GCG Cryptocurrency Markets

Year End Review: 2018

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Introduction of 2018

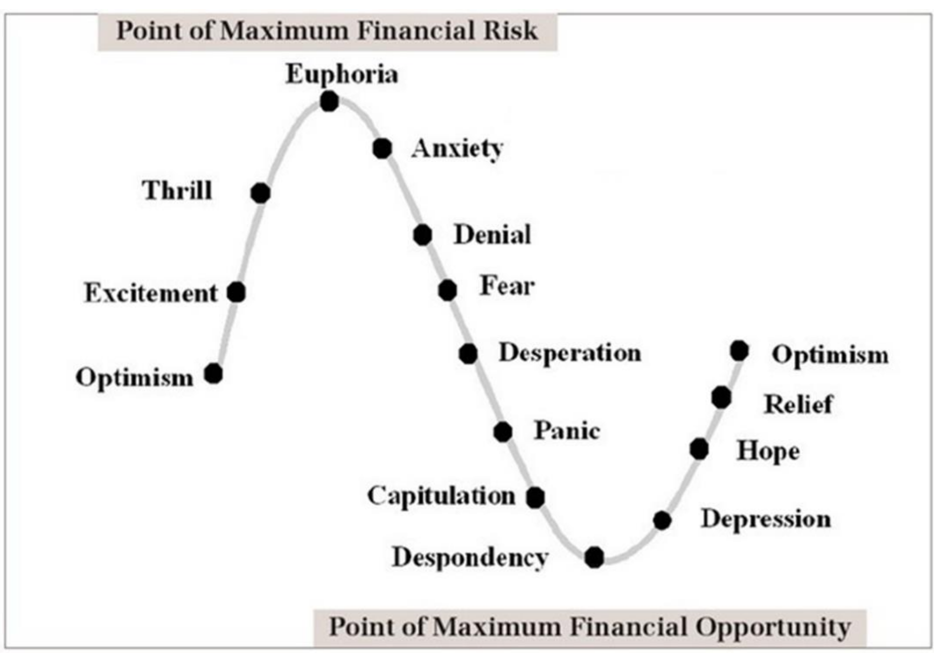
Let's be honest, 2018 was a rough year for anyone who invested in cryptocurrencies; whether you invested in Bitcoin, Alt-coins, a Crypto Index or Crypto Hedge Fund you most likely lost money. Understandably, this has many upset, fearful, and regretful; but, let's cut through these emotions and discuss the market and the future of cryptocurrencies. In the following, I will discuss how prices are determined, why the market sold off, where we are now, and where the market is going in 2019 and 2020.

First, let's discuss ***what drives price*** and the market?

Emotion is the number one driver of market price; two emotions specifically drive the decision-making process; **fear and greed**. As human beings, our emotions related to financial investments wane or wax between these two extremes.

Market prices are directly correlated demand, and demand is a derivative of human emotion. Consequently, it is important to understand that **demand is cyclical.** It is important to understand that technical patterns and signals are lagging indicators of demand and human emotion. The great money managers in the world understand this, and use the crowd's emotion as strong signals to base their investment decisions off of, not technical analysis.

When investors are the most fearful is when the best opportunity presents itself. In the contrary, when investors are the greediest it is time to run for the exit.



How do prices work?

Let's break the price of Bitcoin down to a simple equation (This example can be applied to several different cryptocurrencies):

$$\text{Bitcoin Price} = \text{Demand}^{I} \times (\text{Existing Supply} + \text{Mining Supply}^{M})$$

Demand = number of investors in the market (DEMAND TRUMPS ALL)
I = Rate of new investors or capital into the market
Existing Supply = The number of coins in existence
Mining Supply = New coins being mined or created
M = Rate of mining/new coin creation

Bitcoin and cryptocurrencies are a farce….it went parabolic…

Markets go parabolic all the time, it is called a black swan or fat tail event. Typically, 4-5 occur every year in traditional markets. Bitcoin has gone 'parabolic' several times throughout its life time. It is important to understand that 'parabolic' is relative, any chart can be made to look parabolic given a specific time frame. These are signs of growth, an essential part of boom and bust cycles of capitalism. It is because of these cycles that the strong emerge and the weak falter or adapt; resulting in consumers benefiting in the long run.

