RARESTONE COMPASS

JANUARY 2023

~~HOW TO GET RICH~~

HOW NOT TO GET REKT IN 2023

A NOTE TO THE READER

For every cloud there is a silver lining, for every bear there is a bull.

Whether you are bent, broken, or just plain bored by the length and severity of this downturn, or you are newly arrived, fresh-faced wondering what this magic internet money is all about, we have glad tidings for you. **Your timing is excellent, and given you are reading this report, your friends are true friends.**

Right now, you have the opportunity to harness the full potential of the rising tide. With a steady hand and cold mind, it will lift our portfolios to levels we could scarcely have imagined during the seemingly endless barren months of red. Most of us have looked at charts of tokens that have done x1000s and gazed longingly back at that inflection point where it just explodes, imagining what it would have been like to buy a sack at those prices and forget about it. Check back in, liquidate, send 7 figures to your bank account, and become master of your own time.

Those charts lie all around us now. Some hidden by the debris of the carnage we have been witness to, and some yet to begin their ascent. But they are there, and their number is not insignificant.

At Rarestone Compass, our main goal is to find our way to the north star of immaculate gains. The compass is a device with no equal. Powered by our belief in decentralization, in freedom, in our brotherhood. Born of ancient crypto wisdom, crafted with guile, glowing with fiery purpose, we have assembled around it to meditate and decipher the path forward.

Like you, we are also embarking on a journey. Our newly established cooperative of crypto veterans, researchers, writers and builders is ready to sweat blood and bullets to win back our freedom from a system that increasingly erodes the rights of the individual. We welcome all comers, from those learning how to set up Metamask to those building their own projects. Join our TG community, follow us on Twitter, ask questions, share your ideas, and **never** stop working.

If you want to grab the bull by the horns, then you must seize the bear by the balls.

RARESTONE
COMPASS

How not to get REKT in 2023 (and beyond)

As we enter into 2023 it's good to think about the outlook for the new year, as well as reflect on the previous year.

2022 was quite the bloodbath for investors, it's clear that the bears were in full control. Not only in crypto though, with the S&P 500 returning -19.44% in 2022 it's clear that stonks were no exception. In that market, tech was one of the verticals most heavily affected.

It was a tumultuous year for crypto. We've seen stablecoins depegging, CeFi firms collapsing, mass bank runs on exchanges, a large number of hacks/exploits, and VC funds collapsing. To top it all off we had the FTX saga with Sam Bankman-Fraud in the middle of it. The question that plagues most investors is, what will 2023 bring? Are we in for stormy seas or will we see start seeing the sun appear from behind the clouds?

What's this doc about?

In this report, we'll share our outlook for 2023 and a reflection on 2022. Things to think about and things to avoid doing. The Rarestone Compass will help you find true north🧭

What's up with the title?

Lots of investors get shaken out during bear markets, only to feel nothing but regret when the bull market is back. Others flip bullish when seeing a 30% rally, while everything is still down 95% off its ATH.

Will 2023 be the year that the bulls take back full control? Possibly, but not certain by any means. This is a year where you'll need to have high conviction and be on top of your game. Millionaires are made in bear markets. Sadly, most investors will not jump on this opportunity. They've either lost faith in crypto or (even worse) they've become perma-bears.

This report is brought to you by Rarestone compass — Finding true north in crypto

Join the discussion: t.me/rarestonecompass

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Reflecting on 2022

To say that 2022 was an interesting year for crypto is an understatement. It's been a hell of a ride, even for those who've been trading these magic internet beans for years. It's good to reflect on everything that happened in 2022. The good and the bad.

Market recap

Total crypto daily trading volume: Jan 1, 2022 – 92.6 billion USD Dec 31, 2022 – 27.8 billion USD ***-70% in 2022*** *(-64.8 billion USD)*	**Total crypto market cap:** Jan 1, 2022 – 2.2 trillion USD Dec 31, 2022 – 800 billion USD ***-63% in 2022*** *(-1.4 trillion USD)*
Bitcoin price: Jan 1, 2022 – 46.311 USD Dec 31, 2022 – 16.603 USD ***-64% in 2022*** *(-29.708 USD)*	**Bitcoin market cap:** Jan 1, 2022 – 876 billion USD Dec 31, 2022 – 319 billion USD ***-64% in 2022*** *(-557 billion USD)*
Ethereum market cap: Jan 1, 2022 – 3.683 USD Dec 31, 2022 – 1.199 USD ***-67% in 2022*** *(-2.484USD)*	**Ethereum market cap:** Jan 1, 2022 – 438 billion USD Dec 31, 2022 – 146 billion USD ***-67% in 2022*** *(-292 billion USD)*

Rampant inflation, rate hikes, and quantitative tightening.

The theme of the year: FED meetings and rate hikes. Remember when they told everyone inflation was transitory? Lol.

Inflation ran rampant throughout 2022, which was attempted to be brought down through the use of aggressive rate hikes. In the US, Inflation peaked at 9.1% in July 2022, and some even argued that the US was technically in a recession during the summer.

One thing you should always keep in mind is that those in charge absolutely LOVE playing with numbers and definitions to paint a picture that fits their narrative. It's no secret that the "official" inflation numbers never tell the real story. They just play with the numbers and with the way they perform the calculations. Call it creative mathematics.

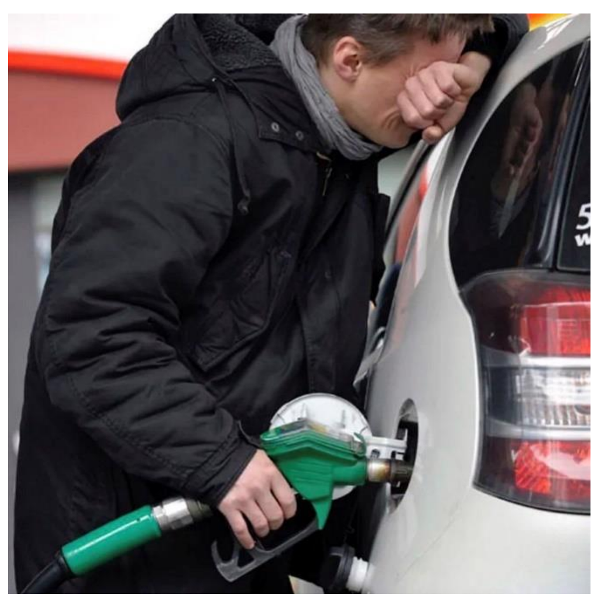
Benjamin Disraeli said it best: "There are three types of lies – lies, damn lies, and statistics."

We can argue about what the real numbers are, about a potential recession, and whether we technically had a recession according to certain definitions… But I think we can just all agree that the economy was definitely on a free fall throughout 2022. Everyday life just kept getting more expensive for the average person.

One explanation for the rampant inflation was the re-opening of the economy – i.e. lifting the COVID restrictions. Demand soared heavily, whereas supply chains struggled tremendously to keep up. That is on top of the fact that consumer demand shifted more towards products than services (even more supply-chain demand). Keep in mind that a significant amount of factories were shut down just as demand began to soar, which is anything but ideal.

And while it may have occurred without its influence, the pandemic irrefutably accelerated the chip shortage. Imagine trying to build a new pc to hit gold 2 in Valorant (let's face it, you're not getting any higher), but GPUs are being sold at 2–3x MSRP. Although GPU prices did mirror BTC in 2022 in the sense they fell 60% from ATH. Sorry, too soon? This lack of chips (not the Lays kind) was felt in lots of other products though, as there are millions of products in 169 industries that rely on them to operate.

And then a war broke out… As if we weren't already struggling with high inflation and supply chain issues… The tensions/war between Russia and ~~America~~ Ukraine took everyone by surprise. Everyone except your vague uncle who says he predicted all of this.



The war caused extra supply chain disruptions and added even more fuel to the rocket ship that the gas prices were already on. Pun intended.

Food prices, and most notably gas and electricity prices, soared heavily after the invasion of Ukraine. In Europe (2022), Russia accounted for 29% of crude oil and 43% of natural gas imports into the EU. You can see how this becomes a problem real quick.

Aggressive rate hikes to combat inflation

The main tool that can be deployed to combat inflation, is to raise interest rates. Rate hikes accomplish one simple thing: they make it more expensive to borrow money. There's a slew of consequences as a result of this, and the market is affected by it in direct and indirect ways. We won't get into them in here.

Making it more expensive to borrow money ultimately causes consumers to spend less money, which reduces demand for products and services. Less demand -> lower prices -> lower inflation.

On the business side, higher cost of borrowing money hurts typically hurts their growth and weighs on their stock performance. If enough companies' stock prices take a beating, the market will take a hit. Rates go up -> stocks underperform -> investors flock to safer assets. This is one of the reasons we've seen the prices on our precious internet beans go down for a while now, since crypto is still very much dependent on the broader speculative assets market. Wen decoupling from stonks?

The picture below shows the rate hikes throughout 2022.

FOMC Meeting Date	Rate Change (bps)	Federal Funds Rate
Dec 14, 2022	+50	4.25% to 4.50%
Nov 2, 2022	+75	3.75% to 4.00%
Sept 21, 2022	+75	3.00% to 3.25%
July 27, 2022	+75	2.25% to 2.5%
June 16, 2022	+75	1.5% to 1.75%
May 5, 2022	+50	0.75% to 1.00%
March 17, 2022	+25	0.25% to 0.50%

Hike rates for 2023 will most likely be lower than in 2022. Even if the Fed's highest forecasts come to fruition, it shows that, at most, only 1.25 percentage points of rate hikes are on the table for 2023. That's nowhere near the 4.25 percentage points of tightening Fed officials approved in 2022 alone.

The biggest fear, however, is the risk of a recession. There's still a lot of debate and opinions on whether or not we'll see a recession in 2023. We don't have a crystal ball, unfortunately. All we can say is: **hope for the best, prepare for the worst.**

Sadly, those that dismiss any chance of a recession (just because it's a "popular" narrative), are doing quite the opposite. They are hoping for the best and preparing for the best…

VC funding throughout 2022

Typically we look at two metrics: the amount of money being raised, and the number of deals being closed. 2021 was the year of handing out grants and investments like they are just fun coupons, it was the biggest year yet for crypto venture capital. So how did VC funding for crypto change in 2022's crypto winter? The answer might surprise you..

