BITFINEX Alpha

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INTRODUCTION

Welcome to Bitfinex Alpha - our weekly look at the week's market developments and our outlook for the week ahead.

This week we take another look at the US Federal Reserves' stance on inflation and the prospect for further interest rate hikes. We analyse bond markets and their macro forecasting abilities and take a look at the US Yield Curve and the risk-to-reward situation for bonds and equities in the current macro-environment. We also present data on how Bitcoin could potentially act as a hedge against monetary inflation.

In our on-chain section, we discuss the number of large entities underwater on their spot Bitcoin holdings, including crypto-exposed equities. As Bitcoin's price depreciates further, there is an apparent miner capitulation for both Bitcoin and Ethereum. Data-backed research is presented for both.

We also note our on-chain volumes for whale-style wallets are sky-rocketing as Bitcoin breached its 2017 cycle high. We discuss the implications and the takeaways.

In market news, Proshares launched the first short Bitcoin ETF, BITI; and Solana developers plan to roll out a smartphone.

Voyager Digital also sent a notice to Three Arrows Capital regarding assets borrowed by the fund, and Goldman Sachs could potentially acquire Celsius assets for $2 billion. We provide an update on the lending services provider.

We also note that $4 billion in miner loans are under stress. A multitude of miners have already defaulted on their loans. We discuss what this means for central miners.

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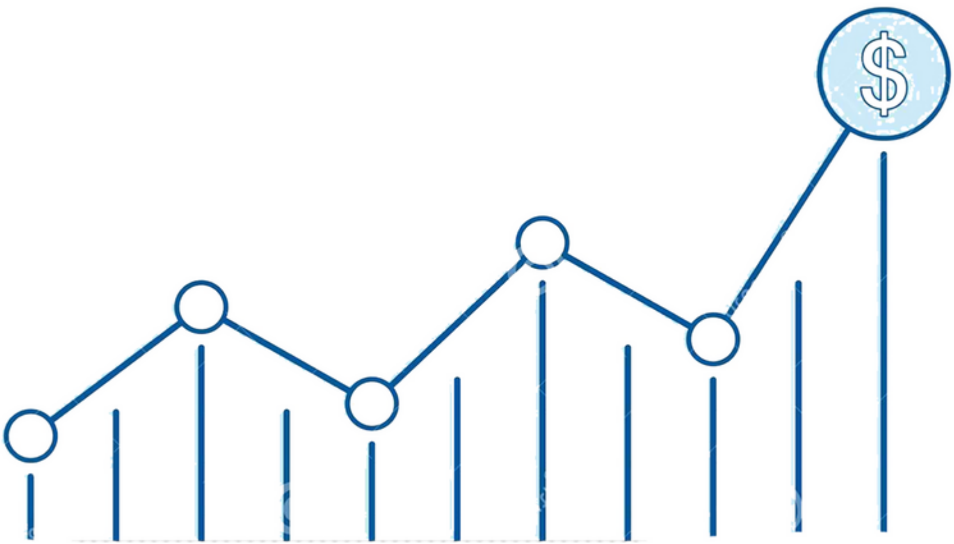

MACRO ENVIRONMENT UPDATE

Interest Rates-Update on the Federal Reserve’s stance:

Interest rate hikes, MoM (Month on Month) inflation, CPI numbers, and Jerome Powell’s (Chairman of the US Federal Reserve) statements continue to be a focus, as we evaluate macro conditions.

The Fed currently appears to be looking at short, sharp interest rate shocks to try to reduce MoM inflation immediately. On Thursday, Powell mentioned that he would not be opposed to 100 bps rate hikes. Policymakers still seem to believe there are no signs of an economic growth slowdown yet, and the Fed is indicating that it will feel more comfortable engaging in a more aggressive hiking cycle if they believe the economy can withstand it.

An exciting piece of information that highlights this is the SEP (Summary of Economic Projections).

FOMC Summary of Economic Projections (SEP)

Percent

Variable	Median[1]				Central Tendency[2]				Range[3]			
	2022	2023	2024	Longer run	2022	2023	2024	Longer run	2022	2023	2024	Longer run
Change in real GDP	1.7	1.7	1.9	1.8	1.5–1.9	1.3–2.0	1.5–2.0	1.8–2.0	1.0–2.0	0.8–2.5	1.0–2.2	1.6–2.2
March projection	2.8	2.2	2.0	1.8	2.5–3.0	2.1–2.5	1.8–2.0	1.8–2.0	2.1–3.3	2.0–2.9	1.5–2.5	1.6–2.2
Unemployment rate	3.7	3.9	4.1	4.0	3.6–3.8	3.8–4.1	3.9–4.1	3.5–4.2	3.2–4.0	3.2–4.5	3.2–4.3	3.5–4.3
March projection	3.5	3.5	3.6	4.0	3.4–3.6	3.3–3.6	3.2–3.7	3.5–4.2	3.1–4.0	3.1–4.0	3.1–4.0	3.5–4.3
PCE inflation	5.2	2.6	2.2	2.0	5.0–5.3	2.4–3.0	2.0–2.5	2.0	4.8–6.2	2.3–4.0	2.0–3.0	2.0
March projection	4.3	2.7	2.3	2.0	4.1–4.7	2.3–3.0	2.1–2.4	2.0	3.7–5.5	2.2–3.5	2.0–3.0	2.0
Core PCE inflation[4]	4.3	2.7	2.3		4.2–4.5	2.5–3.2	2.1–2.5		4.1–5.0	2.5–3.5	2.0–2.8	
March projection	4.1	2.6	2.3		3.9–4.4	2.4–3.0	2.1–2.4		3.6–4.5	2.1–3.5	2.0–3.0	
Memo: Projected appropriate policy path												
Federal funds rate	3.4	3.8	3.4	2.5	3.1–3.6	3.6–4.1	2.9–3.6	2.3–2.5	3.1–3.9	2.9–4.4	2.1–4.1	2.0–3.0
March projection	1.9	2.8	2.8	2.4	1.6–2.4	2.4–3.1	2.4–3.4	2.3–2.5	1.4–3.1	2.1–3.6	2.1–3.6	2.0–3.0

Figure 1. FOMC SEP (source: The Macro Compass)

The neutral rate estimate has gone up to 2.5% for the FOMC. They also intend to hike the Federal funds rate to 3.8%, 130 bps above that neutral limit. This indicates more tightening.

The unemployment rate will be 3.7 percent in 2022. It will nudge up to 3.9 percent in 2023. However, based on their forecasts, the Fed will continue to raise rates by 40 basis points in 2023.

The introductory statement from the announcement was, “The FOMC is strongly committed to returning inflation to its 2 percent objective”. This contradicts their previous commitment to maintaining a strong labor market.

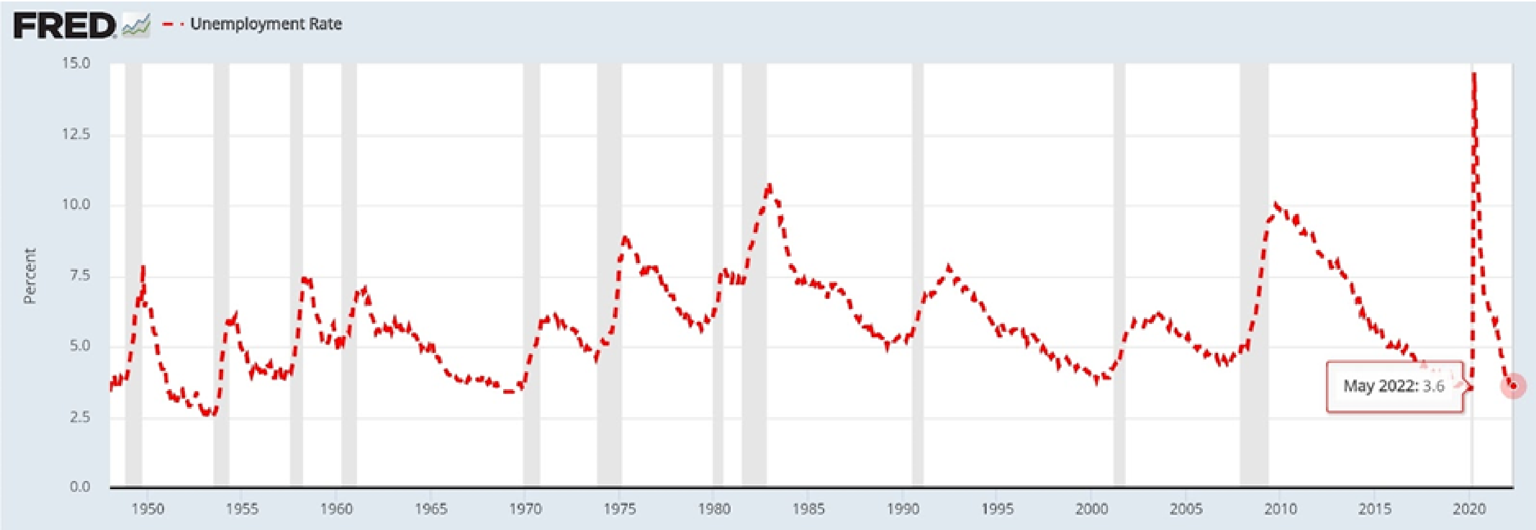

Figure 2. US Unemployment Rate (source: FRED)

The FED has a double mandate of keeping unemployment down and prices stable. The Fed's median projection for unemployment is 4.1% which is 50 basis points higher than the current 3.6%. To drive inflation down, the Fed aims for a "soft-landing" by turning the dial and tamping down the demand in the labor market, which means potentially increasing unemployment. In the Fed's view, a 0.5% increase in the unemployment rate would be a fair trade towards their inflation goal of 2% by the end of 2024. Thus, the labor market doesn't show any signs of strength.

What is the takeaway for an investor?

The Federal Reserve is concerned with rapidly bringing down inflation and will resort to extreme measures to make that possible. Expect a continued aggressive approach towards monetary policy.

Inflation Expectations:

The Fed is also concerned about inflation expectations. Inflation expectations are the rate at which consumers and businesses expect prices to increase. They are essential because these expectations affect what actual inflation would be. If everyone expects prices to rise, say, 3 percent over the next year, businesses will want to raise prices by (at least) 3 percent, and workers and their unions will want similar-sized raises.

