ENIGMA SECURITIES

De-Coding Crypto

Weekly Analysis

Examining the SPX-BTC truism

April 1, 2020

In this week's issue, we look at the truism that emerged over the course of March about crypto markets and equities being tightly correlated, whether that relationship is already waning, and how it might hold over the coming months.

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Our Market View

May you live in interesting times. Another very calm week overall – looks both higher and lower never fully materialised, and most major assets find themselves a couple of percent up or down overall, with the major exception being XRP bouncing up by about 10% going into the weekend.

The broader message is the same as it has been for the last two weeks: the situation looks better in terms of crypto specifically (with regards to questions of market structure and overall confidence among participants in the inherent health of cryptoassets), and overall the magnitude of downside risk does seem to be reducing – but the macro situation is not even closed to being priced-in on traditional markets as of yet, and things could still move in unexpected ways when effects there come to pass.

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

Major

Ticker	Price	7D	1M	6M	12M	Cap
BTC	6298.47	-3.64%	-28.65%	-22.67%	28.39%	115.
ETH	132.073	-1.79%	-42.15%	-25.24%	-16.26%	14.5
XRP	0.17212	8.98%	-27.28%	-32.04%	-47.78%	7.56
BCH	217.401	0.62%	-33.86%	-2.62%	-24.00%	3.99
LTC	38.3878	-0.51%	-36.44%	-32.41%	-54.73%	2.48
EOS	2.20229	-2.90%	-40.18%	-26.55%	-56.66%	2.03

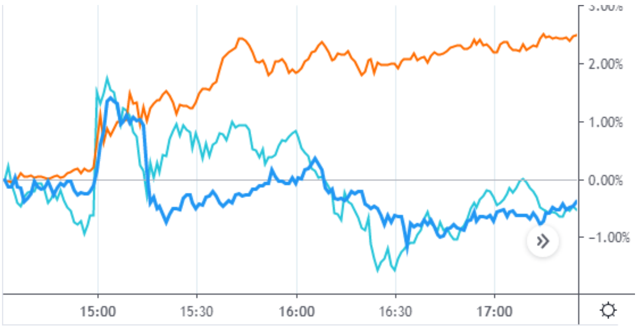
Selected

Ticker	Price	7D	1M	6M	12M	Cap
XTZ	1.59376	-4.29%	-42.68%	74.11%	87.36%	1.12
LINK	2.27753	2.65%	-47.08%	15.77%	-2.02%	0.80

Examining the SPX-BTC truism

One of the big truisms that has emerged over the last few weeks has been this: in the short-term at least, BTC and equities are marching in lockstep, and will likely continue to march in lockstep. This is something that we first noticed in earnest back on 3rd March, and wrote about in the next day's Weekly:

> 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.



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.

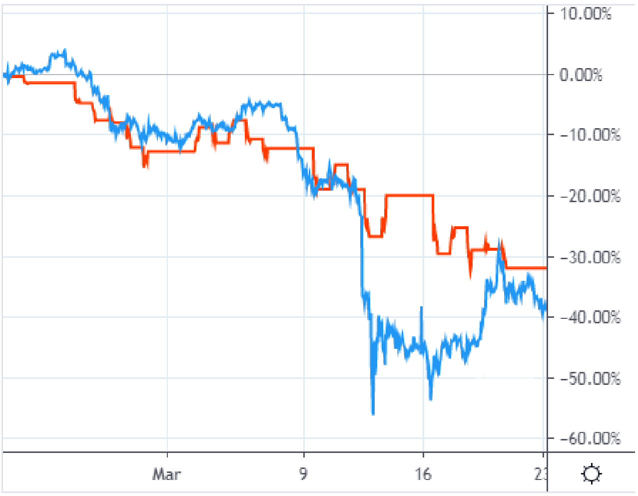
At the time, this was something of a surprising development (and not a particularly conclusive one). BTC and SPX were both coasting off recent highs, and had been drawing down over the prior couple of weeks; at that point, the short-term relationship looked fairly existent, but not so aggressively as to serve as confirmation.

