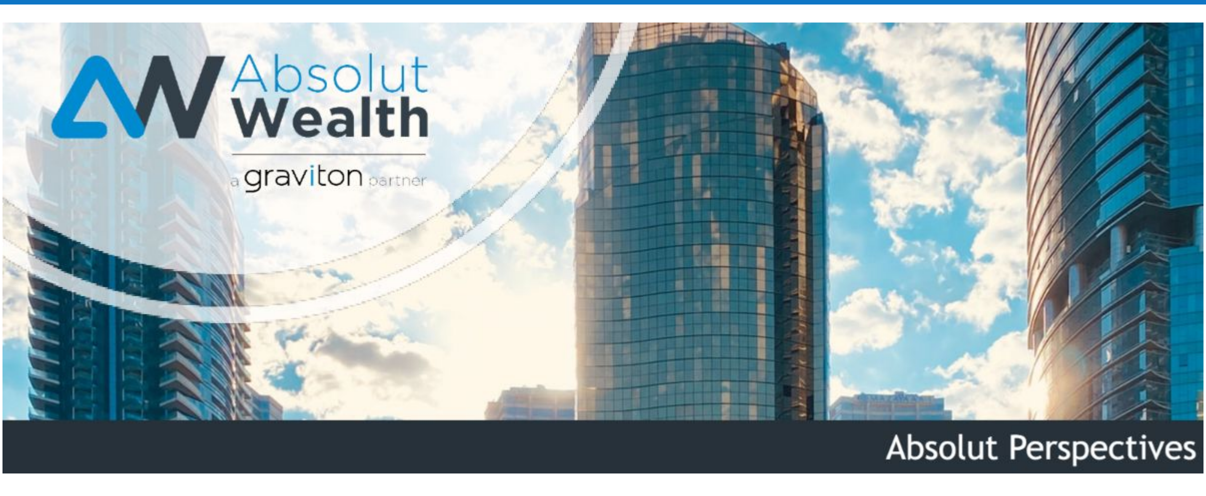


Cryptocurrencies - A Glance Away from Traditional Financial Markets

Richard Harris I January 2023

For January, as bulls and bears continue to try and find direction in Global traditional markets, we thought we would diverge from the norm and introduce a very new, somewhat misunderstood, and exciting asset class known as Cryptocurrencies.

For good reason, Cryptocurrencies have been a hot topic among social circles, asset managers, and the many other people that share varying views on the future of this intriguing technology. As with other new technologies, volatility reigns supreme as buyers and sellers battle it out to establish a fair price and an understanding of the path ahead.

So, what are Cryptocurrencies and where did they originate?

The idea for a Cryptocurrency first began in the late 1980s and was based around the notion that money could be sent untraceably from one party to another without authorization from a 3rd (centralised) party. I.e., sending money safely without the need for a bank or someone else to verify that the transaction is legitimate.

There were numerous attempts to accomplish this process and despite many worthy efforts, the first legitimate attempt was announced by a person / body known as "Satoshi Nakamoto" in late 2008 when the white paper (explanation paper) of Bitcoin was published on the 31st of October 2008.

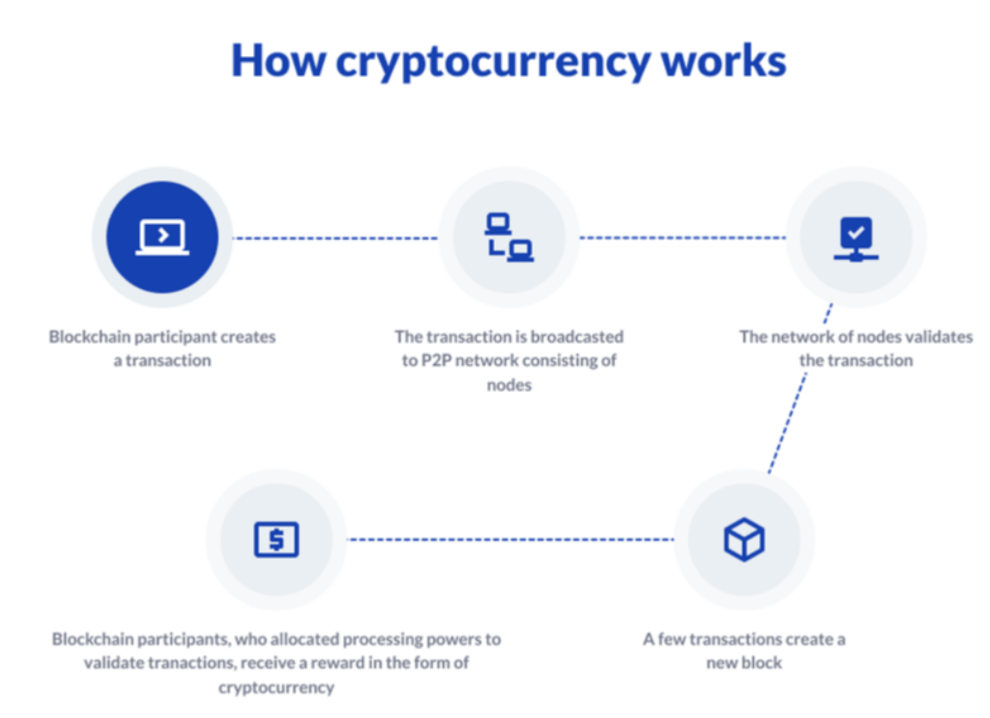
For the purposes of this newsletter, I will try to err away from the complexities behind the technology of blockchain (as even I am still coming to grips with it all) and use this as a way to cover the use cases of (1) Bitcoin and (2) some of the other primary Cryptocurrencies such as Ethereum.

