Horizon Kinetics Blockchain Development ETF (BCDF)

Annual Commentary for 2023

Market Update:

When observing a perceived imbalance, where the price of an asset is markedly affected, it is common to evaluate whether a change in meaningful variables led to the situation. This is a logical approach, as understanding how the environment has been altered can help pinpoint any fundamental changes that may require a re-assessment or prudent action on the part of the investor. The causes of the most recent blips on a performance chart are typically the most obvious, but not necessarily the most important for long-term decision-making. While this thinking may provide fodder for commentary on the *current* state of things, it often misses the forest for the trees.

Bitcoin, specifically, has been the subject of two events that highlight the myopia of the markets when it comes to digital assets. The first was this month's approval of spot Bitcoin ETFs in the United States. This is the culmination of a more than 10-year battle since the original spot Bitcoin ETF application by the Winklevoss twins back in 2013. There is wide speculation, and general optimism, that the offering of a spot Bitcoin ETF will open the doors to institutional adoption, contributing to a higher price by lowering the barriers to demand. Investors that were restricted from holding Bitcoin through digital wallets are now able to through more traditional brokerage means, and the asset itself becomes a readily available option for new portfolio allocations across the wealth management world.

This event truly is a meaningful step in the evolution and adoption of Bitcoin, as investors have been attempting to replicate exposure through equities, derivatives, and other products. Merely holding a portion of treasury assets in Bitcoin classified some companies as "crypto-related", bringing the benefits of a premium valuation in some circumstances, and a complete blockage by association from some platforms. A layer of red tape has been removed.

The next event has not yet happened but is expected to occur towards the end of April 2024. This event is known as the halving, a development that reduces the Bitcoin block mining reward by half, from 6.25 to 3.125. There are generally two ways to procure Bitcoin. One way is to mine it, providing infrastructure for the blockchain by competing for each block reward. The second is to purchase from someone who has already procured the coins. In either case, following the halving, there will be less marginal supply available to service those that demand it.

The current Bitcoin environment is filled with participants that seem focused on holding and growing their bitcoin balances. 31% of Bitcoin in circulation hasn't moved on the blockchain in over 5 years. 43% hasn't moved in over 3 years. 70% hasn't moved in over 1 year. (Glassnode, Supply Last Active, 12/31/23) This is not to say that there is limited transactional activity in Bitcoin. In fact, it is quite the opposite. 365-day average change-adjusted transfer volume on-chain amounted to about $9.3 billion as of December 31, 2023. (Glassnode, Change-Adjusted Transfer Volume, 12/31/23) This is comparable to even the most liquid blue-chip stocks in the world, and it doesn't include the substantial transaction volume that occurs off-chain. The point here is that liquid Bitcoin supply is depleting as a percentage of the total coins outstanding. Gresham's law[1] is playing out in real-time, as fiat debasement is driving hard money out of circulation.

Both the spot ETF approval and the halving are consequential, but viewing them as fundamental changes worthy of revaluation is myopic, in our view. Because for anyone with a truly long-term outlook and an understanding of the asset, these events were (largely) expected.

The halving, specifically, is spelled out in the code. Every 210,000 blocks, which is expected to be about every 4 years, a new halving event occurs, reducing the Bitcoin inflation rate by half. This isn't a surprise, but it is rarely talked about until it is perceived as a near-term catalyst for the asset. Just like the next halving is expected at the end of April, the subsequent halving is expected 4 years after, and so on. If the halving was the only vector that affected the bitcoin market, a rational investor may treat this as an asset closer to an amortizing bond. Assuming constant demand, every day is a step closer towards the inevitable supply reduction. The final token issuance becomes closer. The digital scarcity becomes more pronounced. To the extent that participants either ignore or misunderstand this fact, the benefit accrues to the long-term holders, as they are positioned for all subsequent halvings instead of just the most recent one.

Of course, we have no insight into the inner workings of the SEC or the ETF approval process. It is probably better to say that "adoption" was expected, as opposed to saying an "ETF" was expected, but the latter is just the most recent iteration of the former. Assets with true scarcity are rare, and the excesses of government spending and debasement all too prevalent and appear to be on a self-reinforcing inflationary path. Given the premiums placed on equities tied to bitcoin, and the premium/discount mechanics of the few products that did provide exposure to Bitcoin in the US, there was one thing easy to ascertain: Investors want digital asset access in their brokerage accounts.

Given enough time, we maintained the belief that the regulators' questions preventing access would be answered, and that progress would prevail. Bitcoin will become harder to ignore as time goes on. And had the most recent batch of spot ETFs been denied, the asset itself is designed to operate in an ecosystem non reliant on traditional rails, so the regulatory impediment would likely not have had a significant long-term effect on the adoption of digital assets.

