BITFINEX Alpha

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INTRODUCTION

We at Bitfinex, in our pursuit to make crypto accessible to everyone are striving hard to make the best research available to every participant, irrespective of their financial background.

We have decided to to write a comprehensive, data driven and neutral report on World Economics affecting Crypto, developments in the arena of Bitcoin and providing cutting edge on-chain data from the best sources available to us.

This will ensure availability of every piece of information, to every participant, whether retail or institutional, to make a better decision based on their own merits, in a completely unbiased way.

This week, we cover Inflation drivers in the current economic landscape. With new CPI data released on Friday, we discuss core FED policies and their implications on the economy. We have also made sure to discuss Total Public Debt, the procedure and drawbacks of decades of low lending rates alongside the effects of the world's current Energy Crisis on inflation and CPI numbers. Decentralized Exchanges see a growth slump owing it to DeFi's drying liquidity but still the wheat remains separated from the chaff. We discuss the LUNA 2.0 launch and key differences between centralized and decentralized stable coins. We also have a section where we track Open Interest across multiple exchanges, talk about long term and short term HODLers and their current price bias, SOPR ratio, DeFi cumulative returns, Realised cost basis by addresses, etc.

We hope you like this endeavour. We look forward to your suggestions and support.
We pledge diligent work on continuously bringing the best information and reporting that we can, and strive to improve, everyday.

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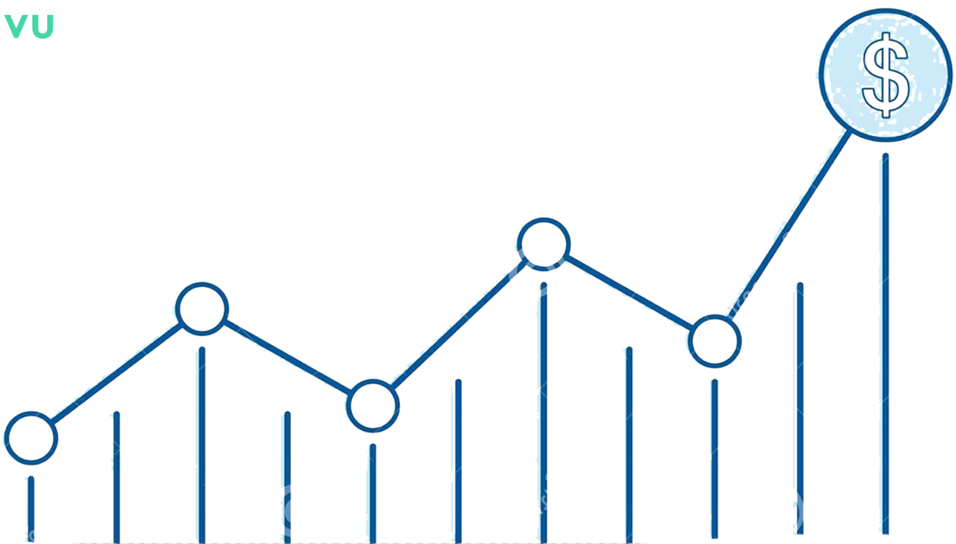

CRYPTO MACRO ENVIRONMENT ANALYSIS

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INFLATION

The cost of living everywhere in the world has been rising due to the inherent characteristic of our monetary system, compounded by the damage caused by the pandemic and the Russia Ukraine War. Last week, the FED officially started Quantitative Tightening, or QT, where the Federal Reserve reduces the supply of its monetary reserves by simply letting its assets (bonds and securities) mature and basically removing the money created from its balance sheet. This is the Fed's tool for curbing high inflation rates.

We expect aggressive Quantitative Tightening to amplify the impact of interest rate hikes in lowering prices. The Fed's plan is to continue to raise interest rates at 50 bps for the remaining FOMC meetings of 2022. If executed, this will bring us to a Fed Funds Rate of 3-5% by the end of 2022. We expect the FED to remain hawkish to bring down the prices as it ought to - regardless of the impact on different aspects of the economy.

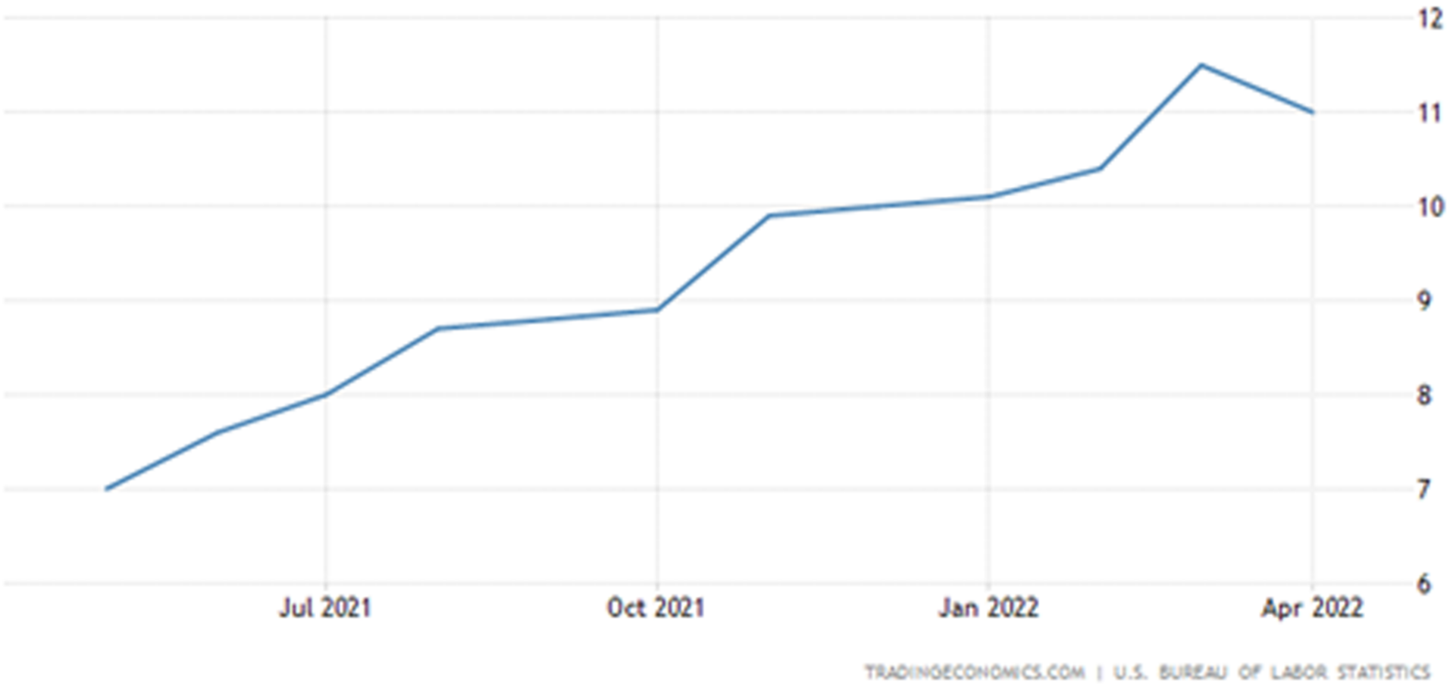

Figure 1: Producer Price Index From July 2021

The Producer Price index (PPI) measures the average change in the cost of input material to produce commodities. As of April 2022, the PPI is at 11%, steeply increasing since 2020. PPI is an important leading indicator for Consumer Price Index (CPI) because eventually, an increase in the production cost will be passed on to consumers. The increasing PPI suggests that inflation will not slow down any time soon.

The big drivers of inflationary markets are the supply imbalance from the resurgence of demand post covid, the complexities from war, the recent lockdowns in some parts of China.

These factors have further stressed the supply chains.

Figure 2: Federal Funds Effective Rate

Looking at the big picture, the pandemic has accelerated what was imminent. The government has been progressively lowering interest rates for decades where businesses, consumers, and the government are encouraged to borrow. These low-interest rates promote the expansion of public debt. Since the US dollar left the gold standard in the 1970s, the economy has been built on credit creation, continuously increasing public debt.

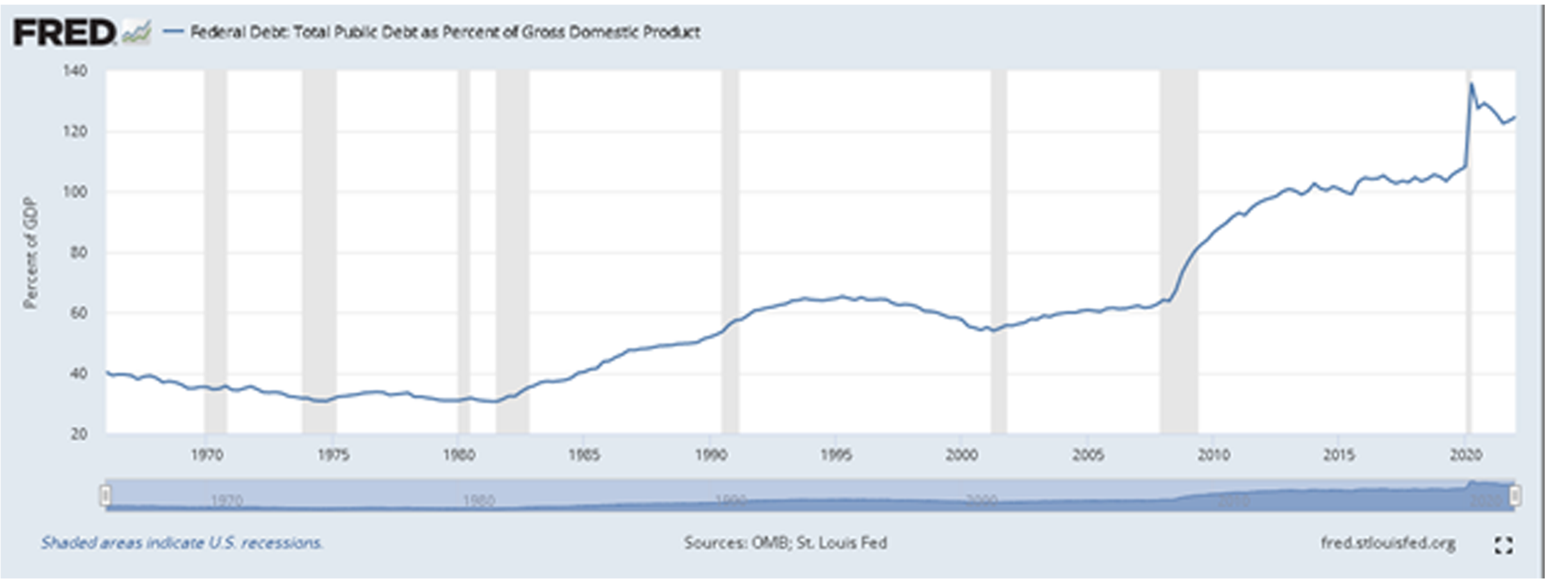

Figure 3: Total Public Debt as Percentage of Gross Domestic Product

The debt to GDP (Gross Domestic Product) ratio measures the total public debt relative to the market value of goods and services produced by a country. It reached its all-time high in Q2 of 2020 and currently sits at 124.67 as of Q2 this year. The low cost of borrowing, together with money printing has taken its toll through the decline of purchasing power, hence the inevitable high inflation rates.

