Market Review

MAR 2022

Genesis

MARCH 2022 MONTHLY REVIEW

Introduction

All months in crypto markets are full of new developments, innovative ideas, intriguing price moves and more than a sprinkling of drama. March 2022 is likely to go down in history books, however, as one of the most dramatic months in all markets, not just crypto.

The continuing war in Europe, the near-inversion of the yield curve, distortions in commodity markets, oil at over $110/barrel and the unprecedented escalation of sanctions are just some of the issues investors have had to get their heads around this past month as they come to terms with a market environment for which there is no rule book.

As such, crypto has had to deal with more than the usual amount of macro drama on top of the always-present micro drama in the form of exploits, exits, acquisitions and volatility. The correlation between BTC and the S&P 500 remains unusually high, while BTC's correlation with the VIX is unusually low. Interest in Ethereum's upcoming consensus algorithm switch is gaining momentum while layer-1s benefited from an accelerated rhythm of ecosystem fund launches and Terra started rewriting the rules around algorithmic stablecoins.

Meanwhile, institutional interest has continued to build, with a flurry of statements from key legacy financial institutions pointing to a growing conviction that the digital asset space is worth the dedication of more resources. And a steady rhythm of large funding rounds and multi-billion dollar valuations underscores the relative strength of venture interest in crypto businesses vs. the shrinking term sheets seen elsewhere in fintech.

The report that follows looks at some of the main themes driving markets in March, in an effort to separate some signal from the constant percussion of noise as crypto markets and the industry that supports them continue to grow, innovate and work through the issues that are telling the story of tomorrow's finance.

In the pages that follow, we touch on:

→ Bitcoin's evolving use case

→ Ethereum's upcoming change

→ Terra's grand stablecoin plans

→ NFT culture shifts

→ The Executive Order

→ ...and much more.

Nothing in this report is intended to be investment advice—our aim is to update and explain some of the shifting narratives driving crypto markets. We hope you find it useful.

(Note: we use uppercase Bitcoin to denote the network, and lowercase bitcoin or BTC to denote the asset; for Ethereum, we use

uppercase to denote the network, and ether or ETH to denote the asset. All $ are USD unless otherwise specified.)

March performance

The March performance of the top 10 assets ex-stablecoins ranked by market cap:

Asset			Price USD	Mkt cap bn	Mar '22	30D RV
Bitcoin	BTC	Currency	$45,562.21	$728.52	5.52%	60.69%
Ethereum	ETH	Layer-1	$3,281.79	$320.43	12.60%	58.83%
BNB	BNB	Exchange token	$436.09	$62.16	10.16%	47.03%
Solana	SOL	Layer-1	$130.55	$35.22	30.90%	82.25%
XRP	XRP	Currency	$0.82	$31.51	4.26%	59.93%
Cardano	ADA	Layer-1	$1.14	$20.50	19.62%	78.61%
Terra	LUNA	Layer-1	$105.00	$19.23	14.88%	113.60%
Avalanche	AVAX	Layer-1	$97.25	$17.06	14.97%	76.69%
Polkadot	DOT	Layer-1/Layer-2	$21.37	$12.25	13.05%	71.38%
Dogecoin	DOGE	Meme coin	$0.14	$11.73	3.72%	60.17%

Top 10 assets ex-stablecoins ranked by market cap. Prices at 0:00UTC 4/1/22. Source: Messari

1 Macro

Rates and Inflation

The daily tragedy of war in Europe has both distracted from and exacerbated the focus on inflation we have seen building up over the month. It has distracted in the sense that the economic woes on the horizon are even broader now than the impact of higher living and borrowing costs. It has exacerbated them by sending commodity prices soaring and triggering concerns of shortages that not only continue to push prices up higher, but also could end up causing severe discomfort and political unrest.

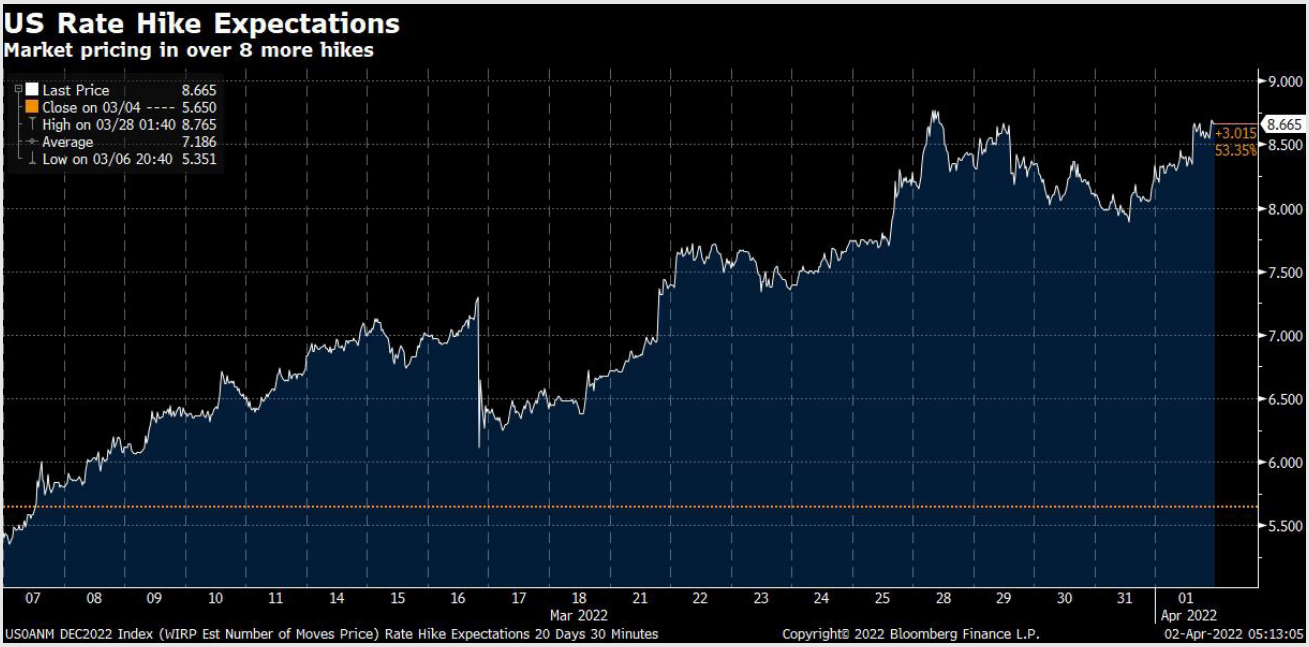
To get a glimpse of the inflationary pressures at work, we need look no further than base commodity prices (data from Bloomberg):

- → The price of oil (ICE Brent) jumped a further 7% over the month and is now up 74% over 12 months. This will obviously impact transport costs and electricity, but also plastics, cosmetics and hundreds of other consumer goods.
- → Natural gas prices jumped 26% in March, 600% over the past year, making home heating and cooking tragically expensive for many, and pushing up the price of fertilizer, transportation and plastics.
- → Wheat prices are up almost 8% in March, over 60% on the year, having traded limit up[1] on several occasions during the month. This will obviously impact the price of staples such as bread and pasta, but also feed for livestock.
- → The price of corn rose over 8% during the month, over 50% over the past 12 months, impacting a significant source of food for people as well as farm animals and livestock.
- → Nickel and iron ore prices were both up over 30% in March alone.

