ZEROCAP

Digital Asset Firm
for Private Clients

Zerocap Q3 2020 Insights

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Zerocap provides frictionless deep liquidity, secure custody and yield products for clients looking to move seamlessly between fiat and digital assets.

Our global banking infrastructure and principal trading model enables fast settlement in all major currencies and OTC assets.

We appreciate and respect the unique requirements of each client and offer a range of execution options to suit, from an Australian AUSTRAC registered entity (Digital Currency Exchange service provider) with banking in APAC, to offshore entities with discreet banking in the USA.

We are the firm for private clients, family offices and institutions.

Director's Note

The confluence of USD unwinding of safe-haven trades, monetary expansion (QE) and the US commitment to spur inflation through monetary stimulus and increased fiscal spending led to further downside in the US dollar. Gold breached it's all time high, punching through $2,000 on the back of inflation concerns and safe-haven flows.

Despite moves in havens, stimulus efforts have been very supportive for broader assets and cryptocurrencies. Global equities ended the quarter close their levels before the pandemic, and the cryptocurrency market cap increased by over 30% this quarter. The pandemic is driving shifting intermarket beta as investors and institutions grapple with the global shutdown versus stimulus, and optimism around a vaccine in early 2021.

Growth stocks are pumping, whilst value stocks and fixed income yields continue their decline – an snapshot of investors' appetite for yield, in an overall negatively yielding environment. The risk premium is getting expensive, the trade is looking more crowded everyday.

Where will investors turn? We can't see any greater value than bitcoin at this point in history.

We have always tried to moderate our views as much as possible in the face of the elastic hype of the crypto space, but it's difficult to find a time in our exposure to bitcoin that we have ever been so bullish. Its market cap still pales in comparison to other asset classes, and yet it is in the midst of becoming a fully legitimate and accepted, global portfolio hedge. One that is drastically needed in the face of the liquidity response to the pandemic, and building nationalistic tensions across the globe.

We believe that bitcoin offers more value now, than in any point in its history. If you had bought in 2011, you would've been buying alongside very early cypherpunks and libertarians. If you'd bought in 2015, you would've been battling divergence in opinions on whether the asset was just a flash in the pan. In 2018, you would've felt the massive blow off and subsequent bear market of the ICO boom. Right now, it simply has too much going for it. The information asymmetry has diminished, and investors are presented with infinitely less risk than in periods over the last decade.

Will there be volatility – yes. Will it continue to be the best performing asset of history into the future? We think so.

For our snapshot of why there is value right now, check out our Bitcoin: This is the Hedge report.

Quarterly Asset Performance

Cryptocurrency Market Performance

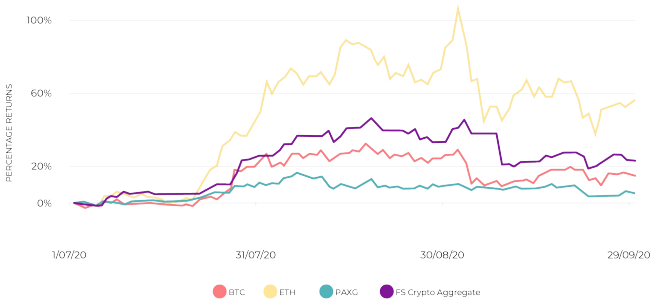
Ethereum leads the pack
ETH returned **55.75%** compared to BTC at **16.08%** over Q3. DeFi (Decentralised Finance) flows, and associated project launches on the Ethereum protocol has led to strong relative performance. The initial hype and retail participation (mania) in the DeFi yield farming craze moderated as September arrived.

Bitcoin's market share slightly decreased from **66%** to **59.3%** over the quarter, leading to rapid value growth in the Ethereum protocol. ETH's market share increased from **10%** to **12%**, alongside other altcoins' robust growth.

