BITFINEX Alpha

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EXECUTIVE SUMMARY

The message from the data last week is that inflation is abating, but the process is slow, and the Fed is not easing up yet. There will be more rate hikes to come and we predict another 50 basis point increase in February and another 25 basis point increase in March.

Even though that will put interest rates at 5-5.25 percent and close to their expected 'peak', we believe there is still upside risk, given the stickiness of services inflation and wage pressures, and the Fed's desire to return inflation to the target two percent range.

The conundrum facing the Fed however, will be how long they can keep rates high while the economy begins to wilt. Retail sales already came in weaker than expected despite November being a traditionally strong shopping month. We should see more pain to come as the reality of higher borrowing costs begins to set in.

In crypto markets, our analysis of volatility metrics and historical data shows that the end of the year can be volatile for the price, driven by lesser volumes and also persistent sideways movement in the higher timeframe BTC volatility indices.

We note also that over the past week, whale sized wallets have experienced an inflow of over 70,000 BTC, but rather than being bullish for the price of BTC as more money is moved off exchange, instead it is seen as a crisis of confidence in centralised exchanges. It is a pattern that confirms a trend that we have seen all year, but which intensified following the FTX collapse. The year 2022 will go down as the year which has seen the largest historical declines of BTC and ETH held on exchanges.

In our summary of the week's crypto news, we round up the latest in the SBF/FTX saga; as well as the withdrawals seen at Binance; wobbles in Tron's USDD Stablecoins; a fund raise for Amber Group and the Donald Trump NFT collection.

This is the last Bitfinex Alpha of 2022, and we will be back again in early 2023. It has been a year of a few brief highs and some extensive lows. However, while giants of the industry like FTX, BlockFi, Three Arrows Capital, Alameda Research, Celsius and many others collapsed, it has made way for a new wave of smaller investors and believers in crypto that have remained resilient in their resolve to bank the unbanked and to take control of their money to move towards universal currencies as well as different implementations of blockchain technology in gaming, synthetic assets and AI.

Happy Trading and we will see you in 2023.

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GENERAL MARKET UPDATE

FOMC Update

At the Federal Open Market Committee (FOMC) meeting last Wednesday, December 14, the Federal Reserve (Fed) increased its benchmark interest rate by 0.5 percentage points and predicted further tightening in 2023 to combat current red-hot inflation, a move that is anticipated to slow the economy and increase unemployment.

The federal funds rate is now between 4.25 and 4.5 percent, the highest level in 15 years. From the peak of the pandemic crisis in 2020 to now, the US central bank has constantly increased interest rates from their near-zero level in March to reduce inflationary pressures.

MEETING PROBABILITIES								
MEETING DATE	350-375	375-400	400-425	425-450	450-475	475-500	500-525	525-550
2/1/2023	0.0%	0.0%	0.0%	0.0%	75.0%	25.0%	0.0%	0.0%
3/22/2023	0.0%	0.0%	0.0%	0.0%	30.7%	54.5%	14.7%	0.0%
5/3/2023	0.0%	0.0%	0.0%	0.0%	24.9%	50.0%	22.3%	2.8%
6/14/2023	0.0%	0.0%	0.0%	0.4%	25.3%	49.6%	21.9%	2.7%
7/26/2023	0.0%	0.0%	0.1%	7.2%	31.9%	42.0%	16.7%	2.0%
9/20/2023	0.0%	0.0%	2.7%	16.1%	35.6%	32.9%	11.4%	1.3%
11/1/2023	0.0%	1.5%	10.0%	26.7%	34.1%	21.2%	5.9%	0.6%
12/13/2023	1.1%	8.1%	23.0%	32.5%	24.1%	9.3%	1.8%	0.1%

Figure 1. *Meeting Probabilities for 2023*

The policy peak, often known as the terminal rate, is estimated to be 5.25 percent. The policy peak can only happen if inflation and wage growth is controlled and shelter costs also reach their peak.

In his press conference following the FOMC meeting, Federal Reserve Chairman Jerome Powell emphasised how he sees services inflation still decreasing slowly because wage growth is still high, which is feeding services costs. The Fed will have to decide how long to keep rates high next year in the face of a slowing economy and rising inflation. We anticipate a rate hike of 50 basis points at its February meeting and another increase of 25 basis points at its March meeting. A policy rate of between five percent and 5.25 percent would be the result of such hikes.

Federal Reserve chairman, Jerome Powell added that the Fed is now concentrating on a monetary stance that is restrictive enough to return inflation to its two percent target.As a result, our initial projection of the policy rate's peak being 5.25 percent would be subject to some upside risk. At its policy peak, we anticipate the Fed to pause its hikes as it evaluates the impact of the 2022 rate hikes on the American economy. This lift-and-hold strategy will be put to test as the economy is expected to slip into a recession next year.

Inflation is still significantly above the two percent objective, but whether or not interest rates are lowered in the coming year or, more likely, in early 2024, will depend largely on whether or not wages continue to grow.

Modest Inflation Amidst Rising Housing Prices

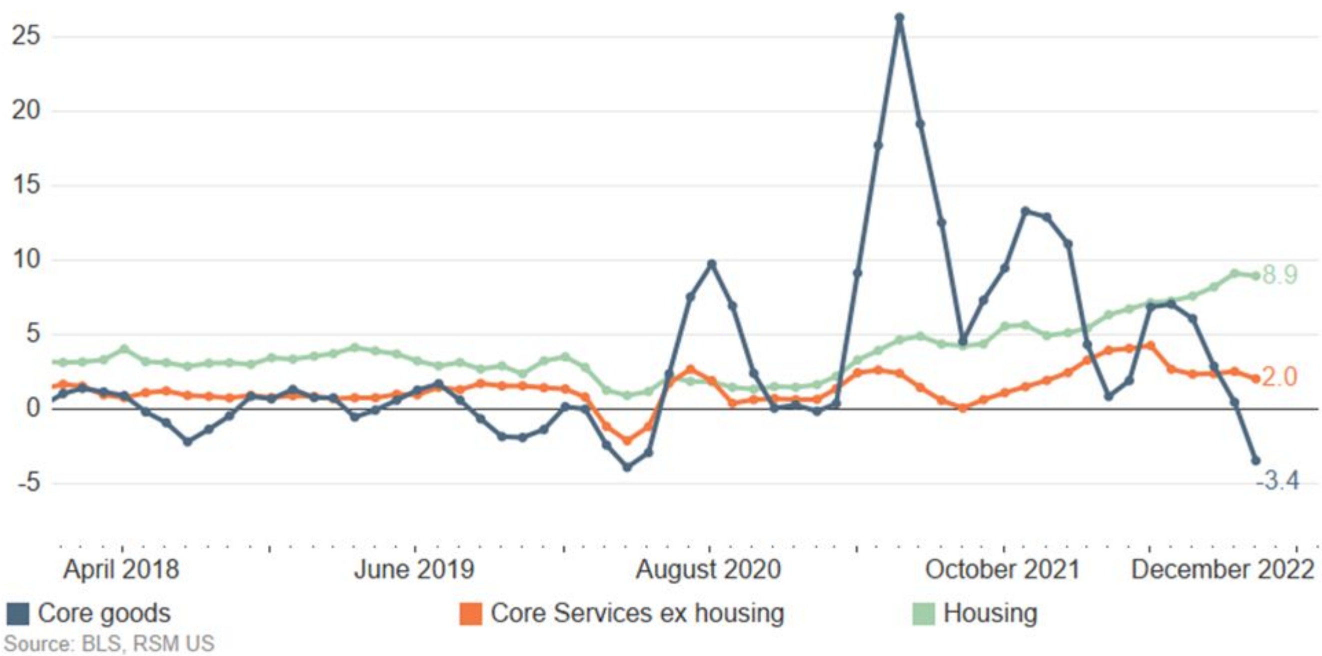


Figure 2. *Core goods and Services CPI changes (Source: Bureau of Labor Statistics, RSM US)*

Inflation in the United States has been at its worst in 40 years, but November's 0.1 percent increase was the mildest reading in a spate of similar increases. Meanwhile, annual inflation dropped to 7.1 percent based on last month's data, the lowest figure since the 2021 yearly close. In June, inflation reached its all-time high of 9.1 percent YoY (Year-over-Year). The inflation prints were released on Tuesday, December 13 by the Bureau of Labor Statistics.

