As we watch government debts rise, our conviction in digital assets grows. It should not be lost on any of us, as we commit endless hours of our finite time working for money, that governments all over the world are printing the same paper we work hard for, as if it is a one ply toilet roll.

War. Emergencies. Pandemics. Irresponsible banking. Disruptions. Borders. It is endless. The formula is simple. Make people panic. Print more money. Distribute it to the few. People are sick of it and the erosion of trust isn't helpful for anyone but those that understand the concept of self-custody.

At the risk of sounding overly sceptical, Chart 1 shows why stock markets are protected by governments and central banks. The rich are sitting on massive potential capital gains and taxes from selling are likely considerably more costly than holding through any recession.

Chart 1 – US equities and mutual funds owned by the wealthiest 10% of the population (1990-2023)

Source: Federal Reserve, Axios Visuals

We haven't seen a chart that estimates how much of the digital asset ecosystem is owned by the wealthiest 10%, but we would expect it to be low. As the scarcity of the USD declines, the value of immutable digital scarcity rises, and many will start to price this in.

Now that ETFs are easily accessible, a centralized and simple flow of capital into the asset class is possible. Many of the top 10% that haven't had the desire to setup a wallet, can now easily get exposure. As the asset class is better understood, their 0.5% allocation will turn into a 5% one.

We have been amused about the minute-by-minute commentary of the ETF launch and subsequent price action. Victors celebrating selling the news a week after the largest capital market on earth opened a fiat onramp will be looked at in hindsight with pity.

Every Bitcoin added to an ETF is one less that a sovereign nation, a forward-thinking corporate, or the wealthy will be able to buy and hold in their own custody in the future. While the importance of self-custody is poorly understood today, it won't be as governments encroach on us to repay debt.

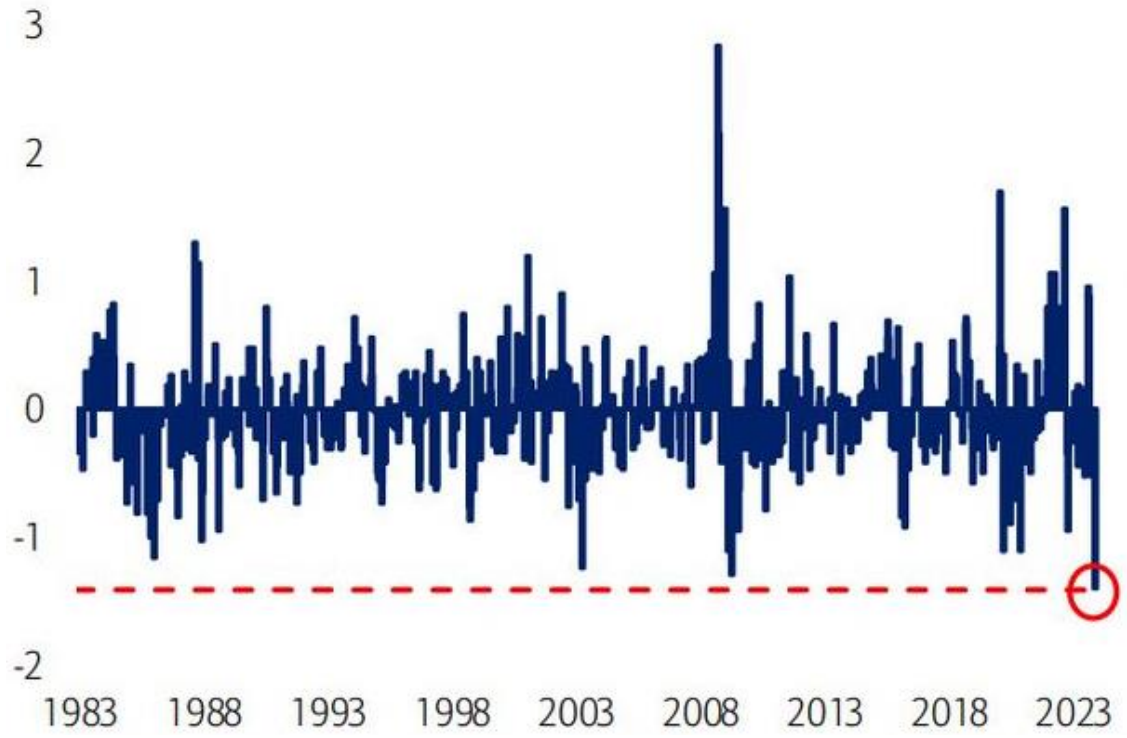
It is interesting to finally see the largest financial institutions in the world agreeing that there are huge benefits to tokenizing everything. Goods, services, and assets will be priced in terms of each other in a 24-hour capital market in the very near term. This is called Web3.

The transition to Web3 will continue to present generational opportunities for our LPs. We are thrilled to be investing their capital and are excited to grow our business into 2024.

Macro

The tail end of 2023 saw a considerable amount of speculation about how quickly the Federal Reserve would cut rates in 2024. It created the fastest easing of financial conditions in history (Chart 2). While the timing feels off to us, its now about when, not if a cut is coming.

Chart 2 – GS US financial conditions index (2 month change) (1983-2023)



Source: BofA Global Research, Bloomberg

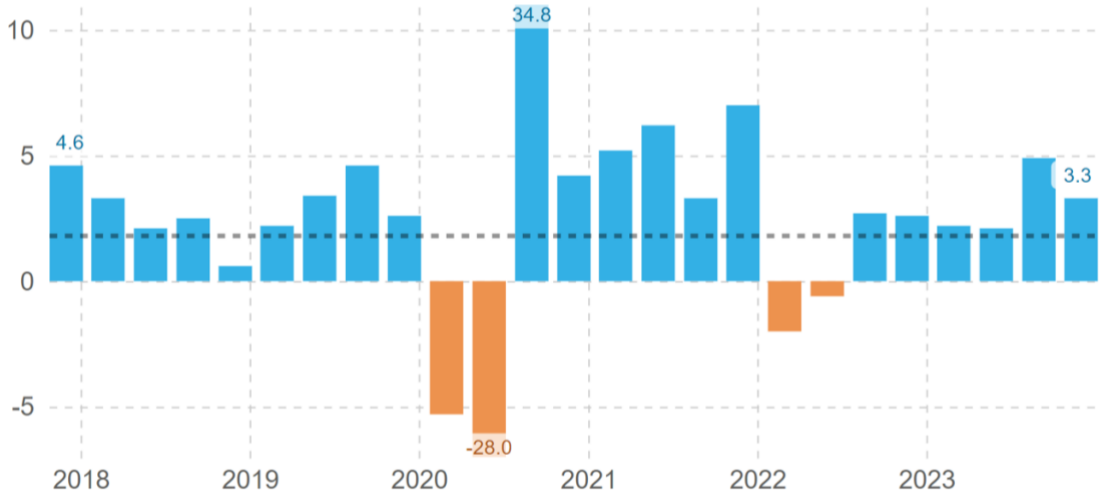
January was all about reining in the expectations of some of the doves that were calling for 100+ bp rates cutes before March, and we think that the strong set of economic data was helpful to reset these expectations (Chart 3).

Chart 3 – Market based probability of a March 2024 Fed cut rate (2023-2024)

Source: TheDailyShot.com

The bears continue to harp on about the same thing: how can the Fed cut rates when trailing real GDP growth in 4Q was 3.3% and markets are at all-time highs (Chart 4)?

