ZEROCAP

Digital Asset Firm
for Private Clients

Zerocap Q2 2021 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.

CIO note

Many in the traditional sphere saw this quarter as a perfect display of the cryptocurrency market's risks and volatility. However, the significant downside that was endured across May and June has seen a continuous wave of institutional investors entering the space alongside this much needed cooling off period. A deep-dive into the causes of this capitulation paints a positive picture for the long-term growth of the asset class. On the surface level, newsflow appeared to be the dominant driver of bears taking control. A host of negative news circulated with ESG concerns leading the narrative from the likes of Tesla, and regulatory concerns out of China. On a deeper level, asset flows and leverage-costs had flipped positive by late April, indicating that demand was drying up and momentum was stalling. Combined with sustained outperformance from altcoins and memecoins, this provided good insight that money flows were exiting large caps and smart money was retreating to stables or cash. Inexperienced investors were chasing momentum with leverage, a serious indication that a correction was imminent. The subsequent move led to a record breaking deleveraging of the sector - a welcomed move by those with a long-term scaling focus. Bitcoin and ethereum fell into ranges soon after as investors began to reposition and accumulate.

Inflation and the global economic recovery from Covid-19 remained the key focal points across traditional markets over Q2. The Federal Reserve stood firm on its current asset purchasing plan, insisting that inflation is transitory week in week out, despite key metrics causing concern amongst investors.

The US' reopening was briefly threatened over the emergence of the delta variant which played in the minds of investors. As we move into Q3 the vaccine rollout in the US and globally will be a key focus for many. If economic recovery continues to show strength, taper talks are likely to continue and asset purchases may be pulled earlier than previously forecasted. This could increase investor expectations of liquidity limitations in the system and rate implications, threatening moderation in growth assets.

Whilst uncertainty remains a marketwide theme, investors need to assess their risk tolerance and diversify accordingly. The potential for asymmetric returns and diversification benefits remain a value point in the crypto sector, especially to those who allocate responsibly. As the market froth has resided, value in the sector will be placed on projects with fundamental value.

As Q3 and the remainder of the year plays out, keep an eye on any moves by the Federal Reserve and the Covid recovery. The potential for big market swings is still there as market uncertainty remains.

Stay safe out there!

Cryptocurrency market performance

The blow off

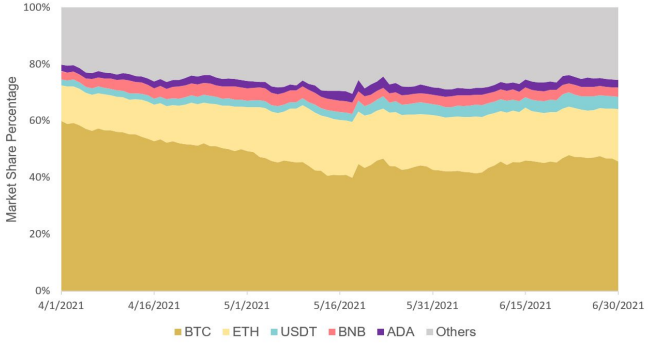
BTC returned **-40.34%** compared to ETH at **15.68%** over Q2. Whilst the quarter started off strong for the entire crypto market, crossing over $2T for the first time, cracks began to surface as institutional adoption and positive news was no longer being met with bullish price action. As the Coinbase (COIN) listing moved closer, smart money began liquidating positions whilst retail funneled into low caps and leveraged positions. On-chain indicators showed signs of a squeeze building, with high open interest and significant transfers onto exchanges (indicating potential selling pressure). When the market stalled out, liquidity began to cascade. The trigger for the move was driven primarily from threats of increased regulation and China's crackdown on digital asset trading and mining ahead of the Chinese Communist Party's (CCP) 100th anniversary celebration. This intervention was further fueled by clarification surrounding their sovereign owned central bank digital currency (CBDC), as well as proposed carbon emissions targets by 2030. The capitulation experienced in mid-May led to an eye watering $1.3T in liquidations, wiping out a huge percentage of long positions.

