De-Coding Crypto

Weekly Analysis

The sacrificial GRAM lamb: an epoch ended?

October 16, 2019

In this week's issue, we examine Telegram's halted ICO, and look at the message that the SEC and other regulators are looking to set out going forward. We also look at the GBTC (Grayscale Bitcoin Trust) premium, a traditionally useful metric, and assess its relevance in a developing market infrastructure.

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Our Market View

May you live in interesting times. The past week has proven to be one primarily of consolidation for BTC and ETH with smaller coins (possibly excepting XRP) mostly marking out a clearer bear trend. A brief challenge by BTC at $8700 on Friday was not sustained, and the coin has traded within range since, descending overnight on Tuesday to its current price.

While there are now some concerning points in trading technicals, for the most part, we feel that recent action is more likely to represent a bear trap than a more severe trend, and remain short-term bullish on BTC for at least the remainder of October.

Market Snapshot

Major

Ticker	Price	7D	1M	6M	12M	Cap
BTC	8150.31	-0.51%	-19.40%	53.20%	26.89%	146.66B
ETH	179.095	-2.44%	-5.71%	3.05%	-11.44%	19.37B
XRP	0.290468	3.60%	12.60%	-11.62%	-35.98%	12.53B
BCH	222.143	-4.34%	-26.11%	-25.98%	-49.99%	4.01B
LTC	54.6085	-5.63%	-22.02%	-33.14%	4.53%	3.45B
EOS	2.95113	-7.46%	-25.85%	-45.80%	-44.82%	3.02B

Selected

Ticker	Price	7D	1M	6M	12M	Cap
BNB	18.5072	6.32%	-18.29%	*Una*	*Una*	2.87B
TRX	0.01564	-8.71%	0.92%	-39.83%	-34.89%	1.03B
LINK	2.30804	-20.58%	47.91%	-0.71%	-0.71%	0.84B

The sacrificial GRAM lamb: an epoch ended?

The question of the moment: has the SEC closed the gate? We, as with others, expected this month to see a shift in approach from the SEC. The agency had marked the end of the financial year, as they often do, with some major settlements - EOS parent company Block.One paid a $24 million fine over their previous ICO, and a second settlement for small token SiaCoin was announced the following day.

While the general reaction to the settlement saw it as a positive for both sides, there was a minority view that expressed some concern over what this meant for future ICOs, STOs, and so on, going forward. The argument went as such: EOS paid $24 million on a total raise of $4.1 billion, a fraction of a percentage; understood in this context, did this not send out exactly the wrong message? Was the implication not that any company in the cryptocurrency space could effectively break securities rules and pay back a fraction of the amount raised as a recompense? To quote Castle Island Ventures partner Nic Carter, via decrypt.co:

> If this is the totality of it then I'm a little disappointed—the SEC has insisted that a standard exists and has failed to follow through on their warnings. It makes them look weak and opens up lots of moral hazard.

Our instinct, as partially expressed in last week's newsletter, was a little less severe. The nature of the Sia Coin fine - $240,000 on a $110,000 raise - and its timing seemed to us to hint moreso that while the SEC was willing to lean to the lenient end on existing major players in the space, the suggestion was this: what's done is done, but what's to come would be a different story.

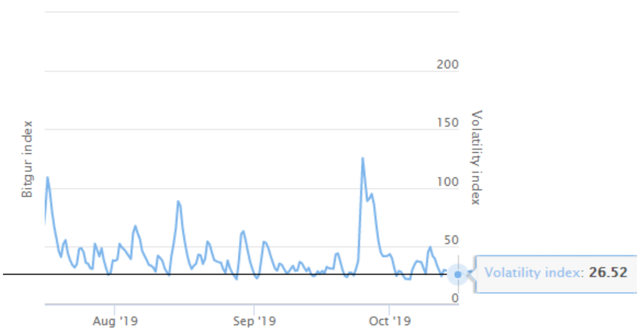
Even allowing for that, the SEC announcement late on Friday that they would be moving to attempt to block Telegram's ICO came as a significant surprise.

