market notes: Blackrock's Bitcoin Halo Effect

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11/17/23 – Marcel Kasumovich, Deputy CIO, Coinbase Asset Management

1. Building is hard, even conferences. Some feel like concerts; others an intimate lounge. I met amazing people at GenesisXBT in Dubai, including Vugar Usi Zade of the famed Usi "The Talks." I'm not a big podcaster – not enough friction for me. Friction makes fire, fire makes heat, heat makes modern living. Friction is good. But I respect the crowd's wisdom and Usi's, with whom I enjoyed a "fireside chat." It went like this:

Usi Asks: Is decentralization dead?

1. What we learned in the 2022 crypto bust is that decentralization works. And it wasn't just Bitcoin and Ethereum. Application layers performed, too. Well-designed US dollar stablecoin functioned without fail. Even lend-borrow platforms like MakerDAO and its algorithmic stablecoin Dai managed through impossibly difficult risk management, liquidating crypto asset collateral to ensure no credit losses. Success.

2. But there's a problem. Scale. To achieve scale the ecosystem needs applications that enter the regulatory mainstream. Algorithmic stablecoin, despite the success of those well-designed, won't make the grade with various regulators already ruling them out. A "permissioned" DeFi layer will emerge. And the logic of that permissioned layer will be determined by regulatory bodies, eventually migrating to a smart contract. Voila!

3. Regulatory bodies agnostic to technology embracing this direction of traffic will win the day. Having a well-defined set of rules is not enough. MiCA is rightly touted as groundbreaking for Europe with clear rules. But regulators need to be alert to arbitrage where EU entities use European clarity to operate offshore, not the intent of MiCA. Regulators working alongside crypto technologists is the best pathway forward.

Usi Says: I'm worried about compatibility and the CBDCs take-over.

4. Let's think back to market prices and the signals they provide. Markets aren't perfect, but they work. Remember Crypto Kitties? They overwhelmed Ethereum in 2018. Gas fees surged and crowded everything else off the network. It was Gresham's Law of crypto – bad money drives out good. But Ethereum didn't break it. There was a price signal – developing scale was a priority. "Ethereum killers" like Cardano emerged.

5. Today? Ethereum killers were rinsed in the downturn, not having the time to achieve escape velocity. Everything is falling into the orbit of EVM compatibility. Take Vitalik's

latest drop, awaited in crypto markets like a new Taylor Swift beat. He brings Plasma, focused on off-chain transactions for scale, back from the dead. Is there better tech? Almost certainly, yes. But Ethereum is infinitely better than what we have – literally as it can bring the marginal cost of financial transactions to zero.

6. CBDCs can live in that world. In fact, they are a terrific outcome for the crypto ecosystem. Traditional financiers are increasingly engaged with the technologies - a good thing. But CBDCs can't scale. Senior, scalable digital money means that funds rush to the central bank in periods of financial uncertainty. You guard against instability by capping the size of CBDC. Don't sweat the small stuff – CBDCs will be tiny.

Usi Ponders: The next bull run is a Bitcoin ETF?

7. A single-asset ETF is an oddity, especially for bitcoin that's so easy to own. But there's a point – it's an easy starting point and a great excuse to engage. Blackrock deserves enormous credit. They led the surveillance-sharing solution and changed their mind, importing their institutional credibility to an ecosystem desperate for a halo. Crypto natives may hate this path. The player isn't the problem, it's the game.

8. A Bitcoin ETF is merely a vessel to accommodate demand. The passage of an ETF, or a wave of them, is the worst-kept secret in Washington's desperation to find an off-ramp to a stale, tired narrative. But you still need demand – and demand will come through the application layers capturing the imagination of users. Those may also come from unexpected places, not the "whale" applications that everyone is waiting for.

9. Like emerging markets. There are more than 2 billion people in the world who are unbanked. It's unacceptable. Crypto technologies can solve that problem. It's similar to Starlink's solution to the internet problem. Capturing those 2 billion people won't create friction with banks – because banks don't want them. Perversely, neither do crypto companies today. Yet, it's an obvious leap to adoption, and an own-goal if ignored.

Usi Laments: Must we work with…governments?

