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MAKOR

De-Coding Crypto

Enigma Weekly

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Our Market View

May you live in interesting times. As usual with BTC: first slowly, then suddenly. Creeped back up to the top of the range over the last few days, stayed up there but without showing much momentum, and then smashed through on Wednesday morning, broke the all-time high, and immediately added another 5% and counting on top of that. While we've had fakeouts of this sort before (as with the first all-time high break at the end of November), this does seem like solid invalidation for the potential end-of-year bearish case; still something to be aware of, but hard not to see overall trend from here as short-term positive for now.

Mixed bag for alts overall - most have slipped slightly vs. BTC, with a handful keeping steady and one or two making modest gains. Our long-term view remains the same - possible that they gain on a transcendent basis on a given day or week, particularly during good days for BTC, but should continue to lose ground in the aggregate. XRP was trading back below $0.50 for the first time this morning; it has since been buoyed on the BTC move, but the velocity it had been gaining after the $0.50 break (down to $0.43 in very short order at one point) does tend to make us think that focus on that level remains extremely relevant going forward.

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

Major

Ticker	Price	7D	1M	6M	12M	Cap
BTC	20696	12.52%	23.15%	121.10%	189.60%	384.4B
ETH	621.54	8.83%	34.08%	171.00%	388.00%	70.77B
XRP	0.50393	-9.10%	75.16%	167.70%	162.70%	22.88B
BCH	303.53	12.59%	19.00%	29.09%	61.30%	5.65B
LTC	88.44	14.14%	22.51%	100.40%	119.70%	5.85B
EOS	3.02984	8.01%	16.65%	18.88%	23.32%	2.86B

Selected

Ticker	Price	7D	1M	6M	12M	Cap
LINK	13.21	6.62%	4.54%	216.80%	610.20%	5.24B
ADA	0.16222	12.53%	55.30%	103.60%	388.50%	5.05B
XTZ	2.322	6.92%	11.17%	-11.45%	57.34%	1.75B

The three big questions for BTC in 2021

How far can we (genuinely) go?

As I write this, BTC has just broken through $20,000, and while there is still some slight uncertainty with how it ends up settling above here (it should be an invalidation of the bear case re: a potential 'Grey Christmas' scenario), it does seem likely now that we end the year on a high, cleanly breaking the 2017 numbers and setting up for a historic uptrend in 2021.

The obvious question that is travelling up through everyone's throats and onto their lips is "just how far we can go from here?". And, in truth: anyone who can give an extremely firm answer to that is, at best, deluded, and understanding that is crucial to managing one's self in what is nonetheless likely to be an universally profitable year.

The strongest criticism of BTC during the 2017 run was that BTC was an asset without intrinsic value. To quote just one of the Warren Buffett declarations in that regard, from February of this year: "Cryptocurrencies basically have no value...they don't produce anything...you can't do anything with it except sell it to somebody else". Of course, in the basic sense, that's not wrong; cryptocurrencies are not productive assets (even if there is a constant effort to portray them as such, as exemplified by much of the branding around the initial DeFi bubble in the summer).

BTC's value is, and always has been, extrinsic. It is worth what people will pay for it.

As an argument against BTC, it's awful; as much as we may want to pretend otherwise, it is no different to absolutely any other store-of-value in that regard. A grand total of 7.5% of gold mined last year was used for industrial purposes, and effective 'gold inflation' (i.e. how much new gold is mined each year compared to effective supply) is usually around 2%. The real-world, baseline value for gold if we abandoned all our preconceptions about it and just used it for functional purposes would be a tiny fraction of where it is now or has been at any point in living memory.

However, it’s not something to dismiss entirely. BTC is, indeed, worth what people will pay for it, and that absolutely is the esteem that anything one sees in terms of price 'predictions' should be held: as capacity to grow towards, not as oracle-like prediction. We want to work out the point at which we essentially exhaust demand in the short term above all else.

So, with that said: how far does that capacity go? It seems almost impossible that it does not, at a very least, represent a multiple of where we are now. The simplest way to put it is simply to express things in terms of the total aggregate market cap for gold:

	BTC price	BTC market cap ($m)	Gold price	Gold market cap ($m)
31/12/2019	7,166	129,936	1517.18	10,573,676
01/12/2020	18,783	348,593	1814.79	12,647,808
5% of gold	*30,114*	*632,390*	*1814.79*	*12,647,808*
10% of gold	*60,228*	*1,264,781*	*1814.79*	*12,647,808*
20% of gold	*120,455*	*2,529,562*	*1814.79*	*12,647,808*

Data via World Gold Council and Tradingview.

