ENIGMA SECURITIES

De-Coding Crypto

Weekly Analysis

At the abyss: the potential implications of $7000

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In this week's issue, we look at price action as we approach crucial levels, and assess the potential implications for longer-term theses of a potential move. We also offer a different perspective on the coronavirus situation.

Written by Joseph Edwards, Head of Research at Enigma Securities.

Our Market View

May you live in interesting times. A rare week - on the one hand, all cryptoassets are down, but on the other, the volatility in equities and commodities markets have put crypto to shame for once. In any case, as our research discusses, this is a crucial moment - recent correlations with equities markets are of extreme concern given the likelihood of further downside there, and the next few days are likely to prove defining.

Looking for a moment at alts: as was the case in 2019, with most having outperformed BTC on the way up, as a class they have generally gave those gains up even more rapidly on the way down, and most are now barely up in BTC terms on the year. The exception is ETH, which has still lost ground but is still up 35% against BTC on the year; how ETH does from here will probably be as good a gauge as any for the trajectory going forward of the traditional mid-caps and large-caps.

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

Major

Ticker	Price	7D	1M	6M	12M	Cap
BTC	7825.68	-10.50%	-20.24%	-24.37%	103.20%	142.9B
ETH	196.416	-12.28%	-10.77%	4.30%	49.80%	21.62B
XRP	0.206245	-11.46%	-23.95%	-20.87%	-33.01%	9.04B
BCH	264.166	-18.08%	-40.90%	-12.66%	102.50%	4.84B
LTC	48.0936	-20.20%	-34.29%	-31.61%	-13.16%	3.10B
EOS	3.03085	-15.59%	-37.40%	-24.48%	-14.44%	2.79B

Selected

Ticker	Price	7D	1M	6M	12M	Cap
XTZ	2.51923	-11.92%	-2.60%	153.80%	476.90%	1.77B
LINK	3.09724	-18.43%	17.80%	150.80%	69.80%	1.37B

At the abyss: the potential implications of $7000

We said in our research on February 26th:

> Ultimately, our view is that this should represent a medium-term trend break – unless relief comes extremely soon, and we see re-establishment comfortably above $10,000, we see more room to run downwards over at least the remainder of Q1.

At that time, we had three levels we were watching: $8600, $8000, and $7800. The first, clearly, has broken. $8600 behaved about as expected - offered some level of support, but very little upwards velocity from it, and eventually collapsed without fanfare.

We now hence find ourselves at $8000/$7800. Again, to recap:

> $8000 is important for a few reasons – just over a 61.8% retrace of the total move up since January, historically important support level, and of psychological importance as the final support before a descent towards December's range in the $7000-$7500 range. $7800 would represent a total drawdown of 30%; any drop significantly below that would force a far fuller reassessment on the health of BTC and cryptoassets in general.

This, then, is a crucial point. We should start by making clear that this is crucial in a slightly different way compared to $8600. The hope (and hope seems the appropriate term here) for $8600 was that it would essentially be a springboard - it was, in essence, the limit for what could be considered an overall correction in an upwards trend.

This did not happen, and we find ourselves deeper. It is possible that we could rally quickly from $7800, but we would argue that the historical precedent suggests otherwise (BTC did rally from four drawdowns of equal or greater magnitude in 2017, but that was after 150+% rallies upwards preceding); our current tendency is to think that the most likely scenario now is a fading of directional volatility, and that we will go on to maintain the levels that we enter Q2 at for the majority of the quarter.

The obvious question, then: if we expect directional volatility to decrease, why does it matter what level we enter at?

When we look back on it, one of the most fascinating features of the Q1 runup will be that this may have been the least retail-driven run for BTC and crypto yet. That is absolutely not to say that this isn't still an overwhelmingly retail-dominated market, or that none of the impulses upwards came from changes in retail demand (particularly on the Asian side); however, there was definitely less than usual in terms of the usual retail-side hype, and definitely an increase in interest from bigger players.