Stocks saw a significant uptick in response to November's modest inflation data. Investors on Wall Street had their fingers crossed that the Fed will slow the pace of interest rate hikes in the United States as inflation cools. The Fed, however, was unmoved by the inflation report and proceeded with a widely anticipated 50 basis point rate increase.

The US Labor Department also released data on Tuesday, December 13 that is worth analysing. Though welcoming and insightful as a whole, the data issued is not without its caveats. The Fed is in a difficult position since easing inflation contrasts with rising housing costs of 8.9 percent.

Housing and services inflation, which feeds into wage pressures, continue to rise despite a slowdown in the primary drivers like commodities, energy, and goods that caused inflation to soar over the past two years. Those increases are consistent with ongoing initiatives to stabilise prices.

Next year, the central bank will likely have to decide whether to continue raising the policy rate in the face of an impending recession. The severity and length of the downturn will depend mainly on this policy decision.

Declining prices of commodities, energy, and goods put downward pressure on costs, while declines in air travel and medical care are tamping down on rising service costs. Inflationary pressures have been diminishing for the previous two years, with the price of goods and transportation cooling off. However, housing expenses increased by 0.6 percent month-over-month, and the comparable rent paid to owners rose by 0.7 percent, from 0.6 percent in the previous month. Both rose by 7.1 percent compared to the same time last year, with housing clearly continuing to play a pivotal role in overall price growth. With wages and housing costs continuing to grow, it would be a misnomer to refer to a 7.1 percent inflation rate as an improvement.

Surging housing costs and the lag in the impact of service cost on wage inflation are likely to increase over a few months. This will result in increased pressure on policymakers to avoid abandoning their efforts too soon, in the attempt to stabilise prices.

Decline In Retail Sales

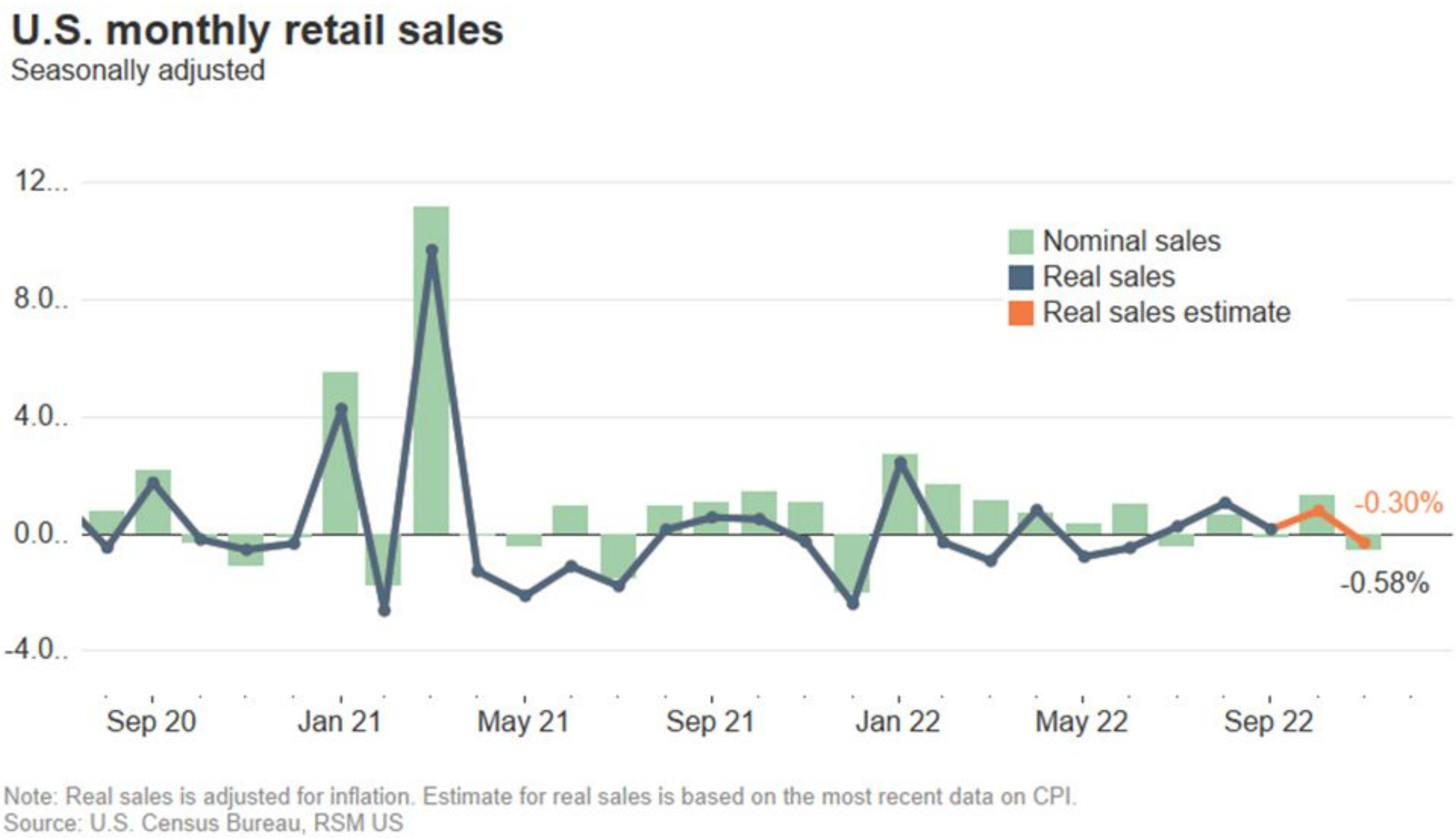


Figure 3. *US Monthly Retail Sales (Source: US Census Bureau, RSM US)*

Consumers reined in their holiday spending in November, causing retail sales to drop by 0.6 percent, the Commerce Department reported on Wednesday, December 14.

Early October shopping and price drops significantly contributed to the larger-than-expected decline. The 1.3 percent monthly sales increase in October can be attributed to the fact that many retailers with surplus stock offered Christmas deals sooner than usual.

Eight of the twelve categories had a monthly sales drop, indicating a broad-based decline in sales. The biggest declines were seen for automobiles (-2.3 percent), furnishings (-2.2 percent), and construction materials (-2.5 percent)—these three groups combined for almost 25 percent of total sales. Food and beverage at stores and restaurants continued to rise at 0.8 and 0.9 percent respectively, indicating the persistence in food inflation.

Spending habits have shifted, with more money going into "experiences" like vacations and dining out and less toward the durable products like sports equipment, furniture, and gardening tools that were more popular a year earlier.

The sales in gasoline saw a slight decrease but may have reflected the reduction in gasoline prices over the past month since the report is not adjusted for inflation.

