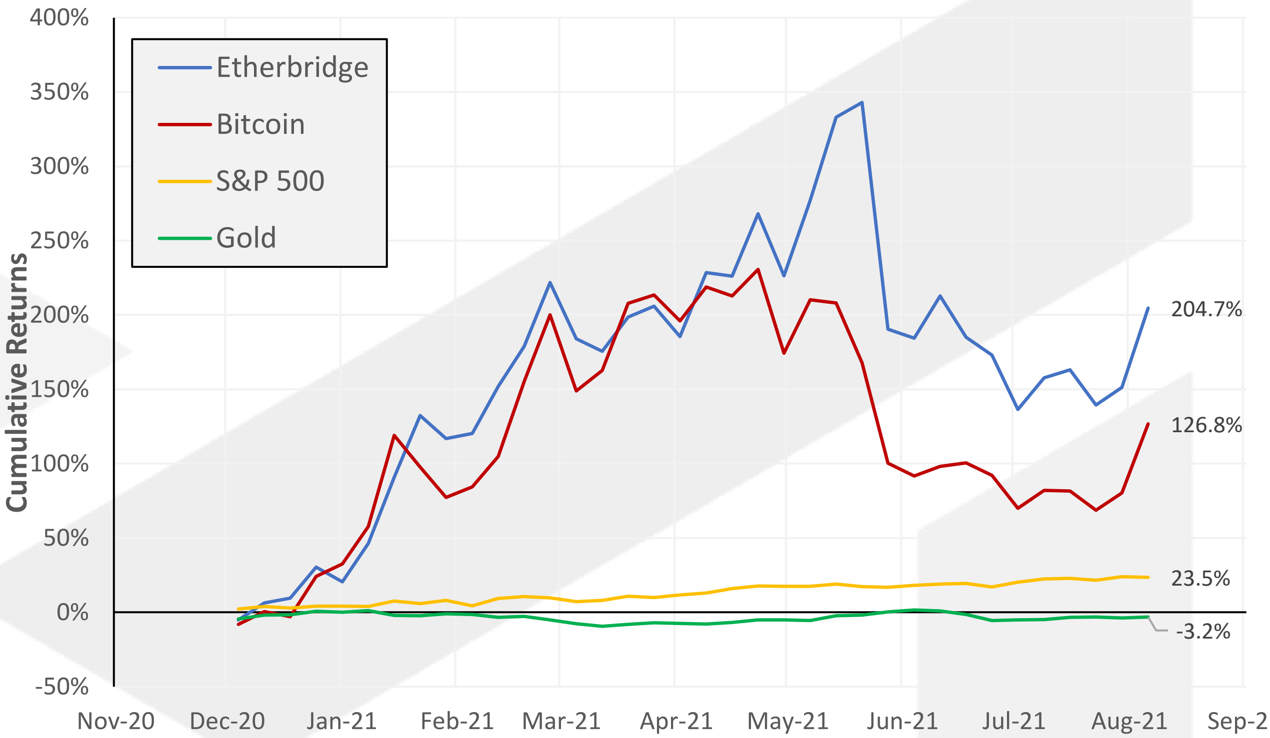
ETHERBRIDGE

Investor Newsletter

Fund Performance Since Inception

The Etherbridge Fund formally launched on the 20th of November 2020. Since then, we have been able to outperform bitcoin returns consistently. Not only has the fund outperformed on a cumulative return basis, but we have been able to produce superior risk-adjusted returns relative to bitcoin with an annualised Sharpe ratio of 2,99 and an annualised Sortino ratio of 4,72.The recent market downturn, whilst not great for returns, has afforded us an opportunity to build positions in networks such as Uniswap, Aave, Compound, MakerDAO and Yearn.finance. These assets are all core financial primitives of the Ethereum financial system.



The remainder of the report includes a risk and return evaluation of the Etherbridge fund and its new constituents and ends with an on-chain analysis of bitcoin, Ethereum and DeFi.

