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GSR Venture Investments

Looking Ahead 2024

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Setting the scene

Before delving into our investment narratives, it is crucial to highlight the key factors shaping the investment landscape in 2024. Examining the macro environment, the year will likely witness over 60 elections that will impact almost half of the world's population. These elections could lead to substantial changes in economic policies, geopolitical stances, and the general attitude toward crypto. With inflation finally trending down, central banks may for the first time in years ease monetary policy, adding yet another potential macro catalyst for crypto.

Turning our attention to the crypto sector specifically, the year has commenced on a positive note with the approval of multiple spot BTC ETF listings in the US. And with several applications in for a spot ETH ETF, it is possible the largest smart contract blockchain may just follow suit with an ETF of its own. Elsewhere, a jurisdictional race is underway among the UK, EU, Singapore, Hong Kong, Saudi Arabia, Abu Dhabi, Dubai, and Bermuda to establish an effective regulatory framework and become a global hub for the industry. We might see a spot ETH ETF and other layer 1 spot ETFs be approved outside of the US first.

Looking ahead, several crypto-specific catalysts are poised to drive change and perhaps push us into a full-blown bull cycle. The return of yield farming and TVL opportunities, alongside ongoing frustration about the usability of on-chain applications, could spur more innovation in 2024. The BTC halving, approximately 100 days away, could bring additional investment into Bitcoin, with continued innovation around inscriptions, BRC-20s, and layer 2 solutions.

Additionally, 2024 may witness the resolution of past traumas, including MtGox repatriation, FTX's collapse, Luna and Do Kwon, 3AC's portfolio, and the Genesis / DCG / Gemini relationship. And last but not least, crypto and AI will increasingly be utilised together, promising yet another eventful year.

Our narratives

1. *Evolving CeFi and hybrid market structure for regulated institutions*

CeFi remains the primary entry point into crypto for retail and institutional players due to its familiarity, ease of use, and faster-to-build-or-innovate nature.

In response to FTX and Binance, numerous hybrid exchanges have emerged, aspiring to blend the transparency of DeFi with the efficiency of CeFi. However, only a few have succeeded in differentiating themselves through effective go-to-market strategies and innovative technologies. Some companies have demonstrated early success by prioritising airdrops and strategic listings. We anticipate the continued launch of new exchanges in the first half of the year, with potential fundraising for Seed / Series A rounds in the latter half, focusing on specific ecosystems. We will continue to see more combinations of CeFi and DeFi offerings on a single platform which offers the market more useful products and increased transparency. In the near-term, permissioned / regulated DeFi projects will be on the rise as the industry braces for greater regulatory oversight.

Alongside the emergence of new exchanges and custody providers, there are new middleware solutions that aim to reduce setup and maintenance costs and address challenges related to capital efficiency. These solutions range from data management to execution, clearing, and settlement. The key differentiators lie in establishing a medium to long-term market structure, with a particular emphasis on Day 1 network effects (Proof of Concept partners) and recurring revenue.

Other prevalent themes include data analytics, cybersecurity, and compliance solutions. Public and centralised data sources can be leveraged to explore data implications, combined with AI for predictive products or automated funds. The need for enhanced security measures and resilience against hacks has become imperative, especially after hackers stole around $1.7bn in 2023. As exemplified by the Binance settlement order, regulators are focused on the lack of proper AML/KYC processes, thereby amplifying the importance of compliance solutions ahead of potential regulations in 2024/25.

2. ***The return of DeFi: credit markets, stablecoins, DEXs, liquid staking & restaking***

DeFi stands as one of blockchain's largest and most innovative segments, offering diverse investment opportunities, enhanced accessibility, and composability.

Crypto needs its credit market to flourish, especially given the lack of credit from outside sources. While credit markets were tight in 2023, 2024 is laying the groundwork for higher-yield credit products, leveraging RWAs and LSTs as collateral as companies get back to the private credit space. New on-chain credit marketplaces are emerging for bilateral un(der)collateralised loans, aiming to minimise third-party oversight. This shift underscores the need for better credit assessments, transparency, and an understanding of duration risk.

In the stablecoin category, there is a rising interest in new stablecoins such as a)

T-bill-backed stablecoins, driven by the high-interest rate environment in the real world vis-a-vis relatively low on-chain yields, or b) decentralised, non-fiat-backed stablecoins. This trend will extend beyond T-bill backing to include collateralised RWA (such as public and private debt) or local fiat (such as GBP / EUR / HKD stablecoins), aligning with evolving regulatory policies. The long-term potential for these stablecoin issuers could lead to the emergence of new payment companies or neobanks focusing on remittance services or savings / investing, or serving as asset managers bringing RWA yield to the crypto sphere.

