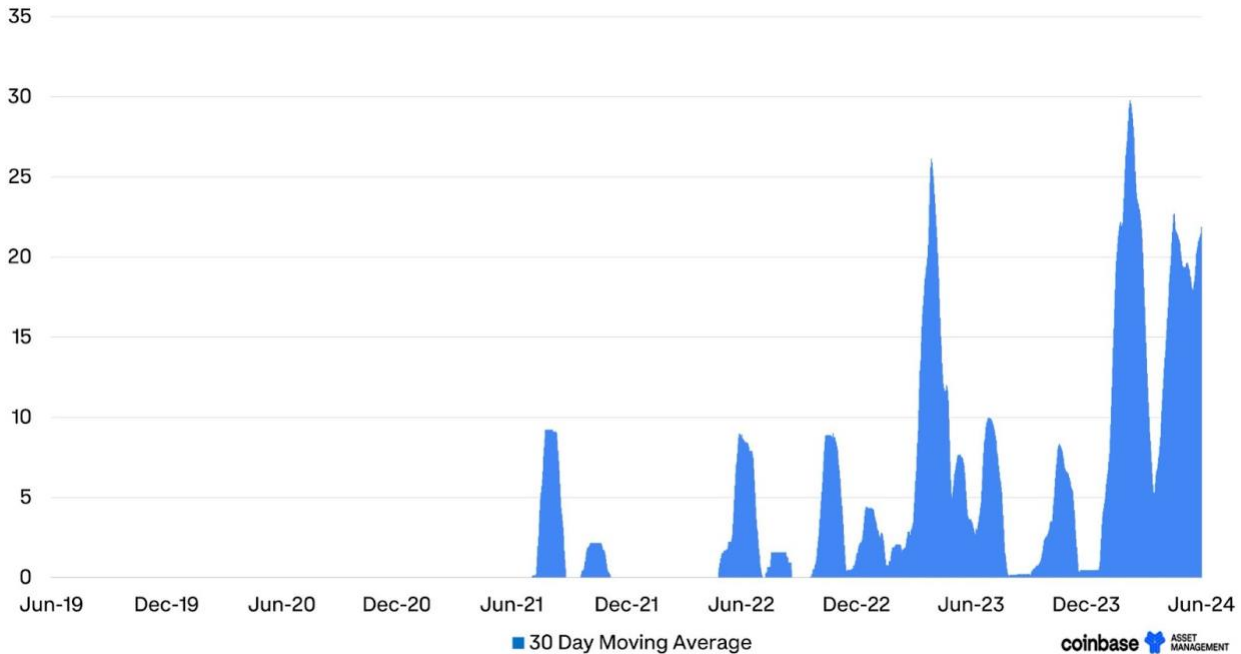


# market notes: Plumbers Need Tools

Passive strategies are dominating crypto investing. Or are they? The details show strong demand for active strategies. Rising market dispersion also indicates greater diversity for active investing in crypto.

Passive strategies are dominating crypto investing. Or are they? The details show strong demand for active strategies. Rising market dispersion also indicates greater diversity for active investing in crypto.

Figure 1: Where’s My (Dispersion) Volatility?



Source: Coin Metrics. Coinbase Asset Management Calculations. Dispersion is the absolute value of the median deviation of daily returns of the ten largest crypto assets relative to bitcoin, measured in basis points. Assets include ADA, AVAX, DOGE, ETH, SHIB, SOL, TON, TRX, XRP and BTC. The measure is illustrative.

**market notes: Plumbers Need Tools**

**6/21/24 - Marcel Kasumovich, Deputy CIO, Coinbase Asset Management**

1. Passive investing seems to be dominating the crypto markets, evidenced by significant **inflows** into exchange-traded products (ETPs). But is it? Institutional engagement has skyrocketed, signaling that crypto is entering the US regulatory mainstream. This has led to a thriving landscape for active management, poised for rapid growth. But the signs are subtle. Exploring volumes and market dispersion reveals a thirst for higher risk-adjusted returns central to active management.
2. We start with trading volumes of ETPs – a familiar theme. They are high. Last month alone, roughly **\$2 billion** changed hands for assets under management of around **\$60 billion**. It represents more than 3% daily turnover, meaning ETP assets are turning over every 30 trading days. Such turnover is indicative of active investing. Investors buy the

ETF and sell the futures against it, earning a spread over risk-free rates that, if well managed, has no correlation to Bitcoin.