Comments from Head Portfolio Manager- Wade Gunning

Global inflation is – in the normalising post-COVID world – being driven by:

- a boom in demand for cars, furniture and household appliances triggered by consumers spending on items that made home lockdown more tolerable;
- disruption to the global supply of some goods such as microchips which are in turn curtailing the car supply (and rising oil prices are not helping); and
- a rebound in the service prices: employees are returning to hairdressers, restaurants, bars, and other in-person businesses slower than customers are.

This rising inflation may disrupt asset markets. High stock, bond, house, and cryptocurrency prices rely on the assumption that interest rates will remain subdued low for the short to medium term. However, this assumption only makes sense if central banks are not forced to raise them to fight ever-rising inflation.

Please note: The following return and risk metrics are for illustrative purposes only. The recent market downturn has afforded us the opportunity to build a position in DeFi assets. This summary serves to illustrate how the Etherbridge fund constituents fair relative to other major assets.

Risk Metrics

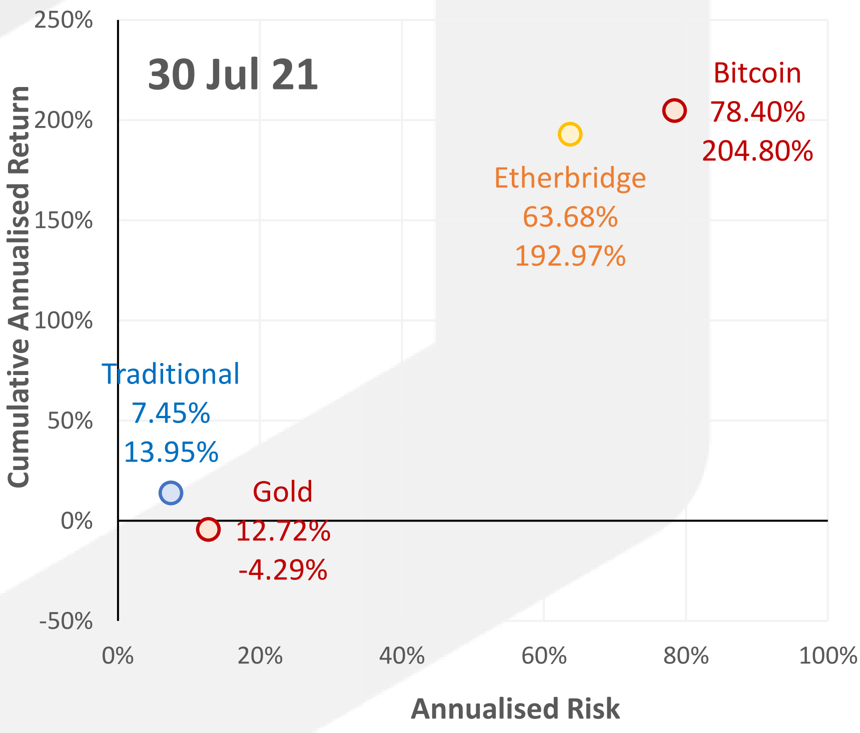
Risk-Return Profile – All metrics are calculated using USD daily data from October 2020.

The traditional portfolio comprises 60% equity (Nasdaq) and 40% bonds (Vanguard bonds).

