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CoinShares Bi-Weekly Digest

Market Summary

11 Spot Bitcoin ETFs were finally and begrudgingly approved by the SEC after more than a 10-year battle. Chair Gensler subsequently noted that Bitcoin is a ‘primarily speculative, volatile asset that's also used for illicit activities, including ransomware, money laundering, sanction evasion, and terrorist financing’ whilst Commissioner Pierce celebrated the decision. Some of the largest ETF providers such as Vanguard have consciously made the decision not to provide Bitcoin ETFs, however we feel this might be a short-lived decision given the opportunity cost.

CoinShares and Galaxy have previously noted that approximately $14.4bn of inflows could occur (10% of a $14.4tn addressable market in the US invest in a spot bitcoin ETF with an average allocation of 1%) pushing price to $141,000 per Bitcoin. The first day of trading saw a total of $4.6B in volume with Grayscale Bitcoin Trust leading the way with $2.32B.

Artemis released developer data showing that the number of commits and active developers on Solana was outpacing Ethereum across most short-, medium- and long-term time frames. This is probably due to a couple of reasons: better composability but probably more so from recent months impressive price action. Optimism is clearly wining mindshare amongst L2s with Coinbase using their tech stack and the ‘Law of Chains’ vision coming out on top. Ethereum has had declining developer activity on Ethereum over multiple time frames perhaps because developers are moving to other alt-L1s, such as Solana, or Optimism. There could also be developer apathy or consolidation, with few developers doing the vast majority of major changes, although this is not necessarily a bad thing.

CPI came in slightly higher than expected for December ending 2023 up 3.4% year-over-year, whilst December’s PPI dipped 0.1%, representing three straight months of decline. The Fed’s interest rate hiking cycle along with QT has done its job of reducing inflation from its highs, with The Fed’s Logan suggests lowering QT pace as RRP reaches lower levels. Although higher for longer could still be on the cards due to persistent economic pressures such as major geopolitical tensions, rising oil prices, the ever-rising US debt and the strong labour market.

The economy remains resilient with The FEDs Brainard and Mester saying “work is not done” when it comes to lowering prices as March is too early for a rate cut. US bank earnings kicked off with mixed results. Geopolitical, and coming economic and financial instability all act as tailwinds for Bitcoin’s price.

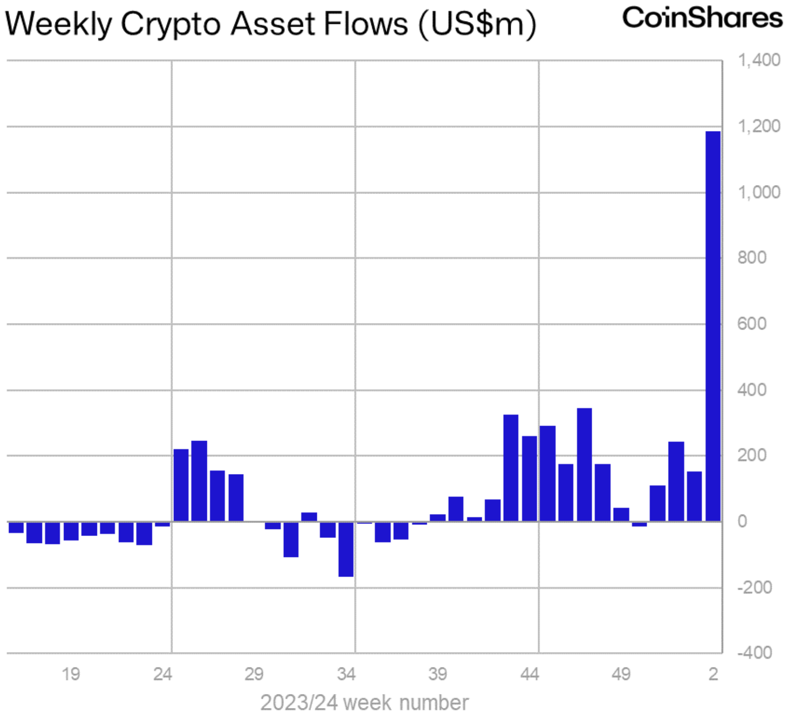
Further Research.

Digital Asset Fund Flows

Continued inflows at US$43m, Blockchain equities see largest inflows on record

- Digital asset investment products experienced their 11th straight week of inflows at $43m, with a notable increase in short position inflows due to recent price appreciation and perceived downside risks.
- Regionally, Europe led with $43m inflows, the US followed with $14m (half in short positions), while Hong Kong and Brazil saw outflows of $8m and $4.6m, respectively.
- Blockchain equities saw their largest weekly inflows on record at US$126m.

Full report here



Source: Bloomberg, CoinShares, data available as of close 12 January 2024

Flows by Provider (US$m)	Week flows	MTD flows	YTD flows	AUM
Grayscale Investments LLC/U	-579.1	-579.1	-579	34,634
CoinShares XBT*	-16.9	-13.5	-14	2,570
21Shares AG	13.9	25.6	26	2,375
ProShares ETFs/USA	265.2	337.4	337	2,122
Purpose Investments Inc ETF:	-21.6	-14.1	-14	1,914
ETC Issuance GmbH	-44.4	-29.1	-29	1,311
Coinshares Digital Securities	9.1	27.7	28	1,106
CI Investments Inc/Canada	7.7	16.9	17	806
Other	1,551.0	1,565.9	1,566	8,077
Total	**1,185.0**	**1,337.5**	**1,338**	**54,917**

Flows by Asset (US$m)	Week flows	MTD flows	YTD flows	AUM
Bitcoin	1,141.8	1,255.2	1,255	38,706
Ethereum	25.7	55.5	55	11,131
Multi-asset	5.6	11.2	11	3,393
Solana	0.5	-4.8	-5	750
Binance	-	0.3	0	310
Litecoin	0.8	2.1	2	122
Short Bitcoin	4.1	3.2	3	80
XRP	2.2	3.1	3	76
Cardano	1.4	5.2	5	69
Polkadot	0.2	0.2	0	34
Other	2.6	6.3	6	246
Total	**1,185.0**	**1,337.5**	**1,338**	**54,917**

