A Private Family Office Insights Webinar Featuring Diffuse Digital 30

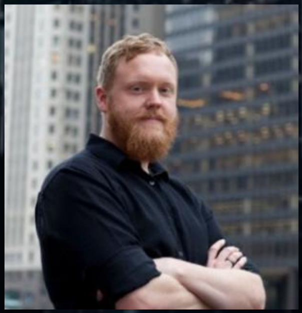
DiffuseLaunch
virtual fund pitch session

Guest Moderator:

Wendy Craft

Chief of Staff
Fulcrum Equities, LLC

Hosts:



Kenny Estes

CEO and Founder
Diffuse

Ayla Kremb

COO
Diffuse

A Private Family Office Insights Webinar Featuring Diffuse Digital 30

In the Family Office Insights Webinar for July, event moderator Wendy Craft, Chief of Staff at Fulcrum Equities, LLC, spoke with our CEO Kenny Estes and COO Ayla Kremb about Diffuse Digital 30, the institutional grade digital asset crypto index fund, and answered the attending family offices' burning digital asset investment questions.

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 Moderator

Wendy Craft is a family office veteran who has spent over a decade serving a number of family offices in the New York area. She is currently the Chief of Staff of a single-family office that serves and coordinates the family business and interests of third and fourth generation members of the family, including real estate, private companies, and cryptocurrencies among other sectors. Linkedin: @wendy-craft

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 that provides exposure to a diversified basket of crypto currencies by investing in the top 30 coins, weighted by market capitalization

WENDY CRAFT: Hello, welcome everybody. This is Wendy Craft. I'm going to go over a few housekeeping rules while everybody populates the room. Today we have Diffuse Digital, and we have two lovely folks who are going to talk about the company and about what they see. I'm going to let you guys take it away.

KENNY ESTES: All right, thank you very much, Wendy. Greetings to everybody out there. Thanks for joining us this afternoon, depending on where you are. We are Diffuse Digital, and we are going to be talking about Diffuse Digital 30 today. It's a new fund that we just launched. As you can see, our tagline is we are the first private institutional digital assets index fund. That's quite a few words, but it will be very clear in just a minute.

About the team, who are we? My name is Kenny Estes. My background is in high frequency trading. I went through your stereotypical story. As an 18-year-old, I started at a 15-person startup, and left it as a 1,500 person public company 10 years later. Along the way, I started spinning up a bunch of boutique investment vehicles. That includes real estate, venture capital, digital assets, and capital markets. We started about nine or 10 different funds across different verticals.

What Diffuse does is an extension of that, where we go out and we find interesting market opportunities, interesting investment strategies, and we create a fund vehicle around them and give that investment opportunity up to people who are looking for orthogonal, non-correlated return risk profiles. That's me. Ayla, do you want to briefly talk about you and your background?

AYLA KREMB: Yeah, I'm happy to. I spent the last decade in all things commercializing technology. That includes everything from working hands-on with startups to innovation labs and raising capital for companies. Kenny and I met about a year and a half ago, and we started Diffuse. It's taken on many shapes and forms, but from that moment onwards, we started launching both third-party funds and proprietary funds, and we've had solid momentum. I'm really excited to share with you today what has come out of our journey, and how you could potentially participate.

KENNY: Now, we'll start right into it because we know we have a hard stop at 45 minutes past the hour (depending on what time you're in). The fund that we launched one June 1 is called Diffuse Digital 30. Diffuse Digital is the moniker we use to describe all our digital asset products, which makes up most of our focus right now, because there's so much opportunity in digital assets across the board.

To talk briefly about what's happened in the past, if we rewind two years ago, when you're talking about digital assets or cryptocurrency, you're probably talking about Bitcoin and Ethereum. That's not the case anymore. Last summer, we saw the rise of decentralized finance, where you take the tasks that are traditionally done by banks, and you do them in a decentralized way, saving all the headache and the expense of golden parachutes, bureaucracy, and things along those lines.

We've seen this massive rise of things that look like revenue generating solutions, where there's no company in the middle of it. It's a fascinating new space. However, this created mass throughput issues. This created a lot of growing pains, and we've seen many Ethereum competitors come to the market. You've probably heard some of the names such as Polkadot, Solana, Cardano, Polygon, Binance Smart

Chain. All of these are really trying to address some of the core problems that Ethereum has, to facilitate and help improve throughput.

