BITFINEX Alpha

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INTRODUCTION

Welcome to Bitfinex Alpha - our weekly look at macro economic conditions underpinning asset prices, on-chain movements for Bitcoin, and our round up of crypto news.

This week we revisit the US Federal Reserve's stance on monetary policy and analyse data from various sources to understand the trajectory for both future policy decisions and global economic growth. We also provide insight into the global energy crisis, the recent behavior in commodities markets, and we contrast policy making in the US and Europe and cover the US dollar's recent dominance against the Euro.

In our on-chain section, we discuss the monthly close for Bitcoin, and some Higher Time Frame price levels. There are multiple metrics that indicate a sharp decrease in futures market speculation by retail traders and investors, while accumulation continues to take place in the spot markets by Whales. Lastly, we also cover recent performance of other key crypto assets, and the diminishing returns across a myriad of tokens and staking protocols.

We continue to see significant developments in the crypto space. We provide you with byte-sized analysis, covering the recent crypto exchange layoffs (though not at Bitfinex), Three Arrows Capital filing for bankruptcy, the rejection of the Grayscale ETF application by the SEC, and the possibility of BlockFi getting acquired by FTX at a 99.5% discount from its previous valuation. We discuss the implications of this news for the crypto markets.

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MACRO ENVIRONMENT ANALYSIS

Federal Reserve chairman Jerome Powell reaffirms the focus on inflation

In the last week we have seen more comments from the Fed, which in the current macro economic environment are critical to understanding the future performance of asset prices. On Wednesday, Fed Chairman Jerome Powell reiterated his comments from the last May Fed minutes, saying that the job of policymakers is to find price stability and combating the new forces of inflation; and that a reversal of globalisation could mean even lower growth.

He added that he believed the US economy was fundamentally strong and can withstand monetary policy moves. Powell believes the more significant risk would be a failure to restore price stability, and the Fed would be executing monetary policy accordingly. Meanwhile, in a separate speech on Wednesday, Cleveland Fed President Loretta J. Mester (FOMC voting member) stated that she supports a 75bps hike in July if economic conditions remain unchanged. (link: https://bit.ly/3a6zdQV)

Figure 1.

Analysing Economic Growth Metrics

What does this mean? Fed policy now is the key determinant to the performance of asset prices. For this issue, we move beyond analysing raw inflation predictions and CPI data and shift focus toward growth metrics.

What are the most critical growth metrics apart from CPI data?

- GDP (Gross Domestic Product)
- Employment figures
- Personal Income and Consumer Spending
- International Trade

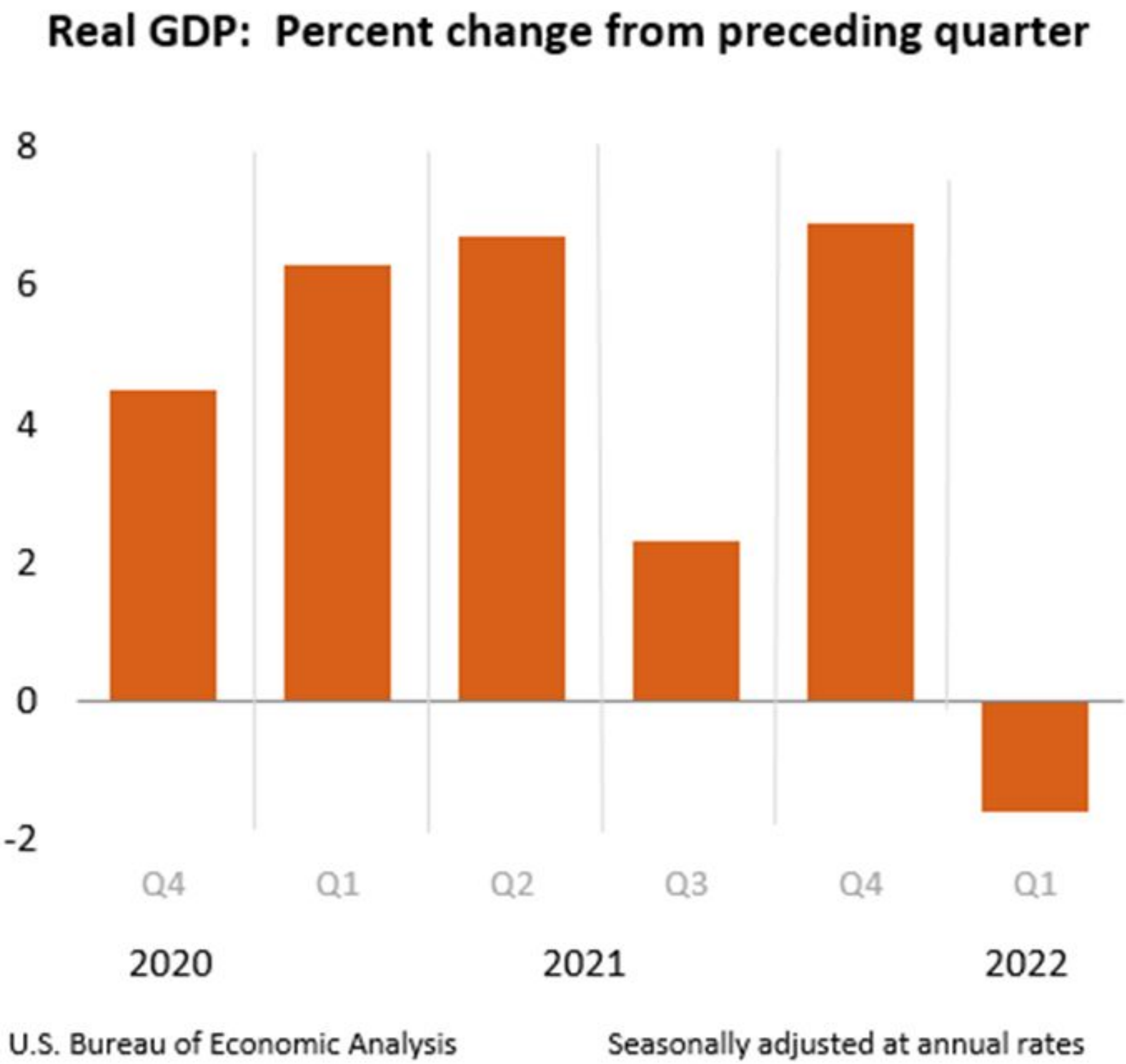


Figure 2. Real Gross Domestic Product percentage change per quarter (source: bea.gov)

Real gross domestic product (GDP) decreased at an annual rate of 1.6 percent in the first quarter of 2022, following an increase of 6.9 percent in the fourth quarter of 2021. The first quarter of 2022 saw a decrease in the metric for the first time since the COVID pandemic reversed growth in Q2 2020.

The decrease in real GDP reflected declines in exports, federal government spending, private inventory investment, and state and local government spending. At the same time, imports, which are a subtraction in the calculation of GDP, increased. The decrease in federal government spending, a consequence of the Fed's new monetary policy, primarily reflected a decline in defence spending on intermediate goods and services. The decrease in private inventory investment was led by decreases in wholesale trade (mainly motor vehicles) and mining, utilities, and construction (notably, utilities).

