Is Owning Bitcoin Enough?

By Josh Shaffer, *BXE CAPITAL*

Blockchain technologies have begun to fundamentally disintermediate traditional markets. BXE Capital expects that the digitization of assets will continue to be a dominant trend over the coming decades, and we believe that early investors in the digital economy have the potential to capture outsized returns during this migration. Many investors have become excited by the innovation coming from digital assets, but they have wrestled with the best way to gain exposure to the asset class. Does Bitcoin capture most of the market performance, or is further diversification necessary? Does active management make sense? Do private markets offer benefits over public markets? These are essential topics that should be addressed prior to allocating to digital assets.

Bitcoin Has Underperformed the Broader Digital Asset Market

The digital asset industry is rapidly expanding and evolving, with CoinMarketCap.com currently listing over 20,000 projects on its website. This has caused many investors to wonder whether it is worth the effort and brain damage to find exceptional opportunities, or if they should just buy Bitcoin and save themselves the hassle. We believe there is a definitive answer to this question: ***the historical performance data suggests that investors should own more than just Bitcoin.***

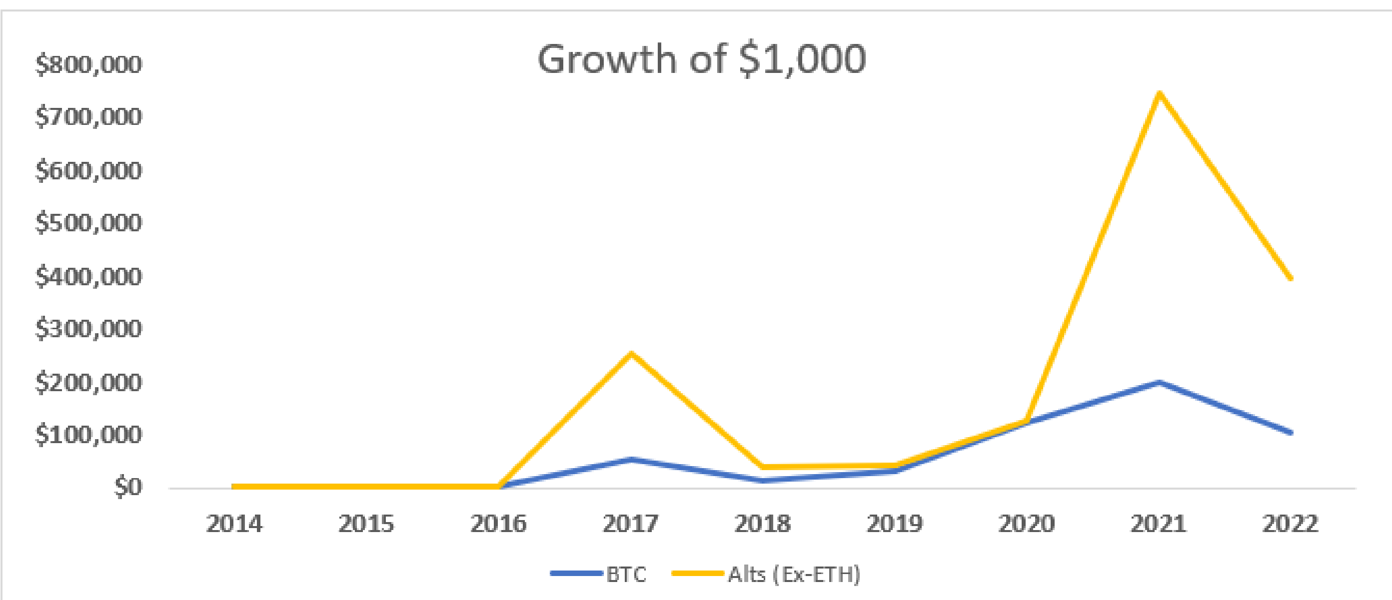
To simplify this analysis, we have divided the digital asset universe into three categories: Bitcoin (BTC), Ethereum (ETH), and Alternative Coins (Total Crypto Market Cap excluding BTC & ETH). Ethereum has been one of the best performing "Alt" coins in history, so to adjust for this outlier, we have carved ETH out of this analysis. The chart below shows the market capitalization of these categories since the invention of blockchain technology.