In some cases, pivotal events in cryptocurrency don't need to be predicted. They are announced years in advance or imbedded in their encoded protocols. In other cases, the realization of a positive event is merely a step in the direction of eventual long-term value realization. These developments, while exciting, show why is it so important to have a long-term (and informed) view as it relates to digital assets. We remain optimistic on the future for digital assets, and will continue to invest with the goal of compounding value for our clients over the long-term.

Portfolio Update:

The portfolio exhibited positive performance in 2023, largely driven by a recovery in the cryptocurrency markets that had collapsed in the prior year. And in similar fashion, the portfolio exhibited a large deviation between those companies that are more widely considered "crypto companies" and those that

[1] Gresham's law is a monetary principle stating that "bad money drives out good".

are not. To be clear, we view all of the companies in the portfolio as eventual beneficiaries of blockchain technology, though we are nonetheless happy that many of our positions appreciated alongside the recovery of the digital asset markets.

The large cash position was a detractor from performance when compared to the broader markets, but we are comfortable maintaining such an allocation as we believe “dry powder” is an important tool when investing in a nascent technology. As confident as we feel about our current positioning, we will look to deploy cash as we see new opportunities arise. Companies that have established business models unrelated to crypto, or that have only recently introduced blockchains as an enhancement to their current operations, were not afforded the same recognition by the market. Even so, these legacy businesses continue to grow as their blockchain initiatives take hold.

Whether their operations are established or developing, we have chosen to focus on companies that will be able to grow synergistically with digital assets like bitcoin, as opposed to the myriad companies that may eventually become displaced by the underlying blockchain technology. In our view, the croupiers known as regulated exchanges present the greatest opportunity, and the greatest optionality on top of a proven business model. The events discussed in the body of this commentary have been noted as catalysts for digital assets but have largely been ignored, thus far, as a catalyst for these companies. There are now 11 Bitcoin ETFs trading on United States exchanges, with the group as a whole breaking records in terms of flows and volumes since their debut. Bitcoin ETF trading has already accrued to the regulated exchanges, and as we’ve discussed previously, trading begets more trading. New products and new exposures create the need for expanded hedging and derivatives use. On top of that, the availability of liquid spot bitcoin continues to be drained by the expecting halvings and the propensity for participants to maintain positions for the long-term. Synthetic exposure through derivatives may present an opportunity to participate in markets far in excess than what is able to be done in the spot market. The Chicago Mercantile Exchange (CME), as an example, currently has the largest open interest for Bitcoin futures contracts in the world (as of February 2024). The New York Stock Exchange (NYSE), Nasdaq exchange, and the CBOE have applied for rule changes that would allow them to list options on the new Bitcoin ETFs. We are confident about the strong fundamentals of these companies and await the realization of these new initiatives.

Important Risk Disclosures

Please consider carefully a fund's investment objectives, risks, charges and expenses. For this and other important information, obtain a statutory prospectus and summary prospectus by contacting 646-495-7333. Read it carefully before investing.

The performance data quoted represents past performance and does not guarantee future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when sold or redeemed, may be worth more or less than their original cost. Current performance may be higher or lower than the performance quoted.

The Horizon Kinetics Blockchain Development ETF (Symbol: BCDF) is an exchange traded fund managed by Horizon Kinetics Asset Management LLC ("HKAM").

Investing involves risk, including the possible loss of principal. Shares of any ETF are bought and sold at market price (not NAV), may trade at a discount or premium to NAV and are not individually redeemed from the Fund. Brokerage commissions will reduce returns. The Fund's investments in securities linked to real assets involve significant risks, including financial, operating, and competitive risks. Investments in securities linked to real assets expose the Fund to potentially adverse macroeconomic conditions, such as a rise in interest rates or a downturn in the economy in which the asset is located.

The Fund is non-diversified, meaning it may concentrate its assets in fewer individual holdings than a diversified fund. Therefore, the Fund is more exposed to individual stock volatility than a diversified fund.

Fund holdings and sector allocations are subject to change at any time and should not be considered recommendations to buy or sell any security.

The Fund invests in foreign securities which involve greater volatility and political, economic and currency risks and differences in accounting methods. These risks are greater for investments in emerging markets.

The Fund may invest in the securities of smaller and mid-capitalization companies, which may be more volatile than funds that invest in larger, more established companies. The fund is actively managed and may be affected by the investment adviser's security selections.

Diversification does not assure a profit or protect against a loss in a declining market.

Fund holdings and sector allocations are subject to change at any time and should not be considered recommendations to buy or sell any security. Please see the schedule of investments for a complete list of holdings.

Associated Risk of Investing in Blockchain Development Companies. The Fund will invest in Blockchain Development Companies. At times, Blockchain Development Companies may be out of favor and underperform other industries or groups of industries or the market as a whole. In such event, the value of the Shares may rise and fall more than the value of shares of a fund that invests in securities of companies in a broader range of industries.

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