Cryptocurrencies

# Banks and fund managers come back for another bite at bitcoin

Strong performance by specialist crypto funds has whetted traders' appetites

**Eva Szalay** and **Laurence Fletcher** in London FEBRUARY 3 2020

Financial markets are cosying up once more to crypto.

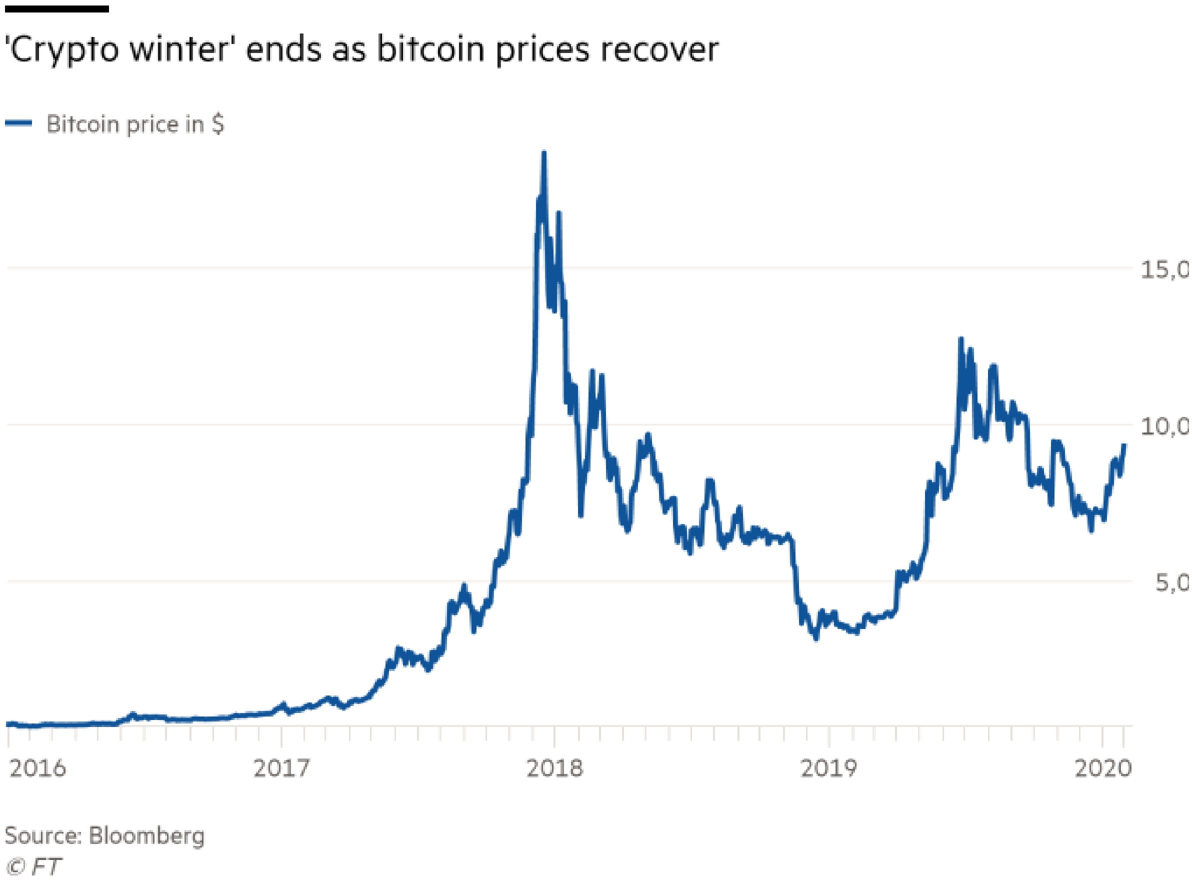
Institutions such as banks and asset managers have long had a vexed relationship with cryptocurrencies, put off by reputational risks, lack of regulation and volatile returns. But a spell of better performance is drawing them deeper in.

Dedicated cryptocurrency funds returned more than 16 per cent in 2019, according to a survey from Eurekahedge. In contrast, traditional hedge fund strategies yielded 10.4 per cent, according to HFR.

"Bitcoin has a higher return on a one, three and 10-year basis than any other asset class," said Steve Kurz, head of asset management at Galaxy Digital, a specialist cryptocurrency firm founded by billionaire investor Mike Novogratz, once of Goldman Sachs and Fortress. "When the returns are so high, investors will have to pile in."

But Wall Street has been hurt before. As the first rush in to cryptocurrencies pushed bitcoin to above $20,000 in 2017, banks launched projects to explore applications for blockchain, the underlying technology. Many of these projects stalled during the crypto crash the following year.

Some big banks kept tabs on the area; JPMorgan, for example, has launched a digital coin ("JPM Coin") that it aims to offer for payments between its customers. But so far, none has set up a dedicated desk to trade cryptocurrencies on behalf of clients.




As prices move higher once more — bitcoin was up 31 per cent in January — interest is picking up again. Deutsche Bank published a report last month saying cryptocurrencies have "numerous advantages compared to traditional assets, which could lead more and more people to use [them]".

The German bank went even further, saying that plans by Chinese policymakers to launch a digital currency could "erode the dollar's primacy in the global financial market".

For specialised traders, crypto has been a rich hunting ground. In early 2018, one employee at a large electronic trading firm said his company made as much as $8m a day from hunting for price discrepancies in a market where individual retail investors were betting against the most sophisticated electronic trading firms on hundreds of unregulated exchanges. Crypto trading has been electronic from the outset, making it a natural fit for computer-driven firms that make profits from buying and selling at speed.

Chicago-based DRW, for example, established a dedicated crypto arm called Cumberland; Mr Novogratz set up Galaxy Digital; while proprietary trading powerhouses such as Jane Street, Susquehanna, Flow Traders and Jump all piled in.

In response, CME Group launched the first regulated futures on a bitcoin index in December 2017, making it possible to make bets on falls in the currency for the first time. Until that point, family offices and private individuals who were holding bitcoin were lending these assets out to hedge funds to make short bets and charging handsomely for the privilege, according to Jan Strømme, chief executive of Alphaplate, a specialist crypto trading company.

But as these large trading firms expanded in crypto, trading patterns shifted too. Instead of profiting from pricing inefficiencies, big firms now look to supply prices to exchanges where most retail clients trade, and make money from the spread between bids and offers. On top of that, these co-called liquidity providers negotiate deals for large amounts of bitcoin privately among themselves, in the over-the-counter market.

"There is a lot of fuss around bitcoin but at the end of the day it's just another asset to trade," said Max Boonen, who left his job as a fixed-income trader at Goldman in 2015 to start a crypto trading company called B2C2. He compares digital assets to exchange traded funds, saying "they will quickly become part of the investment landscape".

Costs for processes such as custody have come down, as have trading spreads, although they are still high compared with traditional markets. Bitcoin has become similar to mainstream investments like equities and bonds, said Mr Boonen, though he added that some institutions are put off by a lack of tools for mitigating counterparty credit risk, such as having trades settled by a clearing house.

Chris Zuehlke, Cumberland's global head, said it was "only a matter of time before traditional banks get involved, perhaps as brokers between customers and liquidity providers like us".

Most market participants accept that the near-3,000 per cent average returns for crypto hedge funds in 2017 are unlikely to be repeated. But opportunities remain, say investors. Hedge fund Tyr Capital made double-digit gains last year, helped by trades such as betting the price of cryptocurrencies and their futures would converge. "As time goes by and more people like us get involved, these things start to disappear," said Edouard Hindi, partner at Mayfair-based Tyr.

"But there's a good three to five years of very, very profitable trading."