BITFINEX Alpha

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EXECUTIVE SUMMARY

As crypto markets rally following a fall in retail sales and Producer Price Index (PPI) data, there is hope that interest rate increases are becoming a thing of the past. Unfortunately, that is almost certainly too optimistic for where we are in the fight against inflation. Indeed, equities have also been falling in the past week, and there are still reasons to inject some caution into the debate about the underlying strength of the economy.

The US debt ceiling - the level at which the government can no longer go to the markets to borrow - has been reached, setting up a potential battle in Congress to raise it. The longer there is no raise to the debt ceiling, the more unsettling it is for markets.

Another potential flashpoint is the Employment Cost Index report, due January 31. If there is no decline here to match the declines seen in retail sales and the PPI, then another 50 basis point increase in rates is on the cards.

The good news is that other indicators in the economy do seem to be responding. Housing new builds, permits and sales continue to fall. Shipping costs have also been declining, down now 78 percent for shipments from China compared to last year.

So why is crypto behaving differently from the equity markets? Indeed, there are some technical anomalies that investors need to take note of. While Bitcoin has rallied to above $23k, open interest for USD and USDt pairs has plummeted in the futures markets. As noted in last week's Bitfinex Alpha, net liquidity also remains extremely low, and a low market depth has allowed a smaller number of traders to move prices up sharply.

On the plus side, however, we are also seeing considerable accumulation taking place by whales in the spot market. These largest investors never offload until they have seen increases of 50-80 percent.

And the decline in derivatives volumes is positive. Price increases without excessive leverage, that's driven mostly by spot purchases, are a lot more sustainable than a derivatives-fueled rally.

Miners are also in better shape. Selling is now at a three-year low. It is a potential indication that miners are now either already transitioned or in the process of transitioning to a source of buying pressure. Miners are hodling their Bitcoin because they anticipate further rises.

In our round-up of the crypto-sphere, we cover in-depth the war of words taking place between the current CEO of FTX, John J. Ray and its former CEO, Sam Bankman-Fried. We also cover 'Genesis' bankruptcy, which is being denied by its parent company, Digital Currency Group; as well as the closure of Bitzlato and the arrest of its founder. We also report on $1 billion of losses at the crypto-focused bank, Silvergate and $45m of fines levied by the SEC on Nexo, the crypto asset lender.

It all sets us up for another exciting week in crypto! Happy trading!

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GENERAL MARKET UPDATE

Potential Default?

Figure 1. US Treasury Building (Source: Wikimedia Commons)

On Thursday, January 19th, the United States reached its debt ceiling, setting up a congressional battle that could negatively affect consumers and the economy. The debt ceiling is the amount of debt that the federal government can accrue as capped by law. Currently, the debt ceiling is set at over $31.4 trillion. Reaching this limit means that the United States can no longer borrow more money, so meeting its financial obligations is becoming more complex. Social Security and Medicare payments, tax refunds, military pay, and interest on the national debt are all on that list of financial obligations.

The Treasury can use on-hand funds or revenues received, such as those collected during tax season (which begins on January 23rd), to meet its financial obligations. The US government can also execute so-called "extraordinary measures" to generate immediate funds. US Treasury Secretary, Janet Yellen informed congressional leaders in an updated letter that the Treasury began implementing such actions on Thursday, January 12th. No additional funds are to be invested into the Postal Service Retiree Health Benefits Fund and the Civil Service Retirement and Disability Fund until June 5th, according to Yellen. All these maneuvers are made to avoid a default.

To put it bluntly, the debt ceiling is arbitrary. It has continually been raised for more than a century. Since 1960, there have been 78 increases, with 20 occurring since 2001. We anticipate that Congress will act as it has in the past and increase it again.

There has been a legislative debate surrounding this debt crisis. The Democrats hope a debt ceiling increase will free up cash to pay back overdue lenders. Meanwhile, Republicans would prefer to slow down the spending (borrowing) before raising the debt ceiling again. With each passing day that Congress fails to reach an agreement on raising the debt ceiling, investors on Wall Street get more concerned about the prospect of a historic default on US debt. If there's one thing the market hates, it's uncertainty in the economy.

In 2011, when the US debt hit $14 trillion, Congress nearly reached a default but avoided it after Republicans agreed to raise the ceiling. Even without a default, this close call shook investors' confidence, which plunged the stock market by 14 percent in less than two weeks.