Most of these increases are likely to be transitory, but could nevertheless last for a long time as even once the war is over, supply chains will take some time to resume a semblance of normality. What's more, it's unlikely they will all resume their pre-war configurations, resulting in the dislocation of efficiencies as new sources find new paths and draw up new contracts with perhaps radically different payment terms.

Meanwhile, the US Federal Reserve is finally acknowledging that inflation is not the transitory problem it originally thought. February's annual inflation figure was in line with expectations at 7.9%, but the annual PPI increase in February was an alarming 10%, the highest since 2009. At the FOMC meeting on March 16, Chairman Powell announced a federal funds rate increase of 25bp, the first increase since 2018.

1 The CME places maximums on the amount many commodity futures can increase or decrease in a given day.



(chart from Bloomberg)

The bond market in March, both before and since the FOMC meeting, has been sending mixed signals, with expectations of more than eight rate hikes before the end of the year coupled with a forecast of declining rates by the end of 2023 and a 2yr10yr spread that hit 0 just as the month ended, for the first time since mid-2019.

The stock market, on the other hand, ploughed ahead with the S&P 500 ending the month over 7% higher than before the invasion of Ukraine. Looking just at the rate increase scenario this is not completely unexpected—in previous rates increase cycles, the stock market continued to rise in the early stages. This time, however, it's not just that discounted cash flow valuations of companies will be hit by higher rates; it's also that profits will be squeezed through higher input costs and wages. What's more, this time around stock market indices have a much higher weighting of high-growth stocks than in previous cycles, which implies an even stronger potential hit to the main indices. And the global economy is grappling with the chaos and destruction of a war that at time of writing looks like it will drag on for longer and end up being more financially damaging than many initially expected, even for countries not directly involved.

The War

It is easy to lose sight of the fact that the traditional economic order was changing radically even before the Russian invasion of Ukraine. The flood of monetary easing triggered by the pandemic, the explosion of government debt and the unwinding of globalization that had started even before supply chains ground to a halt in 2020 all pointed to higher input costs and inflation issues further down the line.

In January, Chairman Powell ditched the use of the word "transitory" to describe the annual inflation that had already reached 7%, and the market became obsessed with the specter of rate increases, pushing stocks and bitcoin into erratic risk-off behavior. When news broke of the Russian invasion of Ukraine, both stocks and crypto fell sharply, with BTC down 7% within the space of three hours.

As much of the world began to align against Russia and as sanctions began to flow, the role of bitcoin on the global stage came under increased scrutiny from supporters and detractors. On the one hand, you had the focus on bitcoin as a seizure-resistant, easily portable independent

store of wealth which refugees could carry across borders and which citizens unable to access their savings could use to transact. On the other hand, you had regulators loudly voicing concern that bitcoin could be used to evade sanctions, in spite of expert testimony to the contrary.

Meanwhile, a different type of attention emerged from two significant moves by the main players in the current power struggle.

1. The decision to freeze Russian access to their foreign currency reserves highlighted how vulnerable fiat-based assets held in centralized repositories can be in times of uncertainty. Bitcoin's bearer-asset nature combined with its ease of transfer (unlike other types of bearer assets such as gold) make it a possible alternative for governments and central banks looking to consolidate reserves in assets that cannot be frozen by unfriendly trading partners.

2. The announcement by Russia that it would only accept payment for oil and gas in rubles from "unfriendly" nations, and the rumblings from Saudi Arabia that it was considering selling oil to China in yuan, point to the shifting power of the dollar as the global reserve currency in which a significant majority of commodity trades are based. Could bitcoin take its place?

Much of the speculation around a growing role for bitcoin in international trade and global reserves is for now precipitate as, at this stage in its evolution, the cryptocurrency has neither the liquidity nor the global regulatory acceptance to satisfy the needs of major economies and corporations. However, the war in Europe has triggered a new level of attention to these types of questions, with even seasoned financial experts and military strategists acknowledging that this narrative is likely to intensify over the coming years as we witness meaningful shifts in the trade relationships and financial plumbing that has been supporting the economic balance of recent decades.

2 Bitcoin

Metrics

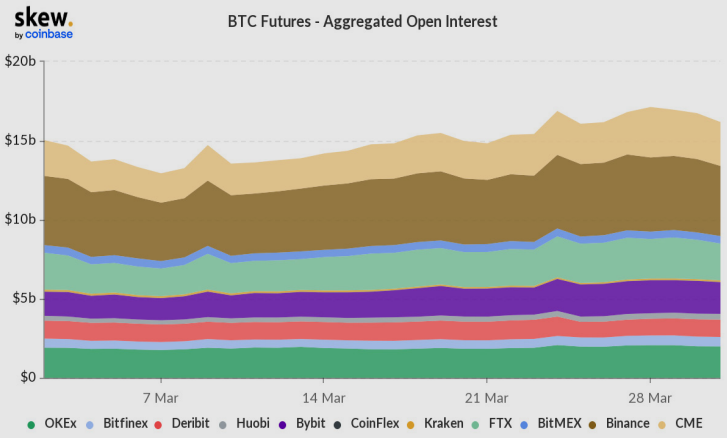
Bitcoin's 5.5% rally in March, coupled with its 12% price increase in February, has almost unwound the dramatic losses of January, bringing the quarterly performance to a neutral -1.7%.

(chart from Messari)

After a macro-fueled surge early in the month that pushed Bitcoin's market cap dominance[2] above 44% for the first time since November, this metric has declined over the past few weeks, pointing to a rotation into smaller-cap tokens with less macro-weighted narratives.

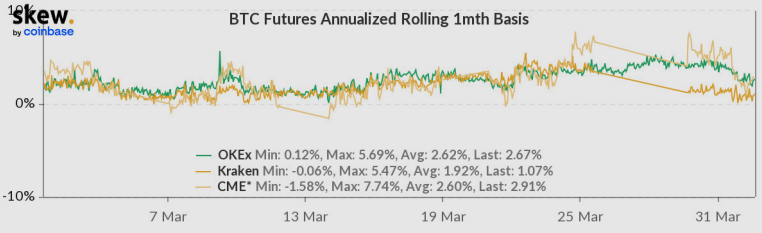
(chart from TradingView)

Nevertheless, derivatives market data pointed to an improvement in sentiment toward the end of the month, with BTC futures and options open interest reaching their highest points so far this year.



(chart from skew.com)

The 1-month annualized rolling BTC basis on the CME also emerged from its year-to-date lethargy to exceed 7% at one point, for the first time since December. What's more, for much of the last week of March, the basis on the CME was higher than that on crypto-native exchanges, hinting at increasing institutional interest.



