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# WISDOMTREE CRYPTO OUTLOOK – A KEY YEAR FOR THE CRYPTO ECOSYSTEM?

Wisdomtree EU  
30 Sep 2021

## Retrospective

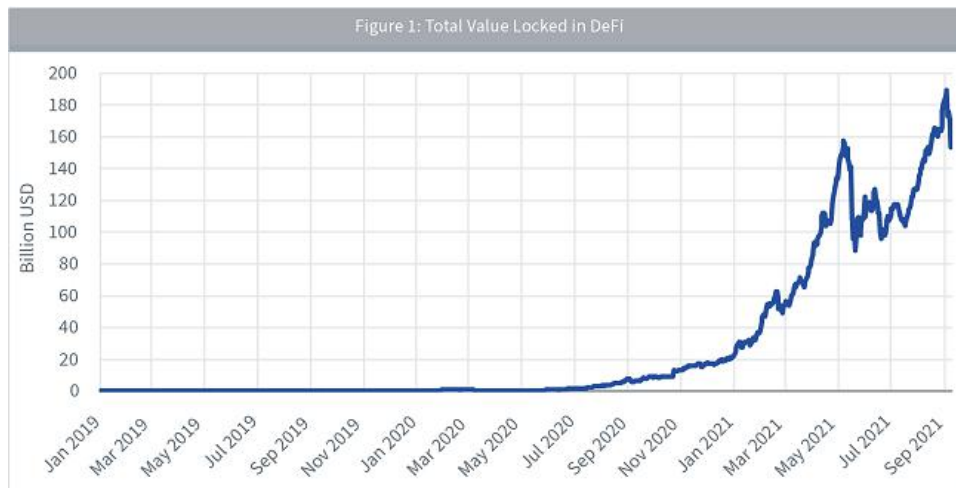
The past year has been particularly eventful in the crypto market, even by crypto standards. Price action has been spectacular in the aftermath of the Covid-19 crash. Bitcoin recovered quickly and then took flight in Q4 2020 and Q1 2021.

Long-awaited institutional adoption became more tangible. The "balance sheet trade" became a new and unexpected theme. Finally, Coinbase's resounding listing back in April 2021 was widely regarded as a deciding event in establishing the legitimacy of the space.

However, the rally marked a pause from May 2021, as Elon Musk reversed his decision to allow customers to pay for Tesla's cars in bitcoin on the back of environmental concerns. This gave rise to an intense debate on Bitcoin's energy consumption. Furthermore, China cracked down on the mining industry, prompting the "Great Mining Migration". After a pause of nearly three months, bitcoin has resumed its upside trend ahead of the [adoption of the crypto asset as legal tender by El Salvador](#).

But bitcoin wasn't the only part of the space to show important developments over the past year. Ethereum and its ecosystem have also significantly evolved. Decentralised Finance (DeFi) has gained in popularity, opening a whole new universe of opportunities for traders. As the growth of this ecosystem unveiled some of blockchains' potential, it also shed some light on the limitations and scaling issues of Ethereum, on which the vast majority of DeFi applications are built, and prompted the Ethereum community to implement EIP 1559 in early August 2021.

As the growth of DeFi started to slow down, it was promptly followed by another new high growth phenomenon: Non-Fungible Tokens. Digital artwork and collectables are being exchanged in increasing volumes, sometimes for extravagant sums of money. Ethereum has also become the place of choice for the development of this ecosystem.



Source: Glassnode. As of September 12th 2021.

**Historical performance is not an indication of future performance and any investments may go down in value.**

Quite a year! However, we believe the year ahead will also bring many exciting new developments around ecosystem development, industry and investors adoption, and regulation.

## Outlook

**Evolve or die: How crypto assets can overcome their limitations?**

**Bitcoin and the environment**

The environmental impact of Bitcoin has been on everyone's lips in 2021. If Elon Musk's about-turn on Bitcoin has had at least one positive consequence, it is the creation of the Bitcoin Mining Council (BMC). It is bringing North America's miners together to discuss the sustainability and energy mix of the mining industry, as well as "promote transparency, share best practices, and educate the public on the benefits of Bitcoin and Bitcoin mining"<sup>1</sup>. Although the BMC does not aim to impose practices on its members, it is a step in the right direction.

We expect the mining industry in North America and Europe to further progress towards a more renewable energy mix. This will take time and effort, but it seems that the industry realises it is in its best interest to go in a more sustainable direction. Furthermore, the mining industry is the part of the cryptosphere that hosts the most listed companies. We would expect shareholders to push for the integration of sustainability considerations into business decisions.

**Ethereum 2.0: A long-awaited update**

The Ethereum community has been working on the future version of the protocol, dubbed Ethereum 2.0, for a few years now to improve the network and make it more scalable, more sustainable, and more secure. The update mostly relies on two major changes: the migration to a Proof-of-Stake consensus mechanism and the implementation of shard chains. These should be implemented in 2022 if everything goes according to schedule.

