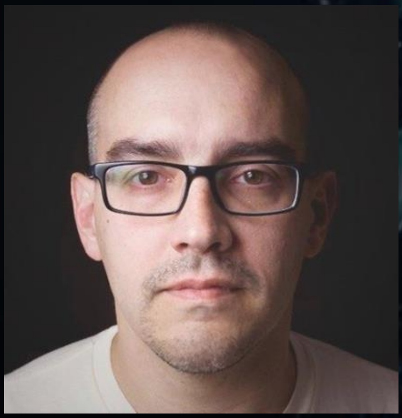
DiffuseLaunch
virtual fund pitch session

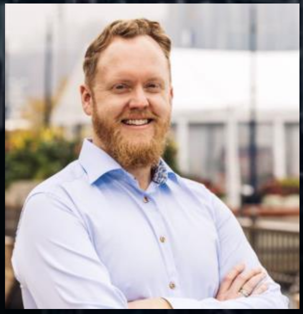
Crypto Index Fund Lists on OTCQX

Guest Speaker:



Dave McClure
Founder & Managing Partner
Practical Venture Capital

Hosts:



Kenny Estes
CEO & Founder
Diffuse

Ayla Kremb
COO & Co-Founder
Diffuse

DiffuseLaunch: Crypto Index Fund Lists on OTCQX

In our very first DiffuseLaunch session for 2022, we were joined by Dave McClure, Founder of Practical Venture Capital, to talk about our exciting new fund, Diffuse Digital 30 – a market weighted, institutional grade index fund of the top 30 hottest tokens in the market.

If you want to make new friends from the Diffuse ecosystem, email contact@diffuse.com.

DiffuseLaunch

This session is part of a virtual events series where we talk about brand new innovative and alternative funds in the market with none other than the masterminds behind the funds.

Guest Speaker

Dave McClure is an engineer, entrepreneur, and an investor in Silicon Valley for over 30 years. Having founded 500 Startups and Practical Venture Capital, Dave has invested in hundreds of startups around the world, including 20 unicorns and 5 IPOs. He is listed in the Forbes Midas List as one of the top 100 global VCs in 2016 and 2017.

LinkedIn: @davemcclure

Diffuse

We are an alternative fund platform offering differentiated investment products.

Diffuse Digital

A family of fund products for investors who want exposure to the potentially attractive returns in digital assets. We partner with service providers respected by Wall Street and adhere to tight compliance, risk management, and investing processes.

Diffuse Digital 30

Our institutional digital asset index fund provides exposure to a diversified basket of crypto currencies by investing in the top 30 coins, weighted by market capitalization.

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KENNY ESTES: Hello one and all. Thank you so much for joining us today. Normally we don't do this, but we do want to get some information in front of you. So, we are going to go ahead and do a quick presentation to explain a little bit about what's going on. We're going to be discussing Diffuse Digital 30, our index fund which we are hoping to list on the OTCQX this year. We're going to give you a little bit more detail about what that's all about.

The notice is for you to read over there. As for the agenda, we have some networking, which you've already done, (congratulations, you're already through the first item). Then, we're going to ever so briefly run through and explain Diffuse Digital 30. And then, we're going to do a live Q&A where Mr. Dave McClure, who many of you know is the moderator, will be grilling us with his own questions and also be taking some from the chat. This is your opportunity to learn whatever it is that you want to learn.

Briefly, what is Diffuse? Diffuse is an alternative investment fund platform. We find high alpha, more esoteric investment strategies, and we turn them into funds. We have a couple of DeFi funds, and we also have Diffuse Digital 30, which we will be talking about here. All these funds are in the digital asset -slash- cryptocurrency space.

The Diffuse team consists of a very select group of people. As for myself, I was a high frequency trader for a long time. I've spun up a lot of funds over the years, Ayla Kremb is COO, and is in charge of marketing operations and commercialization. Ren is our senior trader. Dennis Chookaszian, who many of you may know, is on our advisory board and will most likely be on the board of DD30. We also have two really great technologists Eric Long and Jen Jorgensen, who are making sure that all of the rebalancing and trading is streamlined as much as humanly possible. We also have a lot of other people behind them.

