Vikara returned ~88% on a gross basis in 2023, comparing favourably to the S&P500, NASDAQ and the magnificent seven which returned 25%, 56% and +110% respectively. We are in the early innings of digital asset adoption and are very excited about what is to come in 2024.

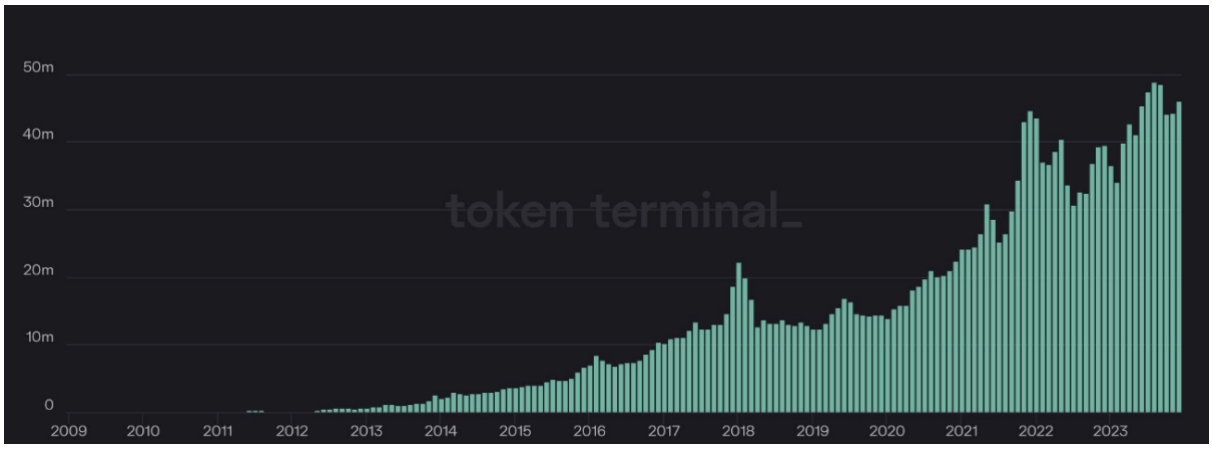
It is hard to believe global equities, real estate, and commodity markets at or close to their highs, while digital assets aren't. Between ETF approvals, the Bitcoin halving, lower rates, a weaker USD, improving inventory cycle, a US election year, and Chinese stimulus, what's not to love?

Digital asset active users continue to grow (Chart 1), global legislation is racing to keep up and capital is flowing into the space. Ironically, it is western investors that continue to drag their feet and remain under allocated. A wealth transfer from boomers to millennials is happening in real time.

We continue to educate investors all over the world about the formation of this global capital market (digital assets) and the opportunity to own the infrastructure layer that will form the basis of the internet in coming years. Many continue to dismiss it because they "still don't understand it".

We encourage our readers to spend time over this holiday period learning about digital assets. It isn't going away. It is accelerating. Ignorance is no longer a reasonable excuse. The opportunity for allocators is incredible and the time to allocate is now.

Chart 1 – Aggregated monthly active users for Top 20 projects (L1/L2) (2019-2023)



Source: Token Terminal

If the above chart was users of a payments platform on the NASDAQ, the stock would be making all-time highs. If it was an order backlog of a semiconductor business, it would be on an astronomical multiple. But because digital assets are misunderstood and full of retail capital, fundamentals ≠ price.

There is momentum building everywhere, except the mainstream western newspapers. The sophistication in the industry is improving, with tokenomics models investor focused and fundamental dashboards helping determine future price performance.

Sadly, a majority of people still don't believe that digital privacy is important, that there is any benefit to self-custody of assets, or that the belligerent printing of cash from governments is an issue. We respectfully disagree on all of these points.

Unfortunately, most will understand these issues better as central bank digital currencies are rolled out, carbon emission taxes are overlaid on societies and capital controls can be used to ensure western investors cannot opt out. Don't be late to this realization.

We have shortened this update due to the time of the year. We hope you all have a fantastic holiday season and a prosperous 2024. Thanks for your continued support.

Macro

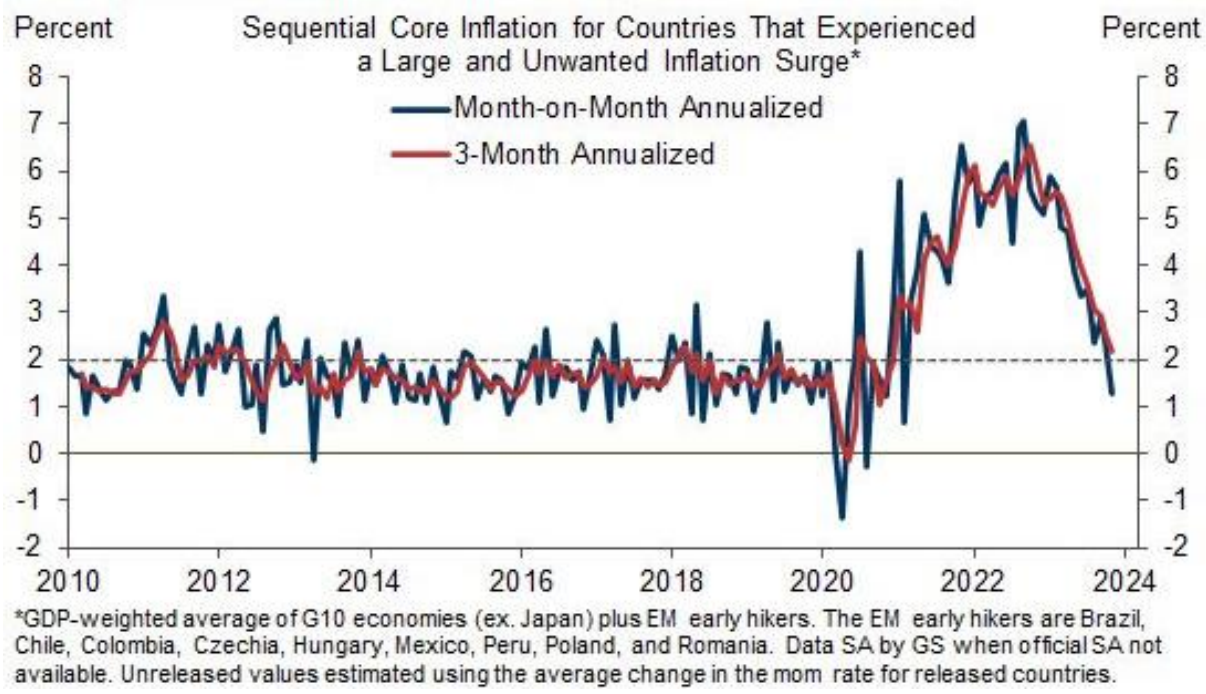
Our positive thesis for 2024 hasn't changed, and the turn in the inventory cycle will convince even the biggest bear that we aren't landing. Chart 2 shows the S&P500 index relative to M2 money supply, which has broken out above a level it has failed at multiple times throughout history.

