

Galaxy Fund Management Newsletter

APRIL 2020 IN REVIEW

MARKET COMMENTARY

The fundamental theses for bitcoin and digital assets took center stage in April as markets recovered amid COVID-19 volatility. Bitcoin rallied to finish with a return of 36.12% while the broader asset class, measured by the Bloomberg Galaxy Crypto Index (BGCI), saw a return of 35.85%. For some this may bring back memories of April 2019, which saw bitcoin rally ~28% and the BGCI rally ~13.5% as the crypto winter began to thaw. However, it's now crucial to understand, *this time is different*. The post-COVID-19 world is a world that doesn't simply want bitcoin and digital assets—it needs them.

April began with choppy trading as bitcoin remained in a volatile range between \$6500 – \$7500 before beginning its ascent towards \$9000 in the last ten days of the month. The last time bitcoin closed in this price range was this past February. The market then was severely levered, which culminated in a violent sell-off in March as markets delevered globally. During April's rally, a foundation formed with seemingly unlevered long buyers—investors who understand bitcoin's role as a non-sovereign, limited supply, and deflationary hard asset against the backdrop of monetary policy with potentially decades-long inflationary consequences. Again, *this time is different*.

What exactly is different? Potential investors in bitcoin or the broader digital asset market should understand **five key developments**: the bitcoin halving, new investor adoption, the post COVID-19 economy, monetary policy, and digital asset infrastructure. As this commentary expands on these themes, remember that *this time is different* because, now, everything is different.

In May we will have an event known as **the bitcoin halving**. This is a deflationary event built into bitcoin's code that cuts the number of bitcoin mined in half every four years. While this may cause near term price volatility or even a move lower as the market adjusts, many see this as a positive event longer term. This will be the third halving event since Satoshi Nakamoto mined the first block over ten years ago, and it will cut production from 12.5 bitcoin per block to 6.25 bitcoin per block. Put simply, the supply velocity of bitcoin is going to decrease at the same time the Federal Reserve is pledging to print trillions more US Dollars—the world's reserve fiat currency. As these trillions are printed and the government effectively borrows from itself, long-term inflation is practically a definite. By stark contrast and thanks to halving, there will only ever be 21 million bitcoin.

New investor adoption: the bitcoin story is resonating as the broader macro environment shifts; non-sovereign, deflationary, and hard assets are in demand, and we're seeing larger, more sophisticated investors enter the market. During 2018's crypto winter after 2017's famed bitcoin bubble, we were often asked, *where is the new money coming into the space?* Well that answer has finally become clear. Not only has institutional infrastructure progressed, but as the world changes important players are entering the space. The most successful hedge fund of all time, Renaissance Technologies, recently announced their intention to trade bitcoin futures. Famed macro investor Paul Tudor Jones discussed in his most recent letter that investing in bitcoin today makes sense; in his view, bitcoin is to today's market what gold was to the market in the 1970s. These recent moves are in addition to endowments such as those of Yale, Stanford, and Harvard all indicating they had bitcoin exposure.

The next two points, **the post-COVID-19 economy** and **monetary policy**, go hand in hand. For better or for worse, the economic climate post-COVID-19 will be different and the way people view money will likely change. Unemployment rose in April to record highs as 14.7% of Americans—more than 20 million people—lost their jobs, leaving many frustrated with our current financial system. Furthermore, as frustration grew and money was printed to fund bailout packages, many Americans felt left behind with their personal wealth dwindling against the backdrop of a rallying stock market, contracting GDP, and growing national deficit. Stocks and the economy were on diverging paths. This again supports the case for bitcoin: bitcoin is not controlled by any centralized government and allows for holders to be their own bank.

Finally, it's important to understand that we have seen immense developments in **digital asset infrastructure**. While not immune to issues that accompany a burgeoning asset class or a new form of technology, the last three years has seen traditional market infrastructure enter the space to help it grow on an institutional level. Bloomberg, a name synonymous with data integrity and market standardization, has been involved with digital assets since May 2018 when the BGCI launched. More recently, trusted custody solutions like ICE/Bakkt and Fidelity have entered the space. CME BTC futures are not only seeing consistently strong and growing volumes, but are also providing sophisticated traders a regulated entity to speculate on whether the price of bitcoin will go higher or lower in the future. Additionally, administrators and platforms around the world are currently trying to figure out ways to provide digital asset exposure for their clients. These developments lower the barrier to entry and will likely allow bitcoin to sustain its rally as the adoption curve accelerates.

