

## Things Are Looking Up: Expectations Of Upcoming ETF Approval Drive Prices and Asset Flows In October

Monthly Insights

November 06, 2023

- Progress on the industry's first spot ETF in the U.S. remains one of the major catalysts for the crypto market rally, together with macroeconomic factors. Industry experts estimate multi-billion dollar net capital inflows as impact of the ETF approval on the digital asset industry.
- Traditional finance powerhouses continued integrating blockchain into operations and executing on M&A, with announcements of new products and deals this month from J.P. Morgan, HSBC, and DTCC.
- Real World Asset (RWA) tokenization is gaining momentum as traditional finance companies open up to decentralized structures. Dollars and Treasuries lead the way and yield moves on-chain.
- Web3 initiatives contributing meaningfully to the bottom line of Web2 FinTech incumbents, like Block's CashApp and PayPal.

## KEY THEMES

### JPM Coin Now Handles \$1 Billion Transactions Daily

- JPM Coin enables wholesale clients of J.P. Morgan to make dollar and euro-denominated payments through a private blockchain network. The bank plans to continue widening JPM Coin usage for its \$10T daily transactions.
- J.P. Morgan also runs a blockchain-based repo application and is exploring a digital deposit token to accelerate cross-border settlements.
- *TenSquared Capital View: JPM Coin is one of the few live applications of blockchain technology in traditional banking, as it delivers instantaneous payments at a lower cost than current technology. Bringing JPM Coin to retail consumers will allow all of its customer base of nearly 62 million U.S. households to access blockchain technology.*

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- In October, J.P. Morgan went live with its first collateral settlement for clients using blockchain. BlackRock used J.P. Morgan's Tokenized Collateral Network (TCN) to tokenize shares of its money market funds and to pledge them as collateral with Barclays for a derivatives contract.
- *TenSquared Capital View: Many of J.P. Morgan's biggest rivals are also pushing ahead with blockchain and digital asset projects as traditional finance is waking up to blockchain's transformative potential for legacy infrastructure.*

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### HSBC Launched Tokenized Ownership of Physical Gold Held in its London Vault

- The company is seeing "an appetite for tokenization solutions that can maintain a link to specific real-world use cases." Tokenized physical gold can be traded between HSBC and institutional investors through the HSBC Evolve platform.
- In 2021, the company teamed up with Wells Fargo to use a shared settlement blockchain ledger to process transactions in US dollars, Canadian dollars, Euros and British pound sterling.
- *TenSquared Capital View: Gold is the second-most tokenized asset in terms of market capitalization after USD. Gold tokenization by Paxos and other players has been around for some time. In the current inflationary environment, gold is in the good position to expand its role in digital finance.*

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# KEY THEMES

## Giant Clearinghouse DTCC Starts Blockchain Push with the Acquisition of Securrency Inc.

- Securrency provides institutions with blockchain-based technology on top of existing legacy systems to enable digital asset adoption in a compliant manner. It was previously funded by WisdomTree and developed a state of the art solution.
- The acquisition of Securrency will enable DTCC to use blockchain technology for end-to-end digital lifecycle processing for tokenized assets, digital currencies, and other financial instruments.
- DTCC is the leading, member-owned post-trade market infrastructure for the global financial services industry. In 2022, DTCC's subsidiaries processed securities transactions valued at U.S. \$2.5 quadrillion, and its depository subsidiary provided custody and asset servicing for securities issues from over 150 countries and territories valued at \$72T.
- **TenSquared Capital View:** *The deal supports our view that many infrastructure-enabling companies in the sector will be acquired by incumbents and traditional finance players. This is the first of many moves in a comping wave of M&A and consolidation.*

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## Worldcoin's World App Surpassed 1 Million MAUs Within Six Months of its Launch

- Worldcoin is an iris biometric cryptocurrency project founded in 2019 by OpenAI chief executive Sam Altman. Users prove their humanness by having their irises scanned. Once it is scanned, they receive a "World ID," which can be used to verify to applications that they are not a bot. Although Worldcoin can potentially disrupt the AI era, the project raises privacy and ethical concerns and is currently among the most controversial cryptocurrency projects.
- The project's mobile World App has now been downloaded over 4 million times and recorded 22 million transactions, ranking it as the sixth most popular crypto hot wallet for self-custody, according to CoinGecko's rankings.
- **TenSquared Capital View:** *The app's growing user activity metrics illustrate the current demand for digital identity in digital finance. The use of coin incentives to drive adoption is a good way of accelerating product-market fit. Worldcoin promises to link two hottest contemporary trends: artificial intelligence and crypto. As AI becomes more popular, we believe digital identity applications will become necessary to help distinguish between humans and AI-powered intelligent software.*

