Blockchain Development ETF (BCDF)

2022 Annual Letter

February 2023

Technology changes. People don't.

Over the past year, we've seen some high-profile examples of dubious behavior exhibited by some tied to the crypto industry. It should be noted that poor decision-making by industry participants is an indictment of the bad actor – not the underlying asset. Unfortunately, across asset classes, over the years we have seen countless examples of the misuse of client assets by brokers.

Past instances of client asset misuse and fraud have led to bankruptcies for the perpetrators, and adjustments in industry regulations to provide additional customer protections. Fraudulent activities committed by commodity trading companies in 2011 and 2012 did not indicate some indelible flaw in wheat or soybeans. The underlying products and assets that these firms transacted in were not the cause of unlawful behavior. They did not "fail" industry participants.

In the wake of recent developments, it seems likely that additional cryptocurrency regulation will be proposed. But it is extremely difficult to enforce restrictions at the base protocol layer. How does any authority effectively impose its will upon a global decentralized system of math, algorithms, rules, and intangible assets? Many misinterpret what these regulatory intentions mean for digital assets.

Participants need to ensure they are getting a fair price, that their assets are secure, and that they are not being manipulated. Within all the prospects of disintermediation and decentralization, we will still need regulated parties to filter through the pseudo-information presented from those trying to game the system. Every transaction provides information content for subsequent valuations. Inauthentic transactions, like spoofing and wash-sales, can easily distort markets. The full benefits of blockchain-based assets cannot be realized without transactional authenticity at the marketplace level.

For nearly every asset class, there are controls related to transactions that realize the practical limitations of human nature. Regulatory authorities do not have the resources to perform these duties directly, so they "deputize" institutions as Self-Regulatory Organizations ("SRO") to police trading and industry participants. We know many of these SROs as financial exchanges.

There are SROs that offer crypto futures, but there are currently no crypto spot exchanges that operate with the designation of SRO. In fact, it is difficult to call the companies facilitating transactions in the spot market "exchanges", as they really only match buyers and sellers without much authority over rule-setting or enforcement. We view them more from a brokerage perspective. Many of these companies hold inventory for market making purposes or for their own benefit, which is something that obscures the neutrality required for Self-Regulatory Organizations. An exchange that takes market risk may not be entirely objective.

This landscape is quickly changing. The Chicago Board Options Exchange now offers Cboe Digital, with a substantial set of rules and procedures for spot market digital asset trading and clearing. It may take some time for review by regulatory authorities, but we believe it is likely that Cboe Digital's Spot Market will eventually be recognized as a much-needed SRO that provides clarity and transparency to crypto spot trading. If this plays out, it is likely that other exchanges with solid regulatory standing will follow. This is an enormous step in the recognition of cryptocurrencies as a legitimate asset class. It is also an enormous development for the portfolio.

True exchanges like Cboe have robust business models: high margins, scalability, and low capex[1] requirements needed to achieve growth. They operate as financial technology companies but lack the excessive tech valuations.

[1] *CAPEX: Capital expenditures (capex) refer to funds that are used by a company for the purchase, improvement, or maintenance of long term assets to improve the efficiency or capacity of the company.*

We view these companies as solid businesses in their current form, with incredible optionality related to the incorporation of blockchain-based digital assets.

We've focused much of the portfolio commentary and decision-making on the prospects of the cryptocurrency market. Though blockchain applications are not restricted to cryptocurrencies, we believe that select cryptocurrencies are currently the most promising use case of the technology. Bitcoin, and a few others with similar implementations, stand out from the perspective of decentralization, scarcity, security, and transparency. The application of the technology to tokenize other assets in a decentralized format with provable issuance, transfers, and balances across participants remains a vision of our management team.

Blockchain does not inherently make a digital asset valuable. There are a variety of iterations that apply different protocols, but the tech can be used to provide substantial improvements to incumbent systems. The digital asset itself still needs to exhibit the same supply and demand attractiveness that drives interest in any investment. This is why, with over 20,000 cryptocurrencies available, we are only interested in a handful from an investment perspective.

A strength of the portfolio lies in the wide net cast by an exchange-heavy approach. For exchanges, it may not matter which digital assets end up the winners and losers of the coming age. As long as a sound platform can apply a consistent ruleset among similar blockchain-based assets, these exchanges can benefit from additional volume across the ecosystem. While we optimistically await additional applications of the technology, we are happy to hold companies that aim to enhance the networks of digital assets we currently find valuable.

BCDF was curated with a forward-looking approach to the blockchain developments within these businesses. While most exchanges are involved with the development of digital asset solutions, it remains a relatively small portion of their revenues given the infancy of the asset class. We believe this will change in the near future, as this optionality is realized, and the asset class is legitimized.

Portfolio Update:

The Fund's negative performance was driven by a significant collapse in the cryptocurrency markets, as highly leveraged companies across the industry collapsed under sustained price pressure. Cryptocurrency as an asset class is still nascent, and many companies with more established exposure remain unproven from an operating perspective. The Fund has largely avoided these companies, preferring to own firms with sound business models even if their blockchain solutions remain in early development.

Major performance drivers remain tied to transactional volume and adoption of cryptocurrencies as an asset class. Financial exchanges and select investment managers exemplify sound businesses that can exploit the optionality tied to any expansion of these metrics. Rising cryptocurrency prices and a renaissance in the bitcoin mining space may give rise to additional opportunities for allocations. We remain optimistic that major vectors of bitcoin economics – the network hash rate and equipment pricing– will eventually normalize, providing an opportunistic environment for those companies with appropriate capitalization and patience.

Data as of: 12/31/2022

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

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.

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 does not invest directly in cryptocurrencies or initial coin offerings and as a result, its performance does not seek to, and should not be expected to, correspond to the performance of any particular cryptocurrency. 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.

HKAM does not provide tax or legal advice, all investors are encouraged to consult their tax and legal advisors regarding an investment in the Fund. You may obtain additional information about HKAM at our website at www.horizonkinetics.com.

The Horizon Kinetics Blockchain Development ETF (BCDF) is distributed by Foreside Fund Services, LLC ("Foreside"). Foreside is not affiliated with BCDF or Horizon Kinetics LLC or its subsidiaries.