

PORTAL

DIGITAL FUND

Perth Private Wealth Network Portal Webinar Notes

February 2021

Macro Outlook

- The world and global financial markets are a complex adaptive system – everything is now more interconnected, including digital currency's.
- The macro picture is currently very favourable to cryptocurrency's.
- Given the outcome of the US elections and Democrats control of the House, the Senate as well as the Presidency, we along with the markets, expect continued fiscal spending and long-term monetary easing. The debasement of Fiat currencies is now beginning to play out.
- Digital currency's represents a way for investors to gain exposure to an alternative financial system, not controlled by politicians and central banks and importantly independent of the debt that is building up in the traditional financial system.
- We are really concerned about inflation. We agree with the Bank of America's shot across the bow as they [hinted at the unthinkable](#): "the tsunami of monetary and fiscal stimulus, coupled with the upcoming surge in monetary velocity as the world's economy emerges from lockdowns, would lead to unprecedented economic overheating." Read [Hyperinflation and the Weimar Republic](#).
- With excess liquidity rampant, management teams get creative and ultimately take more risk, paying out debt-financed dividends to investors or investing in risky growth opportunities that have a negative IRR. This is especially prevalent in the listed Tech space, where valuations are unsustainable.

The Case for Alternatives and Crypto

Bitcoin was born in the GFC of 2008, and the Great Pandemic Recession of 2020 acted as a catalyst for digital assets as respected companies like Fidelity, MicroStrategy, Square and PayPal voiced their approval and put capital into digital assets. Digital currencies are at an inflection point as they no longer just embraced by early innovators and adopters, but by the mainstream and institutions.

As above, the search for yield in a world of no inflation continues and with the amount of money being created, we will eventually see a real debasement of currency's. Owning Bitcoin is a great way to defend oneself against reflation, given the concerns expressed above. As Satoshi Nakamoto, the anonymous creator of Bitcoin stated in an online forum around the time he launched Bitcoin in 2008, *"the root problem with conventional currency is all the trust that's required to make it work. The central bank must be trusted not to debase the currency, but the history of fiat currencies is full breaches of that trust"*.

Thematic Rational for Investing in Digital Currency's

- There has been a lot of anticipation of institutions entering the market, and it is now safe to say the "institutions are here".
- This is a watershed moment for crypto assets, and we believe it is only the beginning, as the vast majority of institutions are yet to make any allocation to digital assets.
- There were many important announcements we saw in the second half of 2020:
 - MicroStrategy announces purchase of \$250M of Bitcoin through their corporate treasury in August and in September they bought \$175M more Bitcoin. Fidelity announced they have built out a custody business too for family offices and endowments and are actively talking to pension funds.
 - In October, Square announces \$50M Bitcoin purchase through their corporate treasury, PayPal announced a new service buying and selling crypto while Guggenheim filed to invest up to \$530M in Bitcoin. ICAP the giant interdealer broker also set up a digital asset group to broke to hedge funds, banks and asset managers.
 - In November, Singaporean bank DBS Bank launched a crypto Exchange and JPMorgan research "Bitcoin could reach \$650,000"

- December saw Larry Fink (BlackRock CEO): *"Bitcoin Can Evolve to Global Asset"*, MicroStrategy bought an additional \$700M in Bitcoin along with MassMutual buys \$100M, and Ruffer Investments buys \$745M in BTC.
- In the US, banks are now allowed to custody bitcoin and that means that prime brokers can offer prime broking and custody for bitcoin, leave the door wide open for every hedge fund.
- Recently, in January 2021 – Tesla bought \$1.5bn in BTC, and now allows transactions in cryptocurrency.
- Bitwise is very close to getting approval on an ETF which will bring in every IFA / RIA into the space.
- Silvergate, a US bank, offers a 24-hour cash/crypto exchange for brokers, market makers and asset managers where other banks wouldn't touch it and now have billions of dollars flowing through each day.

We expect many more financial service providers to start providing infrastructure and services to enable institutional participation in this space.

