Evolution & Revolution

The coming Web3 digital asset revolution

October 3, 2022

Sandy Kaul
Head of Digital Assets and Industry Advisory Services
Franklin Templeton

This article was first published September 27, 2022 in GlobalTrading.

Introduction

The underlying technologies that enterprises use to build and deliver their goods and services have undergone profound changes over the past 50 years.

- The commercialization of computing in the 1960s through to the 1970s allowed for automation of manufacturing process—payrolls, billing, procurement, accounting, inventory management, and factory production lines.
- The emergence of personal computers, private networks and then the internet in the 1980s to mid-2000s led to a transformation of white-collar work outputs driven by commercial off-the-shelf systems including document and content management, office automation networks, email, intranets, and enterprise resource management.
- The emergence of distributed processing and cloud-based development platforms by the mid-2000s turned technology into a service and allowed enterprises to pay-as-they-go in terms of infrastructure and application development, supported by a growing set of artificial intelligence tools and big data processing abilities that shifted business delivery to platform-based ecosystems driven by powerful network effects and behavioral algorithms.

Realizing how profoundly each period of technology innovation has changed commerce and the way that businesses deliver their goods and services is crucial as we stand on the verge of a new wave of tech innovation that has the potential to be perhaps the most disruptive yet.

The shift from Web2 to Web3

Web2 is the hallmark of the current age. It represents an important progression from the initial generation of web offerings in the late 1990s and early 2000s. Web2 moved away from static websites that offered a hierarchical set of pages connected by a menu and page links to dynamic platforms able to align their delivery around the individual user and enable participants to arrange their own services, post and engage with content, build their own networks, and participate in communities. Web2 embedded society and the way that we live into the tech-driven networks that we use every day for a growing number of personal and business tasks.

Yet, the ecosystems that drive today's engagement are commercial enterprises that are constantly weighing the benefits that their network can deliver to their users against the potential profits that they can extract for their organization and shareholders. Creating such profit has led them to utilize their user's data in ways that raise concerns about privacy, collect substantial payments for the services they facilitate—often sharing only a fraction of such profit with the supplier or creator of the services—and develop algorithms to create platform stickiness that can sometimes result in negative crowd behaviors.

Web3 offers a completely different approach. Web3 creates the potential for commercial protocols that can deliver goods and services in a peer-to-peer manner that can be directly accessed by any user via an internet connection. These protocols use smart contracts to enable transactions—self-executing code that is designed to perform a certain task when a pre-determined trigger is activated. A smart contract can be used to buy, sell, or issue an asset, to borrow or lend money, play a game, participate in an exclusive community, buy virtual or physical land rights, and more.

To enable this new type of peer-to-peer ecosystem, Web3 takes a unique approach to facilitating transactions. In Web2, a payment is made in a fiat currency that is processed by a third-party using government-sponsored banking rails which add cost and time to every interaction. In Web3, payment is made in a native coin, a share of which is awarded to independent verifiers that use consensus mechanisms to validate transactions that get instantly recorded and enacted on a blockchain—a shared ledger that is distributed across all nodes that choose to participate in verification and open to any participant via a blockchain browser.

Participation in Web2 platforms is typically recognized via ratings or loyalty points that carry with them only marginal benefit and no rights. In Web3, participation is recognized as a valuable resource and individuals can both directly buy and earn tokens that provide them an ownership interest in the commercial protocols that they use most frequently, incentivizing them to help govern those networks and vote on matters of strategic and financial importance. Web3 allows the network user to be the network owner, lessening potential conflicts of interest.

Implications for the future of asset and wealth management

Smart contracts used to drive engagement in Web3 commercial protocols allow for more than just the execution of a transaction. They can administer copyright-related protections that authorize the use of protected materials and related payments or royalties; they can enforce and transfer property rights; they can be used to establish and exchange digital identity and its related data elements; and they can create opportunities for exclusive access, offer and administer special rights for owners or provide them with unique products or services. Most importantly, a smart contract can be inextricably linked to an asset and embedded into a digital token. The contract moves with the token. If the token is sold, the rights associated with the asset get automatically transferred to the new owner.

This creates the potential for portfolios in the future to deliver not just risk-adjusted returns, but actual utility in the investor's life. We have already as an industry moved toward greater tailoring of portfolios. This shift to add utility will represent a new dimension for investor returns. It will allow an investor's portfolio to bring in new types of cash flows—including an ability to manage and earn income from the sale of their own data. It will provide them access to communities, events, and services that resonate with their personal interests and goals. Determining the assets to be selected for an investor's portfolio and managing the assets earned by the investor through the commercial protocols they participate in most frequently will require a highly personalized collaboration between the asset manager, wealth advisor and client. This portends a degree of stickiness and engagement that can hardly be imagined, but may ultimately result in a more powerful re-imagining of what constitutes active management.

IMPORTANT LEGAL INFORMATION

This material is intended to be of general interest only and should not be construed as individual investment advice or a recommendation or solicitation to buy, sell or hold any security or to adopt any investment strategy. It does not constitute legal or tax advice. This material may not be reproduced, distributed or published without prior written permission from Franklin Templeton.

The views expressed are those of the investment manager and the comments, opinions and analyses are rendered as of the publication date and may change without notice. The underlying assumptions and these views are subject to change based on market and other conditions and may differ from other portfolio managers or of the firm as a whole. The information provided in this material is not intended as a complete analysis of every material fact regarding any country, region or market. There is no assurance that any prediction, projection or forecast on the economy, stock market, bond market or the economic trends of the markets will be realized. The value of investments and the income from them can go down as well as up and you may not get back the full amount that you invested. Past performance is not necessarily indicative nor a guarantee of future performance. All investments involve risks, including possible loss of principal.

