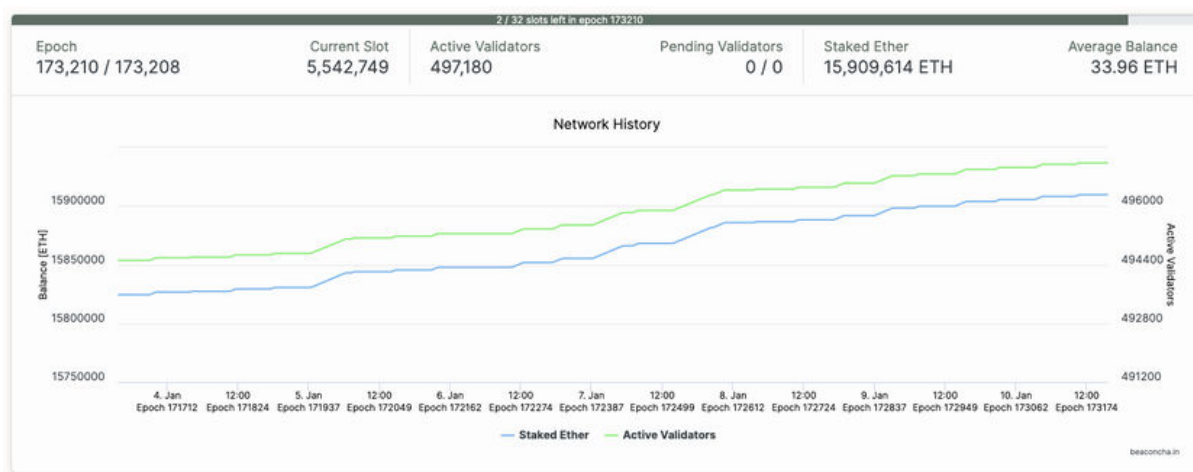


Bullish Insights

2023 Outlook
January 10, 2023

ETH Catalyst

After The Merge, comes The Surge for the Ethereum protocol. This will increase focus on Ethereum’s scalability in sharding applications. Ethereum’s Shanghai upgrade is due to take place on March 2023, which should see the proposal EIP-4895 unlocking staked ETH from the beacon chain. A total TVL of 15.5 million ETH, ~\$19 billion might flood the market. Albeit general expectations were that this is a positive catalyst for ETH, we remain cautiously bearish from a price action point-of-view. Going forward we anticipate a continued drop in gas usage by NFTs as well as MEV bots and increased usage by DeFi and Stablecoins.



Source: Beaconcha.in as at January 10, 2023

A pivot from the metaverse, and guilds

We hit a Minsky moment in 2022 where buzzwords like the metaverse, play-to-earn models, virtual land took headlines then came crashing down. Bear markets tend to wash out fluff. If there is no sustainable business model and a tokenomics structure that is only built for speculative purposes, then chances are you won’t survive this winter. Excessive optimism fuelled by a bullish period in market sentiment drove much of hype in these sectors. Virtual land and assets saw excessive valuations without proper utility figured out. Tokenomic models of low float and high FDV caused a systemic collapse (FTX). These are all endogenous variables that has exacerbated the pain this winter.

Eager investors have been too early in calling a full transition to the metaverse. The anticipation for 2023 is for the metaverse to take a breather and focus a shift towards AR (augmented reality) as well as AI. AR is an in between transition from virtual to IRL (in real life) experiences and in AI, the proliferation of GPT-3 should encourage more user applications and innovation within the web3 space. Certain projects in 2021 have already looked at combining NFTs with GPT-3 (Alethea.ai, Altered State Machine etc.) Coming into 2023, we may see further development and use cases of GPT-3 on the blockchain.

Guilds that were once operating with over 27,000 scholars after the hype of play-to-earn games like Axie Infinity are now pivoting their business model for 2023 to still solve for the user acquisition problem in blockchain gaming but through i.e. tournaments, SaaS marketing.