Though highly unlikely, a US default on its debt obligations would have a devastating impact not just in the US but in global financial markets.

Consumer Spending Continues to Weaken

The path to a slowdown in rate hikes continues to become apparent as US retail sales and producer inflation fall as spending weakens.

Retail sales fell by 1.1 percent in the final month of the year. The US Census Bureau also reported on Wednesday, January 19, that November's figure had been revised downward considerably, from a 0.6 percent drop to a 1.0 percent drop.

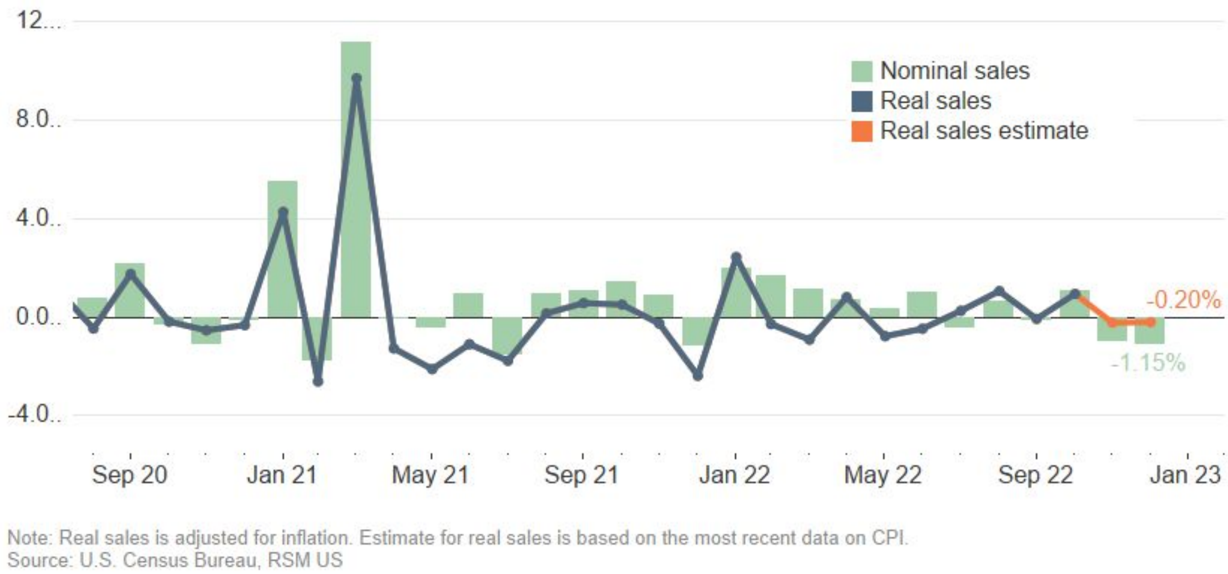


Figure 2. US Monthly Retail Sales (Source: US Census Bureau, RSM US)

The steep declines in auto and gas sales were primarily responsible for the overall decrease in retail sales. Compared to November, vehicle sales dropped 1.2 percent, while gasoline sales dropped 4.6 percent.

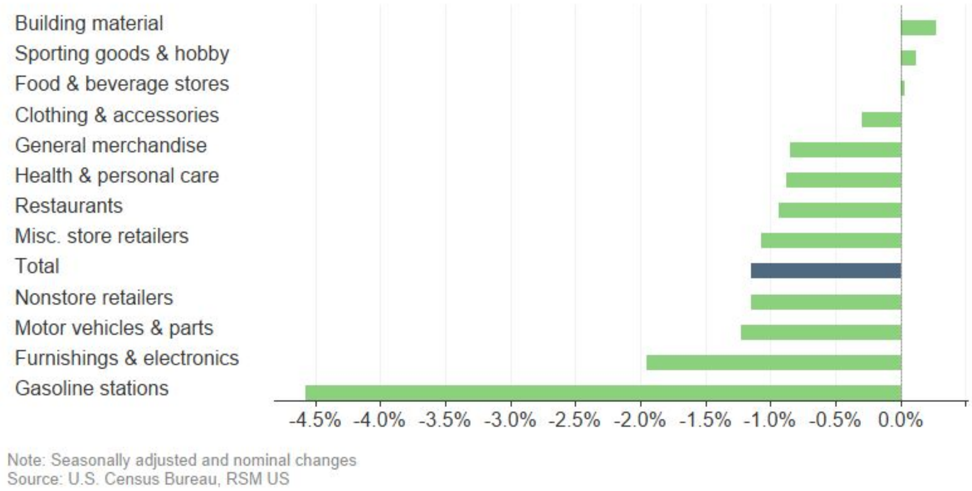


Figure 3. Monthly Percentage Change in Retail Sales (Source: US Census Bureau, RSM US)