Following the events of the last month or so, however, the relationship now looks far stronger and far more 'confirmed' than it did then, to the extent of forming a valid truism at least to some degree.

The ultimate questions with truisms are ultimately this: under what parameters are they useful, and how long will they be useful for? It is hence worth at least touching on both these points today.

1) Under what parameters is SPX-BTC correlation useful?

From early March up until Black Thursday, this was very simple: BTC was moving extremely closely to equities on all time frames. Since Black Thursday, the picture has become a little more complicated. We should start by reiterating our working understanding of the Black Thursday selloff itself; the first stage (where BTC went from $7300 to below $6000), just ahead of the market open, was foreseeable from a mile off, but with specific relation to the SPX, probably represented something of a (less foreseeable) unfurling of tension that had been building since the SPX top:



Credit: Tradingview. BTCUSD (Coinbase) in blue, SPX in orange.

Despite correlations being high enough that it was clear that the short-term relationship was now overwhelmingly likely to be partially causal, BTC was still outperforming; that, combined with the overall shock from the second-biggest day of equities losses since 1987, came to a crashing halt. The further crash during the early hours of Friday morning (at the Asian open) seems to have owed more to internal market dynamics, and ended up being very quickly retracted in full.

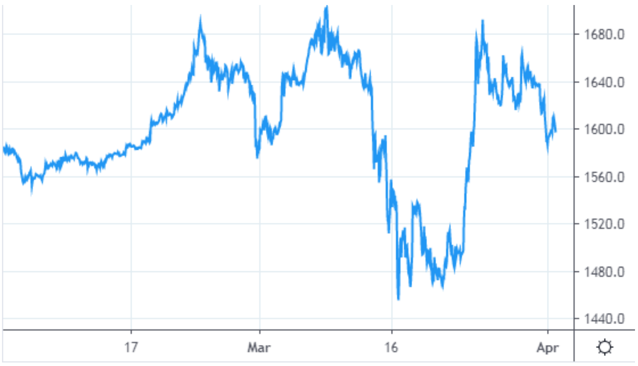
Since the end of the equities trading week on 13th March, the picture has slowly differentiated itself:

Credit: Tradingview. BTCUSD (Coinbase) in blue, SPX in orange.

Correlation isn't quite as non-existent as the graphs would perhaps imply (mainly fueled by an outsized run-up from a $4800 open and $4400 low pre-market for BTC on the 16th), but it is clearly weaker, with the past week and a bit in particular painting a very specific story. We still do see peaks and troughs from the two roughly working in concert, but on the whole, the tightness of the relationship has been waning no matter how one adjusts the axes, and it seems likely that we are at least back to something like the situation prior to March in that regard - where BTC would move on those sorts of events that moved absolutely everything (the Iran crisis, or the emergency rate cut), but not specifically exclusively as something between a risk-on asset and a pure equity proxy.

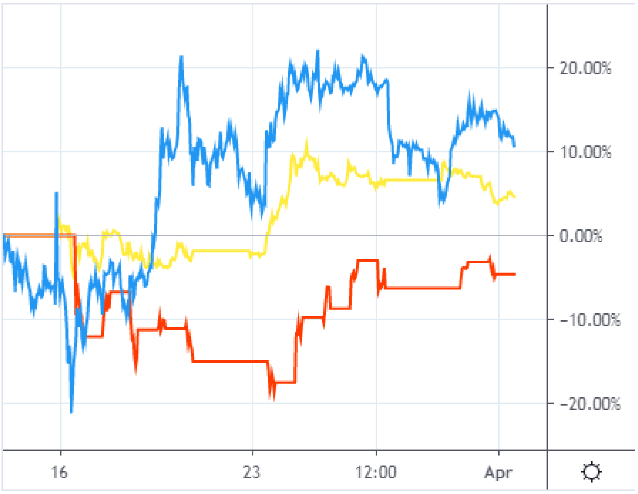
2) How long will [the truism] be useful for?