While Bitcoin returns are 6% higher than Etherbridge's over the period,

$$\left(\frac{205\%}{193\%} - 1\right)$$

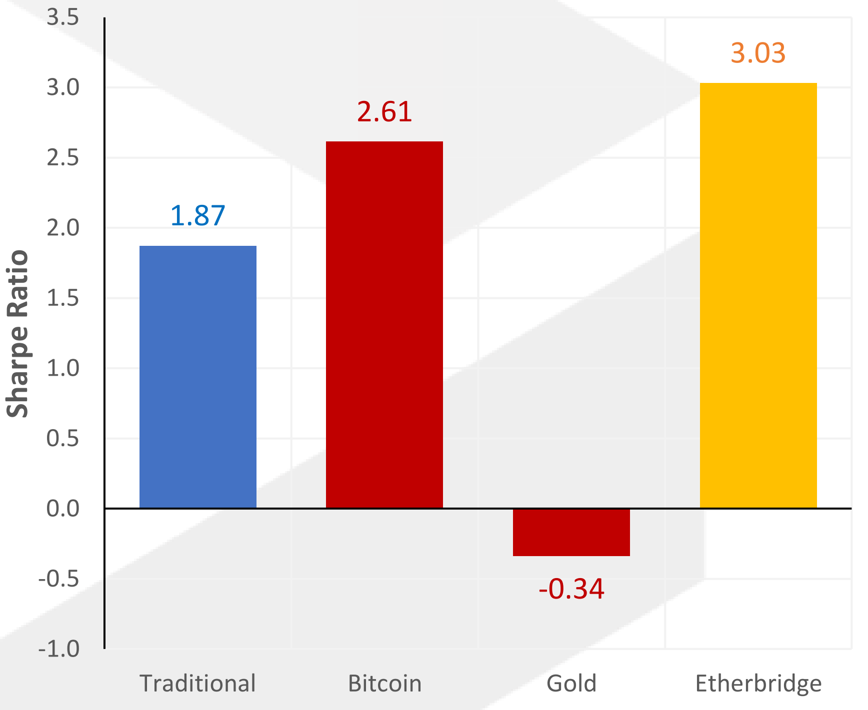
Bitcoin's risk is 25% higher than Etherbridge's model portfolio, which explains the latter's superior Sharpe Ratio (see next panel).

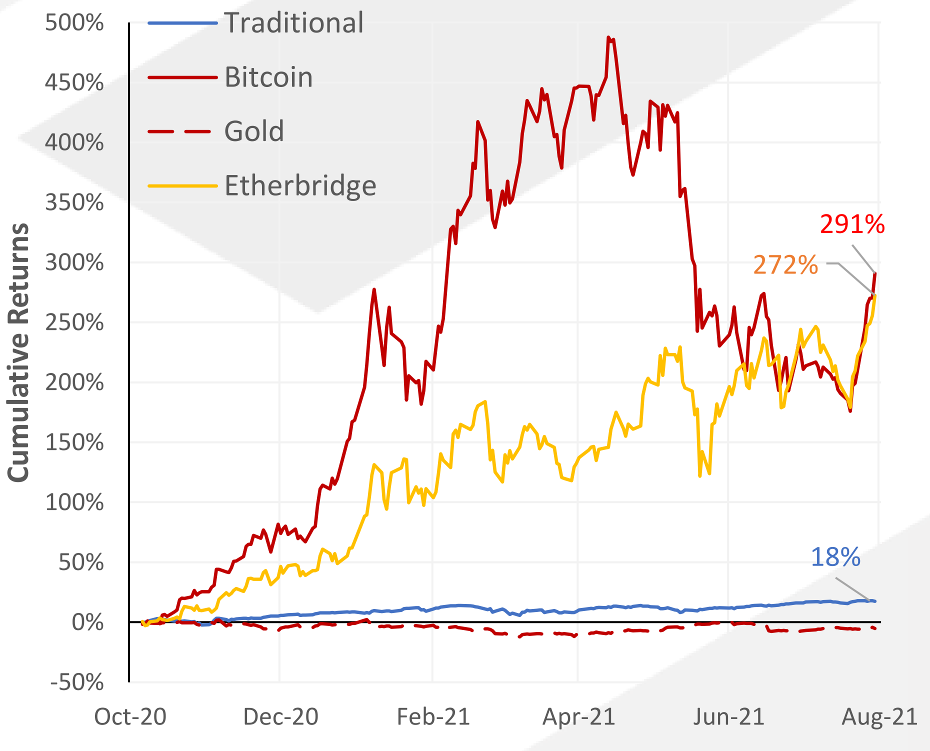


Risk Metrics

Sharpe Ratio – is a "risk adjusted return" metric that accounts for the excess portfolio return (the difference between the portfolio return and the prevailing US bank deposit rate) per unit of risk taken to generate the returns.

Since October 2020, Etherbridges' model portfolio has produced a return that is 3 × greater than the risk taken to generate it, compared with the traditional fund's 1.9 ×.



