



# WHY BITCOIN NOW?

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FUND MANAGEMENT



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This has been an unprecedented year for markets, with no asset class exempt from economic disruption and market volatility. While the overall market has largely rebounded from its March low, digital assets continue to outperform their traditional counterparts and represent an even greater opportunity on a go-forward basis. The case for bitcoin specifically is stronger than ever—now is the time to invest.

The fundamental shift in the macroeconomic landscape has created a supportive backdrop for bitcoin. Broadly, paradigm shifts occur when external forces challenge the status quo. Specifically, there are two trends that make bitcoin an increasingly compelling offensive and defensive play. Bitcoin provides investors upside exposure to digitization: the world is digitizing at a breathtaking pace, and bitcoin is well-positioned to grow alongside that trend. Bitcoin also provides potential downside protection as a compelling macro hedge. Its uncorrelated nature makes it an attractive portfolio diversifier in uncertain times: correlation to equities remains stable during most time periods between -0.2 and 0.2.<sup>1</sup> Moreover, bitcoin's fixed supply—there will only ever be 21 million—stands in sharp contrast to the Federal Reserve's rampant money

printing. May's halving event lowered the coin's annual inflation rate from 3.6% to 1.8% while 2020 US deficit estimates approach 20% of GDP.<sup>2</sup>

Beneath this macroeconomic overlay lies a regulatory foundation that represents another accelerant for bitcoin's 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 their stance on custody: financial institutions may custody digital assets on behalf of their clients. These regulatory developments have strengthened bitcoin as an investable asset.

<sup>1</sup> Source: EXM Capital Research, 2020.

<sup>2</sup> Per the Committee for a Responsible Federal Budget, the fiscal 2020 US budget deficit is expected to hit a record \$3.8 trillion, 18.7% of US economic output.

Institutional infrastructure has developed in tandem with regulatory advancements. 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. EXM itself has played a role in crypto's institutional infrastructure build; we launched the EXM Crypto Fund (ECF) in 2016 to improve data integrity and standardization among digital assets. These infrastructure improvements have in turn established the rails for institutional quality products like our EXM Crypto Index Fund and EXM Dynamic Credit Fund, and are a key reason our funds have received a positive operational due diligence score from a major global investment consultant.

Bitcoin's macro landscape, regulatory foundation, and institutional infrastructure have already caught investors' attention. Its adoption path is now rapidly clarifying. We expect to see bitcoin adoption levels increase across two major investor categories, both of which have largely avoided crypto to date: traditional hedge funds and wealth channels. Legendary hedge fund manager Renaissance Technologies has reportedly invested in bitcoin futures, and Tudor Investment Corporation has made a bitcoin allocation. In a recent letter to investors, macro expert Paul Tudor Jones compared bitcoin's role in a portfolio today to that of gold in the 1970s. He also bet that bitcoin would be the best-performing hedge against the current Great Monetary Inflation and subsequently disclosed a portfolio allocation of "1% to 2%" towards bitcoin as protection against the potential decline of the U.S. dollar.<sup>3</sup> The Tudor news means the proverbial Rubicon has been

crossed for bitcoin, which can now be considered another inflation fighting tool for hedge funds. We expect other hedge funds to follow in Tudor's footsteps. Traditional wealth managers, like hedge funds, are also waking up to the potential benefits of bitcoin. 59% of advisors now indicate that they are likely to allocate client portfolios to bitcoin within the next 12 months. Advisors are also responding to increased end-client interest; 75% of advisors report that they have received client questions about digital assets in the past 12 months.<sup>4</sup> On the consumer side, PayPal is integrating bitcoin transactions for its 325 million users, and bitcoin alone drove \$17 million in gross profit for Square's CashApp in 2Q20, up 154% from 1Q20.<sup>5</sup>

We are not surprised that heightened interest in bitcoin across all investor types coincides with the broad acceleration of digitization. Microsoft's CEO recently said that the company has experienced two years of digital transformation in two months, and Gary Cohn wrote in the FT that the Coronavirus is speeding up the disappearance of cash. In the context of Cohn's piece, it makes sense that early drafts of the CARES Act contemplated distributing stimulus payments to US citizens rapidly and directly via digital wallets. We have also closely followed the revamped, yet still significant, plans to launch the Facebook-backed Libra project and bring digital wallets to Facebook's 2.5 billion users. We believe in a future in which digital money (USD, Chinese RMB), digital payments (Libra), and digital stores of value (bitcoin) exist side-by-side. Each of these projects will require sustained investment in digital payment rails and infrastructure, a reality which offers material support to the bitcoin as a digital store of value thesis. Bitcoin's future is bright, and now is the time to start incorporating it into portfolios.

<sup>3</sup> Source: Paul Tudor Jones' Investment Letter, May 2020.

<sup>4</sup> Source: RIA Channel surveys, 2020.

<sup>5</sup> Source: Square company filings.

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