Chart 2 – S&P500 index relative to M2 money supply (1959-2023)

Source: Tradingview.com

There are many reasons for this. Core inflation in G10 markets (excluding Japan, including early-hiker emerging-markets) collapsed to 1.3% in November, despite running at 2.2% over past three months.

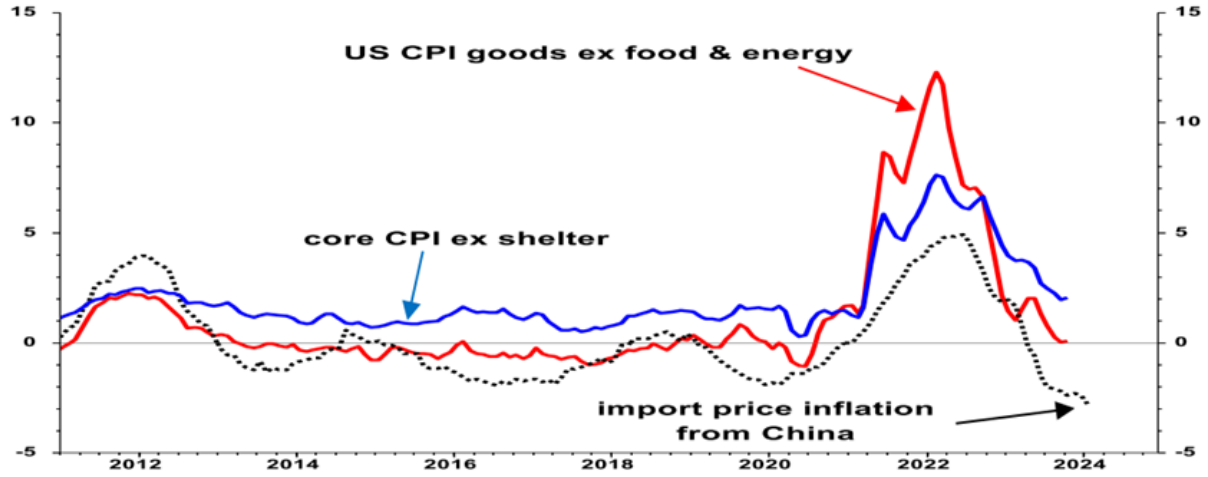
Chart 3 – Core inflation is back within a normal range (2010-2023)



Source: Goldman Sachs Global Investment Research

Inflation is falling as supply chains rebalance, energy prices decline and deflation in China's export prices arrive in western markets. The latter is most important, with China having excess debt, excess capacity, and less customers to sell to (Chart 4).

Chart 4 – China's deflationary goods prices will continue to drag down inflation (2011-2023)



Source: Datastream, Ollari Consulting

China's excess capacity is unable to be redirected to other markets and may create a deflationary environment for years to come. Knowing this, it is unsurprising to see western adversaries disrupt supply chains globally, a key risk to a second wave of inflation in 2024 (Figure 5).

Chart 5 – Maritime Shipping Routes and Strategic Locations

Source: @vtchakarova

Despite these geopolitical risks, inflation expectations have fallen to their lowest levels in two years according to Bank of America's fund managers' survey. In addition, 89% of respondents expect lower short-term rates suggesting the tightening cycle is ending with asset prices at their highs (Chart 6).

