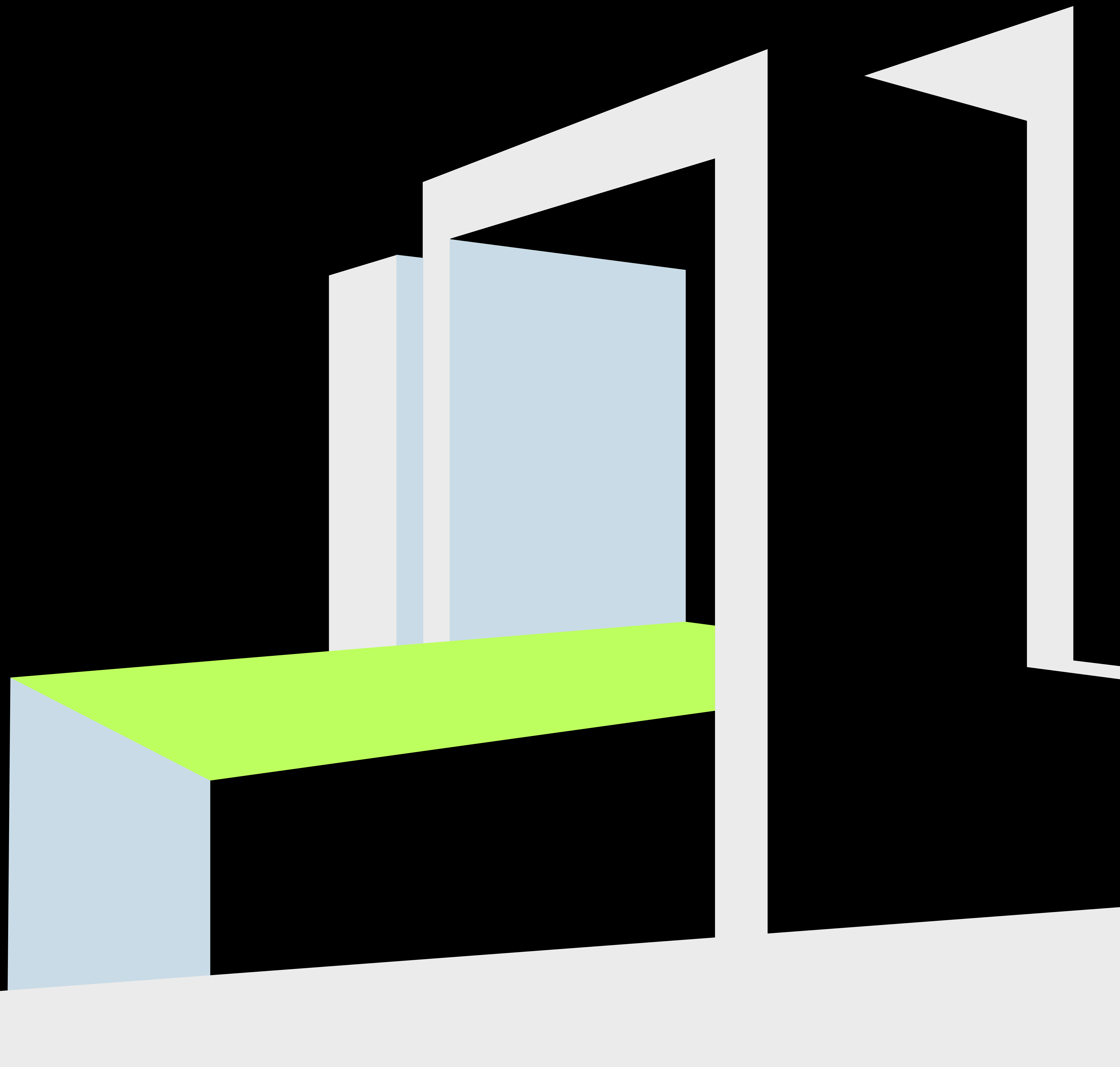
First Digital 2022 Industry Insights & Outlook



First Digital

A Message From First Digital

The price of flagship digital assets has fallen sharply throughout 2022. Bitcoin has diverted from Wall Street. NFT activity has dropped. Some use the term “crypto winter,” while others suggest BTC falling to lows or even zero. Behind all this is a more nuanced picture featuring complex interplays between the broader economy, financial markets, and digital assets.

The topic of regulation continues to be a regular fixture in discussions at a governmental level across jurisdictions. It indicates an ever-pressing need for experienced fiduciaries like First Digital, a fully regulated and compliant way to offer clients safeguarding for their digital assets with a trusted provider.

