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Cryptocurrency Research

Martin Gaspar, Research Analyst
martin.gaspar@crosstower.com

Institutional Adoption Driving Crypto Market

Wave of Interest Fueling Higher Prices

We expect sustained institutional buying to support BTC above $50,000.

The crypto markets have kicked off 2021 at a brisk pace, with many of the leading cryptocurrencies hitting new all-time highs each week, driven by a string of positive developments in the industry. Institutional investors continue to express strong interest in Bitcoin, while public companies such as Tesla have gone as far as taking significant positions in Bitcoin. On the commercial front, Mastercard's announcement that it will integrate certain cryptocurrencies onto its payment network and BNY Mellon's decision to offer certain crypto services underscore rising investor and user demand for crypto. The macro environment is also providing a tailwind to Bitcoin as investors hunt for yield amid the shadow of potential inflation, driven by higher commodity prices and pending stimulus. These developments have helped push crypto prices higher, but the real catalyst, in our view, has been institutional buying. In this report, we break down some of the key signs of institutional activity we are following for BTC and ETH, provide an overview of institutional developments in the crypto space, and discuss what we expect for the remainder of Q1.

Highlights

- **Grayscale continues to be key driver for record BTC and ETH prices.** Grayscale purchased approximately 42,000 BTC ($1.5 billion) in January alone. February has been off to a slower start, with it purchasing around 5,000 BTC ($250 million). Demand for ETH has proven voracious, with Grayscale acquiring roughly 200,000 ETH ($373 million) in February so far.
- **Institutional demand remains robust.** Several institutional investors have demonstrated an interest in BTC and crypto in 2021, including BlackRock and Morgan Stanley. Sell-side firms, such as Deutsche Bank, have also revealed plans to offer certain crypto services, while JP Morgan has indicated it could enter the space as demand increases.
- **Corporate interest picks up.** MicroStrategy continued to purchase BTC and hosted its "Bitcoin for Corporations" event, which was well attended. Tesla purchased $1.5 billion of BTC. Mastercard said it would integrate cryptocurrencies on its network, while BNY Mellon announced plans to offer certain crypto services.
- **Whales buy the dip.** Addresses holding over 1,000 BTC (~$50 million) rose to all-time highs following dips in January, indicating large investors believe BTC remains attractive despite its volatility and relatively high prices.
- **BTC on exchanges further decline.** BTC holders continue to choose to self-custody their coins or withdraw from exchanges to custody accounts. Large exchange outflows in few transactions suggest institutions are behind these outflows.

