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Virtual Asset ETFs as Vehicles for Private Clients to Build Smart Exposures to Cryptocurrencies

Bruce Zhang, Head of Fixed Income at CSOP Asset Management in Hong Kong, is a believer both in the power of ETFs for private investors and the growing universe of digital assets. At the Hubbis Digital Assets Forum in December (2023), Bruce delivered a presentation on accessing virtual assets via ETFs, focusing particularly on the CSOP Bitcoin Futures ETF and the Ether Futures ETF, both of which are listed in Hong Kong. Supported by a detailed and insightful slide show, Bruce highlighted the simplicity of investing in Ethereum and Bitcoin via these ETFs, and pointed to their stellar performance in 2023, with Bitcoin up some 165% and Ethereum almost doubling during the same timeframe.

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BRUCE ZHANG
Head of Fixed Income
CSOP Asset Management

Bruce explained his presentation was to be structured into three parts. The first part would explain why virtual assets are emerging as a significant asset class. This includes the arrival of Bitcoin Futures on the Chicago Mercantile Exchange some years ago, and then the launch of the world's first physical Bitcoin ETF in Canada approximately three years ago, followed by the introduction of the first Bitcoin futures ETF in the US about two years ago. He said all these developments illustrate the transition of virtual assets from a niche to more of a core asset class.

The second part would focus on why virtual asset ETFs are logical for private investors. And the third part of the presentation would concentrate on the key features of CSOP's virtual asset ETFs.

Bruce noted that the total market capitalisation of virtual assets (dominated by Bitcoin hit more than USD3 trillion in November 2021, and after a major fall in values by early December totalled some USD0.8 trillion, or roughly 20% of the market valuation of the Hang Seng Index. In other words, they are too big to be ignored.

Moving to part one of the talk Bruce explained that Bitcoin and Ethereum dominate the market share in both the physical and futures markets. He acknowledged the huge volatility but also observed that this opens the door to substantial potential for capital gains.

He said that despite their high correlation, each coin has unique features. He explained that Bitcoin is a virtual decentralised asset with a finite supply – only 21 million will ever be issued (or mined) – and with 19.22 million already mined.

And Ethereum is seen as a decentralised software platform where developers leverage smart contracts to develop decentralised apps and tokens. Unlike Bitcoin, the total amount of Ether that can be created is unlimited, and smart contracts are Ether's main competitive advantage, especially with the continuing extension of the use cases for smart contracts.

This distinction underscores the unique utilities and characteristics of each cryptocurrency within the broader virtual asset landscape.

Performance can be influenced by numerous factors, such as mainstream equity, bond or commodity market performance, interest rates, central bank liquidity, and of course, regulation, which can both promote or discourage investor participation.

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CSOP launched its two futures ETFs following regulatory liberalisation in Hong Kong. Their Bitcoin Futures ETF launched in December 2022 and is an actively managed ETF tracking the performance of Bitcoin using the CME Bitcoin futures instead of directly investing in the underlying coins. Bruce explained that the ETF provides investors with both tactical (trading) and strategic (longer-term hold) opportunities.

Similarly, the Ether Futures ETF also provides investors exposure to the performance of Ethereum, but via the futures market instead of directly investing in the underlying coins.

But why should investors not directly invest in cryptocurrencies like Bitcoin and Ethereum or use futures contracts instead of investing in virtual asset ETFs? Bruce explained that both Bitcoin and Ethereum have well-established and liquid futures markets, particularly on the CME, where the contract size for Bitcoin futures is equivalent to five Bitcoins, and for Ethereum futures, it is equivalent to 50 Ethereum.

Futures contracts are financial contracts whose value is derived from underlying reference assets, he observed. This, he said, allows for futures-based ETFs to track the performance of the underlying cryptocurrencies very closely, but without directly owning the coins or engaging with the futures market themselves.

Bruce said that both the CME and the Hong Kong markets are properly structured and well-regulated, while the regulation of the underlying virtual assets is still evolving. Moreover, while futures markets are largely for professional investors, the ETFs are easily accessible in small amounts.

With robust liquidity in the underlying futures markets, the ETFs also provide appropriate liquidity. Both ETFs can be bought and sold with traditional fiat currencies, so there are no convertibility concerns. Finally, both ETFs have an independent trustee, in this case, HSBC, providing further comfort to investors.

Bruce closed the presentation by remarking that there are, of course, attendant risks, as with any market exposures, and investors need to assess their risk appetites properly. But he urged the private bank and EAM gatekeepers present to seriously consider their two ETFs as a medium to take calculated exposures to both Bitcoin and Ethereum futures. ■