“The outlook isn’t as chilly as it might feel in the middle of a bear market; there’s still good reason to be optimistic for the future of digital assets in the near term and the long term.”

— **Vincent Chok** | CEO, First Digital

Overview

First Digital: 2022 Industry Insights & Outlook takes a close look at the year that's been through the lens of First Digital, with insights into the cause of the digital asset decline and the outlook ahead.

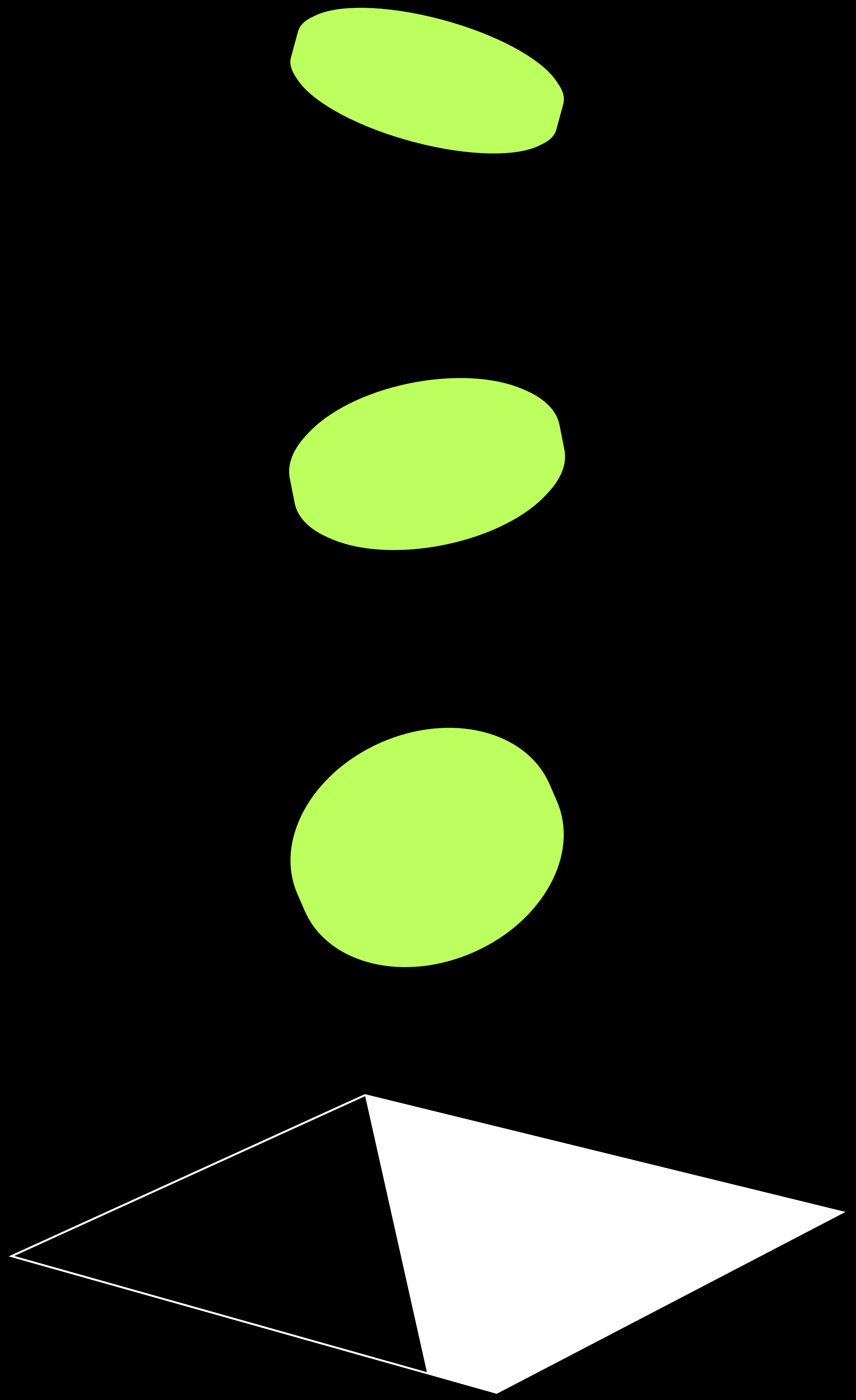
We examine how it all began; from the collapse of LUNA to the implosion of FTX and investor activity that affected prices to fluctuate and hit their lowest in years. While a shift occurred in the industry, this is not the first time; nor will it be the last. What's ahead is just the beginning of a fresh opportunity to switch gears and rethink where the crypto, Web3, and DeFi ecosystem is headed.