Retail spending is largely being pushed by people using their credit cards more frequently and withdrawing money from their savings accounts, both of which saw significant increases during the recent coronavirus pandemic. Earnings growth has also contributed to consumer spending's recent upswing. Retail sales will likely remain stable over the next few months since consumers have accumulated more than $1 trillion in savings and wages are still relatively high. We anticipate a significant drop in sales to begin in the second half of next year, when a recession is more than likely to set in, as most investors and economists expect.

WHAT’S ON-CHAIN THIS WEEK?

Volatility Inbound For The End Of The Year

As we approach the end of the year many firms and traders take a break, however the slowdown in trading activity brings with it the risk of higher volatility, given the declines in trading volume and liquidity.

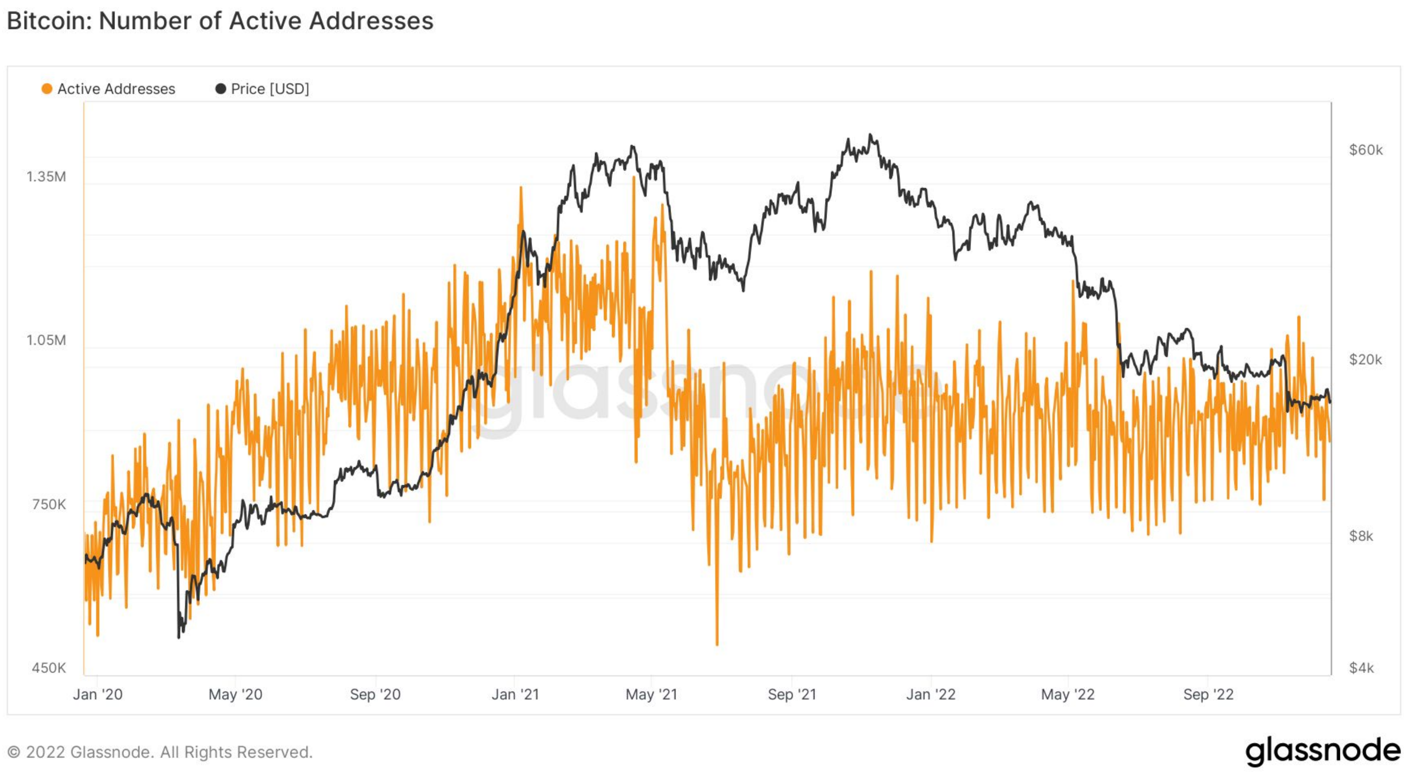


Figure 4. *Number of active Bitcoin addresses. (source: glassnode)*

The average number of daily active addresses (DAA; addresses with unsuccessful transactions filtered out) for Bitcoin throughout 2022 has been 921,445. This is a decline from 1.1 million DAA in 2021. Data since 2013 suggests that there is always a decline of 3-4 percent in the number of daily active addresses in the last week of the year compared to the previous month. Aside from the decline in trading volumes, the fall in DAA could also correspond to reduced mining operations as miners' activity corresponds to BTC's most significant on-chain movements.

An analysis of the different volatility metrics for Bitcoin, also indicates that volatility spikes towards the end of the year.