Macro headwinds, a delicate balancing act

2022 was full of endogenous shocks for the crypto industry, a big focus on 2023 will be the macro narrative. All eyes are on the Fed (Federal Reserve) and whether a pivot is on the cards for 2023. Will Jerome Powell follow in the footsteps of his predecessor Paul Volcker who was relentless in tightening monetary policy in the 70's and 80's to crush inflation? Tighten too much and you risk driving the world into a recession, loosen a little too early you risk a period of raging inflation or worse yet long-term stagflation. Unemployment figures are holding strong at 3.7% well below the rate of concern and economic growth is still in expansion exceeding market expectations in the last reading. With these events combined, seems like Powell still has room to move further in 2023. However, inflation figures are easing with the last reading at 7.1%, seeing consecutive MoM drops and the shift from goods inflation to services inflation is underway. The reason why we pay such close attention to the Fed is because rates move market and US equity markets are still correlated to the crypto market. Albeit correlation figures against the Nasdaq 100 have come down from ~0.75 in October to ~0.22 in December.

In a **bull case** for 2023, if the Fed does pivot, peaking out in the tightening cycle this should drive US equity markets towards a rebound rally and a shift back towards risk-on assets. Liquidity has dried up and the long growth bias in the past decade has come undone.

This should flow onto the crypto market with altcoin season returning should we see a rebound. Bitcoin dominance generally gains momentum in times of deep winter. A rally could mean a decrease in BTC dominance and increase in alts market share. Similar to tech stocks, the net present value of cash flows is rate sensitive, in a base case, even if the Fed does ease hikes towards 2H2023, assets that have earning projections further out into the future are unlikely to see further asset allocation. Yes, this paints a bearish outlook for crypto. In a **bear case**, should the Fed maintain their dovish tone throughout 2023, we may experience a deeper winter in crypto. The expectation is for more pain to come if a pivot isn't on the cards.

Nevertheless, protocols are increasingly competing for capital and yield farming is no longer as attractive in comparison to "risk free rates" a user would reasonably get with US treasuries making it increasingly difficult to draw capital to this side of the market. Assets are in competition after all and to an investor its an opportunity cost of capital.

Themes for 2023....PoPW

PoPW stands for Proof of Physical Work also known as TIPIN, Token Incentivised Physical Infrastructure Networks, is a concept incentivising individual to contribute to verifiable work that will result in the development of in-real-life infrastructure. A few potential projects to note are in health data, DeWi (decentralised wireless) networks and separately Web3 messaging.

DeWi projects – like Helium are not new to the industry per se but may reinvent the way we look at using individual hardware to contribute to a web of decentralised infrastructure. In the case of helium hotspots are powered by participant hardware which provide network coverage for users wanting wireless hotspot access. Participants are rewarded for building coverage and mint the native token HNT. Similar concepts like DIMO for driver data and a cross between energy & web3 where individuals contribute to a network of collective energy infrastructure are interesting topics to keep tabs on

Decentralised health records – with ZK-proofs advancing we are moving a step closer to being able to execute private health records on-chain without compromising sensitive personal data. Research institutes that may lack data points may be able to access the necessary records for research and drug development purposes where at the same time patients are rewarded for the release of their personal data without jeopardising their privacy. Users will truly own their health records and be able to opt in/out of third-party usage.

Social for Web3 – a privacy oriented social platform that utilises decentralised storage facilities. It cannot be censored or banned by central bodies and has portability functions that allow users to hold essentially a “portable identity”. Commerce functions could be embodied into the platform, with in-built crypto payment offerings.

Increased DeFi interest, and consolidation in CeFi

Centralised exchanges saw record outflows this year in the month of November 2022, over 80 000 BTC after the collapse of FTX saw increased investor scrutiny over centralised platforms. Retail users are increasingly sceptical of centralised exchanges and looking at alternatives including self-custody options. DeFi has regained interest with the sector outperforming by 2.9% on a 30-day price change. CeFi on the other hand was the worst performing sector down by 4.4%.

Smaller/regional centralised exchanges may start consolidating as runway shortens. Firms with strong balance sheets and lean operating models should be the survivors of this crypto winter. Distressed exchanges might call for undervalued acquisitions by CEX's with big war chests. Bear markets are the prime time for industry consolidation where larger firms are able to increase acquisitions thus build out user base as well as align strategic opportunities (i.e. acquiring regulatory licences, operating jurisdictions).



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