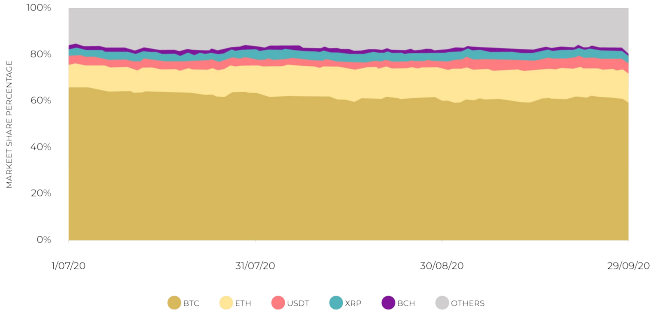
Tether surpassed Ripple in September as the third-largest cryptocurrency by market cap, driven by DeFi liquidity yields, the futures basis trade and Asian business flows.

It truly has been a year of project launches and innovation built on the Ethereum network. DeFi is creating efficiencies in finance that will no doubt shape the future of many asset classes, however, we are cautious that the early adopters and drivers of value at the moment on these platforms are primarily retail, and therefore inherently short-term and speculatively driven. The DeFi altcoins are due for a correction, and Ethereum will likely follow.

2020 Q3 Cryptocurrency Returns



2020 Q3 Cryptocurrency Market Share



Data source: CoinMarketCap

* FX Crypto Aggregate tracks the performance of 630 digital currencies, representing the market as a whole.

Bitcoin

The bitcoin price surged at the end of July to $12,000, retesting $10,000 a number of times over the quarter. Fundamentally, the case for bitcoin is growing by the day. Institutional adoption has been at the forefront of conversation, with Fidelity launching a bitcoin fund and Microstrategy allocating $250m of its balance sheet. We've noticed mainstream banks taking an easier stance on cryptocurrency businesses recently, likely driven by sentiment that low yields could be here to stay, and that diversifying revenue is prudent at this point.

Furthermore, the macro case for bitcoin is growing. The pandemic has been incredibly divisive, and is exacerbating existing structural shifts:

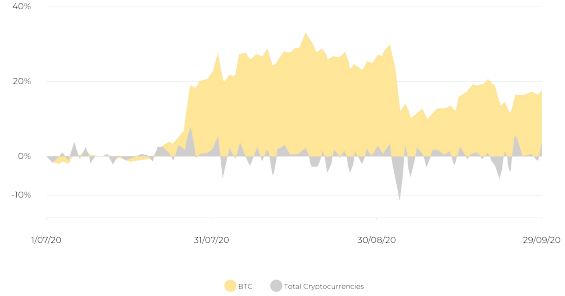
- Nationalism and de-globalisation
- Supply chain disruptions
- Erosion of purchasing power with fiat money
- Ballooning global debt

Gold provides a hedge, but is not as liquid, transportable and non-sovereign as bitcoin. We expect some volatility into next quarter, particularly in the lead up to the US election. As of now (mid-Oct), we are already seeing blasts to the topside and decoupling of equity and intermarket correlations, setting up the stage for more topside.

The cumulative return for bitcoin over Q3, 2020 was **16.08%**. The cumulative market cap change was **$30.75 B**, reaching **$200.74 B** in capitalisation.

BTC Q3 Price & Volume

Market Cap Change



Data source: CoinMarketCap

Ethereum

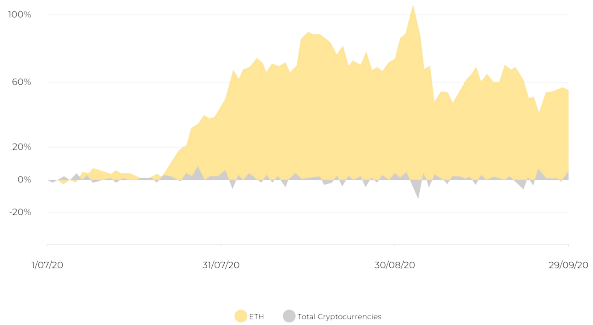
ETH had a stellar quarter, even with the pullback in September, the asset returned a healthy **55.75%** DeFi flows have had momentous effects on the protocol – transactional volume in Q2 was **$10.2B**, where Q3 it was **$120B**. This surge led the the highest transaction fees (gas) that the protocol had ever seen, leading to speculation about whether layer 1 (new competitor protocols) or layer 2 (technology that overlaps Ethereum to solve bottlenecks) solutions were appropriate to scale.