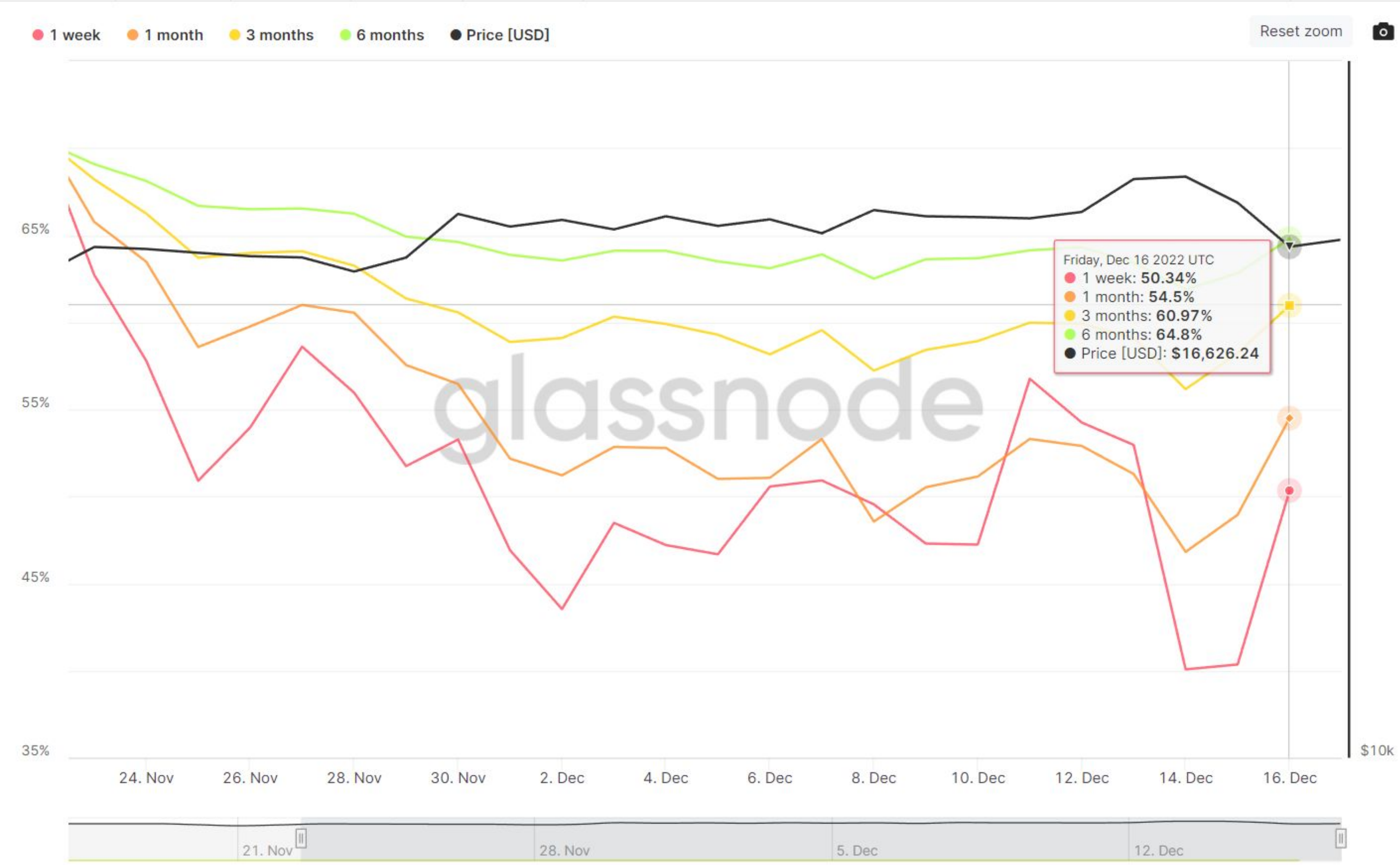


Figure 5. *Bitcoin Volatility Index. (source: Glassnode + Deribit)*

The Bitcoin volatility index is a 30-day implied volatility index which uses dynamic options (primarily) and futures (secondary) data to predict volatility for the upcoming 30-day period. Subtle changes in the metric can result in large fluctuations in price. Parallel sideways movements for longer (three or six-month) implied volatility indicators on the metric coupled with an uptick on the weekly indicator have historically led to volatile short-term moves in price.

In the figure above, the higher (six and three month) indices have been consolidating sideways for about three weeks, with the weekly index jumping 10 percent between December 15 to December 16. The takeaway is that high volatility can be expected; this is already evident on the lower timeframes, even if the higher timeframe price action appears to be in a range between $16,000 and $18,000.

The implied volatility metric is an excellent tool to gauge heavy intraday or intra-week price fluctuations ahead of time. However, there are better tools for higher timeframe (daily or weekly chart) price swings. When we supplement this data with Bitcoin's realised volatility, we become better equipped to predict the magnitude of upcoming price swings.

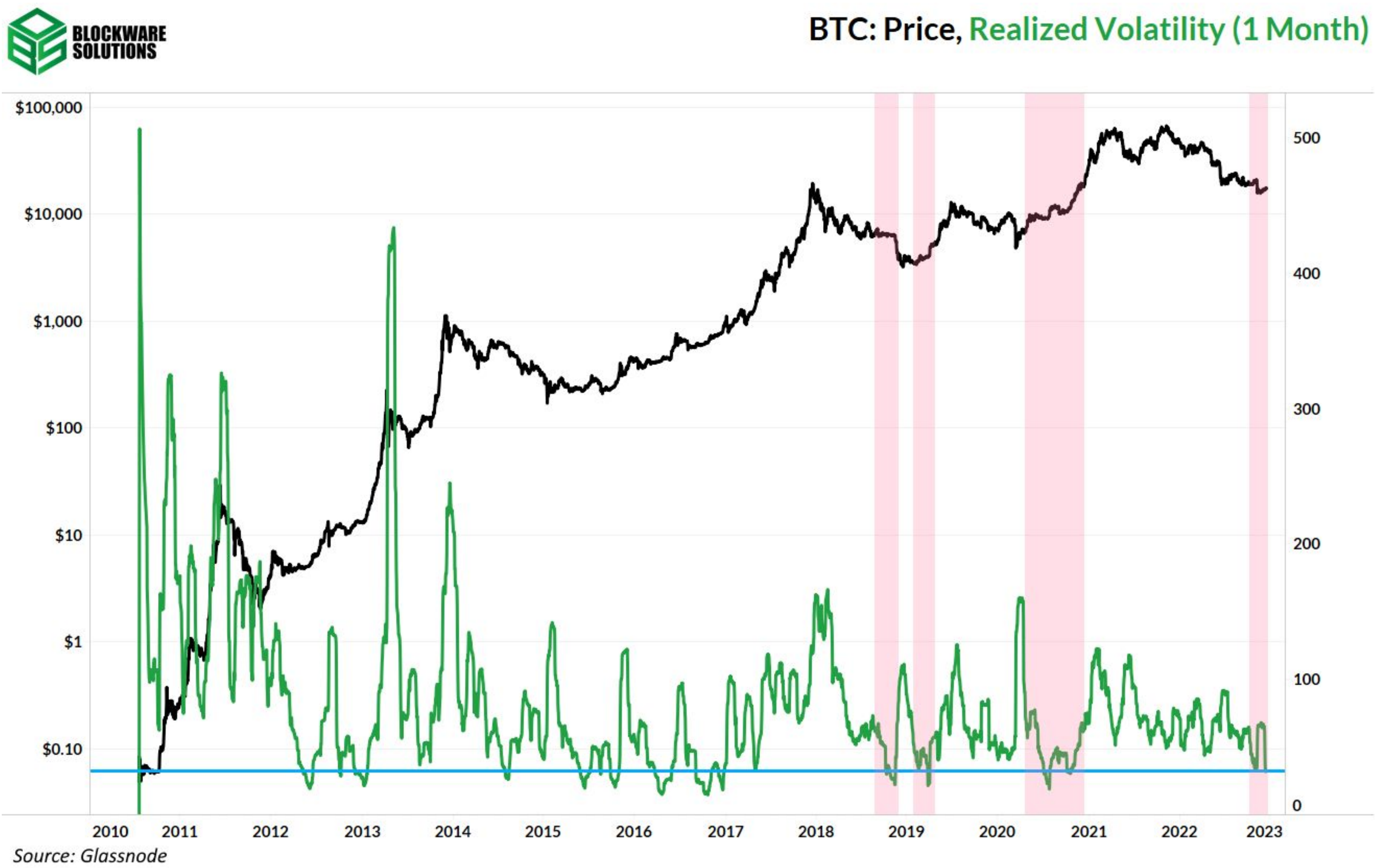


Figure 6. *Monthly Realised Volatility for Bitcoin. (source: Blockware Intelligence)*

While implied volatility refers to the market's assessment of future volatility, realised volatility measures what happened in the past 30 days. In the chart above, low realised volatility highlights the lack of volatility in the price activity during the past month. This is the lowest level of realised volatility since Q3 of 2020, just before the last bull run, discounting the period just before the FTX debacle, which had slightly higher volatility than what we currently have. Prior to that, only the 2018 bear market's bottom had monthly realised volatility that was this low.

Investors should prepare for another swift move soon because smooth sailing does not endure in the crypto market for long. Usually, an uptick in implied volatility with an extended period of realised volatility approaching the zero mark is followed by wild price fluctuations even in the higher time frame.

