ZEROCAP

Digital Asset Firm
for Private Clients

Zerocap Q4 2020 Insights

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Zerocap is an over-the-counter (OTC) wealth firm for digital assets, providing deep liquidity, insured 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 offer a fully insured asset environment in custody on a dollar-for-dollar basis, with a range of yield generating investment options for compounded returns.

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

Director’s note

What an amazing quarter for bitcoin (BTC) and ethereum (ETH), and the markets as a whole. BTC and ETH outperformed equities, despite an amazing equity run on the back of US stimulus expectations and Biden’s win over Trump. Liquidity is flooding the system, and looking for a home – right now, it’s all about risk-assets.

What is interesting in the current dynamic are the early signs of inflation. This crisis response is very different to the GFC of 2008. More fiscal spending is getting into the hands of everyday people, businesses and through loans. We have a situation in Australia where the housing market looks like it’s about to fly again given the RBA’s comments on low interest rate expectations for the coming years. The market was pricing in near-perfect deflation in prior quarters, but we are now beginning to see some early sector rotation into value stocks and commodities. Energy is beginning to move, agriculture, and other key early inflation concern indicators. We’ve argued from the beginning of this crisis that bitcoin would perform in a deflationary and inflationary environment. This certainly seems to be the case on early accounts. In fact, given BTC’s aggressive moves towards the end of this quarter, we’d actually reframe our position – bitcoin will perform in both environments, but aggressively outperform in an inflationary environment.

Director’s note

Where does this leave ETH?

Massive decentralised finance flows have led to ethereum’s appreciation over 2020. The uncertainty is whether ETH would experience downside alongside technology stocks if we get a blow off on inflation concerns. We think that in the short-term, it could totally decouple from BTC and follow tech stocks. Although, in the medium to long-term it could play a key role in asset management hedging – BTC for store of wealth, ETH for exposure to venture capital and growth, but in a significantly less leveraged environment than US equities.

The decoupling of ethereum’s correlation to bitcoin is already underway, and we think it's a great thing. Lower correlation brings more diversity, and could provide scope to hold fully diversified portfolios within the crypto asset universe.

Whatever 2021 brings, it’s clear that holding BTC and ETH in a balanced portfolio has some amazing benefits, that are only going to become more prevalent as more institutions enter the space, invest and/or hedge out their treasuries.

We wish you all the best for the coming quarter and year.

Cryptocurrency market performance

Bitcoin leads the pack
BTC returned **173.1%** compared to ETH at **108.9%** over Q4. The massive interest from institutions, hedge funds, corporate treasuries, and Wall Street names drove bitcoin's strong relative performance. The upgrade of ethereum network became the major driver of ETH appreciation, both speculatively and fundamentally as supply is removed through staking for 1 to 2 years.

Bitcoin's market share increased from **59.3%** to **71.3%** over the quarter, as investors took bitcoin's reserve currency/hedge status more seriously. ETH's market share shrank from **11.9%** to **11%** in part due to bitcoin's robust growth.

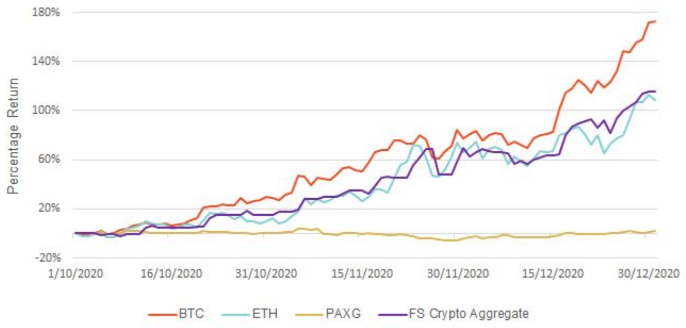
XRP surpassed USDT in November again as the third-largest cryptocurrency by market cap, driven by three main factors -

1. bitcoin and ethereum's bullish moves,
2. the exposure to traditional finance that XRP can offer to investor portfolios, and
3. the airdrop of free spark tokens to XRP holders.