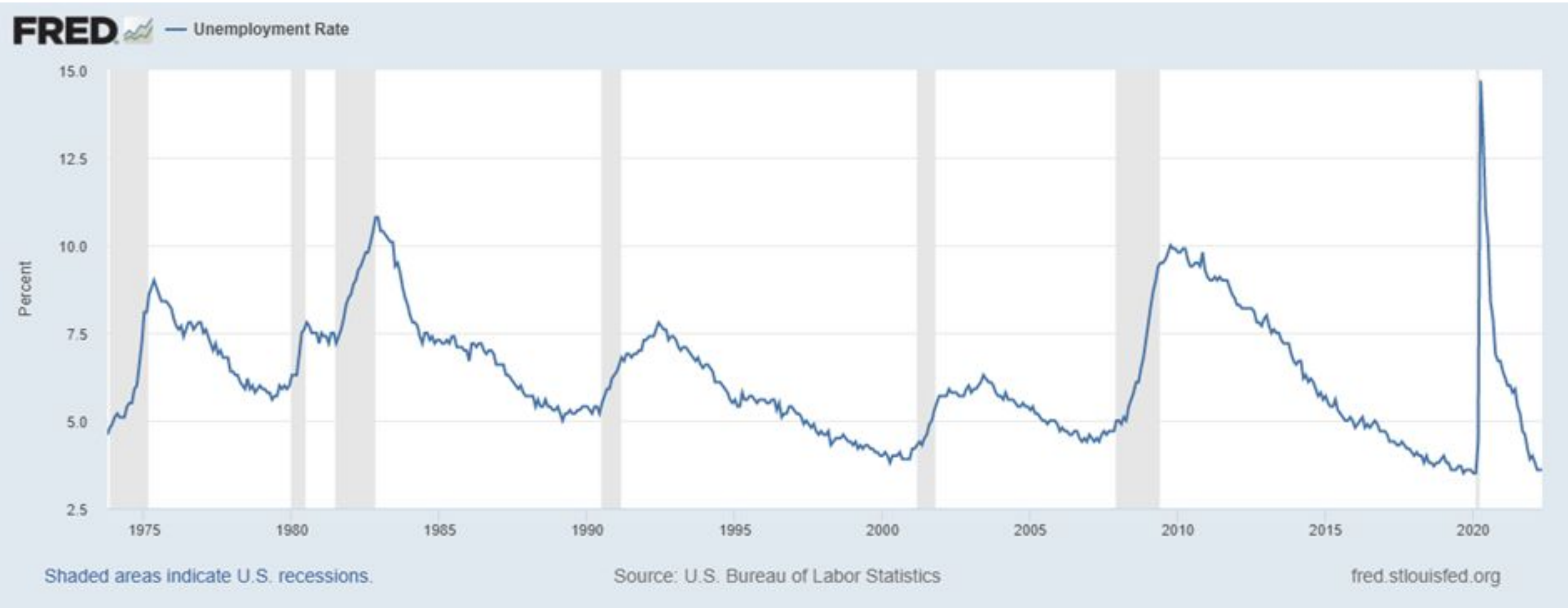


Figure 3. US Unemployment rate (source: FRED)

We revisit the unemployment numbers as the current conclusion of the Fed's policies is that the Federal Reserve is concerned with rapidly bringing down inflation and will resort to extreme measures to make that possible.

The current rate is at 3.6%; the metric has been flat for three months; the median projection as per the Summary of Economic Projections (SEP) numbers stands at 4.1%, which is a 50 bps increase from where we are currently. We are likely in a bottoming phase before unemployment rises aggressively for the next two quarters. In the Fed's view, this would be a reasonable compromise towards their inflation goal for 2023, which stands at 2%.

It would be fair to say that the labour market is not expected to show strength until the Fed meets its inflation targets.

Figure 4. Real Personal Consumption Expenditures in the US (source: FRED)

Personal Income and Outlays is a monthly report issued by the Bureau of Economic Analysis, which depicts consumer earning, spending, and saving. Changes in the amounts and ratios between income, spending, and saving can indicate current and near-term future economic trends.

Expenditure and income decreasing simultaneously is usually a product of rising inflation and aggressive interest rate policies. Under such circumstances, equity markets are expected to trend downwards, and economic growth is bound to slow down. For May, personal income and disposable personal income (DPI) were both up by 0.5% and personal consumption expenditures (PCE) were also up by 0.2%, but on a real basis, after adjusting for inflation, real DPI was down 0.1% and real PCE was down 0.4%.

This week the Atlanta Fed revised its Q2 GDP estimate to -1%, which would put the US' GDP at negative for two consecutive quarters.

