FCAM
Decentralised Digital Investing

Monthly Commentary

SEPTEMBER 2023 PERFORMANCE

TOTAL NET RETURN

PERIOD	FUND RETURN
1 Month	-0.62%*
Life to date	-24.59%*

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

The Fort Stable Fund generated a return of -0.62% for the month of September 2023. It was a poor month for Assets with US equity markets upended by a reframing of global rate expectations and nagging inflation concerns driven by energy costs. The ASX was down 3.68%, the S&P off 4.9% and the 10y UST treasury Benchmark 10-year note yield hit 4.490%, the highest since November 2007. The Interest rate sensitive two-year yields reached 5.202%, the highest since July 2006.

While ETH was down 3.10% we were protected by the long strangle position we had maintained over the prior quarter. Towards the end of the month, we extended that position through the purchase of 29 December 2023 1700 calls and 1500 puts. With implied volatility on ETH options still near recent lows we think this is the best way to position going into the final quarter of the year given the uncertainties around ETF approvals and various legal challenges to SEC enforcement actions. We sit currently long 19% ETH in the fund.

This month we will discuss the macro outlook and the more medium term theme of tokenization.

Macro news and views:

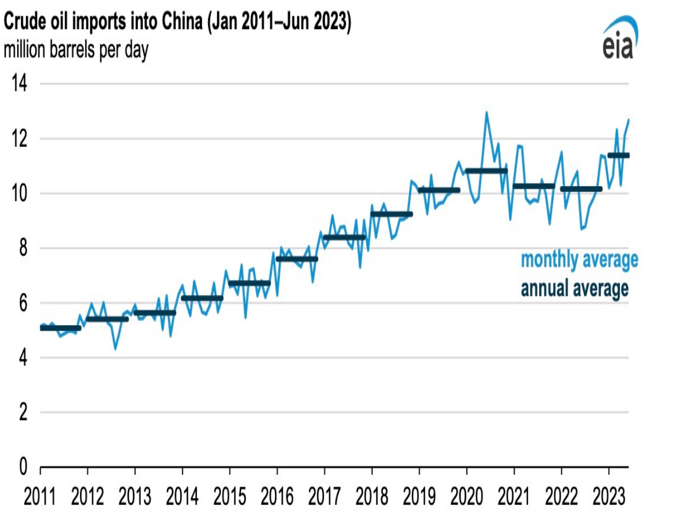
We had a few themes driving markets this month:

Better US inflation data but a worrying move in oil:

The US inflation data was released mid-month. CPI rose 0.6% in August, its biggest monthly gain of 2023, however concern was tempered with base effects suppressing high headline numbers seeing the YoY number come in at 3.7%. The core CPI, which excludes volatile food and energy prices, increased 0.3% and 4.3%, respectively.

Energy markets were unsettled by OPEC reducing production and maintaining tight supply post the summer. In September we saw Crude oil prices breach the psychologically important $90 a barrel level while not accelerating are remaining elevated, this may require further action from the FED. In the medium term if it remains high it will be a drag on spending and growth and keeping inflation elevated that is an economy exhibiting stagflationary tendencies.

One narrative that captured attention over the month was actions of The BRICS alliance, (Brazil, Russia, India, China And Saudi) who are openly discussing changing the structure of energy trade settlements. The de-dollarization narrative is probably overplayed but given that eight BRICS countries include five of the top eight oil producers and the top two oil importers in the world it's important to understand the power that this group has. This cohort is actively seeking alternatives to the dollar for energy trade, settling in local currencies or even gold. This shift in energy trade and potential changes in the role of US Treasuries in the global financial system could have significant implications, we continue to see long end rates under pressure.



Data source: China General Administration of Customs, as compiled by Bloomberg, L.P.