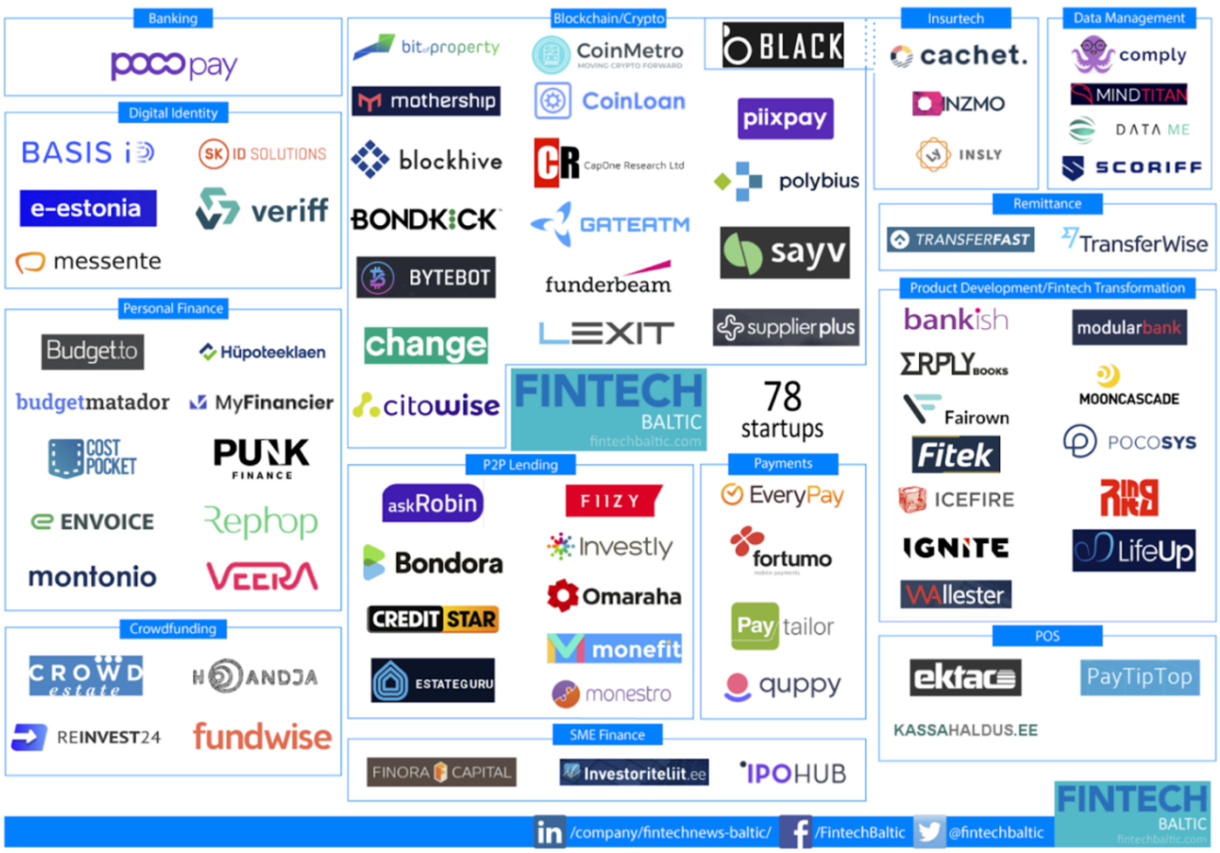
10. Stay optimistic, brother. Even in the darkest moments, innovation is everywhere. It's true, Western governments have pursued fiscal policies that resemble a generational Ponzi scheme. The younger generation simply can't pay the bills accumulated by the older ones. All things unsustainable come to an end. And such adjustments could be messy. Witness the fall of the Soviet Union that left 15 different countries in its wake.

11. But there's beauty on the other side. Like Estonia and her 1.3 million people. An eclectic list of budding technology companies call it home, from Wise to Bolt. It's not the cozy winters and friendly demeanor drawing talent. Its attraction is simple, efficient rules-

based policies like flat taxes and EU e-business licenses. Tallinn and "TalTech" have become a cold-climate hotbed of technologists. Talent begets talent.

12. Who is Estonia for crypto technologies? The race is on, and the UAE is in the mix. It's not that the regulators are easy. To the contrary, they are measured and operate with purpose. They are engaged with the ecosystem. When has a regulator last invited you for a whiteboard session? Or welcomed introductions to entrepreneurs? It's not perfect. It's a step forward. And that's why we're here in the UAE. Let's go.

Figure 1: Estonia – The Little Engine That Did!



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