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Bitwise Asset Management

Tax-Loss Harvesting in Crypto: A Timely Opportunity for Financial Advisors

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Tax-loss harvesting in crypto: A timely opportunity for financial advisors

November 2022

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Agenda

1. Bitwise overview
2. Crypto market update
3. Tax-loss harvesting in crypto: A unique opportunity
4. Five key considerations when tax-loss harvesting
5. Conclusions

Bitwise overview

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Bitwise at a glance

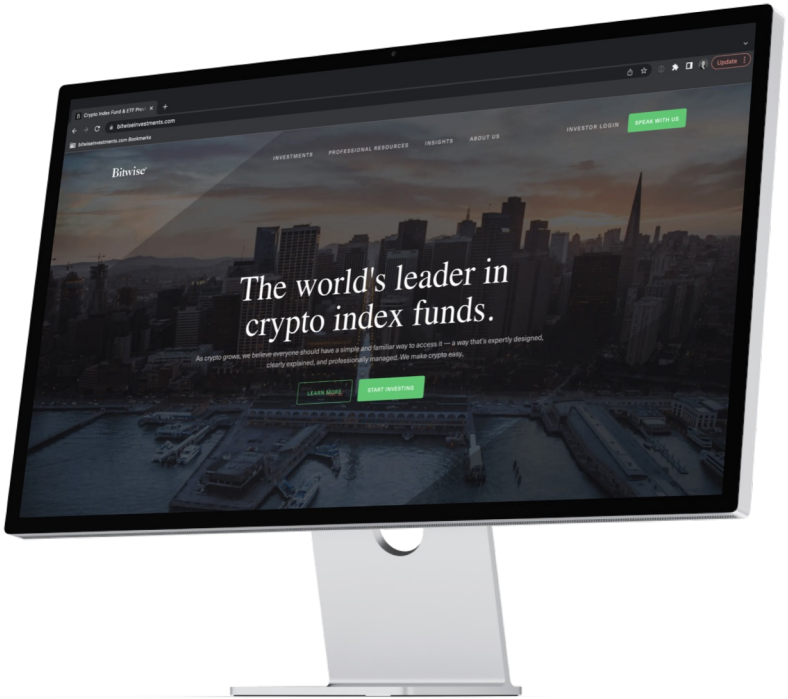
Pioneer
Founded in 2017, it's one of the largest crypto index fund managers in the world. As of year-end 2021, Bitwise managed over $1.3 billion across an expanding suite of investment solutions.

Leading brand
Industry-leading research & education. Authored CFA Institute's "Guide to Crypto."

Professional-focused
Focus on RIAs, institutions, hedge funds & family offices.

Dedicated
Sole focus on crypto asset management, indexing, and research.

Experienced
Team of over 70 professionals helps thousands of investors access and understand this fast-moving market.



Executive team: Bridging expertise in tech & asset management

Hunter Horsley
CEO
Technology Expertise

Product Manager, Facebook
Product Manager, Instagram
Economics, Wharton
Forbes 30 Under 30

Teddy Fusaro
President
Expert in Alts Portfolio Management

10-year ETF Veteran
SVP, NYLife Investments ($550B AUM)
SVP & Head of PM, IndexIQ ($5B AUM)
VP & Senior PM, Direxion ($10B AUM)
Analyst, Goldman Sachs

Matt Hougan
Chief Investment Officer
Renowned ETF Educator & Expert

15-year ETF Veteran
CEO, ETF.com and Inside ETFs
Co-author, CFA Institute's "Guide to ETFs" and "Guide to Bitcoin, Blockchain and Cryptocurrencies"
Columnist, Forbes

Katherine Dowling
General Counsel & Chief Compliance Officer
Legal Expertise

General Counsel and CCO, True Capital Management
MD, COO and CCO, Luminate Capital Partners
Assistant U.S. Attorney, Economic Crimes Unit of the U.S. Attorney's Office for the Northern District of California

Hong Kim
Chief Technology Officer
Software Security Expertise

Software Security Research, Korean Military
Software Engineer, Google
Computer Science, University of Pennsylvania

Mick McLaughlin
Chief Distribution Officer
Built $20B ETF Franchise from $0

15-year ETF Veteran
MD, Head of ETF Sales, Deutsche Bank ($20B)
Manager, Russell Investments ($300B)
Director, BlackRock iShares ($6T)

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Crypto market update

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Our mental model of crypto returns: Three main drivers

1. **Macro Factor**: Crypto is a risk-on asset, and benefits from risk-on environments.

