Portal Market Commentary - May 2023

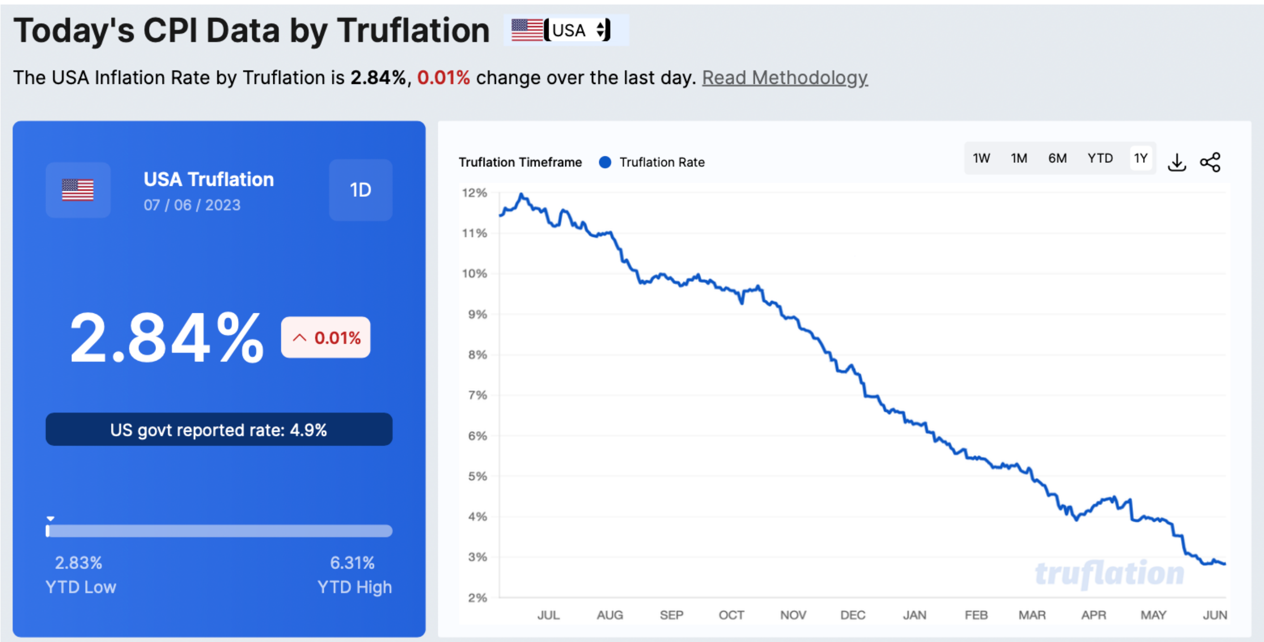
Market Update

May was a largely uneventful month, which was a welcome relief after the spike in volatility in April. Bitcoin has remained range-bound between $27k and $30k. One of the main drivers of this flatlining of volatility is that liquidity has fallen as both volumes and retail flows have slowed since February. The Portal Digital Fund finished May down -3.8% net of fees vs the market as represented by the CCI30 Index down -6% and Bitcoin down -7% respectively.

Market Developments

As we rapidly approach the middle of 2023 we revisit our global macroeconomic analysis, particularly the main drivers of liquidity and risk appetite - inflation and interest rate expectations. The macro-outlook will always dominate the micro-environment as global markets adjust for changes in the future expected price of money – interest rates, and commensurately the appetite for risk in the form of credit extension.

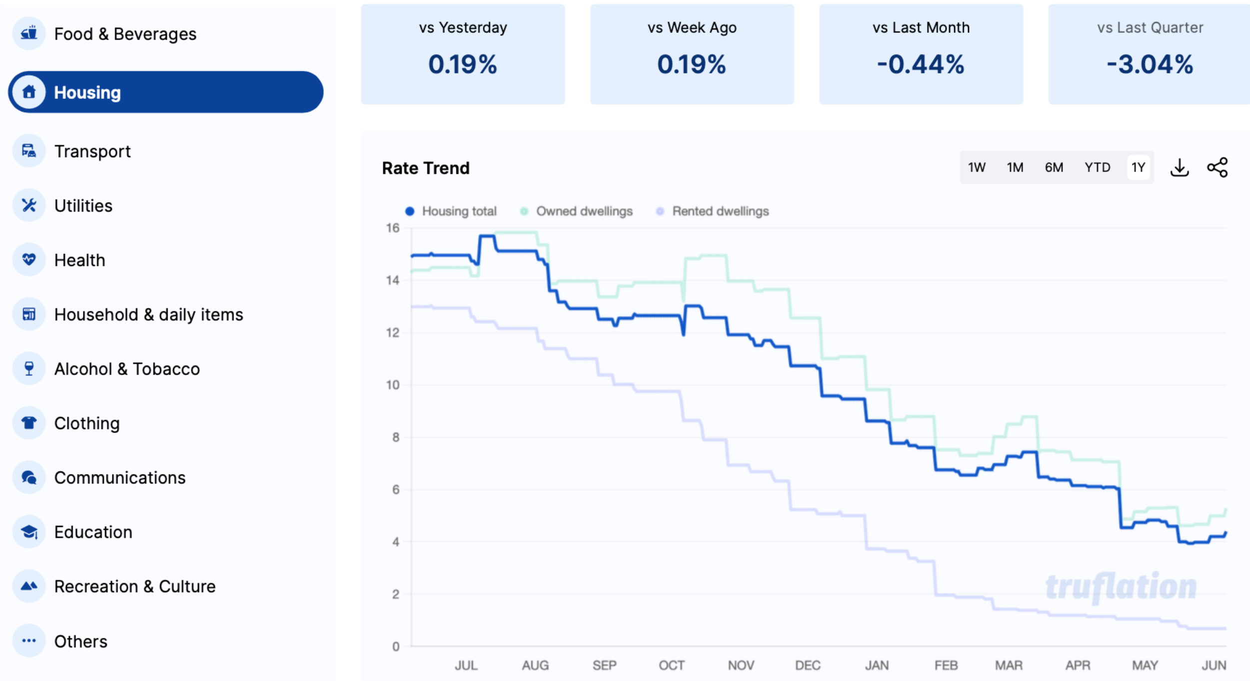
Inflation is … Falling… Falling… Gone!



