A possible Bitcoin spot ETF in the US?

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WisdomTree
Contributor

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A number of eyes are currently fixed on whether the US Securities and Exchange Commission (SEC) will approve spot Bitcoin exchange-traded funds (ETFs). It is not known precisely if and when such an approval could arrive. However, such a decision would be an important milestone for the asset, and digital assets as an asset class more broadly, as its broader adoption continues.

It has been a long time coming

The first application for a spot Bitcoin ETF in the US came in 20131. No approval has yet occurred. Nonetheless, since then numerous other means to gain exposure to the asset have emerged.

Futures-based products have been approved for many years. Incidentally, this became the subject of a lawsuit that the SEC lost against Greyscale (of Greyscale Bitcoin Trust renown) in August 20232. Some companies have placed sizable amounts of Bitcoin on their balance sheets, such as MicroStrategy, which currently holds approximately US$5.9 billion of the digital asset3. This made MicroStrategy stock a proxy for the Bitcoin price. It has been possible to invest in various Bitcoin mining companies for many years, such as Riot Blockchain or Marathon Digital Holdings, which is similar to the way gold investors gain exposure to the asset via gold miners4. Numerous exchanges have existed in various incarnations over the years, many ‘offshore’, where one has been able to acquire Bitcoin.

Each of these options has its downsides as compared to holding Bitcoin directly. Futures-based products are subject to rolling costs and can, periodically, be subject to contango. The performance of companies with Bitcoin on their balance sheet is influenced by the performance of the management team and other risks that any company can be subject to. Bitcoin miners have seen vastly differing performance over the years as they contend with a ruthlessly competitive landscape, combined with the need to manage their operating expenses during downturns in the digital asset ecosystem. Crypto exchanges also have had a nasty habit of blowing up, as the FTX saga that dominated headlines last year reminded us, and have historically fallen prey to cybersecurity failures (though this has gotten much rarer as the industry has consolidated and professionalised).

Why exposure to Bitcoin?

A spot Bitcoin ETF would provide a new vehicle for investors to gain exposure to the asset in the US. Exposure has been historically desirable, as Mirva Anttila, WisdomTree’s Director of Digital Asset Research, has pointed out, “since December 2019 Bitcoin has produced a 54% compound annual growth rate and risen from $7,710 to $43,9155.” A relatively new asset class, digital assets have demonstrated

historical, asymmetric upside akin to early-stage technology stocks, which is difficult to capture outside of early-stage technology investment. Moreover, historically Bitcoin, and digital assets more generally, have demonstrated relatively low correlation with other major asset classes. This makes them unique. It means that even a small allocation within a multi-asset investment portfolio could have diversification benefits. WisdomTree published a White Paper on these topics in June 20226.

The iTunes of Bitcoin

A spot Bitcoin ETF would provide the security, reliability and familiarity of an ETF structure to this asset in the US, which could make it easier for more institutional investors to gain exposure to the asset. This makes it akin to the 'iTunes of Bitcoin'. Those who remember the malware-ridden and complex process of downloading music on Napster, compared to the safety and simplicity of iTunes, will know what I mean.

Implications: short and long-term

Opening up to a new set of institutional investors creates the potential for greater demand for Bitcoin. Futures-based products in the US, which have over US$1.5bn in assets under management7, do not have to be backed by Bitcoin themselves. Spot or 'physically backed' products require the Bitcoin themselves similar to the way a gold exchange traded commodity (ETC) works. Remember that there is a fixed number of Bitcoin that can ever be produced (i.e. 21 million). In April/May 2024 the number of new Bitcoin created every 10 minutes (on average) will be cut in half again as the code-enforced process that occurs every four years, colloquially known as 'the halvening', happens once again.

Stepping back, one should not use a day one approval (or, for that matter, rejection) as a yardstick to assess long-term prospects. There are two pieces to consider. First, for newcomers to the space, becoming comfortable with the asset and the structure of a spot ETF could take time. This is a relatively unfamiliar space for many institutional investors owing, in particular, to its technical complexities. Trustworthy and experienced parties need to provide reliable information and education to these parties in order for them to provide the best investment options to their clients. Second, migration from other investment options could take time. We have seen this trend in Europe over recent years as institutional investors have gradually migrated from futures products to spot (or 'physically backed') products. For instance, during 2023, futures products saw outflows of -US$125m while physically backed products saw inflows of US$1,062b8. This did not happen overnight.

Regardless of the immediate outcome, approval or rejection, it is worth acknowledging where the digital asset industry has come from and where it stands now. Bitcoin was a hobbyist interest in its initial years of existence, which is now 15 years ago. Bitcoin's market capitalisation is currently over US$800 billion9. Some of the world's largest asset managers are now standing in line, at least 12 of them, awaiting a decision on whether the asset will make its next step10. This process is one that new technologies take as they go from niche interests through to mass adoption (radio, television, rocketry, video games and the internet – all started out as hobbyist interests).

One more step – in what is still a long path forward – for the digital asset ecosystem.

1 https://blockworks.co/news/spot-bitcoin-etf-timeline

2 https://www.coindesk.com/policy/2023/10/13/sec-reportedly-decides-not-to-appeal-its-bit-coin-etf-court-loss-against-grayscale/

3 https://x.com/saylor/status/1739995636953485547?s=20

4 https://finance.yahoo.com/news/top-15-bitcoin-mining-companies-135559095.html

5 https://www.wisdomtree.eu/en-gb/blog/2023-12-13/what-has-driven-bit-coin-growth-since-2019-and-will-it-become-more-mainstream

6 https://www.wisdomtree.eu/-/media/eu-media-files/other-documents/investment-case/private/digital-assets-whitepaper.pdf

7 https://www.coindesk.com/markets/2023/11/30/worlds-largest-bitcoin-futures-etf-breaks-2021-record-highs-for-assets-under-management/#:~:text=10%20Years%20of%20Decentralizing%20the%20Future&text=ProShares'%20Bitcoin%20Strategy%20ETF%20(BITO,record%20set%20in%20December%202021.

8 Bloomberg, 31 December 2023

9 https://www.coingecko.com/

10 https://decrypt.co/62912/high-profile-bitcoin-etf-applications

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