

Increasing Allocations in Challenging Markets

Takeaways

- Average allocations towards crypto increased from 1.5% to 2.5% in the quarter. Allocations to coins increased in large portfolios, while smaller portfolios saw larger allocations to crypto-related alternatives, such as hedge funds and private equity funds.
- The proportion of long-term holders—measured as portfolios that held crypto for more than three years—buying crypto assets exceeded the number of portfolios selling them, indicating positive sentiment. Sentiment for short-term holders was muted.
- The percentage of portfolios holding Ethereum versus Bitcoin has grown, and we now see them as roughly 50/50.
- Portfolios holding crypto underperformed portfolios without crypto-related positions on average by 2–3% over the previous year.

Cryptocurrency Allocations Q3 2022

Exhibit 1 presents the dollar-weighted allocation of assets to cryptocurrency and blockchain technologies (“crypto”) for all portfolios and only of crypto holders, broken down by portfolio size, as of Q3 2022. **From the previous quarter, average allocations increased from 1.5% to 2.5%.** This was primarily due to an approximately 1% increase in allocations to crypto hedge funds and private capital in smaller portfolios and an approximately 1% increase in allocations to coins in the largest portfolios. Coins remain the preferred method to gain crypto exposure, followed by hedge funds and private capital. We also see that larger portfolios continue to hold crypto in more modest proportions compared to smaller portfolios.



Exhibit 1

Dollar-Weighted Allocation to Cryptocurrencies and Blockchain Technologies

October 31, 2022

Portfolio Size	All Portfolios				Crypto Holders			
	Coins	Hedge Funds	Private Capital	Total	Coins	Hedge Funds	Private Capital	Total
0–1mm	0.03%	0.03%	0.02%	0.07%	1.68%	1.49%	1.14%	4.30%
1mm–3mm	0.02%	0.02%	0.01%	0.05%	0.81%	0.74%	0.53%	2.08%
3mm–10mm	0.02%	0.02%	0.01%	0.05%	0.45%	0.52%	0.41%	1.37%
10mm–30mm	0.03%	0.01%	0.04%	0.08%	0.54%	0.20%	0.57%	1.31%
30mm–100mm	0.06%	0.03%	0.06%	0.15%	0.63%	0.26%	0.57%	1.46%
100mm+	0.55%	0.13%	0.14%	0.82%	1.72%	0.39%	0.44%	2.56%
<i>Total</i>	0.38%	0.09%	0.11%	0.58%	1.61%	0.38%	0.46%	2.45%

Asset allocations are typically considered on the basis of how much capital is allocated to different investments. While this illustrates how the money is allocated, it doesn't provide a good view of which assets actually drive performance. A risk-weighted view of asset allocations can provide further insight into what drives the performance of portfolios. We calculate the risk-weighted asset allocations by multiplying the dollar allocations by the realized annual volatility of the asset. While past volatility is certainly not a fully reliable indicator of future volatility, it can help provide a better sense of the risk profile of investments and what allocations are broadly driving the performance of a portfolio.

Exhibit 2 shows dollar and risk-weighting of overall cryptocurrency positions in portfolios as of Q3 2022. Despite volatility declining by 20% over the past year, increases in average allocations led crypto risk weights to remain relatively consistent quarter over quarter. **Risk weights for the smallest portfolios remain quite elevated at approximately 19%, implying that the asset class may be contributing disproportionately to overall portfolio returns in some portfolios.**

**Exhibit 2**

Dollar and Risk-Weighting of Crypto Positions in Portfolios

Q3 2022

Portfolio Size	All Portfolios		Crypto Holders	
	Dollar Value	Risk-Weighting	Dollar Value	Risk-Weighting
0–1mm	0.07%	0.32%	4.30%	19.00%
1mm–3mm	0.05%	0.22%	2.08%	9.18%
3mm–10mm	0.05%	0.21%	1.37%	6.06%
10mm–30mm	0.08%	0.36%	1.31%	5.80%
30mm–100mm	0.15%	0.65%	1.46%	6.44%
100mm+	0.82%	3.63%	2.56%	11.30%
<i>Total</i>	<i>0.58%</i>	<i>2.54%</i>	<i>2.45%</i>	<i>10.81%</i>

To measure relative volatility, we are comparing the 1-year rolling average Bitcoin daily volatility against the 1-year rolling average daily volatility of a 60/40 portfolio. Quarter over quarter, this relative volatility decreased from 5.63x to 4.41x.

