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De-Coding Crypto

Weekly Analysis

Alts in December: opportunities for alpha?

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In this week's issue, we focus on the short-term outlook in December and beyond for non-BTC assets, and where potential gains might be seen. We also discuss the regulatory situation around the crypto ruble.

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Our Market View

May you live in interesting times. An extremely quiet week overall for major coins, with BTC remaining pretty tightly rangebound between $7200 and $7650; there were some shocks on the intra-day patterns (most prominent on Thursday), but the overall picture has not been volatile. We tend to expect this to continue to be the case; the overall trend for the month still leans slightly bullish, but it's hard to see a sudden shock in either direction beyond levels already recently seen.

The big story of the week was with small-cap coins, most notably MATIC. We discuss small-caps and the inherent problems more in our research, but suffice to say: there is a reason we generally do not talk about small-caps, and as a group they are becoming more dangerous for prudent investors, not less.

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

Major

Ticker	Price	7D	1M	6M	12M	Cap
BTC	7223.99	0.05%	-16.93%	-18.36%	126.40%	130.7B
ETH	145.394	-0.40%	-21.48%	-45.98%	75.39%	15.83B
XRP	0.222072	3.85%	-18.38%	-45.98%	-22.17%	9.61B
BCH	207.201	0.19%	-27.65%	-51.04%	160.90%	3.77B
LTC	44.189	-1.56%	-28.73%	-68.05%	90.92%	2.82B
EOS	2.59968	-1.36%	-24.78%	-62.47%	44.20%	2.45B

Selected

Ticker	Price	7D	1M	6M	12M	Cap
TRX	0.0143056	-2.07%	-25.37%	-55.59%	19.19%	0.95B
MATIC	0.0188546	-40.38%	23.16%	-15.07%	890.30%	0.05B

Alts in December: opportunities for alpha?

In 2017, BTC climbed to its all-time high, and alts followed suit, for the most part outperforming BTC on the rush towards the top.

Pair	O	H	L	C	Change
BTCUSD	10089	19660	9450	13990	38.7%
ETHUSD	439.25	819.6	402	745.98	69.8%
XRPUSD	0.24	2.48	0.205	1.99	729.2%
LTCUSD	87.59	369	82	230.3	162.9%

Data: Kraken via Cryptodatadownload.

In 2018, BTC fell to a post-bubble low of $3150, but alts did not follow suit, largely gaining both on an oversold BTC but also in some cases against USD:

Pair	O	H	L	C	Change
BTCUSD	3969.4	4286.6	3120	3691.9	-7.0%
ETHUSD	111.64	159.2	80.56	130.86	17.2%
XRPUSD	0.3587	0.452	0.2775	0.3478	-3.0%
LTCUSD	31.65	36.61	22.25	29.77	-5.9%

Data: Kraken via Cryptodatadownload

Having gone two-for-two, sentiment is growing that we should go three-for-three, and that December should once again be profitable territory for divestments from BTC into alts.

While approaching this notion sceptically – after all, two-for-two is not the most significant of hit rates, especially in a nascent market – we do tend to think that there may be something to be said for the December period being unusually encouraging for alts on a fundamental level, especially in alt-BTC pairs. As discussed in the last issue, our general thesis for December leans bullish for BTC, but we would expect general volatility to be low. The experience of the first 10 or so days of December has strengthened our confidence in that; while there have been some very quick, very drastic movements, price has still remained tightly rangebound between $7100 and $7600, with little sign of a true break on either end.

A low-volatility environment for BTC in itself tends to bring more activity into alts for a number of reasons (the nature of crypto as a two-asset class, the long history of alts being traded primarily in BTC pairs, etc.), but the end of the calendar year does seem to bring in additional help as active BTC traders unwind open positions there in anticipation of holiday disruption. This is particularly true in 2019's market, with increased utilisation of CME and Bakkt products, and the complications that the holiday period bring for them.

Taking a short-term outlook (primarily through December, but also looking into the early stages of Q1), where could profitability lie?

ETH

No matter how strongly one believes in the fundamentals of a given project or of the asset class as a whole, it has to be said: cryptocurrency is a buzzword-driven industry, and for 2019, the term to look for has been 'staking' or 'proof of stake'. To offer a brief explanation: proof of stake is a consensus algorithm, in the same manner that proof of work is for Bitcoin and most other major cryptocurrencies. Instead of solving a cryptographic problem as in PoW mining, in PoS, all nodes simply vote on whether to accept a block, with a majority required to accept it.

The 'stake' in 'proof of stake' refers to the fact that the probabilities of receiving a reward in a PoS system are based on existing holdings of the token in question; if one held 2% of coins, one would expect to receive 2% of rewards (and the rewards would be the transaction fees from each block). 'Stake' in this case is meant in terms of a share rather than a risk.