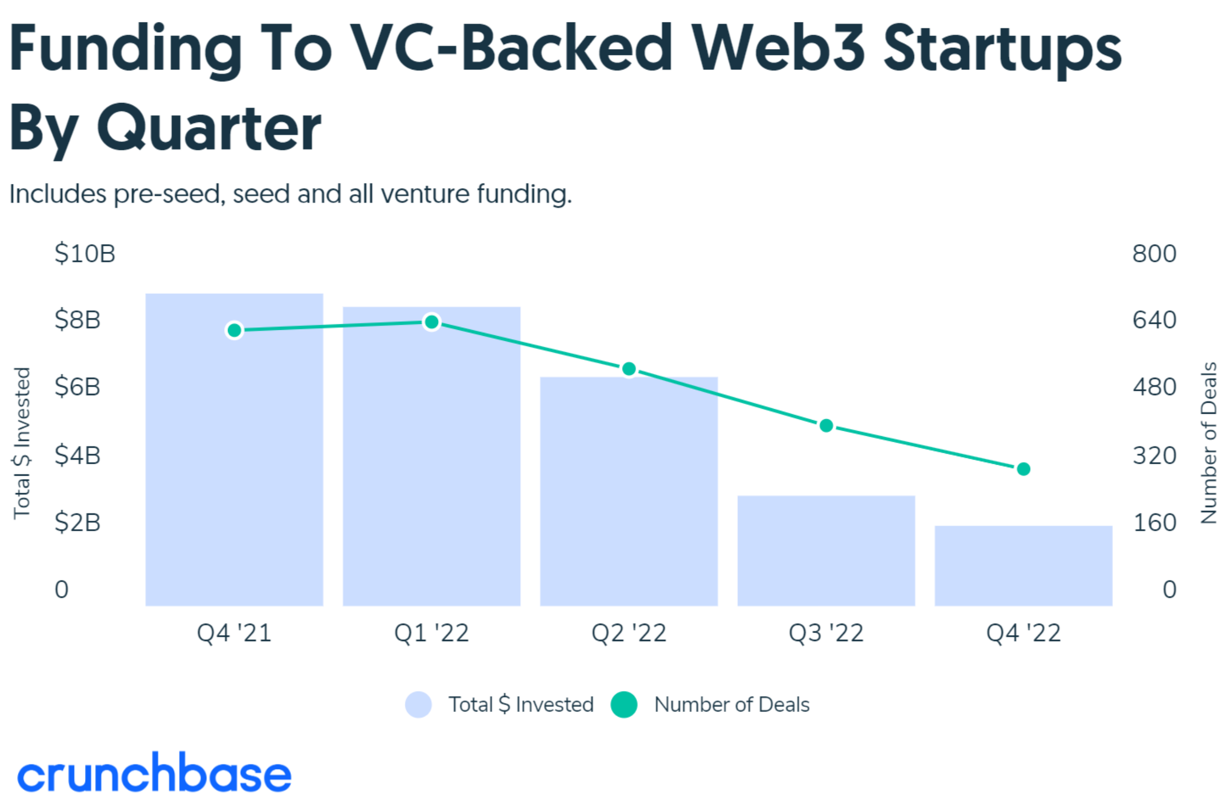
Let's paint the picture for 2022 in 5 key points using insights from Pitchbook:

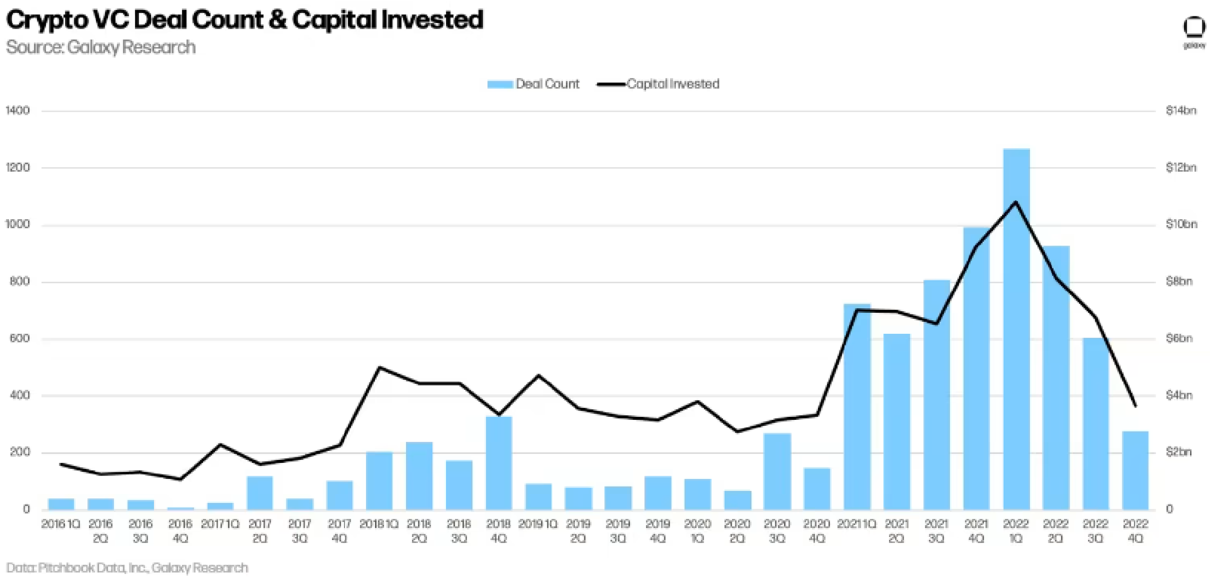
1) **The total funding amount wasn't as far off from 2021 as you might expect**

   2021 was a record year with $31 billion of total funding. 2022 fell slightly short of this number, with a reported total of $30 billion being raised in 2022, spread across 2900 deals (source: Pitchbook). Crunchbase had slightly different numbers – with a reported total of $29.2 billion in 2021 and $21.5 billion in 2022.

2) **Funding declined throughout the entire year**

   We saw the number of investments decline throughout the whole year, each quarter being worse than the previous one. Q3 and Q4 saw significant drops compared to previous quarters, most likely caused by the uncertain macro environment. Q4 of 2022 was the slowest quarter we've seen since Q4 2020. See attached images below.





3) **Q4 marks the first quarter ever (!) where the amount of later-stage deals surpassed the amount of pre-seed deals.**

The amount of pre-seed deals, and thus their share of the total amount of deals, has declined throughout 2022. The % share of early-stage deals has been declining for years, but Q4 2022 marked the first quarter ever that more later-stage deals were being made than pre-seed deals.

However, pre-seed still raked in 60% of the capital during that quarter. So, fewer deals, but more capital allocated towards them than later-stage deals.

Some might say that this is a reflection of crypto maturing as an industry. It could be a sign that we'll see fewer new companies being created, and fewer new products being shipped. It'll be interesting to see if this decline continues throughout 2023.

4) **Valuations and deal sizes declined throughout the year**

Let's be real. The valuations of funding rounds in crypto are insane. At some point, someone thought "Let's raise at a huge valuation, and enter the market with a tiny percentage circulating supply to give the illusion of being at a low market cap with large upside potential" — and everyone just went with it.

That was the real trend for 2021 – playing with the numbers to recruit retail exit liquidity. But hey, don't hate the players, hate the game. This was one of the main drivers behind the run we saw on community-owned and fair-launch projects.

5) 2022 was the biggest year yet for venture funds

Over $33 billion was allocated to over 200 funds. To put that number into perspective: in 2021 $19.4 billion was raised across 140 venture funds.

This means that there is still a lot of cheese waiting to be spread. A lot of dry powder that is parked with these crypto VC funds, just waiting to be deployed. And we should see that capital being put to work within the next 2 – 5 years.

A noteworthy example is Haun Ventures, which is founded by Katie Haun following her departure from Andreessen Horowitz (a16z). Haun raised a total of $1.5B for her fund, the largest-ever initial fund raised by a solo female entrepreneur.

Haun told CNBC that "Web3 is the new era of the internet, and it deserves a new era of investors". Haun Ventures will invest in both start-up equity, as well as tokens.

Noteworthy funding categories in 2022

1) GameFi, NFTs, and metaverse

Hate it or love it, these raked in a boatload of capital in early 2022. Even non-crypto companies hopped on the metaverse train. Epic Games was one of those, they raised a $2 billion round of funding to build out their vision for the metaverse. 2 billies, that's a lot of V-bucks right there.

Crypto was no exception. One of the funding rounds in this category that made a lot of noise was Gunzilla Games with their $46 million round to build out their new gaming platform.

There's also a noticeable trend of game developers entering the web3 space. We've seen a fair share of web3 gaming companies with leadership teams that worked on some of the biggest titles in gaming.

Gaming is an extremely rough industry to break through as you enter a battle for attention with all the other games on the market. Especially the currently established ones, so it definitely helps to have industry veterans on your side.

2) Infrastructure

Infrastructure received a large chunk of the funding throughout 2022. Especially once the GameFi and metaverse trains started slowing down. Q3 and Q4 were solid quarters for infrastructure projects.

We especially saw an uptick in the number of deals for layer 1 protocols, and the funding amounts were nothing to smirk at either. Aptos and Sui (Mysten Labs) were the two rounds that made the most noise, it's unlikely that you haven't heard of them until now. Both raised around $300M to build out their respect respective layer 1 ecosystems.

But, many others think they have what It takes to disrupt the already crowded layer 1 space: Shardeum, Parralelchain, Partisia, Sei Network, Linera, and Aleo — just to name a few.

It wasn't just layer 1's though. You also had projects like Nillion which are focused on computation and data processing through a network of NMC nodes.

