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PRIVATBANK

Digital assets – today and tomorrow

Coronavirus crisis 2020: tailwind for digital assets

The new decade certainly kicked off dramatically: In March 2020, the world hurtled into a global lockdown following the rapid proliferation of a new type of coronavirus. Public life was stopped in its tracks, and both economic and social activities were reduced to a minimum. As a result, and most notably on 11 March 2020, the financial markets witnessed a huge sell-off that extended to all asset classes.

In order to prevent prices from falling through the floor, central banks intervened on a wide scale. Led by the US Federal Reserve (Fed), hundreds of billions of financial liquidity firepower was made available in a very short space of time. Only through this intervention action could calm be restored to investors and thus markets. In addition to the magnitude of this liquidity, the speed of reaction was particularly impressive: the Fed alone expanded its balance sheet by a massive three trillion US dollars within the space of just ten months. By way of comparison, following the great recession of 2008, it took more than six years for the Fed to create this amount of liquidity.

All eyes on Bitcoin

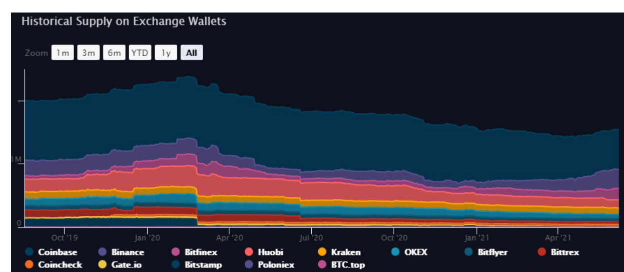
In view of this gargantuan expansion of the money supply, an effective loss in value on conventional fiat currency savings appears unavoidable. The quest for assets that enjoy inherent protection against inflation is increasingly raising investor awareness of the world of digital assets (cryptocurrencies and tokens). For example, Bitcoin has recorded an impressive rise of around 500% since the stock markets hit bottom in March 2020 – and this already includes the sharp setback in May 2021.

Bitcoin's appeal is based above all on the fact that its supply is limited in absolute terms. There will never be more than 21 million Bitcoin units – an irrevocable stipulation of the Bitcoin programme code. Due to this limited supply, Bitcoin can be compared to land, for example: the surface area of our planet works out at roughly 148 million km^2 – and it too is limited in absolute terms. In other words, the more investors migrate to the world of Bitcoin with their traditional assets, the more this "digital land" will appreciate in value.

> «Buy land, they're not making it anymore.»
> Mark Twain

For this reason, investors want to secure their place on the lucrative Bitcoin blockchain sooner rather than later. Moreover, as an increasing number of investors entering this market are likely to be adopting a long-term view, the emerging trend is not difficult to ascertain: Bitcoins bought on crypto exchanges are increasingly removed and presumably transferred to personal wallets, where these assets can be held securely over the long term.

Volume of Bitcoins held on crypto exchanges is at the lowest level for almost two-and-a-half years



Source: www.viewbase.com/coin/bitcoin; 7 June 2021

Hot on the heels of gold

Bitcoin therefore appears to be primarily establishing itself as a long-term means of preserving value. In this respect, Bitcoin is competing above all with gold, which is why this cryptocurrency is also referred to as "digital gold". Champions of Bitcoin argue that it will gobble up an increasing proportion of the market capitalisation of gold in the near future. Indeed, according to CryptoQuant, reaching the mark of 10% of gold's market capitalisation would result in one Bitcoin being valued at over USD 150,000[1]. Other market commentators such as Jeff Currie,

[1] Source: www.cointelegraph.com/news/bitcoin-has-actually-only-taken-2-of-gold-market-cap-new-data-suggests

Head of Commodities research at Goldman Sachs, recently referred to Bitcoin as more of a "risk-on" inflation hedge substitute for copper rather than gold.

