Portal Asset Management unveils its Investment Outlook for 2022

Last year was a breakthrough year. Not only for our investors, who saw an annual return of 80.1%, but for the crypto market. Here's our outlook for 2022.

AUSTRALIA, January 17, 2022 /EINPresswire.com/ -- Digital Assets in 2021

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>
> *Mark Witten, CIO of Portal Asset Management*

2021 is the year that Cryptocurrencies and Digital Assets ("Crypto Assets") came into their own. We witnessed the spectacular rise of DeFi, Smart Contracts and NFT's, the approval and listing of the first BTC ETF, and the recognition that this industry is here to stay even though it cannot be regulated in the normal sense. 2021 also witnessed inflows of $30bn via Venture Capital (VC) and Private Equity (PE) investment and the emergence of Crypto Assets as a mainstream investable asset class.

As Fund Managers, we believe that the macro will always dominate the micro, and as such being on the right side of the thematic via astute asset allocation is more important than trying to pick the next "unicorn". Successful asset allocation combined with prudent management of risk will always deliver superior risk-adjusted returns in the long run.

With that in mind we have identified 5 themes that we believe will impact the Crypto Asset markets in 2022:

1.
INFLATION IS BEING VASTLY UNDERESTIMATED – RATES ARE GOING TO RISE MUCH FASTER AND HIGHER THAN EXPECTED, INCREASING VOLATILITY ACROSS ALL ASSET CLASSES!

Inflation is hitting multi-decade highs across the globe, with Eurozone CPI at an 18-year high and US CPI at a 40-year high as per the charts below:

The Federal Reserve responded to the pandemic by introducing "unlimited quantitative easing" and flooded the world with liquidity by pushing the Fed funding rate, and subsequently global interest rates that set off the US 10-year treasury, to below zero. This was mostly done by manipulating the long bond yield as the Fed expanded its balance sheet by 100% in 2 years from $4 trillion in 2020 to $9 trillion in 2021.

This has created a $27 trillion bond bubble! At its core, this is inter-generational theft and the end of the fiat monetary system as the largest monetary policy experiment in history begins to implode. This is unfolding rapidly as inflation takes hold, as it surely must when the velocity of money reverts to mean (remember MxV=PxQ). As the markets begin to price in higher inflation, with Goldman Sachs expecting as many as 7 interest rate hikes in the next 2 years, we will see some sort of normalizations of the yield curve.

If we normalize rates over the next few years, we could see a 30% drop in the valuation of bonds. Even a 10% drop could see a $4 trillion loss in the USA alone.

Counterintuitively, this could see a rotation out of risk assets into credit once yields kick up as the search for “safe” yield continues. The bond market will move ahead of these actual increases and rerate accordingly.

This is both positive and negative for Crypto Assets. Initially, we could see an inflow into Crypto Assets as a hedge and alternative to fixed income, but then we could also see a lot of volatility as global markets rerate corporate earnings expectations, DCF’s as well as multiples and valuations. This could result in a large correlated correction globally, which will not leave Crypto Assets unscathed. In times of stress, all correlations tend to be one.

In our view, with equity markets at record levels and stretched multiples implying ex-growth earnings, bonds yielding negative real returns, and inflation gathering pace, Crypto Assets remains the top liquid bet on the institutional rotation to an inflation-resistant, store-of-value asset.

2.
WEB3.0 WILL GROW EXPONENTIALLY AS THE BACKLASH AGAINST GOVERNMENT AND BIG TECH GATHERS MOMENTUM

“Web3.0” is the user-owned internet that is basically the architecture for a decentralized internet where websites, apps, and online services are owned by their users, or as Chris Dixon calls it “the internet owned by the builders and users, orchestrated with tokens.” We believe that this is one of the most powerful shifts in the internet status quo as any user-owned economy will always outperform a monopolist-owned economy in the long run.

This is analogous to the shift from the forced labour of serfdom endured by peasants in Europe that inspired the exodus starting in the 1600’s to the “new world” lured by the prospect of religious freedom and owning your own land. In the same way, we are going from an internet built on “rented land” with monopolistic overlords, to an infinite frontier of new possibilities.

This is being driven by a young generation who are unable to afford the assets held by the old guard as they have much higher thresholds for risk. They are generally poor, smart, and hungry – a winning combination. Add in the massive growth in VC funding in the space and we realize why the current incumbent institutions are nervous and scrambling to adapt.

