

Managed Fund update

30 June 2021

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1. Year in review

Perhaps the most remarkable thing about the last twelve months is that we ended it disappointed. Despite the performance of the fund +370% and the progress the whole sector has made in the last twelve months, you can't help feeling it might have been better, particularly because in April it was.

That is the feeling I have had ever since I became involved in this sector. Its capacity to surprise and then disappoint is remarkable but I don't think it will change for another ten years. Only at the point when digital assets become firmly established features of our financial system will things settle down. When we get there, we might be disappointed that things aren't like they used to be. The good old days are now.

As to performance itself, our unit price stands at \$6.10 up from \$1.30 at this point last year. Clearly that is significant, but I think only now are we being rewarded for risk we took in 2018 and 2019 when performance was much less impressive and it's only fair that we consider the performance over a three-year stretch. Even then, a 75% per annum return is very good.

The best performing asset in the fund was the Binance token currently at \$404 up from \$22 this time last year. That might seem ridiculous but perhaps indicates how under researched this sector is. Binance was hugely profitable this time last year and growing quickly. It wasn't until the Coinbase listing in the US that there was a general realisation just how profitable these exchanges had become and that was quickly reflected in the Binance price.

Binance remains a much larger exchange than Coinbase, with a lower market capitalisation. Albeit the legal framework around value is more uncertain and that is now being reflected in regulatory issues in the UK and Canada. What is certain is that Binance will not want to underperform Coinbase and one might become a leading indicator for the other as time progresses.

Our underweight position on ethereum cost us slightly as ethereum significantly outperformed bitcoin in the twelve-month period. I remain comfortable with that, and we will be sharing a paper setting out why that is and why it will remain our position.

All told though, our conviction is stronger than ever. It is not that our economic argument is playing out so nicely, which it is, there are two things which are particularly compelling about the sector.

The Cohort

People under 35 do not need to be 'sold' on digital assets. They have grown up in the digital age and they expect that everything will be digital. They inherently do not trust our current institutions, mostly because they have been failed by them. I do not see this changing, all the arguments we hear, all the bombast, comes from the cohort with the most to lose, the people that benefit from dollar hegemony. Time is on our side.

