De-Coding Crypto
Weekly Analysis

Three concerns for crypto in 2020

January 2, 2020

In this week's issue, we focus on some potential stumbling points for crypto in 2020, including catalysts – and lack thereof – for another bull market, and the infrastructural questions at the heart of the industry that remain unanswered.

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Our Market View

May you live in interesting times. Happy New Year. A relatively quiet couple of weeks, mostly as expected; the dip on the 16th to the 18th was essentially the only time that BTC found itself outside that $7100-$7600 range that started emerging at the start of the month, with volumes diving to their lowest levels since March. It generally seems very likely that there will be a breakout either on the weekend or early next week; our inclination would be that we see one more dip and briefly test below $7000 again before moving back up.

Alts checked out positively almost across the board over the past 7 days, but find themselves down versus BTC on the month. This all still essentially stems from a failure to fully recover from the one single shock that was the aforementioned BTC dip over a fortnight ago. We would expect ETH in particular to keep regaining ground (it is currently up around 3% vs. BTC since the 19th), but we have been extremely disappointed at the rate of recovery so far and are watching carefully for more signs of life in the coming week or two.

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

Major

Ticker	Price	7D	1M	6M	12M	Cap
BTC	7135.78	-1.06%	-2.94%	-37.90%	77.85%	129.4B
ETH	129.382	3.12%	-12.88%	-57.83%	-14.19%	14.12B
XRP	0.191206	1.39%	-13.55%	-52.12%	-47.36%	8.29B
BCH	202.079	8.62%	-5.25%	-51.10%	26.38%	3.68B
LTC	41.3621	3.69%	-9.85%	-65.63%	9.58%	2.64B
EOS	2.58568	3.57%	-5.13%	-56.86%	-6.02%	2.45B

Selected

Ticker	Price	7D	1M	6M	12M	Cap
BNB	13.4566	2.05%	-12.12%	-40.58%	-40.58%	2.08B

Three concerns for crypto in 2020

Let us be crystal clear on this: we absolutely are bullish on the state of cryptocurrency in general in 2020. We tend to think it is more likely than not that BTC will chart a new ATH by year's end, and a lot of the work that has been done during 2018 and 2019 behind the scenes should start bearing public fruit in too many areas to count.

However, as tends to befit the new year, the virtual airwaves are filled with nothing but hope and optimism. To that end, it seems like us to be the perfect time to take a step back, and ask: what foreseeables could go wrong for crypto in 2020?

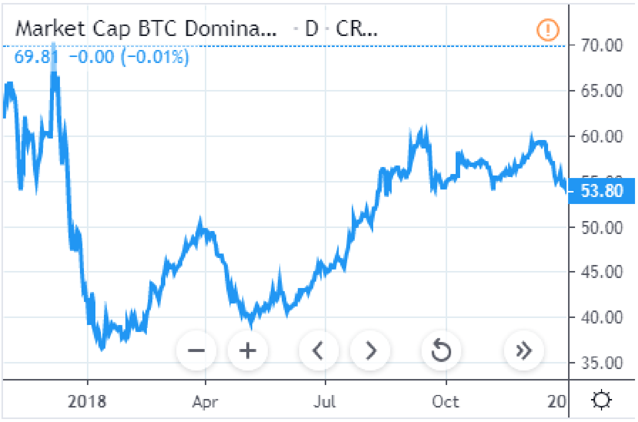
Asset, not asset class

Let us start the year as we mean to go on: with a cliché. If you only read one long-form piece on crypto this year, it should probably be this one from Ryan Selkis over at Messari Research: Crypto Theses for 2020. There is far more in it that we tend to agree with than the inverse, and every time we look back over it, we tend to find another little nugget or two that gets us to thinking. For today, it's this:

> An interesting thing about crypto is that bitcoin has not actually led a supercycle rally since 2013. There's evidence to suggest that, back then, family office and accredited investor interest in the Bitcoin Investment Trust led the rally. In 2017, it was ETH and ICOs that led the rally...Why does this history matter? Because bitcoin *itself* hasn't sparked a proper rally in six years, and the much hyped "halving" narrative is bullshit because the magnitude of the decline in new issuance as a percentage of market cap is tiny. Instead, the 2013 and 2017 rallies were driven by new types of buyers. It just so happens bitcoin is the most likely asset to attract the next major new type of buyer again today: institutions.