2. **Crypto Factor**: Certain developments—like regulatory progress—impact all crypto assets.

3. **Asset-Specific Factors**: Individual crypto assets are impacted by product-market fit, technological progress, etc.

Bitcoin Returns Since March 2020

Source: Bitwise Asset Management. Data from March 1, 2020, through September 30, 2022. Please see important disclosure information at the end of this document. Performance information is provided for informational purposes only. Past performance is no guarantee of future returns. These returns reflect the returns of crypto assets, and not of any fund, and do not include expenses or other costs.

Understanding recent market trends

March 2020 – November 2021

- **Macro: Positive** – Aggressive QE & fiscal stimulus
- **Crypto: Positive** – Institutions enter crypto in a significant way
- **Asset-Specific: Positive** – Bitcoin ETF approvals (globally and U.S.), inflationary concerns rising, record VC investment in crypto
- **Result**: Bitcoin surges from ~$5,000 to ~$68,000

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Understanding recent market trends

November 2021 – June 2022

- **Macro: Negative** – Fed moves to Quantitative Tightening (QT); fiscal stimulus slows
- **Crypto: Negative** – LUNA "stablecoin" collapse; Celsius, 3AC, Voyager bankruptcies; deleveraging
- **Asset-Specific: Neutral** – No major developments
- **Result**: Bitcoin falls from ~$68,000 to ~$18,000

Bitcoin Returns Since March 2020

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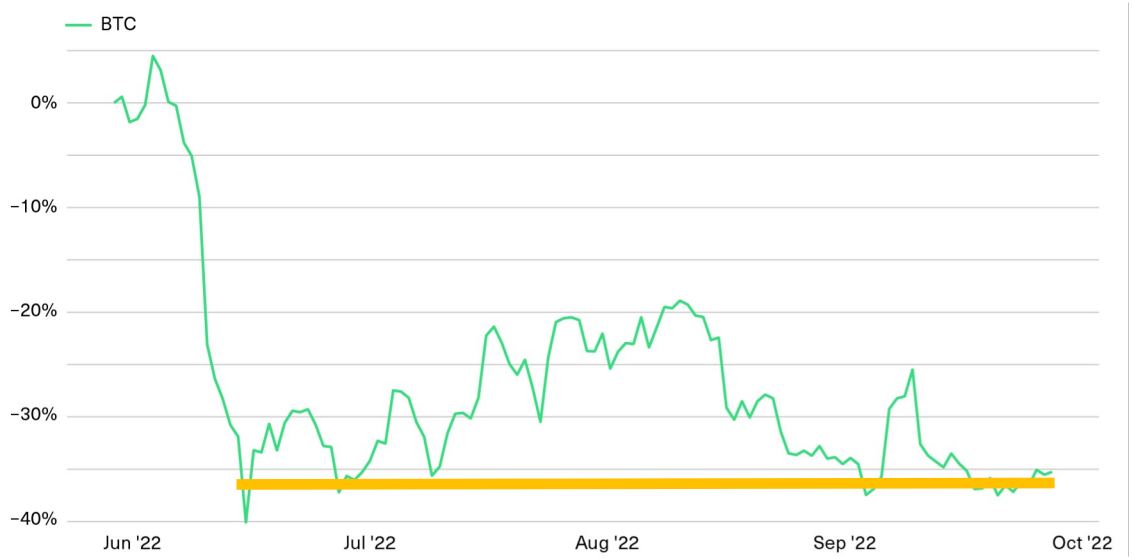
Understanding recent market trends

