De-Coding
Crypto

Enigma Weekly

9th December 2020

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

Our Market View

May you live in interesting times. One of those weeks where the weekly figures are perhaps a touch misleading – we are down across the board, but have mostly been trading in the same sort of range between $18,600 and $19,400, having just happened to drop off yesterday (slipping quickly to lows at $17,600 after losing $18,500).

We are in something of an imperfect place technically – $18,500 is a worrying level to lose, and in general we haven't been seeing what we would want with regards to re-establishing momentum in the $19,000s for an end-of-year push – and with regards to indicators like fund positioning that we mentioned last week, the signs in truth aren't too good with regards to a strong end of the year; a break upwards could still move very quickly, but we are increasingly minded to think that we don't get that break and perhaps slip as low as the $16,000s towards the end of the month – relatively limited in the grand scheme, but still a potential -15% or so from current levels.

On alts, little has changed: expecting underperformance for the most part, overbought projects like XRP continue to lead on the way down but most things outside of ETH are in a similar boat. Worth nothing that XRP is only a few days out now from an airdrop snapshot – balances will be logged in December 12th for distribution of the Spark utility token – and we would tend to expect a potentially significant drawdown in the immediate aftermath of said distribution (especially if price continues to trend down towards that vital $0.50 point pre-snapshot).

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

Major

Ticker	Price	7D	1M	6M	12M	Cap
BTC	18388	-3.30%	19.72%	93.75%	155.30%	341.4B
ETH	569.73	-3.56%	27.86%	138.70%	292.70%	64.81B
XRP	0.55466	-10.50%	119.00%	185.50%	151.70%	25.16B
BCH	266.69	-8.16%	0.83%	10.71%	29.14%	4.96B
LTC	76.54	-11.52%	28.74%	69.23%	74.88%	5.06B
EOS	2.79133	-8.01%	11.38%	6.87%	7.78%	2.63B

Selected

Ticker	Price	7D	1M	6M	12M	Cap
LINK	12.39	-10.34%	-1.72%	199.50%	483.70%	4.90B
ADA	0.14373	-7.93%	35.39%	80.65%	290.90%	4.47B
XTZ	2.163	-9.96%	3.14%	-19.99%	22.01%	1.63B

Explaining the 2020 ETP boom

If one looks hard enough, I am sure that one could find someone, somewhere, that foresaw any given 2020 trend in crypto markets at the start of the year; we are, after all, an industry of prognosticators above all else. However, while I don't doubt that there was somebody out there who can lay claim to it, one of the least crowded areas with regards to euphoric predictions at 2019's end was with regards to the ETP market.

To give something of a heat check, Ryan Selkis (of Messari Research)'s annual Crypto Theses document, which weighed in at 71 pages last year (and 120 this year), dedicated about a page total to ETF discussion, and most of what they said had a tinge of long-term optimism, but was not overly enthusiastic short-term:

> [My 2017 call re: passive indices, e.g., ETFs, eventually overtaking funds] was arguably right, but I overestimated the probability of crypto ETFs getting approved within two years, which is what continues to make crypto funds so attractive. As it turns out, the regulators only want to approve crypto products that depress the price, not add fuel to the fire.

On the 2020 outlook:

> It seems as though pretty much every country aside from the U.S. will have a Bitcoin ETF/ETP by the end of 2020…Still, the SEC doesn't look like it's budging in the election year…I still don't understand how the SEC can allow Grayscale's products to trade (with their ~30% premiums), and not go ahead and bless the damn ETF. It's embarrassing. Bitcoin's markets are at least as transparent as the commodities markets, with much tighter spreads, and arguably less price manipulation.

The full report can be found here, for reference (there is a 2021 version that should be out as of the time of publication); all in all, however, not the strongest statements (in a report full of strong statements) with regards to any potential ETP boom. To be clear, we're not singling out Messari or Selkis here, but just using them as an example of what really was the consensus view overall - expectations were not high without greater market access.

