Monthly investment outlook

Investment Research

September 2024

Contents

1 HIGHLIGHTS

Key Points

- While US equity indices trade around all-time highs, the crypto market is stubbornly ignoring positive developments and latching on to often unfounded rumours to justify price drops.

- An environment of rate cuts coupled with benign economic growth has historically been favourable not just for risk assets but also for investors broadening their portfolios; this is a favourable backdrop to the crypto market, especially at a time when new types of investors are considering crypto allocations for the first time.

- After the crypto market has failed to price in either the positive shift that has occurred in the US political stance towards crypto since May or the tailwind that the rate cut cycle will provide, the opportunity is there for a sharp catch-up rally towards year end.

Market Review – August

August started on a negative note as further supply came to the market from the Genesis restructuring and from Jump Trading apparently unwinding its crypto operations after being investigated by the SEC for their role in Terra's 2022 collapse.

The already bearish trend accelerated as global markets experienced a brief panic on US recession fears in early August. The crypto market dropped by close to -20 percent, with Bitcoin falling by -25 percent and Ether by -35 percent.

Although prices recovered quickly to the levels before the global panic selling, and there were hopes of a breakout on the upside from the trading range the crypto market has been in since March, sentiment turned negative again at the end of the month.

Bitcoin ended the month -8.7 percent, while the overall market dropped -12.4 percent. Ether continued to underperform, not least due to the disappointing launch of the Ethereum ETFs, down -22.2 percent for the month.

2 MARKET OUTLOOK

Crypto falls as risk assets rise

Investors are adding to risk assets in anticipation of the Fed's rate cut cycle, reassured by better-than-expected economic data. Jerome Powell's Jackson Hole speech proclaimed victory in the fight against inflation and made it clear that the Fed's risk bias has shifted to concerns about an economic slowdown.

This was followed by an upward revision of US Q2 GDP, providing an ideal backdrop to risk assets: falling rates and increased liquidity coupled with a soft landing.

But while US equity indices trade around all-time highs, sentiment in the crypto market is negative, with the market latching on to (often unfounded) rumours to justify price drops and stubbornly ignoring positive developments.

This highlights that the crypto market is still driven by idiosyncratic developments to a great extent, but the low correlation this year may also be in part due to new Bitcoin ETF investors not trading Bitcoin as a risk asset. For example, during the brief panic in global markets at the beginning of August, Bitcoin ETF holders were not selling.

Year-end rally ahead?

Financial conditions are loose and are expected to get looser when the Fed cuts rates. Such an environment, coupled with benign economic growth, has historically been favourable not just for risk assets – which have rallied since the Fed's dovish turn – but also for investors broadening their portfolios. This is a favourable backdrop to the crypto market, especially at a time when new types of investors are considering crypto allocations for the first time.

As a more positive regulatory stance in the US and the participation of some of the most prominent traditional financial institutions have credentialised the asset class, even highly conservative traditional investors, such as the state pension funds of Michigan and Wisconsin, have started to make allocations to crypto through the Bitcoin ETFs. ETF issuers such as BlackRock claim that many more such institutions are in the process of doing so.

The likelihood of another wave of inflows as institutions' internal governance processes to authorise the new ETFs conclude, coupled with the backdrop of falling rates and ever-looser liquidity conditions, could provide the impetus for a year-end crypto rally.

After the crypto market has failed to price in either the positive shift that has occurred in the US political landscape with regard to crypto since May or the tailwind that the rate cut cycle will provide, the opportunity is there for a sharp catch-up rally.

Supply rumours

This is especially so as the factors holding back the market may turn out to be unsubstantiated fears.

After the German government's sudden sale of USD 3bn worth of Bitcoin shook the market a couple of months ago, there is a lot of nervousness about potential further supply. Fears that further large supplies of Bitcoin may be sold in the near future have been the single most important factor in depressing the crypto market over the past few weeks.

However, recent rumours about selling by Mt Gox creditors or a large-scale sale of Bitcoin by the US government appear unfounded.

