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Virtual Event Series

LESSONS LEARNED:

Crypto Hedge Fund Successes & Funerals

Guest Speaker:

Ben Jacobs
Managing Partner
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Hosts:

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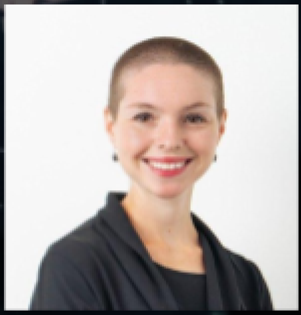

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Lessons Learned: Crypto Hedge Fund Successes & Funerals

Last time on DiffuseTap, Ben Jacobs, Managing Partner of Scenius Capital, talked to us about how 2022 was a bad year for most crypto-focused hedge funds, what today's funds should do to survive a crypto winter, and how a crypto project tends to grows differently compared to a web2 startup.

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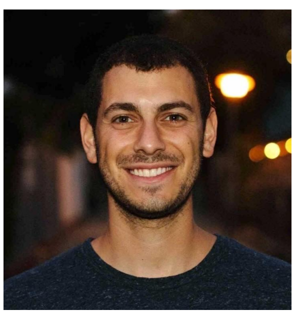
DiffuseTap

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 Speaker



BEN JACOBS is Managing Partner of Scenius Capital, a multi-strategy fund of funds focused on digital assets and blockchain technology. Ben is also the Executive Director of The Medici Network, a global organization committed to accelerating the institutional adoption of digital assets.

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KENNY ESTES: We are here to hear from this man, Mr. Ben Jacobs. Ben, you come very highly recommended, so I'm excited for this conversation. Would you mind telling the folks a little bit about background and what you're up to over at Scenius?

BEN JACOBS: Yeah. Hi everyone, and thank you to Kenny and the Diffuse team for having me today. I live in Los Angeles, but I'm a New Yorker at heart. Although I think LA's bagel scene has gotten much better of late. I run a digital assets asset manager called Scenius Capital where we focus on fund of funds. We have one vehicle that's been live for over two years, which is a fund of liquid token hedge funds.

We have seven funds in the portfolio currently with over 50 LPs globally, and we have a new vehicle that will be coming to market later this year that is a fund of early stage blockchain-dedicated venture funds focused on managers that have sub 100 million AUM. We have an early stage focus that is specialized and deliberately small.

I also am the executive director of an organization called the Medici Network, which has a mission of broad institutional digital asset ownership. I'm also the host of a podcast called Scenius Studio, where we interview leading crypto GPs. We had an episode with Kyle Samani from Multicoin released this morning, so if you're not sick of me by the end of this, you'll definitely be sick of me after you listen to that.

AYLA KREMB: Beautiful. Maybe we'll start out with your thesis on using a fund of funds. Why did you pick that approach of using a fund of funds instead of betting on individual managers?

BEN: This product was actually developed as a solution for my brother and I to allocate to the space in a way that we thought was better than anything we could do as individuals. “Scenius” itself means collective intelligence. I've been investing in digital assets since about 2015, and it is extremely complex. It’s difficult to discern what is real, and what is vaporware.

Over time, just by being patient and investing in the asset class, I had accumulated some capital and instead wanted to outsource investing to managers that were better suited to manage a portfolio in this crazy wild west of an asset class. The idea was that you could diversify some of the risks, and have exposure to different strategies in a fund of funds portfolio.

We then spent a lot of time learning how to do diligence (which rocks the turnover from an operational due diligence perspective), and then how to actually discern who has edge on the investment side. It turns out that a lot of people are attracted to that vehicle. And so, we launched with it. And now, we've continued to hone our skills in evaluating managers, and are now doubling down by launching this new vehicle that we think is highly complementary to the existing fund of hedge funds vehicle.

KENNY: Makes sense. I will say, I am looking forward to the day when I talk to a fund of fund manager whose answer to that question is, “I'm lazy and want somebody else to do all the work.”

Not today though, because it's a lot of work to do diligence. In 2022, a lot of funds didn't necessarily do so well. So, do you want to tell people some of the background there? What hedge funds were crushing it previously, and then when 2022 happened, they were less than crushing it? What were the major reasons you think that that happened?