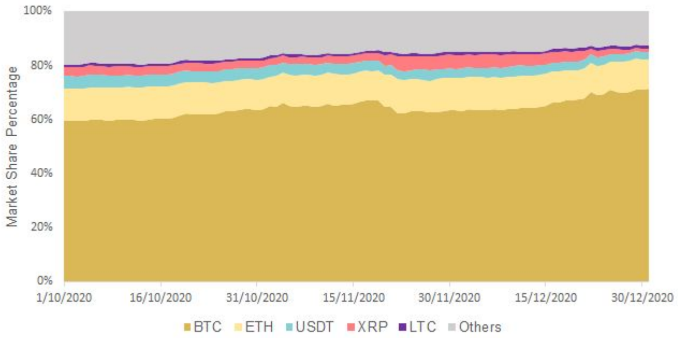
However, charges were laid by the SEC against Ripple and two Executives for conducting a $1.3b unregistered securities offering, causing XRP to fall back to the fourth-largest cryptocurrency by market cap in late December.

The slower growth in total value locked in DeFi verified our previous conjecture that the early adopters and drivers of value at the moment on DeFi platforms are primarily retail, and therefore inherently short-term and speculatively driven.

2020 Q4 Cryptocurrency Returns



2020 Q4 Cryptocurrency Market Share



Data source: CoinMarketCap

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

Introduction
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Quarterly Asset Performance

Bitcoin

The last quarter of 2020 for bitcoin will be remembered. Although BTC experienced market resistance at $20,000, it broke above reaching all-time highs for the first time in mid-December, and surged to nearly $30,000 in the final 15 days of the year.

Fundamentally, the bitcoin boom is a result of convergence across many positive factors. Firstly, traditional investors began appreciating bitcoin's storage of value - its scarcity in the future, rather than its current medium of exchange functions. Secondly, institutional firms jumped in and treated bitcoin as an asset to hold in their portfolios, providing uncorrelated, vastly improved risk-adjusted returns. Following the institutional narrative, savvy retail investors have begun flooding in, with mainstream media picking up on momentum. Meanwhile some Wall Street names and listed companies have become more open to bitcoin All of this amongst a year of Covid-19 global stimulus in the trillions, driving up bitcoin as a hedge to currency debasement and uncertainty.

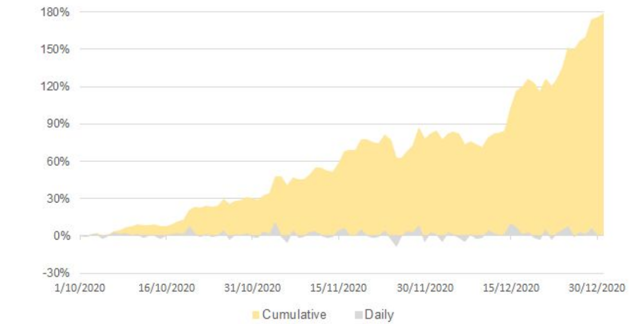
The cumulative return for bitcoin over Q4, 2020 was **173.1%**. The cumulative market cap change was **$342.5B**, reaching **$539.05B** in capitalisation. We believe that when bitcoin's market cap hits $1 to $2 trillion, we will see a new wave of more conservative capital entering the asset class.

BTC Q4 Price & Volume

Source: Coin Market Cap

Market Cap Change

Source: Coin Market Cap & TradingView



Ethereum

Ethereum investors celebrated outperformance in the last quarter of 2020. Benefiting from upgrades to the ETH blockchain network (ETH 2.0) and the tailwind of bitcoin inflows. ETH broke the $700 level toward year-end, and is still only at 50% of its all-time highs in 2018. DeFi flows have had positive effects on the protocol – transactional volume increased from $120B to $138B over the quarter. The transaction fees (gas) in the ethereum network declined in Q4 – the average gas fee in Q4 was 65.98 GWei, where Q3 it was 122.35 GWei. The decline was a welcome respite from aggressive yield farming on DeFi platforms in Q3. However, the gas fee maintained a stable level if measured in dollar terms ($1.50 to $1.79 on average), due to the appreciation in Ether's price.