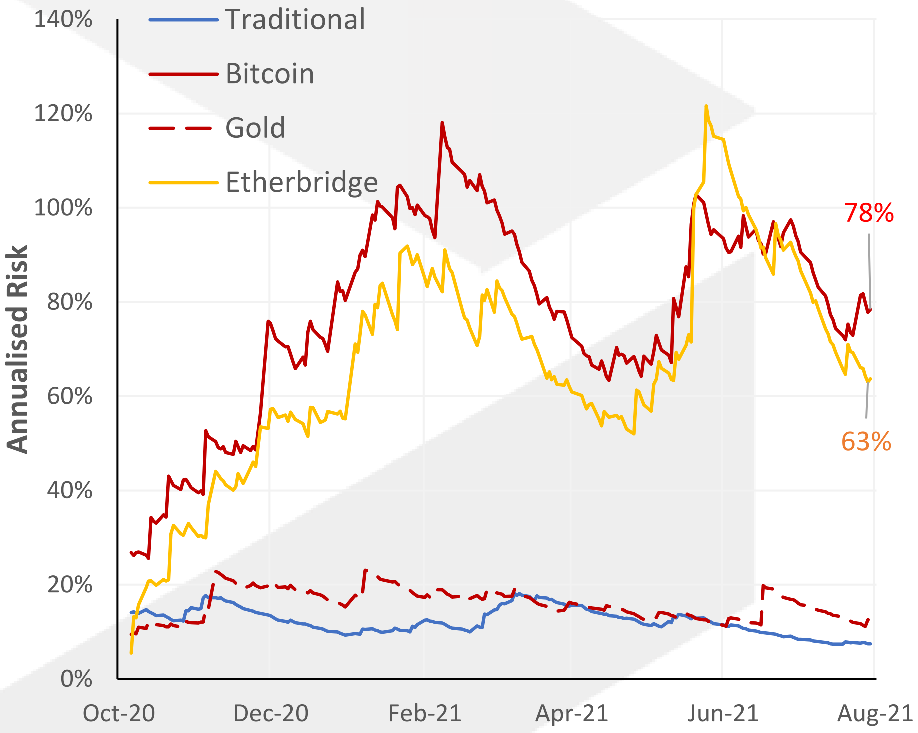


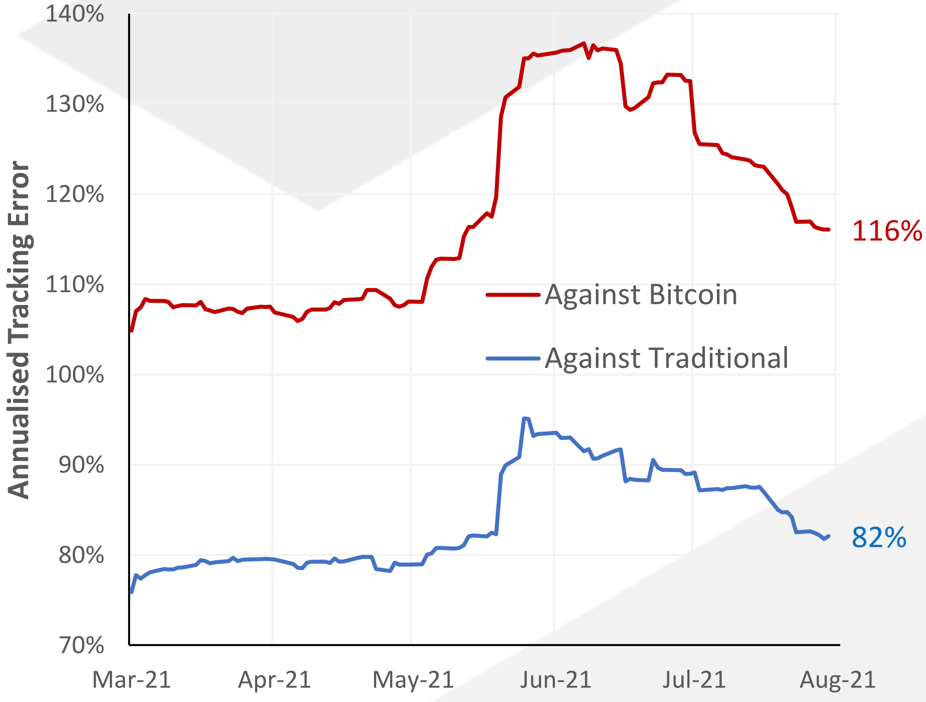
Cumulative Returns – These reflect the return that would have been generated on the respective portfolios since October 2020. Crypto assets have trumped traditional ones.

