WHY DIGITAL ASSETS NOW?

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GALAXY
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BY STEVE KURZ

Partner and Head of Asset Management
Galaxy Digital

We've entered a new phase in the evolution of digital assets. Macro and technological trends are converging as powerful tailwinds. Infrastructure and regulatory landscapes continue to mature. And a new wave of investors is entering this asset class for the first time. We expect these supportive factors to strengthen, making 2021 the most exciting year for digital assets yet.

While the macro environment spells potential trouble for traditional asset classes, digital assets—particularly bitcoin—stand to gain from the uncertainty. In fact, they already have. Bitcoin is up 218% year-to-date on the heels of the U.S. government's record-breaking stimulus in response to the COVID-19 pandemic.[1] As of September 30, the federal budget deficit stands at over $3.1 trillion with an additional $1.8 - $2.2 trillion of stimulus on the table.[2] Bitcoin's fixed supply and uncorrelated nature make it an attractive asset in this context. There will only ever be 21 million bitcoin, and bitcoin's long-term correlation to traditional assets is -0.2 to +0.2.[3]

Another important tailwind is the current trend toward digitization. We are entering a new phase of technological progress, in which manual and analog processes are becoming rapidly digitized. And COVID-19 has only accelerated this trend. Microsoft's CEO noted at the start of the pandemic that, "We've seen two years' worth of digital transformation in two months."[4] More and more companies are dedicating significant resources to the space, and more and more traditional players are changing their tune on digital assets and their underlying blockchain technology. J.P. Morgan, famously skeptical of digital assets just three years ago, has officially deployed a blockchain-enabled payments system called JPM Coin. Moreover, its Global Markets Strategy analysts now report a bullish outlook on bitcoin, indicating that its value could triple, challenging gold.[5]

As financial services incumbents evolve slowly, the technology companies that have quickly embraced digitization are significantly outperforming the old guard. Payments giant PayPal recently announced that it will allow its 346 million users to buy, sell, and hold cryptocurrency

[1] Source: Bloomberg as of 12/18/20
[2] Source: Congressional Budget Office (CBO), 2020 budget deficit
[3] Source: Bloomberg, Galaxy Digital Research
[4] Source: Microsoft quarterly earnings report statement, April 2020
[5] Source: J.P. Morgan, Global Markets Strategy "Flows & Liquidity" report, November 2020

in their accounts. PayPal's stock is up 116% YTD, outpacing traditional institutions who have been slower to embrace the growth of digital payments and digital assets.[6] Overall, 39% of companies have already incorporated blockchain into production according to a recent Deloitte study.[7] We expect to see this number grow as companies continue to look to blockchain as an enabling technology for the next wave of digitization.

Increasing corporate adoption is in large part due to the significant institutional infrastructure improvements we have seen in recent years. This is not the digital assets world of 2017. Blue chip names such as CME, Fidelity, and Bakkt (primarily owned by Intercontinental Exchange) are setting new standards for the custody, trading, and settlement of digital assets. They are collectively subject to regulatory oversight from the SEC, CFTC, and FINRA. Additionally, they are audited by Big Four accounting firms, and have received SOC reports as a result of routine independent SOC exams. Galaxy Digital itself has played a role in crypto's institutional infrastructure build. In partnership with Bloomberg, we launched the Bloomberg Galaxy Crypto Index (ticker: BGCI) in 2018 and the Bloomberg Galaxy Bitcoin Index (ticker: BTC) in 2020 to improve data integrity and standardization among digital assets.

Advances in the regulatory framework and dialogue represent yet another tailwind for digital asset adoption and growth. In mid-2015, the New York Department of Financial Services (NYDFS) started to grant cryptocurrency licenses and charters. Two years later, the US Commodity Futures Trading Commission (CFTC) approved platforms like the Chicago Mercantile Exchange (CME) and the CBOE Futures Exchange (CFE) to trade bitcoin futures. In mid-2018, the staff at the Securities and Exchange Commission (SEC) clarified bitcoin's status as a non-security, an important assessment as debate around cryptocurrency regulation was often focused on coins' status as securities.

More recently, the Office of the Comptroller of the Currency (OCC) clarified its stance on custody: financial institutions may custody digital assets on behalf of their clients. Kraken, a San Francisco-based exchange, recently announced that it received approval for a banking charter in Wyoming—the first digital asset company to do so. Central Bank Digital Currencies (CBDCs) have also been gaining traction in late-2020. China finished its pilot testing of its digital yuan, worth over 1.1 billion yuan in transactions. Furthermore, the ECB has intensified its focus on a digital Euro, hinting that a digital currency could launch in the next few years. Technology companies are also advancing their efforts in digital assets. Facebook is bringing digital payments to its 2.5 billion users with stablecoins via its revamped Libra project, now called Diem. These regulatory developments have strengthened digital assets as an investable asset class, and we expect positive developments to continue.

As the space matures and the tailwinds strengthen, major investors are increasingly taking note. In May 2020, Paul Tudor Jones compared the role of bitcoin in a portfolio today to that of gold in the 1970s. He announced a 1 – 2% allocation as his best bet against the "Great Monetary Inflation." From August to October of 2020 alone, publicly listed companies MicroStrategy and Square announced nearly $500 million in aggregate bitcoin investments, both citing the uncertain macro landscape as key drivers for their decision-making respectively. Beyond bitcoin, so-called "altcoins" continue to increase in value. Ethereum's price has tripled year-to-date, helped by the growth of the Decentralized Finance (DeFi) space—financial smart contracts and applications built on top of the Ethereum protocol. DeFi has experienced exponential growth this year with Total Value Locked (a key metric in the DeFi space) growing from $676M to $13.9B as of this month.

We anticipate seeing more corporate treasuries to follow MicroStrategy and Square's lead as concern about the weakening of the U.S. Dollar increases. Major altcoins will strengthen as the ecosystem continues to evolve. And in this macro environment, technological trends and infrastructure developments will continue to draw more investors to this asset class.

[6] Source: MarketWatch, 12/18/20
[7] Source: Deloitte 2020 Global Blockchain Survey

CONTACT US

(212) 390 9205
GFM@galaxydigital.io
galaxyfundmanagement.com

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