Bitcoin Price (May 2012 – August 2013)

Bitcoin Price (November 2012 – May 2015)

Bitcoin Price (May 2017 – December 2018)

Did market manipulation and 'whales' cause the market to meltdown?!
Absolutely not, see below for more detail.

The 4 horsemen of this year's bear market:

1) In late 2017, there was a large increase in demand for Bitcoin in the form of new retail investors, traders, and speculators coming into the market via 3rd

party exchanges, such as Coinbase, Binance, Bittrex, Poloniex, etc., resulting in 'parabolic' price appreciation.

2) However, in early January 2018, almost all cryptocurrency exchanges stopped accepting new accounts, this means **global account creation went from 500,000+ a day to nearly 0** in an extremely short period of time. Why did the exchanges do this? Quite simply, they did not have the infrastructure or capacity in place to handle the new account creation, AML, and KYC requirements. If they did not take this precaution many other systematic risks may have arose.

3) What about institutional investors? **Much of the infrastructure needed for institutional investors to invest in the space simply did not exist at a tier 1 level.** Financial custodians, accounting, auditors, fund administrators, legal, regulation, etc., were just starting to emerge and gain a credible expertise in the space. Over the course of 2018 we have seen this infrastructure and expertise increase exponentially.

4) Bitcoin Futures were launched, allowing miners to hedge their positions throughout the future. Simply put, Bitcoin was at an all-time high; the demand to buy futures was less than the demand to sell futures. (The miners being the sellers, hedging themselves and lock in profits) Consequently, the futures market began to decline, dragging the spot market down with it.

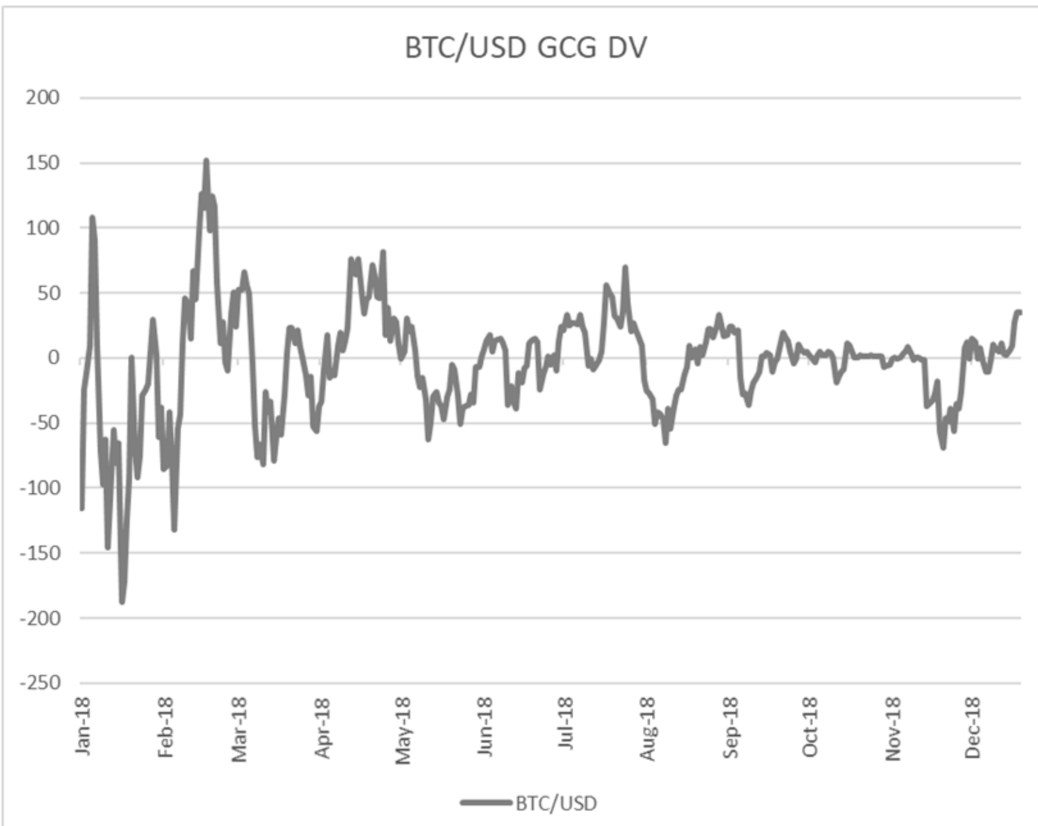
Wait, but what about those all-time highs?
As a result, in January 2018, with new retail traders and capital unable to enter the cryptocurrency market, and current investors fully invested, a perfect storm scenario formed. Most cryptocurrency investors only had 2 options at this point in time, hold or sell. Well, when the Bitcoin futures market began to sell off, it triggered fear and some investors began to sell in the spot market. Eventually, this caused a snowball effect and we saw the market become extremely volatile and fall 70% in 30 days.

