



*When Carlos Betancourt and Kevin Kang met through the Stetson University alumni network, the duo bonded over a shared fascination with cryptocurrencies. Betancourt was a commodities trader at the time, while Kang worked as a portfolio manager and trader specializing in U.S. equities and fixed income. The pair decided to test the waters and began trading cryptocurrencies independent of each other through their personal accounts to see how they would perform.*

Kang and Betancourt immersed themselves in the world of crypto, identifying investment strategies in the nascent marketplace. A few months later, they met up again and excitedly compared notes. “We said, ‘This is incredible. We can do a lot with this,’” Kang recalls. So, in 2016, the pair began formalizing the idea to take the plunge and launch a hedge fund in the crypto space. This laid the groundwork for what would become BKCoin Capital LP, one of the very few diverse-owned hedge fund firms specializing in cryptocurrency trading.

Cryptocurrency is decentralized digital money designed to be used over the internet that is secured by cryptography, which makes it nearly impossible to counterfeit or double-spend. While there are thousands of cryptocurrencies in circulation, the most established are Bitcoin and Ethereum. Many cryptocurrencies are decentralized networks based on blockchain technology — a decentralized ledger of all transactions across a peer-to-peer network.

Only 21 million Bitcoins may be mined, with more than 18 million already in circulation. Its source code stipulates there must be a finite and limited supply. Similar to mining precious metals, Bitcoin can be “mined” by requiring work to extract through computational means. Bitcoin mining is the process by which new Bitcoins are entered into circulation, performed using very sophisticated computers that solve highly complex computational math problems. Similar to traditional currencies and commodities, these Bitcoins trade on several different exchanges, including Coinbase, Kraken, Gemini, and Binance. The size of the crypto market right now is approximately \$2 trillion – about half of which is Bitcoin.

## **THE KIDS IN THE VALLEY**

The logic behind launching the firm was sound. Kang and Betancourt had developed a pair of algorithms – sets of rules that define the optimal time that trades should take place to minimize losses and generate profits. And both founding partners had strong backgrounds in finance and trading – something many of the young, inexperienced crypto players in the San Francisco Bay Area lacked despite successfully raising tens of millions of dollars. Kang and Betancourt believed they could do better than the kids in the valley by bringing institutional-grade risk management, compliance and strategy to the space.

“We partnered up and started conceptualizing what was missing in the space,” recalls Betancourt. “Most of these kids never managed any money, so their risk management was very poor. We wanted to come up with a strategy that would be palatable for an institution, so they didn’t have to worry that the volatility of Bitcoin was going to hinder their performance on a month-to-month basis.”

Developing a market-neutral strategy and the firm’s first algorithms, Kang and Betancourt filed with the SEC to become an investment advisor. From there, the duo had to get creative to generate revenue, launching a FinCEN-registered liquidity aggregation business to bring in some income while looking to raise capital. “We also fixed some of the things that we were doing on our algorithms to be able to become a designated market maker on different exchanges and make some revenue that way,” Kang

recalls. "As we were doing that, we were also following up with all of these potential investors." BKCoin Capital launched in 2018 with a few hundred thousand dollars that both Kang and Betancourt pooled from their savings, along with a bit from friends and family. With so many young individuals in Silicon Valley raising tens of millions of dollars to launch funds with VC backing and no money management backgrounds, the BKCoin team assumed the fund-raise process would be a piece of cake. This assumption turned out to be incorrect. "We launched, and reality hit us in the face. No one was giving us money," recalls Kang. "So, we had to keep our head down and try to build a solid track record so people would take us more seriously."

"From 2018 through 2020, our AUM was still very low, and it was really tough, but we kept our head down – working hard. We developed new strategies, beefed up our tech stack to back-test internally," Kang recalls. "Now it's paying off. I think patience is key because you're going to need the patience to educate people. At first, I think the average time between meeting an allocator to the time we land that allocator was somewhere between nine to 12 months."

The hard reality was that, out of a universe of thousands of potential investors that Kang and Betancourt contacted, less than 100 were ready to actually allocate into crypto. "I think the biggest hurdle was letting the market mature. When you look at crypto hedge funds, over 85% of them are passive in nature," says Betancourt. "They have a very plain, vanilla strategy where they'll hold the basket of crypto and rebalance it once a month or once a quarter. There are not very many active crypto asset managers."

