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De-Coding Crypto

Enigma Weekly

3rd February 2021

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Our Market View

May you live in interesting times. One of those odd weeks where BTC is up by, suffice to say, a lot, but it almost doesn't feel like it – started off 168 hours ago at arrange lows of around $30,000, and have only just (quietly) stepped through range highs of $36,000 to higher. Situation very much currently in process, but action today does finally present a path to higher potentially – resistance should essentially be at the recent all-time high at $42,000, but should also break fairly early if we are able to challenge up there.

ETH also up – interestingly, only slight outperformance against BTC, again a situation where it feels like it should be different. ETH has now firmly broken its own previous high above $1400, and tend to expect to push on further through the end of the week at least – as a reminder, CME ETH futures will launch on February 8th, which remains a point of risk with regards to a potential trend shift for the worse (said markets tending to be suppressive with regards to price in the short term).

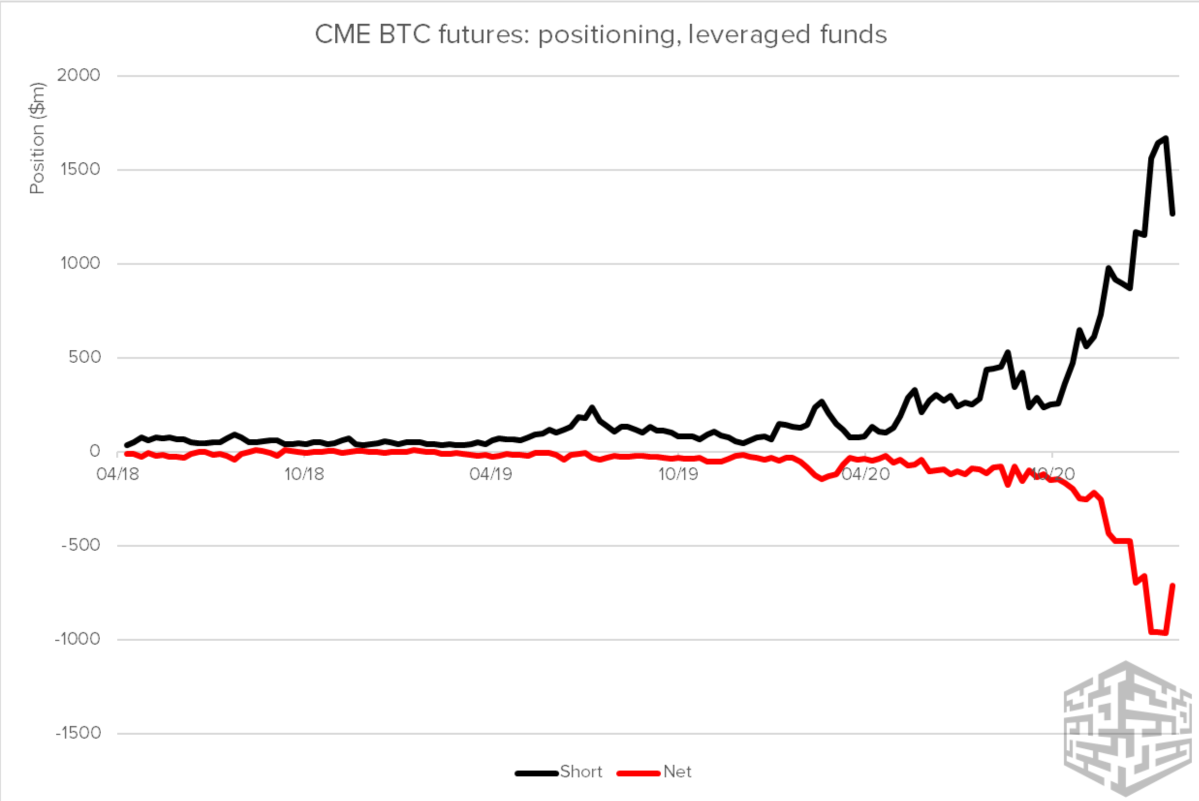
Gains in small-caps fairly even across the board, mostly underperforming ETH and slightly outperforming BTC. Not much to say about most of the large-caps, but would keep an eye on DeFi alts – performed strongly last week, but have been slight laggards this week, and could pick up again in coming days.