Not only did we not get that access in 2020 for the most part (and with regards to the UK, we actually took a step back with the ban on retail clients in the autumn), it wasn't even on the table at any point. Bitwise's ETF attempt was rejected in October 2019, andd withdrawn in January 2020; this left Wilshere Phoenix as the only possibility for a 2020 ETF, and its proposal was rejected in February. It has been widely accepted since before January 1st that no US ETF was coming in 2020 (as Selkis correctly says), and while efforts like 3iQ's Toronto-listed QBTC were on the horizon and were interesting in that regard, they just weren't that holy grail.

However, in spite of that in 2020, the crypto ETP market has gone into overdrive. A quick look at the GBTC AUM chart immediately tells much of the story:

Data via Ycharts.

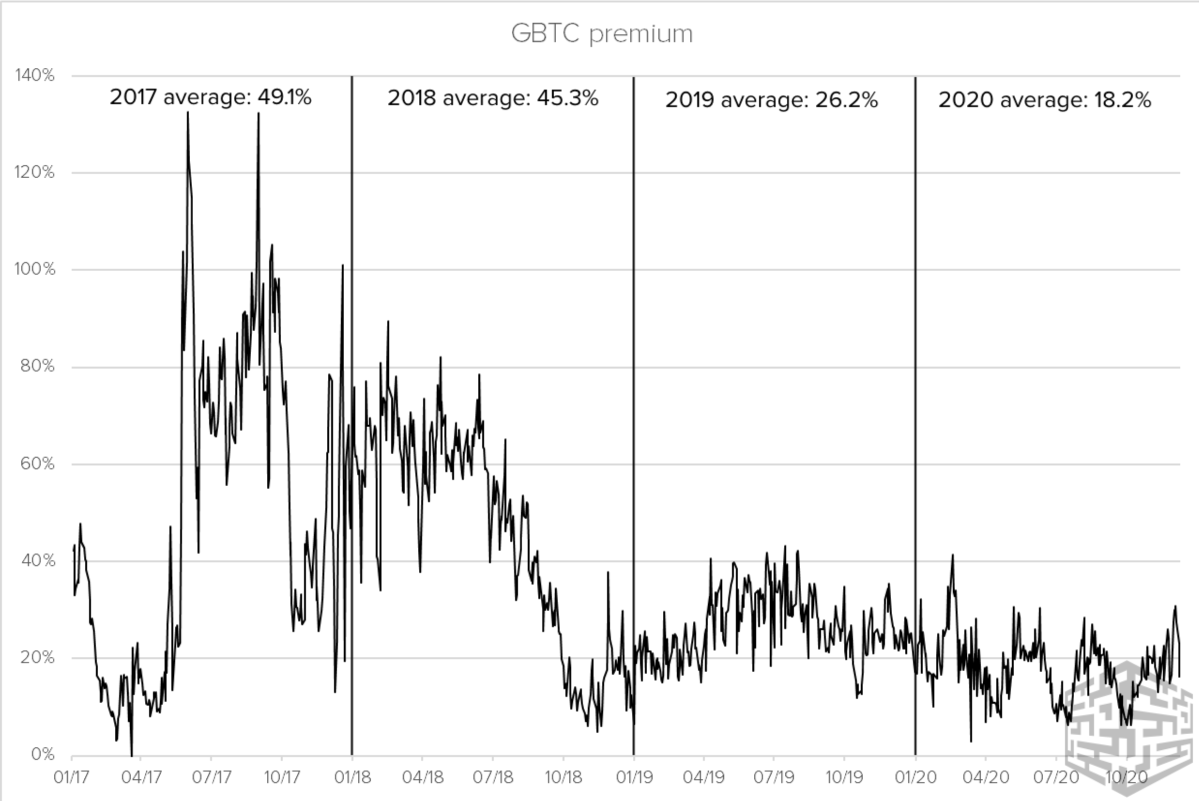
GBTC AUM is up over 400% YTD (on just over a 150% appreciation of native asset price), cresting $10bn last month. For a point of comparison, the AUM of the largest gold ETP is $70bn; while that ETP makes up a smaller share of the total gold market (30% compared to around two-thirds for GBTC), it still very vividly makes the point that for the first time ever, the crypto ETP market is an actually-sizeable entity compared to traditional assets. In fact, in terms of its holdings in BTC terms alone, it grew more in the last year than in the previous four years combined:

