

Market Commentary May 2023

Meme coins, pure hype or investable assets?

What are meme coins?

It is a term used to describe cryptos that have gained popularity due to their strong community and marketing efforts. They often use memes (i.e. an amusing or interesting item such as a picture) and viral social media content to gain attention. They also tend to have little to zero functionality or utility beyond their use as a speculative investment, as their value is usually driven by hype and speculation.

[The Top 5 meme coins](#) have a total market cap of approx. \$16.5bn as of May 14, 2023. Examples of meme cryptocurrencies include Dogecoin, Shiba Inu and more recently Pepe. Surprisingly, the most popular meme coin - Dogecoin, is ranked as the 8th most valuable digital asset by market cap. It is therefore fair to say that meme coins represent a specific market segment (albeit marginal) of the digital assets space.

The story behind Dogecoin & Pepe rise



Dogecoin, [a meme coin born as a joke](#), sky-rocketed in May 2021 after [Elon Musk appeared on "Saturday Night Live" and referred himself as the Dogefather](#). This propelled Dogecoin to a market cap of approx. \$88bn. More recently, 'Pepe Coin', a meme coin launched in April 2023 and based on the 'Pepe the Frog' meme, attracted investor's fever, with one [crypto investor reported to have turned \\$250 into approx. \\$1 million](#).

Are meme coins pump & dump schemes?

Meme coins occasional short and sharp periods of exponential rise have been historically followed by sudden price crashes - [like Pepe](#). This has led to many smaller investor losses and raised concerns of [market manipulation](#). This has not reflected positively on the image of the crypto space and has led to [further regulatory scrutiny](#).



Source: [CoinMarketCap.com](#)

As meme coins' price is driven by market demand (led by speculation) and social media sentiment, intrinsic/fundamental value is difficult to assess. Should the demand (hype) fall or even disappear, meme coins could potentially have zero value at all.

The rationale behind the hype

Let's try to apply a valuation framework to meme coins to figure out why some investors might be willing to invest in meme coins despite their apparent lack of utility.

Future profits? If meme coins lack use cases and the technology to develop a core market with a future flow of income, they cannot qualify as eligible assets for investments.

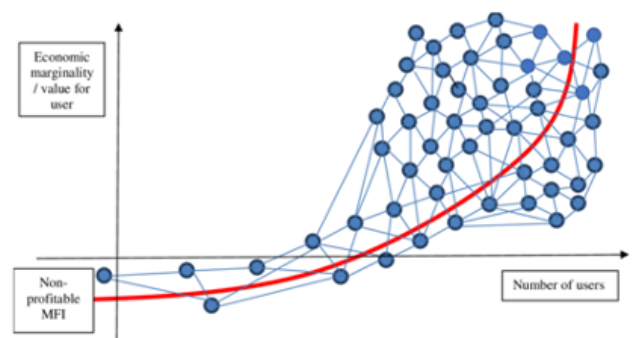
Store of value? If meme coins lack scarcity (like Bitcoin), their valuation cannot increase in line or catch-up with other scarce assets (like gold).

Consequently, it appears to us that meme coins are essentially a bet on future adoption, with the belief that they will become an established means of payment. In which case, they would indeed drive adoption and create value (network value).

Here is Dogecoin foundation's explanation of inflation (or diminished inflation) and why [Dogecoin will have a much more utilitarian and practical place in the economy than other cryptocurrencies](#).

Valuating meme coins as a means of payment

Metcalfe's Law states that the value of a network is proportional to the square of the number of participants or nodes in the network. In the context of cryptocurrencies, this law suggests that the value of a cryptocurrency network is influenced by the number of active users or participants within that network.



Source: Research gate, 'Microfintech: outreaching financial inclusion with cost cutting innovation', 2019 Moro Visconti Roberto

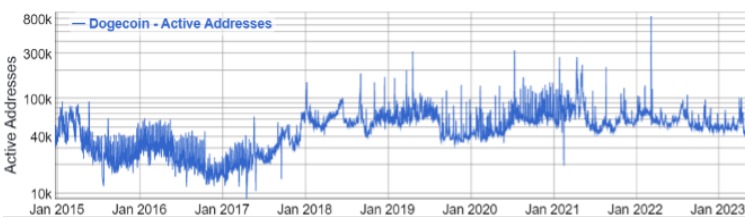
As the number of users or participants in a meme coin network grows, the value and utility of the network also tend to increase. This is because with more users, there are more potential connections, interactions, and transactions within the network, which can enhance its overall value proposition. Consequently, a high market cap can only be justified if the number of users rises quickly and [the tokenomics are not too inflationary](#) (as the new coin issuance will decrease its prices).