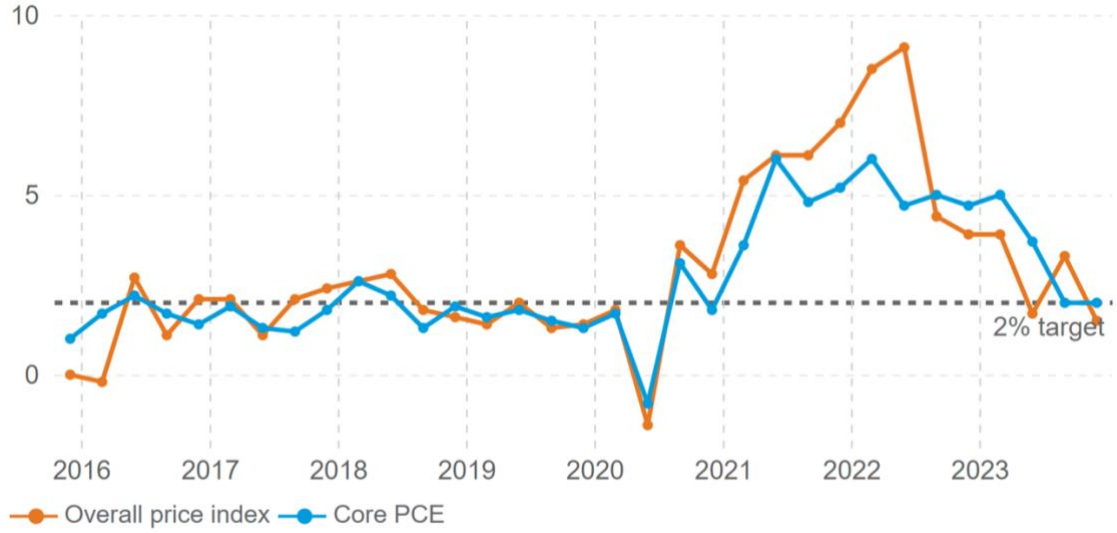
Chart 4 – Quarterly GDP growth (%); annualized and seasonally adjusted (dotted line at 1.8%) (2018-2023)



Source: BEA, RSM US

It all comes down to inflation. The GDP report confirmed much of what we are seeing across the world, that inflation is falling back in line with where it has historically ranged (Chart 5). The further we get from Covid, the closer we are moving towards a pre-Covid backdrop.

Chart 6 – Quarterly Inflation (%YoY) (2016-2023)



Source: BEA, RSM US

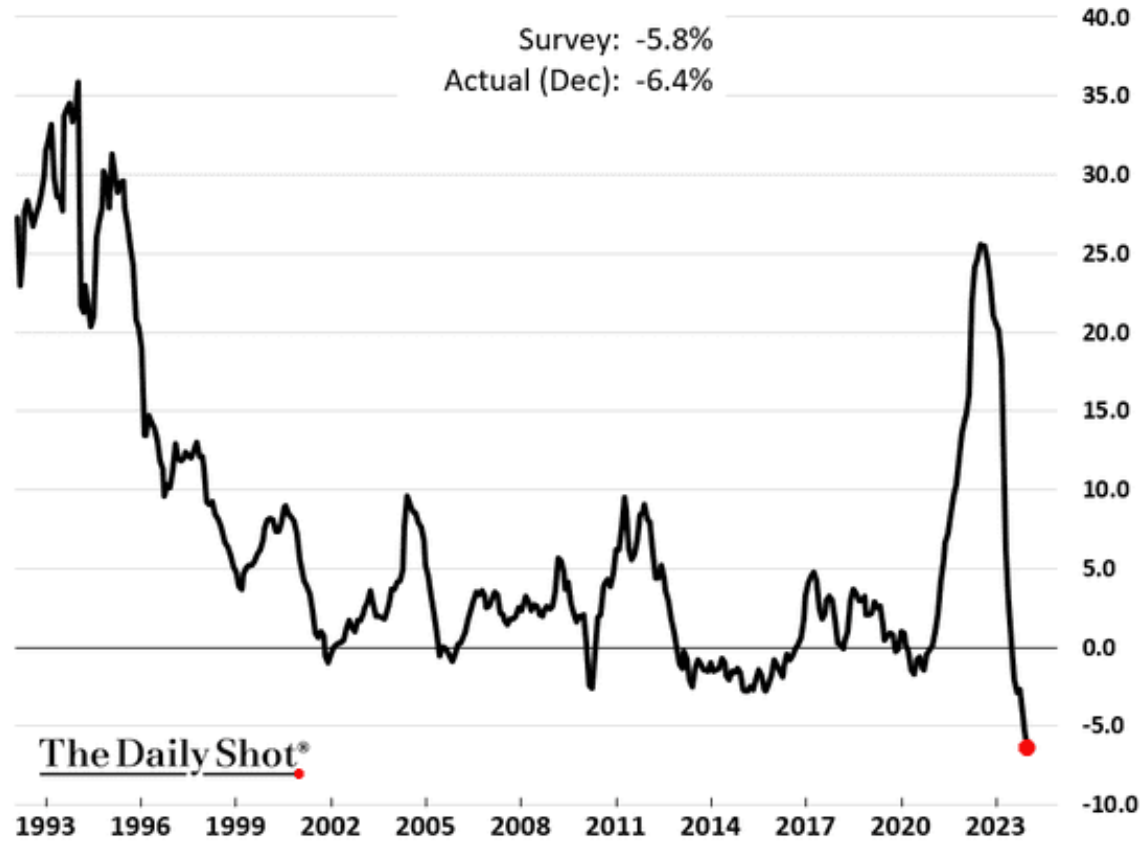
While some still fear a second wave of inflation, we do not see it. The CPI's shelter component, which is 33% of the index, is the only thing holding up the index (which will fall for the foreseeable future). If we strip it out, US consumer prices rose 1.9% YoY, its 7th consecutive month below 2% (Chart 7).

Chart 7 – US consumer price index ex-shelter (YoY % change) (1990-2023)

Source: Creative Planning, @CharlieBilello

We believe a period of stable to falling prices is more likely, with PPI now falling in China and Eastern Europe on a year over year basis (Chart 8). It seems somewhat naïve to believe that this trend will be avoided in the US too.

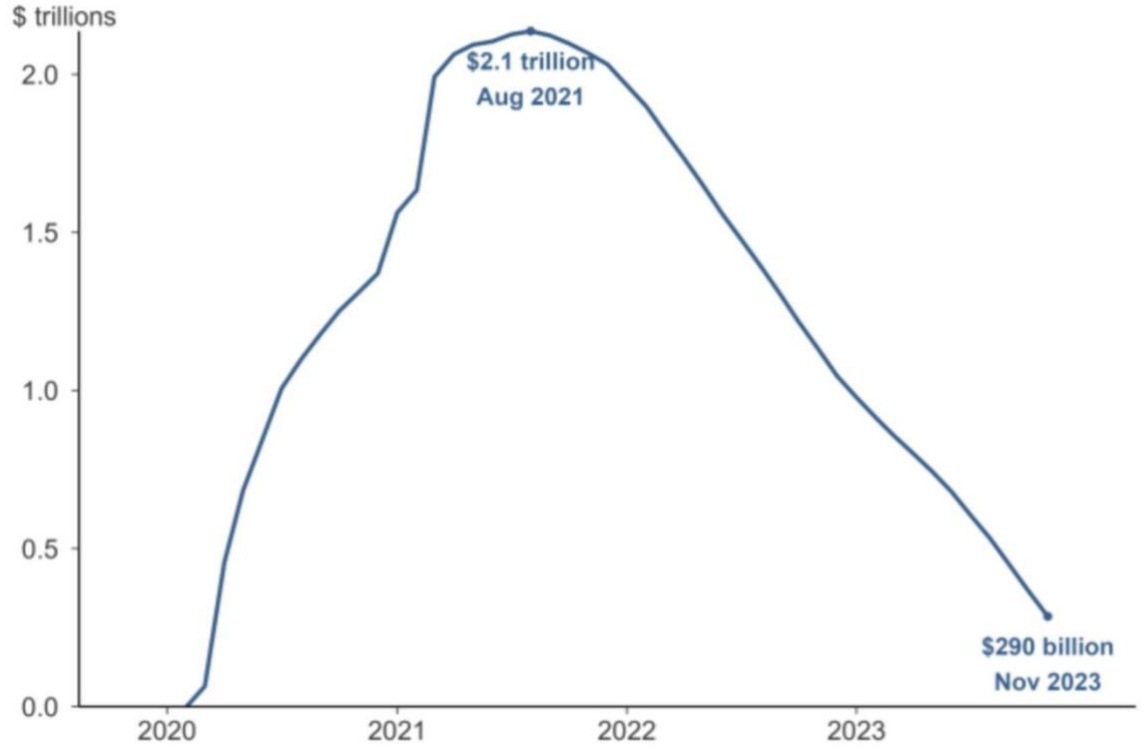
Chart 8 – Poland PPI (1993-2023)



Source: TheDailyShot.com

While we only have data for the US, the excess savings chart is likely the same for most countries. The fact is that excess savings post a period of helicopter handouts in 2020/2021 are normalizing, and without new capital, a restart of inflation even as rates decline seems unlikely (Chart 9).

