De-Coding Crypto

Enigma Weekly

14th October 2020

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

Our Market View

May you live in interesting times. A positive week, and we once again find ourselves at and around historically-high levels, but we still tend to lean negatively with our outlook; at the time of writing, we find ourselves hovering at around $11,500, and we would need to start closing firmly above there (and realistically break $12,000) to have confidence that this represents a trend shift rather than a January 2018 or July 2019-esque echo.

Alts have gained outsizedly on the move, but not overwhelmingly so. Not too much new to say on the large-caps there (we still have little faith in medium-term outperformance for the most part) but a couple of the more interesting shifts among the smaller-caps have been ADA (+19%) and XMR (+21%). Both were relative laggards throughout much of the 'DeFi run', as it were, in absolute terms and in terms of the narratives around them (ADA being seen as institutionally oppositional to ETH, XMR being the most 'BTC-like' of the privacy coins in terms of its network structure and philosophy); worth continuing to keep an eye on both to see if they can continue to build out from here during the DeFi winter period.

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

Major

Ticker	Price	7D	1M	6M	12M	Cap
BTC	11528	8.45%	8.03%	58.77%	44.83%	213.5B
ETH	386.87	13.27%	3.17%	105.80%	124.90%	43.7B
XRP	0.25511	2.62%	3.53%	30.18%	-12.65%	11.54B
BCH	255.77	16.82%	13.33%	4.94%	20.08%	4.74B
LTC	50.85	10.49%	4.16%	15.25%	-5.30%	3.34B
EOS	2.648	-0.10%	-3.35%	-2.96%	-7.65%	2.49B

Selected

Ticker	Price	7D	1M	6M	12M	Cap
LINK	11.29	27.86%	-6.33%	198.10%	379.20%	3.95B
ADA	0.11194	19.41%	16.31%	205.40%	186.10%	3.48B
XTZ	2.362	11.45%	-10.85%	1.12%	168.20%	1.74B

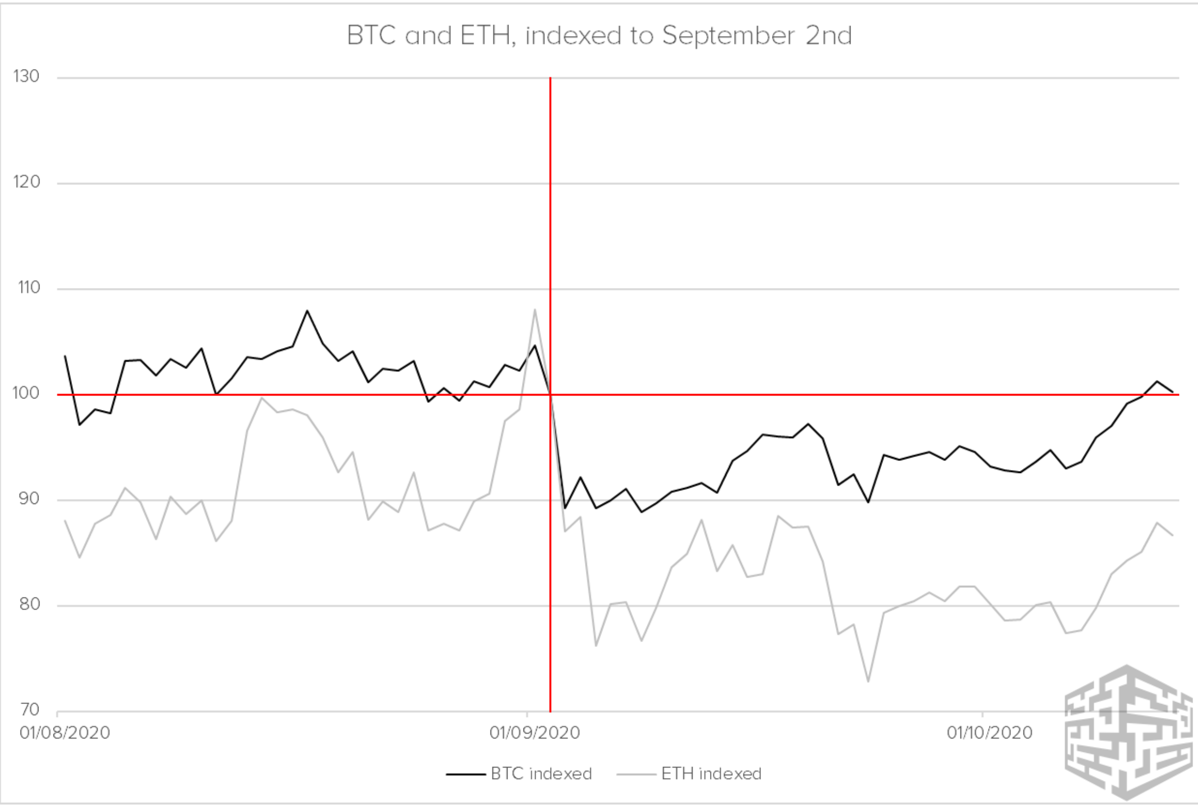
CME and Bakkt latest: is interest waning?