(chart from skew.com)

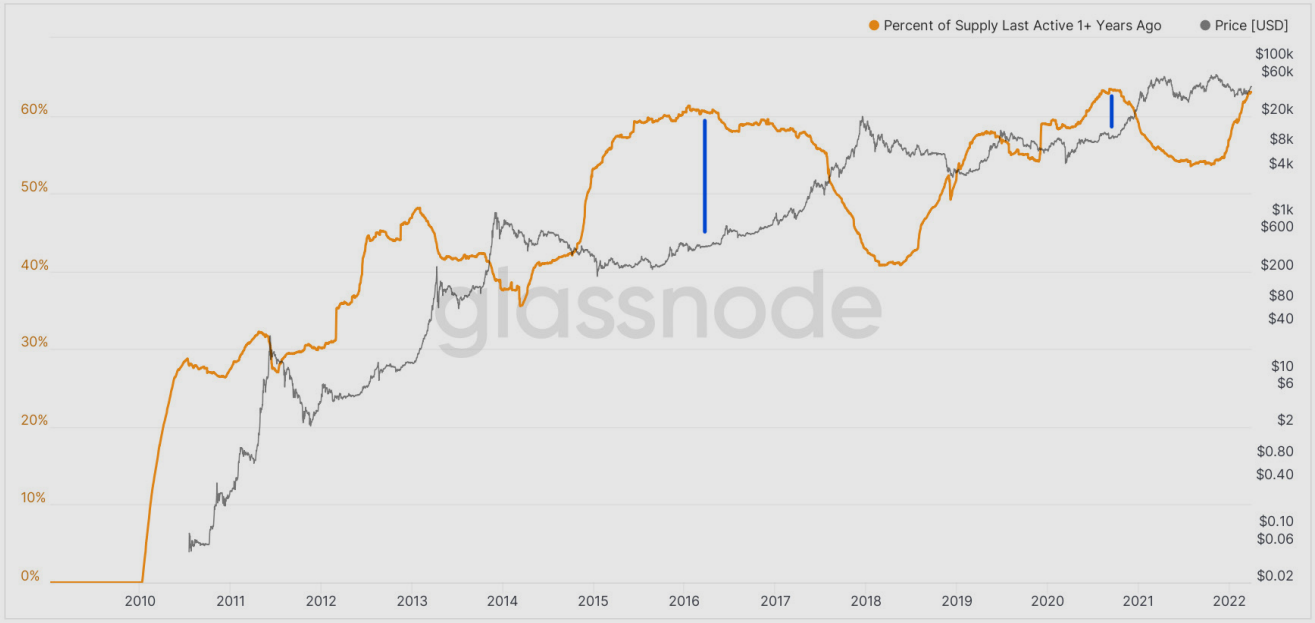
The positive shift in momentum was unwound as the month drew to a close, however, with both the BTC basis and the perpetual futures[3] funding rate[4] showing signs of weakening price optimism.

2 Bitcoin's market cap relative to the total crypto asset market cap, expressed as a percentage and often referred to as BTC.D.

3 A derivatives product unique to crypto markets—these are futures contracts that do not expire, they are automatically rolled over. These typically offer significantly higher leverage than traditional futures and are traded on offshore exchanges.

4 The funding rate keeps the perpetual futures contract price in line with the spot price. When the futures price is higher than that of spot markets, long positions pay a percentage rate to short positions—the wider the difference (i.e.. the more bullish the market), the higher the rate. When the futures price is lower than the spot price (i.e.. bearish sentiment), short positions pay longs—this appears as a negative rate.

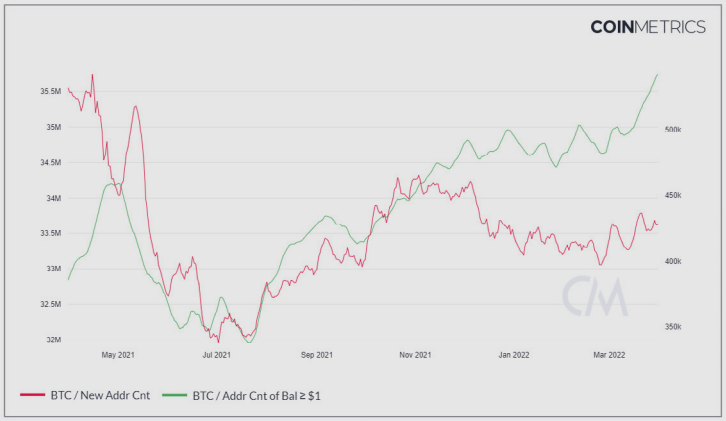
Bitcoin: Percent of Supply Last Active 1+ Years Ago



glassnode

(chart from glassnode)

Nevertheless, on-chain data confirmed the continuing accumulation behavior of longer-term investors. The number of BTC held for over one year exceeded 63%. This has only happened once before, in August 2020, after which BTC then rallied over the subsequent six months by over 300%. A similar peak in January 2016 preceded a BTC price rally of 60% over the following six months and more than 3000% over the following two years.[5]



(chart from Coin Metrics)

Meanwhile, onchain activity is also picking up. The number of BTC addresses with a balance of at least $1 reached an all-time high of 35.5 million, and the new BTC addresses opened daily started to pick up again after months of decline.

Institutional Interest

A striking feature of the past month has been the rapid rhythm of announcements signaling growing institutional interest in crypto. This has been a feature of crypto markets for some time, but the high profile of the names involved this month and the condensed flow of news and statements hints at a shift in the understanding of the potential and a spreading acceptance that crypto is here to stay.

Possible reasons for this shift include:

→ The President's executive order expressing both support for the innovation and caution as to the risks (see more in the "Regulation"

5 We do not mean to imply the same could happen now—the bitcoin market was very different in 2016, a lot thinner and with less institutional participation.

section), signaling that the asset class is large enough to warrant attention at the highest regulatory level

→ Increasing awareness of its potential utility as a global store of value given recent headlines

→ The inevitability of continued increases, at least in the short-term, in global inflation indices

→ A spreading acknowledgement that the established economic order is changing, opening up possible opportunities for new ideas and concepts

Among the key announcements pointing to a heightened level of institutional involvement are:

→ Goldman Sachs revealed that it had executed its first over-the-counter (OTC) derivatives trade, reportedly the first crypto OTC transaction by a major bank in the US. This adds to its offering of BTC non-deliverable forwards[6] as well as CME-traded BTC and ETH futures and options.

→ BlackRock's CEO Larry Fink said in a letter to shareholders that BlackRock was studying digital currencies and stablecoins due to increased client interest.

→ Investment bank Cowen unveiled a digital asset division, Cowen Digital LLC, which will offer institutional-grade trade execution and custody solutions.

→ Market maker Virtu is reportedly expanding its roadmap for crypto services.