Five to three years ago, the entire story of cryptocurrency was Bitcoin and Ethereum. But now, you're seeing this mass proliferation of alternative chains, such as Avalanche, Solana, and Terra. These are all names that you probably have heard of before, and that are effectively chipping away at the market share of Bitcoin and Ethereum. And with the rise of DeFi, and similar items to that in decentralized finance, you're starting to see these new chains generating what looks a little bit like revenue. It's a new thing if you haven't been following the crypto space.

Our general take is that Bitcoin and Ethereum are over time becoming less and less of the story. And we can expect that trend to continue, if not accelerate, within the next year or two. The issue, however, is that most of the big public funds like GBTC and BitWise are really limited in their exposure. GBTC is the 100-pound gorilla. That's one asset. But they don't have a redemption mechanism. They don't have an arbitrage mechanism.

Which is why as of yesterday, if you have been following the news, Grayscales' GBTC is trading at an all-time high discount of almost 30% to their book value. That means the secondary price is 30% lower than just the Bitcoin that they're sitting on in their balance sheet. It's not exactly the most exciting of prospects for more institutional sophisticated investors.

That's where Diffuse Digital 30 comes in, with institutional grade asset selection, product design, and infrastructure. It consists of the top 30 coins. It's market cap weighted. We carefully thought through our structure so that hopefully if and when we list, we will have something that resembles a redemption mechanism to make sure that we don't suffer from those discounts to book value that some of the incumbents do.

In addition, we're using top tier service providers like these folks here on the screen. You will know that a lot of them are all pretty well-respected names in the game. We are trying to make this as institutional grade and scalable as humanly possible.

As for the scaling plan, we launched this back in June of last year with a small raise just to get a 12-month clock listing, which is required before you can list anything. We did give some profit share out during that period. Right now, we're doing a qualified purchaser-only fundraise of 30 million, where we're giving away more profit share to the participants with a target closing of March 1. And then, the next phase is our listing, or hopeful listing, on the OTCQX. We could do that as soon as June, which would really drive up our AUM, as well as our presence in the market. That would make our advisor profit share pretty profitable.

To explain the process itself, again, we started in June and plan to wait a year. We're spending a lot of time working on structuring and have found a very creative structure. We've had lawyers looking into case historical precedent to find support for our positioning, and why we think we're going to be able to do some redemptions when we're listed that incumbents mostly can't do. Assuming that all goes to plan, we will be listed on the OTCQX in Q2, and we will have a redemption mechanism which is going to set us apart from the crowd. We'll be 30 coins instead of one, hopefully with the redemption mechanism, and relatively low fees that basically consist of just the market. In addition, we can do staking and lending to help overcome our tracking.

With regards to performer returns, as we said, the big thing is that the current raise is for qualified purchasers, which requires a net worth of 5 million or more. We're giving away up to a 10% profit share per advisor, which is where all of our fees go. The pitch is for QPs that are interested in this. There's only a 12-month lockup. After 12 months, you can sell your holdings. We're not spending them. We're just investing it in the index.

And then once you sell it, you get basically your money back plus or minus whatever crypto exposure there was, and a little bit of a management fee for the year. In exchange, you get up to 10% profit share, which creates an annuity for you. If you look at the scenarios on the screen, in scenario three, if we're doing 20% growth a month, that gets us to 7 billion AUM by the end of 2024. That's about a two-year period. For perspective, last I looked Grayscale was at a little bit more, at about 30 billion just for their one BTC product. This is a pretty cost-effective way to get exposure to that profit share, and that annuity stream in perpetuity for the lifetime of the fund.

On to the terms. This fund is for qualified purchasers only. The minimum investment is $1,000,000. There's a 2% management fee on that, which goes to the advisor. And then, we do it like BlackRock does other ETFs, where we do a revenue share on any interest that we're able to generate by conservatively lending out our assets. We're not charging for beta. This is a passive vehicle. That's a one and done.

