Highlights from the Equities Leaders Summit 2018

Trump National Doral, Miami

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Executive Summary

On December 7, 2018 Bluesky Capital was invited at the Equities Leaders Summit at the Trump National Doral Miami to discuss the adoption of cryptocurrencies as a new tradable asset class from equity investors. The following key takeaways emerged:

- There are still too many risks for institutional investors to enter in the crypto space, including regulatory, reputational, custody, and counterparty risks.
- Cryptocurrencies as an uncorrelated asset class provide benefits to equity or other investors in terms of portfolio diversification
- Crypto is a highly volatile asset class, creating opportunities for hedge funds that employ trend-following / CTA strategies
- The benefits offered by the blockchain technology and cryptocurrencies imply their mass adoption in the next 10 to 20 years
- High fragmentation and scarce liquidity on exchanges create profitable opportunities for hedge funds that use market making and statistical arbitrage strategies by providing liquidity across crypto exchanges

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About the Author

Andrea is President and Portfolio Manager at Bluesky Capital. Prior to founding Bluesky Capital, Andrea worked as a Quant at Sauma Capital, a quantitative hedge fund in New York, and as a management consultant at Ernst & Young. Andrea holds an M.S. in Financial Engineering from Columbia University, and an M.S. in Industrial Engineering from the University of Rome "La Sapienza".

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Key Takeaways from the Conference

Below are the key takeaways from the conference.

1. Why have some institutions moved into the crypto space and why are others, like banks, asset managers and hedged funds still reluctant?

Cryptocurrencies have 4 main risks still too high for institutional investors:

- Regulatory risk: regulators are finalizing rules regarding the space. Institutions, which traditionally want to have clear rules before investing, are waiting for a more stable regulatory framework.
- Reputational risk: many institutions do not want to associate themselves with a scams ICO's and the cryptocurrency technology that not so far ago was used on the black market by drug dealers or by hackers for ransomware payments because of the anonymity provided.
- Custody risk: there is still not a clear solution on the possibility of losing or hack of a key, and the associated capital as a consequence
- Counterparty risk: crypto exchanges are still undergoing a consolidation phase where new ones come into the market and others go out of business very frequently. There is still a high probability of transferring the money on an exchange that can declare bankruptcy because of liquidity issues of for a hack.

Some hedge funds, especially more nimble ones that manage investments from HNWI's and family offices, have already decided to assume and possible mitigate those risks with appropriate measures and take advantage of the opportunities created by the volatility present by cryptocurrencies. We anticipate that more institutions will enter the cryptocurrency market in the next 3 to 5 years, when there will be more stability and development in the space and a reduction in the previous risks as a consequence.

2. How would crypto exposure impact an equity trader's portfolio?

Historically cryptocurrencies have been uncorrelated to equities and fixed income. This means that equity or other investors who allocate to crypto as a new asset class can obtain portfolio diversification benefits by achieving lower risk for the same level of expected return or higher expected return for the same level of risk.

3. Do the volatility advantages outweigh the risks?

Cryptocurrencies are highly volatile, with an average annualized volatility of Bitcoin around 100%. This presents high risks, but at the same time big opportunities for professional investors who adopt CTA / trend-following strategies which generally perform very well in these market environments. The crypto space is highly similar to the futures market in the 80's or 90's, which was very volatile and almost no institution wanted to invest, while nowadays is one of the most actively traded and liquid market across all asset classes.

4. Is there enough growth potential and opportunity in this space to suggest that mainstream cryptocurrency trading is inevitable?

We believe that there has already been too much investment by big institutions and corporations in the blockchain technology and there are many benefits in adopting cryptocurrencies in terms of speed of payment processing to let it go away. The industry is still very new, in a certain way very comparable early stage of the Internet era in the 90's, where a new technology was brought but people still had to figure out the real potential and new applications of the technology. We believe that complete adoption of blockchain and cryptocurrencies is an inevitable long-term process, which similarly to Internet will probably take between 10 to 20 years to complete.

5. What's the current state of liquidity on cryptocurrency exchanges?

The crypto market is currently highly fragmented, where one cryptocurrency trades on at least a dozen exchanges, and characterized by a lack of institutional liquidity. These creates profitable opportunities for hedge funds and proprietary trading companies who employ market-making and statistical arbitrage strategies that can collect spreads by providing liquidity on multiple exchanges. At the same time, only a few companies have so far entered the market because of the expertise needed and the substantial investment in technology to operate such activities. We believe that more liquidity providers need to enter the market in order for institutions to consider trading cryptocurrencies without having a meaningful market impact and substantial transaction costs as a consequence.

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