SPOTLIGHT: CYRPTO'S WILD RIDE

Our Q2 2021 Commentary Letter featured a spotlight on crypto, just as crypto investors faced a case of whiplash. During that quarter, Bitcoin traded from above $64,000 to below $29,000, while Ethereum rallied from below $2,000 to more than $4,300 before retracing the entirety of the move.

The rollercoaster continues into 2022, with Bitcoin currently trading just above $38,000, while Ethereum has settled at a little over $2,600 (at the time of publication). Amid this price volatility, interest in crypto has never been greater. And it is not only a retail phenomenon, as prominent university endowments such as Harvard, Yale, Brown, and Michigan are reported to have made large investments in the asset class in recent years. Given the broad price move over the last several years, it wouldn't be surprising if these stakes now represented meaningful percentages of these portfolios.

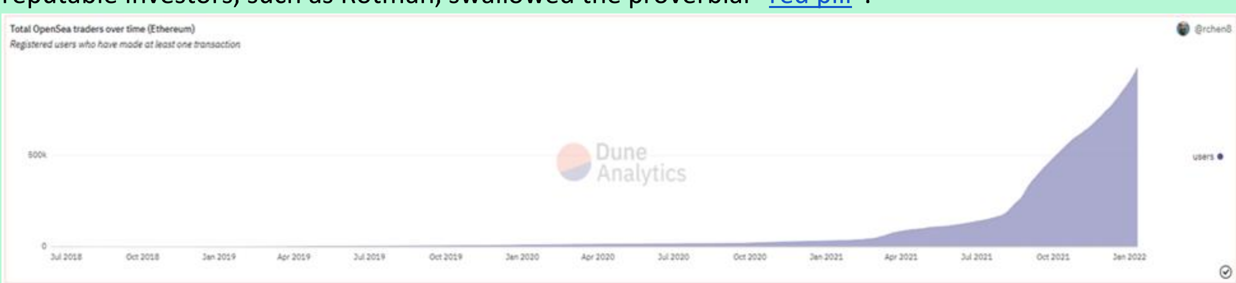
One of the major evolutions of the crypto market in 2021 was the introduction of web3 into the vernacular (the term was actually coined by Ethereum co-founder Gavin Wood back in 2014). Web3, or "consumer crypto", has taken on a broad definition, shifting the conversation beyond just currency and financial applications (DeFi) into immersive applications such as gaming and social media.

As Frank Rotman at QED Investors noted in a Twitter post:

Institutional investors have taken note and are starting to implement guidelines for introducing the crypto asset class to their portfolios. Andreessen Horowitz (a16z) recently made headlines by raising a stunning $2.2 billion in fresh capital dedicated to crypto and web3. a16z has moved the web3 battlefield to Washington, with a number of prominent hires that have extensive policy and regulatory backgrounds, as the firm seeks to influence the various regulatory frameworks that will enable and nurture the nascent web3 ecosystem.

This conversation is far from over – if you listen carefully to regulators, there is still strong sentiment that crypto is a fraud. But research from Tomicah Tillemann and James Rathmell at a16z shows that nearly 80 percent of voters they polled would be more likely to back a candidate that supports expanding web3 – although it is unlikely that this issue figures in many political calculations. For those who were polled – and had a positive view – the primary benefits of web3 were seen as giving consumers more control over their own data, improving internet security and privacy, and supporting individual ownership and the creator economy. Still, policymakers are continuing to study potential use cases of cryptocurrencies, as highlighted by a recent research paper published by the Fed. As the paper points out, key to any proposal for the issuance of a Central Bank Digital Currency (CBDC) is that it yield "such benefits more effectively than alternative methods."

While 2020 was highlighted by the "DeFi Summer", 2021 will perhaps be most remembered by the explosion of non-fungible tokens, or NFTs. Few would have guessed in 2017 that NFTs would emerge as a major use case of blockchain technology, with more than $10 billion of trading volume on prominent NFT exchange OpenSea over the course of 2021, with this activity accelerating into 2022. On the back of this milestone, OpenSea, a member of Y Combinator's W18 batch, raised a $300 million Series C funding round that valued the company at $13 billion. Furthermore, passionate communities such as Bored Ape Yacht Club, CryptoPunks, and Chain Runners captured the hearts and wallets of NFT enthusiasts, while many reputable investors, such as Rotman, swallowed the proverbial "red pill".



This evolution/re-branding of crypto has helped sustain and build interest in the technology as the industry continues to seek product-market-fit. Li Jin, a former Partner at Andreessen Horowitz who currently invests in the web3 ecosystem at her new firm, Variant, has elegantly explained her strategy as investing in the passion economy and new platforms that lower the barriers to entrepreneurship and broaden paths to work. As investors seek opportunities that provide society with access to equal opportunity, fair wages, and financial inclusion, web3 serves as a potential fertile hunting ground.

Another positive crypto trend that gained steam during 2021 was the continued shift towards applying sustainable practices to the production and formation of crypto assets. As Gillian Tett noted in a recent Financial Times opinion piece, there a few reasons to be encouraged about the sustainability of web3:

- A coalition of 200+ crypto entities recently joined forces with the Rocky Mountain Institute to create a Crypto Climate Accord.
- China's clampdown on the industry has forced many miners to relocate while shifting mining operations away from coal-fired electricity to renewable energy sources.
- More energy efficient technology has emerged, such as "proof of stake" and "proof of space and time".

Going forward, we expect less of the crypto/web3 conversation to be about Bitcoin adoption (though we will be closely watching regulators) as activity shifts to alternative layer one blockchains. DeFi, NFTs, and DAOs (decentralized autonomous organizations) are likely here to stay, and the creation of more mainstream consumer-friendly applications such as OpenSea will only increase the momentum of web3, irrespective of the volatility of underlying tokens. We hope to see continued progress on the introduction of innovative financial products that serve the underbanked and are cautiously optimistic that the industry will continue to develop with sustainability as a guiding arrow.