Looking ahead Global Central banks in developed markets have, it seems, reached a point where they are more comfortable to pause and watch their rate hiking handywork while remaining vigilant. The RBA have remained on hold now for the last 3 months and the FED paused this month while remaining watchful for inflationary pressures. Powell said that the Fed is "monitoring the incoming data carefully" and will adjust its policy as needed. He also said that the Fed is "prepared to act as necessary to ensure a soft landing for the economy." Powell's comments about the Fed being prepared to "act as necessary" were seen as hawkish by some investors. This led to a sell-off in stocks and bonds following the meeting. Interestingly the performance of crypto in ETH and BTC was muted in response to the broader weaker market moves.

The Digital Asset Outlook

This month we are going to delve further into the theme of tokenization of Real world Assets. Last Month we touched on the growth in Stable Coins that are quickly becoming an integral building block of crypto ecosystem. This month we want to delve a little deeper into the rationale for creating an alternate financial system on "digital rails", the benefits and the impediments to adoption.

Let's start with a definition of what we mean when we say "Tokenization of Real World Assets". Simply put they are a digital mirror of an asset where the ownership and record of transaction sits on an immutable blockchain. It doesn't replace the asset or the legal structure under which its created, rather it becomes a representation of that asset. What it does replace is the way the asset's ownership is stored and can be transferred. Interestingly it opens up a limitless number of ways the asset's value can be re-organised and reconstructed for the benefit of the owner and the issuer.

Perhaps its easiest to look at an example. "UBS Asset Management, one of the world's largest fund houses, has launched its first "live pilot" of a tokenized money market fund on the Ethereum blockchain.The pilot allows UBS Asset Management to test various fund activities on-chain, including subscriptions and redemptions, the firm said Monday. UBS has utilized its in-house tokenization service, UBS Tokenize, to launch the pilot of the fund." The owner gets the benefit of having the asset on chain and UBS gets to redeem and distribute cheaply and effectively. Currently there is very little "benefit" to owning the asset on chain but that's driven by a lack of assets. There is a world where more assets end up on chain and the benefits expand exponentially.

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The most optimistic will highlight digitization of as a way to improve security, facilitate transparency, provide seamless transactions, and open up new avenues for investment. We believe that tokenisation is the future of finance, lets dig in to the potential benefits.

Investor Access: There are numerous examples but perhaps cash remittance is one that is easiest to understand. An often touted example is that of rent seekers taking an exorbitant amount to transfer value globally, its estimated that foreign workers are in some instances are paying remittance companies up to 5-8% of their salaries to send money back home. The blockchain is not restricted by borders, sending tokenised cash does not require a great deal paperwork and the cost can be reduced dramatically. Money transferred seamlessly via the internet is the building block upon which these participants in an economy improve their life. This article is a detailed examination of the flaws in the current system - here

New Markets: Assets can be split many ways that allow investors and issuers to compartmentalise and allocate or distribute the risk to those that want it. The technology provides a way to monetise things that were previously difficult to quantify, giving people access to more sources of income. Anything in this “new market” space is very much about improving capital efficiency, matching capital needs with capital demands without the need for intermediaries.

Faster Transactions: This again is about capital efficiency, improving the turnover capital potentially releases tremendous value. Right now, the various parties in any chain of asset movement sit on this money earning interest, this is implicitly for the purpose of verification. Is bank A authorised to move money to Bank B? Inside the banking system there are often many more banks involved in foreign transactions than just banks A and B, each of them taking fees and charging spreads on the exchange of assets. Immutable blockchains carry out the process of verification and transfer at atomic speed, that is instantaneously executed with a pre agreed cost. One of the issues with blockchains is dealing with scale and uncertain fees, however during the bear market many scaling solutions and processes in Layer 2 as well as upgrades to the underlying protocol have lowered costs and improved latency dramatically.

Moving from the hypothetical to reality, outside of the few experiments in stable coins issued by Circle, Tokenized Gold issued by Paxos or Bonds issued by Franklin there has been an interesting experiment in the decentralised world with the Maker Dao protocol that has improved the product significantly.