GBTC	AUM, $m	BTC, $	Derived holdings	Growth ($)	Growth (BTC)
29/12/2015	59.94	422	142119		
27/12/2016	157.22	898	175004	162%	23%
27/12/2017	2741	12532	218728	1643%	25%
28/12/2018	765.04	3797	201482	-72%	-8%
31/12/2019	1881	7316	257100	146%	28%
08/12/2020	10570	18316	577091	34%	124%

Data via Ycharts. Holding estimates are derived from AUM data

The ETP has been a breakout product. Why has this been such a surprise, and what does this tell us about the state of crypto markets this year? To start with, on the surprise point: for those professionally in the space, it can be very, very, very easy to look down on ETPs, because with regards to usage by professional traders and the like, they don't really come into the equation; by their nature, they can't compete with spot or derivatives products in terms of liquidity, and in their current form, they don't quite peg closely enough to NAV to be useful for active trading.

Take the Grayscale premium so viciously criticised by Selkis, for instance:



Data via Ycharts.

There is a definite long-term negative trend on the premium as it becomes easier and easier for clients to gain exposure to BTC in other ways, but while it has decreased significantly over the last two years, it has never fully flattened, and still maintains an average of 18% full-year for 2020 (which seems likely to end up higher, not lower, by year's end as it stands).

The premium, and the unpredictability therein, makes most crypto ETPs unattractive to active traders. However, for those simply looking to buy-and-hold, to hold exposure over the course of months and years rather than days and weeks? The premium is, at worst, a relatively minor concern - with reference to Grayscale, and with reference to other products like 3iQ's QBTC, on the buyer's side, it can be seen as a cost of doing business more than anything else.

Further, for some market participants, it's a significant positive, because it presents an opportunity. For many years, the bulk of new share creations in GBTC (and again, note how the actual BTC holdings of the fund grew relatively slowly in prior years) were made by BTC miners putting new issuance into the fund - the idea there being that they were able to create at NAV, hold the shares for a period (initially 12 months), and sell then later for essentially the value of the underlying plus the premium. It was a good way to earn a significant amount of extra value, if you were happy to hold the underlying for that period, and if you were able to create shares under the accredited investor definition.

So, what happened in 2020? There were some minor contributors (like the softening of the accredited investor definition), but there were two major pillars here:

1**) Institutional-level actors gained confidence in holding BTC directly or one-layer-removed.** Even if one remained critical of BTC's long-term value proposition, it became clear in 2018 and 2019 beyond all reasonable doubt that there was going to be enduring value of some kind for BTC on a long-term basis; that combined with an expansion of institutional-grade custodial offerings opened the door to positions that touched BTC on a directionally-agnostic basis at least.

2) **The general institutional-level infrastructure for crypto loan offerings has come along massively in a very short period of time** - moreso in terms of loaning of cryptoassets rather than cash loans collateralised by cryptoassets, though both have done well, as exemplified by a number of loan desks (including Enigma's own).

This, hence, opened the door for many institutions to take arbitraged positions through GBTC - creating the shares through an execution agent on the basis of loaned BTC, holding the shares and the loan liability to the end of the creation lockup period (which was at this point down to 6 months), and selling the shares and repaying the loan liability to collect only the premium without being exposed to underlying price fluctuations.

We have essentially seen a perfect storm on both sides of the equation. On the one hand, we had large numbers of interested investors who were either unable (due to mandates etc.) or unwilling to deal with spot BTC, and hence continued to provide sufficient demand on ETFs to buoy the market; on the other, we had institutional actors who now felt confident in essentially providing a form of liquidity to said markets.

