BKCoin Capital

Market Commentary: June 2021

This month in digital asset markets Bitcoin posts a major win for the decentralization of money as Bitcoin finally gets adopted as legal tender, however, the struggle between the decentralization versus centralization of the global monetary system intensifies as several countries around the world reject the idea of private money. Lastly, more developments arise out of the institutional investment space as the biggest names in the traditional hedge fund space are making an entrance into crypto while investment banks continue to expand their product offerings to include digital assets.

El Salvador becomes the first country in the world to adopt Bitcoin as legal tender. Dubbed the “Bitcoin Law'', the Legislative Assembly approved statue compels merchants to accept Bitcoin as a payment option, forces prices to be stated in Bitcoin denomination, renders the Development Bank of El Salvador to ensure the immediate exchange between both currencies and exempts Bitcoin from capital gains tax (Decrypt). Additionally, El Salvador plans to efficiently mine Bitcoin with geothermal energy making El Salvador’s adoption of Bitcoin a win for clean energy as well (Think Geoenergy). Following the development, several Latin American countries then voiced their support for Bitcoin such as Argentina, Brazil, Colombia, Mexico, Panama and Paraguay (Cryptoslate). It is important to note, that this is the biggest development arising out of the cryptocurrency space this year. Despite El Salvador’s small population of around six million people, the country’s adoption of Bitcoin could be the catalyst that causes a “Domino Effect '' leading other countries to follow suit eventually causing Bitcoin to become a major competitor amongst G7 currencies.

Although the global adoption of Bitcoin as money has just crossed a major milestone, several countries around the world tighten their grip on their monetary systems. The European Central Bank (ECB) voiced their concern against digital currencies issued by tech companies stating that they need to issue its own Central Bank Digital Currency (CBDC) to preserve the status of the Euro (The Paypers). Likewise, the Central Bank of Indonesia is now mobilizing official supervisors to enforce the country’s ban on financial institutions that are utilizing crypto assets as a means of payment causing the central bank governor to emphasize that crypto assets are “not legitimate payment instruments under the constitution, Bank Indonesia Law, and Currency Law” (Cointelegraph). Most importantly, China is now taking more drastic measures in an attempt to ban cryptocurrency within its borders. Baidu and Weibo, two of the biggest internet services in China, have begun censoring keywords relating to crypto (The Block Crypto), while Chinese provinces have recently cracked down on miners causing an estimated 90% of China’s mining operations to be shut down (Global Times). On the other hand, China appears to be very close to rolling out its own Central Bank Digital Currency (CBDC) across the nation as China is completing its third Digital Currency Electronic Payment (DCEP) system trial in Beijing (Decrypt). In other words, it is obvious that China, along with several other nations, now view decentralized digital assets as a palpable threat to their own monetary systems.

Lastly, in other unrelated news, the cryptocurrency market saw several notable developments within the institutional investment space. State Street Corporation, the $3.15 trillion financial services company, is launching a digital currency division. The Chairman and Chief Executive Officer of State Street Corporation, Ron O’Hanley, stated the implementation of its new division is a result of digital assets being “one of the most significant forces'' impacting the financial services world within the next five years (State Street). Goldman Sachs, one of the most prestigious investment banks on Wall Street, is now expanding its trading desk to trade Ethereum derivatives. The rollout of its Ethereum trading desk follows Goldman’s recent launch of its Bitcoin derivatives trading desk back in May (Cointelegraph). In the traditional hedge fund space, George Soros’ investment fund, Soros Fund Management, has been given the “green light” to trade Bitcoin. This is important news because it marks another legacy asset manager entering into the digital currency space ([Bitcoin News]). Along with Soros Fund Management, Point72, the $22B AUM Steve Cohen backed hedge fund, is also in the early stages of launching a cryptocurrency investment division. The fund is searching for a Head of Crypto in order to lead the charge in a sector with "transformative and disruptive capabilities" ([Cointelegraph]).

Portfolio Overview

BKCoin Digital Asset Fund gained 0.88% while the Bloomberg Galaxy Crypto Index benchmark lost -10.53% and S&P 500 returned 2.33% for the month of June. Future spot basis completely collapsed reflecting the pessimism in the market after the huge selloff we had in May, which wiped off a lot of leveraged players. Bitcoin lost 5.9% while Ethereum lost 13.8% for the month - both assets are off almost 50% from all time highs. We saw the death cross in the Bitcoin market mid-June where 50-day moving average crossed 200-day moving average, which was shortly followed by Bitcoin dropping below $30,000 briefly. But the market bounced back above $30,000 swiftly showing the investors didn't completely lose confidence. However, the basis was completely muted, some even traded in backwardation as well as funding rates remaining negative throughout the month. While the market is consolidating, we found some mispricing arbitrage opportunities in the options market and we expect the market to be choppy in the coming months.

