

Hedge Fund ALERT

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Opportunity Touted in Crypto Play

Cryptocurrency-index fund operator **Bitwise** has begun marketing its largest product to hedge funds.

The effort ties in with a plan by the San Francisco firm to list its Bitwise 10 Crypto Index Fund on **OTC Markets'** OTCQX Best Markets exchange.

The pitch to hedge fund managers is that they could invest in the entity via private placements even after it goes public. Those shops, in turn, could take advantage of an under-the-radar market inefficiency while avoiding the hassles typically associated with cryptocurrency exposures.

Early indications are that the effort is attracting strong interest both from hedge fund firms and proprietary-trading operations.

The Bitwise 10 vehicle currently runs about \$40 million, and like Bitwise's other offerings has been heavily marketed through wealth managers. Bitwise unveiled its plan to list the entity in March and could complete the process in the second half.

Why would hedge fund operators be interested? Consider the case of **Grayscale Investments**, which ranks as the largest manager of cryptocurrency funds with \$3.9 billion in 10 vehicles. Four of those entities trade on OTC Markets exchanges, each with a share price that is consistently far higher than its underlying net asset value. The price of entry for private placements, by contrast, is asset value plus a management fee.

Under U.S. securities law, investors must hold their privately purchased shares for 12 months in instances where the vehicles don't report to the **SEC**, as appears to be the case for Bitwise 10, or six months for those that do report. But they then can sell the positions publicly at the quoted prices.

And institutional investors, including hedge fund firms, appear to love the idea. Grayscale began reporting to the SEC in January, bringing the window for sales of its privately placed



shares down to six months. It raised \$504 million overall in the first quarter, with 88% of that amount coming from institutional clients, and reported another \$431 million in April and May.

According to OTC Markets, 27% of the total shares in Gray

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scale's flagship Grayscale Bitcoin Trust currently are restricted. The vehicle's over-the-counter shares have commanded an average premium of 39.6% to net asset value since they became available in 2015. On June 1, they were trading at a 24.1% premium, according to **Bloomberg**.

Grayscale Bitcoin Trust had net assets of \$3.4 billion on June 1.

Grayscale's next-largest fund is Grayscale Ethereum Trust, with net assets of \$331 million. That vehicle was trading at a 489% premium on May 29. The firm's other two over-the-counter vehicles have been trading at premiums of 27.2% and 137%.

In fact, Grayscale's funds have only traded below their net asset values for three days ever — all for Grayscale Bitcoin Trust and none since 2017. And the lowest it got was minus-34 bp.

The premiums reflect a situation in which individuals want cryptocurrency exposures but without the potential risks of owning digital assets themselves. At the same time, large hedge fund managers typically consider the investment tools, services and regulatory environment surrounding that market to be too insecure and unseasoned to justify direct commitments of client capital.

Enter cryptocurrency-focused operations including Bitwise and Grayscale, which increasingly are competing for the attention of those shops. And **J.P. Morgan** agreed in April to offer banking services to two major cryptocurrency exchanges, a move other leading banks have avoided because of legal concerns.

At the same time, notoriously volatile digital-asset values have shown resiliency during the coronavirus pandemic. While the Bloomberg Galaxy Crypto Index lost 58.5% from Feb. 15 to March 16, it was up 34% from Jan. 1 to May 31 — versus a 5% loss for the S&P 500 Index.

Tudor Investment also made waves last month by telling

limited partners it would move a modest amount of capital into cryptocurrency futures.

As for Bitwise, the firm believes its offering is substantially differentiated from Grayscale's. That's because the Bitwise 10 vehicle tracks an internal index of the 10 largest cryptocurrencies. The upshot is that once listed, it would be the only digital-asset index fund available across all U.S. brokerage accounts.

Grayscale's most comparable vehicle is the \$34 million Grayscale Digital Large Cap Fund, which aims to invest in cryptocurrencies representing the top 70% of the market. But the firm doesn't claim to follow a true index for that entity, which it has been touting via a national marketing campaign since listing it in November.

Bitwise 10's privately placed shares presumably would have a 12-month holding period at the outset.

Bitwise is led by **Hunter Horsley**, a former **Facebook** and **Instagram** project manager who founded the firm in 2016. Advising on the effort to list the Bitwise 10 fund is **Annemarie Tierney**, who in November set up a consulting firm called **Liquid Advisors** in Highlands, N.J. As general counsel of the former **SecondMarket**, today known as **Digital Currency Group**, she earlier headed the legal and regulatory efforts that resulted in the approval of Grayscale Bitcoin Trust's over-the-counter listing.

Bitwise's main mode of fund distribution has been a sales staff of eight who each month place some 2,000 calls to financial advisors working on behalf of accredited investors. Its head of business development is **Mick McLaughlin**, who earlier headed exchange-traded fund distribution at **Deutsche Bank**.

In addition to Bitwise 10, the firm manages three smaller passive digital asset vehicles and sub-advises a cryptocurrency index fund for **Morgan Creek Capital**. It also is among numerous firms, including Grayscale, that have sought SEC permission, so far unsuccessfully, to manage exchange-traded funds that invest in digital assets. ❖