After the initial move, the cryptocurrency market entered a bearish consolidation from mid-March – mid-November. This was a result of some investors going bust and demand for cryptocurrencies waning as fear increased (remember demand is cyclical). In is important to understand that throughout this time period the fundamental picture strengthened exponentially and price does not directly reflect the fundamentals of the market.

So, are the lows in?

Well, volatility is starting to come back into the market, during late summer and early fall it was nearly nonexistent. Volatility coming back into the market is a sign of demand starting to reemerge; this is telling me that Bitcoin and the market are trying to find a bottom.

GCG DV Indicator



For example, over the last 12 months the cost to mine 1 Bitcoin in China was about \$3,000, so, I am looking to this as a potential bottom/price floor. However, with the number of miners temporality decreasing, the mining algorithm has become easier to solve; meaning that the cost to mine 1 Bitcoin has dropped. This may open up the July 2017 lows of ~\$1,800; either way, I'm a buyer at both levels because I have strong conviction in the technology and its use case. This goes for many alt-coins as well, as their prices are roughly 80% correlated to Bitcoin.

Consequently, I expect the lows to be put in within the next 60 days.

It's difficult to invest good money after bad money…

This is definitely true, one of the hardest things to do in investing or speculating is to double-down on your convictions after taking losses. This is mainly due to the emotion of fear, we are afraid of losing and the uncertainty of the market. When it comes to investing or speculating it is important to keep the mindset, "I'm playing to WIN"; instead of "I'm playing not to lose."

There are two types of cryptocurrency holders:

1) a speculator who came for profits

2) an investor who fundamentally believes in the technology long term

So, when determining how invest at these current price levels it is important to understand why you are investing. For example:

1) A speculator who bought when Bitcoin was trading at $15,000 should not add to their position, because the likelihood their risk tolerance has diminished significantly is high.

2) An investor who bought when Bitcoin was trading at $15,000, should add to their position at these prices and continue to build positions through time. They understand that **demand is cyclical**. If they liked it at $15,000 and the fundamental picture has strengthened; then they would be a fool not to dollar cost average themselves in at lower prices. By dollar cost averaging into the position the breakeven price is lowered and potential profits are increased.

So, what does the future hold?

2019 and 2020 will be the most significant years for Bitcoin and cryptocurrencies thus far. Fidelity and Bakkt are set to launch their cryptocurrency platforms in Q1 of 2019, these should be strong catalysts for the market. I expect volatility to keep increasing for the market to take 2-3 steps forward and 1-2 steps backward throughout the year.

