

Trading, Holding, Mining: Ways to Make Money From Cryptocurrencies

By **stockhax**



"Cryptocurrencies aren't currencies. They aren't stocks, either," [David Golumbia](#) writes at Vice.

Yet they're often treated — and traded — like both, which can leave even seasoned investors wondering how to regard the new digital investment in the room.

Here, we explore the basics of cryptocurrency as a medium of exchange and as an investment. We'll look at what cryptocurrencies are and how they work, their role as currency, and the ways in which they're held and traded by those who treat them as an investment.

Cryptocurrency 101: What is a Bitcoin?

"Cryptocurrency" is the general term for currencies that exist solely in digital form and depend on computing power for their existence, growth and accounting. Or, as TechRadar's [Nick Farrell](#)

and [Jonas DeMuro](#) explain, “The idea is that you use cryptography to control the creation and transfer of money, rather than relying on central authorities.”

Cryptocurrencies “exist” only as data. But then, so do the majority of fiat currencies. Unlike fiat currencies, however, cryptocurrencies use distributed systems to create and track each unit of currency. The distributed system makes it difficult for any single actor, such as an institution or government, to manipulate the currency’s value, according to Medium’s [Ruzbeh Bacha](#).

In addition to the decentralized nature of the system, cryptocurrencies attract investors with their:

- **Security.** Every cryptocurrency user has a specific, secure digital ID — and so does every Bitcoin, Ether or other unit of cryptocurrency. When a transaction is made, these identifiers are recorded throughout the distributed system, making fraud more difficult: Everyone can see every transaction, and covering one’s tracks would mean altering every copy of the transaction on the system, not just one ledger, according to [Claudio Scardovi](#).
- **Pseudonymity.** Transactions in digital currencies are pseudonymous, meaning that each one is attached to a specialized ID, not to the trader’s actual name. While it is currently possible to connect IDs with real-life identities, certain altcoin projects are seeking to be truly anonymous, according to University of Surrey computer science professor [Alan Woodward](#).
- **Accessibility.** [Hugh Kimura](#) notes that one major limitation of fiat currency exchange platforms like PayPal (or even the pre-digital Western Union) is that they don’t / can’t allow transactions in and out of certain nation-states. One goal of many cryptocurrencies is to make these transactions possible, both opening trade and offering a way to make stable transactions in countries where the national currency is unstable.

Cryptocurrency as a Digital Medium of Exchange

If you're primarily interested in using cryptocurrency as a medium of exchange similar to the dollar, the euro or the yen, base your choice of cryptocurrency on factors such as its popularity and use in transactions.

Currently, Bitcoin is the most commonly accepted currency for buying and selling purposes, with Ether not far behind. Several companies — including Overstock, Expedia, Newegg and Dish Network — currently accept Bitcoin as payment for goods and services. Certain networks, such as [Steem](#), also offer currencies related to their particular service offerings (in Steem's case, content creation and social media participation), making them indispensable in their own domains.

Cryptocurrencies' pseudonymity, decentralized nature and treatment by most taxing authorities (the IRS, for example, treats digital currencies as property and taxes capital gains from transactions, rather than treating them as currency, according to tax attorney [Adam Bergman](#)) also raise the possibility of using cryptocurrencies as a more stable medium of

exchange than local fiat currencies in some countries, such as Venezuela. In these situations, an understanding of any applicable laws or restrictions on the transaction itself, as well as an understanding of your chosen cryptocurrency, is essential.

Cryptocurrencies as Stocks: Mining, Holding and Trading Digital Currency

Although cryptocurrencies are primarily intended to operate as mediums of exchange, in many situations they are treated more like stocks or similar holdings. Such treatment results from a number of factors, including the tax treatment of cryptocurrencies and their novelty.

As Bergman notes, proceeds from the sale of cryptocurrencies are taxed as capital gains in the United States. This makes Bitcoin and other cryptocurrencies an attractive addition to many retirement portfolios, which do not pay tax on investment transactions and which can often defer tax to the future — or even eliminate it altogether.

Another reason traders are investing in Bitcoin and similar currencies, rather than spending and accepting them as payment, is cryptocurrency's relative novelty. "Right now the world is deciding whether it wants Bitcoin to be its money," [Daniel Krawisz](#) writes at the Satoshi Nakamoto Institute. He notes that Bitcoin's value fluctuates rapidly but says such fluctuations are "exactly what [market participants] should be doing because without price signals, there could be no Bitcoin adoption."