Examining the failures, in this case, a fall in prices, global inflation, and an everchanging market, creates room for innovation — learning from the mistakes and using them to shape a better, stable, and sustainable future for the industry.

The Fall of Digital Assets

In 2021, nearly 106 million people globally interacted with cryptocurrency in one form or another — increasing to 300 million in just one year. Tempted by the major returns in the crypto space relative to traditional equities markets, a high influx of liquidity poured in at an astonishing rate. In November 2021, digital assets like Bitcoin, Ethereum, and Solana hit all-time highs.

The industry was taking flight in size and value and until 2022 saw disruptions to the economy and the cryptocurrency ecosystem as we know it.



Market Free-Fall

As the year began, new investors in the space felt hopeful and experienced ones felt optimistic, but that didn't last long. 2022 was the year that brought the industry stagnation and a gradual decline, with Bitcoin eventually falling below the higher end of its price in 2017.

One of the most significant events to shine a light on is the wiping out of the entire $60 billion market cap of the algorithmic stablecoin Terra LUNA (or UST) earlier in May. This triggered the decline of digital asset prices, resulting in double-digit drops.

Then it all came crashing down again in November when one of the biggest exchanges in the crypto industry completely fell apart.

In the blink of an eye, FTX spiralled amidst liquidity concerns and allegations of customer funds being traded via FTX Founder Sam Bankman-Fried's trading company Alameda Research.

Rattled investors began to withdraw large volumes, and FTX's native token, FTT, plummeted while locking down all customer withdrawals. A rescue deal with Binance fell through, making this one of the highest-profile collapses in recent years.

"The crypto landscape has a lot of growing to do. What matters now is how we will collectively learn from this. The market downturn has stripped the industry of malicious players to the detriment of everyday crypto investors.

We need more custodianship, improved security technology, and transparency. It is time for institutions to work, build, and collectively safeguard the market together."

— **Vincent Chok** | CEO, First Digital

Inflation Effect

Cryptocurrency markets are not the only ones feeling the pain; the key issue is the broader financial market and the global economy.

Global inflation is sitting at its highest rate in over 40 years, not to mention the war in Ukraine or the ongoing lockdowns in China — everywhere you look, markets have been in panic mode.

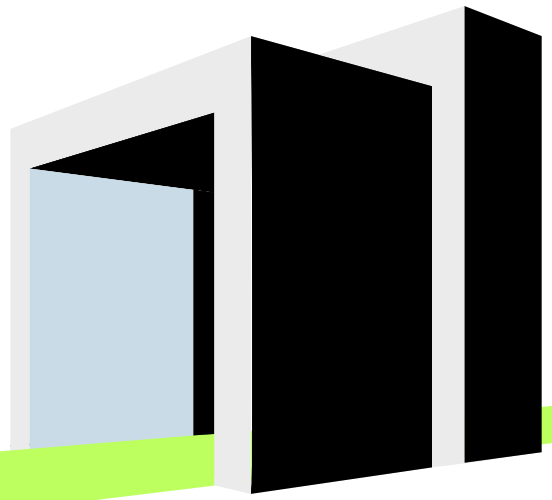
As prices decline, companies shed staff: Coinbase reduced its workforce by 18%, while others face insolvency.

Overleveraged organisations like Three Arrows Capital (3AC) struggled, and digital asset lender Celsius filed for bankruptcy in early July.

After a lengthy period of lockstep between BTC, ETH, and the S&P, digital assets tumbled to new lows as the FTX saga unfolded; while Wall Street saw a surge following slowed inflation.

The digital ecosystem continues to grow rapidly. Neither regulation nor professionalism has kept pace with the growth and complexity of the space, leaving the stage clear for companies like FTX to pull down — however temporarily — a whole sector in their wake.

What's Next?



It was perhaps inevitable the bad actors would be shaken from the tree, like Celsius, which froze withdrawals on June 13 and FTX on Nov 8, each dragging the market down with them. Operating in an unregulated environment meant the risk was abnormally high.

As digital assets become further entrenched in global financial markets, a regulatory regime is needed if the industry is to earn the trust it needs to expand adoption.

A key barrier to crypto investing is trust in regulation. First Digital understands that regulation is necessary to safeguard consumers, and companies operating in the space have a fiduciary duty to take on this responsibility to engender trust.

It's important to remember the crypto industry has not been around for that long, and the last time the market expected Bitcoin not to recover, numerous businesses spent the "crypto winter" designing innovative solutions to the problems that had knocked BTC down in the first place.

Change is already in the air with blockchains like Ethereum, which has now switched to a Proof-of-Stake (PoS) protocol.

And others have seen successful innovation from previous bear markets, like OpenSea's NFT marketplace, which has become widely popular.