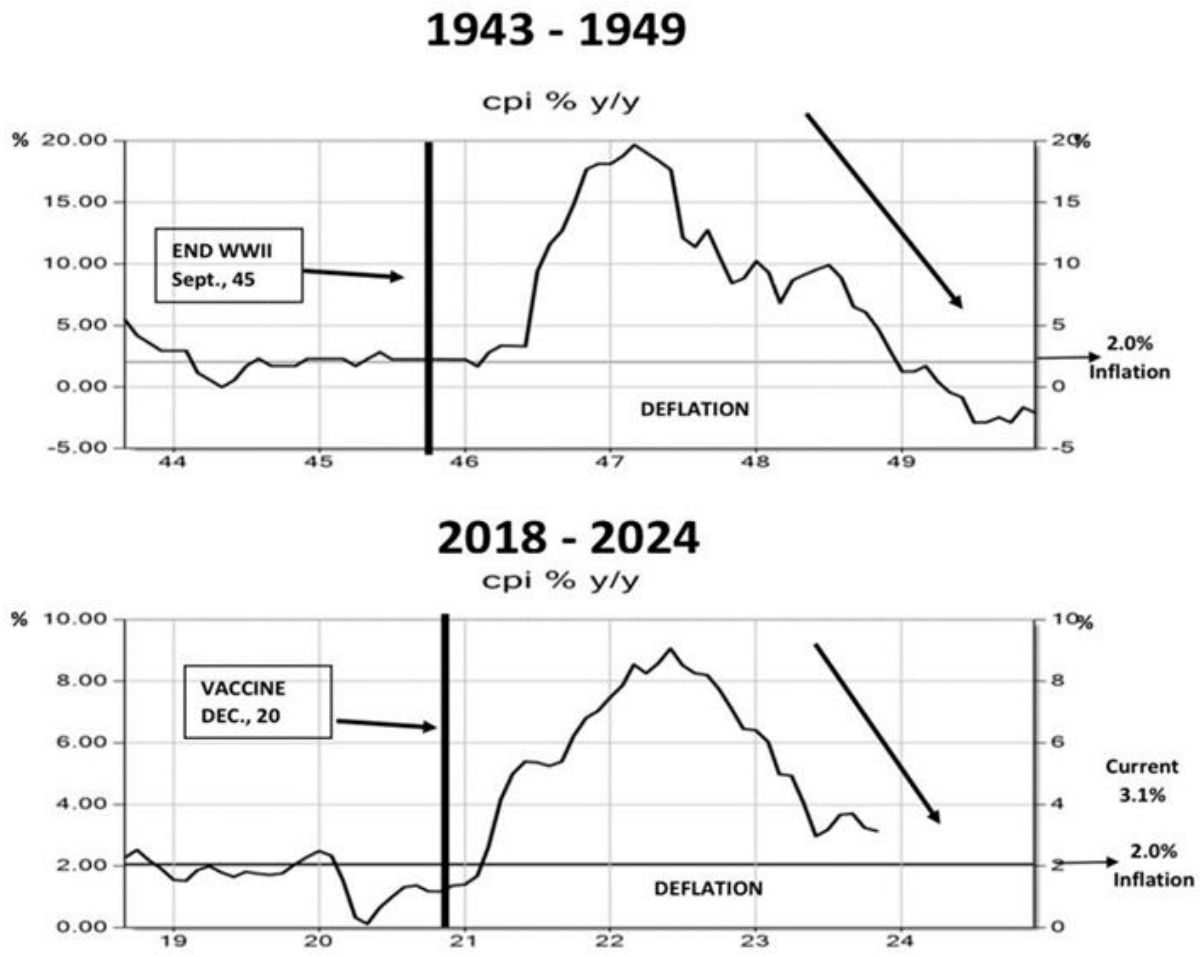
Chart 6 – Fund Manager Survey respondents expect lower short-term rates (2001-2023)

Source: BoFa Global Fund Manager Survey, Bloomberg

Inflation can be blamed on one thing: irresponsible global fiscal and monetary policy driving pent-up "work from home" demand during Covid. As workers return to the office and excess savings dwindle, this was always going to reverse.

The current macro back drop reminds us of a post-World War 2 period. Chart 7 shows CPI moving negative in the years to follow after M2 went negative (which is the same as today). Wouldn't it be fascinating to see growth accelerating while inflation turns negative. This is truly goldilocks.

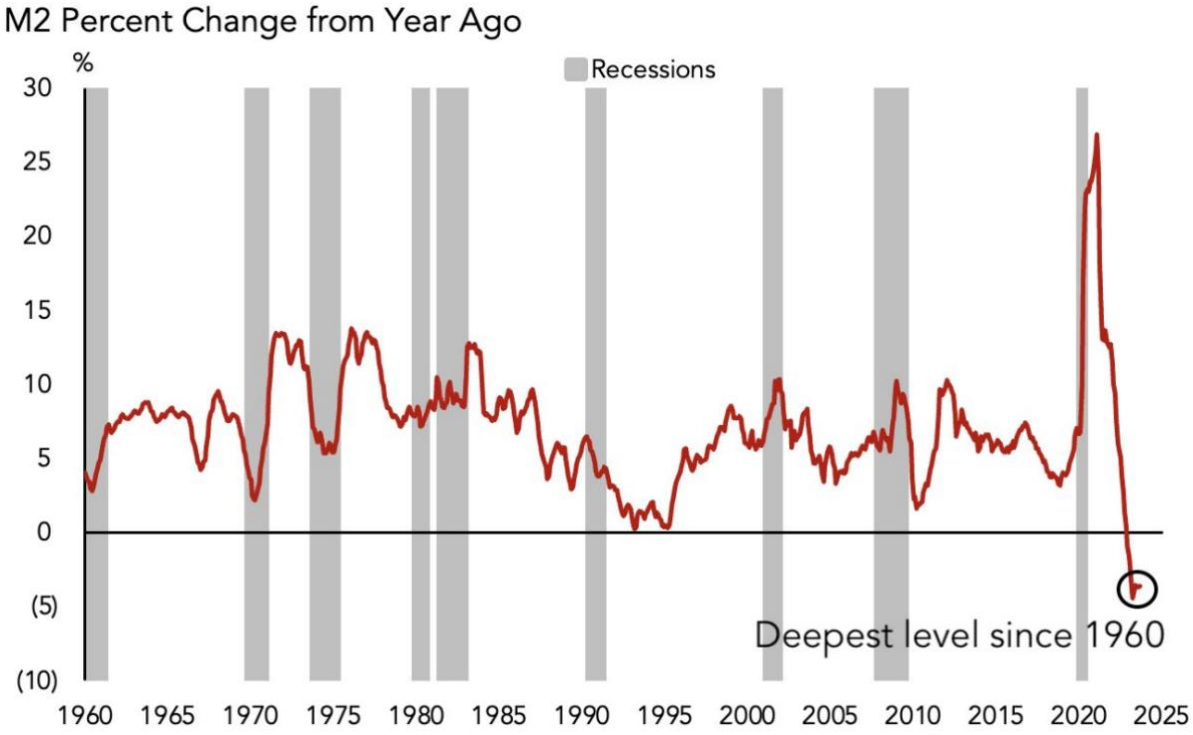
Chart 7 – Inflation post WWII and post Covid



Source: Elaine Garzarelli

A decline in M2 is not necessarily a sign of impending doom in the economy, with the excess in monetary and fiscal policy confusing year over year comparisons (Chart 8).