Token of the month

Token: Aave
Ticker: AAVE
Market Capitalization: $4.05B
Price: $311.24

Key Points

- AAVE now has the most TVL among DeFi protocols ($10.52B)
- The platform's success is driven by its ability to innovate and offer new products

- The launch of Aave Pro, could make Aave a vacuum for institutional capital as well as instigate the next leg of the DeFi bull market

Aave is one of the most well-known and successful DeFi protocols on the Ethereum blockchain. The credit platform enables users to borrow and lend capital via overcollateralized loans, allows users to switch between fixed and floating rates, gives lenders access to increased capital efficiency by distributing aTokens (an ERC-20 compatible asset that can be traded like any other asset within the Ethereum blockchain), offers flash loans (undercollateralized loans as long as it is paid back within a one block transaction), allows users to stake its native token Aave and receive stkAave, which like aTokens has the same accessibility within the Ethereum blockchain and lastly, permits users to borrow and lend against LP tokens from other DeFi protocols.

Aave has always been a pioneer in the DeFi space. Upon its launch, the platform was one of the first DeFi protocols to offer borrowing and lending among a variety of ERC-20 tokens, thereafter, it became the first DeFi protocol to offer undercollateralized flash loans and most recently, it became the first Ethereum lending and borrowing platform to become multi-chain (now compatible with the Polygon Network). Its ability to constantly innovate has been a key driver for the protocol's growth and success as Compound Finance initially supplanted itself as the trailblazer in the DeFi borrowing and lending space upon its launch of liquidity mining. Likewise, Aave's ability to incentivize users by offering liquidity mining on its V2 platform, as well as on the Polygon Network, has been a key factor in its accrual of $10.52B in Total Value Locked ("TVL"), the largest amount of TVL sitting on a DeFi protocol.

Interestingly, the money market platform is now once again pioneering a new initiative in the DeFi space, enabling institutional lending in the DeFi market via its launch of Aave Pro at the end of July. This event could instigate the next bull market in DeFi markets as institutional capital can now finally flow into DeFi protocols. If this initiative successfully unfolds, this could be a similar milestone to the launch of Compound's Liquidity mining program in mid-2020 that kicked off the first leg of the DeFi bull run as it caused the first major inflow of retail capital to enter the market. Additionally, Aave's support for institutional capital could not just lead to an increase in TVL for the project, while also increasing the TVL of other DeFi protocols, but more importantly, it could also pave the way for undercollateralized lending in the DeFi space. Since Aave Pro requires institutions to register via KYC and AML procedures, Aave now has a clear path way to be able to potentially track counter-party risk. In totality, Aave's plunge into the institutional DeFi space should make it a vacuum for institutional capital and as a result, be a key driver for its next stage of growth.

