Our Weekly Paid Newsletter
Richard Cluver Predicts
In our 37th year of service to the investing public of South Africa

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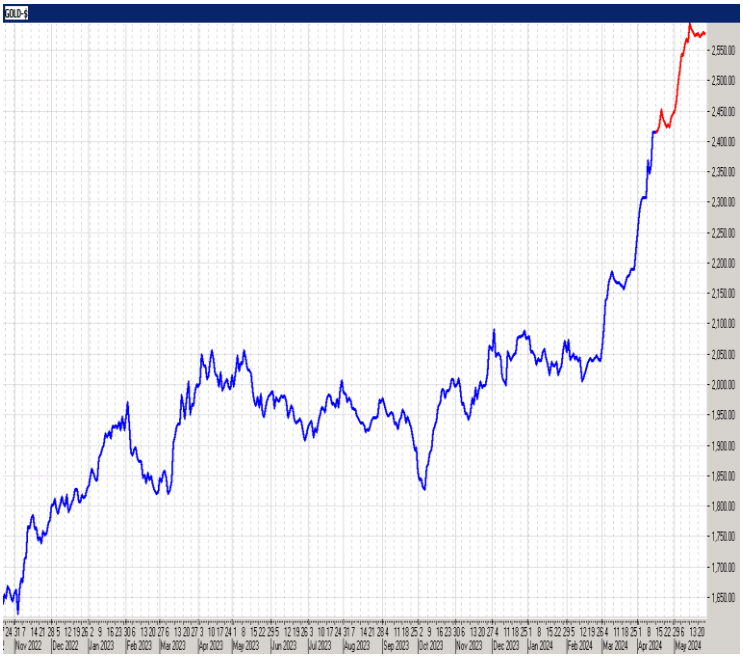
I have lately been explaining how the rising price of inflation hedges such as precious metals, share prices, property and collectibles like fine art and jewellery tend over time to track the real value of money. Of these, gold is the hardest asset of all because of its unique supply/production dynamics which is why it is such a fundamental reference point of monetary inflation.

Meanwhile, despite having put the entire world into the austerity of an interest-rate-induced effort to try and claw back the excessive sums of new money issued in the past quarter century, global inflation is proving an intractable problem. This week a perplexed US Federal Reserve Chairman Jay Powell has been forced to admit that the fight might now have to last longer than he originally expected.

So the pain of high interest rates will be with us for much longer and the social tensions - which are arguably the fundamental reason why nearly a third of the world is now at war and most major nations have begun dramatically increasing their armaments spending – are leading us into a dangerous new era when a nuclear miss-step could give us the terrifying prospect of an Armageddon scenario. Furthermore a severe recession warning is now out there!



The ShareFinder graph on the right graphically measures mankind's monetary fears with its projection in red which suggests gold could go to $2 600 in May:

For a concise understanding of why, precisely, gold is such an important measure of monetary value, I turn to 'Gold Bug' Nick Giambruno who writes, *"For thousands of years, gold has always been mankind's hardest money.*

"Hardness does not mean something that is necessarily tangible or physically hard, like metal. Instead, it means "hard to produce." By contrast, "easy money" is easy to produce.

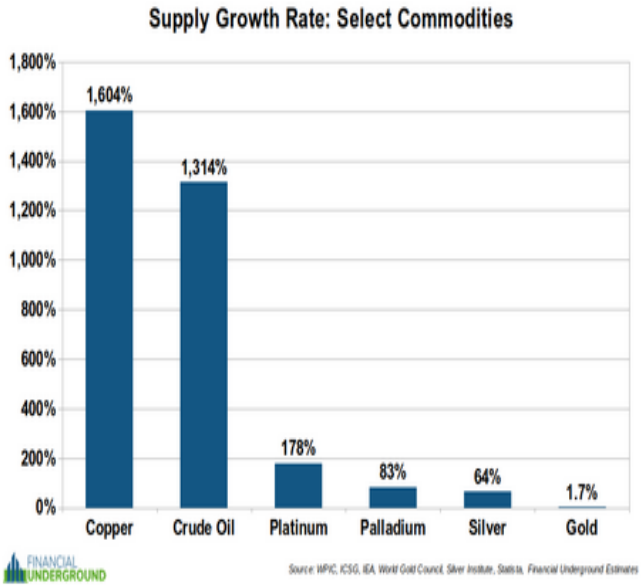
"The best way to think of hardness is "resistance to debasement," which helps make it a good store of value—an essential function of money. The supply response is why most commodity prices tend to revert around the cost of production over time.

"For over 5,000 years, gold has been the hardest asset, the most resistant to the easy money trap. Hardness can be quantified by the supply growth rate, the new supply produced in a year divided by the existing stockpiles. Historically, gold has been mankind's hardest asset with the lowest supply growth rate, which is why it has always been the best money. The World Gold Council estimates there are 6.8 billion ounces of mined gold globally, and annual production averages around 117 million ounces. That means gold's supply growth rate is around 1.7% (117 million / 6.8 billion), which has been relatively consistent for many years.