3. So, active crypto investing is in vogue, after all. But yield opportunities in crypto markets are just “a trade.” In mature foreign exchange markets, the forward price of a currency reflects interest rate differentials. Yes, you can earn a 5% premium owning the US dollar against the Japanese yen. But the forward value of the US dollar trades at a 5% discount to the yen. That basic no-arbitrage condition doesn’t exist in crypto – yet. Institutional capital is capitalizing on the inefficiency.
4. As capital arrives to end some inefficiencies, new ones will arise. Investors can be expected to use familiar filters from traditional markets to evaluate potential active opportunities in crypto assets. Trend-like strategies are ideally suited to benefit from crypto adoption, focusing on price-based risk management to capture upside returns with far less downside volatility. Though dominated by Bitcoin and Ethereum today, that opportunity set will also broaden.
5. And asset dispersion is central to new active opportunities. Dispersion defines the breadth of active strategies – in all assets, not just crypto. To track dispersion, we create a simple metric defined by the median deviation of the top ten crypto assets relative to Bitcoin (Figure 1). Dispersion is spiking higher for longer – a good sign for new strategies. There was no dispersion when Bitcoin stood alone. It shot up in 2021 and is much higher now. It tells us two things.
6. **The first is statistical** – a classic mean-reversion concept. Our dispersion metric illustrates that sharp spikes higher are associated with equally violent downturns. This can be exciting when looking for statistical anomalies. Outlying positive or negative performance relative to the Bitcoin benchmark leads to fast reversion. It suggests investors can bet against large dispersion, as it is short-lived. And the more dispersion that emerges, the more opportunities there are to harvest.
7. **The second is fundamental** – statistical dispersion can be a filter for identifying where to dig deeper on individual assets. Statistical dispersion metrics are unlikely to be reliable on their own for such a new asset class. Imagine a killer application emerges, taking market share from Bitcoin. Statistical arbitrage tells you to be against it. The fundamentals may paint a very different picture. They are better together – like peanut butter and chocolate – more symbiotic than competitive.
8. We can also lean on our [Digital Pulse](#) to capture dispersion patterns, studying common fundamental onchain metrics. Today, the range of scores across the top ten assets is

from 26 for Cardano to 73 with Litecoin (scale of 0 to 100). Similar to price dispersion, the Digital Pulse draws attention to outlier scores by categories and assets. It may signal a continuation of a trend or a reversion. Most importantly, it's a tool that lets active investors screen hundreds of assets.

9. But be careful. Dispersion and disruption come in many forms. Consensus opinion today slots crypto assets as a separate line item from traditional ones. But what if crypto advances within existing corporate structures? The value of disruptive technologies, like the internet before it, may be monetized through conventional means. To that end, MarketVectors created an [index](#) of publicly traded companies. And it also shows dispersion, having greatly outperformed Bitcoin recently.
  
10. Looks can be deceiving. While passive investing may be surging, there is significant active trading beneath the surface. The recent stalling of Bitcoin inflows reflects fewer attractive low risk yield opportunities, not a saturation of crypto demand. The increasing dispersion among publicly traded companies also suggests that investors are exploring diverse strategies for exposure. Despite appearances, it shows active crypto strategies are quietly and steadily gaining momentum.

# Disclaimer

This communication, including any attachments, is intended only for the use of the addressee and may contain information that is confidential or otherwise protected from disclosure. Any unauthorized use, distribution, modification, forwarding, copying or disclosure is strictly prohibited. If you have received this communication in error, please delete this message, including any attachments, and notify the sender immediately. The information and any disclosures provided herein do not constitute a solicitation or offer to purchase any security or other financial product or investment and is not intended as investment, tax, or legal advice. Unless otherwise noted, all information is estimated, unaudited and may be subject to revision without notice. Past results are not indicative of future results.

This communication may contain statements of opinion, including but not limited to, the author's analysis and views with respect to: digital assets, projected inflation, macroeconomic policy, and the market in general. Statements of opinion herein have been formulated using the author's experience, research, and/or analysis, however, such statements also contain elements of subjectivity and are often subjective in nature. In addition, when conducting the analyses on which it bases statements of opinion, the author(s) will incorporate assumptions, which in some cases may be shown to be inaccurate in the future, including in certain material respects. Nothing in this presentation represents a guarantee of any future outcome. The author(s) are under no obligation to update this document, notify any recipients, or re-publish the content contained herein in the event that any factual assertions, assumptions, forward-looking statements, or opinions are subsequently shown to be inaccurate.

This Presentation may contain statements of opinion, including but not limited to, Coinbase AM's analysis and views with respect to: digital assets, projected inflation, macroeconomic policy, the market adoption of digital assets, and the market in general. Statements of opinion herein have been formulated using Coinbase AM's experience, research, and/or analysis, however, such statements also contain elements of subjectivity and are often subjective in nature. In addition, when conducting the analyses on which it bases statements of opinion, Coinbase AM will incorporate assumptions, which in some cases may be shown to be inaccurate in the future, including in certain material respects. Nothing in this video presentation represents a guarantee of any future outcome. Information provided reflects Coinbase AM's views as of the date of this video presentation and are subject to change without notice. Coinbase AM is under no obligation to update this Video Presentation, notify any recipients, or re-publish the content contained herein in the event that any factual assertions, assumptions, forward-looking statements, or opinions are subsequently shown to be inaccurate.

Certain information contained in this Communication constitutes "forward-looking statements," which can be identified by the use of forward-looking terminology such as "may", "will", "should", "expect", "anticipate", "target", "project", "estimate", "intend", "continue" or "believe" or the negatives thereof or other variations thereon or comparable terminology. Forward-looking statements made in this communication are based on current expectations, speak only as of the date of this communication, as the case may be, and are susceptible to a number of risks, uncertainties and other factors. Assumptions relating to the foregoing involve judgments with respect to, among other things, projected inflation, the regulation of digital assets and macroeconomic policy, all of which are difficult or impossible to predict accurately and many of which are beyond our control. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation to future results or that the objectives and plans expressed or implied by such forward-looking statements will be achieved.

Certain information contained herein may have been obtained from third party sources and such information has not been independently verified by the author(s). References herein to third parties are for illustrative purposes and are not an endorsement or recommendation for products or services. No representation, warranty, or undertaking, expressed or implied, is given to the accuracy or completeness of such information. While such sources are believed to be reliable, the author(s) do not assume any responsibility for the accuracy or completeness of such information.