When all the above is taken into consideration, it's clear that this asset class is poised for its next stage of adoption in world that is increasingly *different*.

INDUSTRY INSIGHTS

- **Stablecoins** are cryptocurrencies pegged to fiat currencies by a variety of mechanisms, eliminating the volatility of cryptocurrencies. Since March 12th, the market capitalization of USD-pegged stablecoins in circulation has grown from \$5.96 billion to \$9.47 billion, up 57% in under two months. It's both a reflection of US Dollar demand globally and of growing trust in cryptocurrency infrastructures. Most stablecoins operate on Ethereum, including Tether, the largest stablecoin by market capitalization.
- Eleven members of **US Congress** penned a letter to **Treasury Secretary Steve Mnuchin** encouraging the Treasury to disperse money owed to the public with speed and security using blockchains. Several directives in Congress's CARES package were marred by issues in actually distributing money to Americans. The **Small Business Administration's** Payment Protection Program was stalled by undisclosed issues with its E-Tran application system, which users suggest was not equipped to handle the traffic. Likewise, the IRS's direct payments to Americans was impeded as officials did not have bank account information on file for approximately 15 million Americans, largely poor Americans who do not file annual tax returns because of low income. Non-uniformity in the IRS's information meant that paychecks were sent out at different times, with some delayed weeks from when payments were first sent out. In the letter, bipartisan members of Congress urged the Treasury to "utilize private sector innovations such as blockchain to support the necessary functions of government to distribute and track relief programs and direct that all guidance support the use of technology to facilitate delivery of CARES Act benefits."
- An overhaul to **Facebook's Libra** cryptocurrency was announced in April. The project, controlled by a non-profit called the **Libra Association** based in Switzerland and for which Facebook developed the **Calibra** wallet, drew the ire of regulators in 2019, highlighted by a tense hearing with Mark Zuckerberg in October 2019. In a set of sweeping changes, the Libra Association announced that Libra will offer stablecoins backed by single currencies rather than by a basket of currencies. Some lawmakers in October's Congressional hearing expressed concern that Libra would compete with the US Dollar globally, threatening the US's ability to impose sanctions and exert dominance in the global economy. Libra also announced that they intended to strengthen anti-money laundering and terrorist financing safeguards; the Libra Association recently registered with FinCEN as a money services business. Libra now plans to launch by December 2020.
- **Bitcoin's halving** will take place on May 11th. At that point, rewards to miners will be cut by half to 6.25 bitcoin per block. Though a substantial portion of miners may go out of business as their revenues fall, the remainder will pick up their slack: Bitcoin's "difficulty" will adjust downward, providing lower cost opportunities for the remaining miners.
- As of April 19th, the long-awaited **Ethereum 2.0** now has a stable multi-client testnet running Phase 0 of the Eth 2.0 blockchain. Ethereum today has two primary obstacles to mainstream adoption as a financial medium: scalability and privacy. While upgrades to privacy on Ethereum are further away, increasing the transaction throughput, or scalability, of Ethereum has been a preeminent research objective over the past five years. Ethereum will achieve this on Eth 2.0 primarily by "sharding," splitting validators into separate, smaller chains and reaccumulating them in a root chain. Ethereum saw the dramatic rise of "Decentralized Finance" in the past year, culminating in over \$1 billion locked in Ethereum smart contracts by late January 2020.

Data Point	4/30/2020	3/31/2020	Delta
BGCI	373.41	274.86	35.85%
Bitcoin	\$8835.42	\$6491.1	36.12%
Ethereum	\$211.5	\$134.64	57.08%
XRP	\$0.2161	\$0.1773	21.88%
EOS	\$2.84	\$2.23	27.08%
Bitcoin Cash	\$253.57	\$221.23	14.41%
Litecoin	\$47.11	\$39.23	20.03%
Total Market Capitalization	\$248.18 B	\$177.32 B	

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