Mt Gox has already distributed to creditors the majority of the Bitcoin they have recovered from the 2014 bankruptcy. Close to 100,000 of the 142,000 Bitcoin recovered has been distributed through exchanges, and trading patterns on participating exchanges showed no noticeable change as the distributions were made to creditors.

Considering the apparent lack of immediate selling as creditors received their Bitcoin, the worries inspired by recent Mt Gox wallet movements about imminent large supply hitting the market appear misplaced. After the bulk of the Bitcoin recovered was distributed to those creditors who chose the "early redemption" feature and accepted a haircut, current wallet movements are likely to be related to moving tokens into cold storage rather than to impending further large distributions.

Fears about the US government preparing to sell its over 200,000 Bitcoin holdings appear just as unfounded, as there is no evidence that there is a plan or intention to do this. Indeed, it would be an extremely odd move at this time against the backdrop of the recently filed Bitcoin Act, which would mandate the creation of a 1m Bitcoin reserve.

Kamala Harris's crypto stance

Worries that a Harris election victory would be bearish for the crypto market also appear exaggerated, with the market underestimating the progress already taking place irrespective of the election outcome.

Kamala Harris remains noncommittal on her crypto policies, and the official Democratic Party platform does not mention crypto (unlike the Republican Party platform, which includes strong support for the crypto industry). However, this is unsurprising in the immediate runup to the elections as the Harris campaign seeks to avoid alienating any important constituency.

At the same time, advisors to Kamala Harris's campaign have been contacting key players in the crypto industry to develop relationships, and, at the Democratic National Convention, a Harris campaign advisor suggested the party's nominee will back measures to help grow the crypto industry.

While divisions remain within the Democratic Party on crypto matters, and Harris's advisors include some with a previously anti-crypto stance, the campaign has also appointed crypto alumni, such as ex-Binance and ex-Ripple executives.

After the crypto industry came to dominate US election funding, outspending all other industries, top Democrats recently joined a "Crypto4Harris" virtual town hall to show support and recast their party as pro-crypto after years of being viewed as sceptics of the industry. At the event, Senate Majority Leader Chuck Schumer suggested that US crypto legislation could pass the Senate by the end of the year – which would exceed the market's expectation on timing and is a clear signal of Democratic support for the industry.

It is also important to recognise that the current administration and the SEC in its current composition have already presided over substantive changes, such as the approval of Bitcoin and Ethereum spot ETFs, several "no action" letters ending lawsuits and investigations and bipartisan support for crypto bills. The Overton window on crypto has shifted in recent months, and the trajectory of positive change has been set in motion irrespective of the election outcome.

SEC litigation

A ruling by a US District Judge in the case of Kraken vs the SEC included statements that are potentially very positive for the crypto industry. The judge called the SEC's labelling of tokens on Kraken securities "unclear at best and confusing at worst" and said he understood the agency's claims to mean that crypto assets are sometimes offered as part of investment contracts rather than allegations that individual crypto assets "are themselves securities".

Kraken's chief legal officer claimed the ruling meant that none of the crypto assets trading on Kraken are securities.

The SEC's long-running lawsuit against Ripple also concluded recently, with the judge imposing a USD 125m fine for previous direct sales of XRP tokens to institutional investors vs the SEC's request of a USD 2bn penalty.

The gulf between the SEC's request and the award is seen as another positive for the crypto industry, especially as the judge emphasised that the SEC's case did not involve any allegations of fraud or intentional wrongdoing and no one suffered any financial harm.

Meanwhile, NFT marketplace OpenSea received a notice of intended litigation from the SEC, claiming that NFT art and collectibles traded on the platform are securities. This follows two settlements with NFT issuers in 2023 where the SEC had claimed that either the configuration of automatic loyalty payments on secondary market transactions or the promise that buyers would "profit from their purchases" qualified these as securities transactions.

However, the broad claims against OpenSea appear inconsistent with the SEC not regulating the art market nor eBay, which are de facto equivalents of the NFT art and collectibles markets.

Is Ethereum losing ground?

Following the disappointing launch of the Ethereum spot ETFs in the US, sentiment on Ethereum has become ever more bearish.

