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MAKOR

De-Coding Crypto

Enigma Weekly

27th May 2020

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

Our Market View

May you live in interesting times. A slight down week; failed to hold support at $9600 and ended up drifting all the way back towards $8600 (as was always likely to be the case on such a failure); action since has brought us up and down by a decent margin, but neither end of the range has been seriously tested. Technicals point to some degree of compression and hence we will likely start seeing setup on a bigger move either late this week or early in the next; our bias remains moderately bullish until a close well under $8600.

Alts market has been quiet, but most major alts actually find themselves up very slightly in BTC terms this week; however, none are actually up in fiat, and while there have been a couple of notable moves intraday in areas (ETH, EOS, ADA in particular are worth keeping one eye on), for the most part, there isn't much to say. A rising tide on BTC will lift all ships anyway, but we still lean towards caution on the vast majority of alts, including all non-ETH large-caps.

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

Major

Ticker	Price	7D	1M	6M	12M	Cap
BTC	9138.13	-6.18%	18.55%	20.69%	6.61%	168.0B
ETH	206.331	-3.19%	6.76%	35.78%	-22.90%	22.92B
XRP	0.199353	-2.78%	1.86%	-11.93%	-54.62%	8.79B
BCH	233.400	-5.25%	-1.83%	6.79%	-47.50%	4.30B
LTC	43.5343	-4.12%	-0.52%	-7.99%	-61.96%	2.83B
EOS	2.55036	-3.27%	-5.70%	-7.46%	-70.30%	2.38B
Selected						
Ticker	Price	7D	1M	6M	12M	Cap
BSV	185.99	-7.63%	-4.02%	74.10%	-5.54%	3.43B
ADA	0.553373	-2.73%	23.07%	36.68%	-37.96%	1.44B

Interest re-opened: trends in CME and retail

CME futures and CFTC data

Let's start with something of an old favourite - the outlook on the CFTC end. We last wrote at length about this in our April 29th issue, where our major conclusion at that time was that there appeared to have been a significant bounce in terms of trading activity in the CME's BTC products, both in isolation, and in comparison to other major CME products. Our main conclusion at that time was as such:

> We are at a testing point right now for whether we do end up getting a true breakthrough; our inclination is that we are still probably in the vicinity of the local high, but things like the CFTC indicators clearly do play a part in signaling that the capacity is still there to break further upwards.

At the time of publishing, BTC was trading at $8150; we ended up getting our test ("reaction between about $8300 and $8600 will be crucial") within hours, and we haven't a daily close below $8500 since. With momentum having slowed somewhat over the past two weeks or so - the intraday and closing high both being set on 7th May, and not really substantively challenged since - it seems a good time to revisit.

First: trader count. This is something we have mentioned frequently in the past (see February 19th and April 29th in particular), but to recap: one of the unusual quirks with CME futures is that, via the CFTC Commitments of Traders report (published Friday, accurate as of that Tuesday), we get a snapshot of not only the balance of positions, but the number of entities holding said positions, and this has over the last few months been of particular interest as an indicator of new money coming (and going) from the market. We tend to pay particular attention to the total count, and to the long/short/spread positions for those under the leveraged funds category.

