AUGUST 2023 PERFORMANCE

TOTAL NET RETURN

PERIOD	FUND RETURN
1 Month	-2.07%*
Life to date	-24.12%*

*Post management, performance and entry fees. Past performance is not indicative of future performance.

The Fort Stable Fund generated a return of -2.07% for the month of August 2023. The market experienced an unsurprising summer rollercoaster on very low liquidity. Mid month the market saw significant liquidations across large derivative markets based in Asia. Cryptocurrency traders purportedly suffered $1 billion of losses in liquidations over that 24 hours, according to various sources such as Coinglass data. The precursor to the move was rising concerns over the behaviour of longer dated bonds that we will deal with in the macro outlook below and the overleveraged derivative market that was vulnerable to a squeeze. The fund owns some 1700 strike September expiry puts that were purchased for such an event such as this and protected the fund somewhat from the move at extremes, we added to our exposure close to the 1,600 level taking us back to 17% long. Over the month ETH recovered on further legal clarity on ETF's more broadly which make the SEC's opposition less justified.

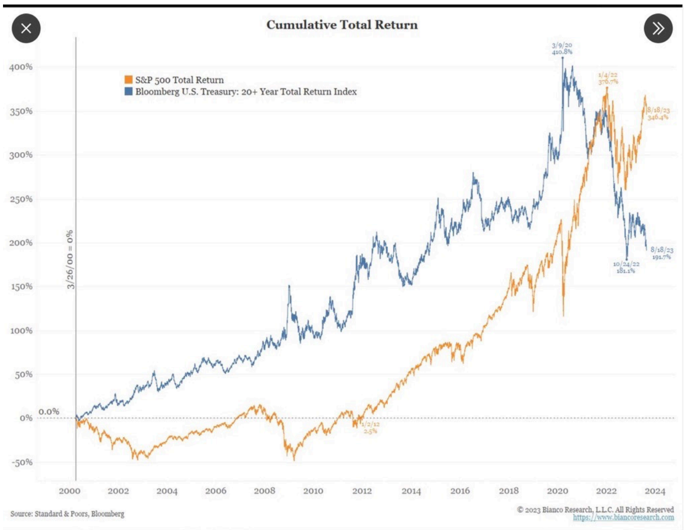
This month we will discuss the macro outlook and the mixed signals we are getting from markets and some crypto specific news.

Macro news and views:

The market sits at a pretty unique juncture. The macro forces all at play are perhaps worth laying out. Focussing on the US, we are in a period of dramatic fiscal expansion that started post 2020. This has seen government debt levels explode higher, this fiscal stimulus seems to be distributed randomly, some direct handouts, some ESG focussed support and some destined for "re-shoring" of manufacturing, its unprecedented... Some would argue that this is an inflationary force, it's certainly helped maintain high levels of employment. The FED are perhaps close to the end of a period of hiking rates that has seen US rates curves remain inverted for a substantial period of the last 2 years, this is normally a precursor to recession that so far hasn't come, this inversion is now reversing. The rate hiking process has slowed the housing market in terms of volumes transacted, caused some failures in the banking sector (Silicon Valley Bank etc) but hasn't yet really impacted employment or growth. What it has done is rewarded savers with higher interest rates and discouraged purchases of goods. Demand for services however, has remained strong. Equity markets and bond markets are painting very different pictures and seem for now to be uncorrelated. This is abnormal. What's "normal" is higher rates means lower equities as the cost of debt servicing has increased which is a drag on profitability and growth.

For now the questions remain:

- Is fiscal support enough to offset the higher cost of capital (interest rates) going up?
- Is the inflationary impulse really behind us or will this Fiscal crowding out that we are seeing allow it to return?
- Is there a cost to running huge fiscal deficits? That is; who will continue to buy your debt when you are issuing so much ?
- Has the correlation of Bonds and equities broken down and if so why? This chart below is fascinating - "normally" Bonds yields or interest rates go up and equities go down.... Not this time, or not so far.



Have we just reversed a 40 year trend? Long end interest rates have declined pretty much for most of our lifetimes. This is what the market has started worrying about this month which we discuss in detail below.

