De-Coding Crypto

Enigma Weekly

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Our Market View

May you live in interesting times. Another ATH week, and a big move on the week itself, but feels like there's more to come – we had one or two big surges, but much of it has been a slow grind up from $43,000 all the way to $51,000, and momentum has been slow even after multiple ATH breaks. We will note that we are getting to the point now where the notion of a possible cycle high starts to even vaguely cross the mind (most sensible prognostications in year past fell in the $50,000 to $150,000 range), and expect selling pressure to start gradually increasing, but for now trend, as always, remains hyperbullish.

An odd week for alts – some significant outperformance from LTC/BCH concentrated into the span of about 24-36 hours over the week, but most even or underperforming against BTC, particularly in the last couple of days. Remember: alts are overwhelmingly likely to be losers (in BTC terms) on any sustained BTC-centric surge, which does appear to be the way the market is moving at this present moment, so expectations should be tapered accordingly.

Please direct all enquiries about this week's research to jedwards@enigma-securities.io.

Major

Ticker	Price	7D	1M	6M	12M	Cap
BTC	51212	13.6%	40.0%	339.2%	430.2%	954.2B
ETH	1816.41	4.2%	44.3%	358.9%	592.4%	208.4B
LTC	224.95	25.6%	49.3%	276.0%	202.8%	14.96B
BCH	710.61	46.0%	40.4%	148.9%	91.0%	13.26B
EOS	4.793	21.2%	71.5%	43.4%	17.3%	4.56B
Selected						
Ticker	Price	7D	1M	6M	12M	Cap
DOT	31.29	35.0%	88.7%	602.5%	975.6%	28.44B
ADA	0.87221	3.6%	135.0%	593.8%	1390.0%	27.49B
LINK	31.65	19.0%	44.3%	101.1%	672.4%	12.88B

Tackling Tether FUD

There is a tendency for things in crypto to repeat themselves, and over the last month or two, we've noticed that one of the big social trends from 2017 and 2018 is cropping back up once again – a line of enquiry that had been dormant for the most part for the last couple of years, but that has started worming its way back into the collective consciousness once again. Namely, the question of Tether, and the question of whether there are questions there to be asked.

What is Tether?

Tether is a stablecoin - a coin whose price is pegged to match the price of another asset, be that a fiat currency, a commodity, or something more esoteric. The overwhelming majority of stablecoins are pegged to USD (specifically, to the value of $1 USD), and this is the case with Tether too; one Tether is equal to 1 US dollar.

To cut through the finer intracicies here: for all major stablecoins, this is based on two things:

1) There is a parent company (USDT and Tether, USDC and Circle, BUSD and Binance, PAX and Paxos, etc.) that offers 1:1 redemption on all tokens - that is, I can take my 1 USDT to Tether (for example) at any time, and they will redeem it for $1.

2) The parent company is essentially trusted in that regard to a high degree of certainty, in terms of the stability of the company, and by extension in terms of the company having sufficient reserves to meet any requests for redemption.

Tether actually largely predates the term 'stablecoin' itself; the coin (originally 'Realcoin') launched in the aftermath of the 2013 bubble and first came into active use in January 2015 (at around the same time as BTC itself hit its post-bubble local low), gradually coming to prominence in the run-up in 2017 - having entered the year as a $10m market cap asset, it grew to over a billion by December 31st, with a notably large flood of new issuance in November and December (i.e. at the end stages of the 2017 bubble):

Credit: Coingecko.

What was the point of Tether?

We mention this provenance, because the basic point of Tether - that is, the reason that it actually came into utilisation on a level enough to attract a $1bn+ market cap (and comparable or higher numbers in terms of nominal daily volume on exchanges etc.) - can be found in that provenance. The banking situation for cryptocurrency firms and clients even now is far from perfect (i.e. there are still major banks that surreptitiously block transactions to firms like Coinbase); in 2013, 2014, 2015, it was flat-out abysmal, and a huge number of exchanges were hence either unwilling or unable for one reason or another to deal with USD (and other fiat currencies) directly.

Bitfinex were one of the first exchanges to support Tether (more on their relationship later), describing it as such at the time:

> We see Tether as a significant optimization for the problems that plague bitcoin traders and exchanges when interfacing with the traditional banking system. We proudly support Tether and encourage other exchanges, OTC traders, and arbitrageurs to also use Tether. We believe that widespread adoption of a secure Blockchain-compatible 'crypto-dollar' will lead to better price discovery, market transparency and liquidity.

