2021 Wrapup & 2022 Predictions

Definitions to know
Layer 1: The "base layer" blockchain that handles consensus, data, and execution. These include blockchains like Bitcoin, Ethereum, and Solana.
Layer 2: Third party solutions that integrate with a layer 1 to help scale, reduce fees, and/or add other features for users. These include things like rollups and side-chains. Basically, just know that they're "add-ons" to layer 1s to help them scale.

Note: None of this is financial advice. These are all predictions that may be way off, and you should do your own research before acting on anything discussed here. Some predictions are purposely a bit far-fetched – I didn't want to just say things like "layer 1s will continue to go up!" or "DeFi will get hurt by regulations!" - the point of this is to provide insights into some *potential* narratives that have not massively caught on yet. You'll also notice I don't mention Bitcoin here once. BTC is perhaps the least risky/volatile crypto asset, and I do have some that I'm holding long-term, but these predictions are focused elsewhere and seek outperformance.

Intro

2021 was a year of rapid change in crypto markets. Bitcoin dominance (as a % of overall crypto market cap) went from over 70% to around 40%, Ethereum went from holding over 95% of TVL to under 65% as non-Ethereum layer 1s took off, "DeFi 2.0" projects came in strong and outperformed blue-chip DeFi projects by a wide margin, and NFT prices went flying. There's more that I'm forgetting, but the point is that crypto markets, and where the attention of most participants points to, are rapidly changing as the space grows and matures. To quote Cobie (@cobie on Twitter):

"You'll notice that it was possible to win the 'crypto video game' by ignoring this changing metagame altogether. You didn't need to be early to [specific] coins to have made good investments in 2021. But, to play at the highest level and maximize wins, you had to identify and exploit the hot-ball-of-money rotations between assets at least a few times."

Before outlining some predictions for 2022, let me say this: regardless of how well these theses stack up to what actually happens, one thing that I'm sure of is that 2022 will also be a year of rapid change. Regulators are looking at laws that will affect the space, more and more institutions are looking at getting involved, the macro picture for global markets is uncertain, and, perhaps most importantly, blockchain and blockchain-related technology is evolving at a rapid pace. Timelines in crypto are notoriously hard to predict – look no further than the multi-year delay of Ethereum 2.0 or the quick rise of the metaverse trend to see this – so being able to adjust on the fly is key. Having some predictions and a thesis is one thing; being able to understand when you're wrong and adjusting your thesis is another. With this in mind, here are some predictions for 2022; in each section, I'll list some tokens to watch… but these will likely change as the year progresses, and new tokens will be added.

The Layer 1 Trade Gets More Complicated & a Cross-chain Future Begins to Prosper

Layer 1 trades, specifically tokens like SOL, AVAX, LUNA, BNB, and FTM, dominated in 2021. These tokens, and even some "layer 2" tokens like MATIC, majorly outperformed Ethereum as Ethereum failed to scale in a meaningful way and priced out smaller market participants due to fees. Will this outperformance and rotation of attention/money between layer 1s continue into 2022? I think it will, for the most part. However, many layer 1 tokens that have had huge run-ups in 2021 will obviously find it harder to sustain that outperformance in 2022. NEAR and ATOM are the two whose ecosystems, in my opinion, have the most potential upside currently due to not having *heavily* caught narratives in 2021 while still having significant developments occurring.

Many market participants are already looking towards what the future could hold. Scaling solutions like ZK-rollups, which implement a "modular" approach to blockchains (execution, data availability, and settlement are separated) have been touted as the "true future" of blockchain scaling. Interestingly enough, we're on schedule to get usable ZK-rollups from the likes of Starkware and ZkSync in 2022. Celestia, Polygon Matic, and Loopring are also working on modular rollup approaches. This narrative could catch fire depending on speed of adoption from users and developers, but it's hard to predict; my gut says we don't see mass adoption of this technology until at least 2023, but 2022 could still be a good year for rollup tokens as the market is forward-looking.

Some other underrated potential layer 1 and 2 related narratives are liquid staking, cross-execution layer architecture, cross-execution layer dApps and games, and consolidation of settlement layers if a modular approach to scaling does take off (again, I find this unlikely to happen in a major way in 2022). The transition to Ethereum 2.0 is expected to happen in the first half of 2022, and this will make Ethereum a proof of stake blockchain. Since ETH will be able to be staked for yield, it would make sense for liquid staking (basically, you can stake your ETH and receive the equivalent amount of a yield-bearing token that can still be traded/moved around) projects like Lido, pSTAKE, and Rocketpool to see increased adoption. Whether this adoption translates to better token prices for these projects is dependent on tokenomics and token utility, but we could very well see liquid staking tokens play a much larger role in DeFi ecosystems leading up to and after Ethereum 2.0.

Cross-execution layer architecture refers to projects like Layer Zero and Composable Finance (and perhaps even Cosmos and Polkadot apply here) that allow applications to facilitate transactions across a variety of chains/execution layers and potentially even pay gas fees in a variety of tokens. Rollups can accomplish much of the same, but this architecture layer will still be very important in creating more seamless user experiences in (at least) the medium-term. This is the next evolution of simply bridging tokens between blockchains, which is often not very user friendly. Keep in mind that many of these projects are currently in development and do not yet have tokens. Wallets may play a role here too.

