



# Liquid tokens as part of an institutional portfolio

a M11 FUNDS research paper

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# Abstract

This paper explores the growing role of liquid tokens in institutional portfolios, highlighting their potential as a bridge between early-stage venture capital and public markets. While Bitcoin has established itself as a core asset, liquid tokens offer unique opportunities for growth and diversification. Tradable on exchanges, these tokens allow for flexible investment in innovative blockchain applications, often granting holders governance rights and profit-sharing.

Comparing Bitcoin's stability to the higher-risk, higher-reward profile of liquid tokens, we find that portfolios with small allocations (1-3%) to liquid tokens have outperformed traditional 60/40 (Equities/Bonds Respectively) portfolios, albeit with increased volatility. This analysis shows that liquid tokens can offer outsized returns and enhanced diversification, similar to early-stage tech investments.

As the digital asset space gains institutional traction—with major players like BlackRock launching tokenized products and regulatory shifts supporting crypto—the case for including liquid tokens in institutional portfolios is becoming increasingly compelling.

**Analysis shows that liquid tokens can offer outsized returns and enhanced diversification, similar to early-stage venture capital investments.**

# Example

Over the past decade, we've witnessed one of the most remarkable developments in financial markets: the rise of digital assets. Bitcoin, which launched in 2009 in response to the global financial crisis, was initially designed as a decentralized alternative to traditional currency, aimed at increasing transparency and trust between parties. Fast forward 15 years to 2024, and Bitcoin has transformed from a niche asset into a financial powerhouse. Its evolution was underscored by the launch of a Bitcoin ETF by BlackRock, the world's largest asset manager, marking the most successful ETF debut in history. In just nine months, this ETF drew \$17 billion in inflows, surpassing the QQQ ETF's prior record of \$13 billion. Currently, inflows exceed \$27 billion, pushing Bitcoin's market cap to \$1.7 trillion—surpassing even silver's total market cap.

Building on its success in the digital asset space, BlackRock has further expanded by launching a fully decentralized, **tokenized fixed income** fund called BUIDL. This fund leverages blockchain technology to tokenize U.S. Treasury bills, providing investors with 24/7 access and a daily yield on these fixed-income products. BlackRock's move—the latest by one of the world's most influential asset managers—signals the vast growth potential of digital assets in institutional portfolios, attracting over \$500 million in assets under management.

**This paper will explore why digital assets, particularly liquid tokens, deserve consideration in an actively managed institutional portfolio.** While much of the discussion has focused on the effects of adding Bitcoin to institutional allocations, we aim to broaden the discussion to include a wider array of digital assets.

## 94%

Of institutional investors believe in the long-term value of blockchain and/or digital assets<sup>1</sup>

## 56%

Of Fortune 500 executives say their companies pursue on-chain projects<sup>2</sup>

[1] "Gaining Ground: how institutional investors plan to approach digital assets in 2024," EY Parthenon, May 2024.  
[2] Web3 Adoption Survey, Coinbase, April 2024.

# Bitcoin versus liquid tokens

Since Bitcoin's inception, extensive research has underscored its potential financial benefits, supporting its inclusion in balanced portfolios. Its investment appeal lies in its exceptional returns, distinct correlation profile, and inflation-resistant qualities. Bitcoin's growth rates remain unmatched by traditional markets, and its low correlation with assets like stocks and bonds positions it as a strategic hedge during economic uncertainty. Often called "digital gold," Bitcoin's fixed supply of 21 million coins adds to its safe-haven reputation, akin to gold, by providing scarcity that centralized fiat currencies lack. Unlike fiat currencies, which can be expanded through policies like quantitative easing, Bitcoin's scarcity positions it as a currency hedge against devaluation and inflation, particularly in markets where central banks may expand money supply.

