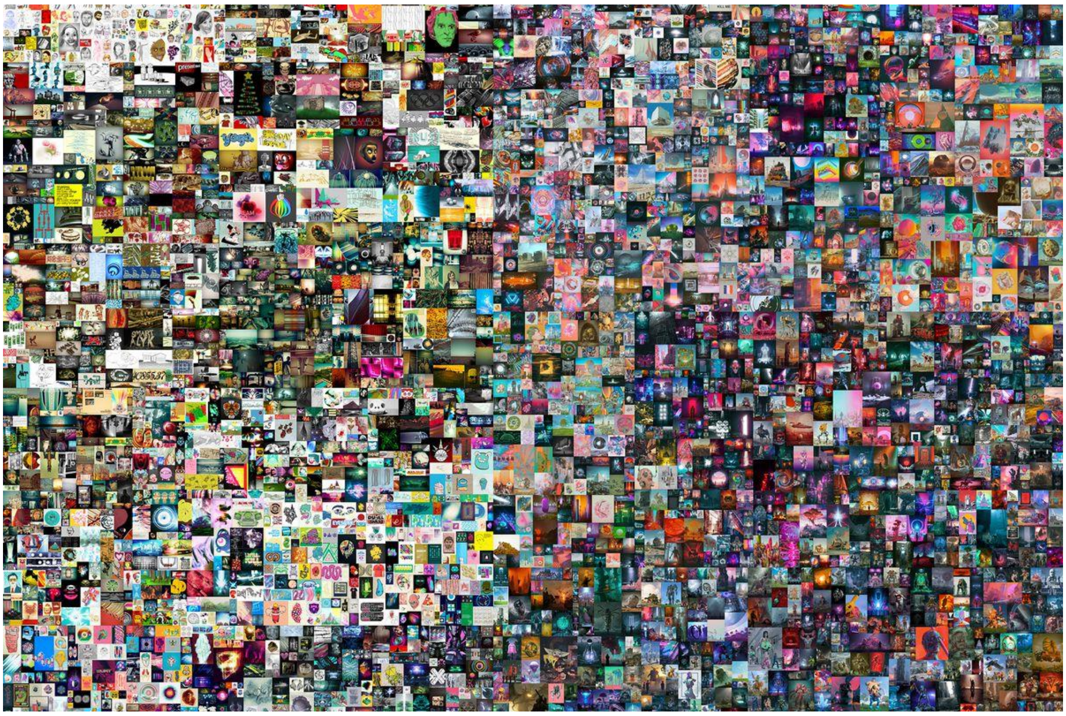
Are NFTs an investment worth considering?

-Satvik Agarwal / 28th March, 2021



A promising digital artist Beeple's "Everydays- The First 5000 Days" (NFT sold for $69 Million)

(Image Credits: Beeple and Christie's.)

Unless you live under a rock, you must have heard about NFTs or non-fungible tokens, a buzzword that has been thrown around a lot for the past month. The total market capitalisation of crypto art, a part of the total assets traded through NFTs, crossed $100 Million in January, which would have increased multi-fold since then, considering Beeple's "Everydays" alone was sold for $69 Million recently.

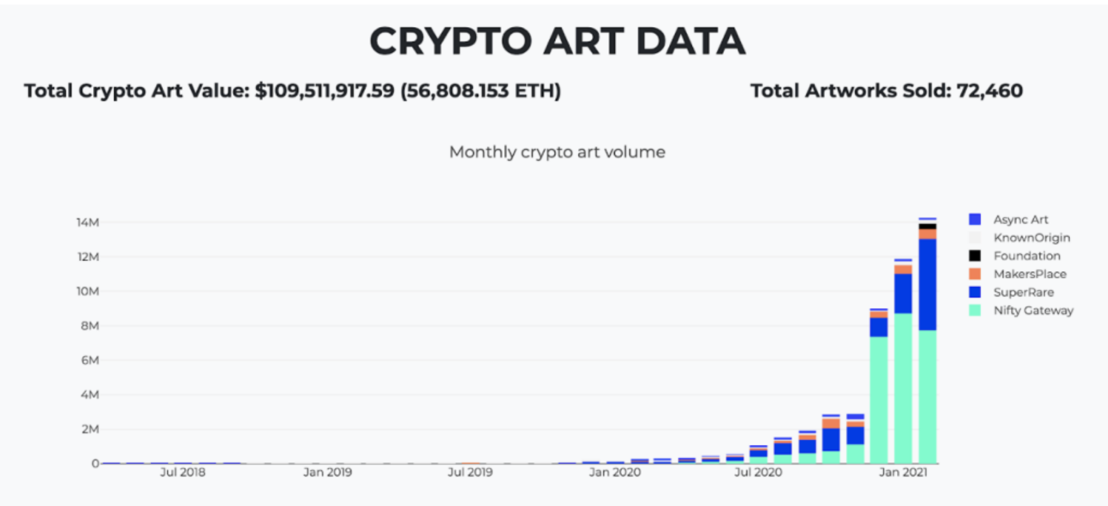
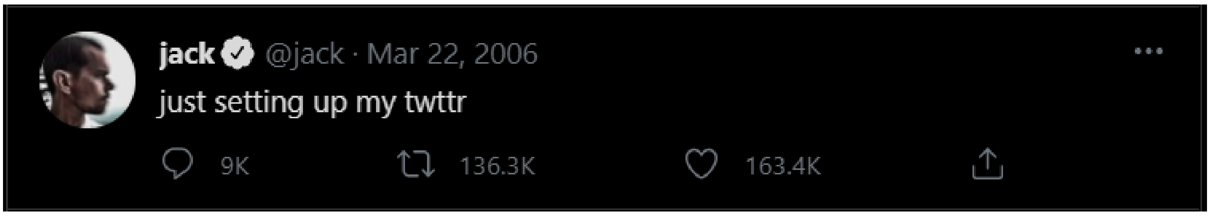


