De-Coding Crypto

Weekly Analysis

Recent trends: CFTC reports and GBTC premiums

February 19, 2020

In this week's issue, we revisit a couple of long-term indicators we examined back in the autumn, how they've changed, and their implications for the next couple of quarters. We also look at new developments in Russia.

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Our Market View

May you live in interesting times. Not really a bad week per se – BTC is down slightly but finally recovered $10,000 levels after coming perilously close to breaking its upwards trajectory of the past 6 weeks, and while most alts drew back, losses were limited for the most part, with ETH and other outliers from last week (XTZ, LINK) actually progressing even further.

While always good to limit how far forward we prognosticate in crypto, the next week or so may genuinely prove to be something of a tipping point for action all the way into Q3 2020. The threat of a trend break is still very much alive, and any daily BTC close from about 9400 downwards would force serious re-evaluation. However, as it stands, we still see continuation upwards medium-term as the more likely outcome.

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

Major

Ticker	Price	7D	1M	6M	12M	Cap
BTC	10155.1	-2.32%	17.34%	0.14%	172.10%	185.1B
ETH	281.157	9.36%	67.86%	47.19%	113.20%	30.9B
XRP	0.295277	-1.98%	26.78%	8.65%	-0.30%	12.91B
BCH	416.856	-12.25%	21.18%	36.41%	230.30%	7.62B
LTC	77.3322	-2.99%	34.83%	5.46%	77.53%	4.97B
EOS	4.53514	-15.37%	24.41%	23.91%	29.09%	4.33B

Selected

Ticker	Price	7D	1M	6M	12M	Cap
XTZ	3.74747	12.41%	139.30%	225.80%	795.70%	2.60B
LINK	4.73324	13.86%	76.29%	118.20%	104.70%	1.66B

Recent trends: CFTC reports and GBTC premiums

CFTC

We last looked at detail in CFTC reports on 23rd October; as a refresher, the CFTC describes them as such:

> Specifically, the COT reports provide a breakdown of each Tuesday's open interest for futures and options on futures markets in which 20 or more traders hold positions equal to or above the reporting levels established by the CFTC.

Since 2018, this has included BTC, via the CME's futures offering (it also previously included CBOE contracts before their discontinuation; Bakkt is currently not included).

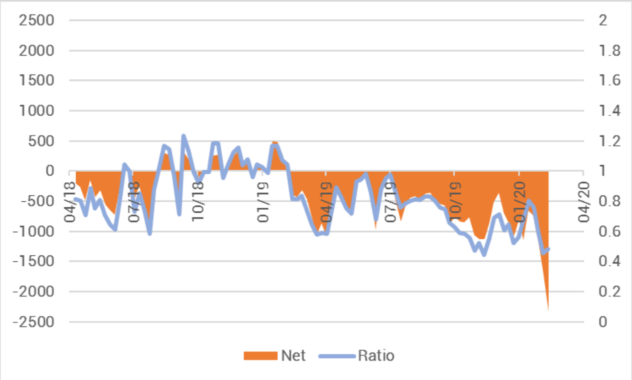
Our interest in October related primarily to leveraged funds (which make up the bulk of CME BTC trading), and their record-low ratio of longs to short (such figures had previously shown some quality as a reverse indicator on medium-term timeframes). To start with, then, we should look at how the collective position of those funds have changed over the past three months:

Price: BTCUSD, Coinbase

'Inconclusive' seems to be the word here; while the reverse indicator seemed to augur the XI pump, said pumps stayed short through the start of the November bleed, and only unwound somewhat at and around the cycle bottoms towards the end of the month.

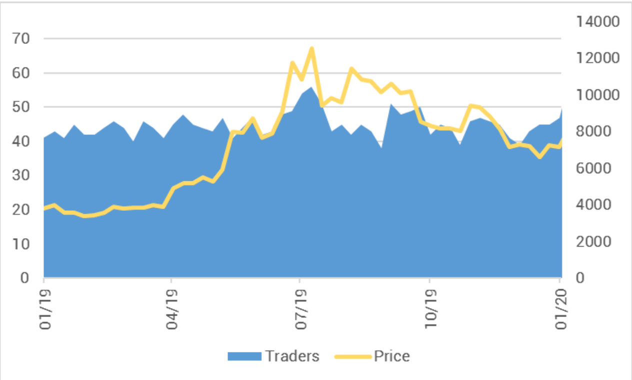
The new year, as it turned out, saw an absolutely enormous influx of money on both sides, to the tune of volume among leveraged funds alone more than doubling (2997 contracts to 6416) between 31st December and 7th January.