Long story short, Bitcoin and Ethereum are not the name of the game anymore. You're seeing all these alternative coins coming on strong, whereas Bitcoin is now referred to as the “boomer coin,” because people look at it as gold. But all of the interesting innovation isn't happening there anymore.

On this chart, here are the top 30 market shares broken down. You can see Bitcoin has just fallen off a cliff since the beginning of the year, and Ethereum has almost flatlined. But the other 30 are coming on strong, and we fully expect that to continue. The issue is that the fund sponsors, the people actually creating these products, the Grayscales of the world, are still very focused on Bitcoin and Ethereum. Last time I checked, GBTC had 25 billion under management. Their one product is just Bitcoin, and it's not even a particularly efficient vehicle. It's roughly comparable to paying somebody 2% per year to hold Microsoft in your account, rather than going out and buying the S&P 500. That DIY diversification doesn't really exist.

That's where we come in. Think of us as the S&P 500 for digital assets, but we're doing the top 30, which consists of all of those that have north of a billion in market cap. We're creating a vehicle to allow institutional and more sophisticated allocators to actually put money in, and we'll talk a little bit more about what that entails later. The key aspect is that if you want exposure to digital assets, you want a one-stop shop, you want solid infrastructure from tier one and tier two service providers, we are your best bet.

Where we start is a beta product. This is an index fund. As you can see here, it's a straight 2% management fee if we lend out any of the assets. We use the same model that BlackRock does, where 80% of any interest revenue goes to the fund, and 20% goes to the advisor. It’s the same thing that an SPI does. It's very flat. We don't gain anything on appreciation. There's no performance fee, or anything along those lines. This is a true index product to allow for your exposure. In addition, it's rebalanced monthly, and redeemable monthly. So this is liquid. You can get out easily. There are no discounts and premiums, which, if you follow the Grayscales of the world, their share price is pretty far away from the actual book value. We don't have those artifacts.

We spent many, many hours finding tier one to tier two Wall Street providers, which includes tax audit fund formation. Everybody we use is respected by Wall Street so that larger allocators can look at it and say “yeah, we know them. We're comfortable with them.” We're not going to use mom and pop shops that are just learning on the fly.

And then lastly, we very carefully thought through how we're going to facilitate the trading. We only use qualified custodians. We have strong fiscal controls governance, and we make sure that we're fully compliant with the regulations. People that are in the space probably have seen a lot of headlines in the last week about regulators coming down hard on BlockFi or Tether, because they decided that they were going to do it in a non-compliant manner, and now it's kind of coming back and biting them. We decided we wanted to do it the right way from day one, again, with the focus on allowing institutions to allocate.

We just launched this June 1. The first phase is the first 10 million, and then we raise. That's where we are right now. This gives us a little bit of scale and takes the fund to roughly break even. The key thing about the first phase where we are, is everybody who invests gets a profit share in the fund for the lifetime of the fund. We'll talk about that in a second. But that, in and of itself, won't get anything like the returns we're expecting with this product. It's going to be worth quite a lot more than the actual original investment.

Now, once we get to about 10 million or so, we'll go to phase two. We have a very strong network of broker dealers ready to distribute this product, but we need to get to breakeven before we can pay them their success fees. So, in phase two, we start paying success fees, onboard all our broker dealers, including one which is a joint venture. We had about a quarter of it there, onboarding about 40 registered reps as we speak. We think that phase two distribution will go very well.

Phase three is when we get to market. There, we can turn it into an ETF. If the SEC has figured out some regulatory things, we can list in Canada, we can turn to the Caymans, or we can turn into an institution-only vehicle. We're going to have to make that as a game day decision when we get a bit to scale, and when we can actually afford any expenses to go in whatever direction we want.

The investment committee right now consists of five people. Right now, it's me on the fund management side. We have two very experienced traditional finance technologists that I've actually known for a couple of decades from high frequency trading. And then, we have a shortlist of other people that we will onboard who bring a lot of credibility to the product. But guaranteed, it will be ready for Phase Two more than anything.