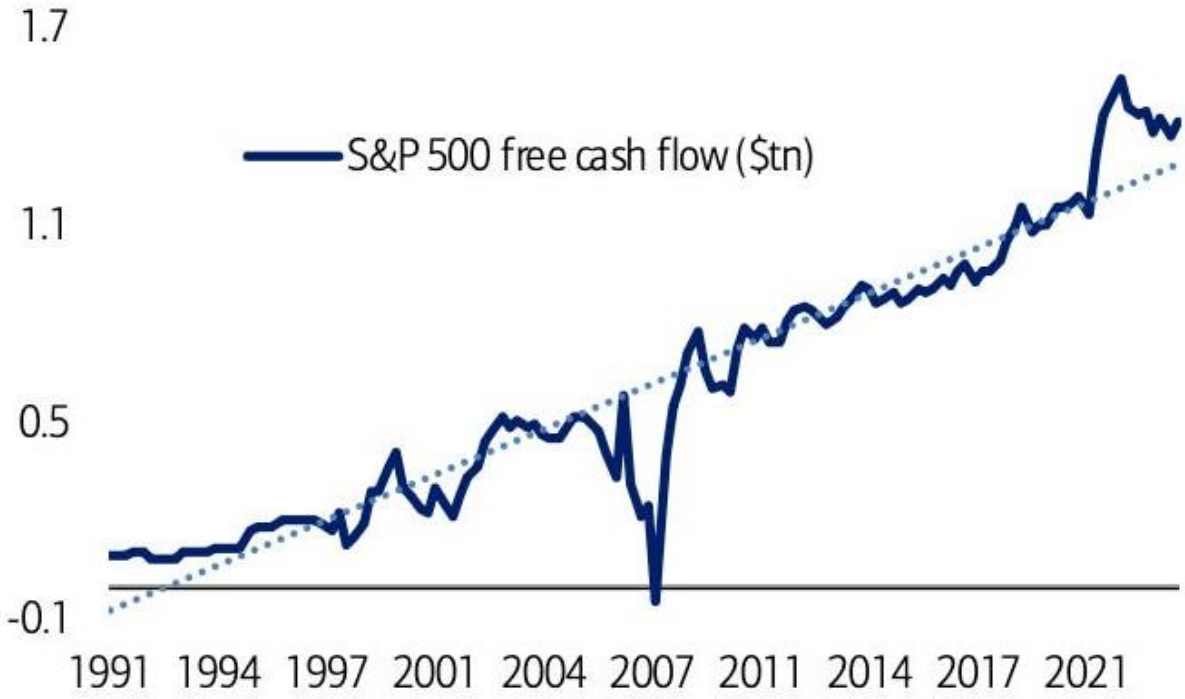
Chart 8 – M2 money supply (1960-2023)



Source: Bureau of Economic Analysis, National Bureau of Economic Research, Game of Trades

Free cash flow across the S&P 500 has yet to correct to pre-pandemic trends, with current S&P FCF of $1.4 trillion being over $100 billion higher than the historical trend implies (Chart 9). This is not a time for lower capital investment or corporate debt defaults.

Chart 9 – S&P500 free cash flow (USD trillion) (1991-2023)



Source: Bank of America Investment Committee, Bloomberg

Markets are starting to anticipate a turn in western world monetary policy, with both emerging and developed market financial conditions easing considerably in recent weeks (Chart 10).

Chart 10 – Financial conditions are loosening quickly (2002-2023)

Source: Ollari Consulting

China is injecting liquidity at a rate not seen since the Covid period, reaching a higher net injection than in recent history (Chart 11). While a lot more is needed to resolve its failing real-estate sector, and the collapsed debt pile, there are signs China is ready to clean up the mess.

Chart 11 – PBOC MLF Cumulative Net Injection (CNY Billion) (2018-2023)

Source: THeDailyShot.com

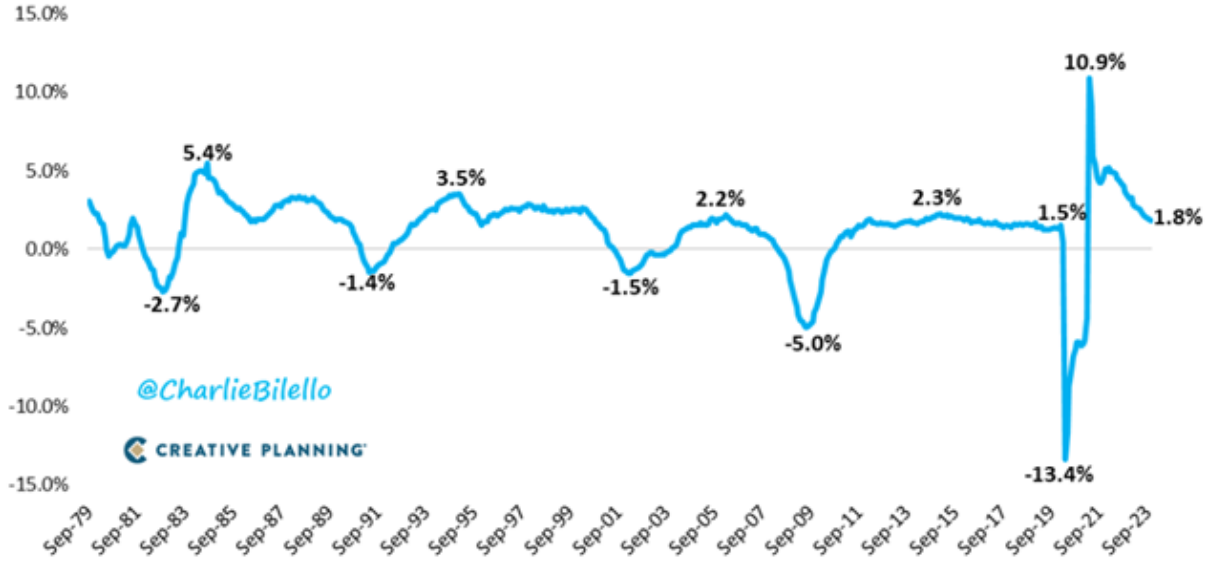
The US service wages index is back at historical levels, indicating that the risk of runaway inflation caused by wages is now under control (Chart 12). This was a major cause for concern in 2023 and will give the Federal Reserve confidence to loosen monetary policy into 2024.