However, rather than focusing solely on Bitcoin's past performance, which has been widely discussed and reported, it's essential to examine the future potential of these types of assets. While Bitcoin's journey—rising from nothing to becoming a \$1 trillion asset class—has been a media sensation, with this the days of 1,000% annual growth are likely behind us. As Bitcoin gains broader institutional adoption, its volatility has gradually declined, and the potential for outsized returns has moderated. However, as the broader crypto ecosystem expands, a larger set of digital assets have offered appealing risk-return profiles in its place.

Now, attention is shifting to a new frontier: **liquid tokens**, which is akin to **tokenized early-stage venture capital**. Unlike traditional venture capital investments, which are often illiquid and have long lock-up periods, liquid tokens are readily tradable on exchanges. This liquidity allows investors to adjust their positions with flexibility, moving in and out of these tokens more freely than with traditional private investments.

Liquid tokens often play key roles within their ecosystems. Beyond acting as investment instruments, they can provide unique benefits to holders—such as governance rights, where token owners have a say in the direction of the project, or profit-sharing mechanisms tied to the success of the underlying application.

In many ways, liquid tokens combine the high growth potential of venture capital with the accessibility of public markets. As early-stage digital assets, they allow investors to capture value from the rapid innovation in decentralized applications and blockchain networks, offering exposure to emerging trends like decentralized finance, gaming, and Web3 infrastructure.

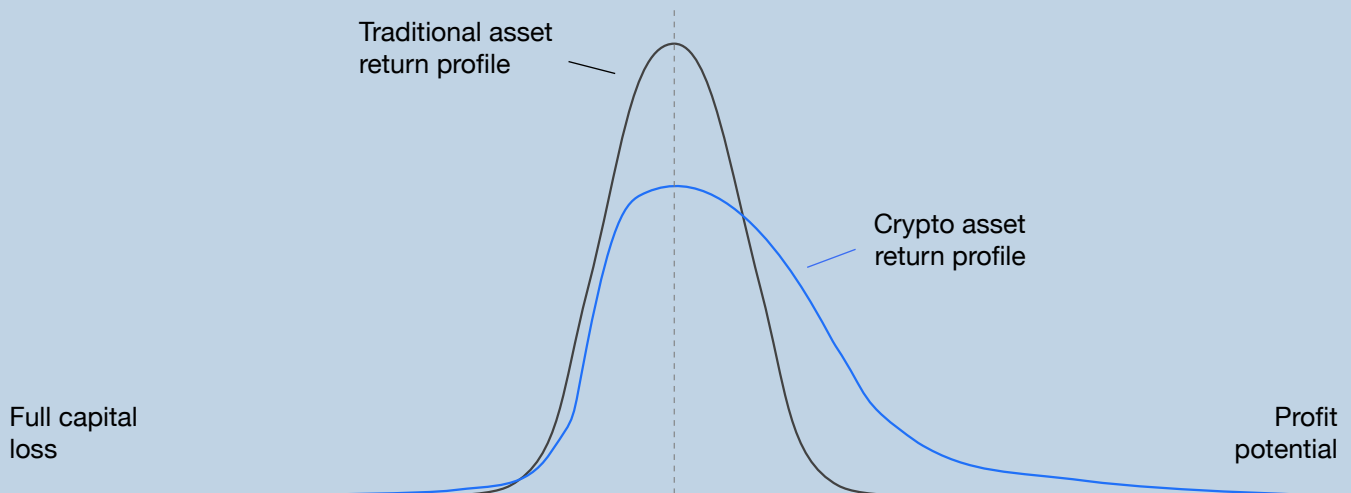
Think of Bitcoin as analogous to a large cap tech stock, representing a large, established, and relatively stable investment vehicle, while liquid tokens are more akin to small cap tech stocks with greater volatility but also higher potential upside. Because these tokens are tied to emerging blockchain projects and technologies, their growth prospects are tied not just to the broader crypto market, but to the adoption and success of the platforms they support.