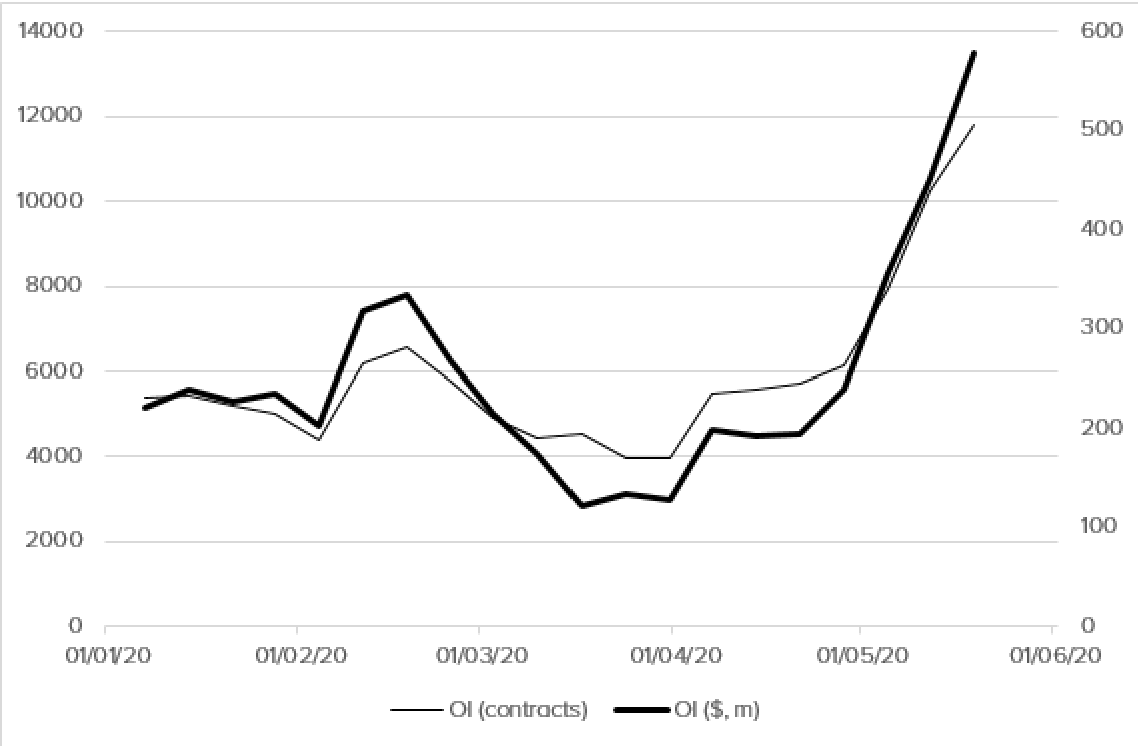
With that in mind, here is the latest on that front:

Date	Tot	LFL	LFSh	LFSp
avg. 12/2019	44	10	14	4
avg. 01/2020	57	20	13	9
avg. 02/2020	56	20	12	7
avg. 03/2020	42	11	14	4
07/04/2020	55	16	17	7
14/04/2020	62	16	21	7
21/04/2020	60	17	20	7
28/04/2020	54	13	16	6
05/05/2020	66	16	20	9
12/05/2020	71	19	23	11
19/05/2020	**75**	**23**	**21**	**12**

Data via CFTC.

For avoidance of any doubt here: this is a very, very dramatic shift. As we said in that aforementioned April 29th issue: "The April 14th figure, for reference, is an all-time high; the previous record was 61 on February 18th, while the 2019 high was 56 on July 9th, and the 2018 high was 46 on December 24th." We have set a new high in that regard in all of the last three weeks, in the context of a market that, yes, has been performing well, but is actually still roughly flat over the course of May.

Looking more conventionally, open interest has also absolutely skyrocketed post-halving, with there being a good chance of it having out-and-out doubled (in BTC terms) at month's end in May, and in any case is up from a low of $122m post-Black Thursday to $577m as of last Friday:

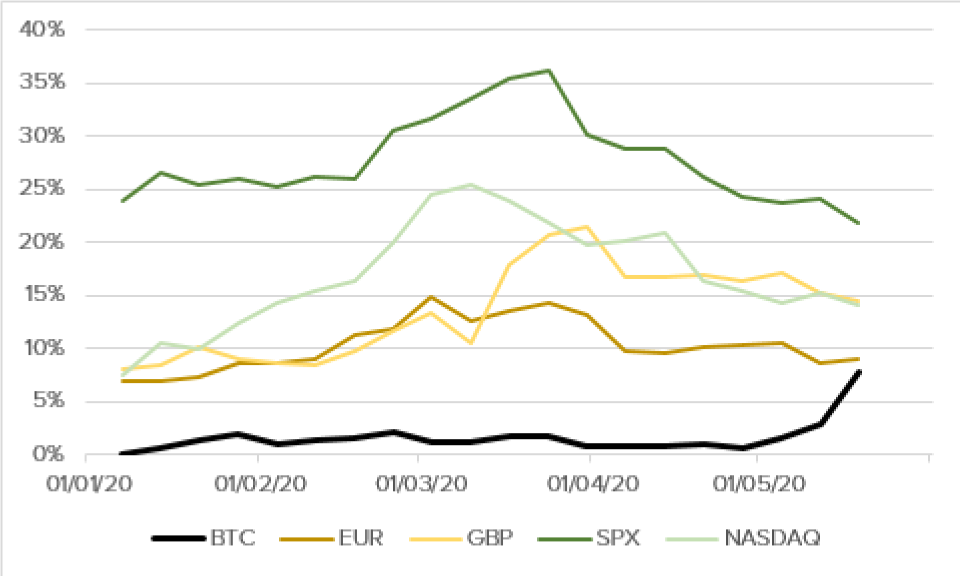


Data via CFTC.