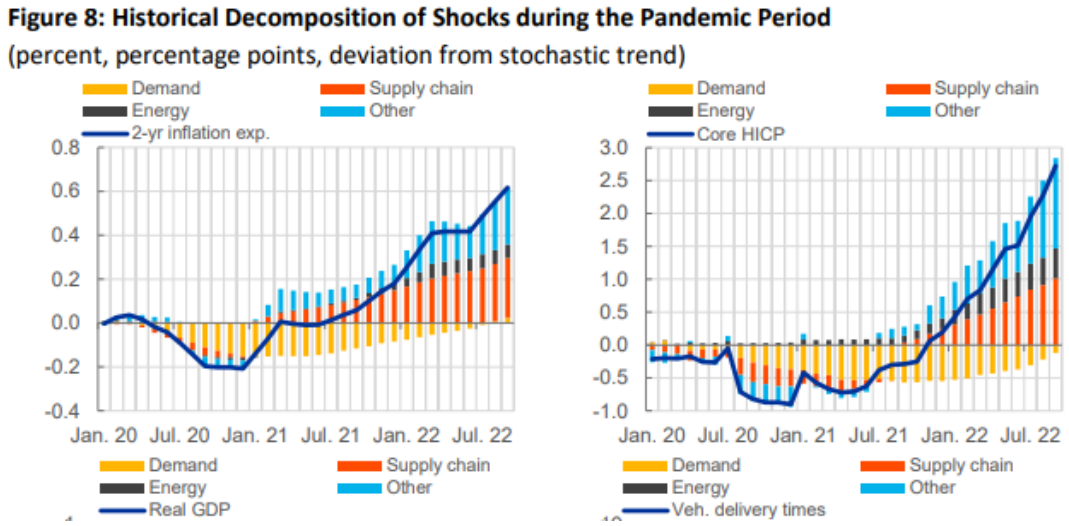
Chart 9 – US consumer excess savings (2020-2024)



Source: Federal Reserve

The ECB seems to have figured this out first, releasing a working paper blaming inflation mostly on the supply chain (and to a lesser extent the energy shock), while noting the demand component is barely positive (Chart 10). This report reeked of a central bank that is about to pivot.

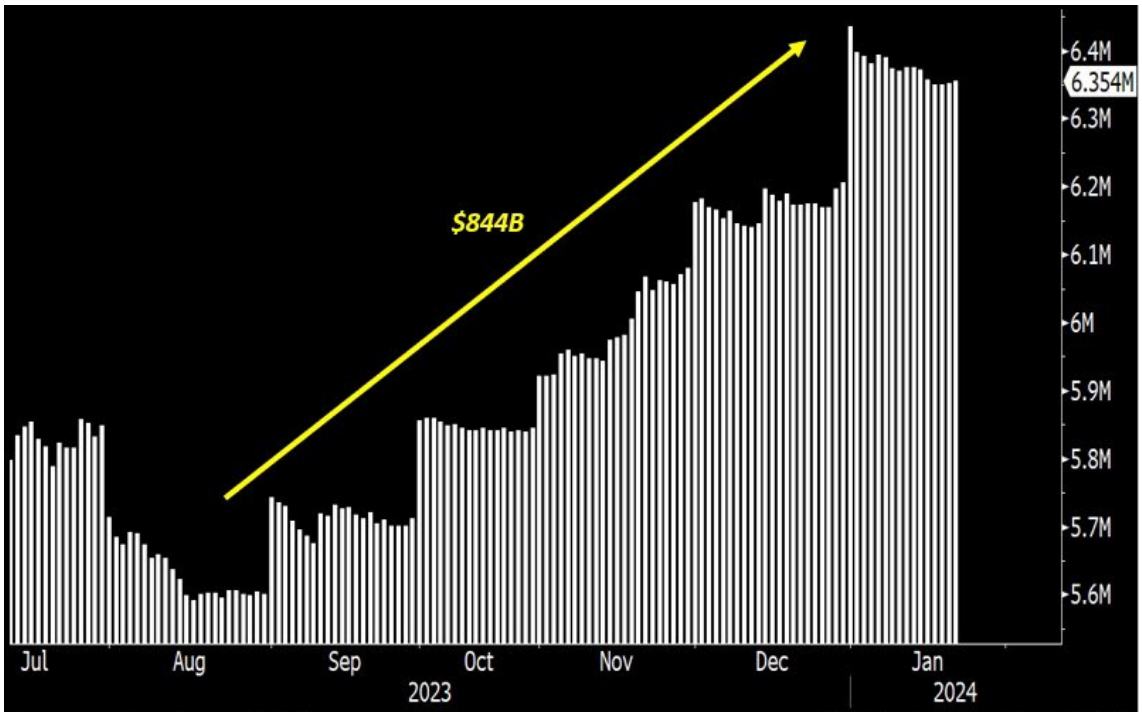
Chart 10 – Historical decomposition of shocks during the pandemic perio (2020-2022)



Source: @atalaveraEcon

While the ECB ponders a pivot, China is printing money, and lots of it. But this is no surprise given it is trying to restart the largest real estate market in the world. The PBOC added $150 billion to its balance sheet in December, a total increase of $850 billion in the last five months (Chart 11).

Chart 11 – China PBOC balance sheet assets (USD millions) (2023-2024)



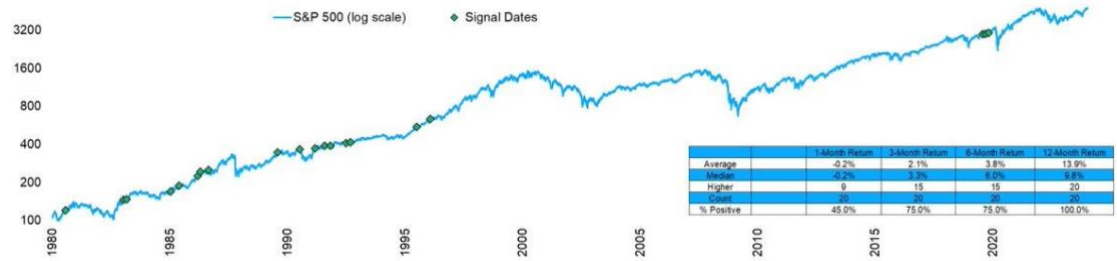
Source: Bloomberg, Crescat Capital LLC, Tavi Costa

While we haven't seen much of a response in China yet, it remains early in the year and we expect this credit to start flowing through later in February as the spring comes.

The Federal Reserve now has a backdrop within which it can ease while seeming acting like the adult in the room. Given it is an election year, the totally "independent" branch of the US government likely bends the knee to pressure from a flailing Democratic party that needs wins.

Which leads us to today, where we are talking about easing while equity markets are at all-time highs. Interestingly, there have been 20 rate cuts when the market was within 2% of the all-time highs since 1980. During that period, markets were higher a year later 100% of the time (Chart 12).