Decentralised Finance (DeFi)

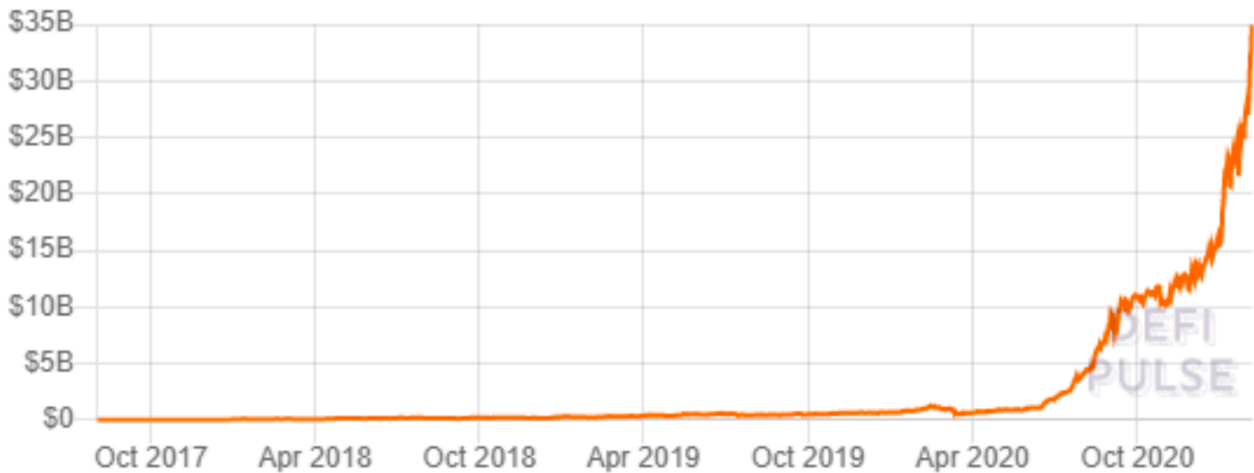
- We believe the real opportunity though in the digital currency space lies in Decentralised Finance or "DeFi".
- The DeFi vision is to create a decentralised financial system that offers the same financial products and services seen in traditional finance without the need for a central authority.
- One of the core tenants of DeFi is composability, a design feature meaning that the components of a system can be connected to each other. In this way, the different products and services in the DeFi ecosystem can be linked together to create new products.
- The applications for this are indeed exponential and whatever valuations are currently applied to this space, they will be underestimated greatly in hindsight.
- As evidence of this potential, Ethereum, the world's second-largest cryptocurrency, attracted a record \$216 million in ETH-related investment products last week, beating the previous week's record of \$195 million. The total cryptocurrency assets under management stood at around \$47 billion last week.

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Total Value Locked (USD) in DeFi