# Attention is shifting to a new frontier: liquid tokens, which is akin to tokenized early-stage venture capital.

# The liquid token opportunity-set

The liquid token ecosystem offers a unique investment opportunity, especially when contrasted with more traditional assets. As shown in the chart, traditional assets generally exhibit a more predictable return profile with limited volatility, while liquid tokens, and crypto assets more broadly, offer considerable right-tail upside. This means they present the potential for significant gains beyond what is typically expected, although with higher risks, including full capital again showing similarities to early stage venture capital.

Idiosyncratic liquid token ecosystem offers considerable right-tail upside



A key factor driving this return profile is the structural inefficiency present in the liquid token market. Unlike mature financial markets, where information flows efficiently and prices adjust rapidly to new data, the liquid token market often displays lagged price adjustments due to varying degrees of market participant awareness. Many participants may not fully utilise available information, creating gaps in understanding that lead to pricing inefficiencies.

These inefficiencies allow for the potential to identify mispricings, especially for those with a nuanced understanding of market trends and ecosystem developments. Coupled with the natural volatility in liquid tokens, these characteristics can lead to unique return profiles that stand in contrast to more established assets like Bitcoin or traditional investments.

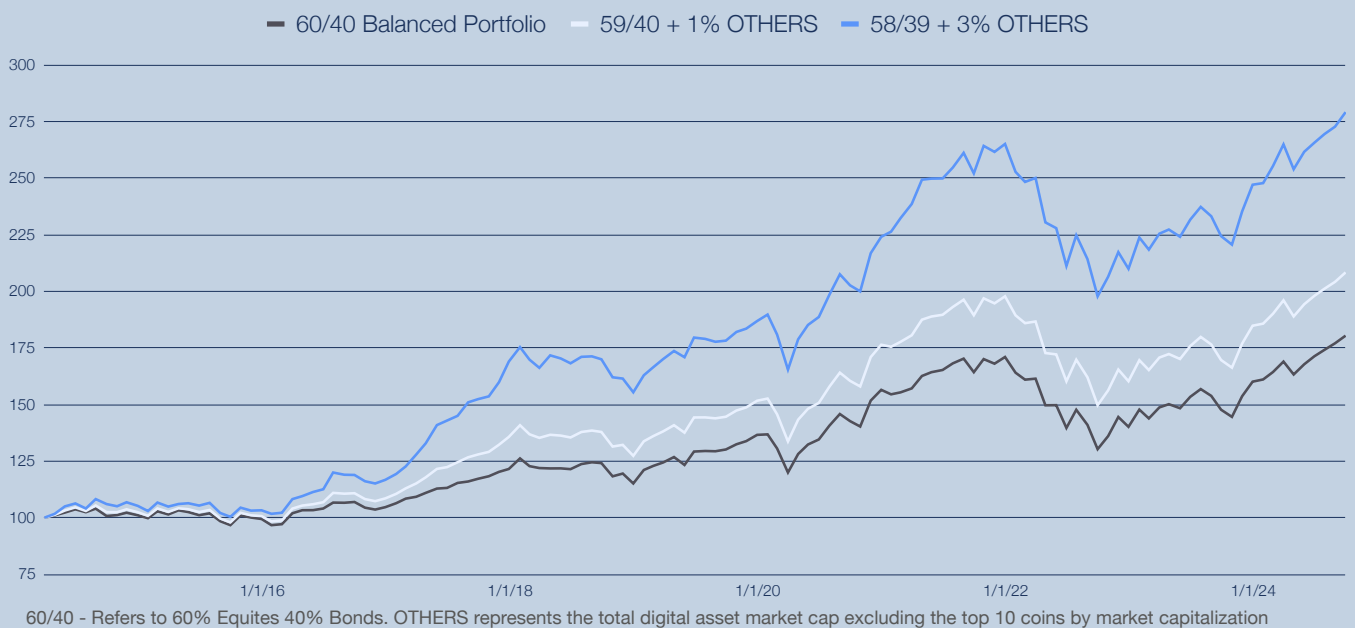
# Performance

As highlighted, liquid tokens exhibit a significantly different risk-return profile compared to Bitcoin and traditional assets. The performance analysis below uses an index termed “OTHERS,” which represents the total digital asset market cap excluding the top 10 coins by market capitalization. This subset captures a broader and more volatile portion of the digital asset market.

