RIVEMONT

Rivemont - Weekly Update #213

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Rivemont is the portfolio manager responsible for the investment decisions of the Rivemont Crypto Fund.

This letter is being written as the latest data on the U.S. inflation rate has just been released. Inflation rose by 7% from December 2020 to December 2021, the largest increase since 1982. The last time this rate was this high, interest rates were at 11.5%. Is it therefore panic on the stock markets, with meteoric rate hikes fears bringing strong downward pressure on stocks and other risky assets? Is bitcoin taking its place as a store of value in an inflationary environment?

... Of course not. The markets are reacting exactly as they have in recent years. While the inflation rate is in line with analysts' expectations, the US stock market is actually rising. Bitcoin continues to act as a risk asset, continuing the rebound it began 48 hours ago after testing its important support at $40,000. This ultimately proves one thing. The U.S. bull market that began almost 13 years ago is still alive and well. It takes a lot, an awful lot, to stop a trend with this kind of momentum. One could be convinced that bitcoin's reaction this morning is a hedge against inflation, but its correlation with the stock market - and its non-correlation with gold, which price is stable - leaves very little doubt as to what is really driving this daily rise.

In the same vein, according to a new study, the correlation between bitcoin and two major U.S. stock market indexes, the S&P 500 and Nasdaq, has reached an 18-month high. Historically, bitcoin has maintained a relatively low correlation with traditional asset classes, but this is becoming less true as institutional players gradually take control of the market. Note that the correlation with gold, considered the ultimate hedge asset, has been negative since September.

Regulation of cryptocurrencies is undoubtedly one of the factors that is likely to have the most influence in 2022. Added to this are the announced distribution of the liquidation of Mt.Gox and the potential geopolitical conflict between Russia and Ukraine, which could have a direct influence on the price of energy. On the first factor, however, it seems that things could move quickly. Indeed, the Federal Reserve's much-anticipated report on cryptocurrencies is "ready to be released" and will come out "in the coming weeks," according to Fed Chairman Jerome Powell. The report is likely to focus on CBDCs, or central bank digital currencies, which Powell said the Fed has been looking into since China launched its own digital yuan. Powell also said the report would seek public input. It is not known at this time whether the report will offer any concrete guidance.

The nature of the report could have monster effects on the markets. Since China banned bitcoin mining, the U.S. has been leading the industry. Will regulators embrace innovation and encourage the development of digital assets, or will they instead take a protectionist stance, wanting to avoid damaging the power of the U.S. dollar at all costs? If the former scenario were to occur, with a then likely approval of an ETF backed by bitcoin directly, all the ingredients for a real new bullish push could suddenly be in place.

Gary Gensler, chairman of the SEC, had the opportunity this week to add his two cents on the nature of cryptocurrencies. The SEC has previously stated that it does not consider bitcoin to be a security, but has taken a position on other cryptocurrencies, such as Ripple's XRP. Asked whether Ether represented a security, however, Gensler brushed off the question. "We don't get involved in these types of public forums to talk about a single project, a single possible circumstance, or to give legal advice on the airwaves in that way." He adds, however, that if "you're raising money from the public and the public is in the expectation of a profit, based on this developer, this sponsor, this group's efforts, that's within the scope of securities laws."

The International Monetary Fund yesterday released a research report on the cryptocurrency industry. The findings there are encouraging, with the paper raising that cryptocurrencies are no longer an obscure asset class within the financial ecosystem, but that the growing correlation with the stock market is undermining the role of bitcoin and other crypto assets as a hedge asset. We are clearly not alone in this observation! Noting that BTC and ETH were rarely correlated to major stock market indices before the pandemic, the authors agreed that crypto assets helped diversify risk for investors by acting as a hedge against fluctuations in other asset classes. "But that changed after the extraordinary responses of central banks to the crisis in early 2020," the authors wrote, adding that cryptos and stocks jumped hand-in-hand as investors' risk appetite increased.

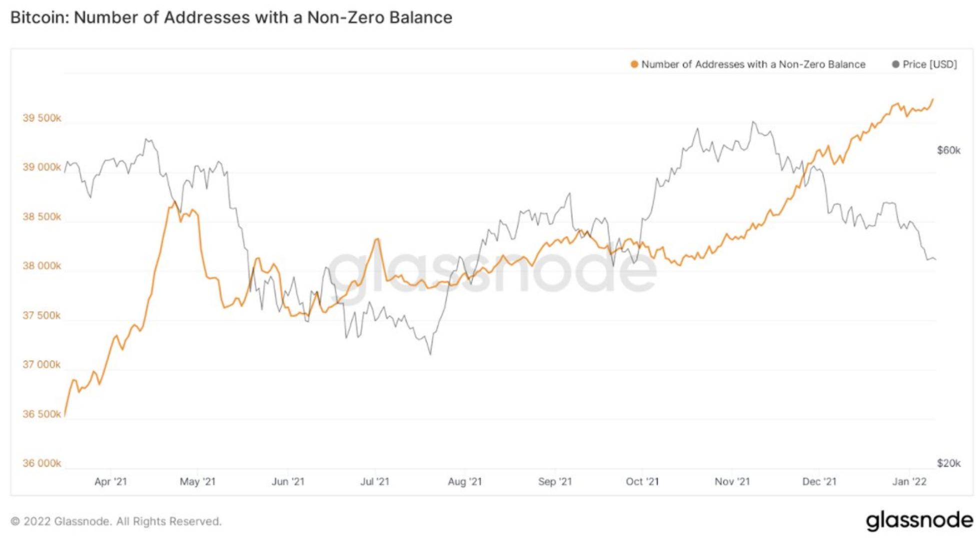
The other major news of the week was undoubtedly a nationwide internet outage in Kazakhstan. The Central Asian country descended into chaos after violent protests triggered by rising fuel prices left dozens dead and hundreds injured. As part of the chaos, Internet and telecommunications outages were reported throughout the country. Kazakhstan accounted for more than 18 percent of the global bitcoin network hash rate last August, second only to the United States. The activity rate of major cryptocurrency mining pools - groups of miners in different locations who join together to produce bitcoin - fell by 14 percent between Tuesday and Thursday, according to data from BTC.com. Many actually blame this crisis for the drop in bitcoin's price last week.