Image Credits: https://cryptoart.io/data

Although critics are calling it a “worthless magic bean” (BBC, 2021) and that they “made no sense” (Editors of BBC, 2021), let’s look at some reasons why NFTs might be worth the hype.

By the very definition, fungible means something that can be exchanged in the same denomination, like money. Thus, anything non-fungible is one of a kind, like paintings, unique memorabilia, etc. This definition has now extended into the digital space, where anything, from a tweet to digital art, can be transformed into “non-fungible tokens” or digital assets. People can now buy certificates of ownership of anything digital, and all of it stored on secure digital ledgers called blockchain, which are also used to store cryptocurrencies, sensitive information, etc.

Recently Jack Dorsey, CEO of Twitter sold the first tweet he ever made on Twitter for $2.9 Million. (BBC, 2021) Critics ask how is this value justified?



(Credits: Jack Dorsey’s Twitter account)

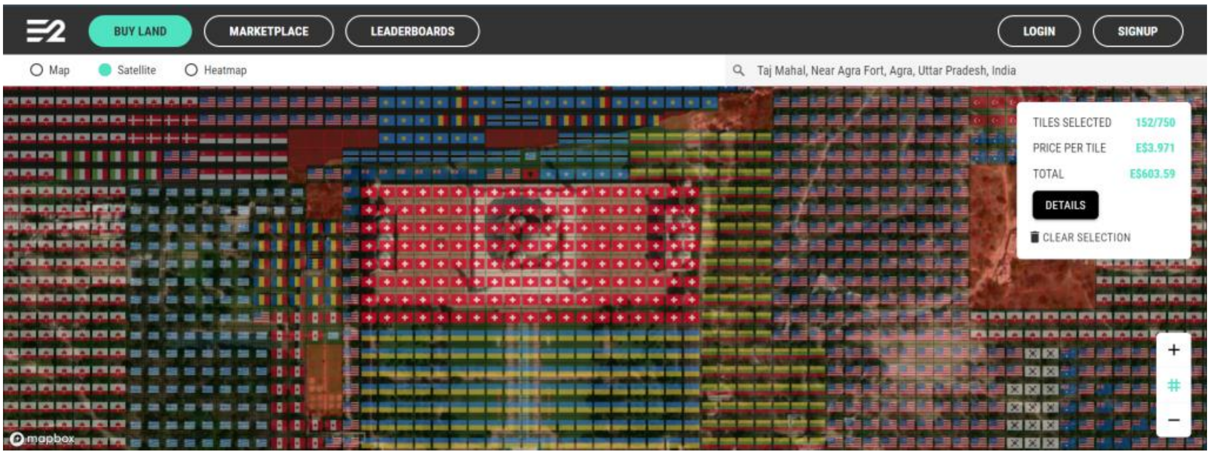
Considering that the tweet is unique, and can’t be replicated as it was tweeted by Jack in 2006, it definitely qualifies for the definition of “non-fungible”. Coming to its valuation, anything can hold value in the eyes of the beholder, after all art is subjective. And generally, value comes from the name of the creator, not just the art. Along with that, its “limited supply” makes it an asset. The Mona Lisa was valued at $100 Million all the way back in 1962. (Findley, Lewis. 2019) Considering it’s just a painting on an old canvas, placed in an elaborate frame, at face value it is not worth more than a few hundred dollars, but due to its non-fungible nature it has such a high valuation.

Similarly, artists have been selling their digital art and music tracks which can be reproduced for the general public by the artist themselves, or through pirated mediums. Since they are available in unlimited supply, they should not hold value, right? The component that provides value to the investor is not the NFT art itself, it is the certificate of ownership. Coming back to the Mona Lisa example, it is reproduced heavily through digital print, painting, etc. But the only one-of-a-kind version that holds value is the one painted by Leonardo Da Vinci. It is considered priceless by the French government, and according to wrongful claims of some French citizens, has the potential to pull France out of debt!