"In other words, no matter how hard humans try, they can't increase the gold supply by more than 1-2% each year, a trivial amount.

"In the chart on the right we can see the supply growth rate of various physical commodities. No other physical commodity comes close to gold's low supply growth rate and resistance to debasement. Monetary commodities such as gold and silver have relatively low supply growth rates. On the other hand, industrial commodities have high supply growth rates.

"A high supply growth rate means new production can easily influence the overall supply—and prices. Annual production for industrial commodities can sometimes far exceed existing stockpiles, which means the supply growth rate is more than 100%. That's because stockpiles for industrial commodities are low as industrial processes constantly use them up.



*"For example, according to the International Copper Study Group, annual copper production is around 21.9 million tonnes, and stockpiles are around 1.4 million tonnes. In other words, new annual copper production is more than **15 times** the amount of existing stockpiles.*

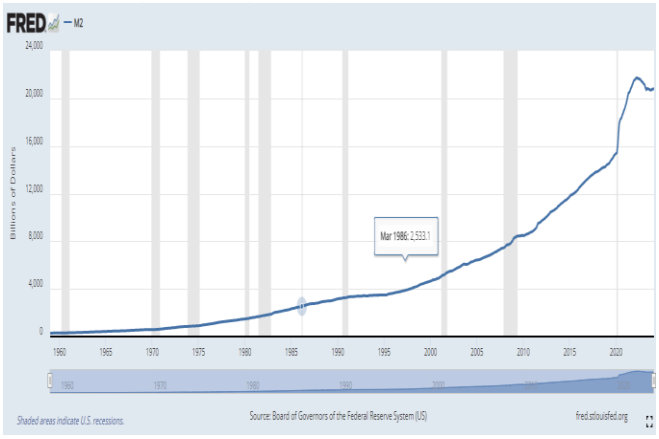
"Copper stockpiles are so low relative to new production because industrial processes constantly consume them, which means new annual production is an enormous factor in copper prices. Here's the bottom line. It's not desirable for an asset to function as a store of value if its price is hostage to the whims of ever-changing industrial conditions. That's why it's a big problem for an asset with a high supply growth rate to serve as a store of value, an essential function of money."

Now most folk seem not to appreciate that paper money - which was originally issued as a promissory note backed by real securities like gold bullion held in the vaults of the issuing bank – together with its many less obvious iterations such as bank overdrafts, credit card money and, more recently, crypto-currencies, collectively represent the total amount of circulating credit: i.e. the 'Money Supply.

In the good/bad old days of gold dollars/sovereigns etc, all money had an absolute value because our coinage was pure gold and by agreement each coin represented one fine ounce of the metal. Gold, furthermore, because of its relative rarity, could not be magicked out of thin air in the manner which the world's central banks today issue money. That was before the teachings of British economist John Maynard Keynes came to dominate monetary thinking.

Keynes demonstrated that modern economies could not on their own recover from a deep recession and that in such cases Central Bank stimulatory intervention was necessary. Simply stated, that idea handed central banks the power to create money out of thin air, figuratively speaking, via the printing press. In other words, a nation's currency no longer needed to be backed by the accumulated wealth of a nation.

So, in theory, where governments of old banked their trading profits and used the money to accumulate heaps of gold bullion, freed of that responsibility the temptation existed to simply print additional sums whenever a 'political' need arose. But, unless such surpluses were again withdrawn from the market once the emergency was over, the result was monetary inflation: when the pound, dollar, rand in your pocket effectively lost buying power. The graph on the right, courtesy the US federal Reserve, illustrates just how many US Dollars have been created since 1960...and just how few have been clawed back since global austerity began!



Governments measure the inflation rate by using monthly shopping baskets which, when scientifically done by means of analysing the composition of the average citizen's monthly expenditure: his rent, grocery bills, utility consumption etc provide a fairly accurate picture of actual inflation. However, such information can highlight irresponsible government and central bank behaviour and so many governments have taken to leaving out such key elements as house rentals which enable them to produce 'Official' inflation rates which could be skewed in their own favour.

Over time, of course, the hidden tax that inflation represents cannot be masked forever. Everyone soon begins to realise that their pay packets no longer enable the little luxuries they could previously afford and, carried to its extreme, the long-term consequence is to close down price-sensitive businesses leading to slowing GDP growth and, eventually, a failing economy.

The problem for the ordinary citizen is how to measure whether his government is telling the truth. Logically then, one might turn to the gold price. Thus I recently demonstrated to readers how, since the US severed the link between the gold price in August 1971, the gold price had risen from 35 Dollars an ounce to a current high of $2 418.20. The implication of that compound annual increase rate of 8.13 percent suggests that the US Federal Reserve is not quite telling us the truth when US official statistics claim a long-term inflation average of 3.5 percent.

