De-Coding Crypto

Enigma Weekly

8th October 2020

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

Our Market View

May you live in interesting times. Slightly down on the week technically, but in reality, in the same area that we've now been for a few weeks, with BTC support at $10,500 holding out for the time being. We discuss our view of the state of the market and demand dynamics in general in more detail in this issue, but the bottom line is that we remain extremely concerned about downside risk, and extremely unconvinced about upside on a medium-term basis. While our overall expectation is for low volatility in Q4, still tend to think that we're going to see periods of compression-into-test, that we're likely coming into one of those tests in the next few days, and that said test is to be more likely to the downside initially as things stand.

Alts continue to suffer, with ETH and mid-caps being the big losers as the DeFi bubble hangover continues. A couple of unusual moves up this week in the form of XRP and EOS; the latter case was a 'headline pump' based on an announcement that Google Cloud were preparing to list as a candidate block producer for EOS. As has been the case in the past with such partnerships, it was something of a fugazi; there have been a number of previous announcements along these lines involving Google Cloud, a blockchain network (Hedera Hashgraph and Theta both being examples of this), and specifically Google Cloud "developer advocate" Allen Day that turned out to be insubstantial, and the announcement has already been partially walked back (Day clarifying to news outlet CoinDesk that "Google Cloud is not getting into crypto mining. This is really an infrastructure play for us"), and much of the pump (which saw EOS reach $3 at one point) has already been retraced.

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

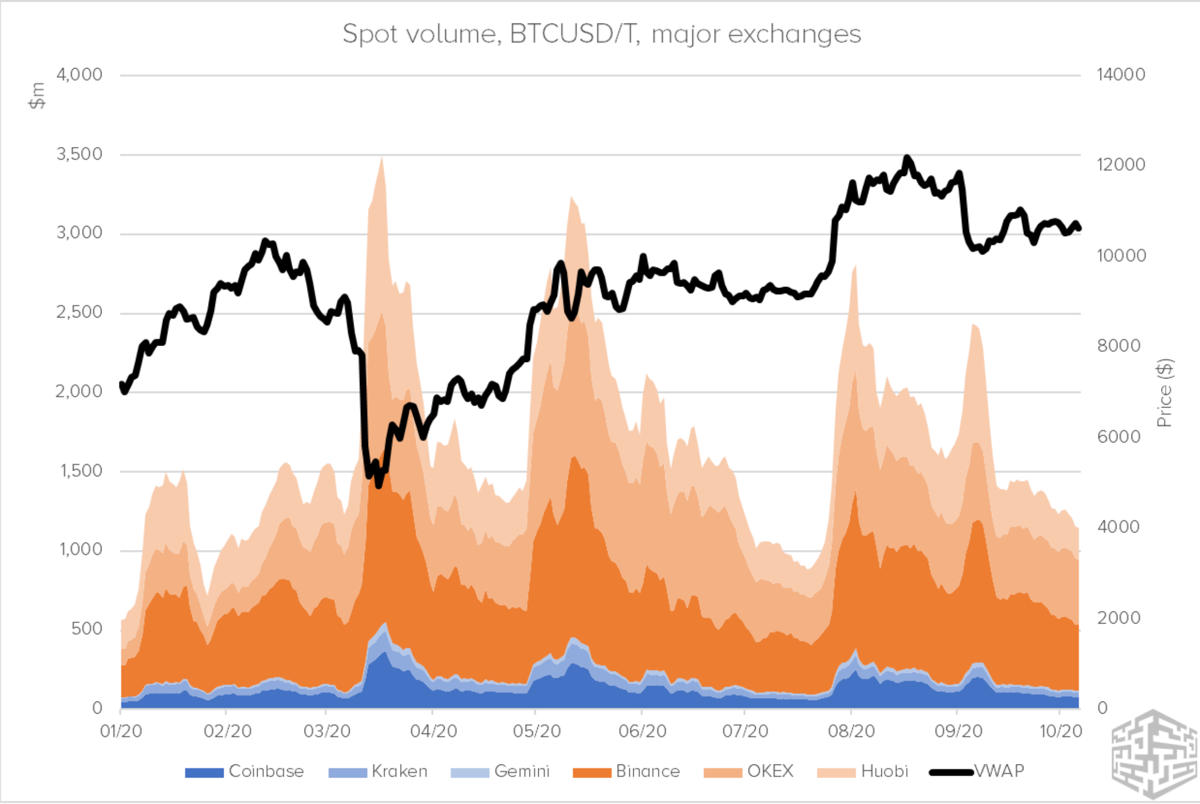
Major						
Ticker	Price	7D	1M	6M	12M	Cap
BTC	10630	-1.41%	4.80%	54.39%	23.85%	196.7B
ETH	340.79	-4.53%	-1.28%	115.20%	78.19%	38.5B
XRP	0.2479	2.91%	4.77%	31.57%	-8.23%	11.2B
BCH	222.59	-2.50%	0.39%	-4.27%	-3.00%	4.13B
LTC	46.18	0.15%	-2.65%	8.88%	-19.63%	3.03B
EOS	2.6686	4.53%	-3.66%	7.33%	-13.61%	2.51B
Selected						
Ticker	Price	7D	1M	6M	12M	Cap
LINK	8.9251	-9.95%	-25.34%	171.40%	238.50%	3.12B
ADA	0.0937	-7.01%	3.74%	179.40%	125.00%	2.92B
XTZ	2.0901	-5.03%	-14.43%	6.68%	129.60%	1.46B