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

Major						
Ticker	Price	7D	1M	6M	12M	Cap
BTC	37195	21.1%	15.5%	214.1%	277.2%	692.5B
ETH	1608.6	27.7%	54.0%	303.6%	619.4%	184.2B
LTC	152.43	23.6%	-2.2%	160.1%	104.8%	10.12B
BCH	445.77	18.5%	9.6%	45.7%	1.1%	8.31B
EOS	3.114	24.0%	10.5%	1.7%	-32.1%	2.96B
Selected						
Ticker	Price	7D	1M	6M	12M	Cap
DOT	19.25	24.6%	101.3%	516.1%	558.6%	17.42B
ADA	0.4387	39.8%	94.5%	198.6%	634.7%	13.82B
LINK	24.90	19.6%	83.3%	96.0%	654.2%	10.06B

Debunking the BTC 'short squeeze'

You may have seen a chart along these lines at some point in the last few days:



Data via CFTC.

The accompanying text on said chart will be something like this: "Look at who else is shorting heavily! It's time to rinse the hedge funds once again! Hashtag GME!" Or some similar populist call to that effect. (The graph will also probably have been taken before that dip last week.)

Now, far be it from us to shut down a bullish call to arms on BTC. However: the messaging here is misleading, and this feels like something of an opportunity to educate, with regards to where those figures are coming from and what they actually mean in practice.

To start out with: these actually come from one of our favourite sources in the form of the CFTC Commitments of Traders (COT) reports. To crib from the CFTC's website:

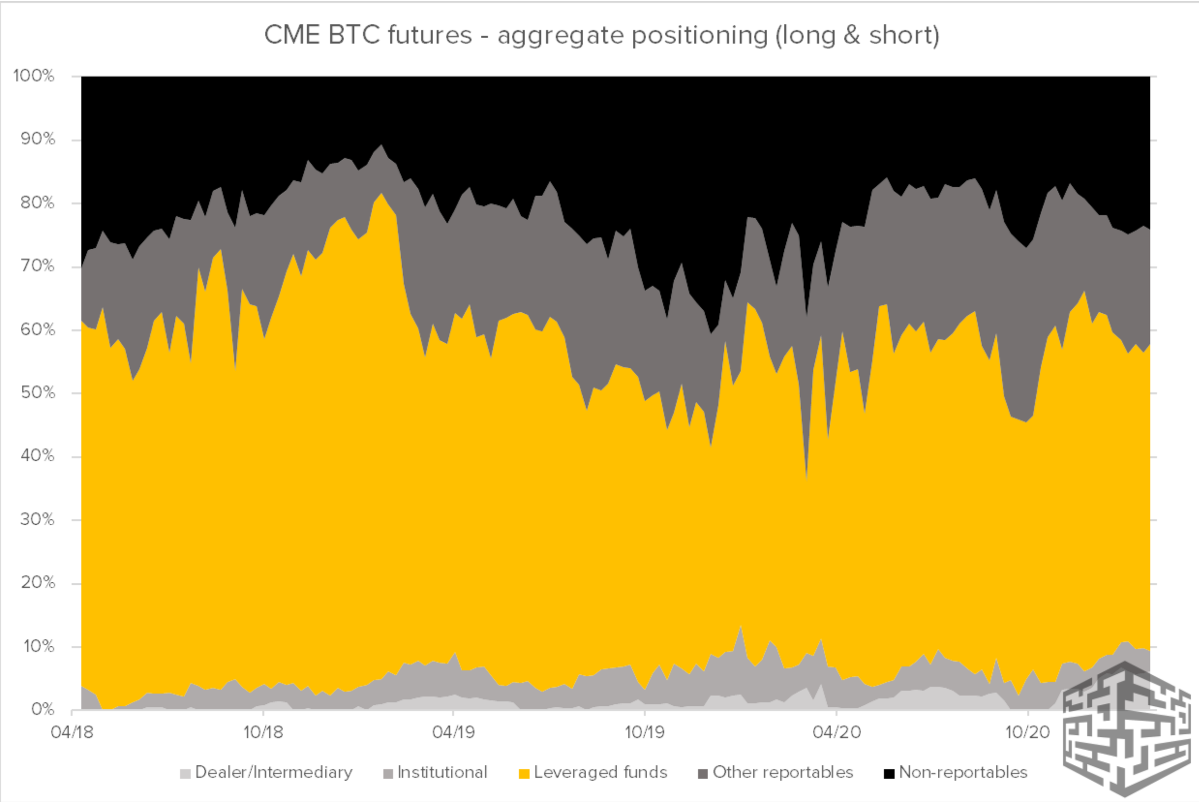
> The Commodity Futures Trading Commission (Commission or CFTC) publishes the Commitments of Traders (COT) reports to help the public understand market dynamics. Specifically, the COT reports provide a breakdown of each Tuesday's open interest for futures and options on futures markets in which 20 or more traders hold positions equal to or above the reporting levels established by the CFTC.