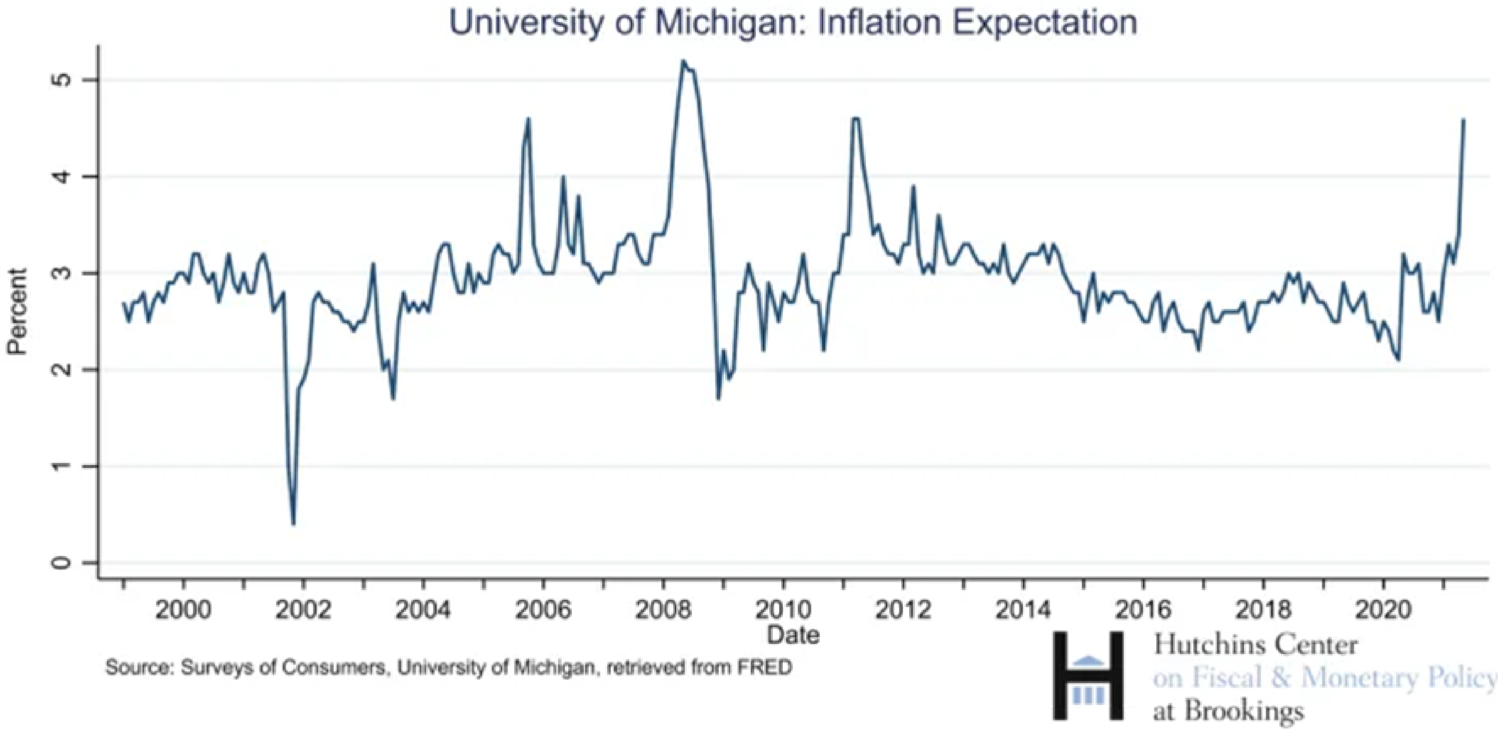

Figure 3. Inflation expectations as per University of Michigan (source: FRED)

Figure 3 indicates that during the next ten years, consumers expect inflation to increase above its current trajectory. Consumers, however, also believe that inflation is more than reported officially. Powell said “we are not going to declare victory until we achieve a series of consecutive, sharp drops in MoM inflation prints.”

How the years 2022 and 2023 unfold depends on the economy’s response to the Fed’s tightened monetary policy and the impact of external factors such as Supply Constraints.

We look at the bond market to gauge the economy’s response.

Bond Markets and their forecasting abilities

In our previous issue, we discussed US Treasury yields and how they have functioned as a recession forecaster. In this issue, we discuss bond markets as they serve as an accurate metric for evaluating the Fed's clarity in its policies.

How does the bond yield curve help us?

- A standard yield curve shows bond yields increasing steadily with the length of time until they mature but flattening a little for the most extended time frames.
- A steep yield curve doesn't flatten out at the end. This suggests a growing economy and, possibly, higher inflation to come.
- A flat yield curve shows little difference in yields from the shortest-term bonds to the longest-term. This indicates uncertainty.
- The inverted yield curve is rare and signals trouble ahead. It occurs when short-term bonds pay better than longer-term bonds.

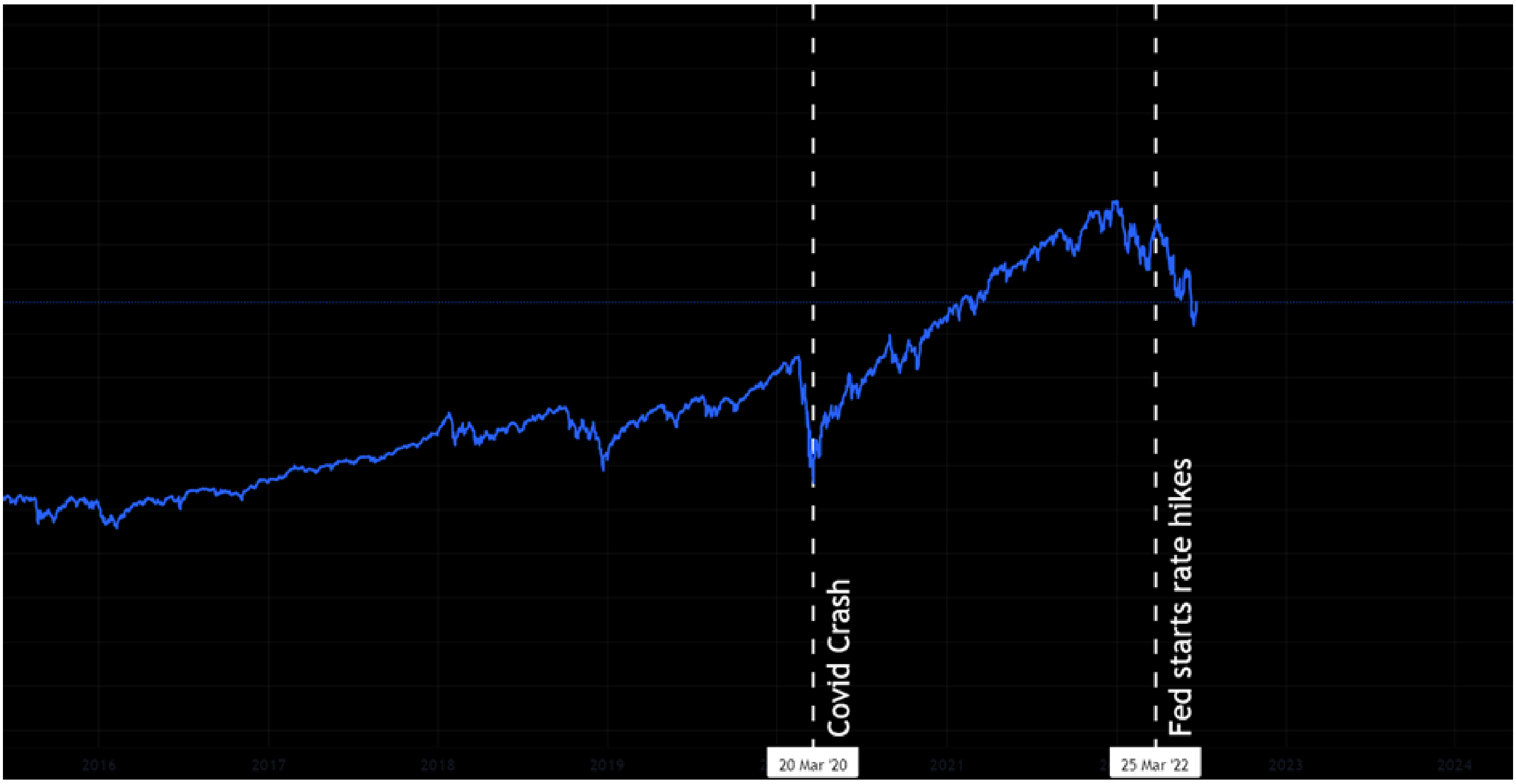

Figure 4. S&P 500 1D chart

A short rally occurred in March as investors realized the economy was still strong and the unemployment rate was low. As inflation data showed no signs of slowing down and the Fed continues to raise interest rates, S&P 500 has been down-trending since the beginning of 2022, now 20% down from its peak. Meanwhile, the 10-year treasury yield has been soaring since the Fed started tightening its monetary policy and has risen to 3.36 last week.

As the equity market experienced a severe drawdown and bonds couldn't serve as a portfolio hedge in this environment, we just witnessed the largest ever "financial wealth" destruction in history.

This is in reference to a May 2022 research note from JP Morgan Chase, which states that total U.S. wealth has plummeted by $5 trillion in 2022, down from $13 trillion to $8 trillion, mainly from a sour stock market.