Our big takeaway in our last issue on institutional derivatives markets (2nd September) was this:

> Our overall view on BTC is still best defined as bullish, especially looking towards 2021...however, we would on the whole tend to say that expectations should probably be tempered somewhat for how quickly we move in each stage until we start seeing more concretely positive indicators with regards to sentiment.

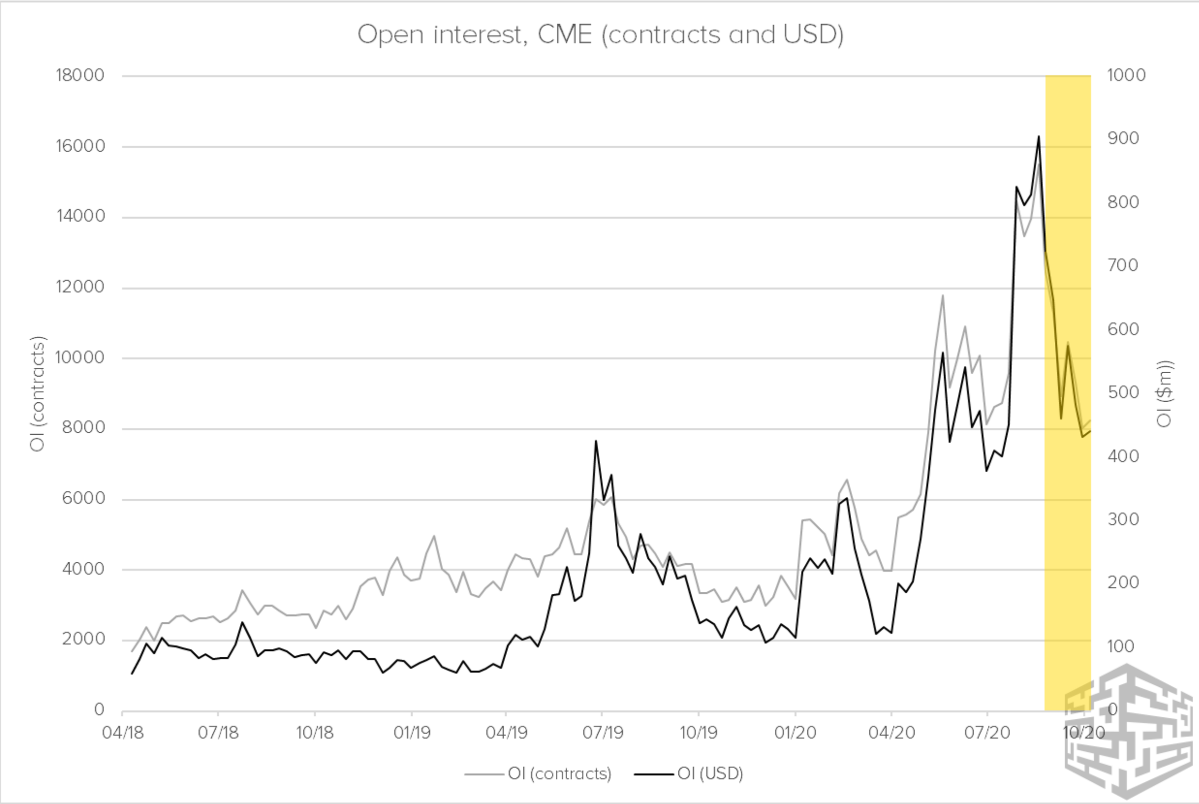
This was at a point where general mood was optimistic, even euphoric; we were coming off a failed breakout on $12,000 which was of some concern, but we were still trading in the high-$11,000s and ETH was one day removed from a huge surge through to a new local high at $490