The Producer Price Index (PPI), which measures the change in prices paid by producers, fell by 0.5 percent in December, according to a separate report released by the Bureau of Labor Statistics on Wednesday. This was the most significant drop since April 2020, when the US economy tried to contain the Covid-19 outbreak. The Wallstreet Economists forecast was 0.1 percent. The larger-than-expected decline in PPI pushed stocks higher, and rates on the 10-year Treasury fell on the day after the report was released. Year-over-year (YoY) PPI moderated to 6.2 percent from 7.3 percent in the previous month, the lowest in nine months.

The PPI report reflects the prices paid by businesses for raw materials like food, fuel, metals, wood, paper, and more. These prices, which are typically passed on to consumers at the retail level, provide insight into the direction of inflation.

The Federal Reserve's (the Fed) rate-hike campaign is having the desired effect; falling sales and producer prices are evidence. However, if the Employment Cost Index, which will be out on January 31, remains strong, there is still a potential for another 50 basis points hike.

US Housing Market: Showing Signs of Bottom

The housing market continues to show signs of bottoming out in December, as building starts and permits fell again, capping off the first year of decline since 2009.

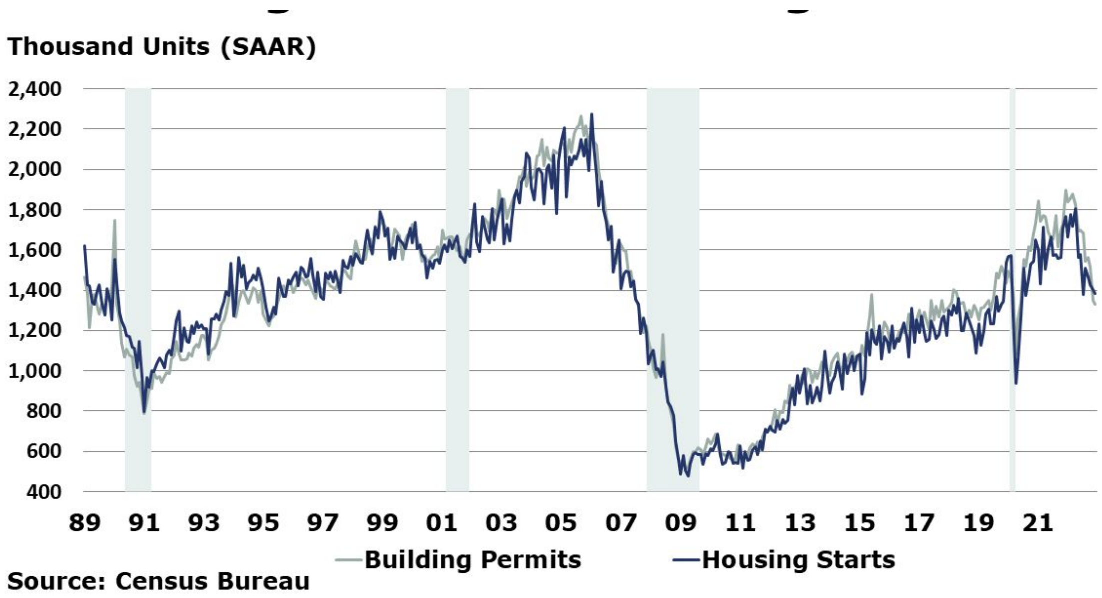


Figure 4. ***Housing Starts and Building Permits (Source: Census Bureau)***

Both housing starts and building permits fell month-over-month (MoM) by 1.4 percent and 1.6 percent, respectively, in December. For 2022, housing starts fell by 3 percent, while building permits dropped by 5 percent.