Source: Bloomberg, CoinShares, data available as at 12 Jan 2024

* Independent daily attestation by The Network Firm

Flows by Exchange Country (US$m)	Week flows	MTD flows	YTD flows	AUM
Australia	2.3	3.0	3	32
Brazil	5.6	10.0	10	478
Canada	-44.2	-43.0	-43	3,707
France	0.5	1.1	1	20
Germany	-27.0	5.5	6	3,151
Sweden	-15.5	-12.2	-12	2,582
Switzerland	24.2	49.8	50	3,440
United States	1,238.5	1,322.2	1,322	40,024
Other	0.5	1.1	1	1,483
Total	**1,185.0**	**1,337.5**	**1,338**	**54,917**

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Spot ETF Launch Price Impact

- Using a US$14.4 trillion addressable market in the United States. One could assume that perhaps 10% invest in a spot bitcoin ETF with an average allocation of 1%, which would equate to US$14.4 billion of inflows in the first year.
- If this were correct then it would be the largest inflows on record, with the largest so far being in 2021, which saw US$7.24 billion of inflows, representing 11.5% of assets under management (AuM).
- On a proportional basis though, 2021 did not see the largest inflows, that was in 2020, where we saw US$5.5 billion of inflows representing a higher 21.6% of AuM. It was also a year where the price rose by 303%, compared to 60% in 2021.
- If we take the aforementioned US$14.4 billion of inflows, the model suggests it could push the price up to US$141,000 per Bitcoin
- We know that Bitcoin effectively diversifies a portfolio and enhances sharpe ratios, as discussed here, but regulatory approval and corporate acceptance are slow burn issues due to Bitcoin's perceived complexity.
- For this reason it may well take some time for corporations and funds to build up their knowledge and confidence before they decide to invest.

Read more

Fund Flows Model Bitcoin

% OF AUM	INFLOWS (US$M)	PRICE PROJECTION (US$)
0%	-	35,715
2%	627	40,310
4%	1,254	44,904
6%	1,881	49,499
8%	2,508	54,093
10%	3,135	58,687
20%	6,269	81,660
40%	12,538	127,604
60%	18,807	173,548
80%	25,076	219,492
100%	31,345	265,437

Source: CoinShares, as at 10 November 2023

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CoinShares 2024 Outlook

- Macro and its impact on bitcoin prices: Bitcoin typically exhibits a negative correlation with the US Dollar, which is understandable given its role as an alternative store of value. However, its correlation has recently increased, a trend often seen during periods of monetary policy shifts or market stress, when investors flock to more stable assets. We anticipate that this pattern is temporary and expect Bitcoin to revert to trading inversely to the US Dollar over the next 12 months.

- Blockchain equities: In 2024, blockchain equities are at risk from either a potential recession or a return of inflation. Since monetary policy changes usually impact the economy after 12 to 18 months, the effects of the last rate hike in July 2023 are still unfolding. If the economy worsens, leading to deflation and higher unemployment, corporate earnings could suffer before the Fed can lower interest rates. Alternatively, premature rate cuts by the Fed might cause inflation to spike, driving up commodity prices and spending, forcing the Fed to restart rate hikes. Balancing these economic risks is vital for the blockchain industry's performance this year.

- The Mining Cycle Remains in Rebalancing Phase: 2024 could be a dual cycle year. The network may enter the year still firmly in a Rebalancing phase (price and hashrate move in balance), and that the network will remain in this phase until some time after the halving. Then, if as expected, price starts to outpace miners' ability to deploy new hashrate, we will reenter the Mining Gold Rush (the bitcoin price is rising rapidly, outpacing hashrate growth). If that indeed happens, mining margins will again be astronomical, causing them to restrict the already halving-restricted flow of new supply entering the market, right as demand accelerates.

- If the Mempool Fails to Clear, the Stage is Finally Set for Bitcoin Plugins: Increasing on-chain fees caused by the clogged up mempool will create fertile ground for Bitcoin Plugins. We expect the usage of these L2s and sidechains to grow at a healthy pace, and to see an increasing amount of services make use of their ability to materially reduce on-chain footprint.

- EIP 4844 – A Crucial Piece in Ethereum's Scaling Roadmap: 2024 will mark an important year for Ethereum to begin achieving its scaling roadmap, and the decreases in fees for users transacting using Layer 2 solutions such as Optimism and Arbitrum, as well as the increase in TPS are set to vastly optimise the networks ability to capture value in the Smart Contract Platform market.

CoinShares 2024 Outlook Cont.

- Solana poised to eat into Ethereum's market share for DeFi Apps and Data Availability: Solana's solidified re-emergence as a formidable competitor indicates a shifting tide in the crypto ecosystem due to its arguably better infrastructure as a DeFi platform and data availability layer.

- Developer Activity Set to Rebound in 2024: We are expecting a significant pickup in developer activity for Bitcoin, Ethereum, Solana. The rising popularity of using Layer 2 solutions to optimise payment settlement and explore alternative use cases will drive the creation of new and innovative projects on Bitcoin. For Ethereum, EIP-4844 will spark an increase in activity and creation for Layer 2's and underlying applications, as well as a strong return of the network in H2, which was a laggard all throughout 2023. Lastly, for Solana, its propulsion as one of the top performers of 2023 as well as a successful implementation of Firedancer will spark huge developer interest to build applications that can handle scale.