Mid-week data does suggest that this has peeled back somewhat this week, but remains significantly above previous highs. This seems like a fairly unambiguously bullish influence; a large number of new players are coming into the CME BTC market, by its nature this should represent relatively fresh money coming into the BTC space. The one slight note of caution we would have is to remember two things:

1) For those willing and/or able to look past the regulatory aspect, market infrastructure and liquidity for futures trading in BTC has been well-developed enough to sustain significant activity for years now; the same has tended not to be true for options trading.
2) The CME launched its options offering in mid-January of this year.

Open interest on options as a proportion of total open interest is still low, especially compared to comparable CME offerings on FX and equities:



Data via CFTC.

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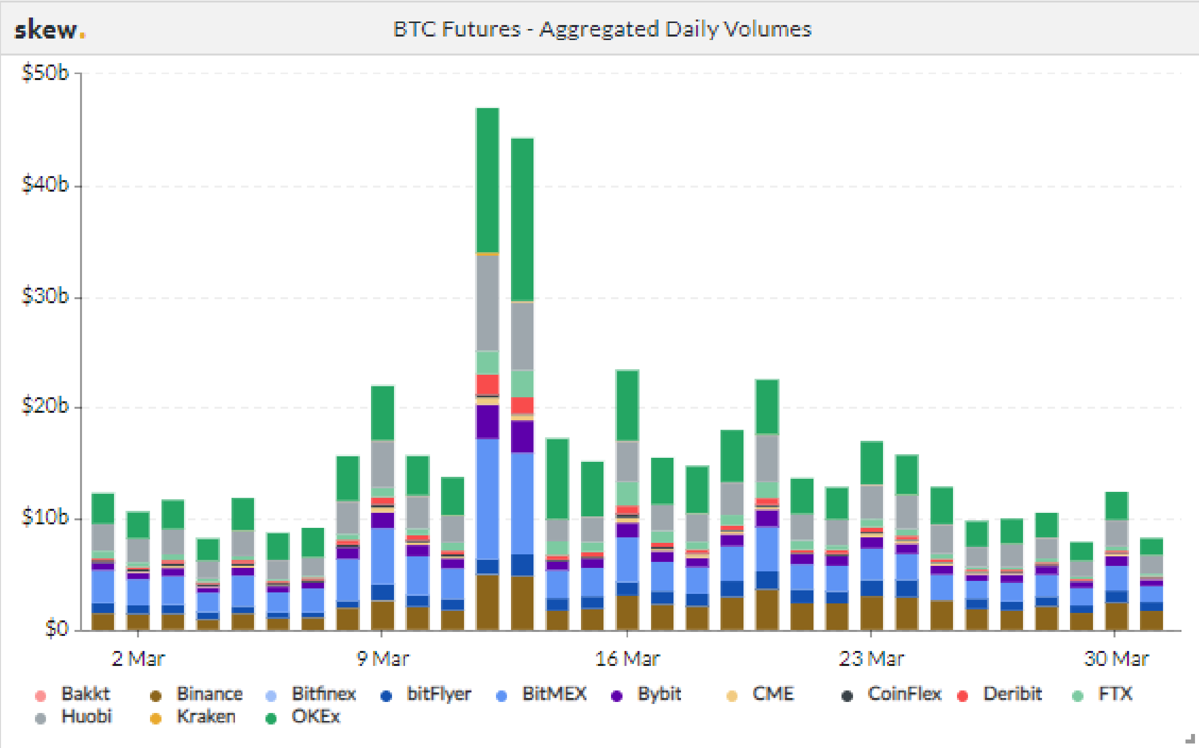
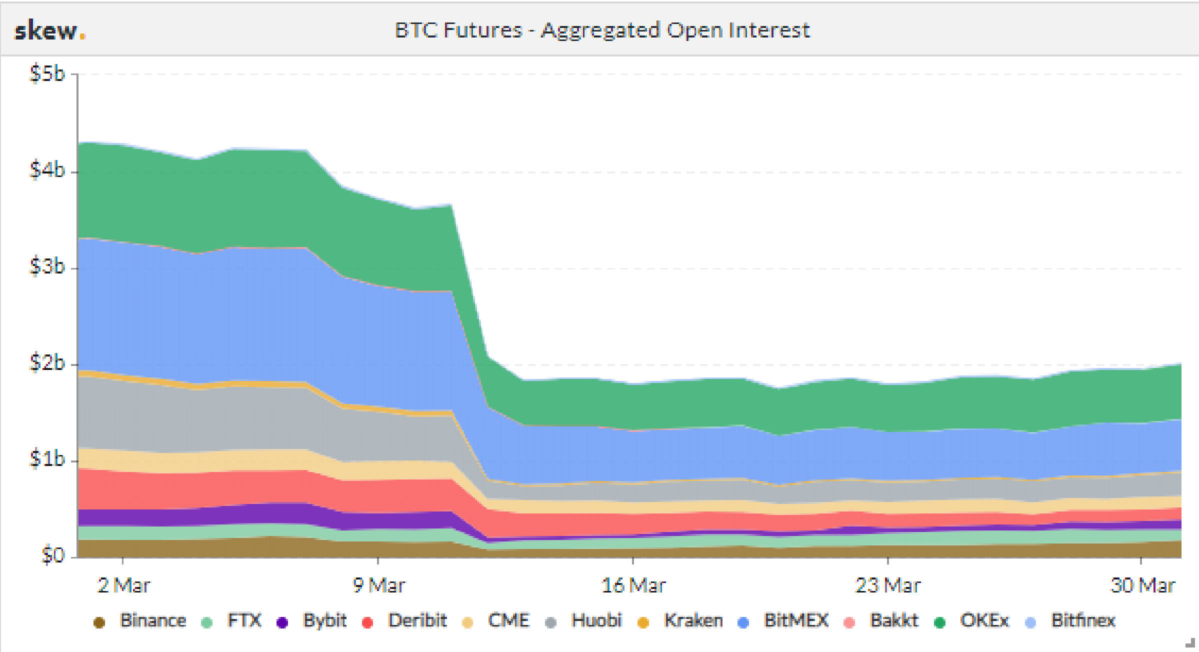
This may suggest that at least part of the boom we're seeing is being driven by existing firms in the space taking advantage (either directly or as an intermediary) of the newly-liquid market for options offerings. Obviously, this is hardly bearish, particularly given what it means for potential institutional trust and involvement in these new options offerings; still, it might mean some slight tampering of otherwise sky-high expectations in the short term.