Institutional Adoption

The worldwide appeal and attention the crypto industry has received over the last few years make it hard to ignore. The biggest banks on Wall Street spent years trying to bring down crypto without much success—forcing them to play catch up instead. Goldman Sachs became the first major bank to make an OTC trade of a crypto option.

There is a gradual shift in finance, but with that comes a huge responsibility.

Out With the Old, in With the New

Anyone with internet access can buy, sell, and trade thousands of digital assets, giving people an alternative way to invest that has never existed before. An entirely new crypto-powered financial system has begun to cut into traditional banking, with exchanges like Coinbase offering Visa-backed credit cards.

Many countries have suffered from exploitative monetary systems but now can escape it with crypto's borderless, non-discriminatory alternative system.

In 2021, El Salvador became the first country to adopt Bitcoin as legal tender, with others following right behind. In Ethiopia, more than 70% of the population has no access to a bank account; crypto unlocks new possibilities and accessibility for many.

With increased adoption comes the need to build more robust and interoperable regulatory frameworks to govern the digital assets ecosystem. While crypto is much more financially inclusive than traditional finance, it is not the final solution.

Anonymous Action

The world has seen interest in digital assets intensify since the pandemic, and crypto is now part of public discourse in global macroeconomic matters.

As a result of new players in the space, trends and activities are bound to emerge, causing havoc. In the digital assets market, around August 2021, large entities bought and sold significant sums quickly to avoid disturbing the market.

For example, last year, on July 19, 100,000 ETH worth around $181,950,000 was transferred from the Gemini exchange to an unknown wallet.

Shortly afterward, ETH's price rose by 6%. Since these sales can affect the price, they are done deliberately to cause that effect and potentially minimize it. If other participants see a major player sell, they'll probably want to sell too.

45.6%

of the total BTC supply is owned by big investors, aka whales.

12 million

of the total BTC supply is owned by smaller investors, aka shrimps, who are purchasing it quicker than it is made.

What's Next?

40% of institutional investors intend to invest much more in crypto over the coming years.

80% of those institutions that already invest in the digital assets space expect to increase their exposure over the next five years.

Crypto's absorption into traditional finance has dimmed its risk-diversification benefits. Before 2020, crypto portfolios could shield investors from what was happening in the real world but are now more closely correlated with equities.

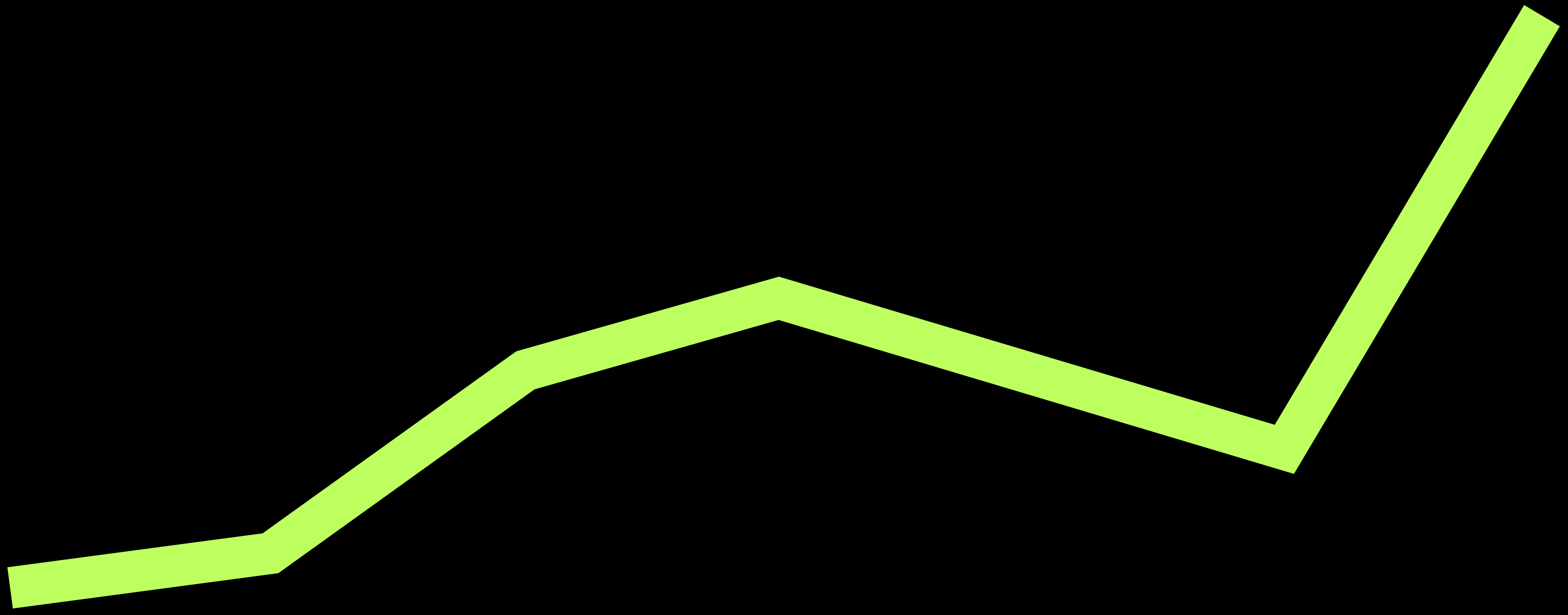
If anything, the link between crypto and equities markets shows that crypto isn't just a fad; instead, it has matured into an asset class that is still being defined.

