De-Coding Crypto

Enigma Weekly

13th August 2020

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

Our Market View

May you live in interesting times. Some relative calm this week – a couple of pushes for BTC above $12,000, a couple of failures, but for the most part continued consolidation above that $11,400 level. This week's issue looks at the place of BTC in the present crypto market bull trend in more detail, but to sum up: we are still bullish on BTC on all time frames, we tend to think it'll outperform the non-ETH majors (as it has been for the most part still, including this week). Support levels being watched right now are $11,400 and $10,500; losing the former would be of concern but not hugely so, but approaching the later would prompt some degree of re-evaluation.

ETH continues to deal with its own white whale at the $400 level, but reaction has been impressive; even with some sharp drops, the $360-$365 area that was formerly resistance has barely been touched. We remain bullish, although we tend to think a stronger catalyst than we're seeing right now will possibly be needed to break $400 (though with few obvious levels of resistance beyond $400, we could see significant appreciation very quickly from there).

LINK has continued to fly as DeFi initiatives grow towards another fever pitch (most non-LINK assets are down today after the inexorable rise and fall of the Yam Finance project over the past 48 hours, but this isn't the first such pullback, and it seems unlikely that we've seen 'peak DeFi' just yet). One interesting note with regards to the next wave of movers: ETH network usage, and therefore transaction fees, are at all-time highs, so it's possible that we actually see a short-term bump in ETH-type network coins (EOS, XTZ, ADA, ATOM, NEO would be the prime candidates here).

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

Major

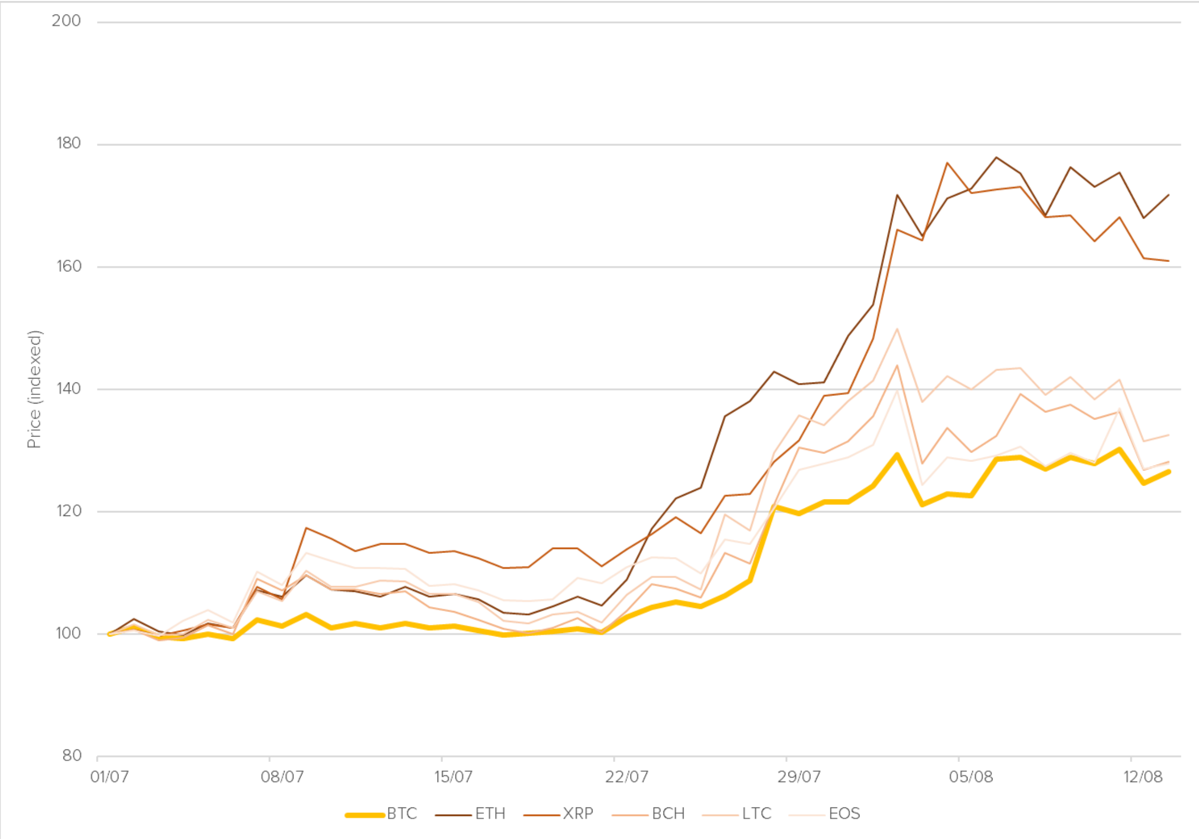
Ticker	Price	7D	1M	6M	12M	Cap
BTC	11585	-1.86%	25.34%	16.47%	13.15%	213.9B
ETH	394.87	-0.82%	63.95%	52.19%	112.30%	44.29B
XRP	0.28031	-7.09%	41.09%	-4.53%	5.27%	12.59B
BCH	284.53	-4.68%	23.50%	-31.27%	-7.58%	5.26B
LTC	54.68	-7.97%	24.37%	-27.31%	-25.26%	3.57B
EOS	3.045	-0.61%	18.82%	-30.84%	14.81%	2.86B