Exchange data

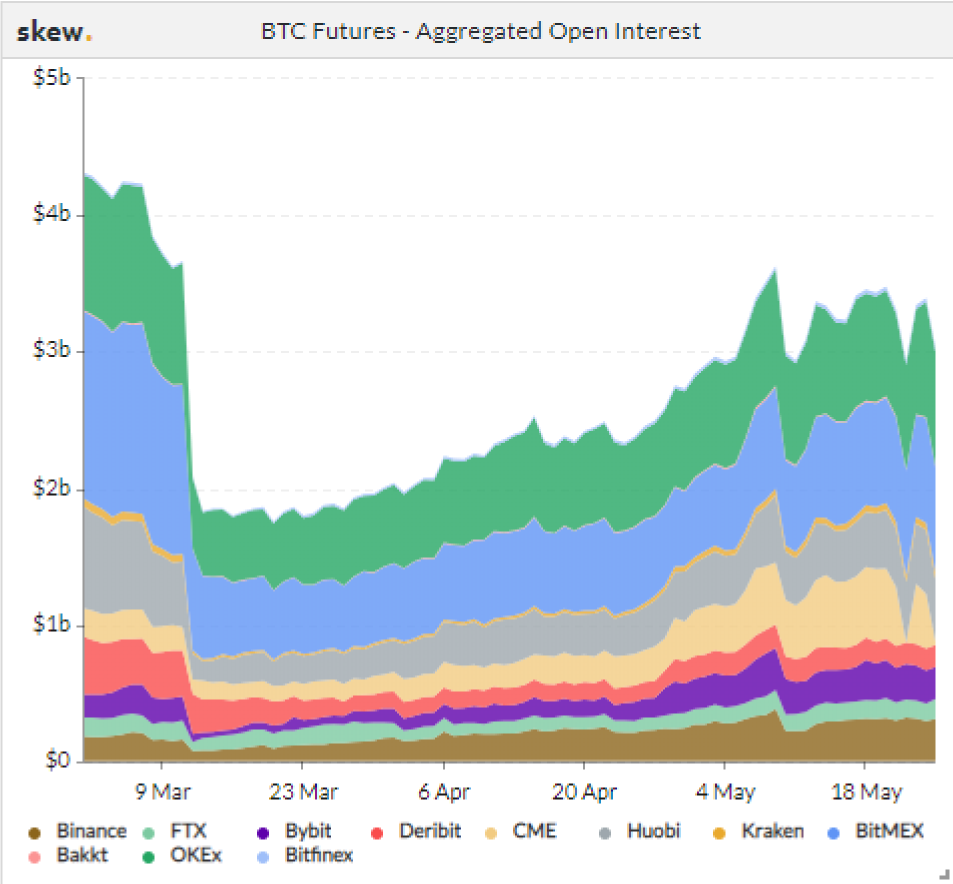
Onto the broader retail outlook. First, open interest. As a reminder, while Black Thursday certainly did see a contraction in trading volumes in its aftermath, the real shock was seen in terms of open interest; a large number of true retail traders saw their positions liquidated entirely, while more sophisticated market participants still found themselves in positions where, at the very least, they had to close positions and withdraw liquidity owing to how severe of an impact the crash had in terms of invalidating existing market-making models. Compare and contrast:





Credit: Skew.

There was a slight decline in volumes post-Black Thursday, though moreso towards the end of March and into April, and to a degree that is barely perceptible on a daily volumes chart; however, the enormous valley in open interest is hard to miss. So, how has that situation developed?



