ENIGMA SECURITIES

De-Coding Crypto

Weekly Analysis

Bitcoin and store-of-value: latest developments

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In this week's issue, we look at recent price action in the context of the store-of-value thesis of cryptocurrency valuation, and how far that framework has held and may hold going forward for understanding price action.

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Our Market View

May you live in interesting times. A week spent in the waiting room for the most part - we broke down on Wednesday and Thursday to a $8500-$9100 range and have been there ever since, testing support a couple of times but never really gathering up the momentum to seriously test resistance.

In isolation, we would say to expect little in the way of volatility on cryptoassets short-term; the complicating factor, of course, is the conveyor belt of shocks affecting the macro picture. Our research this week offers some discussion of the difficulties there, but the key point is that for crypto markets, we see the current wave of macro events as contributing risk, but not predictable directionality; beta, not alpha, is the consideration here.

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

Major

Ticker	Price	7D	1M	6M	12M	Cap
BTC	8722.64	-5.73%	-5.63%	-16.67%	127.20%	159.2B
ETH	223.229	-6.97%	19.43%	25.37%	68.27%	24.54B
XRP	0.232703	-4.36%	-5.46%	-10.36%	-23.87%	10.19B
BCH	322.547	-2.34%	-14.54%	7.80%	154.60%	5.91B
LTC	60.0032	-10.75%	-12.49%	-12.75%	8.61%	3.86B
EOS	3.59778	-8.85%	-13.19%	0.70%	0.31%	3.31B

Selected

Ticker	Price	7D	1M	6M	12M	Cap
XTZ	2.82037	1.92%	32.87%	176.50%	610.30%	1.98B
LINK	4.72396	32.83%	73.64%	167.50%	105.00%	1.65B

Bitcoin and store-of-value: latest developments

Our January 29th issue was concerned with coronavirus and cryptocurrency. At the time, our headline conclusion was this:

> All told, we tend to think that the coronavirus situation profiles out bullishly for BTC and crypto, adding to what was already a bullish profile for crypto-assets throughout much of 2020. Unambiguously so? Not quite, but overall, things look promising, and the next few weeks could prove to be a very important test with regards to how aggressively crypto will perform as a macro asset going forward, or whether it will go back to acting largely out of correlation.

In that regard, short-term results have been mixed. BTC did run up to a high of $10,500 by the second week of February, but has struggled somewhat since; as of today, we are trading just below the level at which we published said newsletter (at the time, we were a hair under $9300; we are now ranging around $8700).

To be clear: we still do believe the situation has been a net positive contributor at least in terms of effects on demand on the Asian side specifically. The Western side is less clear; we would note that, for instance, the breakdown from $10,000 to $8500 took place in the three weekdays following the confirmation of the first large-scale Western outbreak in Italy, which clearly represented a watershed moment with regards to perception of the virus outside of China.

In any case, we would stand by the central point of coronavirus and its broader effects being a net bullish contributor to the overall outlook with regards to broader demand effects; the mountain has not really moved there. For reference, we are currently still bullish on most timeframes of more than 3 months or so, but closer to neutral and waiting for clarification on shorter timeframes.

The part of the thesis we laid out in the aforementioned issue that has seen some new evidence come in has been store-of-value - the idea that, given the properties, perception, and limitations of BTC, the closest comparison for how it is likely to be used (and therefore how it is likely to act price-wise) is to macro assets that are primarily perceived in terms of being essentially a proxy for money (and having limited long-term downside), with particular reference to gold and other precious metals. This is what we said with regards to that at the time:

> We are not as convinced as some on the BTC safe haven theory; while we absolutely believe that store-of-value is ultimately the defining feature of BTC long-term, and that we absolutely believe that it can now be credibly argued from a professional financial perspective that BTC has a proven non-zero baseline value, we remain mindful that BTC is still a highly speculative asset both in real terms and in terms of public perception.

Nonetheless, we conceded that there had been some reasonable degree of cointegration in pricing across 2019 and to date in 2020 (and that if store-of-value did bear out, it would be a bullish contributor).

How has this looked so far? First, we should look simply at BTC versus gold since the new year:

Credit: Tradingview. BTC in blue and right axis, GOLD in orange and left axis.

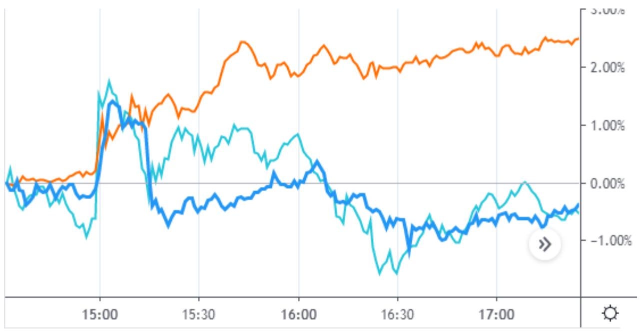
The extremely tight correlation showcased during the Iran crisis has not particularly held, with both gold breakouts seeing BTC near-term flat or worse. It is worth remembering at this point that the BTC/gold relationship in 2019 was never quite as close as it was sometimes made out to be, as our graph from January showed:

Credit: Tradingview. BTC in blue and right axis, GOLD in orange and left axis.