MakerDAO is a collateralized debt platform on Ethereum. Users deposit select Ethereum-based collateral assets into Maker vaults in return for the ability to take out debt as Dai, the protocol’s native stablecoin.

The vaults are smart contracts that hold collateral in escrow until the borrowed DAI is returned. Users have complete control over their deposited collateral within a vault if the value does not fall below a certain threshold.

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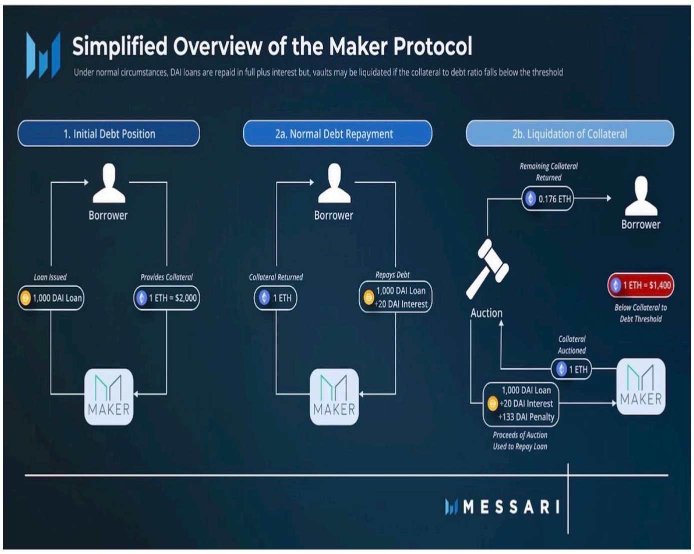

MakerDao came into existence around 8 years ago with the purpose of becoming a fully decentralised, autonomous organisation whose primary objective is to grow the use of Dai and ensure it maintained it's 1:1 peg to the US$ as closely as possible using decentralised market mechanisms.

Maker governance determines which assets are accepted as collateral. Originally, ETH was the only source of collateral. Borrowers of Dai had to provide ETH as collateral and had to maintain a collateral value of 1.50 times the amount they could borrow.

For example, for someone to borrow $1,000, they would need to post a minimum of $1,500 equivalent of ETH. If the value of their ETH collateral fell below this amount, the protocol, via its smart contract code, facilitated a sale of some of their ETH collateral to pay down their loan such that the minimum threshold was again met.

To incentivise borrowers to maintain adequate collateral, a liquidation of penalty 13% was applied to the sale price of the collateral. While these fees generated revenue for the MakerDao protocol, it was not ideal for borrowers who often could not transfer additional collateral in time on what was often a congested Ethereum blockchain.

During episodes of high market volatility, the pitfalls of decentralised collateral became apparent as loans quickly became under collateralised and Dai would lose its 1:1 peg.

In what was considered a controversial move away from pure decentralisation, Maker Governance voted to adopt USDC, the fiat backed, centralised stablecoin as acceptable collateral along with ETH to help maintain the peg stability of Dai. There were concerns that USDC could be frozen at the request of the US Government thereby rendering USDC useless.

Over the years, the protocol has moved away from what was a very idealistic perspective to a much more pragmatic one in terms of acceptance of collateral backing Dai.

During the bull market, Dai was in demand and MakerDao earned substantial fees from lending Dai and from liquidation penalties. However, as trading activity declined, protocol revenues also declined.