Proof of stake is not new - indeed, very few post-2017 projects of any size use PoW – but staking finds itself in an important moment in late 2019 and coming into 2020. There are a few auxiliary factors assisting it (integration of staking by exchanges being a growing trend towards the end of the year, the general zeitgest obsession with both passive income and with green issues), but the movement of ETH from its current PoW system to PoS as part of the ETH 2.0 hard fork has been important in elevating its profile.

Hence, with ETH 2.0 on the horizon - rollout will be a long process, but the launch of Phase 0 (which introduces PoS) is expected very, very early in 2020 (it had been pencilled in for January 3rd in the summer though there has been no recent confirmation of this) - we are particularly interested in ETH short-term and would not be entirely shocked to see even a December 2018-like move from it (where it surged from a local low of $82 in December 7th to $158 on January 6th, albeit only partially retracing an extreme recent drawdown in the process):

Even in isolation, we tend to believe that ETH deserves examination in periods where BTC should tend to be heavily range-traded, given its propensity to break to the downside as or more aggressively than BTC and to then slowly recover those losses.

In any case, it by far represents the best market proposition of any mid-cap alt in the near-term

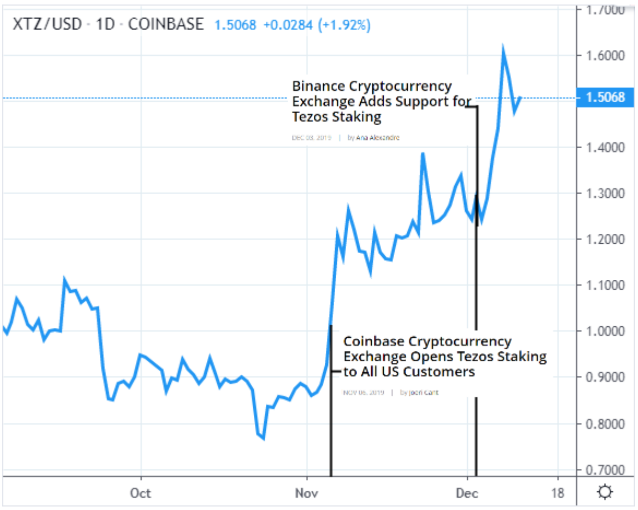
Mid-caps

By far the biggest asset outside of BTC and ETH is XRP, but our perspective on XRP is generally not favourable. It is entirely possible that XRP is near a floor - the $0.20 level has been talked about as such for a couple of months given that it represents pre-2017 bubble levels for the token, and we have currently been trading at around the $0.22 level for an extended period with no signs of further downwards movement.

While we can hence see the case for XRP as a speculative play with minimal downside risk at these levels, we do not tend to subscribe to it. While it is true that XRP has not ranged below $0.20, we tend not to believe that this is because of any inherent quality of the asset, but rather that it simply has not been seriously tested by a negative news cycle or by movement downwards on BTC. Additionally, XRP - an asset whose entire reason to be is based on its partnership and the associated announcements - seems unlikely to receive much in the way of upward catalysts near-term.

More generally, our long-standing position on general payment processing-centric assets (XRP, BCH, LTC, XLM, and so on) has been negative, and while there may be extreme short-term opportunities here and there, we in general see no reason to deviate from that view; as proof of stake and staking was the buzzword of late 2019, we expect Layer-2 solutions to be the buzzword of much of 2020, and that should accelerate the downturn of most of that class.

On that note, taking the short-term outlook, the staking arms race is still likely to continue for some time yet. XTZ has been explosive over the last few weeks, fueled by both Coinbase in November and Binance in December adding on-platform staking integration for it:



Credit: Tradingview. Headlines via Cointelegraph.

We tend to think that XTZ may not have reached its top yet (and that downside short-term is slightly more limited than for most mid-caps), but more importantly, there may be value to be found elsewhere for coins that could take advantage of such interest on positive news cycles short-term.

The main two we are looking to are ADA and TRX; the former is expected to move over to a PoS system in Q1 but is still waiting on associated announcements and partnerships, while the latter currently looks somewhat oversold after November's bleed and has a strong history of forcing and taking advantage of big announcements and registering growth outside of BTC cycles.

Small-caps

In general, we err on the side of caution with regards to discussing small-cap (below ~$1B total market cap) crypto assets, because they are simply too vulnerable to speculative bubbles and to outright price manipulation. At the time of writing, this has just been brought back into focus once again, with a large number of the recent best-performing alts suffering sudden and severe losses overnight.

The starkest example was MATIC, which peaked at a market cap of slightly over $100m, but was for a couple of weeks seeing daily volumes near or in excess of that cap; price, which had been in the $0.010-$0.016 range since its launch in August, suddenly shot up, peaking at over $0.04 over last weekend. The fall, which does no appear to have been driven by any particular news or rumour (and on the other side, there had been a couple of positive headlines during the move up but nothing significant) was sudden and sharp:

Credi: Tradingview.