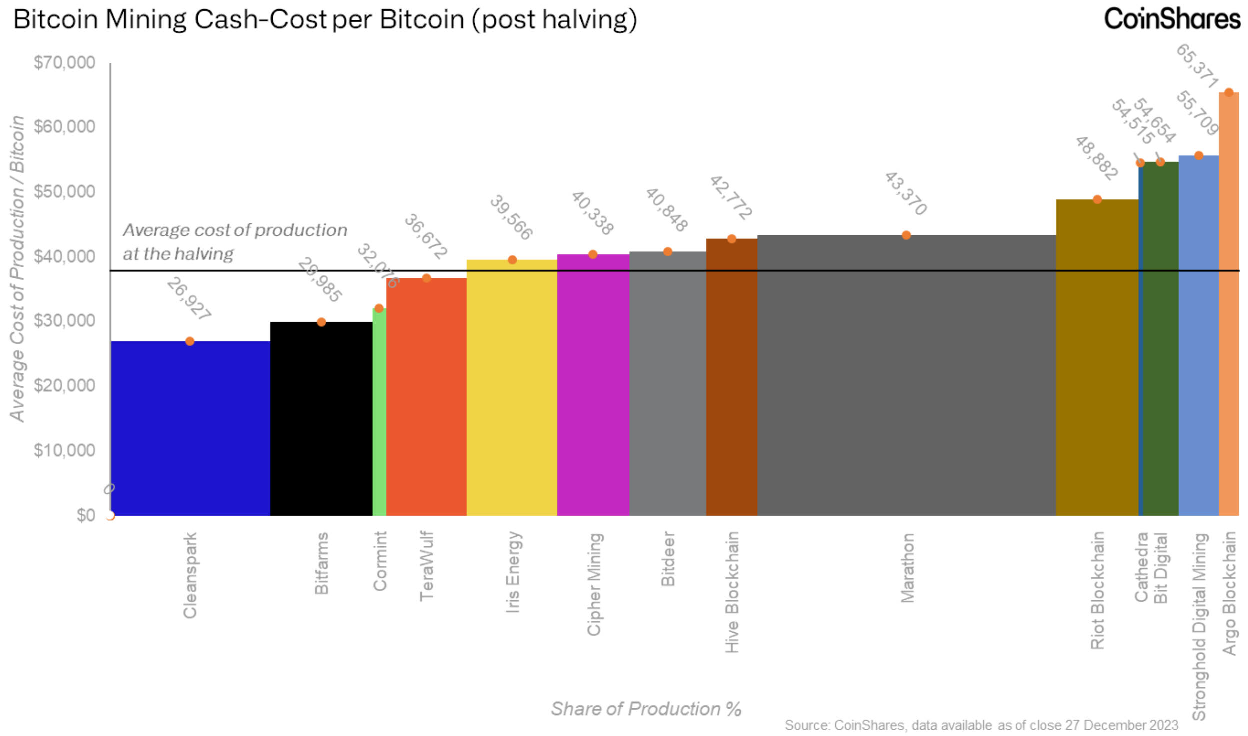
- Ethereum Sentiment Likely to Improve: Fund flows data suggest that Ethereum faced stiff competition from Solana, which has garnered more than double Ethereum's inflows, at US$167 million compared to Ethereum's US$78 million. Ethereum Foundation has demonstrated a growing proficiency in successfully rolling out major network upgrades, as evidenced by the seamless execution of both Shanghai and The Merge, although consistent delays may be frustrating investors. The lack of enthusiasm appears unwarranted, especially considering that Ethereum is the only digital asset currently offering an attractive yield, with its net issuance being slightly negative. Furthermore, issuers are already applying for a spot-based ETF in the US, improving sentiment and the launch of these ETFs are likely to see Ethereum's share of flow recover in the second half of 2024.

- Digital Art & Culture on blockchains: birth of an asset class? Our mid case scenario, and in the event that digital art on blockchains secures a 3% share of the art and collectibles owned by High Net Worth Individuals (HNWIs) by 2030, its market value could ascend to US$100 billion, which would signify a remarkable 15-fold increase compared to present valuations.

- 2024 Regulatory Outlook: 2024 is also an election year in the UK. So, unless the required legislation can be introduced and passed by parliament early in 2024 there is a real risk that there will be a delay in the implementation of the UK's proposals to regulate digital assets within its existing financial regulation framework.

CoinShares Mining Report

- Growth and Sustainability Concerns: The Bitcoin mining network has grown by 90% in 2023, raising questions about its environmental sustainability and profitability, particularly the efficiency and energy cost of the network.
- Mining Dynamics and Hashrate Trends: Bitcoin mining's "difficulty" adjustment mechanism ensures supply inelasticity. Post-halving, higher-cost miners may struggle due to decreased immediate income. This document assesses the average cost of production per Bitcoin post-halving, with findings showing an average cost of US$37,856.
- Efficiency Improvements in the Mining Network: Despite the increasing power demand of the network, there have been significant improvements in efficiency. Using nonce data has helped analyse different mining models' efficiency. Currently, the network's average efficiency is 34W/T, with projections showing a potential drop to 10W/T by mid-2026.
- Bitcoin Mining and Environmental Impact: Bitcoin mining often utilises stranded energy, typically in remote locations. Approximately 53% of Bitcoin mining energy is now sustainably sourced according to Daniel Batten. Bitcoin mining could significantly reduce emissions caused by gas flaring, a major environmental concern.
- Conclusion and Miner Positioning: Most miners will face challenges from high SG&A costs, necessitating cost reductions to remain profitable. Only a handful of miners are expected to operate profitably if Bitcoin prices remain above $40,000.



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ETH Shows a Glimpse of Outperformance

ETH has been starkly underperforming Bitcoin since July of 2022. With the SEC approval of a Spot Bitcoin ETF on the 11th January, the market quickly shifted its attention to the second largest cryptocurrency, ETH. Over the last week, ETH has outperformed Bitcoin by over 20%, with a move of this magnitude not seen since the beginning of the relative downtrend (seen on the right).

With the ETF approval behind us, it is likely that traders are shifting in anticipation of a potential Spot ETH ETF being approved in the second half of this year (although in our view this is more likely in Q1 2025). The outperformance of Ethereum Layer 2 protocols such as Arbitrum and Optimism has also been noteworthy; With EIP-4844 set for H2 of this year, Layer 2 solutions are likely to be big beneficiaries of this with increased profitability and throughput. Whether ETH continues to outperform is yet to be seen.