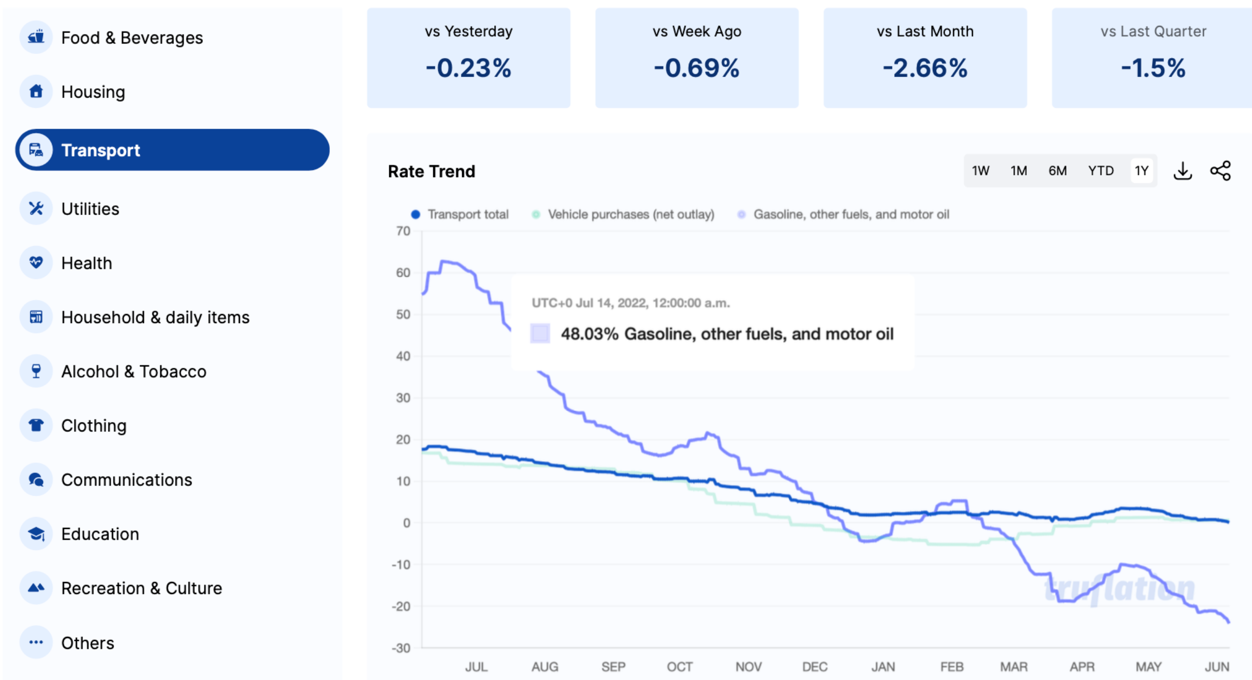
As per the chart above, CPI as measured by [Truflation] (a much more accurate and reliable measure of inflation vs government agencies analysing over 1 million data points) has been falling consistently since peaking at almost 12% in June 2022.

Examining the three largest contributors of overall CPI accounting for 58% – Housing, Transport and Food & Beverages which make up 23%, 20% and 15% respectively of the CPI basket, we can see each sector has been falling consistently since July 2022.

Housing (Owned and Rented Dwellings)