More Signs Of Spot Accumulation And CEX Withdrawals

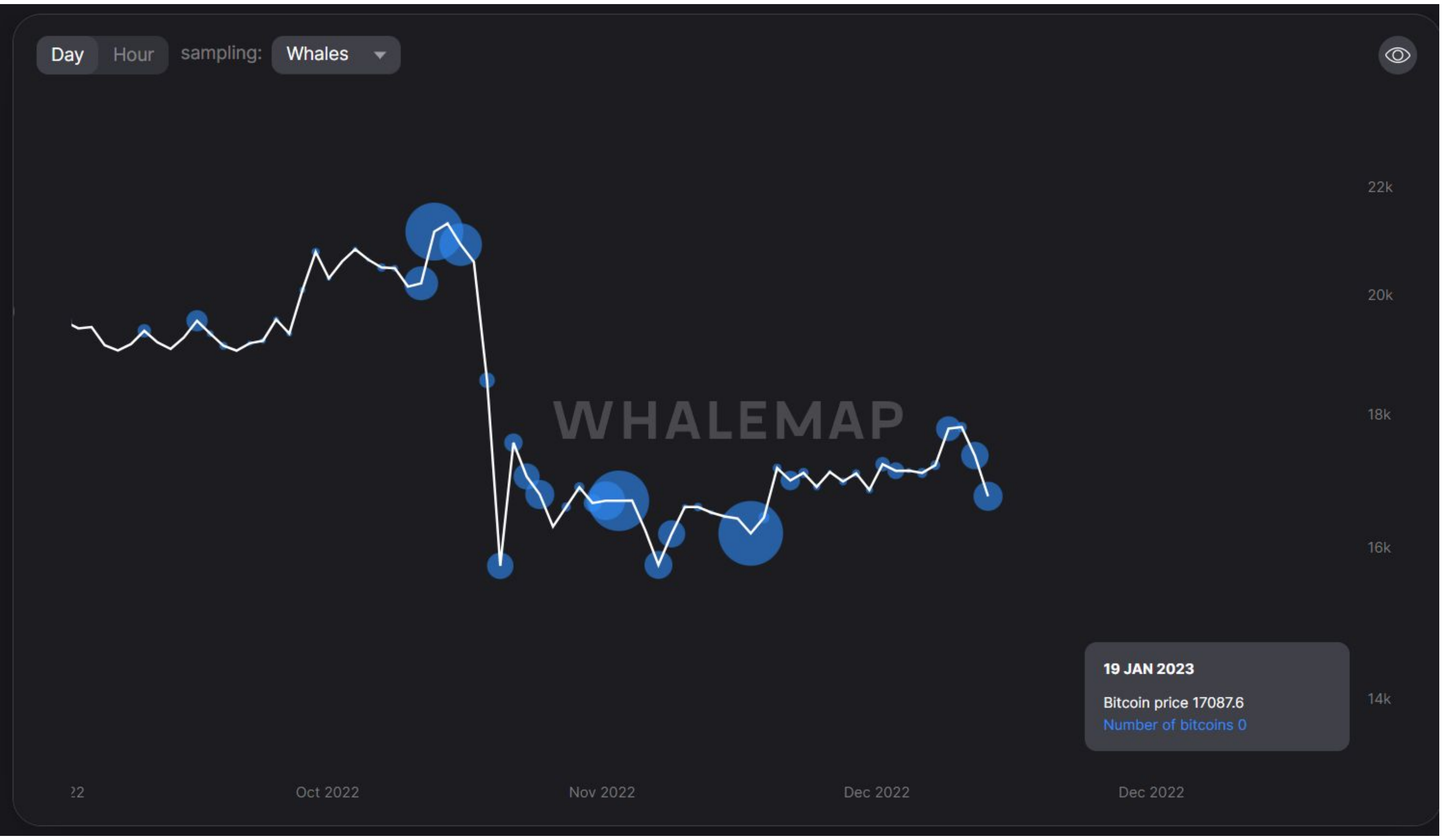


Figure 7. *Large Wallet Inflows (for whales)(source: Whalemaps)*

In figure 7, the white line indicates the daily BTC closing price, while the size of the bubbles corresponds to the amount of inflows into wallets for that particular day.

Over the past week, large or 'whale-styled' wallets have experienced an inflow of over 70,000 BTC. Since Bitcoin price breached the $18,000 mark on November 9, the total inflow into these wallets has been over 400,000 BTC.

Around 120k BTC was accumulated at the $16,100 level, which offers potential support given the scale of buying.

Even though there is accumulation and the macro environment seems to be cooling off given the recent slowdown in monetary policy tightening, we do not see this as a sign of 'risk on'. Whales are accumulating, but as is evident from the chart, major accumulation occurred after the bottom was found, indicating

indicating that whales are also looking to buy into strength rather than aggressively buying.

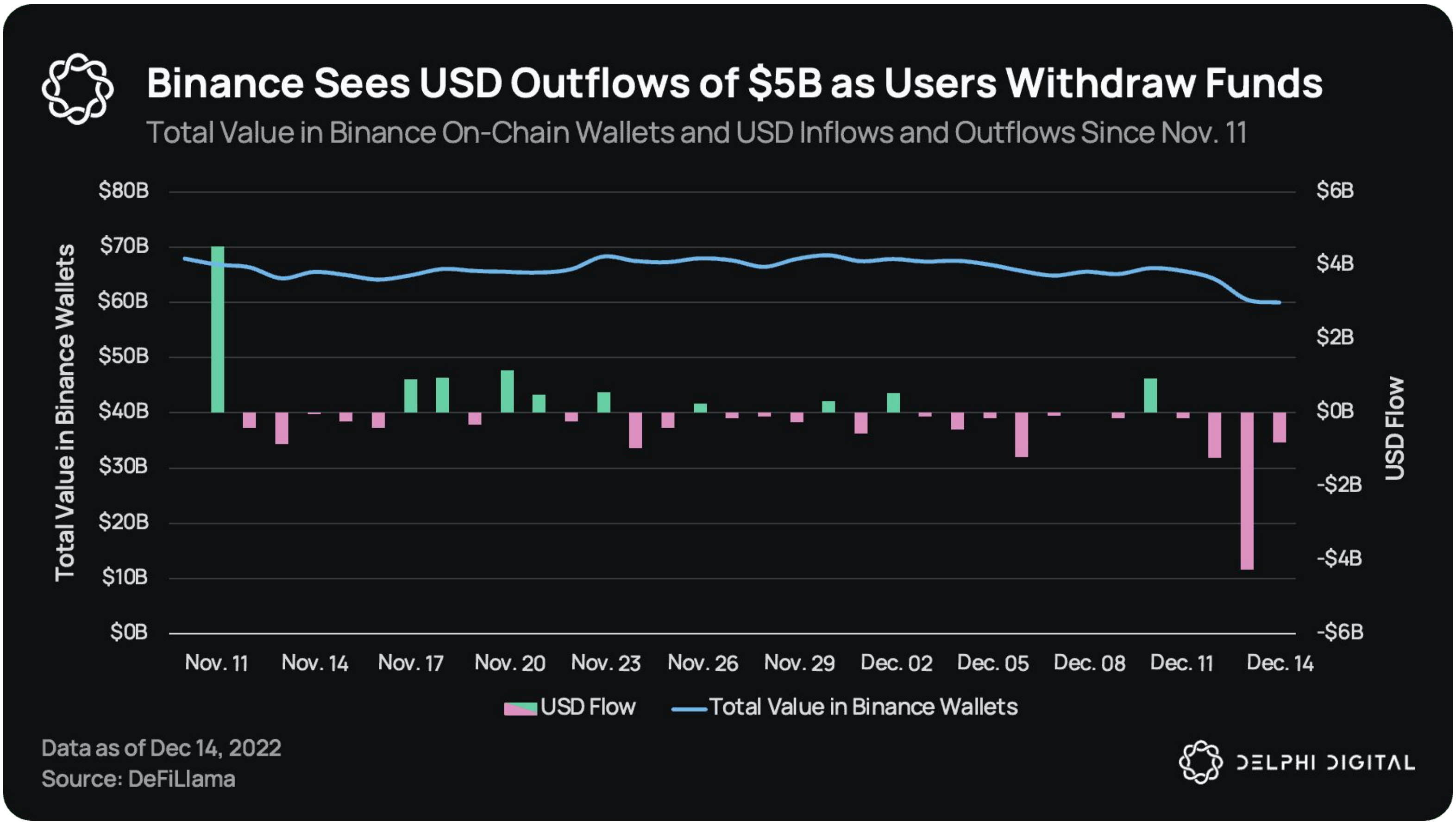


Figure 8. *Centralised exchanges experience record outflows with Binance leading the way. (source: Delphi)*

Among the exchanges seeding withdrawals, none has been more notable in the past week than Binance.