Source: CoinShares, data available as of close 14 January 2024

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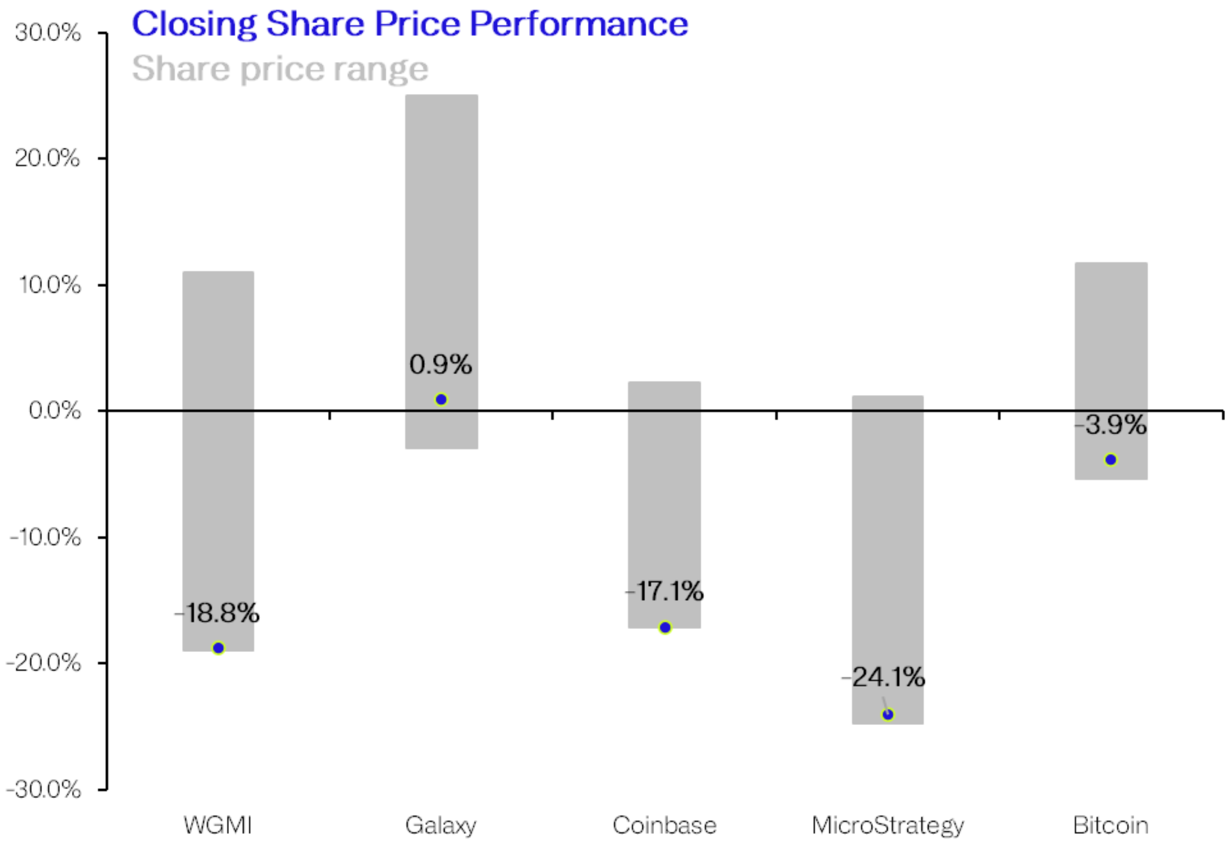
Blockchain Equities

- Last week, the approval of multiple spot Bitcoin ETFs had a volatile impact on blockchain equities. Notably, MicroStrategy bore the brunt of this impact as the ETFs were perceived as direct competitors. The miners, represented by the WGMI ETF, also faced challenges, whereas Galaxy Digital managed to secure a modest gain for the week.
- The positive investment outlook for miners persists, with the belief that those who weather the halving are positioned to reap the benefits of a reset in mining economics. This is despite the potential for a rerating of multiples due to the growing alternatives for Bitcoin exposure.
- MicroStrategy continues to embody a leveraged active management approach to Bitcoin, boasting a current Bitcoin stack of 189,150, facilitated through low-cost debt, featuring a weighted fixed coupon of 3.1%. With a Bitcoin value of US$8.13bn (at a BTC price of US$43,000), and a market cap of US$8.15bn as of January 12th close, the market currently values MicroStrategy's software business at approximately US$20 million. This valuation, if perceived as undervalued, suggests that the Bitcoin balance may be trading at a discount.
- Coinbase stands to benefit from custodian fees, with 8 out of 11 ETF applicants utilizing its services. Additionally, the surge in crypto trading volumes over the past quarter positions Coinbase and Galaxy Digital for strong earnings.

Blockchain Equities Performance (%) 8th - 14th January



Source: Bloomberg, CoinShares, data available as of close 15th January 2024

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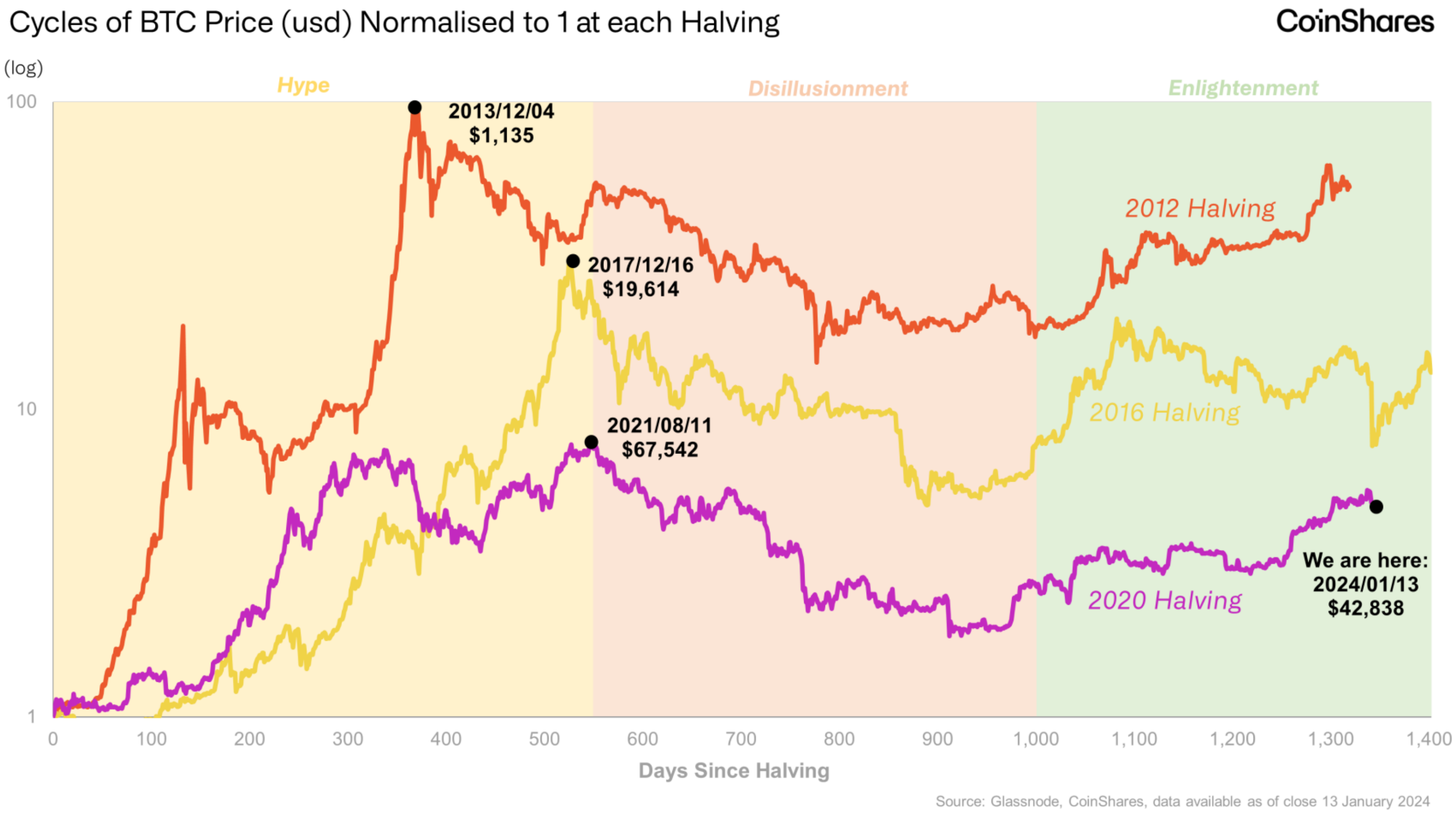
Bitcoin Fundamentals

