ENIGMA SECURITIES

MAKOR

De-Coding

Crypto

Enigma Weekly

15th July 2020

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

Our Market View

May you live in interesting times. Slightly up this week, but it feels more a result of where precisely we set the yardstick than anything else; the market continues to be incredibly quiet, as we continue to fail to break what now looks like long-term resistance at $9600 and long-term support at $8600. Usual refrain: this does not seem particularly sustainable overall, and the further time we spend in this range, the more severe of a move in either direction we're likely to see when we do finally move out of range. Currently riding relatively high after a surge on Tuesday, so there is an opportunity to establish higher, but believe it when you see it.

Alts too have mostly cooled off this week, with a couple in particular – ADA and LINK – actually seeing decent drawdowns compared to previous highs. Some degree of exhaustion was to be expected here (remember that LINK traded at $4.50 at the start of the month), so wouldn't exactly panic as it stands, but our previous concerns about a number of the emergent mid-cap projects getting to levels of capitalisation that have proved to be a limiter in the past remain.

Incidentally, keep a watch on ETH – despite a number of the DeFi success stories (including LINK) relying on the Ethereum blockchain, its growth over the last month or so has been incredibly modest, and at this point, it seems grossly underbought.

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

Major

Ticker	Price	7D	1M	6M	12M	Cap
BTC	9339	1.54%	-2.39%	12.08%	-1.52%	172.2B
ETH	243.96	2.40%	0.56%	52.25%	17.75%	27.29B
XRP	0.19815	0.59%	4.96%	-9.62%	-35.98%	8.88B
BCH	230.35	1.25%	-4.47%	-25.66%	-24.54%	4.25B
LTC	43.50	0.96%	-1.81%	-18.25%	-51.02%	2.83B
EOS	2.5953	2.82%	0.83%	-25.67%	-39.25%	2.43B
Selected						
Ticker	Price	7D	1M	6M	12M	Cap
ADA	0.12200	-4.71%	48.98%	181.90%	104.20%	3.16B
LINK	7.5987	-8.82%	72.89%	209.80%	237.80%	2.66B
XTZ	3.0182	0.27%	12.82%	101.50%	198.90%	2.20B

The return of SPX-BTC correlation: cause for concern?

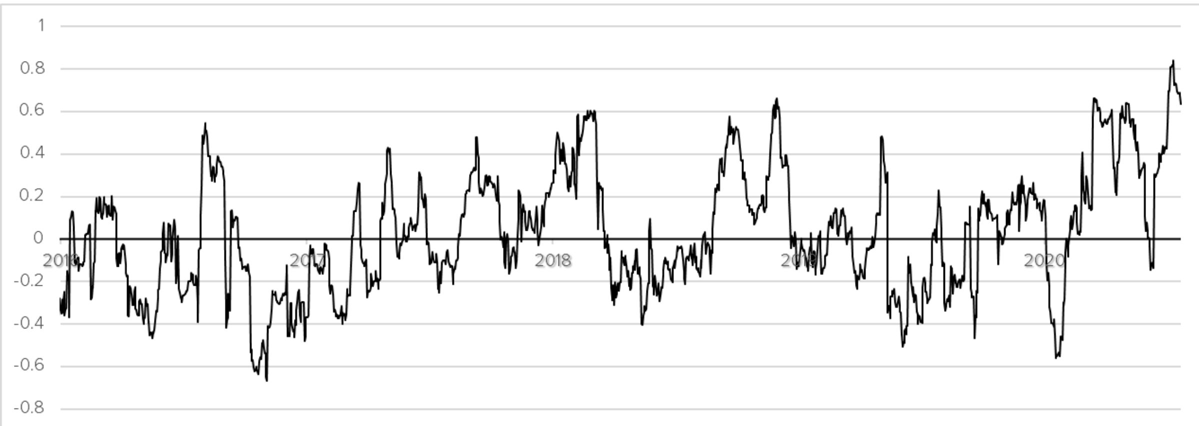
We last wrote about SPX correlation back on April 1st. As we noted, at the time:

> One of the big truisms that has emerged over the last few weeks has been this: in the short-term at least, BTC and [US] equities are marching in lockstep, and will likely to continue to march in lockstep. This is something that we first noticed in earnest back on 3rd March… at that point, the short-term relationship looked fairly existent, but not so aggressively as to serve as confirmation…Following the events of the last month or so, however, the relationship now looks far stronger and far more ‘confirmed’ than it did then, to the extent of forming a valid truism at least to some degree.