June 17 – September 30, 2022

- **Macro: Negative** – Fed strengthens push to fight inflation (Jackson Hole speech)
- **Crypto: Neutral** – FTX backstops crypto ecosystem with $750m in credit lines; credit crisis ends; mixed regulatory news
- **Asset-Specific**: **Positive** – Excitement builds around Ethereum "Merge"
- **Result**: Bitcoin hovers around ~$19,000

Bitcoin Returns Since June Market Bottom



Source: Bitwise Asset Management. Data from June 1 through September 30, 2022. Please see important disclosure information at the end of this document. Performance information is provided for informational purposes only. Past performance is no guarantee of future returns. These returns reflect the returns of crypto assets, and not of any fund, and do not include expenses or other costs.

Tax-loss harvesting in crypto: A unique opportunity

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Risks and Important Information

Tax-loss harvesting involves risks. These include, but are not limited to, the possibility that the strategy might result in a negative return contribution and unintended tax consequences. No information in this report is tax advice: The simulations contained herein are intended for illustrative and educational purposes only and those considering implementing a tax-loss harvesting strategy are strongly recommended to consult with a tax advisor. Past performance is not indicative of future results.

Tax-loss harvesting: How it works

What Is It? Tax-loss harvesting involves selling positions that are down to realize losses, and then using those losses to offset gains elsewhere in your portfolio (or, to a limited extent, to offset ordinary income).

Considerations: Tax-loss harvesting is not without risk. Investors must consider the wash-sale rule, market beta exposure, transaction costs, relative tax rates, and other factors.

Consult a Tax Expert: This presentation is not tax advice.

Tax-Loss Harvesting: A Numerical Example

	CURRENT YEAR	END OF FIRST YEAR	LIQUIDATION OF POSITION	
	INITIAL BALANCE	CAPITAL LOSS: $10	MARKET GAIN: 100%	AFTER-TAX BALANCE
Portfolio without TLH	$100	$90	$180	$164 $80 capital gain

Source: Kevin Khang, Thomas Paradise, and Joel M. Dickson, *Tax-Loss Harvesting: A Portfolio and Wealth Planning Perspective* (Vanguard Research, October 2020), available at https://corporate.vanguard.com/content/corporatesite/us/en/corp/what-we-think/research-library.html. Adapted by Bitwise Asset Management.

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Portfolio without TLH	$100	$90	$180	$164 $80 capital gain
Portfolio with TLH	$100	$90	$186	$167.40 $93 capital gain

TAX LOSS HARVESTING*
$93

Harvest $10 by selling the original investment and purchasing a non-substantially identical replacement security. Offset $10 of ordinary income, resulting in a $3 tax savings that is reinvested. This process pushes down cost basis, embedding a future tax liability into the portfolio.

$3.40 BENEFIT FROM TLH

$2.40
Result of tax deferral

$1.00
Result of tax minimization

Source: Kevin Khang, Thomas Paradise, and Joel M. Dickson, *Tax-Loss Harvesting: A Portfolio and Wealth Planning Perspective* (Vanguard Research, October 2020), available at https://corporate.vanguard.com/content/corporatesite/us/en/corp/what-we-think/research-library.html. Adapted by Bitwise Asset Management.

Tax-loss harvesting: Crypto's volatility profile creates harvesting opportunities

Crypto Has Historically Posted Strong Returns Punctuated by Sharp Corrections

Bitcoin cumulative returns (%) with select major corrections highlighted, from January 1, 2014 to September 15, 2022

Source: Bitwise Asset Management

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How well does tax-loss harvesting work in crypto? A new study from Bitwise

KEY METHODOLOGICAL CONSIDERATIONS

Crypto Exposure: The white paper uses bitcoin as a proxy for crypto exposure.

Traditional Asset Exposures: The study uses the SPDR S&P 500 ETF Trust (SPY), Invesco QQQ Trust Series 1 (QQQ), iShares Core Aggregate Bond ETF (AGG), and SPDR Gold Shares (GLD) ETFs as proxies for U.S. Large Cap Equity, U.S. Growth Equity, Domestic Fixed Income, and gold exposures.

Time Period: January 1, 2014, to September 15, 2022.