The Dogecoin example

Dogecoin's number of *active addresses* per day has been rather flat for the last couple of years.

This contrasts with the exponential adoption model used to back a growing network:

where are the new participants? Maybe this is because there are still a very limited number of companies/retailers using Dogecoin as a means of payment.



Source: [bitinfocharts](#)

Dogecoin's tokenomics are inflationary. [With \\$139 bn tokens already issued](#). We expect another \$80 bn to be issued by 2034. The token issuance of approx. \$5 bn / year translates into an annual inflation of roughly 4%.

Conclusion: it appears that activity metrics do not align with the means of payment model in order to justify current valuations. Current valuations can only be explained by high speculative interest as opposed to a high utility, according to the Metcalfe model. This leaves the meme coin highly vulnerable to a shift in investors' sentiment - since intrinsic value remains low as a result of limited mainstream adoption.

Going forward... meme coins becoming more than meme coins?

Maybe because of a lack of mainstream traction, the most popular meme coins might start adding smart contract functionalities to develop additional use cases to transactions (NFTs, Web 3.0). Dogecoin is an interesting case here.

For example Dogechain, is a smart contract enabled Layer-2 creating utility for Doge, that lets users use Dogecoin to pay gas fees on the network. The Dogechain moves Dogecoin beyond simple transactions. The Dogecoin foundation believes that this will help onboard the many casual holders of the meme token to Web3, exposing them to the potential of smart contracts and all the different verticals made possible by programmable tokens.

This seems to have started working, as per recent on-chain metrics. [Dogecoin, the meme-inspired cryptocurrency recently witnessed a massive surge in network activity](#) with daily transactions reaching an all-time high (ATH) of 650,000, surpassing both Bitcoin and Litecoin. [DRC-20 tokens drive parabolic move in daily Dogecoin transactions](#)

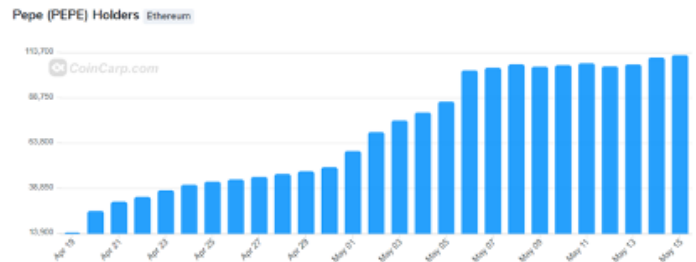
Note from BAM: *Though we felt the need to provide our network with this informative piece/analysis on meme coins, Block Asset Management does not invest directly in/have direct exposure to any meme coin. Meme coins represent a fraction of the digital asset class. They are highly influenced by speculation and small groups of investors active on social networks. The vast majority of digital assets outside meme coins are driven by more traditional valuation metrics. This clarifies the fact that we, @BAM, invest in funds using a comprehensive set of technical and fundamental methods to value digital assets.*

What about Pepe Coin?

Pepe was the meme coin darling of the last month, skyrocketing in value. Even after an exponential rise, Pepe still represents only about 5% of Dogecoin's market cap (of approx. \$10 bn).

According to [LunarCrush](#), Pepe saw a jump in its social engagement activity as discussions and mentions of it soared on social media. This translated into a high growth in the number of Pepe holders, showing a pattern of increasing adoption - similar to other popular meme coins in the past (like Shiba Inu).

Number of holders



Source: [coincarp.com](#)

Can this last?

Pepe remains without any real use case. As Pepe has a total supply of approx. 420 bn tokens, the value of the coin may increase, if or when, demand does (due to the limited amount in circulation).

Given the lack of differentiation, technology, use case and resources around the project, the only scenario that could lead Pepe to increase its long term market valuation is if investors believe it can become a reliable store of value, competing against Bitcoin.

This seems unlikely as Bitcoin was the first and remains the flagship asset of the digital space, benefiting from the longest and most reliable track-record of the sector, the largest AUM, a extremely large and loyal community, ample resources and a full ecosystem of developers and corporate partners.

Conclusion

Meme coins are undeniably part of the digital assets' ecosystem, whether we like it or not. They have historically largely been driven by hype, and unfortunately, most appear to be pump & dump schemes. It is possible that some meme coins ultimately manage to reach mass adoption and develop new functionalities - which would make them economically viable. Ironically, this would mean that the successful meme coins are likely to be those succeeding in transforming themselves into something more than just a meme coin!