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# De-Coding Crypto



Enigma Weekly

31<sup>st</sup> March 2021

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## Our Market View

**May you live in interesting times.** A positive week across the board overall – BTC once again moving slowly towards an all-time high (at \$62,000), ETH seeing a small bounce against BTC, alts lagging. Expectations for April are generally positive; expecting to see a break on that ATH, and a significant leg up arising from it, within the next week or so. While we are probably beginning to enter the latter stages of this bull cycle, it doesn't seem like the end is in sight just yet.

Our issue this week discusses ETH in some detail. In short: we tend to think that if there's going to be a move that takes ETH out of its recent malaise, it has to come very early in the quarter indeed, and our general expectation is that it doesn't happen. ETHBTC has been grinding just above support at 0.03 for weeks, and we would want to see some significant gains over that mark to shift our view positively again; as it is, we tend to think things get worse (in BTC terms) before they get better.

Interesting thing to note on alts: we have seen some significant gains in very unlikely places, most notably on FIL (Filecoin) and EOS. Not much to say right now (the FIL surge in particular seems like it may be connected to Grayscale's listing of a FIL ETF), but worth noting that both FIL and EOS skew extremely heavily in terms of buyers/ownership towards Chinese firms and companies, so could be the first signs of an interesting shift there.

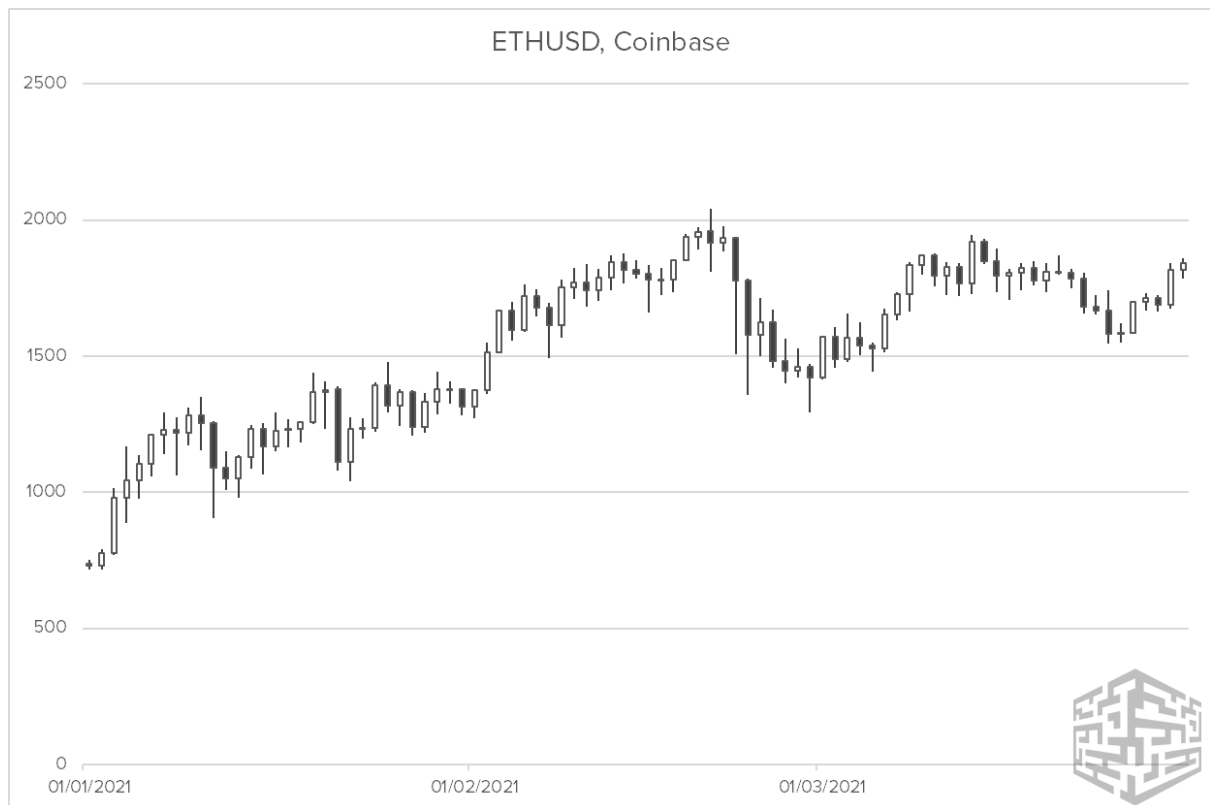
Please direct all enquiries about this week's research to [jedwards@enigma-securities.io](mailto:jedwards@enigma-securities.io).