Bitcoin and Ethereum are by far the most widely held cryptocurrencies on the Addepar platform, with over 13x more than the next closest coin. Exhibit 3 shows the percentage of portfolios on the platform that had positions in Bitcoin and Ethereum on a monthly basis since Q1 2020 when sufficient quantities of cryptocurrencies could be measured. **The percentage of portfolios holding Ethereum versus Bitcoin has grown and we now see them as roughly 50/50.** Additionally, one may note that beginning in Q1 2022, the percentage of portfolios holding each of these cryptocurrencies stopped increasing and even started to decline.



Exhibit 3

Percentage of Portfolios Invested in Ethereum and Bitcoin
Q1 2020–Q3 2022

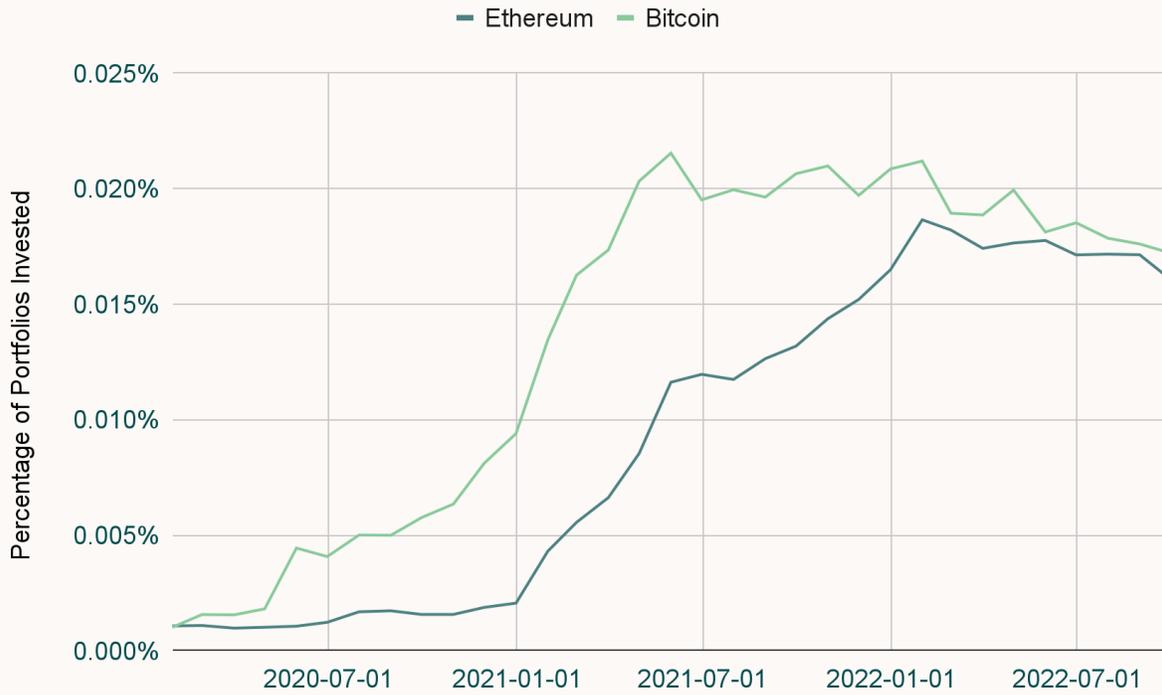
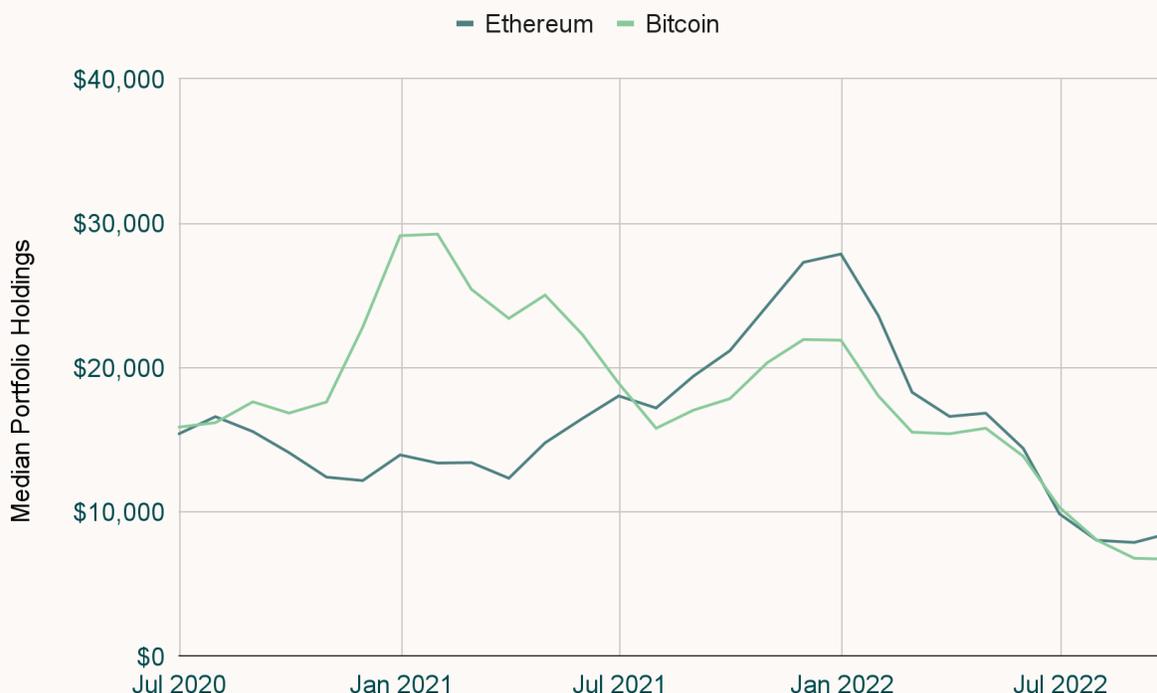


