

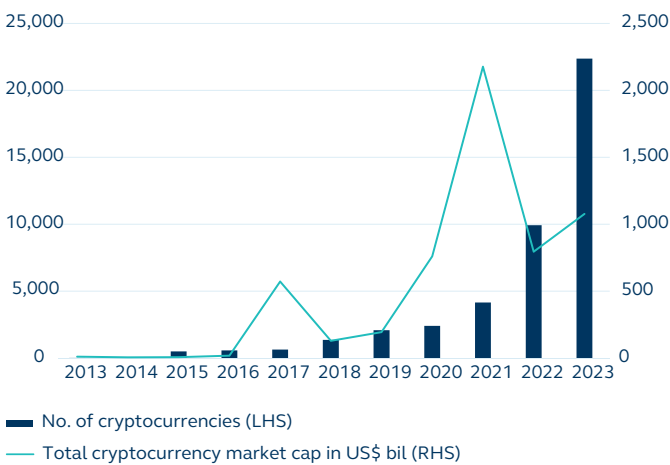
ETF Focus

Crypto Asset ETFs: Hong Kong's New Investment Frontier

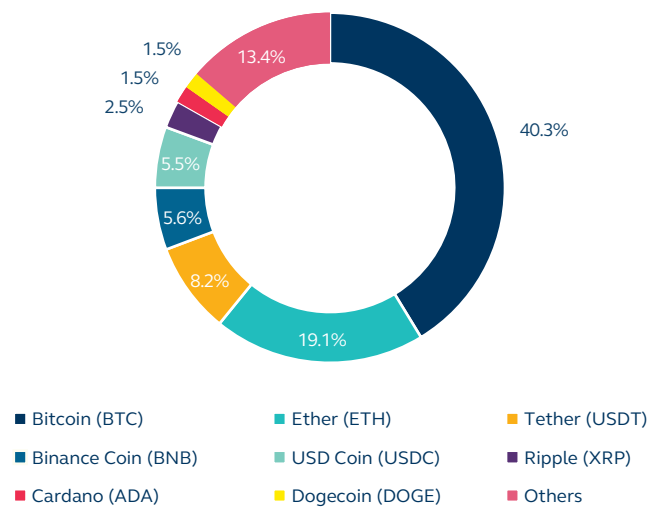
Crypto assets have emerged as a new asset class, transforming the world of finance. In a decade's time, the market capitalisation of cryptocurrencies has increased by more than 100 times to over US\$1,076.6 billion in January 2023. Alongside this growth, the number of cryptocurrencies has risen from just seven in April 2013 to 22,375 in January 2023.

The world's first Ether futures ETF and Asia's first Bitcoin futures ETF debuted in Hong Kong in December 2022, opening up new opportunities for investors to access the crypto market. In the following paragraphs, we will introduce the basics of crypto investing and explore the potential advantages and risks involved in different crypto investment vehicles.

Market capitalisation and number of cryptocurrencies (2013 – Jan 2023)¹



Cryptocurrency market share, 2022²



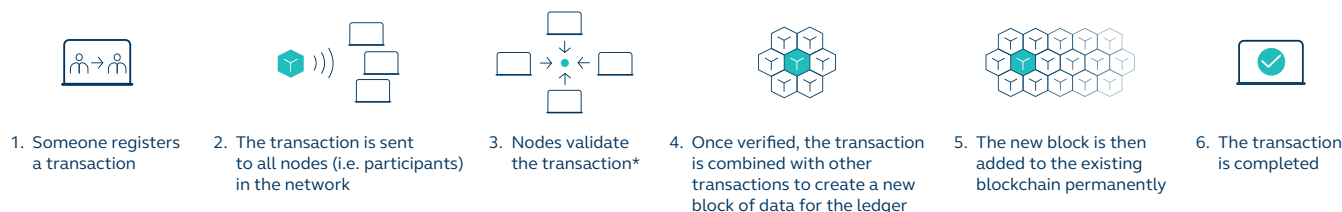
¹ Source: Data of market capitalisation was obtained from Coinmarketcap.com and data of number of cryptocurrencies during April 2013 to January 2022 was obtained from "How many cryptocurrencies are there? Guide to the crowded market", published on capital.com, 17 July 2022, and that of January 2023 was obtained from Coinmarketcap.com. Data downloaded on 30 January 2023.

² Source: Statista, data as of 15 November 2022: <http://www.statista.com/statistics/1269302/crypto-market-share/>

DLT – The Backbone of Crypto Assets

Crypto assets are underpinned by distributed ledger technology (DLT), which allows computers (also called nodes) across a network to validate transactions and update records at the same time. Since each network participant (or node) holds a copy of the exact same data record, DLT does not require a central authority to maintain data consistency across the network, hence achieving decentralisation and providing resilience to data loss. In addition, DLT creates an immutable history of transactions as the transaction record can never be altered once it has been confirmed, offering increased data security.

The blockchain process



*Transaction validation requires network participants to solve complex mathematical problems, a process also known as 'mining'.

Diversifying Asset Allocation with Crypto Assets

With crypto assets emerging as a new asset class, investors may enjoy new investment tools to further diversify the allocation of their assets. A study by Morningstar found that during the period from 2015 to January 2022, the average correlation coefficient of the index returns in digital assets with those in major asset classes was 0.15%, the second lowest among different asset classes (after US short-term interest rate)³, providing investors an additional choice as they build a well-diversified portfolio.

Since the Securities and Futures Commission (SFC) permitted the authorisation of crypto asset ETFs for public offering in Hong Kong in October 2022, three crypto asset ETFs have listed in the city, enabling investors to respond to the news flow from the crypto market during the Asian time zone. Market capitalisation of the three crypto asset ETFs reached HK\$338 million by the end of March 2023.

Among the different ways of investing in crypto assets, ETFs with crypto futures as underlying are a viable tool offering crypto exposure in a regulated stock exchange. These ETFs are also actively managed by ETF managers, and help investors avoid the hassle of account set-up and margin deposits that are required in futures investing.

Comparison of different crypto exposure

	Direct exposure	Crypto futures	Crypto futures ETFs
Pros	<ul style="list-style-type: none"> • 24/7 trading • Buy and sell in different fiat currencies • Can be used for digital payments 	<ul style="list-style-type: none"> • Regulated • Cost effective with leverage 	<ul style="list-style-type: none"> • Regulated • Convenient – trade like stocks • Secure • Lower risk with diversified portfolio
Cons	<ul style="list-style-type: none"> • Higher concentration risk • Account set-up required • Cashing out often requires service charge 	<ul style="list-style-type: none"> • Higher concentration risk • Account set-up required • Margin deposit required 	<ul style="list-style-type: none"> • Trading only available when stock exchange is open • Limited choices due to regulation

On 20 February 2023, the SFC released a consultation paper proposing a new licensing framework for virtual asset service providers, covering various types of virtual assets and conditions for retail investors to trade in these assets. This initiative is expected to promote a regulated environment and bolster investor protection in Hong Kong's burgeoning virtual asset investment market. See more details about Hong Kong-listed crypto asset ETFs at www.hkex.com.hk/etf.

³ Source: Understanding Trends in the Cryptocurrency Market in 7 Charts ([link](#))

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Hong Kong Exchanges and Clearing Limited

8/F, Two Exchange Square, 8 Connaught Place, Central, Hong Kong
info@hkex.com.hk (t) +852 2522 1122 | (f) +852 2295 3106 hkexgroup.com | hkex.com.hk