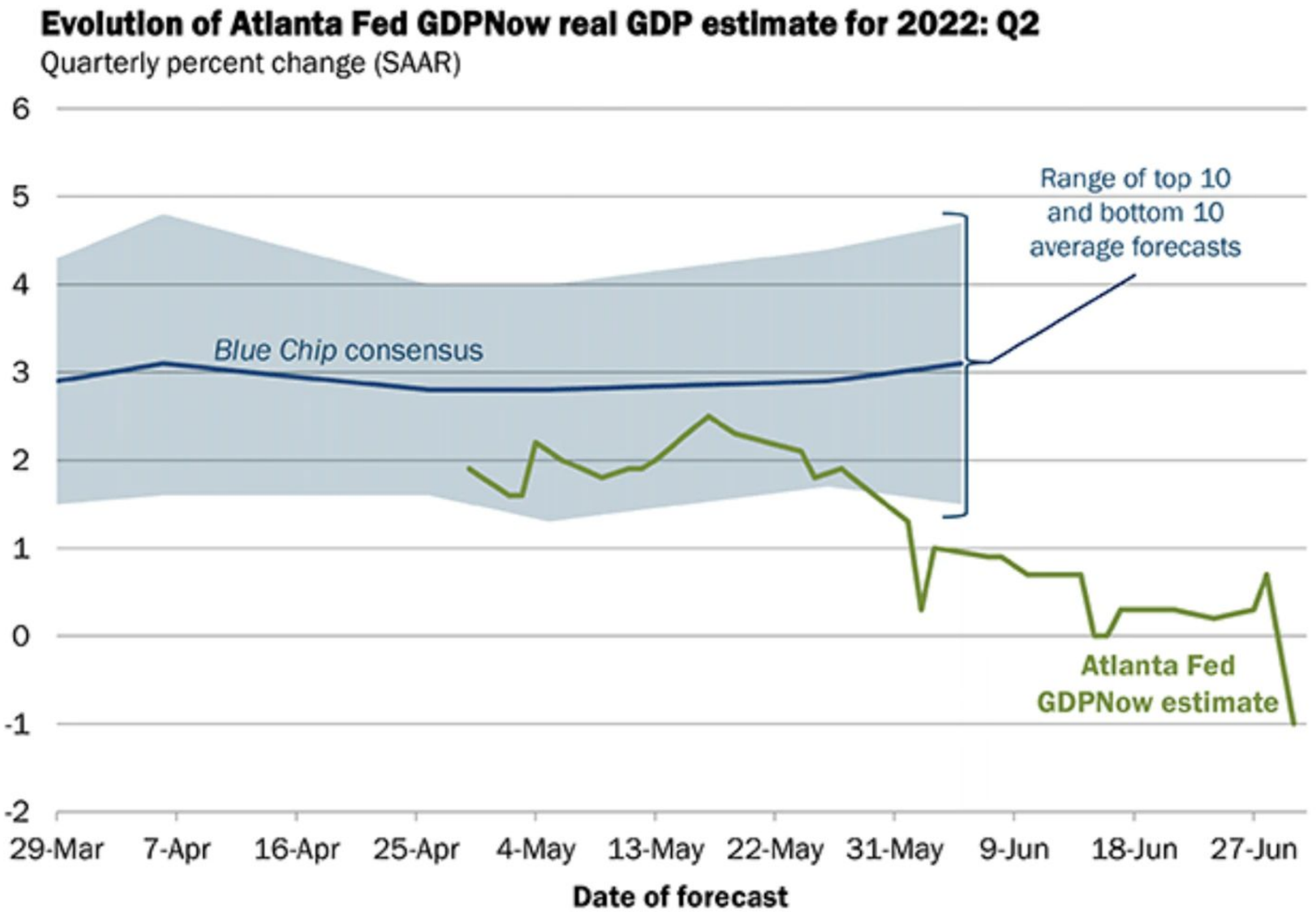


Figure 5. Atlanta Fed GDP estimate (source: Blockware Intelligence)

Thus, the data suggests that we are likely to witness a recession. The official numbers will be released on 28th July for GDP, and a negative number would NOT immediately indicate a recession. However, as per our June 20 issue, we would expect US treasury yields and the bond markets to complement the GDP numbers and conclude that a recession is upon us.

The Energy Supply Crisis

Energy is the most critical driver of economic development, and a supply crisis can create turbulence and uncertainties in the economy. Despite the fact that usage of renewable energy and other sustainable sources of power are increasing, oil is still the main fuel of the economic engine. After dropping to record lows during the COVID pandemic, oil rose sharply to a 14-year peak of $123 per barrel for West Texas Intermediate (WTI) and $133 per barrel for Brent crude in March. As discussed in our June 13 issue, the recent oil crisis was brought about by long-term underinvestment and cautious capital allocation in the energy sector compounded by a surge in demand, coinciding with reduced supply following lockdowns and the war between Russia and Ukraine.

Figure 6. Crude Oil Prices: West Texas Intermediate (WTI) and Brent Oil

Recently, we have seen a decrease in oil prices. As of Monday, WTI dropped 3.3%, while Brent Crude is down 2% since the beginning of June. The cost of oil accounts for nearly 60% of the price of petrol. Hence, vehicle owners found relief as gas prices declined to $4.88 per gallon, almost 9 cents down from last week.

Oil prices also ease as anticipation of an economic slowdown offsets the concerns on supply. The latest indications from the Consumer Sentiment Index and Fed rate hikes have increased expectations of a decline in demand for oil.

Last week, President Joe Biden proposed a federal tax holiday for oil consumers throughout September to Congress in the hope of providing relief. However, it would be prudent not to expect oil supplies to recover with Biden's policy. The downtrend in prices can quickly reverse when there are sudden supply shocks. Despite oil prices cooling down, the fundamentals in the oil and gas industry remain the same. A sustainable relief for consumers, i.e. long-term declining prices, can only happen when demand wanes or supply significantly increases.

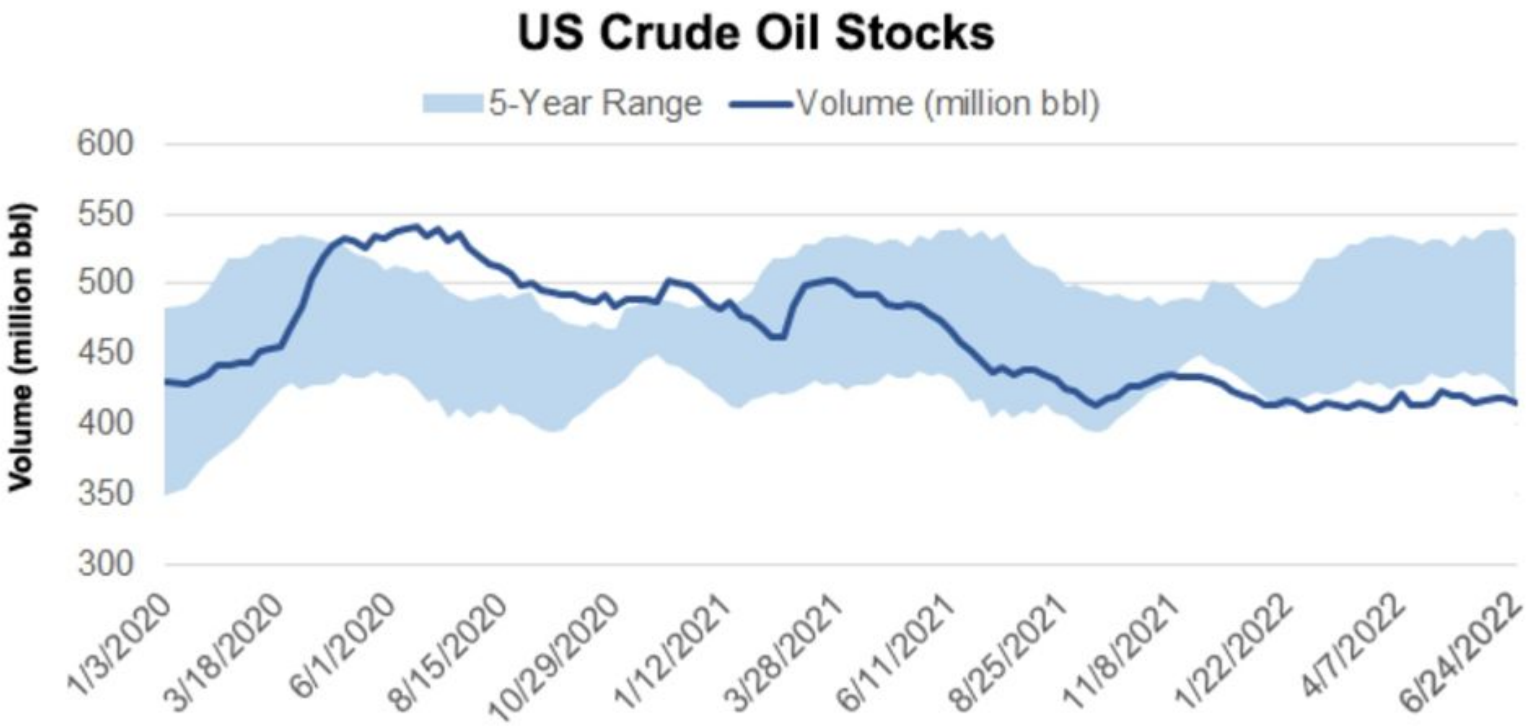


Figure 7. US Crude Oil Stocks, volume against the time axis (source: FRED)

Though the output for domestic crude has reached new highs this year, it is still 1 million barrels per day below the pre-pandemic high, according to data from the Energy Information Association. Crude inventory, excluding Strategic Petroleum Reserve, has decreased by 2.8 million barrels from last week, which is 13% below the 5-year average.