3) Layer 2's

Optimism and Arbitrum took the layer 2 space by storm fueled by sharp growth in TVL on their platforms, as well as large growth in projects building on top of these networks. The speed at which existing protocols flocked to integrate these new chains was also a sight to behold. It's clear that Layer 2's caught the eyes of many investors throughout 2022, and it will most likely continue to do so throughout 2023. Layer 2's raked in enormous funding rounds as well, here are a few that stand out:

- *Optimism* raised a $150M Series B led by a16z and paradigm (march 2022). This brings their total funding up to $178.5M and values their company at $1.5B. These guys have been building since the start of 2020.

- *Arbitrum* had its latest round (a Series B) in august 2021. Nonetheless, I still think they're worth mentioning as their ecosystem has been growing rapidly throughout 2022, as well as the TVL on their platform. Offchain Labs (the company behind Arbitrum) has raised a total of $123M and their latest valuation tops out at $1.1B.

- *Polygon* is an L2 we all know, and probably have used in the past. Personally, I think they're great and their tech is definitely strong. February 2022 they successfully closed another round of funding led by Sequoia Capital India for an impressive total of $450M. This round was joined by Kevin O'Leary and over 40 VC firms.

- *StarkWare Industries*, the company behind the StarkWare L2 scaling solution, raised a Series D which valued their company at a whopping $8B (up $6B compared to their latest funding round). The company raked in another $100M, bringing their total funding amount up to $273M.

- *Matter Labs (zkSync)* raised $200M in a Series C led by Blockchain Capital and Dragonfly. Matter Labs is the company behind zkSync, and their latest round brings their valuation up to an estimate of $800M—$1.2B (source: dealroom.co). Their total funding amount currently sits at $258M.

- *Eclipse* is a customizable rollup provider, enabling developers to deploy their own rollups using any chain or data storage. Eclipse co-founder Neel Somani described the company as a universal layer 2. Ecplise has raised a total of $15M, from Tribe Capital, Tabiya, Polychain Capital, Polygon Ventures, Soma Capital, CoinList, and other VC firms and angels.

- *Boba Network* raised $45M from a total of 28 investors. Boba network is another Layer 2 scaling solution, one of their main USPs is that they allow devs to build Multichain Dapps through their Hybrid Compute technology.

- *Immutable X announced a $500M fund* for NFT and game developers in an attempt to attract more builders, developers, and users to their L2 platform. The fund is backed by Animoca Brands (which is a VC firm focused on NFTs and gaming), GameStop, Double Peak, and other firms.

4) Interoperability and cross-chain communication

LayerZero is a project most will have heard about by now, it might just be the name with the biggest buzz in this category. They raised a total of 140M spread over three rounds.

As you've read above, there is anything but a shortage of layer 1's and 2's that think they will be the next best chain. These verticals are getting more and more crowded. An increasing number of projects fighting for a shrinking amount of available market share.

Right, that's just what we need. More chains. More bridges. Scattered liquidity. Fun!

There's a shift we're now noticing where more things are being built to do the opposite; to connect what we already have. Connectivity between chains, cross-chain swaps, seamless cross-chain applications, and true interoperability.

No one has solved the interoperability challenge yet. One thing is for sure, we'll see more and more projects that aim to solve this.

NFT brands raising funding rounds

Something we've seen in 2022 was NFT companies raising funding rounds leveraging their established NFT brands/collections. Previously they were mostly reliant on fees from secondary markets to sustain themselves, or they would simply drop follow-up/secondary collections — which is risky as it can also backfire on you.

1) Yuga Labs (BAYC)

Yuga Labs had the biggest round, they raised a whopping $450 million bucks at a $4B valuation. The money will be used to build out their "Otherside" metaverse, with their NFTs and the $APE token at the center.

2) **Chiru Labs (Azuki)**

Chiru Labs raised $40M Series A at a $300-400M valuation (estimate).

3) **Doodles**

Doodles raised $54M at a $704M valuation. The funds will be used to scale the Doodles growth strategy and to their IP globally through ventures in music, culture, and entertainment industries, as well as to extend product development efforts via acquisitions and proprietary technology, media, and collector experiences.

4) **Dogami**

Dogami originally sold 12K dog avatar NFTs, and later released a 12K collection of canine accessories in collaboration with clothing retailer GAP. Dogami is building an AR mobile game featuring their NFT pet companions. They closed a $14M funding round at the tail end of 2022. Pun intended 😉

Ethereum turns deflationary: eth 2.0 is here

Ethereum 2.0 was a highly anticipated event for quite some time. Being the #2 crypto in the market, this was one of the most significant events in 2022. Eth 2.0 was an Ethereum mainnet upgrade designed to drastically improve performance.

From PoW to PoS, and from miners to validators.

The change that many will know about, is the shift from a Proof-of-Work to a Proof-of-Stake consensus mechanism. In its PoW state, miners kept the ETH network up and running. With PoS, miners are replaced by validators. Miners not being able to mine Ethereum led to a run on other PoW cryptos like Kaspa. We'll get into that later on.

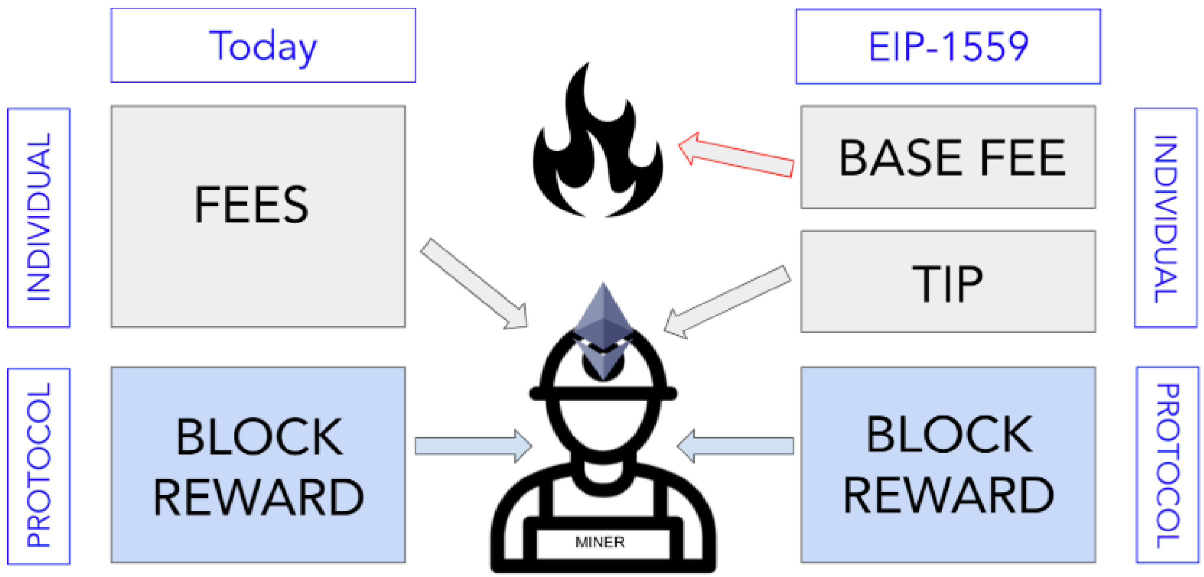
To become a validator, you have to stake 32E for each node that you want to run. The current APR for running a validator node stands at 4.3% — meaning you stand to earn around 1.376 eth per annum per node.

Ethereum sharding is on the horizon

The change to PoS allows for sharding capabilities, which should be released sometime in 2023. Sharding will drastically improve Ethereum's scalability and capacity by creating layers of separate chains (shard chains) that will run in parallel. Theoretically, this means that each shard chain can run blocks at the same time, whereas in its current form, Ethereum can only process one consecutive block at a time.

Ethereum turns deflationary

A new fee-burning mechanism was implemented last year (EIP-1559):



EIP-1559 fee mechanism makes ETH deflationary in nature, **IF** — and only if —the amount of fees burnt outweighs the issued block rewards. What we can already see though, is that the annual supply inflation with EIP-1559 is much less than in the old fee mechanism.

We can compare these using the site ultrasound.money:

At the time of writing, ETH supply has increased by roughly 4.000 ETH since the merge. If EIP 1559 wasn't implemented, in that same time period we would've seen a supply increase of 1.3M ETH. Think about the difference between those two numbers for a second.

This decrease in supply inflation is astonishing. Just think about it; 4 thousand instead of 1.3M! Burns increase as more transactions are made on the network. More demand will lead to less supply. Demand > supply = numbers go up.

ETH switching to PoS frees up market share for PoW protocols

As Ethereum switched from PoS to PoW, miners were no longer needed to keep the network up. This left them with two options: retire from the mining game, or find new things to mine.

ETH leaving PoW behind freed up a large amount of mining power. This led to a re-distribution of mining power from ETH to other protocols. Kaspa was one of the protocols which benefitted tremendously from this. In the course of a few months (maybe a few weeks even), Kaspa saw a large inflow of mining power and an increase in hashing power.

The Luna collapse

The Luna crash – and its aftermath – was one of the most significant moments in 2022. If you were still here and hadn't succumbed to the pressure of the bear yet, then you know how crazy this period was. It's the modern-day tale of a man whose god complex eventually led to his downfall. **A short recap of what exactly happened:**

On May 12th, 2022, the cryptocurrency market experienced a major collapse, known as the "Luna Crash." It led to a ripple effect that was felt throughout the entire industry, followed by an estimated $60 billion being wiped out of the market.

The cause of this crash has been attributed to several factors, including market manipulation, bad design of mint-and-burn mechanics of UST and Luna, liquidity issues, and a lack of regulatory oversight.

One of the key players in the Luna Crash was Do Kwon, the co-founder of Terraform Labs. The two tokens that were in the middle of all this, were TerraUSD (UST) and Luna. TerraUSD is the algorithmic stablecoin on the Terra blockchain, and Luna is the Terra blockchain's native token for paying gas and whatnot.

UST wasn't backed by real currency like most stablecoins though. Do Kwon being the genius that he is, saw the amazing value in his own currency Luna, and thus UST was solely backed by its sister token Luna.

There was a mint-and-burn mechanism between UST and Luna. To maintain the UST peg, 1 UST could always be exchanged for 1$ worth of Luna. Meaning: if UST falls below 1$, say $0.90, then traders can buy UST from the market and exchange the UST that's worth $0.90 for 1$ worth of Luna. You can see why losing the peg can quickly prove to be problematic, as it's a ponzi-like structure.