Chart 12 – New York Fed Services Index: Wages (2016-2023)

Source: TheDailyShot.com

The 1.8% increase in total jobs created over the last year was the lowest YoY growth rate since March 2021, another indicator that the labour market is back in balance (Chart 13).

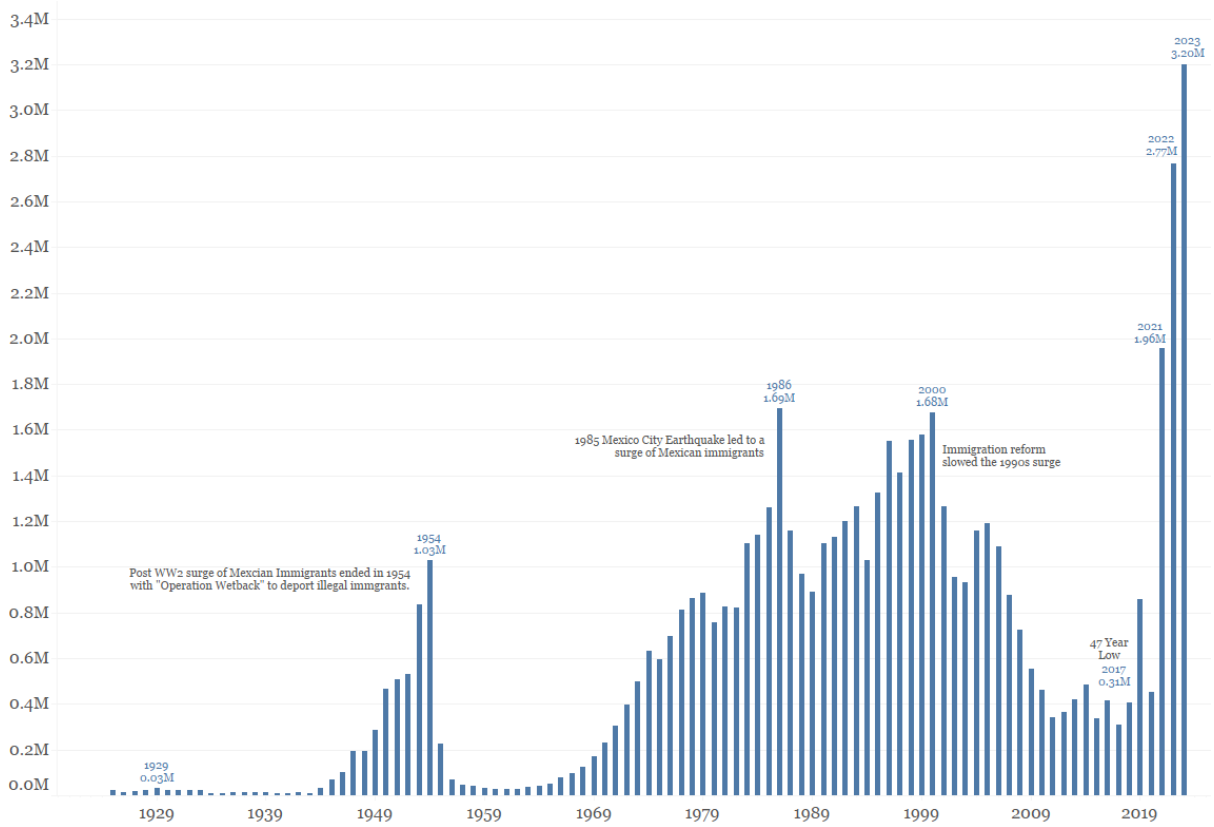
Chart 13 – US Non-Farm payrolls (YoY %) (1979-2023)



Source: Creative Planning, @CharlieBilello

The flow of immigrants crossing the US border will only add to wage deflation (Chart 14). There may be some productivity declines in the early stages of this immigration, but this will be bridged with ever higher government deficits in 2024.

Chart 14 – Apprehension and Expulsion Registered by the US Border Patrol (1925-2023)



Source: US Customs and Border Protection, Bianco Research

While consensus believes that markets collapse after the Federal Reserve starts cutting rates, this isn't always true, as shown in Figure 1. Actually, post periods of high inflation, falling rates is often a positive for most asset prices.

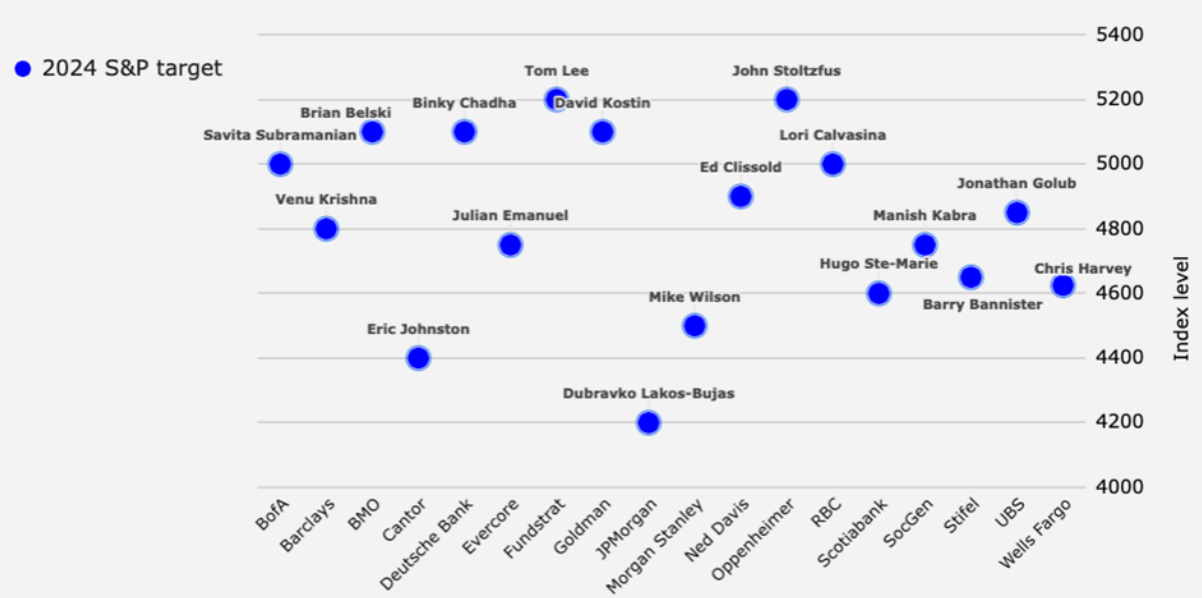
Figure 1 – Cross asset returns in the following three months post the first rate cut (1973-2023)