Our broad conclusion then was that while the data backed up the existence of such a correlation, and it was an useful tool for understanding and trading crypto markets in the extreme short-term, it was not something that was too likely to last long-term.

In the following weeks, the relationship did start to fall away; however, it now appears to at least be back in view to some degree, and it hence seems like an opportune moment to both re-examine how well that correlation has stood up over time (both in the context of the last few years and in the context of 2020 specifically), and how it might hold over what still seems likely to be a potentially tumultuous few months on the equities side in particular.

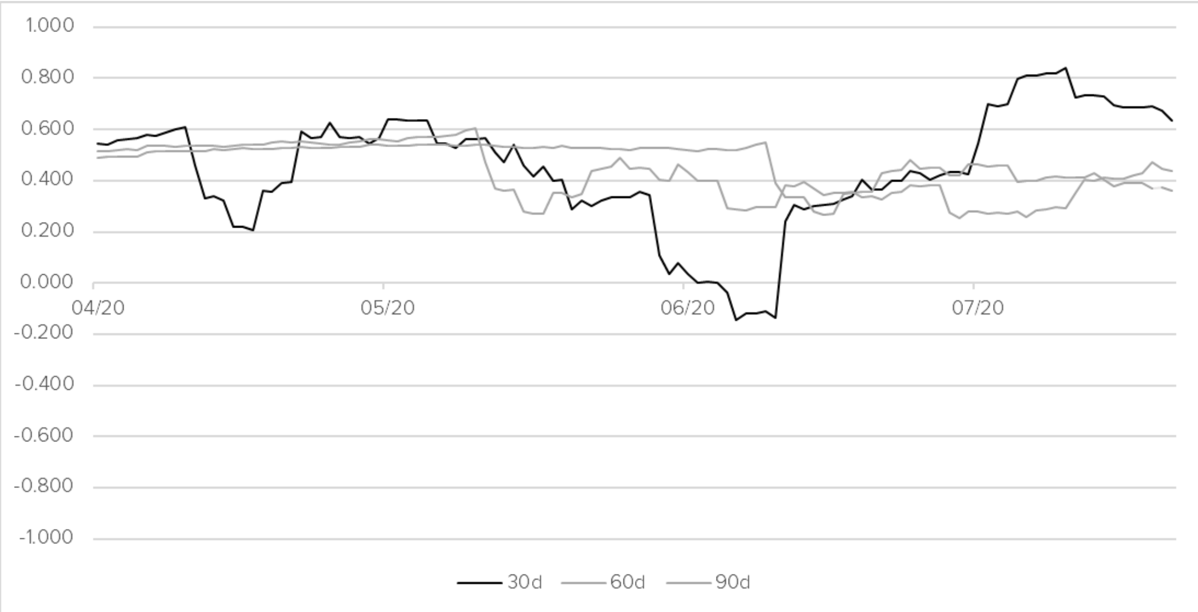
To start off, let us start at the most basic possible point: the correlation over the entire lifespan of BTC, based on daily changes. We will note at this point to start out that for the purposes of this issue, we will specifically be using data on the Oanda SPX500USD CFD, rather than a simple derived index price measure; the contract is sufficiently liquid and well-traded as to be essentially inseparable from index price measurements anyway, and allows us to see implied movements outside of US trading hours (trading on it is active for 115 hours in a typical week).



Pearson correlation, 30-day MA. Data: Coinbase, BTCUSD; Oanda, SPX500USD.

