Blockchain Assets
CRYPTOASSET MANAGERS • EST 2017

Me to ChatGPT - 'Create an image based on the text in this newsletter. 10 seconds later…ChatGPT - 'The above image includes elements of digital currencies, traditional financial symbols, and regulatory symbols, aiming to illustrate the integration of digital and traditional finance within a structured regulatory environment.'

Dear Investors,

On 16 October 2023 the Australian Department of Treasury issued a consultation paper titled 'Regulating Digital Asset Platforms'. A copy of our submission will be available on the Treasury website in due course.

The consultation paper sets out a proposal to create a new financial product called a '**Digital Asset Facility**'. The proposals, if adopted, will bring opportunity for existing and new financial services companies. In this newsletter I sketch out some of those opportunities and how interested parties (including Blockchain Assets Pty Ltd) may position themselves for the changes ahead.

But first the cryptomarkets and other news…

The unit price finished at AUD 3.6139 up 39% for the quarter and up 104% for the year. We are still below our all-time-high for the Fund of AUD 7.24 but I feel confident that we will exceed that level in 2024.

I have never before experienced a price build-up like the one we are seeing for bitcoin at the moment. We have three things driving the momentum.

Firstly, many of the world's largest fund managers, including Blackrock, Fidelity, VanEck, Arc, Wisdom Tree and Franklin Templeton are expecting approval of their applications for a spot bitcoin ETF within the first few weeks of January. These approvals will open the door to over USD 30 trillion of advisor wealth for bitcoin. We do not believe this is factored into the current price. Indeed we feel many traditionally focused investors are unaware of or under-appreciate the significance of this moment in bitcoin's history. I encourage investors to listen to this video which breaks down the status and impacts of ETF approvals.

Secondly, in April there will be a reduction in issuance of new bitcoin. Currently running at 6.25 bitcoins every 10 minutes, this gets reduced to 3.125/10 mins (the so-called halvening). These events happen every four years and thus far have resulted in an up-tick in the price of bitcoin as supply is curtailed in the face of steady and increasing demand.

Thirdly, the Financial Accounting Standards Board (FASB) have changed the accounting standards to allow for mark-to-market accounting of bitcoin and cryptoassets. This removes a significant accounting barrier for public companies who wish to hold bitcoin on their balance sheet. Microstrategy, the first public company to do so holds circa USD 4 billion in bitcoin. Other public companies will follow.

We have read several reports from the likes of Fidelity, ARC Investments, VanEck and Galaxy Digital about what they expect to see happen to the bitcoin price if the ETF applications are approved. All the reports are bullish in price of course, but we have little precedent to consider what happens when significant pent up demand for bitcoin hits its limited supply. Predictions of bitcoin over USD 100k by the end of 2024 are credible and are within our own expectation.

The election of Javier Milei to the Presidency of Argentina is an interesting event in the context of bitcoin. Prior to politics, Milei was a professor of macroeconomics and mathematics for economists. He specialised in economic growth and has written more than 50 academic papers. He is a libertarian, an Austrian economist and fan of bitcoin. His electioneering gimmicks, such as using a chainsaw during a political rally as a prop to indicate what he would do to the political ministries got him elected, we will have to wait and see what he does next to turn around Argentina's runaway inflation (142.5%), crumbling economy and repay their USD 31 billion debt to the IMF. We think Argentina will be the next country in Latin America to make bitcoin legal tender. The tweet below between Elon Musk and Javier is interesting, this obviously is how Presidents and billionaires now arrange meet-ups.

The price of ether is lagging behind bitcoin and in our view will continue to do as institutional money is focussing on bitcoin. However, this is short term. There is a non-zero chance of spot Ether ETF's in the US also getting approved also in 2024. Our investment thesis of 'the flippening' (Ether becoming more valuable than bitcoin) is still something we believe will happen, but the flippening is not likely to happen in 2024.

