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Digital currencies: holding your hand in cryptoland

JAMES KIRBY
Follow @kirby_journo

By **JAMES KIRBY**, WEALTH EDITOR
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For most investors, "crypto" must seem like a party to which they have not been invited: the entire scene is enthralling, dangerous and regularly lucrative.

Just now it seems like there are two types of investors in the space: those who know very little and have few other investments; and those who are very experienced and have crypto "in the mix" just like they have holdings in hedge funds, or dairy herds or gold bullion.

The common denominator among both groups is an unusually high acceptance of risk.

It's not just that the price of your chosen cryptocurrency might plunge or soar at any moment. That's obvious and only slightly different to speculative activity in junior mining companies or leveraged products.

Perhaps more daunting for everyday investors is that the entire scene lacks the familiar pillars of reassurance investors like to see in place – custodians, auditors and the rest of the regulatory architecture providing a level of comfort that you won't be fleeced.

The Australian Competition & Consumer Authority reports that in the first six months of this year at least $20m was lost to crypto scams, and that figure is most likely a hazy guide to the games being played at this end of the market.

Meanwhile, financial advisers are urgently trying to learn the lay of the land in crypto because suggesting that it's all too hard just won't do any longer when money is being made.

Stepping into this cauldron of activity is not easy for any investor, but it is in the nature of markets that solutions emerge for those who wish to part with their money.

Assuming that cryptocurrency continues to become integrated into the wider economy (and that is a big assumption), the major crypto exchanges of today such as Coinbase or Binance may no longer rule the roost as the denizens of Wall Street or Martin Place finance steadily encroach on their turf.

For Australian investors, it will likely play out like this:

Phase 1. In tandem with the mass betting that is taking place on crypto exchanges, very wealthy investors – typically family offices – will enter the game through exotic institutional products that are beyond the reach of most people.

Phase 2. Active investors – typified by self-managed super funds – will enter the sector through specialist funds, where the minimum investment required will continue to fall as competition expands.

Phase 3. Exchange-traded funds will enter the arena, mopping up every last penny of potential crypto money from retail investors.

Just now we are somewhere between Phase 1 and 2.

Inside financial services some of the bigger names are rapidly moving to understand and seek a way to monetise that knowledge. Key players in managed funds such as the Pendal Group are engaged here. In the ETF arena, leading operators such as BetaShares and VanEck have already lodged plans for funds.

Funds are forming – or being planned – to hold your hand as you enter cryptoland. Among the more responsible operators there are clear warnings to the effect that investors typically have 1-5 per cent of their total portfolios in what's become known as the "digital asset" class.

Two specialist funds have emerged of late that give us a flavour of things to come. Both are only open to sophisticated investors and offer the regulatory comforts that are generally offered by investment trusts.

Jeff Yew at Monochrome Asset Management has successfully started a fund that invests in crypto. Yew is a pioneer in the sector, being a former CEO of crypto exchange Binance Australia. He has attracted national attention bringing in wholesale and sophisticated investors.

Emerging from a more traditional background, Steve Bellotti is a former ANZ managing director of global markets who is now building a considerable financial empire where crypto investing is a key element of the product proposal.

Bellotti is CEO of the Digital Native Assets Tracker Fund, where certified sophisticated investors can start with a minimum investment of $10,000.

It's worth looking a little closer at this fund as a window into what is happening. Bellotti says the fund has core positions in two cryptocurrencies – bitcoin and ethereum – and seeks to add value searching for select opportunities among the 20 most popular crypto coins at any given time.

The performance over the fund's short life span is eye-popping: in its September report, DNA Tracker recorded a return of 185 per cent since it was launched in December last year. As you would expect (in common with hedge funds), there are hefty performance fees of 20 per cent.

As spectacular returns like this roll in and financiers figure out ways to bring everyday investors into the game, everyone wants to know what top investors are thinking.

Among the key figures on Wall Street regularly name checked as crypto enthusiasts is Cathie Wood of Ark Invest. This week Wood, who is pushing plans for an ETF in the sector, said bitcoin could rise tenfold in the next decade.

Meanwhile Ray Dalio, the founder of the world's biggest hedge fund, Bridgewater Associates, has revealed he has investments in bitcoin, but he is quick to add it is "a small percentage" of what he has in gold.

Bitcoin is a proxy for the wider crypto market. It is currently at about $US50,000, down from more than $US60,000 in April but well up on the $US10,000 struck in May last year.

Asked about bitcoin's future, Dalio this week said: "If it's really successful ... (regulators) will try to kill it."

It's so true. Speculating on crypto now – whether you have a fund to hold your hand or not – is no longer about whether it can fly, but whether the incumbent regulators of the world will make sure it does not fly much further.

JAMES KIRBY, WEALTH EDITOR

James Kirby, The Australian's Wealth Editor, is one of Australia's most experienced financial journalists. He is a former managing editor and co-founder of Business Spectator and Eureka Report and has previousl... Read more