Now, the problem about the price of commodities is that they are impacted by more than one influence and a big additional factor is the reaction of the public to perceived risks in the marketplace. That is why the gold price plot in the graph below is not a straight line. Moreover, when you deal with long-term graphs you have to deal with a phenomenon known as exponentiation which inevitably creates an upward curvature as is clearly evident in the gold price graph on the right:

The way to deal with is to measure the percentage change in the daily price of the commodity rather than the actual number. We call it logarithmic scaling and you can see the difference in the following graph. Furthermore, I have used a calculation known as the 'Least squares fit' process which enables me to draw a line linking the greatest number of price cycle lows. That's the red line in the middle which enables us to see how the gold price has periodically deviated from its long-term trend as it has responded to public scares in addition to actual inflationary pressure:

Thereafter it is a simple process to draw the green parallel line to try to encompass the most regularly-occurring graph high's and the yellow one intersecting as many as possible of the market price lows. Then the price plot itself becomes simply known as the "snake in the tunnel" and, assuming that inflation is a more or less constant phenomenon, it is then easy to see when investor concern has led in the past to investors rushing into the security of inflation hedges.

What the present graph thus indicates is that investor concern is presently not nearly as high as it was during the 2008 'Sub-Prime Crisis and entirely within the regular cycle of the past 25 years. But the red ShareFinder projection on the right suggests things could get worse!

This is an excellent example of how technical analysis – despite its sometimes cultish criticism - can aid one in taking investment decisions.

The month ahead:

New York's SP500: *I correctly predicted the beginning of weakness to the end of April ahead of a volatile recovery to a new market high at the end of October.*

Nasdaq*: I also correctly predicted the down-turn which I still expect to last to approximately May 10 followed by gains to the end of August ahead of a long decline into the New Year.*

London's Footsie: *I also correctly predicted the start of five weeks of gains then a month down and two of recovery to a mid-August peak and then down to year-end.*

France's Cac 40: *I predicted gains from mid-month and exactly that has happened. I expect them to last until the end of August ahead of weakness into the New Year.*

Hong Kong's Hangsen*: I correctly predicted weakness which I now see lasting to the end of May within an extended recovery well into the New Year.*

Japan's Nikkei: *I correctly predicted the start of a lengthy sideways to weakening trend. However, I now see an extended recovery beginning at the end of May and lasting until late November.*

Australia's All Ordinaries: *I correctly warned of weakness ahead of a volatile recovery likely to begin now. Now I see the recovery delayed to month-end but then continuing to late July followed by weakness right through to next February.*

JSE Top 40 Index: *I wrongly predicted a volatile recovery until the end of October but now see that beginning at the end of the month.*

ShareFinder JSE Blue Chip Index*: I correctly predicted long-term but very volatile gains until late September but I did not see the latest sharp decline coming. Happily it should be all upward from here though!*

Rand/Dollar: *I correctly predicted brief weakness brief weakness between April 18 and June 14. Long term I see gains well into the New Year with the next*

Rand/Euro: *I expected the current gains to be over by the 17th with protracted but modest weakness thereafter. Now I see them lasting a little longer to the 24th!*

The Predicts accuracy rate on a running average basis since January 2001 has been 87.22 percent. For the past 12 months it has been 92.93 percent.

U.S. Money Supply Is Doing Something No One Has Witnessed Since the Great Depression, and It Foreshadows a Big Move to Come in Stocks

By Sean Williams of The Motley Fool

KEY POINTS

Though Wall Street has been a wealth-building machine for over a century, short-term directional moves in the Dow Jones Industrial Average, S&P 500, and Nasdaq Composite are difficult to predict.

There have been only five meaningful declines in M2 money supply dating back to 1870. The four prior instances correlated with economic depressions and high unemployment.

History undeniably favors investors who can take a step back and appreciate the power of perspective.

Motley Fool Issues Rare "All In" Buy Alert

M2 money supply hasn't made a move this pronounced since the early 1930s.

When examined over long stretches, the stock market can't be beat. While other asset classes have produced solid nominal gains for investors, including gold, oil, housing, and Treasury bonds, none have come close to matching the annualized average returns that stocks have brought to the table over the last century.