Exhibit 4 shows the 3-month rolling average of the median portfolio’s holdings of Ethereum and Bitcoin from Q3 2020 through Q3 2022. **Once-pronounced differences between the holding amounts have disappeared over the past two quarters, with Bitcoin and Ethereum held in relatively similar quantities for the median portfolio.** In Q3, the median Bitcoin holding was \$6,700 while the median Ethereum holding was \$8,500.



Exhibit 4

Median Portfolio's Ethereum and Bitcoin Holdings over Time
 3-Month Rolling Average, Q3 2020–Q3 2022



Cryptocurrency Sentiment

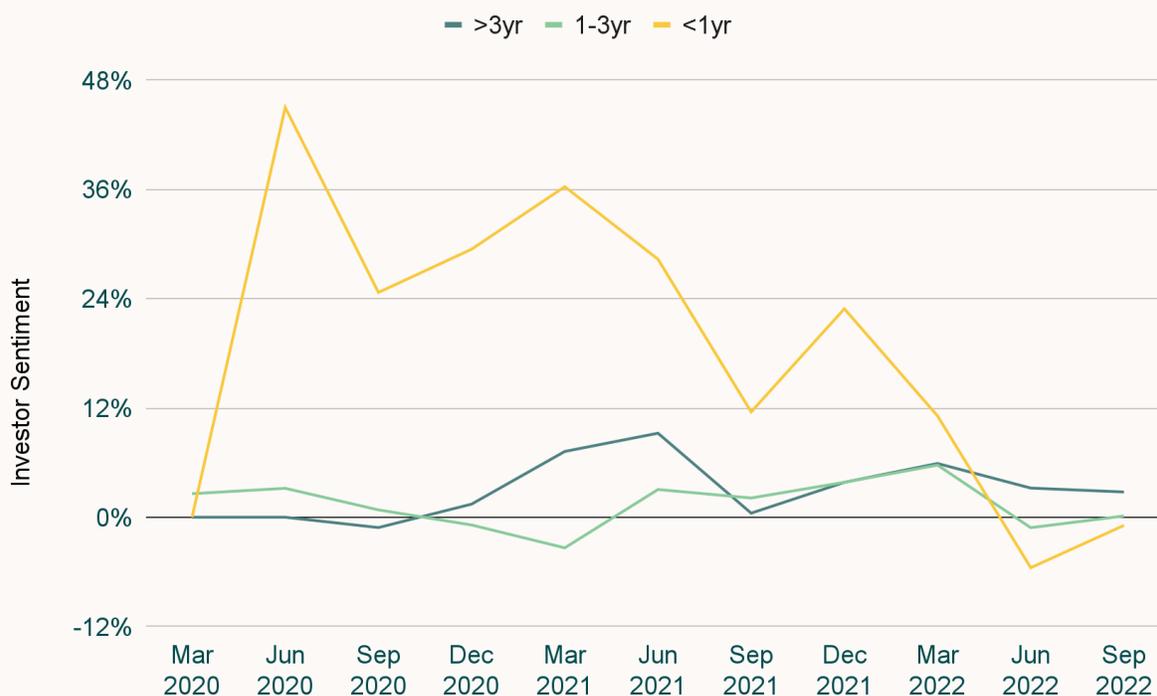
Crypto sentiment is calculated as the relative share of individual portfolios that are net buyers of crypto assets versus those that are net sellers, or net neutral. In particular, every month in which an investor is a net buyer we assign a score of 1, while net sellers are assigned a score of -1. For portfolios that are net neutral during the month, we assign a score of 0. We then aggregate across portfolios. An aggregate positive reading indicates that relatively more portfolios added crypto risk and a negative reading indicates that relatively more portfolios subtracted crypto risk.