→ TP ICAP, the world's largest interdealer broker, expanded the custody network for its soon-to-launch digital assets platform

→ Bridgewater Associates, the world's largest hedge fund, is preparing to back its first crypto fund.

→ Former a16z partner Katie Haun's new firm confirmed a raise of $1.5 billion for two new crypto funds, the largest raise ever for a single-partner firm.

→ We also saw announcements that former executives from Citi, Credit Suisse and Bain Capital are setting up separate crypto projects

6 An agreement to settle on a specified date in the future the difference between the contract price and the spot price. Unlike futures contracts, non-deliverable forwards (NDFs) tend to be non-standardized.

3 Ethereum

Metrics

March delivered a strong performance for ETH, with an increase of over 12%. This was not enough to offset the sharp drawdown in January, however, leaving the quarterly performance at -10%, well below BTC's -1.7%.

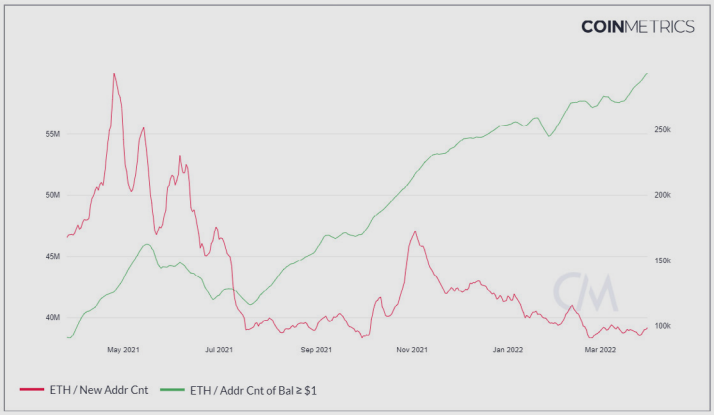
(chart from Messari)

This shift in relative interest can be more clearly seen in the ETH/BTC chart, which tracks the ratio of the prices of the two assets. The ratio going up can signal not only ETH outperformance, but a broader risk-on sentiment as investors focus on higher-volatility assets. A downward slope indicates BTC outperformance, which is common during surges in institutional interest and can also indicate a rotation into the relative "safety" of the most liquid cryptocurrency. In March, however, the narrative is partially influenced by growing interest in the upcoming shift to a new consensus algorithm (*more on this below*).

ETH/BTC

(chart via glassnode)

Onchain activity remained relatively subdued over the month, with average daily transaction volume in ETH terms continuing its gradual decline. The number of both new and active addresses remained more or less steady while, as with BTC, the number of addresses with a balance of at least $1 reached all-time highs.

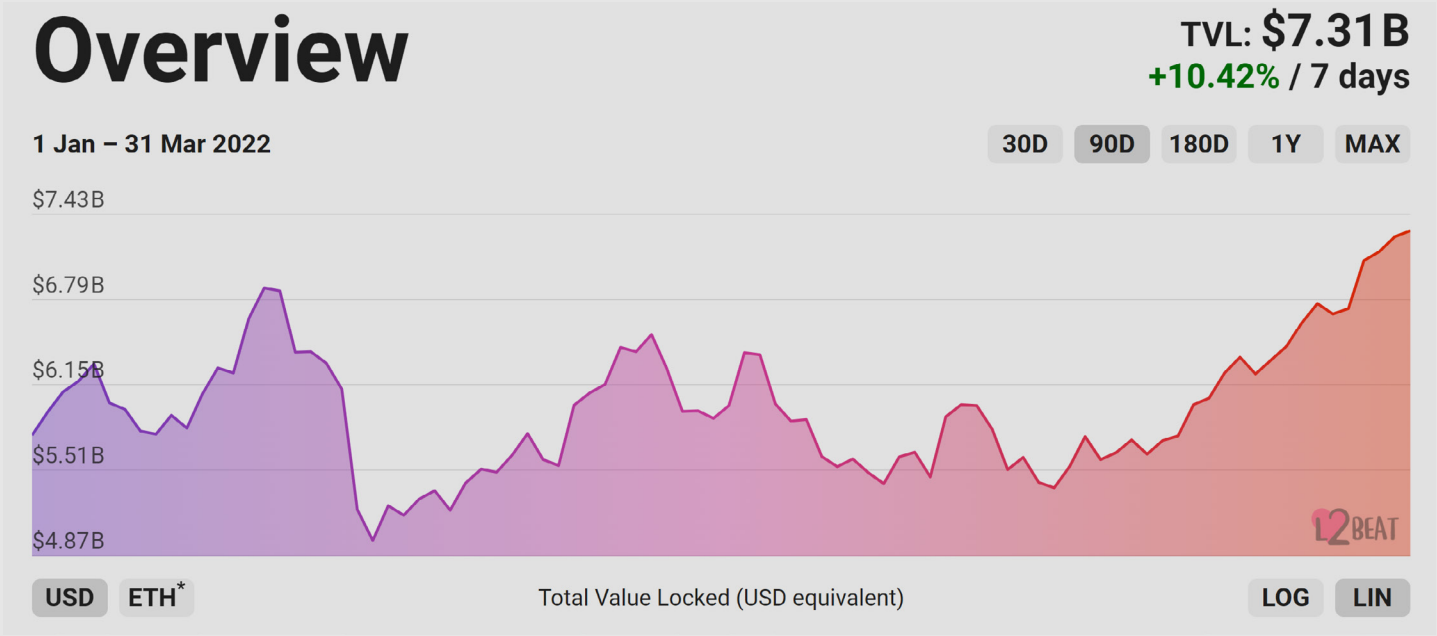


(chart via Coin Metrics)

Part of the decline in transactions and fees could be due to increasing activity on Ethereum layer-2s. According to data from L2Beat, total value locked (TVL)[7] on layer-2 (L2)[8] platforms grew notably in March after a lackluster performance in January and February, driven by strong growth on both L2 leader Arbitrum as well as on Optimism, which announced a $150 million raise led by Paradigm and Andreessen Horowitz at a valuation of $1 billion.

7 TVL is an imperfect metric that measures in USD the value of the tokens locked up in smart contracts on the platform. It is imperfect because it can involve some double-counting, and its value is affected by movements in token prices, but it can be useful to gauge relative value.

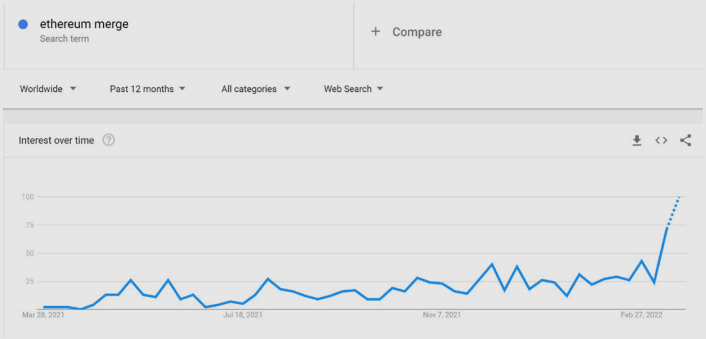
8 Layer-2 refers to networks that run on top of base layer blockchains (called layer-1s), abstracting computation (and thus removing the main scaling limitations of block space and fees) but relying on the base blockchain for security.



