

## JUNE 2023 PERFORMANCE

The Fort Stable Fund generated a return of +0.16% for the month of June 2023. ETH ended broadly flat over the period (+1.8% closing at \$1934), however it traded in a wide range (the low was around \$1640) on a slew of news that we managed to navigate. Early in the month the news flow was dominated by the SEC's legal actions.

Towards the end of the month the focus turned to the more positive news of ETF applications. Before the news flow we had implemented a strategy of buying vol which had compressed to historically low levels over the preceding 3 months. Volatility has picked up since, and we expect price action to remain volatile throughout H2 of this year.

We added to our long position on the dip in ETH, now sitting long 29%. The Fund holds some short-dated call options, which provide gamma if, as we expect, the progress of the applications to list BTC backed ETF's ushers in a new wave of adoption amongst money managers.

The macro backdrop remains confused and potentially at an inflection point. The risk of higher global rates remains, The UK hiked 50Bp and surprised everyone, other global central banks remain poised to continue their hiking cycles even in the face of forward looking and sentiment indicators that reflect a potential slowing of activity driven by elevated inflation and employment remaining buoyant. With this backdrop we have seen the performance of tech stocks remains very robust while bond markets remain inverted (Short end rates higher than long end rates) as they have done for some time now which is the historically the sign of a coming economic slowdown.

The news in the Digital Asset space came thick and

### TOTAL NET RETURN

PERIOD	FUND RETURN
1 Month	+0.16%*
Life to date	-20.84%*

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

fast this month. Standing back a little, it looks like a lot of things came to a head, we have had the regulators in the SEC make their play. They have lodged cases to prosecute actors in the US and internationally that have offered what they deem as securities and for actions that are outside the law. This will take multiple years to play out, in the meantime the hope is that there is a decent chance of a workable legislative framework being enacted. In that vein we had Draft Bill proposed to congress proposing a new structure for crypto assets to move from being lightly regulated securities to a decentralised commodity. We have seen Freedom of Information requests granted that have been granted with regards to Tether and their proof of reserves and bankers and internal emails regarding internal discussion before ex SEC director gave a speech on where he drew the Security / commodity line regarding ETH and BTC. Lastly the worlds largest fund managers have been active There is a lot cover this month so lets get started.

### SEC vs Coinbase

The SEC has filed only two charges against Coinbase, this process is not unexpected given they were served with a Wells notice recently. Equally Coinbase had already sued the SEC as recently as April this year. They sued them for failing to act on its request for guidance on how to comply with securities laws. In its lawsuit, Coinbase argued that the SEC's failure to provide guidance has created uncertainty and had made it difficult for companies like Coinbase to operate in compliance with the law. The SEC had previously

signed off on Coinbase's business model and the previous SEC regime had indicated a clearer stance on what they felt was a security, more on this later.

The specific charges against Coinbase were:

- "Operating as an unregistered securities exchange, broker, and clearing agency." The SEC alleges that Coinbase has been operating its crypto asset trading platform as an unregistered national securities exchange, broker, and clearing agency. This means that Coinbase has not been subject to the same regulatory requirements as traditional securities exchanges, Coinbase has been carrying out KYC checks and complying with FATF obligations.
- "Failing to register the offer and sale of its crypto asset staking-as-a-service program." The SEC alleges that Coinbase's staking-as-a-service program is the offer and sale of a security, but that Coinbase did not register the program with the SEC. Coinbase's will contest its staking-as-a-service program keeps investor assets segregated, it merely allows clients to use the custody and architecture of Coinbase for the investor to stake themselves.

The resolution of this case is likely to end up in the supreme court in many years' time if there is no clarity from Congress. These cases will establish whether a digital asset is a security as determined by the Howey test that we have discussed previously. The 1946 case of the SEC vs a citrus farmer, a precedent set pre the advent of the computer. Clearly what needs to happen

is the regulation needs to be updated to accommodate a new technology, that will happen but likely requires time and potentially a change of government.