The 2% fees and the 20% rev share goes to the advisor, and the advisor pays to fund services. The index costs itself is all baked into one large deal. As mentioned, there is a 12-month lockup, a 10% profit share, and we're targeting to close on March 1. And that is it, we're done with the slides. Over to you, Mr. Dave McClure.

DAVE MCCLURE: Hi folks. I'll be doing a bit of moderation here. Full disclosure, I am an investor in Diffuse. I feel like Kenny and Ayla can help me navigate crypto, and whatever web3 means. I'll try to ask questions on behalf of the group. If you have some comments and questions, please throw them in the chat. I'll be keeping an eye on them there. My background and info is also there.

Very briefly, I've been an engineer, entrepreneur, and venture capitalist. I'm a recovering venture capitalist now. I buy secondary stakes in small funds that are doing well. And occasionally, we do LP commitments in some funds and direct investments in VC companies. As much as I've been in the Valley for the last 20 to 30 years, and as much as I consider myself a technologist, I'm still regularly confused by crypto, web3, and all these cool sexy things called NFTs which seem to constantly skyrocket and crash in value. I'm not quite sure why I would do those investments, but I have given some money to Kenny and Ayla to help guide me in this.

I'm going to try and ask them some questions about what DD30 is all about. So maybe to get started, how is DD30 or Diffuse different from me just buying Bitcoin or Ethereum from Coinbase? How is it different from just putting money with other folks like Grayscale who are managing crypto?

KENNY: That is a good question. The biggest thing is ease of life. With us, and with our index fund, you're getting intelligent exposure to crypto. It's the ideal one stop shop where you can just get that direct exposure. I briefly touched on this in the slides, but a lot of the incumbents (some of them you mentioned there) suffer from some pretty severe dislocations between the secondary trading price on the OTCQX and their book value.

I don't mean to pick on Grayscale because they were the first movers, and they really did a lot for the industry in raising awareness. I'm not trying to cast stones. But a year and a half ago, Grayscale's product GBTC was trading at a 30% premium to book value, which means for every buck one Bitcoin they had on the balance sheet, they were trading at a buck 30.

At the moment, it's about a 30% discount. So, it was a premium before, but now it's a discount. If you're a more institutional or sophisticated investor looking for exposure to crypto overall, that is really a big turn off because you don't really have a lot of exposure in that. That 60% move in the relative to book value has a lot to do with the whims of the crowd versus the actual exposure.

We spent a lot of time on trying to find a creative structure that would allow us not to suffer that, so that the investors can get just a pure exposure to the overall market, and not just one asset or two assets, which we think is going to become more and more of a deal.

The other thing is we're aiming to bake a feature into it wherein we can actually lend out our assets, similar to prime lending for ETFs, which helps overcome any tracking error and the fee drag from us managing it. It's all about ease of life. It's simpler. It gets you the overall market exposure without some of the structuring, or hopefully without some of the structuring artifacts that the incumbents have.

DAVE: Okay. Again, I'm not necessarily crypto expert here, so I'm going to ask some dumb questions. You can tell me they're dumb, but if you could, you can try and answer them. I've bought Bitcoin and Ethereum on Coinbase, and even a little bit of Solana. But my knowledge trails off from there pretty significantly.

How did you guys come up with making the decision for what to include in DD30? What additional 28 alt coins or other strategies are included, and why not 100? Why not 10?

KENNY: When we did the analysis, originally, we looked historically at where we were in terms of market share and the size of the coins. When we chose 30, that actually was pretty close to a billion in market capitalization for the smallest coin. That's pretty significant, and that will allow us to buy into it without destroying the market one way or the other when we rebalance. In addition, fortunately (or unfortunately), Bitcoin and Ethereum are still around 70% of the index at the moment.

DAVE: That's what they're saying. So then, you have those which are representing the top 70%, and also have a long tail of 30%, which is another 25, or 28 altcoins.

