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Easy come, easy go?

An update on the cryptocurrency market slump, May 2021

1. BILANZ Private Banks Private-Banking-Rating 2021

The week of 17 May 2021 brought a dramatic sell-off for most of the cryptocurrencies. Almost no coin or token escaped with losses of less than 30%. What lies behind this severe slump? Does it signify an end to the recent rally? And what does this mean for (potential) investors? We explore all of these questions in the following article.

The recent sell-off of Bitcoin (BTC), Ether (ETH) and the majority of other cryptocurrencies came as a surprise even to investors who are accustomed to major fluctuations. Indeed, the market reaction was so extreme that even large crypto exchanges such as Binance (www.binance.com) and Coinbase (www.coinbase.com) were unable to process client orders at times.

The movement was primarily triggered by two news items that appeared in the week of 17 May 2021:

1. Elon Musk, the founder and largest shareholder of Tesla, announced that the BTC blockchain used far too much energy, and ruled out its use on the grounds of climate and environment protection. This was something of a "back flip", as Elon Musk had announced just a few weeks earlier that BTC could be used as a means of purchase when acquiring one of his vehicles. The volte-face was a seismic development given that Elon Musk is not any old industrial manager, but one with iconic status – and a pioneer in the widespread use of cryptocurrencies.
2. The second key reason cited for the market sell-off was a decree issued by the Chinese government banning financial service providers and banks from commercial involvement with cryptocurrencies. At the end of the week of 17 May 2021, further restrictions were imposed on the trading and mining of cryptocurrencies. According to industry specialists, China is home to the largest and most important mining farms for the major cryptocurrencies. Indeed, one of the world's largest crypto exchanges, Huobi (www.huobi.com), is based in China. The reasons for the hostile stance to cryptocurrencies adopted by the Chinese government include the capital controls still in place to manage the exchange rate of the Chinese yuan, and the urgent drive to develop a state blockchain-based currency. China wants to regain control over the assets of its citizens, and cryptocurrencies represent a way of removing assets from state control.

A number of cryptocurrencies have recovered somewhat in recent days, as the huge fall prompted long-term investors to buy into this market – and in particular BTC – (re) entering the market, or to expand their existing positions.

Can altcoins get back to former highs?
So-called "altcoins" have been relatively harder-hit by this development. This is a term that describes other cryptocurrencies that – like BTC – can be acquired on the open market. At the moment, however, there is no sign of any significant price rise back to previous highs for ETH or other major cryptocurrencies such as Cardano (ADA), Binance Coin (BNB), Polkadot (DOT), Internet Computer (ICP), Dogecoin (DOGE) or XRP (Ripple). We believe this market correction will prove to be an enduring one, which is indicative of a rise in investor caution. It also seems likely to us that speculative investors, many of whom will have had highly leveraged positions in the market, have now retreated to lick their wounds.

Unprecedented market dislocations?
There was actually nothing extraordinary about the drastic market dislocations that unfolded in the week of 17 May 2021. After all, this still young asset class had been on a rally that had lasted for several months. The magnitude of the price correction was in keeping with the comparatively high volatility that continues to characterise the world of cryptocurrencies. In other words, it was only a question of time (and an appropriate trigger) before such a correction occurred.

What is the outlook now?
In the short term it looks likely that the road will remain bumpy, with prices oscillating up and down over the next

few weeks, perhaps even months. In the medium term we believe that the triggers of the recent price slump have highlighted two big challenges for cryptocurrencies:

1. **How can the consumption of energy in the use of cryptocurrencies (and other blockchains!) be rapidly and decisively reduced?** A number of significant initiatives are being implemented in this respect, specifically by the switch from the proof-of-work to the proof-of-stake procedure, which will have the effect of reducing the amount of computing power required (and therefore energy consumption) without jeopardising the security of the blockchain.
2. **What significance will cryptocurrencies retain in the long term once national cryptocurrencies ("CBDCs") are available?** Various projects have been launched in this area in a number of countries (China, Sweden, EU, and Switzerland). What will be crucial here is the way these are designed – in respect of anonymity of payment, but also whether they will be accessible to all or just to banks, and whether central banks will retain rights of intervention.

And this brings us to the long-term outlook. The more widespread and straightforward the use of cryptocurrencies and tokens becomes, the more relevant the project behind them will become. In other words, the specifics of the content will be crucial: What will I receive for this currency? What rights are associated with ownership? What is the goal of the project?

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>
> Milko G. Hensel, Head of Digital Partnerships

Questions of this kind explain, for example, the rapid rise in popularity and price of currencies such as ETH (which among other things facilitates "smart contracts", i.e. the automated processing of contractual conditions) and DOT (which facilitates the connection with and communication between different blockchains). Here we perceive a certain degree of intrinsic value, in marked contrast to a purely speculative concept such as DOGE, which began as a "fun project" and still appears to lack any intrinsic validity.

What does this now mean for (potential) crypto investors?

In our view, the fact that this market has now found a certain floor – albeit a rather fragile one – is a good sign. The recent slump is likely to have removed much of the speculative hot air, even if a number of less experienced investors will no doubt have learned a painful lesson. Well designed, technically sophisticated and market-viable projects and cryptocurrencies will carve out a place in the market. But the route to a mature asset class and a realistic valuation of individual cryptocurrencies will have plenty of highs and lows to come. We will continue to see exaggerations in both directions for the foreseeable future, which means this young asset class will continue to be severely tested.

Maerki Baumann – your reliable partner

We would be delighted to act as your reliable partner in the new world of cryptocurrencies and digital assets. As a regulated bank under Swiss law, we have proven processes and innovative security solutions in place to guarantee that all the relevant legal and regulatory requirements are consistently complied with, even in this relatively new business area. We are in no doubt that digital assets will be a fixed element of any professional investment advisory and asset management service in the future.

Editorial deadline: 27 May 2021

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