Already substantially underperforming both Bitcoin and Solana over the past 1.5-2 years, Ether moved to new recent lows vs both assets. The price of Solana vs Ether has increased almost sixfold since the beginning of 2023, while the price of Bitcoin vs Ether increased by 75 percent over the same period.

As Ethereum transactions have declined by 15-20 percent since the upgrade in March, making Ether increasingly inflationary, while Ethereum-based Layer 2 transactions have tripled, the market has taken an increasingly negative view on the implications of Ethereum's approach to scaling for the fundamental value of Ether.

Meanwhile, as Solana's network activity, revenues and market share continue to grow strongly, and the upcoming launch of the Firedancer validator client will exponentially increase Solana's already very high scalability, market sentiment remains with Solana, with expectations that it might challenge Ethereum's leading position.

However, despite Solana growing strongly and overtaking other protocols such as Binance Chain, Polygon and Tron in most areas, its market share remains a fraction of Ethereum's.

The gap is even more stark if we compare the Ethereum network including the Layer 2 protocols to Solana - which may be a fairer comparison to Solana's all-in-one scaling solution. Transactions on the entirety of the Ethereum network have been growing very strongly.

Additionally, a lot of Solana's growth has come from issuing and trading memecoins, which account for the vast majority of activity on the network. Although Solana has made some headway in other areas as well – such as attracting DEPIN projects (including some migrating from Ethereum to Solana) – the overwhelming share of the economically meritless memecoin casino on Solana introduces a risk from the memecoin craze coming to an end, and it also means that Solana's market share among useful and valuable projects is even smaller relative to Ethereum.

Finally, after a great degree of capitulation, negative sentiment on Ethereum may have reached a bottom. Just as we are seeing a gradual ramp-up of inflows into the Bitcoin ETFs from institutions, the same is expected over time with inflows into the Ethereum ETFs, with the price of Ether prone to upside shocks.

Index ETFs

After a filing from a smaller foreign issuer, Hashdex, major US asset manager Franklin Templeton also filed for a crypto index ETF in the US.

Both filings request the approval of an ETF consisting of Bitcoin and Ethereum but include the language that when the SEC accepts further crypto assets as underlyings for ETFs, the product will be broadened and backed by assets reflecting a crypto index.

Unlike single-token ETFs, which are not expected to be met with much demand, index ETFs are likely to garner significant AUM over time – just as index ETFs in other asset classes do.

The impact of Telegram founder Durov's arrest

After the price of the Telegram-affiliated Toncoin increased 3.5x this year on stellar user adoption and growth trends, the token lost 25 percent of its value on the arrest of Telegram founder Pavel Durov. Other top coins issued on the network, such as Notcoin, have experienced even greater price drops.

Although the decentralised blockchain is separate from Telegram, their historic tie-up means that Toncoin and applications building on the protocol have benefited from access to Telegram's close to 1bn user base.

The market was initially concerned that the actions taken against Durov and Telegram would stunt the strong user adoption trends on Toncoin. However, the opposite seems to have happened so far – network usage increased, and so did downloads of the Telegram app after news of the arrest, with the app moving up in the rankings.

The two outages on the network that happened shortly after Durov's arrest also caused concern initially; however, it appears they were caused by peak usage of the network.

Nonetheless, the market remains cautious until there is greater clarity on the legal issues.