Like any volatile investment, cryptocurrencies can be a healthy part of a healthy portfolio, if investments are made wisely. While cryptocurrencies can't be valued on exactly the same terms as stocks, reasonable predictions may be made based on several factors, including:

- **The trustworthiness of the team.** The development team, or “dev team,” behind a cryptocurrency often greatly affects early interest in the currency and its starting value — and for good reason. A strong dev team is more likely to create a sustainable, more secure system.
- **The long-term plan.** What are the currency’s goals? How does it differ from other currencies trying to achieve the same goals? What are timelines and milestones?
- **The real-world use.** A cryptocurrency with a real-world use case is more likely to be adopted as a medium of exchange, driving up demand for it. By contrast, many initial coin offerings (ICOs) look like no more than a get-rich-quick scheme dressed up in fancy marketing.
- **Your exit plan.** Finally, consider how cryptocurrency fits into your current investment portfolio. What do you want to accomplish from the investment, and what do you need your cryptocurrency investment to do in order to achieve that goal?

The investments you choose will naturally depend on your answers to these questions — and on what interests you.

Mining: Cryptocurrencies as Blood, Sweat and (Digital) Tears

Buying Bitcoin or other cryptocurrencies with fiat money like the dollar is the easiest way to join the digital currency markets. But it's not the only way.

Bitcoins and other cryptocurrencies derive their value in part through their scarcity and through the fact that the creation of new coins — known as “mining” — tightly controlled.

Bitcoin mining is performed by computer programs, which compute an encryption function (known as a “hash”) on a set of random numbers. If the computation results in a number below a certain threshold, a new Bitcoin is created, which is assigned to whichever miner succeeded at the computation.

Because of the way the system is designed, no more than 21 million Bitcoins will ever be in circulation. As of 2017, about 17 million of those coins have been mined. Each Bitcoin is also harder to unlock than the previous coin, pushing the system to invest in better hardware, faster processing of transactions and higher Bitcoin prices.

The system is also designed to make the computation more difficult to achieve the more processing power is devoted to it, which means that simply buying a hangar full of supercomputers and dedicating them all to mining Bitcoin probably isn't the quickest way to start seeing a return on your investment, as Gizmodo's [David Nield](#) notes. Mining itself may be a taxable business, as well, Bergman cautions.

Buy, Sell, Trade: How to Get Started in Cryptocurrency

Whether you're ultimately interested in using Bitcoin or other cryptocurrencies to transact business or in treating them as long-term investments, the process begins at the same place: Creating a wallet.

Like everything else in the cryptocurrency world, a "wallet" is digital: It's a packet of data that contains your unique signature IDs for transactions on the system. A number of online services allow users to create wallets; [Coinbase](#) and [Blockchain.info](#) are two of the most popular, with both web-based and mobile app versions. The latter also allows you to view ongoing transactions in the distributed blockchain ledger, which can make it a useful supplement to trading.

Once your wallet is in place, it's time to populate it with your currency, or currencies, of choice. Bitcoin and similar cryptocurrencies can typically be purchased on exchanges by using other cryptocurrencies or a fiat currency, such as US dollars. [Blockgeek](#) provides a useful step-by-step guide to navigating Coinbase to buy or sell Bitcoins.

With Bitcoins (or your chosen currency) to spend, you can either go shopping or simply monitor your investment. If you're interested in investing, keep these tips in mind:

- **Cryptocurrency exchanges are not related to the stock exchange.** Whether you're using Coinbase, [GDAX](#) or another exchange, you're not exactly on Wall Street anymore. The mechanics are similar, but the specifics and entities differ.
- **Different exchanges let you trade different currencies.** Although Coinbase is the preferred first stop for many traders due to its simplicity, it only deals in Bitcoin, Ethereum and Litecoin. To diversify further, you'll need to check out another exchange.
- **You can trade cryptocurrency stocks instead of the currency itself.** Trusts like [GBTC](#) own and sell Bitcoin shares and can serve as an additional buffer between your portfolio and the volatility of the cryptocurrency market. Before you invest, take a look at any bitcoin trusts and compare them to investing in cryptocurrencies directly.

Cryptocurrency Use and Investment: Final Thoughts

At their core, cryptocurrencies tend to behave like other investments, as Cryptogene convener [Bashir Aminu](#) notes: