ELEMENT

Our Weekly Thoughts

ELEMENT DIGITAL ASSET MANAGEMENT

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At press time, BTC is trading at $7.5k or -10% in the past week. The entire space is following in lockstep, having traded down ~11% in the same time period. Blockchain Week is slowly shaping up to be the biggest head fake in the recent history. The Consensus pump ended up being a crowded trade. Market participants are now taking risk off the table at a time when negative headlines are coming out of Asia and US/Canadian regulators are cracking down on ICO frauds. By themselves, these news headlines are not enough to create a panic and move the market to the extent that its moved. But taken together and coupling the macro environment with trendless price action and what results is a market that tends to react more to bad news than it does to any good news. So if Blockchain Week was one giant party (which in some ways it was), what we're witnessing right now feels like the hangover. Lets hope it passes soon. Anyway, here are some of our other observations this week:

1. The digital asset marketplace is in a state of extreme fallibility. As legendary investor George Soros so astutely stated, as long as a situation has thinking participants, the participants' view of the world is always partial and distorted. How does this apply to cryptocurrencies? Simple. We (market participants) are bombarded with inputs from a variety of sources (social media, colleagues, technical signals, etc) and because we are human, our consumptions of these inputs along with the necessary feedback loops associated with any decision making process are subject to our limitations to condense, order and interpret these signals. We (all market participants) will misinterpret certain inputs. We will make mistakes. We will distort realities. We will fall prey to our own biases. Almost everyone, including some noteworthy public figures, called for major price growth post Consensus. Their versions of reality were shaped by the plethora of inputs available in the world and their actions in their portfolios likely reflected that. Whether or not those actions are appropriate is another story. (Next week we'll continue on this theme and talk about how the market is also in a state of extreme **reflexivity**.)

2. It's time to start paying attention to global supply. In equity markets, the degree to which companies buyback their stock, issue new shares, raise funding through IPOs are important factors in determining a country's or the world's equity prices. The reason is that investors and speculators, on a country-wide or global scale, have a fixed amount of capital to allocate to equity markets, and buybacks and issuance determine the net supply of equities — buybacks reduce a country's supply while issuance raises it. Can the same idea be applied to cryptocurrencies? Few cryptocurrencies have built in mechanisms to reduce the supply of the coin, although there are a few exceptions. Some coins like Binance Coin engage in buyback-like activities by burning tokens. Other coins like Ripple destroy a small amount of the token to prevent spam transactions. On an industry-wide scale, all coins likely lose a small amount over time as coins are lost due to hardware failures or user error. On the issuance side, many coins like bitcoin have a hard cap on the number of tokens that will be minted but are still in the inflationary stage of their lifecycle — currently bitcoin experiences an annualized inflation of about 4.3 percent per year. Projects that create all their tokens at inception (like most ERC-20 tokens) experience de-facto issuance as the tokens allocated to founders or the foundation slowly make their way into the circulating supply. The biggest source of issuance, however, is the large number of new projects that are raising funds through private sales and ICOs. These projects raise the global supply of cryptocurrencies **without** a commensurate increase in the fundamental value of the asset class. According to Coindesk's ICO Tracker, over $7 billion USD of funding has been raised since the start of this year. This represents a large increase in the global supply which depresses the prices of all existing projects. The imbalance between the methods available to projects to decrease supply and the methods available to increase supply also suggest that cryptocurrency prices will continue to face downward pressure.

3. It's also time to apply a little game theory logic to miner activity. Miners represent some of the largest stakeholders in the cryptocurrency universe. Historically, miners have been true believers and supporters of Bitcoin and other cryptocurrencies - choosing to take profits in manageable chunks or holding off on selling coins to support prices. However, the world of mining has changed from one made up of evangelists to one where large-scale facilities (read: businesses) reign, making fluctuations in price more deadly. Although it is not clear what the true break-even cost to mine Bitcoin is (estimates range from $6,000 to $8,600), it is conceivable that in a weakening market where prices are approaching or have crossed this point, miners will sell off their holdings in an attempt to sustain operations especially since machines will be shut down below the profitability point.

4. Cryptocurrency prices are going down but private investments into the underlying technology are going up. This is not like the dotcom era when all capital (both public and private) stalled. The cryptocurrency market was overheated at the start of the year. It corrected. It's quite possible that it is still correcting. This is not a great for recent market entrants who subscribe to the HODL strategy however this kind of market is necessary to flush out all the greedy money (investors and projects alike). The smart money is currently not focused on current price; they care about future price. Venture investment into projects year to date is approaching $1.3B. **Note that this excludes tokens.** That level of investment is indicative for how a long term value driven investor perceives this market. And most institutional crypto fund managers share that sentiment (as do we). We are not too concerned about where bitcoin is trading right now. We're all long term bullish on the growth of this marketplace. And we express this view with a more long term focus on alpha. Whenever we're asked to predict where the price of bitcoin will be tomorrow, we still do make a conscious effort to provide a future value supported by some semblance of a thesis. We think we are good at that. However this type of thinking takes a good deal of effort. Sometimes it'd be so much easier to just yell Fugazi :)

"Number one rule of Wall Street. Nobody...and I don't care if you're Warren Buffett or if you're Jimmy Buffett. Nobody knows if a stock is gonna go up, down, sideways or in circles. You know what a fugazi is?...It's a whazy. It's a woozie. It's fairy dust. "

- Matthew Mcconaughey in *Wolf of Wall Street*

Thanks for reading everyone. Questions or comments, just let us know.

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Disclosures