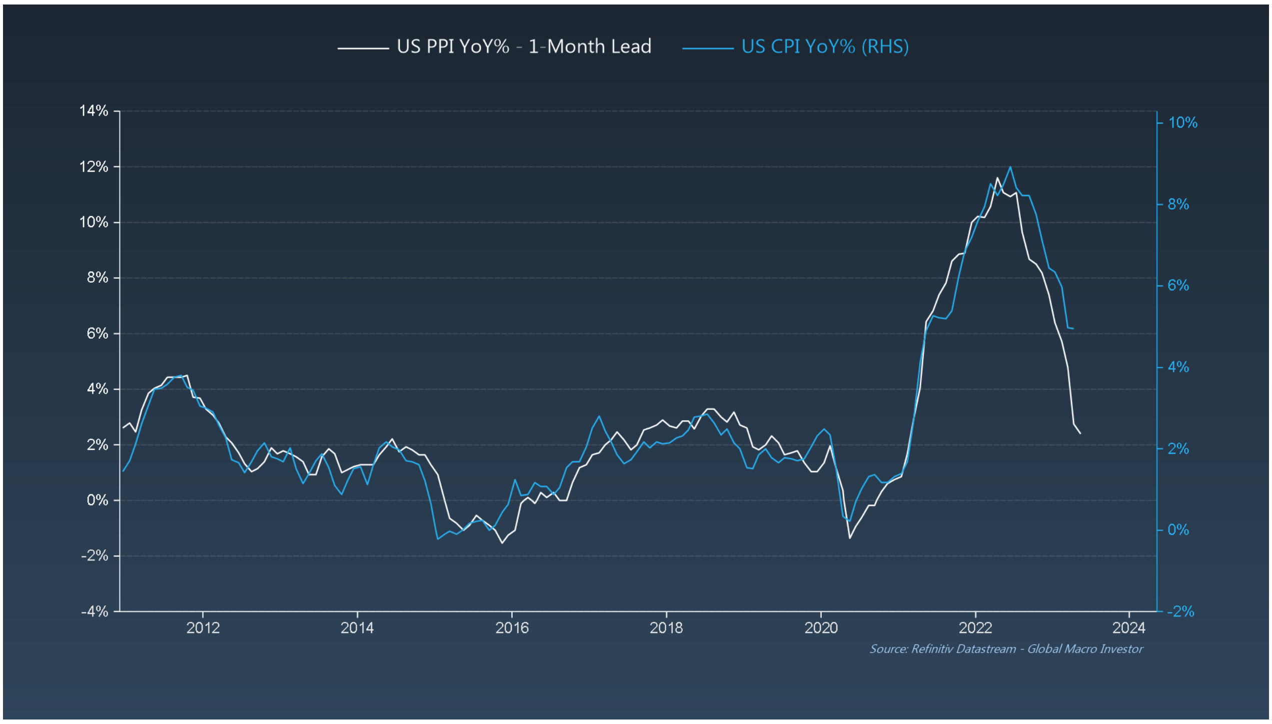
Transport (Including Oil and Fuel)



Food and Beverage

Examining further charts from the Global Macro Investor (GMI) we can see that inflation is falling rapidly in the USA as evidenced by the collapse in the leading PPI YoY% change from +9% in 2022 to the current +2%. This indicates that CPI should track below 3% in H2 2023