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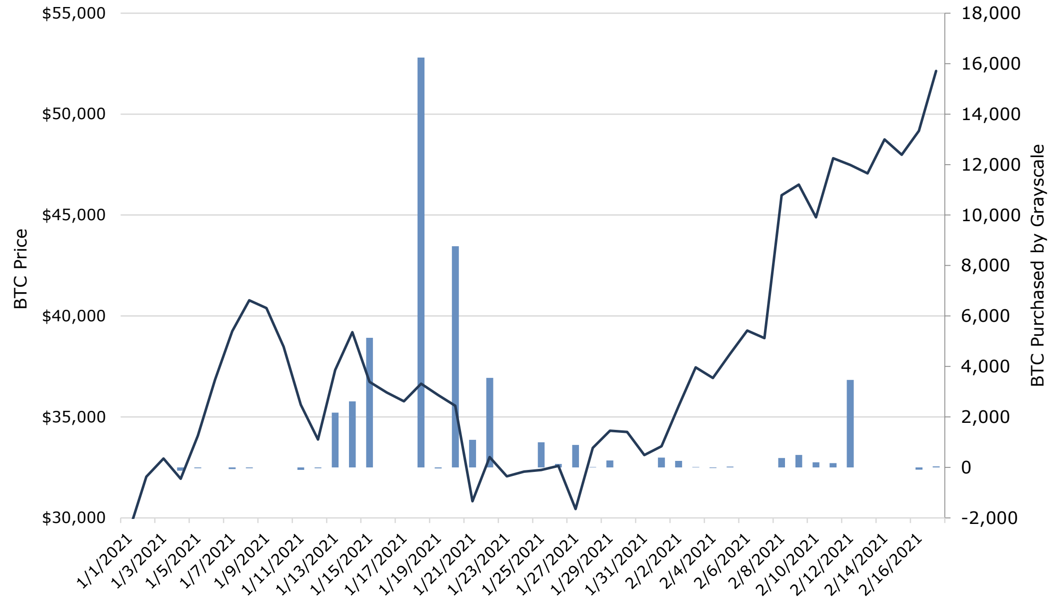
- **Stablecoins point to possible market support.** So far in 2021, stablecoins are being minted at a record pace. Just in January, USDT added nearly $5.5 billion to its market cap (+26.4% MoM). USDC added roughly $2.1 billion in the same period (+54.5% MoM). The explosion in stablecoin issuance has coincided with record amounts of stablecoins on exchanges, which many view as dry powder for dips.
- **Regulatory developments set the stage for broader institutional adoption.** The OCC provided further guidance for banks on stablecoins. It also approved the first ever bank charters for crypto companies, which were awarded to Anchorage and Protego. FinCEN extended the comment period for its proposed wallet regulations, which should allow industry participants to provide greater input for the rules. Treasury Secretary Janet Yellen also provided a written statement for her Senate testimony in January that suggests her department will take a smart, data driven approach to cryptocurrencies.
- **What is next for Bitcoin?** We anticipate institutional interest to remain elevated going into March, particularly in light of higher inflation expectations and market expectations for Democrats and the Biden administration to push through a $1.9 trillion stimulus package. Through the end of Q1, we expect more institutional investors will announce investments in Bitcoin. We also believe it is likely additional financial services companies state an intention to offer crypto services. In addition, we would not be surprised if another major public company adopts or announces it is considering Bitcoin for its balance sheet. With many investors now comping Bitcoin to gold, we believe it makes sense for Bitcoin's price to continue to march higher on the back of the attractiveness of this trade and broader institutional adoption. Furthermore, with continued buying pressure from Grayscale and approximately $1.0 billion of Bitcoin purchases in the near-term from MicroStrategy, we believe there is ample fuel to support the price of Bitcoin above $50,000.

Grayscale Purchases Help Push BTC and ETH to Record Prices

The Grayscale Bitcoin Trust (GBTC) continues to be a key driver for Bitcoin's price, as it snaps up BTC. Since Grayscale does not offer redemptions for GBTC, the BTC the trust holds is effectively off the market until redemptions are allowed, most likely after the SEC approves a Bitcoin ETF. In late December, Grayscale temporarily paused accepting investors into the trust and reopened it in mid-January. GBTC inflows from the reopening date were robust as the trust purchased large amounts of Bitcoin throughout the month, including 16,244 BTC (~$600 million) and 8,762 BTC (~$300 million) on January 18 and 20, respectively, according to data from CryptoQuant. Its inflows in January totaled approximately 42,000 BTC ($1.5 billion). In February, however, the pace of buying has dampened, with Grayscale adding only 5,000 BTC ($250 million) through February 17.

Grayscale purchased roughly $1.8 billion of BTC in 2021 to date.