The only way the Central bank can reduce inflation is to push down demand. By definition, a decline in economic activity created by low demand is a recession.

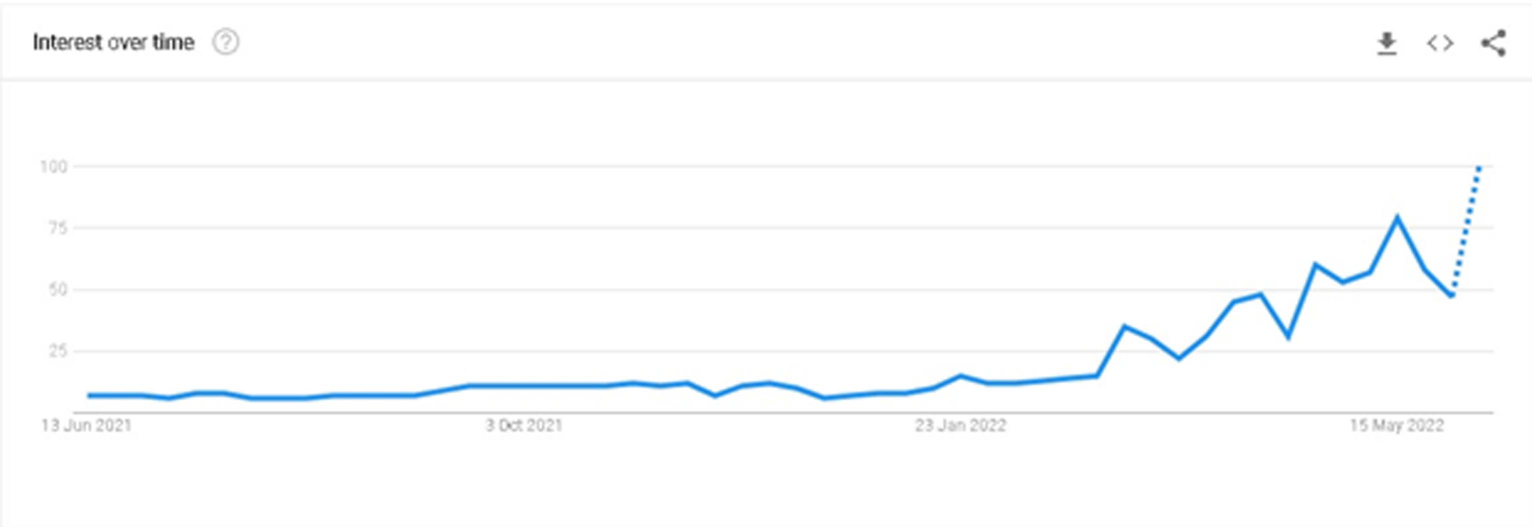

Figure 4: Google Trend Web Search for "Recession" in the US

The 40-year high inflation and high-interest rates cause a growing consumer concern about a coming recession. The May final Report from the University of Michigan for Consumer Sentiment Index came at 58.4, 10.4% down from the April final. The GDP is the key metric that is used to measure the growth of the economy. When GDP drops consecutively for two quarters, the economy is technically in a recession. The National Bureau of Economic Research usually announces a recession. Figure 5 shows the Consumer Sentiment Index and GDP overlayed with the periods of recessions to give a broader perspective of how these metrics perform with economic conditions.

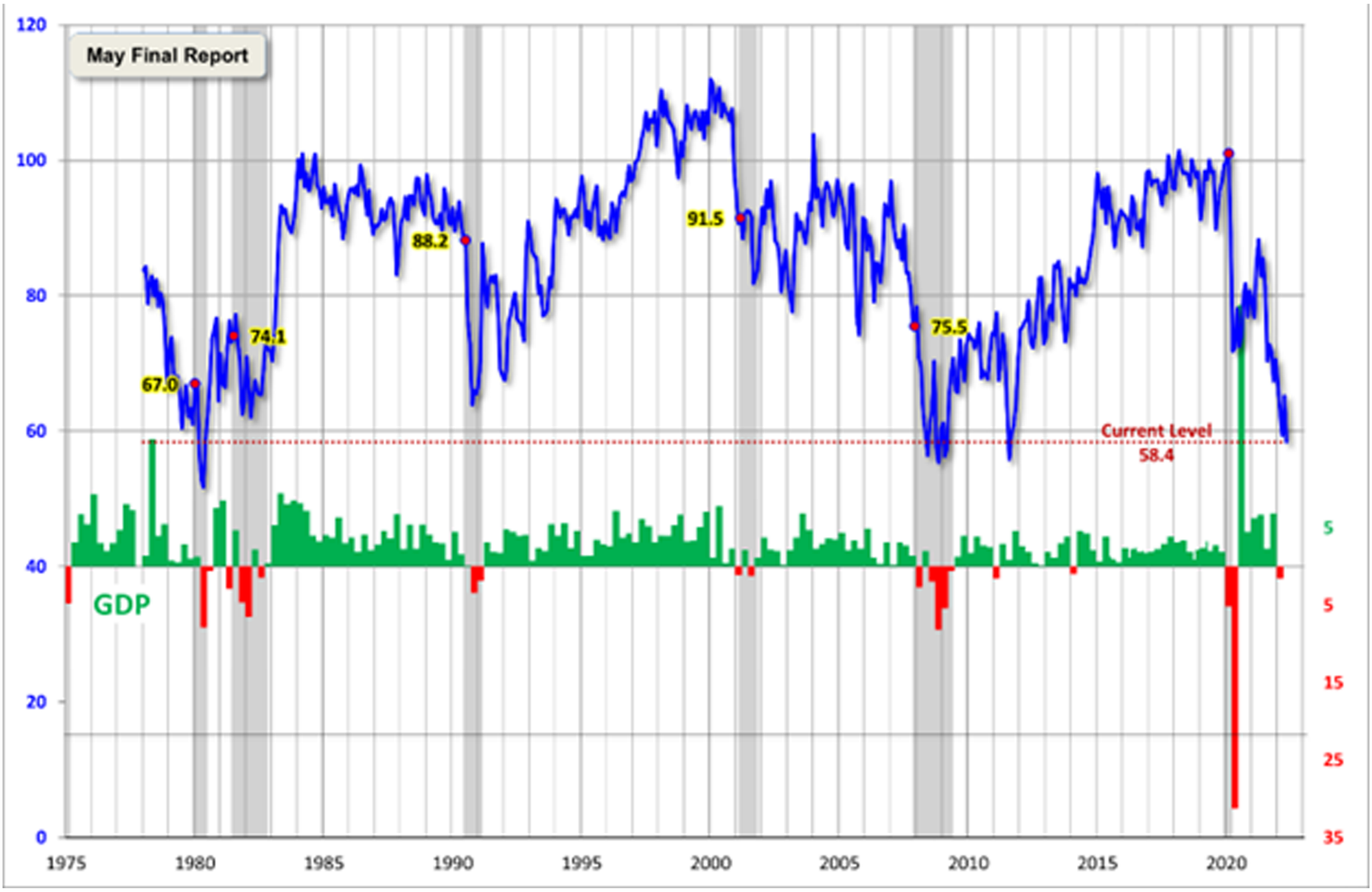

Figure 5: University of Michigan Consumer Sentiment, GDP and Recessions (Source: AdvisorPerspectives.com)

The U.S Treasury yield curve is another indicator worth watching because it has historically been reliable in predicting an impending recession. It describes the yields on Treasury bills, bonds, and notes. The yield curve usually slopes upward; you get more returns for longer locking periods for your funds. Figure 6 shows the spread between 2 and 10-year rates over the last 60 years. When the spread reaches zero and turns negative, also known as a yield inversion, it indicates that investors anticipate an economic slowdown. The shaded area of the chart shows the period of economic recession, where yield curve inversion has shown to be followed by recession.

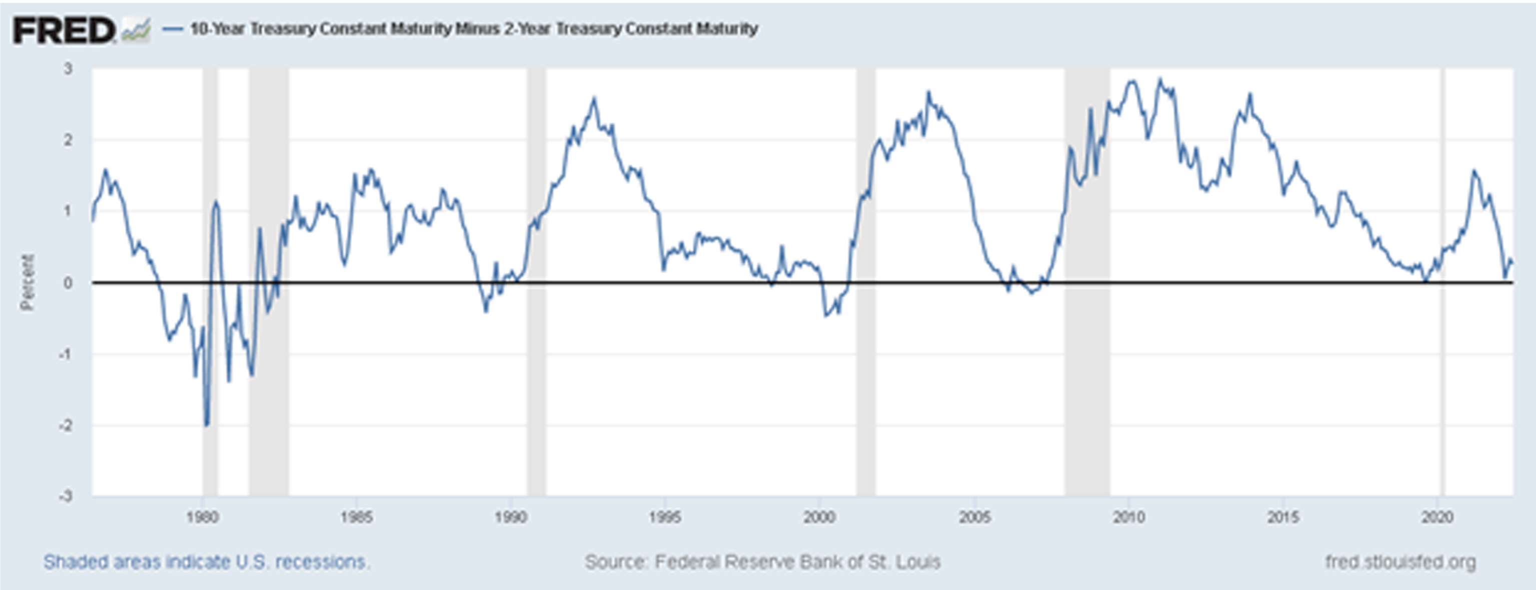

Figure 6: 10-Year Treasury Maturity Minus 2-Year Treasury Maturity throughout History ; Shaded areas indicating Recessions

Early April this year, the yield for the 10-year US treasury note dropped lower than the 2-year treasury note which convinced investors of a looming recession.