Exhibit 5 shows quarterly sentiment towards cryptocurrencies and blockchain-related alternative assets broken down by the time since the portfolio first invested in a crypto-related asset. New investors have been significantly more active than longer-term investors over time. **Interestingly, new investor sentiment has been declining in 2022, and in Q3 it was relatively muted.**



Exhibit 5

Crypto Sentiment across Length of Portfolio's Investment in Crypto
Q3 2022



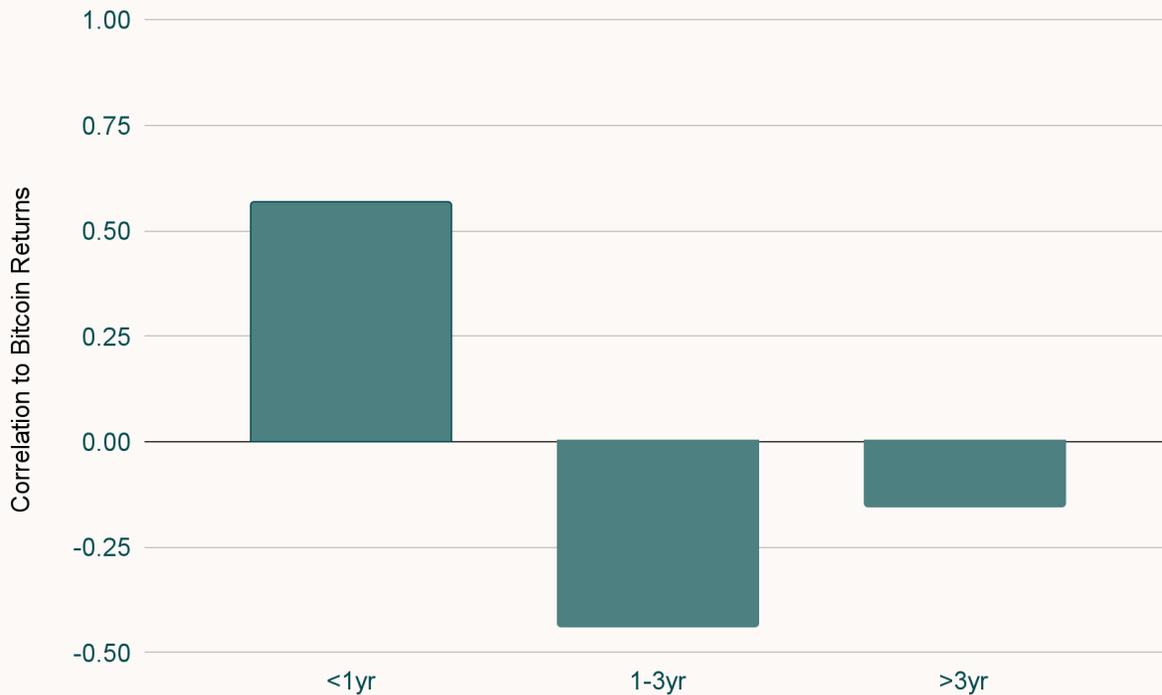
Sentiment is computed by taking the number of portfolios with net positive cryptocurrency-related flows in a period, subtracting the number of portfolios with net negative cryptocurrency-related flows, and dividing by the total number of portfolios with crypto-related positions in that period. We only examine portfolios with greater than \$100,000 in assets to avoid unnecessary noise.

In Exhibit 6, we show the degree to which investor sentiment responds to Bitcoin returns. Not surprisingly, we find that new investors (<1 year) are pro-cyclical to the market meaning that portfolios buy more cryptocurrencies when the market is rising and sell when the market is broadly selling off (correlation $p = 0.55$). However, we do find that sensitivity declines quite sharply for longer-term holders of crypto. Medium-term holders (1–3 years) and long-term holders are counter cyclical and buy crypto during downturns, thus stabilizing the market (correlation $p = -0.45$). Sensitivities are quite muted for long-term holders (> 3 years), which implies that many of these portfolios are rather inert, essentially employing a buy-and-hold strategy (correlation $p = .15$).