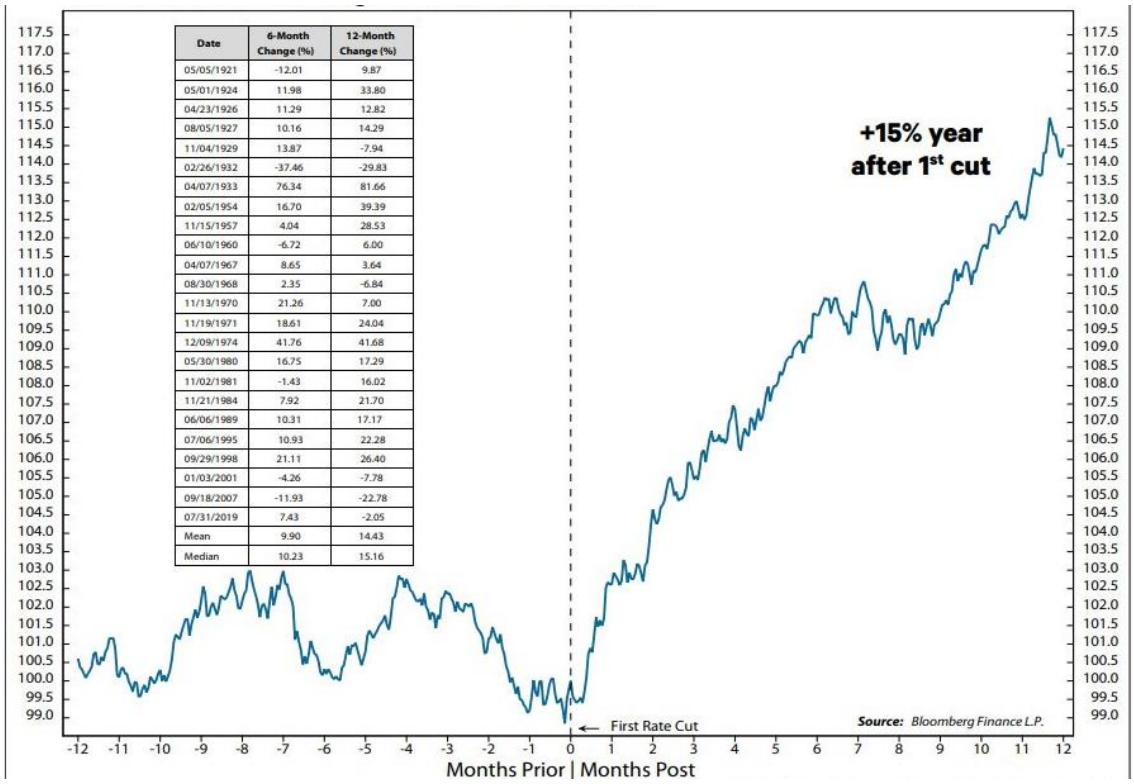
Chart 12 – S&P500 performance after Fed cuts withing 2% of highs (1980-2023)



Source: Carson Investment Research, Factset, @RyanDetrick

Looking further back in time, three notable exceptions (1932, 2001, 2007), the stock market typically moves up 15%+ after the first rate cut (Chart 13). The question is if we are in one of the three exceptions, or not. We don't believe we are for multiple reasons.

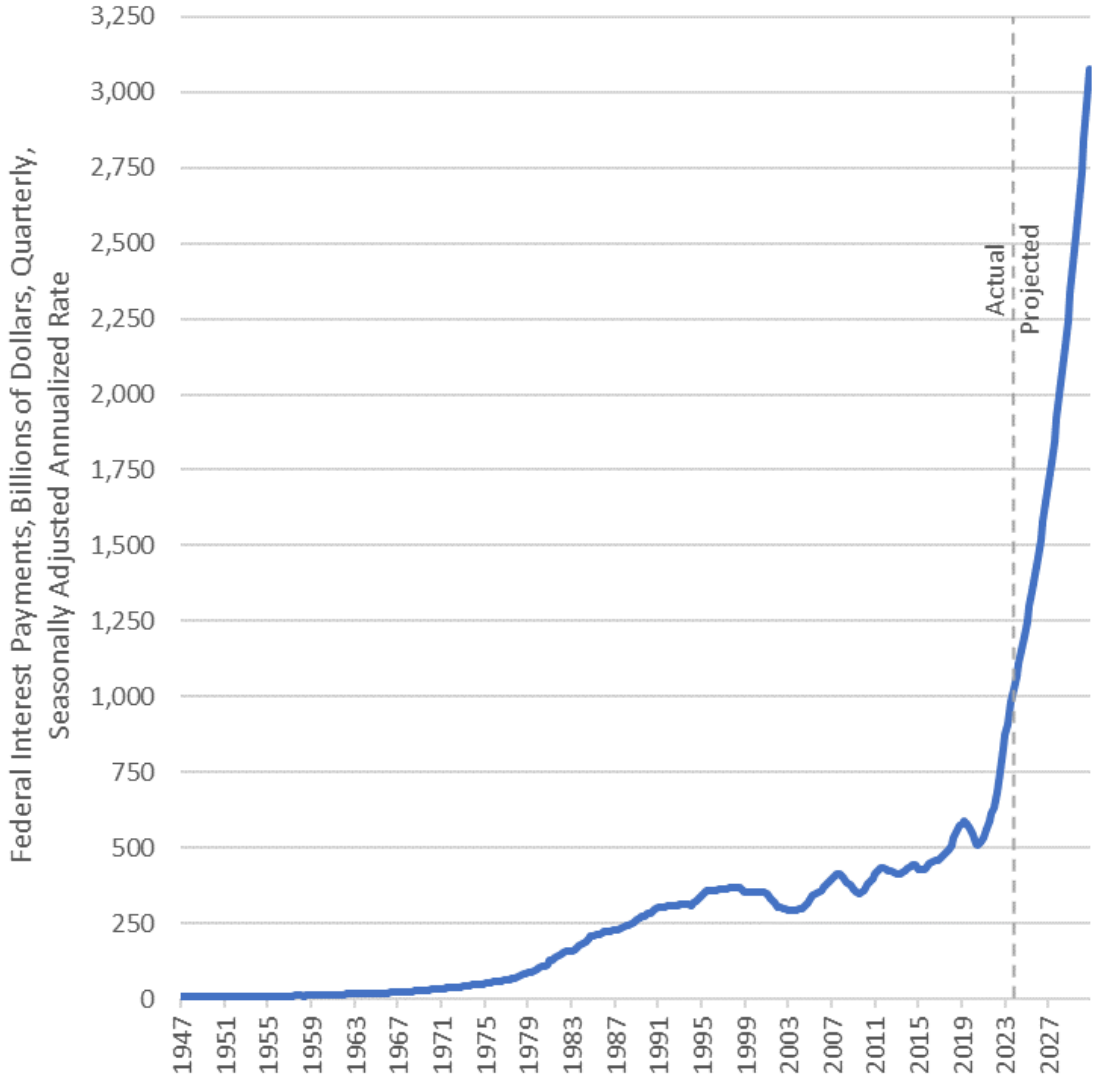
Chart 13 – Dow Jones Industrial Average first Fed rate cut



Source: NDR.com, Bloomberg Finance LP, @edclissold

On one side of the ledger, the US government continues to spend at a reckless pace, with expected interest costs looking like Bitcoin's chart in the early days (Chart 14).

Chart 14 – Federal interest payments (billions) (1947-2027)



Source: Bureau of Economic Analysis, Dr. EJ Antoni

While the debt situation is scary, it also underpins economic activity. In the absence of inflation, it is hard to see US growth declining enough to trigger a recession. On the other side of the ledger, the Federal Reserve is belligerently mitigating any potential risks to its banking system (Chart 15).