We talked about CFTC figures last month, which reveal - among other things - exactly how many parties in regulated categories are trading on CME Bitcoin futures, and noted a few things:

1) The number of total traders each week increased by roughly a dozen (from the mid-40s to the mid-50s).
2) These traders were from CFTC-defined 'leveraged funds' and overwhelmingly taking long or spreading positions.
3) These were not particularly large positions - despite there now being twice as many parties in said category positioned long compared to short, the total ratio of the positions themselves was overwhelmingly short (as it has been since Q1 2019); our read hence was that this growth in trader count represented some institutionals taking the new year as a launching point to get directly involved in the market ahead of growth to come in 2020 and through to 2021.

What has happened since?

Date	Total	Lev, Long	Lev, Short	Lev, Spread
31/12/2019	47	9	16	*
07/01/2020	58	15	18	5
14/01/2020	56	21	12	10
21/01/2020	57	22	11	10
28/01/2020	55	20	10	10
04/02/2020	47	15	11	4
11/02/2020	59	20	13	8
18/02/2020	61	23	12	9
25/02/2020	58	22	11	8
03/03/2020	**40**	**12**	**11**	**6**

CFTC data. Note that a) total figures include all parties and therefore all leveraged parties do not add up to the total, b) CFTC data does not report position counts when held by between 1 and 3 parties; our assumption would be that the asterisked entries are 3.

We should note that there was a slight contraction at the start of last month too (and that almost all CME futures are traded on the contract for the current month), but even so: this is remarkable. GMI founder (and crypto bull) Raoul Pal had a very good point on this front with reference to the overall instability of the equity markets:

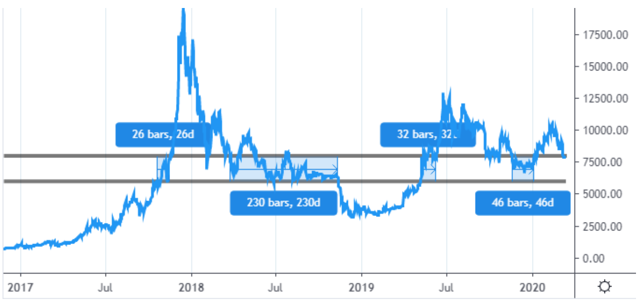
> It feels like any hedge fund that was long bitcoin is having to liquidate. VAR takes no prisoners. (For those new to VAR it is the measure of risk in a portfolio and is connected to volatility, so as vol goes up of all assets, they have to reduce risk).

Institutionals giveth, institutionals take away. In any case, this was a run where Western retail was on the sidelines to a greater degree than any before. Long-term, this seems like an extremely good sign for just how far we can go in the near future; retail has not only not exhausted itself, it has barely broken a sweat so far.

This does present a challenge, however. On the one hand - imagine how far we can go when retail interest does spike. On the other hand - retail equally has not yet been convinced, and this is where the worry comes from. As much as BTC is a speculative asset, its tenacity - the fact that it has always managed to get back to a baseline value after a few months that (while still representing an unthinkable drawdown from its peak) is significantly higher than whatever the previous baseline was.

Coming into 2020, it looked like that baseline had been set at, or just below, $7000 - more than double the roughly $3000 level of crypto winter. Now, to be clear: even the most aggressive of (credible) bear cases would not see us coming anywhere near that $3000 baseline, no matter what. Nonetheless, a move at this point below that $7000 point would still augur extremely ill for consumer confidence. Which brings us to the second problem, and where the title of this piece comes from: the titular 'abyss'.

The simplest way to put it is this: the area between $6000 and $8000 has tended to be one that we move through quickly:



Credit: Tradingview. BTCUSD, Coinbase.

The exception was Q2 and Q3 2018; but, even there, once the short-term after-effects of the 2018 bubble faded, we sunk to the very bottom, only taking very brief trips above support at $6000.

Is this a problem? It is insofar as it means that it is a range with very little in the way of natural and proven support levels, and with $7800 proving itself to indeed be a support level of some relevance so far, this become the danger.