(chart from L2Beat)

The Merge

A big Ethereum announcement in March was the successful merge on the Kiln testnet with Ethereum 2.0, with only minor hitches. This galvanized excitement in the community for The Merge, when Ethereum passes from the proof-of-work consensus algorithm to proof-of-stake.



(screenshot from Google Trends, taken March 27)

To recap, Ethereum was originally built on a proof-of-work network similar to that of Bitcoin, in which energy is expended to process transaction blocks and append them to the blockchain. Network validators get rewarded for their energy expenditure with newly generated ETH as well as with transaction fees.

To mitigate the high energy cost, the plan is for Ethereum to move to a proof-of-stake network in which network "validators" earn the right to validate transactions and be randomly chosen to create blocks by locking tokens up in a "staking" smart contract. The greater the amount staked by a validator, the greater the chances the protocol will ask it to create a block and earn a reward of new ETH and transaction fees.[9]

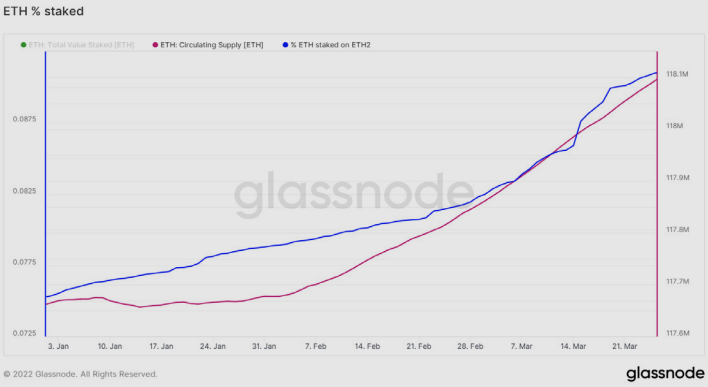
Given the complexity of changing the "engine" that powers one of the largest blockchain networks while it is in operation, the process is being handled in stages. The Beacon Chain, which will manage and execute on the new consensus algorithm, went live with staking contracts in December 2020. There are no active apps on the Beacon Chain just yet, but Ethereum holders can stake their ETH and earn a yield of approximately 4.8%.[10] ETH staked on the Beacon Chain is locked until a few months after the merge—holders cannot port their tokens back to the main chain, which means

9 For now, validators on the Beacon Chain just earn rewards in the form of new ETH, since there are as yet no transactions on the network.

10 https://www.stakingrewards.com/

the tokens are locked until a few months after The Merge[11], whereupon they can be withdrawn to use in apps on the new Ethereum network.

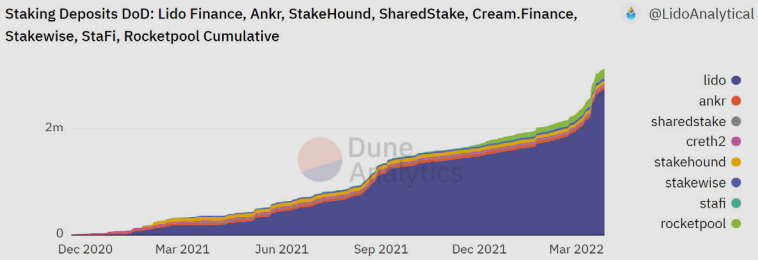
The Merge is currently expected some time in 2022, possibly as early as the end of Q2, but is more likely to be in the second half of the year.



(chart via glassnode)

In March, the amount of ETH staked on the Beacon Chain—which had been increasing at a steady pace since the middle of last year—picked up notably with a large deposit of over $500 million toward the end of the month. Staked ETH now accounts for over 9% of the current supply.

While this does mean fewer ETH in circulation, staking liquidity services have emerged that allow users to deposit ETH in a smart contract that simultaneously stakes it on the Beacon Chain and issues a synthetic ETH that the user can deploy in DeFi apps. The largest of these is Lido, which currently accounts for 25% of staked ETH.



(chart by @LidoAnalytical on Dune Analytics)

One factor galvanizing investor interest in Eth 2.0 is the expected staking yield post-merge, which analysts expect to be between 7% and 15%, notably higher than the current yield of just under 5%. Also, Ethereum's annual rate of supply inflation, currently around 4.3%, is expected to drop to 0.43% once mining rewards are removed, possibly becoming negative through the burning of fees.

(chart via ultrasound.money)

11 To give the network time to be amply tested.

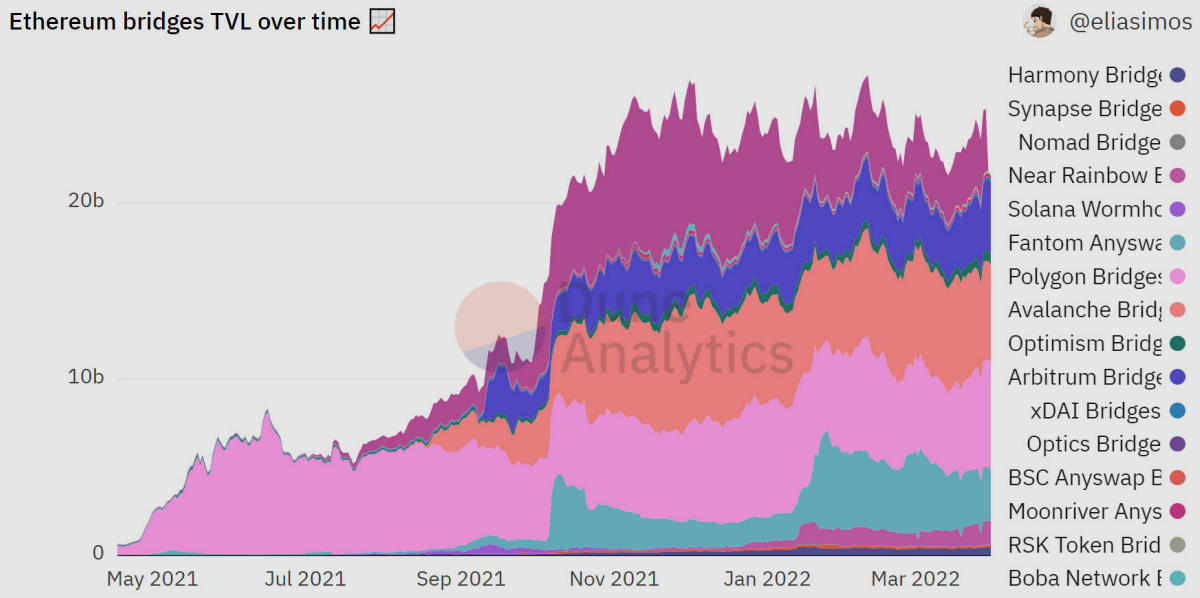
4 Layer-1

Asset		Price	Mkt Cap (bn)	Mar '22	30D RV
NEAR Protocol	NEAR	$13.29	$8.83	36.17%	131.85%
Solana	SOL	$130.55	$40.13	30.90%	82.25%
TRON	TRX	$0.08	$7.67	22.01%	39.00%
Cardano	ADA	$1.14	$38.84	19.62%	78.61%
Stellar	XLM	$0.23	$5.82	16.40%	62.43%
Avalanche	AVAX	$97.25	$25.53	14.97%	76.69%
Terra	LUNA	$105.00	$36.69	14.88%	113.60%

Top 7 L1 crypto assets with mcap > $5bn, ranked by mth chg. Prices at 0:00UTC 4/1/22. Source: Messari

A notable trend in layer-1s[12] (L1s) is the accelerating shift from competition to collaboration, with cross-chain applications, bridges[13] and even reserves supporting the relative technical strengths of each and the synergistic growth of the various ecosystems.