Traders like Algod and GiganticRebirth ([famed for his $10M bet against Luna](), after [Algod proposed a $1M bet with Do Kwon]()) started calling the Do Kwon out for this in Q1. Over the coming weeks, the Luna foundation bought large amounts of Bitcoin to strengthen the UST peg in times of crisis. They accumulated a total of 39.9K Bitcoins.

Back in February, the Luna foundation already bought 1B worth of Bitcoin using its Luna token. The Luna foundation eventually held $2.5 billion in reserves to protect the peg.

Things seemed to be going well for Do Kwon, and you could tell by how much boasting he did on Twitter. UST briefly became the #3 stablecoin in the market, and Luna hit an all-time low circulating supply following the demand for UST.

Then, things went south real fast. Ever seen a token drop -96% in a day? Well, that's what eventually happened to Luna:

- **May 7th marked the start of the Luna death spiral and Do Kwon's downfall**

Over $2 billion worth of UST was unstaked from Anchor protocol. Hundreds of millions worth of UST were being liquidated. A whale watching bot captured an 85 million UST swap for 84.5M USDC.

- **UST peg falls to $0.985**

LFG loans $750M worth of BTC to market makers to defend the peg and loans another $750M worth of UST to buy back BTC after volatility has passed. Over the coming week, LFG would deplete its billions in BTC reserves until a mere 313 Bitcoins were left.

Seeing UST still not recovering the peg, a bank run starts on Anchor Protocol with deposits being taken off the platform. Deposits fell from $14 billion to $9 billion.

- **UST peg falls to $0.35**

But, it's all good, Do Kwon is deploying more capital. Or so he says…

Luna's price takes a huge haircut after mass liquidations on those trying to catch the knife. TVL on Anchor Protocol drops $11 billion in merely two days.

- **Luna drops -96% in one day**

  Luna is now worth less than 10 cents. Keep in mind they had a triple-digit ATH. Following UST and Luna delistings, two halts on the Luna blockchain, and a continuous minting of Luna, its price is now rekt into oblivion. RIP.

- **Luna rekt, with support from validators Do Kwon launches Terra 2.0.**

  Terra 2.0 was launched end of May 2022, with a LUNA airdrop to previous holders. This new blockchain does not have a stablecoin tied to it.

The aftermath

Mass fear, bank runs, coordinated attacks, retail and institutions alike losing billions of dollars – it was a crazy event. While the UST and Luna design were indeed terrible, people still wonder: what actually led to the initial start of the collapse?

Who was/were responsible for the initial depegging that led to the eventual domino effect? Theories have come out on there being a single attacker/entity behind this crash. The following two threads go deeper into this:

- https://twitter.com/OnChainWizard/status/1524123935570382851
- https://twitter.com/4484/status/1524006086147252227

The impact of the Luna Crash was widespread, with many investors and traders losing significant amounts of money. No doubt that there were tons of individual investors who got caught up in this shitstorm. Youtuber KSI tried catching the falling knife and lost $2.8 million on Terra in one day. Yikes.

Hashed, a leading crypto-native VC and early backer of Terra Labs is reported to have lost a whopping sum of **3.5 billion dollars**. F.

Delphi Digital, another name most will have heard of, used 0.5% of its net asset value (a company's total assets minus its total liabilities) to purchase Luna. They also invested $10 million in the Luna foundation's funding round in February. Both investments are marked as zero now.

Crypto's biggest funds (Pantera, Galaxy Digital, Delphi, Hashed, etc.) bought into Terra Luna. Some cashed out early, some got rekt in the process. You would think some of the bright minds among them would've questioned the unsustainable mechanism...

The crash also led to a decrease in the overall value of the cryptocurrency market, as investors became more hesitant to invest in digital currencies.

While the Luna Crash has been a major setback for crypto, it has also highlighted the need for better regulation and oversight in the industry. The weak link that made this crash possible was the lack of transparency and accountability in the market, which allowed individuals like Kwon to manipulate the market to their own benefit.

3AC was also one of the VCs heavily affected, which led to a whole 'nother slew of issues and a big domino effect. Let's dive into that one now;

3AC liquidated

Three Arrows Capital (3AC) was a crypto hedge fund, founded in 2012 by Kyle Davies and Su Zhu. They became one of the biggest names in de industry and boasted large positions in projects like Solana and LUNA. They managed billions in crypto assets (around 18B at its peak). The two founders' egos were almost as big as their portfolio, and that's saying something.

Things were going well and they were on top of the game. What could possibly go wrong? Well, LUNA happened. We spoke about that earlier.

3AC held a large position in LUNA and UST, over $550 million worth. It turns out 3AC was extremely overleveraged to build this position. What happens when you're way overleveraged in an asset that goes from over $600 to zero in a few days..?

What happened next? Su Zhu deleted his Twitter account and went MIA, and 3AC sold 60.000 stETH. That's when the first rumors appeared of missed margin calls. It didn't take long for more information to come to light. 3AC had an outstanding loan of $189M on Aave. Margin calls started piling in from parties 3AC owed money to. They obviously didn't have the funds to repay or even post more collateral.

3AC owed over 3.5B USD to over 20 companies. This is what Cryptoslate reported:

- **BlockFi**: suffered huge losses after liquidating 3AC; eventually being acquired by FTX. After the FTX collapse, BlockFi was forced to file for bankruptcy. Talk about bad luck…
- **Voyager**: lent $650 million to 3AC
- **Genesis**: lent $2.36 billion to 3AC
- **Deribit**: 3AC was an investor of DRB Panama; on June 24, they had to file a liquidation application in the British Virgin Islands
- **Blockchain.com**: lent 3AC $270 million; laid off 25% of staff

- **Finblox**: where 3AC was an investor, had to close withdrawals in the turmoil

3AC's bankruptcy filing revealed even more details, such as making a down payment on a $50M yacht and purchasing two housed in Singapore worth more than $28M. Greed is what ultimately got them REKT.

Su Zhu claims DCG and FTX conspired to attack 3AC

… Su Zhu accused Digital Currency Group (DCG) and FTX of working together to attack LUNA and stETH — which ultimately led to 3AC getting rekt. Remember the threads we shared in the section about the Luna collapse and who might've been behind it?

CeFi bankruptcies (BlockFi, Celcius)

Liquidity crunches, bad risk management, and insolvency. Many entities couldn't weather the storm and had to kneel to the bearish overlords. Here are a few noteworthy bankruptcies:

1) <u>BlockFi</u>

BlockFi originally came close to falling over after the 3AC saga. They were eventually acquired by FTX, which ultimately only delayed the inevitable. BlockFi filed for bankruptcy after the FTX collapse.

2) <u>Celsius</u>

Celsius battled insolvency issues for months before eventually filing for bankruptcy. Celsius froze withdrawals, swaps, and transfers on June 12th, which is the first sign of things are about to take a left turn. Early July, Celsius layer off a quarter of their staff. Mind you, everything was still frozen since June 12th.

4 days after the mass layoff KeyFi (a DeFi platform) launched a lawsuit against Celsius, accusing them of market manipulation and failure to protect user deposits with adequate accounting/risk management.

Eventually, Celsius didn't have any other option than to file for bankruptcy. The filings revealed that Celsius had a $1.3B hole in its balance sheet. Celsius attributed their liquidity crunch to the domino effect of LUNA's collapse. But that just seems like an easy way to deflect accountability for their lack of risk management.

In the end, Celsius users draw the short end of the stick. A US bankruptcy judge ruled that Celsius Network owns most of the crypto deposits of their users. Meaning that the users of the platform are at the bottom of the long list of creditors. They will be the last ones to see any of their invested funds after all the other debts are paid off. Please let this be a lesson to switch to self-custody and stop chasing ponzi-like yield.

3) FTX

   FTX filed for bankruptcy being $9 billion in the hole. We'll get into the shitstorm that Sam Bankman caused later on.

4) Core Scientific

   Core Scientific is one of the biggest Bitcoin mining firms (they account for around 10% of the computing power for the Bitcoin network), yet they proved to be no worthy opponent for the harsh crypto winter. Bitcoin's price dropped a lot throughout the year, to the point where mining Bitcoin was simply no longer profitable for the firm.

5) 3AC

   3AC reportedly had a total debt of 3.5 billion at the time of its bankruptcy.

6) Voyager Digital

   Voyager Digital is a US-based exchange that lend $660 million to 3AC, which they ended up defaulting on. Voyager owes over $1.3 billion to 100.000 creditors.

FTX saga

There's a lot to be said about the FTX saga, but I'm sure you know all about it. We won't get into all the details and the whole storyline. It's another perfect example of one's ego eventually leading to his own downfall.

SBF carefully curated an image of being a huge philanthropist that gave all his wealth away, remember the item he did where he was being portrayed as "the most generous billionaire"? He wanted to be seen as the main guy in the push toward mainstream crypto adoption.

For some mysterious reason, media outlets and even some regulators, are/were quite soft in their descriptions of what happened with SBF and the FTX implosion. But, let's be clear: SBF is a criminal. There are no excuses to be made, this is not about improper risk management or a generous billionaire making a mistake. He's a degenerate gambler that used customer funds to fuel the one thing he valued most in the world: his own ego.

Everything is still unfolding, but we hope those affected in this can eventually get back all their funds, and that SBF gets the jail time that he deserves.

Outlook for 2023

We recapped the 2022 roller coaster ride. It's time to look ahead. What can we expect from 2023? What advice can we give? Which trends do we think will be the key drivers during our new cycle?

We'll split this part of the report into four sections:

1) General advice
2) Practical advice
3) Categories/verticals to pay attention to
4) Opportunities and threats

Do remember that nothing in this report is meant as financial advice, we're just sharing our thoughts, opinions, and our personal plan for 2023.

General advice for 2023

General advice #1: Stay long-term bullish

Crypto is here to stay. If you're still here on this journey, and plan to be for the next 10 years, then you're early. You just survived a year of terrible price action! Hats off to you, young grasshopper.

