

ECONOMIC OUTLOOK

You've probably been hearing a lot about stablecoins, and you might have questions about them, too. Stablecoins are a digital asset that are intended to combine the stability of a traditional currency while adding the trading efficiencies of crypto assets. Here are some of the basics to know about stablecoins.

Not all stablecoins are created equal, and there are three main types:

- Fiat-collateralized coins. These are backed on a oneto-one basis by cash or U.S. Treasury bills but can also be backed by other stablecoin crypto assets like USDC U.S. dollar coin (USDC) or tether coin (USDT).
- **2. Crypto-collateralized stablecoins.** These are backed by highly volatile crypto assets, but are overcollateralized with the intent that they remain stable.
- **3.** Algorithmic (non-collateralized) stablecoins. These rely on code-based supply-and-demand methodologies and are the riskiest form of stablecoin.

The intended purpose of stablecoins is to bridge crypto and traditional finance, providing dollar-like stability. Initially, the idea was for stablecoins to provide for faster and cheaper cross-border payments and to serve as potential backbone for digitized currencies.

Who are some of the players currently? Tether is the largest by market cap, but it is often criticized for its lack of transparency. USDC is issued by Circle (a fintech company) with U.S. regulatory oversight. Paypal USD (PYUSD) is a newer entrant that is connected to a major payment network. DAI is the leading decentralized coin managed by the MakerDAO protocol.

What are some of the risks? At the top of the list is what the market refers to as "breaking the buck." That's the risk that a coin is no longer worth the \$1 it is intended to replicate. Regulatory crackdown may slow, alter or restrict trading in a coin. Integrity risk, where coin users rely on the honesty and solvency of the coin provider, is also a risk area, along with software bugs in decentralized systems that could break down, disrupting the intended stability of a coin. This is only a partial list. >>>



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Where are stablecoins used today, and what does the future look like? Currently, stablecoins predominantly are used for settling other crypto and tokenized assets. Future use may migrate into payment systems, more normal remittances, and non-bank lending.

Countries are looking to regulate stablecoins, which currently function as private-sector alternatives to actual country-specific currencies like the U.S. dollar. More regulation is likely coming, focused on reserve quality, redemption risk and systemic risk. A developed system would likely be subject to bank-like licensing if it holds large reserves.

We expect regulation will materialize that pushes the market toward transparent and institutionally backed coins. In the end, central banks like the U.S. Federal Reserve will likely create a digitized version of the physical dollar we currently know. That is scary for some folks but in a way, it has already happened. We just call it a credit card.

Greg Sweeney is the Chief Investment and Economic Strategist at Bell Institutional Investment Management. He guides the investment strategy, and this outlook is his perspective on the latest market trends and what they could mean for investors. Any views, strategies or products discussed in this article may not be appropriate or suitable for all individuals and are subject to risks.