

# Hedge Fund ALERT

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## Crypto-Hungry Funds Flock to Grayscale

Hedge funds have accounted for most of the capital committed to **Grayscale Investments'** digital currency trusts this year, underscoring fund managers' appetites for exposure to cryptocurrencies without direct ownership.

The burdens of ownership — a paucity of required custody services and intensive security precautions to reduce the risk of theft — are the primary factors keeping hedge funds and other institutions from holding digital currencies.

The hedge funds don't want to miss out on another rise in cryptocurrency values. That's why they have plowed money into Grayscale's investment trusts, even as the value of digital assets plunged some 60% in the first half. According to a report Grayscale released in July, the \$1.8 billion New York firm raised almost \$250 million in the first half of this year — its best six-month fund-raising stretch — even while its top-performing product suffered a loss of almost 50%.

This year's fresh capital came mostly from two dozen hedge funds, most of whom manage from \$1 billion to \$10 billion of assets, according to Grayscale managing director **Michael Sonnenshein**, who heads day-to-day operations. The buyers include global-macro investors, technology-focused funds and value-investment vehicles that see this year's drop in cryptocurrency prices as a buying opportunity.

Sonnenshein said some have specific interests, such as those that want to trade out of gold for crypto, while others are concerned that blockchain technologies will devalue industries to which they are exposed. Some of the funds aim to eventually place up to 5% of their holdings in digital assets, Sonnenshein said, and some are investing on a monthly schedule.

Grayscale's success is just the latest example of hedge fund



managers chomping at the bit to gain exposure to digital assets, even while service providers struggle to meet with demand. Last

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week, for instance, **Business Insider** reported that a prime brokerage unit recently launched by crypto-asset exchange **Coinbase** has added a \$20 billion hedge fund manager as a client. And the Coinbase brokerage is looking to add more large fund managers to its client roster.

Grayscale was started in 2013 by venture capitalist **Barry Silbert**. The investment firm is part of Silbert's **Digital Currency Group**, a holding company that is seemingly ubiquitous in the fast-growing blockchain-technology sector.

In May, Grayscale hired **Rayhaneh "Ray" Sharif-Askary** to run sales efforts. She's a former director at **UBS**, where she handled sales of leveraged-finance products. And in April the firm hired **Samantha McDonald**, the former chief financial officer of **SPDR Gold** exchange-traded fund as head of finance, legal and accounting issues.

Grayscale's eight vehicles are set up as passively invested trusts. It sells interests in the trusts via continuous private offerings to accredited investors. The trusts charge management fees of 2-3% of assets and, under private placement rules, buyers must hold onto their shares for at least a year before they can sell them.

Grayscale's aim is to make all of the funds available for public over-the-counter trading. So far, two have been in existence long enough to be eligible for that status: the Bitcoin Investment Trust with assets of \$1.1 billion as of June 30, and the \$63 million Ethereum Classic Investment Trust.

They are the only publicly traded cryptocurrency products in the U.S. and, as a nod to the inefficiencies of the digital market, both trade at substantial premiums to their underlying assets.

The bitcoin vehicle, which became public in 2015, was valued at a 38% premium over its holdings on July 30, while the ethereum classic vehicle, which went public in May, was valued at a 103% premium. The other six funds, which launched during the five months ended March 1, are scheduled to become

publicly traded later this and next year.

"There's clearly a lot more demand than shares that are available," Sonnenshein said.

While Grayscale's assets are well below its \$3 billion peak in December, when the price of a bitcoin hit \$20,000, it remains the largest crypto-focused asset manager. And it aims to grow larger, via marketing outreach and launches of additional funds. While all but one of its current funds are single-asset vehicles, the firm is considering other kinds of offerings, including actively managed funds and exchange-traded funds, should the **SEC** permit such vehicles. Grayscale's ninth crypto trust, one focused on the privacy-oriented altcoin called ZennCash, is set to launch later this year.

"We have 20-plus ideas around products," Sonnenshein said.

Grayscale's parent company, Digital Currency Group, has amassed a sprawling portfolio of holdings in the blockchain business — some 110 companies in 30 countries. Led by Silbert, its CEO, Digital Currency operates three units: Grayscale, cryptocurrency information provider **CoinDesk** and digital-asset trading operation **Genesis Global**. In addition, Digital Currency holds stakes in companies dealing with blockchain-focused banking, infrastructure and payments, trading-oriented enterprises and numerous non-financial blockchain businesses. Crypto exchange Coinbase is among the holdings of Digital Currency.

Grayscale's vehicles employ several Digital Currency-owned companies as service providers, including Genesis Global, cryptocurrency safeguard companies **Ledger** and **Xapo**, as well as **TradeBlock**, a provider of institutional trading tools for digital currencies.

Digital Currency's investors include **Bain Capital**, **Foxconn**, **MasterCard**, **New York Life**, **Ontario Municipal Employees, Prudential Financial** and **Western Union**. **Glenn Hutchins**, a co-founder of technology investor **Silver Lake Partners**, is a board member, and former **Harvard University** president **Lawrence Summers** is an advisor to the company. ❖