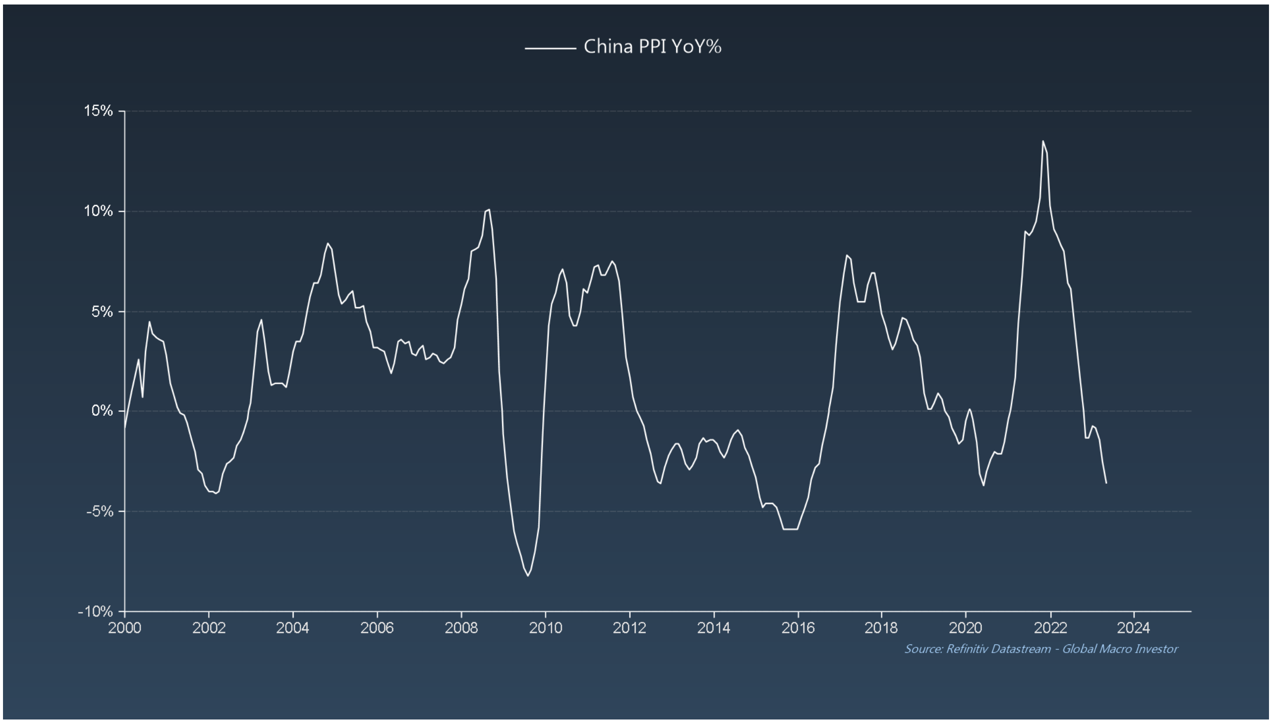
US PPI vs CPI



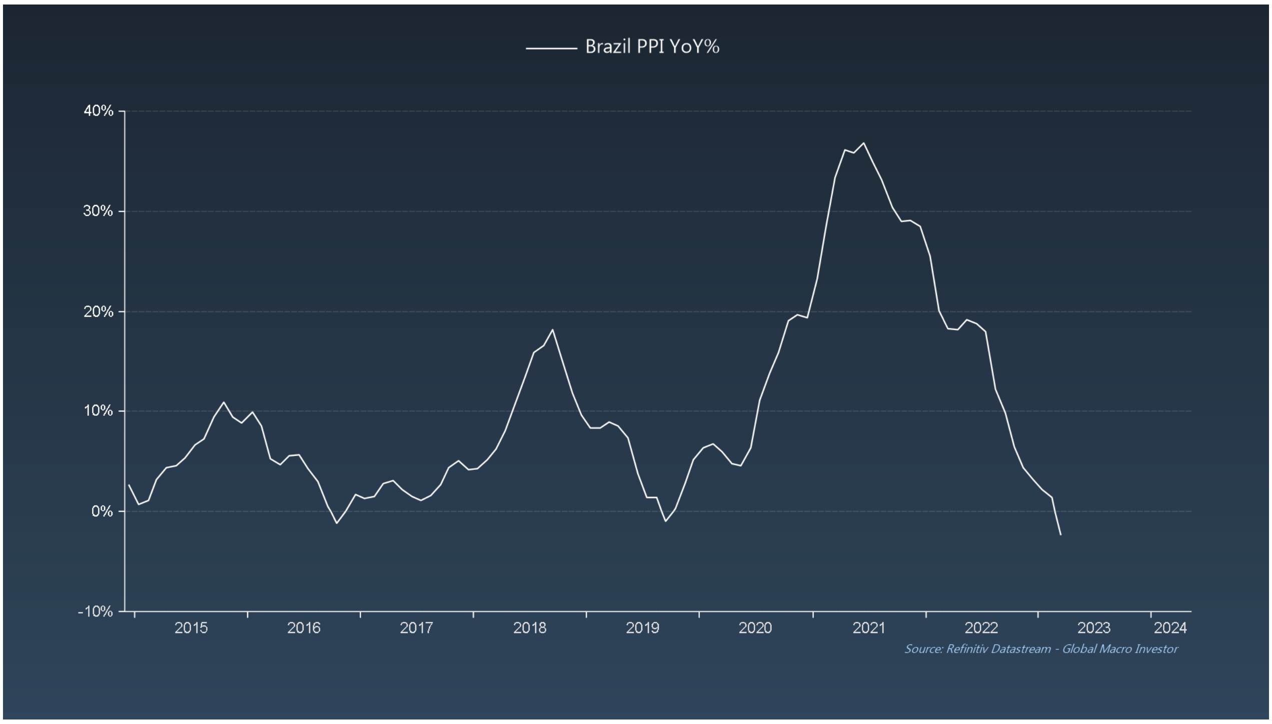
Commodities have also retracted sharply and the powerhouses of the BRICS nations, China and Brazil, have entered deflationary territory.

More importantly, according to Raoul Pal of GMI: “… *due to the base effect, extreme inflation cycles are almost always reflexive (symmetrical in rise and fall) ...elevator-up = elevator-down*”.