Bitcoin's market share decreased from **60.19%** to **45.78%** over the quarter as adoption of alternative blockchain networks began to build. ETH's market share grew from **12.14%** to **18.47%** peaking at **20.12%** in early May.

USDT overtook BNB this quarter, hitting a 34.24% market cap. This was fueled by continued institutional interest and repositioning on the May liquidation as investors retreated to stablecoins to protect their portfolios. While the rise of USDC has challenged USDT's reign, the limitation of USDC trading pairs pinned USDT as the predominant beneficiary of the crash, minting in excess of $6 billion in May.

2021 Q2 Cryptocurrency Returns

2021 Q2 Cryptocurrency Market Share



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

Quarterly Asset Performance

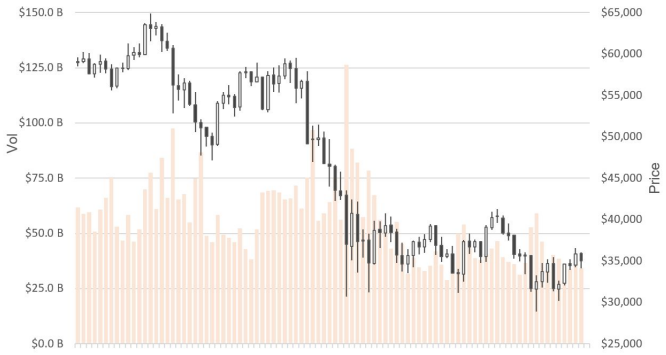
Bitcoin

Bitcoin entered Q2 around the $59,000 mark after nearly a month of consolidation above the $50,000 level. As Coinbase's April 14th IPO neared, price began to rally, supported by adoption news from the likes of Goldman Sachs and Blackrock. The media headlines peaked as the top was marked - stories of Uber drivers telling customers to buy DOGE coin were circulating, and we had truly reached peak hype. Furthermore, the highly anticipated Coinbase IPO rally failed to materialise, and pre-positioned leveraged bitcoin bids saw a stream of liquidations. Tweets from Tesla CEO Elon Musk reinforced the ESG reasoning behind China's crackdown ultimately adding to the capitulation. The two weeks that followed saw a -27.5% sell-off as investors exited their positions. This marked the beginning of negativity in the crypto news cycle as Tesla announced the sale of 10% of their BTC holdings.

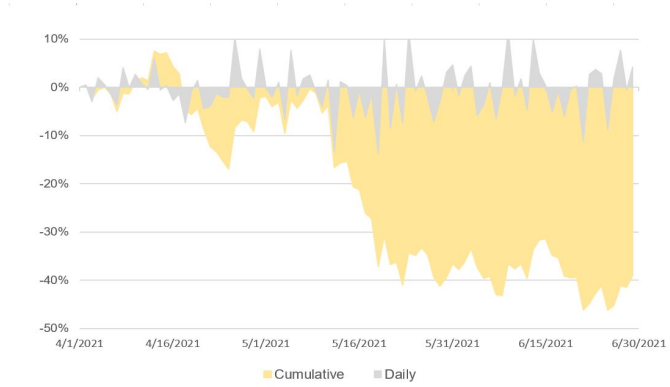
Volatile trading continued throughout the month of May, further reducing overall exposure from new investors and active traders. By June, the asset's consolidation provided little indication of a range breakout despite plenty of newsflow pushing bull and bear narratives. El Salvador's adoption of bitcoin as legal tender provided support for optimism as the cryptocurrency's first significant use case in a sovereign economy. However, the positivity was short lived as China's continued crackdown led to the largest hash rate reduction in the asset's history (>50%).

Overall, the cumulative return for bitcoin over Q2, 2021 was **-40.34%**. The cumulative market cap change was -**$447B**, falling to **$657B** in capitalisation.