However, outright acting in inverse - with BTC falling from highs and drawing down as gold hits new highs (and in an extremely store-of-value friendly macro environment at that) - is, at the very least, unusual, and does contribute something to store-of-value perhaps being less useful as a price action framework from BTC than some were starting to assert over the course of the last six months or so.

Of particular interest in that regard was Tuesday's action, when we saw something of a perfect test case come together with regards to price action over extreme short time-frames. Despite perceptions to the contrary, BTC tends not to be an asset that reacts immediately on headlines, especially compared to traditional markets; that combined with how relatively recently it has matured to the point of being meaningfully responsive at all to macro shocks has tended to make it had to draw relational conclusions with said traditional markets.

However, here, everything aligned in a not-dissimilar way to what happened at the end of the Iran crisis in January (with the Trump press conference that all but confirmed the end of hostilities); while not having quite the set timing of the aforementioned conference, the possibility of an extraordinary Fed cut had been on the radar for days, and hence it was something that was at least being watched for (and had very obvious implications). The 1-minute data tells the story here:



Credit: Tradingview. BTC in blue, GOLD in orange, SPX in cyan.

BTC, gold, SPX: all reacted immediately and with magnitude. The first impulse for all three was upwards; however, as markets digested the implications of the news over the ensuing minutes, we quickly see a divergence that takes gold and equities apart.

BTC, in this case, went with equities, not gold. It should of course be emphasised that we are talking about one event over a very small timeframe here; it hardly represents invalidation of the relationship any more than the Iran crisis correlations represented complete validation.

Yet, it is a piece of the puzzle, and this is a puzzle in need of as good of a solution as we can get for it. For the entirety of the existence of Bitcoin and modern cryptoassets, the question of how they would operate in a stagnant or recessionary period has been purely academic; when the SPX hit its cycle low on 9th March, 2009, the BTC chain was just two months and a few thousand blocks removed from chain genesis. Since then, we have enjoyed the longest and largest equities bull market in history, and consistent, continual global economic growth.

In this regard, the party is now over, and BTC finds itself coming in a macro environment where it has never even been nominally tested - and at a time at that where it is maturing into a state where it is more macro-reactive than ever before. Given that environment, and given the potential respective upside and downside on store-of-value assets and equities assets respectively if the worst comes to fruition, the validity or invalidity of the store-of-value framework may end up being the single most important puzzle for crypto from an investor perspective over the next couple of years.

At this point, we don't think there's a good answer, but our tendency is to think that the best approach is to assume relatively little directionally until proven otherwise. On longer time frames, we would probably expect to see store-of-value bear out on a correlation basis; the broad expectation would be that, by the end of the year, we see crypto up, gold up, and equities down.

We are not, however, convinced that underlying drives of demand and therefore price action are similar enough as of yet to dictate short-term action in any genuinely useful way; and, in fact, the more important correlation to be watching for is unlikely to be whether it moves positively with stores-of-value, but instead if its speculative nature ends up meaning that it moves negatively with equities (which we must emphasise is both unlikely in itself and also less likely than store-of-value correlation, but would be far more impactful regarding the long-term health and value of BTC and other cryptoassets if it transpired to be true).

What we're reading

India's Supreme Court Lifts Banking Ban on Crypto Exchanges (Coindesk): An end to one of crypto's longer-running regulatory sagas. It's seemed likely for a while that the ban would eventually get overturned, but nice to get confirmation. Still, we would caution against expecting too much impact on the broader market; the temptation is always to conflate India with China and assume that demand dynamics will be similar once the floodgates are open, but that rarely works out, and while there will be big beneficaries (e.g. the exchange token for Binance's partner exchange in India, WazirX, gained 60% overnight), broader impact will probably be limited.

How to Stop the Next Quadriga: Make Exchanges Prove Their Reserves (Coindesk): A good read. The exchange landscape has improved dramatically over the last few years, but there are still too many major exchanges where the assurance of stability is little more than them being 'too big to fail'; PoR adoption might be the thing that would finally push out the one or two stragglers who have been able to hold on with less than honest practices in that arena.

98% of bitcoin mining machines will never produce a block, says PwC analyst (The Block): We mentioned it at the start of the year, but this is going to continue to be something to watch across 2020 - advocacy for proof-of-stake systems and movement towards it as part of the overall trend towards ESG-everything. To be entirely clear, we think it's an absolute nonsense and usually a wilful misunderstanding to condemn proof-of-work on environmental grounds, but narratives are narratives.

Steem Community Mobilizes Popular Vote in Battle With Justin Sun (Coindesk): ...incidentally, the saga over the STEEM network is worth reading in that regard.

Actor Steven Seagal settles 'Bitcoiin' ICO endorsement disclosure charges with SEC (The Block): Finally, a bit of lighter reading. That's Bitcoiin, with two Is.

Until next week – thank you for reading.

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