BEN: I would categorize it as two different types of funds, and I'll highlight their failure points in 2022. The first are the more long biased directional strategies. A lot of these funds had accumulated excessive amounts of AUM primarily just by being early. They may not have been traditionally trained portfolio managers or asset managers from the financial sector. Rather, they were technologists, so they were just primarily long on the asset class.

And that strategy worked really well through 2021. However, 2022 exposed those who had not paid careful attention to risk factors, whether that be market risk, or operational risk, or counterparty risks, etc. And so, we saw a number of funds that were on defunct exchanges such as FTX, or they may be trying to juice their yields via a protocol without substance to it, like Terra/Luna. As a result, a lot of these funds were exposed once the landmines started detonating.

And now, the same funds are in a precarious position where they are 50%-80% down off their high watermark, with redemptions coming in. And so, they're in a very challenging position as they scaled up their operations to manage a fund to hundreds of millions, if not billions. And now, they're way off of their watermark, and have a big team, and they're struggling to generate alpha. I would say those are some of the issues with the long bias funds.

The market neutral funds, whether they were doing arbitrage, cash and carry trades, or DeFi yield farming, a lot of these strategies generated attractive returns in 2021 when there was a lot of retail participation and TVL, and all these DeFi protocols were excessively high.

But when inflation started to hit and interest rates started to go up liquidity dried and retail got spooked from all the acts of fraud, the opportunities for these market neutral trades diminished. Similarly, these funds are unable to generate the returns that make it worth it for LPs to take on the inherent risks of investing in a digital asset hedge fund.

People started thinking, is it worth potentially losing all your capital for a 15% net, when you could invest in other means that are far safer? I'd say those are the two categories as to how I would bucket out why 2022 was challenging for different strategies. But things are much better now, so it’s not all bad.

AYLA: Beautiful. I'm going to dive deep with a question here. What will be the impact of BTC ETF from Blackrock or Fidelity? Will this turn into someone actually taking an altcoin ETF to market? What do you think?

BEN: I think BTC is pretty clearly a commodity. I think I read somewhere that Blackrock has had all but one ETF approved. I think this will make it a natural on-ramp for institutions that are getting exposure by maybe buying MicroStrategy, or using Bitcoin futures ETFs. This is a more pure product that I think is superior to Grayscale or what's already out there, and will give comfort to larger allocators that have more rigid parameters as to how they can allocate.

This is a very positive tailwind. There's a reason the traditional finance sector has evolved to where it is. Much of it is imperfect, but there has also been a lot of regulation. People have spent decades refining the industry. And so, for the crypto world to totally rebel against existing financial infrastructure is not the correct way.

Rather, I think DeFi and traditional finance will ultimately blend and hopefully, public blockchains such as Ethereum and Bitcoin will be what will create a broad surface area for these traditional institutions to participate in more crypto-native opportunities.

KENNY: Okay, that makes a lot of sense. You touched on regulators a couple of times there, and obviously, there is no shortage of ETFs pre Blackrock that are denied or just sitting pending. Do you have a view on that? Is the regulatory environment changing? Is the SEC starting to realize that "yeah, you're probably going to lose some of these lawsuits"? What do you think is going on behind the scenes here?

BEN: I don't know how much worse it can get between what happened with the SEC and its enforcement action against Coinbase, Kraken, and Binance. The cat is out of the bag now. Everyone's aware of it, and the markets seem to have rebounded quite well. There seems to be positive sentiment around the Ripple case. It seems less likely now that ETH will be deemed as a security, although we don't have clarity on that.

We're seeing really positive bipartisan efforts by Patrick McHenry and Senator Gillibrand that are promoting this digital asset market infrastructure bill, which is providing clarity. I think the US has recognized now that these other hubs are rolling out the red carpet for innovation, and attracting a significant amount of developer talent. Funds are also setting up operations abroad.

And so, from a geopolitical perspective, being totally against this technology is a losing proposition. I think over time, we'll see some clarity. It may not be perfect from a crypto-native person's perspective, but at least we'll know the colors within which we can draw. That's the most important element for crypto developers, founders, and investors to have the confidence to continue to build and allocate in the investment class.

AYLA: Fascinating. Moving forward, I noticed that you're making a little bit of a shift to start investing in VCs or people that are investing in venture capital. Why that shift towards supporting the picks and shovels of the industry versus liquid tokens? What's your thinking around that, and why do you think that's an important place to be?