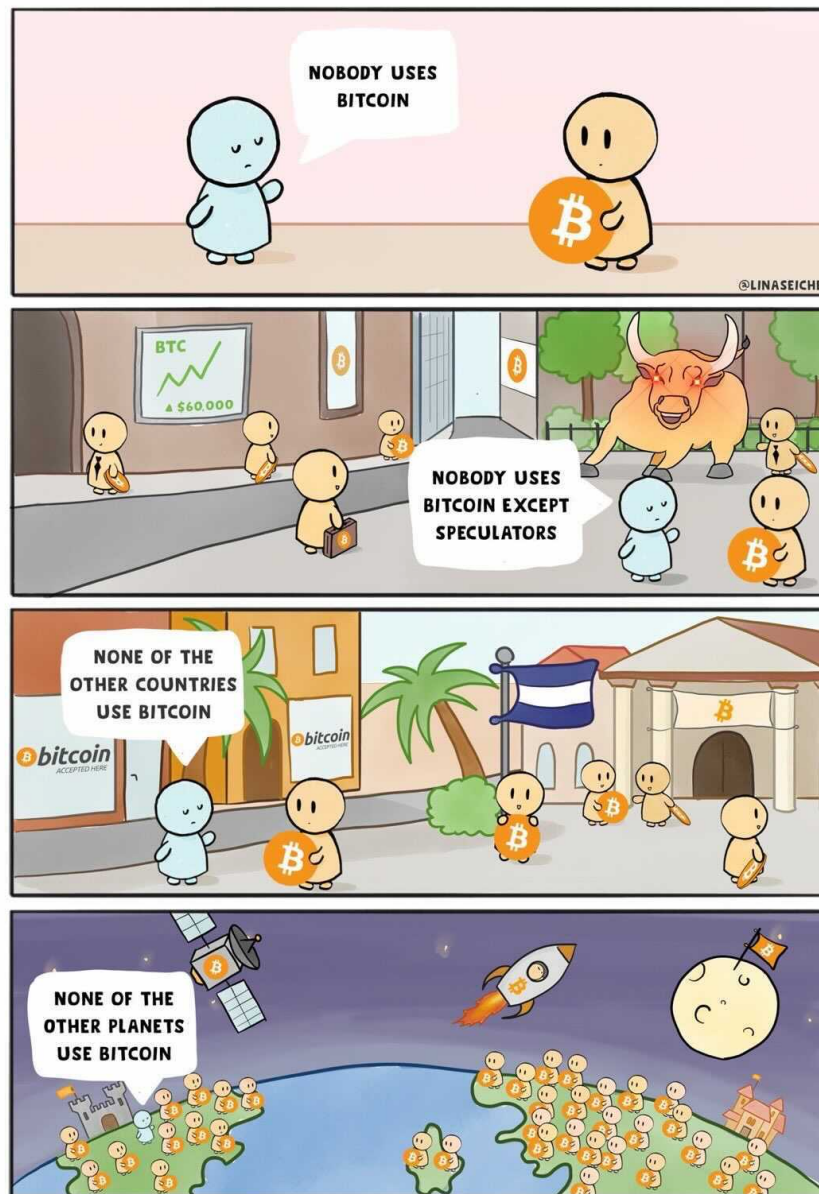
The Technology

The encryption genie only really jumped out of the bottle in the 1990s having been a state secret for 30 years. It is now used everywhere across the internet despite government efforts to contain it. Now that the technology has been applied to money, I don't see money ever going back.

What is more, this tech is so powerful that while it was true 30 years ago that people graduating with high quality degrees went to Wall Street to make their money, I do not believe this is the case any longer. The rockstars these days all work in technology because that is where the money is. Indeed, the true rockstar developers work on digital assets and there are many of them. In the last five years they have made a fortune simply by building out the protocols. I don't see that stopping, I don't think it has even really begun.

Overall, it will be rough. There will be price crashes, there will be bans, there will be exchange hacks and ransoms and bad press. Bitcoin will be in the news every single day and you should draw your own conclusion from that fact alone. The path is very similar to the internet, nobody uses it, it's a novelty and then, suddenly, it's ubiquitous.

I can't really summarise it better than this.



2. Changes going forward

We are making some changes going forward. All of which I think will benefit both existing and new investors.

- **Daily Unit Pricing:** from 1 July 2021 unit pricing will be daily. This will help liquidity since people can enter and exit the fund much more easily.
- **New website:** not quite finished but this will incorporate our historic unit pricing and include daily unit pricing so you can simply refer to the site for valuations.
- **Monthly tear sheet:** from July you will receive a monthly written update on the fund performance. Key health metrics generally across the sector. This should provide everyone with a more fund focussed summary on what is happening rather than the weekly note which has a rather wider span of topics (the weekly will continue).

- **New team members:** we are also adding some new members to the team, and we are delighted to welcome Paul Rayson, former Managing Director of Commonwealth Securities (Commsec). Paul will join our Investment Committee and advise us more generally on our approach to traditional market participants who are entering this sector for the first time.



Currently Chief Executive Officer of Hearts and Minds Investments Limited

Formerly the Managing Director of Commonwealth Securities Ltd (CommSec) and Australian Investment Exchange Ltd.

Paul has extensive experience in investment markets, technology, banking and risk management.

3. Unit pricing

We have charted the movement of the unit price over the year.