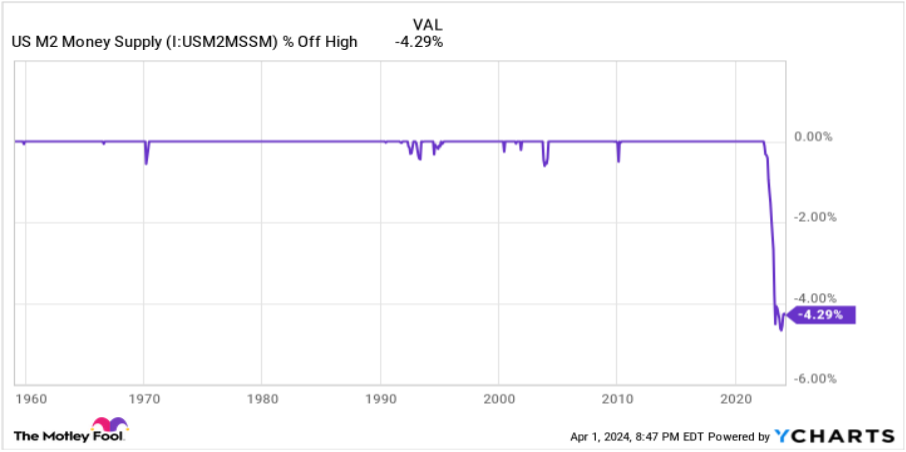
But when the lens is narrowed to just a few years or an even shorter timeline, predicting the directional moves of the ageless Dow Jones Industrial Average (^DJI 0.17%), benchmark S&P 500 (^GSPC -0.21%), and growth-powered Nasdaq Composite (^IXIC -0.12%) with any sustained accuracy becomes practically impossible.

However, this doesn't stop investors from trying to do the impossible. Though there's no economic data point or indicator that can concretely predict which direction the Dow, S&P 500, and Nasdaq Composite will head next, there are a very select group of metrics and forecasting tools that have strongly correlated with moves higher and lower in the major stock indexes throughout history. One of these metrics, which appears to be foreshadowing a massive move in stocks, is U.S. money supply.

U.S. money supply hasn't done this in nine decades

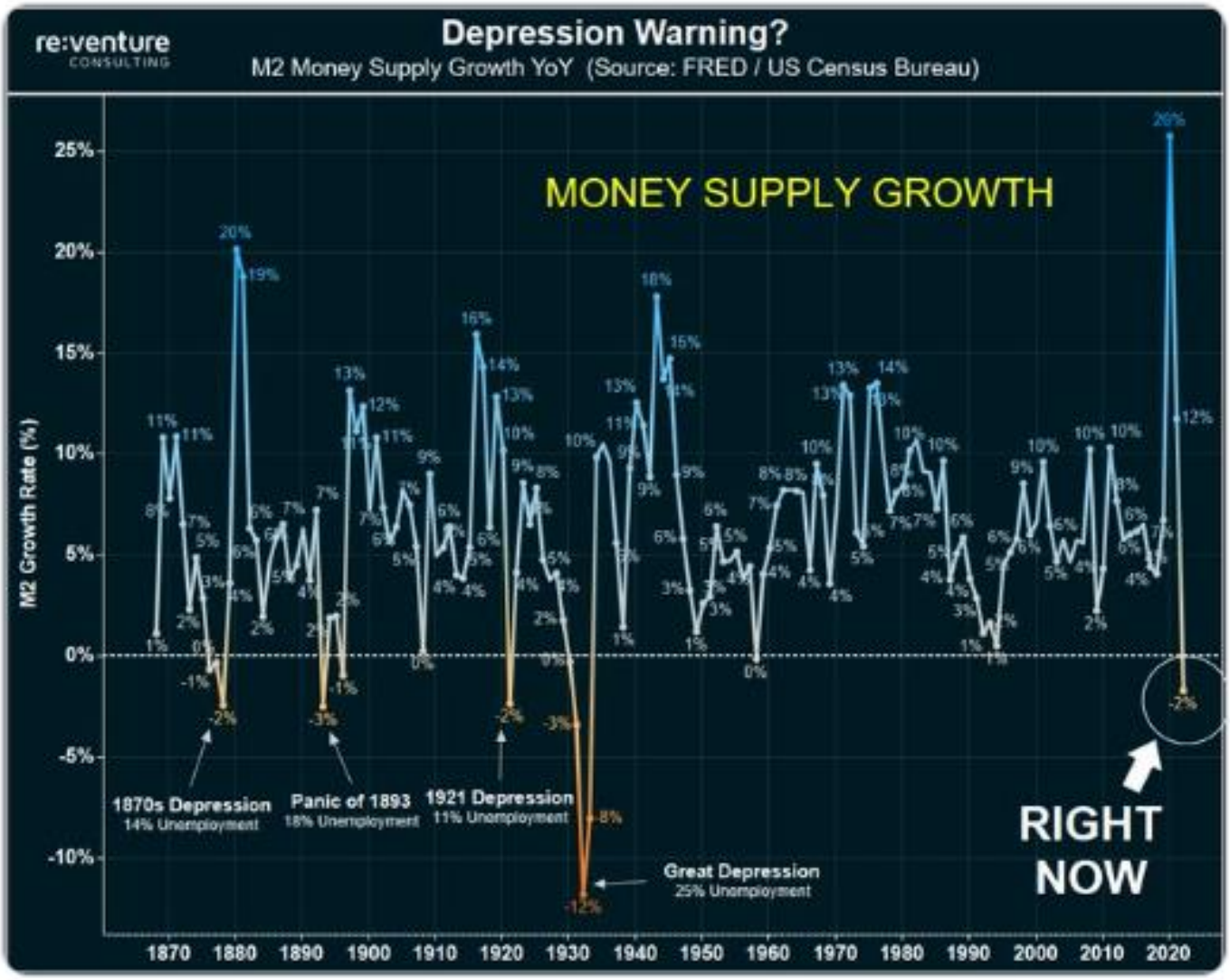
Among the five measures of money supply, M1 and M2 tend to garner most of the focus from economists and the investing community. M1 is a measure of cash and coins in circulation, as well as demand deposits in a checking account. It's money you have easy access to that can be spent immediately.