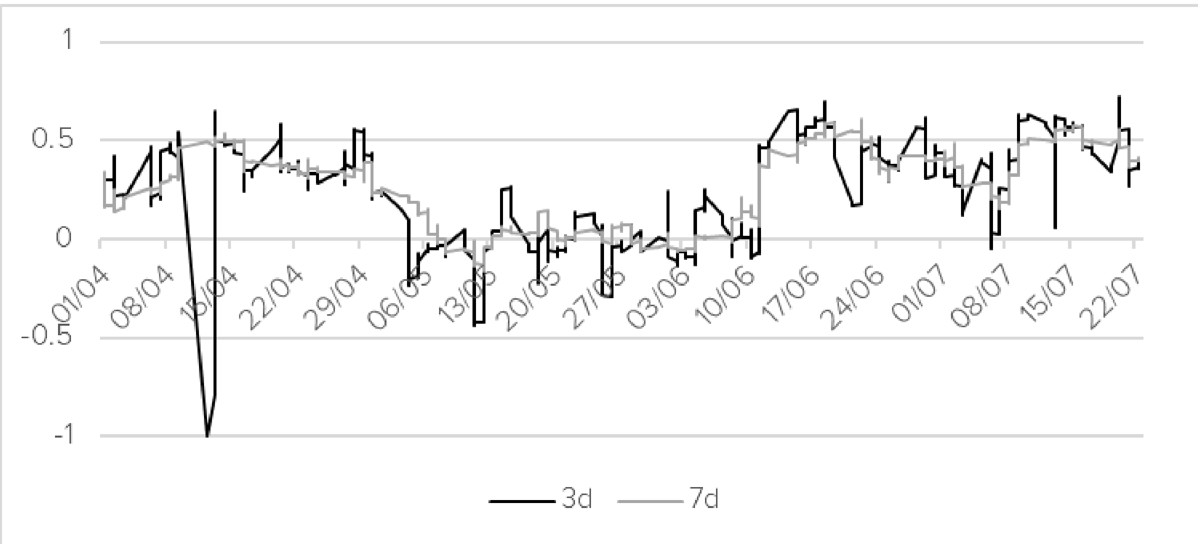
Correlations on price movements were extremely weak or negative for most of the very early years of BTC; we did start seeing some spikes in late 2017 and early 2018 (the SPX happened to see one of its stronger quarters in years in Q4 2017, and continued its boom into January before finally correcting not too far after BTC did the same), but for the most part, not too significant; by way of comparison, assets such as ETH and LTC have maintained somewhere in the region of a 0.8-0.9 correlation fairly consistently since Q2 2018.

However, as you can see, over the past few months, we have been getting far, far closer. While the degree to which it moved was slightly surprising, it is not altogether shocking that the correlation was so high in March; as the saying goes, all correlations go to 1 in a crisis, and the crash in March was one of the most severe crises in that regard in market history. What was a little more surprising was for how long that relationship held into April and March (even allowing for the fact that the nature of these moving-average measurements of course casts something of a weight). Correlation faded for a while, but we have been seeing something of a recovery once more in recent weeks, reaching a peak of 0.840 on 10th July:



Pearson correlation, 30-day, 60-day, and 90-day MA. Data: Coinbase, BTCUSD; Oanda, SPX500USD.

We have been fading slightly since then; looking at things through the lens of hourly data (which tends to naturally be more noisy, but is arguably more important for assessing microcorrelations), we did see correlation continue to rise into the start of this week (particularly on the 3-day MA, albeit with that being a flawed measure owing to market closure over the weekend):



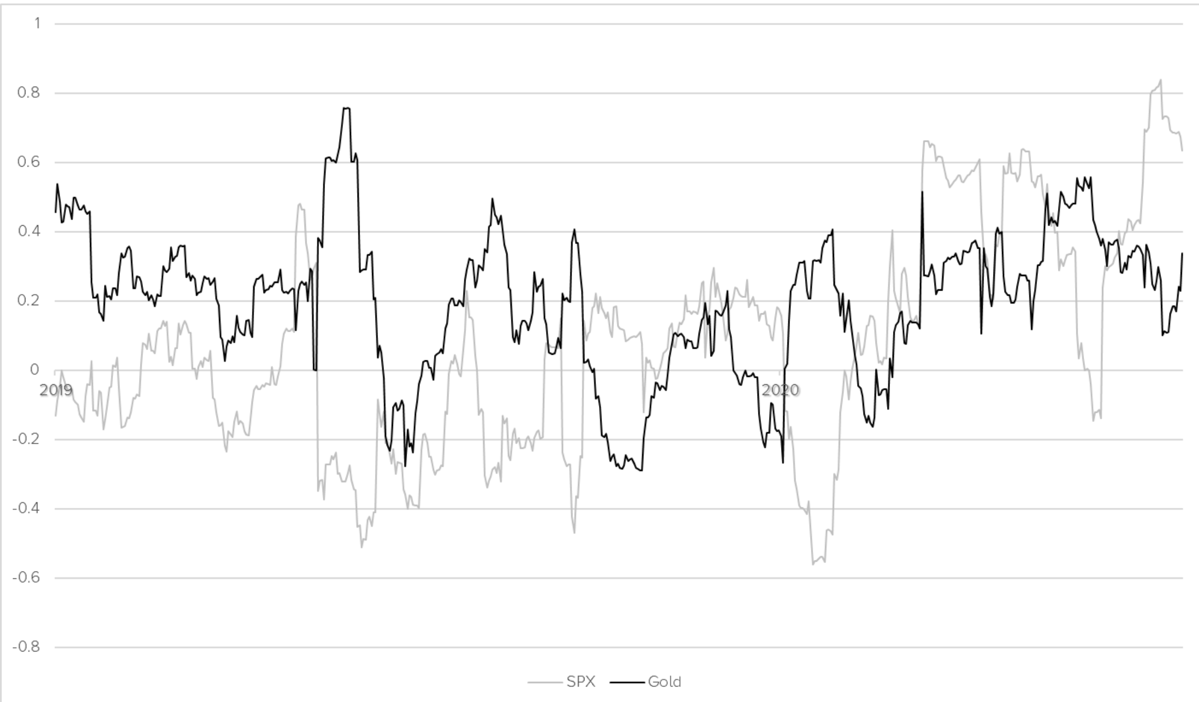
Pearson correlation, 3-day and 7-day MA. Data: Coinbase, BTCUSD; Oanda, SPX500USD.