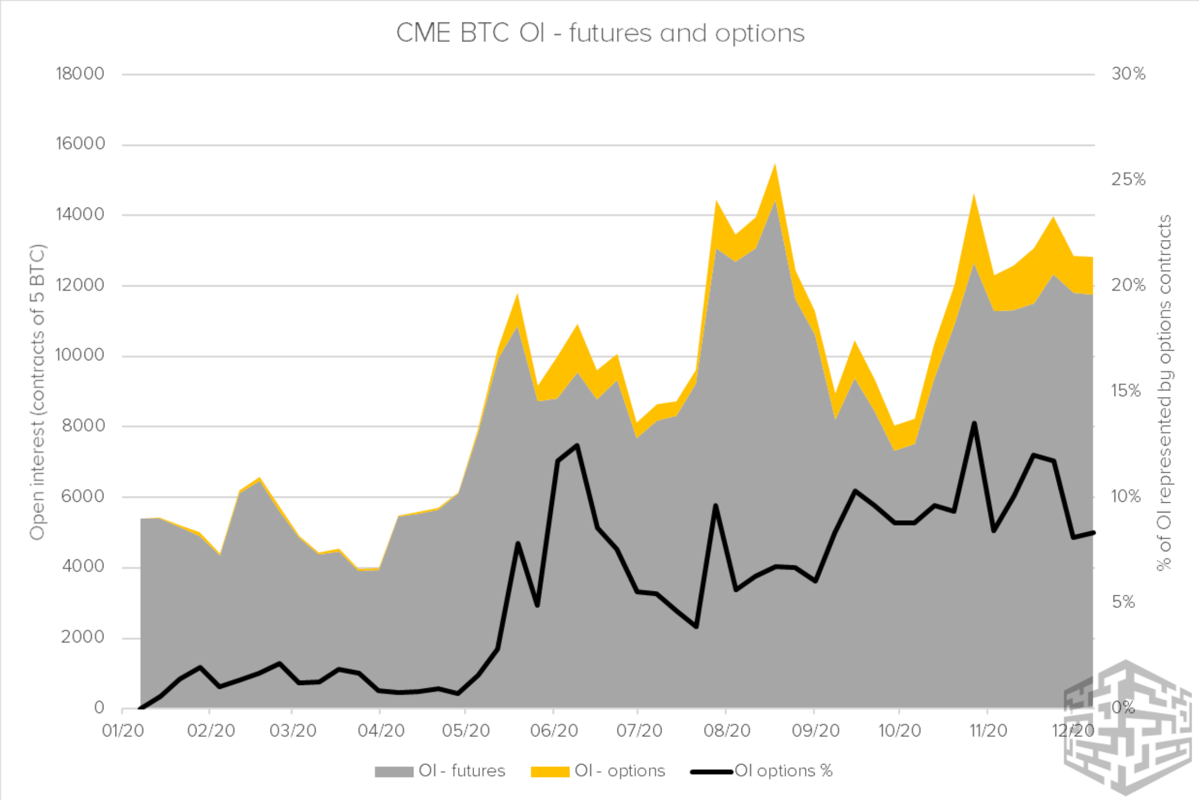
If BTC reaches even 10% of the market cap of gold on a nominal basis (and, we should point out here, the true market cap of BTC is significantly lower due to the number of lost coins etc. at this point), it implies a fully diluted valuation of $60,000 - 3x from current levels, 19x from the cycle nadir in 2019 (for reference: the increase from the 2017 nadir was 27x, although of course it was much higher if measuring back to the beginning of the cycle in 2015).

We tend to think that's likely to be where it lands; anything significantly above $100,000 is probably a fantasy (or, if not a fantasy, contingent on total societal collapse), but we do think capacity is there for a significant increase from current levels. However, everything, ultimately, does depend on demand, which brings us onto our second question.

What do we want to see?

With that in mind: what are the signs that we're looking for with regards to the sustention and expansion of that current momentum? On the positive side, we'd say:

1) The evolution of options-dependent products. After years of waiting, the CME finally launched options markets at the start of the year, and what we've seen in terms of open interest growth over said year has been telling:



Data via CFTC.

Options markets have seen healthy growth, and have picked up on the November/December run, but the treatment of them by institutional actors still feels somewhat like futures in 2018/2019 - still basically a sideshow/spectacle, not something that one would feel confident building on top of as of yet, a year for proving the concept more than anything else. In particular, note that surge in May and June - that was, very, very clearly, simply a case of a small number of actors buying into the myth of the myth re: The Halvening and gambling on out-of-the-money calls just in case we ran upwards in dramatic fashion after it.