A move below $7800 likely takes us directly to $7000 - in other words, we fully retrace the move up. The very act of getting back to $7000 in such short order in turn undermines $7000 as a support, and that point, we risk a 2018-style cascade that takes us all the way down to the $5500-$6000 range.

At that point, we would clearly have to start asking questions about long-term health, because we then find ourselves in a situation akin to 2015 - having to think in years, not months, with regards to regaining significant upwards trajectory. As much as BTC always seems to end up surviving in some form, this would clearly be a serious body blow for the entire ecosystem, during a tech epoch where it faces a trend as close as it gets to a genuine existential threat (in the form of mass digitization of fiat in its various forms).

In any case, for all the gloom, we are not quite there yet; while there may be little to get too optimistic about on short time frames, for now, we are still holding those last levels and momentum is slowing. However, we are still very much staring down the barrel with regards to the greater macro situation, and hence it seems prudent to prepare for the worst - with traditional markets moving like crypto does normally, the potential for quick downside is more aggressive than it's been for a long time.

Coronavirus: the legal perspective

By Alina Kiselevich

With coronavirus spreading and countries closing their borders, people are wondering how exactly the situation will impact the crypto world.

Without a doubt, the outbreak of the coronavirus has its consequences on the global economy. The disease is also affecting the overall ecosystem of the cryptocurrency, and its impact on the prices of the digital coins is evident now.

A general opinion among the crypto enthusiasts is, the virus is likely to have a positive impact on the adoption of cryptocurrencies among people, but not without its cons.

The main pro following the event is that people are trying to limit their use of cash, opting for credit cards and payments on the internet, because cash is more likely to hold the germs. This is likely to boost the adoption of digital coins, therefore helping the prices of the Bitcoin and other digital currencies to go up.

With this being said, China has around 70% share in the Bitcoin mining thanks to the availability of the cheap electricity, but now, while the authorities are ordering means to contain the spread of the virus, coronavirus can be harmful to mining operations.

It is still pretty unclear how exactly the disease will affect the market on the global scale, but digital currencies will definitely emerge stronger and their claim to be a stable alternative to the conventional monetary system will be fortified. The full effect of this virus on social and economic parameters will only be understood once experts get precise numbers, but the adoption of digital currencies will most likely gain more power than before, due to the virus.

What we're reading

Europe's New AML Rules Made Crypto More Attractive to Institutions, Says Boerse Stuttgart Exec (Coindesk): An interesting anecdote. We're more used to headlines about 5AMLD driving business away from Europe (e.g. Deribit moving out of the Netherlands in January), but given that the rule in European finance has always been to seek permission rather than ask for forgiveness, there might be something to it.

Bitcoin's Plunge Due to Traditional Markets Falling or PlusToken Dumping? (Cointelegraph): Worth a quick explanation. We've talked in the past about how a large part of the general bear trend last year can be ascribed to the effect of liquidation of the proceeds from the $3bn PlusToken scam and the resultant effect on supply dynamics. These liquidations largely stopped in late November (after research exposing them), with only a minority position remaining unliquidated; however, a new report from OXT Research (the group responsible for the original research) has noted that liquidations have restarted in spurts since the new year. This has quickly been seized upon in some circles as an explanation for the crash since mid-February. However, while it's a convenient explanation, on the whole, we don't buy it; the speed of liquidation has been tapered massively compared to Q3 and Q4, and is also being more carefully distributed across multiple exchanges. While still contributing downwards pressure, it at this point feels like a secondary concern, not something that should be actively creating market-wide supply shocks as it did before.

The Cryptocurrency Act of 2020 Is 'Dead on Arrival,' Washington Tells Sponsors (Coindesk): Always important to remember: with the US system in particular, 99% of these grand legislative flourishes should be considered immaterial until they're on the President's desk, and not a moment earlier. Still, some good insights in the article itself about where we're going regulatory-wise.

Until next week – thank you for reading.

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