Despite short-term noise, DeFi is clearly here to stay and E\ethereum is the prime protocol for DeFi projects. Venture capital and hedge funds will likely bring upsurges in the short run with the launch of ETH 2.0. Traditional asset management firms taking advantage of improving institutional infrastructure and access points (ETH CME Futures launching in Feb, 2021) could lead to another Ethereum boom in the long-run.

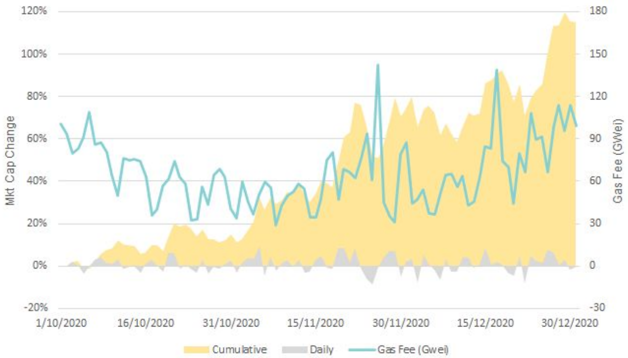
The cumulative return for ethereum in Q4 was **108.88%**. The cumulative market cap change was **$44. 31B**, reaching **$84.16B** in capitalisation.

ETH Q4 Price & Volume

Source: Coin Market Cap

Market Cap Change & Gas Fee

Source: Coin Market Cap & TradingView



Stablecoins

Overall, gold maintained price at $1,900 in Q4. Late November brought upbeat news on coronavirus vaccines driving outflows from the haven, causing some price declines. However, this rebounded in December, when additional U.S. monetary stimulus and speculation on Biden's presidency and its approach to quantitative easing (QE) took hold.

Most top stablecoins increased their market capitalisation and daily traded volume throughout the quarter. DAI evolved into the third largest stablecoin due to liquidity mining and rising demand, whilst the ETH & USDC debt ceiling on the supply side led to tightening liquidity. Other stablecoins had similarly strong performances which squeezed TUSD demand, leading to market cap declines. It's clear that DeFi stablecoins will lead market cap performance over the next year.

USDT	USDC	DAI	BUSD	TUSD
$20.94 B	$3.90 B	$1.17 B	$985 M	$275 M
(+$5.43 B)	(+$1.39 B)	(+$269 M)	(+$481 M)	(-$233 M)
(+34.99 %)	(+55.34 %)	(+30.00 %)	(+95.57 %)	(-45.89 %)

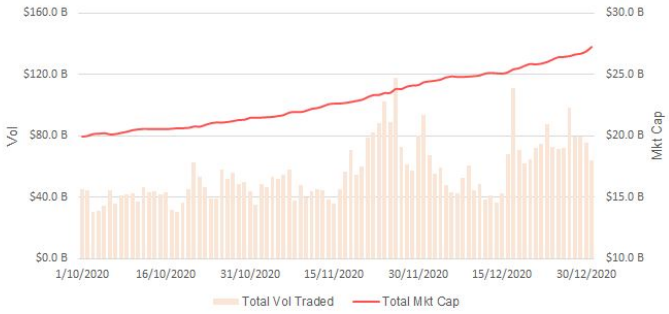
Source: Coin Market Cap

PAXG Q4 Price & Volume

Source: Coin Market Cap

Top 5 Stablecoins' market cap

Source: Coin Market Cap



Introduction
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Macro Overview

Broader Financial Markets

Bitcoin and ethereum significantly outperformed equity market indices, currencies and commodities. Emerging markets dominated traditional market returns. The USD clearly took the brunt of the down move with continued quantitative easing.

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 lower leverage, strong balance sheet companies with hard assets on their books.