China PPI – Deflation



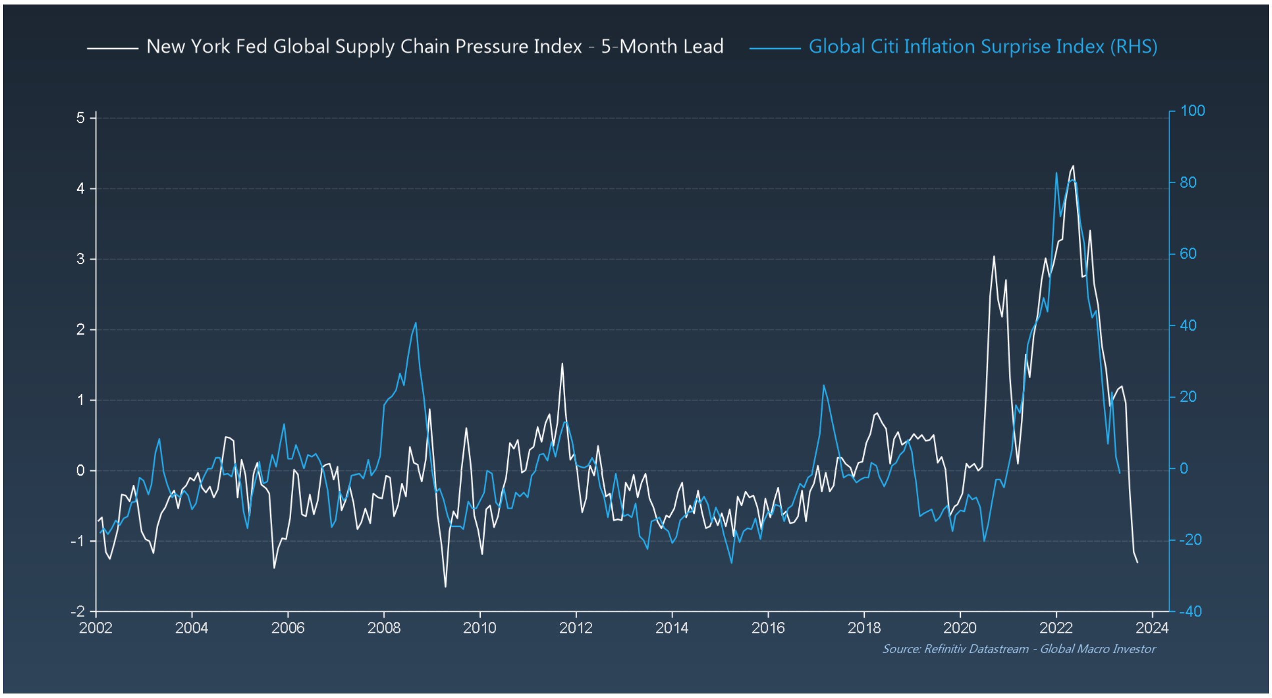
Brazil PPI - Deflation



Given that China and Brazil listed above tend to be leading in the inflation cycle due to their commodity-linked economies we expect that global PPI is currently already foreshadowing a US CPI closer to 1%, leaving plenty of room for the FED and investors to lower inflation and interest rate expectations.

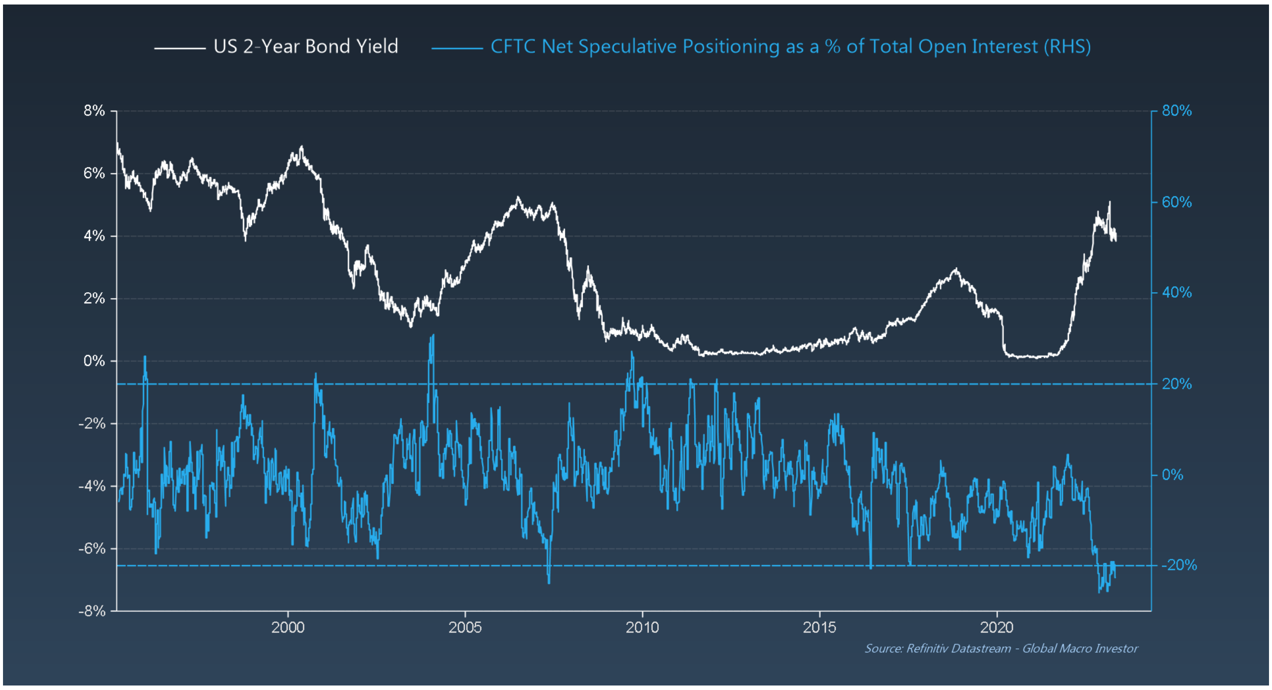
In addition, what's important to understand is that due to the now almost complete normalisation of supply chains, the negative inflation surprise cycle has only just begun as the second order effects of this efficiency begins flowing into PPI and CPI.

New York Fed Global Supply Chain Pressure Index vs. Global CISI



Macro-Economic Conclusion

Inflation is falling much more rapidly than expected across the board, and on the back of this we expect interest rates to also fall more rapidly in line with this. Surprisingly, the market is ignoring this as per the chart below we can see that positioning in 2-year USTs is the shortest since May 2007, although it should be quite obvious that rates are going to fall at least 250bps in the next 12 months.



The (Shrinking) Elephant in the Room - US Regulatory Inaction

The Securities Exchange Commission's attempts to enforce outdated regulations on the cryptocurrency industry lack clear or relevant guidelines. The Commodity Futures Trading Commission (CFTC) has already determined that 7 out of the top 15 digital currencies representing 76% of the total digital market capitalisation are commodities and do not fall within the remit of the SEC. This inconsistency highlights the need for clear and updated regulations in the crypto space.