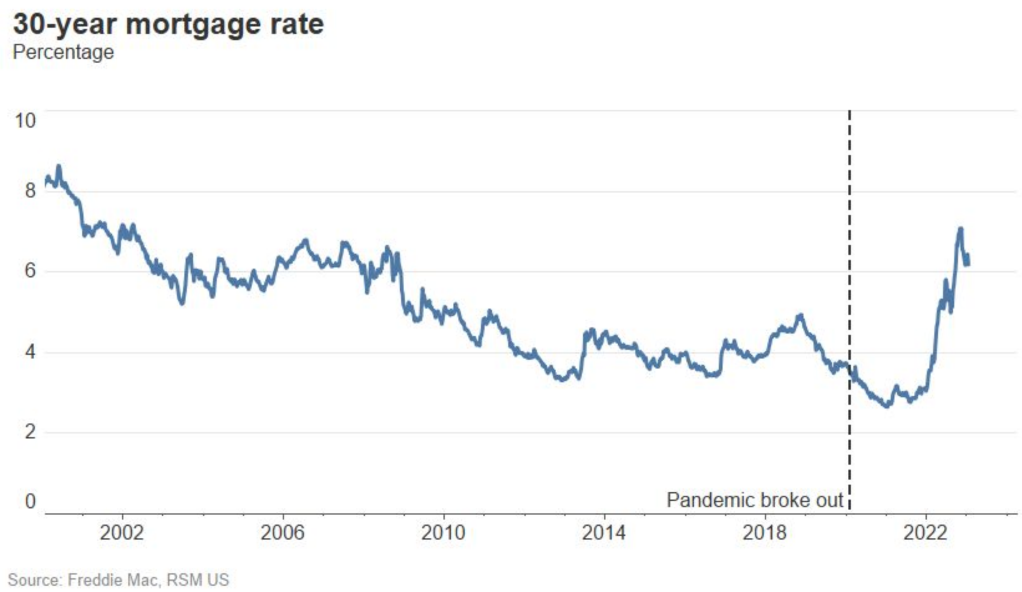


Figure 5. **30-Year US Mortgage Rate (Source: Freddie Mac, RSM US)**

A rise in mortgage rates, which peaked at 7 percent in the fall of last year before levelling off, explains the current housing market downturn.

Even if mortgage rates may have reached their peak, they will remain relatively high for the year, limiting housing demand. This decline in demand is shown in the latest report on housing sales by the National Association of Realtors last Friday, January 21.

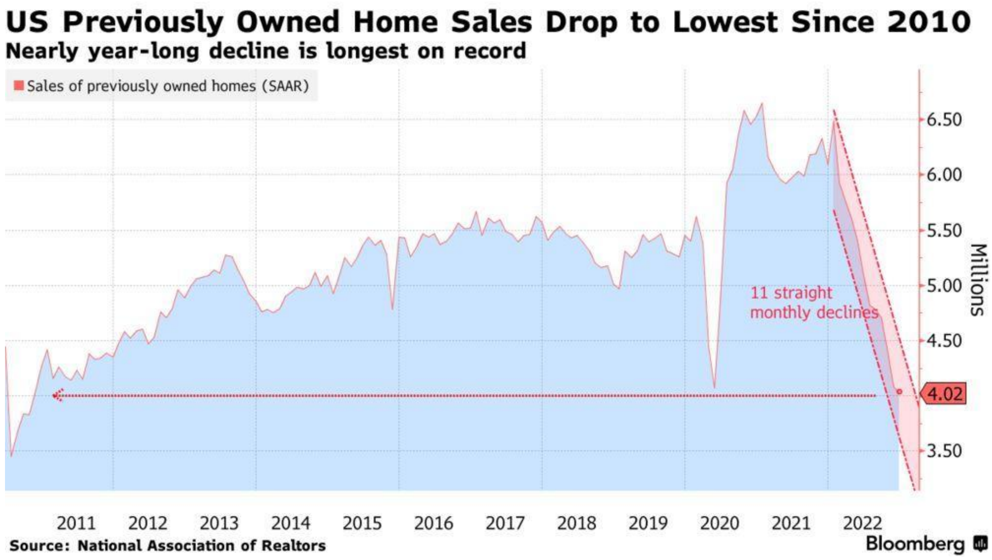


***Figure 6.* Existing Home Sales (Source: National Association of Realtors, Bloomberg)**

The decline in existing house sales continued in December, marking the eleventh consecutive monthly decline and the lowest year for sales since 2008. The Fed has been firm on tightened monetary policy, allowing sales to fall lower. December's sales declined by 1.5 percent to 4.02 million units, bringing the total number of units sold in 2022 to 5.03 million, 17.8 percent lower than in 2021. As the housing market continues to stumble, monthly sales are now lower than the pandemic low of May 2020.