Every four-year holding period in Bitcoin history has presented investors with the opportunity to realise gains.

The size of such gains are however wide-ranging, depending on the timing of investments within bitcoin's historic price cycles.

History suggests bitcoin is likely to embark on a new cycle in roughly 95 days (at block 840,000). Should history repeat itself, it is plausible that the bitcoin price could again reach unprecedented heights.



Bitcoin in a Portfolio

A portfolio weighting of 4% achieves a Sharpe ratio of 1.13 (0.67>benchmark), a correlation fall of 7.1% and an increase in maximum drawdown of 1.5% when compared to a 60/40 equity/bond portfolio.

Various asset Classes Performance in a balanced portfolio (since Oct 2015)

CoinShares	60%/40% benchmark (Equities/Bonds)	4.0% Bitcoin	4.0% Bitcoin (no rebalancing)	4.0% Ethereum	4.0% Gold	4.0% HFRX	4.0% CRB	4.0% REITs
annualised returns	7.5%	14.7%	42.4%	16.3%	7.6%	7.3%	7.4%	7.6%
max drawdown	21.4%	22.9%	67.2%	22.4%	20.9%	20.6%	20.7%	21.7%
volatility	9.2%	10.2%	42.2%	10.2%	8.9%	8.8%	8.9%	9.4%
correlation	-	93.0%	37.1%	91.3%	99.8%	100.0%	100.0%	99.8%
tracking error	-	3.8%	39.6%	4.2%	0.6%	0.4%	0.4%	0.6%
beta	-	1.03	1.51	1.02	0.97	0.96	0.97	1.03
Sharpe (vs cash)	0.50	1.15	0.93	1.30	0.52	0.49	0.50	0.49
Sortino	-	1.48	1.22	1.67	0.65	0.61	0.62	0.61

Source: Bloomberg, CoinShares, data available as of close 15 January 2024

- Data derived from a balanced 60/40 equity/bond portfolio, with an equal weight detraction to allocate to Bitcoin, Gold, HFRX Global, CRB, REITs Top 5 Crypto

- MSCI World total return, Bloomberg Total Return 7-10 year bond, XBTUSD, Gold, HFRXGL Index, CRB & REIT indices are used