Figure 7: 10-Year Treasury Maturity Minus 2-Year Treasury Maturity from January 2022

Though technically, the US is not in a recession now, the continuous decrease in demand from the higher cost of borrowing and rising commodity prices is likely to create a downturn for next year.

THE ENERGY CRISIS

The world is currently facing an energy crisis which has been the biggest contributor to inflation in 2022.

Figure 8: Prices of Energy Commodities From July 2021

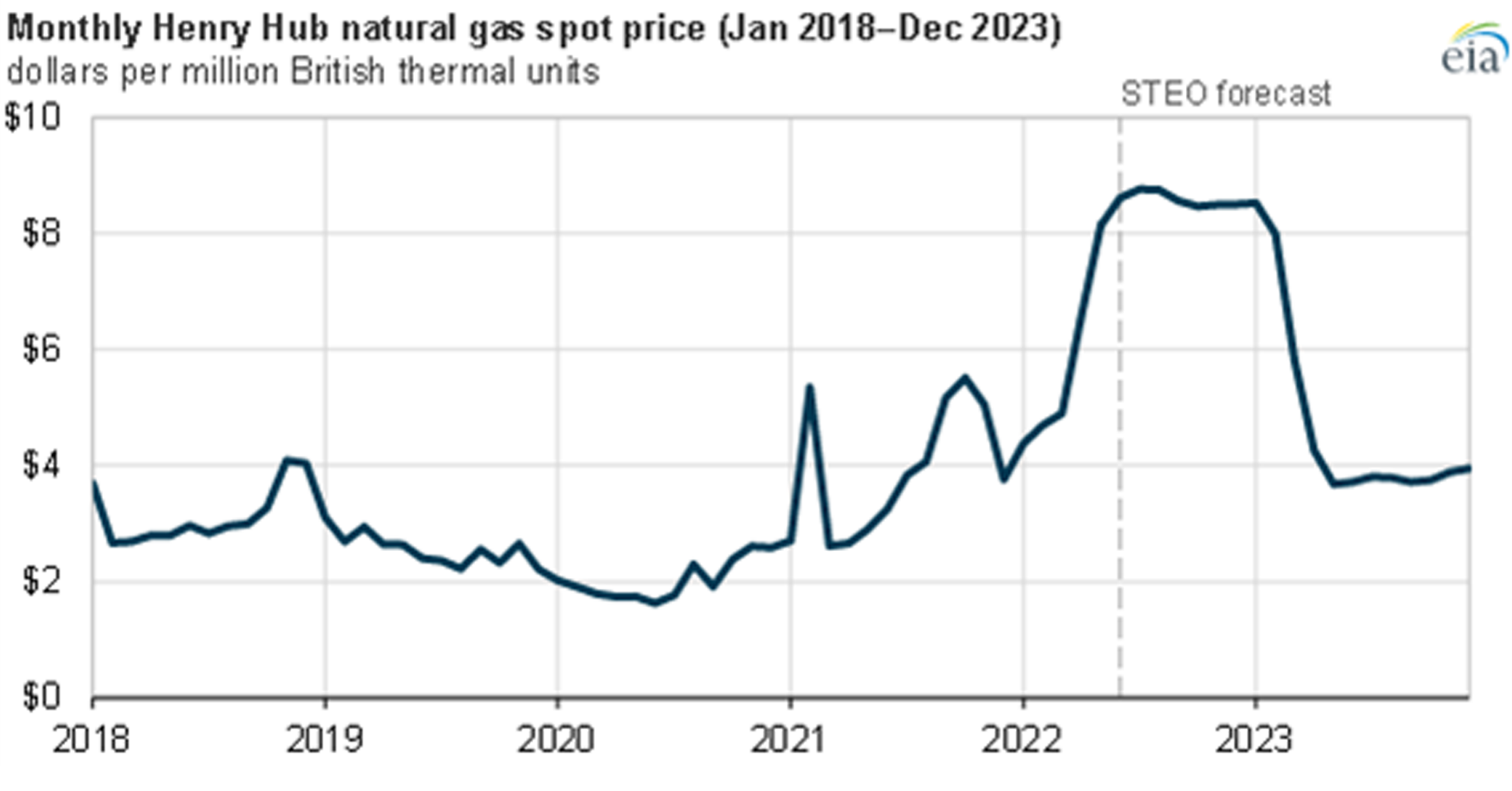

Figure 9: Monthly Henry Hub Natural Gas Spot Price (January 2017 - December 2023) with STEO forecast (Source: EIA)

US Energy Information Administration (EIA) expects the US natural gas prices to remain high for the rest of 2022 due to below-average natural gas inventories and high consumption of natural gas despite high prices.

The energy crisis can be attributed to several factors such as Germany's nuclear phase-out (you can read more about it here: https://bit.ly/3aRrAOe), the Russia-Ukraine war, Asian countries competing for the US exported LNG, the sudden surge in commodities demand in the new normal and buying pressures from China lockdowns.

Figure 10: Global Energy Sector vs Global Equities ; MSCI World Energy Net Total Return / MSCI World Net Total Return (Source: Saxo Bank)

From 2008 to 2021, the Energy sector has shown to underperform the equity market, which lead to underinvestment in energy. When the price of oil plunged in 2014, coupled with ESG mandates and high returns from tech stocks, the energy sector became less attractive to investors.

After years of starving the energy sector of investments, we are faced with the first Global Energy Crisis. With the pandemic and war complicating the picture of the energy landscape, 2022 has come to remind us that Energy drives economies and Energy sufficiency means supremacy.

Moving forward, we expect nations will focus on transitioning to less dependency on fossil fuels but in the short term, there is a dire need to increase the supply of fossil fuels. Hence, we see a rally in energy stocks.

EQUITIES MARKET

After enduring almost a decade of weakness in stocks, the energy sector in the S&P 500 is up by 63% since January, this year.

Figure 11: Energy Sector, S&P 500

Will there still be room for an upside in the energy sector? Though it is not the best idea to pile shares during a rally, the overall picture of the economy sets up a bullish environment for the energy sector and so does the energy equities market. Developed countries are still willing to buy oil and natural gas until their supply comes back to the 5-year levels. The world bank expects prices will increase by 50% by 2022. We are likely to see an upside in the global oil and gas exploration and production industry this year.

Since production and transport of commodities all run on energy, the stock prices of other natural resources like metals and agricultural goods have increased with S&P Global Natural Resource Index advancing 15% since the beginning of the year. S&P 500 index, which consists mainly of tech stocks has sunk 5% since Friday, which is its worst weekly performance this year.

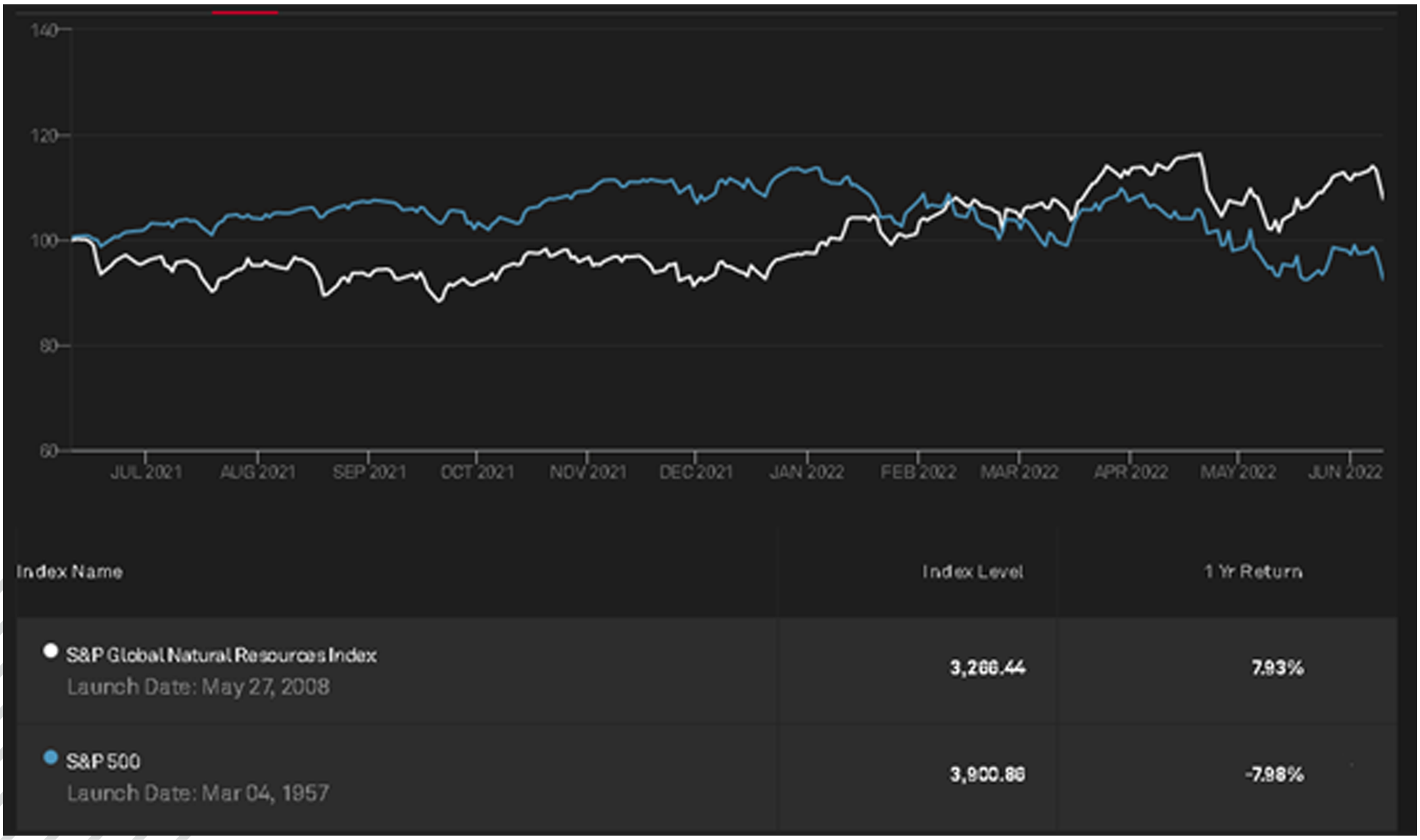

Figure 12: S&P Global Natural Resources Index and S&P 500 , 1 year chart

CPI NUMBERS

The uncertainty in the global economic and political landscape takes its toll on high-risk investments like tech stocks and digital assets. This prevailing pain for investors was aggravated by the recent CPI report. The Bureau of Labor and Statistics report showed CPI increased 8.6% from May 2021, up from 8.3% in April.