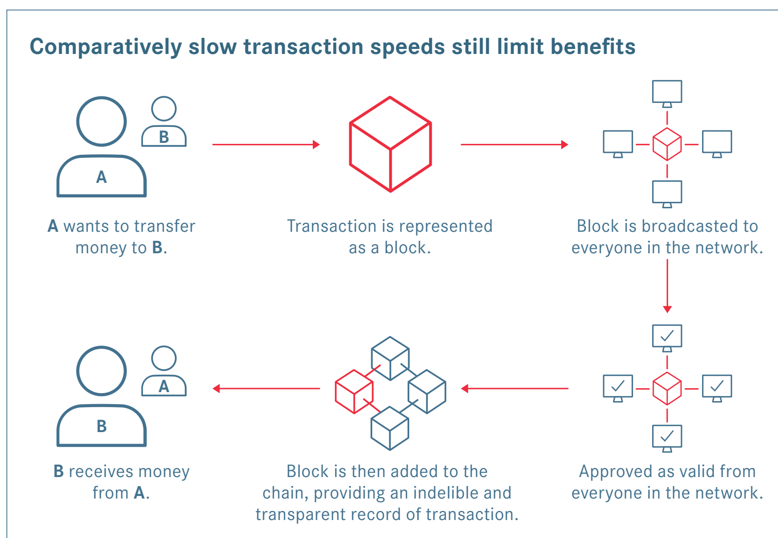
2021 – The year of the institutionalisation of digital assets?
For investors in digital assets, Bitcoin's stunning price rise at the start of 2021 raises the question of how things will play out over the remainder of this investment year. The software strategy firm Microstrategy sparked off a significant trend for Bitcoin only last year: on 11 August 2020, this Nasdaq-listed company acquired 21,454 Bitcoins to add to its existing financial assets for the first time. The company made further purchases over the following months, to the point where Microstrategy was sitting on 70,784 Bitcoins by 1 February 2021.

What some might consider a rather "wacky" strategy has now been copied by numerous other companies. Insurers, technology companies, pension funds, foundations or hedge funds – they all now hold Bitcoins as an alternative reserve asset class. Whereas the stratospheric upward trajectory in 2017 appears to have been driven solely by FOMO ("fear of missing out") on the part of small-scale investors, this time around it is companies and institutional investors who want to leap aboard the Bitcoin train before it's too late. However, institutional investors are still not dominating this asset class. The sharp downturn in May 2021 was partly attributed to a sell-off from overleveraged private investors that was not cushioned by demand from the institutional side.

Exchange-traded Bitcoin funds?
In view of the ongoing institutionalisation and professionalization of the dynamic crypto sector, there appears to be a strong chance of an exchange-traded fund (ETF) with Bitcoin as its underlying receiving market authorisation in 2021. Such a development would make this cryptocurrency readily available to investors on an even broader front. Latest warnings from the US Securities and Exchange Commission (SEC) dampened hopes for a fast authorisation so far!

Meanwhile, the world's leading online payment service PayPal has taken another significant step along the road to the mass acceptance and wide-ranging impact of digital assets: it now offers its customers the possibility of acquiring, holding and reselling a number of cryptocurrencies. What's more, ever since the start of 2021, customers have been able to use their cryptocurrencies to pay for goods acquired from the 26 million retailers who have signed up to the PayPal network. Finally, vouchers to acquire Bitcoin can now be purchased even at kiosks or local supermarkets. This appears to be a further – albeit primarily symbolic – step on the road to establishing this cryptocurrency as an investment staple among the wider population.

A number of challenges will need to be overcome
Despite this growing acceptance and increasing professionalization, there is also a fair backlog of work to be done in the dynamic world of digital assets. The rise in awareness of ESG concerns on energy usage for the Bitcoin network, along with the recent high trading volumes, have resulted in the cryptocurrencies' blockchain networks coming up against their technological "scaling limits". High network fees and relatively long transaction confirmation times are restricting the benefit and therefore the mass-market implementation of use case scenarios in the real world. There are also the nagging problems in the area of "interoperability" – i.e. interaction between different blockchains. Regulatory and fiscal changes to policy add to wider mass adoption challenges.