(1) BITCOIN

Unlike the Rand, Dollar, Euro, or Yen, which are "centralised" forms of currency, Bitcoin is categorised as a "decentralised" currency. Standard currencies that define our current economies are centralised in banks and controlled by the government. With Bitcoin, there is no central governing body and the currency itself is governed and controlled by a network of users who operate and verify the monetary transactions. As mentioned above, it took decades to crack this problem and ensure that such a network could verify monetary transactions in a trustworthy manner without the possibility of being intercepted or hacked.

It is for this reason that Bitcoin itself has had such an appeal. Instead of having to convert currencies and pay third parties to ensure that transactions are safe, people can now transact globally for goods and services using a single currency (Bitcoin) with fees coming in at a fraction of the cost and transactions taking place in a matter of minutes versus traditional international transfers taking anything from 2 days to a week.

Based on this, it is easy to see the use-case of Bitcoin as a decentralised currency, and given there are only 21 million Bitcoins in circulation, you can understand where the value lies, especially as the technology gathers greater adoption and user interface (UI).



(2) ETHEREUM and other "ALTERNATIVE (ALT) COINS"

After the rise and further adoption of Bitcoin, many developers from all around the world started conjuring ways in which the Blockchain (network used for verification) could be applied to different use cases, over and above monetary transactions.

In 2013, Ethereum was created by a programmer by the name of Vitalik Buterin and went live in 2015. It was created with the intention of using Blockchain technology to facilitate "smart contracts" and Cryptocurrency trading securely, without the use of a 3rd party. Ethereum essentially allows other developers to deploy an array of decentralised applications using Blockchain technology.

Unlike Bitcoin, Ethereum offers several methods of exchange, most notably "smart contracts", which is a computer program on the network that automatically confirms and executes or documents legally relevant events or actions according to the terms of a contract or agreement (a mouthful to most I'm sure). A "smart contract" verifies that a specific task has been done without the need of a 3rd party to do so. The contract can then release the agreed upon remuneration for the work that has been done.

This may not sound like a big deal but being able to automate such a process whilst removing parties and layers of fees is a massive step in the right direction and has scope to disrupt and transform almost every industry from Real Estate to Financial Services and could even help improve integrity in elections.

Based on the Blockchain and as a result of the successes, functionality, and opportunities presented by the creation of Bitcoin and Ethereum, multiple "alt coins" and Cryptocurrency / Blockchain derivatives have been borne in the last decade, many with real-world use cases that are likely to create important efficiencies into the future. However, as with many new technologies and industries, there are also many opportunists out there, using schemes and promising somewhat uneducated users upside based on fraudulent activity.

It's anyone's guess where this technology will take us in the coming decades but also unlikely that it will cease to be implemented in a significant way. Much like the late 90s / early 00s and the creation of the internet, there will be many successes and failures as the world tries to better understand the efficiencies created and as adoption takes place.

The Blockchain, and Cryptocurrencies in general, are currently fairly difficult for most to transact in and use on a day-to-day basis but many systems are being created by some of the smartest people in the world to improve user experience and make the technology easier for all to use.

My final note in this newsletter is one of caution; I cannot emphasize enough that with this new technology, a whole new industry of criminals and scammers has been created. It is essential that if you choose to venture into the world of Cryptocurrencies (in their early states), you do so with the help of someone who is already knowledgeable in that space. Only use established platforms. There is no such thing as a "get rich quick" scheme and if it sounds too good to be true, it probably is.

Market Update

Since our last newsletter in December, markets have struggled to find direction but have remained somewhat elevated as China has reopened and market participants continue to doubt the US Federal Reserve's narrative of continued tightening conditions.

Post the 2008 Global Financial Crises, global economies have become obsessed with the easing function of Central Banks, where interest rates are lowered and money is issued into economies at any sign of weakness. This has been necessary due to the fragility of many economies and as a result, many asset classes have moved significantly higher over this period.

However, after the last and most aggressive round of easing, post the start of the COVID-19 outbreak in 2020, many regulators and policy makers have come to realise that this magnitude of quantitative easing cannot be sustained without adverse effects on the economy such as inflation.

The reset of these adverse effects is currently in place and as a result, many companies and asset classes that excelled during the last decade are expected to face headwinds in the near term; those with significant debt even more so.

Year-to-date, we have seen significant moves higher in markets globally. The NASDAQ (US Tech.) has led the way up 16% with Hong Kong's Hang Seng and SA Top 40 close behind, up 11.2% and 9.7%, respectively.