DEXs and aggregators, constituting ~15% of total spot trading volume, will continue to experience growth in 2024. We are seeing DEXs improving user experience by introducing aggregating liquidity sources, swapping without network costs, and mitigating MEV attacks. Aggregators could also emerge as winners on top of DEXs with new features to better capture value for customers.

Liquid staking, the largest DeFi subcategory by TVL, enables broader participation in staking while removing its opportunity cost. Our interest lies not only in restaking primitives but also in Distributed Validator Technology which can increase redundancies and reduce slashing penalties. We are also excited about a potential catalyst through the application of a spot ETH ETF.

3. ***Tokenization of RWA will multiply the size of the crypto industry and bring sustainable yields to crypto users***

We share the following fundamental beliefs when it comes to RWAs:

- Blockchain solutions: Blockchain could address technological, access, and liquidity challenges for traditional financial assets
- On-chain investment: Crypto users want to invest in traditional financial assets without leaving the blockchain
- Efficient asset processing: Trillions of dollars of assets can be processed more efficiently with blockchain technology
- Collateral and yield: RWAs can serve as collateral, providing yield to both DeFi and CeFi
- Capital efficiency: The crypto market can provide a capital-efficient funding source to real-world issuers

RWA developments in crypto today primarily focus on bank-owned solutions (e.g. project Guardian), yield-bearing stablecoins, and DeFi lending protocols. Go-to-market strategies often involve partnerships with sell-side entities (banks, issuers), buy-side actors (funds), private or public chains, DeFi platforms, and regulatory bodies. The types of assets that can be tokenized depend on risk and liquidity, ranging from T-bills and public instruments (bonds, stock, funds) to less liquid instruments like private debt, private funds, real estate, and royalties. High-risk emerging market debt may not be suitable for immediate tokenization, with initial projects likely coming from financial institutions and protocols focusing on bringing high-quality credit to the crypto space.

Key interest areas include credit, secondary trading markets, tools like oracles, identity solutions, regulated trading platforms and wallets, technology middleware, and yield aggregators.

4. ***Gaming is the most likely vertical to see mass consumer Web3 adoption***

Gaming is a massive consumer sector with 3.4bn gamers globally, so as crypto games transition away from play-to-earn to seamless Web3 integrations, we can see a paradigm shift, solving many of the issues with free-to-play and vastly improving the player experience.

Web3 offers the potential to create novel gaming experiences, particularly in AI integration. AI-driven gameplay combined with Web3 ownership can deepen engagement, leading to higher conversion and retention rates, increased playtime, and enhanced user enjoyment. In this landscape, AI agents are poised to be the first use case, relying on Web3 infrastructure and payment rails, further revolutionising the gaming experience. Monetisation models can expand into new revenue streams through Web3, likely becoming the dominant business model in gaming over the next decade. We have specific interest areas including:

- Using Web3 for innovative gamer experiences
- AI x Web3 Gaming for lifelike NPCs and deeper engagement
- UGC, community-based game development, and incentivised modding
- Mobile Web3 Games
- Asia-focused game developers
- Infrastructure for fully on-chain games

5. ***SocialFi had its "Cryptokitties moment" in Friend.tech, signalling the opportune time for Web3 social apps***

Improved blockchain scalability and the emergence of progressive web apps have laid the foundation for Web3 Social to start reaching more mainstream audiences. Friend.tech's launch last summer may well have been the "Cryptokitties moment" for SocialFi. It showed that users are hungry to play with Web3 social apps just as Cryptokitties demonstrated that NFTs were a compelling new use case for users. We expect Friend.tech will inspire an analogous wave of experimentation in SocialFi.

Social apps can be gamified, fostering deeper engagement between artists and superfans, and creating new user roles with incentives.

The first wave of Web3 social apps focused on decentralising and open-sourcing the social graph; this is a philosophically compelling evolution in the design of social media, but so far has not attracted a significant number of new users. Our interest areas include social apps serving as filtering layers for social media, addressing the attribution problem in a generative AI world, apps that allow for new user roles, changing the one-way flow of capital to creators, and gamifying social financialisation. The unique financial aspect of Web3 in SocialFi could extend to speculation through betting systems and incentivisation on successful social platforms.

6. *Emergence of AI and crypto applications*

The intersection of AI and blockchain holds promise for streamlining crypto processes and enhancing efficiency. AI can alleviate friction, while blockchain addresses the intricacies of computing and verification in AI applications. Key areas of interest include:

- Content Generation: AI-driven applications in gaming, generative data for images and music
- Identity and IP Security: Verifying data from AI or non-AI sources, copyright protection, proof of personhood, and enabling micropayments between AI agents
- Cybersecurity and Compliance: Predictive and preventive measures against bad actors, fraud, wash trading, and post-transaction monitoring
- Data Utilisation: AI for predicting and creating trading patterns, applicable to pricing long-tail assets, NFTs, AI-driven index funds, and DAO operations
- AI Improvement Technologies: Exploring technologies like zkML or DePIN for distributed computing power and data storage

However, execution risks include significant costs to build and maintain proprietary AI models and dependencies on open-source systems. Balancing these considerations is crucial for successful integration and sustained innovation in this dynamic landscape.