Any research and analysis contained in this material has been procured by Franklin Templeton for its own purposes and may be acted upon in that connection and, as such, is provided to you incidentally. Data from third party sources may have been used in the preparation of this material and Franklin Templeton ("FT") has not independently verified, validated or audited such data. Although information has been obtained from sources that Franklin Templeton believes to be reliable, no guarantee can be given as to its accuracy and such information may be incomplete or condensed and may be subject to change at any time without notice. The mention of any individual securities should neither constitute nor be construed as a recommendation to purchase, hold or sell any securities, and the information provided regarding such individual securities (if any) is not a sufficient basis upon which to make an investment decision. FT accepts no liability whatsoever for any loss arising from use of this information and reliance upon the comments, opinions and analyses in the material is at the sole discretion of the user.

Products, services and information may not be available in all jurisdictions and are offered outside the U.S. by other FT affiliates and/or their distributors as local laws and regulation permits. Please consult your own financial professional or Franklin Templeton institutional contact for further information on availability of products and services in your jurisdiction.

Issued in the U.S. by Franklin Distributors, LLC, One Franklin Parkway, San Mateo, California 94403-1906, (800) DIAL BEN/342-5236, franklintempleton.com - Franklin Distributors, LLC, member FINRA/SIPC, is the principal distributor of Franklin Templeton U.S. registered products, which are not FDIC insured; may lose value; and are not bank guaranteed and are available only in jurisdictions where an offer or solicitation of such products is permitted under applicable laws and regulation.

Canada: Issued by Franklin Templeton Investments Corp., 200 King Street West, Suite 1500 Toronto, ON, M5H3T4, Fax: (416) 364-1163, (800) 387-0830, www.franklintempleton.ca.

Offshore Americas: In the U.S., this publication is made available only to financial intermediaries by Franklin Distributors, LLC, member FINRA/SIPC, 100 Fountain Parkway, St. Petersburg, Florida 33716. Tel: (800) 239-3894 (USA Toll-Free), (877) 389-0076 (Canada Toll-Free), and Fax: (727) 299-8736. Investments are not FDIC insured; may lose value; and are not bank guaranteed. Distribution outside the U.S. may be made by Franklin Templeton International Services, S.à r.l. (FTIS) or other sub-distributors, intermediaries, dealers or professional investors that have been engaged by FTIS to distribute shares of Franklin Templeton funds in certain jurisdictions. This is not an offer to sell or a solicitation of an offer to purchase securities in any jurisdiction where it would be illegal to do so.

Issued in Europe by: Franklin Templeton International Services S.à r.l. – Supervised by the Commission de Surveillance du Secteur Financier - 8A, rue Albert Borschette, L-1246 Luxembourg. Tel: +352-46 66 67-1 Fax: +352-46 66 76. **Poland:** Issued by Templeton Asset Management (Poland) TFI S.A.; Rondo ONZ 1; 00-124 Warsaw. **South Africa:** Issued by Franklin Templeton Investments SA (PTY) Ltd, which is an authorised Financial Services Provider. Tel: +27 (21) 831 7400 Fax: +27 (21) 831 7422. **Switzerland:** Issued by Franklin Templeton Switzerland Ltd, Stockerstrasse 38, CH-8002 Zurich. **United Arab Emirates:** Issued by Franklin Templeton Investments (ME) Limited, authorized and regulated by the Dubai Financial Services Authority. **Dubai office:** Franklin Templeton, The Gate, East Wing, Level 2, Dubai International Financial Centre, P.O. Box 506613, Dubai, U.A.E. Tel: +9714-4284100 Fax: +9714-4284140. **UK:** Issued by Franklin Templeton Investment Management Limited (FTIML), registered office: Cannon Place, 78 Cannon Street, London EC4N 6HL. Tel: +44 (0)20 7073 8500. Authorized and regulated in the United Kingdom by the Financial Conduct Authority.

Australia: Issued by Franklin Templeton Australia Limited (ABN 76 004 835 849) (Australian Financial Services License Holder No. 240827), Level 47, 120 Collins Street, Mellbourne, Victoria 3000. **Hong Kong:** Issued by Franklin Templeton Investments (Asia) Limited, 17/F, Chater House, 8 Connaught Road Central, Hong Kong. **Japan:** Issued by Franklin Templeton Investments Japan Limited. **Korea:** Issued by Franklin Templeton Investment Trust Management Co., Ltd., 3rd fl., CCMM Building, 12 Youido-Dong, Youngdungpo-Gu, Seoul, Korea 150-968. **Malaysia:** Issued by Franklin Templeton Asset Management (Malaysia) Sdn. Bhd. & Franklin Templeton GSC Asset Management Sdn. Bhd. This document has not been reviewed by Securities Commission Malaysia. **Singapore:** Issued by Templeton Asset Management Ltd. Registration No. (UEN) 199205211E and Legg Mason Asset Management Singapore Pte. Limited, Registration Number (UEN) 200007942R. Legg Mason Asset Management Singapore Pte. Limited is an indirect wholly owned subsidiary of Franklin Resources, Inc. 7 Temasek Boulevard, #38-03 Suntec Tower One, 038987, Singapore.

Please visit www.franklinresources.com to be directed to your local Franklin Templeton website.

The views and opinions expressed are not necessarily those of the broker/dealer; or any affiliates. Nothing discussed or suggested should be construed as permission to supersede or circumvent any broker/dealer policies, procedures, rules, and guidelines.

FRANKLIN TEMPLETON