



WHY DIGITAL ASSETS NOW?

MARCH 2022

GALAXY
FUND MANAGEMENT





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The digital asset class is evolving quickly with new investors arriving daily. Capabilities afforded by blockchain technology are becoming widely recognized and macro and technological convergence is well underway. Improving infrastructure and clearer regulation suggests the whole digital asset class is maturing. As awareness of this new asset class spreads and the value of the underlying digital assets grows, we foresee even more investors piling in through the rest of the year.

We are in one of the most active periods on record for crypto. New all-time highs in asset prices, user adoption, and trading activity are occurring, cementing a role for digital assets in mainstream fintech. And while crypto saw continued price volatility across 2021 – total market capitalization beginning the year at \$783 billion, peaking at \$3 trillion in November, and ending the period at \$2.3 trillion – the crypto sector’s total market cap grew by 180.9%.¹

The rise of digitization is a significant tailwind for digital assets. We are entering a new phase of technological progress, in which manual and analog processes are becoming rapidly digitized. At Galaxy Fund Management, we are not surprised by the growing interest in digital assets across all investor types, considering its coinciding with this broad acceleration of digitization. More and more companies are dedicating significant resources to the space and more and more traditional players are changing their tune on digital assets and their underlying blockchain technology.

Individuals and companies are embracing a need for disruption and change across industries. In 2021, over \$14 billion in private investment was allocated to crypto companies, more than the previous six years combined.² We see this when leaders like MasterCard enable digital asset purchases and announce plans to help central banks explore the development of a central bank digital currency (CBDC). We also see this when Apple Pay receives support from Bitpay’s digital asset card payment system. And when Venmo launched cryptocurrency trading for bitcoin (BTC), Ether (ETH), Litecoin (LTC), and Bitcoin Cash (BCH). Apple intends to roll out a new iPhone feature, allowing merchants to accept crypto payments.³

Indeed, the technology companies that have quickly embraced digitization are outperforming the old guard. On the consumer side, Visa now allows USD Coin (USDC) to settle transactions on its payment network, and PayPal has integrated bitcoin transactions for its 426 million users.⁴ According to a recent Deloitte study, 73% of financial executives agree that their respective organizations will lose an opportunity for competitive advantage if they don’t adopt blockchain and digital assets.⁵ We expect to see this number grow as companies continue to look to blockchain as an enabling technology for the next wave of digitization.



The significant institutional infrastructure improvements that we've seen in recent years have encouraged corporate adoption at an impressive rate. We're no longer living in the digital assets world of 2017. In Q4 of 2021, the S.E.C. approved the first U.S. based bitcoin futures ETF. Last December, Visa launched a multinational crypto advisory service for banking clients and merchants to assist clients and partners with crypto. Most recently, at the beginning of March 2022, President Biden signed an Executive Order outlining the first ever, whole-of-government approach to harnessing the potential benefits of digital assets and their underlying technology.

Galaxy Digital itself has played a role in crypto's institutional infrastructure build. In partnership with Bloomberg, we launched the Bloomberg Galaxy Crypto Index (ticker: BGCI) in 2018 to improve data integrity and standardization among digital assets. By the end of 2021, we have expanded this family of indices to include the Bloomberg Galaxy Bitcoin Index, Bloomberg Galaxy Ethereum Index, Bloomberg Galaxy DeFi Index, & the Bloomberg Galaxy Solana Index.

Advances in the regulatory framework and dialogue represent yet another tailwind for digital asset adoption and growth. In mid-2015, the New York Department of Financial Services (NYDFS) started granting cryptocurrency licenses and charters. Two years later, the US Commodity Futures Trading Commission (CFTC) approved platforms like the Chicago Mercantile Exchange (CME) and the CBOE Futures Exchange (CFE) to trade bitcoin futures. In mid-2018, the Securities and Exchange Commission (SEC) clarified bitcoin's status as a non-security, a vital assessment as debate around cryptocurrency regulation was often focused on coins' status as securities. Central Bank Digital Currencies (CBDCs) have also been gaining traction in late-2021. More than 60 central banks are now investigating digital versions of their currencies, conducting experiments, or moving to pilot programs.⁶ These regulatory developments have strengthened digital assets as an investable asset class, and we expect positive developments to continue.