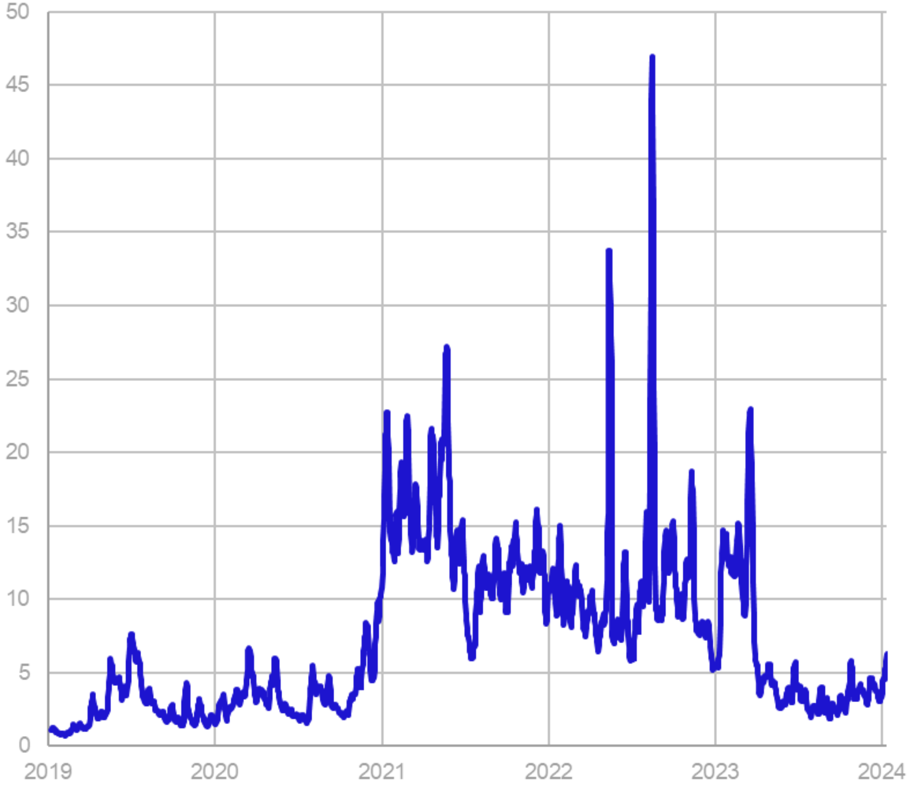
- Rebalanced per calendar quarter

We have written a detailed portfolio analysis here

Crypto Volumes

Volumes are slowly improving for both Bitcoin and Ethereum

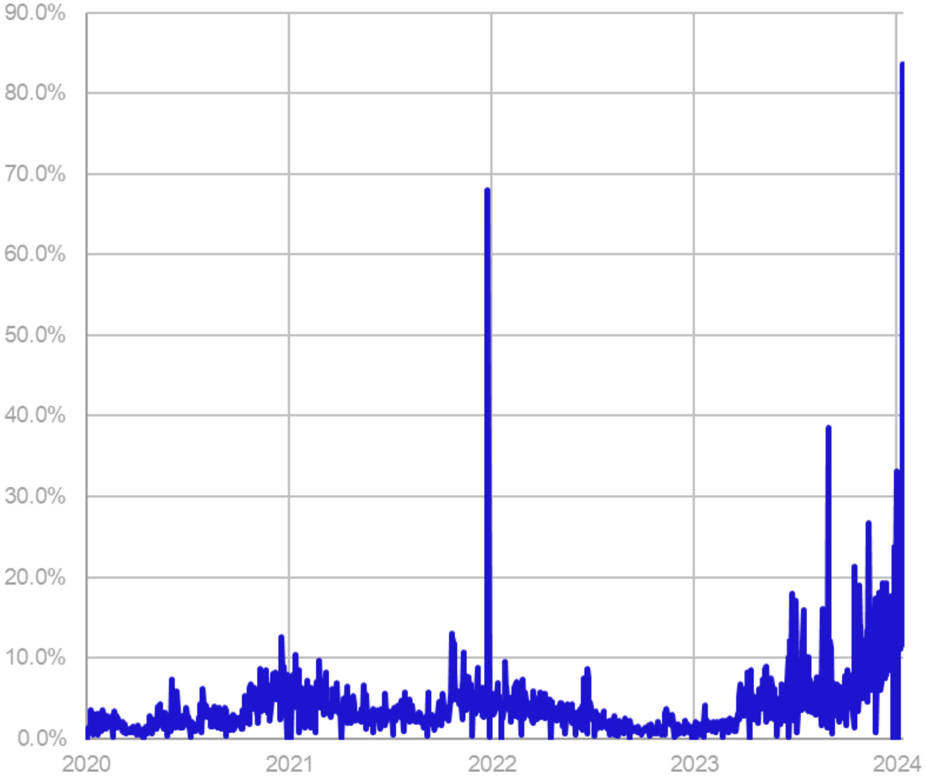
Bitcoin volumes on trusted exchanges (7d DMA US$bn)



Source: Compass, CoinShares, data available as of close 12 January 2024

During this rally, Fait currency exchanges are gaining market share

Bitcoin ETP Volume as a percentage of total market volume on trusted exchanges



Source: Bloomberg, CoinShares, data available as of close 14 January 2024

Market Correlations

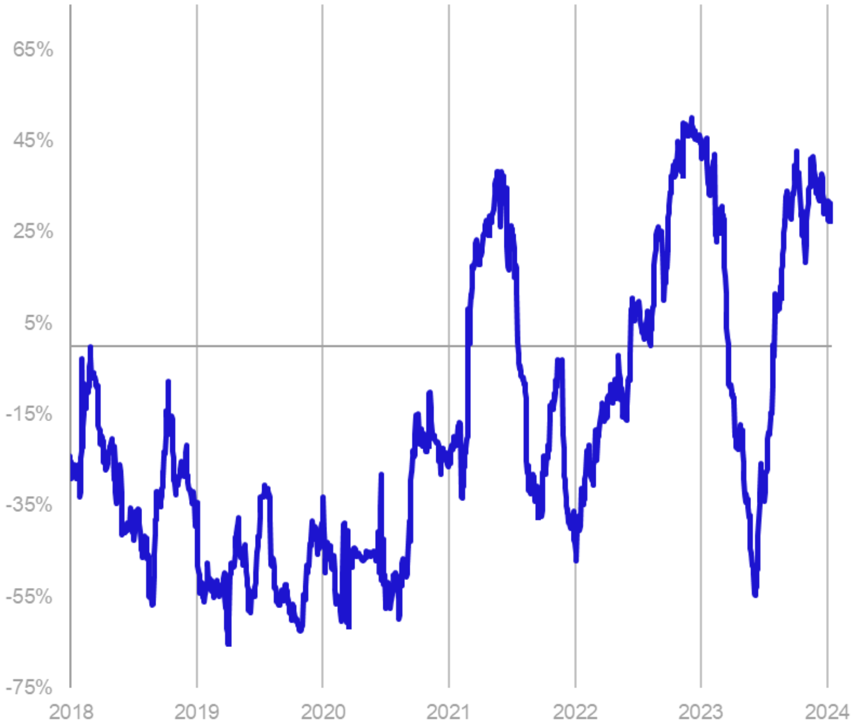
Bitcoin's correlation to the Nasdaq is staying within its long term historical norms having recently fallen to just 2.7%

Nasdaq vs Bitcoin correlation of daily returns CoinShares (3m trail)