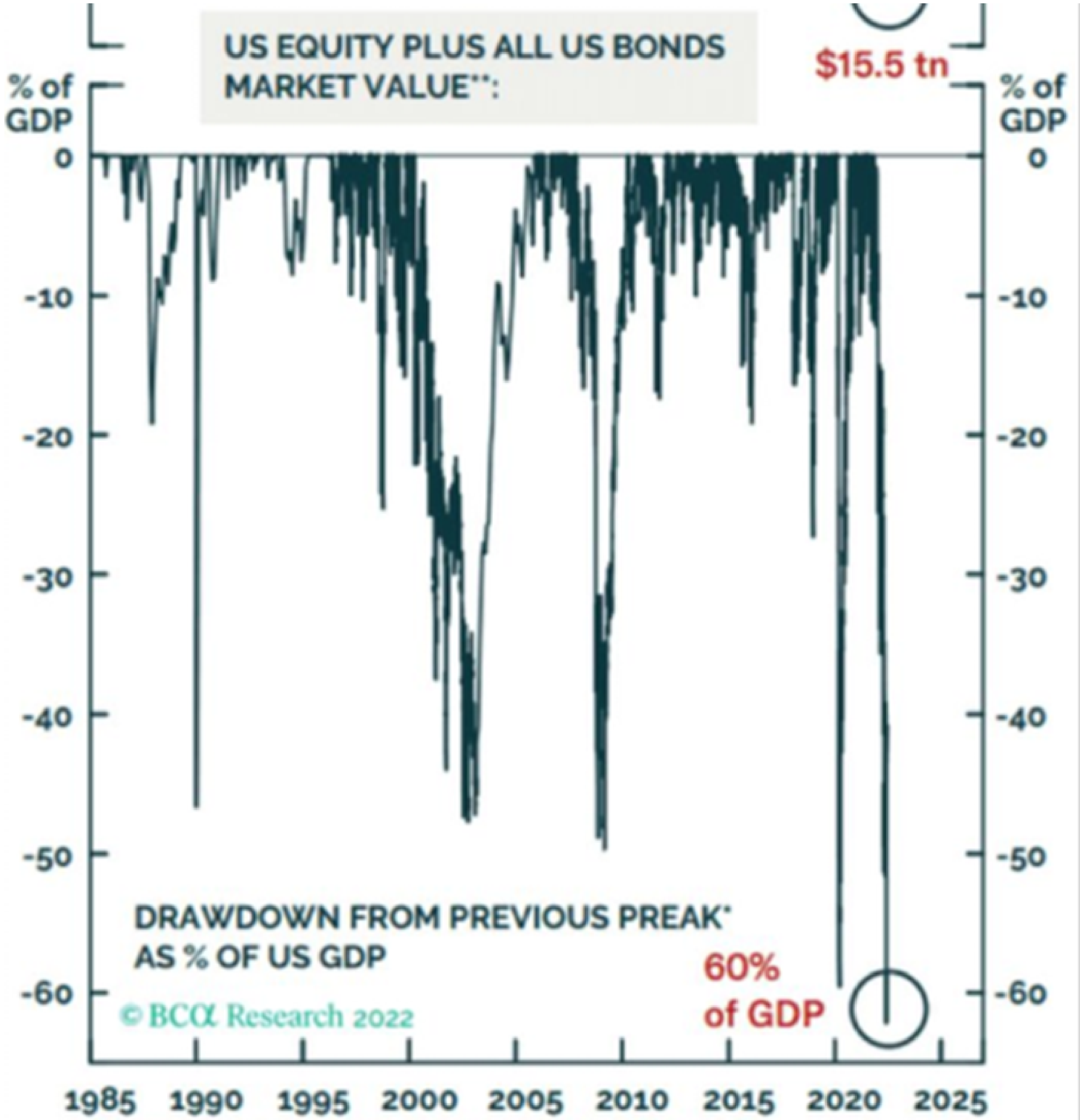

Figure 5. US Equity plus Bonds Market Value (source: BCA Research)

US bonds and equities markets have experienced a drawdown from the previous peak of about $15.5 trillion (or 60% of GDP).

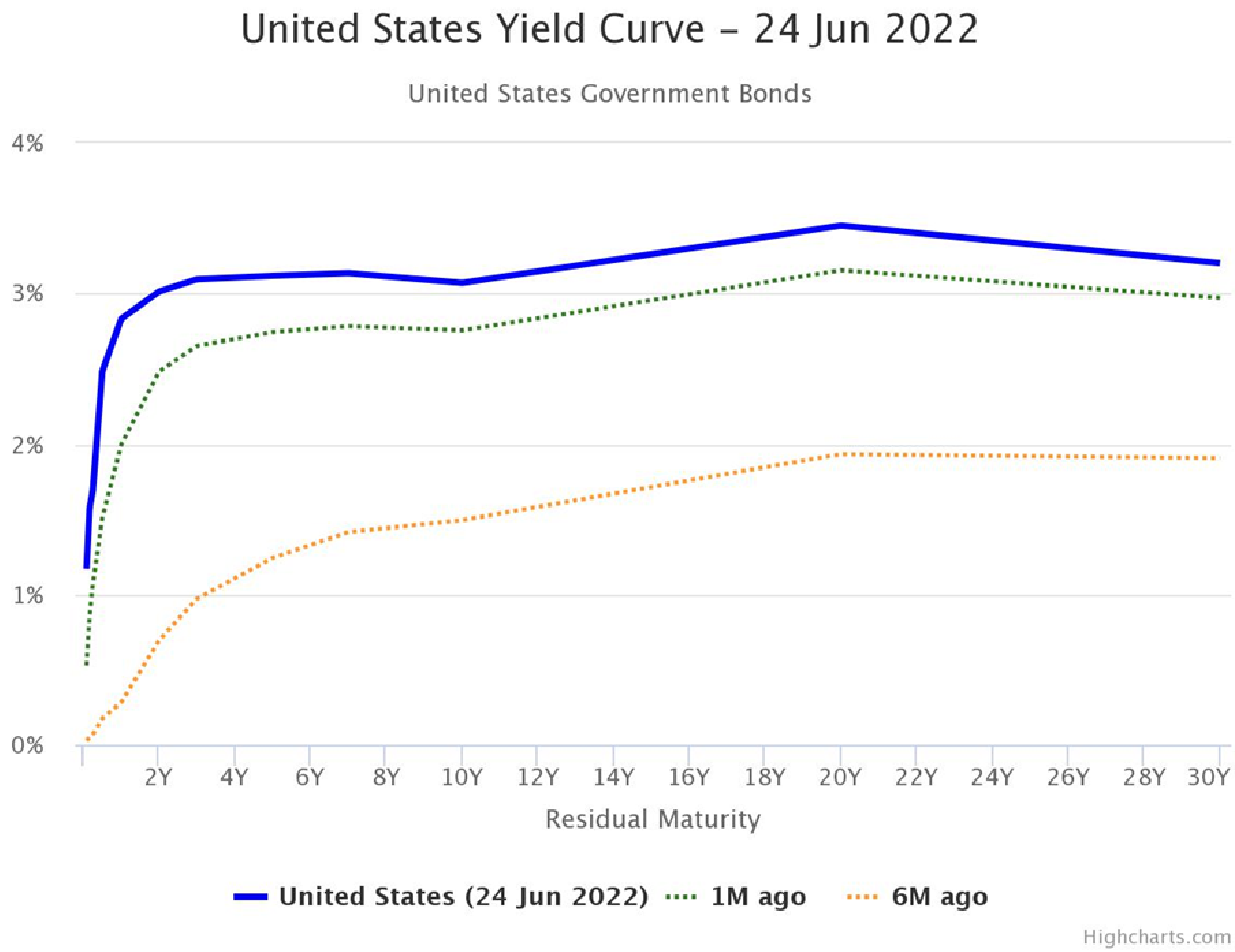

Figure 6. United States Yield Curve (source: worldgovernmentbonds.com)

As discussed above, a flat yield curve shows little difference in yields from the shortest-term bonds to the longest-term. This indicates uncertainty. The metric tells us that the bonds market awaits further clarity for the Fed.

Bonds vs. Stocks

Though bonds, like other investments, carry risk, they are deemed less risky than stocks because, in the event of bankruptcy, the law mandates that bondholders are to be paid first before stockholders. Hence, stock investors require a higher rate of return from stocks than bond yields for the additional risk of holding a riskier asset.

The earnings yield is a decent guide for investors for the expected return for stocks. It is the earnings per share divided by its current price or the inverse value of the Price to Earnings Ratio (PE ratio). The Earnings yield for S&P 500 last week was 6.53. The tightening gap between the earnings yield for stocks and bonds yield will likely make the latter attractive to investors for the foreseeable future.

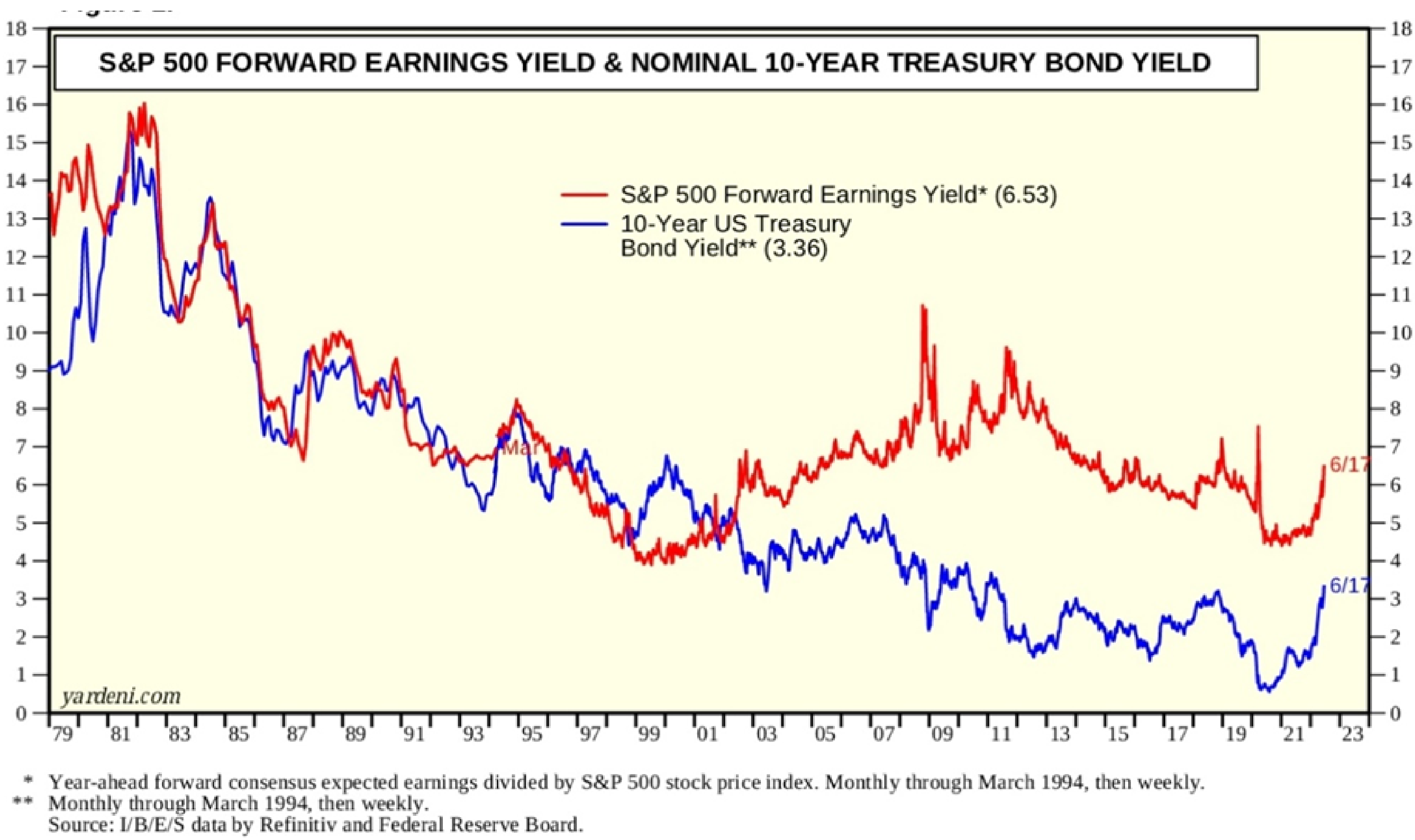

Figure 7. S&P forward earnings yield and nominal 10-year treasury bond yield (source: Federal Reserve board)

Since the last FOMC meeting, the macro environment has not changed, and there has not been a clear sign of inflation cooling off. The market is likely to continue being volatile in the coming weeks.