On the other hand, M2 money supply accounts for everything in M1 and also adds in savings accounts, money market accounts, and certificates of deposit (CDs) below $100,000. This is still money you can access, but you'll have to work a bit harder to get to it. This is also the money supply metric that's raising eyebrows right now for all the wrong reasons.



Most economists and investors tend to pay very little attention to M2 money supply because it's grown with such consistency over time. Since the U.S. economy expands over long periods, it's only natural that more cash and coins are needed to complete transactions.

But in those extremely rare instances where a notable contraction in M2 money supply has been observed, trouble has historically followed for the U.S. economy and stock market.



US M2 MONEY SUPPLY DATA BY YCHARTS.

Two years ago, in March 2022, M2 money supply reached approximately $21.71 trillion. Based on the latest monthly data release from the Board of Governors of the Federal Reserve System, M2 clocked in at $20.78 trillion in February 2024. As you can see in the chart above, this represents a relatively minor 0.5% year-over-year decline, but a more pronounced 4.29% drop-off since March 2022. It's also the first meaningful move lower anyone has witnessed in M2 since the Great Depression.

In one respect, this 4.29% retracement in U.S. money supply may simply be a reversion to the mean after M2 expanded by a historic 26% on a year-over-year basis during the height of the COVID-19 pandemic. Multiple rounds of fiscal stimulus flooded the U.S. economy with cash and consumers who were more than willing to spend it.

On the other hand, more than 150 years' worth of history has been pretty clear about what happens when M2 money supply retraces by more than 2% from a record high.

Last year, Reventure Consulting CEO Nick Gerli shared the post you see below on X (the platform formerly known as Twitter). Gerli leaned on data from the U.S. Census Bureau and Federal Reserve to track M2 movements since 1870.

Gerli noted five instances where M2 money supply declined by at least 2% on a year-over-year basis, including the significant year-over-year move lower observed in 2023. The previous four instances where M2 fell by at least 2% -- 1878, 1893, 1921, and 1931-1933 -- were associated with periods of depression and high unemployment for the U.S. economy.

To evaluate this data agnostically, it must be noted that the nation's central bank didn't exist in 1878 or 1893. Further, monetary and fiscal policy have come a long way since the Great Depression. The probability of a depression occurring today given the wealth of fiscal and monetary tools available is low.

But this data set is pretty clear: If the amount of cash accessible to consumers is declining, and the prevailing/core rate of inflation is at or above historic norms, there's a good chance consumers will pare back discretionary purchases. In short, it's a historic blueprint for a U.S. recession.

Even though stocks don't move in lockstep with the health of the U.S. economy, a recession would be expected to adversely impact corporate earnings. History shows that the lion's share of drawdowns in the S&P 500 have occurred after an official recession has been declared.

Patience and perspective are money-in-the-bank attributes for investors

Considering how resilient the U.S. economy has been in the face of rapidly rising interest rates, the prospect of the Dow Jones, S&P 500, and Nasdaq Composite being knocked off of their respective pedestals may not be something you want to hear or talk about. Thankfully, history is a two-way street that very much favours investors who can take a step back and appreciate the power of perspective.

As an example, let's take a closer look at the course most economic cycles have taken. Although recessions are perfectly normal and inevitable, they've historically come and gone in the blink of an eye. Since the end of World War II in September 1945, only three of 12 U.S. recessions lasted at least 12 months. Further, none of the remaining three surpassed 18 months.

With few exceptions, expansions have endured multiple years. In fact, two periods of growth since the mid-1940s hurdled the 10-year mark. While recessions may be unwelcome in the short run, they've given way to long-lasting periods of economic and corporate growth.

It's much the same story when it comes to Wall Street. Data from market research company Yardeni Research shows there have been 40 separate double-digit percentage declines in the S&P 500 since the start of 1950. Even though we're never going to precisely know ahead of time when these downturns will start, how long they'll last, or how steep the decline will be, history shows that the S&P 500, Dow, and Nasdaq Composite eventually recoup their losses and push to new highs.

In June 2023, market insights company Bespoke Investment Group took things one step further and published data on just how disproportionate bull markets have been, relative to bear markets, in the S&P 500.

The researchers at Bespoke examined nearly 94 years' worth of bear and bull markets in the S&P 500, beginning with the start of the Great Depression in September 1929. While the 27 bear markets were noted as lasting an average of 286 calendar days (about 9.5 months), the 27 bull markets in the S&P 500 stuck around for an average of 1,011 calendar days (roughly two years and nine months), or 3.5 times as long.

