



DIGITAL ASSET LENDING SNAPSHOT

2019 | Q2 Insights

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The digital currency lending market continues to experience sustained growth. In the second quarter, Genesis initiated more loans and borrows than in any other quarter on record, adding \$746M in originations. As of June 30, 2019, active loans outstanding stood at \$452M, a 149% quarter-over-quarter (QoQ) increase from \$181M in the first quarter. Originations increased 48% QoQ, rounding out the fifth consecutive quarter of strong growth. In total, Genesis has originated \$2.3 billion in loans and borrows since launching the business in March 2018.

A strong uptick in USD and “stable coin” borrowing as well as the BTC price increase drove much of the growth over the past quarter. Our counterparty breadth has also expanded significantly, with many non-digital currency focused institutional investors participating in lending, leveraging long, and short selling. As we do each quarter, we would like to share our perspective on the digital currency lending market to provide insight and trends to our counterparties.

(\$ in millions)	3/31/2019	6/30/2019	QoQ Growth
Cumulative Originations	\$1,539	\$2,285	48%
Cumulative Loans	\$892	\$1,362	53%
Cumulative Borrows	\$647	\$922	42%
Active Loans	\$181	\$452	149%
BTC Price	\$4,094.99	\$11,227.01	174%

Figure 1

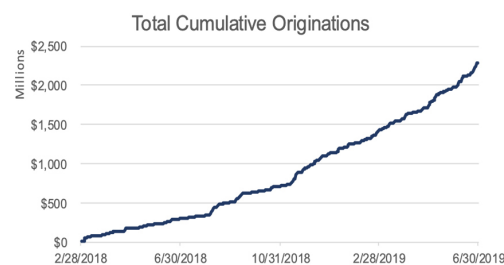


Figure 2

Quarterly Asset Composition

We are happy to highlight that cash lending (USD, PAX, and USDC) now constitutes nearly a quarter of the active book, increasing more than 100% from last quarter. There is strong demand, especially internationally, to borrow USD. However, not everyone in the world has a USD bank account and cross-border wires can be inconsistent.

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Therefore, the USD demand translates to stable coins, which are frictionless, borderless asset-backed coins pegged to the dollar. At the same time, traditional institutions seeking yield are becoming comfortable interacting with stable coins which, in addition to tracking USD, provide an added layer of credit risk on the issuer of the token.

Stable coin issuers purportedly back every token created with a dollar in a bank, and anytime someone redeems dollars, tokens are burned. This simple mechanism allows everyone in the world to access the stability of the dollar with just an Ethereum address. Further, by using stable coins, traditional institutions are forced to understand how to set up a wallet, transact using an address, and generally increase their digital currency knowledge and comfort level.

In fact, some Genesis institutional counterparties that began solely lending cash ended up also purchasing, lending, and shorting other digital currencies. This trend is promising for increased awareness among traditional financial institutions - stable coins are proving to be a suitable bridge towards understanding and interacting with decentralized digital currencies.

Asset	9/30/2018	12/31/2018	3/31/2019	6/30/2019
BTC	60.4%	63.4%	68.1%	62.5%
BCH	3.4%	0.3%	0.3%	0.5%
ETH	3.6%	6.9%	3.6%	3.9%
ETC	4.1%	4.1%	2.3%	0.9%
XRP	17.5%	7.3%	6.7%	2.5%
LTC	3.8%	1.1%	3.6%	3.7%
USD and Equivalents	3%	14%	10%	23.5%
Other	4.7%	2.6%	5.9%	2.5%

Figure 3

Key Drivers of Cash Borrowing

One of the major structural shifts in the market over Q2 was the increasing contango in the futures market for BTC and other digital currencies starting in early May. As markets became more bullish, market makers priced the forward curve higher than spot to reflect the expectation of price increase.

This development increases the demand to borrow cash for two primary reasons. First, investors leverage their holdings by borrowing cash against BTC collateral and then use the cash to buy more BTC. If the price increases, the value of the collateral may increase relative to the value of the loan, allowing investors to draw down on more cash and continue leveraging long. Figure 4 below plots BTC price against cash loan originations as a percentage of Q2 (i.e. cash loans on a given day divided by total cash loans for the quarter). As seen in Figure 4, once price started climbing in mid-April, cash originations picked up significantly. Most cash originations for the quarter occurred in June, when BTC traded from \$8K to nearly \$14K.