The short answer, as mentioned, is that correlation is fading and that it already appears to be becoming a less useful truism for understanding BTC movement. That probably downplays how cautiously it should be approached in terms of being a risk factor, however. The easy response here is to point to gold since this crisis has come into view:



Credit: Tradingview. Gold futures contract, COMEX.

Gold has been more stable than the vast majority of assets since the equities top, but took heavy losses by its own standards during the several days of panic in mid-March, losing about 15% peak-to-trough. Since reaching that trough, it arguably has been more closely correlated with equities than BTC has:



Credit: Tradingview. BTCUSD (Coinbase) in blue, SPX in orange, GC1 in yellow.

The concern, however, is still not the day-to-day; it is, and will continue to be, whether crypto comes under pressure in another wave of equities losses (which we have to presume are coming at some point in Q2; it still does not past muster at all that the economic ramifications have been priced in even if somehow COVID-19 disappeared tomorrow and everything were able to proceed as normal immediately).

Our tendency right now is to think that the situation is improving in that regard, albeit modestly. Volumes and OI on retail venues remain far below where they were prior to the crash, and CFTC figures continue to hit new local lows (open interest dipping below 4000 contracts for the first time this year on the 24th). These are not great signs (though it should be emphasised not too disastrous either - that OI figure is still higher than any time in Q4 2019, for instance), but what they seem to imply above all else is something of a short-term rationalisation of the market - a shaking-out of overleveraged positions and overly-aggressive market markets.

When the next shock comes, BTC will likely still take a hit; however right now, the signs are growing that crypto will be put under proportionally modest pressure, and that we won't see an existential-level threat to market structure again (as happened on the second wave down on Black Thursday). Current price action has not exactly been encouraging in terms of a true short-term or medium-term bull thesis (and we would learn bearish for near-term outlook at current levels), but it has been encouraging with regards to BTC decoupling from the SPX; nonetheless, constant vigilance will be needed in dealing with the risks that will continue to be presented over coming months.

What we're reading

The cryptocurrency space is a 'no-man's land' right now, says CMS Holdings partner Bobby Cho (The Block): "We've been deploying more capital toward our active trading strategies versus our investment side of things," he continued. "We don't know what the world is going to look like in the 6, 8, 12 months from now, especially with where the crypto prices are today." Underlines the very real problem we're faced with now – no matter how much one believes in BTC and cryptoassets as a class, the current situation forces even true believers to keep a couple of toes out of the door just in case things turn sour.

Ex-State Street Blockchain Team Drops DLT From New Data-Privacy Startup (Coindesk): This is a trend we've been seeing a lot of lately – blockchain is not in itself a sexy term, and even projects like Manetu (whose seed round is being led by the cryptoendemic Castle Island Ventures) are quietly dropping blockchain elements from projects if they don't actually provide some sort of advantage to the project itself. Bad news for cash-grabs, but in all honesty, good news for those projects within the crypto and blockchain space that can show that they can add value.

Lowest Exchange BTC Balances Since 2019 — Calm Waters Ahead? (Cointelegraph): Headline question asides (probably not), it's going to be important to keep an eye on the big retail exchanges over the coming months. Most major players left in the space at this point are sufficiently capitalized that they should be able to deal with the effects and after-effects of the macro crisis no matter what, but it would only take one or two major failures to undermine a lot of the relative confidence that has been built up on the retail side over the last couple of years.

Capitulation? BTC Battered by Biggest Mining Difficulty Drop Since 2011 (Cointelegraph): Sometimes, these difficulty adjustments are just variance; this was clearly not one of those cases, with a consistent drop-off in implied hash rate that slowly but surely intensified following the 12th. Despite this, we would tend not to read too much into it either way (because it can be read either way – bearishly as a show of non-confidence from miners, bullishly because there has been a tendency in the past for such contractions to mark local bottoms for price); without a massive price appreciation, most 2016 and 2017-era miners were headed for marginal unprofitability post-halving anyway, so more than anything this likely represents the turning-off of machines that were to be scrapped within a matter of weeks anyway.

Until next week – thank you for reading.

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