### Major

Ticker	Price	7D	1M	6M	12M	Cap
BTC	59071	5.1%	18.9%	459.6%	758.9%	1.103T
ETH	1850.56	9.1%	17.6%	433.8%	1179.0%	213.3B
LTC	192.32	-0.2%	9.1%	321.8%	370.4%	12.84B
BCH	523.33	1.3%	4.7%	140.2%	120.0%	9.78B
EOS	4.431	4.2%	19.8%	79.3%	88.2%	4.23B
Selected						
Ticker	Price	7D	1M	6M	12M	Cap
ADA	1.180	3.9%	-9.5%	1158.0%	3502.0%	37.76B
DOT	37.91	7.2%	4.7%	818.9%	1185.0%	37.14B
LINK	27.34	0.6%	-1.3%	195.0%	1078.0%	11.37B

## Q2 in review: Ethereum's doldrums

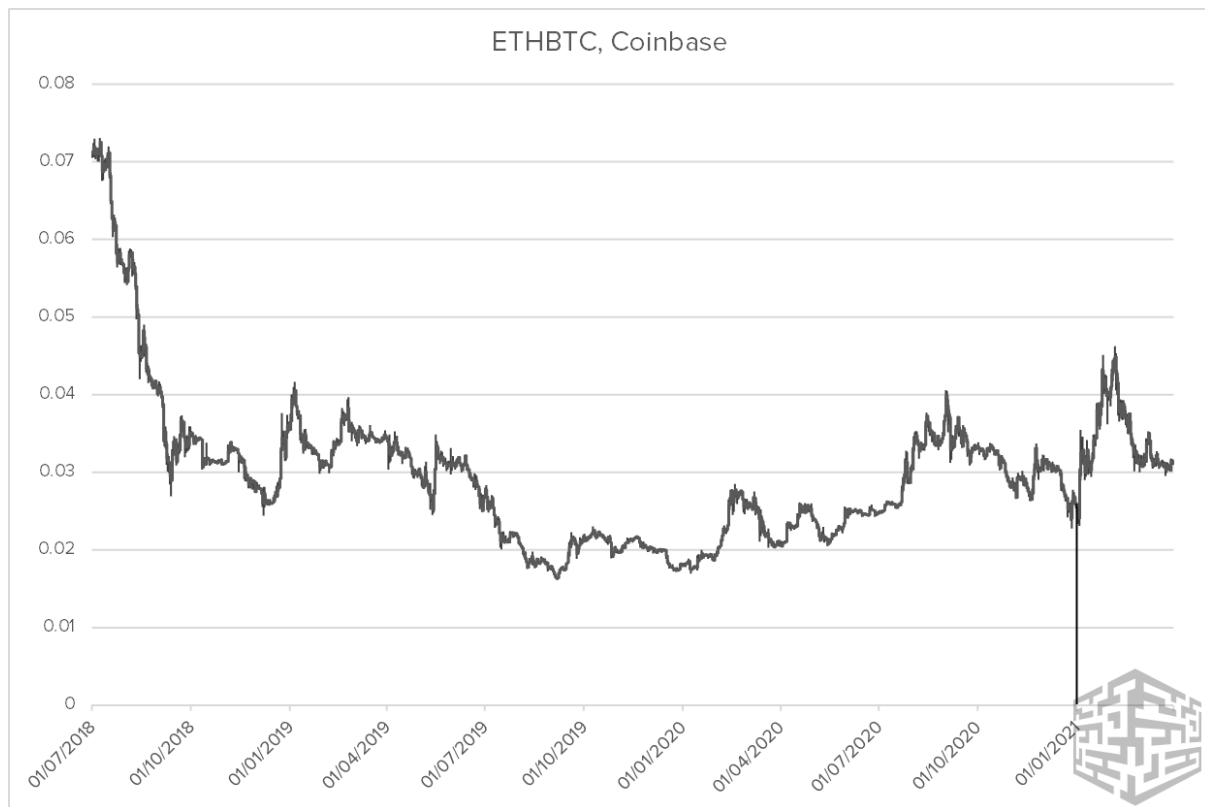
By any and all accounts, Q1 has been a successful quarter for ETH. However, it has also been something of an uneven one:



