Navigating the volatility of blockchain equity ETPs

Published 6 August 2024

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Key Takeaways

- There are a multitude of portfolio construction methods for blockchain equity portfolios
- To address liquidity and concentration, funds are subject to tradeoffs
- WisdomTree's balanced approach limits allocation to highly volatile digital asset miners to improve the risk-return profile and maintain purity to the blockchain theme

The digital asset ecosystem has experienced significant price performance and volatility in the first half of 2024, driven by notable developments in the institutionalisation of the crypto asset class. Regulated digital asset products are becoming more widely available on exchanges, benefiting firms directly engaged in the blockchain ecosystem. Consequently, we've observed strong performance within the blockchain ETP landscape. However, not all blockchain equity ETPs are created equal; different portfolio construction approaches have resulted in divergent performance and volatility profiles.

Figure 1: Performance and volatility in blockchain equity ETPs

Source: Bloomberg 23 July 2024. WBLK represents WisdomTree Blockchain UCITS ETF. BCHN represents Invesco CoinShares Global Blockchain UCITS ETF. BKCH represents Global X Blockchain UCITS ETF. DAGB represents VanEck Crypto and Blockchain Innovators UCITS ETF. Historical performance is not an indication of future performance and any investment may go down in value.

The approaches to blockchain equity portfolio construction

In emerging technology themes, many pure-play firms are small cap with lower liquidity and higher volatility. This is especially true in the blockchain ecosystem and poses trade-offs for creating an equity fund within the narrow space of publicly listed blockchain companies.

The broad and diversified approach

BCHN, the most established fund, adopts a broad and diversified strategy. By including exposures to mega cap tech companies and auxiliary sectors like semiconductors, BCHN aims to mitigate volatility and liquidity risks. As shown in Figure 1, the approach results in lower volatility but has led to lower performance at the start of the year.

Concentrated pure-play exposures

In contrast, BKCH and DAGB focus exclusively on firms directly operating within the blockchain ecosystem – more 'pure play' than the diversified approach. While these strategies offer more direct exposure to the blockchain theme, they also come with the challenge of managing liquidity and volatility. When the ecosystem performs well, these funds most effectively capture the performance of the blockchain theme but are also subject to higher volatility and potentially more liquidity concerns, given investment concentrations in small firms.

WisdomTree: Striking a balance

WisdomTree seeks to balance these factors, providing pure-play exposure that optimises volatility, liquidity and purity of exposure. Our strategy ensures sufficient liquidity and reduced volatility without overlapping other equity exposures in your portfolio (e.g., Nasdaq). Year-to-date, WisdomTree has successfully captured most of the positive returns of the purest baskets with lower volatility.

Mining exposure matters: The role of digital asset miners

One of the critical components in these funds is the allocation to digital asset miners, which are notoriously volatile and highly correlated with the price of bitcoin. The bitcoin halving event in April of this year has exacerbated this volatility and led to a significant dispersion in performance amongst the mining firms, resulting in some price discrepancies across funds. If we look at the allocations to miners, we find very different approaches to capital allocation, with most of the portfolio risk (i.e. volatility) being contributed by the miners.

Figure 2: Capital allocation (outer) and risk allocation (inner) to digital asset miners



Capping allocation to miners to manage risk

For all the funds shown, at least two-thirds of each fund's overall volatility is sourced from these mining exposures. To manage this volatility, WisdomTree caps the allocation to digital asset miners. However,

since our last rebalance in May, this weight has surged to 55% due to the strong performance of specific holdings. We anticipate reducing this exposure to align with target limits in our August rebalance.

Conclusion

The blockchain equity ETP landscape is complex and varied, with different approaches leading to varying performance and volatility profiles. At WisdomTree, we strive to provide a balanced approach that offers direct exposure to the digital asset ecosystem while managing risks through strategic allocation and diversification. We aim to ensure that our investors benefit from the growth and innovation within the blockchain space while maintaining sufficient liquidity and diversification to optimize portfolio risk and returns.

Important Risks Related to this Article

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