



One of the main proposed use cases for bitcoin in portfolios is to potentially enhance portfolio diversification and risk-adjusted returns. (UBS)

New spot bitcoin ETFs: Addressing some initial questions

08 February 2024, 4:23 pm CET, written by UBS Editorial Team

Spot bitcoin ETFs are finally here. In this article, we provide a quick overview of the ETFs and hopefully answer some of the potential questions.

In the past, bitcoin has been referred to as digital gold. Coincidentally, spot bitcoin ETFs are very similar to gold ETFs. They are designed to closely track the price of bitcoin, less expenses. Expenses include the operating expenses, such as the management fee, and the trust's trading costs. The ETFs are structured as grantor trusts and are backed by bitcoin held by a custodian. The amount of bitcoin each ETF share represents will gradually decline overtime as bitcoin needs to be sold to cover trust expenses.

Similar to gold ETFs, there is the risk of theft and the custodian is responsible for the safekeeping of the assets. The custodian is only liable for losses resulting from their own negligence, fraud, or willful default in their responsibilities. Importantly, the issuer also has a role in safekeeping and in execution even if the custody and the digital asset execution partner(s) are the same. So there are more differences than are immediately apparent based on reviewing the higher level information on the ETFs. These differences may/may not lead to meaningful performance disparities between the ETFs.

From a tax perspective, spot bitcoin ETFs do not issue K-1s. While physical gold ETFs are treated as collectibles, spot bitcoin ETFs are treated as property. Therefore, capital gains are taxed at long- or short-term rates depending on the investors holding period. Separate from a shareholder buying or selling, there could be capital gains/losses reported by the issuer (reported to the shareholder via IRS form 1099-B) resulting from the sale of bitcoin to cover expenses.

Advantages

For most investors, spot bitcoin ETFs likely provide a simplified and more secure way to gain exposure to bitcoin, when compared to other approaches. The ETFs relieve investors from decisions/due diligence around custody/storage, crypto

exchanges, and best execution when trading bitcoin. There's also the benefit of the enhanced liquidity from the exchange trading. While bitcoin futures ETFs also benefit from the professional management and the enhanced liquidity, they're not designed to track the price of bitcoin.

Disadvantages

Spot bitcoin ETF investors do not have direct ownership in bitcoin and are bound by market hours for trading. The simultaneous approvals of the ETFs contributed to an immediate price war prior to launch, which helped to lower the cost of spot bitcoin ETFs for investors. While spot bitcoin ETFs could provide lower cost access to bitcoin than some alternatives, direct ownership may be cheaper for long-term investors who do not regularly trade their position. In this instance, the ongoing underlying fees of an ETF may be more impactful than the higher trading costs that may come with direct ownership.

What are the risks?

The risks of spot bitcoin ETFs include all of those related to cryptocurrencies including, but not limited to, significant drawdown risk, regulatory changes, fraudulent activities, cybersecurity breaches, theft, and negative sentiment. The risks section of a spot bitcoin ETF prospectus are enough to give Freddy Krueger nightmares.

For the spot bitcoin ETFs, we also want to stress that the ETF structure doesn't eliminate the liquidity risk of the underlying bitcoin market. ETF prices can quickly reflect the cost of trading in that underlying market. The bitcoin market is especially volatile and there may be a significant cost for investors trading in volatile, illiquid markets.

One of the main proposed use cases for bitcoin in portfolios is to potentially enhance portfolio diversification and risk-adjusted returns. However, we'd caution that bitcoin is highly volatile and there have been three major drawdowns surpassing a 70% loss since 2014.

On a go-forward basis, while it's possible that bitcoin allocations are able to improve risk-adjusted returns of a portfolio, it's certainly not without risk. In the last 10 years, even a 10% allocation to bitcoin in a balanced 60-40 equity bond portfolio would have increased the portfolio's volatility and drawdowns to the levels of an all equity portfolio, and would have seen bitcoin drive about 50% of the portfolio's volatility. Given the correlation to global equities and high volatility/drawdown risk, we believe that there are more effective strategies if the objective is portfolio diversification.

Considerations for selecting a spot bitcoin ETF

UBS does not provide advice on specific virtual assets nor with the selection of spot bitcoin ETFs. Given that the ETFs are each trying to track bitcoin prices, we expect a lot of attention will be paid to fees and liquidity. Investors evaluating spot bitcoin ETFs should consider the following:

- The investment horizon dictates the relative importance of cost vs. liquidity. The longer the time horizon of the trade, the more important expenses become. The more tactical the trade, the more liquidity will matter in terms of ease of trading. We note that given shares can be created/redeemed, so there will be more liquidity than what may be apparent.
- Bitcoin is a volatile asset, so minor differences in expenses likely don't matter much all things considered and shouldn't sway you from an issuer that you have more comfort/confidence in their ability to manage the product.
- Given the importance of safekeeping of bitcoin and the potential for high volatility, investors may want to consider the issuer's experience (or the issuer's partner) within the crypto industry.

While the spot bitcoin ETFs are likely to perform similarly to each other in calmer markets, this may not be the case during more volatile markets. It remains to be seen if the issuers will be able to distinguish themselves in terms of ability to manage the product during turbulent markets.

For much more, see the full report - [Spot bitcoin ETFs: Exchange-traded funds](#), published 26 January, 2024.

*If you direct a trade in a security tied to virtual currencies or cryptocurrencies, you do so on an unsolicited basis. Please note that UBS does not provide advice on specific virtual assets nor with the selection of spot bitcoin ETFs.