BEN: I have high conviction in both opportunities. On the liquid token side, projects that have proven product market fit are down 70% from their all time highs, and therefore represent pretty good value. So, I do think there is a significant opportunity on the liquid token side. However, venture appears to be the best method by which LPs and allocators are comfortable accessing blockchain technology.

There are a lot of companies and protocols that don't have a live liquid token due to them wanting to be patient and waiting for regulatory clarity. Too many projects issued a token just because it was an easy way to make money. Going forward, I think there are going to be less “pumpamentals” involved in token generation events. These projects are being very deliberate as to how they're planning a token launch, if there is even a need for a token at all.

With new primitives like restaking with EigenLayer consumer applications and infrastructure, or middleware like Oracle, they may not even need their own token to bootstrap their own network. The only way to really access some of these opportunities is via venture. And so, while valuations on the early stage side have not compressed as much as on the liquid side, I still think there is a tremendous amount of innovation that needs to happen in this asset class, both from an infrastructure perspective, and from an application perspective.

We created the second product to ensure that investors who may not be able to stomach the month-to-month volatility can be confident that they're still getting exposure to the innovation that's happening here.

KENNY: First off, “pumpamentals” is great. I've never actually heard that term before, so thanks for adding it to my lexicon. We have a very practical question from Roman in the audience. You mentioned some of these have found product market fit. He's looking for examples.

I would actually add on to that from a venture mindset, because I ran a VC fund in a former life. Things like discounted cash flows imply a particular valuation that might be divorced from what a crypto valuation would be. So, how do you view things like product market fit and valuations fitting together?

BEN: I think product market fit is a tricky thing to evaluate in digital assets because with all these wallets, which are not assigned one-to-one and one person could have multiple wallets, it's tough to discern how many active users there are engaging with the specific protocol for an application.

However, the fact that decentralized finance has facilitated hundreds of billions of dollars of loans and transactions without the need of any middleman or centralized party is indicative of there being a kernel of something. NFT volume and the launch of all these PFP projects, many of which will fall flat on their face, have pressed the button on the culture that I think is emblematic of something being there. And again, all this is new. It's two to three years old at this point from when I really started to catch momentum.

I don't think you can track the metrics the same way as you would a web2 startup, where you're looking at audience growth and retention and churn. But I think we're seeing actual on-chain activity. And while it's down from where it was back in 2021, we're now seeing new technology like layer twos and app chains that are improving the highways so that when there is a killer app, people will be able to operate in a way that is sustainable longer term.

I don't think you can compare it one-to-one with web2 metrics, but I think there is enough proof in the pudding to demonstrate that some products like Uniswap, Compound, Synthetics, and dYdX have captured material attention. And then, a category that I'm excited about that I think represents a really compelling future is DePIN, which you could consider as decentralized physical infrastructure networks.

I'm sure many people have heard of Helium. Helium launched a network that was user owned and operated, where anyone could run a hotspot and contribute to this broad spectrum of IoT connectivity. Now, that same model has been applied to other verticals.

A project that I personally am a big fan of is DIMO, which provides digital infrastructure for moving objects. Very similarly, this project has bootstrapped demand by creating a device that you plug into your car. You connect the DIMO app to the device, and then you provide data about your car. That includes energy consumption, movement, traffic, information, transportation information, etc. And in return, you get supplied with the DIMO token and ownership stake in the network.

On the other side, you have insurance companies, OEMs, battery providers, etc. that purchase $DIMO and stake it in order to access this global community of people who have plugged in their car and are supplying data. So, rather than being siloed by a specific car company like Honda or Tesla, you're seeing it across all these different vehicles. I think we're going to see that model applied to decentralized compute. We are going to see it with AI LLM models being trained by people, and then being compensated for their time and efforts via tokens in that network.

The projects we'll look at there include Gensyn and Render. These are emblematic of new kernels of product market fit, that are actually doing quite well in a bear market, and in the next bullish regime, could really catch fire. We've seen the proliferation of DeFi, NFTs, and stablecoins. Now, I think we're starting to see real world use cases, as people like to frame them, and I think DePIN could be an example of that, which I'm excited to monitor.

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Corporate Director, CME Group

DiffuseTap: Institutional Grade Governance

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Susan Brazer
CEO & Founder, LionShare Media

DiffuseTap: Media Metaverse 2022

Susan described 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

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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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