After running a higher ratio and similar net for the first couple of weeks, action from the 21st onwards - when a rejection above $9000 gave way to a temporary bottom of $8300 on the 24th-25th - has been overwhelmingly towards the short side. Ratio is basically at the low that was set in November, and net differential has never even been close to current levels as a result of heightened volume:



Should we be alarmed? On the one hand, again, our main argument back in October was that our broad thesis was that leveraged fund activity is not a signal but rather a counter-signal; while they were onside during November and December, they have still as a group tended to be off far more often. On the other hand, the magnitude of the position(s), at the very least, should prompt pause for thought.

The interesting wrinkle here comes in the form of trader numbers. The CFTC figures report the raw number of reporting parties on all sides; since we are talking about, at most, a two-digit total quantity across all categories here (steadily around 50 total for most of the past 18 months, with the majority being leveraged funds), so clearly not the most granular of figures, and changes in that week-to-week throughout 2019 mostly seem unremarkable and, more importantly, without any real relationship to price or momentum:



Price: BTCUSD, Coinbase

However, this changed in the new year, and not in the way one would expect:

Date	Total	Lev, Long	Lev, Short	Lev, Spread
03/12/2019	39	9	10	*
10/12/2019	43	11	14	*
17/12/2019	45	9	18	5
24/12/2019	45	11	14	4
31/12/2019	47	9	16	*
07/01/2020	58	15	18	5
14/01/2020	56	21	12	10
21/01/2020	57	22	11	10
28/01/2020	55	20	10	10
04/02/2020	47	15	11	4
11/02/2020	59	20	13	8

CFTC data. Note that a) total figures include all parties and therefore all leveraged parties do not add up to the total, b) CFTC data does not report position counts when held by between 1 and 3 parties; our assumption would be that the asterisked entries are 3.

Despite the weighting of total positions, the number of parties taking each side essentially flipped. There are a couple of conclusions we take from that:

1) The short surge is likely concentrated in a very small (even singular) number of parties, and there has been an influx of smaller funds willing to take the other side. This tends to be a bullish sign; crypto is a market that rewards the agile over the outsized.
2) Less directly, the swell of trader numbers is another piece of the puzzle for theses on the new year having been something of a milestone point for bigger money looking to get involved in the cryptoasset space.

While 2019 was a disappointing year in terms of retail interest and the development of retail-facing infrastructure, it was actually a fairly encouraging one in terms of both building tracks for institutions to operate on, and building up the record of said tracks for its would-be passengers to reassure their risk management departments with.

Volumes on retail venues over the last few weeks have by no means been bad, but they have consistently been lower than even May 2019; for a run of such magnitude, we have felt somewhat light on the traditional fuel sources. This perhaps goes some way towards explaining why.

For what that may mean going forward, hard to say; the immediate impulse would be to say that such institutional inflows will not snowball on themselves in the way that retail did in 2017 and 2019, and to consider tapering short-term expectations somewhat. It's worth keeping in mind, but right now, it seems at the very worst to be a very mildly bearish contributor, and may even turn the other way; we remain a long way off any shift away from retail domination in BTC and all other crypto markets, and if markets are up 45% prior to really beginning to tap into the well of retail demand, it could end up becoming an actively bullish factor.

GBTC

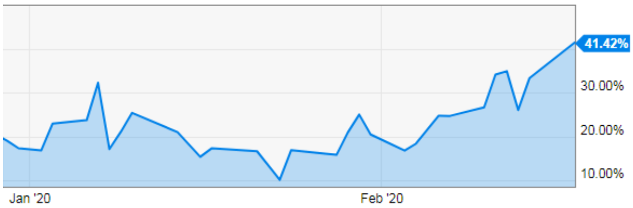
This is another thing we looked at a few months ago (16th October). To recap:

> The Grayscale Bitcoin Trust (GBTC) is, in brief, a single-asset investment product tied to an underlying store of Bitcoin. It has been around since 2013, is only available to accredited investors, and has attracted attention on a number of occasions over the last several years because of what is known as the GBTC premium - that being, the difference between the value of the underlying holdings (Native Asset Value, or NAV) and the price of the product on the secondary market (i.e. its listed value) at a given time.

