ENIGMA SECURITIES

De-Coding Crypto

Weekly Analysis

Following the slow money? CME futures and leveraged funds

October 23, 2019

In this week's issue, we take a look at CME futures – much-maligned for the perceived negative effect of 'expiry week' – and aim to turn it around and find any clues in market direction from position distribution in the lead-up.

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Our Market View

May you live in interesting times. Volatility has continued to be low for BTC throughout October, with scant few threats to trade out of range at all from the market leader. We tend to think that there will be a breakout – most likely upwards – either late in this week or during the next; a lack of a breakout may be market-altering for the worse as we pass into a less than certain November and December.

Meanwhile, there has been more significant movement outside of BTC; in particular, XRP finds itself significantly up on the month so far as it attempts to find and hold above 0.30, and ETH finds itself approaching its September lows – we see a very strong case for ETH being one of the more fundamentally undervalued assets in the cryptocurrency market right now on a short and medium-term basis.

Major

Ticker	Price	7D	1M	6M	12M	Cap
BTC	8005.08	-0.51%	-18.75%	54.88%	24.87%	144.15B
ETH	167.406	-5.13%	-19.90%	7.59%	-16.84%	18.12B
XRP	0.289661	1.37%	3.65%	-0.77%	-36.15%	12.52B
BCH	2.88047	-0.71%	-27.54%	-15.32%	-49.49%	3.96B
LTC	52.6196	-2.11%	-27.54%	-25.32%	2.11%	3.32B
EOS	2.88047	-1.37%	-24.37%	-37.50%	-46.00%	2.95B

Selected

Ticker	Price	7D	1M	6M	12M	Cap
BSV	101.49	16.50%	-12.68%	94.48%	16.49%	1.83B
XMR	56.51	6.04%	-19.83%	-8.40%	-45.35%	0.98B
LINK	2.66357	17.60%	44.36%	15.03%	N/A	0.97B

Following the slow money? CME futures and leveraged funds

The cycle comes around once again. The CME's BTC futures expiry day has been something that has gradually attracted notice, particularly over the last couple of months - first with BTC taking around a 10% loss in the run-up in August, and then again when the timing of the CME expiry with the fallout over Bakkt saw a 20% drawdown from peak to trough across the week.

Research from Norwegian investment and research firm Arcane Crypto suggested that, from January 2018 to September 2019, 15 out of 20 days preceding settlement yielded negatively:

> The trend is striking. Bitcoin falls on average 2.27% towards settlement each month. In comparison, the average on a random day over the same period is hardly negative, with a fall of only 0.06%. If we adjust for large outliers, by looking at the median rather than the average, the trend is even clearer. Then, the average price movement is positive on a randomly selected day, plus 0.04%. If we only look at the period before settlement, however, the price falls by 1.99% on average.

This research only specifically tackles a very short period in futures leadup, too; the full week preceding tends to be significantly more severe. Clearly, a worrying trend; and, with BTC trending positively (albeit not even vaguely threatening to leave range) over the last week or two, we acknowledge concerns of another trap.

We hence looked into the behaviour of investors in CME futures, as defined by CFTC reports, to see if any insight could be gleamed. We primarily looked into this trend with leveraged funds, which are defined in the CFTC as follows:

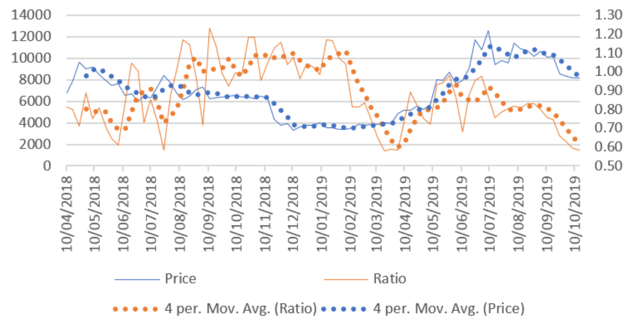
> These are typically hedge funds and various types of money managers, including registered commodity trading advisors (CTAs); registered commodity pool operators (CPOs) or unregistered funds identified by CFTC. The strategies may involve taking outright positions or

or arbitrage within and across markets. The traders may be engaged in managing and conducting proprietary futures trading and trading on behalf of speculative clients.