KENNY: Exactly. That's the ideal index in terms of what we can actually custodize. Because again, we only use qualified custodians of Bank Trust. It's a little bit less than 30, but that's improving every time we add a new custodian as we get larger and scale more.

DAVE: Great. You said something about sticking in lending. I understand a little bit of that, but maybe could you explain how you provide access to that to your investors?

KENNY: There are any number of ways that we can go about that. The simplest is just conservatively lending our assets to big players. As an example, right now, the fund is still small. We haven't had a need to spin out the more sophisticated infrastructure. But we're doing about 50% loan-to-value loans to third parties, like FalconX, who have enormous balance sheets. They can pay us a relatively conservative interest for lending out those assets.

They then turn around and are conservatively lending it out in the back to prop traders and people like that. We're able to do that to generate yield above and beyond just the pure beta tracking feature of the fund. And it's our understanding that, at least in the U.S., no other provider is structured to be able to do that.

DAVE: Okay. Maybe you could give a little bit more detail on why you guys, versus other folks who do similar structures. I guess the big grill out there is probably Grayscale, but are there others? And what do you think are the differences or advantages that you guys bring that they don't?

KENNY: Grayscale and Bitwise are probably the two biggest in the U.S. The one thing we are not is an ETF. The nice thing about an ETF is that there are tax advantages. We're going to have 30 assets that we're rebalancing at least once a month, but our weightings will change. The S&P 500 does it quarterly, and that creates long term or short-term cap gains.

Tax leakage is the term. And until there is a spot ETF in the U.S. that's approved, that's not going to go away. Outside of the U.S., there are also some ETFs that have been approved, Bitcoin and Ethereum in particular. But they're not U.S.-based. In the U.S., we're trying to get as close as we can without actually being an ETF while still being fully compliant.

DAVE: There's a question in the chat about jurisdiction. The jurisdiction is the U.S., is that correct?

KENNY: Yes, exactly. We're Delaware LP. We're hopefully going to be listing on the OTCQX. And as such, we're not going to be able to do a lot of offshore derivative trading and things like that, at least for now. But maybe down the road we'll have to change that. And so, certain items like Ripple probably aren’t going to be in there anytime soon, or never, because we are going to do everything by the book when it comes to regulation.

DAVE: Okay. You mentioned something about ETFs. Could you maybe explain a little bit more why there is no ETF yet? What is the future for ETF, and are there any more technical stories there?

KENNY: Understandably, the SEC is concerned about how this space is so new, especially outside Bitcoin and Ethereum. It's new, and it feels a little bit like the wild west, if I can be honest with you. There are cowboys all over. There are scams up the wazoo. And you have the Dogecoins of the world who will be in our index.

There was another question from the chat which we can answer now. We're doing this purely formulaic. I went to Chicago Booth in a former life, and Eugene Fama, who won the Nobel Prize, proved that if you just do a market cap weighted index, you're probably going to do pretty well in the long term and outperform most active managers. That's where we’re coming from.

I believe the ETF environment in the U.S. only has one ETF. I haven't checked in a couple weeks, but the approved ETF wasn't a spot ETF. It was a futures Bitcoin ETF. We're pretty far away from the SEC being comfortable enough with this space to approve a proper, deep liquidity ETF, like something we're doing with 30 or so coins with the tax advantages.

DAVE: Okay. You mentioned this before but just to catch up, you're strictly doing a market weighted approach to the top 30 assets. What are the specific reasons for any additions or deletions there?

KENNY: The index is the top 30 market cap weighted, excluding wrapped coins and stable coins. With stable coins, if the price is moving, something probably went wrong. And then, wrapped coins are kind of double coins. Wrapped Bitcoin is like a double count Bitcoin. We take those out so we don't overweight silly things, or things that don't move. That's the index that we'll be tracking against.

Now, with the fund itself, there are some real-world implications of, "hey, if there's not a qualified custodian as defined by the SEC, and we're taking a conservative approach, that means they have to be able to hold the asset under a Bank Trust license." That's the wrong terminology, but close enough. I think right now, we're only actually able to hold about 20. But that's like 95% of the index, because it's so heavily weighted. And as we roll on more custodians, that will just get better and better over time.