Back to this month's moves. Bond yields in developed markets rose through August, the benchmark US 10yr yield increased from 3.90% to a high mid month of 4.35%, matching the yield high seen in October 2022, it currently sits at 4.11%. Rates markets have been driving risk assets and the USD, so let's take a look at what drove rates this month.

On August 2, Fitch downgraded US sovereign debt from AAA to AA+. "In Fitch's view, there has been a steady deterioration in standards of governance over the last 20 years, including on fiscal and debt matters, notwithstanding the June bipartisan agreement to suspend the debt limit until January 2025," the rating agency said. Of course, Janet Yellen strongly disagreed with the Fitch decision and called the move "arbitrary". Regardless, bond yields rose and the curve steepened.

Another reason for the yield rise was markets anticipating a hawkish speech from Jerome Powell at the Jackson Hole central banker's symposium on August 25. In reality Powell was quite balanced, reinforcing the higher for longer narrative and a willingness to 'do whatever it takes' to bring inflation down. He also pointed out that interest rates are now in restrictive territory and therefore attention needs to be paid to downside risks to the economy.

Supply and demand for US Bonds has shifted, and this is another reason pressuring yields higher. The international demand for US Bonds has declined, in fact there is evidence that two major holders of US Bonds, China and Japan, have been reducing their holdings as they battle against their currencies weakening against the USD (intervention in the FX market would have them selling USD to buy their own currency, liquidating US treasuries in the process). In contrast, US institutional holders of US Bonds have increased their holdings to record highs, as shown in the JP Morgan and Bank of America positioning surveys.

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On the supply side, most analysts would agree, US deficits are currently on an unsustainable path in the medium/long term. Over the course of the rest of the year, Treasury has to issue $2trn in long dated securities, with appetite from abroad dwindling, supply concerns will continue to put upward pressure on long end yields.

We are finely balanced: for us there are 3 scenarios:

1. Recession - Growth starts to contyract and the lagged impact of rate hikes slow the economy. At this point there is a greater impulse for rate cuts which is positive for risk assets which justifies their current levels and is supportive for digital assets probably after a sell off / liquidation
2. Growth remains resilient, inflation remains above target but contained, employment eases, this higher inflation persists for many years and acts as a tax on citizens. Assets go sideways.
3. Debt levels matter – Even though the USD is the world's reserve currency there comes a point where demand can't meet the supply / issuance which means that rates sit sustainably higher than they have. (reversal of the 40 year trend) Demand for finite assets (commodities / physical assets / limited supply (Gold / BTC)) or assets with defensible moats and earnings do ok.

The powers that be want 2. Given they make the rules expect them to be skewed towards that outcome in the long run. To us however the risks of the market pricing 1 or 3 are what drives our asset allocations.

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Digital news and views:

It wouldn't be a month end note in Digital assets without more court rulings and positioning for legislation. The US remains the epicentre of the financial world and resolution of its stance on digital assets is the most significant headwind we are facing. The good news is that the courts seem to increasingly be coming to the conclusion that objections to digital asset initiatives by the SEC aren't founded on solid grounds. This is not to say that these grounds can't change, ie new laws, but existing structures being used to slow roll progress are currently being stretched too far. This month the D.C. Circuit Court of Appeals ruled that some of the regulator's arguments in rejecting Greyscale's bitcoin spot ETF applications seemed "arbitrary and capricious," The Judge indicated the SEC's denial of the application was inconsistent with the approval of a pair of bitcoin futures ETFs, and did not explain why it viewed these types of products differently given the underlying bitcoin market had a "99.9% correlation" between spot and futures market prices. This saw prices bounce towards the end of the month and analysts such as Bloomberg's ETF team announce that they increased their odds of approval this year to 75%.

Currently in the pipeline there are 4 Bills in various stages of draft to resolve outstanding issues:

1 - Financial Innovation and Technology for the 21st Century Act – Republican sponsored

This bill aims to create a process for establishing categories for digital assets - commodity or security and would further clarify the jurisdictions of regulators. The bill would give the Commodity Futures Trading Commission (CFTC) power over digital commodities and clarity on the SEC jurisdiction.