The Federal Highway Administration reported that as of March this year, Americans drove 7.9 billion miles more than the same month in 2021 and 5 billion miles more in March 2019, pre-pandemic. With limited production capacity and depleting inventory, a surge in demand can lead to a price bounce at any time.

Copper: A Consumer Prices Indicator

A valuable indicator for consumer prices is the industrial "workhorse" metal, copper. Copper is used intensively in construction materials, electrical wiring, plumbing, electronics, and power generation. Because of copper's widespread application, the red metal is considered a barometer of the world economy. The copper price is on track to witness its steepest quarterly decline since March 2020.

Figure 8. LME Copper Price in USD per tonne.

Figure 8 shows that the three-month copper prices on the London Metal Exchange are down 19% this quarter. The sell-off in metals is accelerating as copper has reached a 17-month low.

Investors appear increasingly convinced that growth will fade amid tightening monetary policy and Europe's energy crisis.

Bonds and Equities

Commodity Prices influence public companies and, consequently, the equities market. The declining commodity prices triggered upward momentum for equities. However, the rally was short-lived and was retraced completely this week.

Figure 9. SPX and NASDAQ Daily charts

Worst First 6 Month Starts For The S&P 500 (1871-2022)	
Data Source: Tradingview	
1932	-43.48%
1877	-23.74%
1962	-23.48%
1970	-21.01%
2022	-20.58%

Figure 10.

If we examine all first halves of a year for the S&P 500, going back to 1871, only four years were worse for the index. As the tech stocks suffer a historic crash for the first half of 2022, a bull case for the remaining half of the year is still difficult to map out.

The market is currently pricing another 75 bps rate hike in July, likely triggering a further leg down.

Figure 11. US Government Bonds 10-Year yields

The fixed income market is regarded as less volatile than the equities market, yet bond yields are also experiencing bumpy price swings. The 10-year Treasury yield moved 56 basis points within the first two weeks of June to reach its peak at 3.5%, only to drop another 50 basis points in the following two weeks. With increasing commodity prices and rising inflation, interest rates rise to compensate for the loss of value of money for a loan. Hence, the opposite is likely to happen when there is a decrease in commodity prices. The recent decline in bond yields is following this economic thesis.

Reiterating current developments, the equities market is still struggling to find a direction, while the bonds market is telling us that investors are shying away from high-yield bonds and high-risk assets in general.

Dollar Dominance over Euro

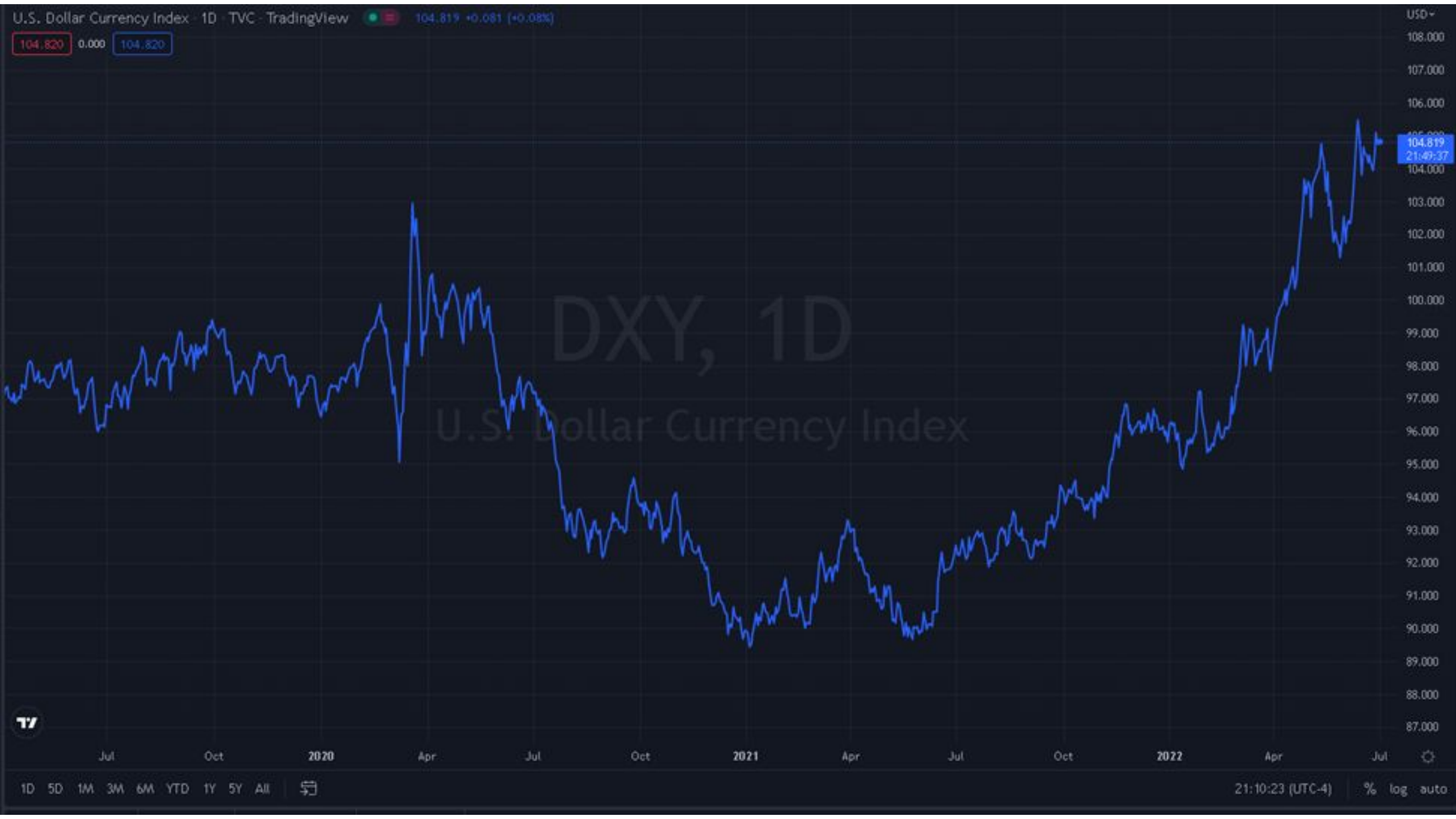


Figure 12. US Dollar Index, Daily chart (source: TradingView)

The dollar index reached its 20-year high in June. The Fed’s aggressive interest rate hikes have driven the currency up as it attracts foreign investments, thus raising the currency's demand. The Fed has responded more swiftly to inflation than its peers, like the ECB (European Central Bank).

Figure 13. Euro against the US Dollar, Daily chart (source: TradingView)

Since early 2021, the Euro has been steadily declining against the Dollar. The European energy crisis brought about by the Russian-Ukraine conflict, the ECB downplaying the risk of recession, and supply chain disruption have put pressure on the currency. The ECB is set to raise interest rates for the first time in 11 years, with an important meeting set for later this month.