In addition, new cryptocurrency futures will be listed, causing the market to rally. I expect the futures market to lead the rally, as buyers will have the opportunity to buy specific cryptocurrencies for future delivery at current breakeven prices (the price it costs to mine/produce one coin). In contrary, the miners/producers will not sell futures near these current prices because their profit is minimized. Miners are better off 1) halting production, hence increasing scarcity; 2) taking risk in the spot market; or 3) continuing to mine and holding through time.

In 2019, new regulation will start to be put in place, giving investors more comfort with the cryptocurrency space.

Institutional money has already begun to go to work in late 2018 and is expected to continue throughout 2019-2023. Retail money will follow suit as the learning curve and barriers to entry will continue to be reduced.

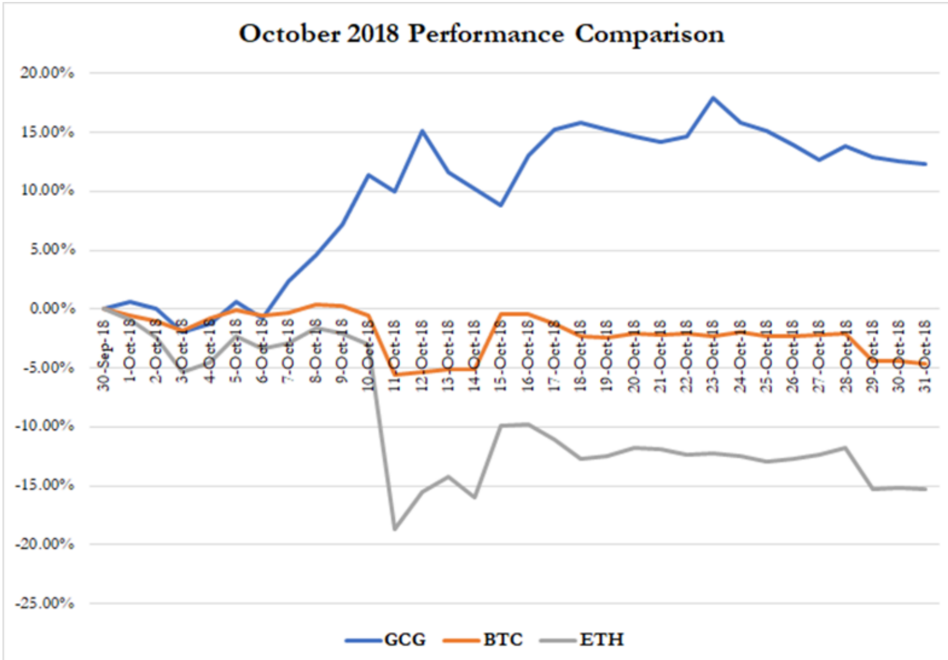
Roughly 1-3% of global assets will be allocated to cryptpcurrencies over the next 2 years. More importantly, there are over 2,000 cryptocurrencies in existence today, 80-90% of these will fail in the next 2 years. Consequently, the 1-3% allocation of global assets will be allocated in only 10-20% of the cryptocurrencies in existence. Consequently, leading to new highs for this select group of cryptocurrencies.