As the space matures and the tailwinds strengthen, major investors are increasingly taking note. Paul Tudor Jones compared the role of bitcoin in a contemporary portfolio to that of gold in the 1970s. He announced a 1-2% allocation as his best bet against the "Great Monetary Inflation." Publicly listed companies MicroStrategy, Square, and Tesla announced significant bitcoin investments. In a recent RIA Channel survey of more than 500 financial professionals, 60% of the individuals surveyed said they were likely to allocate to a digital asset, like bitcoin, Ethereum, or Solana.

Beyond bitcoin, other digital assets and stablecoins continue to increase in value. The aggregate stablecoin supply has grown by 388% – from \$29 billion to over \$140 billion.⁷ From January 1, 2021 to December 31, 2021, Ethereum grew over 400%, assisted by the growth of NFTs and the decentralized finance (DeFi) space – financial smart contracts and applications built on top of the Ethereum blockchain. DeFi has experienced exponential growth this year, with Total Value Locked (a key metric in the DeFi space) growing from \$24B at the beginning of 2021 to over \$70B today, as of February 2022.⁸

We anticipate seeing more investment in digital assets to follow as we go through what some have dubbed "the great wealth transfer" and money moves from the boomer generation to a more digitally-native investment population. And, exciting developments like DeFi have far-reaching and revolutionary implications. DeFi is actively innovating to rebuild the current financial infrastructure in a way that is not only faster and more cost-efficient but also fully transparent. This is a future where transaction settlement is not only instant, but openly verifiable, and one in which counterparty risk no longer exists. This is the future of finance driven by digital assets.



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Investment Risks Generally. An investment in the Fund, involves a high degree of risk, including the risk that the entire amount invested may be lost. The Fund will invest in Digital Assets (such as Bitcoin, Ethereum, other cryptocurrencies or blockchain based assets, including those that represent the Decentralized Finance (or DeFi) portion or sector of the digital assets market) using strategies and investment techniques with significant risk characteristics, including risks arising from the volatility of the global Digital Assets markets and the risk of loss from counterparty defaults. The Fund’s investment program may use investment techniques that involve substantial volatility and can, in certain circumstances, substantially increase the adverse impact to which the Fund may be subject. All investments made by the Fund will risk the loss of capital. No guarantee or representation is made that the Fund’s investment program will be successful, that the Fund will achieve its investment objective or that there will be any return of capital invested to investors in the Fund, and investment results may vary.

Different from Directly Owning Bitcoin, Ethereum or Other Digital Assets. The performance of the Fund will not reflect the specific return an investor would realize if the investor actually purchased a Digital Asset. Investors in the Fund will not have any rights that Digital Asset holders have.

No Guarantee of Return or Performance. The obligations or performance of the Fund or the returns on investments in the Fund are not guaranteed in any way. Any losses of the Fund will be borne solely by investors in the Fund. Ownership interests in the Fund are not insured by the Federal Deposit Insurance Corporation, and are not deposits, obligations of, or endorsed or guaranteed in any way, by any banking entity.

Regulation. Digital Assets, including Bitcoin, Ethereum and DeFi tokens, are loosely regulated. Ongoing and future regulatory actions may alter, perhaps to a materially adverse extent, the value of a Fund’s investment. If any Digital Asset is determined to be a “security” under U.S. federal or state securities laws or a Digital Asset exchange is determined to be operating illegally, it may have material adverse consequences for Digital Assets due to negative publicity or a decline in the general acceptance of Digital Assets. As such, any determination Digital Asset exchanges are operating illegally or that any Digital Asset is a security under U.S. federal or state securities laws may adversely affect the value of a particular Digital Asset or Digital Assets generally and, as a result, the value of a Fund’s investment.

Exchanges. Exchanges may suffer from operational issues, such as delayed execution, that could have an adverse effect on the Fund. Digital Asset exchanges have been closed due to fraud, failure or security breaches. Any of the Fund’s funds that reside on an exchange that shuts down or suffers a breach may be lost.