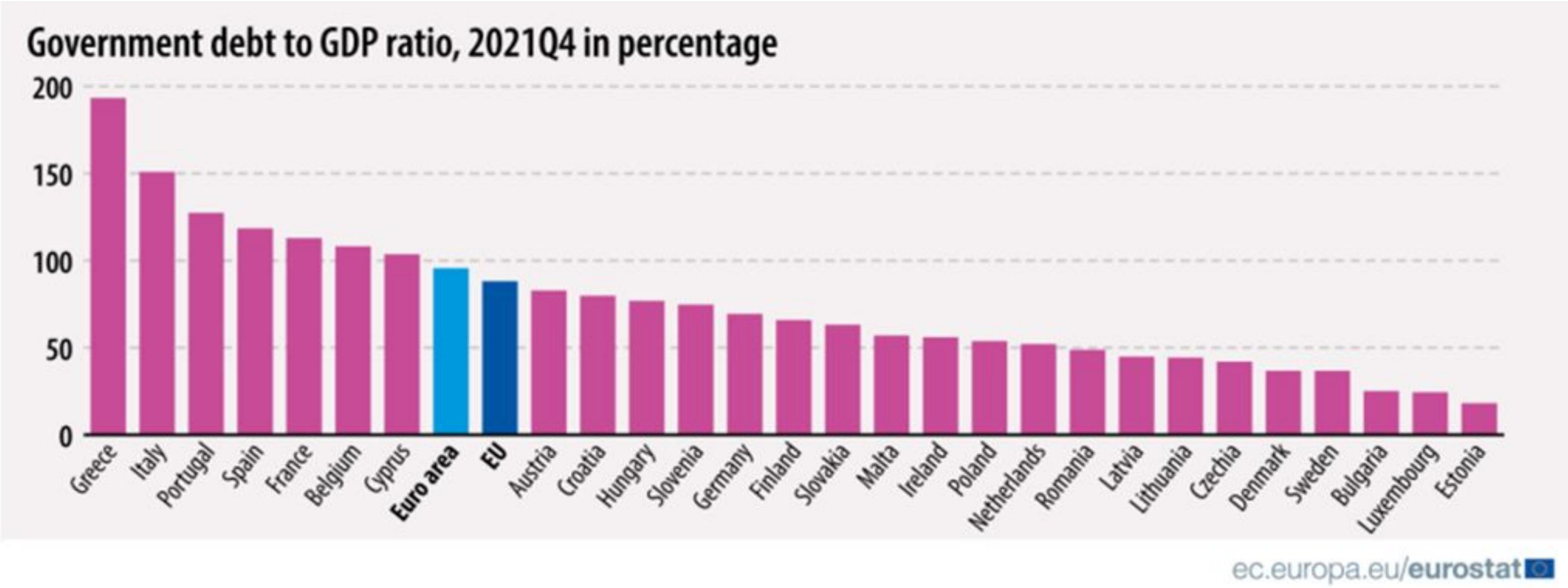


Figure 14. Government debt to GDP ratio in 2021 Q4 percentage (source: Eurostat)

A credit-based monetary system must grow continually, or the bubble will pop. As in the US, Euro debt is larger than total Euro supply, as measured by the Euro Area M1 Money Supply metric. In a credit-based monetary system, liabilities are collateralised by other liabilities. It is thus impossible to cease money printing immediately, and the hole of inflation will therefore only grow deeper.

The ECB is in a much tougher position in comparison to the US Federal Reserve because it monitors a shared currency amongst a multitude of nations without a Fiscal Union. While the US states share government revenues, European countries do not. Countries of the European Union have had higher debt levels since the ECB was established.

During an impending global economic crisis, investors are reducing exposure to Euros as the currency has increased the risk to its monetary system, given the severe energy crisis, compared to assets like commodities, cryptocurrencies, gold, and the US Dollar.

WHAT'S ON-CHAIN THIS WEEK?

Monthly Close and HTF levels

This week, Bitcoin prices have stalled with similar choppy price action as the previous week. Thus, we analyse the higher time frame price levels and revisit important on-chain metrics.

Figure 15. BTC Monthly Chart, Bitfinex

Bitcoin saw a +12% price spike, right before the monthly close to close the monthly candle above the 2017 cycle high. However, Bitcoin ended June with a third consecutive red monthly candle, with the total drawdown since the last green monthly before April, being close to 60%.

The most significant talking point, however, is the 12% spike to close above 2017 highs. In our previous issue, we discussed whale wallets currently underwater on spot BTC holdings and the drawdown for long-term holders in terms of market cap.