DeFi lenders revamp

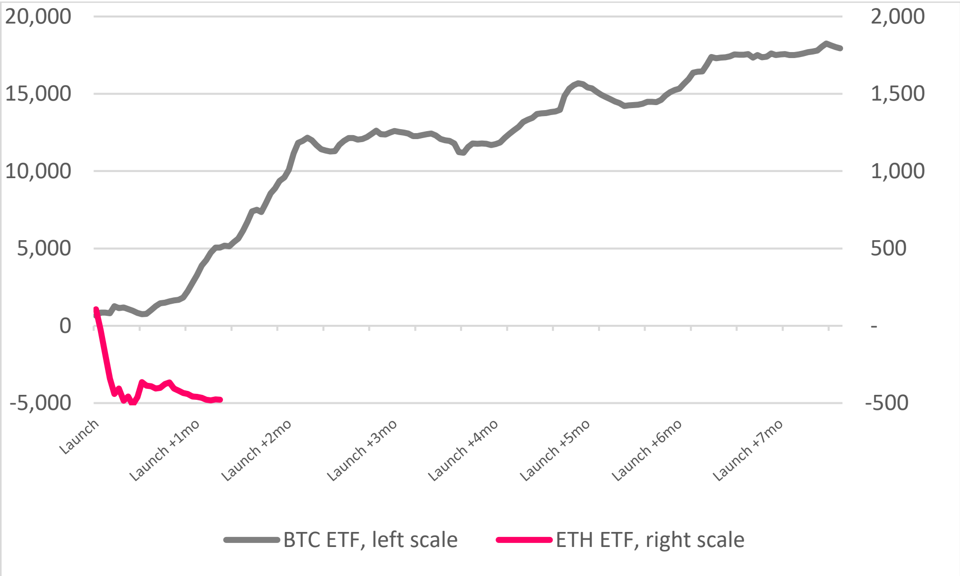
With DeFi lending one of the most mature subsectors of the crypto market, leading decentralised lending protocols Aave and Maker are looking for ways to grow and progress, with Maker focussing on a rebrand and revamp and Aave looking to improve its tokenomics to increase the fundamental value of the token.

Aave rallied strongly in the face of a declining market in August after a proposal to improve the economic model of the token. Meanwhile, Maker is aiming to broaden its user base by rebranding as "Sky" and aiming to appeal to the mass market by presenting itself as a better version of traditional finance.

3 CHART OF THE MONTH

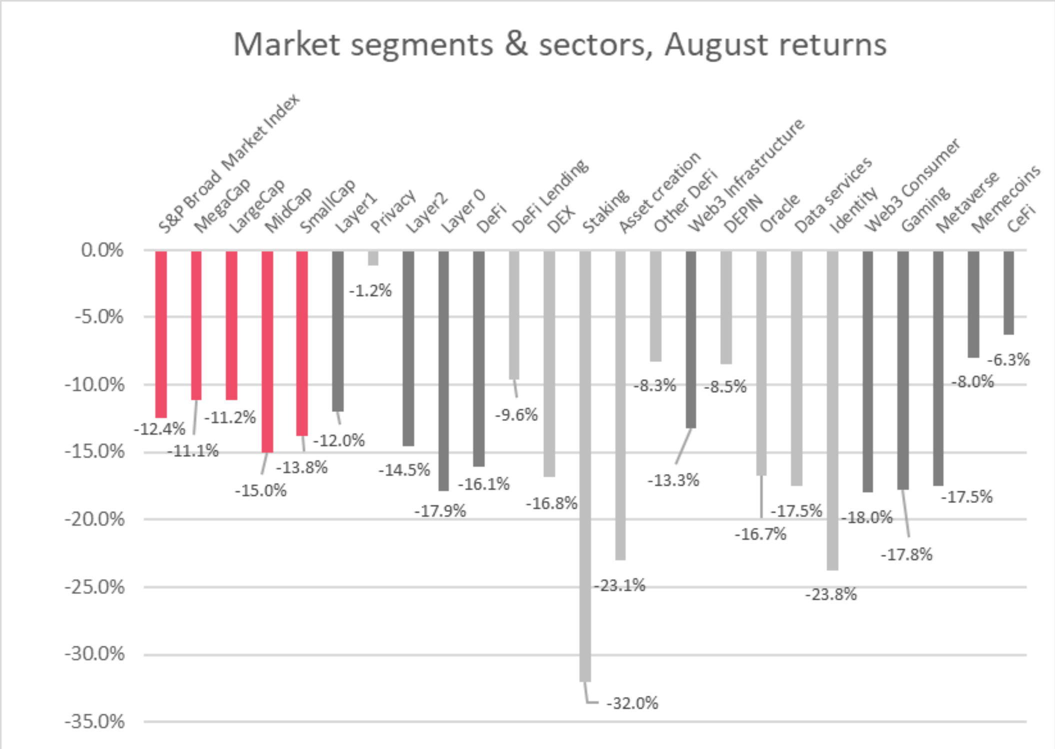
After a strong first day with decent seed inflows, the Ethereum spot ETFs have mostly seen net outflows since. Unlike the Bitcoin spot ETFs, whose cumulative net flows were always positive, the Ethereum ETFs' cumulative net flows turned negative on the second day of trading and have stayed negative since. This is mostly due to Ethereum's lesser name recognition, the surprise approval and resultant short marketing period and the lack of access to staking, which makes it more likely that the Grayscale outflows are recycled into spot Ether rather than into other Ethereum ETFs. The lack of a staking yield also means that the CME futures vs ETFs arbitrage trade is less profitable in the case of Ether, which means fewer market-neutral inflows than we have seen in the case of the Bitcoin ETFs. However, as institutional investors new to the crypto market are just getting familiar with Bitcoin, and now Ethereum, it is unlikely that they would be holding off due to a preference for Solana over Ethereum – indeed, it is extremely unlikely that these types of investors would be familiar with Solana. Rather, it will simply take time for these investors and platforms to familiarise themselves with Ether and conclude their internal due diligence processes.