Source: Bloomberg, CoinShares, data available as of close 15 January 2024

While Equity/Bond volumes remain alarmingly high at 29%

Equities vs Government Bonds correlation of daily returns (3m trail) CoinShares



Source: Bloomberg, CoinShares, data available as of close 15 January 2024

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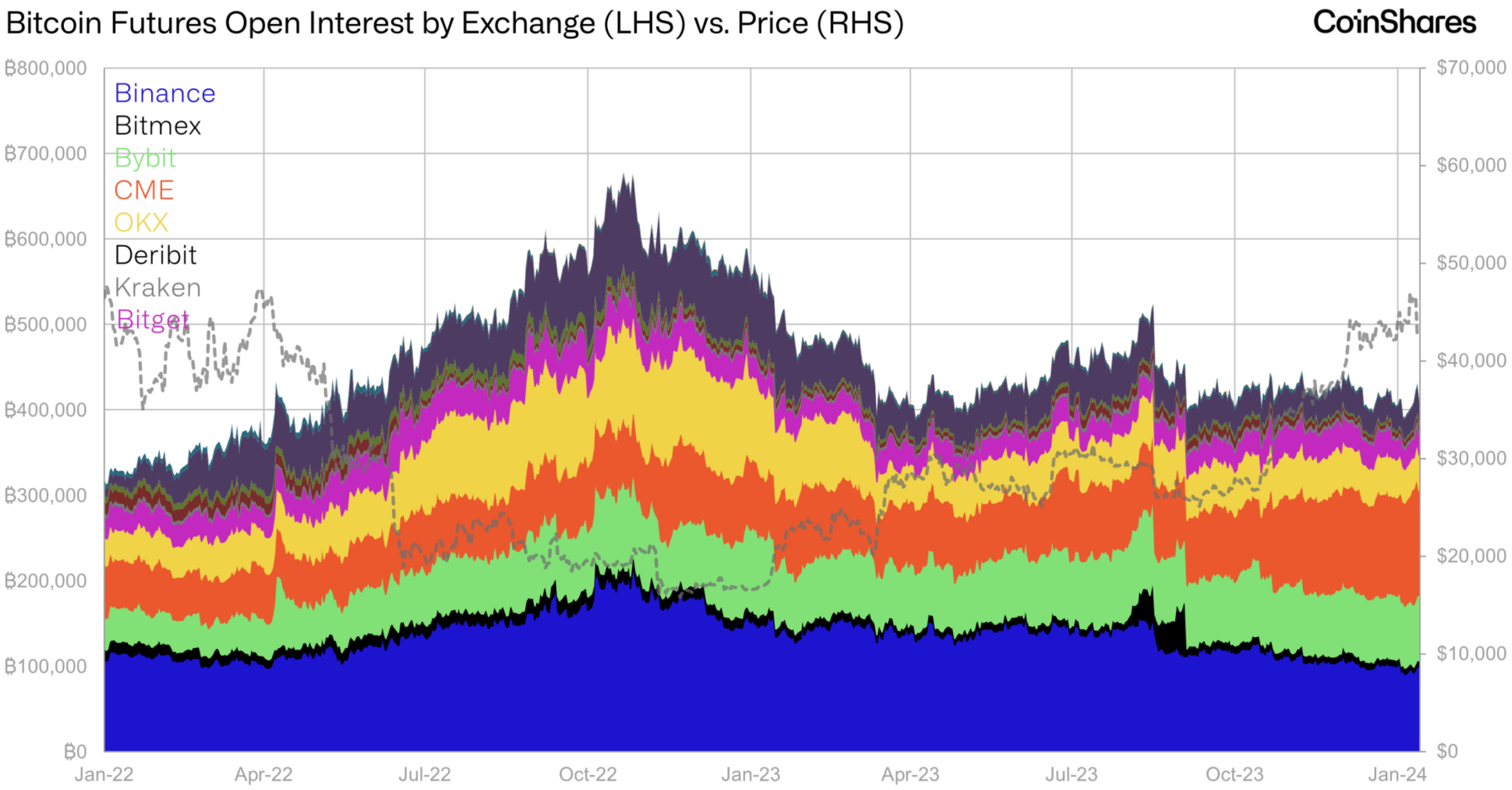
Bitcoin Futures Overview

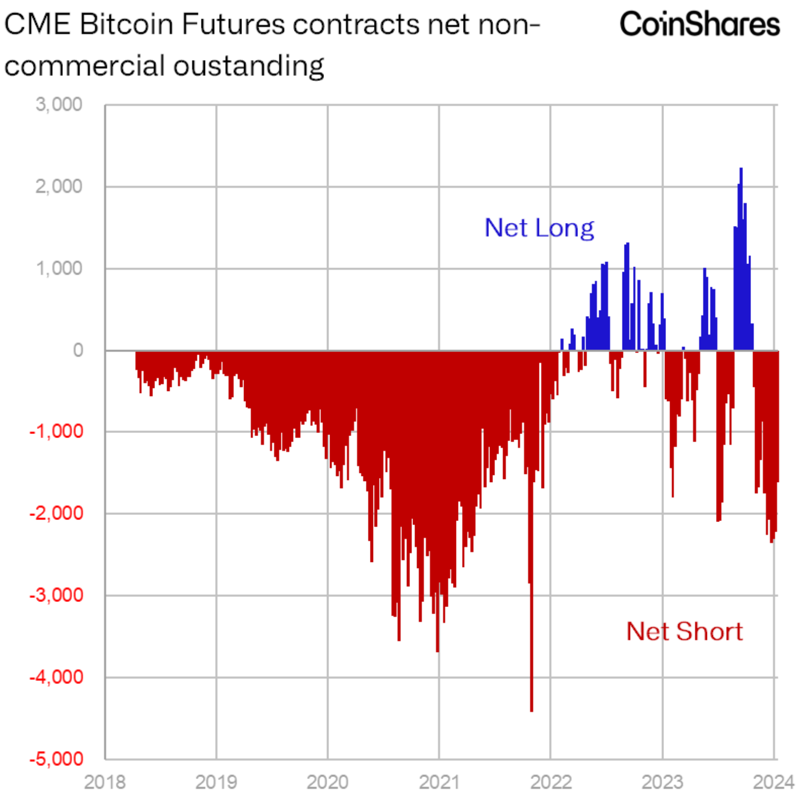


Source: Coinglass, Glassnode, CoinShares, data available as of close 13 January 2024

CFTC Bitcoin Futures

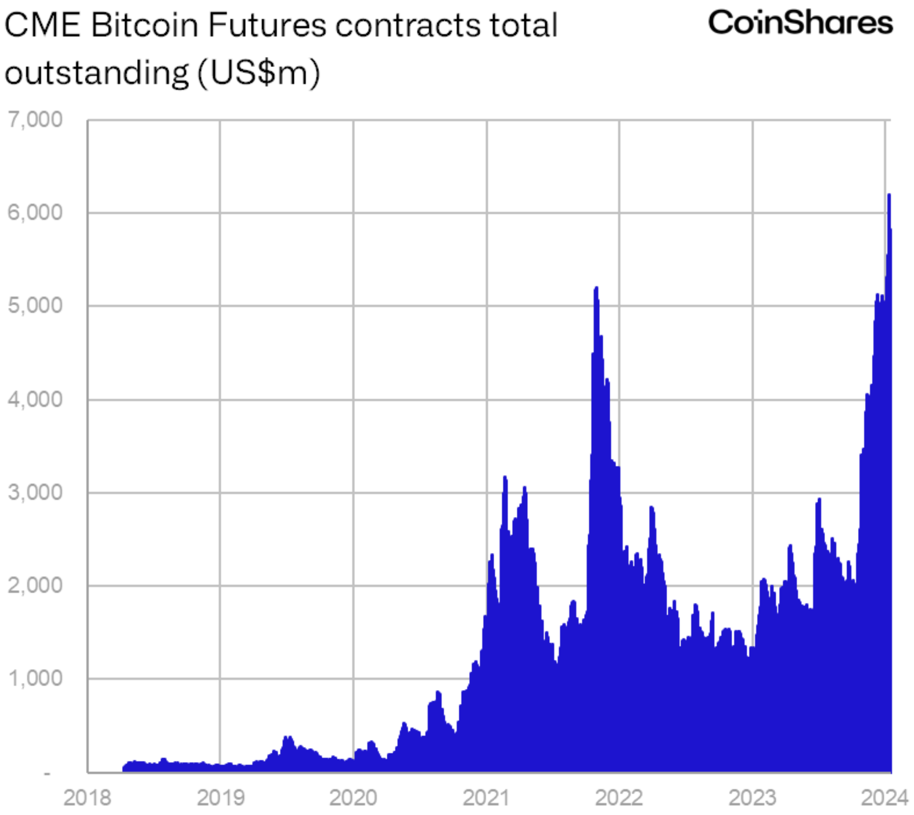
In the CME, futures contracts on Bitcoin have risen by 282% this year, almost matching the historical high of US$5.2bn, while on a net basis moved sharply negative signifying increased exploitation of futures-spot arbitrage.