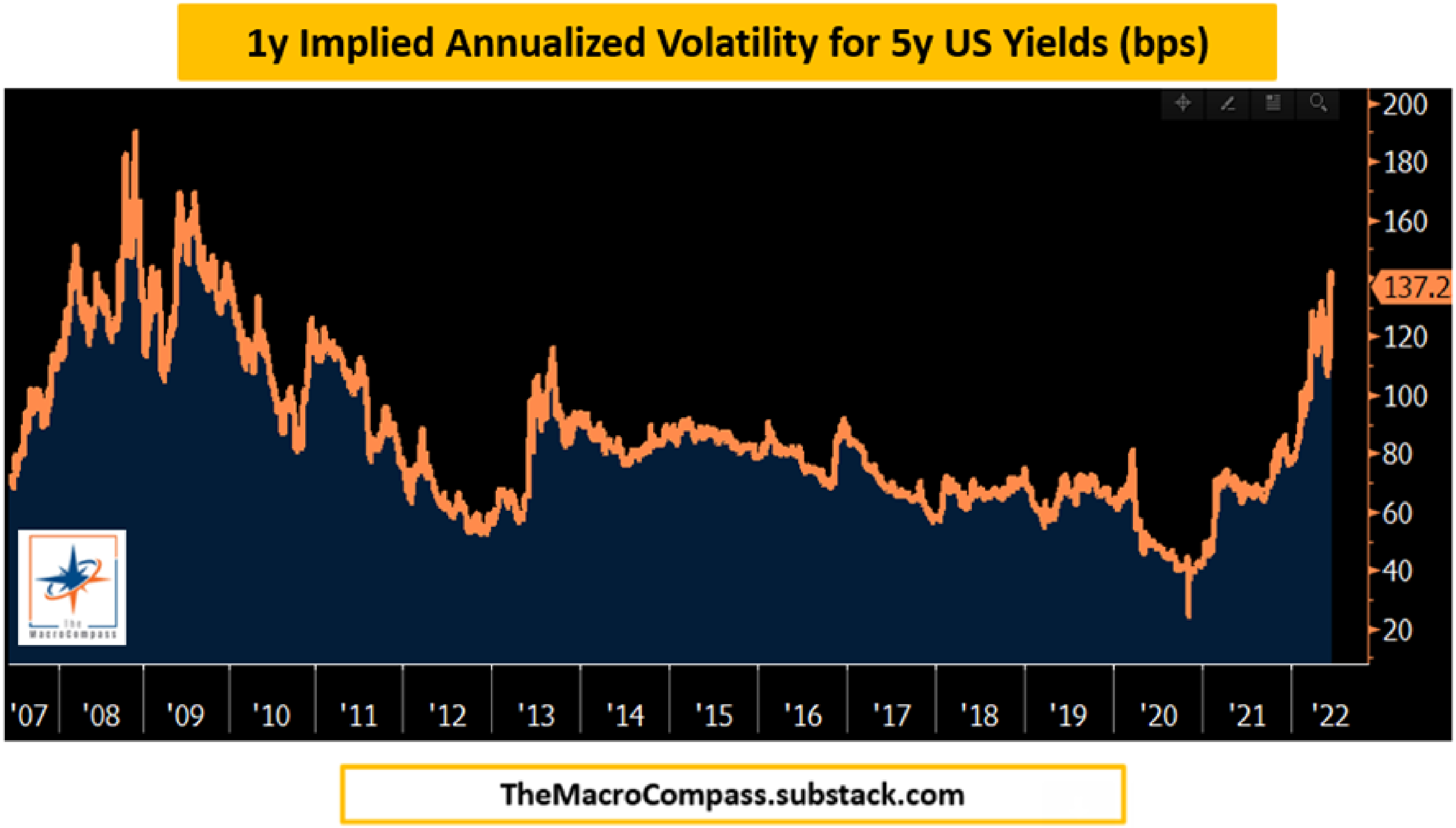

Figure 8. Implied Volatility for Bond Markets (source: The Macro Compass)

The implied volatility level (annualized, in bps) that traders have incorporated into 5-year US swap yields is shown in figure 7.

At 137 bps, indicating a daily movement of around +/- 8.5 bps, the implied volatility in bond markets is very substantial, and such a high level of uncertainty in the world's biggest and most liquid market cripples any meaningful ability to take risks elsewhere.

The status of the Ukraine-Russia conflict and inflation slowing down are the key factors to watch out for that can catalyze the stocks for a leg up.

Bitcoin as a hedge for monetary inflation

The usual narrative of Bitcoin acting as a hedge against consumer price inflation has proven to be false, but there is a case for it to act as a hedge against extreme monetary inflation.

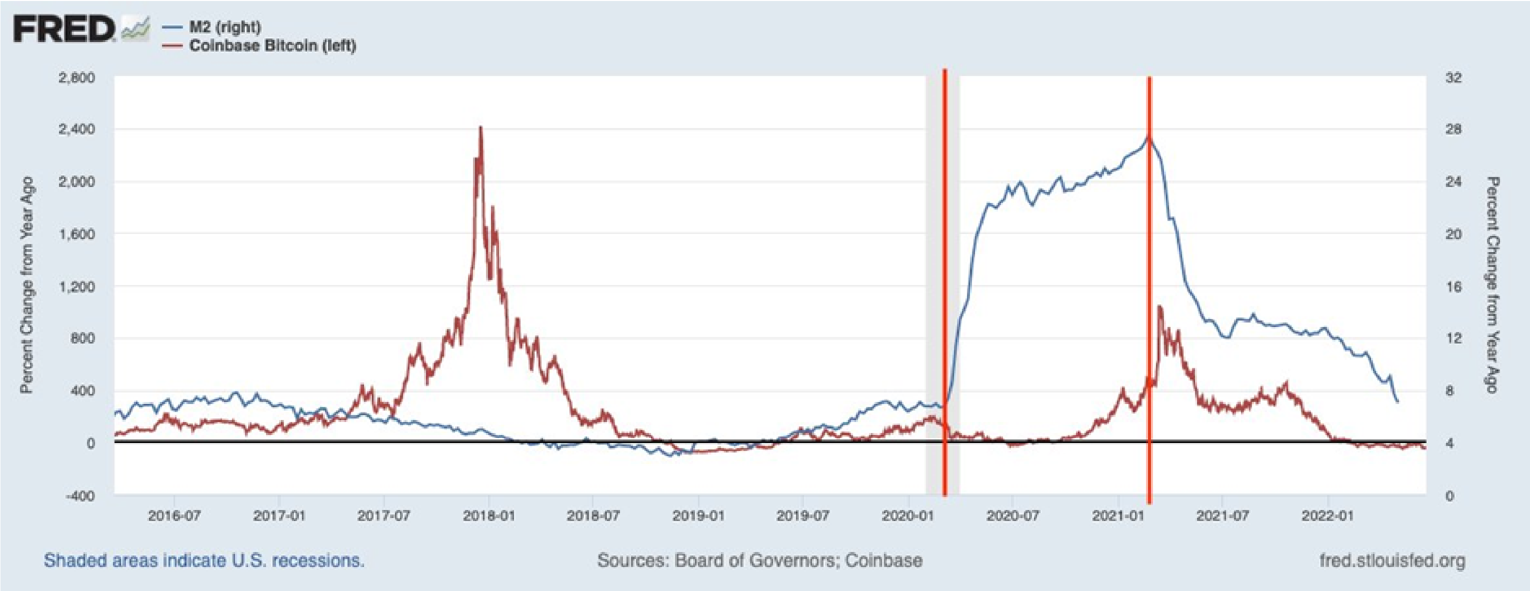

Figure 9. M2 Money supply vs. Bitcoin Price (source: FRED/@JanWues)

M2 is a measure of the money supply that includes cash, checking deposits, and easily-convertible near money. M2 is a broader measure of the money supply than M1, which includes cash and checking deposits only.

In 2020 the year-over-year percentage change of the M2 started to increase rapidly within a short time frame. The year-over-year percentage change for Bitcoin's price followed with a lag. After the flash crash that year, Bitcoin’s price reached new all-time highs, whereas M2 also made new highs.

The year-over-year percentage increase peaked for M2 at the end of February 2021; bitcoin's price peaked shortly after that in the mid-March 2021 this cycle.
Thus, it can be argued that Bitcoin’s price has functioned as a lagging indicator for the M2 money supply over the past two years. This is where the argument of Bitcoin acting as a hedge against monetary inflation arises.

WHAT'S ON-CHAIN THIS WEEK?

Monthly Levels On Bitcoin: -

Open: $31798.3
High: $31974.2
Low: $17605

Weekly Levels On Bitcoin: -

Open: $20543.5
High: $21675
Low: $19626

Figure 10. (Data from Bitfinex BTC/USD pair)

Bitcoin continues to hover around the $20,000 mark, coinciding with the previous cycle peak in 2017. The rest of the crypto market has seen altcoins plunge 80-90% from their 2021 peaks. In this issue, we discuss what this price drawdown means for investors and larger entities.