President Biden reacted by saying, “Today’s numbers indicate why I have made battling inflation one of my top priorities.”

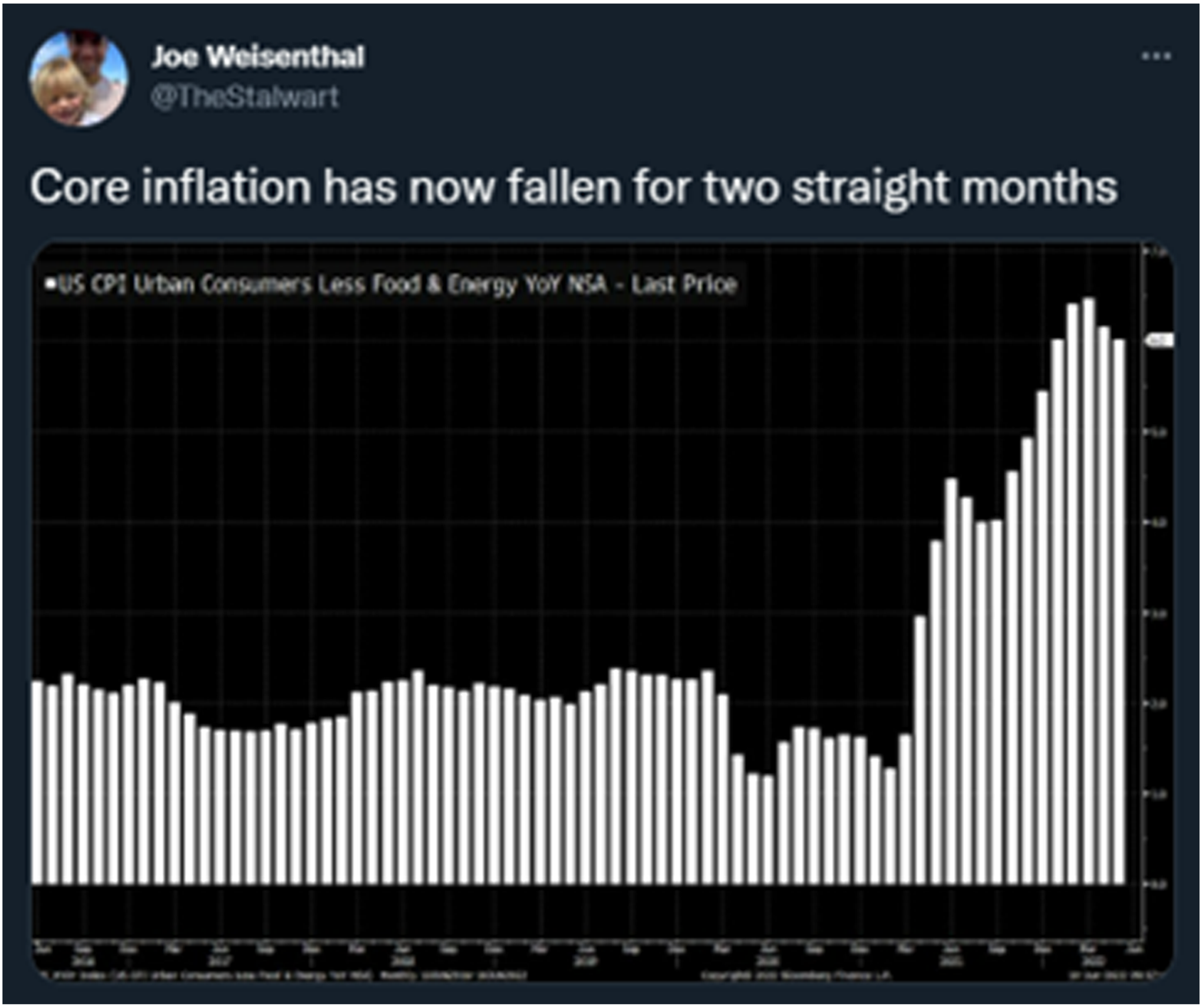

Figure 13: (CPI Urban Consumers YoY core inflation data Source: @TheStalwart)

While economists estimated CPI to be at 8.3%, it appears that inflation has not cooled off as expected. The inflation rate is a major concern for investors as the inflation metrics will dictate the path forward of Fed monetary policies. As cryptocurrency has historically shown to react negatively when FED is hawkish, Bitcoin's recent price action follows this market trend. After 24 hours since the CPI report release, Bitcoin tumbled by 4.2% while other major crypto assets, Solana, Cardano and Ethereum fell by 9%, 11%, and 7% respectively.

WHAT'S ON-CHAIN THIS WEEK?

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OPEN INTEREST AND BTC DOMINANCE

Bitcoin alone accounts for 63 percent of all open interest in the market, implying that the cryptocurrency commands more than $15 billion of OI. This massively improves over April, when Bitcoin's open interest dominance had fallen to 50%.

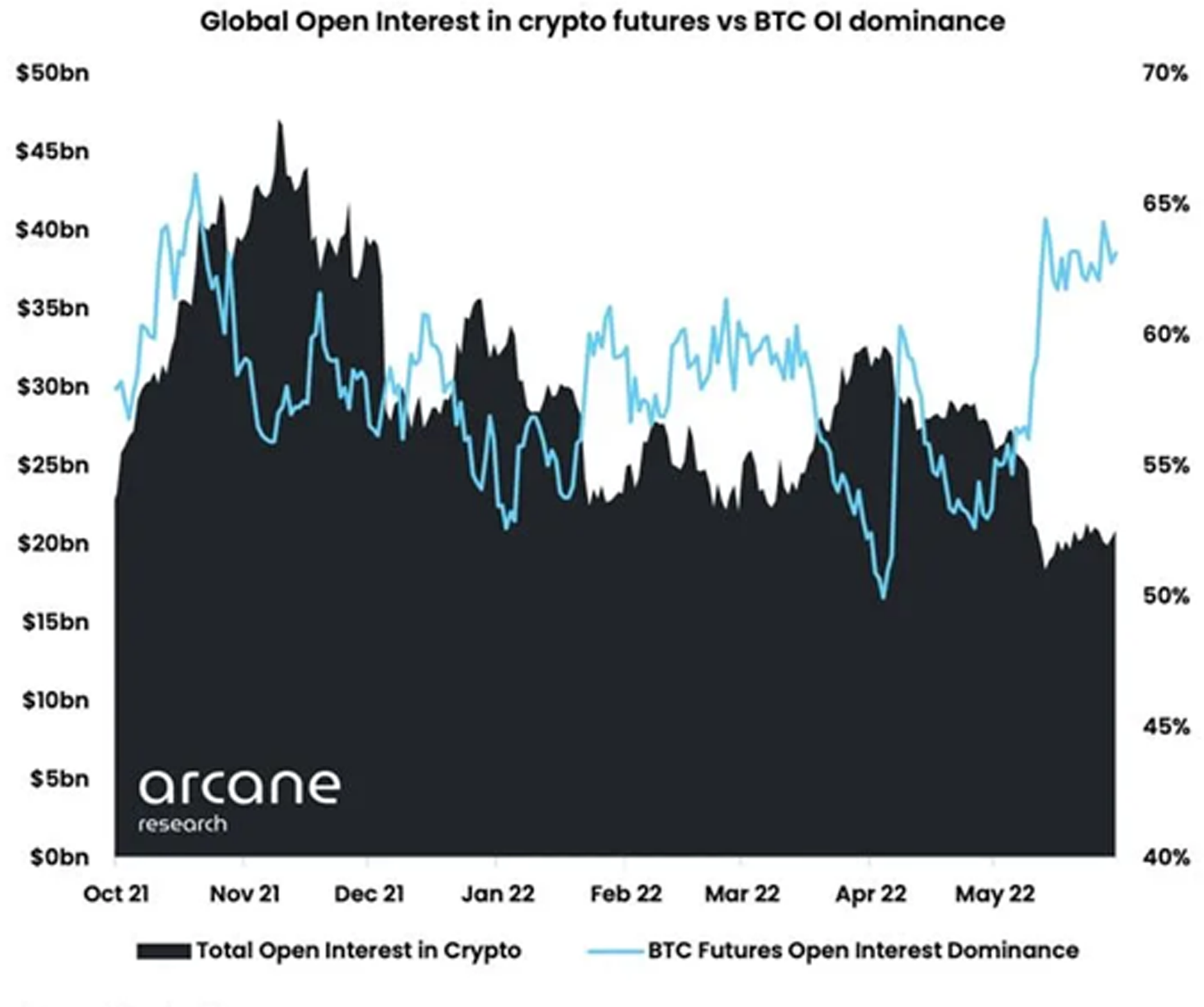


Figure 14: Open interest in crypto futures vs bitcoin open interest dominance (Source: Arcane Research)

Meanwhile, altcoins have had a rough run, and a lot of liquidations and de-risking have taken speculators out of the market.

Systemically, during a bull market, long term holders (with BTC holding dormant for more than 155 days) sell their BTC to take profits while speculators start buying. Conversely, a prominent trend in the bear market is the decreased number of short-term holders in the market as they sell their BTC for long-term holders to accumulate. A long-term holder will acquire more bitcoin even at an unrealized loss.