## CRYPTO STRATEGIES

BKCoin Capital offers five distinct, customizable strategies for institutional investors:

- **Market Neutral:** A USD-denominated market-neutral strategy created to provide investors with consistent low volatility returns by utilizing in-house proprietary arbitrage algorithms to capitalize on market inefficiencies and mispricing within digital asset markets. "We want to offer our investors an exposure to digital assets, but with much less volatility," says Betancourt. "We're just looking for mispricing in the market and taking advantage of the arbitrage opportunities."
- **Bitcoin Smart Beta:** This is a Bitcoin denominated strategy that utilizes arbitrage, mean-reversion, momentum, and trend following components to provide superior risk-adjusted returns for investors that are seeking bitcoin accumulation.
- **Ethereum Smart Beta:** A strategy that utilizes arbitrage, mean-reversion, momentum, and trend following components to provide superior risk-adjusted returns for investors that are seeking Ethereum accumulation.
- **Decentralized Finance (DeFi):** A combination of multiple strategies that typically invests in 10-15 liquid tokens at any point in time while performing meticulous fundamental and risk analysis. The strategies are predominantly driven by discretionary and quantitative strategies focused on decentralized finance and adjacent assets.
- **Market Making:** This strategy provides liquidity across major exchanges by quoting two-sided markets on multiple currency pairs. The firm's proprietary high-frequency algorithms allow it to provide deep liquidity at every level of the order book and generate alpha by collecting the bid-ask spread with dynamic hedging.

The market-neutral strategy started with an interexchange arbitrage algorithm, which is similar to purchasing, for example, a share of Apple stock on the NASDAQ at \$100 and selling it on a European exchange for \$110. The underlying asset is the same, but the 10% difference between those exchanges is generated income. As more institutional investors started entering the space, those opportunities started to evaporate, so the firm focused on currency paired trades.

Similar to traditional forex trades, but instead of swapping between the U.S. dollar to Euro or Japanese Yen, BKCoin uses this strategy to swap between the U.S. Dollar to Bitcoin, Bitcoin to another cryptocurrency such as Ethereum, and back to the U.S. Dollar, pocketing any spread. The firm also generates alpha from a spot-futures arbitrage – buying Bitcoin and shorting the future in a contango market and realizing that 20% or 30% annualized spread. As the futures expire, BKCoin captures that premium.

### **AN EDUCATION SITUATION**

One of the biggest challenges for the young firm is educating potential LPs unfamiliar with cryptocurrencies and investment strategies in the space. “The first thing that we do is almost like an educational session with them,” says Betancourt. “Particularly the ones that have come from a more traditional space and are still trying to wrap their minds around what’s going on. Our largest investor is a very large family office, and it took us over two years to land them.”

Despite those challenges, BKCoin’s value proposition is its ability to generate alpha while mitigating risk in the crypto space. “As a former fixed-income manager, if you have a single-digit return or low-teen returns, those are home runs,” says Kang. “Whereas in cryptocurrencies, because this asset class is so new and the market’s still not efficient, there are so many opportunities. Bitcoin is up 3x this year alone, and Ethereum is up 6x. We’re trying to offer investors exposure to this very promising space with a lot of return potential, but with much less volatility, with institutional-grade risk management and compliance.”

Just like the crypto market, BKCoin is evolving as a firm. “In the crypto world, we’re already past the whole Bitcoin-Ethereum understanding. We’re already focusing on layer two of decentralized finance,” says Betancourt. “For those that are not paying attention, it’s going to be a rude awakening because within five years or so, everybody’s going to have a universal credit score based on the transactions that they’re making on their digital wallets and on the blockchain, and we’re cutting out the middleman.”

Decentralized finance, or DeFi, is a blanket term for various financial applications in cryptocurrency or blockchain networks that is open to anyone to use rather than going through a middleman like a bank or brokerage. “In five years, I would expect DeFi to really change the landscape. About 16 months ago, the total value locked in DeFi was around \$300-400 million. It’s now at \$58 billion,” says Betancourt. “The power is incredible. There is no middle person. There is no brokerage charging you fees. It’s just peer-to-peer.”

While only two S&P 500 companies have invested in Bitcoin, insurance companies are looking into this space for alpha, as are certain underfunded pension funds to potentially make up for any shortfalls. And BKCoin Capital is evolving along with the market. “Not only have our strategies evolved, but we’re also launching exciting new funds this year,” says Kang. “We’re continuing to evolve, and we want to be the go-to active multi-strat fund in this space. Hopefully, when it’s all said and done, we’ll provide a lot of value to those folks who are tired of being in a passive crypto fund and want to have somebody actively manage their wealth. We’re very excited for the rest of this year.”