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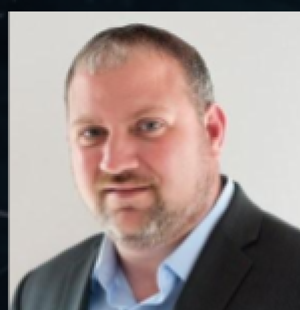
Virtual Event Series

Getting ETFs DeFi Ready

Guest Speakers:

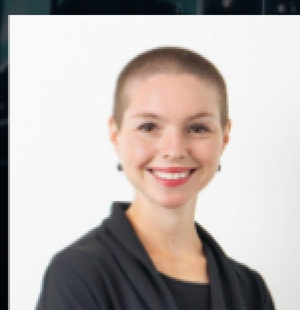
Dan Weiskopf
Portfolio Manager
Toroso Investments



Michael Venuto
CIO & Co-Founder
Toroso Investments

Hosts:

Kenny Estes
CEO & Founder
Diffuse



Ayla Kremb
COO & Co-Founder
Diffuse

DiffuseTap: Getting ETFs DeFi Ready

Last time on DiffuseTap, Dan Weiskopf and Michael Venuto of Toroso Investments, talked to us about what makes ETFs the superior investment, how funds profit from zero fee ETFs, and how the rise of DeFi will affect ETFs across the board.

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DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas)... straight from your armchair like a boss.

Meet the Speakers

Dan Weiskopf is a portfolio manager of Toroso Investments and member of its investment committee. His portfolio management experience spans over 30 years, with almost 20 years as an ETF strategist. Prior to focusing on ETFs, Dan founded MH Capital, a small cap hedge fund, and also worked at American Diversified Enterprises, a family office.

Linkedin: @dan-weiskopf

As Co-founder and CIO of Toroso Investments, Michael Venuto is responsible for investment management, research, and trading. Michael has spent over 20 years in asset management, including his stint as Head of Investments at Global X Management and Director and Portfolio Manager at Horizon Kinetics.

Linkedin: @michaelvenuto

About Diffuse

We are an alternative fund platform offering differentiated investment products. From digital assets, to VC funds, and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds. For more information visit www.diffusefunds.com.

KENNY ESTES: Dan and Michael, do you want to tell us a little bit about your background and Toroso investments?

MICHAEL VENUTO: Yeah, let me do the first part. My name is Mike Venuto. I am the co-founder and CIO of Toroso investments. Our core business is basically everything ETFs. We touch on every part of the ETF ecosystem. We've helped SoFi bring ETFs to market, and we've helped pretty much all the independents. When somebody wants to launch an ETF, they come to us and we help them get it launched and grow. That's our core business. We do the trade execution and all the parts of the ecosystem.

Part of why we got invited to this five to six years ago is I went down the rabbit hole of blockchain and crypto. I really got to the point where I thought, if anything could destroy the ETF market, it would be blockchain. This is the thing that could replace it. I went on MarketWatch and said this, and got laughed at. Yet, here we are five to six years later, and we're starting to see some of that reality be built into the technology.

When we saw that threat, I decided to launch the first publicly traded blockchain ETF, BLOK. It's now the largest blockchain ETF. We've got clones from just about everybody at this point, but we're still doing the best numbers primarily because of the active research that my partner Dan Weiskopf does.

We do everything ETFs. If you want to launch an ETF, you should be talking to us. And if you want to learn about the public blockchain companies that are out there, you should definitely be talking to Dan. So, Dan?

DAN WEISKOPF: Thanks. We're very transparent about what we do. I've been involved in ETFs for about 15 to 20 years. I'm known as the ETF Professor on Twitter because I often speak about how structure matters, which is really a broad subject matter. It really highlights security selection. Most anything that is liquid can be wrapped in an ETF, but it depends on your structure.

As Mike said, I'm also co-PM of BLOK, and I talk to all the management teams that are involved in the blockchain that are publicly traded. I ran a hedge fund prior to getting involved in ETFs, which gave me a leg up in terms of talking to these management teams. I'm also very involved in ETF Think Tank as the lead ETF strategist for the tank, which is a great discussion to have.

AYLA KREMB: Thank you. I will put you guys immediately on the spot with a bunch of questions. For the audience, please don't be shy to ask questions in the chat as well. We discussed this during our prep call, but isn't the ETF a superior investment? Where would you rank the ETF as an investment opportunity?