We now find ourselves today at essentially the same point as when that issue was published in BTC terms, and a little below it for ETH and other large-caps:



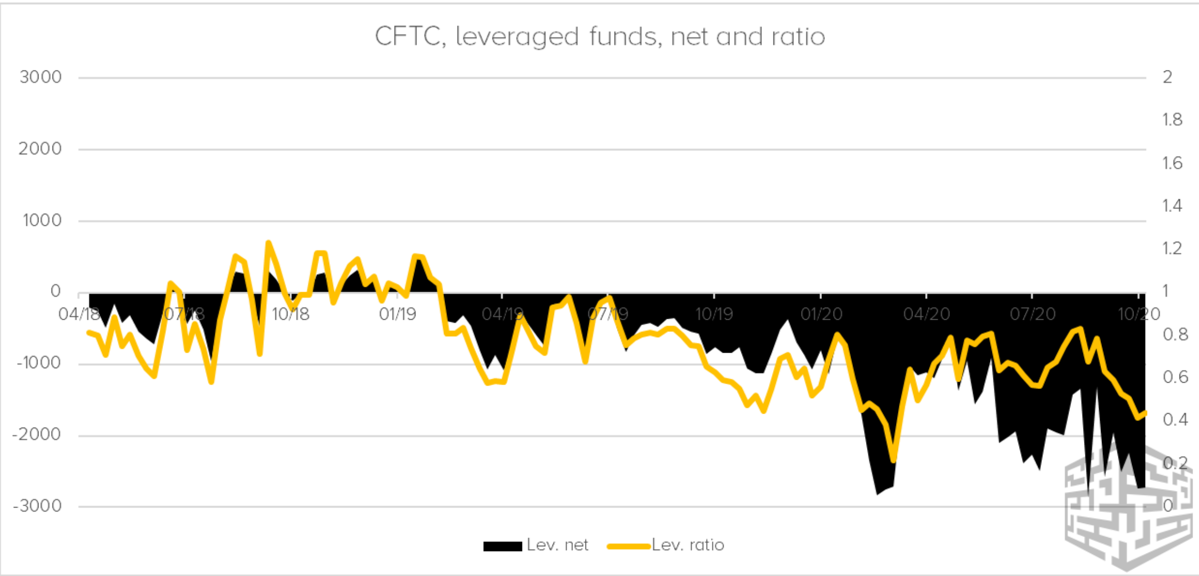
Data via Tradingview. Reference prices: BTCUSD and ETHUSD, Coinbase.

It hence seems an appropriate point to revisit the figures on the institutional side. To start with, looking at raw open interest:



Data via CFTC and Tradingview. Reference price: BTCUSD, Coinbase.

While still significantly higher than at any point prior to Q2 of this year, open interest has markedly declined in both BTC and USD terms compared to where it was over the summer, ticking up only slightly in mid-September before recording the lowest two prints since the halving in BTC terms for the last two weeks. This, clearly, is a concern with regards to sentiment, and of particular note here is the net and ratio with regards to what the CFTC categories as leveraged funds. As a refresher, we tend to look at these with particular interest, because apart from being by the largest bloc, these still do represent by far the most 'traditional' players in space. The numbers there are particularly concerning:



Data via CFTC. Enumerated in contracts.