*Data via Tradingview.*

ETH opened the year at \$700, and exits Q1 at \$1800; in anyone's books, that's a success. Similarly, even when compared to BTC, ETH has made gains of 20-25% overall. However, with regards to USD, we find ourselves 6 weeks out now from the previous all-time high (at \$2041), with little in the way of a renewed challenge to the upside; with regards to BTC, the peak was even further back, and even to the layman, clearly, that 3-month chart does not exactly paint an attractive picture with regards to where the asset is going.

Of course, the refrain in crypto is always: 'zoom out'. Let's look at the ETHBTC pair in that context:

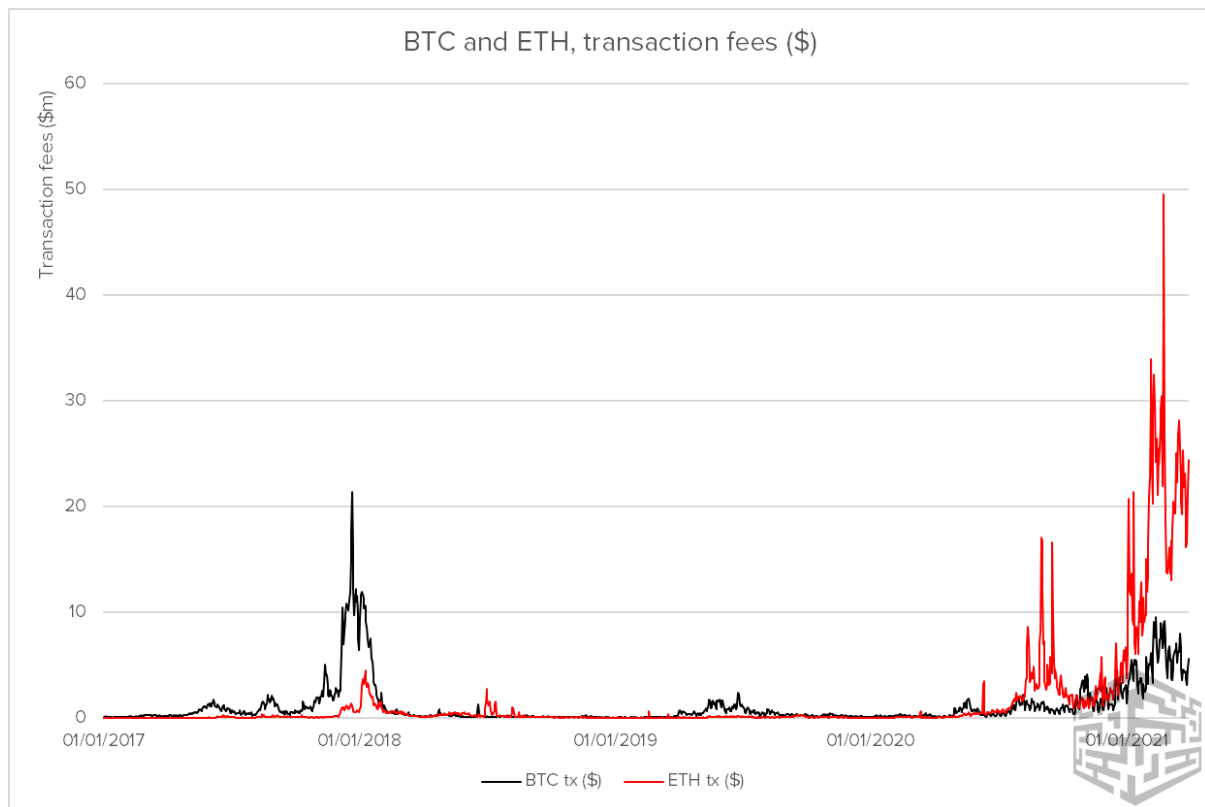


Data via Tradingview.

