In September 2017, in a small rented house in Berkeley, a young MIT graduate was working on collapsing the kimchi premium. The kimchi premium is a crude reference to the gap in the price of Bitcoin on South Korean exchanges versus other places in the world. If a trader could buy Bitcoin at lower prices, say on an exchange in the United States, and sell that same Bitcoin for a higher price in South Korea, they could profit off the difference. Better yet, if they could automate this trade and replicate it many times a day, they could make millions. Sam Bankman-Fried (commonly known as SBF), that young MIT graduate in that small house in Berkeley, did just that.

This was the start of Alameda Research, a small crypto currency hedge fund that would leave a big impact on the world. Alameda was quickly successful in Bitcoin arbitrage and was able to raise $50 million dollars. The firm soon had 15 employees in a 600 square foot walk up in Berkeley. Stand-up desks populated the kitchen, the closet was reserved for sleeping, and take out containers were everywhere but the firm was very successful. Bitcoin arbitrage didn't last forever but because crypto was so new, there were other trades to be had. The problem: there wasn't an exchange, or platform, out there that could support the types of trades that Alameda was making, or wanting to make.

The obvious solution for SBF was having Alameda build that platform. In May 2019, Alameda launched FTX, short for "Futures Exchange". FTX was a robust cryptocurrency exchange that had the best user interface in the crypto space and did not have any of the technological challenges that plagued their competitors. FTX was aimed at institutional investors looking to make complex trades on one platform and also retail traders, who were growing in numbers as crypto adoption was rapidly gaining pace. FTX was also attractive to investors because its business model was easy to understand: The exchange would make money from charging traders fees on their transactions and that's it; it was a way for investors to invest in a cryptocurrency company without exposing themselves to the price risks inherit in cryptocurrencies. Another plus for outside investors was that SBF was pro-regulation; he wanted FTX to be the respectable face of crypto.

FTX was very successful and in the summer of 2021 had closed their series B funding round at a valuation of $18 billion. The list of investors included storied venture capital firm Sequoia Capital, Softbank's Vision Fund, hedge fund Tiger Global, and the Ontario Teachers' Pension Plan; this was the "A-list" as far as investors go. As FTX grew so did Alameda, but Alameda was now having a problem. The cryptocurrency space was starting to get crowded and as the price of coins like Bitcoin and Ethereum soared more and more users entered the space. Suddenly, the abundant potential trades that Alameda could execute at its inception were disappearing. In response to this, Alameda started making riskier and riskier traders using leverage, which is borrowed money.

At the heart of Alameda's borrowing was FTX's own token: FTT. It's common for cryptocurrency companies to mint tokens that can be traded on exchanges so speculators can participate in the growth of the companies without directly investing in them. Unlike shares of stock in a corporation, these tokens did not represent ownership stakes in the company nor did they entitle the holder to a proportionate share of the company's profits, they were backed by nothing.

FTT was FTX's token and, while a small percentage of the tokens outstanding were released to the public to trade, FTX held the majority of the FTT outstanding. In fact, it was Alameda that held most of the FTT and it was their FTT that was used as collateral for billions of dollars in loans that they then used to execute their increasingly risky trading strategy. Let's take a step back and think about this: FTX could issue as much FTT as they liked out of thin air and since they controlled most of the FTT outstanding, they could control the price of the token. As long as the price held up, crypto lenders were willing to provide loans using FTT as collateral. It was as if FTX had discovered an infinite money glitch in a video game. What could go wrong?

As it turns out everything could wrong. In January of 2022, FTX did another round of funding, lead by another impressive list of investors that now valued the business at $32 billion. Everything was going great for FTX but not so much for Alameda and the crypto market in general. The collapse of FTX, the blue-chip crypto exchange with the regulation friendly founder, took all of 10 days. On November 2nd, 2022 a crypto trade website called CoinDesk published a story that revealed that Alameda held over $5 billion in FTT, the native token of its sister company FTX. This prompted concern about the amount of leverage Alameda was using and caused some holders of FTT to sell their positions. In a matter of hours FTT's price had collapsed and Alameda's lenders were contacting the firm demanding that Alameda put up more collateral. SBF then used FTX's customer's money to try and bailout Alameda, turning what can only be described as horrible risk management in to outright fraud. On November 11th, 2022 FTX, and all of its subsidiaries, filed for bankruptcy. The firm, which had been valued at $32 billion just month prior, was now worth $0. Its investors and customers completely wiped out.

This is a fascinating story but why should we care? After all, Trillium does not invest in crypto and we have no plans to either. It's important for two reasons: 1) FTX serves as a great example of the far-reaching effects of loose monetary and fiscal policy and 2) it signals a great change in the world that we should be acutely aware off.

The first reason is easy to understand: When interest rates are zero and governments are pumping trillions of dollars into their respective economies, the standard used to greenlight investment dollars plummets. Investors flushed with ever increasing amounts of free money will move further and further up the risk spectrum and as those risky investments start to make money, a type of rush in to those assets occurs. Investors have a fear of missing out (FOMO as the kids call it) and thus may not apply the same standard of due diligence that they would in less boom times. The result is a flood of capital into companies on the fringes of the investable universe and when the inevitable bust happens, it's these companies that come down crashing the hardest, like FTX. One of the toughest parts of investing is realizing what kind of market you are in and then avoiding the mistakes of that particular market. Trillium is happy to be an observer in crazy growth markets and an opportunist in bust markets.

The second reason is a bit harder to understand but ultimately more important. Before the mass adoption of smartphones information flowed much slower through the world. If there was a major geopolitical or macroeconomic event the first people to know about it would be subscribers to a special service, like Bloomberg or Business Wire. Next, the media would report on it and this is generally when the masses would learn of the event. Today, a lot of news is broken on services like Twitter, through freelance journalists who use the platform, their tweets are then shared by Twitter users and, if enough users share the tweets, the tweets go viral and this is now how the masses learn about the event. This happens across platforms but the point is the way in which information is discovered and disseminated has changed profoundly. This is important to us because as investors access to timely and accurate information is of the utmost importance. FTX would not have existed in a world without smartphones and Twitter but it serves as a great example of how the world has changed, and that is something we need to be acutely aware off.

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