It's official. A new bull market is confirmed.

The S&P 500 is now up 20% from its 10/12/22 closing low. The prior bear market saw the index fall 25.4% over 282 days.

Read more at bespokepremium.com.

2/6/34	3/14/35	-31.8%	401	3/14/35	3/10/37	131.6%	727
3/10/37	3/31/38	-54.5%	386	3/31/38	11/9/38	62.2%	223
11/9/38	4/11/39	-24.4%	153	4/11/39	10/25/39	26.8%	197
10/25/39	6/10/40	-31.9%	229	6/10/40	11/7/40	26.7%	150
11/7/40	4/28/42	-34.4%	537	4/28/42	5/29/46	157.7%	1,492
5/29/46	5/19/47	-28.5%	355	5/19/47	6/15/48	23.9%	393
6/15/48	6/13/49	-20.6%	363	6/13/49	8/2/56	267.1%	2,607
8/2/56	10/22/57	-21.6%	446	10/22/57	12/12/61	86.4%	1,512
12/12/61	6/26/62	-28.0%	196	6/26/62	2/9/66	79.8%	1,324
2/9/66	10/7/66	-22.2%	240	10/7/66	11/29/68	48.0%	784
11/29/68	5/26/70	-36.1%	543	5/26/70	1/11/73	73.5%	961
1/11/73	10/3/74	-48.2%	630	10/3/74	11/28/80	125.6%	2,248
11/28/80	8/12/82	-27.1%	622	8/12/82	8/25/87	228.8%	1,839
8/25/87	12/4/87	-33.5%	101	12/4/87	3/24/00	582.1%	4,494
3/24/00	9/21/01	-36.8%	546	9/21/01	1/4/02	21.4%	105
1/4/02	7/23/02	-32.0%	200	7/23/02	10/9/07	96.2%	1,904
10/9/07	11/20/08	-51.9%	408	11/20/08	1/6/09	24.2%	47
1/6/09	3/9/09	-27.6%	62	3/9/09	2/19/20	400.5%	3,999
2/19/20	3/23/20	-33.9%	33	3/23/20	1/3/22	114.4%	651
1/3/22	10/12/22	-25.4%	282	10/12/22	6/8/23	20.0%	233
	Average	**-35.1%**	**286**		**Average**	**114.4%**	**1,011**
	Median	**-32.9%**	**240**		**Median**	**76.7%**	**522**

**Bear markets defined as 20%+ declines that were preceded by a 20%+ rally.*
**Bull markets defined as 20%+ rallies that were preceded by a 20%+ decline.*

To add to the above, the longest bear market in the S&P 500's history was just 630 calendar days (Jan. 11, 1973 - Oct. 3, 1974), by Bespoke's measure. Comparatively, 13 of the 27 S&P 500 bull markets were longer than the lengthiest bear market.

No matter how unpredictable things may seem in the short term, or how dire a picture historically accurate money-based metrics may paint, time is the undisputed ally of investors. If you have a long-term investment horizon and trust in the undeniable expansion of the U.S. economy over time, even a historic move lower in M2 money supply is nothing to worry about.

Decentralised Finance may transform how money is managed

By Tammy Whitehouse

Wall Street Journal

The velocity of money may soon accelerate significantly as blockchain, digital assets, and cryptocurrency enter and begin to proliferate in mainstream market spaces.

Although the industry has had high-profile setbacks, cryptocurrencies have gained significant attention, with major commercial entities across sectors and geographies taking steps to plan for, experiment with, pilot, or adopt cryptocurrencies, stablecoins, and tokenized assets. As these assets are programmable, they have the potential to replace certain services that today are provided by intermediaries such as banks, stock exchanges, or brokers. Blockchains, or distributed ledgers, can enable digital assets to be created, stored, and transferred transparently in real-time, immutable transactions across decentralized peer-to-peer networks.

“The scale of exploration suggests more widespread adoption with the potential to disrupt the existing economic framework,” says Lara Abrash, chair at Deloitte US. “To move forward responsibly, it is critical we prudently establish clear governance models to keep transparency, fairness, and accountability at the fore.”

Numerous countries are setting in place regulatory frameworks to permit the use of digital assets within their financial systems, which could enable a wide range of transactions for financial institutions, commercial and nonprofit entities, governments, and consumers—managing anything from global treasuries and complex supply chains to payroll, benefits administration, digital rights of intellectual property, taxation, and investment accounts.

Consumers already have options to use stablecoins for a wide variety of retail purchases without involvement of a traditional bank account, credit card, or cash; however, these options are often complex and expensive. In a world where more people may have access to cell phones[1] than bank accounts,[2] and as the cost and simplicity of access improve, a digitized system of currency may provide people globally with more equitable access.

“Increasing acceptance of tokenization of tangible and intangible assets could transform the way common transactions are carried out for entities, governments, and consumers globally,” says Tim Davis, a principal and global and U.S. Risk & Financial Advisory blockchain and digital assets leader, Deloitte & Touche LLP.