2020 Q4 Multi-Asset Class Performance

Data Source: Coin Market Cap & Investing

MSCI ACWI vs Commodities quarter term cycle

Data Source: Tradingview

S&P500 vs Commodities long term cycle

Data Source: Tradingview

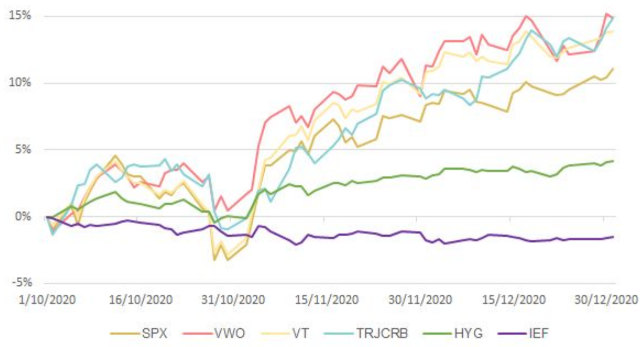
Intermarket Performance

This chart maps the performance of US equities, emerging markets, global equities, commodities, high-yield corporate bonds and 7-10 year US treasury bonds. Positive Covid-19 vaccine news encouraged investors away from safe haven assets to equities and commodities – high correlations illustrating the unique properties of the pandemic. Meanwhile, massive outflows from the U.S. treasury bonds lead to price declines and yield upticks against the backdrop on inflation concerns.

As mentioned, the exit valve to performance here has been the USD. The outbreak of the pandemic in March led to liquidity crunch across asset classes, and has since stabilised amongst the stimulus packages. It is less likely that we suffer another liquidity event caused by variants of coronavirus given the liquidity buffers in place at the moment. If the coronavirus variants prolong the pandemic, the U.S. dollar may appreciate as a safe haven currency given how short the market currently is, whilst exuberance in other markets could similarly reverse. The market is pricing in a perfect run out of this pandemic – and are are still cautious around the vaccine rollout timeframe and potential bankruptcy risks from highly-leveraged firms.

Intermarket Cumulative Return

Data source: TradingView



Correlations

Bitcoin
BTC's correlation with gold maintained at a moderate positive correlation, supporting BlackRock's conjecture that bitcoin would supplant gold as the safe-haven store of value. The correlation with the U.S. equities was trending to zero. We do not expect the correlation with the equity market to fall below zero in the first half of 2021 as it did in June 2020 given risk-flows into tech and associated crypto asset flows. Despite this, bitcoin's ever-changing dynamic beta is building increasing value to portfolios in the current macro environment.

Ethereum
The correlation between ETH and BTC dropped from Q3's **0.84** to **0.67** in Q4. We infer that ethereum's moves will continue to gradually decouple from bitcoin, given the increasingly varied use cases between the assets. The investment inflows on the back of ETH 2.0 led a positive correlation with the U.S. equity market recovery. The correlation with gold followed a similar path as with U.S. equities, ending the quarter with a weak positive correlation.

Bitcoin Correlations (12 Weeks Rolling)

Source: TradingView

Ethereum Correlations (12 Weeks Rolling)

Source: TradingView

Performance & Volatility

This chart illustrates bitcoin's unique beta.

In the beginning of 2020, the options market was pricing in a presidential election shock, which was reflected in high October VIX futures value on the January futures curve. Historically, over the past 20 years, the VIX experienced an average of a **30%** increase from September to October in each U.S. election year (**52%** in 2008 and **44%** in 2020). The second wave of COVID-19 infections exacerbated the VIX surge this year.

Excluding seasonality, the cumulative return of BTC was negatively correlated with the VIX index, displayed in the chart after mid of November. VIX and BTC volatility were also negatively correlated. Ethereum presented similarly to bitcoin. We expect this correlation to shift if inflation comes to fold – leading to a blowoff in equity markets and an increase in BTC's velocity to the topside (store of wealth). What is less certain is how ETH will react in this environment. We think it may totally decouple from BTC's and follow tech stocks.

Gold's performance was less pronounced. Its role during this pandemic is still not clear – most current flows are pointing to inflation concerns via hedging. 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, that is when gold will really move.

Quarterly performance vs risk (volatility)

Data Source: TradingView

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