The Telegram Open Network, and the associated GRAM coin, have seen their fair share of criticism over the preceding months. While TON presents more effective use cases than most blockchain projects simply because of its affiliation with Telegram and its userbase (acknowledged in March 2018 as over 200 million, and probably at least approaching 300 million by now), there were still concerns that the coins, and the SAFT (Simple Agreement for Future Tokens), represented a very deliberate attempt to sell a security without full disclosure.

To attempt to sum up the scheme, as presented by critics, very simply: Telegram has technically sold no GRAM as of yet. They have, however, raised $1.7 billion in SAFTs sold to accredited investors in January and March 2018 (which they tacitly agree as being securities). On the ICO date (which was to be October 31st), the SAFTs are converted to GRAM, which has hence technically not been involved in any sort of pre-sale, and hence is a commodity rather than a security.

The SAFT scheme always stood on very shaky ground, but the tacit opinion among all in the space has been that TON and GRAM were big enough that even with those concerns, and with the relatively low portion of US and Western money involved (the SEC estimated that around one-third of tokens were bought by US residents), this, too, shall pass. Clearly, it has not, and whether GRAM is ever issued now remains to be seen. The larger question, then, is this: what exactly does this represent going forward?

The biggest thing we would point to is simply the stability of most major market-cap coins over most of the past week, including at the time of writing:



Credit: Bitgur. Bitgur Volatility Index (BVI) measures overall market volatility based on the following coins: BTC, ETH, XRP, BCH, LTC, BNB, EOS, BSV, XLM, TRX.

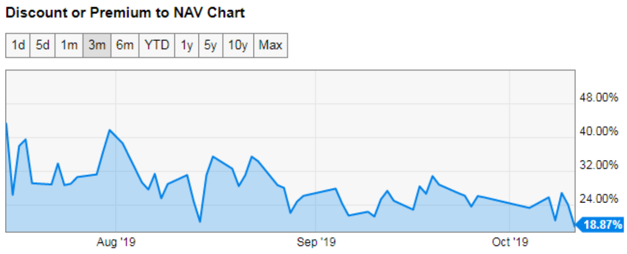
To reiterate from last week, our tendency is to think that it is already too late for new (non-stable) coins or tokens, and that anything to come is almost certainly going to be built on systems that are either totally or substantially already in place - certainly BTC and ETH, and with room to prove for XRP and smaller networks. The SEC's shift to activity here, and the direction it sets for FY 2020, further reinforce that as a general principle for us.

The expansion of cryptocurrency over the preceding half-decade or so has been conducted in such a way where, admittedly somewhat necessarily, actors and companies have again and again plunged themselves into grey areas of regulation and legislation. The SEC are sending out a very clear message to the crypto industry: we are past that now. This is no bad thing, but the implication is clear: for companies coming into the space, the mantra must be to move cautiously, and be very careful indeed around the fine china. We hence see this news as generally bullish for all established high-cap coins.

GBTC premiums and the contraction of spread

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.

The premium, in effect, represents how far institutional investors are willing to effectively overpay for exposure to BTC, and hence a high premium is generally considered to be bullish for BTC, and a low premium is considered to be bearish. In this light, recent weeks have not presented good augurs. The premium, which peaked above 40% on June 21st (slightly after midway through the run to $13,000) showed below 20% on Friday (at 18.87%) - the first time since June, and threatening a return to the lower range seen between October 2018 and late March 2019. At the time of publication, it was down further, to just 16.12%



Credit: ycharts.com

This, understandably, has caused a not-insignificant degree of concern, headlined by this assertion by Cane Island Alternative Advisors's Timothy Peterson:

> When bitcoin's price was well above the GBTC premium, it fell substantially. Now, a gap has opened up again. GBTC's premium has fallen from $4.00 per share to $2.00 per share. This implies that bitcoin's price should fall from about $12,000 to $6,000.

We acknowledge the worry here, and remain very much concerned regarding the possibility of a spiral downwards if the current second support in $7500-$7700 range is tested. Nonetheless, we would caution against reading too much into the GBTC premium. For one, the nature of GBTC as a product is that its premium exists primarily because of a fundamental inefficiency in the market (i.e. it is a way for large institutions to get exposure to crypto in the absence of other regulated products) - we would expect GBTC's premium to reduce over time as institutions are able to gain exposure through other means.