MICHAEL: This was the main topic in the breakout room we just had. I'll repeat some of it. An ETF is an exchange traded fund. It's created under the 40 Act laws. Just to give it some context, we've got laws dictating what should go into a pooled investment vehicle when a lot of these things didn't even exist or were even contemplated. That's why the SEC is so far behind. Now, the 40 Act laws contemplated the concept of a mutual fund.

An ETF is just a mutual fund that is exempt from one rule, and that rule is pricing once a day. An ETF prices every second at this point. Because it prices every second, it can do intraday creation and redemption. That means shares can be created or redeemed in the middle of the day, not just at four o'clock PM. That creates a unique benefit to ETFs that mutual funds, hedge funds, LPs, and other structures don't have. That benefit is the ability to wipe out cap gains.

By using that intraday creation and redemption, you're able to completely wipe out any short term or long term capital gains. Dan and I experienced that in 2020 with BLOK. We were able to sell 100 million dollars of Canaan up to 300%. All those gains go to a market maker, not to us. The market maker doesn't have to pay because it's ordinary business. In the world of traditional finance, yes, an ETF is a far superior vehicle.

Now, if you start to get into the types of things that this audience is excited about, like tokens and blockchain protocols, at this point, the SEC and our regulators in the U.S. are so far behind that the ETF vehicle is probably three or four years away from being able to really own these types of things. They can't even get comfortable yet with Bitcoin. So, getting comfortable with other things is going to take some time. That's why there are other vehicles out there like what you guys are creating at Diffuse, where you put these things into a package. Dan, do you have anything you want to add to that?

DAN: That explanation was highly technical and I absolutely agree. For me though, what I love about an ETF is the transparency. You know exactly what you own. Whereas in other vehicles like a mutual fund or hedge fund, you don't know what you own. The tax efficiency also makes it a no-brainer. That's what really drove me to the ETF marketplace.

People talk about the fees, and low fees are great. But these days, I really would like to know what I own. And if I can avoid paying taxes, that's a wonderful thing. I've always been very surprised that family offices have been slower on the uptake in using ETFs in very specific scenarios. According to JP Morgan, the ETF marketplace will get to 30 trillion by 2030. We'll see.

KENNY: Interesting. I do know that there are more ETFs than stocks at this point, which is interesting. You kind of foreshadowed it. Now, the audience here is crypto-heavy. Alts in general, but crypto in particular. With DeFi or decentralized finance, the grand ambition is to take everything that financial services do and take out the financial institution. Do it decentralized, transparent, and on-chain. The question is, are ETFs one of the products that are destined for the trash heap with the rise of DeFi? What are your views on the interconnection between those two?

MICHAEL: Okay. You kind of just told the origin story of BLOK there. When I got red pilled, I said “Hey, my company provides the custody, the infrastructure, the links to the stock exchange, the links to the APs.” So, when I'm talking to a Morgan Stanley adviser for example, I always bifurcate the concept of trusted third party into two buckets. You have the trusted third party that verifies your transactions. That includes custodians, transfer agents, exchanges, and all that. All of them are dinosaurs, and they know it.

They're all investing in this space, and they all will be extinct somewhere between 5 and 20 years, depending on when regulators get on board. The regulators are the only thing stopping it. And that form of trusted third party, the verifier, will go to DeFi over the next five to 20 years. Then, there's a second form of trusted third party. That trusted third party is the one that is selling you advice. That's not verification. That's the trusted third party that says, “here's what I think should be in the portfolio,” or “here's how I think you should be allocated.”

That type of advice cannot be taken away by DeFi. We've seen it in TradFi, with robo advisors and all these things. They really haven't chipped away in any way shape or form. Nobody cares. Yes, I can buy crappy advice for a really low price. But if I want real advice, I'm going to pay a higher price. I don't see DeFi as killing ETFs. I see DeFi as a way to deliver good IP in an ETF structure.

Take the asset management that we do or whoever does, package it in a BTF or a blockchain traded fund that comes in some sort of token, and you've got it decentralized. You're taking away the trusted third party that's probably going to rob you at some point. Instead, you're just delivering the second version of trust, which is advice. That's the way we see it.

AYLA: You said your business is all things ETFs, but what specifically are you guys doing to get ready working with the DeFi structure? Is it one of these more derivative type ETFs that you might be putting together? What are you thinking about when it comes to trying to get your business ready for DeFi, considering it's all ETFs?

MICHAEL: Yeah. We started with investments. We were investors in anything that we think could help us build infrastructure on the blockchain in the future. We invested in On-Ramp. I don't know if many of you know them, but they're basically trying to build the pipes that connect RIAs to the on-ramps of crypto. For us, that was a way to watch somebody else and finance somebody else doing this.