Cheaper Shipping Cost from China helps ease inflation

The falling price of goods has significantly contributed to easing inflation in the US and global economies. The fall in transportation costs and the year-over-year decreases in oil and energy prices are primarily responsible for the improving inflation picture.

Shipment from China to the US now costs 78 percent less than last year, according to the Shanghai Containerized Freight Index, which peaked last January and has been declining since June.

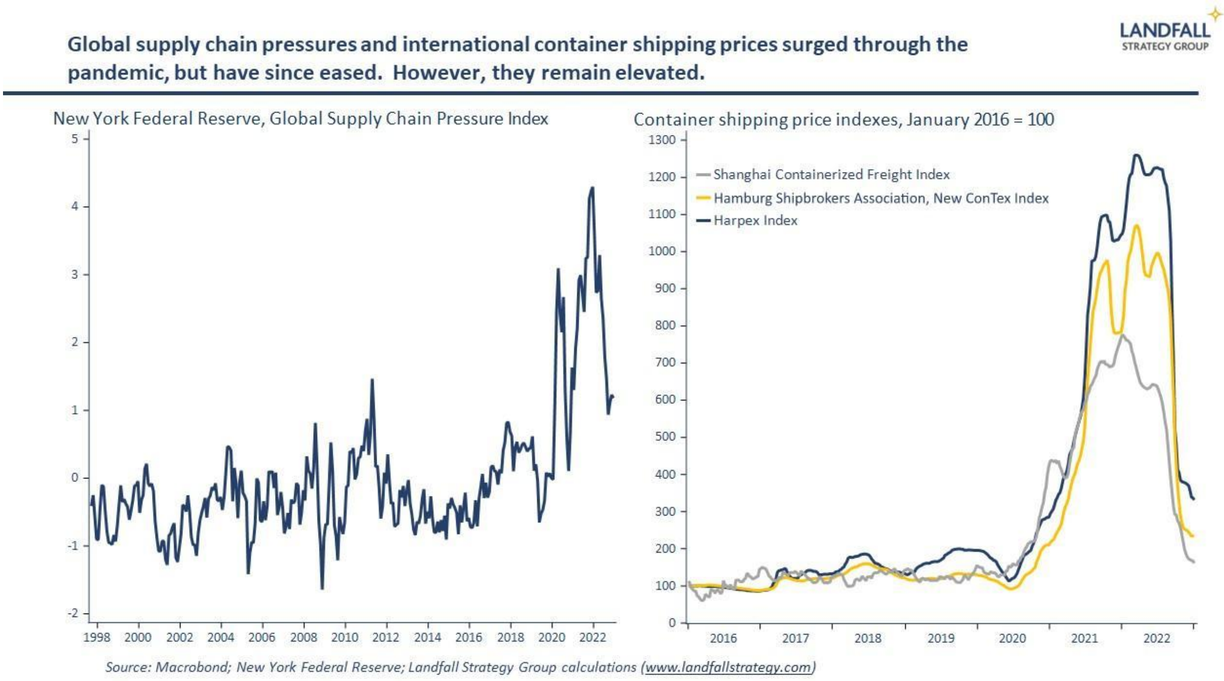


Figure 7. Easing Global Supply Chain Pressures (Source: New York Federal Reserve, Landfall Strategy Group Calculations)

The decline in shipping costs from China to the US has improved the supply chain. The RSM US Supply Chain index, which measures bottlenecks in the supply chain, currently sits at 0.4 standard deviations above neutral, suggesting the gradual normalisation of global supply chains.