Exhibit 1. BTC Price vs. BTC Purchased by Grayscale



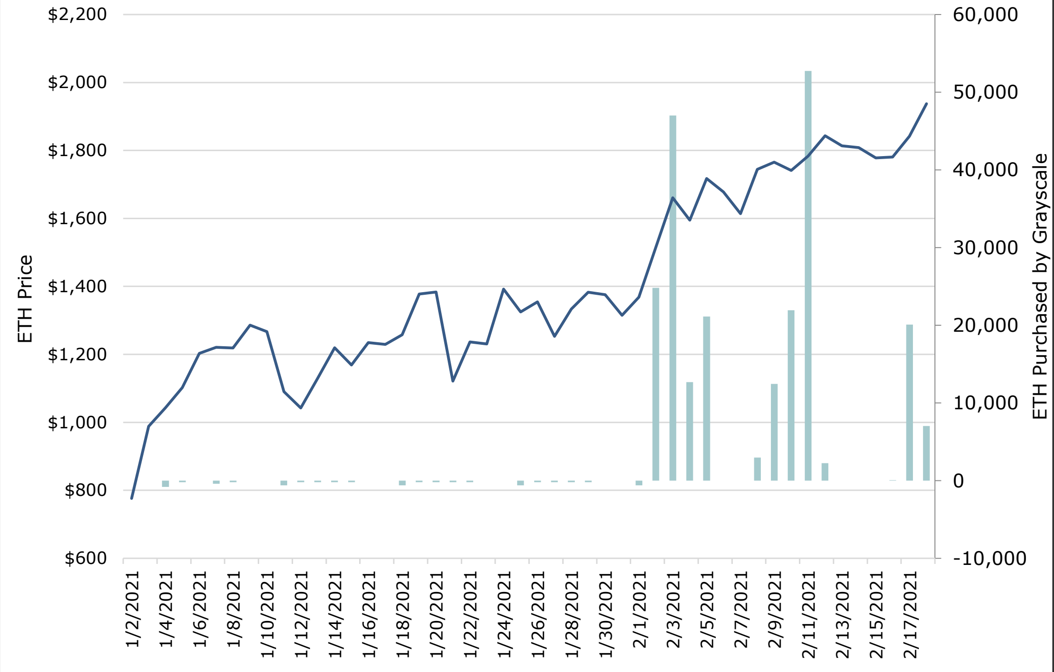
Source: CryptoQuant, Glassnode

The GBTC premium (price on OTC vs. NAV) shrank considerably in January, and even turned negative multiple times. In our view, there were two factors behind this: 1) Relatively large amounts of GBTC shares created in summer 2020 that became unrestricted, leading to elevated supply on OTC and 2) Potentially less aggressive retail buying of GBTC on OTC, given the weakness in BTC price in mid-to-late January. We believe the lower premium (single digit percentage currently) may have stifled investor appetite for GBTC in February.

Grayscale Ethereum Trust

The Grayscale Ethereum Trust (ETHE) also saw robust inflows in February after it reopened to investors. This was ahead of the launch of CME Ethereum futures on February 8 and as ETH and DeFi tokens saw significant price appreciation. For the month of February through February 17, Grayscale purchases of ETH totaled approximately $373 million, per our calculations.

Exhibit 2. ETH Price vs. ETH Purchased by Grayscale



Source: CryptoQuant, Glassnode

Institutional Interest Remains Robust

Headlines of institutional investors purchasing or examining Bitcoin were abundant since the start of 2021. A major development on this front was a CoinDesk report that several endowments of U.S. universities, including those of Harvard and Yale, had been investing in BTC. In our view, the fact that these kind of institutional investors with long time horizons are investing in BTC is a significant validation for the cryptocurrency. Other notable firms in the news that are eyeing investing or involvement with BTC include Morgan Stanley and BlackRock. Furthermore, plans by Deutsche Bank to offer crypto custody and BNY Mellon's announcement that it plans to hold, transfer, and issue bitcoin and other cryptocurrencies on behalf of its clients point to rising institutional demand for crypto.

CoinDesk reported endowments have been purchasing BTC.

Public Companies Purchase More BTC

The biggest news for Bitcoin in February is likely Tesla's announcement that it purchased approximately $1.5 billion of BTC and intends to accept it as payment. This makes it the second publicly traded company to invest over $1.0 billion in BTC. MicroStrategy also continued to purchase BTC in January and February, purchasing $10 million of BTC in each month. On February 19, MicroStrategy announced it issued $1.05 billion of convertible notes, with use of proceeds to acquire additional BTC. MicroStrategy's sustained and sizeable BTC purchases are impressive and will likely drive the price of BTC higher, in our view. Whether Tesla will make additional BTC purchases will be interesting to see.

In February, MicroStrategy issued roughly $1.0 billion of convertible notes to purchase more BTC.

MicroStrategy held its "Bitcoin for Corporations" event on February 4-5, where there were approximately 8,000 firms, with 1,400 attending the session regarding legal considerations for integrating Bitcoin into a company's corporate strategy. In our view, this attendance indicates that there is considerable corporate interest in Bitcoin. While MicroStrategy indicated the process to adopt Bitcoin as a treasury reserve asset took it about 8 months, we believe it is likely other firms are already in the process of examining if Bitcoin is right for them. We think it is possible we could see more companies announce they hold Bitcoin in the remainder of Q1, and believe it is likely more companies will adopt Bitcoin by the end of the year.

Several financial services companies have announced plans to offer crypto products in recent months.

