FCAM

Decentralised Digital Investing

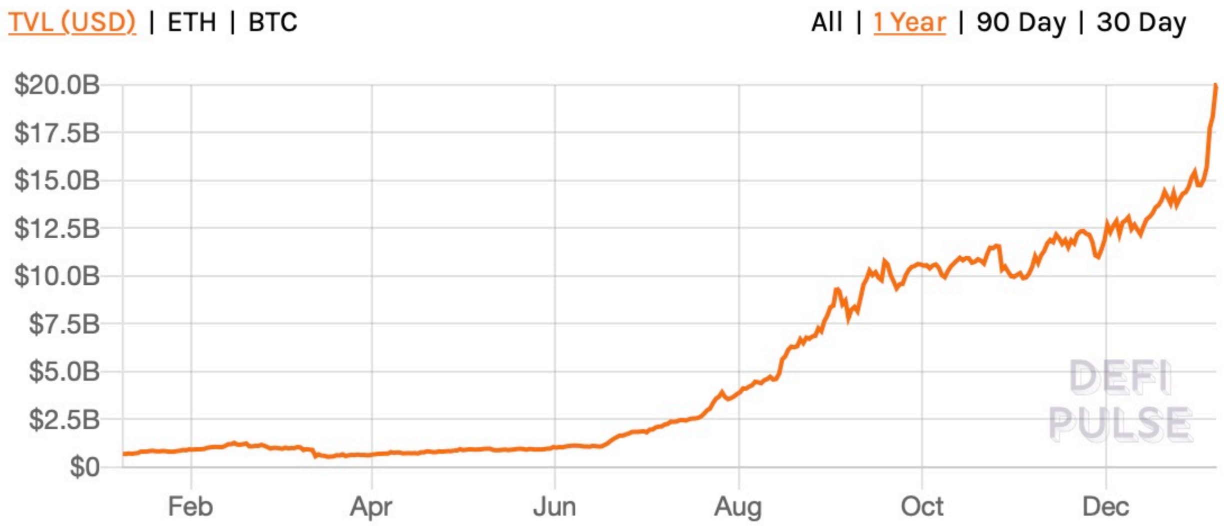
2021

A Breakout Year for Decentralised Finance

2021 is setting up to be a breakout year for DeFi. Our view is that DeFi has a long-term potential world-altering future ahead. A future in which individuals can undertake financial activities peer-to-peer at a global scale. The road to achieving these future goals will be intriguing as new technology comes to terms with regulation, legacy systems, competition and national interests.

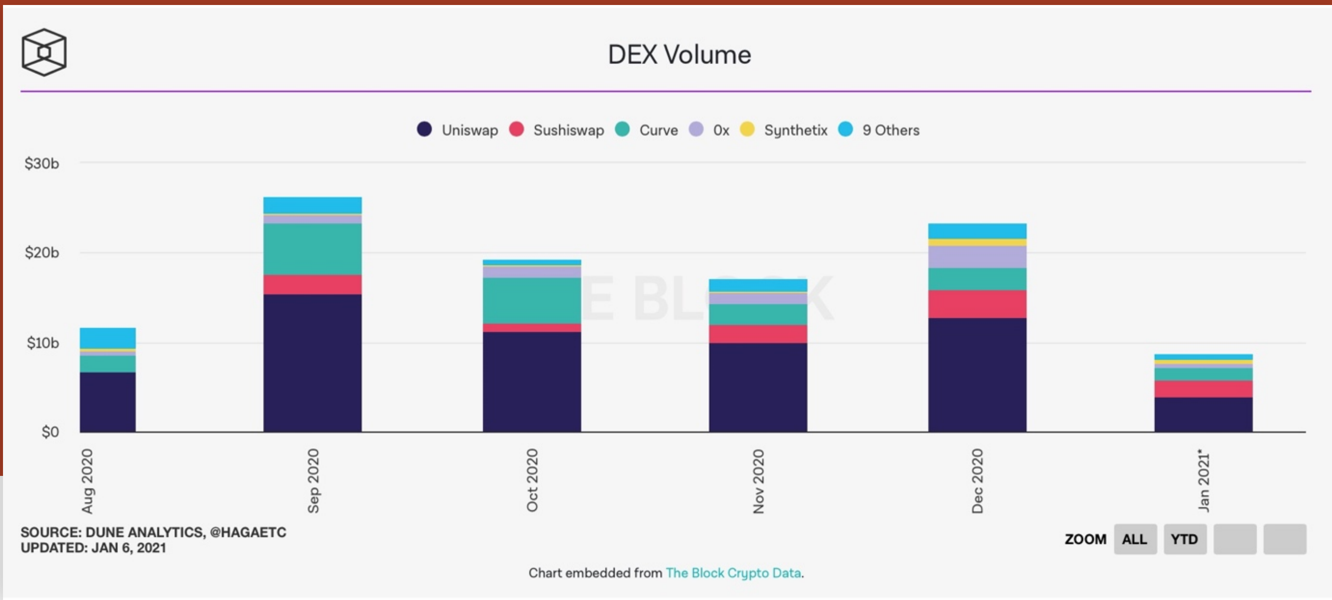
DeFi had a fantastic year in 2020. The aggregate number of users (1.2million) and capital committed to the space (US$20 billion) grew astronomically at annual growth rates in excess of 1,000%. This growth was driven by a boom in a number of decentralized applications (Dapps) coming to market mid-way through the year. Dapps that facilitate core functionality (borrowing, lending and exchanging) of the digital asset financial system all went live on the Ethereum blockchain attracting a fervor of interest in the DeFi ecosystem.