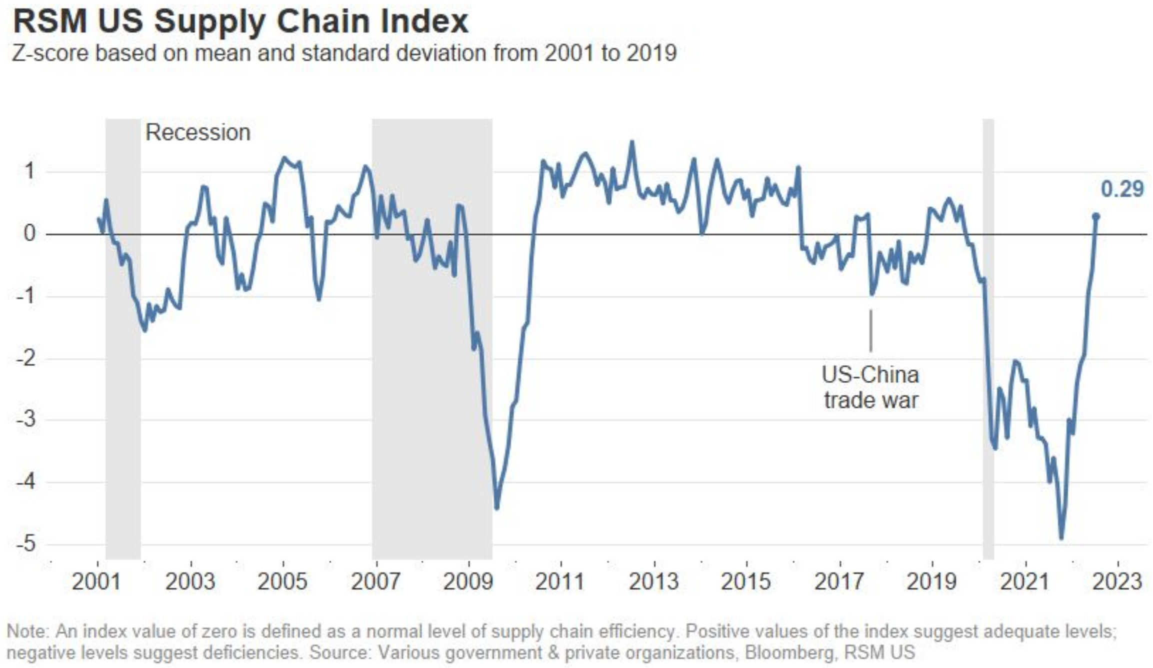


Figure 8. RSM US Supply Chain Index (Source: Bloomberg, RSM US)

An increased supply of consumer goods brought by falling shipping costs implies a further decline in inflation, which will be considered as the Fed determines the appropriate federal funds rate.