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2- Responsible Financial Innovation Act (RFIA)- Bi Partisan

It also aims to clarify the SEC and CFTC's roles in crypto regulation. It has a strong focus on consumer protection and establishes a path for simplified Digital asset tax treatment. It would also see depository institutions be the only ones allowed to issue stablecoins, bringing them under a Federal umbrella vs state as they sit now and would make room for decentralized autonomous organizations (DAOs) in the tax code. Lastly clarity is also focussed on the Federal Reserve's role in which would be ordered to process bank applications for master accounts from crypto firms on an equitable basis. This bill would give banks more comfort in supporting the industry.

3 - Digital Asset Market Structure Bill (DAMS) - Republican

This bill is getting some attention. On June 26, Representative Maxine Waters sent letters to Treasury Secretary Janet Yellen and SEC chair Gary Gensler asking them to weigh in on the bill. It aimed to create a decentralization test where token would have to undergo certification with the SEC to prove it is adequately decentralized before it can be given commodity status. Before that point crypto exchanges would be able to register with the SEC as an alternative trading system (ATS) and the regulator wouldn't be able to deny registration due to a platform trading digital assets. The SEC would be required to allow broker-dealers to custody cryptocurrencies if they meet requirements.

4 - Digital Commodity Exchange Act (DCEA) - Republican

First introduced in September 2020 with an updated version of the DCEA was reintroduced in April 2022 – it aims to put parameters in place for Stable Coins, it hands the CFTC the power to register and regulate spot exchanges, which are brought under the same rules as other commodity exchanges. Crypto project developers could also voluntarily register with the CFTC by submitting disclosures required to publicly trade and list their assets on an exchange.

These are all just proposals, and there seems to be a significant political divide forming, however proposals are an important step finding some common ground. What's becoming more apparent by the day is that the existing system is not fit for purpose and the court rulings are stacking up. Politically the winds seem to have changed, the political cost of objecting to progress in the digital assets space is now outweighing the benefit in terms of public opinion.

Stable coins –

The release of PayPal's stable coin this month (PyUSD) was issued with minimal fanfare, backed by Paxos with its use cases still unclear however it potentially brings 400m people into crypto / blockchain and not one of them will need to know they are using crypto. Stable coins are indeed the first real world scalable use case for value transfer and are the original building block required for the development of any alternate financial system, in this case a digital representation of cash. PyUSD will be transacted initially on the ETH network and underlying layer 2 solutions.

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A global investment firm called Brevan Howard undertook a survey and generated a significant report* (link below). The Highlights are that in 2022, stablecoins transactions added to over $11 trillion all done seamlessly "on-chain". PayPal settles $1.4 trillion, we assume this explains why they see opportunity in this space. Those volumes almost surpass the payment volume of Visa which come in at $11.6 trillion, and is already close to 1% of the volume settled by Fedwire.

All of this is being made possible by increases in efficiency. The dramatic evolution of throughput is continuing to accelerate. Activity across Layer 2 networks is booming, with combined L2 throughput outpacing the Ethereum mainnet by 400%. The weekly average scaling throughput of Ethereum's Layer 2 ecosystem surpassed 50 transactions per second (TPS) for the first time on Aug 15, hitting an all-time high of 50.83 TPS two days later.

In summary

The underlying evolution of the technology continues, how that is valued and is perceived is driven by the narratives that dominate the time you are in. Warren Buffett in famous letter to shareholder stated that "in the short run, the market is a voting machine but in the long run, it is a weighing machine." It's a simple analogy but powerful. The market can behave like an irrational electoral contest based on emotions and various other stimulants. Right now we sit inside a macro and economic backdrop that's pretty exceptional in history, its impact on sentiment to assets is why crypto assets sold off as they did in 2022. With improving clarity on the regulatory front, the undeniable progress in the technology and some sort of resolution of the macro mire we sit in today we expect markets to move from a voting machine, where they tend to ignore a assets underlying fundamentals to indeed a weighing machine.

*https://digify.com/a/#/f/p/ef09be008ee64ab68bda4f0a558302a2

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