TVL (USD) | ETH | BTC

All | 1 Year | 90 Day | 30 Day

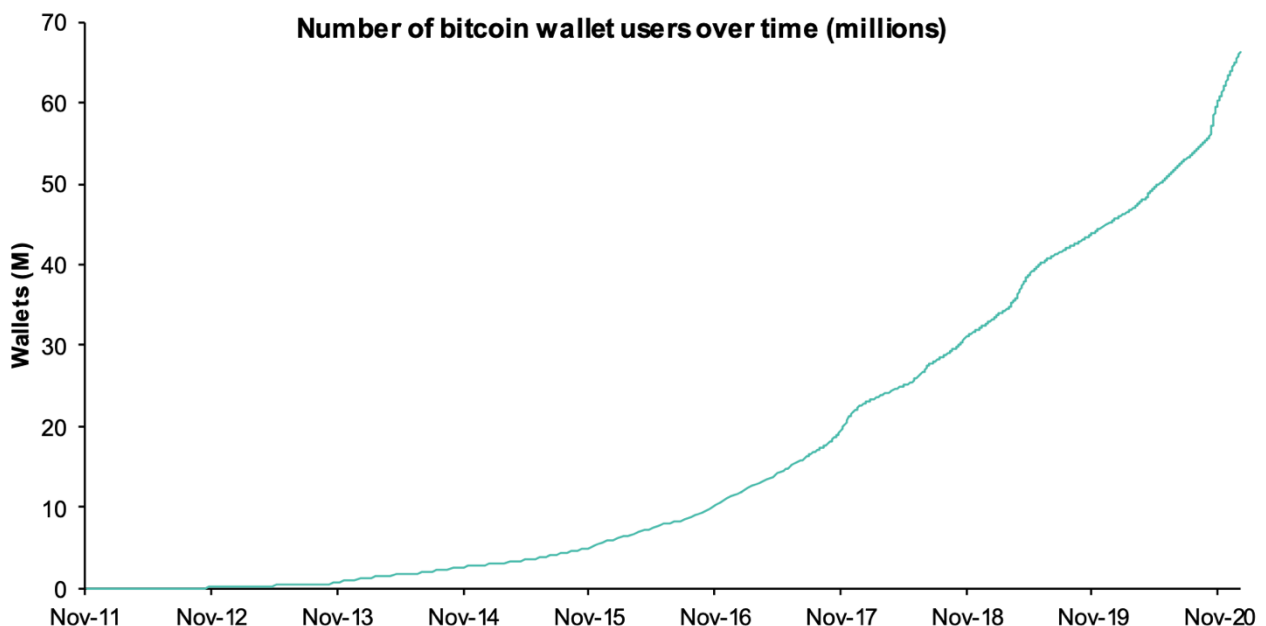


Source: DeFi Pulse (data as of 2/5/2021), Bernstein analysis

- According to the latest weekly crypto inflows report published by CoinShares, last week saw a total of \$602 million investment in digital assets, the third-largest inflows on record.
- Bitcoin saw weekly inflows of \$367 million, a significant jump from the previous figure as institutional demand for BTC increased after Tesla announced a \$1.5 billion Bitcoin investment.

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The rise of DeFi parallels the continued growth of crypto interest, including in Bitcoin. The number of Bitcoin wallet users on Blockchain.com is now 66M



Source: Blockchain.com, Bernstein analysis

- Distributed ledger technologies (DLTs), such as the blockchain, have the potential to transform financial markets.
- From equity issuance and capital raising for small companies, to post-trade processes, clearing and settlement of securities, the technology challenges the current construct of financial markets, affecting infrastructure and participants alike
- The rise of digital assets won't be without complications; however, large-scale adoption faces a number of technology-related challenges (scalability; settlement finality; interoperability; network stability; cyber-risks); governance risks related to AML/CFT; digital identity issues; and data protection and privacy issues; as well as raising questions about the legal status of smart contracts.
- Tokenisation of assets involves the digital representation of real (physical) assets on distributed ledgers, or the issuance of traditional asset classes in tokenised form.
- The application of DLTs and smart contracts in asset tokenisation has the potential to deliver a number of benefits, including efficiency gains driven by automation and disintermediation; transparency; improved liquidity potential and tradability of assets with near-absent liquidity by adding liquidity to currently illiquid assets; faster and potentially more efficient clearing and settlement.
- It allows for fractional ownership of assets which, in turn, could lower barriers to investment and promote more inclusive access by retail investors to previously unaffordable or insufficiently divisible asset classes, allowing global pools of capital to reach parts of the financial markets previously reserved to large investors.

Reference:

<https://www.coindesk.com/how-institutions-will-take-crypto-mainstream>

Conclusion: The Asset Allocation Decision.

The four issues for investors to consider when allocating capital are:

1. **Cash:** Whether a large monetary overhang in the recovery phase will eventually stoke consumer price inflation through the debasement of fiat currency. Our view: As above, yes, sooner than we think.
2. **Equities:** Are corporate earnings going to justify the current lofty equity valuations and market multiples given the collapse in consumer demand? Our prediction: No, Big Tech is also cyclical, and we will see a reversion to mean in valuations.
3. **EM vs DM:** We prefer Emerging Markets over Developed Markets, with India and SE Asia standing out as very good value, with the right demographics, high savings rate, and the rate of change in growth not being priced correctly.
4. **Credit:** Can interest rates go any lower or stay this flat indefinitely, and what does this mean for the yield curve and investing in bonds? Our view: No. At some point the US 10Y Treasury will price in the coming inflation and spark a rotation out of equities and back into bonds. Will this be enough to compensate for current bond holders for the negative returns as rates expectations go up and prices fall? This is where the real bubble lies.
5. **Property:** Is real estate immune from this crisis given the continued growth in online away from bricks and mortar and rising vacancies? Our view: No, real estate is commoditised space and exists to enable commerce, both retail and corporate, and manufacturing. There is not enough income and cash flow to support rentals in major cities.

As above, we have no confidence in the outlook for the traditional asset classes and believe that investors should tilt their portfolios to alternatives. We further believe that digital currencies provide a real solution to the current money-printing crisis and furthermore our fund provides a real uncorrelated risk-adjusted return in a world of no growth and no inflation.

Contact: E: mark.witten@firstdegree.asia

W: www.portal.am

***Disclaimer:** This document does not constitute an offer of Participating Shares in the Fund. The offer of Participating Shares is made solely pursuant to the Offering Memorandum for the Fund dated 10 February 2020 (the "Offering Memorandum"), and an application for subscription for Participating Shares may only be made by completing and returning the subscription agreement issued by the Fund (the "Subscription Agreement"). Copies of the Offering Memorandum and the Subscription Agreement may be obtained from First Degree Global Asset Management Pte. Ltd, the Investment Manager of the Fund.*