We analyzed portfolio performance by adjusting the balanced portfolio (60% Equites / 40% bonds) with incremental allocations of 1% and 3% to this liquid token asset class. The table below presents key metrics such as cumulative returns, annualized returns, risk, Sharpe ratios, and maximum drawdown.

The chart demonstrates how portfolios with modest exposure to liquid tokens have consistently outperformed the traditional 60/40 portfolio. Allocating just 1-3% to this asset class has led to an improvement in total and risk-adjusted returns, as reflected in an elevated Sharpe ratio. However, while this exposure has delivered stronger returns, it has also introduced higher volatility, leading to greater fluctuations in portfolio value.

Overall, the results suggest that a small allocation to liquid tokens can be a valuable addition to a traditional portfolio, though with the trade-off of increased volatility.



	60/40 Standard	59/40 + 1% OTHERS	58/39 + 3% OTHERS
<b>Cumulative</b>			
Average Monthly Return	0.5%	0.6%	0.9%
Cumulative Total Return	80.4%	108.3%	179.1%
Annualized Return	5.9%	7.4%	10.5%
Annualized Risk	10.0%	10.3%	11.4%
Sharpe Ratio	0.104	0.210	0.264
<b>Rolling 1-year</b>			
Annualized Return	17.3%	18.0%	19.7%
Annualized Risk	10.1%	10.3%	11.0%

# Is it too late?

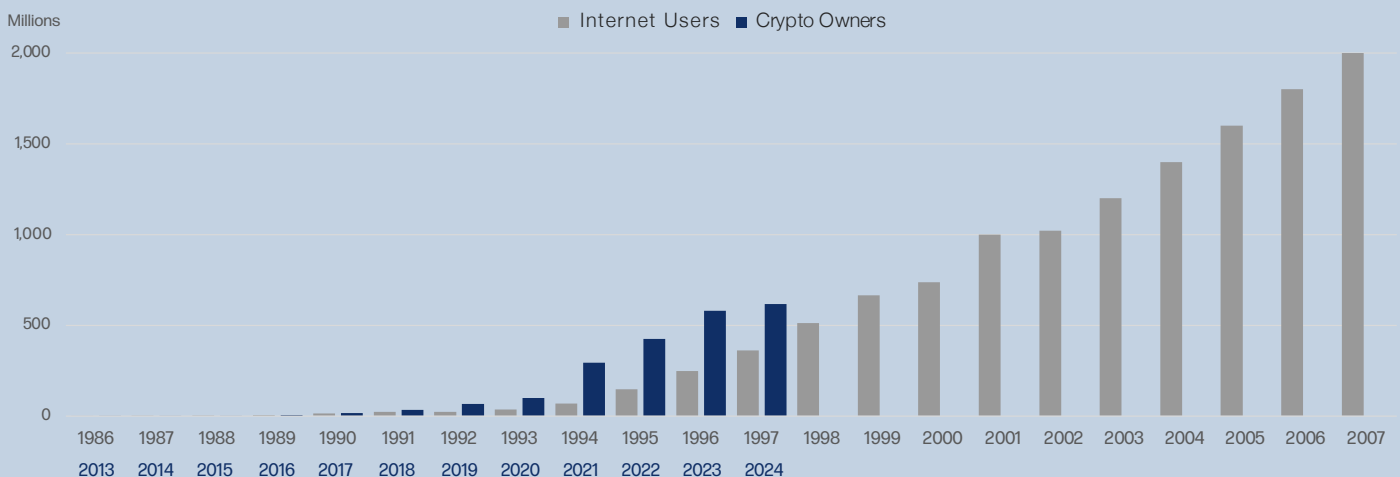
While the historical performance of liquid tokens has been remarkable, it is important to focus on what the future holds, which is why we believe this opportunity is far from over. Despite significant growth in recent years, we are still in the early stages of adoption, much like the internet in its early days.