Credit: Skew.

In an adverb: significantly, and while we have stalled a little in previous weeks (topping out on May 9th) and in any case came up a touch shy there of matching the total aggregate level we achieved previously, looking exchange-by-exchange, we see some interesting trends:

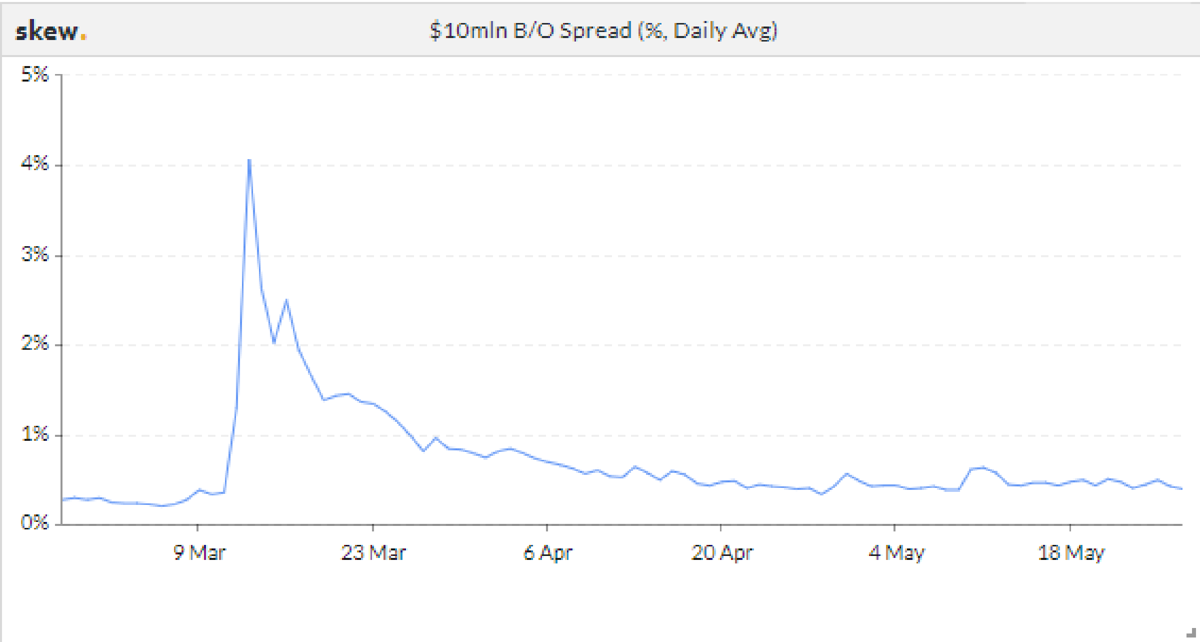
	11/03	13/03	01/04	01/05	09/05	26/05	26/05
BitMEX	**1240**	-51%	-56%	-54%	-40%	-36%	**790**
OKEx	**888**	-48%	-36%	-18%	-4%	-8%	**817**
Huobi	**481**	-70%	-52%	-28%	3%	-4%	**461**
Deribit	**340**	-28%	-64%	-51%	-49%	-52%	**163**
Bybit	**173**	-79%	-39%	29%	78%	34%	**232**
Binance	**158**	-49%	9%	70%	142%	98%	**313**
FTX	**142**	-35%	-24%	-20%	-3%	-5%	**135**

