BOX 3. CRYPTOCURRENCY ASSETS

It was a challenging quarter for crypto exchanges. In early June, the SEC filed more than a dozen charges against Binance, the largest cryptocurrency exchange in the world, and its founder Changpeng ("CZ") Zhao. Among its charges were claims that the company was operating an unregistered securities exchange and a more troublesome claim that Binance and CZ were misappropriating customer funds. A day later, the SEC brought similar, albeit less nefarious, charges against Coinbase. While the charge against Coinbase also accused the exchange of operating illegally, Coinbase CEO Brian Armstrong was not named personally in the suit. Coinbase stock fell more than 12% on the news, but this development should not have come as a total surprise to investors, as a Wells notice was issued to Coinbase back in March, leading to a very public response from the company.

Core to the SEC's lawsuits is the question of whether crypto tokens are securities (and therefore whether or not crypto exchanges are even legal). This has been a longstanding philosophical debate amongst various industry stakeholders, and further clarity on this issue should be welcomed. The filing specifically names Solana's SOL token, Filecoin's FIL, Algorand's ALGO, and Axie Infinity's AXS, among others, as tokens that should be considered securities, while the largest crypto token by market cap, Bitcoin, is not referenced. According to a report from Mizuho Securities, the tokens that were named may represent more than 30% of Coinbase's revenue. The outcome of this case will be a close watchpoint going forward. As others have mentioned, thoughtful regulation will be required for the crypto asset class to truly scale within institutional portfolios.

It's important to note that after Q2 closed, a U.S. federal judge ruled that, while institutional sales of Ripple's XRP token "constituted an unregistered offer and sale of investment contracts," secondary sales, or "programmatic sales," of XRP on crypto exchanges, did not. Coinbase's share price appreciated on the news, as investors appear to believe that this ruling portends positively for Coinbase.

balance sheet flexibility, and promising AI-related growth drivers. The strong recovery in domestic and international travel has been another pocket of strength. The Defiance Hotel Airline and Cruise ETF for example gained 18.7% for the quarter and is up 34.3% YTD; however, most other sectors, including financials, energy, utilities, and health care, have been largely left behind.

With the S&P 500 sitting at approximately 19.6x forward earnings, it is difficult to envision much multiple expansion from here, given elevated inflation still forcing the Fed to maintain its hawkish stance. It would not be surprising to see some reversion from this year's winners due to profit taking and for some of the higher quality companies in the left-behind sectors to do some catching up. Multiples for small-cap and cyclical stocks could catch up to the mega caps, but such a move into riskier investments would not be typical of the late cycle. Such a move would require some consensus as to whether we've achieved a soft landing or avoided any landing at all.