The total value in Binance's on-chain wallets dropped from $65 billion to $60 billion from December 12-14, this is the most significant outflows seen at the exchange since it started disclosing its addresses last month.

The collapse of FTX has caused a crisis of confidence in exchanges and third party custody solutions and led to increased BTC withdrawals off exchanges at an accelerated pace. The market maker Jump Trading has, notably, redeemed $106 million in BUSD during the past week (as per *Nansen* whale tracking data).

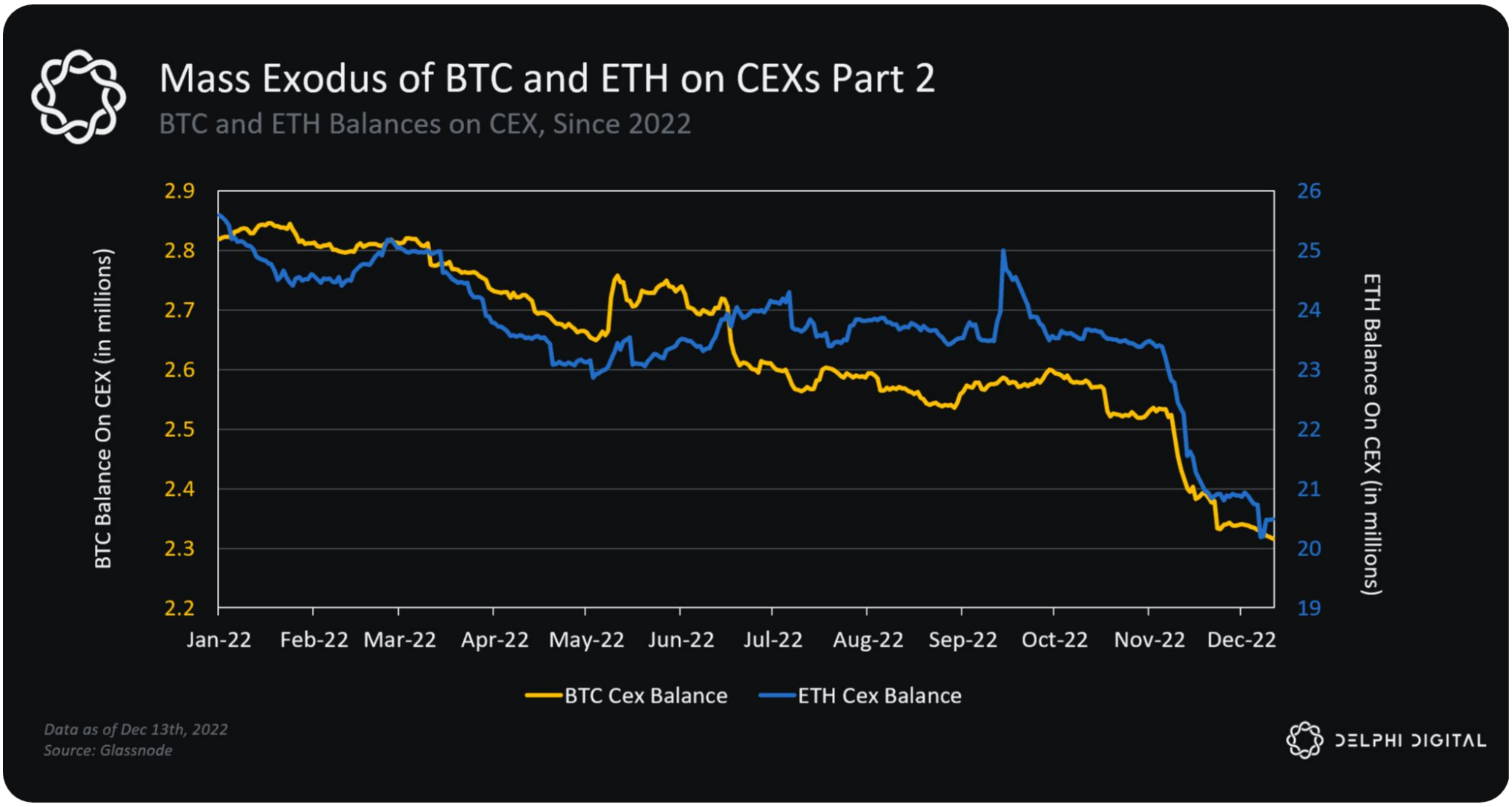


Figure 9. *BTC and Ether balances on centralised exchanges for 2022. (source: Delphi)*

2022 has seen the largest YoY percentage declines in BTC and ETH held on centralised exchanges, both down nearly 20 percent. The month of November also saw historic decreases in CEX holdings. In the last 30 days alone, BTC held on CEXs has fallen 8 percent, with ETH seeing an 11 percent fall (roughly 185k BTC and 2.6M ETH).

The percentage decline in November marks the third-largest monthly decline in BTC's history and the fifth-largest in ETH's, with both percentage declines being the largest ones since 2017.

NEWS FROM THE CRYPTO-SPHERE

Sam Bankman-Fried arrested

Figure 10. *Bankman-Fried escorted out of the Magistrate Court building after his arrest, in Nassau, Bahamas, December 13, 2022.*

Sam Bankman-Fried (SBF) was scheduled to testify on Tuesday, December 13, before the US House of Representatives Committee on Financial Services. However, before his testimony could happen, SBF was arrested in the Bahamas at the request of the US government on Monday evening, December 12.

The same evening of SBF's arrest, the US Attorney's Office for the Southern District of New York confirmed in a Tweet that SBF was arrested by the Royal Bahamas Police Force at the request of the US government, based on a sealed indictment filed by the Southern District of New York (SDNY).

US Attorney SDNY
@SDNYnews

USA Damian Williams: Earlier this evening, Bahamian authorities arrested Samuel Bankman-Fried at the request of the U.S. Government, based on a sealed indictment filed by the SDNY. We expect to move to unseal the indictment in the morning and will have more to say at that time.

12:52 AM · Dec 13, 2022

10.1K Retweets 2,515 Quote Tweets 52.1K Likes

Figure 11. *The US Attorney's Office for the Southern District of New York tweeted about the arrest and clarified indicment details*

After the indictment was unsealed, it revealed that prosecutors charged SBF with eight criminal charges:

- conspiracy to commit wire fraud on customers
- wire fraud on customers
- conspiracy to commit wire fraud on lenders
- wire fraud on lenders
- conspiracy to commit commodities fraud
- conspiracy to commit securities fraud
- conspiracy to commit money laundering
- and conspiracy to defraud the Federal Election Commission and commit campaign finance violations.

The Securities and Exchange Commission (SEC) also announced charges against SBF for "orchestrating a scheme to defraud equity investors of more than $1.8 billion." "We allege that Sam Bankman-Fried built a house of cards on a foundation of deception while telling investors that it was one of the safest buildings in crypto," said SEC Chair Gary Gensler.