In terms of both net and ratio (and in terms of both contracts and USD for the record), we are now at or near record levels of short positioning; the number of long positions held in that regard has decreased by more than 70% (in contract terms) from the peak in August.

While the pure predictive power of the ratio is somewhat questionable (we did see a major drop-off in March just prior to the broader market crash, but it wasn't particularly helpful in that regard throughout much of 2019), we do nonetheless tend to think that this bodes ill through the end of the quarter; as we've said, we tend to see any market movement through to the end of the year, and with retail interest still extremely low, we really do need to see institutional buyers stepping in at these higher levels to have much faith in any emergent quarterly bull trend.

The trader count figures tell a similar story:

Date	Total	Lev. Long	Lev. Short	Lev. Spread
06/20 avg.	*66*	*19*	*18*	*9*
07/20 avg.	*72*	*22*	*19*	*8*
08/20 avg.	*92*	*33*	*17*	*13*
25/08/2020	86	30	19	13
01/09/2020	88	31	14	12
08/09/2020	84	27	21	12
15/09/2020	79	23	19	13
22/09/2020	77	22	20	13
29/09/2020	70	16	21	11
06/10/2020	76	20	23	12

Data via CFTC.

The groundswell of traders dabbling with small long positions in the market in August and September has - for now - faded away, and we are now once again negative in the long vs. short net in that regard too (which is more unusual than the sub-1 in the ratio department). We tend to think that this exodus won't be a permanent one by any means, but again, it weakens any near-term bull-case, and we do again need to note that we did see a very similar fading in March (and also in July 2019).

Of course, there still is the question: is this a CME problem? Is this just a case of institutional market participants moving elsewhere? The short answer is "no", the slightly longer answer is "partially, but by nowhere near enough to make up the discrepancy":

Week of	CME volume	Bakkt volume	Bakkt share
03/08/2020	192615	10882	**5.3%**
10/08/2020	206310	9673	**4.5%**
17/08/2020	220955	15360	**6.5%**
24/08/2020	177165	21986	**11.0%**
31/08/2020	310370	15877	**4.9%**
07/09/2020	162230	10991	**6.3%**
14/09/2020	146555	43173	**22.8%**
21/09/2020	152370	18622	**10.9%**
28/09/2020	160550	22648	**12.4%**
05/10/2020	96750	11699	**10.8%**

Data via Tradingview. Volumes in BTC and based on most recent contract.

There has been an upswing since the last issue, especially on the week beginning September 14th, but volumes on Bakkt remain a fraction of those on the CME, and come nowhere close to accounting for the difference here.

Again, we have to stress when talking about derivatives datapoints like this with regards to institutional demand: nothing here should be read as long-term bearish in our view. These are ultimately short-term products (as of Tuesday's close, 73% of OI and 86% of volume was on the nearest contract, i.e. October expiry, with just 1.3% at or beyond January 2021), and one of the many quiet structural developments of the last year has been that it has become much easier for institutions to gain direct or near-direct exposure to BTC on a custodial basis (through GBTC's continuing growth, through the emergence of ETFs with considerable AUM on Canadian and European exchanges, through the expansion of institutional custodial offerings by firms such as Gemini and Coinbase, etc.).

Institutional demand in aggregate is increasing, not decreasing; as much as there's a degree of novelty to the Microstrategy and Square stories (especially on the Square side), we do still tend to think that the meter is ticking up in that regard. However, the exodus in recent weeks continues to colour our view for Q4 towards bearish bias and a low-vol bias; while one can never say never (and we still ultimately think that election aftermath risks are being understated by markets across the board), it's hard to see an impetus that could suddenly reignite that interest before the end of the year.

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.