BTC Q2 Price & Volume



Market Cap Change



Ethereum

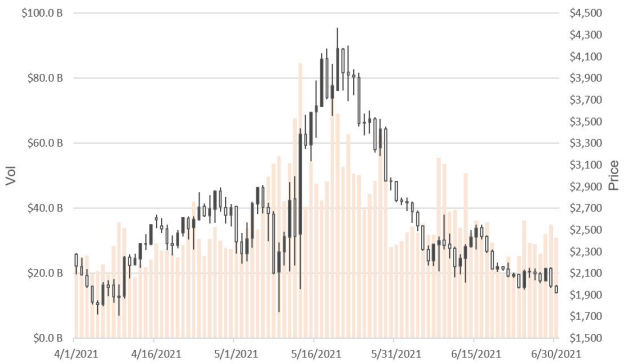
Ethereum continued its stellar performance in Q2, continuing to establish new highs up until mid-May where it recorded its all-time-high (ATH) at $4,380, a 132% gain in six weeks. Key news events over this period were namely the successful Berlin Hardfork, the listing of two ETH ETFs on the Toronto Stock Exchange, and the ecosystem's Q1 report which revealed a 20x transaction volume compared to 2020. Despite the positive newsflow, it is more likely that the rapid asset appreciation was a result of increased institutional adoption of the ecosystem (NFTs + DeFi) as well as capital flows from bitcoin as a result of redistribution and an increasingly popular future investment case for ETH with the London fork supply metrics.

The traditional market rotation "sell in May" weighed on all asset markets and the crypto space was not ignored. ETH faced a sustained drop to $1,700, temporarily bottoming four days after BTC and bringing the altcoin market with it, driving many assets to experience 50-70% drops and ultimately wiping **-$879B** off the altcoin market capitalisation. Following this event, the asset ranged alongside bitcoin for the remainder of the quarter.

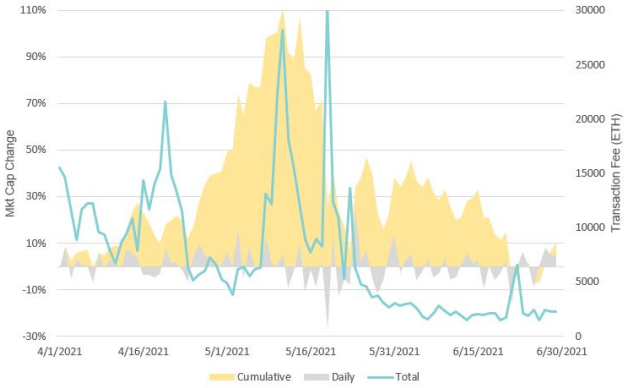
Total value locked in ETH 2.0 rose to **$12.47B**, displaying a significant interest in the development of the network and the yield opportunity that staking ETH offers. Transaction volume remained consistent as ETH tackled new highs but swiftly subsided in June. The quarter had an average transaction fee of 0.0053 ETH ($12) more than half that of the previous quarter. The anticipation of ETH 2.0 also elevated optimism with its moderation of fees.

The cumulative return for ether in Q2 was **15.68%**. The cumulative market cap change was **$37B**, reaching **$265B** in capitalisation.