Currently, we are at the worst point in Bitcoin’s history to implement the HODL model.

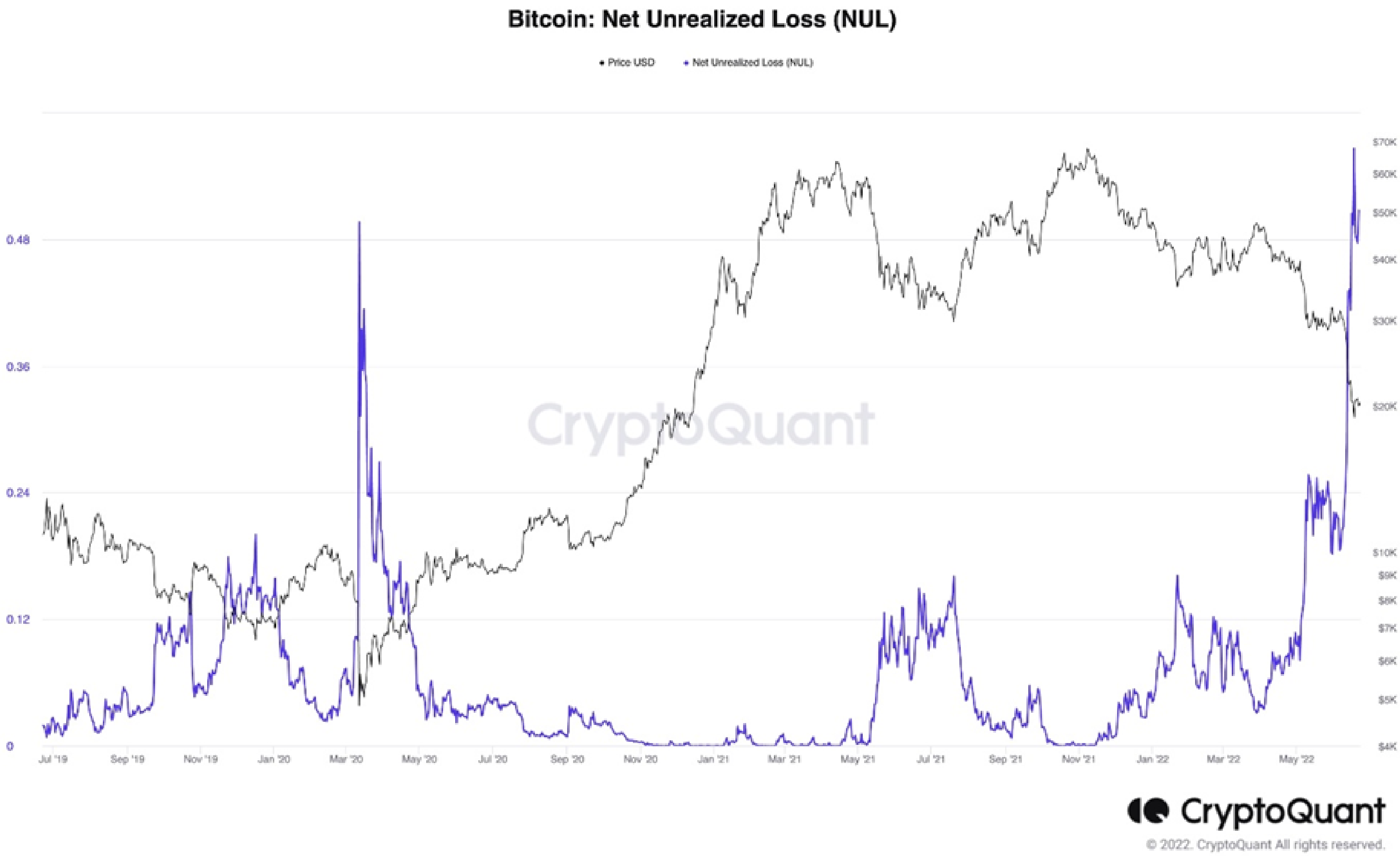

Figure 11. Net Unrealised loss on spot Bitcoin (source: CryptoQuant)

The net unrealized loss on spot holdings is the largest in Bitcoin's history. This implies that there are a lot of trapped retail investors as well as entities that are facing significant drawdown from their cost basis.

225,413.6658	$4,708,371,371	1.18%	27
Total Bitcoin Holdings	Total Value (USD)	Public Companies Bitcoin Dominance	Companies

#	Company	Symbol	Country	Total Bitcoin	Entry Value (USD)	Today's Value (USD)	% of Total BTC Supply
1	MicroStrategy Inc.	NASDAQ:MSTR	US	129,218	$3,970,000,000	$2,699,065,869	0.615%
2	Tesla	NASDAQ: TSLA	US	48,000	$1,500,000,000	$1,002,609,247	0.229%
3	Galaxy Digital Holdings	TSE:GLXY	CA	16,402	$134,000,000	$342,599,935	0.078%
4	Square Inc.	NASDAQ:SQ	US	8,027	$220,000,000	$167,665,509	0.038%
5	Marathon Patent Group	NASDAQ:MARA	US	4,813	$150,000,000	$100,532,465	0.023%
6	Hut 8 Mining Corp	TSX:Hut-8	CA	4,724	-	$98,673,460	0.022%
7	Coinbase	NASDAQ: COIN	US	4,483	$130,100,000	$93,639,526	0.021%
8	NEXON Co Ltd	TYO: 3659	Japan	1,717	$100,000,000	$35,864,168	0.008%
9	Voyager Digital LTD	CSE:VYGR	CA	1,239	$7,927,182	$25,879,851	0.006%
10	Riot Blockchain, Inc.	NASDAQ:RIOT	US	1,175	$7,200,000	$24,543,039	0.006%

Figure 12. Public companies with BTC holdings (source: Coingecko)

Microstrategy, for instance, has an unrealized loss of more than $1.2 billion on its Bitcoin holdings. Furthermore, crypto funds like Three Arrows Capital and lenders like Celsius hold long-term leveraged positions. Thus, crypto exposed equities are "trapped" in their investments, and forced liquidation of their assets could call for further Bitcoin price depreciation.

Tumbling miner profitability on Ethereum

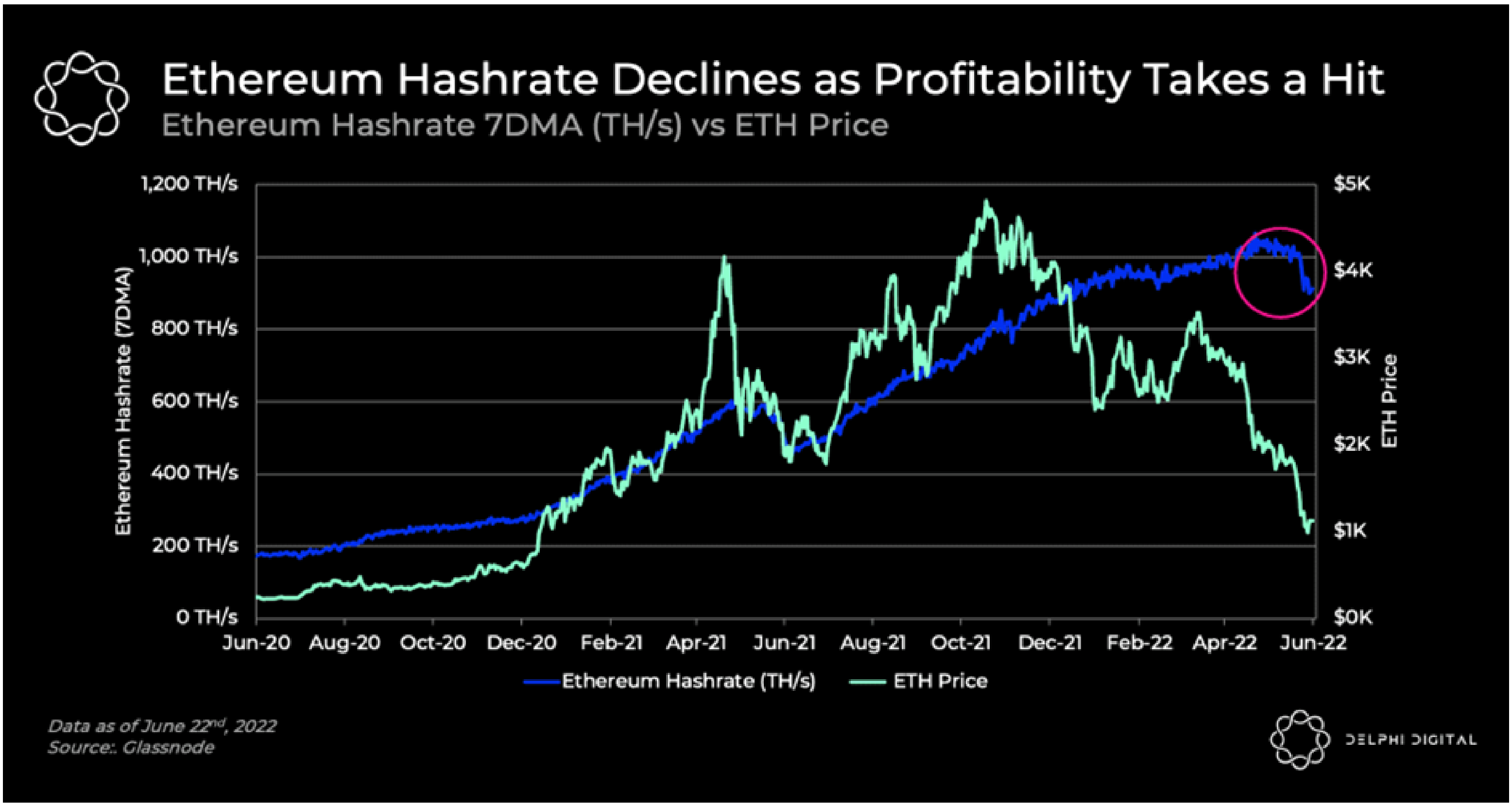

Figure 13. Ethereum Hash Rate compared with price (source: Delphi)

The amount of processing power miners use to protect the Ethereum Network is measured in hash rate. Since April, the Ethereum hash rate has decreased by 10% as mining profitability has been severely impacted.