DAVE: Okay. So, moving on to the big elephant in the room. Something has been happening in crypto over the last week to 30 days. It's been dropping like a rock. That's the technical term. It would be great to hear about what your returns have been over the last six to 12 months. But maybe as important, or more important, is what is happening to crypto, and what are your takes on where the next 3, 6, or 12 months will go?

KENNY: Yep. We haven't updated the returns slide for the new one. With this product, we're not making claims about where crypto is going to go in the future.

DAVE: What? Come on. I want a guaranteed 7% plus on the upside.

KENNY: [laughs] Exactly. That's not us. I don't know what it is. But what I will argue is that for sophisticated institutional investors, most of them do some portfolio allocation, which looks a little like a capital model. And there, they have a concept called the efficient frontier. I think it will be very difficult for any sophisticated investor to argue that crypto is not on the efficient frontier. And that's just because it's done so well. I think we're past the point of no return, where it's not going away.

If anything, I would say that in the long term, it's highly likely that most of the financial system will be replaced with some form of digital asset. Even if it's just a digitized dollar, it's still going to be a digital asset, and there's going to be all sorts of infrastructure built out around it. That's my personal opinion. I could be wrong. But regardless, if you as an allocator believe that this is on the efficient frontier, then some percentage of your portfolio needs to be invested in there. It might be 50 pips, depending on what your assumptions are around it.

However, currently we don't have a great way for institutions to get exposure to crypto, because there are discounts and premiums, like we've talked about quite a bit. We're hopeful that we found a structure to help get around or to help solve it. Outside of that, it's all self-indexing. But then, that typically requires some institution to go out and have a wallet, and to invest in key management, which is a whole other process. But wouldn't it be great if there was just one place where we could get the exposure and not have to think about those things? That's exactly what we're trying to deliver.

DAVE: I will say, congratulations on the great timing on buying the dip, now that we're hitting the bottom. I'm not sure that Warren Buffett, Charlie Munger, or Jamie Dimon are going to be your initial customers, but maybe the rest of us will be. Could you maybe talk a little bit about what the requirements are to participate? I'm assuming most folks here know what a qualified purchaser is, but maybe you could talk about that just briefly. And also, how do I go through the process of participating if I'm interested?

KENNY: Well, first off, be in business. [laughs] But seriously, I'll be candid with this. Right now, we're out ahead of the puck on a lot of things. We are doing something that's pretty de novo here. It's a pretty creative structure, and there's no certainty that this is going to work the way we think. We have done a lot of legal research to support our positioning, but nothing is set in stone. So, we're still working through the details on a lot of this, and as of right now we're only open to qualified purchasers. What that means is a net worth of more than 5 million.

DAVE: So it's not a typical accredited investor bar, but actually a higher bar.

KENNY: Yeah. There's an open debate right now to see if we can actually reclassify some stuff to that later. But right now, it is just QPs. When we get closer to the raise, it's our understanding that we will do a more open raise, as part of the process of actually listing on the OTCQX. As of today, it's our understanding that once we are listed, retail investors will be able to invest. But again, all of this is a little bit on the fly.

DAVE: But for the moment, only people who are QPs can get in ahead of the rest of the masses.

KENNY: Yeah. And if we can get it to line up properly, we'll do another raise for accredited investors, or potentially put them in closer to the date. We'll probably still offer some profit share, but it would be a little bit less.

DAVE: Right. Now we're getting close to the end, so maybe we can take some audience questions or any notable things that are in the chat. I've been trying to keep an eye on that. Maybe Ayla has some specific things that I've overlooked as well.

AYLA KREMB: Yeah. Will we hedge? Yes or No?

KENNY: Oh, that's a good question. Negative. This is a beta exposure. You want the exposure? Here's the exposure. If we had, you probably wouldn't need the exposure. That would be more of an actively managed fund. Same way that it doesn't make any sense conceptually for the SPY, which is an ETF tracking the S&P 500. Again, this is not an ETF. The SPY doesn't hedge. They just give you the S&P 500, and you can work that into your overall portfolio.

