Important Information about Cryptocurrencies

Cryptocurrencies or "crypto," such as bitcoin and ethereum, have become a growing part of the discussion around our financial landscape, but are still not well understood. We have prepared this document to help you understand the characteristics and risks associated with an investment in cryptocurrencies.

As detailed further below, cryptocurrencies, and their related markets are complex, rapidly evolving and remain subject to significant uncertainty and risk. An investment in cryptocurrencies is therefore only appropriate for certain types of sophisticated investors who desire to supplement their traditional investment portfolios with this asset class and at the same time can bear the special risks associated with such assets (including but not limited to the risk of total loss of investment).

It should be noted that due to the rapid evolution of crypto and the underlying technologies and related markets, any description or summary we provide regarding crypto may quickly become outdated. Accordingly, individuals considering such investments are strongly encouraged to consult updated, reliable sources of information, and where appropriate, seek independent financial, legal, and tax advice before making any investment decisions.

Characteristics of Cryptocurrencies

Cryptocurrencies are a type of digital asset, specifically digital currency, designed to function as an exchangeable store of value. Cryptocurrencies are not backed by governments and do not exist in physical form. Crypto can be privately traded and can either gain or lose their value as supply and demand dynamics change.

Although each is unique, cryptocurrencies are often built on and exist electronically on a virtual network, such as decentralized blockchain technology, which utilizes online transactions without the need for a central intermediary to process. In contrast to traditional currency, cryptocurrencies use blockchain and/or other encryption technology to maintain decentralization and protect its value.

Crypto can be bought, sold and even stored on various platforms, such as cryptocurrency exchanges through trading applications and directly in peer-to-peer transactions between individuals. At the time of the creation of this document, it is estimated there are at least ten thousand actively traded cryptocurrencies and potential investors seeking exposure to crypto may do so through a variety of investment methods, including direct investment or via a purchase of securities, such as exchange traded funds, that may own crypto.

Blockchain Technology

The blockchain is a type of distributed digital database that records transactions in a manner designed to be secure, transparent, and tamper resistant. Instead of one central database, identical copies of the database of transactions are maintained by many computers (or nodes) around the world. Records of transactions are grouped together into "blocks." Each block contains a group of transactions, a timestamp, and a "cryptographic" reference to the previous "block." Each block references the one before it, thereby forming a chronological and encrypted chain. To add a new block, the nodes in the network must verify the validity of the transaction before the transaction is added to the digital ledger, or blockchain. Blockchain technology thereby operates without the need for a central authority, such as banks, or a clearinghouse. Once included, records on the blockchain are irreversible and therefore cannot be duplicated or changed. Although typically associated with crypto, there are several potential alternative uses for blockchain technology.

Bitcoin and Ethereum

Bitcoin and ethereum are two of the largest and most well-known cryptocurrencies running on the blockchain. However, they differ in both purpose and design.

Bitcoin (BTC) was launched in 2009 designed as a decentralized medium of exchange operating outside of government and bank control. Bitcoin has a fixed supply and is currently treated as more of a store of value than an alternative to traditional currency as a medium of exchange. Bitcoin utilizes a "proof-of-work" system to validate transactions via a network of computers solving mathematical equations competing for a predetermined amount of bitcoin through a process called "mining."

Ethereum (ETH) was launched in 2015 as the native cryptocurrency of the ethereum network, which was created to provide a platform for developers to create various decentralized applications. In contrast to bitcoin, ethereum utilizes a "proof-of-

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Important Information about Cryptocurrencies

(Continued)

stake," methodology to validate network transactions, randomly selecting one person with staked crypto to validate the transaction.

Understanding the Risks

Certain of the material risks and other important considerations associated with investment in crypto are highlighted below. Additional information regarding investment risks generally and other important consideration is also available at www.bairdwealth.com/retailinvestor.

- **Extreme Volatility and Valuation Risks.** Cryptocurrencies are highly speculative assets and are subject to extreme volatility. Prices can fluctuate dramatically within short periods of time and may result in significant losses including the potential loss of the entire value of the asset. Cryptocurrencies are not backed by predictable cash flows, governmental guarantees, or any physical assets. As a result, there is a total lack of clarity on how to quantify the value for cryptocurrencies. Limited liquidity, concentration of ownership, and reliance on unregulated trading venues further distorts valuations and contributes to volatility. New legislation may substantially increase volatility or prohibit access to the markets entirely.

- **Complexity.** Cryptocurrencies and the technologies that support them are complex and rapidly evolving. The underlying and related technologies, such as blockchain technology, smart contracts, and encryption methods can be difficult to understand. This complexity increases the risk that investors may misinterpret the factors that drive an asset's value as well as the obligations related to its use. The absence of uniform standards across platforms and protocols means that features such as transaction validation, custody, and governance can vary significantly from one cryptocurrency to another.

- **Lack of Regulation.** The regulatory environment surrounding crypto-related products is opaque and rapidly evolving, with limited investor protections in place as of the date of this publication. Neither crypto nor the platforms that allow access to buy or sell crypto are regulated by any government agency or central bank. Unlike bank deposits and securities accounts, Crypto holdings are not insured by any federal or state insurance programs (such as SIPC or FDIC). Therefore, should an exchange or crypto custodian fail, investors may simply lose their funds.

- **Cybersecurity and Fraud.** Cryptocurrencies are entirely digital and rely on complex digital infrastructure making them subject to cybersecurity risks. Theft or loss of a private key or wallet access can result in permanent loss of assets with no recourse. Cryptocurrency exchanges, wallets, and custodians have been the frequent targets of cyberattacks. Even well-established platforms could be subject to phishing attacks, malware, ransomeware, or other vulnerabilities in third party software. Platforms have been hacked and investors have lost money as a result.

- **Tax Treatment.** The rules governing taxation are subject to change and may vary across jurisdictions. Uncertainty exists regarding proper treatment of certain transactions, reporting requirements across the different platforms, and what may create a taxable event. Maintaining accurate transaction records and seeking guidance from qualified tax professionals are critical steps in reducing tax risks. There is uncertainty as to how crypto will be classified under tax regulations (for example as securities, commodities, property, or money) and with future guidance could come potential tax reporting ramifications or other retroactive compliance risks.

Please consider these and other risks before seeking exposure to crypto or the crypto markets. While the historical returns of an investment in some cryptocurrencies may be compelling and the market for crypto continues to mature and evolve, an investment in crypto is highly speculative and involves substantial and unique risks, including the risk of total loss.

More Information

The U.S. Securities and Exchange Commission (SEC) provides resources on digital assets and investor protection, and its website contains alerts and guidance related to cryptocurrency risks (https://www.sec.gov/spotlight/cybersecurity). The Financial Industry Regulatory Authority (FINRA) offers investor education materials and warnings about the speculative nature of digital assets

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Important Information about Cryptocurrencies

(Continued)

(https://www.finra.org/investors). The Commodity Futures Trading Commission (CFTC) has information about Bitcoin and other digital assets, including regulatory developments (https://www.cftc.gov/Bitcoin). The Consumer Financial Protection Bureau (CFPB) also provides resources on emerging financial products, including cryptocurrencies (https://www.consumerfinance.gov/). Finally, the Federal Trade Commission (FTC) publishes consumer alerts on scams and fraud related to cryptocurrency (https://www.consumer.ftc.gov/).

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