Still: the relationship remains generally existent, and there are both micro and macro implications to this. The micro implication is: in moments of extreme stress, expect to see more of what we saw both pre- and post-Black Thursday, with regards to BTC acting as a risk-on asset. For instance, looking at Q2, if we take the top 5% and bottom 5% of hourly performances on SPX500 (in terms of percentage change), we find this:

Q2 2020		SPX			BTC				
	Count	Min	Max	Avg	Min	Max	Avg	+	-
Top 5%	76	0.58%	1.85%	0.87%	-1.62%	4.14%	0.43%	62	14
Mid 90%	1318	-0.58%	0.57%	0.02%	-5.62%	4.70%	0.03%	692	626
Bot 5%	74	-1.70%	-0.59%	-0.94%	-4.66%	2.44%	-0.41%	16	58

There were several moments in late March and early April where BTC moved aggressively with the SPX, including notably drops and surges on 15th and 23rd March respectively Hence, at the least, it remains something to be aware of, particularly given the macro context. The significance of the recurrence of SPX correlation is not with regards to providing an immediate market signal (as much as we'd like to have such a signal right now), it's with regards to this: what happens when (and, no matter how optimistic you are, there has to be a when about this to some degree) equities run into trouble once more?

The theory - or, at least, the hope - throughout 2019 in particular was that BTC would be able to prove that it isn't a pure risk-on asset, and would trade more in the vein of something like gold. The last few months have not been kind for that particular narrative, and correlation has drifted extremely low over the past few weeks:



Pearson correlation, 30-day MA.

No matter what the vision for BTC long-term may be, it right now seems hard to see it as trading as anything other than a risk-on asset. That's not to say that it will always be traded or priced in that manner, but for the time being, it seems that the 'digital gold' narratives – insofar as it relates to price and perception – probably need to be put well on the back-burner.

Does that spell doom for BTC's outlook going forward? Not really; even if we accept that it's likely to trade as such, it's hard to see a situation like Black Thursday occurring again in the short-term (particularly given that so much of said crisis was a liquidity crisis above all else, and that there hence was not only a sentiment contribution, but to at least a small degree, a mechanical contribution from institutional traders directly leading from the collapse in equities and similar markets to crypto markets); we are unlikely to see a repeat of $4XXX or the like.

It does, however, bring back that impetus to pay close attention to the state of equities markets going forward, and it does somewhat colour our view poorly for Q4 – between earnings season in October, the Presidential race ending in November, and the potential disaster scenario of attempting to deal with a still-ongoing pandemic during the winter months for the US and most other traditional markets hubs, there is clearly a huge amount of risk accumulating.

Our concern when we fell in March was whether BTC would break – not in terms of extinction, but in terms of seeing an extended vacuum of confidence similar to 2011 or 2013. Clearly, it has not broken, and while it's a cliché, chances are better than not that we don't see it go that low again on a similar future crisis. However, at current levels, there remains plenty of room for it to bend, and as we often say, it will need to be monitored closely as we get to those risk periods.

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.