The price of Ethereum has fallen over the last three months from $3,500 to a low of $880. Because of the decline in prices, miners now make less money in terms of dollar value. This is made worse by increasing energy costs; the energy price index is currently at a five-year high.

Once The Merge takes place and Ethereum switches to a Proof-of-Stake chain, mining would be utterly unprofitable since miners stop receiving rewards. This could affect ETH price as supply decreases and miners halt profit-taking.

Mining Profitability on Bitcoin

Bitcoin has always maintained a relationship with its cost of production. This gives us an indication of the all-in sustaining price for mined BTC.

Glassnode noted that the current cost of production is around $17,600, which was the low achieved last weekend, before prices began rising again.

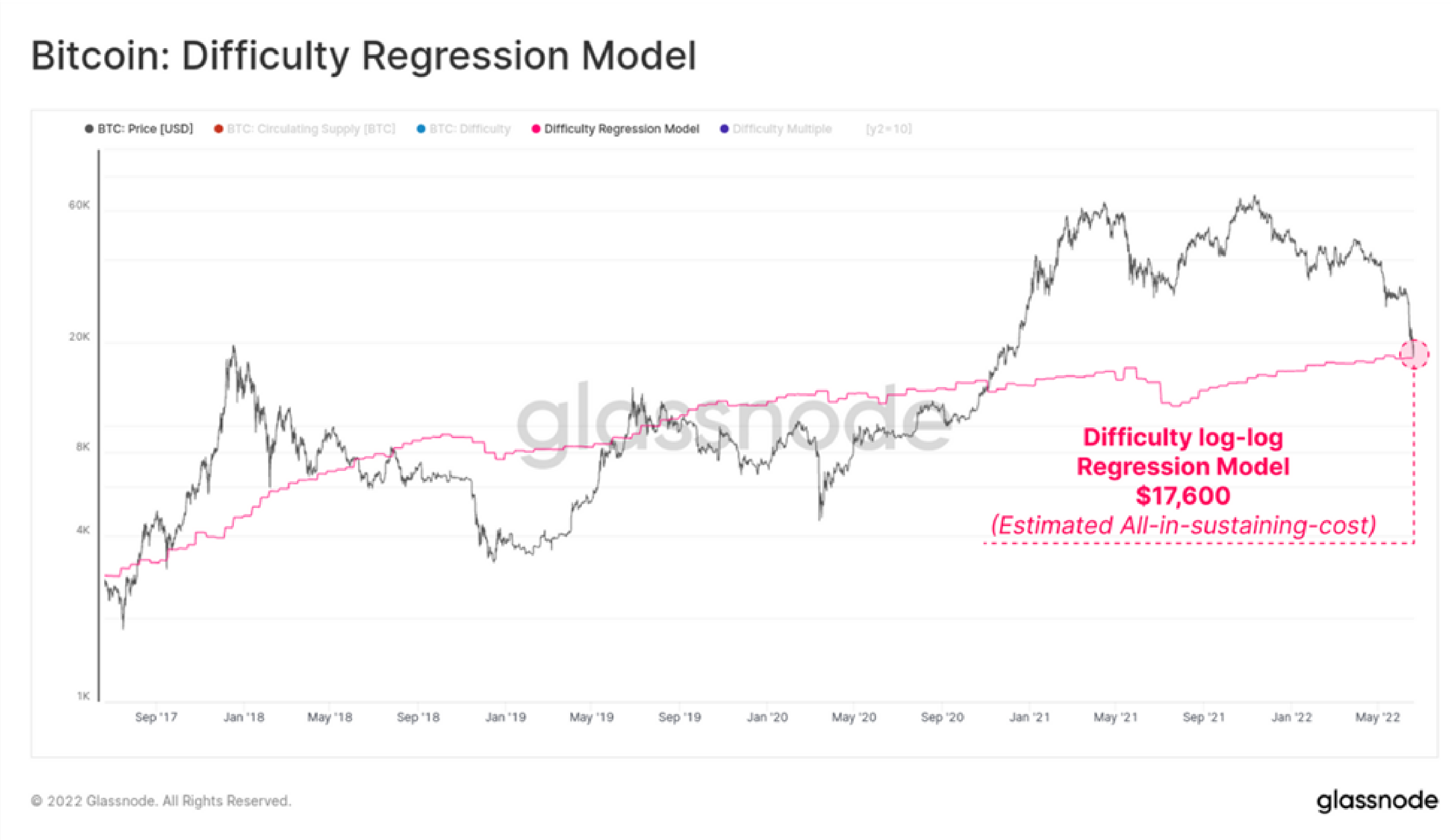

Figure 14. Mining cost evaluation using log-log regression model (source: Glassnode)

We can also estimate the Realized Price for Miners as a gauge for their mined balance cost basis, currently at $26,170. The amount of money leaving miners' treasuries increased due to the intense financial strain, reaching rates of 5k–8k BTC monthly.

Figure 15. Bitcoin Hash Ribbon (source: glassnode)

Hash ribbons (figure above) indicate whether miner capitulations are occurring. Miner capitulations are when a significant net % of miners are turning off machines over an extended period of time.

During miner capitulations, miners are not only turning off rigs, but are likely selling off their BTC treasury, as noted by Arcane Crypto in figure 16. Historically, miner capitulations have been the last leg down in a Bitcoin bear market, as many miners are pro-cyclical. At the start and during the capitulation, sell pressure from weak miners is considerably increasing, but once the capitulation has ended, the network is left with only the most vital miners with the lowest operating expenses. This ultimately ends with less forced sell pressure on a day-by-day basis.

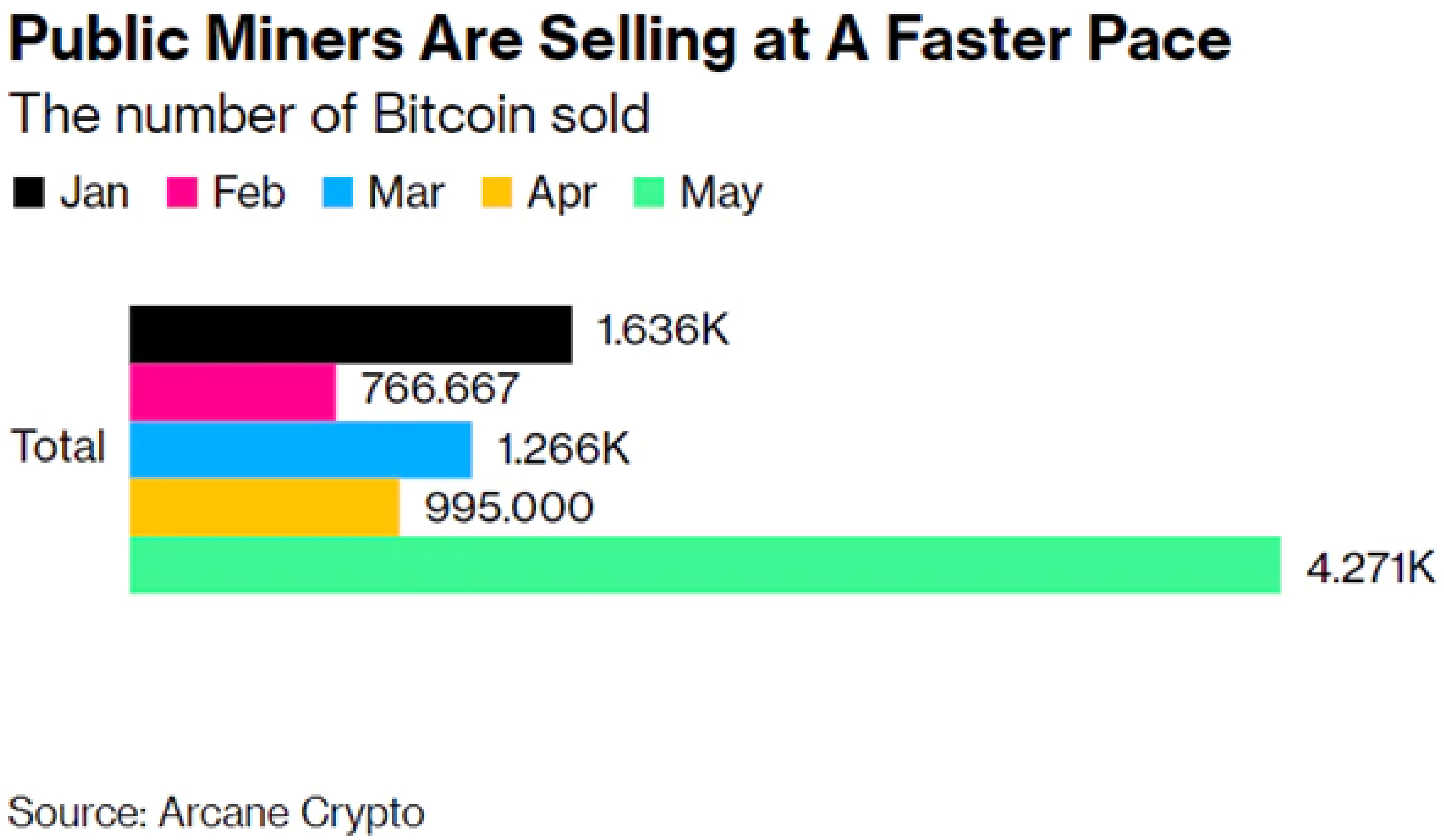

Figure 16. Selling pace by public miners (source: Blockware Intelligence)

This is now analogous to the bear market capitulation episode in 2018–2019. Surprisingly, miners have ceased selling to cover operational costs and have seen balances rise at a rate of 2.2k BTC per month after Bitcoin failed to maintain its previous consolidation's low band ($28k).

This continues to bolster our argument that there exists a massive number of entities, including miners trapped with unrealized losses on their spot Bitcoin holdings.

On-chain volume for Whales

Whalemaps has a feature to filter on-chain volume based on the size of the wallets.