Ethereum currently relies on a Proof-of-work (PoW) mechanism for its consensus protocol and faces similar concerns as bitcoin with its energy consumption. But 2022 should see a

significant change in the Ethereum protocol with the transition from PoW to a Proof-of-Stake (PoS) mechanism. Instead of requiring miners to commit computing power to the network to secure it, PoS requires nodes willing to participate in the validation process to put value at stake in the form of ethers. Should the validators act maliciously, ethers will be taken from them, and thus they lose value. As they do not need to mine anymore, they consume much less energy, and therefore PoS is considered more sustainable. Furthermore, it means that the cost for validators is greatly diminished, and they thus need fewer ethers to be incentivised to participate. PoS is expected to reduce fees and be accompanied by a modification of the issuance mechanism, including a reduction in the issuance of new ethers.

The transition to PoS should allow for sharding, the second major implementation. Shard chains are side-chains dedicated to a particular type of application. They can process and record transactions in parallel and thus greatly scale up the capacity of the network. This could potentially allow Ethereum to scale up to 100,000 transactions per second from 30 today.

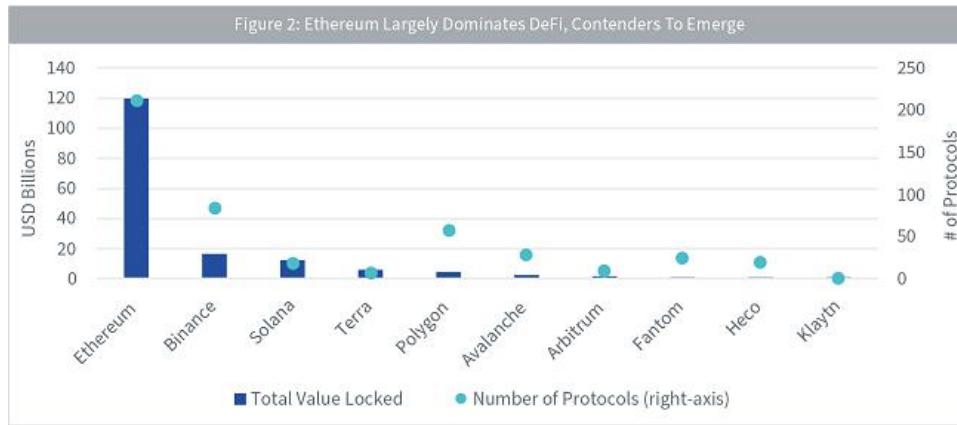
Those are exciting changes that promise a bright future for Ethereum. But such changes can also have unexpected consequences and come with some risks. It will be important for investors to monitor this closely.

#### **Alternative layer-1 solutions: A promising future**

Ethereum is willing to implement important changes, and rightly so. Younger layer-1 alternatives exist, with specific features and improvements on older protocols, aiming for their share of the pie. Those include Cardano, Binance Smart Chain, Polkadot or Solana, among others. Cardano, for example, is already using PoS, while Solana can accommodate over 50,000 transactions per second (vs around 30 for Ethereum).

We do not see these replacing Ethereum in the foreseeable future, though, since the Ethereum ecosystem is strong, diverse, and expanding. The platform benefits from the associated network effects and the space's largest developing community, making it difficult to be displaced. However, we would expect other blockchains to grow and see their ecosystem develop.

Some very promising projects are being built on top of alternative blockchains, and we will closely monitor how they unfold. One example of such a high-profile project is the Pyth Network, which aims to deliver real-time on-chain market data. The project is based on Solana and backed by some of the largest players in the systematic trading space, including Jane Street, Jump Trading, Virtu and DRW. The potential of such a project is far-reaching, as it would bring "real-world" financial data on blockchain, available for use in DeFi, opening the path to a whole new universe of trading and investment services.



Source: DeFi Lama. As of September 23rd 2021.

**Adoption: what to expect for the coming year?**  
**Industry integration**

Companies such as PayPal, Twitter, Robinhood, Maersk and many others in many industries have started testing use cases for blockchain technology and crypto-assets. For example, in April 2021, PayPal began to allow US users to spend cryptocurrencies at millions of online merchants. It has since gradually announced additional support for crypto, including the possibility to convert cash back from Venmo credit cards into crypto automatically. More recently, in August, PayPal announced it will expand the crypto trading function to the UK market.

Through such examples of these real-life applications, one can start testing the potential for the mainstream adoption of bitcoin and crypto technology. It helps push the industry forward and test crypto's potential in the real economy. Looking ahead, this trend will likely stay as more companies explore the use cases, and regardless of the outcome, this trend will work as a catalyst in the short term to drive the interest in crypto as an asset class.

**The balance sheet trade: more to come?**

One of the interesting themes of the past year was the "balance sheet trade". Several listed companies, including MicroStrategy, Tesla, Square or PayPal, announced they bought bitcoin onto their balance sheet. This came as a surprise to many and largely fuelled optimism in the cryptosphere.