The collapse in MATIC was coupled with smaller but significant (10-15%) daily drawdowns on a number of other small-caps and even mid-caps which had seen recent speculatively-driven gains. At the time of writing, no consensus has emerged on who or what is to 'blame' for the crash, though it should be noted that daily MATIC volumes had actually exceeded the coin's market cap for large parts of its run upwards; at its absolute peak, MATIC had a cap of $100m (circulating supply of around 2.5b at $0.04) per, and from November 25th onwards, daily volumes on Binance dropped below $100m on weekends only. Post-crash, the 24-hour moving average for MATIC volume topped out at over a billion on Tuesday afternoon – approximately 20 times the coin's market cap at that point.

This was in large part made possible by the coin's eligibility for margin trading on Binance; the addition of leverage trading on such small and illiquid markets was from the start ridiculous, and unfortunately will likely be a contributing factor to these sorts of bubbles going forward as Binance and other exchanges use such means as a way to chase new retial customers.

Wherever blame may lie, it underlines: small-caps usually lack even the small measures of inherent value that the XRPs and EOSs of the world hold, and we tend to believe that they should mostly be avoided.

The crypto ruble: the legal perspective

By Alina Kisilevich

The regulatory framework for cryptocurrencies in Russia is not defined. It is neither adopted, nor banned. We might call in the grey area for now, but Russian lawmakers are aiming to legally implement the definition of digital assets and related topics onto the federal level of legislation. It is greatly supported by regular consumers and investors among the citizens, or people genuinely interested in the topic, especially Russian youth. There are quite an amount of different e-sources run by blockchain and crypto enthusiasts.

The global study “State of Cryptocurrency”, that was focused on the attitude of consumers from various regions of the world reads that, 18% of Russian citizens between the purchase of cryptocurrency and the new iPhone for the same amount of money will choose the former. The number of cryptocurrency owners in Russia turned out to be higher than in other countries in which the study was conducted. 12% of respondents in Russia reported cryptocurrency Though, in practice, when it comes to legislation, financial authorities signify desire to introduce a ban on cryptocurrency, which is explained by the large amount of crime in the cryptocurrency market. Nevertheless, according to experts, the ban can lead to contradictory consequences, meaning that even though it will probably fight crime in this area, at the same time there will be nothing to tax for a budget of digital transactions, which will affect the development of the economy in general, followed by the formation of a gray market.

This month, The Russian Union of Industrialists and Entrepreneurs appealed to Russian President Vladimir Putin with a request to entrust the relevant departments to work out law bills as quickly as possible for them to regulate the sphere of cryptocurrencies, and the president agreed to such appeal. In this letter, representatives of the union said that many business entities in the country are ready to issue their own digital tokens, supported by goods, and sell them to the interested consumers on the market. However, this is not possible due to the absence of an appropriate law. Even though currently the State Duma (the lawmakers) is working out the adoption of the law on digital financial assets, the representatives say that even if this law is adopted, it will not make it easier for those willing to issue tokens. They say, for the process to be run smoothly, clarity is required in the areas of taxation, currency regulation, certification, licensing, as well as possible criminal and administrative liability.

For now nothing implies that there are any plans for a crypto ruble, but the amount of attention this area is getting within Russian legislation, from having somewhat hostile attitude to neutrality to legislation plans, there is a chance for it to happen in the following years, especially if Russian authorities pay attention to the partner-country China.

What we’re reading

Cryptocurrency Exchange OKEx to Launch Options Trading This Month (Cointelegraph): OKEx will be interesting to watch over the coming months - not quite as close to the Chinese government as Huobi, and not quite as hostile as Binance, it's possible that the Malta-based exchange might be able to carve itself out a greater niche if the wheels start coming off the Binance train in 2020.

Georgia Governor Appoints Bakkt CEO Loeffler as New US Senator (Coindesk): Not clear yet who replaces Loeffler at Bakkt, but signs point to Adam White, which is encouraging; while Loeffler was predominantly a traditional markets figure, White is a crypto endemic, having being a director of Coinbase from 2013 to 2018. That's no knock on Loeffler or anyone else newer to the space, but it would be a significant show of confidence by ICE in the future of Bakkt in our view.

No More Bitcoin for Nordea Bank Employees, Experts Question the Motive (Cointelegraph): It's very odd and a little disappointing that Nordea seem determined to keep this prohibition in place; there might have been some practical merit to it in 2018 (albeit even then it was an extremely authoritarian policy) because of some of the mania that had developed around the ICO boom, but that holds less and less water as we move into 2020. Regrettable, but at least a fairly isolated policy by all accounts.

The end of fiat money?/Cryptocurrencies: the 21st century cash (Imagine 2030, Deutsche Bank Research): An unusually good read for a DB report overall. "Eventually, it is possible that inflation will become more and more embedded in our system and doubts will rise about the sustainability of fiat money. The demand for alternative currencies will therefore likely be significantly higher by the time 2030 rolls around".

Until next week – thank you for reading.

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