This year has been about proving solidity and proving liquidity in that regard; while still imperfect in places (e.g. CME volumes/liquidity still running weakly outside of the next monthly expiry), we are at or near a place where institutional actors are going to start feeling confident about building sophisticated products on the basis of options markets (things like the increasingly ubiquitous autocall in equities derivatives markets); we tend to think that progress in that regard is likely to have an outsized positive effect on price, and hence should be watched carefully.

2) A major access development, in one form or another, on the ETP/ETF side. As we spoke about last week, we tend to think that there's a definite connection to some degree with 2020's upwards trend and the increased accessibility through one way or another of crypto ETPs. Again, just to emphasise how ridiculous ETP growth was this year, we're including the GBTC AUM chart once again (it will likely pass $11bn today):

Data via Ycharts.

A lot of avenues have been tapped at this point, but the one very clear potential development that remains is an US-listed ETP. While nothing immediate is on the horizon there, expectations are generally that we do finally see some positive movements in that regard (SEC commissioner Jay Clayton – a long-time opponent of crypto – retiring, previous US ETP applicants like Bitwise and Wilshere Phoenix moving forward with OTC products for now as essentially a test case for such a move after having not done so in the past); we actually think there's a not inconsiderable chance that a launch could end up marking something close to a cycle top down the road (like the CME launch did in 2017) rather than being an accelerant in itself, but either way, movement in that regard is worth monitoring.

3) The slow, boring march of institutional underpinning. As we've said many times: the rally in recent weeks has been underpinned by significant spot buying from family offices, HNWIs, and some larger actors mainly through vehicles like Grayscale. The continuation of full orderbooks, and of large actors coming around to the perception of BTC as a store-of-value and as a treasury asset, continues to be instrumental to its growth.

While we do think that there will inevitably be a retail element to this run at some point, given the amount of money we are talking about at this point to raise BTC price and market cap by each successive percentage point, we have to continue seeing those consistent flows if the market state is to remain constructive and not give way to 2018-style volatility again.

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What do we not want to see?

Most of our concerns fall into one of two categories at this point:

1) CEXpocalypse. CEX in the crypto world refers to centralised exchanges - the Coinbases, Binances, OKExs of the world, which remain the dominant vehicle by which most of the market still gains exposure in one form or another to BTC (and other coins).

You will see the odd claim that DEXs (decentralised exchanges) will destroy CEXs next year, having gone from basically irrelevant compared to them in 2019 and before, to something of at least some note in 2020. We don't really buy into that for a number of reasons (the custodial element of CEXs, accessibility to new clients, stablecoins are still ultimately crypto themselves), but we could see bumpy times ahead.

Almost all actors in the space do have potential problems lurking in the shadows (OKEx and Huobi's negatively evolving relationship with Chinese authorities, Binance's rumoured restructuring scheme and their related lawsuit against Forbes for reporting on said scheme, Bitfinex linked to Tether's eternal legal concerns in an increasingly hostile legislative environments, etc.); only the major US ones (Coinbase, Kraken, Gemini) seem to be in a genuinely solid spot, and even Coinbase has its issues operationally as of late.

While a body blow to one would be far less damaging to the rest of the space compared to a similar theoretical occurrence in 2017/2018, it does remain a concern, especially given their continuing status as the principal on-ramps for most new buyers.

2) A 2017-style mania. One of the big things that has caught experienced players in the space off guard with regards to recent action is that we have seen very, very limited drawdowns for the most part; the September dip went down just 21% from local highs in total, and the late-November dip was just 17%. Drawdowns have still done what they tend to do with regards to wiping out derivatives traders and the like, but they aren't triggering spot sells for the most part; the market has been remarkably stable.

To sound like a broken record: this is because of the nature of the buyers on this run, and the time horizon it's being bought for, i.e. that horizon being anything other than immediate. In essence, more of the treasury asset talk.

While we don't think buyers right now are looking for a quick buck by any means, ultimately, there will be a point at which most end up selling; however, we tend not to think of it as being at a certain price, but rather at a certain threshold of volatility. In our view, that hence will be the other big thing to keep looking at as we end up moving up; there will come a point at which selling pressure re-emerges, but it's likely to be defined quite differently to how we're used to thinking about it from the 2017 and 2019 runs.

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.