There are several good reasons for companies to do so, which makes us believe we will see more of this over the coming year. First, this may help companies develop internal expertise and processes around crypto. For others like MicroStrategy's Michael Saylor, bitcoin is an investment and a bet on the future growth of the crypto ecosystem. It also helps with PR, each of MicroStrategy addition onto its now \$5bln+ bitcoin pile systematically makes it into the news.

Coinbase already announced in August that it would invest north of \$500mln into crypto and will continue to invest 10% of its profits. Although we do not expect this to become a widespread trend that would have a game-changing effect on demand for crypto in the short run, such news and announcement are beneficial in that they help positive sentiment and bring legitimacy to the asset class.

## Investor adoption: hurdles remains, but are falling

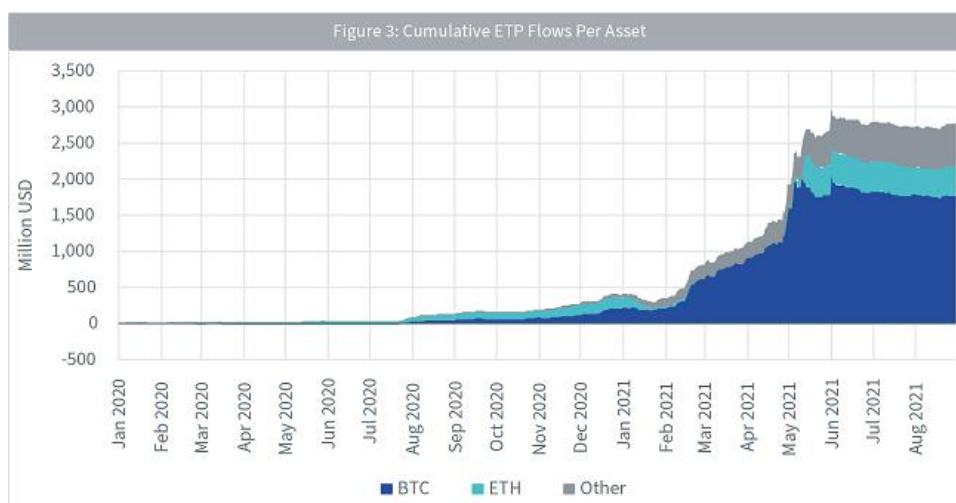
We believe that in the past institutional adoptions has been hindered by several factors, including the lack of market infrastructure and regulation, market volatility, and the need for investor education to help gain a deeper understanding of the space. We have seen many developments in those areas over the past few years and expect a continuation and acceleration of this trend.

Market infrastructure has greatly improved with the development of institutional-grade trading and custody services. In turn, this has enabled the creation of many new access vehicles, such as regulated futures or exchange-traded products (ETPs), making it easier for investors to get crypto exposure than direct holdings. All heads are now turned to the US to see when the US Securities and Exchange Commission (SEC) will allow bitcoin exposure in an exchange-traded fund (ETF).

The general level of education in the space is also improving, as most firms now have at least some form of crypto working group. We have witnessed this trend across all institution types, including multi-asset managers, investment banks and pension funds.

Regulation probably remains the main hurdle, as many actors indicate they need more clarity from regulators. In Europe, this can be particularly challenging, as countries can take different stances on crypto, and their regulators tend to focus on different sub-areas of the crypto space, be it custody and trading or retail protection and product. Multinational investors have to navigate this fragmented landscape, which can be very challenging.

Bringing the crypto space under the regulatory umbrella seems to become a major priority. Most countries in Europe and North American do not call for an outright ban on crypto-assets and related services. But building a framework around such a young and innovative asset class is a process that takes time and needs to be done right.



Source: WisdomTree, Bloomberg. As of September 12th 2021.

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**The El Salvador experiment: will bitcoin be a successful legal tender?**

On September 7th 2021, El Salvador became the first country to adopt bitcoin as legal tender for daily transactions alongside the US dollar. The initial roll-out of the wallet experienced some technical issues on the day. The move also sparked concerns amongst investors as this could bring volatility to the country's reserves, while its liabilities are mostly denominated in dollars.

This event marks the first significant bitcoin adoption by a country. Should this develop in the right direction, it could set the example for other countries to "bitcoinise" part of their economy. This remains a very long shot, and the coming year might be key for the potential long-term adoption of non-CBDC<sup>2</sup> crypto assets.

## Conclusion

The crypto ecosystem is fast-paced, and we expect it to continue moving fast next year. We believe regulatory developments will be key to lifting the remaining hurdles barring institutional investors from entering the space. It will also help the ecosystem better manage its product offering. The transition to Ethereum 2.0 will be on everyone's radar and will be transformative for the platform. Finally, we believe important growth areas such as NFTs and DeFi will continue to thrive and could potentially reshuffle part of the ecosystem as several promising software platforms compete for a share.

This blog was drafted in collaboration with Alice Liu.

## Sources

<sup>1</sup> [bitcoinminingcouncil.com](https://bitcoinminingcouncil.com)

<sup>2</sup> Central Bank Digital Currency

## Related Blogs

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