With regards to the investment terms, it's 250k minimum, and a 2% per annum management fee. Like I said, it's an index fund with that 20% lending revenue. It's the same way you get prime lending interest as with BlackRock managing ETFs. We do the exact same thing. Eighty percent goes to the fund, 20% goes to us. The advisor covers all formation expenses and all OpEx, so when you put money into this entity, it's going to be invested in the index. It is not going to be spent. There's no lockup. It's a monthly retention, and we launched it on June 1.

As I mentioned, for the profit share for phase one, we're using what we're calling a "jump ball". Where we are in our fundraise towards that 10 million determines how much of a profit share LPs get. For the first million tier, which is almost full at this point, they receive 2.25% profit for the lifetime of the fund. The second million gets a little bit less, and then those at 30 million gets a little bit less than that. The idea is to give people an incentive to come in early, which is obviously the hardest one to raise, so you can get to scale and really do that broker dealer push sooner rather than later.

Now, one key thing is that profit share vest over 18 months. If somebody's super cynical, or Machiavellian, they could come in, invest, let the money sit there for a year and a half, pull out in full, and they can keep the profit share as effective in annuity for the lifetime of the fund. In terms of the cost basis, that profit share is one and a half years' worth of management fees, which is negligible at the end of the day. That is the product.

In short, Diffuse Digital 30 is the first institutional grade digital assets index fund. It launched about two months ago, and we're scaling rapidly. Ayla, is there anything else you're supposed to touch on there, or should we go right to Q&A?

WENDY: Everybody, if you could post your questions in the chat for the Q&A, that would be fantastic. If not, I'm going to take the moderator hosting priority chair and ask questions myself. So I guess you guys have to ask some questions, because if not, then I'm going to do that. Okay, my turn. What do the top 30 digital assets consist of?

KENNY: We use almost the same methodology that the S&P 500 does. The only difference is that we rebalance more frequently. S&P 500 rebalances quarterly, whereas we do it monthly because, frankly, digital assets move faster, and constituents come in and out a lot quicker. The selection is market cap weighted. It's practically the same methodology. We just strike a NAV on the last day of the month.

And then, there's the new constituent lists. We trade into that position, and then we hold it. For those of you who have picked up an MBA at some point in your life, this is very much like Cap 101. People have won Nobel Prizes about why this is the best way to invest for the long term.

WENDY: There has been a lot of buzz in the family office space about digital assets. Can you explain why it's better to invest in digital assets through a fund than individually?

KENNY: Essentially, this way you don't have to manually go out and do the pieces. You get better economies of scale, as a general rule for the trading that we do. And another big one, and this is a key one for institutions, is custody. If you're going to be doing it yourself, and you have some money sitting in an account, that's great. But we have proper and appropriate fiscal controls and qualified custodians and we very carefully thought through how to make sure that the investor capital was safe. Also, having very good technologists to do the execution of it results in less slippage, and overall better execution. We're going to have more scale for lending. We're not doing it right now, but we do plan to do so, which actually will probably overcome most, if not all, of our fee drag, to track against that index.

WENDY: We just received a question from the audience. Which exchanges will you be using for this?

KENNY: Right now, we just launched with Coinbase, and there's two pieces to this. One is custody, and one is where we do the trading. Coinbase has pretty decent coverage on the trading side, mesh on the custody side. Our goal is to try to find custodians who can give us the best fee rates that we possibly can. And lastly, we have 21 of the 30 constituents, which is still 90% of the market cap so it's pretty good tracking. And then, as we want to add more tokens that Coinbase doesn't support in an effective way, we'll go to new custodians. We'll go to where the liquidity is.

WENDY: I wanted to ask, I know there's a lot of regulatory action. I get sent something at least once a week. How is that going to affect your operations? How has that been responded to? If you can talk about that a little bit.

KENNY: Ayla, you want to take that one?

AYLA: Yeah. It comes in two levels. One of them is the actual structure of the fund. The structure is actually a fairly straightforward Reg D fund, which is co-industry standard. That shouldn't be at risk itself. We haven't tried anything fancy or advanced there, even if we wanted to go for an ETF that would obviously be completely dependent on the regulatory environment.