Bitcoin was the only major digital asset for several years, and it generated truly outstanding returns in its infancy. In 2013, however, a handful of Alts came on to the scene, and they've been outperforming Bitcoin ever since. In the eight full years since the inception of the Alt market, Alts have outperformed Bitcoin four times and underperformed four times. However, when Alts outperform Bitcoin, the magnitude of the outperformance is meaningful. In fact, the compounding created by these high returns has helped to create consistency in the outperformance, with Alts outperforming Bitcoin over every rolling time period within the past seven years.

Year	Calendar Year Return BTC	Calendar Year Return Alts (Ex-ETH)	Excess Return
2011	2,409%		
2012	280%		
2013	6,309%		
2014	-52%	-8%	45%
2015	48%	-56%	-104%
2016	139%	179%	40%
2017	1,433%	20,300%	18,867%
2018	-72%	-85%	-12%
2019	100%	9%	-90%
2020	313%	201%	-112%
2021	62%	488%	425%
2022	-48%	-47%	1%

Period	Trailing Annualized Returns BTC	Trailing Annualized Returns Alts (Ex-ETH)	Excess Return
YTD	-65.6%	-64.8%	0.8%
1-Year	-9.7%	102.7%	112.3%
2-Year	61.8%	135.9%	74.1%
3-Year	71.5%	90.6%	19.1%
5-Year	82.9%	179.7%	96.8%
7-Year	84.3%	119.5%	35.2%

If an investor would have put $1,000 into Bitcoin at the end of 2013, that portfolio would be worth around $100,000 today. You won't hear any complaints about a 100x return. However, if the same $1,000 was invested into a basket of Alts, the investor's portfolio would be worth nearly $400,000. **Since inception, the Alt market in aggregate has outperformed Bitcoin by over 300%.** Again, this analysis excludes Ethereum, the best performing Altcoin.



There are several possible explanations for the difference in performance. Certainly, growing from a small base is easier than growing from a large one, so there is a structural size factor in play. However, we believe that the key driver of this outperformance stems from the fact that Bitcoin acts more like collateral, storing value for holders, while Alts perform more like equities, generating new value for holders. As Bitcoin continues to grow and mature, we expect that this performance differential will continue to widen going forward.

Active Management Is Essential

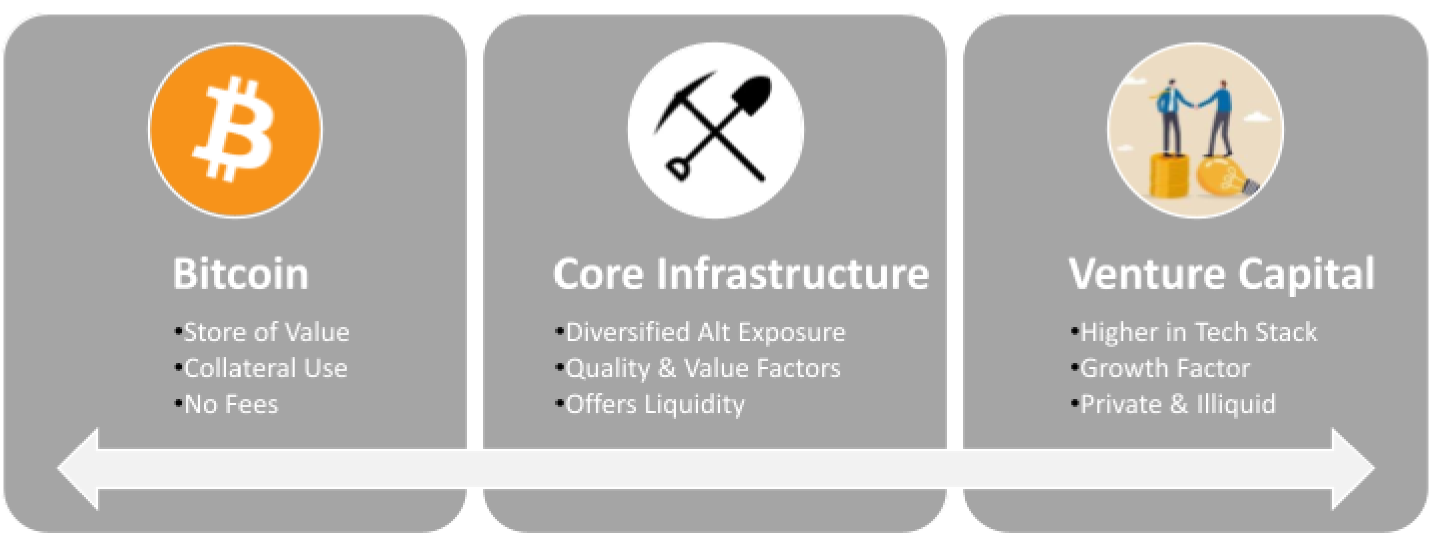
We believe that active management is essential when investing in digital assets. The market is already large and complex, and the potential for additional disruption is still bigger. This technology shift will have implications in every industry across all regions, leaving a massive scope for investors to understand. In addition, there are over 20,000 investible projects across dozens of subsectors. Filtering this universe is no easy task and it requires an excellent process. Prudent investors must do fundamental research on their portfolio holdings in order to know what they own and protect investor capital. Significant edges can be gained in digital assets by doing competitive analysis, sizing addressable markets, understanding absolute and relative valuations, doing channel checks, and tracking growth metrics in real time.