By 2017, usage of Tether had moved away from simply being a funding method for USD-denominated markets; markets were being traded on the basis of USDT as a native unit in itself. Binance, who were very much the model children of the 2017 explosion in infrastructure terms (the exchange started trading in July 2017 and had grown to be the largest spot platform in some estimates by the year's end), have never offered formal USD markets; the primary pair on Binance is BTCUSDT. (Binance US now does offer USD markets, but Binance USD volumes are a fraction of the main exchange).

Understanding this is crucial to the whole puzzle. The key to Tether's rise was that, particularly as firms moved towards specific USDT-denominated markets and the like, going USD->USDT->BTC was in practical terms an easier on-ramp process (into BTC but also largely into alts etc.) than going USD-

>BTC, particularly given the state of the onshore and offshore markets respectively in those final months of 2017 (with firms like Coinbase, who have never traded in USDT, being overwhelmed to the point of customers having no guarantee on new accounts and deposits registering in an acceptable amount of time).

The (legitimate) issues with Tether

We should stop at this point to say that, as tends to be the case in such situations, the criticism of Tether doesn't come from an entirely unsound place; to glance over a few of the more important points:

- The ownership structure of Tether Limited, and specifically its relationship with Bitfinex (the exchange that initially put it on the map) is murky at best; the two have shared ownership and are generally considered to be sister companies, and there have been concerns in the past about the exact nature of the relationship between the two (with particular note to a $900m credit line from Tether supporting Bitfinex operationally during the 2018 bear market).

- There is a lack of auditability with regards to Tether's accounts, and Bitfinex/Tether did admit publically at the nadir of the bear market in April 2019 that the present supply was only 74% backed by cash and short-term securities (hardly a small fraction of course, but not 100%).

- Tether is ultimately not a trustless asset because of its reliance on a central authority, which actually meant that crypto advocates (many of the same people who have been among Tether's strongest defenders against the current wave of criticism) were extremely negative towards it in those 2017/2018 runs. It can be frozen at will by the parent company, its peg could collapse if something did happen to the parent company, and so on.

This opened up Tether to a lot of criticism back then, and it should be said that there were points in the 2018 crash where the peg did threaten to break:

	High	Low	Low vs. $1
Oct-18	0.9991	0.8500	15.00%
Nov-18	0.9968	0.9310	6.90%
Dec-18	1.0177	0.9790	2.10%
Jan-19	1.0148	0.9914	0.86%
Feb-19	1.0000	0.9844	1.56%
Mar-19	1.0001	0.9913	0.87%

Data via Tradingview. Kraken, USDTUSD.

However, ultimately, it never did, and the cacophony largely died down in 2019 (particularly after Tether were able to prove, if not total, at least substantial proof of reserves in that aforementioned 2019 declaration).

The non-issues with Tether.

Tether is absolutely a flawed asset in that regard, and we're not going to pretend that it's not. But the discourse over the last few weeks in particular - which are repeats of what we saw in 2017/2018, but in a much more virulent form - has gone much further than that. This has been pushed, even promulgated, largely by one article: "Inside Crypto's Doomsday Machine", an anonymous report put out on blogging site Medium at the start of January.

The central thesis, to make a long story short, is along the lines of the following:

1) The writer of the account bought the absolute low of the crash in early 2020, but just sold, because
2) A post on the money flow into Bitcoin from Tether caught his eye, and he did some digging, and
3) He found that the bulk of new inflows into Bitcoin were coming through Tether, and that there were question marks about how well-backed Tether was, and therefore
4) Tether is a scam, and Bitcoin is being held up by, essentially, Ponzinomics - the printing of unbacked Tethers by its parent company. Therefore, the Tether peg is vulnerable to collapse, and if the Tether peg collapses, it takes pretty much all crypto markets with it.