DAVE: Maybe you could talk a little bit about how the profit share works. Not sure we covered that.

KENNY: Yep. There are two fee streams to three that are generated by the fund. The first is just a flat 2% management fee that we talked about. The second is any interest that we're able to generate or staking revenue that we're able to generate. We do an 80-20 rev share on that, which is the same thing that BlackRock does with their prime lending for ETFs. So that 20 goes to us, and that 80 goes to the LP. And by the way, the 20% goes to the advisor.

And then, the other one is more hopeful. We haven't even baked it into the model, but the index itself could become valuable. If we get enough AUM and people start referencing it, we aim to own the license to that. So that could be a potential revenue stream. The pitch is that if you invest now, you are only locked up for a year afterwards. You can sell in full; we're not spending your money. It's just sitting in an index. So, you're going to have crypto exposure, which you can hedge pretty easily if you were so inclined.

At the moment, you're actually paying shorts. And after 12 months, you can take your money back out. You're really only out with the beta movement up or down, which is hopefully up at this point, because as somebody said in the chat, we might be at the bottom. Who knows, we're not going to preempt the market. But the key thing is that you will get that profit share from those fee streams in perpetuity. And so, it creates a nice annuity for you for as long as we're doing this fund, which hopefully is a very long time.

DAVE: Great. I think we're almost at the end, but if I want to learn more, where do I go? Any links in the chat or things to get started?

KENNY: The website is a good place to start. You can email us at contact@diffusefunds.com. That's a pretty good shout because we're a 506c, so we're actually able to put a fair amount of stuff on there. There are also a couple of logistical items that the wall is asking for, like a 2% fee which is paid quarterly. But it's not a performance fee. There aren't going to be drawdowns or anything like that. And I think that right now, we're getting three and a half to 4% on lending. It's nothing crazy, but that's because we're not charging that much in fees. It goes a long way to deferring that.

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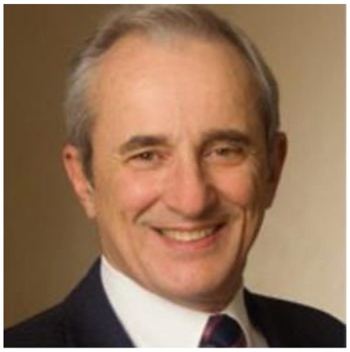

Dennis Chookaszian
Corporate Director, CME Group

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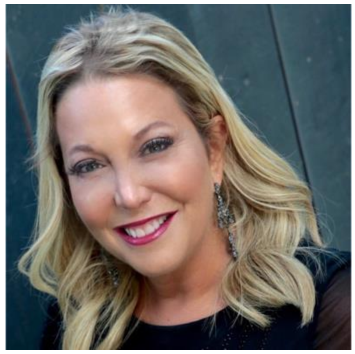
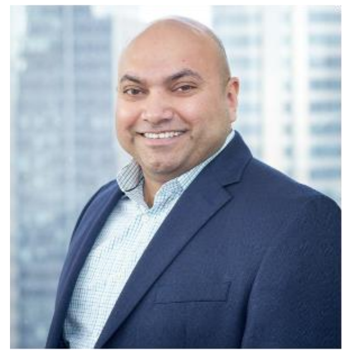


Susan Brazer
CEO & Founder, LionShare Media

DiffuseTap: Media Metaverse 2022

Susan talked about the 2020 digital media landscape; the evolution of media distribution; how converging, emerging technology points to the metaverse; and the prospect of having an open, decentralized, and free Web 3.0 marketplace. Read on



Raj Mukherjee J.D.
VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes Decoded with Binance.US

Raj explained the complexities of the US crypto tax landscape, how he built a dynamic tax information system for Coinbase and Binance from scratch, and how investors can profit from crypto without getting caught in a taxation mess. Read on

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