ETH Q2 Price & Volume



Market Cap Change & Gas Fee



Stablecoins

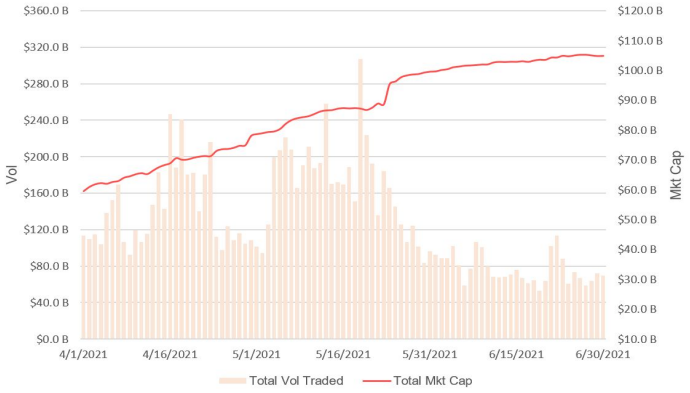
Over the course of April and May PAXG, a gold pegged digital asset, saw price build to its highest level since early January, reaching $1,945. Investors began to move into the safe haven asset as cracks started to show in global economic and Covid-19 recoveries. Renewed inflationary concerns from supply chain disruptions and fading consumer optimism facilitated inflows.

All top stablecoins increased their market capitalisation and daily traded volume significantly throughout the quarter. Both DAI and BUSD continue to show impressive growth, adding around $4.5B each to their market capitalisation. DAI's increase in popularity was primarily driven by its wide use case in yield farming and DeFi liquidity pools while BUSD benefited from the continued adoption of the Binance Smart Chain and Binance's ever growing trade volume. USDT and USDC also witnessed staggering growth over Q2, primarily due to investors exiting existing positions as the market tumbled. As market prices stabilise, it is expected that a large portion of this additional capital will be distributed back into the ecosystem, potentially stemming growth amongst stablecoins for the remainder of the year.

USDT	USDC	BUSD	DAI	TerraUSD
$62.47 B	$25.16 B	$10.06 B	$5.40 B	$1.91 B
(+$42 B)	(+$11 B)	(+$4.7 B)	(+$4.4 B)	(+130 M)
(+198 %)	(+81 %)	(+88 %)	(+445 %)	(+7.3 %)

PAXG Q2 Price & Volume

Top 5 Stablecoins' market cap



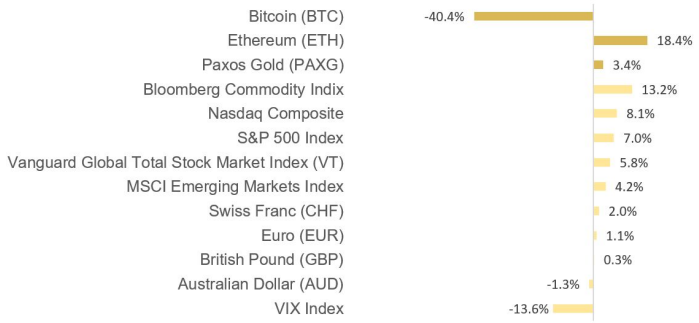
Macro Overview

Broader Financial Markets

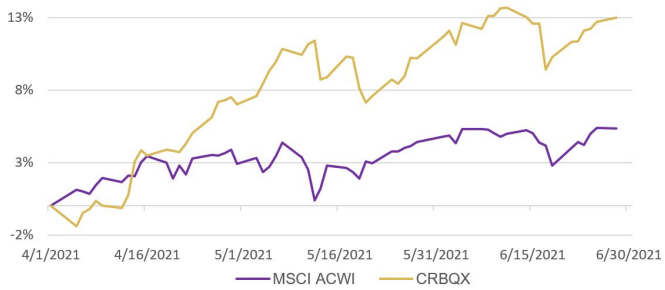
While bitcoin took a hit this quarter, ethereum was still able to outperform major equity market indices, currencies and commodities. Commodities continued to outperform equities, marking the confirmation of a key cyclical shift into inflationary hedges. The covid vaccine rollout and global focus on economic expansion sparked a supply shortage of raw materials for manufacturing and other key sectors. This ultimately fueled inflationary pressures in tandem with consumer demand, marking up prices across the board with a notable rise in the energy sector.