We don't 100% agree on the fecality of the halving narrative (although more on that later), but this did bring us back to something that we tend to think has quietly been a big theme in the collective consciousness of the crypto markets this year: that informed investors are realising that crypto cannot be usefully viewed as an asset class, but rather merely as an asset, and that this is unlikely to change near-term.

A cynic might say that this should probably have been a lesson learned already in 2018; that year opened at 41% BTC market dominance, with BTC down around 30% from would prove to be its ATH, but XRP and ETH still trending up towards theirs on the 7th and 13th of January respectively. By year's end, BTC dominance was back up firmly above 50%, even with its price firmly set in the \$3000s – even with some late rallies in December (e.g. ETH nearly doubling from its local low in mid-December by the start of January) nothing else really escaped its gravity.



Credit: Tradingview.

The counter-argument there would be that it was called 'crypto winter', not 'Bitcoin winter' for a reason; sentiment was that the market collapse was essentially a vote of no-confidence in the state of the market as a whole, which far from invalidating the ETHs and XRPs of the world, actually strengthened the case for them going forward in a 'corrected' market (as it would suggest the need for a reconstruction of what crypto was to be built on going forward).

In any case, the feeling we get going into 2020 is much, much different from the one we had, and we believe most investors had, going into 2019. On December 31st, 2018, it would not have been completely out there to suggest that BTC might have withered away as something of value five years down the line; after all, BTC is the ultimate network-effect commodity, and with how hard confidence in it was hit in the minds of many during and after the bubble, the thought surely lingered - maybe its Geoffrey Howe moment had come?

On December 31st, 2019, that seems much less defensible. We have seen the end result of that late-2018 trend - the low was already in, and while price would take a while to recover, it never fell (even on the intraday) below that \$3000 level, at which it had started its parabola to \$19,000 in late Q3 2017. We have not necessarily seen the 'completion' of this year's trend, but it now seems extremely unlkely that we breach \$6000 (the bottom of Q3 2018's range). The Rubicon has most likely already been crossed.

BTC has proven itself to have some measure of value that is very unlikely to go away unless through inorganic means (i.e. regulatory pressure). Alts have not. In a year where BTC will still finish up just shy of 100%, more major alts find themselves up than down, and even the ones that are up (LTC and BCH most notably) are a) only up because of just how far they fell after the collapse of BTC (both finishing the year on 90+% drawdowns) and b) have extremely poor prospects indeed going into 2020 given that their use cases (layer-1 payment processing) are looking less and less relevant to the future landscape of the industry. Even if we entirely exclude the true 'bubble months' (December 2017, January 2018, February 2018) from ATH consideration, the figures across the board are grim:

Drawdown from all-time high since March 1st, 2018

Coin	ATHD	ATHPr	010120Pr	DrDn
BTC	26/06/2019	12876	7217.7	**43.94%**
ETH	01/03/2018	869.24	130.94	**84.94%**
XRP	04/03/2018	1.0023	0.19333	**80.71%**
BCH	05/05/2018	1748.89	203.59	**88.36%**
LTC	04/03/2018	213.47	41.68	**80.48%**
EOS	29/04/2018	21.412	2.6058	**87.83%**

Data via Coinbase and Bitfinex. Figures are daily closes.

(For reference, if we included the aforementioned months, drawdowns would be over 90% for ETH, XRP, and BCH, and barely under for LTC; by contrast, it would be barely over 60% for BTC).

There is very little even by way of indication of good news on the horizon for most major alts (excepting ETH, but even that has been having its share of technical struggles recently), and with regulatory eyes now firmly trained on the industry, 2020 is unlikely to be a prolific year for new layer-1 projects. If a similar stimuli does end up being needed, it's hard to see where it comes from if the ETH 2.0 PoS transition doesn't prompt it.

We will note, though, that Selkis himself does predict higher highs without necessarily needing a surge:

> There won't necessarily be a sudden surge higher. Instead, it will be more like a snowball: one off announcements of adoption begin to increase in frequency before the price begins to tick slowly higher.

In general, we tend to agree (and 2020 absolutely should be the year of layer-2 and Lightning Network), but this could still profile out to a disappointing year overall, possibly akin to 2016 (which saw price move from $434 to $790 through late December - an 82% increase but on an order-of-magnitude lower market cap - before a late surge into the new year took it up over 100%) and possibly even meaning a failure to challenge for a new ATH.