Let me say it again, in the grand scheme of things you're still early. We're witnessing the birth of a new asset class. The soon-to-be 12^{th} sector of the S&P 500. A new financial system. The power of the few will transfer over to the many. Diseases will be cured. The world will be saved. *(Ok, some of these might be tiny exaggerations.)*

We have full faith in crypto in the long run, that's what allows us to keep a cool head. Even when the numbers (momentarily) stop going up. Ignore the noise and zoom out a little. Trust me, you'll sleep a lot more peacefully.

General advice #2: Don't let human greed convince you that crypto has failed

We talked at length about 2022 and all the things that happened. Terrible macro environment, hacks, bankruptcies, and a whole lot of bad actors. HOWEVER. **Do NOT let this distract you from crypto's long-term potential and do NOT let it deteriorate your conviction for this space.**

Outside of the macro conditions, most of the collapses and destruction we've seen in 2022 can be attributed to human errors. Or simply human greed, pick your poison.

If anything, this fact should boost your conviction for true decentralization and DeFi. This space once was all about people coming together and building something awesome. Take Bitcoin for example; the idea of a global network of miners upholding a truly decentralized, transparent, open-to-all, global network. That's a beautiful concept.

Decentralized protocols are what it's all about. Real innovation. Practical blockchain/tokenization use cases.

The lack of regulation allowed us to play around with things, to build stuff, and to experiment (and print gains with shitcoins). However, that lack of regulation allows bad actors free rein to act as they wish. This will change soon.

General advice #3: Consistent investing beats chasing pumps
There's a 90% chance that you have some friends who don't really care about crypto, but only message you about it when it's pumping. At some point in time, you probably have gotten messages like: "is it too late to buy?" or – my personal favorite – "did I miss the bottom??"

We all know guys who only jump into crypto (or any speculative markets for that matter) when the market is booming, in the midst of the bull. 9 out of 10 times, these guys get rekt. And eventually, they give the gains they made (if any) back to the market. Why is that?

It's because they don't care about the fundamentals, they only care about chasing pumps. Please, don't misunderstand this statement. It's not a moral thing, it's not us looking down from our high horse. It's merely a reflection of what these guys do wrong, and why – unlike them – you are going to make it.

They are driven by FOMO. They don't know about profit-taking strategies and most often don't even understand what they are putting their money in.

They are not prepared for when the music stops. And, when it inevitably stops, they can't find a chair to sit on. So they end up having to leave the game.

I cannot emphasize this enough: BEAR MARKETS ARE WHERE THE MONEY IS MADE. See, your friends aren't interested when the market has slowed down. They want in on the action when the market is hot. They don't want to buy low and sell high, they buy high and sell lower.

Being PATIENT (!), studying the fundamentals, researching, and spending time in smart communities (I only know one, wink wink), is what will lead you to blow up your portfolio and print those gains that are worth screenshotting.

A SAVVY, CONSISTENT INVESTOR WILL ALWAYS OUTPERFORM A PUMPCHASER.

General advice #4: Stay in the market – don't get lazy, don't lose interest, don't burn out.
Leaving the game is one of the biggest pitfalls for investors. This ties strongly into our previous point about long-term investors beating pump-chasers. Why do pump-chasers lose? They

simply leave crypto and don’t come back until they hear about Bitcoin nearing the previous ATH again.

Bear markets can be long, but remember: **they don’t last forever**. Gains will be made. ATHs will be printed. Charts will pump. Until that happens, you have one clear goal: to survive.

Don’t lose interest in crypto.
Don’t get lazy.
Don’t get burnt out.

Also, don’t get liquidated 😉

These are the pitfalls that keep most people from achieving true wife- and life changing gains. Now is the time for building. For accumulating. Learning about new protocols and

Practical advice for 2023

Practical advice #1: Portfolio rebalancing

When a new run starts, the market will have changed from the previous cycle.

There will be a different narrative. Some projects might have made tons of progress, others will look like they are still in the same spot.

Take GameFi for example. It was a glorious run while it lasted. But, ask yourself; how many of those projects will still be around next cycle? How many will have completed their games? How many will have figured out the perfect balance of in-game tokenomics? Probably not many.

The same goes for many of these "older" projects. Really look at it objectively. How big is their ecosystem? Do they have users? Adoption? Or is it still just a whitepaper and a CEO in a suit making promises?

So, it's probably not a bad idea to do some restructuring to your portfolio. A general rule to follow is this: take a token that you are currently holding and ask yourself if you would buy said token at its current price. If the answer is no, then it's probably best to just sell and move on. On that note: everything has dropped significantly. So, if you're switching your bag around, it's very different from you selling the bottom.

Practical advice #2: Focus on the blue-chip projects

The main things you should be accumulating are blue chips like Bitcoin and Ethereum. They are cheap, they are the market leaders, and they are the first to run (which tends to cause momentary dips in the rest of the market). There will come a point where it's more profitable to scale into alts, but that time won't be reached anytime soon.

We're not telling you to completely ignore alts altogether. Buy them if you want. Just spend the majority of your investable funds on the blue chips like BTC and ETH. Or other large layer 1's of your choice.

Practical advice #3: Stay flexible, don't tie up too much liquidity.

You'll want to be flexible during periods like these. For most, liquidity will have dried up. You need to have some funds free to play around with. Don't be fooled, there are still loads of opportunities during the bear. An NFT flip here, a swing trade there. Just don't get tied up. Stay nimble and on your toes. Be water.

Practical advice #4: Go for newer projects, or fully diluted ones. Preferably nothing in-between.

Three words: shiny object syndrome. Heading into a new cycle, it's common for investors to start paying more attention to the newer and shinier projects.

Investors will forget about the boring aggregators, the "payment solutions of the future", the outdated layer 1's with no adoption, the platforms that still don't have Dapps built on them even though they've been in development for 3 years, the GameFi projects that used UE5 elements to make a trailer and lure in investors yet don't have an actual beta to test out, the IDO platforms that haven't launched a decent project in ages…

Forget all that, it's time to look ahead, anon. Once the market starts its next run, investors stop paying attention to the older projects that they once loved and drop them like they're used tissues. Maybe not completely, and maybe not right away, but over time you'll notice that these older projects tend to underperform the newly launched tokens.

People want to get into the hottest narratives. Investors forgot all about DeFi in 2021 and went balls-deep into GameFi. It was truly glorious for a while until it wasn't. In a year's time, investors will be looking into whatever the hottest narrative is at that time, and they'll look for the shiny tokens with a fresh image.

The following types of projects offer the greatest opportunities and potential ROI:

1. Tokens that have recently launched (a few months old)
2. Tokens that are fully diluted or close to it (meaning they have at least 80% of the total supply in circulation)
3. Fair-launch projects with an actual solid team and idea

The above is only our opinion of course, and how we plan to make full use of the next cycle. Here are some additional thoughts per category:

(1) Newly launched projects likely fit into whatever narrative is hot at the time. Get in, and get out in time. Some of them will stick around and go on to build wonderful things. Most won't. Always think back to previous narratives like DeFi and GameFi. How many DeFi protocols are still around today? How many working web3 games do we have today? There's your answer.

These projects tend to have a fresh image as they just started/launched. If they launch in a bull market, it means that most of the holders will have made some amount of profit. They're happy campers. Now think about older projects where holders are down 80 – 90%. They're unhappy campers. All of a sudden they care about development and adoption, and they start being more vocal in their critique. New communities > old communities. Of course, there are exceptions in the market.

(2) Fully diluted projects or those that are close to fully diluted. The main driver behind this category is that these projects don't have any supply inflation, or at least a minimal amount.

One thing most investors don't think about is that most tokens have supply inflations that make the Venezuelan Bolívar look like a safe haven. Ok, maybe not thát bad.. but still high! Token unlocks are something that retail investors tend to fear, as they expect a huge dump from these tokens directly being market sold. In reality, that's not the main thing to worry about, unless it's a huge quarterly unluck or something. If the project is solid enough, and there is enough volume on it, then it should survive an unlock just fine.

The thing people forget, however, is that all these extra tokens being released lead to supply inflation; more tokens that enter the market. The market cap goes up, without any fresh investment coming in. More and more fresh investments are needed to give us that oh so euphoric feeling of numbers going up.

Your tokens are being diluted over time, sometimes at a high rate. That's no bueno, though in a full bull season, you'll notice the negative effects of this much less. Nonetheless, fully diluted tokens will be an amazing opportunity. Though their ROI still can't match category 1.

(3) Fair-launch projects had a solid moment in 2021 and early 2022. Let's be real, the current VC playbook isn't sustainable. People are smartening up. They aren't just exit liquidity anymore.

Fair-launch refers to projects that didn't have large early investment rounds. They didn't raise millions of dollars, they don't allocate 10% of the supply to influencers, and they don't have huge supply inflations due to vesting schedules. Everyone gets the same opportunity.

Whereas "fair launch" used to be reserved solely for meme-coins and degen bets, we're now seeing an increasing number of fair launch tokens with a solid team and vision. Beware though, this has its downsides that make this category a lot riskier. You'll likely have a lower hit rate here, but it's definitely worth playing the field.

Practical advice #5: Early-stage deals: the sometimes not-so-wonderful world of private- and seed rounds

As mentioned, liquidity has dried up quite a bit. VCs are turning down more deals. Influencers can't generate enough exit liquidity anymore.

For you, this is an opportunity. Opportunities are available to those who are willing to seek them out and grab 'em by the cojones. Or their lady parts. We're not sexist, just [redacted].

You have two options; getting a direct SAFT or SAFE + token warrant with the team, or going through a pooling group. A pooling group is where they pool money together to write a big check as a collective, and get access that way. Kind of like a syndicate in Tradfi.

The first option is the safest way, but harder to get. You need one of these things:

1. Lots of capital so you can write big checks worth 10-25K and up
2. Being able to provide strategic value. This can be a large audience or a service you can offer them for free that might prove valuable. For example, introductions to launchpads or angel investors.