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## The Lightning Network Grew by 1212% in Two Years

- The Lightning Network, a layer-2 payment protocol built on the Bitcoin blockchain, routed 6.6 million transactions in August 2023, or about 213k per day. This is a 1,212% increase since the August 2021 estimate by K33 Research firm. The key sources of transactions are gaming, social media tipping, and commerce.
- In dollar terms, the annualized volume of routed transactions reached \$940M in August 2023, a 546% increase in two years. Bitcoin's core function is as a store of value, and only an estimated 11% of users use it for payments today, according to research by Binance.
- **TenSquared Capital View:** *Although the network is still relatively small, the statistics support the narrative that Bitcoin's use for micropayments is very much alive. Layer-2s have been a path to solving some of the structural debt with Bitcoin and Ethereum, and a way to leverage the security of the underlying chain.*

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## Yuga Labs Is Refocusing On Gaming

- Yuga Labs' CEO Daniel Alegre, formerly of Activision Blizzard, announced a strategic shift of the NFT giant to gaming and development of its metaverse, Otherside.
- Yuga Labs, which owns the premiere Web3 IPs like Bored Ape Yacht Club and Crypto Punks and has thrived thus far, with robust sales, royalties, and a \$450M seed round in March 2022.
- Yuga Labs will look to external partners to help build its future gaming experiences, with its work with spatial computing firm Hadean, game studio Faraway, Big Rhino, and its Roar acquisition.
- **TenSquared Capital View:** *Doubling down on gaming is a timely move by Yuga Labs as it will allow the company to maintain deeper user and community engagement. Despite the slowdown in the industry around NFT volumes and price levels, the company's long term approach and internal restructuring are a strong positive sign.*

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# POTENTIAL MULTI-BILLION DOLLAR IMPACT OF ETF APPROVAL ON THE DIGITAL ASSET INDUSTRY

- The rising demand for bitcoin as digital gold and optimism about the prospects for spot Bitcoin ETF approval in the U.S. market led to Bitcoin’s price surge (+28%) in October, outperforming most traditional assets and other crypto assets. This was the main theme in crypto in October.
- The market is now expecting a spot BTC ETF approval either at the end of 2023 or the beginning of 2024.
- The long-term impact of the spot Bitcoin ETF launch is positive for the industry as it will bring a long-awaited stamp of approval for the emerging asset class. It will open the crypto market for large pools of institutional capital that today can’t properly invest given the custody complexity and shifting regulatory landscape. The approval will likely lead to discussions around a spot ETH ETF in 2024.
- Anecdotally, it’s very difficult to get exposure to Bitcoin via major US private wealth platforms such as Morgan Stanley. They don’t even offer the ability to buy publicly listed trusts such as GBTC.
- Estimates of the potential impact of spot Bitcoin ETF approval on the crypto industry have varied:
  - Galaxy Digital estimates **approx. \$80Bn** of inflows into spot BTC ETFs **in the first three years** following the approval. This estimate assumes approx. \$50T in assets managed by the U.S. wealth management industry, the adoption of BTC by approx. 10% of total available assets in each wealth channel with different ramp-up scenarios and with an average allocation of 1%.
  - Taking into account all third-party managed assets (McKinsey estimate of \$126T) and global wealth (UBS estimate of \$454T), Galaxy Digital assumes that the market could allow for **\$125Bn to \$450Bn** of potential new inflows into Bitcoin investment products **over an extended period**.
  - FalconX quotes an ETF issuer estimates that crypto U.S. spot ETFs could attract as much as **\$55Bn in the first five years**.
  - According to NYDIG, the BTC price appreciation since the appearance of the ETF filings and the change in bitcoin’s market cap over that time, \$180B, implies **nearly \$18B in AUM for spot ETFs** (based on a 10x money multiplier).
- In the short term, market participants expect around \$1Bn inflows into Bitcoin investment products and BTC price appreciation to continue. FalconX estimates that the current bull market is likely pricing **initial net inflows of between \$500M to \$1.5Bn**. Based on this analysis, for BTC to establish a new range between the current \$34k level and more than \$40k, the total net inflows would need to amount to more than \$1.5Bn. Conversely, if total net inflows disappoint and come below \$500M, the BTC price could return to the \$30k level or even below.