Harvesting Strategy: Daily harvesting evaluations; no transaction costs; no wash-sale consideration.

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TAX-LOSS HARVESTING IN CRYPTO: A SIGNIFICANT AND UNDEREXPLORED OPPORTUNITY FOR FINANCIAL ADVISORS

October 2022

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Tax-loss harvesting in crypto: Five key considerations

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Consideration 1: The “wash-sale rule”

1. The Wash-Sale Rule—General: The wash-sale rule prohibits investors from selling one security, recognizing the loss, and then buying a “substantially identical” security within 30 days.

2. The Wash-Sale Rule—Crypto: Tax practitioners take different views on whether the wash-sale rule currently or in the future may apply to crypto.

3. Consult a Tax Professional: Bitwise does not provide tax advice, and encourages advisors to consult with tax professionals before engaging in any particular tax strategy.

Consideration 2: Trading costs and market risk

1. Trading Costs: Our study did not incorporate trading costs into its analysis. Commissions, spreads and slippage must all be considered when implementing a strategy.

2. Market Risk: Investors may miss out on appreciation if they do not re-allocate to the market after harvesting a lost, and may achieve different performance if they change investments (particularly when navigating the wash-sale rule).

3. Future Tax Risk: Investors who engage in tax-loss harvesting may lower the cost basis of their positions and therefore face high realized gains in the future. If tax rates rise, this could reduce tax alpha or even lead to losses.

Consideration 3: The availability of capital gains

1.How Are Losses Used: Realized losses can be used to offset current gains elsewhere in a portfolio, to offset a small amount of ordinary income, or can be carried over to future years.

2. The Magic of Compounding: Studies of tax alpha—including our own—show that much of the value in tax-loss harvesting strategies comes from reinvesting tax savings and profiting from the compounding of that investment over time.

3. Many Wealthy Investors Have Embedded Gains: According to surveys, families in the top 10% of wealth have 6.1% of their total wealth in unrealized capital gains on average. This can create near-term opportunities to deliver immediate tax benefits for clients.

	2019 SURVEY		
INCOME PERCENTILE	REAL ESTATE	BUSINESS	FINANCIAL
Less than 20	18.0	7.9	0.5
20.0 to 39.9	21.7	3.2	0.9
40.0 to 59.9	18.2	3.2	1.2
60.0 to 79.9	13.6	3.7	1.9
80.0 to 89.9	14.7	3.4	2.4
90.0 to 100.0	8.6	17.3	6.1

Consideration 4: Relative tax rates

Comparison of Potential TLH Benefit: Different Tax Rate Differentials

Growth of a $100 initial investment from January 1, 2014 through September 15, 2022 with and without TLH, broken down by different tax rates for TLH sales and portfolio liquidation.

	TLH ALPHA						
ASSET	**AVERAGE**	**MEDIAN**	**MINIMUM**	**MAXIMUM**	**% OF WINDOWS WITH TLH ALPHA > 3%**	**% OF WINDOWS WITH TLH ALPHA > 5%**	**% OF WINDOWS WITH TLH ALPHA > 10%**
Strongly Positive (40% and 20%)	20.70%	9.87%	0.00%	82.30%	68.7%	62.7%	49.8%
Moderately Positive (30% and 20%)	14.30%	7.23%	0.00%	53.70%	65.4%	57.4%	44.6%
Neutral (20% and 20%)	12.60%	6.57%	0.00%	44.80%	64.9%	56.6%	44.1%
Moderately Negative (20% and 30%)	6.90%	3.93%	0.00%	23.50%	55.5%	46.2%	33.4%
Strongly Negative (20% and 40%)	5.13%	2.33%	-6.15%	20.20%	44.0%	34.2%	25.6%