Regardless of the short-term noise, DeFi is clearly here to stay and the top 20 DeFi projects by market cap are all built on Ethereum. Furthermore, the expectation of Ethereum 2.0, the updated protocol due at the end of 2020, could help buoy the asset in Q4. Furthermore, if the NASDAQ decides to make another topside move, spurring venture capital liquidity, we see ETH moving higher into the year's close.

The cumulative return for Ethereum in Q3 was **55.75%**. The cumulative market cap change was **$14.82 B**, reaching **$40.61 B** in capitalisation.

ETH Q3 Price & Volume

Market Cap Change



Data source: CoinMarketCap / TradingView

Stablecoins

Gold had a nice run above $2,000, spurred by the weakened US dollar and lower US bond yields, before stabilising around the $1,900 level at the end of Q3.

Top stablecoins increased their market capitalisation and daily traded volume throughout the quarter. The drivers have been threefold.

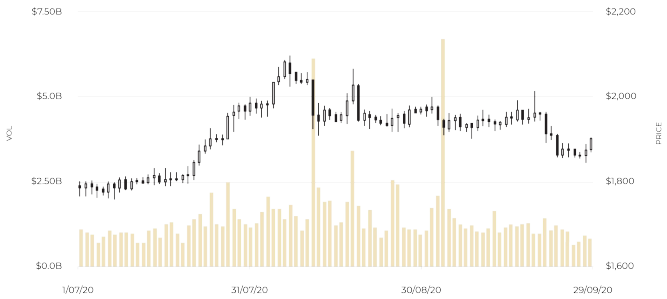
1) The futures basis trade that requires USD and USD stablecoin exposure as a funding currency
2) Hedge against market volatility
3) Demand from China – after the 2017 ban of fiat onramps, market volatility has led to USDT demand as a margin currency for trading activity

USDT	USDC	BUSD	TUSD	HUSD
$15.48 B	$2.54 B	$472 M	$509 M	$127 M
(+$5.84 B) (+60.6 %)	(+$1.61 B) (+173.75 %)	(+$311 M) (+187.69 %)	(+$365 M) (+252.53 %)	(+$8.5 M) (+7.18 %)

Source: Coin Market Cap & TradingView

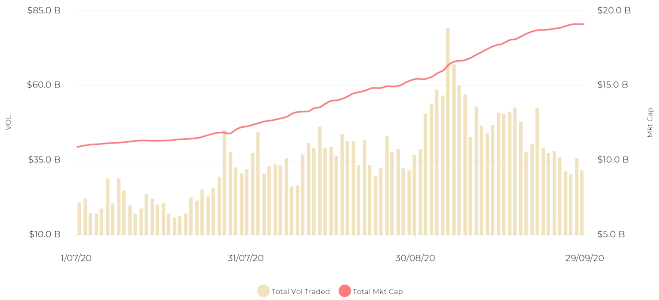
PAXG Q3 Price & Volume

Source: Coin Market Cap



Top 5 Stablecoins' market cap

Source: Coin Market Cap



Macro Overview

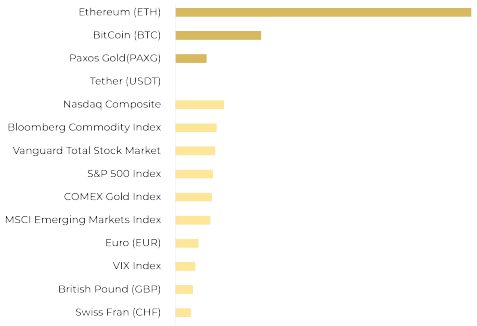
Broader Financial Markets

Further to Director's Note comments, bitcoin and ethereum significantly outperformed market indices, currencies and commodities. The USD clearly took the brunt of outflows, losing to safe haven and risk-driven flows.