The second option is not ideal, but sometimes it's necessary. Why is it not ideal? Two reasons:

1. The group owners act as a middleman between the members and the teams they are raising for. So you have to trust them with your money, and trust them to send your tokens in time. Some of these vesting schedules take years, will they keep sending that entire time?
2. Aside from the trust aspect, the good groups that offer strong projects aren't that easy to find. Keep in mind, the deals that are offered in here are meant to be kept confidential. They won't be advertised everywhere. To find them, you need to talk to people and try to make some connections. Spend time in the groups that are easy to find, and talk to other members to see if they can recommend other groups.

Another tip for pooling groups is that most have a private group as well. Typically reserved for either larger investors or those that participate in a lot of pools. There's usually some sort of screening related to this, or you get invited to the group by someone you met along the way. <u>These groups are where you get the strongest projects.</u>

Did you know you could've been an early investor in projects like Solana, aleph zero, and harmony, just to name a few? Nothing is off limits my friend, but finding a way in is always the hardest part.

Before you get into these early-stage deals, we really need to make a few things clear. This is an even riskier type of investing in crypto. It's illiquid, there are vesting schedules, a lot of these teams aren't actually good people, and a large portion of them will ultimately fail. The vesting schedules have gotten longer and the valuations have been rising sharply.

But, in the long run, all you aim for is that the winners outweigh the losers. If you would like to get an understanding of the mindset behind this type of investing, we highly recommend the book "Angel" by Jason Calacanis.

A Rarestone Compass syndicate is something we plan on creating further along our journey.

Practical advice #6: Maximize investable funds
Now is the time to grind. If you have a business, put in the extra work. Always wanted to start that side hustle and make some extra cash on the side? Take the leap.

Your goal this year should be to maximize the amount of money you can **SAFELY AND RESPONSIBLY** invest into the market. Don't go all-in. Don't overextend. Leave some money to pay the bills. But, do what you can to maximize the amount of funds you can invest. Maybe postpone that vacation to Miami to next year?

Practical advice #7: Play the narratives
Playing the narratives is all about keeping your ears close to the streets. Or in this case, Telegram and Twitter. If you pay attention you can catch them in the early waves. Then, it's all about riding them until they fade away.

Right now, it's all about AI. Is it overblown? Probably, yeah. But there's been a handful of projects that've been printing harder than Jerome Powell in 2020. Just be sure to secure your profits and try to time the end of the narrative correctly. Typically that happens when you see a lot of copy-paste projects spawning.

Practical advice #8: Learn to master your emotions
Trading and investing is an emotional game. And that's all it is, it's a game. Those who learn to control their emotions will ultimately win this game. It's player vs player (though we came up

with the community vs community evolution). Every time you sell, someone is buying from you. When you buy, someone is selling to you.

Your goal is to not be the sucker that buys someone else's bags at ATH and is left holding it. Mastering your emotions is what will transform you from a single leaf being blown in all directions by the wind, to a concrete wall that can survive the harshest of weather conditions. And yes, that comparison doesn't make sense. How else do I convey to you how big of a difference this one single thing can make in your investing efforts?

Don't get married to your bags. It's ok to be excited about a project, just don't become a fanboy. Or a community hero for that matter. It will cloud your judgement. It's the reason we have people who still believe in a luna comeback. Ever believed so much in a project you kept DCA'ing on the way down, instead of being rational? Pretty sure we've all done it at least once.

Practical advice #9: Find smart people and keep them close
Sometimes all you need is that one piece of alpha from a friend which allows you to rake in a huge gainer. You can't cover all corners of the market by yourself. That's impossible.

So, it's simple. Find smart people, or those that drop solid info from time to time, and get close to them. Provide value to them, and they will provide value back. Self-plug: there are a lot of smart people in the Rarestone Compass group. You're welcome to join us: t.me/rarestonecompass. Although.. is it even a plug if we're the ones writing this report?

Categories and sectors to pay attention to in 2023

1) Artificial intelligence
Right, let's start with the most obvious one.

Everyone is talking about AI nowadays. Your uncle who loves conspiracies is convinced we'll meet our new AI overlords soon, and your average mid-level manager is drooling over the thought of AI replacing employees and reducing costs.

News flash, AI won't replace humans. Sure, it will drastically change the way we work and what exactly we spend time on. But that's about it.

One thing you need to be aware of is that most of the crypto projects, SaaS tools, or businesses that claim something is AI, are just hopping on the bandwagon. In the background is not actually AI what they are claiming to use or claiming to have implemented. But hey, that's a discussion for another paper.

In any case, pay attention to this sector. Everyone is flocking to this vertical ever since chatGPT became available to the public.

2) DeFi, Premissioned DeFi, and CeDeFi.
DeFi was one of the leading categories that fueled the previous run (remember DeFi summer?)

It would be lovely to see a mass exodus from centralized ponzis to decentralized ~~ponzis~~ protocols. Stop trusting platforms like [redacted] and [redacted] with your hard-earned money! Who cares about a 5% lending yield anyway? It's so silly. It's all marketing budget and (sometimes not so) clever ponzinomics.

Coming back to the topic of DeFi. We've seen our fair share of bad actors and overleveraged entities in 2021/2022. People will start to embrace truly decentralized protocols again. And we don't know about you, but we're seeing a lot of new DeFi protocols spawning recently.

Trust smart contracts, not people named Matt who wear suits.

We included CeDeFi here for one reason. It's an idea we got from an article from a VC firm. They're predicting a rise of established names/companies (centralized ones) who build their own DeFi protocols. They can be traditional financial companies or even established CeFi protocols. The first one to get it right will probably be quite the success story.

We also predict a rise in permissioned DeFi. Regulated institutions cannot access DeFi due to compliance and regulatory concerns. Permissioned DeFi changes that. Within a permissioned DeFi market, all participants are KYC/KYB verified and AML compliant, providing even the most regulated of institutions to tap into the power of DeFi. It’s an enhanced version of DeFi that allows institutional investors to participate in DeFi in a way that is non-custodial, safe from counterparty risk, yet still complies with local and international compliance.

Fireblocks is one of the pioneers in this niche. Fireblocks is an institutional-grade platform for the custody, transfer, and settlement of digital assets. They had one of the biggest funding rounds in crypto in 2022, raising $550 million to fuel their mission of providing institutions and institutional investors exposure to digital assets.

3) DeWi and DePin

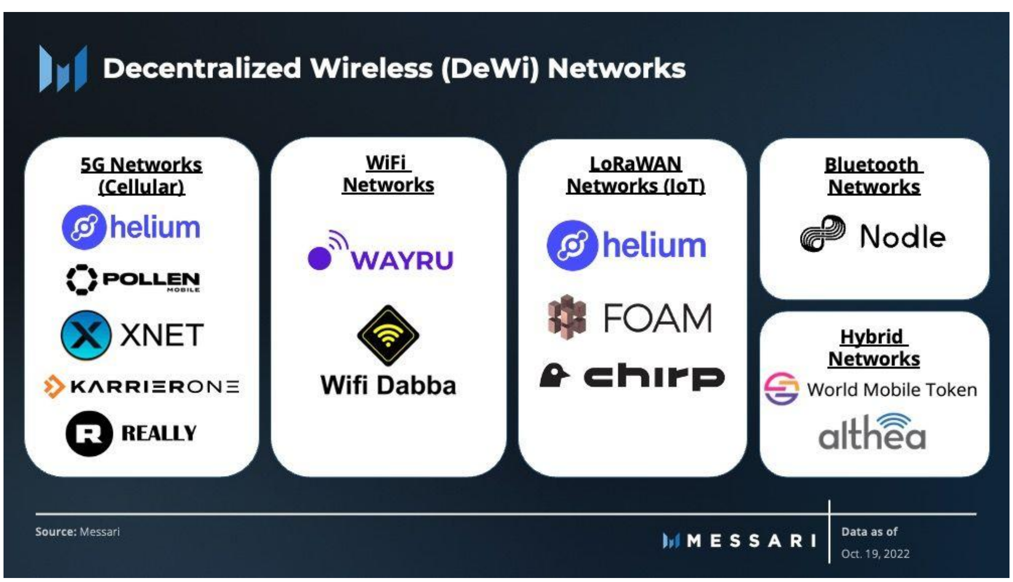
DeWi and DePin refer to ‘Decentralized Wireless’ and ‘Decentralized Physical Infrastructure Networks’. It’s a movement that is currently in its early stages, as it’s not something that is often talked about. Let us give you a quick introduction to these two movements.

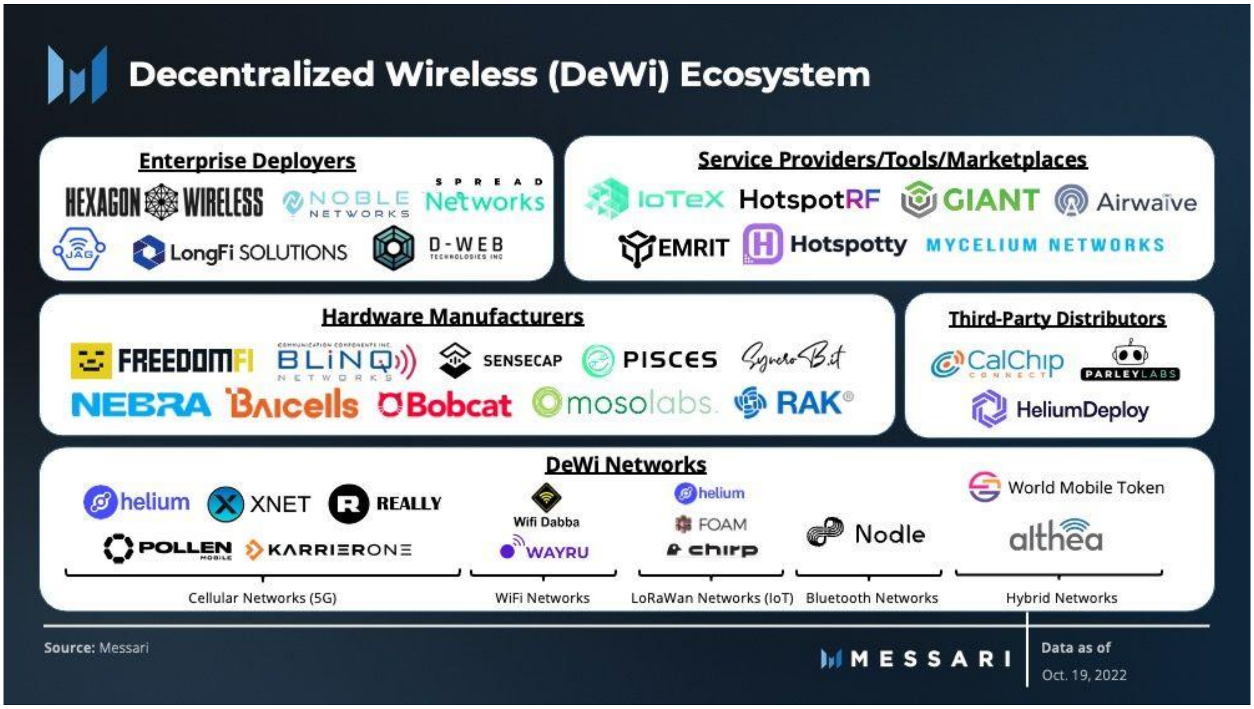
DeWi (Decentralized Wireless)

We live in a hyper-connected world of IoT devices. Nowadays, it seems like almost every device needs to be connected to the internet. Even fridges for some reason. In a world where everything needs to be connected, we’re seeing tremendous increases in network usage and the amount of data that we create every day.