Therefore, NFTs would qualify as unproductive assets, which neither have fundamental value nor provide regular cash flows, much like popular investments like sneakers, baseball cards, Pokémon cards, paintings, and autographs. NFTs hold potential, as they are opening up the entire digital ecosystem which includes anything on the internet, to be commoditized and invested in. Like any other unproductive assets of such sort, the main concern that remains is the lack of liquidity, as you never know if someone would be ready to buy it from you at decent premiums. Thus, they might not be amazing investments with justifiable prices, but their application holds potential and might make some buyers wealthier, especially in the long run narrative.

Moving on from its definition and viability, let's look at its applications and how it can be implemented in different problem-solving ways:

Digital Real Estate: A new concept of a "virtual earth" has been introduced by a website like Earth2 in a primitive form. It essentially is a virtual 1:1 scale of the planet, and it has been putting up this virtual real estate on sale. While it may sound like a Ponzi scheme to some, it holds huge potential. With adoption of virtual/augmented reality technology, and ever-increasing marketing needs, it could be a "Club Penguin" meets "Ready Player One" platform, where brands pay huge amounts of money in promotion. This could become sources of income for the owners of those particular virtual properties. NFTs and blockchain will be the key enablers to make this technology possible and successful.



The virtual property of Taj Mahal on Earth2 already purchased by various citizens around the world, and being used for promoting their companies, social media profiles, etc
(Credits: Website of Earth.2.io)

Curbing Piracy: Controlling illegal reproductions of music, movies and books can be made much easier with the use of NFTs. With full ownership and distribution rights possessed by the owner of the NFT, in this case, the creator, they can adopt a system of checks and balances that can make reproduction more difficult, especially for art that they want to distribute only to limited people, at higher premiums (Editors of Zephyrnet, 2021), essentially adding exclusivity to their content, like the booming platform, OnlyFans. Although copycats might find some way or the other to crack the code, it will certainly be very difficult to get public content, and nearly impossible for exclusive content.

Replacing copyrights and domain name sellers: If you look at it, ownership of digital assets is not a new thing. It is implemented by copyrights and domain name ownership currently. NFTs are essentially disrupting this and giving control to the creator/owner instead of the government and domain name selling websites. Although regulations won't allow the government's role to be disrupted out of the copyright process, it will certainly ease the process for creators to exercise their ownership.

Investment for all: Art has been an unaffordable investment for all except the elite. Art as an investment is not volatile and pays off for some in the long term. NFTs can solve this inequality in investments by enabling huge ticket sizes of art-based investments into small amounts of money, like real estate investment trusts (REITs) and exchange-traded funds (ETFs). Thus, art enthusiasts and investors can end up buying a small percentage of a Mona Lisa-esque artifact or content piece in the future, due to increased accessibility. Moreover, they could help in increasing the security and transparency of general financial transactions in this sector by leveraging blockchain.

Supply chain transparency: "In 2019, popular fashion brand Louis Vuitton unveiled its plans to launch a blockchain platform that would use non-fungible tokens to authenticate the provenance of high-priced goods." (Protokol, 2020) Thus, producers and consumers will be able to see the entire journey their product takes, ensuring legitimacy to their goods, which is a huge problem for luxury goods due to the numerous copies circulating in the market. Similarly, this technology can be used to track problematic supply chains, like the diamond supply chain, to ensure that blood diamonds weren't involved.

However lucrative NFTs look like, there a wide variety of concerns surrounding their use and validity. Some of them are:

Regulation and the lack of it: Like any other technology, governments of developing and conservative countries are scared of new technology, believing that it will disturb the people's way of life by wreaking havoc through scams, privacy issues, etc. Considering investments are a highly regulated field in most countries due to their sensitive nature, it might be a bleak future ahead for NFT investors if some countries highly regulate or even ban them.

Lack of regulation on the other end might lead to ownership issues, stealing of content, etc. Even though blockchain is extremely secure, the various other applications involving NFTs might not be.

Energy usage: "Bitcoin consumes a similar amount of power to the Netherlands." (Rowlatt, Justin. 2021) Considering all the NFTs will be stored on similar blockchains and are involved with uncountable calculations happening every second, their server load is extremely high. If the adoption of this technology continues at the rate at which it is booming right now, it might lead to an energy crisis in our hands. This could essentially mean that it would have to be shut down before it ever could reach its full glory, due to its high dependence on non-renewable resources to run.

Illiquidity: Investing in an NFT is like investing in art, which is very illiquid. The investor should be excruciatingly patient, and should also be in a position to bear losses. It carries more risk than the average investment, without the certainty of a higher reward for it.

Thus, an NFT might not be the best investment for a prudent investor, but the technology holds a lot of world-changing applications to it. Moreover, with personalities like Elon Musk popularizing its use by selling the NFT of a song based on NFTs (although, backing out of the sale at the last moment), one never knows if it could go "to the moon" or come crashing down.

(Credits: Elon Musk's Twitter account)

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