In addition to the fundamental work described above, one must also be up to date on the latest issues surrounding regulation, fraud, counterparties, and taxes. Global policies are rapidly changing and require specialized knowledge to understand corresponding investment implications. As you can see, this level of granularity and complexity is far beyond the scope of an average investor. Identifying a portfolio of quality investments that can capture the broad growth of the digital asset economy is a job best suited for active managers.

Even if an investor wanted to establish passive exposure to digital assets, there are many technical and execution issues in just trying to access the market. For example, sub-sectors of this economy are still being dreamed of and defined, so this makes "indexing" a portfolio nearly impossible. Even if one could identify an index to represent their target exposure via an ETF, structural and legal impediments prohibit ETFs from investing in spot markets. Just owning the top coins by market cap is not a great solution either, as many of the biggest names are meme coins or names that are in overhyped (overvalued) sectors.

Balancing Digital Asset Exposure

BXE believes that investors should take a balanced approach when allocating to digital assets. We believe that Bitcoin deserves a spot in most portfolios. In addition, having some exposure to venture capital experts also makes sense, as they can take longer-term views, drive valuation creation, and offer hands-on help to founders that need it. However, we believe that a majority of a digital asset portfolio should be focused on liquid, core infrastructure investments within the Alt coin market.



There are several reasons why we think that Core Infrastructure should be central to digital portfolios:

- **Market Growth Capture –** Owning high-quality, dominant digital assets is the best way to capture appreciation from the migration from traditional markets to digital assets. We believe that owning the picks and shovels and charging tolls is a safer way to access the market than trying to predict the winning applications at this still-nascent stage. As the digital economy continues to rapidly evolve, a flexible, diversified, high quality portfolio should thrive.

- **Liquidity Provides Optionality**– Tokenized Core Infrastructure investments have a return and risk profile similar to early-stage venture investing, but they offer much better liquidity than traditional VC. This gives investors the ability to make rapid changes to their portfolio depending on market conditions (e.g. fundamentals change, price target achieved, tax loss harvesting, etc.). The optionality provided by liquidity is an essential asset in this rapidly evolving industry.

- **Being Public Drives Value Creation** - The goal of many protocols within the digital economy is to grow their networks to a size where they can benefit from a network effect in a particular sub-sector or market. Network effects keep competition at bay and ultimately drive value to owners. In addition, network effects typically lead to one or a few market participants dominating a space, so it is common to see “arms races” for network growth early on. These factors create a meaningful disincentive to stay private in the digital asset market, unlike what usually happens in equity markets.

- **Diversification & Portfolio Balance** - Just because an investor has exposure to a digital asset VC fund does not ensure that they own core infrastructure. A portfolio that is heavily weighted towards private capital is at the mercy of market conditions during its investment period, so it is more likely to have vintage diversification issues, unintentional sector tilts, and a bias toward growth over quality. Core Infrastructure investments help to balance portfolios by providing diversified, high-quality exposure via market leaders and incumbents.

- **Most VC Funds Are Too Large** – Size is often the enemy of performance, and many venture funds in the digital asset market today are way too big. These funds must put money to work and are often more interested in how much capital they can deploy than the valuation at which they deploy it. They are less likely to spend time on exceptional opportunities unless they can deploy enough capital for an investment to “move the needle” in their portfolio. This often creates attractive opportunities in secondary markets relative to private markets.

Market digitization is a theme that is not going away. It is critical for investors to establish an asset allocation framework for digital assets if they hope to monetize this opportunity. We believe that partnering with a best-in-class, Core Infrastructure manager is the optimal way to access this market.