Source: Bitwise Asset Management

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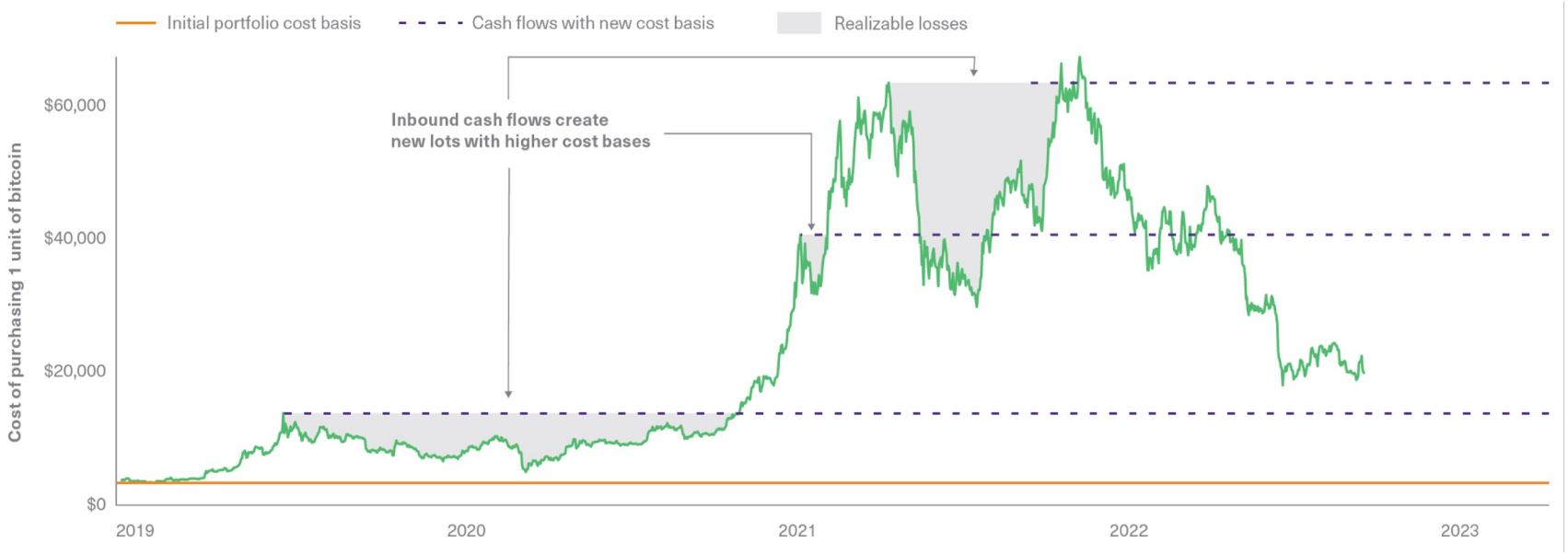
Consideration 5: The presence of recurring cash flows

Periodically Adding to a Portfolio Can Create New Opportunities for TLH



Source: Bitwise Asset Management, adapted from Vanguard Research

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Conclusions

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Conclusions

1. **Tax-Loss Harvesting Can Be a Valuable Strategy in Any Asset Class:** After all, all investors have assets that lose value at some point.

2. **Tax-Loss Harvesting May Be Particularly Valuable In Crypto:** Crypto's enhanced volatility gives investors significant opportunities to harvest losses and potentially generate tax alpha.

3. **Tax-Loss Harvesting Offers Advisors a Business Development Opportunity**: Advisors can add value in a down market, building client appreciation. They can also bring outside assets inside their practice.

4.**There Are Many Considerations When Engaging in Tax-Loss Harvesting:** From the wash-sale rule to trading costs, multiple factors influence the value of tax-loss harvesting strategies

5. **Consult Your Tax Expert:** This is not tax advice.

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Prospective investors in any Fund should very carefully consider such risks prior to making any investment decision, including the fact that certain Funds may not offer a redemption program if the shares of the Fund are traded on a secondary market. The Shares of Funds that are publicly quoted on the OTCQX Best Market are Shares that have become “unrestricted” under Rule 144 of the Securities Act (although Shares held by affiliates and insiders will be subject to additional restrictions on resales, including restrictions on the number of Shares that may be resold within any three-month period). Shares that have become unrestricted after the statutory holding period may be quoted on the OTCQX Best Market and may be purchased and sold throughout the trading day through any brokerage account with access to such markets.

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