coinbase ASSET MANAGEMENT

market notes: Right Place, Right Time – Active Crypto Strategies

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1/19/24 – Marcel Kasumovich, Deputy CIO, Coinbase Asset Management

1. Markets are the ultimate voting machine. Prices twinkle like stars in the night sky, sending direction to weary travelers on where to allocate capital. Great ideas are rewarded with a lower cost of capital, attracting more investment for future growth. Ideas don't even have to be profitable for the foreseeable future. The market voting machine will scrutinize even very long, uncertain horizons – common in young companies creating new markets.

2. Winners are celebrated. But as in all creative destruction, without a loser, the game can't be played. Like a junkyard, distressed credit investors specialize in keeping the good parts of bad companies. FTX and its FTT token is a live case in point. Its market value cratered from ~$10 billion to ~$200 million – and is now up 5-times from those lows. The market sees residual value. Shaky investors were recycled for ones attentive to recovering that value.

3. It's not always pretty. Markets overheat. Bubbled behaviors create false signals. Rapidly rising asset valuations start from a promising premise. But the temptation of cheap capital can lead to bad investments. It's a recurring cycle. The game within the game is how to evaluate cycles when investing. Active investors dig from macro to micro to identify opportunity and assess risk for timing strategies. Passive investors trust that trees grow, taking the index route.

4. Despite the tension, active and passive investors have a symbiotic relationship. One can't live without the other. Passive investors rely on active markets to determine what is added or removed from an index. Yes, passive players may be slower to rising stars or buy at the top. But they capture long and enduring trends at scale. Active investors pay their bills as a liquidity provider to the needs of passive investors while hunting for more concentrated, thematic bets.

5. Timing the cycle matters for both. Passive investors yawn at cycles, banking on secular trends. Recent history has reinforced this view. But passive investing was born from timing, too. It was in the right place at the right time – the late 1970s, when asset valuations were low, inflation was set for a secular downtrend, and emerging markets were readying to provide cheap goods to the world. John Bogle's creation of index investing was radical – like crypto now.

6. Passive investment trends underscore the attraction of exchange traded products for crypto technologies. They are delivering easy access at a low cost and at cheap valuations. It's the "set it and forget it" approach to investing. Yet, beneath any passive portfolio is an active choice. Every day an investor could change their minds. Doing nothing is an active choice not to, on the grounds that cost is not worth it. But it's also not market law.

7. Take Japan. Equity indices peaked 12,439 days ago. That's more than 34 years of frustration for passive portfolios. The Nikkei 225 index was more than 80% below those peak valuations at its lows. "But it's Japan," passivists cry. It's special. A vicious cycle of policies that socialized losses

and an aging population that sold falling asset prices for liquidity. It was the wrong place at the wrong time for passive investing – no surprise, investors actively chose to stop.

8. Japan teaches us it's not all or none. Even if engaging in passive strategies, an active mindset matters. And this is how we build. Our systematic tools quantify the stage of the macrocycle while keeping our pulse on the micro of the digital economy. Systematic tools start the conversation, identifying where we are relative to past norms. The active part is a stress test, attentive to differences from norms. There are always differences – degree is what matters.

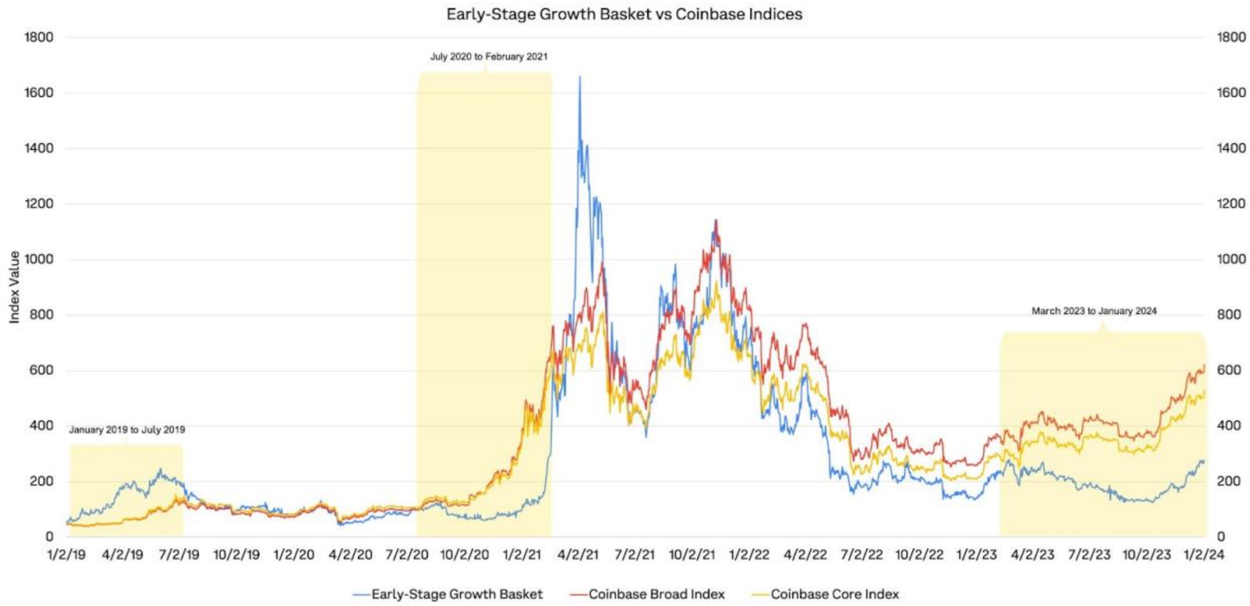
9. Unique features of this cycle are like an asteroid racing towards earth – too distant to be scary today, but too big to ignore tomorrow. Our Macro Pulse signals an economy early in its expansion. Activity is low and rising, a state begging for exposure to risk assets based on the past. But it's also a stage that comes after a severe recession – only, that didn't happen. So, we are careful of the macro and see promise in depressed micro sectors – like crypto.

10. It's no wonder asset managers looking at unusually high valuations in traditional markets are attracted to the potential of crypto technologies. And it's an active choice, even when passive investment strategies are being delivered. Let's take a look at this through the lens of the crypto indices and investment styles. Figure 1 shows the Coinbase Core Index, the Coinbase Broad Index, and early-stage growth token assets across diversified industry groups.

11. Even in nascent crypto markets, the simple chart shows the art of blending active and passive investing. The early-stage growth tokens led the 2019 cycle, lagged the 2021 upturn, and is moving in-concert with broader indices now. It's another market screen for timing the cycle. Early-stage growth tokens may not be practical for all – the information sure is! The rapid surge in 2021 signaled overheating. Now, balanced gains signal a disciplined, durable cycle.

12. This is yet another useful tool to add to your toolbelt. Crypto technologies are firmly planted in their building stage, and it is incumbent for us to keep making new tools. Active. Passive. Skeptical. Indifferent. Uncertain. Excited. We are here to engage no matter your perspective.

Figure 1: Early-Stage Growth v Coinbase Indices – It's Not Just Beta



Source: MVIS. Crypto Compare. CBAM Calculations. Early-Stage Growth Assets represent an equal-weighting of Rocket Pool, Ravencoin, Holo, Basic Attention Token, Stacks, and VeChain across six diversified sectors (7/16/18 = 100). For illustrative purposes only.

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