			Returns 3 months after Fed cut				
1st Fed cut	Background	Recession	10Y yield	2s10s	US$	Oil	SPX
Sep 3, 1973	1st cut preceded oil shock/recession	Nov'73 - Mar'75	-52bps	17bps	5.0%	83.7%	-9.9%
Jul 1, 1974	1st cut as stagflation raged	Nov'73 - Mar'75	32bps	69bps	1.8%	-2.3%	-26.3%
Apr 1, 1980	1st cut after oil shock, short recession	Jan'80 - Jul'80	-256bps	302bps	-9.7%	0.5%	12.5%
Jun 1, 1981	1st cut preceded recession begins	Jul'81 - Nov'82	195bps	-36bps	5.5%	-3.1%	-7.1%
Oct 2, 1984	1st cut (to weaken US$)...soft landing	None	-84bps	125bps	3.9%	-12.5%	1.1%
Oct 19, 1987	1st cut after stock market crash	Jul'90 - Mar'91	-150bps	-17bps	-5.7%	-12.7%	10.9%
Jun 5, 1989	1st cut was 12 months before recession	Jul'90 - Mar'91	-17bps	-13bps	0.4%	-7.2%	9.5%
Jul 6, 1995	1st cut...soft landing (after bond crash in '94)	None	1bps	-15bps	3.6%	-2.0%	5.1%
Sep 29, 1998	1st cut after LTCM collapse	None	12bps	-15bps	-1.4%	-26.7%	18.4%
Jan 3, 2001	1st cut post-dotcom crash, preceded recession	Mar'01 - Nov'01	-20bps	46bps	5.0%	-6.5%	-17.9%
Sep 18, 2007	1st cut preceded recession & GFC in 2008	Dec'07 - Jun'09	-36bps	43bps	-2.3%	11.0%	-4.3%
Jul 31, 2019	1st cut...soft landing (prior to COVID crash)	None	-33bps	2bps	-1.2%	-7.5%	1.9%
Average			**-34bps**	**42bps**	**0.4%**	**1.2%**	**-0.5%**

Source: Bank of America Investment Strategy, Globa Financial Data

Wall street analysts cannot make up their mind on where markets go next year, with one of the widest ranges for a year out on the S&P500 in years (Figure 2). It is overly simple, but the S&P500 hasn't declined during a re-election year since 1952, averaging a 12% in those years.

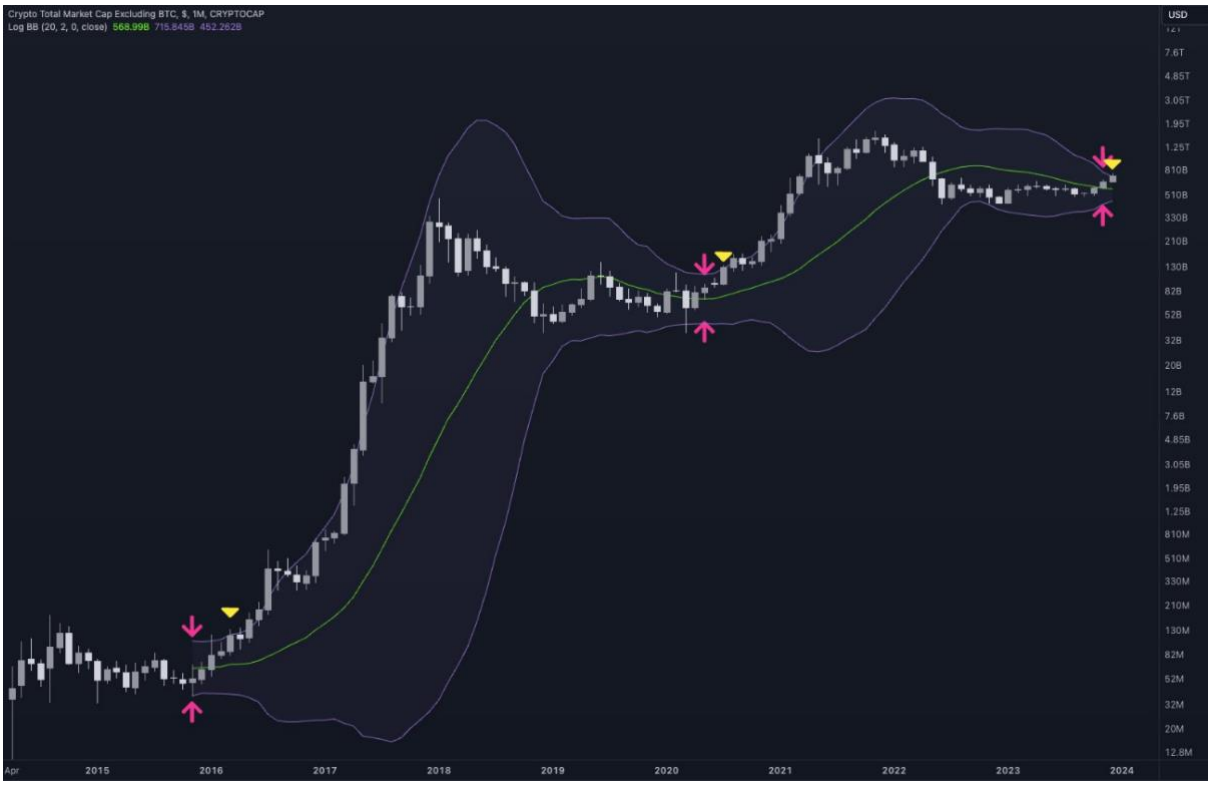
Figure 2 – Wall Street S&P500 target prices at the end of 2024



Source: Ollari Consulting

We would love to have a similar chart for estimates on where the total market cap of digital assets ex-Bitcoin is by the end of 2024. It would be an equally wide range, but it would have an extremely positive skew (Chart 15).