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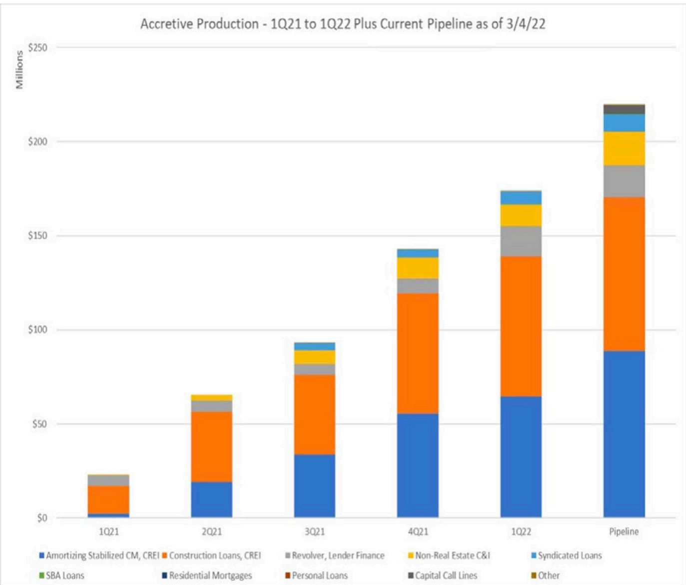
"According MakerDao participants, further RWA integration is the next step for scaling DeFi. In a historic first step to integrating traditional U.S. banking infrastructure with the DeFi ecosystem, MakerDao approved Huntingdon Valley Bank's collateralized lending proposal as its latest RWA vault addition.

Huntingdon Valley Bank

Huntingdon Valley Bank (HVB) is a Pennsylvania Chartered Bank founded in 1871 that is focused on generating commercial loans for domestic businesses. At the end of 2021, the bank reported over $550 million in assets and over $375 million in outstanding loans.



Source: Huntingdon Valley Bank

HVB's originated and syndicated loan production, as shown above, is heavily diversified amongst its nine different product offerings and is forecasted to continue growing for the near future. During 2021, HVB averaged roughly 4.65% in average returns across commercial loans.

Through an 87% majority vote, Maker governance approved HVB as the first U.S. bank to connect to the DeFi ecosystem. In exchange for the sale of a portion of the loans originated by HVB, the bank will have access to DAI liquidity. In addition to proving its financial stability and experience, HVB must ensure that its assets are not a significant risk for its new partner. That said, the standards for RWA vaults are more stringent than other approved asset types, and the necessary infrastructure needs to be in place for seamless operation.

How it Works

In its greenlit proposal to MakerDAO, HVB introduced the MakerDAO Bank Participation Trust (MBPTrust) through the setup of a Delaware Statutory Trust. This arrangement will essentially create the link between HVB capital and the DAI stablecoin. The trust would act as an intermediary on behalf of MakerDAO, mitigating any commercial issues with HVB and overseeing the issuance and destruction of DAI. A Delaware Statutory Trust structure has previously been used with 6S Capital's RWA Vault.

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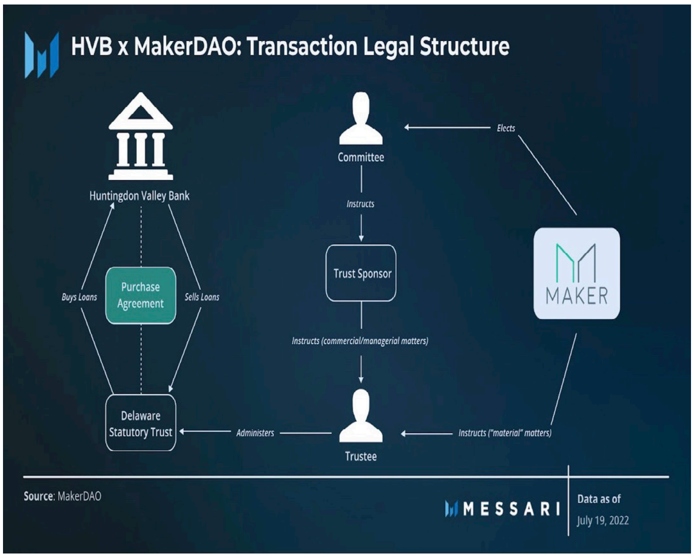

HVB proposed a mix of commercial real estate and business loans for the first portfolio purchase agreement. The underlying collateral for these loans typically comes in the form of investments, receivables, inventory, equipment, or other tangible assets and is fairly liquid. HVB has acted as a loan servicer for the entirety of its existence and will continue to do so in this proposed scheme, accumulating servicing fees by doing so. That said, HVB can liquidate the underlying collateral with minimal slippage in the event of a default.