The halving, stock-to-flow, and millenarianism

We have had multiple enquiries over the last couple of months about the stock-to-flow model. To explain in brief for the uninitiated, stock-to-flow refers initially to an economic measure of scarcity - essentially, the ratio being produced in a given year versus the total (non-consumed) stock held by humanity as a whole at any given time. Saifedean Ammous, author of The Bitcoin Standard, makes the point as such in reference to gold:

> For any consumable commodity [..] doubling of output will dwarf any existing stockpiles, bringing the price crashing down and hurting the holders. For gold, a price spike that causes a doubling of annual production will be insignificant, increasing stockpiles by 3% rather than 1.5%. It is this consistently low rate of supply of gold that is the fundamental reason it has maintained its monetary role throughout human history.

This quote is used in the opening for what has become the 'other' meaning of stock-to-flow - namely, a theory article written and promulgated by pseudonymous self-described 'Bitcoin quant' PlanB (@100trillionUSD on Twitter). The argument can be summed up briefly as this: gold's price, and other precious metal prices (silver, palladium, etc.), in terms of their implied market cap, correspond relatively closely to their stock-to-flow ratios; furthermore, BTC price since its inception has also mapped relatively closely to it.

The stock-to-flow ratio of BTC will roughly double after the halving (since new supply will be halved), and this should in turn eventually lead to an exponential increase in price (roughly $100,000 per BTC, though even its strongest advocates will generally quote lower, shorter-term estimated valuations).

Circling back to what Selkis said - "the much hyped "halving" narrative is bullshit" - this is what he, and many others of the better-informed in the crypto space, tend to be referring to at this point when they take aim at the halving.

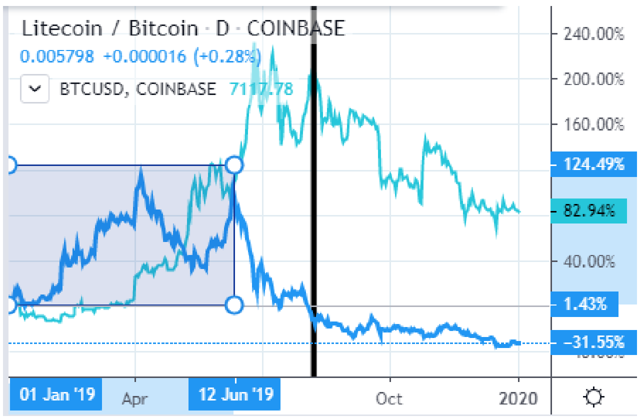
Of course, halving optimism is by no means new, first attracting its share of breathless commentary approximately five seconds after it was obvious that the early 2018 bubble was over; but the particular presentation of stock-to-flow has started to become the rallying call for a new generation of small-scale crypto investors.

There will be a lot of discussion over the next few months over whether stock-to-flow should be taken seriously, and whether the halving is priced in, and so on, and so on. This is mostly a discussion for another time. For now, let us simply talk about this: why are BTC advocates so worried about the discourse around stock-to-flow by its believers? After all, using the 365-day moving average, the stock-to-flow 'projection' for price on January 1st, 2021 would be between $33,000 and $34,000; higher than most predictions (for the record, Selkis has tended to make a point of not prognosticating specifically on price in such a manner) but not hugely so, with plenty willing to suggest a 2020 ATH topping out in the $20k-$30k range.

There are a number of arguments that can be made against stock-to-flow in economic or econometric terms, but in reality, the biggest problem, and the reason that it has drawn ire, is this: the stock-to-flow discourse is essentially millenarian. You are familiar with millenarianism, even if you think you aren't; it's mostly commonly used in reference to religious cults that predict an epochal event (typically the end of the world), often on a very specific date, and dedicate their everything towards that expectation.

While stock-to-flow's biggest advocates (most notably PlanB) have been keen to make statements downplaying that $100k figure in particular, there can be absolutely no doubt that, particularly for anyone being introduced to crypto by stock-to-flow, the interpretation cannot help but verge on the prophetic. This is clearly very, very dangerous for an industry that is only now, and just barely, beginning to dig itself out of the credibility hole that the hawkers and hucksters put it in at the height of the bubble in late 2017.