Total BTC Net Inflows (USDmn)	BTC Orderbook Ask Depth (Native Units)		
	1000 (bullish)	2000 (base)	3000 (bearish)
-	28,500	28,500	28,500
250	31,170	29,954	29,364
500	33,753	31,170	30,253
750	36,187	32,436	31,170
1,000	38,798	33,753	32,115
1,250	41,185	34,775	32,760
1,500	43,718	36,187	33,753
1,750	46,408	37,284	34,431
2,000	48,775	38,798	35,474
2,250	51,263	39,973	36,187
2,500	53,878	41,185	36,915
2,750	56,066	42,433	38,033
3,000	58,926	43,718	38,798

Total BTC Net Inflows (USDmn)	BTC Orderbook Ask Depth (Native Units)		
	1000 (bullish)	2000 (base)	3000 (bearish)
-	-16.2%	-16.2%	-16.2%
250	-8.3%	-11.9%	-13.6%
500	-0.7%	-8.3%	-11.0%
750	6.4%	-4.6%	-8.3%
1,000	14.1%	-0.7%	-5.5%
1,250	21.1%	2.3%	-3.6%
1,500	28.6%	6.4%	-0.7%
1,750	36.5%	9.7%	1.3%
2,000	43.5%	14.1%	4.3%
2,250	50.8%	17.6%	6.4%
2,500	58.5%	21.1%	8.6%
2,750	64.9%	24.8%	11.9%
3,000	73.3%	28.6%	14.1%

Source: FalconX Research with data from CoinMetrics

- Spot Bitcoin ETF approval is undoubtedly a positive catalyst for the crypto market and digital assets industry in general. We believe that digital asset financial infrastructure companies, like crypto exchanges (both centralized and decentralized), stablecoin issuers, custodians, prime brokers, and trading infrastructure companies will benefit the most from the ETF approval in the near to medium term.

# THE STATE OF RWAS: THE SURGE OF TOKENIZED GOVERNMENT SECURITIES

- Tokenization of real world assets (RWAs) is one of the en vogue use cases of blockchain. The value of tokenized assets across public blockchains amounts to \$119Bn, according to 21.co and Dune Analytics.
- USD stablecoins, the first successful tokenization implementation, have already reached product-market fit. Stablecoins represent ~10% of crypto's total market value and ~97% of all tokenized assets.
- Other assets such as gold, real estate, music royalties, venture fund LP interest, bonds, and even diamonds have also been tokenized over the last 5 years.
- Tokenization gained substantial traction as key institutional players such as J.P. Morgan, BlackRock, and Goldman Sachs entered the space.

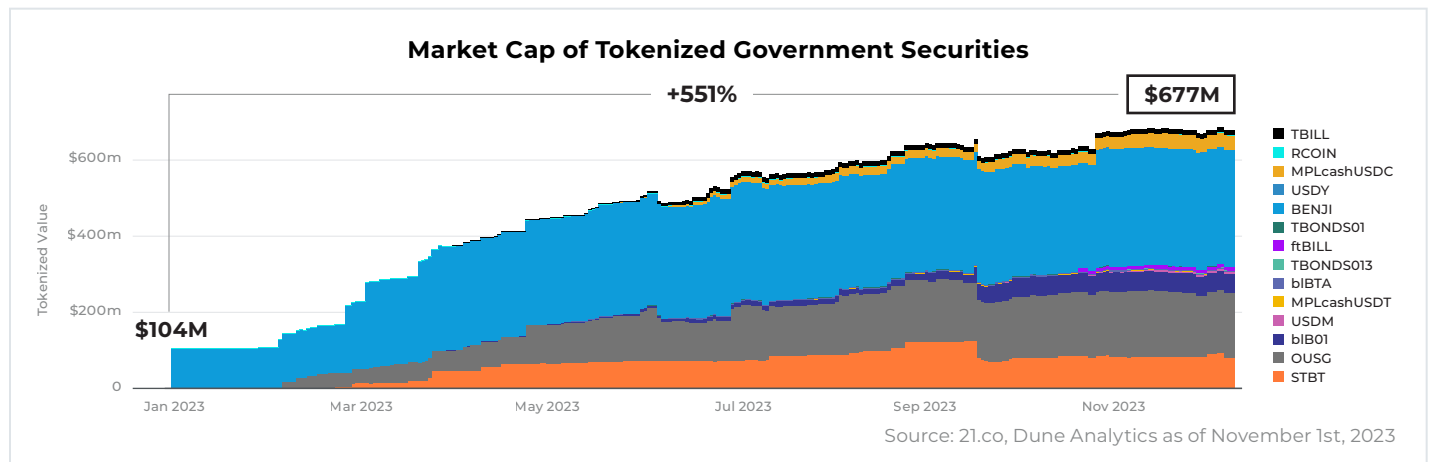
## Market Capitalization of Tokenized Securities