Overall, the portfolio is intended to have a mix of fixed and variable rates with a typical term length of fewer than five years. Furthermore, all proposed loans must meet the following criteria set by HVB and are subject to additional criteria dependent on loan type:

- Customer currently in good standing with the bank
- All loans must be rated 6 or better out of 10 (lower is better)
- Properly collateralized
- Satisfactory cash flow coverage of loan payments
- No events of default
- No loans to insiders
- All loans meet standard compliance measures.

Upon origination and throughout the life of the loan, HVB will re-evaluate the credit risk associated with the asset to ensure it remains in good standing. The initial vetting process is intended to ease the burden on MakerDAO and the MBPTrust, but both parties have set their independent approval process to determine if loan participations are eligible for funding.

HVB will initially retain a minimum of 50% pari-passu exposure for each loan and, over time, hopes to incrementally reduce ownership down to 5% (with the remainder falling in the hands of MBPTrust). By bearing such a considerable financial risk, HVB is incentivized to honor the best interests of all parties involved. In the long term, HVB hopes to prove its credibility to reduce its risk exposure.

HVB was approved for an initial credit line of $100 million that will be deployed over a 12 to 24-month period. This partnership marks the largest debt ceiling to date allocated to an RWA vault.

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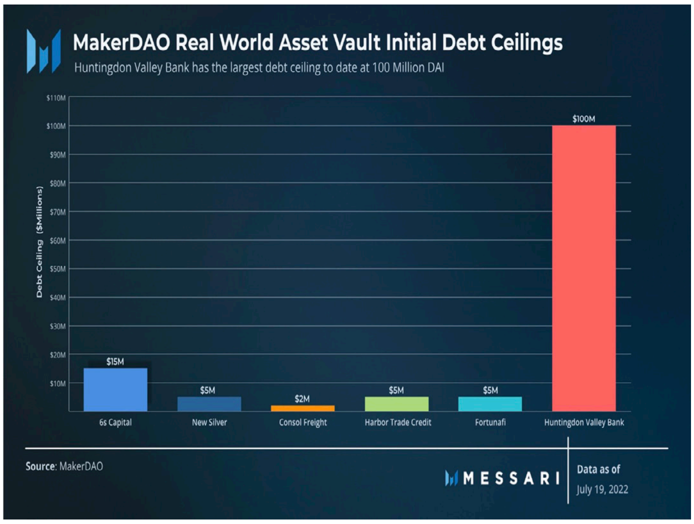

Partnership Implications

The partnership allows MakerDAO to earn revenue through vault stability fees to combat declining revenue streams from the current bear market. Per the proposal, the expected net yield at the time of origination and participation is conservatively set to 3.00%. Any over-performance in yield over servicing, reporting and governance fees will go to MakerDAO.

By embracing real world assets, MakerDAO is tapping into a multi trillion-dollar industry that until recently was rather isolated from the crypto space. It will not only be able to scale and diversify its current assets but will strengthen its dominance in the collateralized debt market by establishing a bridge to the real world. In the long term, MBPTrust can support multiple banking institutions, resulting in more revenue streams for MakerDAO if the partnership with HVB is executed effectively.

Through this partnership, MakerDAO exposes itself to underlying real world loan risks and the accompanying concentrated risk in a single banking institution. However, the proposed structure places most of the risk ownership in the hands of HVB. The bank's conservative underwriting practices, adherence to Pennsylvania law, and financial skin in the game should mitigate the risks for all parties involved.

On the other hand, HVB gains a significant boost in exposure and credibility by partnering with one of DeFi's greatest players. Through this new partnership, HVB will also be able to increase its lending limit above $7 million per borrower and access a deeper liquidity pool.