Chart 15 – Emergency loans from the Fed BTFP facility (2022-2024)

Source: Bloomberg

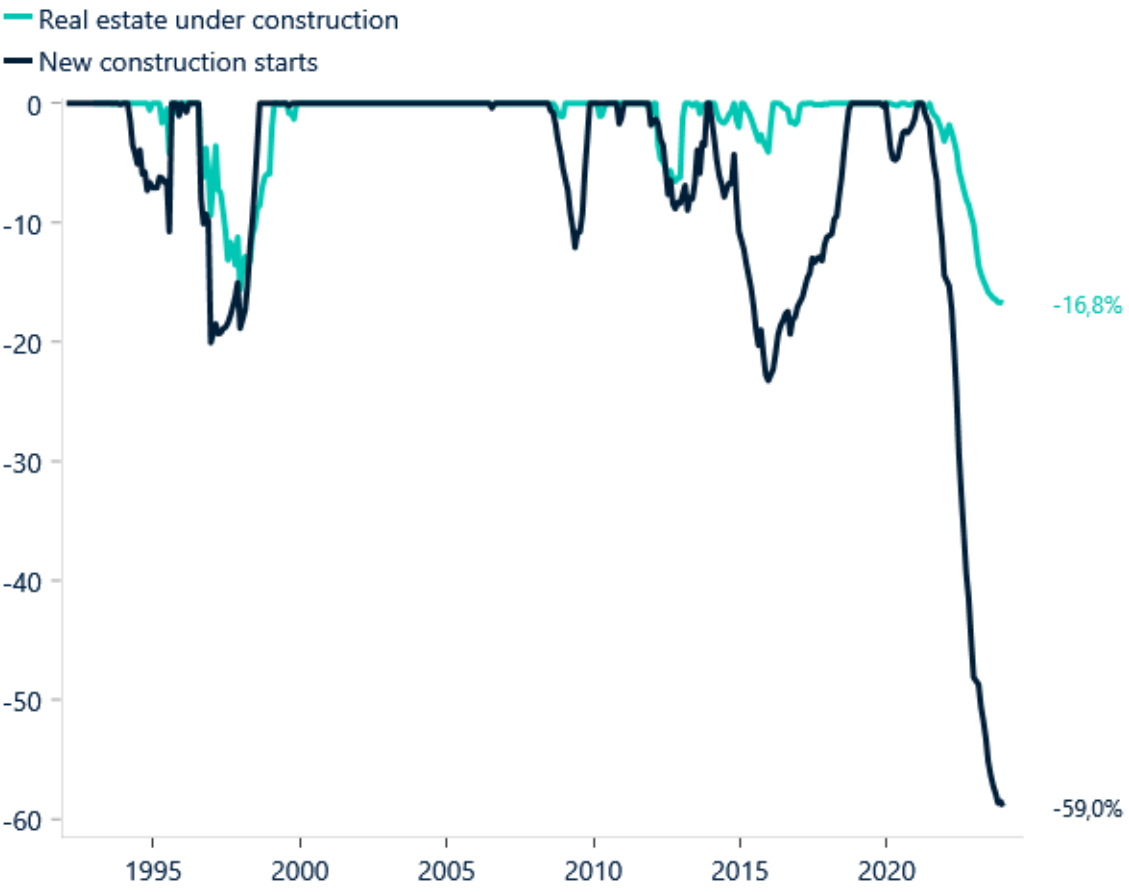
While the banks offset duration risk for the remaining months they can, the real solution to the problem is lower rates. It reduces duration issues and stimulates residential property markets before they grind completely to a halt (improving loan books) (Chart 16).

Chart 16 – Buying conditions for housing surveyed by consumers (1960-2023)

Source: University of Michigan, National Bureau of Economic Research, Federal Reserve Board, Game of Trades

China is having a similar issue, with construction starts falling off a cliff as it works out what to do about the litany of incomplete developments which still need to be completed (Chart 17).

Chart 17 – Chinese construction status split into new and existing projects (1995-2023)



Source: Convera, Macrobond

While there are several things in the market that might be of concern, slightly lower rates at the Federal Reserve will largely fix the issues. As we have mentioned before, markets need an exogenous event to collapse, with nothing we have mentioned above new or unknown.

As a result, we think there are a lot more potential positive catalysts for the upcoming year than negatives. Couple this with digital asset ecosystem catalysts, we believe it's an opportune time to gain exposure to a new asset class called crypto.

Digital Assets

2024 began with a bang. The total market capitalisation of crypto ex-Bitcoin and Ethereum (TOTAL3) peaked on January 2, after a 65% increase from the October 20, 2023 low.

Since then, TOTAL3 is down 8%, taking a much-needed breather ahead of numerous upcoming catalysts including April's BTC halving and what likely a more accommodative stance from central banks globally (China has already re-introduced the punch bowl).

Starting off, news we found interesting during January 2024 includes:

- Mexican telecommunications giant Telefónica partnered with Nova Labs, the company behind the Helium Network ($HNT), a decentralized wireless network. Telefónica will use Helium Mobile Hotspots to lower infrastructure costs and expand its coverage in Mexico.
- Solana ($SOL) Mobile's Saga phones pre-sale orders, due for delivery in 2025, have reached 40,000. This follows the initial 20,000 sold at the end of 2023.
- The Fox Corporation, the media conglomerate behind brand names like Fox News, partnered with Polygon ($POL) to launch a blockchain platform to track how their content is being used online. The Verify platform's goal is "to establish the history and origin of registered media" used by artificial intelligence (AI) firms.
- Beam wallet, which is built on Optimism ($OP) and Base, acquired Join, which facilitates Amazon and Shopify purchases using stablecoins. Beam wallet is one of several new user-experience-focused wallets that is attempting to eliminate seed words or native-coin gas fees to make shopping with crypto more user friendly.
- Mercari, one of the largest e-commerce platforms in Japan, will allow users to purchase products using BTC starting in June.
- Coinbase partnered with Africa's Yellow Card to expand access to its products in 20 African countries, integrating Yellow Card's payment rails so customers can on and off-ramp fiat to BTC and USDC on its Ethereum layer-2 rollup Base.
- Google revised its advertising guidelines to permit cryptocurrency trusts, such as Bitcoin ETFs, to promote their products on the search engine.
- Figure Technologies Inc., a blockchain and lending startup founded by former SoFi Technologies CEO Mike Cagney, is seeking approval from the SEC to issue the first interest-bearing stablecoin.
- The SEC pushed the decision on BlackRock's spot Ethereum ETF to March, although the final deadline for the Blackrock ETF is not until August. The first "final" deadlines are VanEck and Ark 21Shares' Ether spot ETF applications with May 23 and May 24, respectively.
- Thailand's Securities and Exchange Commission (SEC) announced that they removed restrictions on retail investors purchasing digital assets backed by real estate or infrastructure.
- Donald Trump continued his launch of NFT collectibles, this time launching his Mugshot edition on Bitcoin Ordinals.

January 2024's top news was the largely expected SEC approval of spot Bitcoin ETFs. While the Bitcoin price peaked on the same day as the SEC approval of January 11, it sold off the following two weeks due to a confluence of factors.

These factors included FTX estate selling GBTC as part of bankruptcy to re-pay credits, GBTC holders rotating out of higher fee products, and the simple sell the news event (leverage dropped significantly immediately following approval).

As it tends to do, history is repeating itself. The past two BTC halvings (July 9, 2016 and May 11, 2020) were led by drops in Bitcoin. In January 2016, BTC fell 24% to 352 (yes, 352!!!) and in February-March 2020 BTC fell 62% (notably exacerbated by the initial Covid sell-off) (Charts 18 and 19).

From the bottom of the 2016 and 2020 cycle, BTC increased over 56x and 17x, from its pre-halving low to its respective peak. The next halving will occur towards the end of April 2024, less than three months from now.

Chart 18 – BTC Price Performance (Jan 2015 – Dec 2017)

Source: Tradingview; Vikara Capital.

Chart 19 – BTC Price Performance (July 2018 – Dec 2021)

Source: Tradingview; Vikara Capital

While the BTC price did fall as low as $38.5k on January 23, down 21% from January 11 high above $49k, the same day the ETF was approved, the price action took away from the fact net inflows of $655m into BTC occurred in the first 24 hours of spot ETF trading (Figure 1).

Figure 1 – Day One BTC spot ETF flows

Ticker	Name	Day 1 Flows ($ MLns)
BITB	Bitwise Bitcoin ETF	$237.90
FBTC	Fidelity Wise Origin Bitcoin Fund	$226.97
IBIT	iShares Bitcoin Trust	$111.67
ARKB	ARK 21Shares Bitcoin ETF	$65.33
EZBC	Franklin Bitcoin ETF	$50.07
BRRR	Valkyrie Bitcoin Fund	$29.40
BTCO	Invesco Galaxy Bitcoin Etf	$17.36
HODL	Vaneck Bitcoin Trust	$10.56
BTCW	WisdomTree Bitcoin Fund	$0.99
DEFI	Hashdex Bitcoin Futures ETF	$0.00
GBTC	Grayscale Bitcoin Trust BTC	-$95.07
	Total	$ 655.2
	EX-GBTC	$ 750.3
BITO	ProShares Bitcoin Strategy ETF	$ 91.8

Source: Bloomberg; x.com (@JSeyff)

While we manage a non-BTC portfolio of tokens, money into Bitcoin helps the entire crypto ecosystem. In the first 12 trading days, volume totalled $25.9bn ($12.7bn if you exclude GBTC). Blackrock now has $2.2bn and Fidelity has $1.9bn in their respective BTC ETFs.