On the commodity front, Copper, Gold, and Silver have moved higher by 11%, 5%, and 2%, respectively, with Natural Gas taking the wooden spoon (down 38%) as the Northern Hemisphere has experienced an exceptionally mild winter, something that was not foreseen.

Consumer Discretionary, Technology, and Real Estate have been the sectors that have led the way so far this year, up between 10% & 15% after being bashed significantly lower in 2022. On the other side of the coin, those that performed most last year such as Consumer Staples, Health Care, and Energy have struggled to get out of the gates.

As we are all acutely aware, South Africa has had its own struggles year-to-date with electricity supply and infrastructure strength remaining at the forefront of all our frustrations. Unfortunately, there seems to be no short term solution in sight and hopefully the population votes wisely in the 2024 general elections.

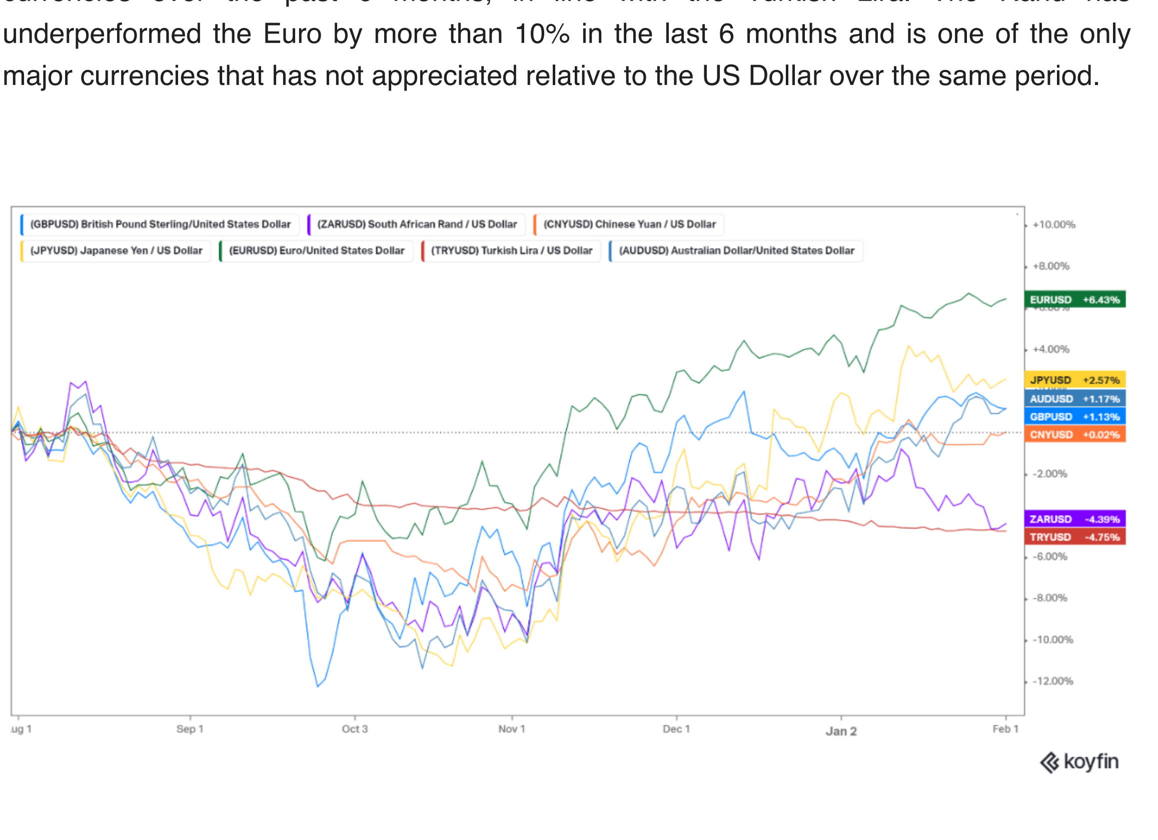
Despite the above, South African Indexes have continued higher, led mainly by Naspers and Prosus (Chinese Technology) and by renewed demand for commodities with China reopening. Some might think that the Rand is holding up well but against major peers, however, it has not, as the Dollar has weakened almost 11% from its September 2022 highs. The chart of the month will highlight this.

Our market outlook, both locally and offshore, remains cautious as we continue to monitor ongoing global developments and commentary from Central Banks. We remain defensively positioned with maximum offshore exposure and relatively high levels of cash and defensive allocations among our portfolios. We will look to deploy into higher return (alpha) generating investments that offer adequate risk-adjusted returns at favourable entry points in the near future.

Chart of the month:

ZAR / USD versus other major currency pairs (over the past 6 months)

As you can see in the chart below, the Rand (in purple) has underperformed other major currencies over the past 6 months, in line with the Turkish Lira. The Rand has underperformed the Euro by more than 10% in the last 6 months and is one of the only major currencies that has not appreciated relative to the US Dollar over the same period.



"Don't judge each day by the harvest you reap but by the seeds that you plant" - Robert Louis Stevenson