7. *Permissionless blockchains: enabling global monetary value exchange*

Permissionless blockchains are the optimal technologies and economic frameworks to establish unified, non-sovereign, global, and real-time monetary value exchange networks. Our primary focus remains on cross-border interoperability, a sector representing $100tr in annual value transfers. This sector is segregated with a multitude of local payment methods each not interoperable with one another, where the role of a stablecoin could be the intermediary layer. Despite slow crypto adoption due to a lack of incentivization and network effects, we anticipate infrastructure innovation will continue to develop and demand for crypto payment will grow as the industry expands. Our key focus areas include:

- Onchain P2P On and Off-Ramps: Simplifying entry and exit points for users within the blockchain network
- Interoperability between Local Payment Methods: Utilising stablecoins as intermediaries to bridge the gap between non-interoperable local payment methods
- Crypto Native Issuing and Merchant Acquiring: Enhancing the integration of crypto-native solutions for issuing and acquiring payments
- Bitcoin Lightning and Taproot Assets: Exploring the potential of Lightning Network and Taproot to enhance the scalability and functionality of Bitcoin-based transactions

8. ***Blockchain infrastructure today is far from perfect; innovations are needed to improve execution, governance, usability, and composability***

Monolithic blockchain structures face scalability and customisation challenges, prompting a shift toward modular approaches. Developers can now independently select execution, settlement, consensus, and data availability environments. This has led to innovations like data availability solutions, shared sequencers, and new execution environments.

The inscription trend has triggered outages and surged transaction fees on major networks, emphasising the need for change. Traditional VMs process transactions sequentially, but parallel VMs process multiple transactions concurrently, boosting transaction throughput. However, the transition to parallel execution could involve complexities such as conflicting transactions, increased trust assumptions given the additional layers, and an ongoing transformation closely monitored for advancements in scalability and efficiency.

Privacy technology will be taken further through focuses on increasing computation available for on-chain apps via solutions amalgamating ZK-proofs and Fully Homomorphic Encryption (FHE). With ZK acting as a true or false check, FHE permits computations on encrypted data, pushing us one step closer to blockchain uses in the medical sector and private information like payroll.

Observing the substantial BTC holdings reluctant to move away from Bitcoin, there is a growing interest in earning yield on BTC and engaging in on-chain activities. Narratives around Ordinals and BRC-20 tokens have gained traction, further supported by approvals of BTC spot ETFs. We will watch this space with much anticipation.

9. ***The re-emergence of Decentralised Physical Infrastructure Networks (DePIN)***

While DePIN projects (currently under 1% of the total crypto market cap), are not new, significant growth is anticipated this year. DePINs reemerge as a cutting-edge solution to address compute, data, and centralisation challenges in 2024. Further developments in established DePIN projects have led to full ecosystems evolving.

AI will continue to play a large role in the importance of DePIN due to the large compute processing, data frameworks, and data storage that it can require. This is matched by ethical questions of whether these powerful AI technologies should be under a centralised partner or rather democratised to a decentralised system. In addition, projects can bootstrap supply-side obstacles through token incentives which can lead to lower prices as well as improved real-time updates compared to traditional options once a true network effect is seen. The pivotal factor lies in growing the demand side commensurately, including partnerships with large Web1 and Web2 companies, given some of the most successful projects so far have been combinations of traditional players in their industry and decentralised technology. The success of DePINs hinges on balancing these elements in the dynamic landscape of 2024.

Closing thoughts

We see a very exciting year ahead across many areas in crypto, with several key events poised to shape the market significantly. Acknowledging the potential impact of macro conditions, challenges persist in areas such as regulation and rebuilding trust with retail and TradFi investors. However, amidst these hurdles, positive indicators of adoption and underlying innovation are evident. Anticipating a strengthening crypto landscape, we foresee continued validation of its long-term ambitions for the future.

About GSR

GSR has ten years of deep crypto market expertise as a market maker and active, multi-stage investor. GSR sources and provides spot and non-linear liquidity in digital assets for token issuers, institutional investors, miners, and leading crypto exchanges. GSR is deeply embedded in every major sector of the crypto ecosystem. We work with leading crypto native entrepreneurs as well as financial institutions taking their first steps into the world of digital assets. GSR Markets Pte. Ltd. has received In-Principle Approval from the Monetary Authority of Singapore (MAS) for a Major Payment Institution licence.

About GSR Venture Investment

GSR is an active, multi-stage investor in more than 100 crypto companies and protocols building the future of finance and technology. Since 2020, we have invested over $100m into the ecosystem and formed lasting relationships with our portfolio companies through our vast network, extensive suite of services, and a global team.

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