Selected

Ticker	Price	7D	1M	6M	12M	Cap
LINK	16.923	73.32%	119.90%	274.90%	596.50%	5.92B
ADA	0.13758	-4.32%	8.03%	121.40%	189.90%	3.57B
XTZ	4.265	30.81%	45.81%	31.59%	257.20%	3.12B

BTC and the bull trend: driver or passenger?

It's becoming increasingly easy to forget just how good of a position BTC is in right now; as of this week, we are up around 25% on the quarter to date, and 60% on the year. Yet, even with the recent breakthrough at $10,500, BTC actually lags all traditional majors on the quarter:

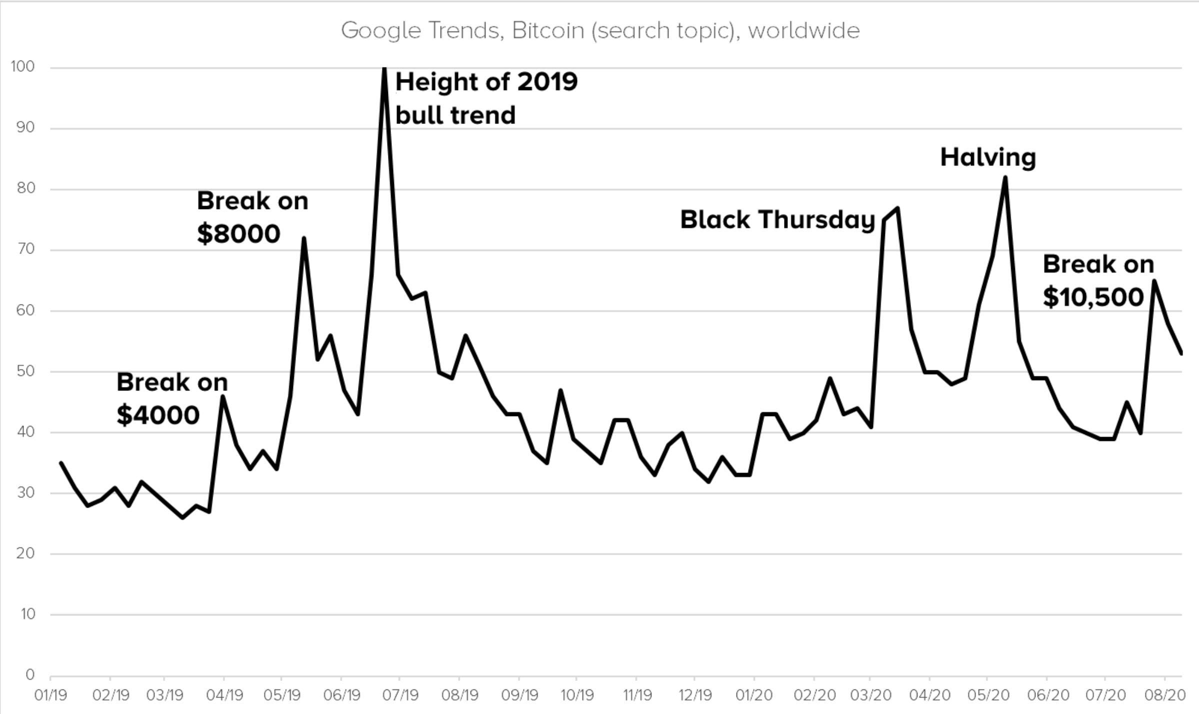


Reference prices via Coinbase. Indexed to opening price on 1st July 2020.