CME Bitcoin Futures contracts net non-commercial oustanding



Source: Bloomberg, CoinShares, data available as of close 15 January 2024

CME Bitcoin Futures contracts total outstanding (US$m)



Source: Bloomberg, CoinShares, data available as of close 15 January 2024

Active vs Passing Crypto Investors

Passives tend to be higher beta, so have outperformed actives measurably in recent months, returns dispersion across funds remains much higher for actives.

NB. actively trading funds only, there is survivorship bias, NAV data frequency very low of Actives

Source: Bloomberg, CoinShares as of close 15 Jan 2024

Digital Asset fund Performance & Risk CoinShares	*Passive*	*Active*
1m	*11.9%*	*4.9%*
3m	*73.8%*	*34.9%*
6m	*78.7%*	*29.3%*
1y	*203%*	*64%*
2Y	*18%*	*15%*
annualised returns (since 2019)	*55%*	*63%*
# actively trading	*187*	*24*
% actively trading (January)	*99%*	*47%*
assets under management (US$m)	*52,459*	*2,458*
Average annual fee (%)	*1.31*	*1.56*
max drawdown	*83.2%*	*41.5%*
volatility	*75.5%*	*40.7%*
return dispersion (weighted)	*5.6%*	*4.3%*
sharpe	*0.71*	*1.52*

Source: Bloomberg, CoinShares as of close 15 Jan 2024

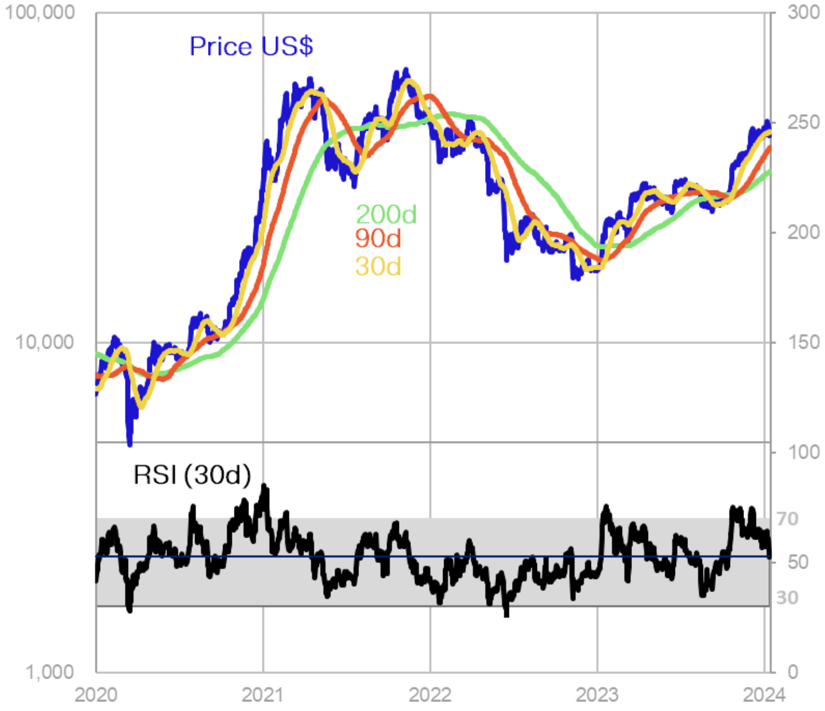
Technical/Value Indicators

Recent price appreciation has pushed led to a technical overbought position from a relative strength (RSI) perspective

MVRV Value indicator has risen above the long term average but not looking over valued at this point. More research on this indicator is available here.

Bitcoin Moving averages and Relative Strength Index

CoinShares



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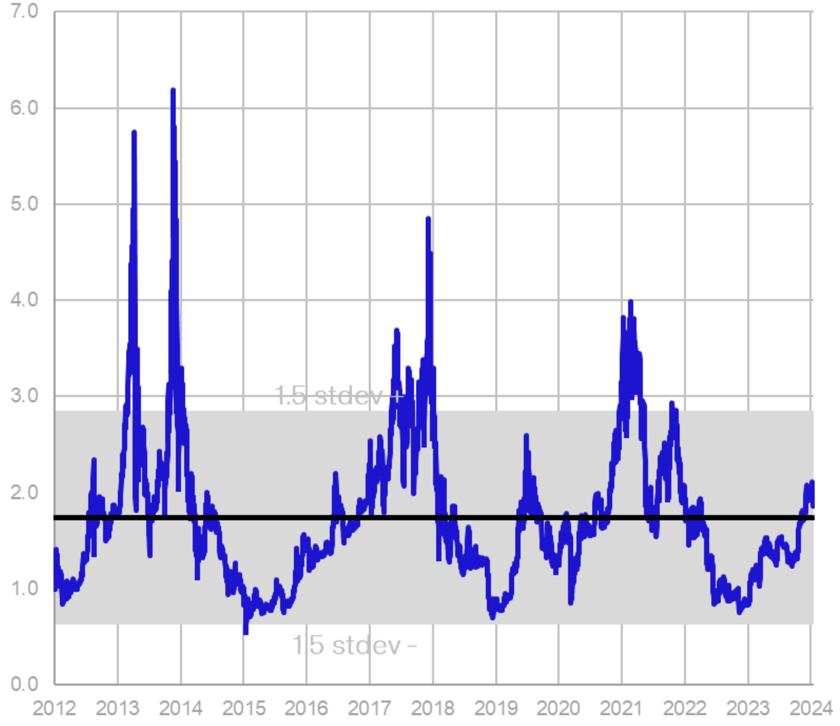
Bitcoin Market Value / Realised Value (MVRV)

CoinShares



Source: Glassnode, CoinShares, data available as of close 14 January 2024

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