

Galaxy Fund Management Newsletter

JULY 2020 IN REVIEW

MARKET COMMENTARY

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When history looks back on the progression of the digital asset class—its graduation from cypher-punks in the far corners of the internet to Main Street investors—July 2020 may prove to be a pivotal moment. Digital assets are seeing their highest demand since late 2017. While that spectacular bubble put the asset class on investors' radar, it left much to be desired in terms of infrastructure, regulation, and education. Fast forward nearly three years and we're entering the second half of 2020 with vast improvements in all three areas. These developments came just in time for two other tailwinds: investors are focused on transformative technologies in the COVID-19 era, and rampant money printing is fueling their inflationary concerns and mistrust in the monetary system. Digital assets may be ready to sustain their next lift-off moment.

July's rally was once again led by a combination of efforts that saw a gradual push higher throughout the month in bitcoin, Ethereum, and the Bloomberg Galaxy Crypto Index (BGCI), a measurement of large cap liquid digital assets.

Bitcoin rose to its highest levels in nearly twelve months, up 24.43% to close at \$11,354.56. It started the month hovering around \$9,100, then began an orderly climb as inflation fears continued to take root in investors' minds. The CARES Act stimulus benefits moving toward month-end expiry further supported bitcoin's increase, as did uncertainty around keeping the economy afloat amidst a choppy re-opening. Gold had its own climb to all-time highs; the two assets seemed to move in lockstep, further supporting bitcoin's validity as a digital gold. Spot volumes on major exchanges soared north of \$1.5bn going into month-end as buyers seemed to flood the market following a July 22 announcement by the Office of the Comptroller of the Currency (OCC). This announcement outlined yet another infrastructure milestone: federally chartered banks and federal savings associations now have the authority to provide cryptocurrency custody services for customers. Open interest on CME futures hit an all-time high of nearly \$750mm on July 24 and continued to see elevated futures volumes as the month drew to a close.

As mentioned in last month's newsletter, it was expected the decentralized finance (DeFi) applications would continue to push Ethereum higher amidst increased use of those applications on the underlying blockchain. Ethereum continued its stellar year as BGCI's best performing asset, with a July increase of 53.02% and a closing price of \$344.73. DeFi has seen growth of nearly \$3.5bn in 2020 with assets like Compound,

Dharma, DAI, and decentralized exchanges (DEX) driving smart contract growth in primitive financial functions—lending, debt issuance, liquidity, and exchanges. Look for this to continue to be a driving theme for the asset class.

The BGCI finished over the 500 mark for the first time since February at 502.50 with all six constituents finishing in positive territory. ETH, XRP, EOS, and BCH all posted gains north of 30%. The 39.48% increase for the index was its highest monthly gain since January; broader large cap digital assets certainly seemed to benefit from the consolidation of liquidity at the top of the asset class.

