ZEROCAP

Digital Asset Firm
for Private Clients

Zerocap Q1 2021 Insights

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Zerocap is an Australian wealth management firm and prime broker for digital assets.

We offer a personalised global service for OTC trading, institutional-grade insured custody, and a range of yield-generating products and regulated funds.

We believe that digital assets are the cornerstone future of finance. Zerocap is a forward-thinking business that is building for this future - a digital age requires digital assets.

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

CIO note

What a quarter for digital assets, and broader speculative markets. The run continued from the prior 3-months, with more liquidity entering the system. No signs of taper talk yet from the Fed, leading to a fairly consistent run across risk assets, notwithstanding some interesting shifts in market structure when the Gamestop activists decided to teach the Hedge Fund shorts what a squeeze looks like.

We are entering overbought territory, yet it's tough to forecast what the trigger could be for downside moves across speculative assets. US10Y yields have spiked intermittently throughout the quarter, yet the inflation narrative has not truly taken hold of the market. The stimulus packages seem to be never-ending. Institutional inflows into BTC and ETH continue to grow. Where is the top?

Our feeling is that broad intermarket flows have been pricing in perfection on the vaccine rollouts and economic recovery. The market is also not yet gunning for the inflation trades in a big way just yet - although we are seeing notable turns in value stocks, with commodities outpacing global equities over the quarter, in particular agriculture and energy. This could be the early signs of a broader turn from the more aggressive investors - hedge funds, boutique investment firms and value driven flows that have powder dry, or some leverage, to allocate.

This said, the market is still undecided on how equities, gold and cryptocurrency will play out if we see negative economic data, or unexpected inflation spikes. Despite some mixed signals: all-time highs for growth equities whilst raw material prices also hit all-time highs, the consistent theme is QE = buy stocks and short volatility, and digital assets are along for the journey.

The quarter has seen massive growth in crypto assets, driven by institutional inflows, speculation and robust scaling solutions across layer-2 protocols coming to light. Bitcoin market cap dominance has fallen over the quarter against the rest of the crypto market. The market cap dominance tends to oscillate over time, and given liquidity conditions, we expect further loss of market cap dominance until the market starts taking inflation seriously or we get tapering from the Fed.

Despite shifts in market cap dominance, the whole crypto industry is still clearly buoyed, and we see this continuing as a result of DeFi flows and scaling solutions launching, as well as new access points for BTC and ETH. ETFs, ETPs and a host of other vehicles to express investment ideas in the crypto market for non-native investors could lead to the next leg up.

We wish you a productive and exciting quarter ahead!

Cryptocurrency market performance

Ethereum takes over

BTC returned **99.92%** compared to ETH at **162.3%** over Q1. Performance was largely supported by the continued wave of institutional adoption with companies such as Visa, Paypal, Tesla and Microstrategy driving many to consider the asset class. Added retail awareness has also amplified gains for altcoins, many of which are built on the Ethereum protocol.

Bitcoin's market share decreased from **70.93%** to **60.19%** over the quarter on the back of altcoin rallies while BTC consolidated. ETH's market share grew from **11.1%** to **12.14%** with a local top at 17.5% at the start of February.

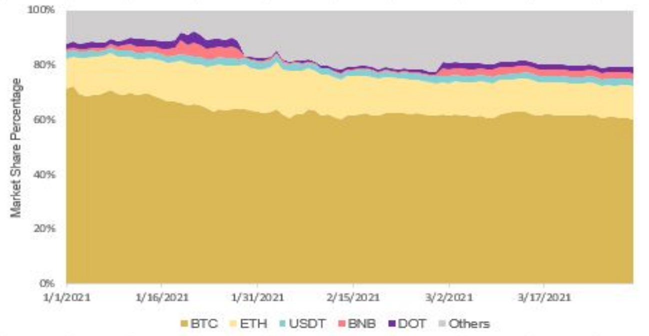
BNB has surged its way to the third-largest cryptocurrency by market cap, driven by three main factors -

1. Adoption of Binance Smart Chain,
2. Integration of Binance Smart Chain onto existing (and popular) DeFi apps, and
3. Ethereum's high gas fees.