The second layer is the individual tokens, the constituents that we actually are covering. For example, if any of them come under scrutiny of the SEC, they would then drop off our radar as well. We wouldn't have them as part of the constituent list anymore. And we do reserve the right to remove some of the coins, like Dogecoin, for example, which they might not want to have on the list for security, safety, or other reasons. So I would say in terms of regulations, it would be more about who is going to be part of the constituent list, versus are going to be able to fund this fund or not.

KENNY: The key thing is, we really did it with compliance from day one. We're not trying to try to slide by or get away with anything. We decided that we were going to be upfront, and say here's exactly what we're doing, and how we're doing it. And so, we make it a point to get good lawyers to make sure that we have that covered.

WENDY: Fantastic. We have a couple more questions. One of the audience members is asking, do you also trade short term? For example, hold a position for less than a month?

KENNY: We don't, at all. When we considered it, we looked at the expense of doing the trading, and the slippage that entails. I found that a month was about the sweet spot but doing it more frequently didn't really help our coverage to the index. And again, the idea is to track the index, not absolute returns. The other thing is that it creates more tax by doing more active management. By design, this is a passive fund, and we want to focus on that.

WENDY: Thank you for that explanation. We have another question. Binance offers much better liquidity compared to Coinbase, so why are you sticking with Coinbase?

KENNY: It's a valid question, and it is definitely true for the less liquid stuff. We're optimizing for that right now with execution slippage. But with the amount of liquidity differential between Binance and Coinbase, which, at magnitude right now we are about a million, it's pretty negligible. As we grow, as we scale, and that becomes more significant in terms of absolute dollars, we will definitely onboard them.

But the reason we're doing profit share in phase one (we can't emphasize this enough), is because we are out ahead of the bunch. We don't have full coverage on qualified custodians because straight up, no qualified custodians offer a lot of these. We don't have the absolute ideal execution across 20 different exchanges because of that scale. It doesn't make sense. However, it doesn't make any difference on the people's returns or to the tracking. That's where we are, and that will definitely improve and get more sophisticated as we go.

WENDY: I have a question. You're going to invest in the top 30 digital assets, so how are you going to weigh those investments? Is it evenly distributed across all 30? Is it weighted more heavily towards "fake" Bitcoin? How is that going to work?

KENNY: It's straight market cap. The way you get the market cap is equal to the number of outstanding tokens or coins times their price. Easy peasy. Right now, I think Bitcoin and Ethereum combined are 68% of the index last I looked. You can see that in that first slide, on that first page. This presents an organic way to shift your exposure as that trend continues.

The other piece is that all of these are super liquid, right at the top 30. All of them have north of a billion-dollar market cap. So, the relative difference of liquidity between Binance and Coinbase isn't really going to cause much of a difference. If we were going to weigh 200 coins, that would be a different story.

WENDY: Is it going to be straight market cap no matter what happens to the market? Or is there any situation that would cause you to get away from something when something bad is happening?

KENNY: The tradeoff of that is a good debate. Tim just asked a question around the other side of the same coin — how formulaic and how discretionary? That's the big question. Right now, we're entirely formulaic. We can trade it if it is in the top 30 market cap, full stop. Now, that could change. A good example would be Ripple. Right now, it's in the index. If the SEC comes out and says it is illegal to own this asset, okay, we're going to put some discretion in there, and we're going to take it out if that's the clearest and easiest to make sure we're in compliance.

Outside of that, with pretty much all formulaic, we actually had quite a lot of back and forth with Dogecoin, like I mentioned, which arguably has artificially inflated prices. I don't know what that actually means, and that's kind of the whole point of the index funds. Because it's got the exact same coin base as Bitcoin. Whether one has more inherent value than the others is difficult to determine, so we did go with a formulaic approach. We do have some discretionary, but we will use it very loosely.

WENDY: Goodwin's asking, have you backtested the strategy, and thereby have an indication of what return investors could expect?

KENNY: Yeah, let me pull this. So the first thing is, this is not a returns-focused fund. This is an index tracking fund. There's the distinction. This is not going to be an IRR product, or we're going to be actively deploying and making returns.

Now, having put that caveat in there, here is the 2020 historical analysis. This is through June 13, probably a bit out to date. Here's Bitcoin, there's Ethereum. There's the DD30. We really started in earnest in 2021, where the coins three through 30 started overtaking. And that blackline all the way to the bottom is the SP500. The point is, it is kind of off the charts on a historical basis.