This document is prepared and published by the Global Wealth Management business of UBS Switzerland AG (regulated by FINMA in Switzerland), its subsidiaries or its affiliates ("UBS"), part of UBS Group AG ("UBS Group"). UBS Group includes Credit Suisse AG, its subsidiaries, branches and affiliates. In the USA, UBS Financial Services Inc. is a subsidiary of UBS AG and a member of FINRA/SIPC. This document and the information contained herein are provided solely **for your information** and UBS marketing purposes. Nothing in this document constitutes investment research, investment advice, a sales prospectus, or an offer or solicitation to engage in any investment activities. This document is not a recommendation to buy or sell any security, investment instrument, or product, and does not recommend any specific investment program or service.

Information contained in this document has not been tailored to the specific investment objectives, personal and financial circumstances, or particular needs of any individual client. Certain investments referred to in this document may not be suitable or appropriate for all investors. In addition, certain services and products referred to in the document may be subject to legal restrictions and/or license or permission requirements and cannot therefore be offered worldwide on an unrestricted basis. No offer of any product will be made in any jurisdiction in which the offer, solicitation, or sale is not permitted, or to any person to whom it is unlawful to make such offer, solicitation, or sale.

Although all information and opinions expressed in this document were obtained in good faith from sources believed to be reliable, no representation or warranty, express or implied, is made as to the document's accuracy, sufficiency, completeness or reliability. All information and opinions expressed in this document are subject to change without notice and may differ from opinions expressed by other business areas or divisions of UBS Group. UBS is under no obligation to update or keep current the information contained herein. **The views and opinions expressed in this material by third parties are not those of UBS.** Accordingly, UBS does not accept any liability over the content shared by third parties or any claims, losses or damages arising from the use or reliance of all or any part thereof. All pictures or images ("images") herein are for illustrative, informative or documentary purposes only and may depict objects or elements which are protected by third party copyright, trademarks and other intellectual property rights. Unless expressly stated, no relationship, association, sponsorship or endorsement is suggested or implied between UBS and these third parties.

Any charts and scenarios contained in the document are for illustrative purposes only. Some charts and/or performance figures may not be based on complete 12-month periods which may reduce their comparability and significance. Historical performance is no guarantee for, and is not an indication of future performance.

Nothing in this document constitutes legal or tax advice. UBS and its employees do not provide legal or tax advice. This document may not be redistributed or reproduced in whole or in part without the prior written permission of UBS. To the extent permitted by the law, neither UBS, nor any of its directors, officers, employees or agents accepts or assumes any liability, responsibility or duty of care for any consequences, including any loss or damage, of you or anyone else acting, or refraining to act, in reliance on the information contained in this document or for any decision based on it.

Additional Disclaimer relevant to Credit Suisse Wealth Management

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject Credit Suisse to any registration or licensing requirement within such jurisdiction. Your personal data will be processed in accordance with the Credit Suisse privacy statement accessible at your domicile through the official Credit Suisse website <https://www.credit-suisse.com>. In order to provide you with marketing materials concerning our products and services, UBS Group AG and its subsidiaries may process your basic personal data (i.e. contact details such as name, e-mail address) until you notify us that you no longer wish to receive them. You can optout from receiving these materials at any time by informing your Relationship Manager.

Except as otherwise specified herein and/or depending on the local Credit Suisse entity from which you are receiving this report, this report is distributed by Credit Suisse AG, authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA). Credit Suisse AG is a UBS Group company.

Please visit | <https://www.ubs.com/global/en/wealth-management/insights/chief-investment-office/marketing-material-disclaimer.html> | to read the full legal disclaimer applicable to this material.

© UBS 2024. The key symbol and UBS are among the registered and unregistered trademarks of UBS. All rights reserved.

Appendix

Exchange Traded Funds (ETFs) Disclosure

For purposes of this report, ETFs include index-linked funds regulated under the Investment Company Act of 1940 that trade on US securities exchanges under exemptive relief from the Securities and Exchange Commission. The shares of all of the ETF issuers discussed in this Report are listed on U.S. securities exchanges. The ETFs are either open-end, registered investment companies (including UITs) operating under an exemptive order from the SEC, or collective investment vehicles, formed as grantor trusts, limited partnerships or similar structures that offer pass-through tax treatment to investors. The different structures provide different rights for investors. For example, ETFs registered under the Investment Company Act of 1940 must stand ready at all times to redeem shares (albeit only in creation unit size) whereas those ETFs that are not subject to registration under the Investment Company Act of 1940 may suspend redemptions at any time. We refer to ETFs registered with the SEC under the Investment Company Act of 1940 as “40 Act ETFs” and to non-registered ETFs as “33 Act ETFs.” All of the ETFs discussed in this Report track an index of financial instruments or provide exposure to a single commodity type.

US-registered, open-ended index-linked funds are redeemable only in Creation Unit size aggregations through an Authorized Participant, and may not be individually redeemed. Many ETFs are redeemable only on an “in-kind” basis. The public trading price of a redeemable lot of ETFs may be different from their net asset value, and ETFs could trade at a premium or discount to the net asset value. UBS AG or its affiliates act as authorized participants for many of the ETFs discussed in this report. In addition, UBS is a regular issuer of traded financial instruments and privately issued financial products that may be linked to the ETFs mentioned in this Report. UBS regularly trades in ETFs. Through these and other activities, UBS may engage in transactions involving ETFs that are inconsistent with the strategies in this report.

ETFs are subject to the same risks as the underlying securities and commissions may be charged on every trade, if applicable. This definition does not imply that ETFs are endorsed by the Securities and Exchange Commission. ETFs are sold by prospectus, which contains details about ETFs, including investment objectives, risks, charges and expenses. Clients should read the prospectus and consider this information carefully before investing. Clients may obtain more information about ETFs, including copies of prospectuses or summary, from their UBS FS financial advisor.