The 'Ethereum-killer' narrative was a key focus of the quarter, as competitors scrambled to provide an influx of new crypto-investors with quality alternatives to the increasingly expensive Ethereum network. BNB's success this quarter was by and large the biggest beneficiary of Ethereum's high gas fees, although a wave of layer-2 scaling solutions could pose a threat to the market share it captured in Q1.

2021 Q1 Cryptocurrency Returns

2021 Q1 Cryptocurrency Market Share



Data source: CoinMarketCap

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

Quarterly Asset Performance

Bitcoin

Bitcoin entered 2021 around the $30,000 mark after a sustained drive from $20,000. An influx of institutional adoption drove the price to more than double its previous all-time high early in January at $42,000. After a near-month-long cool down, and various pro-BTC announcements from the likes of Blackrock and Tesla, the uptrend resumed to peak at $58,400 before a trail of liquidations and fear sent the asset below $45,000. The month of March was spent recovering progress and was fueled by even more institutional heavyweights committing to a future with crypto involved. Visa, Paypal, Morgan Stanley, Deutsche Bank, JP Morgan and Fed Chair Jerome Powell are just some of the names to have professed their interest in integrating crypto into their processes and offerings in the near future, fueling sentiment and encouraging wider adoption, not only for institutions but retail also.

In addition to the variety of reputable proponents, a number of Bitcoin ETFs and trusts were established on the Toronto Stock Exchange, Swiss Stock Exchange and Brazilian Stock Exchange. The passing of President Biden's Covid-19 stimulus bill also remained a key price driver, as the addition of $1.9 trillion to the US economy heightened inflation fears.

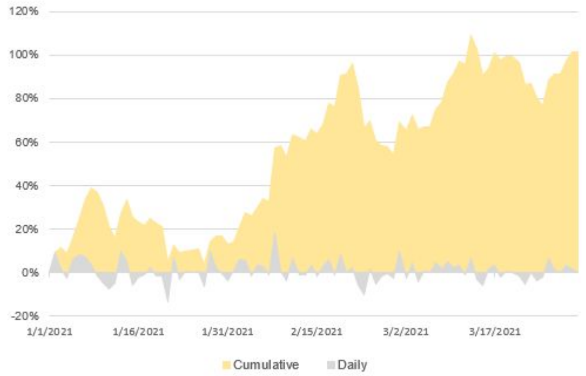
Overall, the cumulative return for bitcoin over Q1, 2021 was **99.9%**. The cumulative market cap change was **$554B**, reaching **$1.1T** in capitalisation.

BTC Q1 Price & Volume

Source: Coin Market Cap

Market Cap Change

Source: Coin Market Cap & TradingView



Ethereum

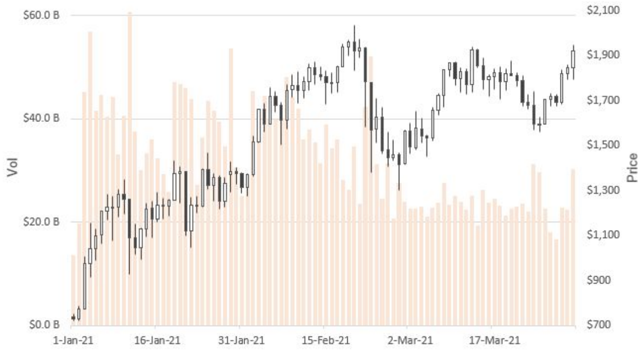
Ethereum launched into 2021 with significant market cap growth and price appreciation. Market participant growth was largely driven by the DeFi boom, open interest in derivatives and promising news on layer-2 scaling solutions. Volatility early in the quarter was commonplace as the derivatives market overheated and trade volume was sustained. The 2018 high was hit early in January, establishing a new high at $1,440. While retracements were sharp, new highs were met consistently over the course of the next 6 weeks fueled by institutional adoption, the CME ETH futures listing and non-fungible token (NFT) hype.

