

Galaxy Fund Management Newsletter

JUNE 2020 IN REVIEW

MARKET COMMENTARY

Paul Cappelli, Portfolio Manager

The summer typically brings a perceived slowdown to markets. In this respect, like many others, 2020 is an exception. The last six months have seen a global pandemic, market volatility, social unrest, and political division on historic scales. Many of these events—unthinkable at the start of the year—will shape the way we move forward personally, socially, politically, and economically for decades to come. As we reflect on the first half of the year and its impact on society, let's take time to examine key developments in the digital assets space as technology, digitization, and monetary policy continue to drive investment themes against this backdrop.

The global pandemic forced a massive technological shift as millions worldwide scrambled to merge their old routines with “the new normal”. The NASDAQ Composite rose roughly 12%, driven mainly by tech companies helping businesses and individuals alike navigate this transition. Bitcoin, Ethereum, Decentralized Finance (DeFi) applications, and the Bloomberg Galaxy Crypto Index (BGCI) led the way within the digital assets space. These moves gave us a glimpse of what may be building blocks for the next wave of financial applications going forward, and for the space overall.

Bitcoin rose more than 30% during the first half of 2020 as the Federal Reserve printed trillions in CARES Act aid. Bitcoin's halving event in May, which programmatically lowered its annual inflation rate from 3.6% to 1.8%, highlighted its deflationary attributes while monetary policy fueled fear of future inflation. Investors took note as bitcoin's price recovered from March's deleveraging sell-off that saw prices briefly dip below \$4000. Bitcoin crossed back into the \$8500 to \$9500 range to close out the first half of the year, with famed institutions and investors from RenTech to Paul Tudor Jones making highly publicized bitcoin investments. Inquiries increased across investor channels, from individuals to advisors to institutions, showing heightened interest in how bitcoin can benefit portfolios. In addition to infrastructure developments by brand names such as ICE/Bakkt, Bloomberg, the CME, and Fidelity, the next wave of tech-based access points is positioning bitcoin for mass adoption. PayPal recently announced that its 325 million users will be able to buy, sell, and transfer bitcoin. Financial services aggregator Square Inc., a \$50 billion market cap company, continued to cite bitcoin as a key growth driver. It is important to always consider these developments alongside the fact that there will only ever be 21 million bitcoin in existence.

While bitcoin certainly had a noteworthy first half, the second largest digital asset, Ethereum, rose more than 70% in the same period. The platform caught a tailwind in 2020 as financial smart contracts have driven users to implement the protocol around what has become known as DeFi. With the Ethereum blockchain as one of its operating systems, DeFi applications are working to develop the core for automated programmable finance. In this series of networks, users can individually perform financial functions such as lending, exchange use, derivative market making, payments, and asset management. Look for this to be a driving theme alongside bitcoin in the second half of 2020.

In addition to bitcoin and Ethereum, the BGCI also saw a strong first half with a return of 27%. The benchmark continued to see consolidation of returns around the largest, most liquid assets. This is another investment area in the digital assets space that has seen increased investor interest. As the market continues to grow and new assets capture market share, investors have indicated that indexed investing may be a strong complement to straight bitcoin exposure in their portfolios as they can benefit from the broader growth of the asset class over time.

As we usher in the second half of 2020, the only certainty that exists is uncertainty. The global pandemic, social unrest, and market volatility will persist as the US political system draws closer to what many believe is one of the most important elections in our history. In contrast, look for the themes developing in the digital assets space to be steadfast drivers of growth for this asset class as we move into 2021.

INDUSTRY INSIGHTS

- Last year the Bank for International Settlements published research that showed 61% percent of respondent Central Banks were pursuing general purpose **Central Bank Digital Currencies** (CBDCs), also known as digital cash. Two major G7 nations, the US and Japan, had held out with sources on both sides previously making statements similar to a recent comment from a Bank of Japan Governor who remarked, “It does not seem that there is a demand for a CBDC from the public at present” in December. On the contrary, last week the Bank of Japan announced that they will begin testing a CBDC.
- Similarly, US lawmakers in the Senate Banking Committee hosted a virtual discussion on June 30 about the digitization of money and payments, including a focus on the possibility of a **Digital Dollar**. Mike Crapo (R-UT) described stablecoins: “a new type of cryptocurrency [that] has emerged aimed at achieving these benefits while marginalizing the volatility of some of its predecessors. Stablecoins, which may be issued by a central entity, deliver price stability by having their value

pegged to another asset, like commercial bank deposits or government-issued bonds.” The House of Representatives Task Force on Financial Technology also held a hearing on the Digital Dollar topic in June.

- **Reddit** announced in mid-June a competition for scaling solutions on Ethereum called “The Great Reddit Scaling Bake Off” to find the technology that is best equipped to handle 100,000 users immediately and 430 million eventually. Reddit, which has previously announced in-community tokens for two subreddits, is now conducting an initiative to find the most promising solutions to handle its user base. It’s all directed towards a future in which internet communities have native tokens that reward participants for their contributions to the community.
- **PayPal** announced on June 22 that it would roll out direct sales of cryptocurrencies to its 325 million users, including built-in wallet functionality. The service is expected in the next three months, but it is unclear which cryptocurrencies will be offered. The move comes as PayPal and Venmo are losing out to competitors like Robinhood and Cash App which offer cryptocurrency purchasing. Cash App specifically brought in \$306 million in revenue from its bitcoin offering in Q1 2020, compared to \$222 million for fiat-based services.
- Ethereum’s so-called “decentralized finance” ecosystem caught attention in June as money market protocol **Compound** unveiled a token for governance over the Compound network. Compound instituted a concept now being called “liquidity mining” whereby \$COMP tokens are distributed to users of the protocol as a bootstrapping mechanism. Liquidity in Compound’s lending pools grew from \$90 million on June 13 to \$635 million on June 28. In all, value locked across all DeFi protocols has skyrocketed to \$1.98 billion from \$677 million on January 1.

Data Point	6/30/2020	5/29/2020	Delta
BGCI	360.26	374.02	-3.68%
Bitcoin	\$9140.27	\$9402.22	-2.81%
Ethereum	\$225.28	\$219.95	+2.43%
XRP	\$0.1758	\$0.1970	-10.76%
EOS	\$2.35	\$2.60	-9.42%
Bitcoin Cash	\$221.64	\$237.85	-6.82%
Litecoin	\$41.17	\$44.51	-7.51%
Total Market Cap	\$259.85 BN	\$262.40 BN	

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