Retail trends: spot, derivatives, DeFi

Our most recent issue on retail spot and derivatives was on August 19th, a couple of days after what would turn out to be the local BTC high for the time being (at above $12,000); at the time, we noted that volumes had largely not caught up with the price breakout:

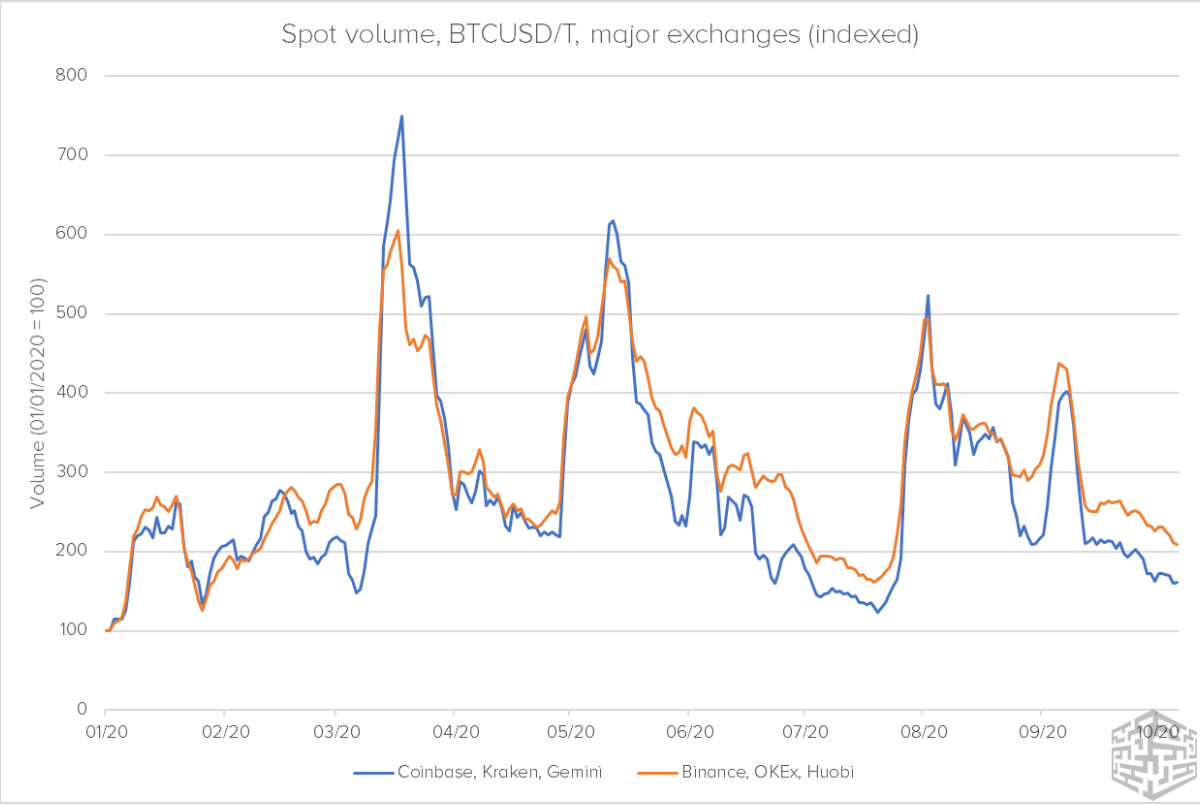
> The situation of course is by no means horrible, and certain venues have held up better than others (particularly Binance), but peak volumes so far have been lower than March and May (but better than February), and in general we've seen weaker volume growth than we have on similar previous breakouts, with things seemingly going in the wrong direction over the last couple of weeks.