With $47B locked in DeFi by the end of the quarter, the space has experienced insurmountable growth and propelled Dapp ecosystems such as Ethereum to new heights. Total value locked in ETH 2.0 rose to ~$6.8B, displaying a continued interest in the development of the network. While transaction volume remained relatively consistent with the previous two quarters, value per transaction dropped, implying a potential cooling off period. High gas fees are likely to blame as we saw consistent spikes above 200 GWei over the quarter with highs of nearly 400 in late February and an average of 150 GWei (~$7.50) for Q1. Sustained transaction volume is visibly straining the Ethereum network although, the anticipated implementation of EIP-1559 among a host of other layer-2 solutions provide direct combatants to this shortcoming of the ecosystem and are expected by mid-year.

The cumulative return for Ethereum in Q1 was **162.3%**. The cumulative market cap change was **$137.8B**, reaching **$221.2B** in capitalisation.

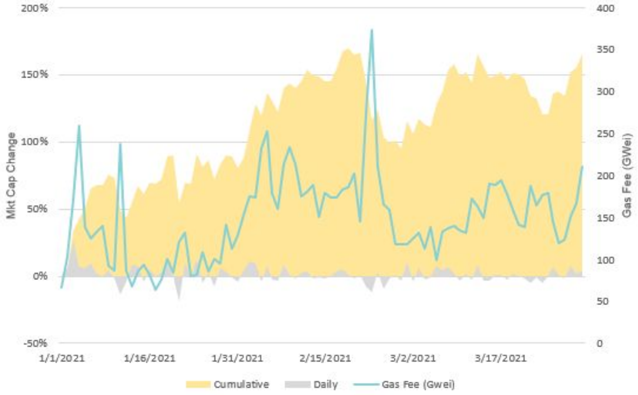
ETH Q1 Price & Volume

Source: Coin Market Cap



Market Cap Change & Gas Fee

Source: Coin Market Cap & TradingView



Stablecoins

Despite minor spikes over the course of the quarter, gold sustained a slow decline to close March 31st at $1,700 on the back of a strengthening US dollar. Continued optimism surrounds the Covid-19 recovery and suppressed inflation fueled a risk-on environment, pulling money from safe havens like gold and funneling it into equities.

All top stablecoins increased their market capitalisation and daily traded volume varied drastically throughout the quarter. DAI was overtaken by BUSD (Binance Smart Chain's stablecoin) due to significant user growth. With three of the top five stablecoins' primary use case in DeFi, it can be expected that as the sector continues to grow, so to will their market share. The top two stablecoins also received eye watering user growth as leveraged trading and spot order volume increases to new highs.

USDT	USDC	BUSD	DAI	TerraUSD
$20.94 B	$13.9 B	$5.34 B	$985 M	$1.78 B
(+$25 B)	(+$7.37 B)	(+$4.17 B)	(+$2.3 B)	(+1.6 B)
(+119 %)	(+189 %)	(+356 %)	(+233 %)	(+878 %)

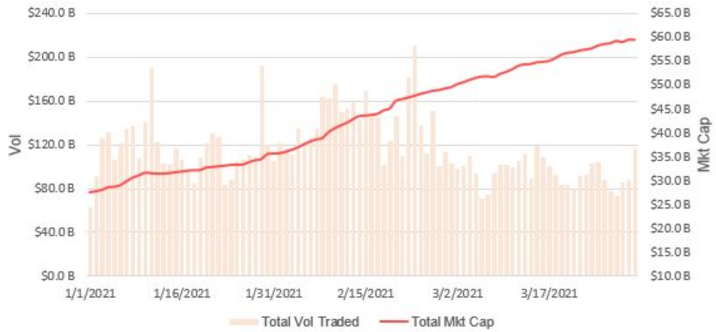
Source: Coin Market Cap

PAXG Q1 Price & Volume

Source: Coin Market Cap

Top 5 Stablecoins' market cap

Source: Coin Market Cap



Macro Overview

Broader Financial Markets

Bitcoin and Ethereum significantly outperformed equity market indices, currencies and commodities. On a broad scale, commodity markets outperformed weighted global equities significantly, reflecting shifts into value stocks. This will be a key cyclical shift if it continues this year.