Whether or not that continues is a whole other thing. But I think there's enough market validation at this point that if you're an allocator, there's a pretty compelling argument that some percentage of your portfolio needs to be in digital assets. Fifty pips are fine, but you need to have a product that allows you to do that in an intelligent way. And that's what we're trying to deliver.

WENDY: I think you've kind of answered this before, but if you can go into it again, how are you allocating between the different coins?

AYLA: Maybe I'll do this one. It's market cap weighted. That's how we decide how much to allocate each individual coin. We calculate how much the market cap of that actual coin is, currently. And we do that every 30 days. It's not a discretionary decision on our end of how much you allocate to each one. We try to be as mathematical as humanly possible about it.

WENDY: Thank you very much, Teddy said. So, you said it was liquid, and that I can get out monthly. Does that require a 30 days' notice?

KENNY: Yep, exactly. Thirty days' notice. And the other thing, for everybody who's on the call right now, the profit share is given out quarterly. Even if you invest with the intent of planning on keeping it around for a year and a half so you can get that super cool profit share for the lifetime of the fund, and then things change and you need to pull out, that's fine. You don't get any of the unvested profit share, obviously, unless you take out only half of it. Half will continue to be vested and prorated down. But you absolutely can get that money out of a 30-day notice at the top of the month or the bottom, not depending on how you define these things.

WENDY: Thank you. Another question is what limits, if any, will be applied to your lending activities and what lending platforms do you intend to leverage for this (pun intended)? Will staking factor into your strategy?

KENNY: To answer your question, being conservative on the lending is the name of the game. We do have risk policies that we started with, and that might change. But currently, it's at a 33% loan-to-value ratio. We're not doing this because we haven't found something that we're comfortable with yet. Underwriting individual pools is a whole different thing. We would obviously want to have an over-collateralized pool with a very clean and efficient clawback mechanism in case the collateral levels were breached on the downside, so that we can make sure we are made whole.

There's one custodian that we are onboarding as we speak, that is of the opinion that they can offer that. But again, even if we go that route, we would very much do it in a safe manner. Because the last thing we would want to happen is to lose principle for unforced error.

Staging is absolutely on the roadmap. Good question. Trust me, one of our funds is a DeFi fund that we launched about a couple of weeks ago, and there are zero qualified custodians that will allow you to stick into a reasonable pool. You can maybe get one or two that are put into Uniswap, where the stable coin yields are just not worth doing right now. You'd rather do the lending. Now, as that market expands, we would expect to go that route, and, again, conservative being the name of the game, we will put together some risk policies around how and where we would be able to stake.

WENDY: Thank you. I want to jump back really quickly into regulations. The regulations are different in different states, and there really hasn't been a great deal of federal regulation. How are you dealing with that for this fund?

KENNY: We are a private equity fund. We started simple, and we can always make it more complex. We're a limited partnership as well. The reason we did that is because that allows us to really invest where we'd like to invest, as long as we restrict to accredited investors and make sure we have everything clear. We struggle to see a scenario where the SEC is going to come out and say you'd have to cease and desist this product immediately.

Now, the longer-term implication or question is, what does this become. We talked briefly about that where in phase three, ideally, we turn it into an ETF. Because then, the index fund where we are right now would not be very efficient from a tax perspective, where you have to trade and deal with capital gains or capital losses.

If you become an ETF, you don't have that problem anymore. It's a more deep liquidity profile for a secondary. You can actually allow retail investors to do trades, which is certainly the preferred way to go. But the SEC has not authorized that. Even if the SEC wanted to, going back to the qualified custodian issue, this product wouldn't be able to do it today because there's not enough coverage from qualified custodians in the market to do full 30 right now. So even if we want to become an ETF, we really couldn't do the top 30 today. But that's changing fast. Today we have 21 or so constituents we have on qualified custodians, but three or four months ago we only had 14.

AYLA: Yeah, that's moving fairly quickly. One thing to also think about is the reason why it's going to start moving more quickly as time goes by. These custodians are having one hell of a time keeping up. We see about a 20% or so turnover in these constituents on a month-by-month basis. Imagine Coinbase having to onboard a large percentage of new coins on a monthly basis. It's quite the effort on their end as well. There are some states that don't actually allow them to add another asset unless the state has signed off on it, which is kind of a hindrance. One custodian we considered was Anchorage, which we chose not to go with. But we see that being more and more solved, or not solved, over the next six months.