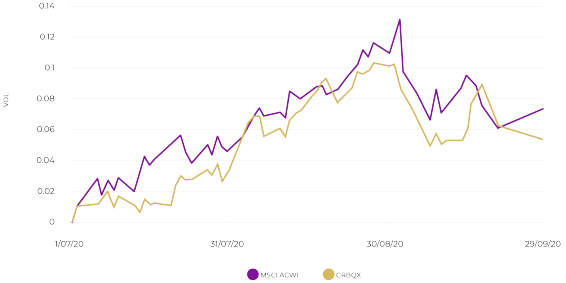
The USD exit valve has driven positive correlations in the equity / commodity cycle over the quarter. Despite this, we see a decoupling of this correlation on a longer-term timeframe, with a move to value eventually being adopted by funds moving into low leverage, strong balance sheet companies with hard assets on their books.

2020 Q3 Multi-Asset Class Performance

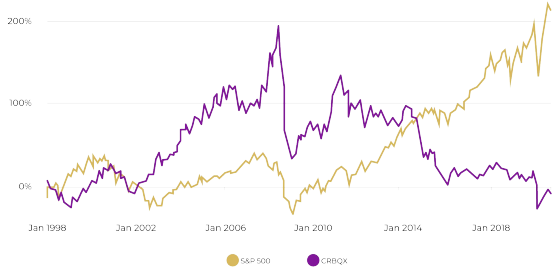
Data Source: Coin Market Cap & Investing



S&P500 vs Commodities quarter term cycle



S&P500 vs Commodities long term cycle



Data Source: Tradingview / Google Trends

Intermarket Performance

This chart maps the performance of US equities, global equities, emerging markets, commodities, high-yield corporate bonds and 7-10 year US treasury bonds. The high correlations are remarkable over this period, and indicative of the unique properties of the pandemic.

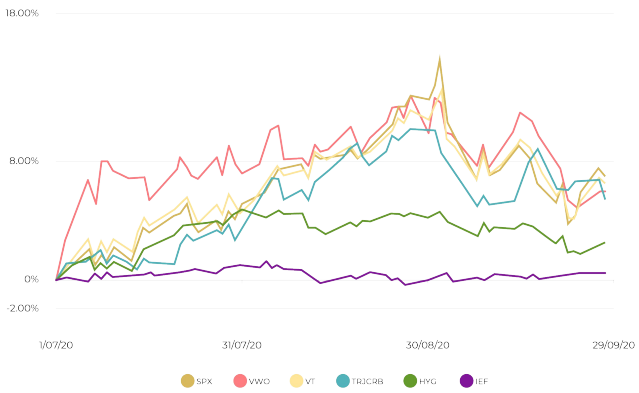
As mentioned, the exit valve to performance here has been the USD. Where to from here? The liquidity event in March has occurred, and the market is pricing in very little chance of a liquidity crunch into the future. Despite this, we still see great value in the USD at these levels. The market is pricing in a perfect 2021 vaccine scenario, and any shaky issues or unexpected global shocks could be positive for the USD as investors and institutions reposition. In addition to a hedge against any upcoming shocks (or even news that simply less-positive), we are also holding USD as a income asset through yield generation in lending and futures interest rate strategies.

Notably high yield corporate bonds remain buoyed despite significant risks of insolvencies. There is a reasonable chance that credit spreads widen given potential insolvencies and insufficient velocity of fiscal stimulus.

See our yield primer for further information on USD, stablecoin and digital asset fixed income strategies.

Intermarket Cumulative Return

Source: TradingView



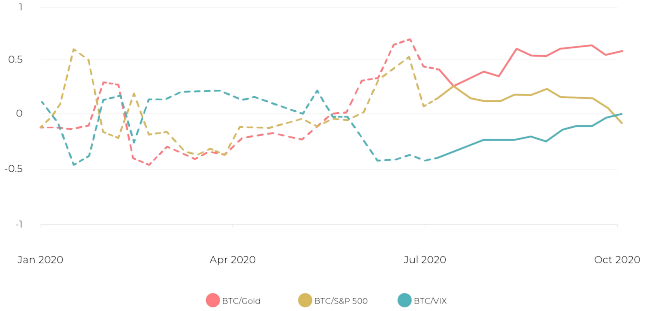
Correlations

Bitcoin
BTC's correlation with US equities was decreasing, finally slipping into negative territory at the end of this quarter. Instead, gold and the VIX volatility index drew an increasingly positive correlation, acting as safe haven flows and inflation hedges. Bitcoin's ever-changing dynamic beta is building increasing value to portfolios in the current macro environment. This is being picked up by Fidelity and other asset managers, and we expect fundamentals to improve into year-end.