In global equities, growth stock returns exceeded those of their value counterparts primarily driven by the (so far) successful rollout of the covid vaccine and overall signs of a strong economic recovery, particularly in the US. Talks of tapering circulated amongst FED voting members in June briefly halting this trend. However, major indexes such as the S&P 500, NASDAQ and Dow Jones all finished the quarter with newly established ATHs in Q2.

2021 Q2 Multi-Asset Class Performance



MSCI ACWI vs Commodities quarter term cycle



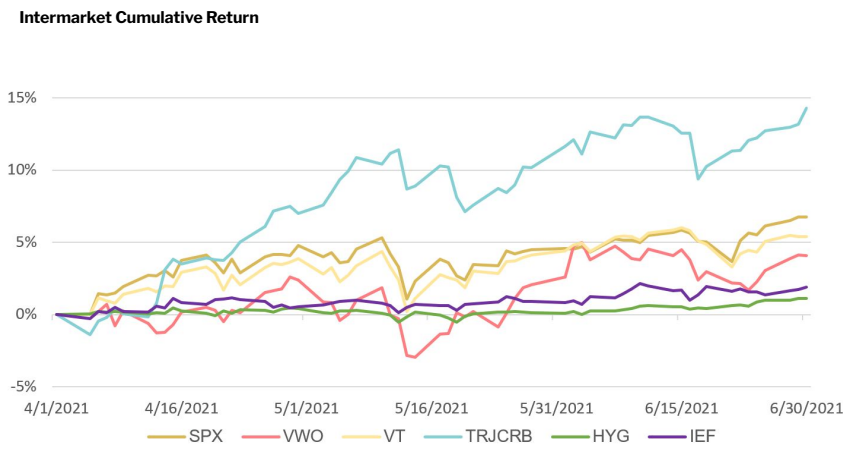
S&P 500 vs Commodities long term cycle

Intermarket Performance

The Covid-19 vaccine rollout among developed nations and positive economic growth (and recovery) from 2020 were the major fundamental drivers in Q2. However, the announcement of the Delta strain mutation combined with elevated inflation concerns dampened sentiment towards the end of the quarter. While governments and central banks both reiterated that inflation is transitory, the Fed's discussion around earlier than expected tapering of asset purchases and shifting guidance on the timeframe to normalise interest rates, suggests that inflation figures should be observed with caution in the medium-term.

The fixed income credit market underperformed rates during the quarter, primarily driven by a lower global risk appetite. The Govie (Government bonds) market was supported by safe haven inflows due to some panic selling in risk assets. Continual intervention by the FED also provided a cap on market bond yields, and will likely continue to do so until hard data confirms a surge of inflationary expectations, or a firm tapering timeframe.

Global equities saw a positive quarter following a better than expected rebound in the growth data count. The US markets outperformed both its European and Asian counterparts due to high vaccine take up and faster normalisation of activities. Emerging markets faced a similar but more severe Covid cases than the EU, as the vaccine rollout remained incredibly limited and the Delta strain ripped through major economies such as India.



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

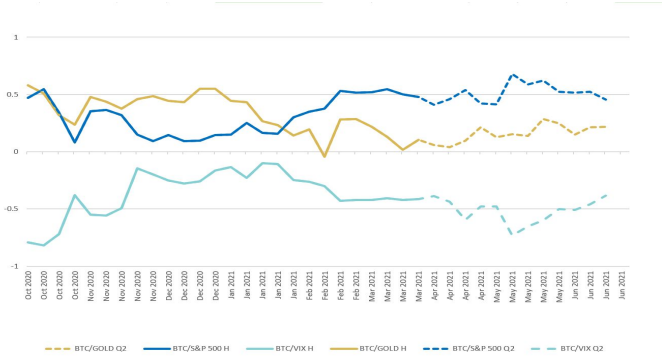
Bitcoin

BTC's correlation with gold dropped to a weak positive correlation in Q2. Gold's positioning as an inflation hedge was in play this quarter, with the asset value peaking in mid-May as a result of inflation and economic recovery concerns. With BTC entering its range at the same time, an uptick in correlation was seen, hinting at a potential resurgence of the BTC inflation hedge narrative. Strong positive correlation with the S&P 500 continued through the first half of Q2 as BTC was impacted by macro newsflow. While the asset has been treated as a growth stock by investors following its decoupling from gold at the beginning of the year, we are seeing a move away from this narrative. This adds further value to the premise that the asset's current accumulation phase will provide a valuable hedge against volatility in equities.