The trajectory of liquid tokens is analogous to the dot-com boom, where there was a rapid surge followed by a market correction, similar to the 2021 crypto market cycle. However, what makes the current landscape different is the exponential advancement in blockchain technology, driving broader adoption as time goes on.

As the saying goes, history may not repeat itself, but it often rhymes. We believe the crypto market is at a pivotal point, where the immense growth we saw in the early stages is only the beginning. As technological adoption continues to accelerate, particularly in areas like decentralized finance (DeFi), AI, and Web3, the future potential for liquid tokens remains substantial. This makes the opportunity to invest in this space still ripe.

The accompanying chart shows **Bitcoin's adoption** compared to **internet adoption** during its early years. Despite Bitcoin's impressive growth, it is still following a path similar to the internet's early adoption curve, suggesting that much of the potential upside has yet to materialize

## Global Tech Adoption: Internet Users vs. Crypto Owners



Source: Galaxy Research, Data: Our World in Data, Cambridge Judge Business School, Statista, Crypto.com

As the digital asset space matures, the case for including liquid tokens in institutional portfolios becomes increasingly compelling. Bitcoin has established itself as a cornerstone asset, but liquid tokens offer a new dimension by providing exposure to **tokenized early-stage venture capital** in a liquid form. These assets present the potential for outsized returns and enhanced diversification, allowing institutions to tap into innovative, decentralized applications and networks that carry unique utilities and growth prospects, adding a dynamic layer to traditional portfolios.

Though inherently more volatile than Bitcoin, this volatility in liquid tokens, when managed effectively, can be a source of enhanced returns. Above research has shown that even a modest allocation of 1-3% to liquid tokens within a conventional 60/40 portfolio has the potential to improve risk-adjusted performance.

Despite the advancements in digital asset adoption, the sector remains in its early stages, with substantial growth on the horizon. Major institutional players like BlackRock have demonstrated confidence in the industry by launching multiple ETFs and even a fully **tokenized fixed income fund**, underscoring that the digital asset revolution is just beginning.

Political developments have also created a favorable backdrop for digital assets. For instance, recent pro-crypto stances from President Donald Trump include proposals such as a federal Bitcoin reserve—a notable shift from his prior skepticism and a strong endorsement of digital assets. Trump has also pledged to replace SEC Chair Gary Gensler, criticized for stifling innovation, with someone more supportive of crypto adoption. This could accelerate the approval of crypto ETFs beyond Bitcoin, opening access to assets like Solana and further liquid tokens. Pro-crypto wins in the Senate have further strengthened this outlook, as key seats flipped by candidates backed by crypto PACs lay the groundwork for legislation that may shift oversight to the more crypto-supportive CFTC. Meanwhile, a favorable macroeconomic environment, with global central banks easing post-pandemic monetary policies, has increased liquidity—a factor historically linked to positive performance in risk assets, including digital assets.

In conclusion, liquid tokens offer a powerful diversification opportunity for institutional portfolios seeking exposure beyond Bitcoin. By combining high growth potential with the stability of blockchain-based ecosystems, liquid tokens can complement traditional assets, adding both performance enhancement and strategic value.

With institutional giants like BlackRock leading the charge, digital assets appear to be at the early stages of a broader transformation in asset management.

This paper is presented by M11 FUNDS, a specialised investment manager in digital assets that manages the M11 Liquid Token Fund. This research underscores the core mission of M11 FUNDS: bridging the gap between traditional investors and digital assets by providing regulated access to this evolving asset class, as one of the first movers in Europe.





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