And then, we are now working with Hashdex to build the trading infrastructure to execute things the same way that we do with equities and with tokens. All of this is in the background. Right now, the core business is getting ETF structures to work. But what we don't want to do is forget about the things that are going to replace ETFs. So, we try very hard to be ahead of it with small strategic investments.

My team literally trades 6 billion a day of U.S. equities and swaptions, treasury futures, gold futures, Bitcoin futures, and all kinds of traditional finance vehicles. And now, I've got them figuring out how to trade an index of 10 or 15 tokens. Why wouldn't you teach the team how to do that and be prepared for how the world is going to change?

The other thing we're doing is we look for companies constantly. We're not just looking at public companies, we're looking at the privates too because they're going to come public. Dan maintains the database for that. If anyone on the call is in a private company that's looking to go public soon, come to BLOK. We actually have helped people go public. Dan, do you want to add on to that?

DAN: I will. I also want to give you a little bit of a little bit of credit. So, some of this is learning on the job. Mike forced us to come up with the idea of creating our own NFT. I'm not soliciting the NFT. We don't make money on the NFT. But this is the way our thought process works. We approach something and learn as we go sometimes. And I think in the way of blockchain or crypto, that's the reality.

To explain the database further, we have about 250 companies that are public. They range from names like IBM, Visa, etc. to smaller companies, including companies in the metaverse. In talking to the management teams, we're learning as we go. We're going to get hit sometimes because this is a highly volatile space, but we try to manage things with a great deal of diversification. Because when things go bad, we just don't want to blow up. That is the overarching goal.

So, we break down the database categories between direct Bitcoin exposure through some ETFs traded in Canada, to private blockchain companies such as IBM and Accenture. Miners are also a category that we're very intimately involved with, and that requires us to also visit the companies. I'm dwelling too much on what we do in BLOK, when this is really a focused conversation around ETFs. But the point here is that in the way of ETFs, this is actively managed. We were early adopters. I think an ETF offers an opportunity set that is often under appreciated by the marketplace.

MICHAEL: It's amazing that people still think they're all passive, when around 78% of ETFs that have launched in the last 12 months are active. That whole debate about passive versus active is gone.

KENNY: Okay. We'll pick up a related question here from the chat. When people think about ETFs, they think about spiders most of the time, as a general rule. Fee compression is a major issue that's happening there. How are you seeing that for the more actively managed ETFs? How can you justify relatively high fees? Is that sustainable going forward? And what are your responses when people throw that crisis in your way?

MICHAEL: It's funny because we don't even care anymore about the fees. Like I mentioned earlier, we're behind SoFi's ETFs. The first thing they launched was a zero fee ETF. We're actually making money on a zero fee ETF. That's how the world works. Beta, and the things that are not having any value in terms of trust or IP, are going to be priced at zero. And then, things that have value in terms of trust, IP, and advice will be priced appropriately.

Today, actively managed ETFs represent about 5% of the AUM of the ETF world. The bulk of it is still sitting there with Larry Fink and really cheap beta crap. Even though they only represent 5% of the AUM, right now active ETFs represent almost 12% of the revenue of the industry. That should tell you where the puck is going. Going back to the conversation we were having earlier about the two forms of trust, DeFi will disintermediate verification trust, but it will enhance the ability to deliver advice trust. And that advice trust will carry a premium.

DAN: It's funny that people hone in on the fee issue because it's measurable. But the reality is that if something is 75 or 50 basis points, it's still really cheap if it's delivering alpha. Obviously, you want people to get paid for what they do. People forget that. There's a breakeven level of between, I'd say, $20 million to $50 million for an ETF. And if that breakeven isn't achieved in, say, two to three years, they disappear.

MICHAEL: That's where DeFi comes in. Their breakeven will be much lower once DeFi occurs, because that breakeven is paying the U.S. Bank, the New York Stock Exchange, this exchange, transfer agents, etc. That adds up to around 200k. So, if we could disintermediate that 200k down to a decentralized 50k, the breakeven is so much lower.

DAN: I mean, yeah, that's great. But when you talk about that happening, do you think that's going to occur in a year? In 2025 or 2028? I think it's a great concept, but I don't think it's on the horizon.

MICHAEL: It's all about the regulators.

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Corporate Director, CME Group

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CEO & Founder, LionShare Media

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VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes Decoded with Binance.US

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