Final Thoughts

There are several RWA proposals for MakerDAO in the works, including tokenized short-term bonds, financing green energy projects, and a recently approved vault for SG-Forge, a subsidiary of French bank Societe Generale. Earlier this year, MakerDAO voted to invest 500M Dai into a combination of U.S. treasuries and bonds. Overall, MakerDAO is diving into real world asset diversification as a long-term strategy.

The HVB and MakerDAO union is the first large-scale partnership between a U.S. banking institution and DeFi. MakerDAO has a lot to gain by tapping into RWA's, especially to capitalize on a diversified revenue source, but it is also paving the way for other protocols to follow suit. The success of this innovative partnership with an off-chain entity has the power to potentially bridge the gap between traditional financial institutions and decentralized finance."

source: Here

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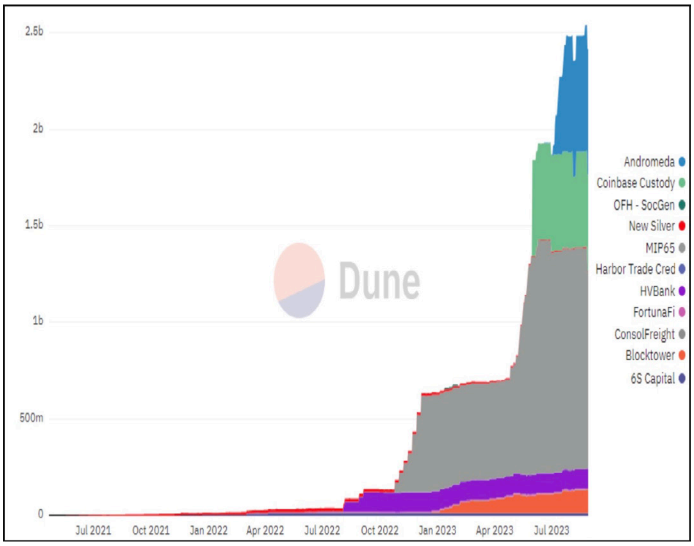
While early RWA transactions were tokenized real estate transactions and private credit protocols, these assets entail some credit risk which needs to be managed by the Dao.

Since the US federal Reserve began raising interest rates, MakerDao has embraced US Treasury bills as a RWA. With yields on short dated government debt now around 5.25%, investors are able to earn a significantly higher yield on Dai than they can earn via fiat backed stable coins such as USDC.

RWAs continue to comprise a significant portion of Maker's Stability Fees. In August, RWAs made up 65% of all Stability Fees generated by the protocol. Year to date, RWAs (including stablecoin income) have generated 64% of the total Stability Fees for Maker.

A summary of Maker's RWA exposure over time is shown in the chart below:



A detailed breakdown of Maker's Real World Assets can viewed in the link here:: As of August 2023, MakerDao has invested $1bn of their $2.7bn of RWA in US govt debt and govt.debt backed ETFs.

In summary

Technology is embraced for two reasons, greed, and/or fear. Banks and asset managers will lead the transformation and it's embraced at a faster pace when both sentiments are working in tandem. The existing system will be transformed by tokenization of assets. The promise of Web 3.0 may end up being Web 2.5 when it comes to finance as we see resistance to a fully decentralised system. That said however, the scale of the industry is such that it will throw off numerous benefits to all participants.

The Banks will look at this as a tool to improve their capital ratios and reduce costs. In a unipolar world where they are limited to domestic markets and opportunities they need to increase the efficiency of their capital. They will look at the fractionalization potential to create new products in efficient ways releasing the value of their inventory of exposures, assets, and liabilities. The Asset managers will use the technology to drive down costs, they will also be able to better structure portfolios and opportunities for end clients through smart contracts and mixing and matching tokenised assets to generate the appropriate return profiles. Blockchain and tokenization do appear to be on the verge of moving mainstream to solve a variety of problems and create an equal amount of opportunities in the legacy system.

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