What do we see here? In some senses, this actually puts the Q1 performance in a more negative context; ETHBTC was running at a six-month low coming into the new year (albeit mainly predicated by BTC's meteoric rise rather than ETH dropping off in USD terms). On the other hand, however, it does show how significant the Q1 breakout was; ETH reached its highest level against BTC since its 2018 drawdown (wherein it fell 85% in USD terms from its peak even prior to the onset of Crypto Winter, reaching lows of \$80 in December).

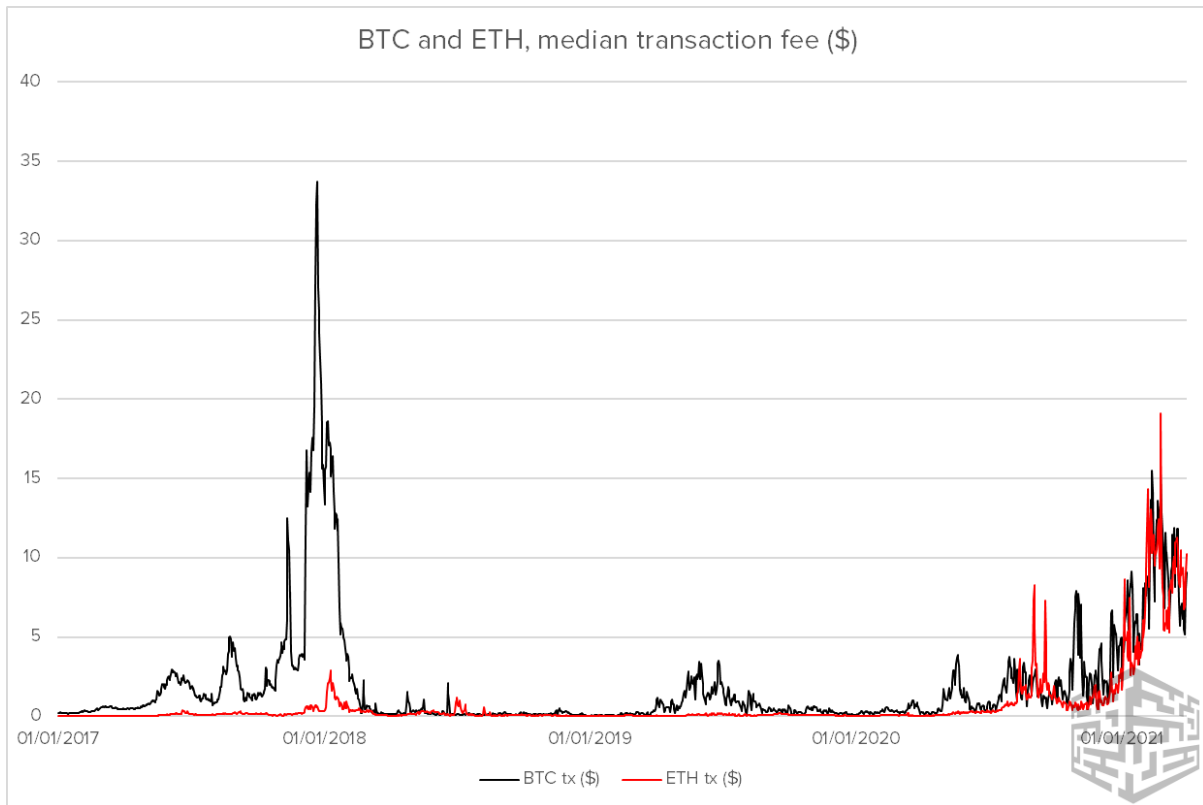
Crucially, it shows that while we remain a long way off 2018 levels, we are hardly in freefall. In terms of recent history, ETHBTC at 0.03 is healthy, and on the higher side compared to most of 2019 and 2020. While it may still be a significant distance off previous highs in BTC terms, we are not talking about an asset that seems to be in terminal decline - a distinction we ultimately feel necessary to make because the vast majority of other crypto assets with the provenance of ETH, including those with multi-billion-dollar market caps, are.

