WHY ETHEREUM NOW?

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GALAXY
FUND MANAGEMENT

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Bitcoin may be the first and best-known digital asset. But the second-largest digital asset, Ether (commonly called Ethereum or ETH), also merits serious consideration by forward-thinking investors. The Ethereum blockchain has grown into the world's most actively used blockchain, with open-source rails that allow for decentralized applications to tap into its smart contract capabilities. As Ethereum continues its ascent, here are five tailwinds that we believe indicate the asset has more room to run.

INCREASING ENGAGEMENT WITH THE ETHEREUM NETWORK

Usage of the Ethereum network continues to grow and, as demonstrated by the number of active wallets, some experts claim Ethereum usage is outpacing that of bitcoin.

Ethereum has a remarkably robust developer community, spanning both ETH core developers and developers who build decentralized applications on top of Ethereum. Experts are calling the Ethereum blockchain a sponge for strong developer talent. Ethereum's current utilization rests around 51% after the implementation of EIP-1559.[1] This positive shift may lead to upward pressure on the price of Ether.[2] In addition, Ethereum is the most widely used collateral base in decentralized finance (DeFi) with 5.9M total locked value, or about $7.2B.[3] Outside of DeFi, other communities are being built on top of Ethereum, including NFTs, stablecoins, and other applications. Therefore, as developer engagement with the Ethereum network increases, we expect the asset to strengthen.

ETHEREUM BLOCKCHAIN IMPROVEMENTS

The upcoming Ethereum upgrade to ETH 2.0, along with their recent implementation of EIP-1559 should make the Ethereum blockchain more scalable, secure, and sustainable. The two in conjunction are important because of the synergistic benefit achieved when you combine a Proof of Stake model (ETH 2.0) with a deflationary supply asset (Ethereum after EIP-1559). When sharding, the process of splitting a blockchain into multiple interconnected blockchains that work to independently process transactions, is combined with the power of off-chain rollups (encrypted packages of data) ETH 2.0 should be able to have 100,000 transactions per second (TPS), compared to its 15 TPS during ETH 1.0.[4]

Ethereum 2.0 is the initiative to increase the scalability of the Ethereum blockchain and switch from Proof of Work (PoW) to Proof of Stake (PoS). This transition provides several benefits:

- PoS is inherently faster and more efficient than PoW because validators only have to verify transactions. They no longer have to solve a mathematical "proof of work" equation.
- PoS requires less energy consumption than PoW, an important consideration as the digital asset industry moves towards climate-focused, sustainable, "green" initiatives.
- PoS aligns the operators upholding the network with the network/asset itself. Under a PoS system, the validator has to hold and stake the chain's native asset. So validators, by definition, hold a substantial amount of Ethereum and have a vested interest in seeing its value rise.
- Switching to PoS will allow Ethereum to implement sharding. This functionality should allow Ethereum 2.0 to host up to 100,000 transactions per second (compared to Ethereum's current 15 TPS), become more decentralized (phones will be able to run Ethereum), and have increased security due to reduced hardware requirements.

1) Source: ycharts.com, as of 06/01/2022.
2) Source: Bloomberg.com.
3) Source: DeFi Pulse, as of 06/14/22.
4) Source: Co-founder Vitalik Buterin's forum post.

EIP-1559 went live in August 2021, changing Ethereum's transaction fee model through the implemention of a "base fee" that is algorithmically determined by the congestion of the network. This will work to reduce the volatility of gas fees on Ethereum by making them more predictable and stable. In addition, under EIP-1559, the base fee is now burned by the network and removed from the circulating supply, introducing a deflationary supply model for Ethereum. EIP-1559 carries the potential magnitude for impact on ETH's price comparable to a bitcoin halving event.[5]

The combination of Ethereum 2.0 and EIP-1559 will lead to more people using Ethereum, creating a more secure, decentralized network and enticing the number of people using Ethereum to increase – thus, further fortifying the network. The projected result of this is a deflationary asset increasing in both security and user activity.

ETHEREUM IS A NATURAL NEXT STEP FOR BITCOIN HOLDERS

In the past few years, bitcoin has received outsized attention as a first mover and the largest digital asset. As bitcoin investors' comfort with crypto increases, their research and comfort often progresses to Ethereum. Investors then discover more palpable aspects of the network in terms of how they use the asset and what it means. Bitcoin was the breakout crypto asset; its lane focuses on its store of value properties, signifying bitcoin as digital gold. Ethereum, on the other hand, offers an entirely different use case, often referred to as Web 3.0. While bitcoin focuses on securely validating transactions (A to B), Ethereum is more of a mesh fabric offering greater flexibility as a network and allowing for more interoperability.

Ethereum benefits from the enthusiasm, curiosity, and familiarity that bitcoin has already forged on the investor's trail into cryptocurrency. We see continued interest in the exploration of Ethereum from an institutional perspective, an investment perspective, and a development perspective.

INVESTORS WARMING TO THE POTENTIAL OF DECENTRALIZED FINANCE

Decentralized finance (DeFi) is a global, open alternative to traditional financial services. Substantially all of the DeFi ecosystem is being built on the Ethereum network. Advancements in blockchain technology empower DeFi developers to recreate the architecture of legacy financial systems with a code-based digital infrastructure of DeFi apps. These apps replicate traditional financial functions such as borrowing, lending, and exchanging assets, and they do so in a permissionless manner without relying on traditional financial intermediaries.

For financial professionals considering investing in the crypto sphere, DeFi is a more tactile, palpable adaptation. DeFi developers are using their familiarity with the way finance works now and looking at potentially better methods via more advanced technology. And while there is still a debate around exactly what bitcoin is, people are focusing more on the utility of the Ethereum network.

INCREASED INSTITUTIONAL ADOPTION AND EASE OF ACCESS

Institutional adoption of Ethereum is gaining steam following Bitcoin's playbook in maturing as an institutional asset. Institutions and companies like the European Investment Bank and Visa have validated the Ethereum blockchain by announcing issuance and settlement use cases, respectively. Ethereum is gaining recognition from custodians as well.

Last December, Visa launched a multinational crypto advisory service for banking clients and merchants to assist clients and partners with crypto. Most recently, at the beginning of March 2022, President Biden signed an Executive Order outlining the first ever, "whole-of-government" approach to harnessing the potential benefits of digital assets and their underlying technology.[6]

Ethereum's last bull run was mainly tied to bitcoin's concurrent run. Four years later, Ethereum now stands on its own with clear, real-life use cases. The Ethereum blockchain will continue to mature as the base layer technology for smart contracts and decentralized applications. And Ethereum will stand to benefit as the next iterations of the internet and finance evolves.

5) Source: Arca, 05/2021.
6) Source: White House Fact Sheet, 03/2022.

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