	Market Cap, \$	Market Share	1M Change	1Q Change	YTD Change	1Y Change
<b>Fiat-Collateralized Stablecoins</b>	114.7Bn	98.1%	0.3%	-1.6%	-14.1%	-14.9%
Blockchain - ETH	69.9Bn	59.8%	-0.9%	-3.6%	-27.5%	-29.2%
Blockchain - Tron	44.8Bn	38.3%	2.2%	1.8%	20.7%	24.0%
<b>Commodities</b>	969.4M	0.8%	6.1%	1.0%	3.3%	7.0%
<b>Government Securities</b>	677.3M	0.6%	-0.6%	5.7%	551.4%	182638.0%
<b>Asset-Based Finance</b>	351.7M	0.3%	-0.3%	3.5%	66.5%	70.6%
<b>Real-Estate</b>	107.1M	0.1%	-16.2%	-0.6%	66.1%	81.8%
<b>Corporate Bonds</b>	63.7M	0.1%	0.0%	0.0%		
<b>Private Equities</b>	21.6M	0.0%	0.5%	1.1%	21.7%	22.8%
<b>Equities</b>	5.4M	0.0%	3.6%	6.5%		
<b>Private Funds</b>	4.0M	0.0%	13.5%	74.8%	1115.4%	1115.9%
<b>Total Tokenized Assets</b>	<b>116.9Bn</b>	<b>100%</b>				

Note: includes tokenized assets on Ethereum, Avalanche, Base, Optimism, Arbitrum, Polygon, Gnosis, and Tron

Source: 21.co, Dune Analytics, Coinmetrics as of November 1st, 2023

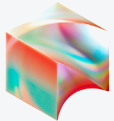
- Tokenized U.S. Treasuries have witnessed a remarkable growth of over 550% this year, with a total of \$677M in assets. The rise of on-chain U.S. treasuries is partly due to the prevailing high-interest-rate environment (5% nominal interest rates today vs. 1-1.5% five years ago). Issuers include well-established traditional finance players like Franklin Templeton, as well as crypto native companies like Ondo Finance, Backed Finance, and others.
- Over the recent years, the leadership of major institutions has become more aware of tokenization's benefits, including instantaneous settlement, the ability to run operations 24/7, automate intermediary functions, and maintain transparent audit and compliance records.
- A survey conducted by EY suggests, that investors may allocate 7% to 9% of their entire portfolio to tokenized assets by 2027. Seeing this opportunity, some of the largest financial services companies are investing heavily in the space and bringing offerings and investments to market.



- Tokenization is likely to scale into a multi-trillion-dollar opportunity by 2030. Projections on the size of the tokenization opportunity vary but estimates range from Citigroup's \$5T to Boston Consulting Group's \$16T by 2030.