Equities Market

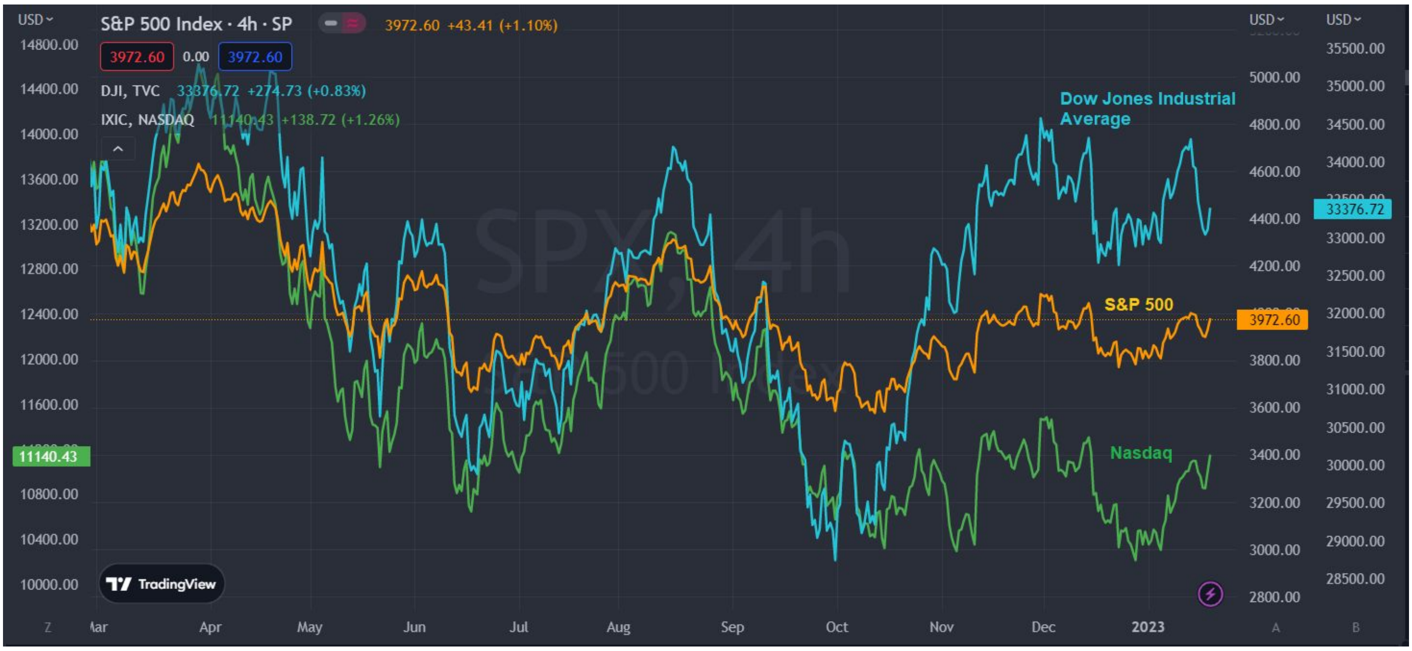


Figure 9. S&P 500, Dow Jones Industrial Average and Nasdaq Composite (Tradingview)

After a strong start, the US stock market had its worst week of 2023. The Dow Jones Industrial Average (DJIA) lost almost all of its year-to-date (YTD) gains, the S&P 500 lost some of its YTD gains, and the Nasdaq added to its YTD gain. For the week that ended January 20, DJIA fell by 2.7 percent, S&P 500 declined by 0.7 percent, and Nasdaq Composite rose by 0.6 percent.

Uncertainty of future economic growth appears to be the culprit with the decline in retail sales, building permits, house starts, and a US debt crisis amidst its divided Congress.

WHAT'S ON-CHAIN THIS WEEK?

Spot and Short-closures driven rally

Figure 10. BTC/USD+USDT aggregate futures Open Interest. (source: coinalyze)

On January 14, BTC broke out from the $20,000 barrier for the first time since November 2022. Following this breakout, open interest plummeted for USD, and USDt pairs as the price was stuck in a range between $20k and $21.5k. Eventually, as legacy markets closed for the weekend, BTC proceeded to break up further and reach $23k levels, almost 50 percent higher than the 2022 bear market lows.

It is important to note that USD and USDt futures open interest plummeted after lower time frame range breakouts throughout this leg up in January 2023. BUSD open interest, on the other hand, has remained solid while decreasing by a much lower percentage during the same move

Figure 11. BTC/BUSD perpetual features and open interest. (source: coinalyze)

This phenomenon and the number of short liquidations (data covered in the last edition of *Bitfinex Alpha*) alongside net short closures (figure below) have supplemented the rally. The net liquidity in the market remains extremely low, and a low market depth has allowed a smaller number of traders to move prices up sharply.