Risk Metrics

Volatility (Risk) – an estimate of the volatility (or riskiness) of each portfolio. This metric uses a time-weighted scheme which assigns heavier weight to recent events and a lower weight to more distant events.

Cryptoassets are riskier than traditional assets. The Etherbridge model portfolio offers lower risk than Bitcoin.



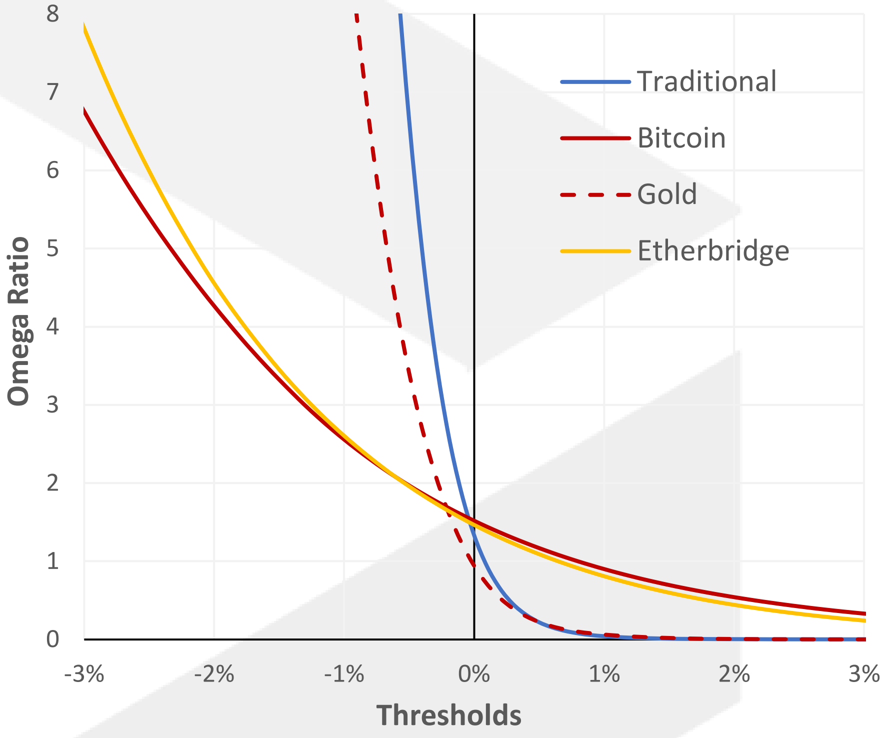


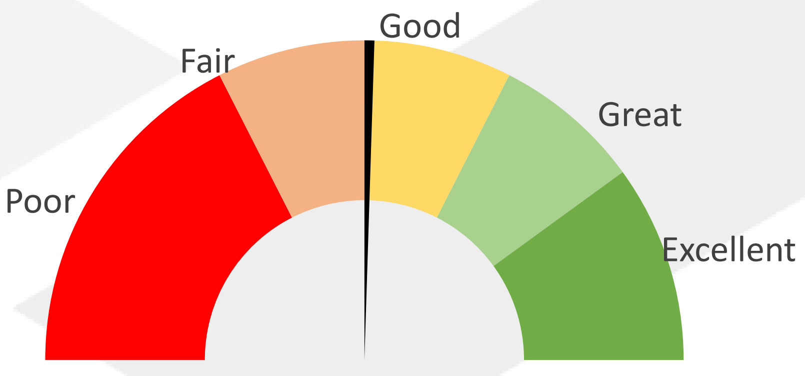
Relative Return – or tracking error (TE), is a measure of the (annualised) risk of the portfolio relative to a specific benchmark. A TE of 0%, for example, would mean a portfolio was invested in identical constituents as the benchmark and in the same ratio.

For comparison, standard actively managed traditional portfolios have TEs of between 3% and 5%.