Essentially, any product that comes under the CFTC's remit has a weekly snapshot taken of open interest and long/short positions, which are published in the aggregate and with a limited breakdown with regards to the category of firm holding said positions. These categories are:

1. Dealer/Intermediary - banks, derivatives dealers, etc.
2. Asset Manager/Institutional - to quote the CFTC explainer, "pension funds, endowments, insurance companies, mutual funds"...there is an extremely high bar here for what counts as an institutional buyer, and essentially only those with the most restricted of remits end up here.
3. Leveraged Funds - anything that could be reasonably described as a hedge fund in any capacity, ranging from multi-billion-dollar superfunds to small family offices.
4. Other Reportables - this is anybody that doesn't fall into another category, holds large enough positions to fall under reporting requirements (which, on BTC, is 1 contract, or 5 BTC - i.e. all firms fall into this category), and is a large enough firm to be required to report trades in general.

The unofficial other category is non-reportables, which is simply any market participant that does not meet the four requirements above.

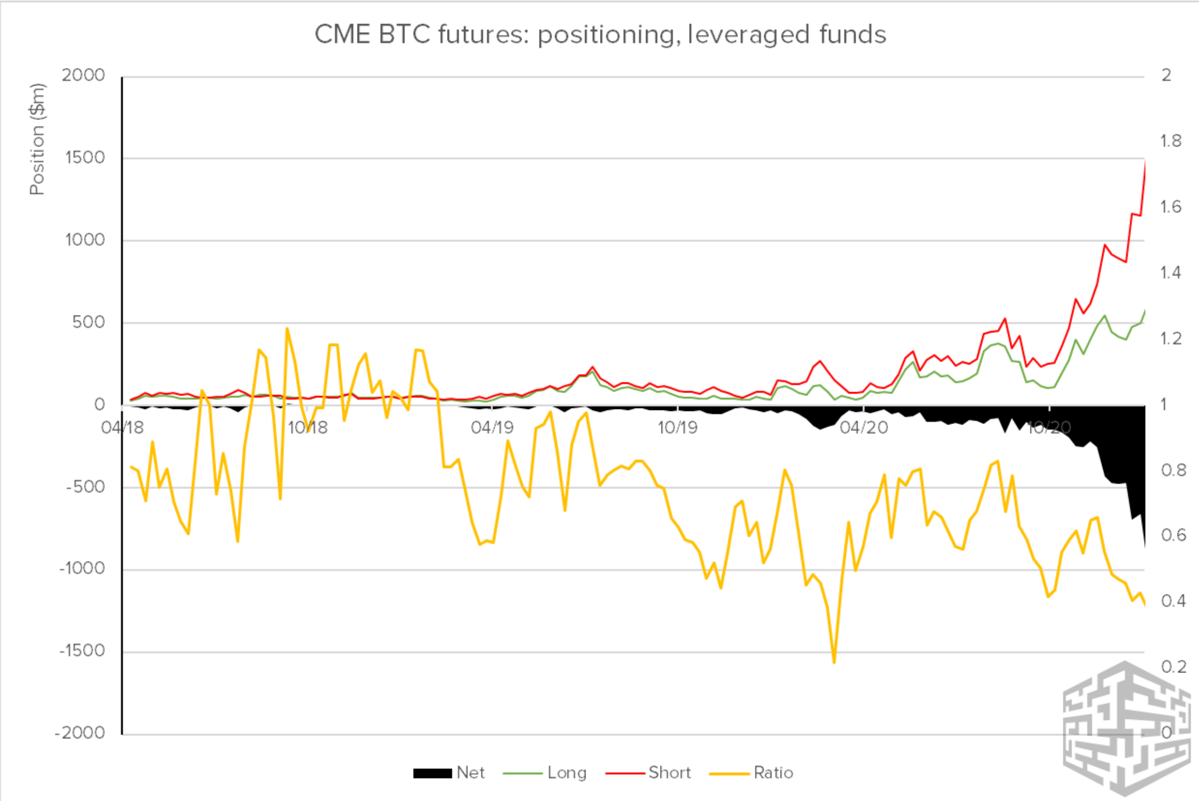
What does this mean with regards to BTC? The first thing to understand is that the 'leveraged funds' category makes up the overwhelming majority of trade in general on BTC futures, and has consistently done so since the market became big enough to be generally reportable (i.e. trader count rose above 20) in April 2018:



Data via CFTC.

While the CFTC figures have some minor issues with potential double-counting from spread positions and the like, the overall trend is inescapably consistent: leveraged fund positions have made up between 45% and 70% of all positions since inception, with the other two defiend categories holding a tiny share, and other reportables and non-reportables making up the difference.

That's the first thing to understand. The second is that leveraged funds, as a category, are indeed at record levels with regards to being net short right now. However, if we take the ratio rather than merely the net, we see a slightly different picture start to emerge:



Data via CFTC.