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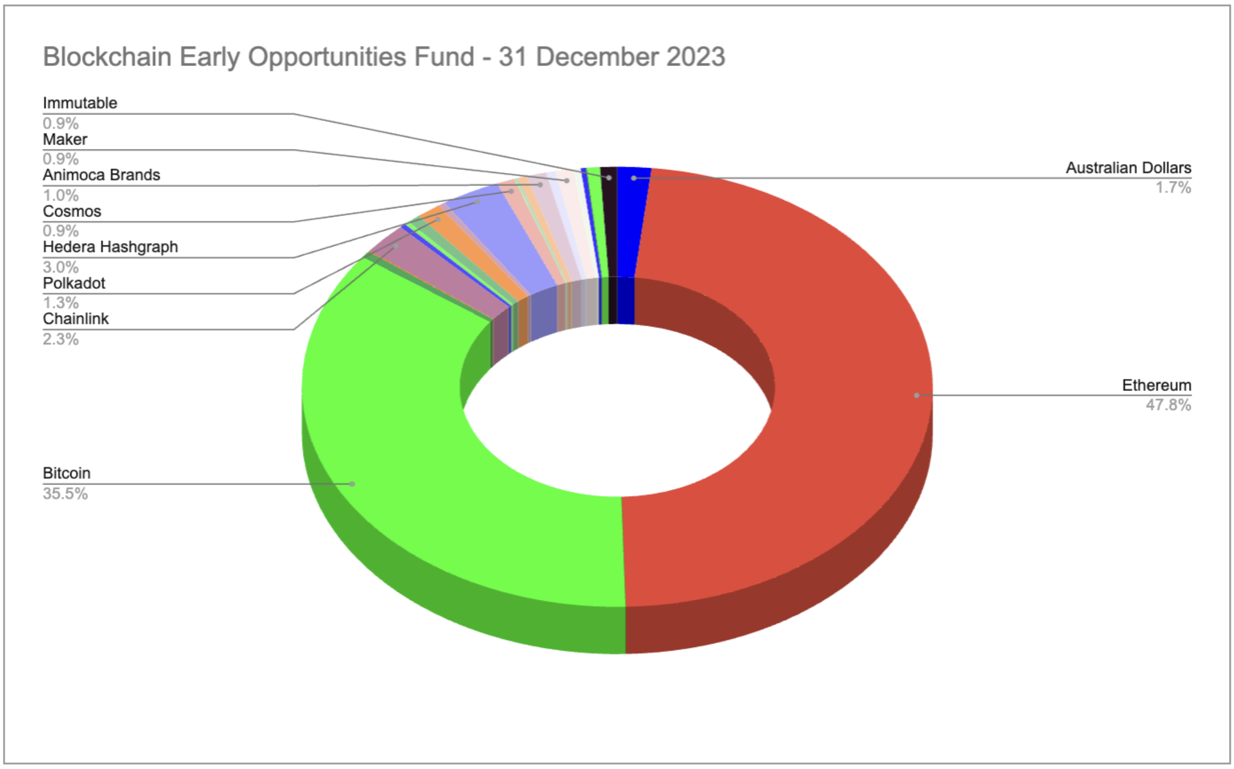
Metric	30 September 2017	31 December 2017	31 March 2018	30 June 2018
Unit Price	$0.93	$2.14	$1.18	$1.09
Return Since Inception	-7.00%	114.00%	18.00%	9.00%
Metric	**30 September 2018**	**31 December 2018**	**31 March 2019**	**30 June 2019**
Unit Price	$0.7480	$0.5178	$0.5507	$0.9501
Return Since Inception	-25.20%	-48.22%	-44.93%	-4.99%
Metric	**30 September 2019**	**31 December 2019**	**31 March 2020**	**30 June 2020**
Unit Price	$0.5270	$0.3937	$0.4408	$0.6034
Return Since Inception	-47.30%	-60.63%	-55.92%	-39.66%
Metric	**30 September 2020**	**31 December 2020**	**31 March 2021**	**30 June 2021**
Unit Price	$0.9449	$1.6575	$4.5682	$3.4543
Return Since Inception	-5.51%	65.75%	356.82%	245.43%
Metric	**30 September 2021**	**31 December 2021**	**31 March 2022**	**30 June 2022**
Unit Price	$4.9905	$5.7599	$5.3393	$2.1182
Return Since Inception	399.05%	475.99%	433.93%	111.82%
Metric	**30 September 2022**	**31 December 2022**	**31 March 2023**	**30 June 2023**
Unit Price	$2.3768	$1.7762	$2.7288	$2.8312
Return Since Inception	137.68%	77.62%	172.88%	183.12%
Metric	**30 September 2023**	**31 December 2023**	**31 March 2024**	**30 June 2024**
Unit Price	$2.5963	$3.6139		
Return for the Quarter	-8.30%	39.19%		
Return for the past 12 months	9.24%	103.46%		
Return Since Inception	159.63%	261.39%		
Assets Under Management	$17,408,071.56	$24,513,665.82		



Regulating Digital Asset Platforms (in Australia)

The proposed regulatory framework for digital asset platforms, as set out in the Australian Treasury's consultation paper, if adopted, will usher in a new financial product and will be the first regulatory link between traditional financial (TradFi) products and cryptoasset financial products.

Overview

The framework uses the 'factual control' over the cryptoassets as the regulatory anchor point. This makes good sense to us because it makes the custodian of the assets responsible for their safe keeping.

A second plank to the approach is to provide consistency with existing regulations for traditional financial products. Again this makes good sense as it dovetails the new laws with the existing laws.

A New Financial Product

The new financial product will be known as a 'Digital Asset Facility' (DAF). A DAF will be able to provide services such as trading, staking, tokenization and fundraising for 'digital assets'.

Examples of digital assets include :

1. a tokenized security, such as a tokenized version of BHP stock;
2. tokenized and 'financialised' real world assets, such as valuable art and collectibles; and
3. digitally native tokens such as bitcoin and ether.

A DAF will need to hold an Australian Financial Services Licence and will be regulated in the same way as any other AFSL holder.

It is anticipated that a DAF will be able to provide 4 services (called 'Facilities'). These being : Trading, Staking, Tokenization and Funding. Each facility will need a separate contract.