Leveraged funds make up the majority of the market here; dealers and asset management at the very most account for about a sixth of what leveraged funds contribute (which themselves represent just over half of all positions in most cases). They tend to be net long, but their positions are so small as to be not particularly relevant.

The second-biggest defined portion of the market ('other reportables', counting all reporting traders who are not dealers, asset managers, institutional investors, or leveraged funds) is also typically net short; hence, the overall reported position is essentially always net short. Non-reporting traders – which is generally taken to mean primarily individual speculators in most CFTC markets, given that it comprises of investors with a small enough portfolio that they are not required to report – are always net long, and have provided an increasing share of positions in general, going from around 20% throughout 2018 and the early months of 2019 to 29% at last report (October 15th).

What we find of particular interest is the relation between the long/short ratio on leveraged funds. We define simply as the sum of all short positions divided by the sum of all long positions - a ratio of above 1 indicates that funds are net long, a ratio of below 1 implies that they are net short, and higher or lower determines the severity of that position. Here is said ratio mapped to spot price on each day:



Data: BTC spot prices via Gemini and Cryptodatadownload, Commitment of Trader reports via CFTC.

There is, clearly, a mild inverse trend; leveraged funds were longest when the market was struggling, and shortest when it began its recovery (and continued to be short well into it). What we care about primarily, however, is how well this sector of the market reacts in the short-term to upcoming losses. CFTC data is compiled every Tuesday, and repots on Friday; accordingly, we mapped the spot prices on both days against the next Friday, and tracked the change from both.

Date	LFR	Tue	Fri	Fri+1	Tue-Fri+1	Fri-Fri+1
17/09/2019	0.75	10192	10169	8197	-19.57%	-19.39%
20/08/2019	0.83	10747	10408	9582	-10.84%	-7.94%
16/07/2019	0.76	9429	10535	9851	4.48%	-6.50%
18/06/2019	0.88	9084	10234	12388	36.37%	21.05%
21/05/2019	0.94	7954	8004	8516	7.06%	6.39%
16/04/2019	0.89	5204	5287	5140	-1.22%	-2.77%
19/03/2019	0.58	4001	3987	4083	2.03%	2.41%
12/02/2019	0.81	3589	3567	3947	9.97%	10.64%
15/01/2019	1.17	3583	3608	3561	-0.63%	-1.30%
18/12/2018	0.96	3668	3839	3889	6.04%	1.31%
20/11/2018	1.13	4355	4288	3984	-8.52%	-7.09%
16/10/2018	0.99	6428	6386	6401	-0.43%	0.23%
18/09/2018	1.13	6340	6760	6621	4.44%	-2.04%
21/08/2018	1.14	6477	6692	7017	8.35%	4.86%
17/07/2018	0.74	7323	7335	8192	11.87%	11.69%
19/06/2018	1.05	6741	6077	6202	-7.99%	2.07%
15/05/2018	0.81	8476	8230	7463	-11.95%	-9.32%
17/04/2018	0.8	7894	8855	8926	13.07%	0.80%

While there has generally been a long-term trend of leveraged funds being slower to adjust their positions based on market conditions – particularly with regards to their continuing to take exceptionally long positions across crypto winter, and moving to extreme short positions shortly before the start of the rally from lows in March – the picture in terms of being able to read short-term on that basis is less steady. The elephant in the room is that, over the last three months, the ratio of shorts increased (though we should note that overall volumes from leveraged funds fell from a peak of just under 7000 in early July to 3200 at last report), and all three months saw significant losses over the course of the week.