Four of the top five decentralized applications ranked by TVL operate on more than one chain (Curve, Lido, Anchor and Aave, with the exception being MakerDAO), according to DeFi Llama. TVL on bridges between Ethereum and other layer-1s dropped almost 15% on the month, according to data from Dune Analytics, but was still over $21 billion, almost double the level of six months ago. Furthermore, we are starting to see some chains adopt the assets of others as reserves.



(chart by @eliasimos on Dune Analytics)

12 Layer-1s refer to blockchains that serve as the base for decentralized applications.

13 A blockchain "bridge" is a smart contract that converts an asset based on one blockchain (for example, BTC) into an asset that can be used on another blockchain (for example, wBTC, which can be used on Ethereum). Asset 1 is deposited into an account which then automatically issues an equal amount of asset 2, with the same price behavior and value as asset one but "wrapped" in code that enables it to move around on a different blockchain.

Terra

A key recent example of this was the storming into the BTC community of Terra, the second largest layer-1 in terms of TVL, according to data from DeFi Llama. Last month, we saw the Luna Foundation Guard (LFG) raise $1 billion from the sale of LUNA tokens to a group of investors and declare that the funds would go towards buying BTC for the reserve of Terra's native algorithmic stablecoin UST.

Then, in mid-March, we saw the LFG announce a plan to burn[14] 4 million of LUNA in order to mint around 372 million UST, saying it would be used to accumulate "exogenous collateral." Since then, the LFG has said it will be investing a total of $3 billion in BTC in the short term, with most of that amount raised by selling UST against tether.

The objective of the BTC purchases is to diversify the reserves backing UST and thus relieve concerns of a self-reinforcing spiral should a slump in the price of LUNA lead to users exiting UST which would lead to a further slump in LUNA. The introduction of an unrelated crypto-native asset with an independent monetary policy and a high degree of decentralization would, in theory, provide a resilient support for what Terra co-founder Do Kwon hopes will become the virtual world's stablecoin.

It's worth noting that technically, the BTC held in reserve will not be collateral for the UST stablecoin. Rather, it will be used to support UST were its value to vary from the $1 peg. A proposal submitted by Jump Trading would see the BTC reserve as a balancer for the value of UST at $0.98—should holders of UST wish to exit their position, they could exchange $1 worth of the stablecoin for $0.98 worth of BTC. This asymmetric balancing in theory will guarantee that the bitcoin reserve will only be needed when UST is depegged.

At the end of March, the LFG had accumulated 30,727.97 BTC with a market value of $1.4 billion and just over $1.5 billion still left to purchase over time. Kwon has hinted that the amount the LFG will eventually invest in BTC reserves could reach $10 billion, and has expressed an intention to also eventually incorporate other tokens for the reserves, to solidify the relationship between Terra and blockchains such as Solana, Avalanche and Ethereum. This could—given the potential symbiosis between apps on the other layer-1s—position Terra as both a layer-1 and a layer-2 as UST gets a more diversified role in the DeFi ecosystem.

(chart via Messari)

14 Terra's native algorithmic stablecoin maintains its peg to $1 through a balancing relationship with the network's token LUNA. When UST demand drops, users can redeem the token for an equivalent USD amount of LUNA. When demand exceeds supply, users can mint more UST by depositing LUNA in the minting contract, whereupon it is taken out of circulation ("burned").

Avalanche

(chart from Messari)

As we mentioned in our February Market Review, Avalanche has been gearing up to launch subnets, a scaling solution which allows users to build customized blockchains that connect to the mainnet. The developer conference held in Barcelona in March did not bring any concrete subnet announcements, but it did reveal some other significant developments:

→ Ava Labs, the team supporting the development of the Avalanche blockchain, announced the launch of Core, a native wallet that will support bridging functionality, enabling users to interact directly with Avalanche apps using a wider range of assets.

→ The Avalanche bridge, currently one of the largest bridges to Ethereum according to data from Dune Analytics, will start supporting bitcoin in Q2, allowing users to use their BTC in Avalanche apps.

→ The Avalanche Foundation and web3 social media platform Op3n announced the Culture Catalyst initiative, a $100 million initiative for creatives to build projects on Avalanche.

→ The first award from this new fund went to musician Grimes, who revealed plans to create an "intergalactic children's metaverse book".

→ The Culture Catalyst ecosystem fund follows the announcement earlier in the month of a $290 million fund to attract subnet developers. Early participants include Aave, GoldenTree Asset Management, Wintermute, Jump Crypto, Valkyrie and Securitize, as well as the game DeFi Kingdoms, which launched its DFK Subnet on the last day of the month.

Ecosystem funds

Supporting development on specific blockchains has for some time been a relatively simple tool for kickstarting projects that will bring in users and revenue which in turn will boost the value of the native blockchain tokens in which these funds are often based. While this may at first sound recursive, the concept has proven to be effective in bootstrapping value, as well as a necessary incentive in an increasingly crowded and competitive layer-1 ecosystem. A blockchain without apps holds little immediate appeal to users, and these days app developers have many blockchains from which to choose. The potential of assistance in covering development costs, as well as possible upside if paid in tokens, could complement other factors such as tech support and community.

Thus, ecosystem funding is worth keeping an eye on as an indicator of where app growth could boost value (although, obviously, not all apps are successful).

Some significant fund launches in March include:

→ Avalanche's $290 million incentive program to spur on growth of subnets, and its $100 million creator fund with web3 platform Op3n (both mentioned above)

→ Hedera's HBAR Foundation's $100 million sustainable impact fund and its $155 million HBAR fund for DeFi applications.

→ The $250 million aUSD Ecosystem Fund to support startups building use cases for Polkadot's stablecoin Acala dollar.