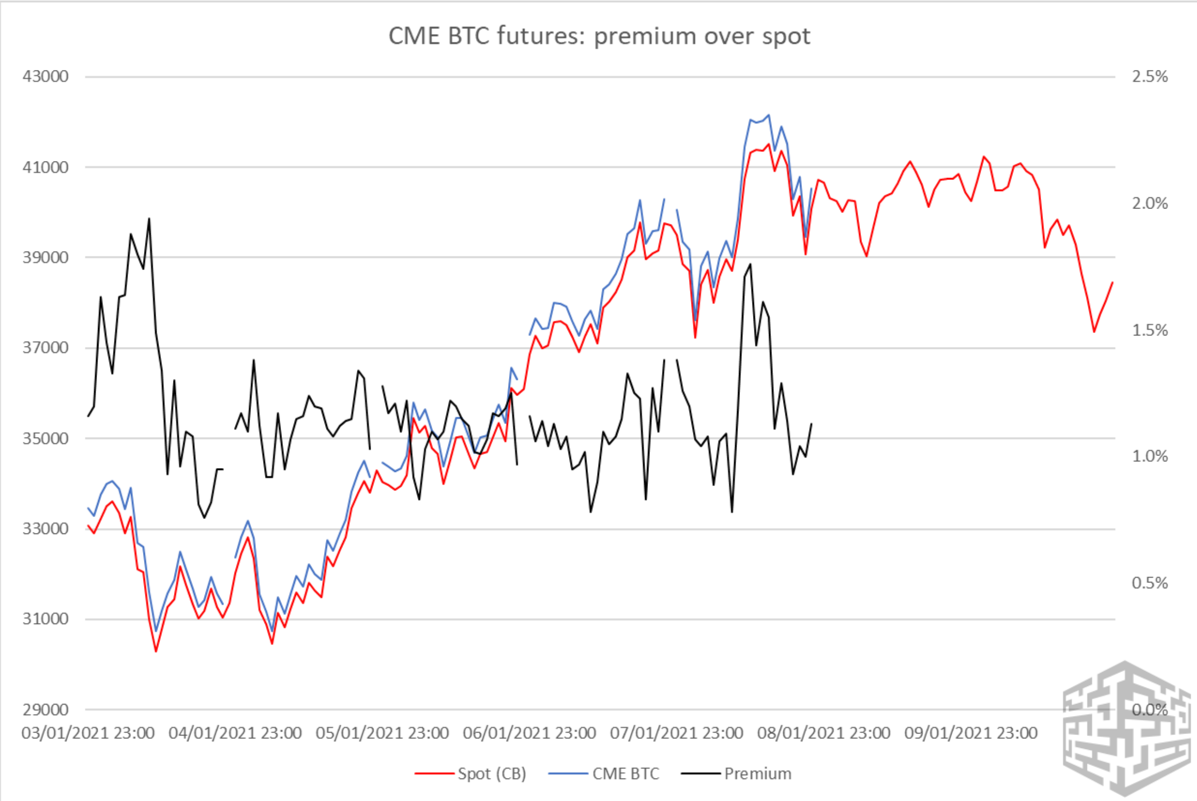
Leveraged funds are heavily short right now, but not unprecedently so; the 'record net' is coming from BTC's own hyper-appreciation.

So, no sudden short rush, which brings up the next question: is there some long-term drive to keep BTC price down from said funds? Well, in the first place, if there has, it's been failing to work for a long time, given that we saw the same ratio of positioning at $10,000 as at $37,000. But the reality is that these figures, fundamentally, don't represent a directional bet on BTC.

There are, by this point, plenty of true believers in the institutional ranks with regards to the promise and directional outlook for Bitcoin and crypto long-term. But just as important as the true believers, from a markets perspective, are the people who are simply ready to acknowledge Bitcoin. They may not believe in it as a directional asset, but they believe - and acknowledge - that it's just not going to collapse suddenly or disappear.

That stability opens up the door for every professional's favourite trade - the arbitrage trade - and when all's said and done, this is the entirety of what's happening here. As with most assets of a similar nature, BTC trades consistently in contango;

Hence, if one longs spot, shorts futures, and liquidates their spot as the future expires, they will usually see a decent return - for instance, in the first week of January, CME traded at a premium of between 0.76% and 1.94% on each hourly close:



Data via CFTC

This has been a large driver of interest in CME BTC, and the single largest driver in terms of the long-term growth of that net short - this isn't speculators weighing against BTC, but rather diretctionally-neutral actors looking to take advantage of a market opportunity.

So: the idea that there is some huge institutional short on BTC is just not at all accurate. The funny thing about declarations like this is, of course, that there are multiple readings one can make of it - bearish in terms of continued suppression, bullish in terms of a GME-like 'retail revolt' in favour of BTC (though we've quickly seen how long that tends to work when talking about setting a mob upon a single asset…) - but all readings are essentially extreme ones, forecasting massive volatility and massive gains or losses.

We continue to lean bullish on BTC in the medium-term and long-term as always, and we are mindful of the state of markets in general right now with regards to the 'retail mob' and the like. However: don't get caught under any false pretences here.

Even if the narrative here does end up taking hold, crypto markets right now, especially with reference to BTC, are not set up for the same sort of structurally-driven action that we have seen over the past couple of weeks elsewhere; that's by no means a portent of an actively bearish situation, but don't fall for the promises of mania being made by some (and if we are to see any such carryover with regards to a general mini-bubble, it will most likely be on ETH and the DeFi space rather than BTC).

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.