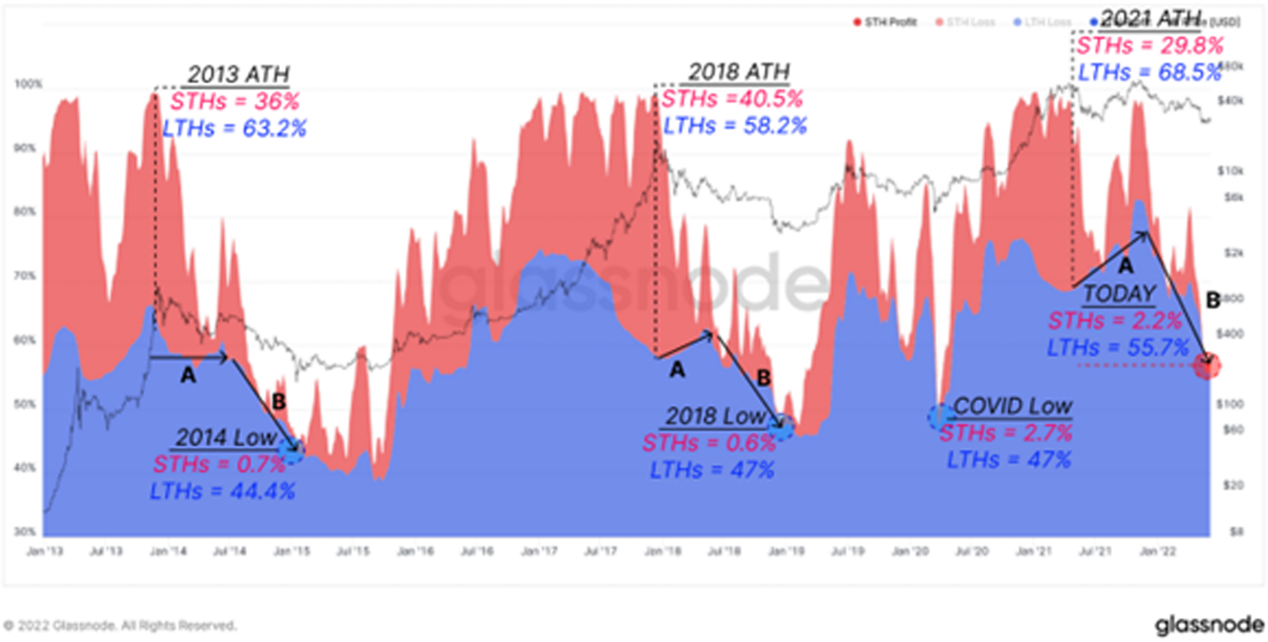


Figure 15: Bitcoin Long & Short Term Holder Supply in Profit (14 DMA); Source: Glassnode

Figure15 shows the share of supply in profit by long term holders and short-term holders. When BTC price declines, short-term holders are flushed out of the market, as seen at the 2014, 2018 and 2020 lows. This usually occurs in the later stages of the bear market.

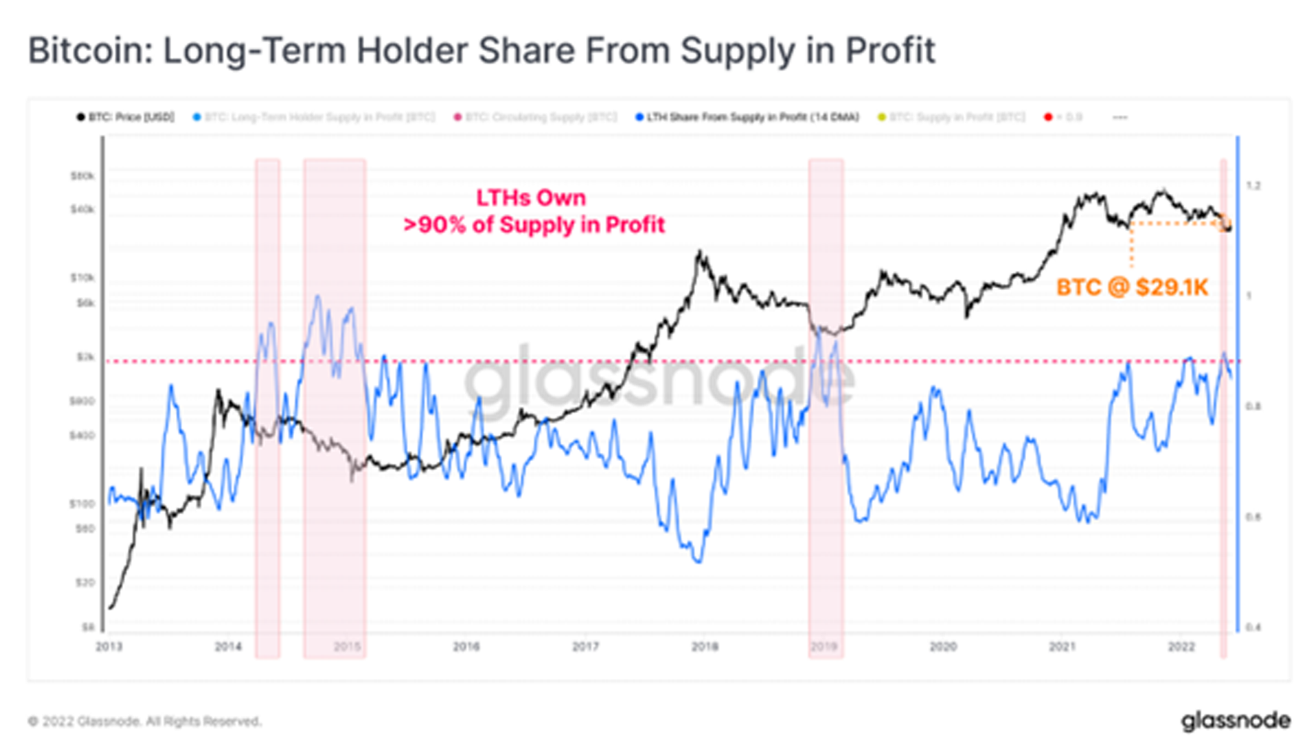


Figure 16: Bitcoin Long-Term Holder Share from Supply in Profit. Source: Glassnode

Figure 16 shows how the Long-term holders are dominating the supply that is in profit. The accumulation of long-term holders can be seen in Figure 17 where high levels of activity among HODLer wallets occur when Bitcoin hovers below 30k.

Figure 17: On-Chain Volumes by HODLers
(Data as of 11th June, Source: Whalemap.io)

Figure 18 shows the Spent Output Profit Ratio (SOPR) between Long-Term holders and Short-Term holders. SOPR is the realized Bitcoin value at a particular time divided by the value when it was bought. It shows that the long-term holders shoulder most of the unrealized losses as the SOPR ratio falls below the neutral line of 1.0 since April 2022.

Figure 18: Long-Term Holders and Short-Term Holders SOPR ratio

The wallets or addresses with a cost basis lower than the trading price are all 2-3 years old or older, as seen by the Realized Price By Age graph in figure 19. Thus, despite ongoing decline, long-term holders of 2-3 years are still in profit while holders who bought since January 2021 are currently underwater.

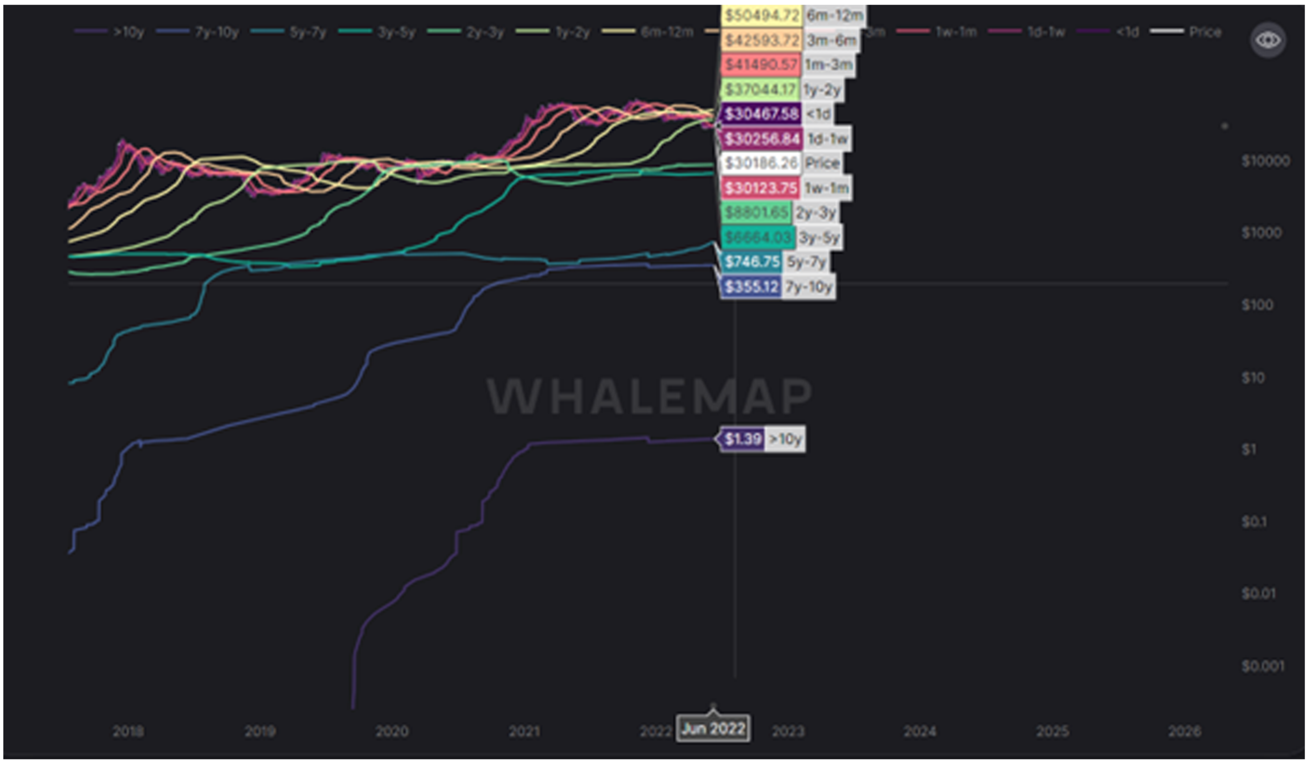


Figure 19: Realized Price of Bitcoin By Age of Wallets and Bitcoin Price

The LUNA Foundation Guard's large BTC holdings infused a frenzy of Bitcoin unloading at the lows, but there was a minimal domino effect to older wallets offloading. Our data from on-chain volume is unlikely to represent whale offloading.