That seems a good place, then, to start from: ETH is alive, and Ethereum is alive. Real utilisation is higher than ever; to give the simplest possible example, transaction fees (i.e. how much consumers are paying to miners to transfer assets each day) on ETH have been higher than the 2017 BTC peak (\$21m on December 22nd, 2017) on 34 days across the past 2 months, and are consistently dwarfing BTC's transaction fees even as the latter has gained ground in price:



*Data via Coinmetrics.*

Of course, there's an amusing element to that, insofar as we are talking about transaction fees as a positive, in the context of an asset class which was formed in the first place in part because it was a less expensive (and more efficient) way of remittance etc - and, we should note here, it absolutely isn't just a case of higher volume, with median transaction fees increasing thousands of percent from just a year ago on both BTC and ETH (albeit not yet to those seen at the peak of 2018's BTC congestion):



Data via Coinmetrics.

These two graphs, all by themselves, get to the heart of the problem, and to why ETH has performed relatively poorly even as ETH utilisation has increased in pretty much any metric one could think of (we will spare you the full deluge in that regard). The harsh truth is that, all the way up to 2019 and early 2020, Ethereum had no killer app; it was twenty billion dollars of fallow land.

This perhaps sounds like an exaggeration. It's not, at least not substantially. As late as July 2020, we noted that six of the top ten applications (in terms of gas usage, i.e. transaction fees) on Ethereum at that time were honest-to-G-d Ponzi schemes or connected to them.

Rank	Project	Ethereum spent	USD spent	Ponzi?	Notes
1	Tether USD	11.5K	\$2.71M		
2	0xe871da...98c30	10.7K	\$2.60M	Maybe	Allegedly connected to a hack on Korean Ponzi Good Cycle
3	0xt2d801...74e84	10.7K	\$2.60M	Maybe	Allegedly connected to a hack on Korean Ponzi Good Cycle
4	SmartWay Forsage	5.52K	\$1.29M	Yes	
5	MMM	2.45K	\$583K	Yes	
6	0xe386e3...a5149	2.31K	\$568K	Maybe	Unclear providence but connected to previous exchange hacks
7	Easy Club	2.11K	\$494K	Yes	
8	Unswap V2	1.97K	\$462K		
9	Nest Protocol	1.25K	\$295K		
10	Kyber Network	892	\$211K		
Total, top-10		49.4K	\$11.81M		
Total without Ponzis		15.6K	\$3.68M		

Data via ETHGasStation.

It's not that there wasn't positive activity within Ethereum as an ecosystem; many of the building blocks of the DeFi ecosystem were being built or were even actively operational to some degree in 2018 and

2019. It is, fundamentally, the reason that investors continued to pour money into said ecosystem, and why ETH stood strong while 'Ethereum killers' like EOS and TRX largely languished.

However, fundamentally, utilisation remained low. TVL (Total Value Locked) across DeFi protocols was \$285m at the end of 2018; by the end of 2019, it was just under \$700m, an appreciable increase but barely a blip compared to raw and percentage growth that then came in 2020.

In the span of about a year, utilisation has increased a hundred-fold on a network with fixed throughput (the PoW implementation and system currently used by Ethereum caps it at somewhere between 10 and 30 transactions per second). Our fallow land from before has been developed, and the blocks that have been built find themselves...not overcrowded necessarily, but at the very least, oversubscribed.