The important detail here is that the aforementioned last report – October 15th, the last report published before expiry – is reporting the lowest LFR on record (0.58), which is a level we have seen just once before. While the 0.58 ratio on 19/03 did not spark an immediate rise, it did preempt the beginning of the rally in April, and in that case, leveraged funds doubled down hard and only moved when the position had became impossible to deny:

Date	LFR	Tue	Fri	Fri+1	Tue-Fri+1	Fri-Fri+1
14/05/2019	0.93	7995	7362	8004	0.11%	8.73%
07/05/2019	0.72	5745	6378	7362	28.14%	15.43%
30/04/2019	0.75	5266	5660	6378	21.11%	12.68%
23/04/2019	0.82	5538	5140	5660	2.20%	10.11%
16/04/2019	0.89	5204	5287	5140	-1.22%	-2.77%
09/04/2019	0.73	5195	5092	5287	1.76%	3.83%
02/04/2019	0.58	4903	5041	5092	3.84%	1.00%
26/03/2019	0.59	3920	4083	5041	28.60%	23.47%

We do believe that there is some inverse leading quality in leveraged fund positions on futures in general as it relates to BTC. The Bakkt launch in particular was a rare case where we would expect, as a group, for leveraged funds to enjoy an informational advantage over more agile investors in cryptocurrency; this is unlikely to be the case going forward, and hence we see the current net short position from less agile investors as bullish.

At the time of writing, BTC finds itself down around 3% from Monday after a rise on Sunday. While respecting the 'CME effect', we do not see a breakout downwards as likely on the week; our expectation right now would be that BTC most likely continues to trade in-range through expiry week, with the potential for a breakout to the upside during the final week of October and into early November.

What we're reading

Bitmain fulfills commitment to Rockdale, Texas, with launch of cryptocurrency mining farm to construct 50MW facility (Yahoo): Note that this is distinct from the Layer1 news last week. Planned since last August, but a surprisingly confident move nonetheless in the context of concerns over how profitable mining will be over the autumn and winter. Worth noting that hash rate continues to hold up as it stands which is making us more confident than before of not seeing a miner-prompted crash on downward movement in November or December, though we still consider the jury to be out there.

Binance Announces Ruble Trading at Russian Gov't-Sponsored Event (Cointelegraph): Binance continues to play hard and loose. The Russian market isn't all that interesting from a growth perspective, and while 'government sponsorship' always excites, bear in mind that a) Russia has continued to move slowly on crypto regulations, b) Russia spent much of the 00s giving official government positions to spammers and other cybercriminals – it doesn't mean much.

Trump Administration Popped 2017 Bitcoin Bubble, Ex-CFTC Chair Says (CoinDesk): This is coming from Christopher Giancarlo, who has tended to be sympathetic to crypto – crux of the argument is that CFTC permitting futures created an instrument to short and therefore gave a tool to sceptics. Skew Analytics: "Futures markets improved radically the price discovery process for bitcoin - it really kicked off in 2018 and was led by BitMEX & its perpetual swap product The final rip to $20k in Q4 2017 might not have happened in the first place with a more developed futures market" – a fair point. In any case, worth appreciating the progress made towards rationalisation over the last couple of years.

Poloniex and Circle part ways (FXStreet): Retail exchanges continue to struggle with volume, and the threat of a race to the bottom prompted by moves to zero-fee structures among traditional brokers looms. Expect to see a great deal of rationalization in the market over the coming period.

Ripple's XRP Sales Down 73% in Q3 Compared to Previous Quarter (CoinTelegraph): A partially-planned move, it must be said, but while it's certainly possible for XRP to succeed, we remain significantly less confident in it as a long-term value proposition, with long-term use cases, compared to BTC or ETH in spite of its recent gains.

NY District Court Postpones Telegram's TON Hearing to 2020 (CoinTelegraph): Telegram have already delayed issuance until at least April 2020, and at the time of writing, we are waiting on the results of a ballot of investors over whether to scrap the launch as currently formulated entirely. We think that it is entirely possible that it never sees the light of day, but in any case, we see the whole fiasco as one to be avoided on an ongoing basis.

Until next week – thank you for reading.

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