Figure 20: Bitcoin Transaction Inflows to Exchanges (Highlighted: Early May Sell-off as Terra unloads BTC reserves fights to defend UST de-peg)

Nevertheless, the fact that all Bitcoin purchased in the last year using investor-style wallets has experienced a drawdown from its original cost basis is concerning.

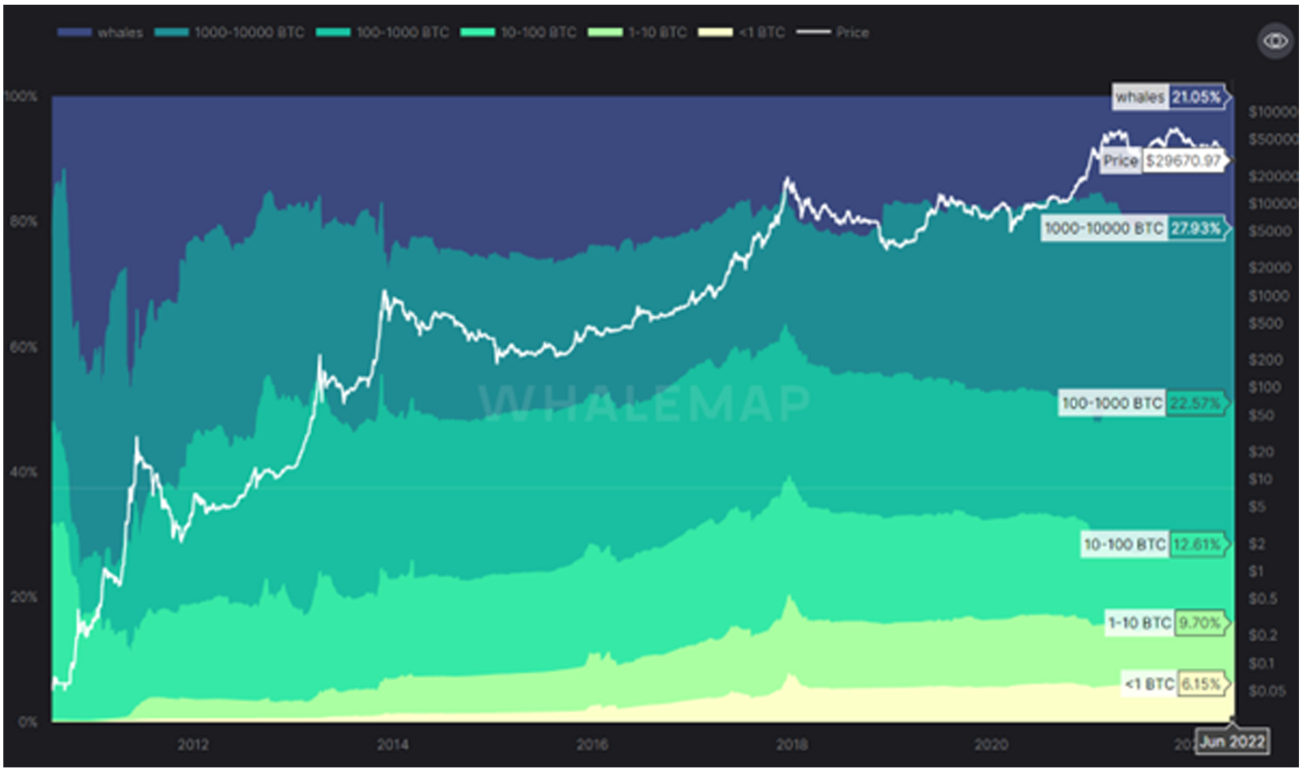


Figure 21: Realized cap by address waves (source: Whalemaps)

Another insight into the involvement of larger players and normally dormant wallets is through the realised cap by address waves graph. This shows what percentage of realized capitalisation belongs to addresses of various sizes. With more than 48.9% of the BTC in circulation still owned by wallets holding greater than 1000 $BTC, it is assumable that there has been no “whale capitulation” event that various Twitter or blog posts talk about.

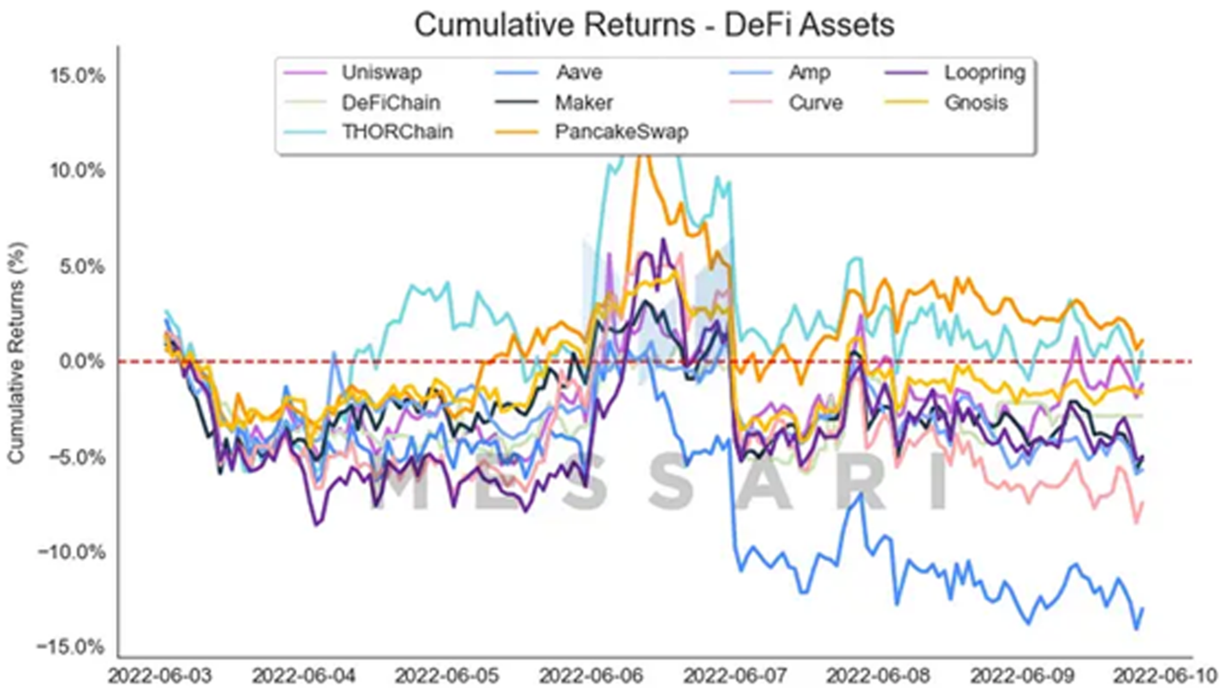
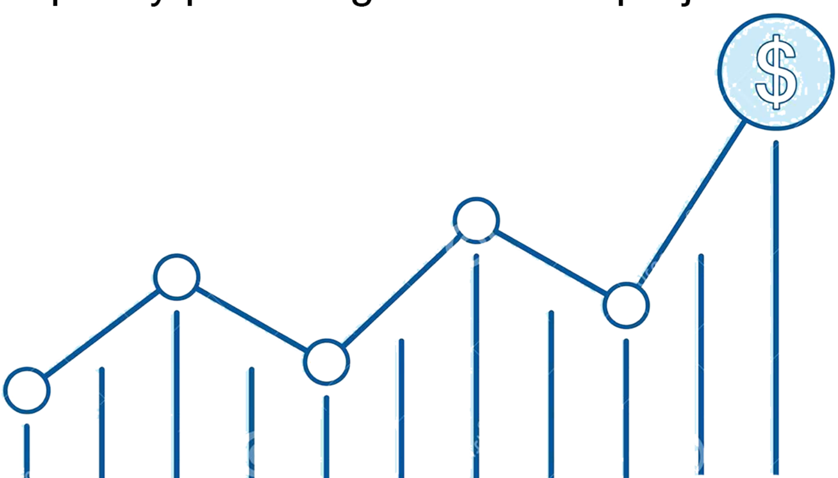


Figure 22: Cumulative Returns for DeFi assets (Source:Messari, data only till June 10th)

While BTC has seen some green the previous week after months of relentless selling, it is in the process of closing another week in the red while DeFi assets experience further token price depreciation amongst drying liquidity as discussed in the DEX section below. The sector had a midweek spike that momentarily sent all top assets to positive territory; however, the short-lived rally changed direction and left most in the red.

The LUNA fiasco has essentially caused 20% of DeFi to evaporate through its domino effect of investors losing trust in staking and liquidity providing models on projects.



CRYPTO NEWS

CRYPTO NEWS

DEXs CONTINUE TO GROW BUT AT WHAT RATE?

Being a successful DEX, in the context of the broader crypto ecosystem with high speeds, liquidity, and low fees from centralized competitors is an exceptional feat. The top DEXs currently account for north of 10% of all crypto spot trading. This figure has steadily risen since it peaked at around 6% a year ago. We expect activity to increase as these products and the underlying blockchains grow more advanced, and DEXs to gain more market share.