With increasing adoption comes risks such as volatility, fraud, policy intervention and the need to build interoperable regulatory frameworks.

A lot of work is involved in creating frameworks that protect investors and are not necessarily a privilege enjoyed equally around the globe. First Digital is preparing to grow its presence across APAC, Europe, and North America to provide innovative solutions to asset safety and management in the next few years.

Inside the Global Pressures

Energy prices are historically high, inflation is soaring, and there is likely to be an economic recession — partly due to the war in Europe. The effects are result in rising fuel costs as sanctions bite on one side and energy shortages affect the other, demonstrating the vulnerability of even the most bullish businesses.



Global Inflation
2015-2021

Supply chains could not keep up with the growing demand for certain commodities, leading to prices rising. At the same time, food shortages are happening due to Ukraine's struggle to ship its wheat exports. Some products are caught between rising fuel costs and wheat prices, like the price of meat, for instance.

An economy characterized by a tight labour and property market, high interest and inflation face a sharp correction amid significant global conflict and a squeeze on living standards from the supply chain.

The fall in digital asset prices is more directly related to the current state of the economy and the changes it inflicts on how people live than any of the events in the space itself.

Pandemic Aftermath

The last couple of years have been defined by unprecedented levels of quantitative easing, and near-zero interest rates as central banks around the world emptied their toolbox to stimulate spending during the pandemic.

Federal Reserve Chair Jerome Powell moved to raise interest rates in a series of increases that brought the rate from 0.25% in March to 4% in November, seeking to correct after holding down rates and buying bonds to support the economy through Covid lockdowns.

Crypto has proven especially sensitive to interest rate hikes and rising inflation triggered by US fiscal policy. As rates rise, investors seek safe harbours. Falling tech stocks indicate falling investor appetite for some-day-potential returns, as well as increased costs.

Some strategists report that prices could plunge until they land back to where they were before the pandemic started two years ago.

