on the black market. Money laundering is also a problem in the crypto world. Now hear us on this: We're not saying that everyone who uses cryptocurrency is a bad person. But we *are* saying that if someone wants to commit criminal activity and avoid being tracked, the crypto world is an ideal place for them.

4. Cryptocurrencies have an unproven rate of return. Trading in cryptocurrency is like gambling. Because it's exchanged peer to peer without any tie to regulatory standards, there's no pattern to the rise and fall of its value. You can't predict changes or calculate returns like you can with growth stock mutual funds. There just isn't enough data, or enough credibility, to create a long-term investing plan based in cryptocurrency.

SHOULD I INVEST IN CRYPTOCURRENCY?

Here's the deal: If you're out of debt, have an emergency fund that will cover three to six months of expenses, and you're already investing 15% of your income in growth stock mutual funds—which are hundreds of times more secure than crypto—then you may make the choice to play around with cryptocurrencies.

But we want to warn you: When you invest in crypto, be prepared to say good-bye-o to your money. It's not a good way to build wealth. There are thousands of millionaires who agree with us.

Don't give in to stupid just because there's a lot of hype. We've talked to people who have *taken out a mortgage* or *cashed out their entire 401(k) early* to invest in cryptocurrency! No, no, no! Don't put it all on the line and risk your financial future, your retirement dreams, and your family's well-being.

At some point in the future, cryptocurrencies might become legitimate and widely used. But for now, be safe and be smart.

INVEST WITH CONFIDENCE

Get-rich-quick schemes seem too good to be true because they are. The reality is, the road to building wealth is slow and steady. Millionaires don't build wealth through risky investments like cryptocurrencies. In fact, in The National Study of Millionaires, we found that the number one wealth-building tool of millionaires is their workplace retirement plan, like a 401(k). If you're looking for a proven plan to build wealth (and more advice on crypto), we encourage you to check out our SmartVestor program. These pros have been vetted by our staff at Ramsey Solutions and want to guide you through the process of investing.