Interesting Tidbits

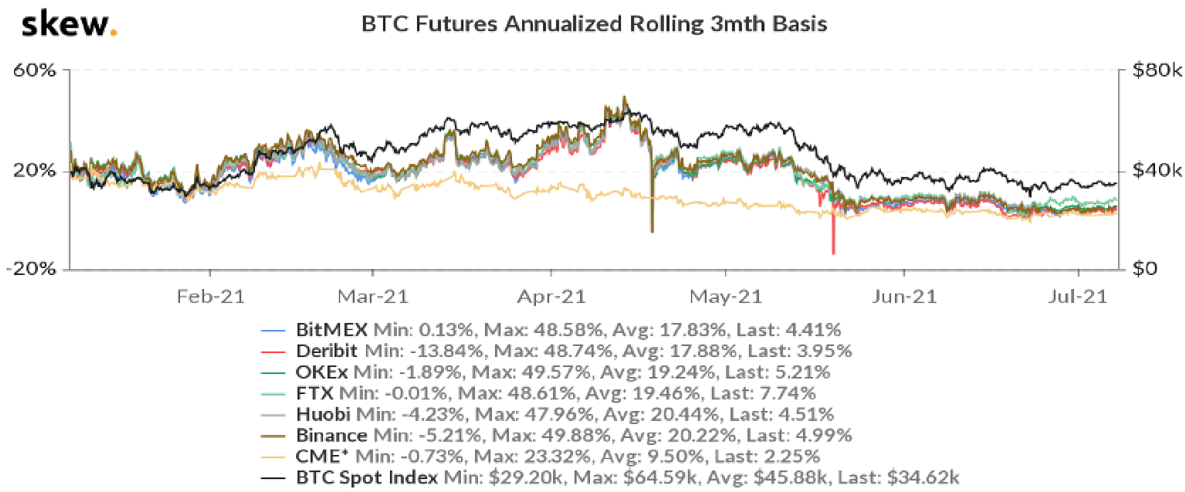

Chart 1.0: Bitcoin Basis Remains Subdued
Bitcoin's annualized three month (Quarterly) basis is averaging sub-double digit yields as Bitcoin's sell off in May continues to keep bulls, but more importantly, leverage on the sidelines. However, this is not uncommon as Bitcoin's basis has historically been extremely volatile fluctuating between market cycles.

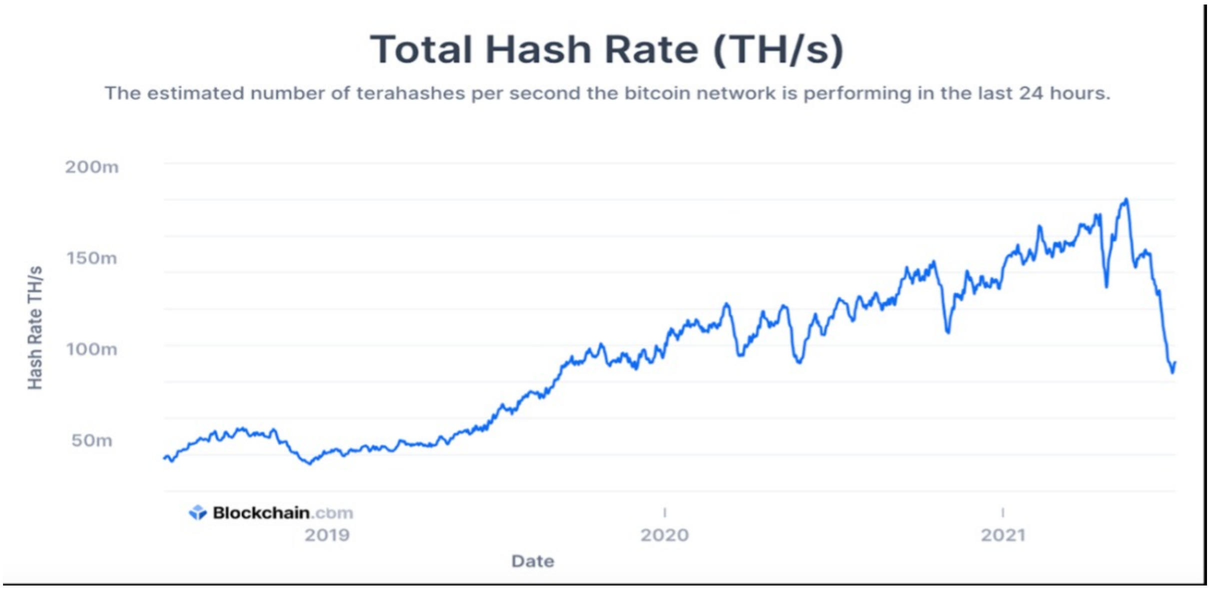

Chart 2.0: Hashrate Drops, but the Bitcoin Network Remains Strong
The recent mining ban across China has caused Bitcoin's hash rate to drop over 60% in the month of June. The political shock is expected to cause the extermination of 90% of China's crypto mining industry. Although hash rate is a key metric that measures the health of the Bitcoin network, the recent collapse actually shows the resilience of the Bitcoin network as it is still able to successfully operate despite such a major shock to the ecosystem.

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Looking Ahead

Despite the drawdown in cryptocurrency markets, we expect cryptocurrency markets to bounce in the second half of 2021 as Bitcoin's choppy price action may have institutions deploying capital into the asset anticipating that traders have finished selling off bitcoin. Likewise, important developments are expected to hit the DeFi space in the month of July possibly helping to juice the market's return during the month as Sushiswap prepares for a major product release and Uniswap is prepared to launch liquidity mining on its platform in the near future. Investors are also keeping close eyes on Cardano, as its upcoming smart contract release in August is a highly anticipated "make or break" development for the project.