SPECTRUM

THE BIRTH OF A NEW ASSET CLASS:

Why should you look at digital assets now?

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Bitcoin and other digital assets are having a rough ride in 2022 and these times can prove rather unsettling for investors. Time to call it quits? I don't believe so.

Blockchain and its many applications have a high potential for disruption in several business areas and in any case, will significantly improve the user experience of old and new digital services. A number of business activities will soon leverage blockchain technology even further. Opportunities will arise.

Strong words against cryptocurrencies publicly stated even by prominent central bankers and government officials along with this very negative 2022 remain in huge contrast with the sheer number of projects and activity going on in digital assets even now. One warning however: it is still early days for this new industry and this means there is significant risk involved. And risk needs to be managed.

The blocks of the digital economy are being assembled right in front of our eyes: we are witnessing the birth and development of a new asset class. Blockchain technology has become the underlying infrastructure of the current global technology revolution. It's time to consider creating your own investment strategy, considering digital asset exposure.

Price action versus use cases

Bitcoin and ether - the two leading cryptocurrencies by volume - are having a rough ride in 2022 and most of the other crypto-assets are doing even worse. The most heavily traded cryptocurrency, bitcoin, has been hovering around the $20,000 mark in the last few months and is still a far cry from its all-time high of $69,000 achieved in November 2021. It is down about 54% since the beginning of 2022 according to Cryptocompare. Other top coins are not doing very much better: ether is down 53% and the Cryptocompare DeFi index is down 57%. Crypto-exposed stocks such as Square, Microstrategy and Coinbase as well as top crypto mining stocks are all down double-digits, some well below the -50% mark. Pretty gloomy digital market right now! And this may go on for some time.

However, this is just one side of the "coin". In the end, most of these assets showed growth of several hundred percent in 2021, some were in the thousands. Bitcoin was worth $10 just about 10 years ago. One only needs to look at the level of use of blockchain in terms of transaction levels, the number of users and projects, and this shows a totally different picture. The number of monthly transactions on the bitcoin network was at a healthy 7.6m in July 2022 according to Coin Metrics. Bitcoin's hash rate, the measure of computational power used to verify transactions and add blocks in a proof-of-work (PoW) blockchain and (hugely simplifying) measuring the strength of the bitcoin network, is near its all-time high of over 200 EH/s. Some expect to see this number double again soon. Looking at users, projections of increased uses of digital wallets are striking: a very recent study from Juniper Research[1] has found that the total number of digital wallet users will exceed 5.2 billion globally in 2026, up from 3.4 billion in 2022; representing strong growth of over 53%. The research predicts that the presence of "superapps" will drive digital wallet use in developing countries that are currently considered cash-heavy.

Innovation at core

The growth of digital wallets is an example of the disruptive power of blockchain and more generally speaking FinTech. This supports the high activity in terms of virtual currencies. The research cited above identified QR code payments as the most popular digital wallet transaction type. In terms of acceptance of cryptos, nearly 75% of retailers plan to accept either cryptocurrency or stablecoin payments within the next two years, according to a June survey conducted by Deloitte[2]. A huge step forward considering global cryptocurrency payment started in the US in 2014.

In an interview with Giovanni Pons of La Repubblica, a leading Italian newspaper, I shared the innovation potential of digital assets in this way: "We have just entered the third wave of the internet evolution and this can bring massive improvement. The first wave, from 1991 to 2005 was a "read-only" version of the net, equivalent to an online encyclopedia. From 2005 to 2020, we moved to "write and read" capabilities: web content was enriched online and social networks are a good example of this. Could anybody picture this evolution in the early days? From 2020, we move one step further with Web 3.0: other than being able to write and read, one can enjoy full ownership of their own contents and share/sell them thanks to decentralised addresses and networks. You become the owner of your work and your image in the Metaverse or in virtual shops. A parallel economy with wide possibilities is made possible thanks to blockchain." Technology becomes more user friendly and capable of mass adoption: this has the potential to substantially change the world as we see it.

The (Californian) gold rush… and more to come?

With all this hype, no wonder the blockchain industry is attracting a lot of talents, even in the middle of the so-called crypto "winter". According to a report by LinkedIn and cryptocurrency exchange OKX[3], "The total number of people working in the blockchain industry among LinkedIn's worldwide members grew by 76% year-on-year as of June 2022". The United States, India, China, the United Kingdom and Singapore are the top 5 countries in the world in blockchain talent. The study highlights the high demand for and large shortage of technical talent in the global blockchain industry.

Looking forward, this report places Web 3.0 and the Metaverse as key areas of growth in the blockchain industry: "It is predicted that blockchain technology and the cryptocurrency ecosystem will certainly continue to explode as the Metaverse and Web 3.0 concepts develop at a rapid pace and gradually take hold. As part of the digital economy revolution and a new generation of information infrastructure, blockchain will rapidly develop and penetrate all areas of the global economy.

Risks: still early days!

A number of blockchain projects have been seriously hit by hackers exploiting vulnerabilities or simply were scams. According to CipherTrace - a Mastercard company, "Illicit cryptocurrency activity in 2021 is a much larger dollar value compared to prior years, it is important to note that it continues to decline as a percentage of overall activity". CipherTrace estimates the total percentage for 2021 illicit activity was between 0.10% and 0.15% of overall cryptocurrency activity compared to between 0.62% and 0.65% of overall cryptocurrency activity in 2020". Many crypto crime-related businesses note a shift of criminal activity led by the sheer expansion of DeFi in 2021: significant attacks at a rate of almost one per week were reported in DeFi projects; these were either exploit (taking advantage of a code vulnerability) or fraudulent activity generating billions of dollars of losses. The top 3 in 2021-2022 were Axie Infinity Ronin, Poly Network and Wormhole; you probably have heard of them considering the press coverage they got.

The blockchain economy is in its early days, regulation across the globe has started capturing these new businesses. This means that one needs to be extra cautious, take the volatility impact seriously, significant drawdowns are likely - and also focus on where they hold and how their assets are protected, which opens a whole potential in post-trade and the custody side of the business.

There is an infinity of examples and applications of blockchain in almost all segments of the real economy; it seems pretty clear that cryptocurrencies, digital assets and blockchain will not stop there.

For some, this crypto "winter" may be seen as a great opportunity.

1 Juniper Research, Digital Wallets, accelerating to a cashless society, August 2022
2 Claudina Castro Tanco, Merchants getting ready for crypto, Deloitte in collaboration with PayPal, June 2022
3 LinkedIn and OKX, 2022 Global Blockchain Industry Talents Insight, August 2022