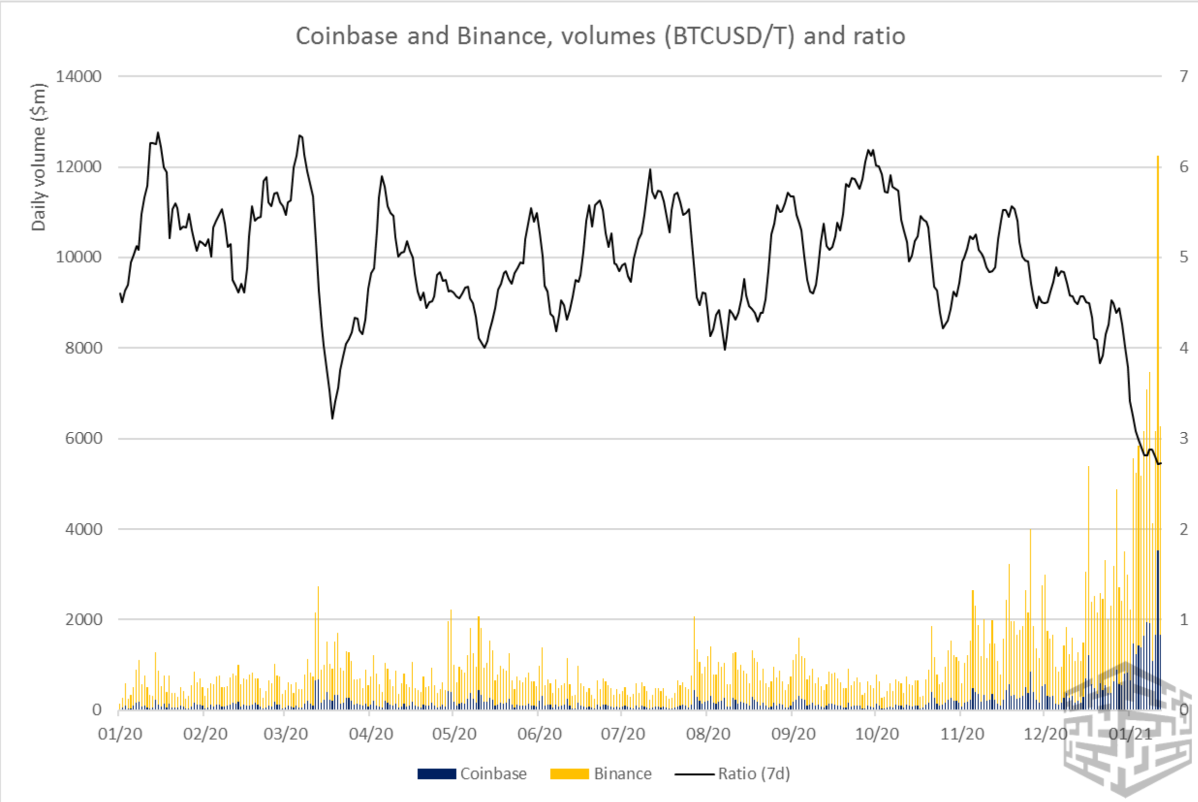
Now: this drummed up a little attention at the time, went away, but has come back in the last few weeks. Why?

[GRAPH]

Issuance, which was already steadily increasing over the second half of the year, has increased massively as BTC has appreciated in the last few weeks. So: is the article right? Is BTC growing out of the control on the basis of fake money?

The answer is 'almost certainly not'. Firstly: as much as Tether printing has been significant, the market has actually shifted back towards being more directly USD-centric over the past few years. The central assertion of the article is that 70% of inflows are coming from USDT markets right now, which is straight-up untrue; two of the three exchanges he cites in the article in that regard (Bit-Z and HitBTC) are known to fake the vast majority of their volume and are not considered legitimate by any firm actually trading in the space.

On the retail side, the figure is closer to 50-65% USDT nominal on any given day when removing the most infamous fakers; in reality, it's significantly lower due to the amount of OTC buying and lend/borrow (which, at this point, is taking place overwhelmingly in USD and other fiat, not USDT). This is only getting lower as institutional actors (who of course do not touch Tether for the most part) gain more market share; as we have noted previously, volumes on the largest retail USD venue (Coinbase) have actually been increasing in proportion to the largest USDT venue (Binance) as price has been rising:



Data via Tradingview.