Whale Accumulation Has Not Ceased

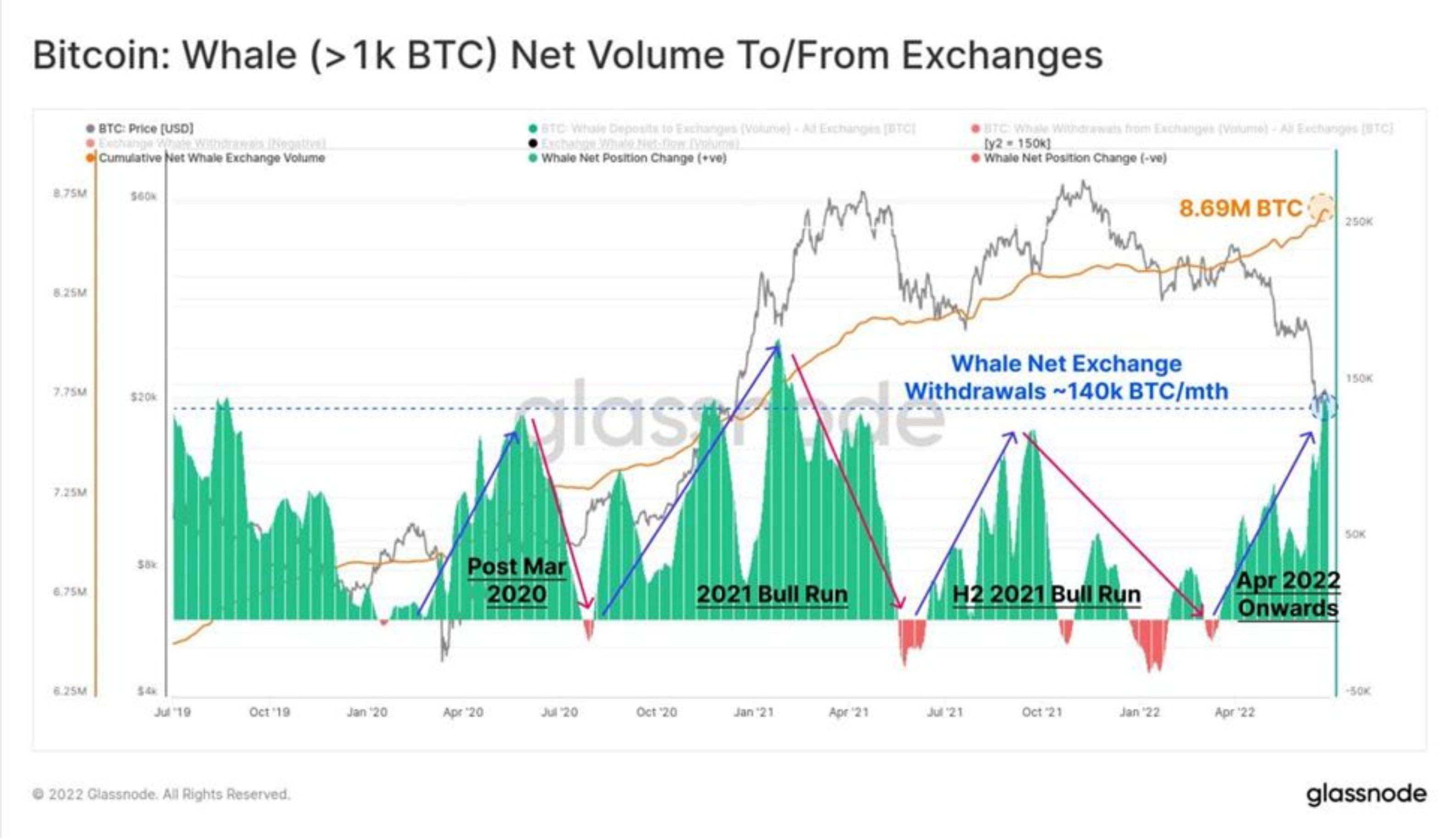


Figure 16. Whale net volume across major exchanges (source: glassnode)

On-chain data suggests that whales are still accumulating. The net exchange withdrawals from exchanges have only increased with Bitcoin price depreciation. Whales are categorised as entities owning greater than 1k BTC; these entities are adding to their balances aggressively, acquiring 140k $BTC/month directly from exchanges. Whales now own 8.69M $BTC (45.6% supply).

skew.

Bitcoin Quarterly Returns (%)

Year	Q1	Q2	Q3	Q4
2014	-37.99%	33.95%	-40.14%	-18.08%
2015	-21.31%	4.59%	-8.15%	82.84%
2016	-3.77%	61.81%	-9.21%	62.60%
2017	8.23%	125.32%	80.89%	210.13%
2018	-49.89%	-6.70%	2.92%	-42.54%
2019	8.90%	157.54%	-21.50%	-13.60%
2020	-10.58%	42.23%	17.98%	168.78%
2021	102.93%	-40.37%	25.03%	5.40%
2022	-1.46%	$\boxed{-56.27\%}$	-2.74%	

Figure 17. Bitcoin spot Quarterly Returns

This accumulation is occurring at a time when Bitcoin has lost 56% of its value in the second quarter of 2022, its worst quarterly performance in more than a decade.

On-chain Volume and Open Interest

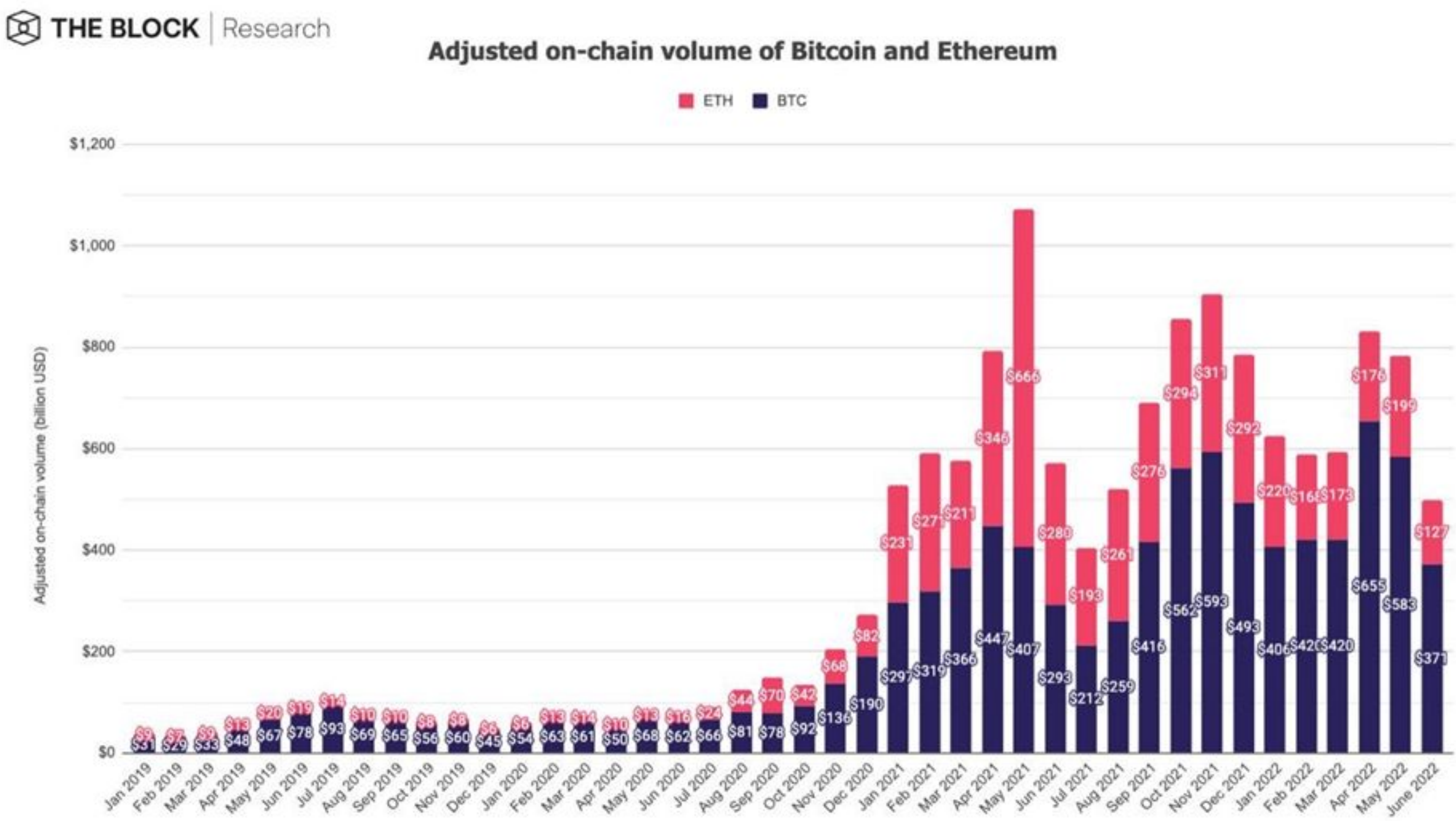


Figure 18. Adjusted On-chain volume of Bitcoin and Ethereum (source: The Block)

Total adjusted on-chain volume decreased by 36.3% to $498B (BTC: -36.4%, ETH: -36.2%). This volume decrease contradicts our accumulation data, so the conclusion is that smaller players and retail investors have mostly either been wiped out or are no longer participating in spot markets or in futures market speculation for risk-on assets like Bitcoin and Ethereum.

Figure 19. Futures Open Interest on BTC (source: CryptoQuant)

The above conclusion is complemented by the futures markets' open interest in Bitcoin and Ethereum, which shows declines in BTC/ETH futures down (BTC: -30.7%, ETH: -30.2%).

Reducing Returns

Figure 20. BTC Monthly Returns (source: glassnode)

In terms of monthly performance, this has been one of the worst 2-month stretches for the asset in its history.

While a lot of BTC losses are being realised by liquidations and other forced selling of positions, including those of large crypto funds like Three Arrows Capital, lenders like Celsius and miners, as seen in figure 21 below, Ethereum and other staking protocols have seen a significant number of investors stuck in long term staking agreements.