Figure 2 – Bitcoin Spot ETF Metrics (through January 29, 2024)

Ticker	Name	Total Volume 12 Days ($ Mlns)	Total Flows 11 days ($ Mlns)	Assets* ($ Mlns)	Day 12 $Volume ($ Mlns)
GBTC	Grayscale Bitcoin Trust BTC	$ 13,202	-$5,041.2	$20,843.8	$570.1
IBIT	iShares Bitcoin Trust	$ 5,310	$2,173.4	$2,185.9	$460.9
FBTC	Fidelity Wise Origin Bitcoin Fund	$ 4,557	$1,925.8	$1,941.6	$315.4
ARKB	ARK 21Shares Bitcoin ETF	$ 1,422	$596.4	$604.6	$106.8
BITB	Bitwise Bitcoin ETF	$ 754	$588.3	$570.4	$52.2
BTCO	Invesco Galaxy Bitcoin Etf	$ 357	$282.9	$287.1	$14.1
HODL	VanEck Bitcoin Trust	$ 119	$55.2	$123.6	$16.6
BRRR	Valkyrie Bitcoin Fund	$ 32	$112.8	$110.7	$3.5
EZBC	Franklin Bitcoin ETF	$ 130	$59.5	$57.3	$3.6
BTCW	WisdomTree Bitcoin Fund	$ 55	$6.3	$8.5	$21.0
	Total	$25,938.4	$759.4	$26,733.4	$1,564.3
	Total EX-GBTC	$12,736.2	$5,800.6	$5,889.6	$994.2

Note: *Scaling for bars in assets column are adjusted

Bloomberg

Source: Bloomberg; x.com (@JSeyff)

Why is this important for the rest of crypto? Liquidity. As new money enters to buy Bitcoin, that new liquidity has the potential to be used elsewhere in the crypto ecosystem.

Following on the back of the BTC spot ETF approval, old school institutions, like ones with dead founding fathers as their symbol, have jumped aboard. Over the past two weeks, 77-year old, $1.5 trillion AUM asset manager, Franklin Templeton has been pumping cryptos tires.

Figure 3 – Ben Franklin Laser Eyes

Source: x.com (@FTI_US)

Figure 4 – Franklin Templeton on Solana

Source: x.com (@FTI_US)

Figure 5 – Franklin Templeton on Solana

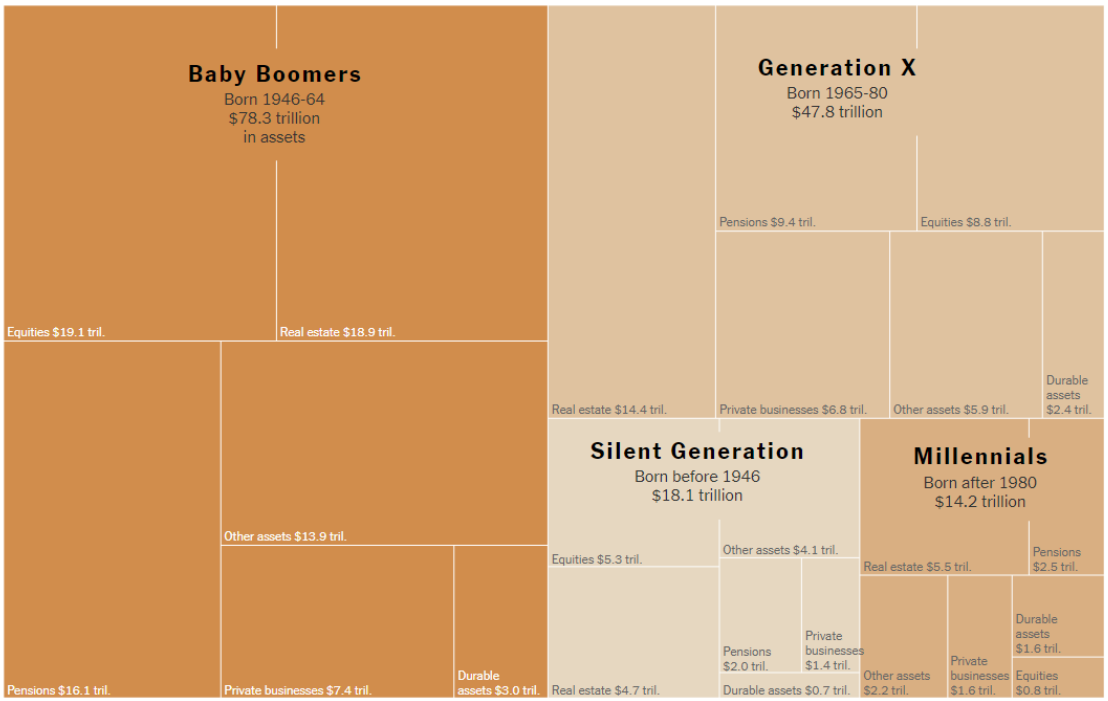
Source: x.com (@FTI_US)

Others jumped in to be on the right side of history.

- Blackrock: Larry Fink stated on January 14, 2024 “we believe this is just the beginning. ETFs are step one in the technological revolution in the financial markets. Step two is going to be the tokenization of every financial asset.”
- Morgan Stanley: "The adoption of bitcoin beyond speculative purposes continues to evolve.” Also calling the approval "a potential paradigm shift in the global perception and use of digital assets."
- Fidelity: “We expect corporations may get more comfortable with the idea of putting digital assets on their balance sheet” after updated rules from the US Financial Accounting Standards Board (FASB) allowed companies to report both paper losses and gains from their crypto holdings.

This is very important in our opinion. Baby boomers, who control over half of all wealth in the US (Figure 6), have been underallocated to digital assets.

Figure 6 – Baby Boomers own $78.3 trillion in assets



Source: New York Times

According to a Galaxy Digital survey, only 6% of Baby Boomers hold crypto versus 31% of Millennials (Figure 7).

Figure 7 – Crypto Adoption by Generation – Aggregated Survey Data

			By Generation				
Survey Source	Survey Date	Total	Baby Boomers	Gen X	Millennials	Gen Z	Millennial / Boomer Ratio
Pew	Mar-23	17%	–	–	–	–	–
Atlanta Fed	Oct-22	10%	–	–	–	–	–
Coinbase	Feb-23	20%	–	–	30%	36%	–
FINRA / CFA	Dec-22	–	n/a	39%	57%	39%	–
Bitget (global)	Apr-23	–	8%	25%	31%	17%	3.9x
Investopedia	Apr-22	–	6%	28%	38%	23%	6.3x
JPMorgan	Dec-22	13%	4%	11%	20%	n/a	5.0x
NerdWallet	May-22	25%	7%	27%	42%	31%	6.0x
Morning Consult	May-22	17%	8%	12%	28%	24%	3.5x
Morning Consult (BTC only)	Oct-23	11%	3%	12%	19%	16%	6.3x
CNBC-Momentive	Nov-22	10%	4%	12%	15%	12%	3.8x
	Avg	15%	6%	21%	31%	25%	5.0x