Tech stocks have suffered this year with shares in Meta down

***234%**

Netflix's value has declined by

***56%**

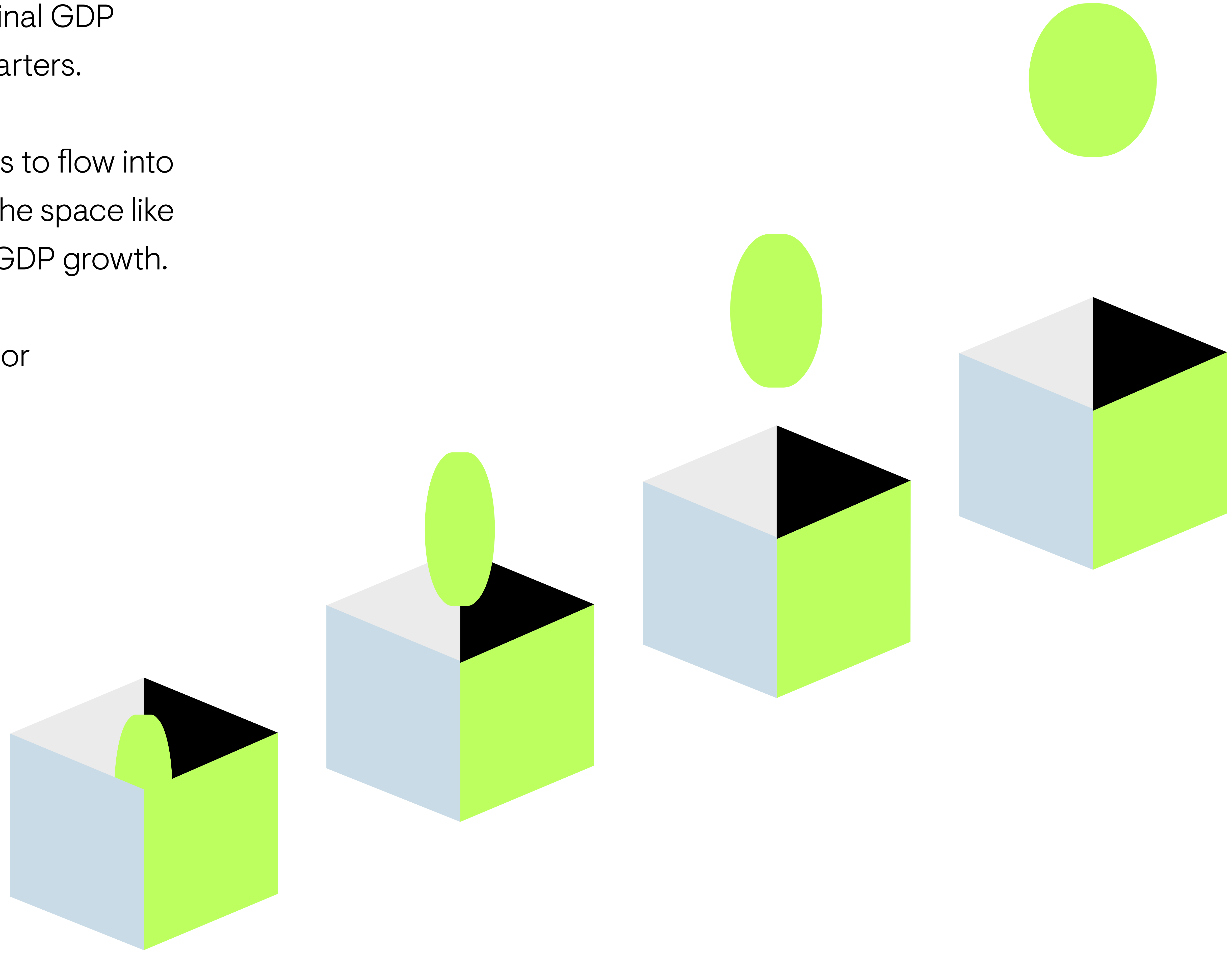
* at time of writing (Nov '22)

What’s Next?

A recession now seems inevitable and occurs when nominal GDP growth is outstripped by inflation for two consecutive quarters.

At the same time, significant institutional money continues to flow into the major digital assets while new businesses emerge in the space like Solana, driving growth higher than inflation and broader GDP growth.

While major national economies may be in recession, major blockchains are not.



Are Digital Assets Killing the Earth?

It's no secret that the relationship between digital assets and the environment is complicated.

Digital assets' growing carbon footprint has caused authorities to think twice about the damage it is imposing on the earth, especially for the future.

Market dynamics play a significant role in the energy consumption of cryptocurrencies. Market crashes cause a drop in asset prices that are no longer profitable for miners, resulting in slowing down or turning off their devices completely.

Guzzling Energy

It starts with Bitcoin mining, which produces more carbon emissions than gold mining.

A single Bitcoin transaction now requires more than 2,000 kilowatt-hours of electricity or enough energy to power the average American household for 73 days.

China accounted for over 65% of all global Bitcoin mining activity until the spring of 2021 when a ban halted operations. Lured by a promise of cheap coal power, miners flocked to Kazakhstan, the second biggest mining hub.

But it didn't last long when the government made power cuts, leaving miners to flee — Texas quickly took the top spot.