In contrast, countries such as Europe, Switzerland, the UK, Singapore, and Hong Kong have taken steps to implement regulations that enable crypto assets to operate within their jurisdictions. This global trend further emphasizes the importance of establishing comprehensive regulatory frameworks for cryptocurrencies.

The recent legal actions by the SEC against platforms like Binance and Coinbase have raised concerns which have not been addressed by the SEC in any constructive way. While the SEC accuses specific tokens of being unregistered securities, they have not pursued the issuers themselves. This approach lacks a thorough legal determination and has potentially disrupt the market without due process.

As a result, the crypto industry is looking to the U.S. Congress for new regulations tailored to digital assets. House Republicans have proposed a draft bill that aims to craft effective regulation and address concerns about Chair Gensler's approach hoping to provide regulatory clarity and stop the USA from falling behind in this significant new technology and asset class.

The Investment Case for Crypto

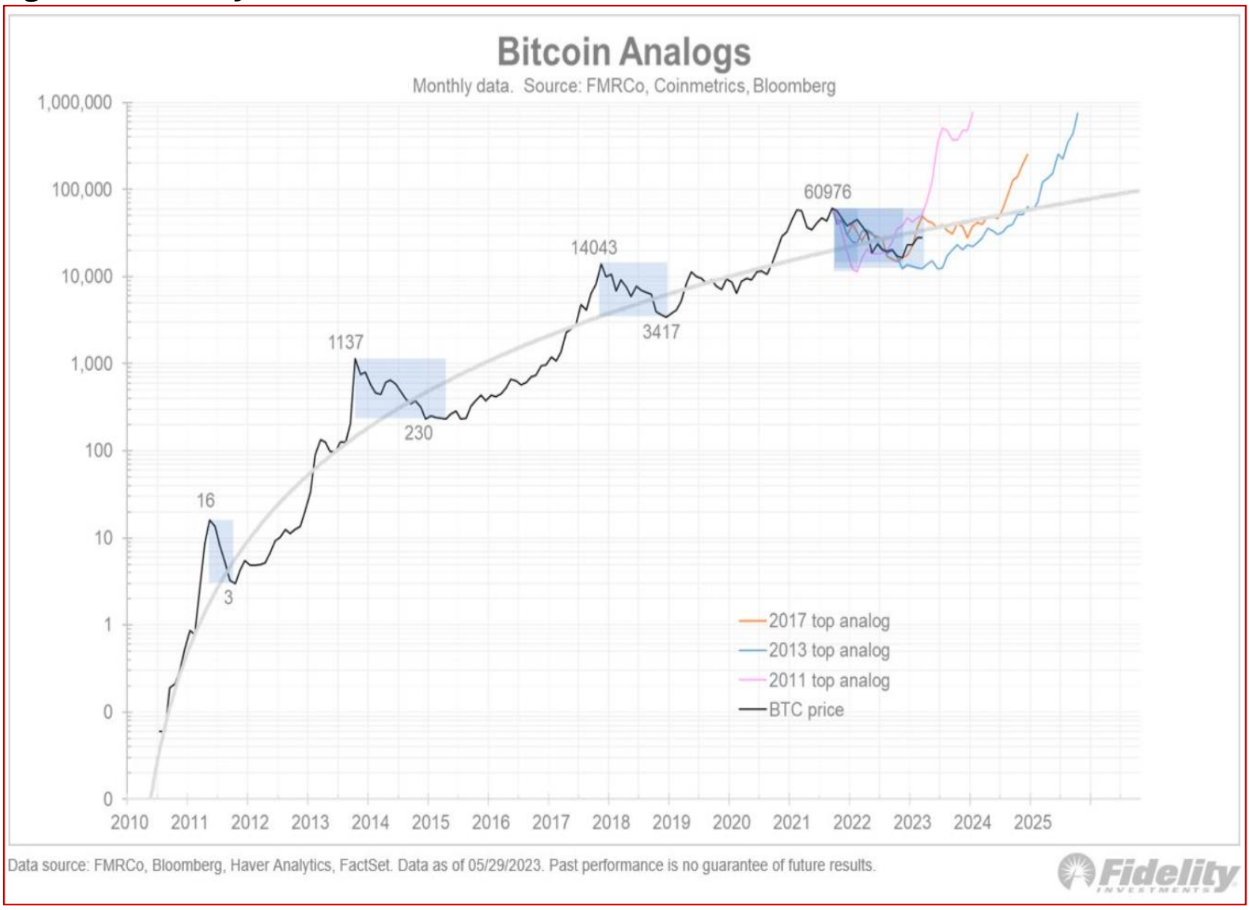
We believe we are at the tipping point of a very rapid surge in adoption of Crypto Assets, and this is underpinned by the actual growth in both institutions and government as detailed in past newsletters, combined with the private sector seeking independent alternatives for everything from money transfers to loans being enabled by DeFi alternatives and the further potential provided in Web3.0.

Impact of a Crypto Allocation on Diversified Investment Portfolios

The crypto market is effectively long-term "VC-like" investing with real-time, public market pricing and liquidity. The biggest positive in allocating to the market is the ability to own liquid assets that can generate returns far superior to those in other markets. The obvious negative is the potential to lose all of one's investment.

The risk of total loss can be mitigated by allocating across various digital asset sectors by use case and time horizons and by limiting one's allocation to the digital asset class to 2-5% of a portfolio. This small allocation to the crypto market that rises by 10x or 20x in the next bull market would likely be a meaningful wealth creator.