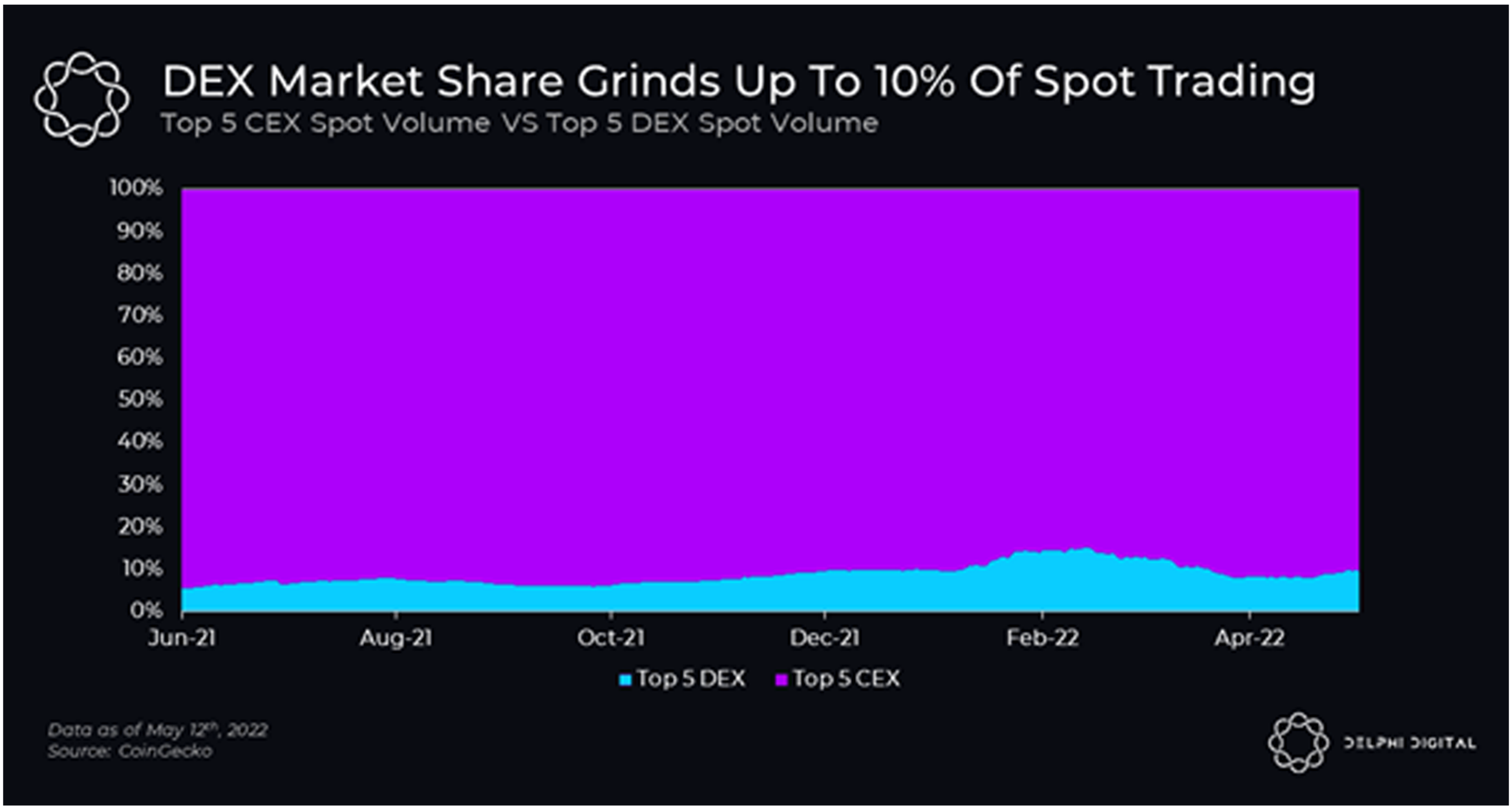


Figure 23: Spot Volume Gradient between top 5 CEXs and top 5 DEXs (Source: Delphi digital

Bearish market conditions have driven people away from DeFi as investors go risk-off and larger players deploy capital towards short-term trading strategies.

This begs the question, how well have DEXs withstood bearish and illiquid conditions?

Decentralized perpetual contracts have failed to keep at pace due to subpar technology and the complexity of the problem. Centralized exchanges dominate futures volume.

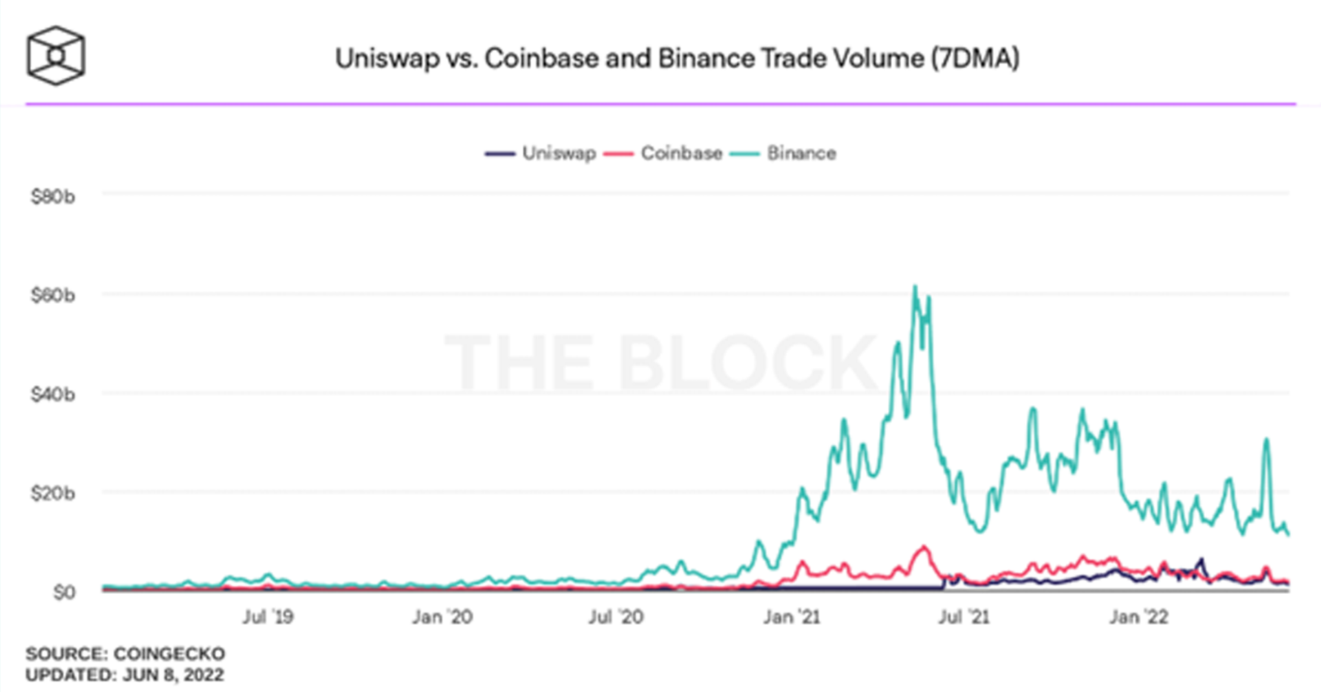


Figure 24: Source-The Block

Data confirms that over the last 6 months, the top decentralized exchanges like dydx and Uniswap account for less than 1.5% of futures trading volume.

Established institutions continue to climb onboard the Bitcoin bandwagon:

Figure 25

Goldman Sachs released its annual insurance survey with cryptocurrency included for the first time.
The survey of 328 chief investment officers and chief financial officers, representing nearly half the $26 trillion global insurance industry indicated that six percent of respondents were invested in crypto or considering doing so.
Forbes reports that Mike Siegel (global head of insurance asset management and liquidity at Goldman Sachs) said, “If this becomes a transactable currency, they want to have the ability down the road to denominate policies in crypto.”
The new asset class would be another option to pay for insurance coverage if insurance companies began accepting crypto payments.

Figure 26: PayPal to allow transfer of cryptocurrencies off of its platform

Paypal has also issued a statement that it would finally launch a service to support native transfer of cryptocurrencies between Paypal and other wallets and exchanges.

INSTITUTIONAL INVESTORS ACCUMULATING:

New data shows that institutional investors are buying on weakness and taking advantage of low prices to accumulate more digital assets. Crypto investment products enjoyed inflows of $87mn during the last week of May, with Bitcoin taking the lion's share, pushing year-to date inflows just past the half a billion mark to $0.52B.

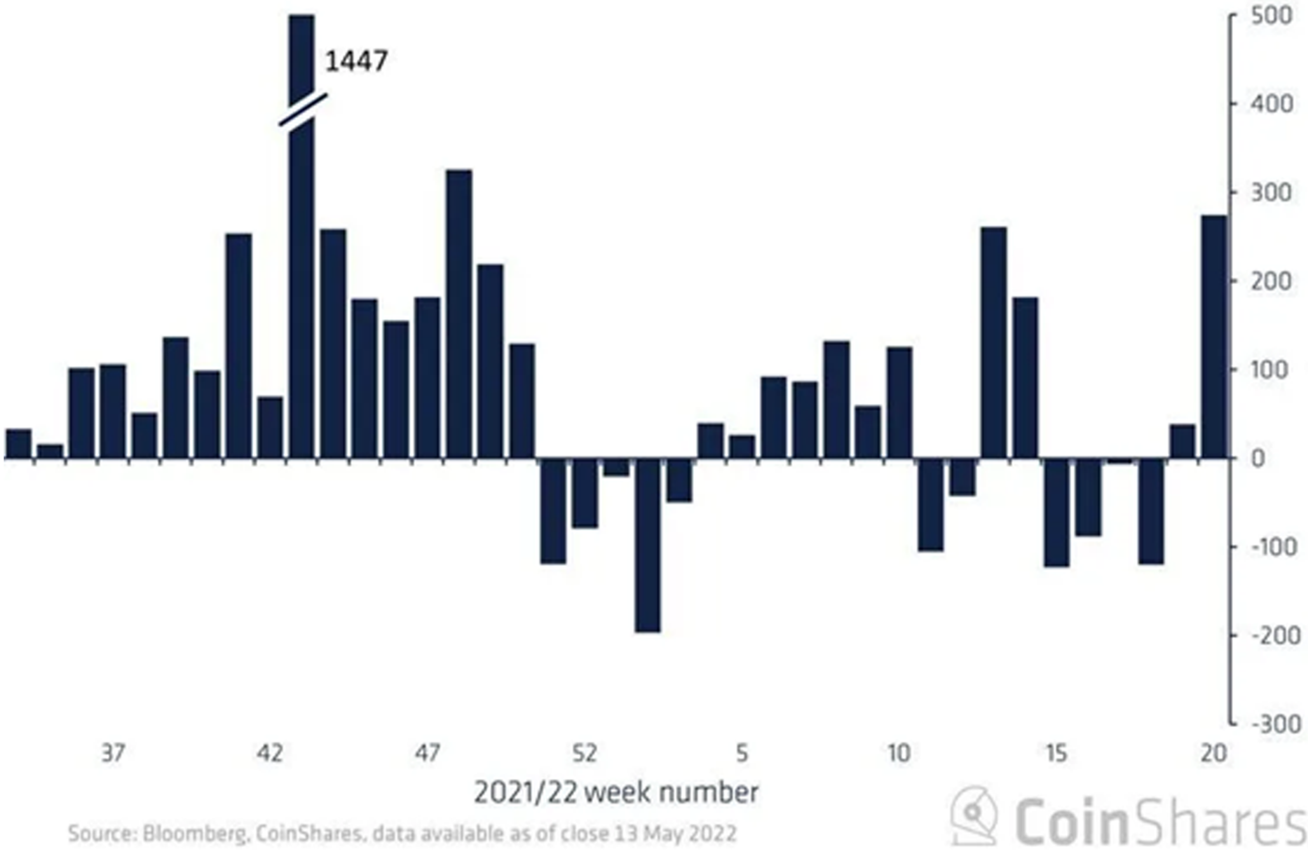


Figure 27: Weekly Crypto Asset Flows (US $m)

May data shows that crypto-focused funds saw the largest weekly inflows since October '21. Bitcoin's largest Exchange Traded Fund is provided by Purpose which raked in more than $380 million in inflows.