However, an additional context here is that GBTC is currently in the middle of a special offering - it has reopened its private placement window as of October 8th, allowing accredited investors to purchase at no premium (with an one-year lockup). GBTC volumes have hence been significantly lower than usual (1.2 million on Monday for the lowest day of trading since March), as there simply is not an incentive for institutionals to buy at open market prices, and there has rarely if ever been a real incentive for retail investors to invest (moves have been made by Grayscale in the past to make GBTC more accessible to retail investors - most notably, a 91-for-1 split on stock in January 2018 that brought it from a previous peak of $1970 to its current range - but it is still, by design, not an attractive retail product).

There is an argument to be made that the act of opening private placement might itself be of concern; what we would say is that Grayscale opens placement approximately every six months or so (with the last opening in July), and this is hence no bolt from the blue. Additionally, Greyscale's quarterly report, released on Tuesday, indicated that Q3 of 2019 had seen their heaviest inflows to date (at $171.7 million, or around $2 million a day).

Overall, while we recognise the cause for concern in falling GBTC premiums, we put relatively little weight on it as a bearish indicator in the current state of market development, and it does not significantly alter our overall market outlook.

What we're reading

Facebook's Libra announces board as support shrinks further (Reuters): Less than ideal, but it should be stressed that the withdrawals represent a very specific class of partner – five payment providers, Ebay (a former subsidiary of PayPal), and one other in the form of Booking Holding. Other partners have reaffirmed their support in strong terms, and we also note a far more explicitly conciliatory approach to Visa and Mastercard (who have fewer concerns over their pre-existing businesses in China) than PayPal, Stripe, or Booking Holding (who all have significant interests there already).

Grayscale Wins Approval for First Public Digital Currency Index Fund (CoinDesk): "The DLC exposes investors to the largest cryptocurrencies based on market capitalization at any time. The fund targets upwards of 70 percent of the digital currency market. As of Sept. 30, 2019, that was 80.3 percent bitcoin, 9.9 percent ethereum, 5.8 percent XRP, 2.2 percent bitcoin cash and 1.8 percent litecoin". A nice step forward, though we remain sceptical of just how much value 'diversified' products of this nature in cryptocurrency possess.

CFTC Chairman Confirms Ether Cryptocurrency Is a Commodity (CoinDesk): To be entirely clear here: this is not any sort of bold step forward. Tarbert: "We haven't said anything about ether – until now. It is my view as chairman of the CFTC that ether is a commodity." – nothing has been carved in stone here. The general presumption anyway has been that ETH is under no serious regulatory threat, and this declaration is interesting only insofar as it opens the door for more official regulatory clarity over the coming months.

Bank of England's Carney defends the idea of cryptocurrencies (The Star): "That's not good enough in this day and age. Those payments should be instantaneous, it should be the same as us exchanging a banknote online. It should be virtually costless and it should be 100 per cent resilient." 'Carney defends Libra' has been, and will continue to be, good headline bait above all else, but it does demonstrate that for all the talk of hostile regulators, there are high-level impetuses towards rationalization of payment systems too.

Texas Bitcoin Mining Startup Gets $50 Million From Peter Thiel to Steal China's Crypto Crown (Fortune): Again, the headlines are a little much, but this is intriguing, particularly: "Liegl says Layer1 aspires to be the biggest Bitcoin miner in the world by controlling all aspects of the process—from chip manufacturing to electricity production to cooling. In the longer term, the company plans to use its mining facilities as a base layer for a larger cryptocurrency enterprise that will include financial services." In the context of the current semiconductors bubble, the timing for a project with such a large focus on infrastructure and operating expenses seems to be worth noting.

Wilshire Phoenix Updates Its Bitcoin ETF Filing With SEC (CoinTelegraph): The dance begins again. Should be noted that tone has been near-apocalyptic from crypto legal experts lately. Compound Finance's General Counsel Jake Chervinsky: "At this point, it's reasonable to assume that Jay Clayton's SEC will never approve a bitcoin ETF. His term ends on June 5, 2021, but could go another 18 months longer. Usually we'd see new ETF proposals filed immediately after rejection, but it might be time to take a year off."

Until next week – thank you for reading.

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