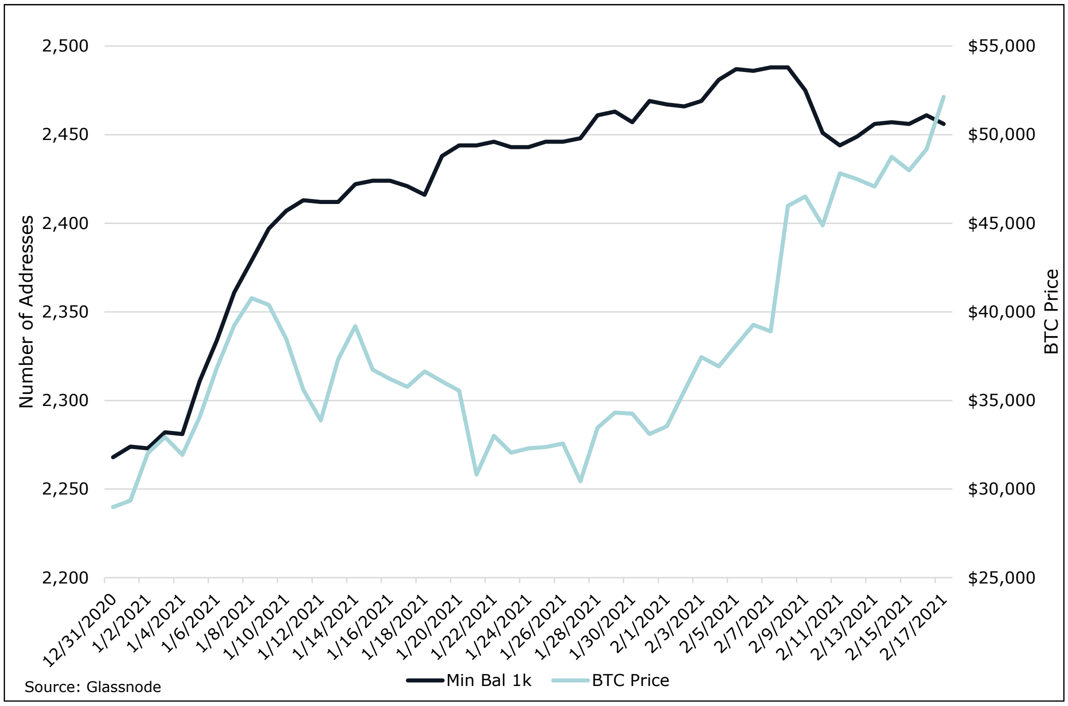
Commercial applications of Bitcoin and other cryptocurrencies are also in the spotlight. Mastercard announced in February that it intends to integrate certain cryptocurrencies on its payments network. BNY Mellon also announced plans to offer certain services for cryptocurrencies. This comes on the tails of companies including PayPal and S&P announcing plans in 2020 to offer certain crypto products and services. It seems that many traditional financial services companies are seeing opportunities with crypto and we expect more companies to detail similar plans later in 2021.

Whales Buy the Dip

Addresses with at least 1,000 BTC hit an all-time high of 2,488 on February 7.

Another sign of continued institutional demand is on-chain activity for wallets holding over 1,000 BTC (roughly $50 million as of February 17). While the number of addresses holding at least 0.01 BTC ($500) increased 2.9% from December 31, 2020 to February 17, 2021, the number of addresses holding at least 1,000 BTC surged 8.3%, which, in our view, underscores rising institutional interest in owning BTC.

Exhibit 3. Addresses Holding At Least 1,000 BTC



Source: Glassnode

Notably, addresses holding this amount soared in the days leading up to the $40,000 mark in January, where they seemed to level off during the month's first downturn and further increased following the second, more prolonged market pullback in the month. In our view, this is strong evidence that institutional investors 1) Took advantage of the pullback and 2)

Are investing into BTC with a long-term view, given that a 25% drop in price that month did not seem to cause a shakeout for these investors.

Address Activity – Overall BTC

Looking at address activity by the amount of BTC held, we notice some interesting developments. Importantly, the number of BTC addresses holding 0.01+ BTC (~$500) increased by approximately 250,000 (2.9%) over the period, rebounding from a roughly 7,000 MoM decline in December 2020. Since this measure of BTC addresses encompasses both retail and institutional-sized balances, we believe the increase points to growth in overall investor interest in BTC. Moreover, totaling approximately 8.7 million addresses, this figure is at all-time highs, further underscoring BTC interest and adoption.

Addresses holding over 0.01 BTC are at records, indicating strong investor interest.