That said, developers and programmers are working flat out to come up with solutions. The operators of the cryptocurrency Litecoin (LTC) offer a rapid, efficient and cost-effective network. In this way, they are laying the foundations for already familiar use case scenarios and creating the possibility of micro-payments or counterparty-free credit transactions.

Far more comprehensive and complex is the latest upgrade of Ethereum, the blockchain network underpinning the cryptocurrency Ether (ETH). Here developers are seeking to construct a more powerful and even more comprehensive network in the form of Ethereum 2.0 – in keeping with the motto "building the plane as you fly". This mega-update involves a major transformation to the consensus procedure: the preservation and validation of transaction history will no longer be based on the proof-of-work ("PoW") principle as in the case of Bitcoin[2], but on the much more energy-efficient and rapid proof-of-stake

[2] Proof of work ("PoW") typically comprises the solution of a task by the user or his/her computer. The idea behind it is that the user of the service must first complete some relevant work before being able to use the service in question. (Source: Wikipedia)

"With this new legislative basis, Switzerland will have one of the most advanced regulatory frameworks for blockchain technology in the world. Switzerland is thereby consolidating its leading position not just as a location for innovative blockchain companies, but also in respect of the corresponding legislation."

Thomas Jutzi, Professor for Financial Market Law, University of Bern

("PoS") approach[3]. If everything goes to plan, this monumental scaling project should be complete in 2023.

Tokenisation – still a dream?

The scaling of blockchain technology should ultimately help to make the breakthrough for the realisation of numerous use scenarios. One of these would be the tokenisation of real assets. The potential of the tokenisation market is enormous: it is set to rise to around USD 24 trillion by 2027.[4]

Tokenisation is essentially the replication of a previously illiquid asset (e.g. real estate or a work of art) in the form of a so-called "digital twin" on the blockchain, thereby facilitating liquid trading. As the resulting tokens can be broken down into whatever fractions are desired, this process gives investors with limited means access to these otherwise non-bankable assets.

Demand for non-fungible tokens (NFTs) has exploded into the mainstream media with Christie's auctioning a work of art by the digital artist Beeple and achieving a record price for an NFT of USD 69.3 million. Whether this is sustainable in the long term remains to be seen…

Knowledge transfer

Would you like to know more about tokenisation? Read our article "Tokenisation: from material to digital" to gain a straightforward overview of this blockchain opportunity.

Blockchain law for the crypto nation

If investment tokens of this kind (also known as security tokens) are to make the breakthrough, clear legal parameters will have to be put in place. In many countries, these simply do not exist as things stand. Switzerland is more advanced than most here: With considerable assistance from the local crypto industry, the Swiss legislator has drawn up a blockchain bill that puts in place a legal framework covering the blockchain and its use scenarios. The first parts of this have been in force since 1 February 2021, with the remaining provisions expected to take effect on 1 August 2021.

Thanks to so-called "registered securities", legally acquired investment tokens – such as blockchain-based equities or bonds – can now be issued in a regulated way. Similarly, the bill strengthens the proprietary rights of the holders of digital assets, even if the latter are held with the bank. In addition, crypto exchanges that would like to offer investment tokens or digital assets in a regulated way can apply for the corresponding licence from the Swiss Financial Market Supervisory Authority (FINMA).

A look into the future

Public blockchains such as Bitcoin and Ethereum will fundamentally transform the way in which people experience the world of finance. As we have seen, much of the crypto world is still a work in progress. Blockchain networks are currently going through the acceptance phase entailed by the monetisation of their specific blockchain-based tokens and in layer 2 use case in decentralised financing (DeFi). Unsurprisingly, it is the trading and price aspect that dominates the debate today.

It is already becoming apparent how our approach to money can be expected to change. With the right apps, we will be able to send and receive money via blockchain protocols within a matter of seconds in the future – around the clock, seven days a week and 365 days a year.