Key aspects of the evolving environment—commercial adoption, regulation, and tokenization, or the process of cryptographically representing assets in digital form—provide context for how the currency and payments landscape may be poised to scale toward critical mass, suggesting organizations may want to consider how they can begin planning and embarking on their own digital asset journeys.

More Brands Are Taking Notice

A growing number of major platforms that form the backbone of the modern global economy are planning for or beginning to consider the potential impact and opportunities associated with cryptocurrency and digital assets, Davis says. “These include major banks and banking networks, card networks, and technology providers who are experimenting with or operating nodes on blockchain networks, or are developing plans to do so,” he says.

With access provided on 428 million active accounts, including 35 million merchant accounts,[3] PayPal’s adoption of crypto on its platform represents a significant step in the transformation of how value is exchanged, says Rob Massey, a partner with Deloitte Tax LLP and global and U.S. tax blockchain and digital assets leader. PayPal account holders can buy, hold, and sell some common cryptocurrencies. Account holders can also cash it out to pay for purchases and transfer crypto between eligible PayPal and Venmo accounts as well as other wallets and exchanges.[4] “PayPal’s adoption of crypto enables a critical component for adoption—access,” Massey says.

In another example, J.P. Morgan has developed and deployed methods for representing traditional assets on blockchains to enable frictionless settlement. Some of the launches to date include JPM Coin System,[5] a blockchain-based account ledger and payment system, and Onyx Digital Assets,[6] a multi-asset tokenization platform that enables financial institutions, assets, managers, and fintechs to record and represent financial assets as programmable tokens on a blockchain.

More recently, J.P. Morgan and Apollo Global Management issued a report describing their vision for a tokenized approach to portfolio management—personalized investment portfolios at scale with simplified and streamlined order execution and settlement processes for both traditional and alternative investments.[7] The system would be powered by blockchain, smart contracts, and the tokenization of assets.

Goldman Sachs has also moved into the digital assets space with trading in cryptocurrencies[8] and the launch of its own digital asset platform.[9] Goldman and others such as S&P Global, Moody’s, Broadbridge, and Capgemini have joined Canton,[10] a privacy-enabled open blockchain network that provides connections among entities using smart contract technology. The permissioned blockchain is designed to provide interoperability and control for powering synchronized financial markets to enable secure, controlled exchanges of data and value.

“Blockchain development is progressing at a pace where the technical ability to manage high volumes of transactions globally with the necessary levels of transparency and privacy is becoming more feasible,” says Wendy Henry, the global blockchain and digital assets lead with Deloitte Consulting LLP. “The capability of enterprises, especially financial institutions, to be able to build applications and establish tokenized assets on public networks is a notable development in the evolution of cryptocurrency and digital assets. Although financial institutions are not yet leveraging this capability at scale, it can enable scaling that can lead to more widespread adoption.”

What’s more, as the capabilities of generative AI evolve rapidly, AI platforms could serve as agents performing financial transactions on behalf of people, Davis says. “Digital assets are well suited to AI platforms as money can be moved, controlled, and programmed directly,” he says. “Supercharging the way money is used suggests new risks and benefits, and the rapid acceleration of AI could help accelerate the adoption of digital assets.”

Additionally, platforms such as Bitwave are emerging to provide a connection between blockchain-based technologies and traditional finance.[11] Bitwave is a digital asset subledger that feeds into common ERP systems to enable programmable money, including payments with vendors, customers, and employees. The platform enables accounting, auditing, and reporting of data captured in distributed ledgers—capabilities that can be critical for scaling adoption.

Another important evolutionary step: the layering of networks over existing networks to aggregate transactions in a way that can improve flow and throughput. Much as high-rise buildings can increase real estate capacity in dense geographies, a layer-two distributed ledger can benefit from the safety and security of the layer-one network it is on while having significantly lower transaction costs and higher throughput. For

example, Optimism's OP Mainnet[12] is an open-source extension of Ethereum to scale the Ethereum ecosystem.

"As major platforms continue to launch applications, consumer and business acceptance of cryptocurrencies and digital assets is growing rapidly," Davis says. "These are important indicators that further disruption of currency and payment systems globally is on the horizon."

Regulation is Evolving Globally

A regulatory framework for digital assets is taking shape in many jurisdictions around the world, says Brian Hansen, an Audit & Assurance partner with Deloitte & Touche LLP and U.S. Audit & Assurance Blockchain and Digital Assets leader. The Group of 20's Financial Stability Board and International Monetary Fund provided comprehensive guidance for how authorities can address the macroeconomic and financial stability risks posed by crypto-asset activities and markets. The European Union's Markets in Crypto-Assets Regulation adopted in June 2023 provides rules for crypto-assets that are not otherwise regulated in existing financial services legislation. And Hong Kong's securities commission issued regulations on tokenized assets, stablecoins, and crypto trading.