Risk Metrics

Omega Ratio – a metric that makes no assumptions about how the portfolio returns are distributed (the standard assumption is that returns are normally distributed, which – while simple to understand – can be misleading). In short, "good" portfolios rise quickly to infinity for thresholds $< 0\%$ and decay slowly towards 0% for thresholds $> 0\%$.





Etherbridge Daily Risk

Daily Risk Dashboard – Provides an indicator of a portfolio's riskiness relative to its maximum over the observation period.

Correlation Analysis – Indicates the degree of co-movement (positive values showing movements in the same direction and negative in the opposite direction).

	Traditional	Bitcoin	Gold	Etherbridge
Traditional	**1**	0,197	0,201	-0,130
Bitcoin		**1**	-0,012	0,029
Gold			**1**	0,047
Etherbridge				**1**

On-chain Report
Comments from Jason Carpenter CIO

2021 has been a rewarding year for anyone participating in crypto markets with bitcoin up 20,40% and Ethereum up 246%. Whilst the two most well-known crypto networks have done well, the best performance can be found in the broader crypto landscape. The top sectors being centralised exchanges and DeFi, both up 1353% and 1119% respectively over the past year.

Bitcoin

Bitcoin flew into the new year, breaking previous all-time highs and charging on to a new all-time high of $65,000. Every bitcoin cycle comes with a renewed interest in previously debunked fear, uncertainty, and doubt. As bitcoin reached new highs on the back of institutional interest and many famous investors acknowledging its investment case, it fell under the spotlight of naysayers and sceptics.

Concerns over Chinese influence in Bitcoin mining, environmental concerns and China's regulatory stance emerged as important considerations for those looking to allocate to the asset class. These concerns significantly disrupted the investment flows that we witnessed in Q1 and early Q2 of 2021.

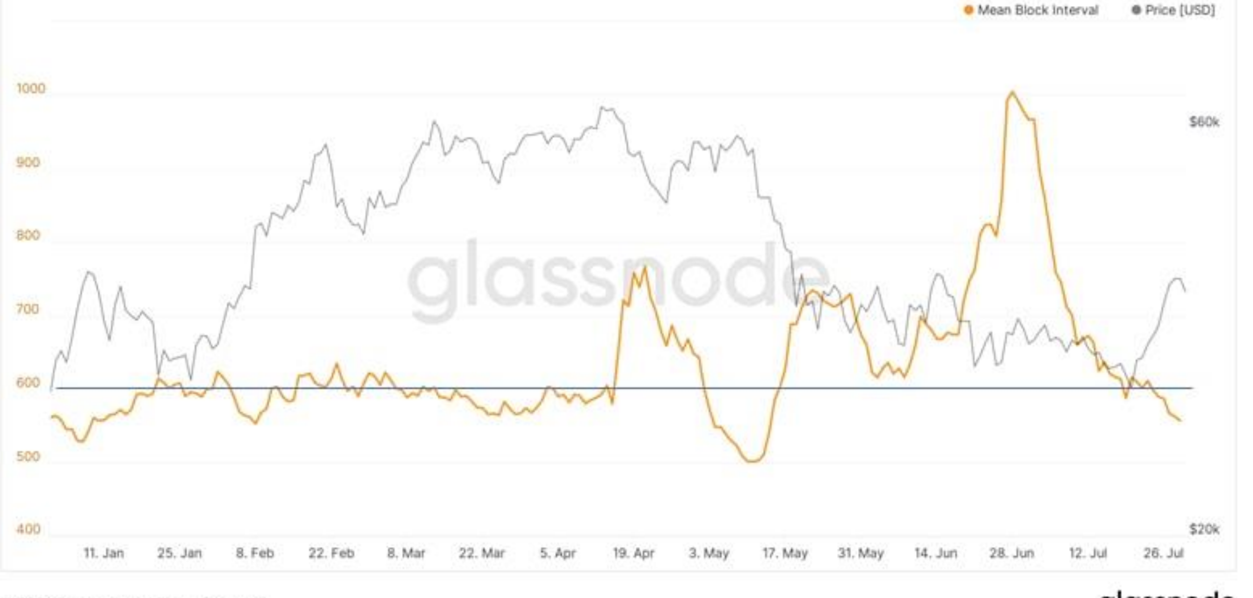
We have written many times on bitcoin and energy, so this report will focus primarily on the effects of the China ban on Bitcoin mining and its impact on the Bitcoin network.