## SEC vs Binance

The SEC filed in total 13 charges against Binance and its founder (CZ) Changpeng Zhao. Binance was up until recently negotiating with the SEC to settle issues, these charges remove that option for Binance. Post the collapse of Silicon Valley Bank and Signature bank the SEC have gained access to transactions that feel are worthy of attention. In summary the charges allege that Binance engaged in a variety of securities law violations, similar to Coinbase but with some added wrinkles:

- "Failure to register as a securities exchange and the unregistered offer and sale of securities." They also allege that Binances own coin in BNB and stablecoin in BUSD are securities. This will set an interesting precedent for the stablecoin industry as currently the stance is that they aren't securities.
- A concern for sure is the accusation of commingling of customer funds, particularly post FTX fiasco. The SEC alleges that "Binance commingled customer funds with its own funds, which created a risk of customer funds being lost or misappropriated", they aren't implying this currently being done now, rather it was sloppy historical internal processes.
- "Lack of disclosure." The SEC alleges that Binance failed to disclose material information to investors, including information about its ownership structure, risk controls, and trading practices.
- "Manipulation of trading." The SEC alleges that Binance engaged in market manipulation by

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Binance indeed is an extremely opaque organisation with a very unconventional corporate structure headed by CZ who is a Chinese born Canadian citizen. There have been some leaked transcripts and emails that indicate that senior people inside the firm had acknowledged that barred American clients could in fact deal with them through VPN's and to push clients towards this solution. Given we are dealing highly sophisticated trading firms it's probably unclear that they need an explanation of geofencing. Regardless the SEC is contesting the same charges as Coinbase with some Binance specific charges that means that it's unlikely that Binance, the world's largest platform by volume, will be in the US anytime soon.

Summing up the court cases. Coinbase is well capitalized and will be a lightning rod for the industry to galvanise around to resolve the US regulatory stance, they have indicated that they will fight this to the Supreme court for resolution unlike others such as Kraken who are less well capitalised and closed their staking service when threatened. Binance is certainly a bit trickier and feels more personal as there may well be DOJ charges coming against executives there. The commingling of assets and market manipulation charge is surely a more significant issue, the question remains whether it was sloppy internal processes or indeed something more nefarious, for now the firm trades on and remains a significant player.

### **The Hinman emails:**

The Hinman emails are a series of emails that were exchanged between former SEC Director William Hinman and other SEC officials ... the key word is

former, Hinman was part of the regime at the SEC prior to Chair Gensler. The emails were prior to a speech that Hinman gave where said that he did not believe that Bitcoin or Ethereum were securities, many businesses saw this as a sign of the SEC stance and built business strategies around this.

The stance prior to these emails being released by the SEC was that it was just a personal view for William Hinman, the emails display that this was hotly debated at senior levels and acknowledged that the market would take this the speech as guidance. The emails show that there was some disagreement internally about whether the speech could create confusion or clarity about the SEC's position on cryptocurrencies. Regardless he was the former director of the SEC's Division of Corporation Finance, a senior role and he gave the speech in that official capacity and people acted on it.

The emails were requested by a company called Ripple who is currently involved in a legal case with the SEC. Ripple is suing the SEC for alleging that XRP is a security. Ripple argues that the Hinman emails show that the SEC has no clear policy on how to regulate cryptocurrencies, they relied on representations that were made and want to be regulated as such and not be deemed as offering a security.

The SEC has not yet responded to the Hinman emails. It remains to be seen how the SEC will use the emails in its case against Ripple or how effective Ripple will be in relying upon them however the emails are a significant development in the Ripple case.

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## Prometheum:

A curious start-up was granted license this week, the first of its kind special broker dealer license was issued to Prometheum. A great summary can be read [here](#):

Prometheum claims of being fully regulated by the U.S. Securities and Exchange Commission (SEC). In a recent interview with CoinDesk, Prometheum co-founder Aaron Kaplan said that the company is “fully regulated” by the SEC. However, Kaplan did not provide any specific information about the nature of Prometheum’s regulation. In a blog post, Blockchain Association lawyer Marissa Coppel wrote that “there is no evidence that Prometheum is a registered broker-dealer or a member of FINRA.” Coppel also noted that Prometheum’s website does not include any information about its regulatory status.

The fact that the company however have been rolled out as an exemplar of what a crypto exchange should look like with its CEO testifying before a Senate Panel this month is perplexing, particularly given the pressure on others such as Coinbase who have tried to abide by regulations.