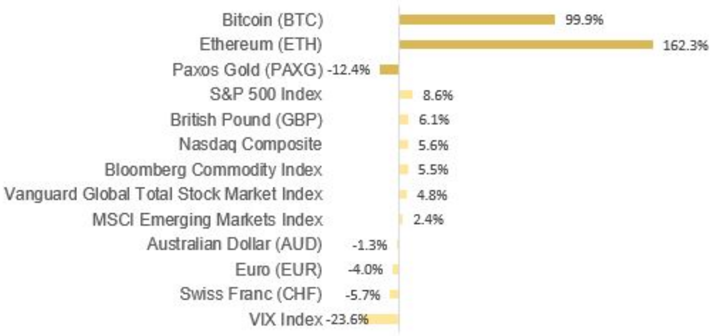
The move to value stocks rise early in the quarter was superseded by positive macroeconomic news droving hope for a quicker than anticipated economic recovery. As such, growth stocks took over towards the end of the quarter. While many indicators point to low inflation, with leveraged growth stocks at or near all-time highs, we are conversely seeing raw material prices at all-time highs - suggesting that supply chain shocks and the general inflation narrative will be a key focus in the coming months.

MSCI ACWI vs Commodities quarter term cycle

Data Source: Tradingview

2021 Q1 Multi-Asset Class Performance

Data Source: Coin Market Cap & Investing



S&P 500 vs Commodities long term cycle

Data Source: Tradingview

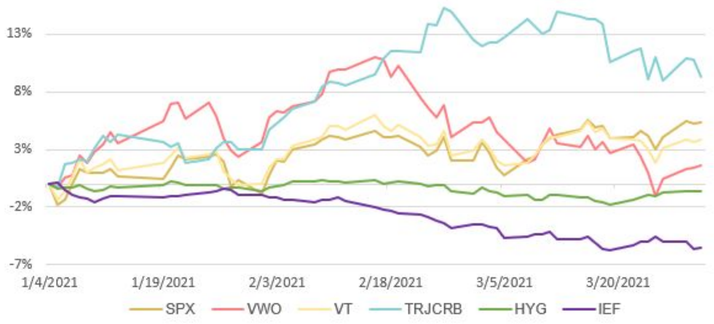
Intermarket Performance

Covid-19 vaccine news drove market sentiment for the first half of the quarter as many waited for the Biden administration to implement its fiscal stimulus. Inflation fears were a key driver of the bond market which saw a consistent tug of war between the Federal reserve and investors. Moments of yield spikes in longer-term treasuries were primarily driven by positive news such as high growth in US factory construction numbers and the strengthening US dollar, leading many to pivot to higher risk alternatives, primarily equities. The sell-off that followed was in-part because of Japanese investors exiting positions before the end of their financial year (Mar 31). Whilst there are cyclical factors at play, there is uncertainty around what spikes in the US10Y rates will mean for equities and broader intermarket assets over the coming year. Indicative of a firming economy? Or of surprise inflation, or even stagflation as some of the alternative media have posited over this quarter.

Ultimately, whilst sentiment has most certainly become more positive when compared with 2020, issues surround vaccine rollouts, overtly positive responses and faith in the US government's plan for economic recovery persist. Pricing in perfection leads us to believe that downside risks persist. A combination of unprecedented fiscal stimulus, leveraged firms and a crowded long trade pose a significant risk if the market turns on the back of unfavourable news.

Intermarket Cumulative Return

Data source: TradingView`



This chart maps the performance of US equities, emerging markets, global equities, commodities, high-yield corporate bonds and 7-10 year US treasury bonds.