It additionally isn't even in the same stratum as a number of other projects – LINK (+260%), XTZ (+85%), and ADA (+65%) most notably - that are now at the point of seeing volumes, liquidity, and market caps comparable to the traditional majors. Despite performance that has not only been positive, but in theory somewhat earth-shaking, BTC finds itself for once to be the laggard.

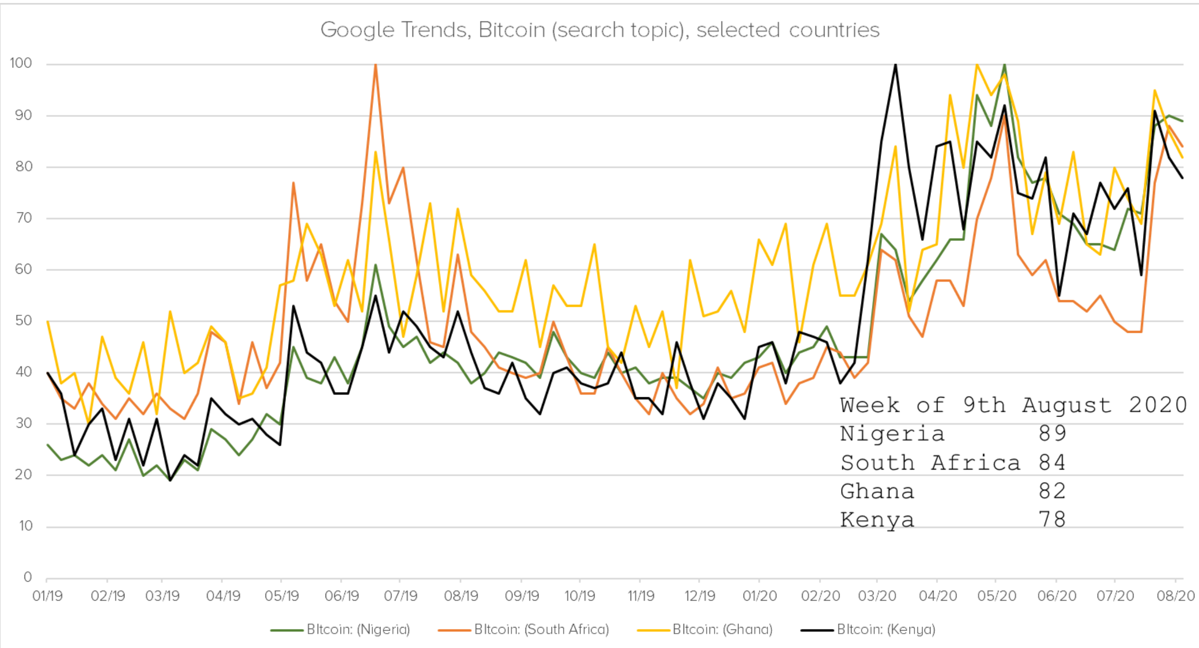
That, then, leads to this: even as we consolidate at historically high levels and look to map out the picture above, has BTC been a driver or passenger in the recent market rally, and in either case, what does it mean for the outlook towards the back half of Q3 and into Q4?

Certainly, the 'passenger' side of the argument does have some strength to it. BTC was absolutely not a first mover on the move in general (the clearest example is ETH breaking range on 23rd July and BTC not doing so until the 26th), and in general, retail enthusiasm remains noticeably low compared to both 2017 and 2019; take everyone's favourite secondary indicator, the Google Trend, for instance:



Data via Google Trends. 100 = peak search volume since start of period (January 2019).