Total Value Locked (USD) in DeFi



Decentralised Exchange (DEX)

volumes jumped from $3 billion to over $104 billion in 2020. Protocols such as Uniswap and Sushiswap have come to dominate the world of exchanges, recording volumes comparable to those of their centralized exchange counterparts. In 2020, the Total Stablecoin Supply grew 350% from $5.9 billion to >$27 billion.



With institutions diving into digital assets in 2020 we expect institutional interest to move from Bitcoin as a store of value, to include the Ethereum blockchain and the decentralised applications that it supports. As more capital, developers, and users enter DeFi, the challenges of using decentralised financial protocols should decline. Better user experience and education in DeFi will enable broader participation and exponential user growth in the sector.

Whilst we expect similar if not greater amounts of growth for the sector in 2021, we envisage commercial success will bring increased regulatory scrutiny and commercial pressure from legacy financial industry participants.

During 2020 a group of landmark regulatory actions and proposed bills against some of the most systemic players in the digital asset ecosystem offered a reminder that regulatory action takes time – but regulators are fully engaged and working towards an endgame.

US national banks are now allowed to operate blockchain nodes and use stablecoins for settlement of financial transactions, according to a decision issued by the US Office of the Comptroller of Currency (OCC). This is a big deal for mainstream digital asset adoption. This will allow the US dollar to move across blockchains like Ethereum and into the traditional banking industry. We believe the OCC ruling is a major move to ensure that the US stays financially competitive on the global stage. Additionally, the US Financial Crimes Enforcement Network (FinCEN) has proposed rules to introduce KYC/AML standards for transferring digital assets between exchanges and digital wallets. The OCC has also put its support behind the need for KYC/AML as it relates to the growth of the stablecoin market.

All regulation is not created equally in our opinion, and the introduction of the Stable Act in December has proposed regulation that may be too overbearing. The Act intends to regulate stablecoin issuers by requiring them to obtain bank charters, a costly and time-consuming process. We openly welcome regulation and expect to see more efforts to regulate DeFi in the future as the market for digital assets grows.

At a sovereign level the race to introduce the first Central Bank Digital Currency (CBDC) is heating up. These are sovereign sponsored currencies operating on blockchain technology. The People's Bank of China (PBOC) are actively testing a pilot program called Digital Currency/Electronic Payment (DC/EP) that is expected to go live in 2021. Mainstream financial media is covering the development in this space closely and it is worth following at a geo-political interest level.

What will happen once sovereign governments issue digital currencies

is unknown at this point but what we can see is that it will have a material impact on the way that the current financial system operates by virtue of the way financial data is communicated and stored and the limited requirement for intermediaries when performing financial transactions.

On the technology front, the ETH2.0 upgrade project launched in December 2020, combined with Layer-2 scaling techniques, it is intended to solve Ethereum's scaling problems for the long run. This will hopefully allow faster transaction times and cheaper transaction costs for those operating Dapps on the Ethereum network. There are a number of exciting Dapp projects under development that will complement and compete against the existing DeFi protocols already operating.

Whilst the token rewards offered in 2020 to incentivize liquidity providers to their platforms have disappeared the growing need for capital and liquidity in the DeFi ecosystem will continue to grow as the number of users and aggregate value of the digital asset ecosystem increases. This should ensure that a robust rate of return will be available for liquidity providers throughout 2021.

We are entering a financial revolution which has blockchain, digital currencies and assets at its core. The technology has been developed,. The application layer for digital decentralised finance is now under construction. Regulation, the ultimate stamp of legitimacy, will be implemented.

It is going to be a fascinating decade for money and finance. FCAM looks forward to guiding your capital through the new and exciting world of DeFi that lays ahead.