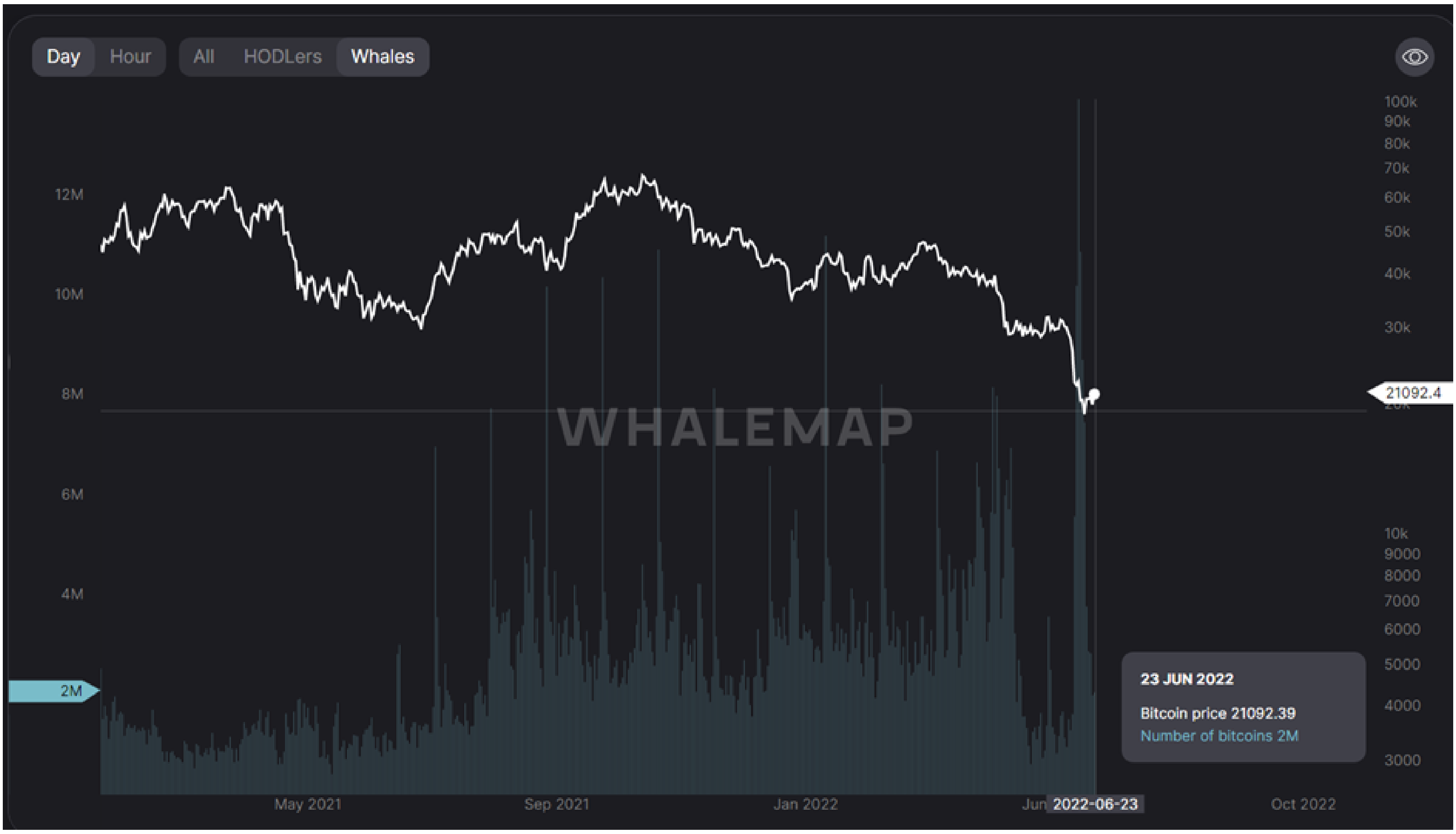

Figure 17. On-chain volumes for Whale-style wallets (source: Whalemaps.io)

The amount of Bitcoin moved on-chain during the price depreciation below 2017's cycle top is alarmingly high. This metric could be understood as the aforementioned large entities liquidating their spot positions to reduce losses.

CRYPTO NEWS

ProShares launched a Short Bitcoin ETF

Figure 18.

ProShares aims to introduce the first short Bitcoin-linked ETF in the US, the supplier of financial products revealed on Monday. Eight months after creating the first U.S. Bitcoin futures ETF. The ProShares Short Bitcoin Strategy, which will trade on the New York Stock Exchange under the ticker BITI, is a means for investors to profit from drops in prices of the cryptocurrency. Its expenditure ratio will be 0.95 percent.

In a news statement on Monday, ProShares CEO Michael Sapir stated that recent events have demonstrated that Bitcoin may lose value. According to Sapir, “BITI affords investors who believe that the price of bitcoin will drop with an opportunity to profit or potentially hedge their cryptocurrency holdings. BITI enables investors to conveniently obtain short exposure to bitcoin through buying an ETF in a traditional brokerage account.”

ProShares claimed that BITI seeks exposure through bitcoin futures contracts and intends to generate results that reverse those of the S&P CME Bitcoin Futures Index. It will be interesting to observe how well-timed this rollout is. While many continue to speculate that the cryptocurrency market is at or near a bottom, markets remain rife with uncertainty as investors wait for the Federal Reserve's next move and any indications of peaking inflation.

Voyager's disclosure to Three Arrows Capital

Voyager Digital LLC was established as a cryptocurrency platform in the United States in 2018. It offers global customers and businesses cryptocurrency payment solutions through its subsidiary Coinify.

Figure 19.

In a recently released market update, Voyager disclosed that if Three Arrows Capital does not pay back its loan, its operational subsidiary, Voyager Digital LLC, may send it a notice of default. 15,250 BTC and $350 million USDC make up Voyager's exposure to 3AC. The company sought the total amount on June 27, 2022, after initially asking for a payback of $25 million USDC by June 24, 2022. Both sums remain so far unpaid, and 3AC will be forced to default if payment is not made. Voyager expects to pursue recovery from 3AC and is speaking with its legal counsel on available legal remedies. The amount they will be able to collect from 3AC is currently unknown to Voyager.

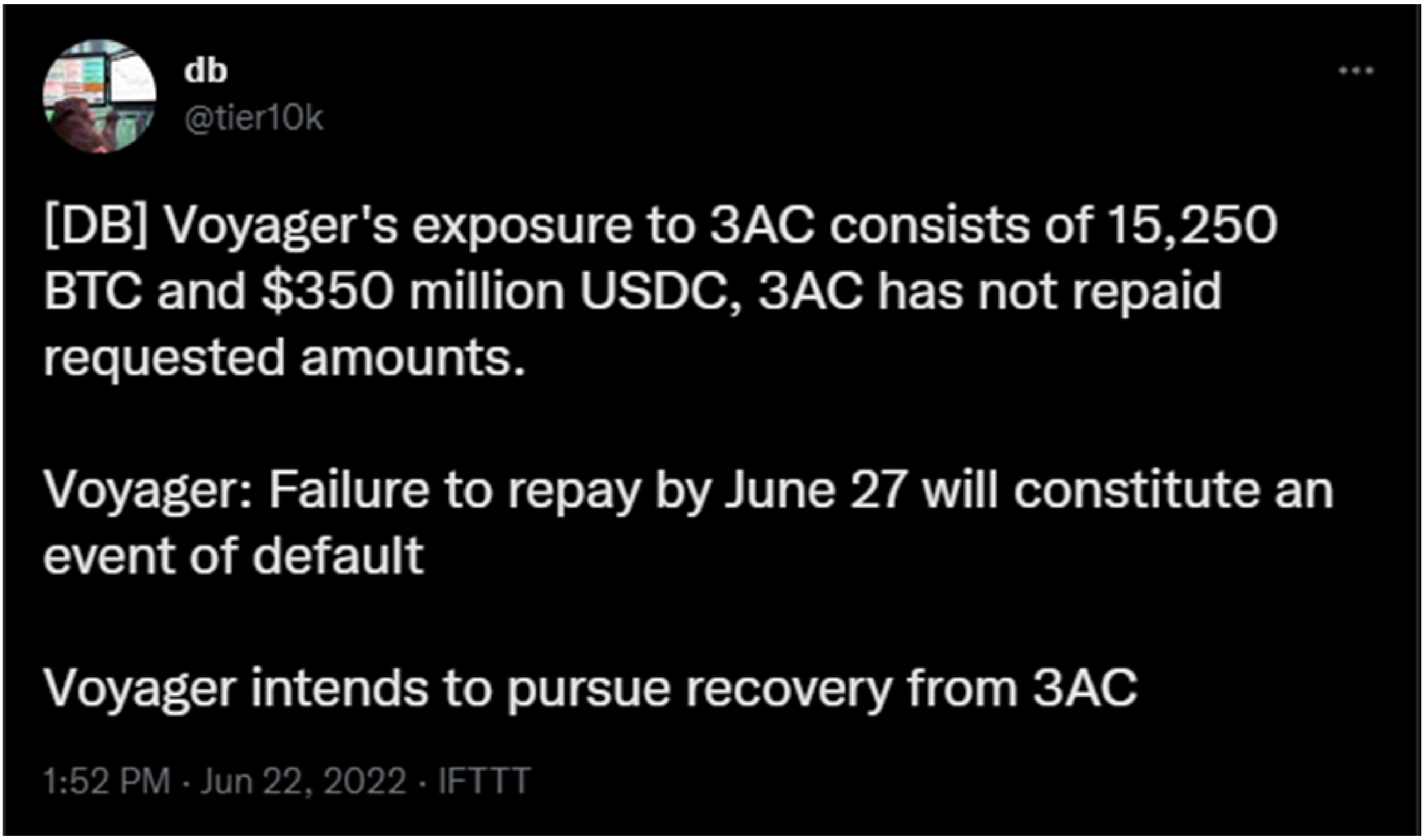

Figure 20.

Shortly after the disclosure, the price of Voyager Digital Ltd. (VOYG) fell by over 50% to the price of 0.78$.

Figure 21.

Solana developers announce a Web3-focused mobile phone

Figure 22.

With the release of an Android phone and a new subsidiary dedicated to web3 mobile apps, the team behind Solana is attempting to barge into the telecom industry. Solana Labs CEO Anatoly Yakovenko unveiled the new Android phone, Saga, at an event in New York City. The group is creating the gadget specifically for web3, including decentralized trading platforms and NFT marketplaces.

The phone will come equipped with a 6.6-inch display, 512 GB of storage, and private key security features.

Yakovenko's transition into mobile complements his prior work as an engineer at Qualcomm, where he oversaw teams that developed technologies used by companies like Samsung, LG, and Google. Yakovenko stated, "almost 6 billion people use smartphones worldwide, and more than 100 million individuals own digital assets, and both of those figures will continue to expand. Saga establishes a new benchmark for the mobile web3 experience", according to Yakovenko.