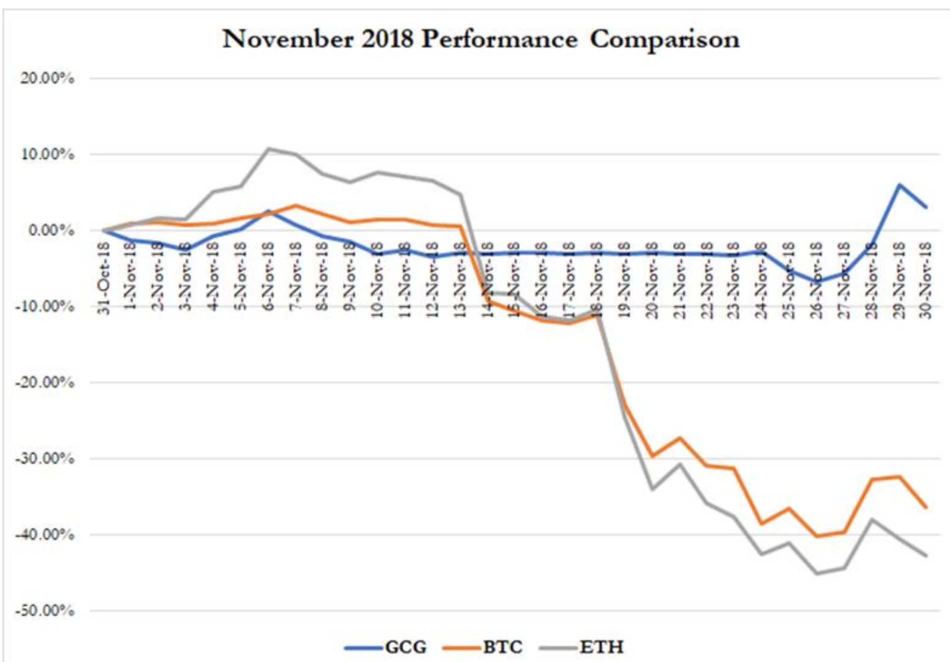
How to make money in these markets…anyone can buy and hold
Our strategy is to recognize when the market is trending and when the market is in consolidation. Meaning, we are trying to quantify human emotion in the market.

We have developed a proprietary in-house algorithm to help us quantify this. Regardless which direction the market is moving we will be on for the trend, if the market is consolidating then our risk tightens up and we move to the sidelines. This allows us to run a business model that can last; markets will always have trends.

Why not implement trend following sooner?
Quite simply, the historical data did not exist for many of the alt-coins. Now that many alt-coins have been in existence over a year, running algorithmic backtests are starting to become more reliable.

The GCG Difference
By utilizing the algorithm in our trading strategies, we have been able to recognize shifts in market momentum faster. Thus, increasing our trading edge, leading us to outperform over the last two months.





In Conclusion

I am very optimistic about the future, especially 2019 and 2020.

When it comes to prices; the demand cycle is nearing the bottom and demand is starting grow on the institutional side. Moreover, with additional cryptocurrency futures inevitably getting listed; this provides an opportunity for investors to take long leveraged positions at near breakeven prices. Consequently, putting bullish pressure on the futures market that will drive spot prices higher.

The fundamental picture is strengthening too. The market infrastructure has grown tremendously over the last 12 months; there are now a large number of financial services businesses that have expertise in the cryptocurrencies, digital assets and blockchain technologies. Consequently, regulation is not far behind; often expertise starts in the private sector then moves into the public sector. This is essential in order for 1-3% of global assets to be allocated in this market.

Maturity of cryptocurrency projects; the bear market of 2018 has exposed the weaknesses of many 'projects' or cryptocurrencies. Consequently, I expect roughly 80-90% of cryptocurrencies to fall by the wayside. This provides great opportunity for the quality, blue chip, cryptocurrencies as there will be a concentration of capital in the remaining 10-20%.

How do we plan to profit? I take fundamental research very seriously, GCG has an in-house proprietary ranking system that values cryptocurrencies based on fundamentals; such as, project viability, operational risk, development team credibility, liquidity of the coin, etc. Based on these criteria and basket of cryptocurrencies is built, then backtested on our proprietary algorithm. After this filtering process, conclusions are drawn on which specific cryptocurrencies may be the most profitable to trade in certain market conditions.

All in all, with the demand cycle beginning to strengthen, fundamentals strengthening, infrastructure increasing, regulation on the way, and our tiered investment strategy; I feel strongly that we can achieve a profitable 2019 and generate strong alpha.

Happy Holidays,

Michael Groff