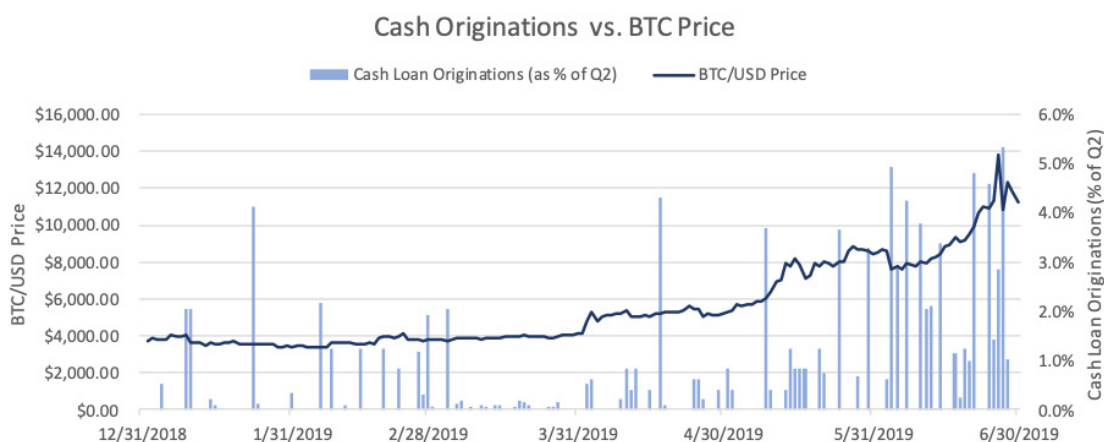


Figure 4

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The second reason for increased cash borrowing is the opportunity to capture a basis spread between futures and spot, where the premium often outweighs the cost to borrow cash. This trade is also attractive to many traditional firms familiar with trading in other asset classes because it is a relatively low risk way to exploit the steep forward curve. Figure 5 below plots the difference between the nearest dated future and spot (negative numbers are backwardation, positive contango) versus cash originations. As seen in Figure 5, cash borrowing increased when basis grew wider, which happened to be highly correlated with the spot price increase in figure 4. Further, if the market flips bearish and forward curves become more in line with spot, the trade converges to profitability much quicker, making the effective annual realized return significantly higher than the cash borrow rate.

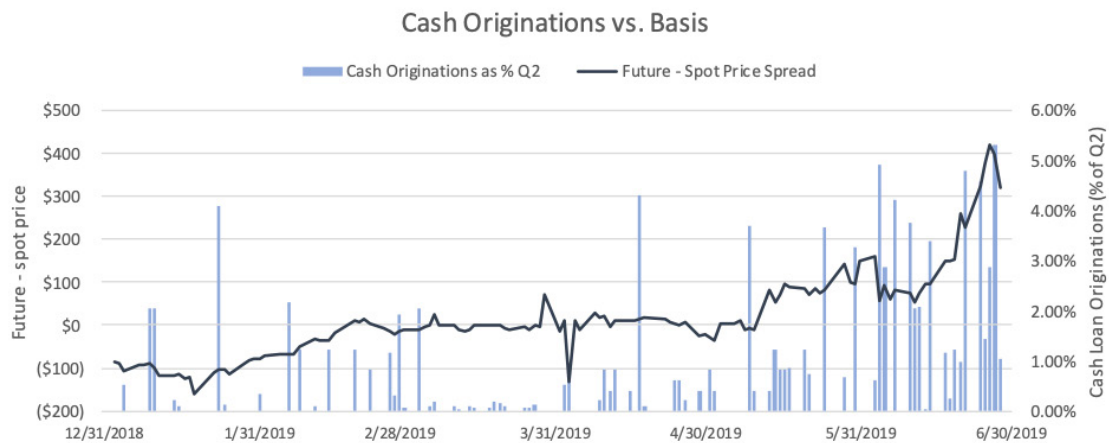


Figure 5

A byproduct of the above basis trade is a reduction in the BTC interest rate. Since buying spot and shorting futures allows traders to effectively collect interest and have BTC working capital, the demand to borrow BTC decreases. Additionally, the supply of BTC available for lending increases as traders can earn extra yield by lending out the spot purchase leg of the trade, or they can post it as collateral to get a cash loan and recycle into the basis capture. We have seen a material reduction in BTC rates over the quarter as a result of the structural forward curve shift into contango.

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Libra

We have been asked whether we think Libra is positive for digital currencies. In our view, it is very encouraging that people are even asking the question. Libra will enable hundreds of millions, if not billions, of people to understand the utility of a digital currency and the difference between a permissioned and permissionless ledger.

Closing Remarks

At the end of Q4 2018, we forecasted: “Momentum trading, expedited short settlement, basis trading, and cash lending will all be key drivers of lending growth in 2019.” Given what we have seen the past two quarters, it is safe to say this forecast was correct and we look forward to continued growth for the rest of year. Thank you for your continued support, and please reach out to us if you have any questions.

Questions?

If you have any questions, please feel free to reach out to matt@genesiscap.co and roshun@genesiscap.co.