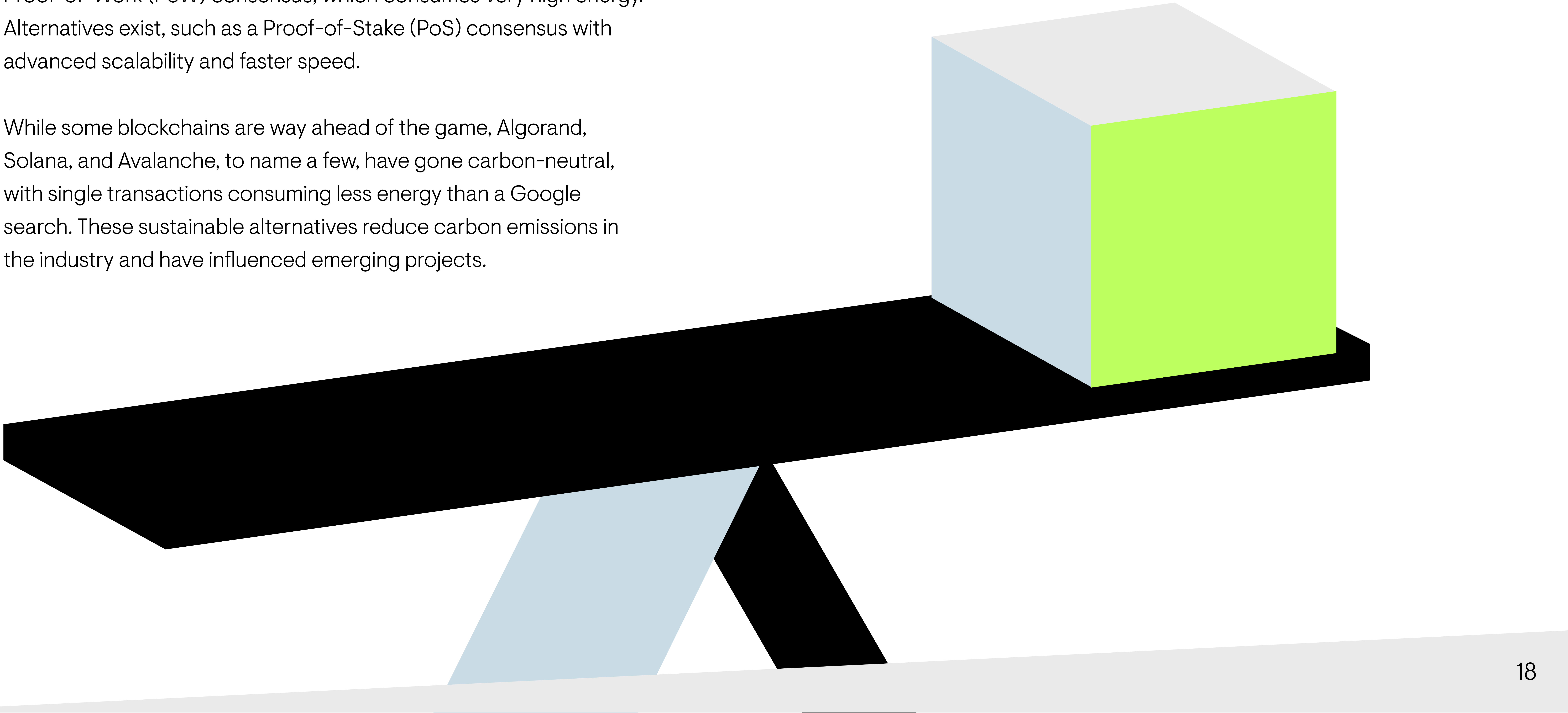
Bitcoin miners started to earn more than ETH miners, but both are seeing a drop in profitability. The earning potential for miners and the Bitcoin-halving event saw block rewards fall from 12.5 BTC to 6.25 BTC.

56% of mining is now conducted using renewable energy sources.

Behind the Tech

One of the first generations of blockchains, Bitcoin still uses a Proof-of-Work (PoW) consensus, which consumes very high energy. Alternatives exist, such as a Proof-of-Stake (PoS) consensus with advanced scalability and faster speed.

While some blockchains are way ahead of the game, Algorand, Solana, and Avalanche, to name a few, have gone carbon-neutral, with single transactions consuming less energy than a Google search. These sustainable alternatives reduce carbon emissions in the industry and have influenced emerging projects.



What's Next?

As an outcome of the current state of the market, many networks are finding new ways to improve their protocols, especially regarding reducing emissions.