Secondly: the writer does not understand how crypto exchanges make money on a fundamental level. For instance, one of his major assertions is that exchanges are able to offer generous rewards programs and high leverage and the like in Tether because they are receiving free/discounted Tether, or at the very least value Tether at less than $1 internally. In reality, these exchanges present those incentives as a loss-leader, because as it turns out, when you offer 100x leverage in a 100-vol market, what you end up developing is something close to a casino; and, as with most casinos, it's a game where the house has a significant edge in the aggregate, both just from fees etc. and from the tendency of said markets to liquidate over-leveraged positions on both ends in one fell swoop.

Is that to the credit of the crypto industry? No, of course it isn't - and this is the interesting thing about a lot of Tether criticisms, both in this article and elsewhere. Tether has problems, and the crypto industry has problems with regards to how it conducts itself in a lot of cases - the volume fakery, the manner in which derivatives products are used to create unlicensed casinos for all intents and purposes.

However: the central idea of the article - that USDT is being created unbacked - is almost certainly nonsense. It's one of those notions that's difficult to entirely disprove as such, because we can't audit Tether's reserves precisely; but extraordinary claims require extraordinary evidence, and there is little in the way of evidence for this creation of mass unbacked Tether. We absolutely do know that the Tether creation process is an operational reality (because enough trusted firms in the space have been through it over and over, especially in 2017), we know how Tether is used practically, we do know that Tether was largely backed as of 2019…

In other words, at this point, the question is not whether Tether is being used legitimately at all (it absolutely is), but rather one of scale – how much of its activity is legitimate. There are limits to what can be proven in that regard; but it ultimately seems to be stretching credibility to its absolute breaking point to suggest that the vast majority is completely fraudulent.

The article ends with this:

> To be crystal clear: every time you sell Tethers on Kraken, you are forcing Tether Ltd. to pay you in US dollars. If you can manage to sell enough Tethers for USD on Kraken, then Tether Ltd. will run out of dollars and this whole machine — which currently undergirds 70% of all crypto trading flows — will fall apart. Well-capitalized hedge fund managers may wish to re-read the above paragraph, and ponder its implications.

This paragraph rather lays bare the entire point of the article in the first place - it's a call-to-action against Tether and against the crypto industry. Fear, uncertainty, doubt - FUD. It's a term we tend to dislike - in crypto, it's often used as an answer to any concern, including entirely legitimate ones - but it feels very appropriate for what's happening here.

So, to sum up:

1) There simply is no strong evidence for unbacked Tethers propping up BTC price. Anything that has been presented is generally circumstantial at best; the most common such argument for reference is that USDT issuance has tended to peak near crypto market peaks, which, while true, proves almost nothing (how is it not equally plausible that demand for new USDT peaks at those points where buying is naturally at its most aggressive?). The strongest/most concerning one we've seen is that foreign exchange reserves in Bahaman banks (where Tether's primary bank Deltec is based) have not been increasing in proportion with recent Tether printing, but Tether deposits in practice often go to correspondent banks outside of the Bahamas (as confirmed publically by FTX founder Sam Bankman-Fried), so even that is far from ironclad.

2) There are legitimate concerns to be had over holding Tether in the long-term (primarily relating to the simple fact that it is a centralised, poorly-audited coin being essentially operated by an offshore entity), but there are no concerns in the short term (and we will note that the Tether peg has not slipped at all on OTC or on any major exchange in the weeks since that article was published).

3) If anything did happen to Tether, it would clearly be a significant negative for the crypto ecosystem. We will however say this: it would not be an existential threat, which it may have been briefly at points in 2017 and 2018 (due to the role of USDT-only exchanges in structural expansion at those points, and due to the lack of trusted alternatives - nowadays, USDT still holds a nearly 80% market share, but Circle's USDC among others provide the same functionality with far fewer concerns in that regard).

Until next week – thank you for reading.

ABOUT US

Enigma Securities is a leading, regulated liquidity provider, offering its clients bespoke liquidity solutions through the use of a proprietary electronic trading platform and API access.

The firm was founded in 2017 as a subsidiary of Makor Partners Limited (UK), amid growing institutional demand for digital asset trading. Looking to seize the new, exciting opportunities presented by cryptocurrencies and blockchain technology, Enigma became one of the first regulated brokerage firms to set up banking relationships and custody solutions to meet institutional standards.

Since its launch, the firm has expanded its capabilities to the broader Fintech arena, leading innovation while working to bridge the gap between the traditional financial services industry and cryptocurrency markets.