The Future of Financial Services

Current Digital Asset Environment

Already operating as unregulated digital asset facilities are the Australian based crypto exchanges. They typically offer the usual array of cryptoassets, bitcoin, ether and anything else which in their view is not considered a 'financial product'. These are very lucrative businesses, perhaps like stockbroking in the old days but without the back office costs, heavy regulation or the need to speak to clients (it's all online).

Also in the digital asset space are funds like ours, the Blockchain Early Opportunities Fund, which is regulated as an unregistered Managed Investment Scheme.

As far as I can tell, traditional financial services companies, superannuation funds and financial advisors are largely absent from the crypto markets in Australia.

Near Term Environment

Once implemented, the DAF regulations will link traditional financial markets with crypto markets. There will be no regulatory reasons

<u>why TradFi cannot offer Digital Asset services to their clients.</u>

Also there will be no regulatory reason why (at least in theory) crypto exchanges cannot provide services relative to traditional financial products, such as tokenized crypto securities and fixed income products (for example - tokenized Bank stocks and bonds). However, if a DAF does wish to offer tokenized versions of existing financial products, they will have to observe the same laws as existing trading venues and market participants.

Aside from regulation we have to consider the different client bases of TradFi and crypto exchanges. Whereas the former are typically at the wholesale client end of the scale, the latter are typically at the younger retail end of the scale. In time these client groups will bleed into each other and create a greater pool which will be attractive to both new and existing operators.

I expect that TradFi will move into the digital asset space faster than the other way around. This is primarily because of the requirement for market operators to hold a Financial Markets Licence and to clear trades through a licenced Clearing and Settlement business. Currently only the ASX has a Clearing and Settlement Licence. This barrier will prevent the crypto exchanges from entering into the crypto securities market for the foreseeable future.

TradFi businesses will have no regulatory barriers, but they will need to build or buy exchange technology and crypto teams to serve their clients. TradFi client sentiment towards bitcoin and crypto more broadly will change to the positive as US based institutions venture further into the space throughout 2024/25. This change in sentiment coupled with the regulation of the industry brings great opportunity.

Longer Term Environment

We have heard many people say things like '...blockchain technology will do to the banks what email did to the post offices…'. Of course things are never as simple as this quote tries to imply.

One of my clients, many years ago, was an on-line brokerage company called instinet (now owned by Nomura). This was in the mid-90ies in Hong Kong and at that time there was a view that on-line broking would lead to the extinction of traditional brokerage services. In the end this did not happen because human beings like to speak to other human beings, particularly when it comes to important things like personal financial wealth. The financial markets are now bigger than ever and employ more people than ever before. But the service delivery model has changed.

The same thing is going to happen with the evolution of cryptoasset marketplaces. The winners here will be those firms who are able to allocate the right amount of resources at the right time to evolve their firms to catch the opportunities that this technology brings.

The proposed regulatory framework is one part of the puzzle falling into place. Already we have a number of highly profitable businesses operating what will become regulated DAF's, these are the so called crypto exchanges. Once regulated they will be able to consider building other services such as financial advice, initial token offerings, custody and potentially the full range of financial services.

At the same time, as a regulated financial product, existing financial service providers will be able to advise their clients on which DAF to use, which assets are of interest and again potentially offer the whole suite of financial services within the cryptoasset ecosystem.

In other words, the potential to offer new services to clients via both the traditional service providers and the newcomers is greatly increased. I imagine there will be a number of mergers and partnerships. It will not be a winner take all outcome, but certainly there will be a benefit in being first to market with a holistic offering of digital and traditional assets.

If the momentum on the regulatory front continues in this direction, 5 years from now it is highly probable that many of the current financial service providers will be advising their clients on bitcoin, ether and tokenized assets such as collectibles, real estate and precious metals. They may also have a number of new younger clients.

The existing cryptoasset exchanges are in my view going to have to lift their game. They will need to expand into the advisory space, but without the ability to advise on securities and other traditional financial products, they will be at a disadvantage relative to the incumbents.

Ten years from now there will be no distinction between traditional financial services companies and crypto exchanges. Like we have seen with every other industry, clients want a one stop shop. Clients will want to speak to their advisor about every possible asset available to them as investors and those advisors who are equipped to advise and execute on that advice will gain market share.

What does this all mean for our Fund?

Regulation brings clarity and clarity brings adoption. The new operating system for financial services is just one use case for the assets we are holding. We are not invested in just one company or industry. Our assets are base layer operating systems for all industries globally. The value of these systems grow as they are used. Financial services is a significant use case, but others include gaming, social media, the metaverse, health, biotech, AI and all others.

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As always, please do not hesitate to contact me on 04 5090 0151 or at ian@bca.fund if you have any questions.

Best Regards

Ian Love
Founder and CEO
Blockchain Assets Pty Ltd

The content of this newsletter has primarily been prepared by a human, Ian Love. Artificial intelligence may have been utilised for some fact-checking and for providing explanations of some specific words and concepts.

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