Chart 15 – Total crypto market capitalization excluding Bitcoin (2014-2023)



Source: Tradingview.com

Digital Assets

It was another exciting month in digital assets, with funds continuing to flow into the ecosystem, driving prices for many tokens higher. While Solana's surge took control of the narrative, plenty was happening during the last month of 2023. Some of the news we found interesting is below.

- German conglomerate Bosch released a Web3 connected small device capable of generating data on real world conditions such as weather, light and noise pollution, and seismic activity that allows users to earn crypto rewards by providing data, without involving a centralized intermediary. Each device is fitted with a unique digital identity that enables it to interact with peaq, whose krest network ($KREST) is running on Polkadot ($DOT) "canary network" Kusama ($KSM). Fetch.ai ($FET) is providing autonomous AI agents that can optimize the devices' activity to maximize owner rewards.
- Societe General (SG) issued its first green tokenized bonds on the Ethereum ($ETH) blockchain. SG said the use of tokenization will "increase transparency and traceability as well as improve fluidity and speed in transactions and settlements" and by using the blockchain as a "data repository and certification tool for issuers and investors" including carbon footprint detail.
- Solana ($SOL) announced that it has sold out of its initial 20,000 Saga phones in the US market, but only after incentives including owners the ability to mint the "Saga Genesis NFT" the first time they boot up the phone that unlocks half a dozen free rewards, such as a "welcome pack" with $20 in USDC stablecoins and Bonk ($BONK) tokens plus dropping the price from $1,000 to $599.
- Immutable ($IMX), a Web3 gaming company, has launched a new wallet infrastructure, called "Immutable Passport," that allows users to create and recover their wallet using a Google or Apple account or through an email address.
- Hong Kong's Securities and Futures Commission (SFC) and the Hong Kong Monetary Authority (HKMA) announced that they are ready to receive applications for Virtual Asset Spot exchange-traded funds (VA Spot ETFs), alongside the existing crypto futures ETFs
- GBA Capital, backed by China's state-owned National Engineering Laboratory, announced that they will launch a $10 billion Web3 VC fund.
- Starbucks will begin issuing NFTs in South Korea in January 2024, the first time they will do so outside the USA.
- Sotheby's announced that it sold "close to $35 million" in digital art in 2023
- The Swiss city of Lugano officially announced that it has started accepting Bitcoin ($BTC) and Tether ($USDT) as payment for taxes and all other community fees.

Before we jump into what we believe will drive crypto in 2024, we want to highlight that anti-crypto Army General Elizabeth Warren continued on her crusade this month.

She penned a letter to Coinbase and industry groups Coin Center and the Blockchain Association, saying the crypto industry should avoid lobbying efforts and called it a revolving door for former government workers, claiming both are working to "stonewall common sense rules".

The irony and absurdity of this statement is beyond comprehension. Take for example that the healthcare industry "officially" spent $725 million on lobbying efforts in 2022. Or that "revolving door" politics are part and parcel in DC.

Former FDA Director, Scott Gottlieb, is on Pfizer's Board of Directors. Former SEC Chairman Jay Clayton is on the board of Apollo Global Management. Former Ambassador to the UN Nikki Haley left government in 2019 and immediately joined the board of Boeing. The list goes on and on.

It's also well known that Warren ally and SEC Chairman Gary Gensler (aka "Elizabeth whisperer") is effectively Senator Warren's hammer in the regulatory fight against crypto. The good news is that the loudest voices continue to lose credibility as the industry matures and money flows back in, even in the face of a combative regulatory regime.

In fact, the SEC was forced to apologize this month after a federal judge threatened to sanction the agency after they were found to have made "materially false and misleading representations" when securing a restraining order against the crypto firm DEBT Box (Figure 3).

Figure 3 – SEC Apologies Over Materailly False and Misleading Statements

FORTUNE CRYPTO

REGULATORS · GARY GENSLER

SEC 'deeply regrets' errors in crypto case, asks judge to waive sanctions after misleading statements

BY LEO SCHWARTZ

December 23, 2023 at 2:55 AM GMT+11

Source: Fortune.

We also found it unsurprising that the same month Jamie Dimon said crypto should be banned (while JPM builds DeFi solutions!), Senator Roger Marshall admitted that he and Senator Warren worked with the largest US banking industry lobbying organization, the American Bankers Association (ABA), for assistance in crafting their controversial anti-crypto bill - the Digital Asset Anti-Money Laundering Act. Hey, at least they are transparent for once.

Chart 15 – Senator Roger Marshall Saying the Quiet Part Out Loud

Source: x.com

One can only hope that 2024 is a new year in the current administration's fight against crypto, one they seem to be losing.

In the spirit of keeping the annual December monthly shorter than normal, we will end by highlighting factors that are likely to drive digital asset markets higher, possibly much higher, in 2024.