If we continue down this road, then our current wireless networks will not be sufficient anymore (that’s the thesis behind this movement anyway). And that is exactly where the DeWi narrative comes into play.

We are now seeing experiments of crypto protocols that aim to deploy and operate a global decentralized wireless network powered by blockchain magic. A network that is operated in a trustless and permissionless manner will empower the next generation of IoT devices.





The current legacy wireless network market is dominated by a select number of players. In the US, 98.9% of the market is controlled by just three companies.

The incentive for people to participate in a decentralized network, and to run hardware in their homes, are to mine or earn tokens in exchange for keeping the network up and running.

The main player in this field is Helium, who started this movement years ago. They grew their network to over 900.000 hotspots over the world using token incentives.

Helium recently rebranded to Nova Labs, and raised a $200M Series D. Once you hear about the investors in this round, it'll hopefully open your eyes to the fact that people are starting to pay attention to DeWi.

[Nova Labs Series D investors]:

- Tiger Global
- Andreesen Horowitz (a16z)
- Three major telecom companies:

  Deutsche Telekom
  Nokia
  Liberty Global

- Goodyear ventures (the venture arm of US tire company Goodyear) – also a user of the Helium network

- Google Ventures
- Pantera Capital
- Seven Seven Six

DePin (Decentralized Physical Infrastructure Networks)

Decentralizing hardware capacity is the main thesis here. It's all about our precious cloud space and invisible connectivity infrastructure.

DePin is about decentralized networks of physical infrastructure, in which users are incentivized by tokens to complete certain tasks or run certain hardware. The fact that it's token incentivized is what gives the network a self-sustaining nature.

Some also refer to this as "proof of physical work" (PoPW) – a system where users are incentivized by tokens to do verifiable work to build real-world infrastructure. In the case of Helium, PoPW verifies the device's status and rewards the owner based on a predetermined set of rules, like deploying a 5G hotspot.

DeWi and DePin are two words, but both are typically used to refer to the same phenomenon.

4) Appchain and modular blockchain platforms/providers

Appchains, or 'application-specific blockchains', are a type of scaling solution that may drastically improve your (D)app's scalability and performance. It's a blockchain that is exclusively designed for operating your specific application. They don't run multiple apps like most public blockchains.

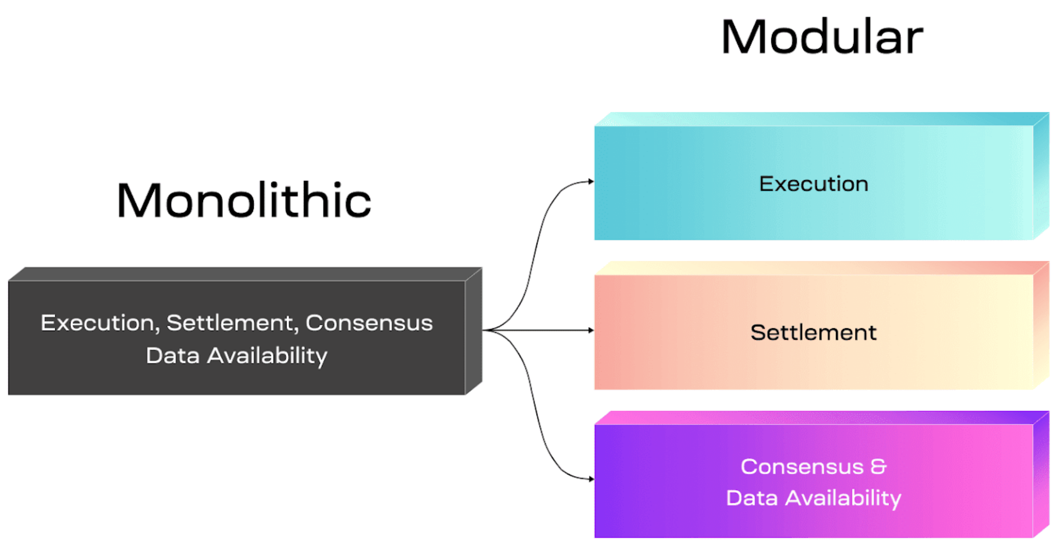
The benefit of running an appchain is that it allows you to handpick your economic structure, governance structure, and consensus mechanism. Appchains run on top of an existing layer 1 blockchain, taking advantage of that L1's security. Running an appchain on top instead of just building on the L1 gives developers the freedom to handpick the features that want for their app/appchain.

It allows for customization and empowers them to make changes to the chain when they feel they are needed. Appchains are kept online by validators of the main chain that can a specific appchain to validate for that specific appchain.

What about modular blockchains?

A Blockchain typically is said to have four main functions: consensus, execution, data availability, and settlement. A monolithic blockchain (think: Bitcoin and Ethereum) undertakes all of these four key features in its main consensus layer. In theory, this means that there's a limited amount of space to carry out all the tasks surrounding data availability, etc, etc. All the nodes for these four key features are kept within one block.

Running all of these four functionalities at a chain's base layer may limit the chain's max throughput. That's why in modular blockchains – unlike in monolithic blockchains – the functionalities are separated into different layers.



Each layer has its own main thing that it takes care of. For example, the execution layer functions independently from the other layers, which allows its nodes to focus solely on executing transactions. Cosmos was one of the bigger projects in this niche.

We recently saw Celestia Labs raise $55M to build out their vision of monolithic blockchains, in a round led by Bain Capital and Polychain Capital. Other noteworthy names included Coinbase Ventures, Jump Crypto, Placeholder, Galaxy, and Delphi Digital. FTX ventures was also involved though, so…

The opportunity for appchains and modular blockchain providers

Scalability in general will be a huge race throughout 2023 and beyond. 2023 will admittedly be less of a race as on-chain activity slows down, but that should significantly pick up by the end of the year. We'll be keeping a close eye on projects that empower developers to launch their own appchains, as well as projects that offer the ability to launch modular blockchains.

5) Real yield

Just hearing the word 'yield' probably causes all the warning signs in your head to go into overdrive. We don't blame you and certainly understand it.

We've seen many yield opportunities over the past years. Most of them turned out to be unsustainable at best. In the worst case it was just a ponzi, or yield was paid out of the marketing budget.

We are now seeing projects that try to play into the "real yield" narrative. E.g. yield from accrued fees, yield from asset-backed loans, etc. There are different ones out there (we won't be naming any specific ones at this time). Real yield refers to yield that is being generated by something tangible, typically based on some sort of revenue stream. Not just lending, which is basically a meme now.

There's no doubt that this is a lot riskier of an industry that needs a lot more transparency (and honesty). But, it seems poised for improvement. Having trusted, real yield may also open the door for more institutions to come in.

Institutions have seen the yields being offered in crypto land. They couldn't play though. It was too risky or too uncertain when it comes to regulations. However, a regulated way to receive yield that is audited and based on an actual sustainable revenue stream, now thát is something that might get them excited.

6) PoW protocols

Admittedly, a lot of people are against or bearish on PoW protocols (aside from Bitcoin). However, we've seen the run that Kaspa had throughout 2022. It was a strong one.

As mentioned earlier, ETH was the main PoW protocol that slurped up most of the mining power. Now that ETH has switched to PoS, there is a large contingent of miners ready to allocate their mining power to a new protocol.

So, finding strong PoW protocols/blockchains early on might prove fruitful. Not only to mine a sum of it when the needed hashing power is lower but also to buy some tokens OTC in the early days (as was the case with Kaspa).

Opportunities for 2023

Opportunity #1: Recently raised venture funds are sitting on large sacks of dry powder, waiting to get deployed into the market.

As mentioned earlier in the report, 2022 was the biggest year for venture funds yet. Over $33 billion was allocated to over 200 funds. Just think about those numbers for a second.

All that dry powder is waiting to be Salt Bae'd across a range of projects over the next 2 – 5 years. On the flip side, funding has been on a clear slowdown throughout 2022. It's declined consistently throughout the year. We'll have to wait and see how this progresses throughout 2023. Our personal thoughts are that it won't be until the second half of the year that things start picking up again.

Haun Ventures is one that might be competing for a spot among the top web3 VCs. Founded by Katie Haun (ex a16z), having raised a $1.5B fund. The largest-ever initial fund raised by a solo female entrepreneur. Clearly, the big pockets want in on this web3 action.

Opportunity #2: Equity over tokens

Let's be real, most protocols don't need tokens. And no, governance is not a strong token utility. Unless it's paired with other things of course.

Sometimes it feels like tokens are only issued as a way for VCs and founders to extract liquidity from the users of the product, or from those who buy the token looking for a quick flip.

Opensea is the leading NFT marketplace, yet it doesn't have a useless token (at least not yet). You don't always need a token.

There's already a big shift in motion where seed rounds are more often being raised as an equity round paired with token warrants (SAFE + token warrant). And yes, most of these will still end up going the token route. But it'll be exciting to see if more founders just start building high-quality products, and find a way to create a revenue stream.