225,413.6658 Total Bitcoin Holdings	$6,804,979,503 Total Value (USD)	1.18% Public Companies Bitcoin Dominance	27 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	$3,900,942,910	0.615%
2	Tesla	NASDAQ: TSLA	US	48,000	$1,500,000,000	$1,449,064,834	0.229%
3	Galaxy Digital Holdings	TSE:GLXY	CA	16,402	$134,000,000	$495,157,529	0.078%
4	Square Inc.	NASDAQ:SQ	US	8,027	$220,000,000	$242,325,905	0.038%
5	Marathon Patent Group	NASDAQ:MARA	US	4,813	$150,000,000	$145,298,938	0.023%
6	Hut 8 Mining Corp	TSX:Hut-8	CA	4,724	-	$142,612,131	0.022%
7	Coinbase	NASDAQ: COIN	US	4,483	$130,100,000	$135,336,618	0.021%
8	NEXON Co Ltd	TYO: 3659	Japan	1,717	$100,000,000	$51,834,257	0.008%
9	Voyager Digital LTD	CSE:VYGR	CA	1,239	$7,927,182	$37,403,986	0.006%
10	Riot Blockchain, Inc.	NASDAQ:RIOT	US	1,175	$7,200,000	$35,471,900	0.006%

Figure 28: List of top 10 companies public companies with Bitcoin holdings. (coingecko)

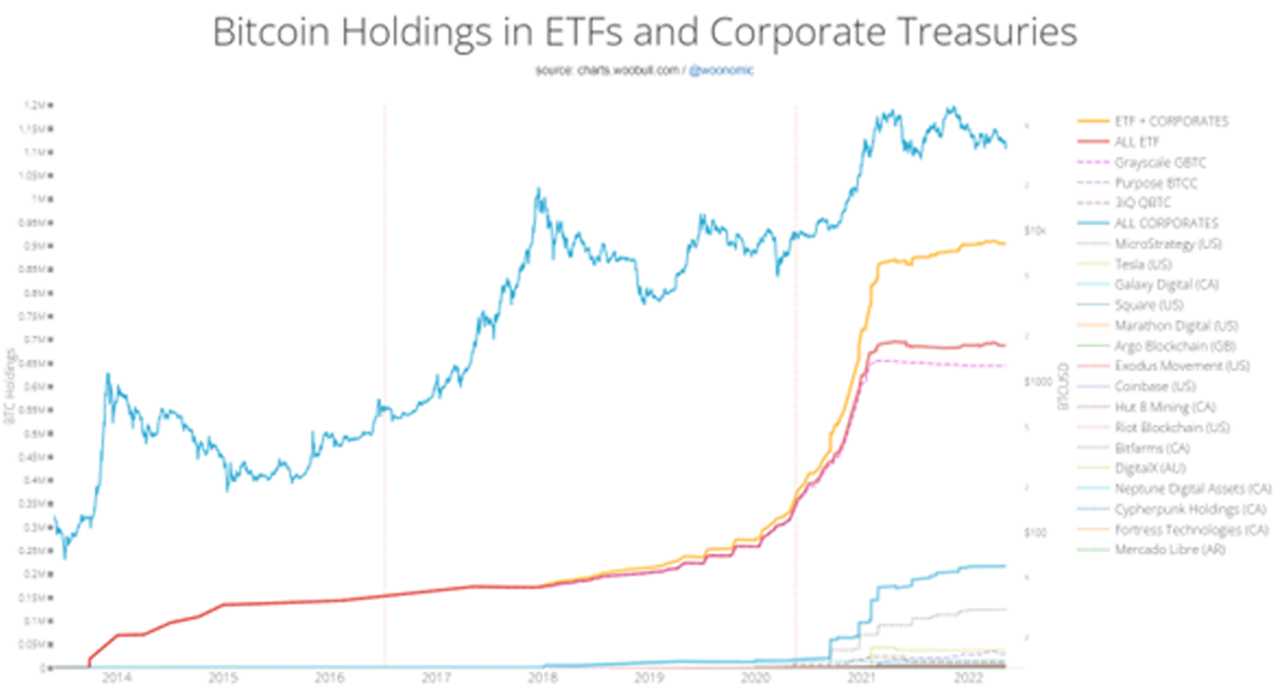


Figure 29: Visualizes Bitcoin Holdings in ETFs and corporate treasuries. (source:woobull.com)

Figure 30

Luna 2.0 has failed to rescue the Terra ecosystem as it plunges 85% since its release date. It was made to revive the Terra ecosystem after its algorithmic stable coin, UST, de-pegged from a dollar leading to Luna's death spiral. Further declines were seen as Terra CEO DO Kwon set his twitter to private on June 7 which raised concerns among the community.

Figure 31

Many projects built on the Terra ecosystem are abandoning the chain and jumping ship. Polygon, a side chain of Ethereum is taking advantage of the collapse by launching a multi-million-dollar fund to help Terra projects move to Polygon.

In Seoul, financial and securities crime investigators have reportedly subpoenaed employees of Terraform Labs, the crypto start-up behind the failed stable coin, UST. Prosecutors' concerns are focused on how much prior knowledge there was of the design flaws. Investigators have reportedly secured a statement claiming some Terraform Labs insiders were opposed to launching LUNA and UST, after internal modelling of the protocol ultimately failed. Prosecutors are also probing whether crypto exchanges adhered to the proper listing process for UST and Luna and some potential price manipulation.

Figure 32: Do Kwon was ordered to comply with subpoenas issued by the SEC in February. Must hand over documents related to the Mirror Protocol and provide testimony to the SEC. Source: Crypto Briefing

For our readers who are unfamiliar, we'll explain Anchor protocol,Terra Luna and the UST crisis completely.

ANCHOR

As mentioned, Anchor Protocol is a DeFi protocol built within the Terra ecosystem. It is created by TerraForm Labs, the same start-up co-founded by Do Kwon and Daniel Shin that developed Terra.

Stablecoins borrowed from the market are subject to an algorithmically determined borrow rate, which fluctuates dependent on market supply and demand for stablecoins and rises as the utilisation ratio rises.

$$\text{utilizationRatio} = \frac{\text{stablecoinsLent}}{\text{stablecoinsDeposited}}$$

Type your te

In the Anchor borrowing protocol, after depositing the bAssets (bonded assets) on the pos Blockchain, you can borrow ($UST) up to a certain LTV ratio. It's important to know that if you borrow close to LTV limit, any fall in the price of your collateral can result in liquidation.

Takeaways:

- Algorithmic stable coins continue to persist. The launch of USDD and other similar projects is evidence of this new trend.

- Anchor Protocol's deposit inflation
  Anchor Protocol's 19.48% interest was the main reason for the LUNA price rally which in turn fuelled the ANC price rally. The deposits on the 'high-yield savings protocol' had risen extremely high and reached their peak just before the crash.

Figure 33: The current deposit stands at $631M which was $14B on May 6th, before the depeg. The borrowing remains non-existent but never surpassed $3billion even at peak volumes, hence the unsustainable design of the entire protocol. This disparity put massive pressure on the reserves.

Web5: A decentralized web platform

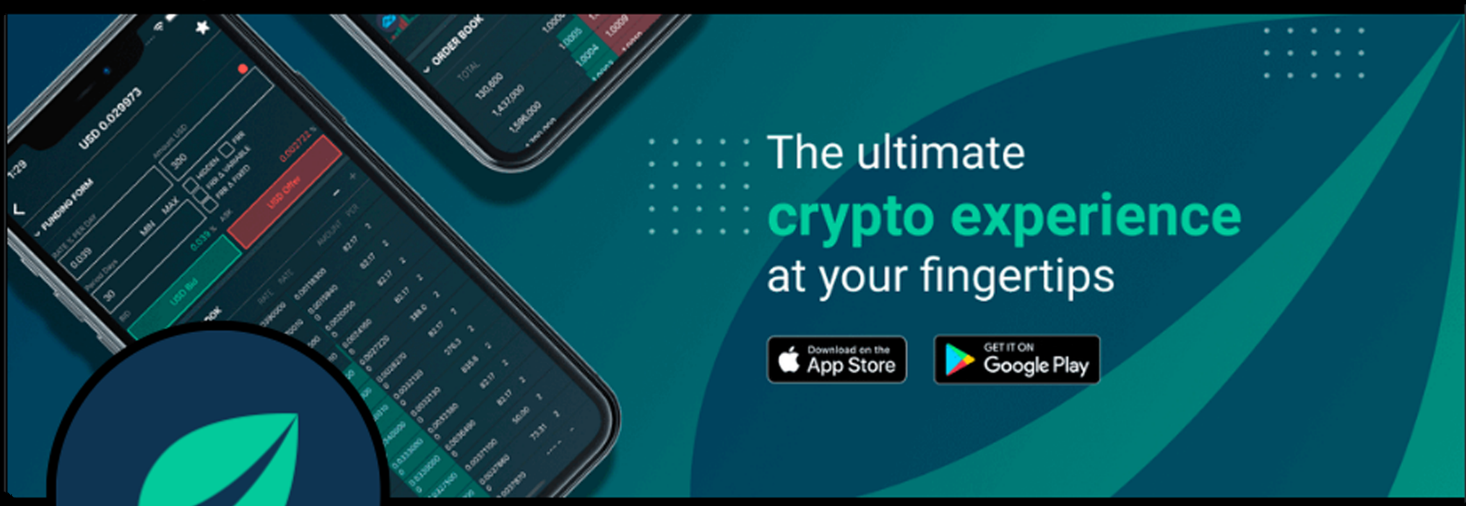
On 10 June 2022, Twitter founder Jack Dorsey's team TBD (@TBD54566975) Announced Web5: An extra decentralized web platform.

What does it mean? What are web3 and web5?

Web3 is a part of the internet that allows users to access decentralized apps powered by blockchain technology. Web3 proponents place a premium on user privacy and data control. Critics of web3 argue that it has the power to aggravate class disparities.

This is where web5 steps in. Web5 Foundation is completely built on Bitcoin Foundation. From TBD's official documents, the game changer moment is -web5 implies that users are not exchanging their data for free. Rather they own their data under a self-owned identity. The goal is to create a new class of decentralized apps and protocols where people are the power.

Figure 34



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