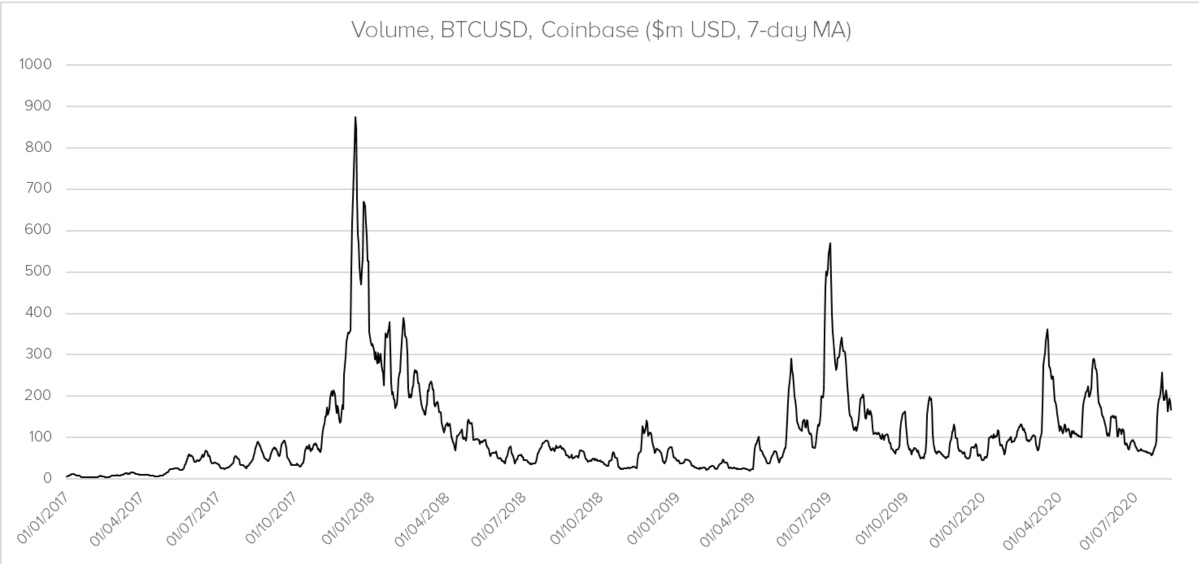
There has been an uptick, and we have seen spikes at or over 2019 levels in some regions, most notably in a handful of African countries. There is a reason for that; FX provision in those areas has historically and structurally been non-existent, simultaneously creating a longer-term use case for BTC while also putting barriers in place to participation of said regions in crypto markets (given that said markets are, and remain, primarily USD-denominated, with even certain currency majors being under-served, let alone EM currencies); companies finding ways past these issues have quietly been an area of significant growth this year. Nigeria has far-and-away led this trend, but is not alone:



Data via Google Trends. 100 = peak search volume since start of period (January 2019).

We will note here that searches for ETH, DeFi, or anything related remain a fraction of BTC's; there has been a marked uptick (searches for Ethereum run at about 20% of the rate of searches for Bitcoin after being 10% in February and even lower earlier in the year and in 2019), but the point is moreso to illustrate that for the most part, as in February, there has been no retail rush to market yet.

In terms of volumes on products used as on-ramps, there has been an appreciable increase on regular volumes (in USD terms) since the break on $10,500, but remain below 2017 and 2019 levels looking at e.g. Coinbase and BTCUSD:



Data via Coinbase.

Reduced market share on any one given exchange compared to 2017 can be waved away for any number of reasons, but lower than the halving or post-Black Thursday (although, we will note, still significantly ahead of February) is notable. Our tendency is to think that BTC is indeed not the driving force right now in with regards to performance in the crypto markets, which we tend to think is a fairly widely-shared view. The more important question is whether it has the capacity to do so over coming months, and we tend to still think that it does. The obvious comparison for us is looking at Q2 and Q3 2017:

Reference prices via Coinbase. Indexed to opening price on April 1st 2017.

It should be emphasised here that while ETH was starting from a low base, it wasn't all that low in context; at the Q2 open, it was $50, and far, far higher in BTC terms than it is now (0.046). As much as BTC was itself gaining, even in 2017, it wasn't the main driving force in markets for much of the summer in terms of price action and its own growth, only really stepping back into the limelight as the market gave way to outright mania in November and December.

History doesn't repeat, but it rhymes. In terms of the particulars of this market cycle, this is not yet BTC's time. Crypto markets right now are still being driven primarily by money that was already endemic to the space (look no further than the 'yield farming' buzzword for proof of that); interest is absolutely increasing, but it's a slower process than we tend to perceive from within the space itself.