It now seems like an opportune moment to revisit. Starting with the spot picture, things are, on the whole, not looking good:



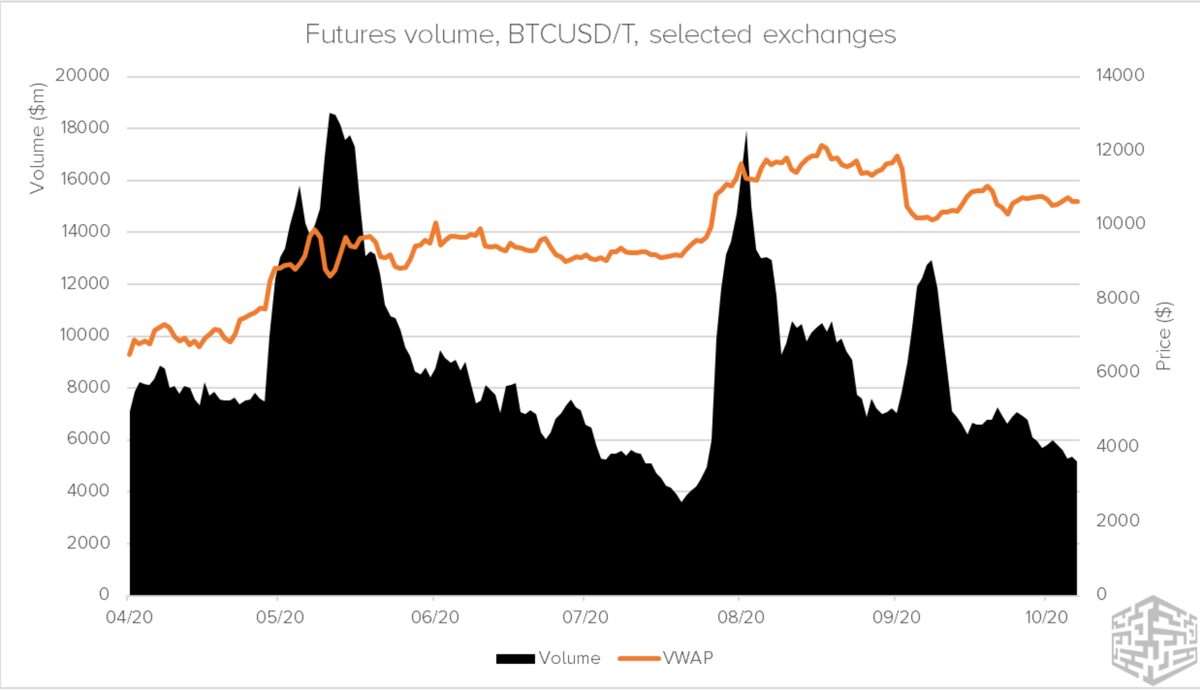
Data via Tradingview. 7-day MA. VWAP based on BTCUSD, Coinbase.

The breakdown at the start of September and resultant price action of course hasn't helped, but even apropos of that, volumes on all venues have been steadily declining, with regulated venues (which among other things, tend to be most sensitive to new demand, particularly among Western retail consumers) seeing a sharper drop-off than Binance/OKEx/Huobi:



Data via Tradingview. 7-day MA.

Demand simply has not materialised as expected over the $10,000 mark for the most part; while the fact that there equally has been no rush to sell is somewhat encouraging longer-term (the 3rd September crash actually saw lower volume in BTC terms than many of the down days in the April and May rebound), there just does not appear to be an appetite for BTC (and other crypto products, as we will discuss) among retail products. The picture with regards to futures data is on the whole similar:



Data via Glassnode. 7-day MA.