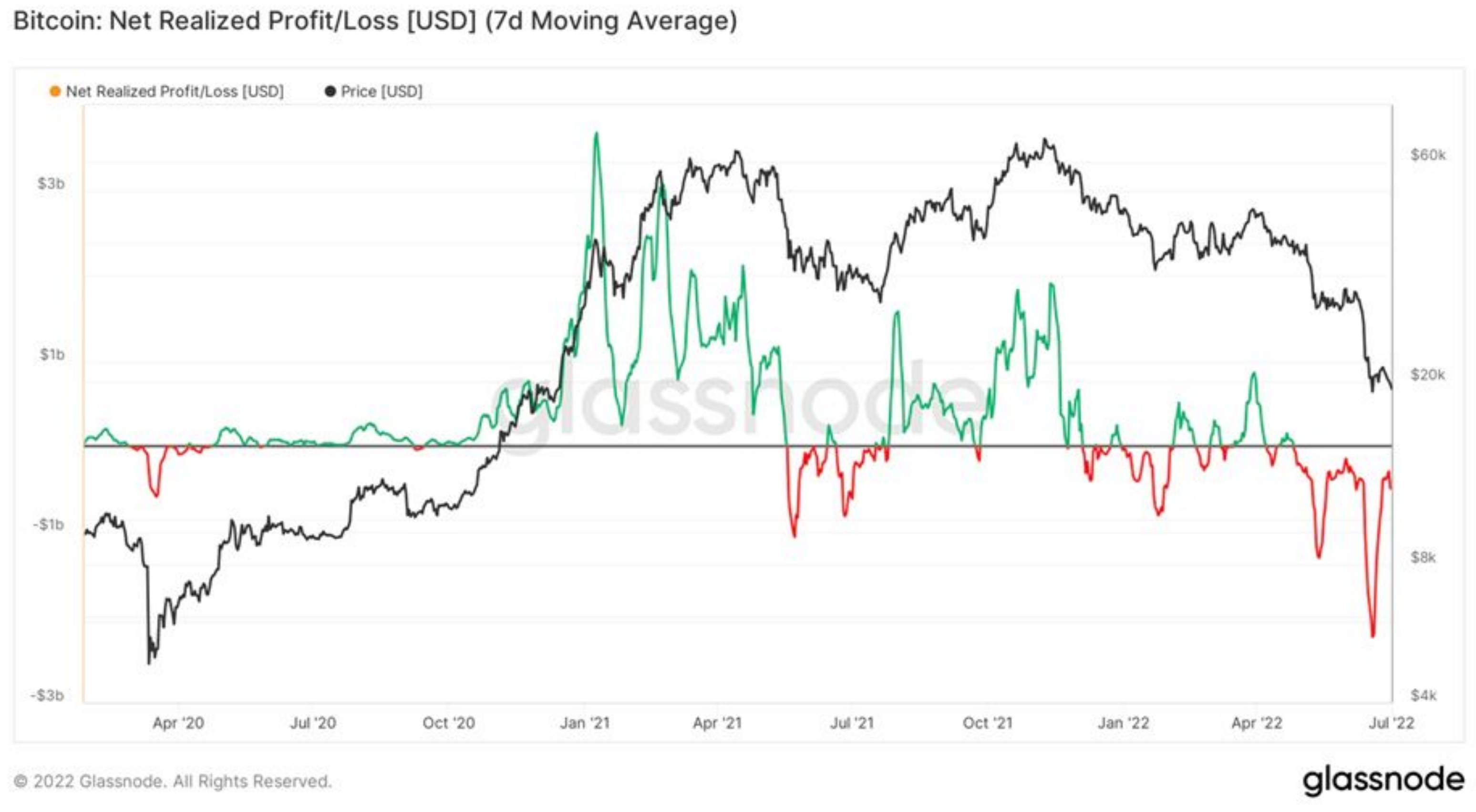


Figure 21. Net Realized Profit/Loss relative to BTC price (source: glassnode)

Capitulation is also reflected in on-chain metrics such as realised losses and Net Unrealized Profit/Loss. This chimes with the miner capitulation we reported in our previous issue.

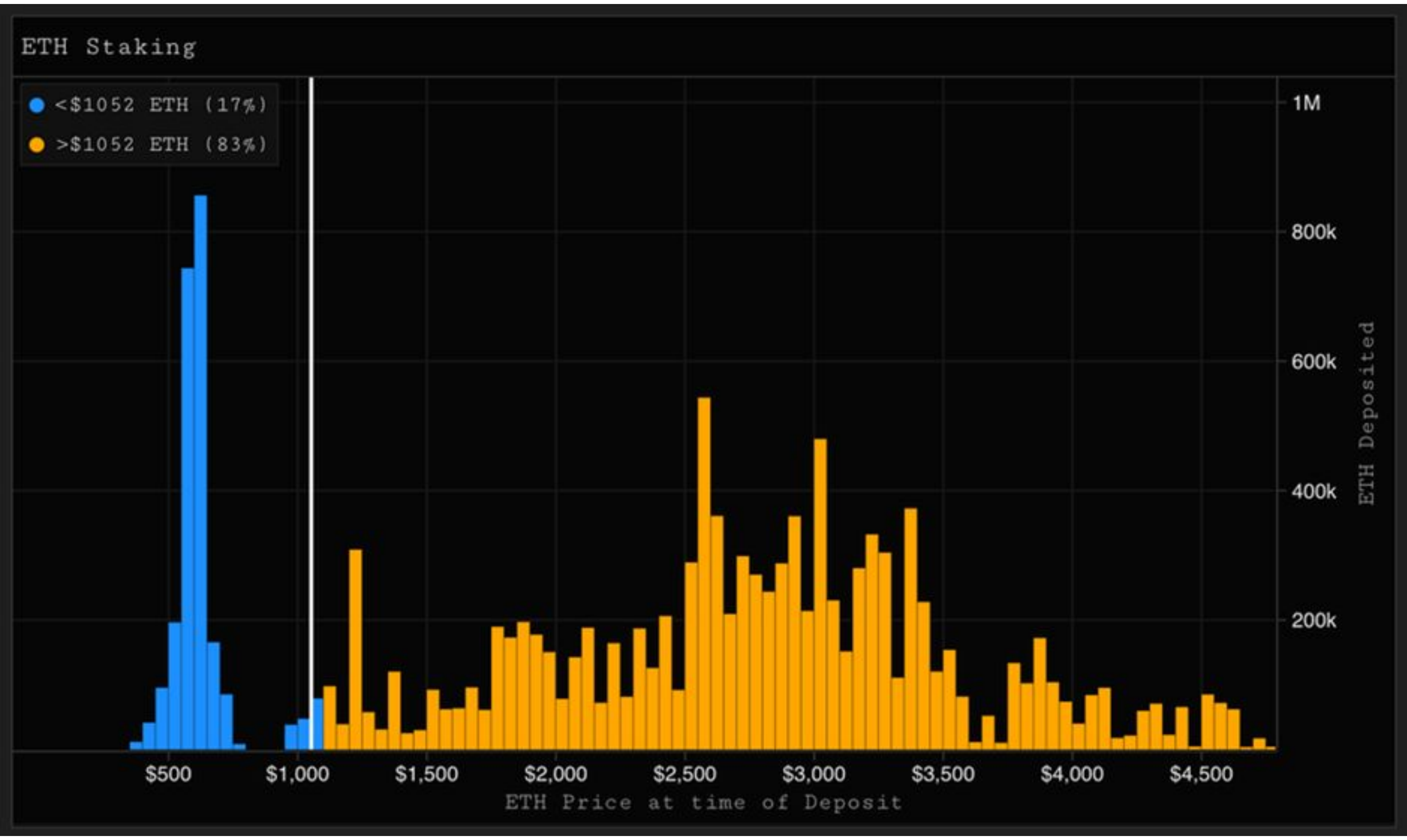


Figure 22. Ethereum stakers by price (source: parsec)

The drawdown for investors staking 32 ETH to activate validation software is reflected in figure 22. Statistics for other staking contracts on various protocols also reveal the magnitude of the unrealised loss that remains locked in DeFi protocols and contracts.