Cross-execution layer dApps and games refers to dApps and games that can take advantage of multiple blockchains and/or rollups, potentially using some of the infrastructure projects mentioned above, to create a simpler or, in the case of games, more entertaining user experience. Applications and games that are early to this party should be in a good position to see major token price increases. DeFi Kingdoms' multi-chain plans and Sushiswap's multi-chain deployments resemble this idea, though leveraging cross-execution layer architecture or rollups to make the experience more seamless is more of what I had in mind.

Finally, although we've seen a wide variety of layer 1 tokens take off in 2021, there's a chance, depending on how much adoption rollups and a modular approach to blockchain scaling get, that the money moving around different layer 1s eventually consolidates into just a few while the rest experience declining usage and token prices. Since, in a modular scaling approach, the settlement layer is responsible for securing all proofs of transactions and, depending on the approach, transaction data, the most decentralized and secure chains (like Ethereum) could take the lead here. However, this is one that I have very little conviction on, mainly because the level of decentralization needed for settlement layers is not really known yet, and there is also a good chance that a modular approach does not really take off in 2022. Again, it's hard to calculate exact timelines in crypto. New execution and data layers can capture value here too.

Regardless of the modular vs monolithic debate result and on what timeline that whole thing plays out, infrastructure will continue to get better and enable much better user experiences. We're obviously still not to the point where crypto is *easy* to use (bridging can be a mess, different tokens are needed to pay gas for different chains, separate chains confuse new users, finding truly valuable use-cases is hard for new users, etc.), but we are certainly moving towards a future where it *is* easy to use. I don't think 2022 is the year we make it there, but things will continue to heavily improve. Some examples of improvements we should see over time are: abstraction of separate chains via wallets and other infrastructure (mentioned above), specialization of parts of chains (modular approach), app-specific chains and/or wallets, and pre-built products that make it easy for non-crypto users to interface with crypto. Honestly, I think we're severely underestimating how different things will look, UX-wise, in 5-10 years. Infrastructure-building teams of extremely smart people combined with an influx of great Web2 developers who will get access to better tooling will result in improvements that many of us may be unable to imagine right now.

Tokens to watch:
Layer 1s: ATOM (staked), LUNA, NEAR, ETH, AVAX, SOL
Liquid staking: LDO
Infrastructure: ALEPH, AKT, AR, POKT, unreleased tokens (Layer Zero, Celestia, Starkware, ZkSync, etc.)

Ce/DeFi 3.0: The Derivatives Explosion

"DeFi 1.0" includes protocols like Compound, Aave, Maker, Synthetix, and Yearn. "DeFi 2.0", which includes protocols like Olympus, Convex, and Abracadabra, was a 2021 development characterized by protocol owned liquidity, increasingly powerful governance tokens, partnerships and interoperability ("B2B" focus), easily obtainable and more capital efficient leverage to satisfy increasing risk appetites in crypto, and cross-chain deployments. It also has pushed many DeFi 1.0 protocols to adopt new tokenomics or seek out ways to expand cross-chain or via partnerships.

I predict that "DeFi 3.0" will show up in 2022 and be characterized by protocols offering exposure to a variety of derivatives including options, perpetual futures (already somewhat here), and new derivatives that allow users to bet on things like NFT prices or the volatility of a major token like ETH. Projects like Opyn, Ribbon, Gearbox, and Dopex come to mind, but newcomers will likely emerge and current projects will play a role as well. The use-cases for options, specifically, in DeFi are far-reaching.

Despite this high growth in on-chain derivatives, I see centralized derivatives (specifically options) growing at an even faster rate as more options (pun intended) become available and more players are allowed to participate. Additionally, financial institutions and fintech companies who want to stay relevant will add in crypto services (buying/selling, loans, yield, stablecoins, etc.), and companies currently offering crypto services will expand their offerings. This will continue to bring new money into crypto. New crypto listings on Robinhood may also spark large rallies in the tokens that get listed.

Another possibility here is that protocols like Aave and Compound, who have been working to allow institutions to come into DeFi in a more controlled environment (KYC'd participants and all that), succeed in this and we see these tokens take off, prompting DeFi 3.0 to look more like a revolution where centralized entities are able to interface with DeFi in a more controlled setting. I don't find this quite as likely, but it's a possibility especially if harsher regulations show up.

Tokens to watch: RBN, DPX, PERP, GEAR, COMP, unreleased tokens

Macro Concerns Will Continue To Tug at Crypto Markets Broadly

As mentioned above, macro concerns around inflation, a tightening monetary policy in the US and abroad, Chinese real estate issues, supply chain congestion, Covid, and potential crypto regulations are all at the forefront of global markets as we move into 2022. The S&P 500 is up about 30% on the year. In fact, four of the last five years have seen the S&P 500 increase by more than 15%. The combination of all of this looks like it *could* be setting us up for a pullback and/or recession, but the question is: When?