In the case of derivatives products, it should be said that there have been two major crypto derivatives-specific stories over the past week or so. The latter was the announcement by the British FCA on Tuesday that it would be banning the sale of crypto derivatives to retail as of January 2021, which was unexpected albeit not entirely unheralded (the FCA has been concerned about crypto derivatives as a predatory product for a while now, mooting a ban last summer and issuing an official reprimand to BitMEX back in March over its operations in the UK).

The former, bigger story was last Thursday, with the announcement that the Commodity Futures Trading Commission in the US was bringing both civil and criminal charges against several BitMEX leadership figures (with the one US-based individual of the group – co-founder and CTO Samuel Reed – taken into federal custody) for "having illegally offered leveraged retail commodity transactions, futures, options, and swaps on cryptocurrencies including bitcoin, ether, and litecoin, allowing traders to use leverage of up to 100 to 1 when entering into transactions on its platform."

The short version with regards to the implications of that move is that while there's no immediate operational event, it is ultimately likely to be the beginning of the end for BitMEX (shortly before publication, it was announced that all four members facing criminal charges would be stepping down from their positions at BitMEX parent company 100x Group; our tendency is to think that this doesn't bode well for either party). 16% of open positions on the most traded contract (BTC perpetual swap) were closed over the course of the next couple of days, with other platforms mostly picking up OI over the next few days to compensate:

	BitMEX	Binance	Bitfinex	Deribit	FTX	Huobi	Sum
01/10	-10.84%	-2.69%	-1.62%	-2.10%	-4.85%	10.10%	-2.80%
02/10	-15.94%	1.78%	-1.95%	-1.75%	-4.65%	9.51%	-3.85%
03/10	-15.96%	2.42%	-2.12%	-1.05%	-2.70%	11.38%	-3.08%
04/10	-16.32%	2.93%	-0.99%	0.76%	7.29%	13.61%	-1.53%
05/10	-14.13%	11.03%	-0.71%	6.19%	9.52%	14.99%	1.89%

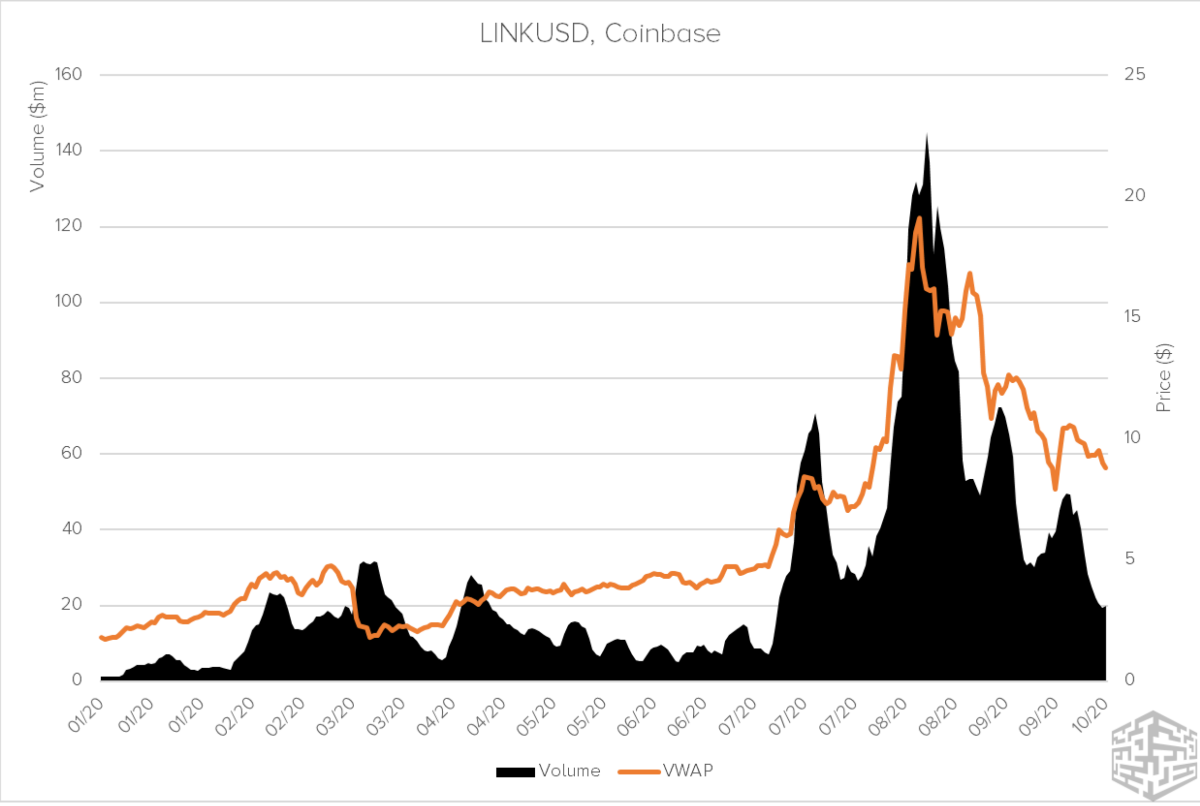
Data via Glassnode. Open interest, change since 30/09.