KENNY: One last thought on that, because you brought up. There are different ways to become a qualified custodian. The easiest way to do it is to become a chartered bank that gets trust licensed. There's two different layers. Each state has trust licenses that they can issue, and there's also federal trust licenses. Most qualified custodians are at the state level. Anchorage is one she mentioned that has a federal license. It's about the only one that does. We would like to get to the point where we have federal chartered trusts across the board, just from a regulatory diligence point of view, for more institutional allocators when we get to phase two.

WENDY: Can you just go through the ask again, so that everybody could hear it? Because a few people did jump on light today.

KENNY: Okay, good. So, here’s the investment terms. The minimum investment is 250,000. We will be increasing that when we get to 5 million. We're about at one right now. Again, we just started our marketing outreach, hence this call. It's 2% per annum, 20% on the rev share for the lending. There's no performance fee, in the traditional sense of when it appreciates, 20% of it goes out the door. We don't do that. We cover the OpEx. It's a monthly redemption, it's investable now. We actually have closes on the first day of every month, so if that's of interest, definitely come out. When you do make an investment, we'll also do the profit share agreement at the same time, in proportion to how much the investment is.

WENDY: Thank you very much. I'll just keep going. This is really interesting because usually you don't get direct answers on regulation, and how you do that and everything else, so I really appreciate that. Anyway, you said phase two is going to start in September.

KENNY: Phase two will start when we hit 10 million. That's when we start going out to broker dealers. We'll see. Like I said, we just started the outreach. I would say this August is just before phase two starts.

WENDY: Fantastic. Well, I can't thank you both enough. If anybody wants to follow up, I believe that Arthur will be sending out an email so that you can contact Diffuse. And if you want to right now, you're welcome to send a message to all panelists with your number if you want them to reach out to you, and they can provide you with the materials, and if not, that will come in a follow up email.

Again, thank you both. This I really think is fascinating. And I think it's been a long time coming that this was done. I'm one of those people who are like, “oh, Bitcoin, Ether. I don't know what I'm doing. I don't even know how to do this thing with Coinbase." Well, I do now. I really was looking for something like this, which is kind of like idiot-proof investing, really. And it just wasn't out there for so many years. So kudos to both of you. It's really amazing.

KENNY: And Wendy, you're our target audience. If somebody is really gung-ho and really understands crypto, our product could be of less value. Same way if you're actively doing stock picking on a day-to-day basis, you're probably not investing a lot in the S&P 500. It's exactly for people who get the hype, who think there's something there, and want that exposure.

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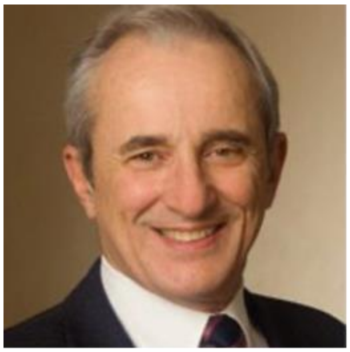
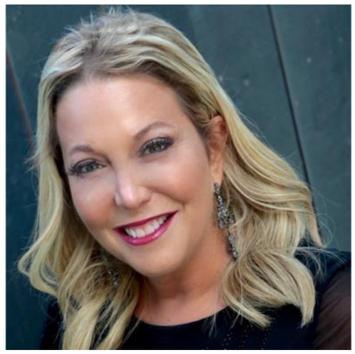


Dennis Chookaszian
Corporate Director, CME Group

DiffuseTap: Institutional Grade Governance

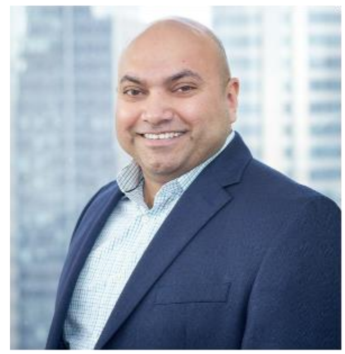
Sharing his decades-long expertise on corporate governance, Dennis discussed how to avoid a co-partnership going sour, the problem with overly idealistic CEOs, and the importance of keeping your board in check. Read on



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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