There's also a possibility that persistent inflation, which certainly helped asset prices, combined with central banks (like the Fed) actually reversing course on tightening monetary policy, continues to prop up asset prices. Global macro is obviously a very nuanced subject and is sensitive to a countless number of factors, but, overall, crypto has behaved like a very risk-on asset and has shown correlation to broader market volatility and equity prices, especially as more traditional market participants enter the space. A selloff in equities would almost certainly hit crypto even *harder*, price wise, than it hits equities.

My prediction is that these fears will be realized at some point in 2022, and we will see a large selloff that could either begin a (likely short) crypto bear market or prompt central banks to reverse course and "save" markets. It's impossible to predict when, but watching what Jerome Powell says, how the central bank balance sheet moves, and how traditional markets move, among other data points, can help predict this. If I had to take a wild guess, I'd say this could begin as early as February, but that's a total shot in the dark and I'm by no means a macro expert. Regardless, de-risking on market pumps may not be a bad idea, *depending on whether or not you agree with this point*.

This also means that comparing current crypto price action to previous cycles is, in my opinion, a futile exercise. The broader landscape has changed, major market participants have changed, and the technology and its adoption has changed. Overall, I think that macro, over the course of 2022, will play an outsized role in crypto price action; though, just as was the case in 2021, specific sectors of crypto will continue to outperform even if most major tokens take a dive.

A final note here: 2022 may also very well be the year where governments and centralized exchanges start *requiring* you to link your private wallet to your personal information. It can still be anonymous to others, but I would not be surprised to see this requirement put in place by regulators and enforced by centralized exchanges and other fiat on/off ramps. This may even lead to higher discrepancies in prices (for smaller market cap tokens) between centralized and decentralized exchanges as it becomes harder for arbitrageurs to keep prices in line, though I find this less likely.

Tokens to watch: Stablecoins, *maybe* FTT

Bad Token Design Will Be Brought to Light

FDV, or fully diluted valuation, has thus far not been an *extremely* important or talked about data point when evaluating investments in tokens. However, in 2022, this could change. There are many projects, specifically many Solana projects and game-fi projects, that are on schedule to have massive amounts of tokens released into their circulating supply through token unlocks or other means. In most cases, this means dilution for current holders and increased sell pressure. I predict that investors will become much more conscientious about FDV, most projects with high token emissions will see token prices decline in a major way, and new projects will be forced to think very hard about token unlock schedules due to this. We may even see more projects move to metric-based unlocks, such as "early investors get 30% of their tokens unlocked once the project reaches milestone x", rather than simple time-based unlocks. Cobie, the same person I quoted earlier, has a good article on why most, but not all, large token unlocks are harmful to the token price.

Further, good token design will be rewarded. Projects that do not dilute holders but rather provide actual value to holders and/or have sustainable revenue, cashflows, and a moat will do well as these projects are recognized for their medium/long-term sustainability (or so I predict). As more traditional players enter crypto, they likely aren't going to go buy the next OHM fork or the new dog coin; they're going to buy tokens that actually have sustainable models and capture real value.

Tokens to watch: YFI, CVX, FXS, ETH, OHM, ALCX

NFTs Markets Consolidate, Crypto Gaming Gets Real

I predict that "profile picture NFTs" will continue largely dying out, while certain projects with strong historical relevance (Crypto Punks), strong communities and incentives to hold (Bored Ape Yacht Club), or "real" art (Fidenzas) stay relevant, especially among the core/wealthy NFT community. Profile picture NFTs and similar "cash grabby" projects can only scam new participants for so long, and we're reaching the point where more and more users understand that these are probably going to lose them money unless they quickly sell them or there's an NFT bull market underway.

NFTs will likely continue to see a big year, however, through gaming. NFTs in crypto games that come with utility such as the ability to earn high monetary rewards, perform specific tasks, enter a contest, or show off to your friends in popular games should continue to do well. NFTs with real-life utility, such as the ability to redeem them for something valuable, are obviously good candidates as well. Overall, market participants will demand more from their NFTs, for the most part, than just a picture stored on the blockchain. Gaming is one such way to realize this utility.

Overall, crypto will need better infrastructure to be able to provide gaming experiences that rival traditional popular games. Imagine Rocket League with the added ability to put money, in the form of tokens, on games or to compete in tournaments for prizes - that's pretty much impossible to do in a decentralized way right now, given the technical challenges. In-game betting, in-game randomness, privacy, seamless UX, and decentralized hosting all need better tooling to enable crypto gaming to reach the next level. DeFi Kingdoms (JEWEL) and other games will be able to add PvP in a "turn-based" way, but to go even further we'll have to wait for better infrastructure to appear. In the meantime, simpler games should dominate.

Tokens to watch: JEWEL, CRA, unreleased tokens

Honorable Mentions

Privacy tokens, *some* algorithmic stablecoins (UST, FRAX, FEI, others)

<u>Current Top Holdings</u>

1. Stablecoins
2. ETH
3. CVX
4. SOL
5. Smaller holdings & possible buys – DPX, JEWEL, ATOM, LUNA, OHM, YFI, NEAR, RBN, AVAX, LDO