Solana Mobile will provide developers with a framework to construct mobile-first cryptocurrency apps on the Solana blockchain and expand Saga. According to a press release, the Solana Mobile Stack "offers a new set of libraries for wallets and applications, allowing developers to construct rich mobile experiences on Solana." Solana is investing $10 million into a developer’s fund to encourage developers to create apps utilizing the new ecosystem.

Pre-orders for the gadget need a $100 deposit and might cost up to $1,000. Solana hopes to start shipping the device by early 2023.

$4 Billion in miner loans under stress

Miners have racked up to 4 billion USD in loans that are secured against their equipment. As Bitcoin faces a prolonged slump in prices and they remain reluctant to realize losses by selling BTC below their cost basis, as discussed in our on-chain section, there is excessive pressure on these loans to default.

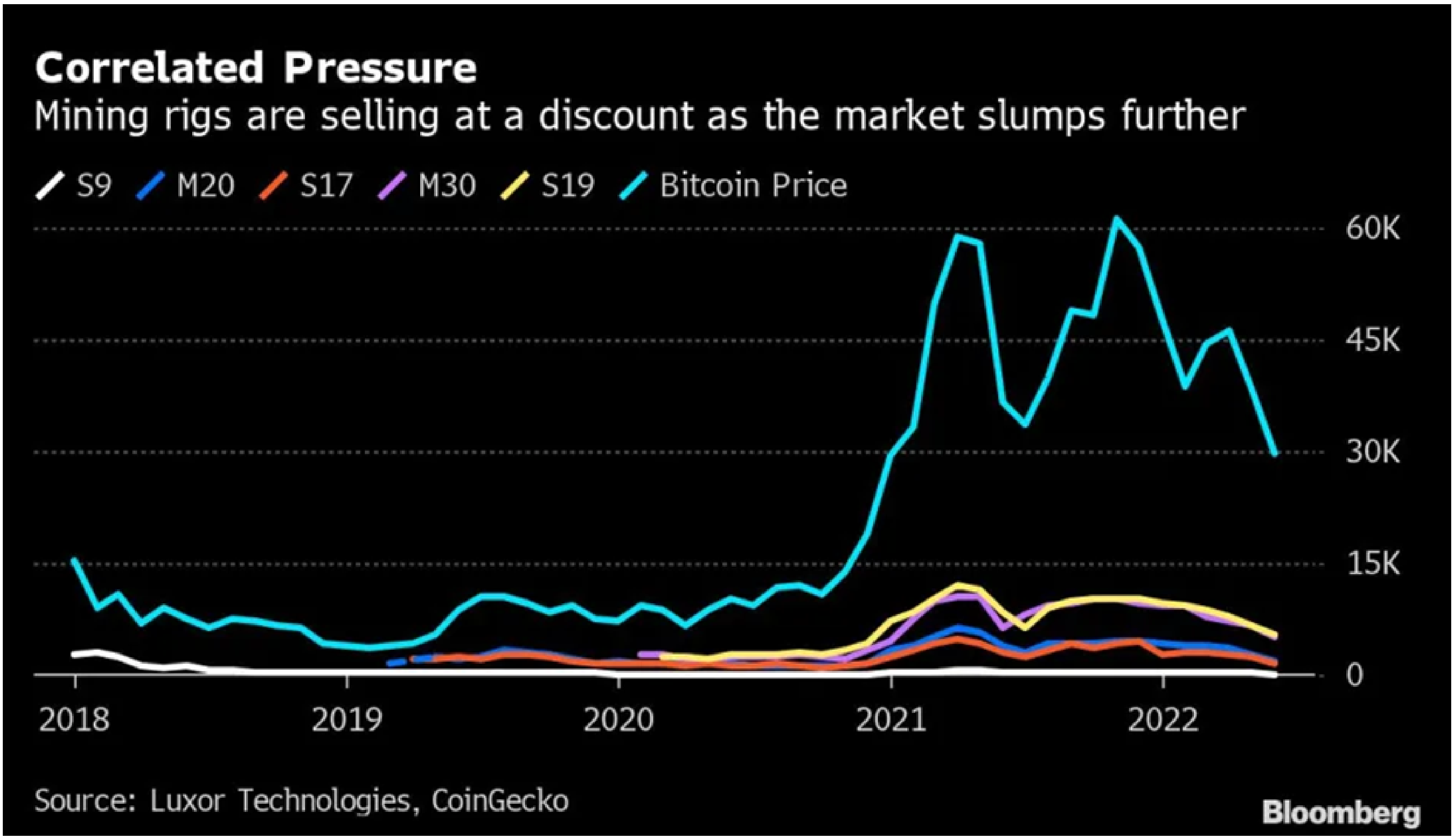

Figure 23. Mining rigs cost fluctuation with BTC price (source: Bloomberg)

Analysts claim that an increasing number of loans are currently underwater as the value of many mining rigs accepted as collateral by lenders has decreased by half.

Few miners have so far defaulted on payments on their loans, but recent sales indicate trouble. Core Scientific Inc. sold more than 2,000 Bitcoin for operational expenses in May. To pay back a portion of its $100 million debt with Galaxy Digital Holdings Ltd, Bitfarms Ltd. sold roughly half of the tokens it had just mined. New York Digital Investment Group LLC has also provided it with another machine-backed loan.

Thus, we see that mining capitulation is not just a possibility anymore but a reality.

Update on the Celsius Insolvency situation

A widespread sell-off in virtual currencies and the failure of well-known tokens caused a domino effect in the industry.

As we have seen in our last newsletter, Celsius is a centralized lending platform facing liquidity issues. It had paused its withdrawal system for clients with investors unlikely to bail it out.

According to the Wall Street Journal, sources familiar with the situation claimed that the Celsius Network had hired restructuring specialists from consulting firm Alvarez & Marshal in preparation for potentially declaring bankruptcy.

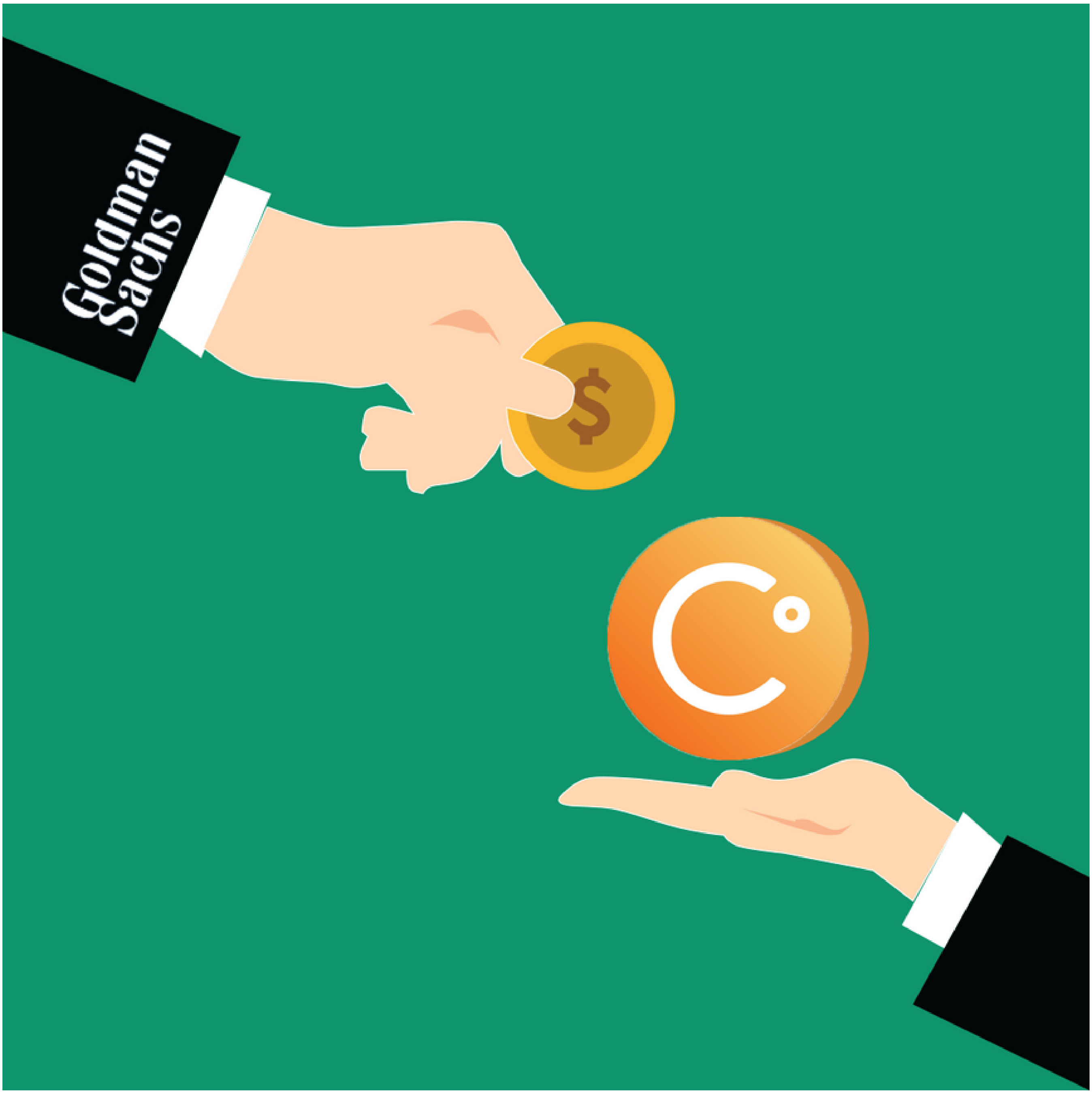

Figure 24.

There are also reports that Goldman Sachs is looking to raise $2 Billion from investors to buy the troubled Crypto lending platform, or its assets, in the event that a bankruptcy filing takes place, which would give them a highly lucrative deal of buying assets owned by Celsius at the cheapest possible rates.

Figure 25. Nexo and Celsius are cryptocurrency lenders and have been rivals for years.

According to The Block, Celsius has also engaged the assistance of global investment firm Citigroup to advise on potential solutions, including reviewing a proposal from competing cryptocurrency lender Nexo.