Approximately 130 jurisdictions globally are either launching, piloting, developing, or researching central bank digital currencies (CBDCs),[13] although U.S. regulators are still in early stages of conceptualizing a U.S. CBDC. California also adopted two bills to establish a virtual currency licensing regime and to regulate digital financial asset transactions.

At the federal level in the United States, the regulatory tone has been different as risks and volatility in cryptocurrencies have prompted added scrutiny on several fronts. The Financial Stability Oversight Council issued a report finding that connection points between digital assets and traditional finance could pose systemic financial risk and urging federal agencies to continue to enforce existing rules and regulations.

In a significant development for U.S. markets, the Securities and Exchange Commission approved the listing and trading of several spot bitcoin exchange-traded funds, clearing a path for mainstream investment in bitcoin in traditional brokerage accounts via these approved funds. From a reporting standpoint, the Financial Accounting Standards Board has developed guidance on how companies would account for cryptocurrency and other digital assets under GAAP. The Internal Revenue Service has also developed guidance on digital assets, treating them as property for federal tax purposes. Meanwhile, banking regulators are urging financial institutions to exercise caution.

Tokenization is Taking Shape

As technology adoption and regulation continue to evolve, the global financial ecosystem is moving closer to becoming a token-based economy—one in which assets are represented in digital form on blockchains and the exchange of value is decentralized, Davis says.

Nonfungible tokens have already gained attention in certain niche areas such as sports and art, but blockchain technology and the evolving regulatory environment can support tokenization for a much broader variety of tangible and intangible assets with an understanding of the risks. These assets can include securities, loans, public and private funds, hedge funds and money markets, private equity, environmental credits, real estate, commodities, ownership rights, voting rights, and content licensing. Items of value can be converted using encoded rule sets and attestations, and they can be transacted over blockchains to significantly improve efficiency and transparency.

"Tokenization provides many potential benefits that are becoming increasingly compelling," Massey says. "Consider the typical costs and friction associated with a transaction, such as a commercial loan, and how tokenization and management of value through a distributed ledger could enhance the process." Using smart contracts and other automation tools, tokens could be coded so that they would execute, clear, and settle virtually instantaneously. The process could be faster and less costly while providing around-the-clock access and enhanced transparency.

Digital assets and tokenization could help companies better manage trapped cash on their balance sheets. “It could enable them to explore new ways of facilitating cross-border payments, repatriating cash, and improving work capital management,” Massey says. “It could significantly enhance payroll processes, providing a way to compensate people on a more ongoing or recurring basis, such as per job for gig workers or per day for salaried workers. Tokenization could streamline many of the traditional banking processes by reducing settlement time and cost.”

Ultimately, tokenization could lead to a system of programmable money, where value is built into smart contracts, and terms and conditions are coded in, Henry says. “Even without third parties intermediating transactions, companies could see dramatic improvements in cost, efficiency, and transparency, which could dramatically transform how they handle finance and treasury functions,” she says.

As an example of the potential benefits, consider the friction normally involved in cross-border payments, which are subject to layers of process, regulatory scrutiny, and cost. With tokenization and programmable money, transactions can be executed instantly, anytime, and from anywhere. They can be automated based on certain triggering events, with transparency and control built in. Rather than having funds tangled up in payment channels, they can be deployed under working capital strategies and tapped at the moment needed.

Taking Action

“While there are still regulatory uncertainties regarding how a system of decentralized finance may unfold, many organizations see the potential benefits of such a system, prompting a growing number of organizations to launch or consider launching their own digital asset strategies,” Abrash says. “Companies can consider many different possible pathways to planning and embarking on their own digital asset journeys.”

Form a cross-functional group. Assemble a team from across the enterprise—finance, treasury, accounting, technology, legal, risk, tax, compliance, operations, supply chain, human resources, and marketing—to explore what is happening in the crypto and digital asset spaces and consider opportunities and risks.

Understand blockchain and Web3. Learn how the enterprise could benefit from a transformed method for sharing and validating data, one that provides a transparent, immutable record of transactions without an intermediary. Consider possible use cases where accountability and auditability are important and where data needs to be accessible and transparent to multiple parties who are operating at arm’s length.

Consider possible uses of crypto. Despite significant volatility and high-profile failures in the cryptocurrency markets, maturity is developing as people become more familiar and exercise more discipline and rigor. Companies can consider opportunities to invest, buy, sell, hold, and take or make payments using cryptocurrencies after significant effort, analysis, planning, and execution with respect to risks and opportunities, rules and regulations, and processes and controls.

“As the cryptocurrency and digital asset spaces evolve, barriers to entry and scale are gradually falling away,” Massey says. “The global economy is moving closer to widespread adoption of these new ways of doing business.” When cryptocurrency and digital assets become easier to access and transact than fiat currencies and traditional processes allow, organizations may witness a groundswell of adoption that transforms the way value is exchanged.

—by Tammy Whitehouse, senior writer, Executive Perspectives in The Wall Street Journal, Deloitte Services LP