The following day of his arrest, Tuesday 13, SBF had his first Bahamas court hearing, facing Magistrate Judge Joyann Ferguson-Pratt, who signed an emergency warrant for his arrest Monday at the request of the US SDNY.

SBF’s attorneys asked the judge to consider a $250,000 bail, claiming that SBF needs to be taking medication for allergies and depression, as well as so he can keep to his vegan diet.

Judge Joyann denied SBF's bail application, stating that he was a flight risk, and scheduled the next extradition hearing for February 8, 2023.

Until then, SBF is being kept at the Bahamas Department of Correction.

Binance FUD (Fear-Uncertainty-Doubt)

Figure 12. *Binance CEO Changpeng Zhao (CZ) speaks at a recent event in Athens, Greece, on November 25, 2022.*

According to a Tweet shared by analytics firm Nansen, Binance, the giant crypto exchange, has seen a net withdrawal of $3.6 billion from December 7 to December 13.

The reason for these withdrawals may be (a Reuters) report on December 12 claiming that the US Department of Justice is looking to press charges for possible money laundering against Binance and its executives.

Binance then responded to the allegation stating that "Reuters has it wrong again" and "they're attacking our incredible law enforcement team. A team that we're incredibly proud of – they've made crypto more secure for all of us,"

Binance also shared the statement originally sent to a Reuters reporter in the same Tweet.

CZ, Binance CEO, said in a statement that "We have seen this before. Some days we have net withdrawals; some days, we have net deposits. Business as usual for us." "Things seem to have stabilised. Yesterday was not the highest withdrawal we processed, not even the top five. We processed more during LUNA or FTX crashes. Now deposits are coming back in." CZ added.

Following these Tweets, analyst Andrew Thurman of analytics firm *Nansen* published another Tweet stating that he and “the chads” at Nansen’s Tokens team have released a new percentage feature upon request from CZ and that in this new feature “Binance is only down 2.5 percent on a 7-day basis, BUSD reserves, in particular, are beefy.”

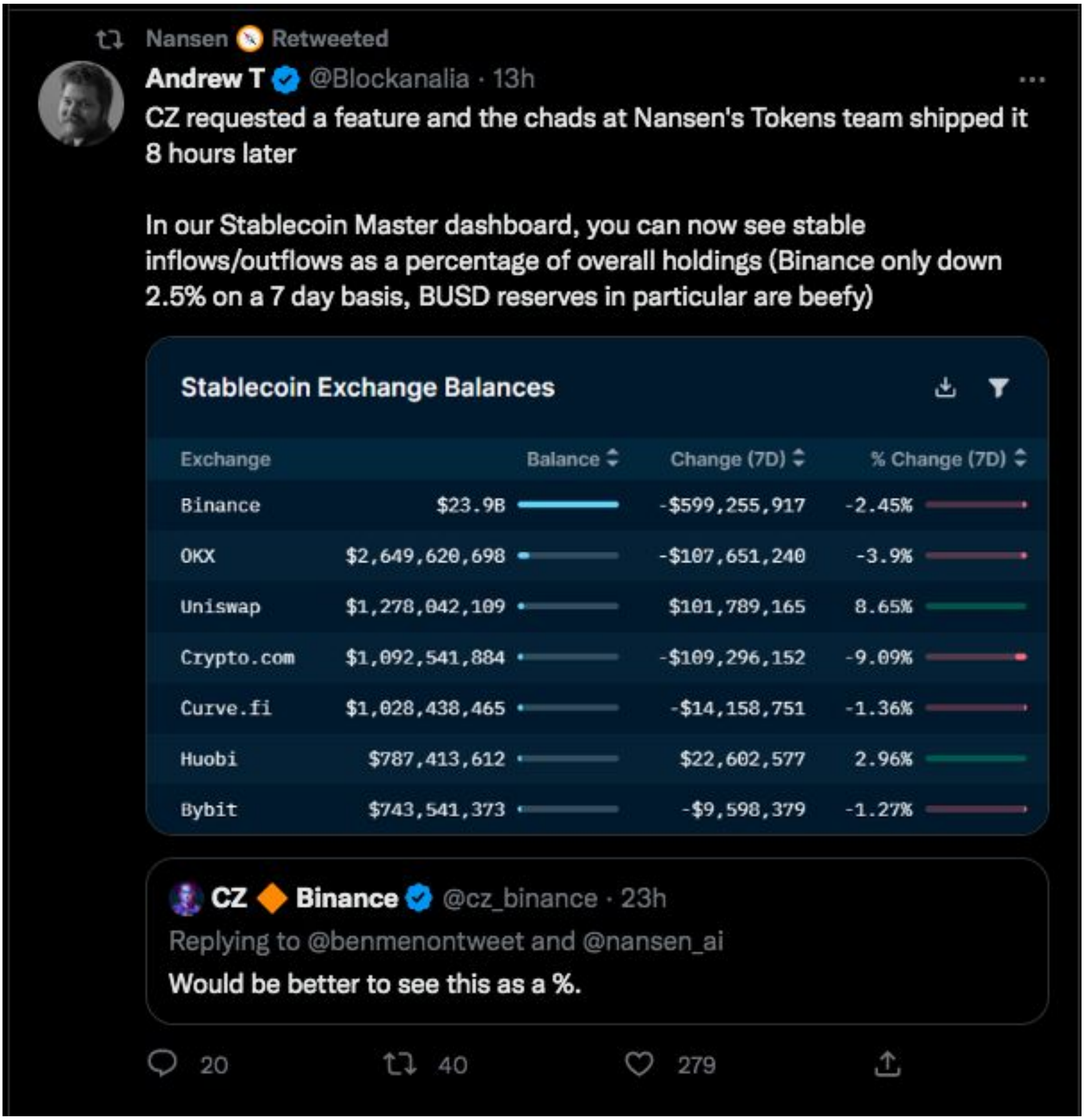


Figure 13. *Analyst Andrew Thurman’s tweet*

Tron's stablecoin USDD is over collateralised by 200

Figure 14. *Justin Sun, CEO and Founder of Tron*

Tron's decentralised USD, known as USDD, has been struggling with its peg since last month, and on Monday, December 12, the stablecoin declined below $0.97.

The USDD stablecoin is supposed to be pegged to the US dollar at a 1:1 ratio, which means that the coin's value is considered to be tied to the value of the US dollar.

Subsequently to the USDD drop in price, Justin Sun, founder of Tron blockchain, Tweeted that his stablecoin is over collateralised by 200 percent and that he is "Deploying more capital – steady lads".

Figure 15. *Sun's tweet from December 12.*

Justin Sun also included transaction details in the Tweet, showing that he swapped over $199,952 USDT and $559,820 USDC for a total of $774,129 USDD in hopes of restoring USDD to its dollar peg.

Figure 16. *Transaction details tracked by our analysts*

Following Sun's Tweet, USDD's official Twitter page announced on Monday, December 12, that "assets with a combined value of over $1.45 billion are safeguarding the USDD peg".

Amber Group Raises $300 Million To Survive FTX Contagion

Figure 17. *Michael Wu, the CEO and Co-Founder of Amber Group.*

Crypto trading firm, Amber Group, has announced on Friday, December 16, that it has completed a $300 million Series C funding round led by Fenbushi Capital US and joined by other crypto-native investors and family offices.

Amber Group also stated that prior to the FTX collapse, the company was in the process of completing a Series B+ fundraiser, but decided to pause it and proceed with Series C fundraising round instead.