In addition to the concerns about Prometheum’s regulatory status, there have also been questions about the company’s legitimacy. In a recent article, The Block reported that Prometheum’s CEO, Aaron Kaplan, has a history of making false and misleading statements. The Block also reported that Prometheum has been accused of operating a Ponzi scheme. The company was founded in NY in 2022 by Aaron Kaplan, they have raised a total of \$48m in capital with some of this linked to CCP (Chinese communist Party) affiliated investors.

It is important to note that the SEC has not made any public statements about Prometheum. Under the licence that they hold they can trade “securities” but given that no crypto assets have applied or been approved as securities they have a license to transact nothing. The fact that they don’t have a product or assets to trade however they were given the access to and attended congressional hearings raises serious questions about the potential political games being played which brings us nicely on the next section.

## Market Structure Bill:

This month the 2023 Digital Asset Market Structure Draft Crypto Bill was introduced to US congress by members of the Financial Services and Agriculture committees, both of which create legislation for the SEC and CFTC, the two bodies that regulate Securities and Commodities. The proposal is still a discussion draft, and it is not clear whether it will be introduced as legislation or how much support it would generate. However, the bill provides an important starting point for the discussion about how to regulate the digital asset industry in the United States, which as we can garner from all of the above is sorely needed.

In summary it would create a statutory framework for Digital Asset Regulation spelling out what is and isn’t included, that is, a definition, and a pathway to register as a Digital Assets Exchange. The Draft Bill defines a digital asset as “a digital representation of value that is secured by cryptographic techniques and is used as a medium of exchange, a unit of account, or a store of value.” The bill would give the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) joint jurisdiction over digital assets.

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The SEC would be responsible for regulating digital assets that are considered securities, while the CFTC would be responsible for regulating digital assets that are considered commodities. It provides a clear and concise playbook for stablecoin operations, token project registration with the SEC and steps for a token to transition from a security to what the legislation terms a “sufficiently decentralized commodity.”

The legislation would provide a framework for digital asset exchanges and would require them to register with the SEC or the CFTC. They of course would need to comply with all the anti-money laundering and consumer protection requirements. At this point exchanges would be able to facilitate trading inside the US for tokens that are registered.

This type of bill will fundamentally change the market structure, tokens and commodities that would trade on US based exchanges for US based investors and you would assume other developed market exchanges would be trading these registered tokens. Tokens in that pre-registration phase would largely be traded in DeFi pools. If you're an insider, like a founder or an investor in a protocol the designation of your token will be different initially and liquidity will be provided by DeFi protocols. As you transition to an SEC registered security you will be subject to increased oversight requiring disclosure of holdings and activities, the flip side is that you gain access to greater pools of institutional liquidity and capital. From there you will eventually transition to something that's sufficiently decentralized and then be designated a commodity with reduced oversight. What this will effectively do is help clean up the long tail of tokens, many of which aren't trying to solve real world problems or create true social and economic value.

The Draft has been met with mixed reactions from the digital asset industry however it is a starting point. The proposal probably lacks the bipartisan support required, the focus of a core group of Democrats remains on foiling any progress in the space.

## **Blackrock Bitcoin ETF application**

Blackrock, the world's largest asset manager, filed for a spot Bitcoin ETF (exchange-traded fund) with the Securities and Exchange Commission (SEC) on June 15, 2023, The SEC generally takes up to 45 days to respond with approval, denial or delay. This is the latest in a series of attempts by major financial institutions to launch Bitcoin ETFs in the United States. The initial reaction has been that Blackrock, the world's largest asset manager, wouldn't apply for something they weren't confident of being granted. In fact, Blackrock have applied and been approved for hundreds of ETF's being rejected only once, the thought is that they aren't risking their reputation lightly. Other very large Asset Managers have relodged their application also.

The significance of Blackrock's application is twofold. First, it is a sign of continued institutional interest in Bitcoin. Blackrock is a major player in the financial markets, and its decision to file for a Bitcoin ETF suggests that other institutional investors are also considering exposure to Bitcoin.

Second, Blackrock's application is a significant test for the SEC. The SEC has been reluctant to approve Bitcoin ETFs, citing concerns about market manipulation and investor protection. However, Blackrock's application is designed to address many of the SEC's concerns.

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If the SEC approves Blackrock's application, it would be a major victory for the cryptocurrency industry. It would also open the door for other major financial institutions to launch Bitcoin ETFs, which would likely lead to a surge in institutional investment.