A great summary from the latest Messari Report: "DeFi offers savers 5% vs. Wall Street's 0.5%. Non-fungible tokens ("NFTs") give creators monetization opportunities without Hollywood's 50%+ rents. Open games and social graphs remove the 100% take rate from tech incumbents and eliminate de-platforming and censorships risks."

Portal Asset Management firmly backs this thematic and believe we are at the beginning of the most transformative shift of the global economy, and it's about time!

3.
INSTITUTIONS ARE HERE, AND THEY ARE FUNDING THE NEXT GENERATION OF CRYPTO ASSET APPLICATIONS VIA VC AND PE

VC has piled into Crypto Assets in 2021 with an amazing $17bn raised in H1 2021 alone and close to $10bn worth of deals done in the same period. We expect close to $30bn in capital to have been deployed in 2021 to this space across the entire spectrum. This is by far the most in any single year and indeed surpasses to the total amount raised in all previous years combined!

We have been hearing for years that the "institutions are coming". Well, they arrived in 2021 and we are seeing many large financial institutions mobilizing resources across dedicated research teams, trading strategies, internal funds and custody solutions. Supporting our observations, a recent study conducted by Fidelity Digital Assets found that seven in ten institutional investors expect to buy or invest in Crypto Assets in the near future.

The pace of innovation to replace the legacy plumbing in the institutional financial services infrastructure is significantly influenced by cryptocurrencies, digital assets and the blockchain and DLT infrastructure. This is leading the mass migration out of TradFi into CeFi, and the next wave of investment into the market is going to be large and sustained for the foreseeable future.

4.
THE SEGMENTATION OF THE MARKET WILL NOW LEAD TO CRYPTOCURRENCIES DECOUPLING FROM DIGITAL ASSETS SUCH AS DEFI, SMART CONTRACTS AND NFT'S.

The arrival of real investors into the Crypto Asset space is creating a segmentation across liquidity, risk, and duration spectrums. The market was initially driven by short-term speculators, hedgers, and arbitrageurs who are now being underpinned with fundamental and thematic investment funds that have longer-term time horizons and are more “patient” money. These investors understand that the different Crypto Asset sectors have different value drivers. The market narrative has changed gone from “everything is a cryptocurrency” to “actually, there’s currencies, protocols, DeFi apps, distributed computing platforms, NFTs, work-to-earn markets...”

We have witnessed the emergence of hedge funds that are focused on identifying the next thematic to attract liquidity and then analyzing the fundamentals of the tokens they invest in, rather than just trying to extract Alpha by trading Beta. Ari Paul, CIO of BlockTower wrote one of the most insightful threads on the recent decoupling of Crypto Asset markets:

“This is the cycle where crypto use cases unrelated to Bitcoin’s were finally validated and achieved meaningful adoption...In previous cycles it made little sense to be a sector specialist in crypto. Defi and NFTs were basically nonexistent 4 years ago. Most other “sectors” didn’t meaningfully exist as such. “Decentralized file storage”, “smart contract platforms”, “privacy” and other “sectors” by which crypto coins were often segmented were arbitrary and arguably nonsensical...Now, being a DeFi yield farmer or NFT speculator, is arguably a full-time job, and you need, or will soon need, a small team just to keep up with one of those segments.”

Going forward, professional fund managers will have a huge ongoing competitive advantage versus retail investors. There are massive information asymmetries in protocol “reporting” standards, a steep technical learning curve, and limited risk management infrastructure that keep barriers to Crypto Asset investing high.

5.
THE METAVERSE AND GAMING

The metaverse, which is a combination of multiple elements of technology, including virtual reality, augmented reality, and video where users "live" within a digital universe, has arrived. The COVID lockdowns accelerated us into a fully digital world, bringing not just entertainment but also our work lives online. As the rest of our lives migrate from physical space to cyberspace with online education, entertainment, work, and even socialising, digital status games and cyber-flexing are simply an inevitability.

Gaming is the next big thing in the Crypto Asset space. In the past few months, we have seen the emergence of a new term in the crypto circles: GameFi. It defines the amalgamation of blockchain gaming and DeFi principles to pass the value incentives to the community rather than game studios and other centralized platforms - Web3 for gamers.

The gaming assets provide full ownership via NFTs, which can be traded and monetized. However, GameFi is not just about in-game NFTs and tokens. It expands beyond games to a metaverse, an online environment that incorporates many other features such as virtual stores, webinars, and online art galleries.