The question, essentially, is whether there's anything else positioned to capture the zeitgeist when crypto is on everyone's lips again. As it stands, we still tend to think the answer is that BTC remains unique in terms of filling that role. Other layer-1 like-for-like solutions (LTC, BCH, XRP among others) continue to steadily sink against it, and while we are extremely bullish on ETH (perhaps even moreso than BTC even at current levels), it still lacks the longer-term track record and crucial narrative details (i.e. programmatic scarcity) to take position in the latter stages of the bull cycle.

Where does that leave us in terms of a medium-term outlook, with particular regard to Q4? The answer is still 'not too badly indeed'. As it stands, we are still consolidating at a level that continues to give us a succession of the strongest weekly closes in recent memory; even including the 2017 bubble, the last two closes have been in the top 15 ever, and excluding it, are in the top 5. Additionally, even with a couple of major moves, we have been trading on relatively low volatility for those levels, especially last week:

Week beginning	O	H	L	C	Intraweek range (%)
11/12/2017	15290	19892	15200	19379	30.69%
01/01/2018	13863	17178	12953	16174	30.48%
04/12/2017	11290	19697	10950	15290	77.48%
18/12/2017	19379	19385	10400	14222	46.36%
25/12/2017	14222	16490	12500	13863	28.06%
08/01/2018	16174	16275	12800	13656	21.48%
03/08/2020	11067	11920	10912	11688	9.11%
05/08/2019	10978	12320	10978	11541	12.23%
22/01/2018	11518	11849	9945	11536	16.53%
15/01/2018	13656	14253	9005	11518	38.43%
01/07/2019	10761	12064	9651	11474	22.43%
26/02/2018	9600	11495	9404	11470	21.78%
10/08/2020*	11688	12086	11120	11566	8.27%
27/11/2017	9401	11891	8596	11290	35.05%
27/07/2020	9941	12134	9935	11069	22.12%

Reference prices via Coinbase. Data for 10/08/2020 as of daily close, 12/08/2020.

We still seem poised to move on higher, with the major question marks being potential levels of resistance, and potential drawdowns along the way. Our tendency right now is increasingly to see somewhere between $12,100 and $12,500 as being the crucial point; this was the high of the second push upwards in August 2019, and we have already seen momentum reverse aggressively upon moves into that area on a couple of occasions recently.

If we can get past that point, we tend to expect an incline over the next couple of months towards and over the 2019 highs towards $14,000; this would represent just over a 20% increase over current prices. This will still probably come in the context of underperformance against ETH and small-caps over a similar timespan (although we do expect most other traditional majors to slip again over time; across the full year, only ETH is actually up against BTC, and unlike when ETH broke through and held resistance against the BTC pair in June, recent moves don't seem to us to constitute a full-on trend shift as it stands).

Market sentiment can then be gauged at that point. The essential point is: while we don't exactly think that a 2017-type frenzy is required, for BTC to break much past those 2019 highs (and to an all-time high, and ultimately beyond), there needs to be more demand in the form of new inflows than is being exhibited right now. We talked about this back at the time of the halving, when the stock-to-flow model of BTC valuation (that compared it to gold and implied a valuation in the high five digits or six digits post-halving) was being spread around:

> This is a discussion that could go on and on, so we'll try to keep it as brief as possible. The most important thing to understand here is to emphasise: while we have been talking about the importance of supply dynamics in this piece (and will continue to do so), crypto markets more broadly have always been demand-driven above all else, because growth from current levels requires an ever-expanding portion of the population to both mentally buy in to the idea of them as money, and, of course, literally buy into them in terms of creating more new demand than there is new supply… A 50% contraction in new supply is absolutely meaningful, and indeed should over time produce an exponential return in prices, but to get there is still going to require an absolutely huge amount of new money coming in.

Demand is moving in the right direction, but it's not there just yet. We have been, and continue to be, bullish on BTC; with four-and-a-half months left in the year, we still tend to think that there's still a better than even chance that we seriously challenge the ATH within the year.

Between the macro situation and associated narratives, staking and DeFi finally revitalising the alts market, and BTC-specific variables like the supply dynamic (still long-term bullish in spite of some of its advocates), the stage is set for it; its audience just aren't quite in their seats just yet.

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.