This is a fear that has undoubtedly been accentuated by what happened with LTC this year:



Credit: Tradingview

LTC rallied hard during the first half of the year in anticipation for its own halving event in August, gaining massively against BTC even as BTC was in the early stages of its own rally . By the halving itself, however, it was already back essentially where it started on January 1st against BTC, and post-halving, has substantially underperformed every single large or midcap on the market (including those like BCH and XMR which face similar fundamental redundancy problems with regards to BTC layer-2 rollouts). It remains up in USD terms, but barely; at $96 on halving day, it crossed below $48 in late November, spawning a million jokes about the halving now being complete.

Of course, BTC is not LTC; an underperforming halving will not all but kill it off on its own. However, the narrative around it does matter, and if stock-to-flow as a narrative grows into the cryptocurrency equivalent of the Iraqi dinar revaluation scam, it could eventually lead to a similar sort of rout to the Q4 bleed this year - not necessarily an increase in supply (amusingly enough, one of the features of millenarian groups is that the failure of an event to arrive tends to strengthen the belief of those already within), but certainly a sudden withdrawal and ensuing absence of demand that severely depresses prices over a period of months or longer.

Exchange fakery

And when the exchange owner saw the breadth of his domain, he wept for there were no more metrics to spoof.

This has been a 'fun' year for exchanges. The biggest open secret in the industry was blown open in March when the Bitwise ETF documentation admitted that 95% of exchange volume on crypto markets was fake. This has, since, set off something of an arms race among exchanges - for the complete fakes, for the legitimate, and for those with real but embellished volume, all alike - as they sought to prove that they were one of the legitimate few, and as various interested parties in turn looked to figure out if they actually were.

At first, it was simple - publish some volume numbers and hope nobody scrutinised your order books. Soon, that was no longer sufficient, and the order books having to be faked too. Of course, this is crypto, and everything is available 24 hours a day, so you need to wash trade, and you need algos doing it for you.

While there are still cases where it is very, very obvious that it's happening, enough exchanges have gotten good enough at hiding this in turn that the new metric is liquidity - take a snapshot of the order book, and see how much BTC one could actually buy or sell within a certain % of the listed price.

This, too, is unlikely to hold; faking liquidity is more difficult and potentially riskier than faking volume, but can still be done to some degree on a public exchange or derivatives platform.

This cat-and-mouse game does bring up a broader point, however: that the clock may finally be running down on those exchanges that are failing being able to plausibly fake their metrics. While these have always proved to be entities that are remarkably good at kicking the can down the road, 2020 might see the shutdown or collapse of some that have been considered major players in the space for a long time, as there becomes less and less room for such exchanges to hide (from informed investors at least).

While good news for OTC desks and the exchanges and derivatives platforms that are built to last, if it does come to pass, there may be some shockwaves. 2019 was a remarkably good year for exchanges; yes, there were a couple of hacks, but all were storms that were very easily weathered, and only a tiny handful of small regional exchanges (Quadriga in Canada being the only really significant one) went under entirely.

There are warning signs flashing on multiple major exchanges going into 2020; probably the most concerning one is HitBTC, with recent research by Rich Sanders at Cipherblade suggesting that the exchange (which, while real usage is on the low side, is still consistently listed on most third-party sites as a top-10 exchange globally) may actually insolvent. While the furthest thing possible from uncharted territory from crypto, it nevertheless does bring up serious concerns with regards to the implications for retail confidence should it happen during the next bull run.

What we're reading

DLive Joins BitTorrent Ecosystem to Make Blockchain-Based Content Sharing Mainstream (Cointelegraph): One of the few blockchain-related projects in the broader gaming space that looks like something other than a complete waste of everyone's time right now. The metrics are nothing to write home about but they're not as bad as one might think, and as critical as we tend to be of the Tron Foundation and Justin Sun, there's a framework for growth here.

Thanks to Better UX, This Year Dapps Will Go Mainstream (Coindesk): A worthwhile read. Of course, we'll believe it when we see it; we've been to too many conferences and had too many people walk us through buying a coffee from them with their quick and easy wallet app. It does however feel like the underlying infrastructure is improving.

Google has restored MetaMask's Android app (The Block): On a related note, this is good to see. Google has been sending out some extremely odd messages on crypto as of late – notably the YouTube 'crypto ban' scare from last week – and as much as it's frustrating to deal with them, things like the Google Play app store are close to non-negotiable as a necessary vector for short-term adoption.

Until next week – thank you for reading.

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