We spoke about it at the time because GBTC premium had traditionally been regarded as something of an augur; it has essentially always outstripped NAV by a fairly significant degree (its low over an extended period was around 10% during the absolute depths of crypto winter in November and December 2018, and had contracted to a significant low in late October (which conventional wisdom would see as bearish). Our argument at the time was that:

1) the short-term drop in premium was mostly likely due to a placement window (GBTC allows accredited investors to buy in at NAV during these windows; while this comes with a significant lockup period, premiums nonetheless tend to shrink at these times)
2) we would naturally expect GBTC premium to shrink as market infrastructure improves, and for overall it to become a less correlated indicator; it is a product that benefited dramatically from being first-to-market and being positioned to take advantage of direct exposure being too fraught with risk even for small investors. Premium did increase in the bull run in 2019 (and was a leading indicator of further upside), but nowhere near as dramatically as it had in the past.

This, then, makes the move over the last couple of weeks in particular, extremely interesting:



Credit: Ycharts.

The premium over the last week, and particularly on Monday, was essentially identical to levels last seen in the second week of May - a time at which BTC was just coming back over $6000 (a run of just over 50%) and would, as it turned out, be on the precipice of another 100%+.

How significant will it be? While we tend to think that GBTC premium as a broader augur is a correlation that has weakened (and will continue weakening) in general, and this tempers expectations accordingly, we have to note that this is coming very starkly against what we expect to be the general convergent trend (i.e. over time, premium will decrease in net), and also happens to again contribute to the story that CFTC reports also paint - that bigger money has driven early action in this cycle, with all the complexity in dynamics that brings.

Russia's "Sandbox": the legal perspective

By Alina Kiselevich

Russia of 2020 is on the verge of moving cryptocurrency from the grey zone. The Central Bank has successfully finished the trial for pilot blockchain platform for issuing and turnover of digital rights. Such a platform provides ways for tokenization of goods, service and securities.

The special feature is the ability to issue hybrid tokens, provided simultaneously with various assets by any organization. All this allows expanding the business opportunities for attracting financing, and also creates new convenient investment tools for consumers.

This platform is provided by a program of the Bank called the "Sandbox". Any organization that has an idea worth sharing can apply. The "Sandbox" helps test innovative technologies and services in the financial market and, if successfully piloted, initiate the preparation of legislative changes aimed at removing barriers to their implementation.

This blockchain platform may begin its work after the adoption and entry into force of the federal law on "Digital Financial Assets". When this happens, under the Russian law the mention of definitions of crypto assets will de-facto mean its legitimization.

Such changes to Russia's stance on crypto not only bring its government to be more acceptant of the digital assets, but also may affect the Eurasian market, in particular the CIA countries. Having China as an influential neighbor, Russia may even want to look at the idea of implementing the digital Ruble on its wide territory.

What we're reading

Coinbase Becomes First 'Pure' Crypto Firm Approved as Visa Principal Member (Coindesk): A nice move for Coinbase, and it does raise an interesting question: how will traditional payment processors treat crypto firms during and after the next bull run, especially with narratives shifting heavily away from payment processing itself as a reason-to-be across the crypto space?

Crypto Custodian Copper Raised $8 Million for Expansion (Cointelegraph): We've seen quite a few successful raises like this recently. While 2019 saw the rally to 13k, it never quite felt that investment followed back in with said rally, as the hangover from the ICO boom just refused to go away; it definitely feels like the overall environment is now changing in that regard.

DeFi Project bZx Exploited for Second Time in a Week, Loses $630K in Ether (Coindesk): This has, unfortunately, been the big mainstream media crypto story of the week. This is probably going to be a stumbling block with a lot of decentralized finance projects as usage increases (and things are moving quickly, with aggregated capital locket in DeFi crossing the $1b mark earlier in the month); for all the positives these systems have, and will have long-term, the nature of both their product and of crypto in general essentially makes them like piñatas for would-be attackers.

Crypto Hedge Fund See Best January on Record (Cointelegraph): Not exactly shocking in a month where the market as a whole ran higher, but still will be interesting to keep an eye on.

Until next week – thank you for reading.

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