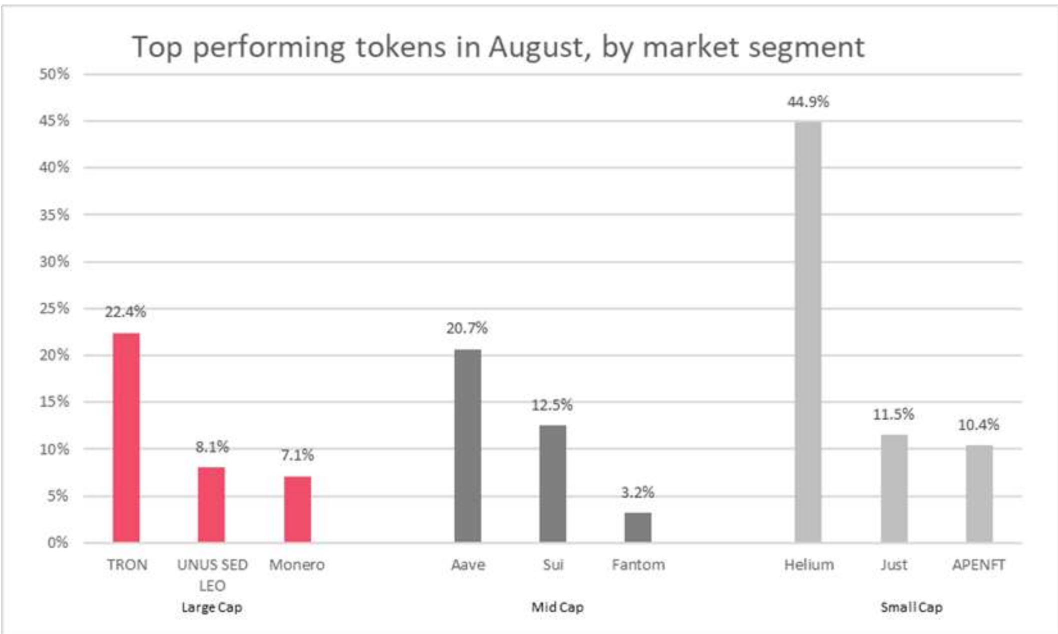
Net flows into Bitcoin vs Ethereum spot ETFs since launch, USD m