Exhibit 4. Change in Addresses Holding Varying Amounts of BTC, Dec. 31, 2020 vs. Feb. 17, 2021

Adresses Holding BTC of At Least	% Change
0.01+	2.9%
0.1+	2.1%
1+	0.3%
10+	-2.8%
100+	-0.1%
1000+	8.3%

Source: Glassnode

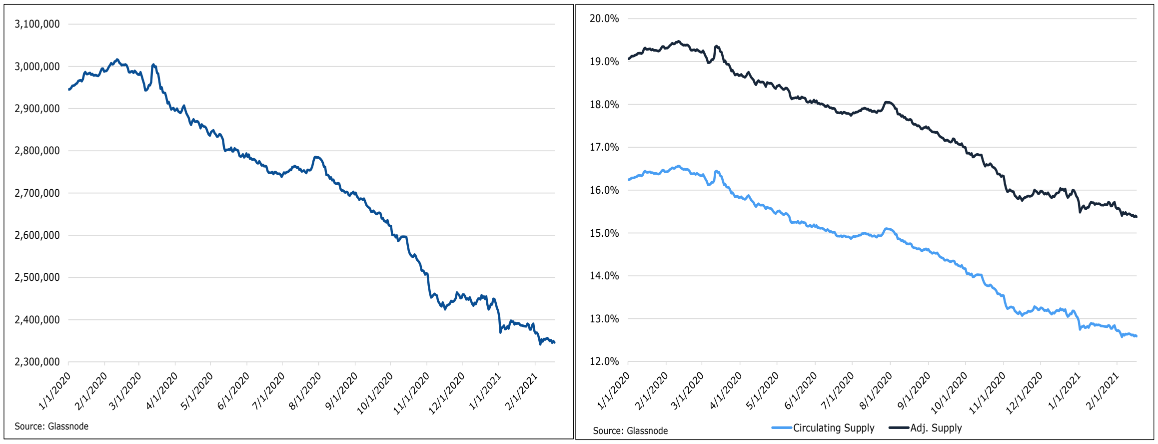
Other notable movements came in wallets holding 10+ BTC, which fell 2.8% MoM, and pressured growth in the total number of wallets with 1+ BTC (+0.3%). We believe this may have been from larger holders taking profit at record BTC prices during January and February. Notably, the data shows that nearly all of the decline in addresses with 10+ BTC was from addresses holding 10 to 100 BTC. So, what happened here? A further look at the data shows that addresses holding 10 to 100 BTC has steadily declined in recent months after hitting a local peak of approximately 139,000 addresses on November 26th, 2020, right around the time BTC was hovering or surpassed its previous all-time high of $20,000. As of February 17, the number of addresses holding 10 to 100 BTC stood at approximately 133,000, down roughly from 4.3% from November. This supports the notion that some large holders have been steadily taking profits at record BTC prices or have been splitting funds across multiple addresses.

Bitcoin on Exchanges Lowest Since Summer 2018

The number of BTC on exchanges has declined for nearly all of 2020 and shows no signs of abating in 2021. It has declined throughout January and February to date, declining by approximately 75,000 BTC to 2.36 million (-3.1%) from December 31, 2020, according to data from Glassnode. A net 48,000 BTC were withdrawn from exchanges in January, while a net of roughly 27,000 have been withdrawn from exchanges in February through the 17th, putting the month on a similar pace to January.

As of February 17, BTC on exchanges as a percentage of circulating supply totaled 12.6% and 15.4% (adjusted for lost coins), declining 40 bps from the end of 2020, respectively. In our view, these figures indicate BTC users are increasingly choosing to self-custody or are purchasing coins in OTC deals. The outflows also suggest that BTC users are taking a bullish view on the asset, considering that BTC is typically sent to or kept on exchanges for the ability to sell it. Both trends suggest less selling pressure and a shift to long-term holding.