BTC: Hash Rate, BTC: Difficulty

 glassnode

China has taken an anti-crypto since 2013, and much of the news that drove prices lower was regurgitated. However, there was new information in that China was formally banning all bitcoin mining activity. This led to a fall in the hash rate (computational power) securing the Bitcoin network and a change to mining difficulty. The chart above highlights the point; the hash rate went down 45% in just over a month.

Bitcoin: Mean Block Interval (7d Exponential Moving Average)



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The drop in hash rate resulted in slow block production, with median block times reaching almost 1000 seconds. However, on schedule, the difficulty adjustment occurred, returning Bitcoin to its 600 second target time.

Bitcoin

Bitcoin: Total Miner Revenue - All Miners (7d Exponential Moving Average)

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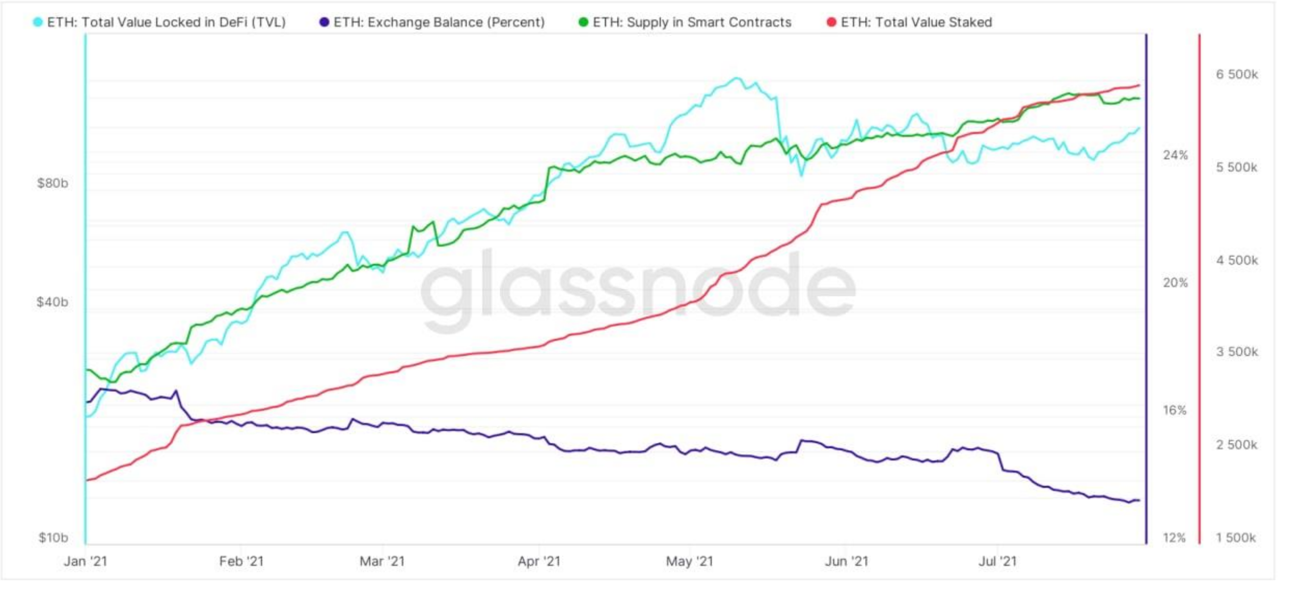
Miner revenues also experienced a significant knock and have begun to recover in part due to the recent rally from lows of $29000 to just above $40000, as well as changes to the difficulty of mining.

While having a significant effect on on-chain fundamentals, this event serves as yet another example of Bitcoin's robust network. Bitcoin will face many similar challenges in the future, and it's good to see that through a combination of hash rate securing the network and the difficulty of mining, block production can quickly get back to target times without human intervention.