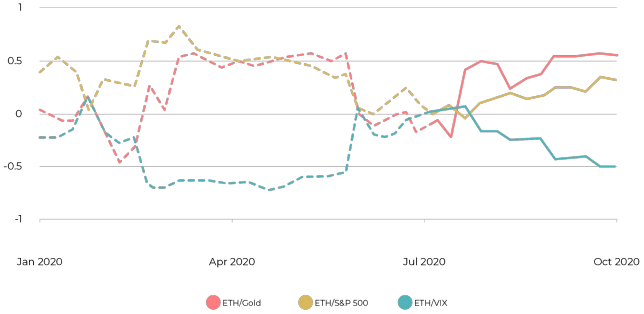
Ethereum
ETH followed closer correlations to US equities, particularly growth stocks. DeFi projects launching, all of which tend to move when venture capital flows are strong, led to a beta curve similar to that of the Nasdaq and key growth stocks. Naturally this led to an increasingly negative correlation to VIX, illustrating the market's unwillingness to take out heavy insurance against equity market downside.

With the upcoming US presidential election, we expect to see volatility, a heightened VIX and potentially short-term downside in ethereum. Although given the uncertainty in capital flows right now, this is a difficult environment to forecast for ethereum into November.

Bitcoin Correlations (12 Weeks Rolling)
Source: TradingView



Ethereum Correlations (12 Weeks Rolling)
Source: TradingView



Performance & Volatility

This chart illustrates bitcoin's unique beta.

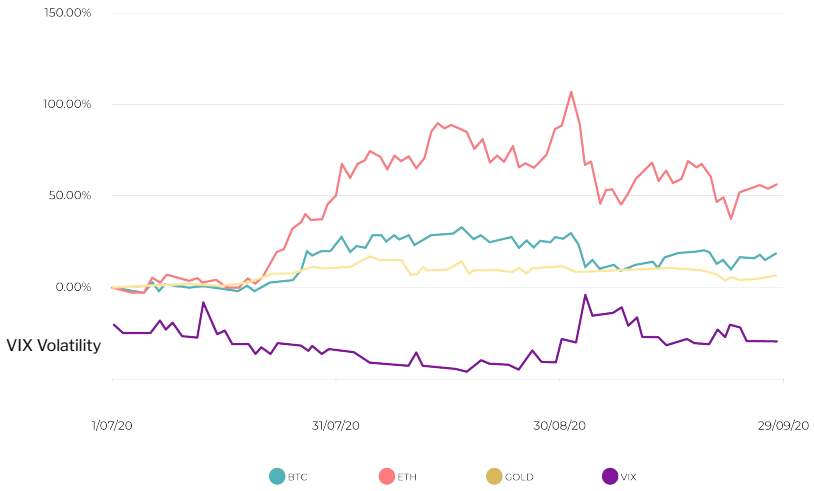
Leading up to September, we saw decreasing volatility in the VIX as bitcoin rallied. Into August the correlation switched positive, as bitcoin rallied as a safe-haven asset. The correlation decoupled toward the end of the quarter. Another reason this asset is so valuable in a portfolio – you achieve leverage without having to take on leverage, and improve risk adjusted returns in broader equity/bond portfolio mixes.

Ethereum's performance was less pronounced, predominantly following DeFi in and outflows, which in turn, correlated with risk moves in broader US growth stocks.

Gold followed a typical negative correlation with the VIX, ending the quarter below its highs. Gold's role during this pandemic is still not clear – most flows right now are pointing to inflation hedge concerns, however that narrative in the investment fund landscape and broader media is not taking hold just yet. When we see concerns become mainstream, or inflation start to affect grocery prices, this is when gold will really move. Unlike bitcoin (yet), there are plenty of onramps for larger funds to allocate to gold and this would be the first port of call in a negative yielding bond environment with inflation taking hold.

Quarterly performance vs risk (volatility)

Data Source: TradingView



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