Galaxy Fund Management Newsletter

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PORTFOLIO COMMENTARY

After a strong start to the year, gravity returned to global markets as fears surrounding the Coronavirus sent markets into the red and they posted their worst overall returns since 2011. During the week of February 24th, stocks fell 11% amidst the uncertainty of how far global disruption would reach. While digital assets did not remain unaffected amidst one of the more violent global sell-offs in recent memory, they did show their chops as an uncorrelated portfolio position with the Bloomberg Galaxy Crypto Index (BGCI) holding on to finish up 1.81% for a final mark of 398.44.

Opening the first half of the month charging hard out of the gates, the BGCI closed with one of its best finishes in nearly ten months on February 14th at 525.32. As pressure mounted across all asset classes, the second half of the month led to choppy price action and mixed returns for holdings of the portfolio. The last fourteen days saw the BGCI fall 24.15%; five of our six holdings fell on the month amidst increased volatility. Ethereum was the fund's best performing asset with a return of 24.99% and a final price of $225.21. It was a nice resurgence for the Web 3.0 protocol as developers on the platform flocked to ETHDENVER 2020, a signature conference for which ETH builders gather to engage in discourse on growth and the future vision of the Ethereum ecosystem. Competing platform EOS struggled as it fell 14.56% on the month for a final price of $3.50. It was a tough month for payments as all three holdings fell. XRP finished close to flat on the month down 0.92%, despite the Ripple Technologies CEO publicly announcing that the company's main source of income was selling the XRP token. Ripple Technologies and its executives are said to be the largest holders of the remittance token XRP. Bitcoin forks and payment tokens Bitcoin Cash and Litecoin moved lower in tandem and finished down 16.44% and 12.25% respectively.

February proved to be a volatile month for bitcoin. The flagship asset traded in the low $9,000 range to start the month before climbing above the $10,300 mark on February 14th. As markets sold off and leverage flowed out of the system, bitcoin moved lower in the back half of the month finishing above $10,000 once before an orderly move down to a closing mark of $8,657.34, a modest drop of 7.02%. Even as the market traded lower, both spot and futures exchange volumes remained strong and consistent. By measure of what has become known as the "Real 10" in the spot market, along with Bakkt and CME in futures, combined volumes saw several sessions of 1BN+ which indicates a healthy liquidity environment for bitcoin.

In addition to asset performance, February saw three key developments for the digital assets space that tie to long-term themes. First, SEC Commissioner Hester Pierce proposed new legislation to support token projects in an effort to achieve decentralization. Under the proposal, new projects would be given a three-year grace period from the time of token sale to develop their networks without penalty of securities laws like the Howy Test and Supreme Court Assessment. A second announcement came from the Libra project as they continue to tweak their proposal for how the token will be rolled out. Bloomberg reported that the payment token was undergoing a change to allow digital versions of government-backed currencies. Many believe that this will be viewed as positive for regulators worldwide. The final announcement of the month, which came as little surprise, was the rejection of the Wilshire-Phoenix Bitcoin ETF. Regulators continue to cite their inability to get comfortable with bitcoin's ability to meet the requirements necessary to get approval for an ETF wrapper. While the asset class has made exceptional strides in improving market structure over the last three years, it's clear that this type of product is not something we will see in the near term.

As uncertainty in the markets continues to persist and fear grips the headlines, it's important to look for the positives that may be reflected in the next wave of investment, and consider the role that assets that offer both low correlation and secular growth opportunities can play in a portfolio. Through the first two months of 2020, both bitcoin (+~23%) and the BGCI (+42%) turned in strong performances. While these data points capture just a moment in time, performance of these assets is certainly something to keep an eye on as digital assets continue to grow and fear of the unknown exists in global financial system.

INDUSTRY INSIGHTS

- While the majority of Central Banks globally are weighing the idea of a digital currency, **Chairman Powell** continues to shut the idea down. He responded to CBDC questions, saying, "The idea of having a ledger where you know everybody's payments [is] not something that would be particularly attractive in the United States." **Secretary of the Treasury Mnuchin** said in December that "Chairman Powell and I have discussed this at length—we both agree that in the near future, in the next five years, we see no need for the Fed to issue a digital currency."