→ A $150 million Fetch.ai development fund led by crypto exchanges MEXC Global and Bybit

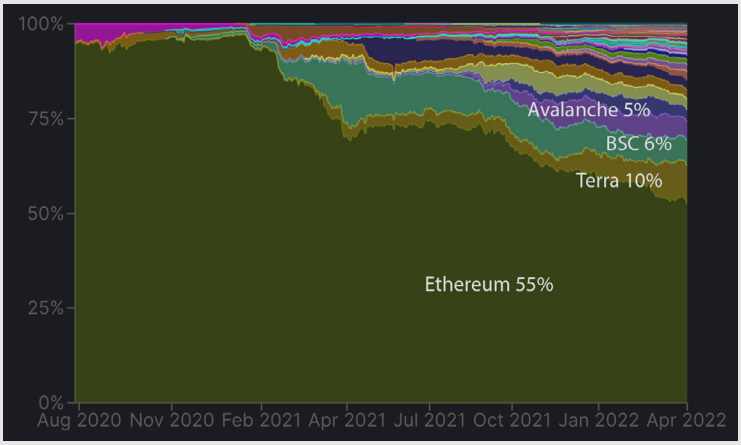
5 DeFi

Asset		Price	Mkt Cap (bn)	Mar '22	30D RV
THORChain	RUNE	$11.60	$3.92	190.00%	206.78%
Loopring	LRC	$1.18	$1.54	43.03%	199.59%
Aave	AAVE	$206.35	$2.87	42.18%	142.31%
PancakeSwap	CAKE	$9.24	$2.41	34.89%	102.57%
Compound	COMP	$148.78	$0.99	23.79%	103.00%
Uniswap	UNI	$11.28	$7.78	7.61%	76.34%

Top 6 DeFi crypto assets with mcap > $800m, ranked by mth chg. Prices at 0:00UTC 4/1/22. Source: Messari

The Emergence of Cross-Chain DeFi

It is widely accepted that the future of crypto is multi-chain. The dreams of hosting every decentralized application on a single blockchain are lost. High gas fees on Ethereum have driven users to cheaper, higher-throughput L1 blockchains such as Terra, Solana, Polygon, Avalanche and Fantom, bringing Ethereum's share of total TVL down to 55% from 80% at the beginning of the year. With liquidity fragmented across disparate L1s, the DeFi ecosystem is deeply in need of a standard protocol to facilitate cross-chain communication.



(chart via DeFi Llama)

To date, bridges are the core infrastructure enabling DeFi users to swap tokens cross-chain. While bridges provide a key service to users, they have also been subject to security vulnerabilities. In late March, the Ronin Bridge was hacked for $624 million, currently considered the largest DeFi hack ever. The second and third largest exploits also involve bridges—last year, Poly Network was hacked for $611 million, and in February 2022, Wormhole suffered a $326 million exploit.

With the crypto ecosystem moving toward a multi-chain universe, omnichain communication protocol LayerZero made a splash with their launch in mid-March and subsequent $135 million raise led by Andreessen Horowitz, FTX and Sequoia Capital at a valuation of $1 billion. Similar to how the internet relies on TCP/IP as a standard communication protocol for data packet transfers, LayerZero aims to be a standard protocol for arbitrary message passing between blockchains. The first application built on LayerZero is a token bridge called Stargate Finance, which on March 18 auctioned off 100 million STG tokens, raised $25 million to bootstrap its liquidity, and attracted approximately $2 billion of liquidity within a week of launch.

Cross-chain applications and interoperability solutions could be a major trend over the next year. Stargate already posted a proposal on SushiSwap's governance proposal to integrate its bridging solution to seamlessly connect SushiSwap's isolated markets deployed on 16 different EVM chains.

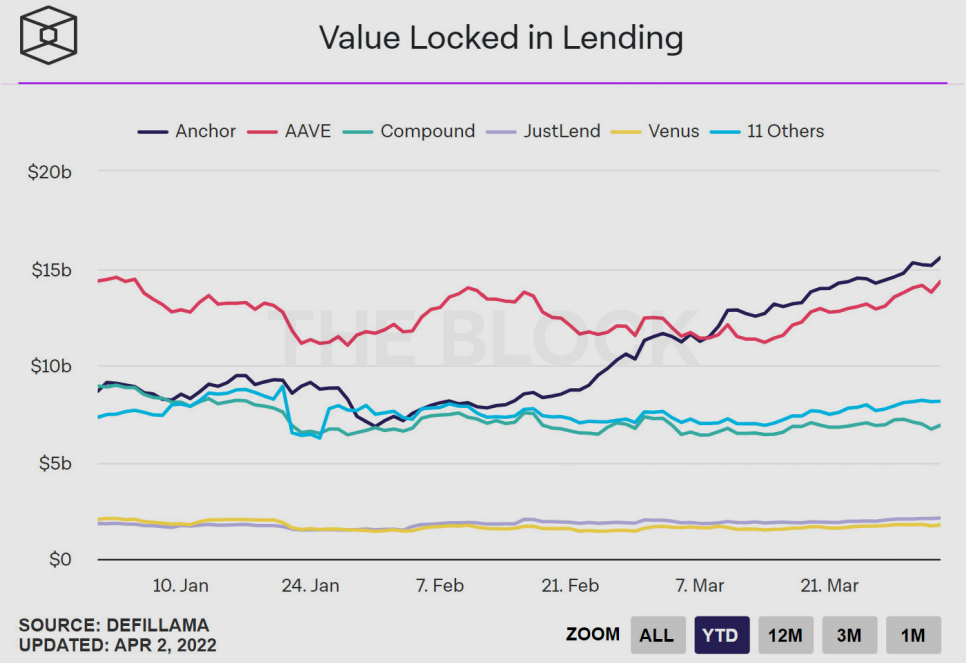
Aave

(chart from Messari)

One of the top performers of the month was crypto lender Aave with a 42% price increase and a 22% TVL increase (according to data from The Block Research), making it the second-largest DeFi lender in terms of TVL, behind Terra's Anchor.

This performance was largely on the back of its v3 launch which ushered in several innovations including:

- → Deployment across Polygon, Avalanche, Fantom, Arbitrum, Optimism and Harmony (Aave currently operates on Ethereum, Polygon and Avalanche)—Ethereum Mainnet deployment will follow at a later date
- → Cross-chain "portals" which facilitate bridge liquidity, allowing users to swap assets from any blockchain on which Aave is deployed, even if the bridge does not have enough liquidity on hand—this could expand Aave's addressable market while allowing a broader range of onchain trading strategies
- → A higher borrowing power if the borrow and collateral assets are both within the same highly correlated asset category, boosting users' capital efficiency
- → The listing of new collateral assets along with restrictions that limit potential protocol risk
- → The reduction of transaction fees by 20–25%
- → The introduction of specific features for L2 networks



(chart from The Block Research)

6 NFTs

What M&A in NFTs Says About the Culture

Astonishing announcements from the NFT space are becoming commonplace, with a relatively constant stream of new ideas, investments and participants. However, the news of a mega-acquisition involving intellectual property rights took the market by surprise, especially given the brand names involved. In early March, the creator of the Bored Ape Yacht Club (BAYC) project Yuga Labs announced that it was acquiring the rights to two historic NFT collections: CryptoPunks and Meebits.