OpenSea receives a 2.5% fee for each sale made on the platform. It's how they make their revenue. Going that route to sustain your business, pay your expenses, and generate returns for your investors makes a lot more sense than going the token route. In some cases at least.

One thing you should realize as well is that investments are often being made into the company behind a certain token. Sometimes, early investors don't want to invest in the token. They want equity in the company behind it.

Would you rather invest in a GameFi token with bad tokenomics, or do you want equity in the gaming studio that built the game?

Opportunity #3: Airdrop farming is back

What a lot of people don't realize, is that a large portion of your favorite layer 1's, layer 2's, DeFi protocols, DEXs, and bridges attribute a certain portion of their total supply to early supporters or reserve it for an airdrop. Even Aptos had an early supporters airdrop.

Either way, finding protocols and dapps early on and engaging with them, may make you eligible for an airdrop. It's free money, what's not to love?

Now, remember, if something sounds too good to be true, then it probably is. There's no such thing as a free lunch. Farming airdrops can be tedious. Most often they take a lot of time, and sometimes there eventually isn't even an airdrop. However, if you do manage to become eligible for one, it can be a nice payday. We've seen people receive 4 – 5 figure airdrops. So, it's a nice way to make a little extra shopping money.

Biggest things to look out for? Incentivized testnets, crew3 campaigns, bug bounty programs, testing programs, and getting roles in Discord servers. Most of these are a waste of time, so we suggest you only do it for projects you are excited about. Layer 1's and 2's have so far been the most sought-after when it comes to airdrops.

Some protocols that we recommend keeping an eye on over the coming months, and potentially trying to do some farming for are Arbitrum, LayerZero, Nillion, and EigenLayer. Remember; these are unconfirmed. You may end up with nothing.

We suggest you focus on the bigger projects that are in the infrastructure category. Blockchain layers, interoperability platforms, etc. Skip the random DeFi and NFT platforms.

Opportunity #4: A push for regulations, making it easier for institutions to enter crypto.

Whether you are happy about them or not, it's undeniable that we'll see a lot more urgency among regulators to push out some frameworks surrounding crypto. Especially since the FTX collapse. After watching the FTX hearings it's clear that those in power have varying views on this industry.

Some congress members hold the view that SBF was a single bad actor, and that this event shouldn't be a reflection of the entire crypto market. Another congress member (Sherman) was much harsher in his judgement and argued that this is not a single isolated event. Rather that crypto in itself is a horrible thing that should be banned. He argues that crypto's only use case is tax evasion.

In reality, he's just scared of what crypto's success would mean for the US dollar's position as the world currency. Those in power are trembling and trying to cling to their power for dear life.

Nonetheless, regulations could be a good thing. Regular audits for centralized exchanges could be good. It could've even prevented the whole FTX situation. Let's also not forget there's a lot of uncertainty around the whole world for people wanting to get into crypto. Where do they buy it safely? What about taxes? We need more clarity.

Institutions also clearly want to get in on this crypto action. But, they can't. At least not yet. It's not safe enough, and it's not regulated enough. Typically, Bitcoin is the only thing they get into. It doesn't go much further than that. And even Bitcoin is hard to tap into for them! And that is exactly why we need some form of regulation. When we have those, that is when the big money will finally start pouring in.

Regulations are the final barrier that needs to be crossed to go from a limited number of degens trading shitcoins to an unlimited amount of users and institutions alike tapping into the power of decentralized currencies.

Threats for 2023

#1: Potential macro headwinds prolonging the bear market (medium/high risk)

Central banks are cautiously optimistic about bringing down inflation to acceptable levels while avoiding a recession, but there are still substantial risks such as inflation pressures persisting, central banks being too focused on lagging indicators, and geopolitical risks that could cause a volatile environment.

The Fed will likely continue raising rates early in 2023 to continue making it more expensive to borrow money to try to bring down inflation. During the tail-end of 2022, we saw U.S. inflation come down after topping at 9.1% in June. Yet, the Fed is still concerned if they'll be able to realize a soft landing toward a 2% inflation rate.

Whether we should expect a recession or not has been quite the debate for a while now. There are two camps here; you have one side that believes the FED won't be able to bring down inflation without entering a recession. The other believes a recession can be avoided, and likely won't happen. It's hard to predict which of these two will eventually be right.

One thing we know for certain is that the almighty swayer of markets Mr. Powell, and his buddies at the Federal Reserve, will continue to increase rates until inflation comes down to 2%. The only question that remains, is how aggressive they will be.

Aggressive rate hikes could be a sign that we're in for more pain in the markets, or at least need more time before a potential bull run. On the flip side, the Fed dialing down the respective hikes could be a good sign for investors to turn hopeful again. However…

Keep in mind, whatever happens, inflation needs to come down. Jerome "money printer" Powell re-iterated that fact back in December 2022. He mentioned that even though inflation has slowed, more rate increases are needed. **He describes the max pain scenario to be a failure to raise rates high enough, which would lead to inflation becoming entrenched into the economy. The cost of getting it out of the economy would then be substantial.**

Don't get it twisted, we're not in the habit of fear-mongering, but take a potential recession into account when you make investment/spending choices. There is no 100% guarantee we will be able to avoid it, or that we will even have one. We could go into all sorts of metrics here, but they change rapidly over time and there are always debates on which statistics actually matter. Let alone the opinions on what story the numbers tell us…

To end this section: remain cautious. Remain objective. Look at the numbers, then form your opinion. Don't look for the numbers that fit your bias.

#2: Projects running out of runway (low risk)

There are typically three ways that projects cover their costs and sustain their business:

- They sell their own tokens
- They use the capital they raised
- They generate sustainable revenue

There is a small risk of certain projects running out of runway. Runway is a term used to describe how long a start-up can stay in business before running out of money. We know that a lot of projects don't actually have a way to generate revenue for themselves, or it's only a low sum. That's no bueno.

If there is no revenue stream, then they're most likely using the funds that they raised to sustain the business. Well, how much have they raised? And how long is their runway solely based on that capital? It strongly depends on how much they've managed to raise, and how lean their business is.

A third way that projects sustain themselves, is to sell their own tokens. If you look at the total token allocations of projects, you'll notice that most of them have a dedicated amount of tokens allocated toward development, marketing, etc. Those tokens are subject to a vesting schedule and are typically sold to cover their costs.

If your token has fallen a lot ánd you have a vesting schedule, then you can't get enough funds fast enough. If you don't generate revenue, or revenue has fallen significantly, then you rely on raised capital. If that runs out… then you're toast. Unless you can acquire some follow-up funding.

We've seen a fair share of projects lately that went quiet. No updates, no development, just silence. It's such a shame to see. However, we still label this as a low risk. High-quality projects with solid, consistent development progress throughout the years should have no trouble pulling through.

#3: Overregulation (low/medium risk)

We mentioned regulations as an opportunity for 2023. And we truly believe that in the long run it's a net positive.

However, there's a chance that regulators take the FTX situation (as well as the other unlawful things that happened throughout 2022) and use it to OVERregulate. I.e. making the rules way too harsh.

We know that US congressman Brad Sherman at least will be pushing for a ban on crypto in general. It's unlikely he will succeed in that mission though, and there are enough congress members who do not agree with his views.

We do know that there is a lot of fear among those in power though, as we mentioned before. They fear the threat it poses to their oh-so-precious banking system. They need to feel secure in the power that they hold. And there is nothing that goes against their ethos more than transparency and decentralization.

#4: FTX fallout/aftermath (low risk)

Remember the domino effect after the UST depegging? Luna went down completely, and with that, we saw a large aftermath of 3AC going down and taking a few companies with them along the way.

FTX is arguably much larger than the Luna situation. Some drew parallels with the 2008 financial crash and compared FTX going down to the 2008 collapse of investment bank Lehman Brothers. Not everyone saw it that way of course, and some compared it to different events (like the Bernie Madoff ponzi scheme).

There's no doubt though, that there was a visible aftermath of FTX going down. Keep in mind that FTX was seen as the go-to exchange when it came to being safe and complying with regulations. Quite ironic, isn't it?

FTX had previously raised 7 funding rounds, having raised a total of $1.8 billion in funding. Most investors have already marked their investment as a complete loss. Sequoia marked down their $214 million investment to zero. Paradigm is out $278 million.

Early FTX investors have been taking some of the heat lately for their lack of due diligence in the corporation. SBF once pitched FTX to Chamath Palihapitiya for an investment, after which Chamath's firm gave two pages worth of recommendations – including the suggestion to form a board of directors. SBF proceeded to tell Chamath to go fuck himself.

Did the lack of a board of directors not surprise any of the other firms? Did they not see any of the other red flags that Chamath mentioned in his podcast?

Sadly, aside from $1.8 billion in investments being marked to zero, customer funds were affected too. Retail investors and larger companies alike.

Some projects stored their treasury funds on FTX, which is now uncertain if they'll be made whole, and when. In any case, getting their treasuries back in full seems unlikely at this stage.

Aside from treasuries, companies like venture funds held large sums of money on FTX as well:

- Galois Capital mentioned they held significant funds on the exchange, with one source estimating the sum to be around $50 million.
- New Huo Technology, the owner of the Hong Kong-based crypto platform Hbit Limited has $18.1 stuck on FTX.
- Nestcoin (a start-up that operates and invests in web 3 applications) held significant funds on FTX, to cover operational expenses. Following the stop on withdrawal, Nestcoin no longer has enough funds to pay all of its staff.
- Crypto trading firm Amber group held almost 10% of its trading capital on FTX at the time it went bust. Amber Group had to lay off 40% of its staff (300 employees) and terminated a $25 million deal with football club Chelsea. Amber Group is currently raising a $300M series C to crawl back after the FTX fallout.

To summarize this report, we can say the following: stay long-term bullish, be short-term cautious. Not to be confused with being blindly bearish.

Thanks for reading. We're inviting you all to join the discussion, share your thoughts on the market, or just hang out and lend us your knowledge: t.me/rarestonecompass. You can also find us at twitter.com/rstonecompass.

Signed,
The Rarestone Council