



## Market Report | 21.01.2023

# Market Review 2020 - 2021: Start and Consolidation of a new Bull Cycle

**The last bull market cycle not only brought massive price increases in the realm of digital assets, but also led to the birth of new sub-sectors. In addition to the emergence of the decentralized finance (DeFi) sector, a thriving NFT sector developed. The widespread adoption of public blockchain networks ultimately paved the way for new blockchains and layer-2 scaling solutions due to scalability limitations.**

Towards the end of 2020, after the COVID shock and in line with the emergence of new use cases on the blockchain infrastructure, a new crypto bull market was born. In December 2020, the alpha asset Bitcoin broke its old all-time high of \$20,000 from 2017 for the first time in 3 years of bear market. The last cycle could no longer be dismissed as a successor to the tulip mania.

The COVID crisis and subsequent quantitative easing (QE) measures by the US Federal Reserve led to an unprecedented expansion of the money supply in 2020. This increased investors' risk appetite. Institutional investors joined retail investors on the

demand side and included the new asset class in their portfolio allocation.

### A new narrative emerges

After the third halving of its inflation rate, Bitcoin experienced a significant premiere: US software company MicroStrategy announced as the first publicly traded company to diversify its balance sheet assets into Bitcoin.

The company's Bitcoin investments quickly expanded, with the real impact hidden in a new narrative for the digital asset. MicroStrategy became a successful poster child for the adoption of Bitcoin



Figure 1: Bitcoin price 2018-2021 | Source: Tradingview



as an alternative to gold that should be integrated into every company's investment strategy. Public appearances and private conversations of CEO Michael Saylor underpinned this narrative, and only a few months later, car manufacturer Tesla was convinced to expand its balance sheet with Bitcoin. PayPal and other payment service providers, as well as Wall Street banks, have since integrated the largest cryptocurrency into their services, and numerous other developments have increased attention on the maturing crypto space.

### DeFi - the first seeds of Web 3.0

Parallel to the developments in the Bitcoin ecosystem, the decentralized finance (DeFi) space was born on the largest smart-contract-enabled blockchain, Ethereum. It became possible to conduct financial transactions directly among participants (P2P) at a new level. Thanks to its permissionless nature, anyone could use DeFi applications. Decentralized trading platforms and credit platforms emerged, where liquidity could be borrowed or lent against the deposit of crypto collateral. The result was a yield curve determined purely by supply and demand without the intervention of a central bank.

Through the integrated Automated Market Maker protocols (AMMs) - a central component of blockchain-based exchanges - it was possible from this point forward to participate in liquidity pools and receive a portion of that pool's trading fees. With the emergence of different DeFi platforms, a liquidity battle ensued, fought with inflationary token emissions of the respective platforms to increase attractiveness. Liquidity providers were rewarded with token payouts when they participated in the respective platform's liquidity pools. Over time, numerous new DeFi applications emerged on various blockchains, all vying for liquidity and users by offering higher and higher payouts of their protocol tokens.

### Non-fungible tokens (NFTs)

Apart from crypto-native investment funds and interested retail investors, the DeFi sector did not attract a large audience. A much larger audience composed of collectors, artists, gamers,

individualists, cult followers, and other individuals found their blockchain use case through another development. As a continuation of meme coins, the ERC-721 standard, a non-fungible token variant on the Ethereum network, met a use case with enormous potential. It was the birth of NFTs; a genre that was not noticed for a long time but continued to drive the now-growing crypto hype.

These individual tokens could be linked to digital objects. Images, as the most common example, were now immutably assigned to a user via their wallet address. Limited collections found brisk sales among digital collectors, and with NFT trading platforms not long in coming, a marketplace soon emerged where daily sales of several hundred million dollars were recorded. Further NFT use cases in games and the metaverse fueled the trend even further.

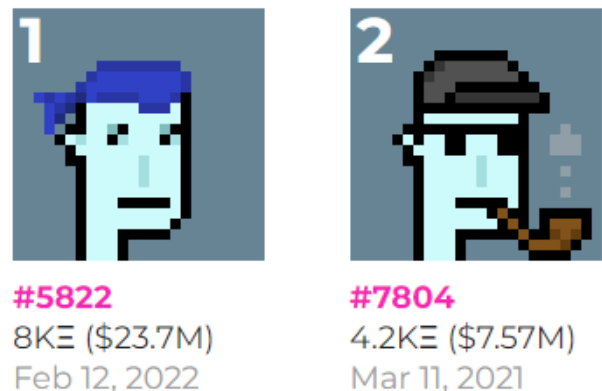


Figure 2: Highest CryptoPunk NFT sales | Source: LarvaLabs

### Capacity limits of blockchain infrastructure

The rapid growth of DeFi and NFTs has led to an overload of the Ethereum blockchain, causing transaction fees to skyrocket. The blockchain trilemma had struck, and new scaling solutions were needed to meet the increased demand for blockchain capacity.

This gave rise to alternative smart contract platforms and layer-2 solutions built on top of the Ethereum blockchain as the main ledger. These newly created blockchain networks made it possible to deploy successful DeFi and NFT applications on alternative chains with lower transaction costs. These blockchains had their own native tokens to



attract users and validators to the brand new ecosystem. The applications on the blockchain alternatives, in turn, distributed their own tokens to attract liquidity and users.

#### **Bitcoin ETF: knighthood for institutional adoption**

The euphoria around digital assets, driven by new use cases, propelled Bitcoin and all the other cryptocurrencies to new price levels. A new asset class emerged from its infancy and the traditional financial world wanted a piece of the digital pie. After the listing of Bitcoin futures and options on American exchanges, the first US-listed Bitcoin ETF followed in October 2021. A knighthood for the oldest cryptocurrency and a starting point for many US large banks to finally offer their clients digital asset services.

#### **A daily growing supply meets limited demand**

The market was greedy, demand was enormous and supply even more so. Every day, new tokens worth tens of millions were issued, new NFTs were created, and allocations from venture capitalists were unlocked. DeFi protocols offered their own token returns in the triple-digit percentage range to attract vital liquidity. In addition to this, there were the usual block rewards for miners, which already amounted to around \$60 million per day for Bitcoin alone.

In November 2021, about a month after the long-awaited US Bitcoin ETF, the total market capitalization of the roughly 30,000 outstanding, officially counted tokens was just over \$3 trillion. The now over \$65,000 Bitcoin made up about one-third of the total market capitalization. Only 11 months earlier, the market was at a Bitcoin price of \$20,000 and a market capitalization of all recorded tokens of \$750 billion. Of course, no one could predict when the music would stop playing. However, the senselessness of the projects and the sheer infinity of new digital tokens seeking buyers clearly indicated a speculative phase.