Correlations

Bitcoin

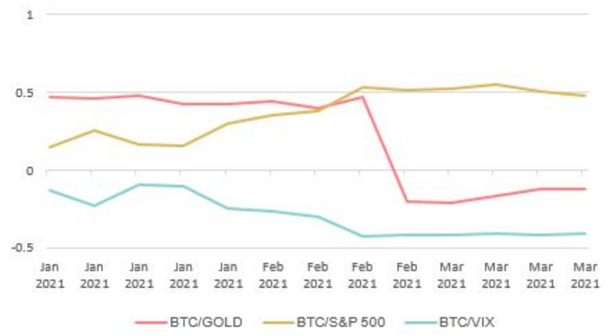
BTC's correlation with gold maintained a moderate positive correlation in the first half of the quarter before swiftly turning negative when Bitcoin recorded one of its most significant drops of Q1. Gold has not been the 'go to' as a safe haven this quarter, or even as a hedge against US10Y spikes, leaving many questioning gold's role. Bitcoin's moderately positive correlation with the S&P500 suggests that Bitcoin inflows have been driven more by speculation than the desire to safeguard from inflation. The market is still determining its take on inflation metrics, and how flows play out at an intermarket level. There is no firm trend on this yet, apart from early signs of value stock and commodity upticks.

Ethereum

The correlation between ETH and gold remained low, shifting between weak positive and weak negative over the course of the quarter. While correlation between ETH and the S&P500 started at a similar level to gold, it increased consistently to a strong positive correlation by late February, like bitcoin, echoing speculative flows. We believe that ETH and BTC correlations will continue to decouple if the inflation narrative really takes hold - BTC as the hedge, ETH as the speculative play that may suffer from short-term downside due to correlations with growth assets.

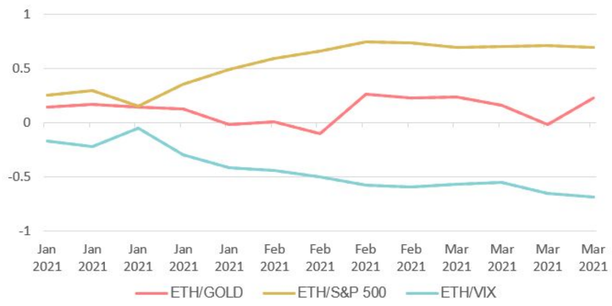
Bitcoin Correlations (12 Weeks Rolling)

Source: TradingView



Ethereum Correlations (12 Weeks Rolling)

Source: TradingView



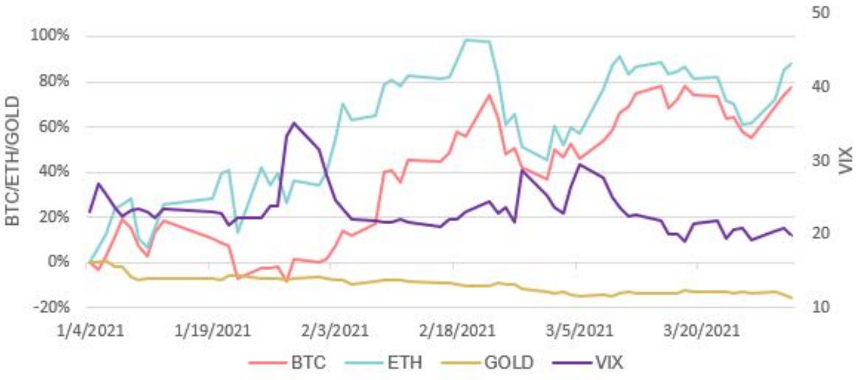
Performance & Volatility

The VIX experienced a muted quarter despite some short-term spikes above the 30 point mark. The S&P had an extremely positive quarter, with the largest retracement only recording a ~5% loss. Positive news guided the US economy and associated markets throughout the quarter, with few events spiking prolonged risk moves. The most significant of which was in late January which saw volatile derivatives markets flair up amidst fiscal stimulus and excessive leverage use in the trading of Gamestop and AMC, largely driven by an amateur investor group crowdsourcing market power. Is this a new market dynamic?

As expected, Bitcoin's relationship with the VIX remained moderately positive, reaffirming Bitcoin's speculative flows and its relationship with equities this quarter. Similarly, ETH's increasingly positive correlation with equities led to a strengthening negative correlation with the VIX.

Gold's performance was less pronounced. Its role during this pandemic is still uncertain – some indicators are pointing to inflation concerns via hedging, others are pointing to outflows. Although the hedging narrative in the investment landscape and broader media is not as powerful as it once was, if we see inflation concerns become mainstream or our grocery prices increasing every week, that is when gold could shine.

Quarterly performance vs risk (volatility)



Data Source: TradingView

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