Yet the real game-changer for gaming is “Play-to-Earn”, which brings digital identity, assets, and ownership into players' hands as the gaming industry is becoming decentralised. This will lead to the massive growth of the gaming industry, currently built on centralized systems of value

Today, more than 3 billion people around the world play video games, and there is an entire infrastructure around professional gaming— one that has created significant opportunities and wealth for top players. The very best of them are considered athletes: employed as salaried team members, sharing in prize money at tournaments, and commanding lucrative sponsorship agreements. Others monetize live streams of themselves by playing games on viewership platforms like Twitch or YouTube Gaming.

Video games now represent a $336 billion industry, according to BITKRAFT Ventures, accounting for a widespread of software, hardware, and intellectual property. As gaming has grown to become the world’s largest media category ahead of linear TV, on-demand entertainment, film, and music, certain characteristics have developed with it.

Importantly, almost all game-based economic activity is centralised, giving developers and publishers the rights to everything going on within their games. The business case for this is to capture the billions of dollars generated from the sale of in-game content, digital items, and subscriptions—but it also means that the vast majority of players themselves have few ways to share in the value without following the route of professionalization.

This is why play-to-earn games are so revolutionary: this type of video game allows players to ‘truly’ earn and own digital assets that they can then sell outside of the game at their own discretion. Play-to-earn could bring digital identity, assets, and ownership into players’ hands

In fact, it seems that play-to-earn games are spearheading a larger trend at play: the increasing convergence of the physical and digital worlds. And with that, the emergence of the legendary ‘metaverse’—which has been as much at the center of the recent academic debates as it has been the stuff of rejuvenated corporate agendas, most prominently that of Meta (née Facebook).

The metaverse may create a society in which a person's digital identity and assets are more meaningful than their physical counterparts. The metaverse marks the moment in time in which digital assets, experiences, and relationships are assigned an even bigger value than our physical surroundings.

CONCLUSION

The world and society at large are undergoing a tectonic shift during this “Great Reset” and “Fourth Industrial Revolution” espoused by the World Economic Forum and UN as Agenda 2030 is rolled out. There is resistance socially, as there always is to change, but there are also the unintended consequences such as the backlash of Web3 and what decentralization really means: wealth creation in the hands of the creative community and not the corporations.

Volatility is here to stay, for now at least. We see the likelihood of inflation causing interest rates to rise more than expected and a reduction in investment liquidity. This could cause a reduction in liquidity in crypto in the short term. It could also result in the further debasement of fiat currency and continuing inflation. Both are good for Crypto Assets.

We will continue to see the bifurcation of the industry as investors realize that not everything is a cryptocurrency and there are real cash-generative business models appearing via NFT’s and distributed computing platforms, especially now in the play-to-earn gaming space.

Web 3.0 is the new frontier market and continues to grow with the promise of decentralized platforms profiting and empowering individuals. This iteration in gaming is the next adaptation of Web3 with some 3.4 billion gamers globally, and their rate of adoption into the Crypto Asset has already proven to be much quicker than any other demographic.

There are many other really positive themes that we have not had the time and space to discuss, but have included a short review of a few of the many other reasons to be optimistic provided by Mitchell Dong, founder and CIO of Pythagoras Investments, including:

- Continued consumer adoption as evidenced by retail activity with Robinhood, Paypal, Coinbase and other retail outlets where consumers can buy or sell Bitcoin.   Robinhood disclosed that in the second quarter, trading fees from crypto amounted to 40% of their revenues. FTX and Crypto.com are making big waves by buying the naming rights to the Miami Heat and LA Lakers basketball arenas.

- Continued institutional adoption as evidenced by big financial houses like Goldman Sachs, JPM Chase, Citibank all offering to their clients the ability to buy and sell crypto. Large insurance companies are investing in crypto like Mass Mutual, NY Life and Liberty Mutual. University Endowments such as Harvard, Stanford, Yale, Princeton, Brown are rumoured to have invested in Bitcoin. Custodians such as Northern Trust, State Street and Standard & Chartered are said to be evaluating custodian services to crypto.

- Continued sovereign adoption of crypto. Witness China’s early rollout of its government-backed digital currency. There are over 50 governments evaluating digitalizing their local currency. Also, witness El Salvador adopting Bitcoin as a national currency with many other Latin American and African countries following this movement

Risk is commensurate with reward, and risk varies inversely with knowledge and experience.

Many investors mistake volatility for risk. Volatility is not risk, volatility is so opportunity. Risk is the risk of permanent capital loss. That happens when you are wrong, not when the market is volatile, which, once again, Portal Asset Management see as an opportunity.

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