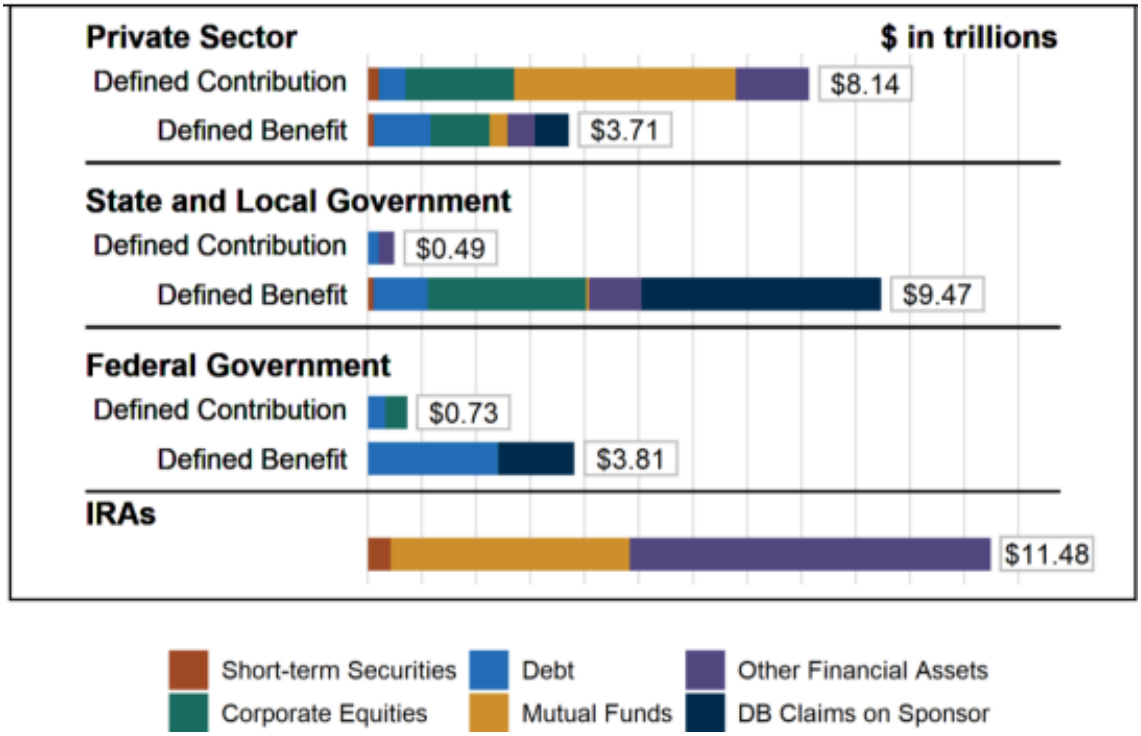
Source: Galaxy Digital

Further, most remain sceptical of crypto as an asset class. While that is beginning to change, we believe credentialled, familiar brands such as Blackstone and Franklin Templeton do far more good than harm in building crypto as a must allocate asset class.

It's not a novel idea to think that once institutional money properly enters crypto, the game changes. Fixed supply likely means token prices have one way to go as infinite money supply meets finite token supply. Think about the amount of capital in the US pension system. According to Federal Reserve data, there is over $26 trillion in pension assets across private and local, state and federal governments.

Note this $26 trillion doesn't include US insurance funds, endowments, IRAs, or funds (mutual, hedge), nor does include the massive amount of money held globally. Take for example the Government Pension Investment Fund of Japan with $1.7 trillion in AUM or Government Pension Fund of Norway with $1.5 trillion in AUM.

Chart 20 - U.S. Pension Plans and Individual Retirement Accounts (IRAs) Holdings



Source: Congressional Research Service (crsreports.congress.gov); Federal Reserve's Financial Accounts of the United States as at September 20, 2023.

While some pension funds have invested relatively small dollars in bitcoin miners, crypto VC funds and/or in private companies, we know of very few that have invested in liquid token funds and even less who have principally invested in tokens themselves.

We expect this to change with digital assets taking the same path that hedge, private equity, venture capital and real asset funds (collectively "alternatives") did over the past 20 plus years, where asset managers continually raised their allocations to alternatives as low or zero interest rate policy compressed overall returns (we'll be there again, maybe sooner than later).

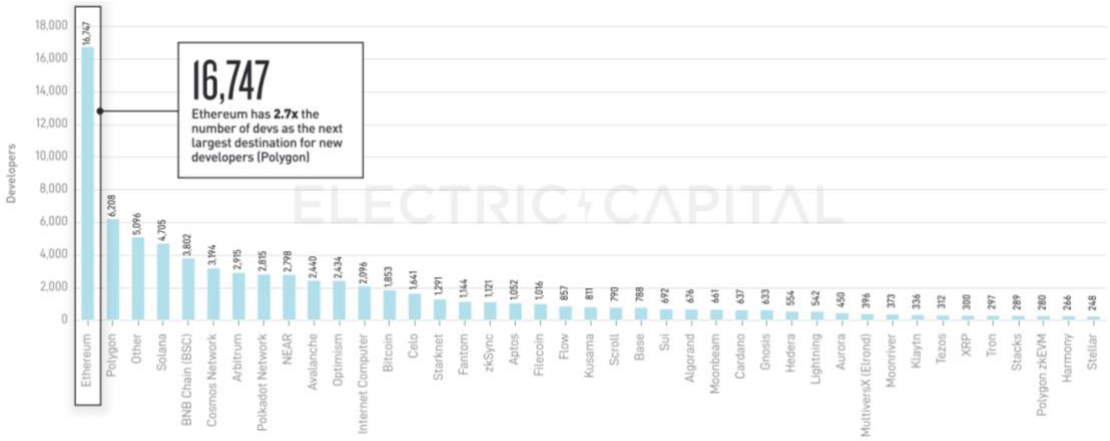
That said, we do not think the institutional party starts raging until proper regulation is in place. But even smaller amounts of institutional capital making their way into the crypto market will have a pronounced effect on prices while also lowering overall volatility. We want to be ahead of that bullet train. You probably should want that too.

Three reports worth perusing were released this month.

First, Electric Capital's Developer report is a must read. The 181-slide presentation has a ton of data with many key takeaways such as "monthly active developers fell by 24% in 2023, although developers who have been in crypto for 2+ years are at an all-time high after growing at 52% annualized for the past 5 years."

In terms of where developers are working, Ethereum attracted the highest number of new developers in 2023 by a wide margin. Polygon, Solana, BNB and Cosmos round out the top five (Chart 21).

Chart 21 – Number of new developers who wrote code in each crypto ecosystem in 2023



Source: Electric Capital's January — December 2023 Developer Report; DeveloperReport.com

Second, Flipside released The Onchain Crypto User Report which has plenty of useful data. For example, Ethereum acquired the most users at 15.4 million while Polygon, a Layer 2 scaling solution built on Ethereum, acquired 15.2 million users in 2023 (Figure 8).

Flipside defined an acquired user as one who conducted at least two transactions on a particular blockchain, with at least one taking place in 2023.

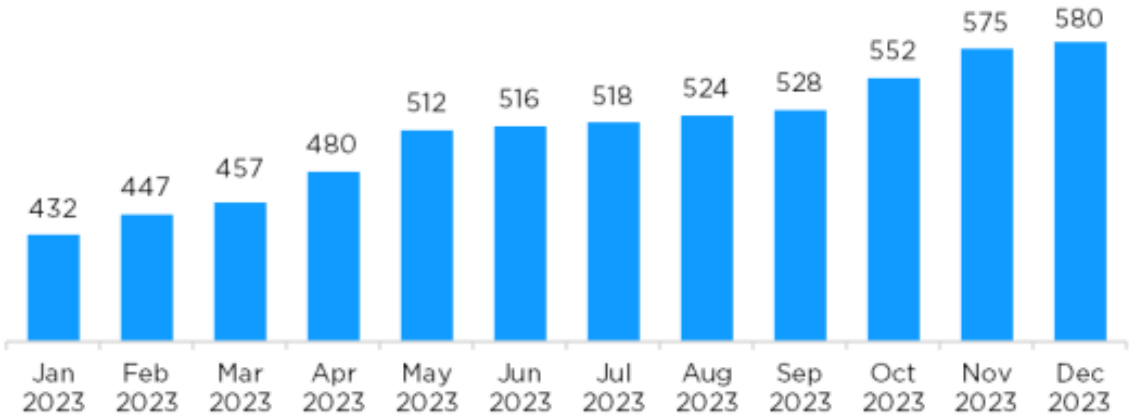
Figure 8 – Blockchain Acquired User Growth (2023)

Chain	Acquired Users *(2023)*
Ethereum	15,408,536
Polygon	15,240,523
Bitcoin	10,655,223
Solana	5,604,319
Arbitrum	7,378,618
Optimism	3,335,226
Avalanche	2,534,441
Base	1,940,910

Source: Flipside

Last, a report by Crypto.com showed crypto ecosystem user growth continues to expand rapidly. The report estimates the global number of cryptocurrency users to be 580 million, an increase of 34% in 2023 (Chart 22). Bitcoin ownership increased from 222 million to 296 million users while Ether rose from 89 million to 124 million users.

