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market notes: Is That Pic You!? Verify, Don’t Trust

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Marcel Kasumovich
Coinbase Asset Management

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03/22/24 – Marcel Kasumovich, Deputy CIO, Coinbase Asset Management

1. Corrections in high-volatility assets are the norm, not the exception. Bitcoin experienced a pullback of more than 20% this month, matching the largest corrections in 2020-2021. More broadly, drawdowns exceeded 10% on 13 occasions during that upward trend. Yet again, US monetary policy is at the center of this uncertainty. Fear leading into the FOMC was met with relief, as Chair Powell viewed the rate-cut narrative as largely unchanged. After all, the Fed is a supertanker.

2. Every cycle is different. Every bout of volatility is a learning opportunity to identify those unique features. Exchange-traded funds (ETF) are the new kid on the bitcoin block. Is it fast-twitch speculation or slower-moving allocations? New Bitcoin ETF holdings say it's the latter (Figure 1). There was virtually no response to price weakness. Yes, demand growth slowed. But there was also no rush for the exits. This is typical of allocation without leverage – it's a longer horizon.

3. With longer horizons comes higher volatility. Longer-term volatility has also crept higher with the rise in asset valuations as investors contemplate a higher range of outcomes. No doubt, Bitcoin volatility expectations are 80% over the next six months, up from 50% at the start of the year. Will the future of finance run on those blockchain rails, and how will value accrue to its holders? These are views over a 10-to-20-year horizon, not today. It's not just fast-twitch muscle.

4. When fast money influences slower allocations, that's where trouble emerges. And it is always centered around leverage. The benefit of higher volatility crypto assets with uneven portfolio correlations – asset allocators don't need leverage. On the contrary, institutions are willing to sacrifice upside to actively manage downside risks. Just as ETFs are an easy onramp for passive investors, so will familiar fund structures be for institutions seeking actively managed strategies.

5. Institutions are engaging in the megatrend. Tokenization is today's rage. But there is a quieter macro case building – intellectual property (IP). And IP has a feature that investors adore. It wasn't derailed by financial crises, economic recession, or geopolitical uncertainty. US intangible investment has surged to 31% of gross private investment. Since 1950, it has only contracted three times with the worst performance down 2% in 2002. It is rare to find such limited cyclicality.

6. Intellectual property may feel like an abstraction, categorized as an "intangible asset." But you know all of the top companies by name, and by their recent dominance. Apple, Microsoft, Google, Amazon, Tesla, and Facebook have a sum total of nearly $10 trillion. The concentration of wealth and power is the technological equivalent of the Robber Barons during the Industrial Revolution – an unsustainable concentration of wealth and power ripe for disruption.

7. What better way to disrupt technology than with superior technology? Finance companies are coming to that reality faster than technological ones. After all, users are the primary source of IP

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in the tech sector. Want to build an amazing mobile application? The odds are high it'll be on Apple's App Store, contributing a healthy margin for the value of the network. But just as social media is flattening content, blockchain technologies are a natural disruptor of intellectual property.

8. Technological convergence is the disruption. Delivery of video content through the internet made traditional television obsolete. So, too, is transmitting voice and data through copper wires. Technologies converged to the speed of the internet and wireless protocols. Virtual experiences became a cost-effective way of consuming reality. You can enjoy the original production of Hamilton streaming – being at the show would have cost you thousands of dollars.

9. Artificial intelligence is the next iteration with the lines between virtual and reality increasingly blurred. Watching an AI-generated video of yourself knowing that it isn't you is amusing – and disturbing, as the quality is only going to improve rapidly. Content is the next phase of intellectual property. And being able to protect it will be paramount. Puzzled about the use case for blockchain technologies? "Don't trust, verify" takes on a much broader meaning – the guardian of truth.

10. "What's yours is yours" captures the deep implication for the future of intellectual property. Micropayments tied to crypto technologies will allow people to get paid for their property directly. All of it. Naturally, not all computations will happen on a blockchain. But it is natural for assets to be verified onchain and their value delivered directly to you. All assets become tangible. From property to payments, the next generation of premier companies will deliver that user experience at scale.

11. Choose wisely.

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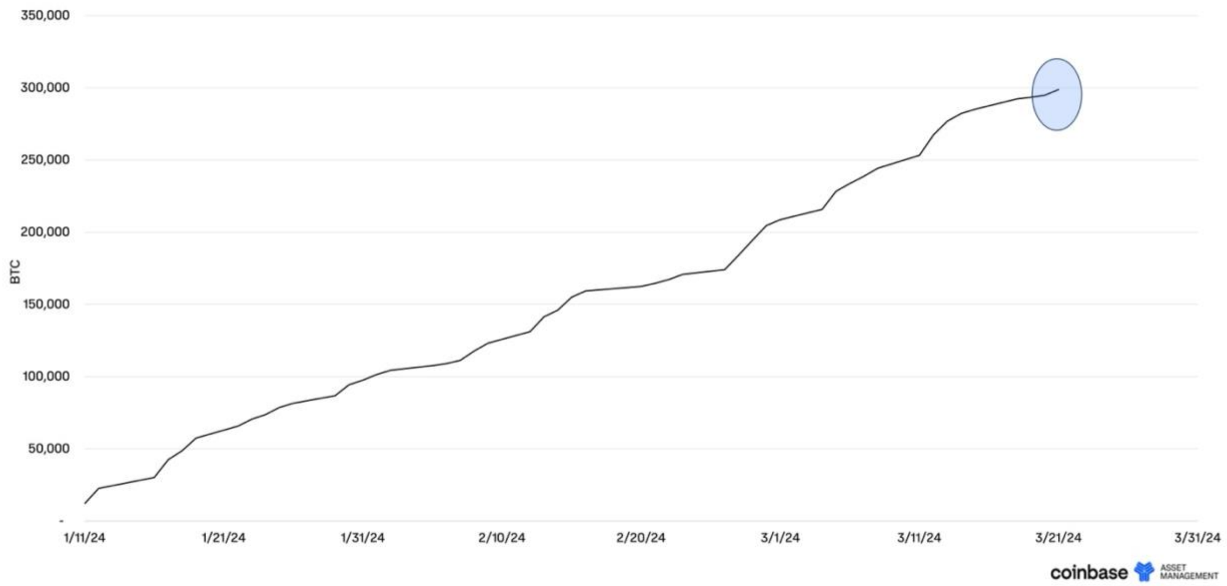
Figure 1: Bitcoin ETF Holdings Excluding GBTC – No Jitters



Source: Bloomberg LP. Coinbase Asset Management calculations.

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