Data via Skew. All percentages compared to 11th March.

BitMEX, the long-time leader in the retail crypto derivatives space, has been the enduring victim of Black Thursday; Deribit has also failed to come close to establishing previous levels of activity for the most part. Both venues have a few things in common – they are purely crypto-based exchanges (no fiat deposits, no fiat-to-crypto onramps), they have been at the forefront of offering relatively advanced derivatives products (Deribit holding a firm majority of market share on options, and BitMEX having set many of the industry standards for futures over the last few years even where they weren't first-to-market on them), and they have hence been generally popular with individual and small-shop traders.

There are a couple of considerations at play here, then. First, in BitMEX's case in particular, there were platform-specific concerns that have kept money away in the proceeding weeks and months following Black Thursday; the short version is that there were severe flaws exposed in BitMEX's liquidation engine (the mechanism by which BitMEX deals with margin traders seeing losses beyond their capital), it is likely that those failings were part of why markets kept crashing beyond where they should by all other accounts have stabilised (from around $5500 down), and that combined with some other technical issues did a lot to undermine confidence in BitMEX going forward.

In particular, the platform's liquidity on relatively large amounts (low seven to eight digits) was always one of its selling points compared to competitors; while still easily among the retail market leaders in that regard, it has never quite fully recovered from the crash, going from around 25bps on $10m to around 50bps weeks/months later:



Credit: Skew.

The broader consideration is this: the 'unrecovered' OI as it were seems to point to a withdrawal from the market of a specific class of investor – in general, mid-sized organisations, usually with a relatively limited operational remit (pure HFTs, small-scale market-makers), that – while representing an outsized proportion in metrics such as trading volume – nonetheless represent a relatively small portion of both existing capital, and of new capital flowing into the market.

We should be careful not to extrapolate too much from the Binance boom specifically (given in particular how new Binance's futures offerings are), but it Is a relevant point to note: the exchanges that have gotten volumes and OI back to normal, or even improved compared to February, have been the ones with the most appealing products to new and/or relatively unsophisticated retail clients.

Conclusion

Price action over the last few weeks hasn't been truly negative for the most part, but it hasn't been too aggressively positive either; the failure to sustain a break through $10,000, while unsurprising from a technical perspective, does seem to have put a damper on sentiment to some extent, more than we would have expected in all honesty.

However, what we're seeing in terms of activity is painting something of a different picture. We should say: there are metrics of activity that are still flashing relatively poorly. Moving averages for volumes on services that effectively act as on-ramps first and foremost (such as Coinbase) have persistently been dropping throughout the month, for instance, and the futures curve remains relatively flat; we aren't seeing a full rush to market.

What is true, however, is that things are gradually picking up, and they're picking up among demand sectors that potentially augur better than anyone else for growth going into Q3 and Q4 of this year – the very, very large (in the form of CME-connected investors), and the very, very small (in terms of exchanges like Binance with very wide user bases). We hence tend to see the medium-term outlook as currently moving in a more bullish direction over time.

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.