Figure 2: Bitcoin Cycles: Good Time to Allocate?



Source: Jurrien Timmer, Fidelity Investments

As per Postmodern's latest market commentary: *"As the technology is being developed, the biggest driver of crypto market pricing is rising or falling speculation, which has come in the past from Western hedge funds and Asian retail investors. This makes the market highly reflexive (up begets up and down begets down)."*

Lower overnight interest rates to battle recession fears, for example, would make it easier for hedge funds to borrow and allocate to volatile, non-income producing assets like crypto."

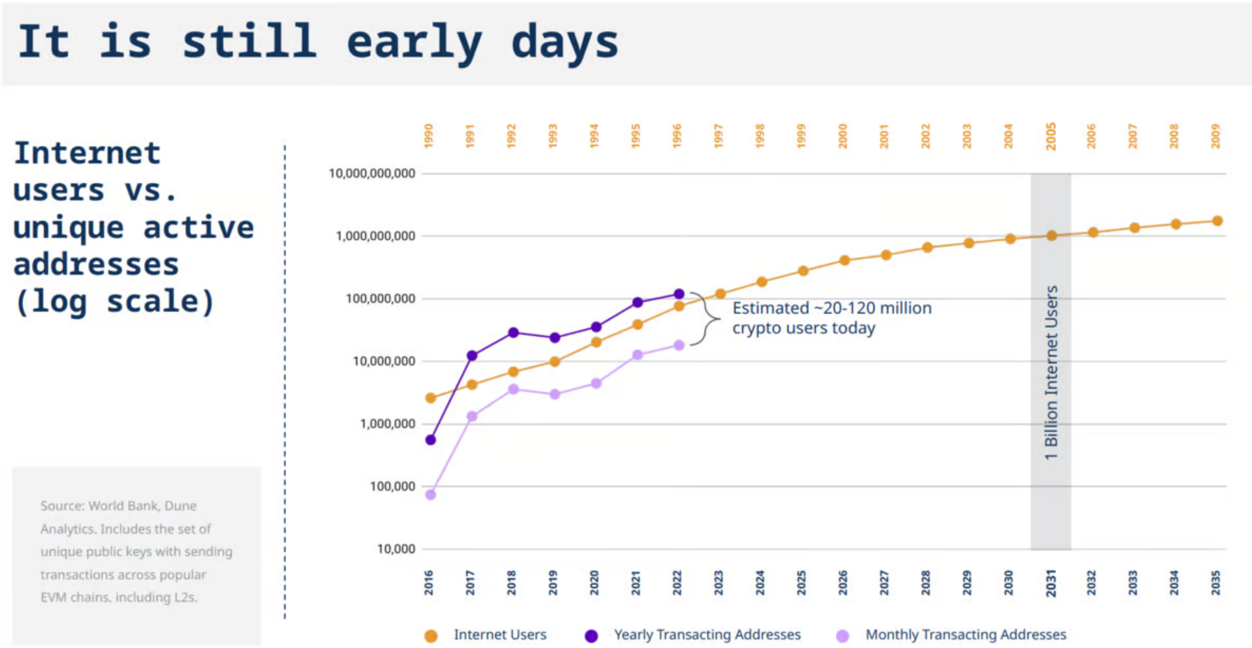
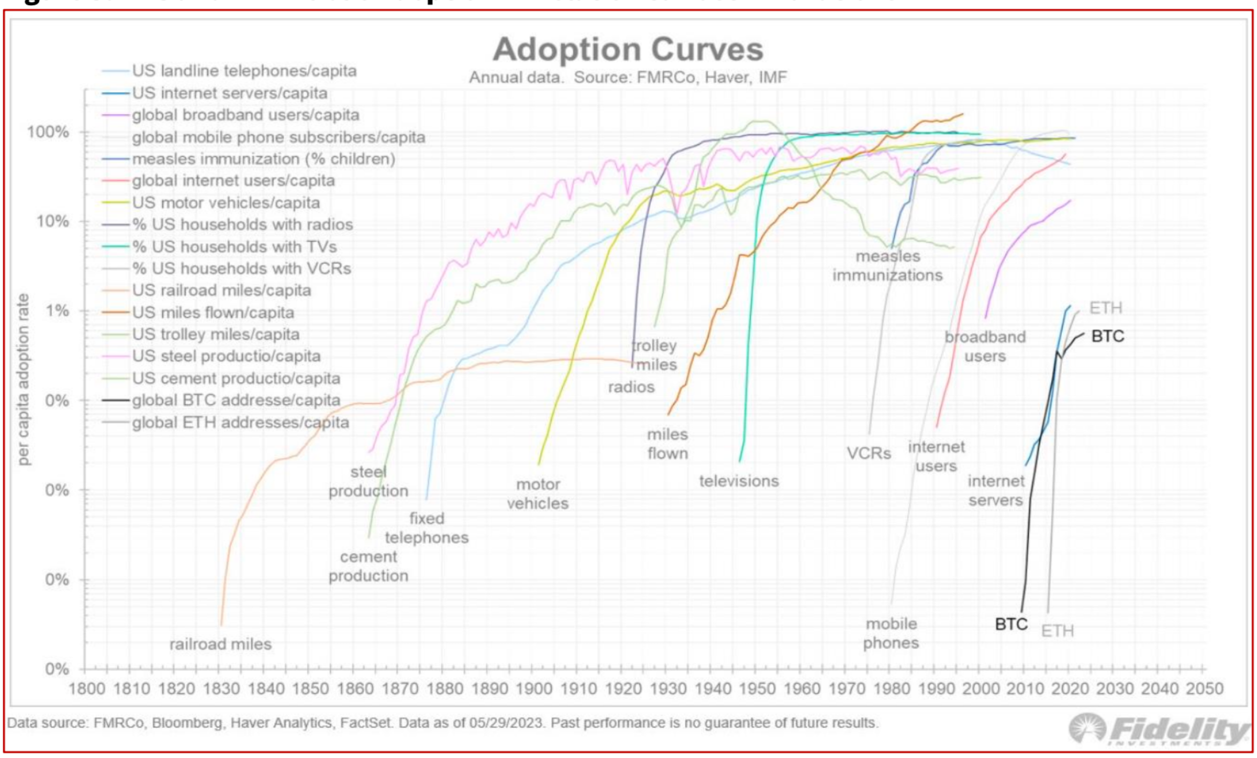