The issues are likely to be that the new ETF would only provide its reports quarterly, a deviation from the SEC's stipulation of daily reporting and a discrepancy worthy of note. The application also aims to create a structure that addresses the SEC's concern also around market manipulation. The concept of "surveillance" is one that the SEC had issue with, the spot market remains very fragmented, the Blackrock ETF clearly is aiming to address this issue by accessing multiple potential venues to allow the investigation of potential anomalies if they arose.

Interestingly the new ETF would also nominate Coinbase to be the chief custodian of the fund's physical Bitcoin, ironic given all the discussion around the SEC challenging Coinbase's' business model. Our sense is that Blackrock are well and truly inside the fence and would not be wasting time if they hadn't been given a sense that indeed could be successful.

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## **Franklin Templeton upgrades access to FOBXX OnChain**

Franklin Templeton has announced that its Franklin OnChain U.S. Government Money Fund (FOBXX) is now supported on the Polygon blockchain. This means that investors can now buy and sell FOBXX using the Polygon network, which is a Layer 2 scaling solution for Ethereum which we have discussed previously.

The move to Polygon is a significant development for FOBXX, as it will make the fund more accessible to a wider range of investors. Polygon is a popular Layer 2 scaling solution for Ethereum, and it offers a number of advantages over the Ethereum mainnet, including:

The move to Polygon is also a positive development for Franklin Templeton, as it shows that the company is committed to using blockchain technology to improve the efficiency and accessibility of its investment products.

Some of the key benefits of using Polygon for FOBXX:

- **Lower transaction fees:** Polygon transactions are significantly cheaper than Ethereum mainnet transactions. This means that investors can save money on trading fees.
- **Faster transaction speeds:** Polygon transactions are processed much faster than Ethereum mainnet transactions. This means that investors can buy and sell FOBXX more quickly and easily.
- **Increased scalability:** Polygon can handle a much higher volume of transactions than Ethereum mainnet. This means that FOBXX can be accessed by a wider range of investors.

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Overall, the move to Polygon is a positive development for FOBXX and Franklin Templeton. It will make the fund more accessible to a wider range of investors, and it will reduce the cost of trading FOBXX. Equally it shows the adoption of blockchain technology in traditional financial firms is ongoing.

## Summing up the month:

The SEC have made their play regarding regulation by enforcement and the market has deemed it not as bad as feared. Its not good for participants in the space to be locked in battle with their regulator. Given the financial position of Coinbase and Binance they will be contesting the charges.

There are pending legal cases that are close to resolution and seem to be potentially leaning in favour of the industry. The SEC's objection the Grayscale application to convert to an ETF seems to have found favour in the courts with the Judges presiding. The Ripple case about the SEC assertion that its token XRP is a security, is again leaning towards a favourable ruling.

The institutions are coming... (slowly) This has been a narrative for a while and with the lodging of all the ETF applications from the well-connected and regarded financial institutions its another indication that there is continued interest to work in the space. There may well be a lot of activity initially from the banks on their own private chains and infrastructure that won't be interoperable but the validation that it brings to decentralised initiatives is important.

The industry has endured a particularly difficult past 12 months but there is progress. The resolution of Digital Assets status in the US is important. The American market has the deepest and most sophisticated financial markets and having the digital asset industry being recognised and accommodated is an important milestone. The race is on between the current regime at the regulators endeavouring to bring Digital Assets under the umbrella as it stands now, that is regulation by enforcement, and the politicians adapting the existing framework to attempt to include crypto specific assets.

Currently the cost of delay for the US financial system by working through the courts or congress is not so high that the US is missing out on the innovation and potential for transformation, this highlights the benefit of the being the incumbent. Digital Assets and innovation generally are by definition global, capital goes where its rewarded and where the rules of law are clear. The UK is making a push to be a hub for digital assets and innovation, one of the worlds largest venture funds in A16z have moved their crypto business to London. In HK there is a new regulatory regime and the regulators are pushing the main banks in Hong Kong (HSBC and Standard Chartered) to bank the crypto industry, this is a very different stance to banks in the west. Progress is slower than we would all like however its gaining momentum and this month we think will be looked upon as a pivotal moment in time where the industry and regulators began to hash out and commit to address the outstanding issues which potentially remove the shackles retarding true innovation.

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