This is much more than a major M&A deal; it also represents the changing nature of the NFT market, and highlights the impact the concept has had on culture more broadly.

CryptoPunks were not the first NFTs, but they were the first collection to capture the imagination and investment of a significant cohort of crypto enthusiasts, and the first to achieve "brand" status. Its structure (a limited number with hierarchical randomly generated characteristics) and pixelated aesthetic were a strong influence on subsequent collections, but the retention of image rights by creator Larva Labs triggered frustration in a community that felt its use of the images as profile pictures was a strong contributor to the collection's value. For instance, Larva Labs signing an agreement with United Talent Agency for representation for the Punks and sister collection Meebits across film, video games and other media jarred with the decentralized "Punk culture".

The Bored Ape Yacht Club emerged just under a year ago with a similar structure (a limited number with hierarchical randomly-generated characteristics) but a remarkably distinct aesthetic and IP policy—Bored Ape holders held the rights to the IP. This was a radical change from how art has traditionally been handled—historically, in practically all types of creative expression, the creator retains the IP.

The Yuga Labs innovation unleashed a wave of creative ideas and a new type of engagement: Bored Ape holders have been setting up virtual rock bands, hiring talent agents, developing video series, building games, publishing comic strips, branding sneakers and more. Yet its culture remained distinct from that of CryptoPunks, with a long roster of high-profile celebrities bringing glamour and status to the brand. The CryptoPunks culture stayed relatively subdued and focused on a counter-culture ethic, in spite of some eye-watering sale prices and the more decentralized nature of BAYC ownership.

(image via Bored Ape Yacht Club website)

NFT Tokens

March was a huge month for Bored Apes creator Yuga Labs, even beyond the CryptoPunks purchase.

It raised $450 million in a round led by Andreessen Horowitz at a $4 billion valuation, some of which will go toward building a metaverse which will enable it to diversify revenue through land sales.

And the Apecoin token (APE) was launched in mid-March, giving us a glimpse of what could become a new type of art-based business model in which collectors get rewarded over time with more than just community and signaling privileges. The issuer of the token is not Yuga Labs but ApeCoin DAO[15], and holders of the token become members of the DAO. Owners of Bored Ape and related NFTs received 10,000 Apecoin (worth $125,000 at the end of March) and, unusually, it was listed almost immediately on several leading exchanges.

The potential for NFT and metaverse innovation is intriguing: Yuga Labs has said that they envision using Apecoin as a currency within the coming metaverse; Animocca Brands has introduced Apecoin convertibility within its Benji Bananas game, which could point to other eventual game/metaverse cross-overs; and since you don't have to hold an NFT from the Bored Ape family in order to hold Ape, it could open up a new type of broader community membership.

15 Decentralized Autonomous Organizations are owned and run by members and often have a governance token that confers voting rights and other benefits.

7 Regulation

The Executive Order

The long-awaited executive order (EO) from President Biden was finally released on March 10, and although it contained no substantive policy recommendations, the market reacted positively to the unexpectedly supportive tone. While it starts out citing the imperative to protect consumers as well as global financial stability, it moves on to stress US leadership in technology and finance and the need to remain competitive. There was no hint at a blanket clamp-down; rather there was the recognition that the entrance of crypto assets onto the global financial stage is complex, with risks but also with potential.

Among the positive surprises in the text:

→ President Biden indirectly acknowledged the need for a reform of some areas of the current financial system, specifically mentioning the lack of financial access for many and hinting at the inequality in many financial services.

→ The President acknowledged the right to financial privacy.

→ Bitcoin mining was singled out, but in a vague and surprisingly balanced way, with a call for a report that addresses "the potential for these technologies to impede or advance efforts to tackle climate change at home and abroad".

→ CBDCs got an entire section, and the document mentions the merit in participation in "multi-country conversations and pilot projects". CBDCs are controversial mainly due to the potential privacy incursions, but it could be argued that a multinational effort might have more checks and balances.

→ Particularly encouraging was this sentence, which recognizes both the potential utility and impact on financial systems as well as broad humanitarian concepts such as democracy, privacy and independence (emphasis added):

"The United States has an interest in ensuring that it remains at the **forefront of responsible development** and design of digital assets and the technology that **underpins new forms of payments and capital flows** in the international financial system, particularly in setting standards that promote: **democratic values;** the rule of law; **privacy;** the protection of consumers, investors, and businesses; and **interoperability with digital platforms, legacy architecture, and international payment systems.**"

More broadly, the EO is a significant step toward regulatory clarity, the lack of which has often been cited as one of the main barriers to greater institutional participation in crypto markets. The directive asks practically all parts of government to submit reports within specific timeframes (generally 180–240 days) on potential impacts of various aspects of cryptocurrencies and related industries.

And it is worth noting that the crypto industry, which just a few years ago was not even a blip on the legacy system's radar, is now worth attention at the highest regulatory level.

Regulatory Clouds

In spite of that positive development, there are still clouds on the horizon that are worth keeping an eye on.

Europe

On Thursday, the European Parliament voted in a revision to the Transfer of Funds Regulation, which contains the following provisions:

Exchanges will be required to identify the destinations of all crypto transfers and will need to verify the information.

- → This includes all transfers, even tiny ones, to unhosted wallets (Metamask, Ledger, Trezor, etc.)
- → It effectively involves exchanges gathering personal and financial information on individuals and entities that are not their clients.
- → It treats crypto transfers differently than fiat transfers, which have a 1000 euro reporting threshold.

Exchanges would also need to inform authorities of every single transfer over 1000 euros even if there is no suspicion of bad activity.

- → Apart from the violation of privacy rights, the prohibitive cost of this could lead exchanges to simply not allow transfers to unhosted wallets.
- → This is possibly the intention of the EU, since the provision contains language that points to further steps regarding the "risks posed by transfers from or to unhosted wallets, including the introduction of possible restrictions".

US

A new SEC proposal wants to expand the definition of "dealer" to include people and businesses that use automated and algorithmic trading technology to execute trades and provide market liquidity.

- → It doesn't mention DeFi explicitly, but most DeFi platforms would fall within the definition.
- → DeFi platforms would be required to register with the SEC.
- → This would mean that all DeFi services would have to identify counterparties, something they can't do.
- → There are some carve-outs:
  - → this would only apply to platforms with over $50 million of assets (which includes the top 100 DeFi apps on Ethereum alone, according to DeFi Llama);
  - → and it would only cover DeFi apps that handle digital assets that are considered securities.

Both moves point to the relative anonymity offered by many crypto transactions as being a pain point for regulators increasingly concerned about the use of digital assets for money laundering and sanctions evasion. The crypto lobby in the US is relatively well-positioned to push back on impractical legislation, with a growing number of crypto-friendly politicians understanding the potential for their constituents. Europe is unfortunately still lacking well-funded and coordinated policy groups to advocate for the industry.

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