Figure 3: BTC and ETH Public Adoption in Relation to Past Innovations



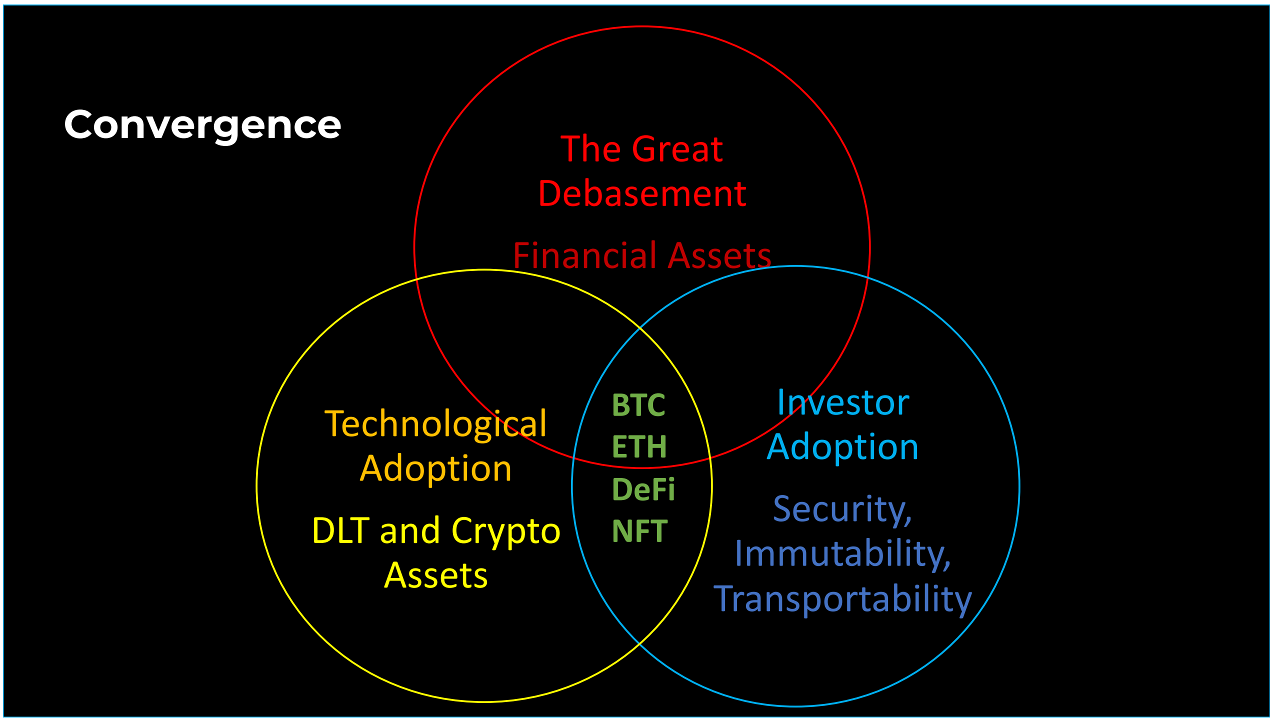
Source: Jurrien Timmer, Fidelity Investments

Another potential benefit of a crypto market allocation is that it can be a significant portfolio diversifier. As it has in the past, the crypto market may have extended periods in the future in which returns are uncorrelated or inversely correlated to equity and bond markets.

Crypto assets are well worth an allocation, especially given their significant upside potential in the form of a perpetual call option on the technology and asset class which we discussed in our last market commentary.

Conclusion

We reaffirm that the three trends we identified and discussed in 2022 as per the graphic below continue to gather pace and will result in continued adoption and growth in the crypto asset space.



We continue to believe that this is the greatest opportunity for wealth creation and democratisation of access to capital and participation in the global economy and that this will give rise to the next unicorns, regardless of governments attempts to stifle it.

From a regulatory perspective, the safest way for allocating in a compliant and efficient manner to the public crypto market is through a dedicated, regulated, financial service license-compliant cryptocurrency and digital asset focused fund with independent administrators and a fully audited track record that accepts suitable investors only.

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

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