"While the vast majority of our clients and products remain intact, a few of our specific products would have experienced significant drawdowns as an aftermath of the FTX default unless we could find ways to protect those affected clients further." The company said.

Last week (The Block) reported that according to a person with direct knowledge of the matter and a document obtained by (The Block), Amber Group owes about $130 million to Darshan Bathija, the CEO of crypto lender Vauld.

Amber Group Tweeted on the same day, stating, "Regarding certain false allegations against Amber today, our legal counsel will issue an official statement shortly and take potential legal actions".

Former US President Donald Trump's NFT Collection

Figure 18. *Examples from Trump's NFT collection*

On Thursday, December 15, US former president Donald Trump announced on Truth Social, a social media website he created since he was banned on Twitter, that he was releasing his collection of 45,000 NFTs.

According to the collection website, these NFTs are described by Trump as "Digital Trading Cards" and are similar to "baseball cards" but collected digitally.

The website also claims that each NFT buy will enter the buyer into a "sweepstakes" for a chance to win thousands of other prizes; furthermore, those who purchase 45 NFTs all at once will guarantee a ticket to attend a Gala Dinner with Trump in South Florida. This will cost buyers around $4,455.

By Friday morning, December 16, according to the website, all NFTs had sold out. At $99 each, the NFTs collection generated around $4.4 million in sales.

2022 CRYPTO TIMELINE

January

FTX, the crypto derivatives powerhouse, disclosed $400 million in Series C investment, nearly tripling its valuation to $32 billion in six months.

February

Russia attacked Ukraine on February 24, 2022, as the 2014 Russia-Ukraine War escalated. The Russia-Ukraine war and the subsequent energy crisis have taken a toll on the world's economy this year, not sparing cryptocurrency. It also went on to highlight what the crypto sector is capable of as Ukraine has raised more than $50 million in crypto donations.

March

The US government took a solid step to regulate cryptocurrency and bring more clarity to the industry, led by president Joe Biden. The executive order directed federal agencies to create comprehensive plans for U.S. crypto regulation and enforcement.

March

Axie Infinity, one of the leading blockchain games of all time, lost its credibility after a nine-figure Ronin Network hack attack. Players left the game in disappointment for better alternatives.

May

Terra, a high-cap crypto ecosystem, collapsed after its stablecoin UST depegged which caused its death spiral. TerraUSD was a highly popular "algorithmic stablecoin" pegged to the U.S. dollar, backed by the Luna tokens.

Over the month of May 2022, the token plunged as low as 10 cents on the dollar while Luna incurred an eventual 99 percent loss in its value.

July

Celsius Network Bankruptcy Triggers a chain reaction of events. Platforms like Maker, Compound, and Aave and investment firms like Genesis, Galaxy Digital, and Three Arrows Capital which had lending relationships with Celsius also took a hit.

July

THREE ARROWS CAPITAL

Three Arrows Capital (3AC), a crypto hedge fund, tumbled when it suffered heavy losses due to the collapse of LUNA and Terra, and after allegedly defaulting on a series of loans worth $3.5B.

July

Voyager Digital, the US crypto lender filed for bankruptcy, after suddenly halting customers' trading, deposits and withdrawals.
The catalyst behind the fall is said to be the failure of Three Arrows Capital (3AC) to repay a $670 million loan.

August

US treasury bans tornado cash after finding out that it's being used as a tool for money laundering.
The incident marked a black mark in crypto history, as this was the first time an authority sanctioned an open-source code instead of a platform.

September

The much-awaited Ethereum Merge was completed on September 15, which helped Ethereum reverse some of its losses this year.
This shift to proof-of-stake helped Ethereum improve its energy efficiency and mitigate its carbon footprint.

October

Elon Musk aquires Twitter which is largely seen as positive in web3.
Although Elon Musk's relationship with cryptocurrency has been rocky, the consensus seems to agree that his purchase of Twitter was a good move for the Web3 ecosystem as a whole.

November

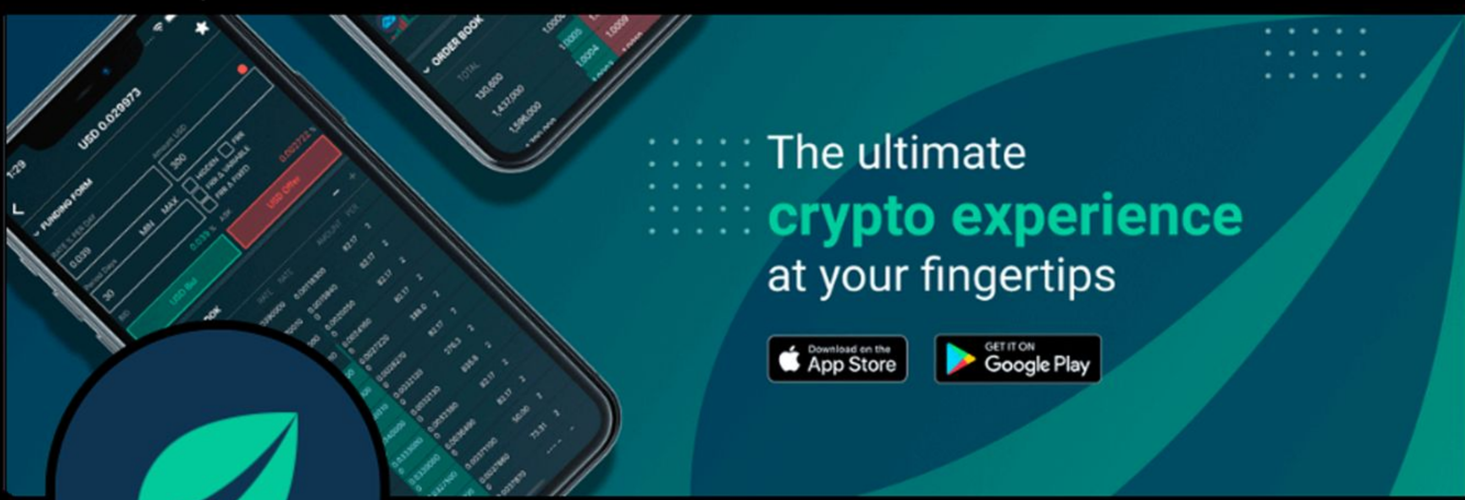
FTX collapse, caused a major setback in the crypto industry. FTX was seen by the masses as a credible crypto exchange and has won a large community in a short period of time, but the lack of transparency and poor management of the FTX ecosystem set off the market, and the rest is history.

November

BlockFi

As FTX contagion spreads, the crypto lender BlockFi filed for Bankruptcy, after facing serious liquidity issues.

As we wrap up the year, we recall the brief highs and the extensive lows that the entire crypto industry has faced this year. 2022 will be remembered as the year that recession fears affected the macro climate significantly and the bear market reared its ugly head. However, while giants of the industry like FTX, BlockFi, Three Arrows Capital, Almaeda Research, Celsius and many others collapsed, it made way for a new wave of smaller investors and believers in crypto that have remained resilient in their resolve to bank the unbanked and to take control of their money to move towards universal currencies as well as different implementations of blockchain technology in gaming, synthetic assets and AI. 2022 was also the year that the City of Lugano made Bitcoin legal tender and initiated a social movement that has benefited their economy on numerous fronts. This is a step in a positive direction for Bitcoin and crypto where adoption and understanding of cryptocurrency and crypto assets goes beyond the concept of just being a speculative investment.



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