

market notes: NFTs are NOT FOR TOURISTS



July 22, 2022

NFTs are all around us – and they are here to stay. Tomorrow, they will be transformative for property rights, broadening the value of ownership. Today, NFTs are scratching the surface; a proof of concept, focused on building communities. NFTs won't be monkeying around for long...

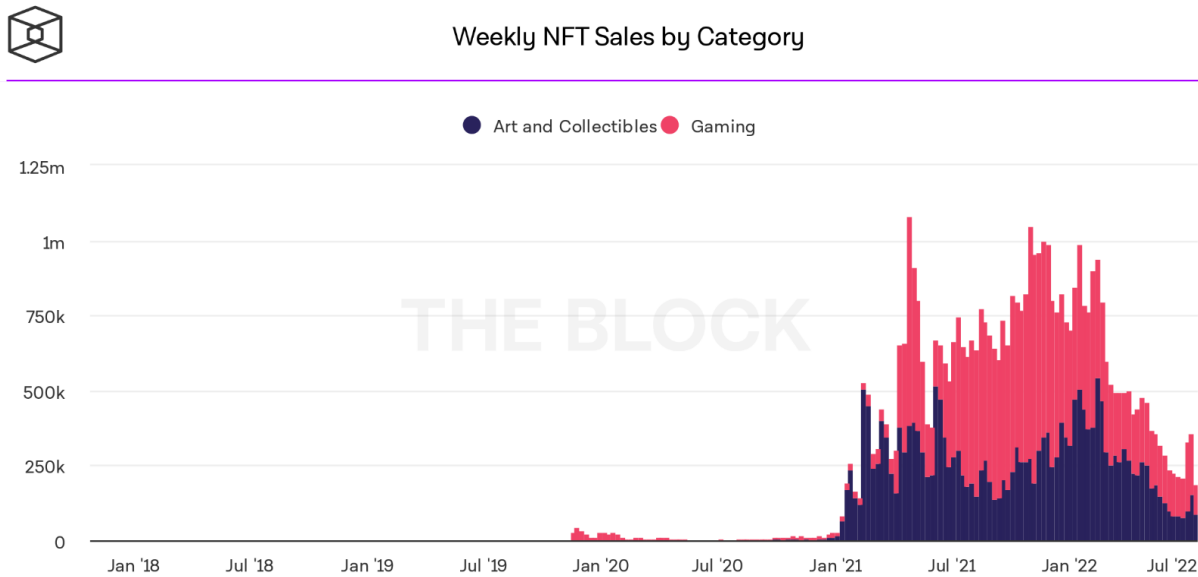
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1. In serious conversations about digital assets and blockchain technology, bring up NFTs and you might be greeted with rolled eyes, audible sighs, and other visible signs of dismay. After all, it's hard to be particularly impressed by JPEGs – a file format that was first introduced in the early 1990s. And yet, despite the primitive format, NFTs saw a surge of interest and activity last year (Figure 1). This year's decline in NFT transactions marks a counterbalance, a cooling. It is an opportune moment to reflect on how NFTs took off in the first place, and where they might take us next.
2. Start with the simplest manifestation, a humble JPEG. Is it art? Oxford's English dictionary suggests yes; art is defined as "the expression or application of human creative skill and imagination, typically in a visual form." New York's MoMA is at least open to the [possibility](#), and Sotheby's seems to [agree](#). As far as modern art goes, NFTs are certainly not the first to be controversial. Pablo Picasso's early cubist work Les Femmes d'Alger (O.J.) is a prime example of a painting that is [hideous](#). Truly, beauty is in the eye of the beholder.
3. The beholders are one of the beautiful things about NFTs today. Despite their controversy, NFTs create communities. And for the most prominent of these communities, membership doesn't come [cheap](#). Much like the broader art world, the divide between those who can consume it publicly versus those who own it privately is wide. Cross the barrier and you find yourself in an exclusive group of individuals with common interests. This doesn't speak to the economic value of NFTs, but it might be a credible argument for their utility. Private membership clubs are long-standing traditions, with members benefiting from the network and resources of their shared community. NFTs are an ultra-modern version.
4. Today the art and community aspects of NFTs might be the most well-defined use cases. Ultimately, both are built on the idea of underlying property ownership – and that is where the potential applications for NFTs are far more expansive. Property ownership is also the core of the technology. An NFT isn't strictly art, or strictly a JPEG, or strictly anything, other than a record of ownership. Records of ownership have all kinds of real utility.
5. It seems natural to have digital (read: intangible) ownership records of intangible goods. We see this already in gaming applications. In-game purchases of loot packs and other game add-ons existed long before NFTs. Now, ownership of those items is fluid in a way that was not previously possible. Under the old paradigm, a gamer would invest significant time and capital unlocking features that would be accessible to that individual. Ownership was immutable, available to no one else. Enter the NFT. Now the products of one gamer's time and labor can be transferred to another, for the right price.
6. Take this idea and extend it into the music industry, a space that's been transformed by the transition from tangible to intangible consumption. Recording artists and studios were once compensated by sales of physical albums. That model has largely been supplanted by royalties from streaming services. The next iteration is for artists to derive their compensation from selling the royalties, rather than the music. For fans, this creates a new way of having a real economic stake in an artist. For creators, it offers a path towards independent production. [Royal](#) is already hard at work making this a reality, with backing from major artists like Nas and The Chainsmokers.
7. Go broader than music and think about intellectual property (IP); that most intangible of goods. Patent holders and artists license their IP and collect fees on usage. But licensees may misestimate or underreport actual usage, or simply infringe. What if NFTs served as access points to proprietary information and a record of product movement? This could greatly simplify, and even automate, the collection of licensing fees. Complex global supply chains need not pose such a challenge for geographically specific IP enforceability. The full history of rights ownership and utilization would be discoverable and verifiable. More optimistically, digitized and decentralized records of IP ownership could alleviate the need for regional patent and trademark offices.
8. Let's not neglect the physical world while exploring the realm of possibilities. Imagine NFTs as a record of ownership of physical property. This would be the title to your car or a land deed, just digitized. It

simplifies fractionalized ownership and creates interesting opportunities. A timeshare is effectively fractional ownership of a vacation house. What if your NFT can unlock the door?

9. Fractional ownership democratizes access and unlocks the potential for diversification without onerous capital commitments. Purchasing a pair of Michael Jordan’s game-worn sneakers might no longer be out of the question. Even if you have the cash to buy a Picasso, perhaps you’d rather buy an NFT that confers partial ownership of a diversified fine-art collection – especially if that NFT grants you access rights to the pieces in accordance with your ownership share.
10. There’s a catch. Ownership has limited or no real value in the absence of credible systems for enforcement. Property rights today are provided through legal channels and governmental power. On-chain solutions for documenting property ownership and providing access rights only work so long as enforcement is still conferred. It is a reminder that we are still early. The technology and supporting systems are still under development. All the more reason to remain optimistic about where we are headed. It won’t just be JPEGs for long.

Figure 1: Weekly NFT Sales by Category



SOURCE: CRYPTOSLAM
UPDATED: JUL 20, 2022

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