The Managed Fund Performance FY2021



The key call outs in particular:

- **A.** The **PayPal** announcement: this was a first from an old money entrant who started selling a number of assets on their app including Bitcoin and Ethereum. This is still developing as only US customers can do this, once PayPal rolls out to the rest of the world the impact may well become more significant
- **B. Micro-strategy** and the commencement of bitcoin corporate treasuries. Perhaps one of the strongest advocates for bitcoin over the course of the year was Michael Saylor of MicroStrategy. Their significant investment in 91,000 bitcoin in December last year was a huge moment
- **C.** The **Tesla** announcement: this generated the surge in March and April. As I said in our weekly updates at the time the attachment of Bitcoin to Tesla was something I would prefer to avoid and I still would like Elon to stop opining on Bitcoin. At the very least that he is prepared to invest company money in Bitcoin reveals that they understand the environmental impact of bitcoin is likely to be a net positive and not the other way around, even if we aren't there yet.
- **D. Elon Musk** intervention. An unhelpful moment but when we look back this will be fascinating, it shone a light on the ESG argument around bitcoin and as it turned out 50% of bitcoin was mined with renewable energy, higher than almost any other sector in the world.
- **E. China** banning mining. A significant and difficult moment. This continues to play out and will be a gift for America if they decide to accept it. This is the first state-sponsored attack on the Bitcoin network with 35% of the hash rate disappearing. The price reacted accordingly but the protocol itself barely blinked.

4. Risks

We are now moving into a different era of risk for this sector. Originally, we would have had to consider the “will we even make it risk”. I don't think that is a significant factor now, perhaps the conversation is better expressed as “in what form will we make it”.

Regulation

International regulators are now looking closely at cryptocurrency. The Basel Committee has published proposals in June that would require very high levels of collateral from banks that engage with cryptocurrency to the point that it will make their proprietary trading un-economic.

This is actually a gift to the whole FinTech sector because you can effectively count out the incumbent banking sector from being meaningfully involved. The real issues are:

What will America do?

We know a ban is unlikely, but I think on-ramps are likely to get much stricter over a certain amount. They could meaningfully slow progress as follows:

- Ownership declarations. If you own digital assets, you must disclose them. If you don't and subsequently dispose of them tax will be penal.
- A higher rate of tax on cryptocurrency assets (hard to do constitutionally).
- Declarations for all payments and purchases of assets in bitcoin.
- Cross-border declarations as there are now for cash >\$10,000.

What will China do?

China will likely continue to take a strategic interest in cryptocurrency despite their recent crackdown. They will not risk ceding their current advantage in digital payments to the US. So, I expect the following:

- Digital yuan-renminbi in the next 12 months. This will be a huge moment. I should call out also that Brian Armstrong the CEO of Coinbase met Jerome Powell head of the Federal Reserve in May to discuss this. He didn't miss his opportunity.

"Crypto is as important as the birth of the internet in terms of the jobs, GDP growth, and innovation it can create. The U.S. will need to be a major player in crypto to stay relevant long term."

- Expect extreme pressure on USD Tether while the yuan launches.
- Mining to return in 2023.

China is clearly leading despite the crackdown; the question is only how far ahead are they?

Europe

I expect the most draconian measures from the ECB. They simply have the weakest enforcement mechanisms because of the multi-nation structure of their currency. We cannot rule out an outright ban from Europe. Whatever happens you can almost be certain they will be years behind China and America and from the perspective of this industry have just about rendered themselves irrelevant, as anyone who has tried to operate in this sector from Europe will tell you.

5. Fund components

Thematically there are no major changes to the Managed Fund:

- **Store-of-Value:** digital gold
 - This category is represented in the fund entirely by Bitcoin. We do not yet see any competitors for this particular segment of the market and we do not expect to see any.
- **Decentralised ecosystems:** virtual worlds, with their own economies and currencies.
 - Decentralised worlds like Decentraland – essentially virtual reality environments building their own economies.
- **Gaming:** video games with native digital currencies and purchasable assets.
 - Closed loop eco-systems so users will spend inside a game.
 - Strong imperative for developers to integrate native currencies which they can monetise.
 - Integration of currency takes games out of the net of the Apple ecosystem where many of them are trapped.
- **De-Fi:** decentralised finance. Specifically, this means peer to peer finance arrangements managed by computer code and not by middlemen like brokers, banks and FX desks.
 - Binance is our major position here
 - Ethereum will continue to benefit since it is the basis on which many of the DeFi platforms are built

Looking forward to an exciting few years.