Exhibit 6

Correlation between Crypto Sentiment and Bitcoin Returns by Length Invested
 Quarterly Sentiment and Return, Q1 2021–Q3 2022



Performance

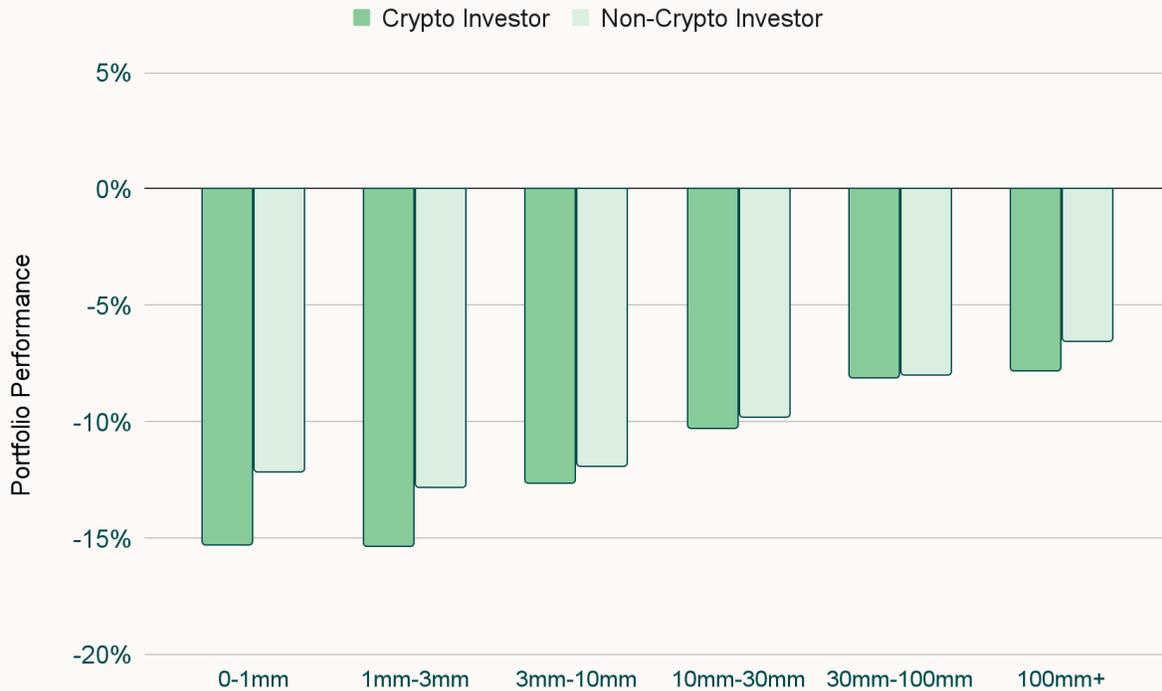
Exhibit 7 presents the median one-year performance of portfolios that invested in cryptocurrencies in October 2021 compared to those portfolios that did not, broken down by portfolio size. The figure shows that portfolios that did not invest in cryptocurrencies performed better than those that did, across all portfolio sizes. Differences in performance were particularly pronounced for smaller portfolios. Those portfolios with <\$3mm in assets and crypto-related positions performed 2.5% worse than portfolios that did not have crypto exposure.

During the last twelve months, Bitcoin fell 60% in value. The median portfolio with less than \$1mm in assets held ~4.5% in dollar-weighted cryptocurrency and blockchain exposure during that time, which translates to a ~2.7% loss. This explains most of the difference between crypto versus non-crypto portfolio performance for portfolios with less than \$1mm in assets.



Exhibit 7

1-Year Total Portfolio Performance of Crypto Investors by Portfolio Size
 Portfolios with and without Crypto Exposure, Median, Q4 2021–Q3 2022



Conclusion

We’ve provided a range of views and transparency into the behavior of portfolios with crypto-related exposures on the Addepar platform. We continue to publish updates to these views on a quarterly basis, and also invite you to review our companion pieces on Q3 2022 portfolio positioning and Q3 asset allocations.

Please email research@addepar.com if you have any questions or suggestions for how this publication can be improved.



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