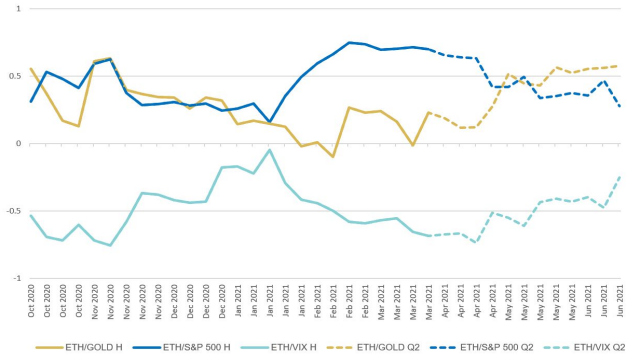
Ethereum

The correlation between ETH and gold strengthened in Q2. While this is largely due to ETH's correlation with BTC, the main driver is likely ETH's stellar performance in early May in lieu of weakness across BTC and equities (an environment in which gold thrives). This is further supported by the asset's declining correlation to the S&P 500 over Q2.

Bitcoin Correlations (12 Weeks Rolling)



Ethereum Correlations (12 Weeks Rolling)



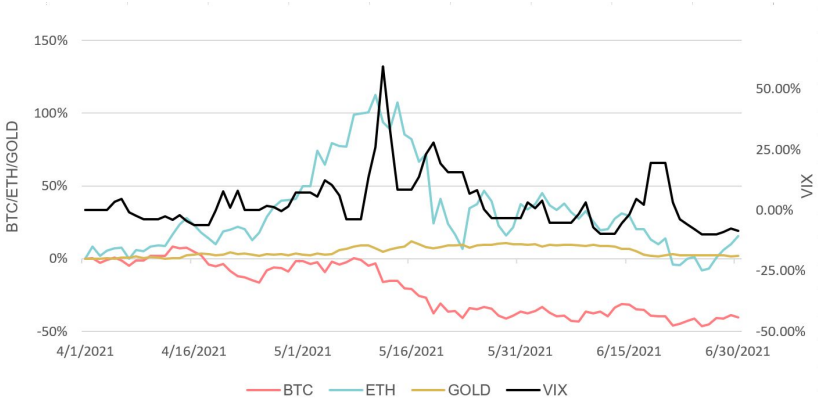
Performance & Volatility

Volatility remained subdued during the second quarter, with the VIX index fluctuating within a tight range between 15 and 20 throughout the period. The proxy measurement, which is sometimes labelled as the “fear” index, reflected a steady S&P 500 growth during Q2. The biggest single period retracement was a 4.24% drop over a three day period (10/5-12/5) and caused a spike in the VIX to 27.6.

Bitcoin’s correlation with the VIX became increasingly inverted over the month of May, as risk aversion took hold across the crypto space. This negative correlation moderated over the three months. In contrast, ETH’s reduced correlation with equities displayed much better diversification from traditional risky asset classes following the mid-May volatility spike.

As anticipated in Zerocap’s Q1 report, gold’s performance as an inflation hedge was heightened during most of Q2, with a clear migration of fund flows into the asset class during both April and May. June saw a slight ease as central bank verbal intervention continued to talk down inflationary expectations. Media discussion surrounding diversification out of gold into Bitcoin as an alternative inflation hedging tool emerged towards the end of Q2, further providing support for the cryptocurrency’s valuation.

Quarterly performance vs risk (volatility)



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