Money will ultimately become a fluid concept. As well as facilitating micro-payments that allow any content on the internet to be financially supported, this development will also lead to the possibility of "streaming" money. What does that mean? As long as their activity is backed by a proprietary digital wallet, users can – for example – read an article, watch an online film series, or attend a video conference. A lucrative market will open up for producers of all kinds of content.

The anachronistic nature of today's salary payment norms will also be radically changed: As soon as money can be streamed, there is nothing to stand in the way of more flexible salary payments. The era of having to wait patiently to be paid for already completed projects will become a thing of the past. In all places and at all times, people will be able to earn money in real time.

[3] Proof of stake ("PoS") is the term used for a process where a blockchain network achieves consensus as to which participants may work on the next block. This involves a weighted random selection based on duration of participation or deposited assets. (Source: Wikipedia)

[4] Source: www.medium.com/finoa-banking/market-outlook-on-tokenized-assets-a-usd24trn-opportunity-9bac0c4dfefb

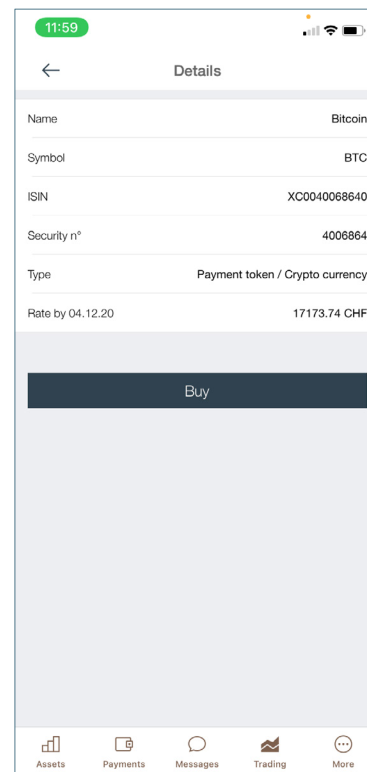
So many currencies...
Talking of earning money: In the future, "money" will require a much broader definition. Just as the process of industrialisation made goods and raw materials available as mass products, so too will money be commercialised. The sheer spectrum of goods supplied will be supplemented by an equally large number of issuers making money available in the form of stablecoins, platform tokens, digital central bank currencies or digital loyalty points.

Thus, an inconceivably large number of things will at some point exist as digital tokens on a public blockchain, with the ability to function as "monetary means" in some form or other. It will even be possible to tokenise the performance of an individual; examples of this already exist in top-level sport.

Convenience in high demand
Given these fundamental changes associated with digital assets and their underlying blockchains, it seems only reasonable to ask the following question: Will we all have to become programmers in order to be part of this new world? Certainly not! Even if the dynamic world of digital assets still appears somewhat cryptic to many people as things stand, a lot of work is going on behind the scenes to make it accessible to the broadest possible audience. Let us not forget that back in the 1990s – a time of cumbersome user interfaces and significant entry barriers – hardly anyone could foresee the day when surfing the internet would become child's play.

The evolution of the world of digital assets is likely to follow an identical pattern. Just as browsers made the internet accessible to all, so too are digital wallets opening the door to the big wide world of blockchain. The point is that wallets are not just digital repositories; they are also user interfaces and a key service element for various blockchain applications. They have gradually become more user-friendly in recent years – and will inevitably evolve further. It will be exciting to follow how things develop from here.

With Maerki Baumann's mobile banking app, you can issue stock market orders in both fiat currencies and cryptocurrencies with just a few clicks.



Digital assets – everything from a one-stop shop

If you have any questions or are interested in our crypto services, your Maerki Baumann client advisor will be happy to assist. In addition, our specialists are there to support you individually with their long-standing expertise if you have any questions on digital assets. It is important to us that you gain the best possible insight into this innovative asset class – so that you can then make your own investment decisions with assurance and in-depth knowledge.

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