Hence: the boom on Grayscale, and gains on other ETF products also, with eight in BTC or ETH (including two 2020 launches in 3iQ and ETC Group) at above $100m AUM right now, and all but one (Bitcoin Tracker One, which has been affected by UK regulatory issues) seeing growth beyond the valuation of the underlying assets in that time:

Product	Asset	Issuer	Listed in	AUM ($, 07/12/20)	AUM ($, 01/01/20)
Grayscale Bitcoin Trust	BTC	Grayscale	OTC	10570	1881
Grayscale Ethereum Trust	ETH	Grayscale	OTC	1671	65
Bitcoin Tracker Euro	BTC	Coinshares	Stockholm	803	250
The Bitcoin Fund	BTC	3iQ	Toronto	321	0
Ether Tracker Euro	ETH	Coinshares	Stockholm	265	47
Bitcoin Tracker One	BTC	Coinshares	Stockholm	430	203
BTCetc	BTC	ETC Group	Frankfurt	183	0
Ether Tracker One	ETH	Coinshares	Stockholm	116	22

With regards to what's next, we have a few broad points of note.

1) **Premiums will probably continue to compress on BTC ETPs, but it will continue be a slow trend, and we will see ebbs and flows on it.** Margins on these arbitrage trades are likely to get tighter, and require better execution, but the concept itself remains in-play for the time being.

2) **Not every new market will present a major opportunity, but even ex-US, there are probably still areas that can be tapped.** QBTC has been a great recent example of that. Ultimately, what matters here is demand leading into liquidity to enable said products, and potentially similar trades, so e.g. we're not raising the roof for a listing in Ulaanbaatar or what-have-you; still, there does still seem to be some opportunity space there.

3) **We are still growing into the digital gold narrative, but we are growing into it, and that presents a promising trajectory.** Remember: when the first gold ETP was listed in the US (in 2004), gold was trading at just over $400/oz. It was $800 by the end of 2007, and over $1600 by the end of 2012. The market itself went from $2bn to $24bn to $148bn in that time.

Developments in ETP markets this year, in concert with the broader global financial situation, have been very reminiscent of 2007; without looking to make too crude of a comparison, it does nonetheless suggest to us that we remain early in those developments, despite how much ground we have already gained in that regard.

Partner content

Iconic Funds Issues Report on Bitcoin Trading Strategy Performance

Iconic Funds commissioned a research report to determine the effectiveness of traditional trading strategies when applied to Bitcoin. The empirical study analyzed three common strategies, namely Trend Investing, Turnaround Investing and the so-called "Halloween Strategy", and compared their returns to a passive buy-and-hold exposure. Data was sourced from Bloomberg and considered multiple time periods over the past decade.

The research determined Trend Investing strategies are highly effective when applied to Bitcoin. Multiple moving-average strategies were reviewed with nearly all outperforming the buy-and-hold benchmark over the same time period. The same could not be said for Turnaround strategies, which yielded a wide variety of results with no discernable pattern when applied to Bitcoin. The report concluded that while buy-and-hold strategies, when applied to Bitcoin, have historically yielded unprecedented returns, well-devised and executed Trend Investing strategies are the top performers.

"Bitcoin may be largely uncorrelated to traditional markets, but that does not mean traditional strategies don't work well when trading it", said Patrick Lowry, CEO of Iconic. "While I am a buy-and-hold investor myself, disciplined traders who take advantage of Bitcoin's infamous volatility with tried-and-true strategies have a massive opportunity to generate immense returns for investors. This is why Iconic launched our Multi-Manager platform earlier this year, to empower up-and-coming managers with such strategies and offer investors exposure to them."

The "How effective are common investment strategies with Bitcoin?" research report marked the third empirical study commissioned by Iconic Funds this year. Previous reports focused on the impact a crypto allocation had on the Sharpe Ratio of various portfolios as well as an examination of the correlation crypto has to traditional market indices. Iconic Funds' issues such research reports quarterly.

Until next week – thank you for reading.

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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.