When Russian grandmaster Garry Kasparov - ranked No. 1 from 1984 to 2005 - speaks on various topics, the world listens. The man who undoubtedly has a great logical and mathematical mind sees cryptocurrencies as a way to counterbalance government powers. According to Kasparov, bitcoin offers protection from rampant government spending, "because you are protected by mathematics," meaning the logic of the code itself. What does he think of the industry in general? "Now we have thousands and thousands of tokens. It's like the Internet bubble. Ninety-nine point nine percent will be gone. But the ones that survive will become the Google of the world. I'm not here to judge which ones, but there will be few that survive - that's why I'm talking about a basket of coins."

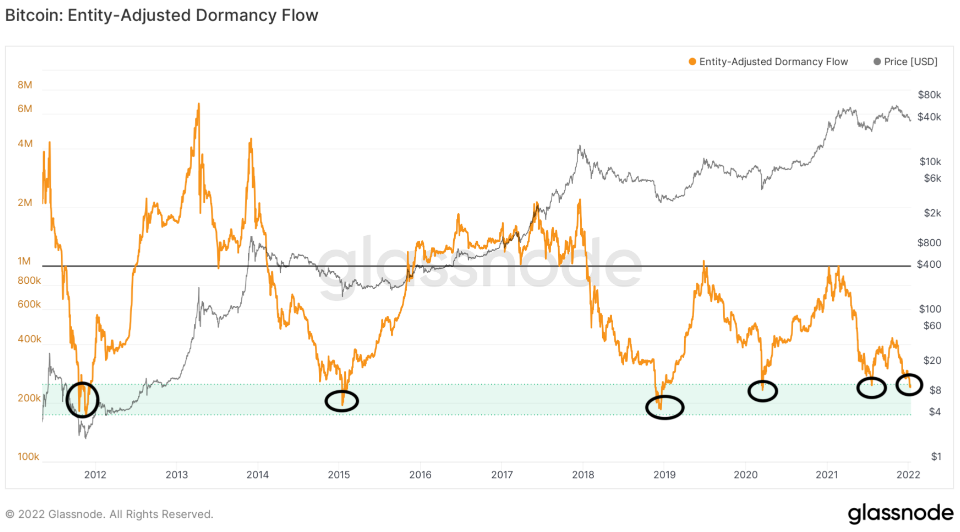
Legendary investor Bill Miller is the latest to publicly admit to investing in bitcoin and other cryptocurrencies. In his case, however, that investment is far from small. Miller revealed that half of his personal net worth is invested in bitcoin and other crypto assets, going against his own widely known advice that investors should only allocate 1 to 2 percent of their portfolios to digital assets. He said he first bought bitcoin in 2014, when it was trading around $200. He continued to buy them and stopped when it reached around $500. He then started buying bitcoins again in the spring of 2021, when the coin was hovering around $30,000, just after it had collapsed from its all-time high of about $66,000 (now that's a pretty similar environment to the current one...). In a recent interview, Miller also compared bitcoin to digital gold in terms of a hedge against inflation, adding that it's also an "insurance policy against financial catastrophe that no one else can provide," given its supply limit of 21 million coins. "It comes down to the very basic level of supply and demand. Bitcoin is the only economic entity where supply is not affected by demand."

Speaking of legendary investors, our own Martin Lalonde, president of the firm, was on TVA Nouvelles Gatineau yesterday to talk about the recent decline in the price of bitcoin. You can watch the interview again under this link. The interview starts at the 15 minute mark.

Contrary to the opinion of many, Pascal Gauthier, CEO of Ledger, believes that individual investors will be the cause of the next price increase. It must be said that his opinion is not exactly disinterested. According to him, the retail investor trend is preponderant and it's "always the same thing". He explains: "The number of addresses with the minimum number of BTC is actually increasing in relation to the number of whales. There is a deep trend of retail investors around the world; they are trusting Bitcoin more and more. These are the people who will drive the price up." Recent data from Glassnode abounds in this regard. The number of BTC addresses with a non-zero balance has never been higher, reaching just under 40 million.



A historically reliable blockchain indicator suggests that bitcoin may be in the final stages of a downtrend, having lost nearly 40% of its value over the past two months. Entity-adjusted dormancy flow, a ratio of the cryptocurrency's current market value to the coin's annualized dollar value of coin dormancy, has fallen to levels that have historically corresponded to a subsequent rise. "Low dormancy flow values indicate times when market cap is undervalued relative to the yearly sum of realized dormancy, indicating moments where bitcoin is a value price," Glassnode explains. This signal has only flashed 5 times before in the history of Bitcoin.



Finally, it should be noted that outflows from bitcoin exchanges saw their biggest daily increase since September 2021 this week. Nearly 30,000 BTC left the main exchanges in a single day as buyers copied miners to remove BTC supply from the market. "Volumes are low. This means the market can have huge moves up or down easily," commented Samson Mow, CEO of Blockstream. "Given that we've already had one big move down, and everyone is buying like crazy, I would say the next move is up."

While capital was in maximum protection mode in last week's bearish environment, we have taken back the majority of our positions in the past 24 hours.

Rivemont Investments, manager of the Rivemont Crypto Fund.

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