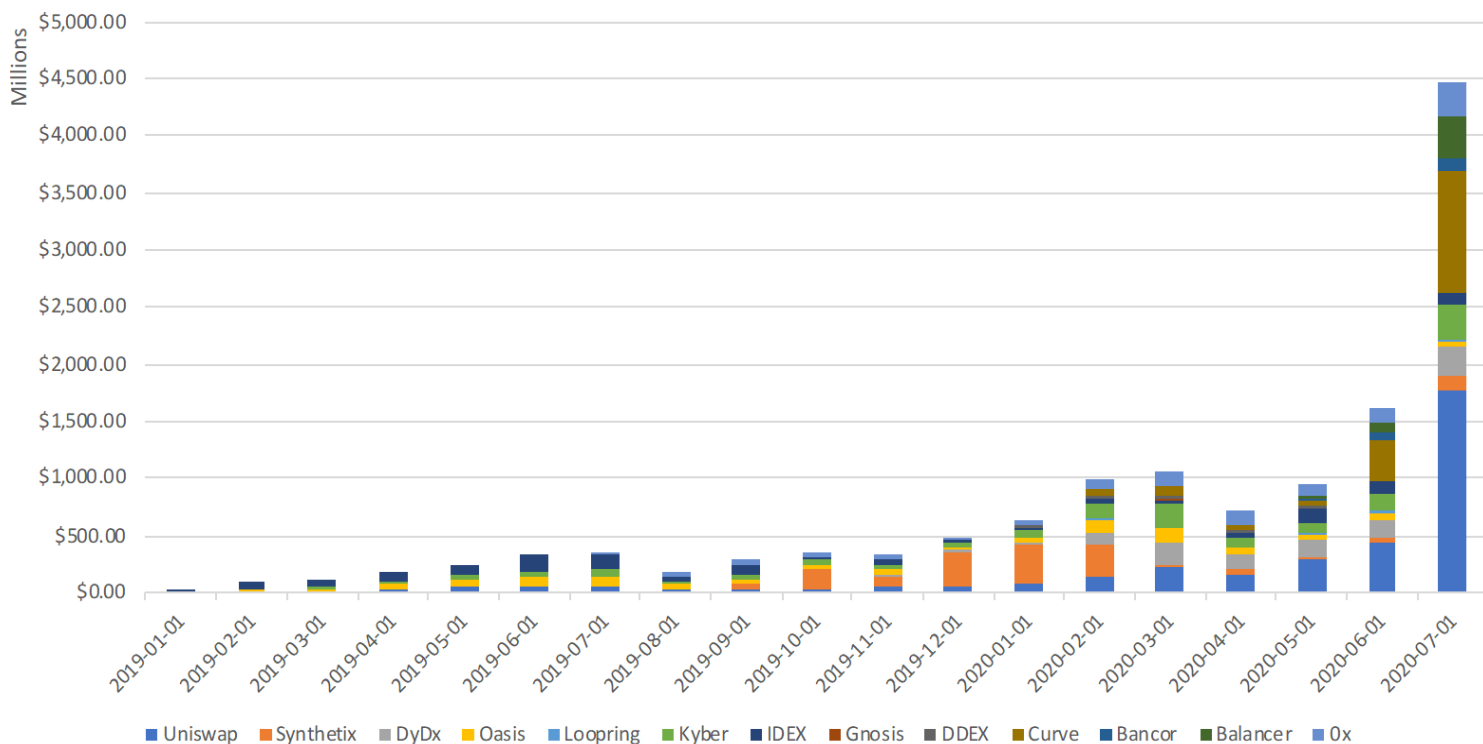
INDUSTRY INSIGHTS

- The US **Office of the Comptroller of the Currency** released a decision in late July that national banks and federal savings associations are permitted to provide cryptocurrency custody services for their clients, increasing the maneuverability of traditional banks to participate in digital assets on behalf of their clients. The OCC's letter came in response to a request from an unidentified national bank or federal savings association that asked the OCC to clarify their stance
- **Goldman Sachs** recently instituted a Head of Digital Assets, a first for the bank. Meanwhile, JPMorgan has long been involved in digital assets with their Ethereum-based platform Quorum.
- Putin revised **Russia's** cryptocurrency regulation on July 31 when he approved cryptocurrency for trading in the country, but took specific measures to ensure that cryptocurrencies could not be used as means of payment. Russian banks will be able to open cryptocurrency but will be required to register with the Central Bank. It also approved stablecoins to be used as settlement instruments for transactions in other cryptocurrencies.
- While **bitcoin** remains a strong instrument in opposition to monetary inflation, its staunchness to measured technological progress and protocol changes frequently means that innovation happens more rapidly in other areas of the crypto ecosystem. This is a feature of bitcoin that makes it particularly well-suited to serve as a store of value instrument. Rallies across the crypto space in July, including in bitcoin, largely originated on the back of rapid growth in the on-chain **Ethereum** space, with excitement and optimism then cascading across the wider ecosystem. As a reminder, Ethereum extends bitcoin by introducing general programmability into monetary units themselves, allowing for applications to be built on the Ethereum blockchain itself, including the “decentralized finance” space which replicates financial primitives like lending, exchange, derivative contracts, and capital allocation in smart contracts. By May

and June, growth in Ethereum’s decentralized finance space specifically became evident. Its headline statistic, total value locked (TVL), which corresponds to the total economic value locked in decentralized finance smart contracts, went from \$900mm on May 1 to \$2.02bn on July 1. TVL, admittedly a metric of capital inefficiency as opposed to capital efficiency, reached \$4.21bn by July 31, bolstered by a few developments:

- Leading lending protocol **Compound** announced the \$COMP token, which affords token holders governance powers over the parameters of the network. \$COMP was also used in a novel “liquidity mining” scheme, an effort to bootstrap liquidity in the Compound protocol by rewarding recipients for lending and borrowing.
- Lending protocol **Aave** introduced their Credit Delegation protocol, a step towards solving uncollateralized lending in decentralized finance by offloading the burden of counterparty risk from the protocol to individual users that already provide liquidity to the pool.
- **Decentralized exchanges (DEX)** grew substantially in volume thanks to strong user experience improvements, embodied by automated market makers. Automated market markets allow for frictionless, programmatic swaps between swaps with guaranteed execution.

Monthly DEX Volume from Jan. 1 2019



- Regarding technical developments in the space: **Polkadot** officially went live with their mainnet in late July when a governance proposal officially stripped admin rights from the Web3 Foundation, the research group behind the Polkadot protocol. Polkadot is Ethereum's primary competitor in the race to develop a scalable Layer 1 for general-purpose computation. Stripping admin rights decentralizes the protocol and hands power over to the community.
- Separately in scaling, **Reddit's** Scaling Bake-Off concluded on July 31 with 22 teams submitting proposals to scale transaction throughput to Reddit-scale of hundreds of thousands of transactions per day. Many teams showed results that exceeded the requirements laid out in the competition specification.

Data Point	7/31/2020	6/30/2020	Delta
BGCI	502.5	360.26	39.48%
Bitcoin	\$11,354.56	\$9,140.27	24.43%
Ethereum	\$344.73	\$225.28	53.02%
XRP	\$0.2554	\$0.1758	45.39%
EOS	\$3.10	\$2.35	31.57%
Bitcoin Cash	\$302.27	\$221.64	36.03%
Litecoin	\$58.13	\$41.17	7.57%
Total Market Cap	\$346.84 BN	\$259.85 BN	

Sources: Dune Analytics, Github, Forbes, Wall Street Journal, CNBC, Reddit

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