While BitMEX facing an existential threat of course isn't a good thing for retail market health and confidence by any means, and the combination of the CFTC enforcement and the FCA ruling will certainly have implications for certain other firms (albeit likely none of the other three major players in retail derivatives right now, i.e. Binance/Huobi/OKEx), it is unlikely to pose a structural threat to said markets in the way that it might gave done a year or two ago; BitMEX market share had already been in a persistent downtrend over the past few months and since March in particular.

In any case: even factoring out the impact from the BitMEX and FCA news, volumes and interest on retail derivatives markets are in a similar downwards trend to spot markets. Why have trends in this regard been so poor? As we've said in most recent issues, the key thing to understand about the BTC rally over the past few weeks is that it has not been BTC-driven; it has instead been ETH, and more specifically the DeFi boom, that has been the locus of interest, both in terms of established and new retail money.

The problem is that in DeFi (and, for now, ETH), if the show is not over, at the very least the lights have dimmed. There was always something of an air of doubt around the sustainably of the DeFi boom with regards specifically to the question of demand; the boom had been built on the back of yield mining, and while part of the genius of yield mining was the way in which it was able to constantly recycle held assets into returns (and hence do more with less with regards to assets needing to change hands), it was ultimately still built on inflows of new money into said assets.

While BTC's drawdown has been relatively modest, recent drawdowns among DeFi assets have been brutal; LINK, which has been probably the single most prominent such asset (highest market cap, infrastructure-integral for large parts of DeFi, was already in a generally positive trend prior to the DeFi boom), is down 50% from its mid-August peak and in both price and volume downtrends:



Data via Tradingview. BTCUSD, Coinbase. 7-day MA.

Most pure DeFi plays have suffered even moreso; to give an example, the yearn.finance token, which has been front and centre in the boom (as one of the first projects to really capture the crypto community's imagination back in July and due to its ongoing association with DeFi software developer and cult hero figure Andre Cronje), is now down over 65% off its highs in September:

Data via Tradingview. YFIUSDT, Binance.

Even in the most generous estimates of the potential of DeFi, as we've expressed previously (most notably in the 16th September issue on alts), we tend to think that DeFi has reached something of a plateau point for the time being. (Cronje himself has gone silent over the past two weeks after an early version of his newest project, Eminence, was hacked for $15m just hours after deployment). The last couple of months have essentially represented an exhaustion of the potential of what can be done 'on-the-fly' to some extent (one of the in-jokes of the DeFi community is that everything is "tested in production", i.e. deployed with the implicit acknowledgement that there could easily be bugs or exploits in the system), and we tend to expect things to slow down at least through Q4 of this year.

With no further boost from DeFi, and probably not much from ETH in the short-term (ETH 2.0 still remains firmly planted on the horizon), we hence tend to think that it likely has to be BTC driving the market, if said market is there to be driven. While that's not impossible going into the very end of Q4 and beyond, we find it hard to see a scenario where that happens over the next couple of months in the current macro climate, and hence continue to lean bearish on the quarter as it stands.

Until next week – thank you for reading.

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ABOUT US

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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.