Ethereum

If there were one word for Ethereum in 2021, it would be "Utility". It is becoming increasingly difficult to overlook the massive network of projects and services being built on Ethereum. Bitcoin seems to rely more heavily on narrative and catalyst events to drive the subsequent s-curve adoption of the network. Ethereum, on the other hand, is incredibly useful; it is genuinely programmable value. This usefulness is what drives the s-curve adoption in Ethereum.

ETH: Total Value Locked in DeFi (TVL), ETH: Exchange Balance (Percent), ETH: Supply in Smart Contracts, ETH: Tota...



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The chart above summarises this idea of "Utility". This year we have seen Ether held on centralised exchanges shrinking whilst witnessing tremendous growth of Ether in smart contracts, locked in DeFi and staked in order to secure the Ethereum network once the transition to Proof of Stake is complete.

This dynamic is great to see and something we expect to grow accustomed to in the 2020s. Every time ETH leaves a centralised exchange, it finds its way into Ethereum based financial services "DeFi". The more we see ETH being used for real use cases, the better.

DeFi assets have also had an excellent first half of 2021, and for valid reasons. DeFi assets are unique in that many of them have capital like attributes, which means we can apply traditional valuation frameworks to understand their value accrual better.

Asset	Total Value Locked	Outstanding borrowed Volume	Exchange Volume	180D Cumulative Revenue	Price to Sales
Uniswap	$4,3b		$258b	$722m	21,6x
MakerDAO	$7,1b	$2,3b		$50,5m	47,76x
Compound	$8,7b	$6,7b		$185m	18,97x
Aave	$11,3b	$8,4b		$126m	17,09x
Yearn	$3,7b				

We are witnessing actual value accrual in DeFi networks, many of which are early-stage projects with positive cashflows. The most exciting element of DeFi is that when compared to fintech and traditional finance alternatives, these networks can perform similar functions at incredibly low operating costs, making value accrual all the more possible.

We expect the back end of 2021 to reflect these truths. Our expectation is that as sophisticated investors enter the space, they will be more comfortable allocating to cryptoassets that better fit into traditional valuation frameworks.

Opportunities and Risks for the Remainder of 2021

The remainder of 2021 comes with it both opportunities and risks for our core assets at Etherbridge. We look forward to monitoring the interplay between bitcoin price action, central bank balance sheets and consumer inflation numbers. In general, Bitcoin and the crypto market are more than 30% down on the back of record-high inflation numbers in the United States; this goes entirely against bitcoins narrative as an inflation hedge. Potentially this dislocation is a result of profit-taking, regulatory concerns or too much leverage in the system, but one thing is for sure, bitcoin will need to start trading more like a safe haven asset if it expects the market to recognise it as one.

The second half of the year holds much promise for the Ethereum network and DeFi sector. Ethereum will implement the much anticipated EIP-1559 improvement and then, in stages, perform the migration to ETH 2.0. A successful transition to ETH 2.0 will help scale the Ethereum network and unlock unimaginable growth in the broader Ethereum ecosystem. However, an unsuccessful transition could be problematic for the network and reinvigorate interest in 'Ethereum killer' networks, leading to a loss of market share for Ethereum.

The last risk worth noting is around the stablecoin regulatory environment. Stablecoins have increasingly become integral to the workings of many DeFi networks. Unfortunately, stablecoins introduce central points of failure on which governments can apply pressure. At the moment, governments seem to be going down the worst possible path of either applying current regulatory frameworks to stablecoins that aren't compatible, or even worse, attempting to create new blanket regulations to differently designed stablecoin networks. Poorly regulated centralised stablecoins could lead to considerable demand for decentralised algorithmic stablecoins such as MakerDAO's Dai.

Whilst cognizant of the risks that lay ahead, we are confident that the second half of 2021 will be rewarding for investors. The addition of DeFi assets into the Etherbridge fund has significantly increased risk-adjusted returns and offers clients a broader exposure to innovation in cryptoassets. We continue to deliver on our core mandate of investing in the key infrastructure of the digital age.

We thank you for your support.

ETHERBRIDGE

INVESTING IN THE REAL EMERGING MARKET

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