Galaxy Fund Management Newsletter

MARCH 2020

PORTFOLIO COMMENTARY

The global pandemic caused by the novel Coronavirus will leave us looking back on March 2020 as yet another turning point that changes the way we think and live. Like 9/11 and the Financial Crisis of 2008, current events will once again bring forth a paradigm shift in how we approach our lives both socially and economically. It is times like these that often bring out the best in human ingenuity, propelling us to new heights with technological advancements that establish better living standards in the years and decades to come. Over the past decade, we have witnessed never-before-seen advancements in technology within the context of globalization. One of those advancements was bitcoin, born out of concerns created by the Financial Crisis of 2008. Today, bitcoin is no longer a financial experiment. It is a global asset over ten years old with a market cap of ~$200 BN, and it may finally be ready to take center stage in a world of rapidly changing monetary policy and currency debasement. As you read through the below recap of the past month, think about the future of money, bitcoin's place in the portfolio, and the intersection of traditional investments with digital assets.

After a volatile sell-off close to February, global markets continued the trend entering March as the seriousness of the Coronavirus pandemic began to take hold. The number of COVID-19 cases and deaths rose daily as nations began to accept the grim reality of what could lie ahead. Businesses and schools closed, jobs were lost en masse seemingly overnight, home confinement was necessary, and our very way of life itself came into question. Despite stocks moving lower in volatile fashion while the DOW and S&P 500 tried to shrug off large percentage moves with U.S. Treasury yields plummeting, bitcoin weathered the storm into the first weekend of the month trading in a relatively tight range between $8600 – $9100 amidst strong volumes.

When the week of March 9th opened it seemed no asset anywhere was safe. Cash became king once again as all assets correlated to one. The U.S. 10 Year note yield hit an all-time low of 33bps amidst an unprecedented global sell-off that saw markets turn red and leverage leave the financial system at a feverish pace. As our nation's leaders began to focus on public safety, preparing our healthcare system, and sending non-essential employees home, uncertainty brought the markets to a feeling of peak fear on March 12th.

Bitcoin then hit its lowest point since February of 2019, briefly trading below the $4000 level on the evening of March 12th before stabilizing in the $5500 range, eventually leading to a recovery to close the month above $6400. Volumes soared north of $5 BN on real exchanges and remained elevated in the days following the move. Lending markets saw supply dry up and demand increase as rates to borrow shot up nearly three times their recent average to 12%. Futures also leveled off during this time. The aggressive price drop in the spot market was likely the combination of a few key factors: panic selling after U.S. equities closed, nearly $1 BN of deleveraging on large BTC exchanges (some offered 50x – 100x leverage), and rumors that some key exchanges were having issues with deposits and withdrawals.

While the price drop may have hurt bitcoin's store of value narrative in the near-term (which we still believe holds true in the long-term), it is important to understand that the Fed's actions may now present an even greater case for bitcoin as a new weapon in portfolios. In an effort to keep markets liquid and businesses and financial institutions solvent, the Fed printed an additional six trillion U.S. dollars on top of a 5% deficit. These figures could easily run significantly higher when all is said and done. As the government continues to take these measures and monetize stocks and bonds in conjunction with the reality of global currency debasement, the case for owning hard assets is rapidly being proven. It is clear that monetary policy in the U.S. will need to remain dovish in an effort for sustained quantitative easing to support market recovery.

The actions seen over recent weeks will most certainly lead to inflation, which is exactly what bitcoin is suited to protect against. Creating trillions of dollars of liquidity fueled by debt right before our eyes does not come without consequences.

Bitcoin is a limited supply, non-sovereign hard asset that holds the same worth no matter where you are in the world. Its digital nature gives anyone with an internet connection access to the same source of value without borders. Long said to be digital gold, bitcoin may now be the call option on the future of a system with unknown monetary policy, while gold is today's "flight to quality" asset of choice.

INDUSTRY INSIGHTS

- The COVID-19 crisis has been an accelerator of many already-developing trends, including Central Bank Digital Currencies (CBDCs). A provision for a **Digital Dollar** was included in early drafts of Congress's third stimulus package as a means to distribute cash directly to Americans. The provision did not make the final cut, but other countries have made substantial moves. The **People's Bank of China** stated in an April 4th note that "Steady progress was made in reform and innovation in key areas, and statutory digital currency research and development work was carried out steadily… The People's Bank of China will undoubtedly further its research and development of the national digital currency with enhanced top-down design." While an exact launch date is unknown, a **Digital Yuan** could be released within the year. Meanwhile, the **Bank of Korea** has resumed its CBDC research having initiated a 22-month pilot program, and the **Banque de France** launched a program to test the suitability of a **Digital Euro** in settlement processes. Additionally, the Bank of International Settlements noted that COVID-19 "calls for CBDCs."

- In May, bitcoin will undergo its third halving event, where the block reward for miners will decrease from 12.5 BTC per block to 6.25 BTC per block. **Halving** events have a number of consequences for bitcoin and the surrounding ecosystem. First, BTC's price has exploded following both of the previous two halving events. Second, many bitcoin miners with relatively high costs will be forced out of business and could be liable to sell existing BTC reserves, creating downward pressure on the market. Galaxy Digital's Research team investigated the consequences of widespread miner selling and found that the upper bound for miner reserves to be sold was 115,000 BTC. Additionally, depending on the period that is unrolled over and what percentage of the upper bound is sold, it could result in anywhere daily sell pressure between 0.05% and 6.60% of Average Daily Volume with the lower estimate being far more likely.

- A **US District Court** Judge ruled in favor of the **SEC** to block **Telegram's TON** blockchain launch in late March. The Telegram Open Network project, which raised an astounding $1.7 BN Initial Coin Offering in 2017, would plug a cryptocurrency into their existing distribution and messaging channels. However, the judge wrote an opinion that, "Telegram, as a matter of fact rather than legal obligation, will be the guiding force behind the TON Blockchain for the immediate post-launch period … As such, the initial 175 purchasers possess a reasonable expectation of profit based upon the efforts of Telegram because these purchasers expect to reap whopping gains from the resale of GRAMs in the immediate post-launch period." As a result, the TON failed the Howey test on the grounds that the Telegram Open Network's GRAM token implied an expectation of profit for stakeholders through the efforts of the third-party Telegram, making it a security. Telegram has appealed the ruling.

Data Point	3/31/2020	2/28/2020	Delta
BGCI	274.86	398.44	-31.02%
Bitcoin	$6491.10	$8657.34	-25.02%
Ethereum	$134.64	$225.21	-40.21%
XRP	$0.1773	$0.2358	-24.81%
EOS	$2.23	$3.50	-36.13%
Bitcoin Cash	$221.23	$312.26	-29.02%
Litecoin	$39.23	$59.47	-34.03%
Total Market Capitalization	$177.32 BN	$241.86 BN	

Sources: Forbes; United States District Court — Southern District of New York

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