Congresspeople in the October Libra hearings, however, expressed concern that the U.S. would fall behind other countries like China with regard to a digital currency. Sweden has also made strides towards an "e-krona". One of the main sticking points for Congresspeople in October was that Libra did not prioritize American interests; a basket of currencies would include more than just the U.S. Dollar and the Foundation would be based in Switzerland. Switching to an approach that prioritizes U.S. interests is a clear strategy to appease legislators, and it could be the direction that Libra will take.

- A merger between **Consensys**, the development studio for Ethereum infrastructure, and **J.P. Morgan's Quorum** unit in mid-February will see Consensys bring the Quorum unit in-house within six months. Quorum, which is a team of about 25 people, is an Ethereum-based distributed ledger that enables transactions and contract privacy for permissioned parties, including other major banks. J.P. Morgan pioneered the Interbank Information Network (IIN), which allows banks to exchange in real-time as a way to verify that a payment has been approved. Other banks in the IIN include RBC and Santander, as well as 394 other institutions that are using Quorum as part of the IIN. Additionally, J.P. Morgan has planned to use Quorum to issue **JPM Coin**. Reportedly, neither of these initiatives will conclude upon the transition of Quorum to Consensys. Additionally, news came out later in February that Ernst & Young would be joining Consensys and J.P. Morgan, using Ethereum to coordinate firms' resource planning in an effort called Baseline Protocol. The Head of Consensys's so-called Web3Studio said that the effort would use Ethereum as a message-driven middleware, rather than a source-of-truth data repository. He quipped, "It's a pretty boring way to use a blockchain. I think we could use a little boring."

- **India's Supreme Court** overruled the **Reserve Bank of India's** ban on cryptocurrencies at the very beginning of March, paving the way for growth of cryptocurrencies and blockchains in an economy with already fast-growing fintech and technology sectors. In April 2018 the RBI banned all RBI-regulated entities, including banks and other financial institutions, from dealing in cryptocurrency. The RBI did not ban cryptocurrency per se but choked any financial dealing with them. The regulation notably forced crypto exchanges in the country to close or relocate. The Securities Exchange Control Board of India had been silent on the issues; now, India's Supreme Court has set aside the RBI's order, arguing that it failed proportionality, namely that it failed to treat institutions dealing in cryptocurrencies equally under the law. However, the RBI was quick to appeal the decision, noting that widespread use of cryptocurrencies could put India's banking system at risk, a remarkably different attitude than the U.S. and others are taking in their apprehension around cryptocurrencies.

- The **South Korean National Assembly** unanimously passed an amendment to existing financial services laws that will provide a comprehensive regulatory environment for cryptocurrencies in South Korea. The amendment will help institutionalize cryptocurrency trading in South Korea by reallowing for crypto businesses to gain a "real-name account", while actively imposing obligations on cryptocurrency providers and financial institutions that force them to remain compliant. Real-name accounts had previously been unavailable to crypto businesses with the exception of Bithumb, Upbit, Coinone, and Cobit. Now, the cryptocurrency industry can expand under the purview of regulatory bodies.

- For the first time ever, there are **18 million addresses holding bitcoin for one year consistently**. These so-called "hodlers" control a total of 8 million BTC. Last year at this time, 14.85 million addresses were holding bitcoin for one year consistently, with a total of 5.2 million BTC. The number of addresses controlling more than 100 BTC is now at an all-time high (over 14,500) and has gained nearly 5% in one year. The number of addresses controlling more than 1000 BTC has gained more than 31% in the past year. These signs all strongly suggest that the trend in the last year is toward accumulation of bitcoin by the largest parties on the network.

Data Point	2/28/2020	1/31/2020	Delta
BGCI	398.44	391.36	1.81%
Bitcoin	$8,657.34	$9,311.36	-7.02%
Ethereum	$225.21	$180.18	24.99%
XRP	$0.236	$0.238	-0.92%
EOS	$3.50	$4.10	-14.56%
Bitcoin Cash	$312.26	$373.70	-16.44%
Litecoin	$59.47	$67.77	-12.25%
Total Market Capitalization	$241.86 BN	$255.97 BN	

Sources: Reuters; Coindesk; The Block; Tech Crunch; Global Legal Insights; Daum; PR Newswire; SEC.

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