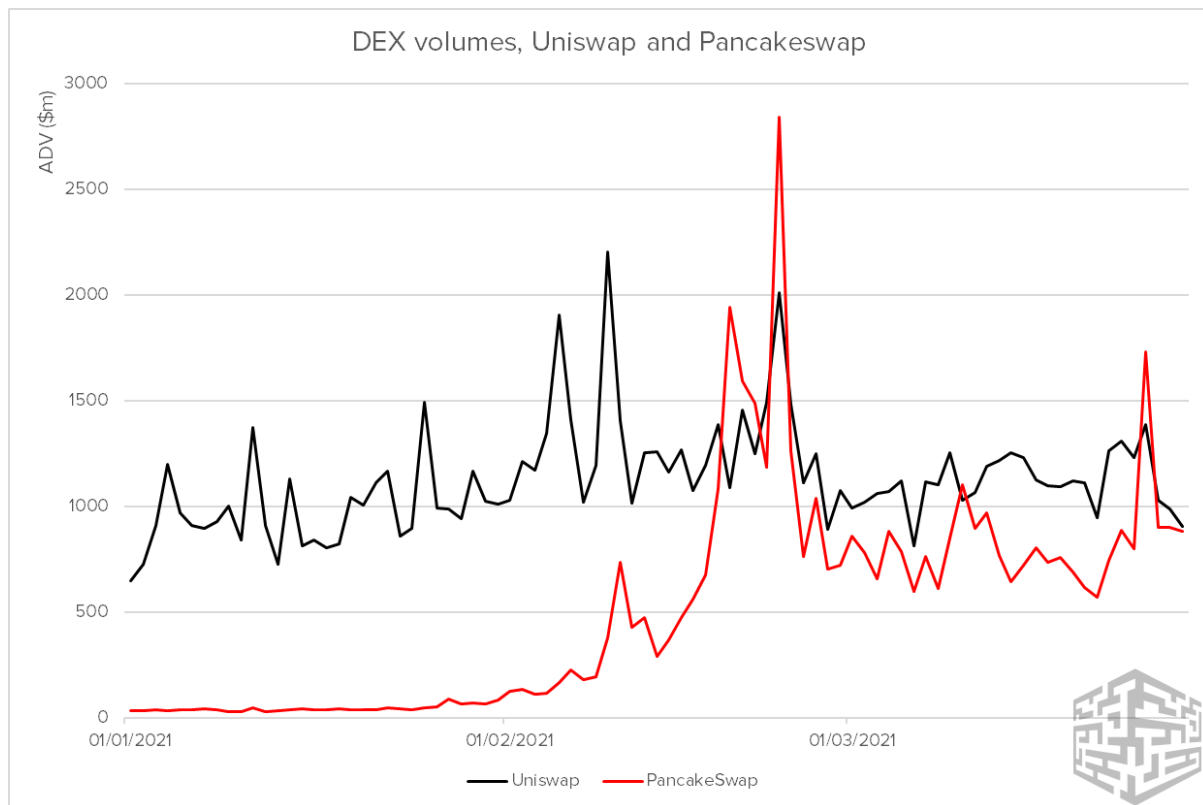
The thing to understand, however, is this: this is not a permanent or existential problem for Ethereum. The central point of Ethereum 2.0, for instance, is not the environmental impact of abandoning proof-of-work mining, or the institutional interest that staking-as-a-service brings in. It is, instead, to fundamentally remedy that throughput problem via sharding (essentially splitting the central blockchain into a potentially infinite number of sidechains) which increases theoretically throughput to a near-unlimited number (guesses tend to start at 10,000 transactions per second).

In the short-term? It is, of course, an issue, particularly given the nature of most activity on the Ethereum network. Remember: Ethereum's 'killer app' in 2020 was, as it turned out, decentralised exchanges - the Uniswaps and Sushiswaps of the world. The entire selling point of these apps, and the entire reason that people started to gravitate towards them, was that they were able to offer that most consistent of value drivers - the trading of some sort of asset, and therefore the ability to find myriad ways to make money off said trading.

When you go from spending \$5 on every individual transaction to \$50, those opportunities, naturally, dry up; that's the situation that Ethereum finds itself in right now. It is, at the moment, unattractive to the sorts of people - the Uniswap traders, the crypto hedge fund wunderkinds - who were instrumental to the market rolling over on itself over and over again in the summer and autumn of 2020.

Again: long-term, this is ultimately an issue that Ethereum 2.0 genuinely should largely fix, or at least provide the tools to fix. Even medium-term, it is usually a mistake to bet against the ingenuity of blockchain developers in finding ways to alleviate those issues (for a very high-level example: remember that much of the BTC network congestion at the peak of 2018 was coming from millions of transfers in and out of exchanges, and that when Coinbase started regularly 'batching' transactions in March 2019, transaction count dropped from 350,000 to 270,000 in the span of about a week, providing significant relief).