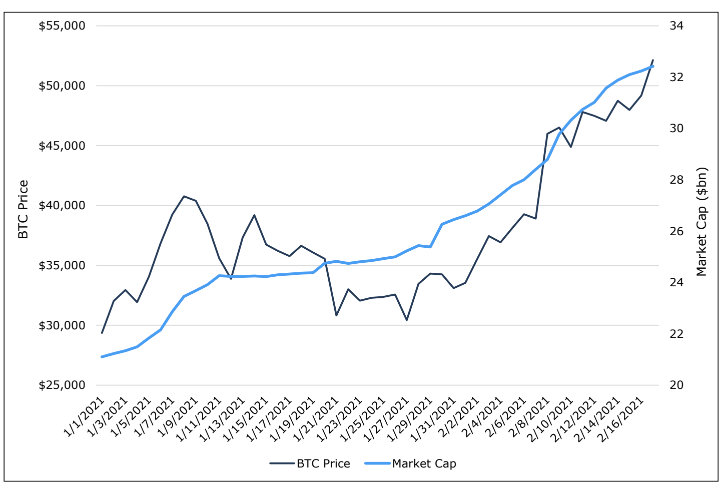
Exhibit 5. BTC on Exchanges (L) and as % of Circulating Supply (R)



Record Stablecoins on Exchanges Could Be Dry Powder

The number of stablecoins on exchanges have risen to all-time highs in January and February, according to data from CryptoQuant, totaling roughly $7.4 billion as of February 17, up 158.9% from December. This comes on the heels of record stablecoin issuance. Just in January, USDT added nearly $5.5 billion to its market cap (+26.4% MoM). USDC added roughly $2.1 billion in the same period (+54.5% MoM). In February, through the 17th, USDT added another $6.0 billion, while USDC minted $1.5 billion. It is not immediately clear what is driving the explosive growth in stablecoins in recent months. Many in the crypto space view stablecoins sitting on exchanges as dry powder, ready to be deployed into crypto, which we note could merely be conjecture at best. We hope to explore the drivers of stablecoin issuance, why so many are on exchanges, and whether stablecoins on exchanges have an outsized role in stabilizing prices during dips or sit idle.

Exhibit 6. USDT (ERC-20) Market Cap vs. BTC Price



Regulatory News

Developments on the regulatory front were largely positive in 2021 thus far. The Office of the Comptroller of the Currency (OCC) approved the first ever banking charters for crypto companies, including Anchorage and Protego. The OCC also said national banks can participate in independent node verification networks and use stablecoins to conduct payment activities and other bank-permissible functions. In our view, these actions set the stage for banks to begin to integrate cryptocurrencies.

One notable departure from the OCC was crypto advocate Brian Brooks, who stepped down as Acting Comptroller of the Currency in January. In a webinar prior to his departure, he mentioned that much of the groundwork of the OCC's actions regarding the crypto space had been in the works before he joined the OCC. This leaves us optimistic that the OCC will continue to push productive guidance for banks on cryptocurrencies.

FinCEN's proposed wallet rules had their comment period extended 60 days in January. The originally proposed rules were hotly contested in the crypto industry, so we are hopeful the extended comment period will allow industry participants to better shape the final rules.

Another regulatory figure that could shape crypto in 2021 is Gary Gensler, Biden's nominee for SEC chairman. His background involves teaching courses on blockchain and cryptocurrencies at MIT. We believe his understanding of the space could result in constructive regulations and could even lead to SEC approval of a Bitcoin ETF.

Janet Yellen, now Treasury Secretary, said in her written testimony to the Senate in January that "it [is] important we consider the benefits of cryptocurrencies and other digital assets, and the potential they have to improve the efficiency of the financial system." She also noted the need to encourage legitimate use of crypto, while curtailing illegal use. In our view, these comments indicate that the Treasury will approach crypto in a thoughtful manner.

Outlook

We believe Bitcoin has several strong tailwinds and believe the price of Bitcoin is likely to run considerably higher over the next couple months. The biggest drivers, in our view, are the almost guaranteed BTC purchases from Grayscale (as long as the GBTC premium remains attractive) as well as the $1.0 billion of BTC purchases we expect from MicroStrategy in the near-term, following its debt financing. Moreover, we anticipate further interest from institutional investors as more begin to understand Bitcoin and its unique properties in the current macro environment. Through the end of Q1, we anticipate more institutional investors to announce positions in BTC or note that they are examining the asset. We also expect additional public companies to consider holding BTC on their balance sheet now that Tesla has broken the ice. We note that with financial institutions and payments firms like Mastercard intending to offer crypto services, many companies may realize it is beneficial for them to also become involved to meet or get ahead of demand for crypto as payments for products. Finally, we point out that a growing number of investors are comping Bitcoin to gold, citing its properties as digital gold. Such a comparison suggests Bitcoin could hit a market cap in the trillions, which means it is currently undervalued. If many investors adopt this method of valuing Bitcoin, we anticipate the price to trend higher to match these expectations.

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