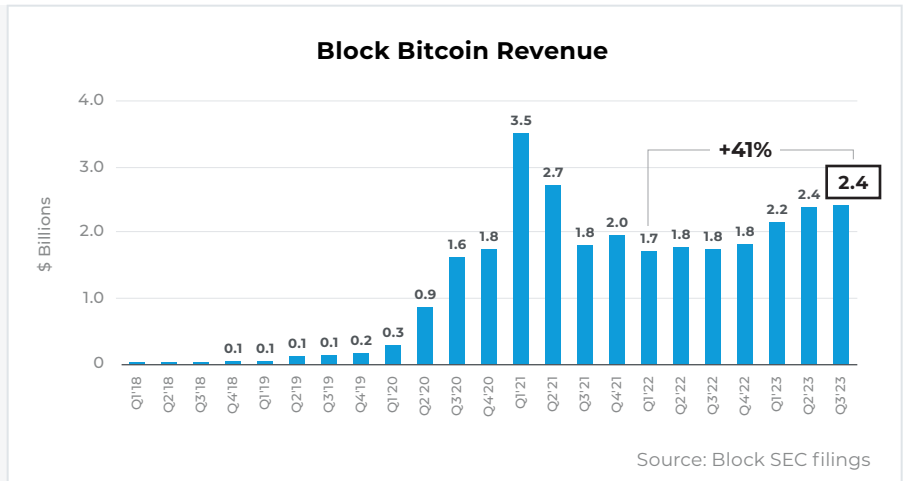
# WEB3 BOOSTING THE BOTTOM LINE OF FINTECH INCUMBENTS

- Fintech giants PayPal and Block were two of the first Web2 companies that added crypto to their product offerings in response to emerging demand from their retail clients.
- Today, the robust growth in Block bitcoin sales and PayPal customer crypto assets demonstrates growing mainstream interest and adoption of cryptocurrencies as an investment and payment option. This trend could encourage other Web2 companies to explore and embrace digital assets.
- We expect a new wave of crypto consumers to come via payment apps and traditional finance.



## BLOCK

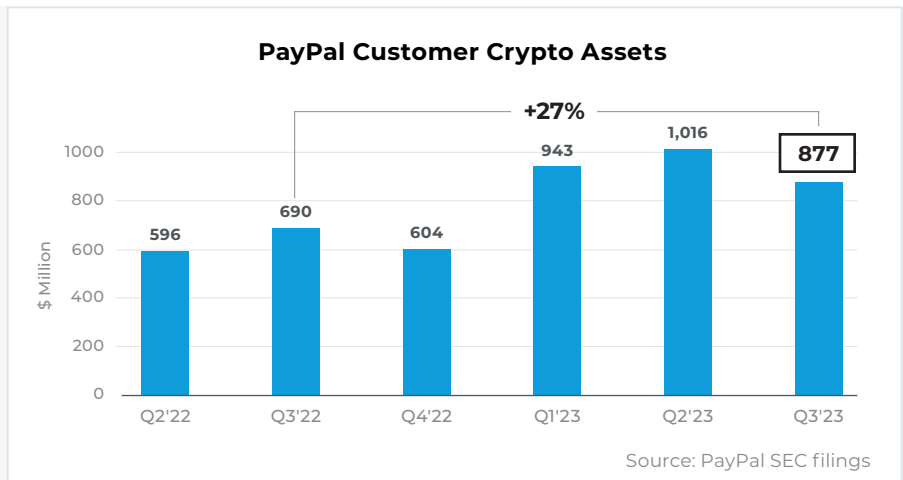
- As of Q3'23, Block (Square) has 55M monthly active users and \$205Bn in gross payment volume.
- CashApp is one of the most popular payment apps in the U.S.
- Block MCap was \$27Bn as of 09/29/23.



- Bitcoin revenue climbed to **\$2.4Bn** in Q3'23 from \$1.7Bn in Q3'22 (+41% Y/Y) and reached **42% of Block's total revenue**, up from just 37% a year ago.
- Earlier this year, Block announced a new business line where the company will serve as a liquidity provider on the Lightning network (Bitcoin layer-2 network) to merchants by helping them cash out quickly.



- As of Q3'23, PayPal had 430 million active consumer and merchant accounts in 200+ countries.
- The LTM total payment volume reached \$1.5T.
- PayPal MCap was \$64Bn as of 09/29/23.



- PayPal customer **crypto assets grew 27% in Q3'23 Y/Y** and reached **\$877M**.
- In August, PayPal announced the launch of its stablecoin, which will fuel further adoption.
- In November, the company achieved registration with the U.K.'s Financial Conduct Authority (FCA) as a crypto service provider, and now it can begin marketing its crypto services to users in the United Kingdom.



## IMPORTANT DISCLOSURES

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