NEWS FROM THE CRYPTO-SPHERE

Crypto Exchange lay-off spree

cryptocom :	5%
BitOasis :	5%
Robinhood :	9%
Bitso :	10%
Gemini :	10%
Coinbase :	18%
BlockFi :	20%
BitMex :	25%
BitPanda :	27%
Bybit :	30%
Vauld :	30%
Banxa :	30%

Figure 23. percentage of layoffs for crypto exchanges (source: TechCrunch)

Government policy changes and bearish market conditions have been the catalyst for exchanges laying off employees over the past two months. Figure 23 shows the percentage of employees laid off so far.

Figure 24.

Coindesk reported on June 28th that cryptocurrency exchange Huobi could soon join the club; layoffs might exceed 30%. The main reason is the sharp drop in revenue after removing all Chinese users. Bybit, Coinbase and Huobi are the most significant international exchanges forced to resort to employment terminations. (source: https://tcrn.ch/3AjSfhj)

FTX signs deal giving it the option to buy crypto lender BlockFi

Figure 25.

The Financial Times reported on 1st July that FTX has signed a deal giving it the option to buy crypto lending company BlockFi. (link: https://on.ft.com/3yfgsmg)

The deal allows FTX to purchase BlockFi for a maximum of $240 million, the company said on Friday. The purchase price is determined by a set of performance goals. The exchange declined to provide a minimum deal price.

CNBC reported that a term sheet as low as $25 million might be signed by the end of the week. Even at the top end of the FTX deal pricing, it significantly reduces BlockFi's worth. According to PitchBook, the company's value last year was $4.8 billion.

The term sheet also pads BlockFi's balance sheet with a larger loan.

FTX provided a credit facility of $400 million. BlockFi executives said the company had not yet drawn on this credit facility and has “continued to operate all our products and services normally.”

In addition to BlockFi, FTX CEO Sam Bankman-Fried's other main business, the trading company Alameda Research, provided Voyager with a $500 million loan. As to why BlockFi agreed to move forward with the deal, the company pointed to crypto market volatility and the failure of hedge fund Three Arrows Capital. BlockFi has reported $80 million in total losses so far.

Three Arrows Capital Files for Bankruptcy

Figure 26.

A British Virgin Islands court ordered Three Arrows' BVI branch into liquidation earlier this week. 3AC filed for Chapter 15 bankruptcy in New York the same week. Chapter 15 filings are generally tied to foreign proceedings. However, the BVI court has ordered the local 3AC branch to enter liquidation. According to Bloomberg, the Chapter 15 filing will let the firm protect its U.S. assets even as its BVI assets are liquidated.

The domino effect we discussed in our previous two issues is again being seen at play. The firm borrowed large amounts of funds from several crypto lenders, including BlockFi, Celsius, Babel Finance and Voyager Digital, but was unable to pay when markets turned down. The lenders in turn halted withdrawals or needed credit lines extended to weather the storm.

SEC rejects Grayscale’s ETF proposal

Figure 27.

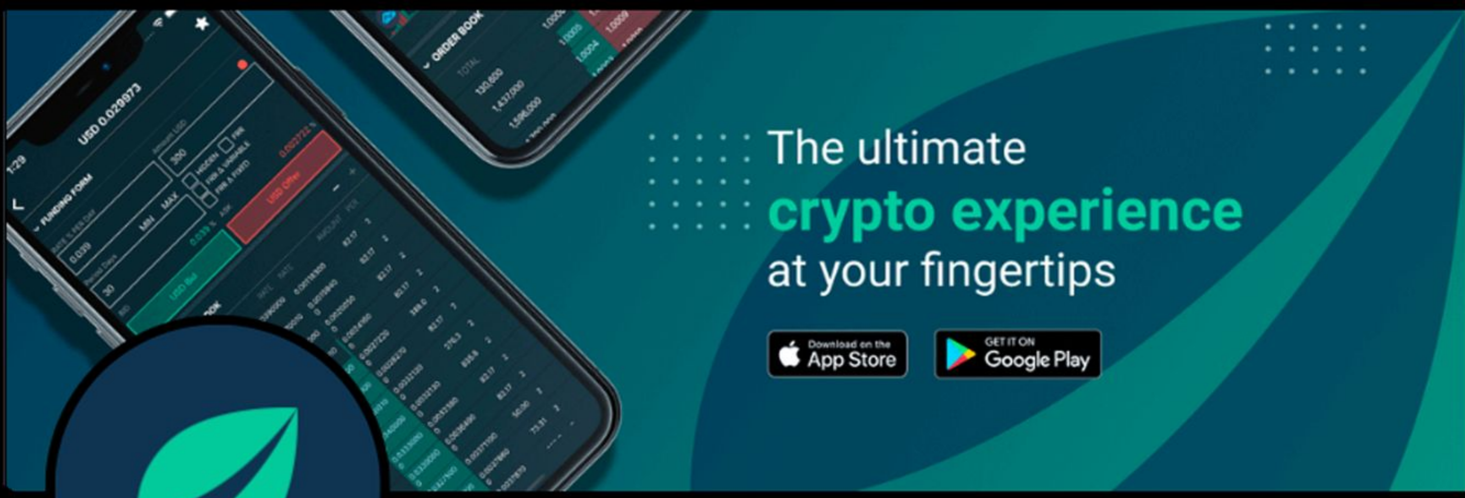
The SEC rejected Grayscale's application to convert its flagship product, the Grayscale Bitcoin Trust to an exchange-traded fund on Wednesday.

Grayscale Investments responded with a law suit against the U.S. Securities and Exchange Commission (SEC) barely an hour after the announcement of the rejection.

Figure 28. CNBC covered statements from Michael Sonnenshein

“Grayscale supports and believes in the SEC’s mandate to protect investors, maintain fair, orderly, and efficient markets and facilitate capital formation -- and we are deeply disappointed by and vehemently disagree with the SEC's decision to continue to deny spot Bitcoin ETFs from coming to the U.S. market,” said Michael Sonnenshein, Grayscale’s CEO.

IIn the filing, Grayscale asks the U.S. Court of Appeals of the District of Columbia Circuit to review the SEC's order.



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