Market Commentary - February 2023

Synopsis

Global asset markets are a complex adaptive system that is constantly evolving as they process multiple sources of information. This compounds in convolution and our investment process has to reflect this complexity and be adaptive in performing investment analysis via “Mosaic Theory” as we develop our investment views.

In analysing the difficult year that was 2022 we believe that all the abysmal challenges faced by both the global financial markets and cryptocurrency and digital assets (“crypto assets”) markets will lead to the crypto assets market being made stronger in many ways. We agree with the view put forth in Fidelity’s 2023 Look Ahead Report: *“Like a biological system that learns from and forms a response to an attack, adversity in the digital asset ecosystem has the potential to create a more resilient, or “anti-fragile,” industry.”*

Update on Regulations: Emerging vs Developed Markets

Regulation has become a more pertinent issue in the crypto asset space and many countries are no longer looking to the USA for leadership. Instead, they are moving to both protect and stabilise their domestic financial markets, and also to grow and embrace innovation in the fintech sector, particularly in regard to crypto assets. The balance of power is shifting, and we believe Europe and Asia represent the next frontier of growth and adoption by institutions as these countries look to adopt and implement crypto asset regulations in the vacuum left by a withdrawing USA.

This is further evidenced by key Emerging Market (EM) countries such as Brazil, Russia, India, China and others such as Indonesia, El Salvador, Vietnam and the Philippines driving innovation and adoption in crypto assets. They embody an entrepreneurial hunger and drive to disrupt incumbents. This combined with their relatively youthful populations high propensity to save will further ensure their respective governments embrace positive regulatory stances towards crypto assets.

The direct economic impact of the conflict in Ukraine for Russia was their ejection from the international SWIFT payment system. Major international credit card networks and banks exited Russia summarily when the war began. However, because Russia built a state-owned domestic debit network after the 2014 annexation of Crimea, the country's payment systems were able to continue to function and trade, particularly with China and India.

The has resulted in many EM's countries reassessing their use of the USD as the default global currency as the USA's foreign policy becomes increasingly hostile to any regime that attempts to diversify away from the USD and/or pivot towards the East.

Likewise, Brazil has earnestly begun to deregulate industries like payments, opening up merchant acquiring and payment processing services for local competition to reduce dependence on the major global payment processors. This intervention in favour of disruptors has significantly reduced pricing, improved customer service, and increased the pace of product innovation via crypto asset based solutions.

Aligning with other EM's, India has allowed increased investment in industries like insurance from 25% to 75%, facilitating an increase of global capital flows into the industry and spurring innovation via FDI.

Indonesia is also favouring accommodative policy but is earlier in the process. Indonesia's Financial Services Authority (known as OJK) has put together a Digital Finance Innovation Roadmap to help balance innovation and consumer protection.

A recent Bloombergs article surprisingly stated that the *"Chinese Government Approves of Hong Kong's Crypto Plans"*. Hong Kong is therefore once again gearing up to become a crypto hub as the Chinese government is giving subtle hints of approval towards the plan. Unexpectedly, a Hong Kong regulatory body outlined conditions under which retail investors would be allowed to purchase cryptocurrencies.

This is really positive as it opens up the largest EM's in the world to the potential of participating in the crypto asset space with a more clear and concise regulatory framework.

Conclusion
Given the challenges of 2022, particularly the fraud committed by the management and shareholders of FTX, we have seen increased calls for regulation, particularly of centralised exchanges.

We must remember that pruning is painful, but a necessary process for future healthy growth. Indeed, a bittersweet benefit of a bear market and the commensurate lack of funding and liquidity is that unsustainable business models are abandoned, and it also will result in regulatory clarity, and improve methods of identifying and addressing bad actors. This is all very positive for institutional investors participation in the longer term.

We expect progress across several dimensions of regulation, especially with regards to tokens and their clear definition as securities. Other areas requiring regulatory focus and clarity include stablecoins, custody, and intellectual property.

Importantly, the rapidly shifting global geopolitical landscape as the USA continues its decline and loses military and economic dominance will have an impact on crypto assets adoption and regulation. Citizens in many Emerging Markets do not have access to well-functioning financial markets, and no longer trust the USD.

Therefore, decentralised ledge technology via crypto assets could present significant opportunities to their current systems. There is also a growing possibility that crypto facilitates a much-demanded move away from a USD-dominated financial system as the East continues to rise.

Amid crypto's recent volatility and negative headlines, it has been easy to lose sight of how some decentralised finance mechanisms fared quite well and demonstrated how the use of transparent blockchains in finance can improve the resiliency of a system. We see many potential ways in which crypto innovation can be a solution to regulatory challenges. Critically, there is a wide range of outcomes for crypto regulation and adoption around the world. Striking the right balance between privacy and regulatory oversight is of paramount importance, particularly for users under oppressive political regimes in both EM's and DM's.

Please feel free to contact me should you have any enquiries.

Contact: E: mark.witten@firstdegree.asia W: www.portal.am

Disclaimer:

This document does not constitute an offer of Participating Shares in the Fund. The offer of Participating Shares is made solely pursuant to the Offering Memorandum for the Fund dated 10 February 2020 (the "Offering Memorandum"), and an application for subscription for Participating Shares may only be made by completing and returning the subscription agreement issued by the Fund (the "Subscription Agreement"). Copies of the Offering Memorandum and the Subscription Agreement may be obtained from First Degree Global Asset Management Pte. Ltd., the Investment Manager of the Fund.

Notice to Investors in Switzerland: This is an advertising document.

The Confidential Offering Memorandum, the Articles of Association as well as the annual reports of the Fund may be obtained free of charge from the Swiss Representative. In respect of the Shares distributed in Switzerland to Qualified Investors, place of performance and jurisdiction is at the registered office of the Representative.

- *Swiss Representative: FIRST INDEPENDENT FUND SERVICES LTD, Klausstrasse 33, CH-8008 Zurich.*
- *Swiss Paying Agent: NPB Neue Privat Bank Ltd, Limmatquai 1/am Bellevue, P.O. Box, CH-8024 Zurich.*