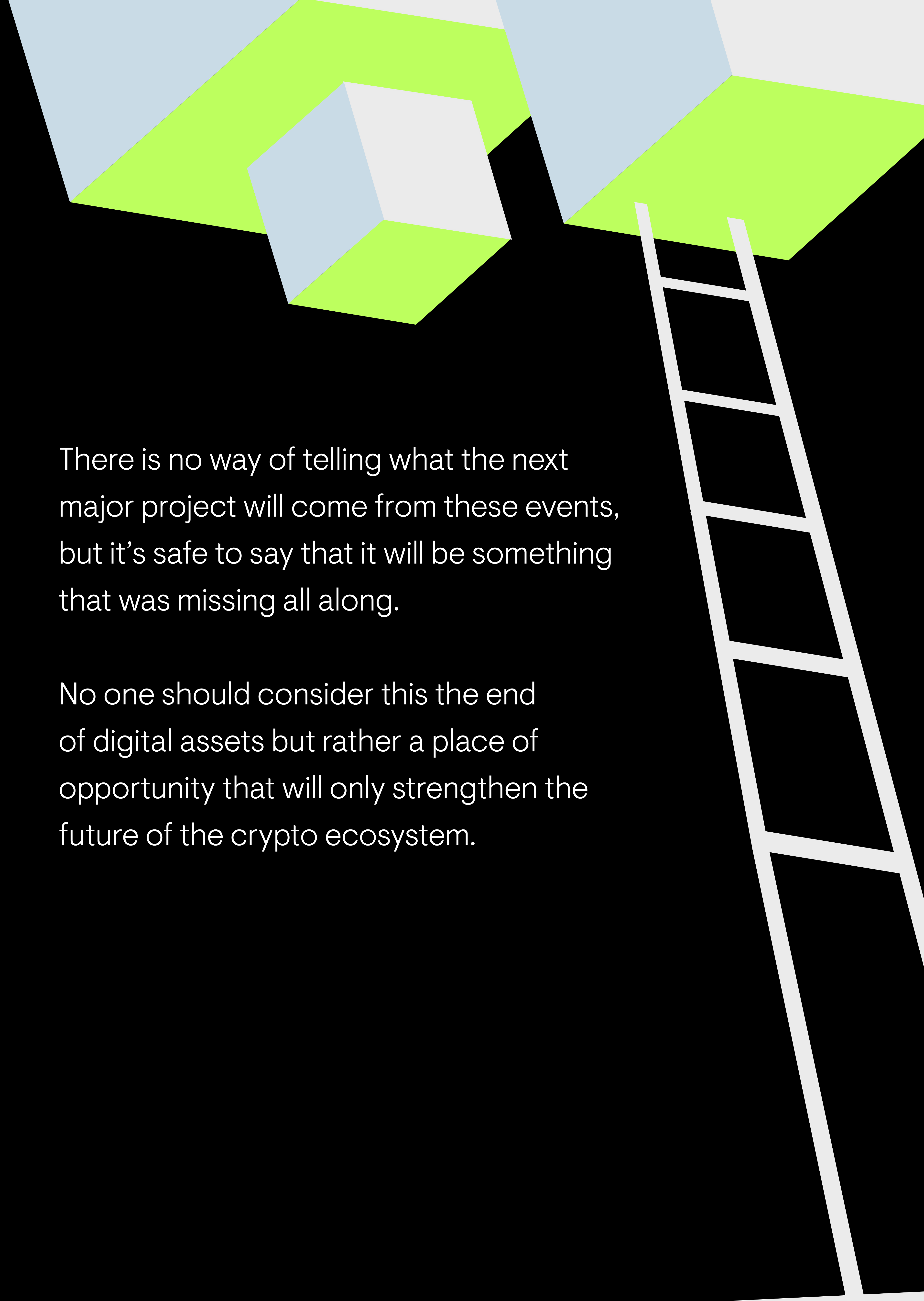
The biggest leap comes from Ethereum, which uses more power than Facebook and Google combined. The blockchain announced earlier in the summer that its upgrade, the Merge, will hopefully position ETH as the top digital asset. The long-awaited update took place on September 15; successfully transitioning the blockchain from a PoW consensus to a PoS consensus to make it significantly more sustainable.

Immediately after Ethereum changed its protocol, the network saw a 99% reduction in its carbon footprint. There is hope that other blockchains will follow Ethereum's lead, considering the industry's future and the environment.

First Digital understands the responsibility to go green, the importance of reducing its environmental impact, and offsetting its carbon footprint.

We are actively looking into eco-friendly initiatives while contributing to community-led projects.

Conclusion: Looking Ahead



Digital assets are not Bitcoin. There is a bigger focus on digital assets than ever before, indicating a continued interest and the potential for a stronger comeback. The picture is far less clear and one-directional than a glance at the headlines or what reading price charts would suggest.

As we shift away from traditional systems, we adapt accordingly to the highs and lows of the impacts of the economy, whether it’s inflation or a whale moving a huge amount of BTC.

Not everything can be controlled, but there are many ways to improve significantly. Regulation is a must for the security of digital assets to ensure that the loss might not be as influential when another bear market happens.

Concepts like DeFi, DAOs, and smart contracts were once pipe dreams. NFTs were still limited to rudimentary drawings with no utility to speak of. With this gradual shift in the industry, so much innovation is waiting to take its course.

There is no way of telling what the next major project will come from these events, but it’s safe to say that it will be something that was missing all along.

No one should consider this the end of digital assets but rather a place of opportunity that will only strengthen the future of the crypto ecosystem.

“Those who focus on building and technology & infrastructure will rise out of the ashes. First Digital has experienced multiple market cycles over the past few years. Our focus has been and continues to be the same, protecting our client’s assets first and foremost, without limiting their ability to grow their assets within our ecosystem. There’s a duty between the major players in the industry to come together, build together and innovate together. The pie is big enough for all of us to co-exist.”

— **Vincent Chok** | CEO, First Digital

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