Value. Several factors may affect the price of Digital Assets, including Bitcoin, Ethereum and DeFi tokens, including, but not limited to: supply and demand, investors’ expectations with respect to the rate of inflation, interest rates, currency exchange rates or future regulatory measures (if any) that restrict the trading of a Digital Asset or the use of a Digital Asset as a form of payment. There is no assurance that a Digital Asset will maintain its long-term value in terms of purchasing power in the future, or that acceptance of bitcoin payments by mainstream retail merchants and commercial businesses will continue to grow.

Protocol. Many Digital Asset networks, including Bitcoin, Ethereum and DeFi tokens, operate on open-source protocols maintained by groups of core developers. The open-source structure of these network protocols means that certain core developers and other contributors may not be compensated, either directly or indirectly, for their contributions in maintaining and developing the network protocol. Lack of incentives to, or a failure to properly, monitor and upgrade network protocol could damage a Digital Asset network. It is possible that a Digital Asset protocol has undiscovered flaws that could result in the loss of some or all assets held by the Fund. There may also be network-scale attacks against a Digital Asset protocol, which could result in the loss of some or all of assets held by the Fund. Advancements in quantum computing could break a Digital Asset’s cryptographic rules. The Fund makes no guarantees about the reliability of the cryptography used to create, issue, or transmit Digital Assets held by the Fund.

Volatility & Supply. Values of Digital Assets have historically been highly volatile, experiencing periods of rapid price increase as well as decline. For instance, there were steep increases in the value of certain Digital Assets, including Bitcoin, over the course of 2017, and multiple market observers asserted that digital assets were experiencing a “bubble.” These increases were followed by steep drawdowns. During the period from December 17, 2017 to February 5, 2018, Bitcoin experienced a decline of roughly 60%. More recently, during the period from February 13, 2020, until March 16, 2020, the value of Bitcoin fell by over 50%. Supply of Digital Assets is determined by computer code, not by a central bank. For example, uncertainty related to the effects of Bitcoin’s recent and future “halving” could contribute to volatility in the Bitcoin markets. The value of the Bitcoin or other Digital Assets held by a Fund could decline rapidly in future periods, including to zero.

Decentralized Finance (DeFi) Risks. Decentralized Finance (or DeFi) refers to a variety of blockchain-based applications or protocols that provide for peer-to-peer financial services using smart contracts and other technology rather than such services being offered by central intermediaries. Common DeFi applications include borrowing/lending Digital Assets and providing liquidity or market making in Digital Assets. Because DeFi applications rely on smart contracts, any errors, bugs, or vulnerabilities in smart contracts used in connection with DeFi activities may adversely affect such activities. DeFi lending is subject to counterparty risk and credit risk, but because lending is automated through the DeFi protocol, rather than individual decisions made by a portfolio manager on behalf of a Fund, such risks may be exacerbated, particularly if there are flaws in DeFi protocol’s code or operation. DeFi applications may involve regulated financial products or regulated activities, however because of their decentralized nature, there is generally no entity subject to regulatory supervision. Accordingly, DeFi applications may be subject to more risks than engaging in similar activities through regulated financial intermediaries. In addition, in certain decentralized protocols, it may be difficult or impossible to verify the identity of a transaction counterparty necessary to comply with any applicable anti-money laundering, countering the financing of terrorism, or sanctions regulations or controls. All of these risks could cause the value of DeFi tokens held by a Fund to decline, including to zero.



IMPORTANT DISCLOSURES

- 1) [CoinGecko.com](https://www.coingecko.com), February 2022.
- 2) Messari Report, "Crypto Theses for 2022."
- 3) [Apple.com](https://www.apple.com), February 2022.
- 4) Paypal, September 2021.

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- 5) Deloitte 2021 Global Blockchain Survey.
- 6) PWC, Accessed February 2022.
- 7) The Block Research, "2022 Digital Asset Outlook Report".
- 8) DeFi Pulse, February 2022.

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