Source: Farside Investors

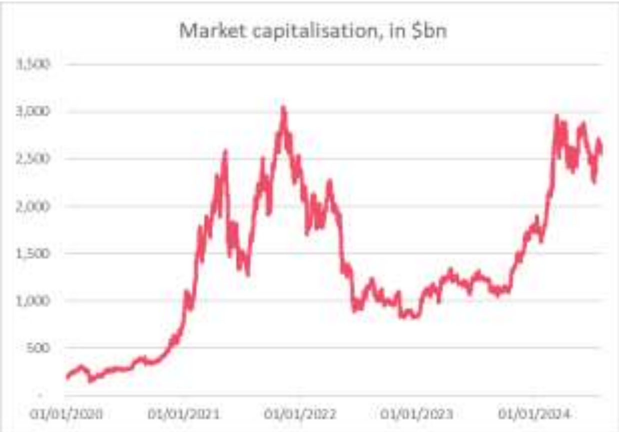
4 MARKET PERFORMANCE

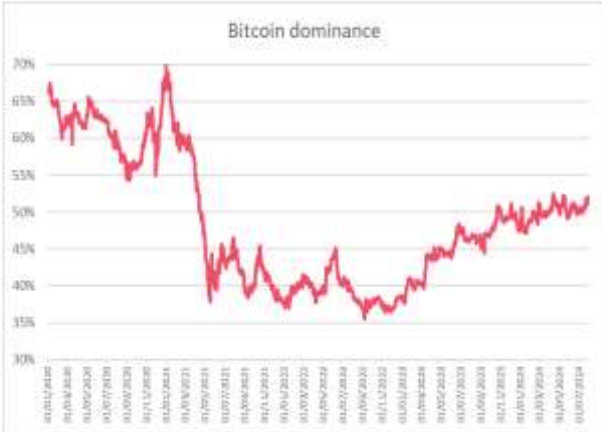




Source: CoinMarketCap/Sygnum Asset Management

Market performance continued



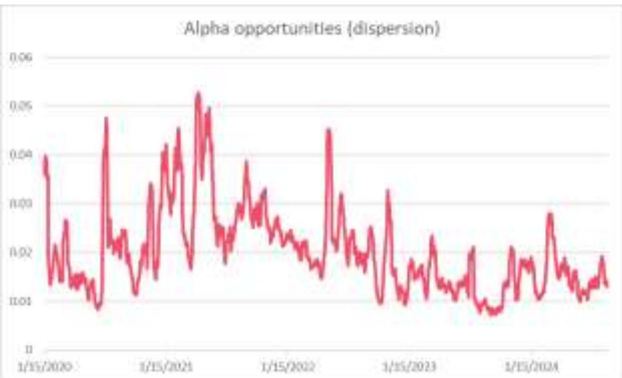


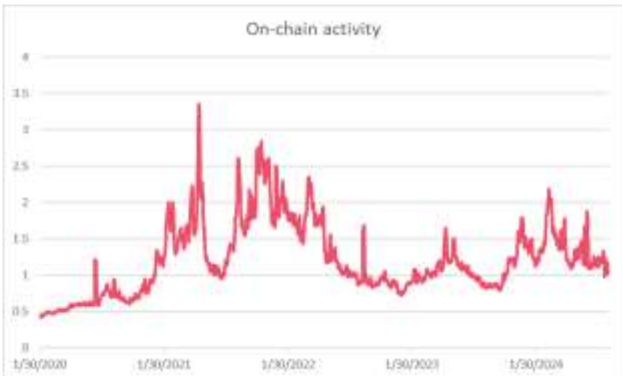
Source: CoinMarketCap/Sygnum Asset Management

5 SENTIMENT ANALYSIS

Market sentiment has seen sharp reversals recently, moving back and forth between greed and fear. All other metrics have been tending increasingly bearish such as momentum, option skew, onchain activity.

The 3-month correlation metric increased due to few days of apparent correlation during the global the market crash in early August, however, correlation has been low to negative since.





Source: Sygnum Asset Management analysis, 31 August, 2024, various data sources

For more information on this topic or to talk to a member of the Sygnum team, please contact us here or call us on +41 58 508 20 00.

About Sygnum

Sygnum is the world's first digital asset bank, founded on Swiss and Singaporean heritage. We empower professional and institutional investors, banks, corporates and DLT foundations to invest in the digital asset economy with complete trust. Our team enables this via personal, expert service and secure, convenient access to our integrated portfolio of crypto banking, asset management, tokenisation and B2B banking services.

Sygnum is a licenced Swiss bank and is also regulated in the established global financial hubs of Singapore, Abu Dhabi and Luxembourg. We believe that the future has heritage. Our diverse crypto-native team of banking, investment and digital asset technology professionals are building a trusted, regulated bridge between the traditional and digital asset economies that we call Future Finance.

To learn more about how Sygnum is shaping this trusted digital asset ecosystem, please visit sygnum.com.