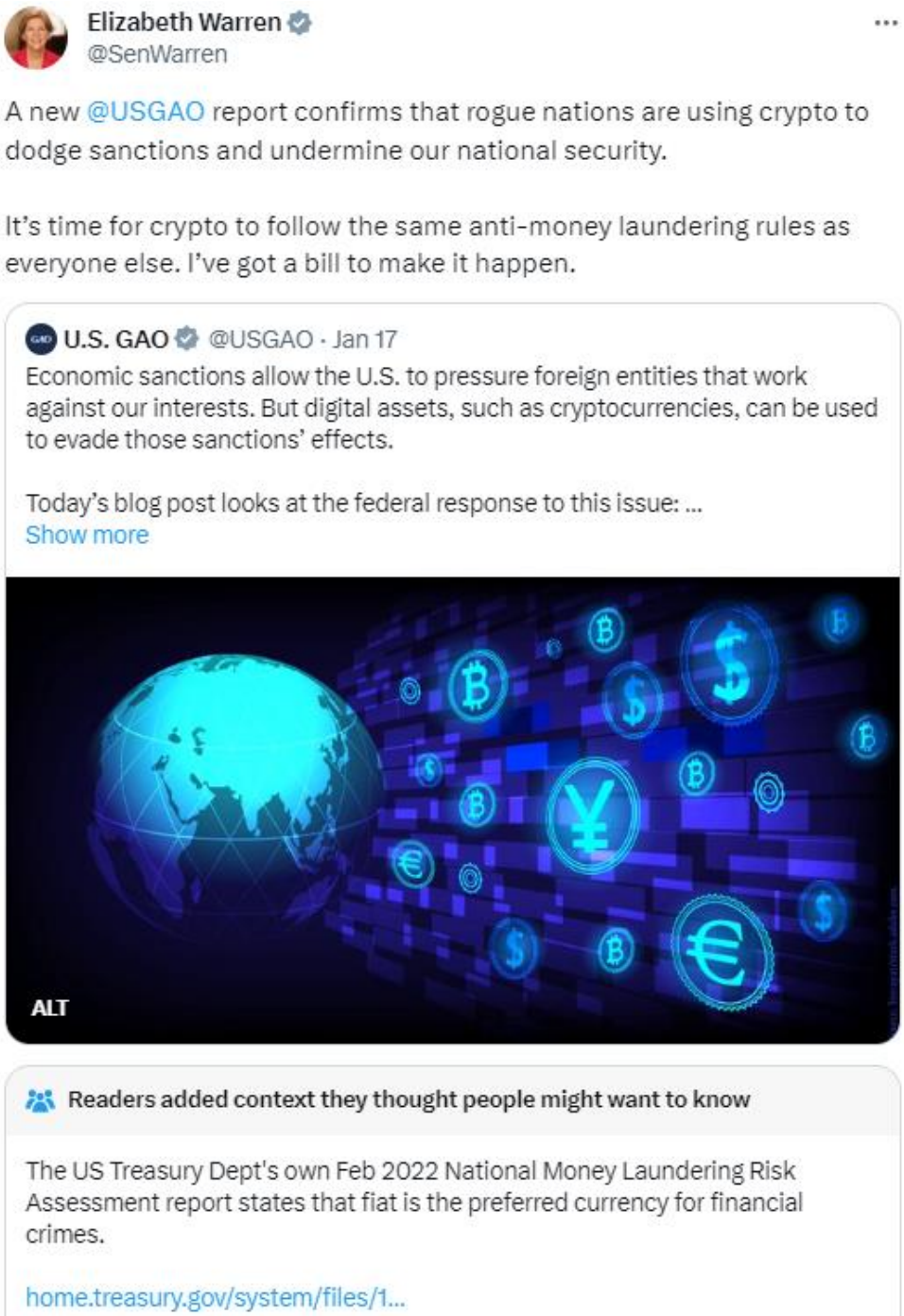
Chart 22 – Total Number of Crypto Owners Globally (in millions) (2023)



Source: Crypto.com; Crypto Market Sizing Report, January 2024

Last, and not least, another month, another Elizabeth Warren community note. It was the standard money laundering narrative but this time looping in national security fears.

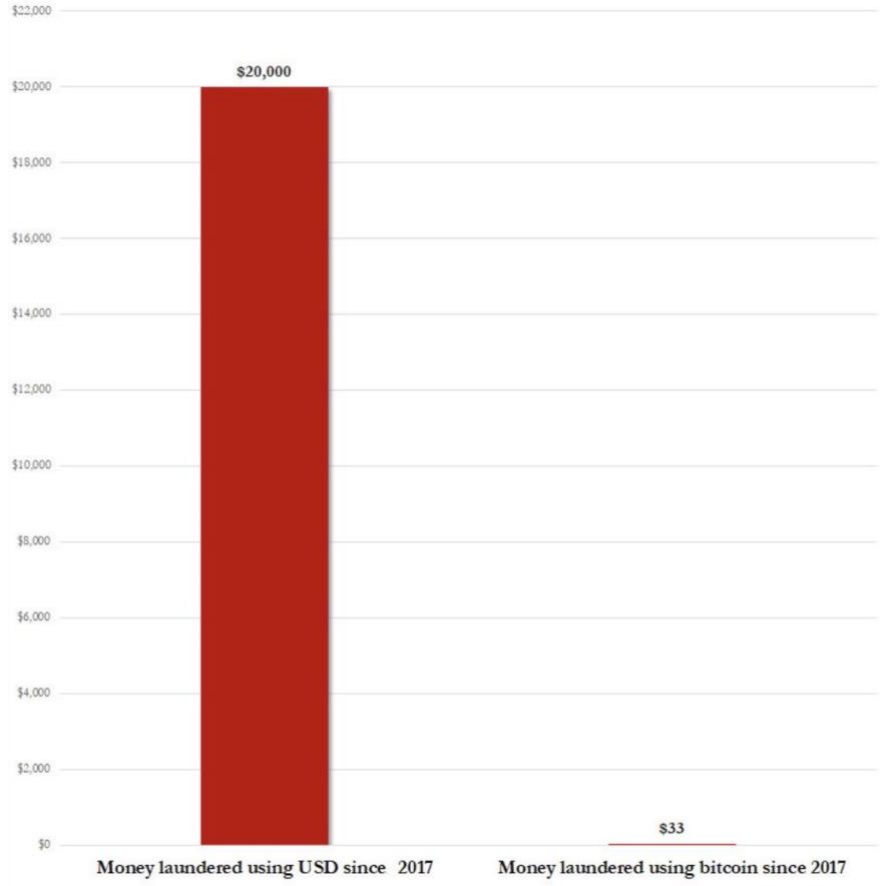
Figure 9 – Senator Warren once again bashing crypto



Source: x.com (@SenWarren)

As anyone who pays attention knows, fiat is by far and away the preferred currency used to commit illicit transactions, per the United Nation's own data.

Chart 23 – Money Laundered Since 2017 (USD v BTC) ($US billions)



Source: United Nations Office on Drugs and Crime; Global Investigations Review

While USD fiat is of course a much larger overall market, the idea that crypto is used primarily as a tool for bad guys continues to be peddled by fewer and fewer.

Figure 10 - $125m smuggled from London to Dubai aboard commercial flights)

WSJ

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U.K.

What's in Those Huge Suitcases? $125 Million in Cash

A network of smugglers flew business class to gain extra luggage allowances, moving more than $1 million at a time from London to Dubai

By Margot Patrick Follow

Updated Jan. 13, 2024 at 12:01 am ET

Source: WSJ.com

Fact is you can't hand anyone a "physical" bag of Bitcoin now, can you? But you can absolutely get your digital bags packed. We think it's time.

Contact Us

Vikara is an open-ended fund, with investors able to add or redeem monthly. Please contact Luke or Mark if you would like to discuss anything further.

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