Short-term, however, we are seeing the sort of money that fuelled ETH's rise in the first place being employed elsewhere. By far the most notable one is PancakeSwap, which is essentially an Uniswap clone for the Binance Smart Chain, which went from nothing to doing very similar volumes to Uniswap in a matter of days in February:



For reference, BNB - the native token for PancakeSwap and BSC - finds itself up 300% on the quarter in BTC terms. Most of the big gains in general this quarter have been concentrated in similarly-exposed tokens and projects (SOL, the token for Solana, a heavily VC-backed network that is targeting similar spaces, is up over 500%; Polkadot's DOT is up 100%).

There is definitely a significant space in the market that has been ceded by Ethereum over the past few months with regards to the sort of money that propelled it upwards before. In truth, this is probably something that few of the big players in the Ethereum ecosystem are exactly losing sleep over; there is, after all, only so far you can go off the back of these sorts of retail traders, and much of the chatter in recent months has been about making Ethereum into a network that ultimately will be enterprise-ready, whatever that may mean.

All of this goes a long way to explaining Ethereum's disappointing performance over the last few months, and it paints something of an interesting picture going forward. While we were more reserved than some on this front, the general expectation was that, over the course of the bull run in 2020/2021, that in terms of pure spot trading, ETH would basically act as a 'high-beta' version of BTC - further up when BTC went up, further down when BTC went down - and hence would represent the 'fastest horse' with regards to general crypto investment in 2021. This is what we said on January 20th, for example:

Given all of that, and given how ETH has very consistently pegged closely to BTC on all but the shortest time frames, it is nearly impossible to see a situation in which we don't continue to trend upwards on it in both USD and BTC terms, and there is a case to be made now that it is both a) investable (if not invested in as of yet) on an institutional level as of this year, b) likely to be the 'faster horse' going forward.



At the time, ETH was at 0.036; we would indeed see significant further gains in the weeks to come (up above 0.046), but ultimately find ourselves down right now (albeit, of course, still up in USD terms). Simply put, the 'high beta BTC' idea has not been playing out short-term for a good few weeks now.

We remain medium-term and long-term bullish on ETH; ultimately, projects like PancakeSwap are, at their core, not significant long-term competitors to their ETH counterparts for the most part, and networks like Binance Smart Chain are not serious competitors to Ethereum, particularly when we are speaking in the context of that ultra-high-throughput future, and the networks needed to make those work.

However, with regards to short-term speculation, what we have been seeing with regards to flows and new money has not exactly thrilled, especially in the context of where we are in the supercycle right now (it seems likely that BTC is on the cusp of another significant macro-driven move, and ETH has disappointed in those moments over the last few months - see the dip in late December against BTC).

Ultimately, ETH probably still will continue to return positively in USD terms, and there will be some moment in the cycle where it has its 'moment' and bursts upwards with some vigor. However, right now, it is hard to feel particularly confident in it in BTC terms on a short-time frame, and we tend to think there are two broad scenarios here:

1) We see a surge very early in the quarter which turns everything on its head. March has traditionally been a very poor month for crypto; we have discussed this in previous research, but the short version is that this performance likely has its roots into a confluence of tax-related issues in various jurisdictions that forces selling (and a lack of buying) among retail investors in particular. We actually (as expected) didn't see the traditional March drawdown this time around, but it is ultimately possible that this above all else has been the issue with ETH for the past few weeks, and that things pick up going into April.

2) If we don't see said surge, we may have a 2017-style scenario where ETH continues to underperform throughout BTC's run, and only sees some sort of relief as BTC interest is exhausted and the cycle as a whole starts to turn. To put this in some perspective here, ETH depreciated nearly 85% from its June peak in 2017 until it finally put a low in (at 0.023) on December 7th; it seems incredibly unlikely that we see the same magnitude again (not least because of the rise in BTC price that would probably be required for ETH to drop that much without completely collapsing), but it does put into perspective how much ETH could drop in BTC terms while remaining in an overall crypto bull market.

***Until next week – thank you for reading.***



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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.

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