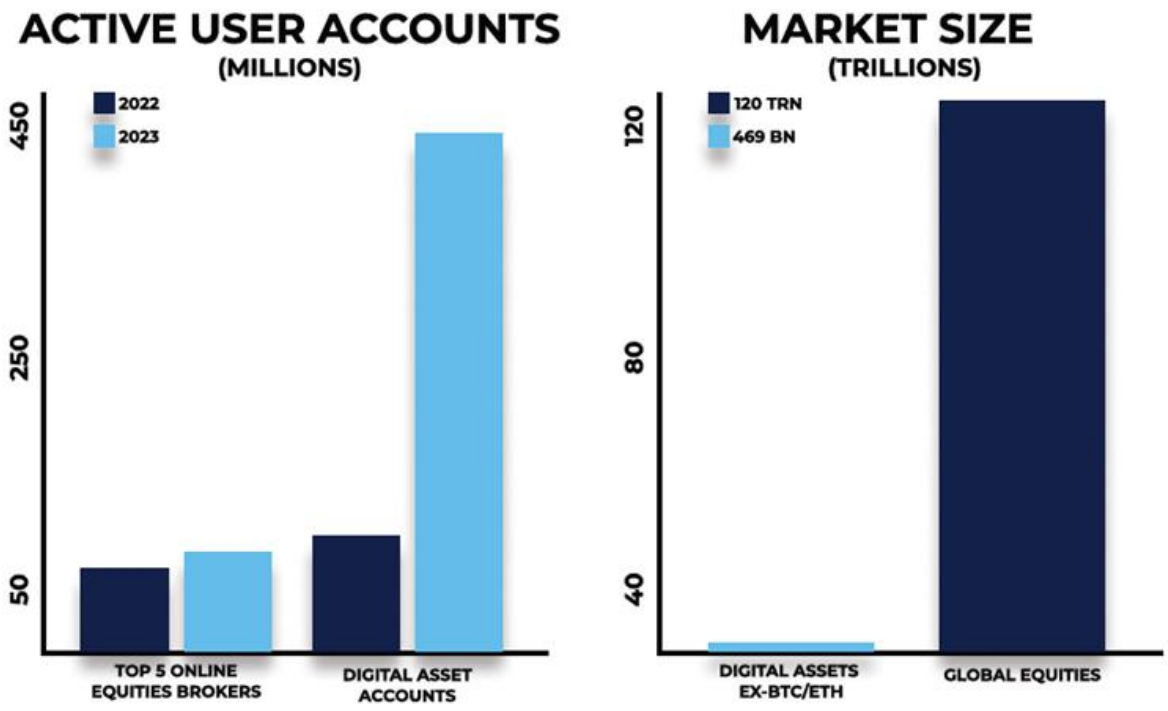
1. More accommodative monetary policy: liquidity flows into digital assets. Period.
2. Bitcoin halving: using history as a guide, digital assets surge post halving, or when the reward for bitcoin mining is cut in half. The three halvings since BTC's launch in 2009 were in 2012, 2016 and 2020 and all led to a significant increase in the price of BTC (Chart 16). Higher BTC drags the entire ecosystem higher, with altcoins having significantly outperformed BTC in all previous cycles.

Chart 16 – BTC Price Performance (2010-2023)

Source: x.com; @MDXCrypto; Note: current year as at 30 Nov 2023

3. ETF approvals: a spot BTC and/or ETH ETF approval, especially for the likes of Blackrock, furthers adoption and solidifies that digital assets are an asset class that investors need to have exposure to, even if it's a small allocation in their overall portfolios.
4. Ecosystem adoption globally, especially amongst younger users and investors, continues to surge with over 400 million digital assets accounts now open. Further, the total market cap of all tokens ex-BTC and ETH is 1/255th the size of global equities markets (Chart 17).

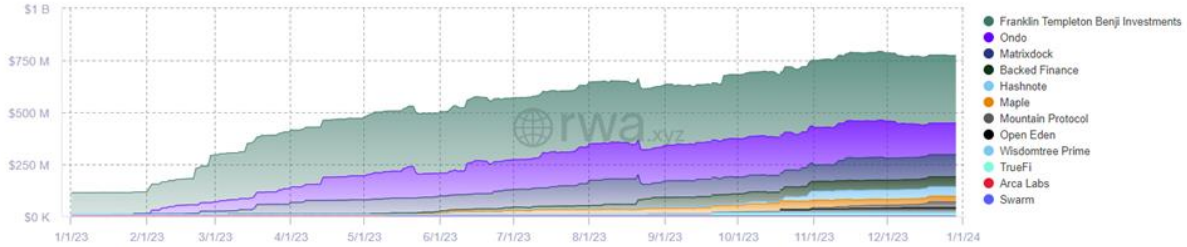
Chart 17 – Active User Accounts (Online Equities vs Digital Assets) (LHS) and Market Capitalization (Digital Assets ex-BTC and ETH vs Global Equities) (RHS)



Source: Vikara Capital

5. Real use cases: what started as magic internet money has evolved into real business use cases being adopted across the entire socioeconomic spectrum, democratizing, and facilitating asset ownership. Take tokenized US treasuries for example (Chart 18).

Chart 18 - $750m of US Treasuries now tokenized



Source: rwa.xyz

What previously was a high net worth only product, is now available to anyone, anywhere (assuming you want the USG as your counterparty 😉). One can get tokenized exposure to commodities, real estate, or art, which have been historically only available to a select group of individuals. Same goes for in-game (video game) assets.

What has traditionally been a walled garden where the gaming assets effectively belong to the gaming platform, blockchain allows for true ownership where assets can be bought, sold, traded or even taken out of the game and used elsewhere.

Given there are over 3 billion gamers globally and the entire market capitalization of the crypto gaming sector is less than $10 billion, we view this as a massive near-term opportunity.

These are just two use case examples, with many more targeted use cases such as KYC verification or healthcare record keeping (think most know trying to track down medical records can be a difficult or even impossible task).

Given digital asset user adoption, monetary tailwinds and that we are likely still in the early stages of a potentially explosive upmarket, we believe it is an opportune time to allocate to digital assets.

If history is a guide, the clock is ticking as once liquidity really starts flowing, boats rise, fast. We invite you to get onboard.

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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Mark Riccio: Mark.riccio@vikara.com

Vikara, in Sanskrit, describes the process of change. Its definition is constantly evolving, changing with economic cycles, technology, and geopolitics. It is a transformation of thought or logic, a modification in the direction of travel, an alteration in action or participation. It is one thing to want change, but another to drive it. We believe in a world where commerce doesn't need intermediaries. Where people are paid directly for content, time, and effort. Where privacy, data and free speech is given, not something to opt-in for.

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