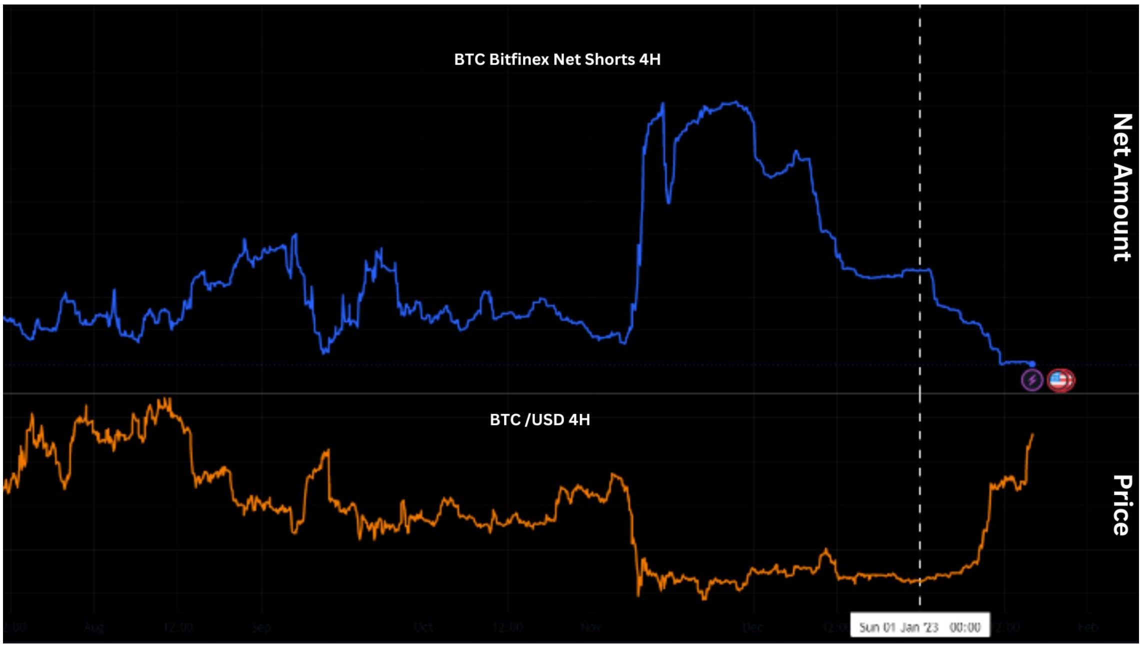


Figure 12. BTC/USD average 4H chart. (source: Bitfinex futures)

Short closures and short liquidations have fuelled the move up rather than organic demand. Net shorts on Bitfinex are down 76.4 percent since the beginning of the year. In fact, due to low liquidity, slippages while longing altcoins are at an all-time high. All this data boils down to a single data point, market sentiment is bearish, especially for retail traders.

While this might seem negative at first, it is important to note that retail traders or Bitcoin shrimps are the last to supplement any BTC move on derivatives. The questionable climate surrounding the current rally is relieved due to spot demand. Due to low liquidity on futures, many whales continue to add to spot positions.

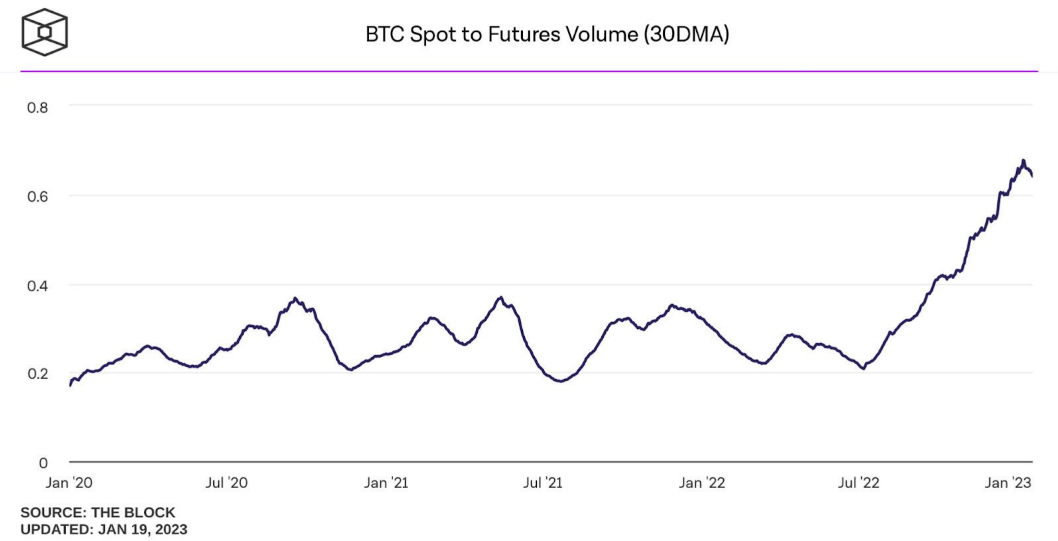


Figure 13. BTC spot to futures volume aggregated across exchanges. (source: The Block)

Bitfinex Alpha had covered several instances through December where whale accumulation was evident. Large BTC wallets and long-term holders usually never offload spot positions before 50-80 percent moves.

A trend we don't want to see is massive leverage or derivatives volume as the price increases. Some amount of leverage and derivative volume is to be expected, especially once the next bull-mania phase is entered. But when price increases absent excessive leverage, driven mostly by spot purchases, the move is likely to be sustained in the short term.

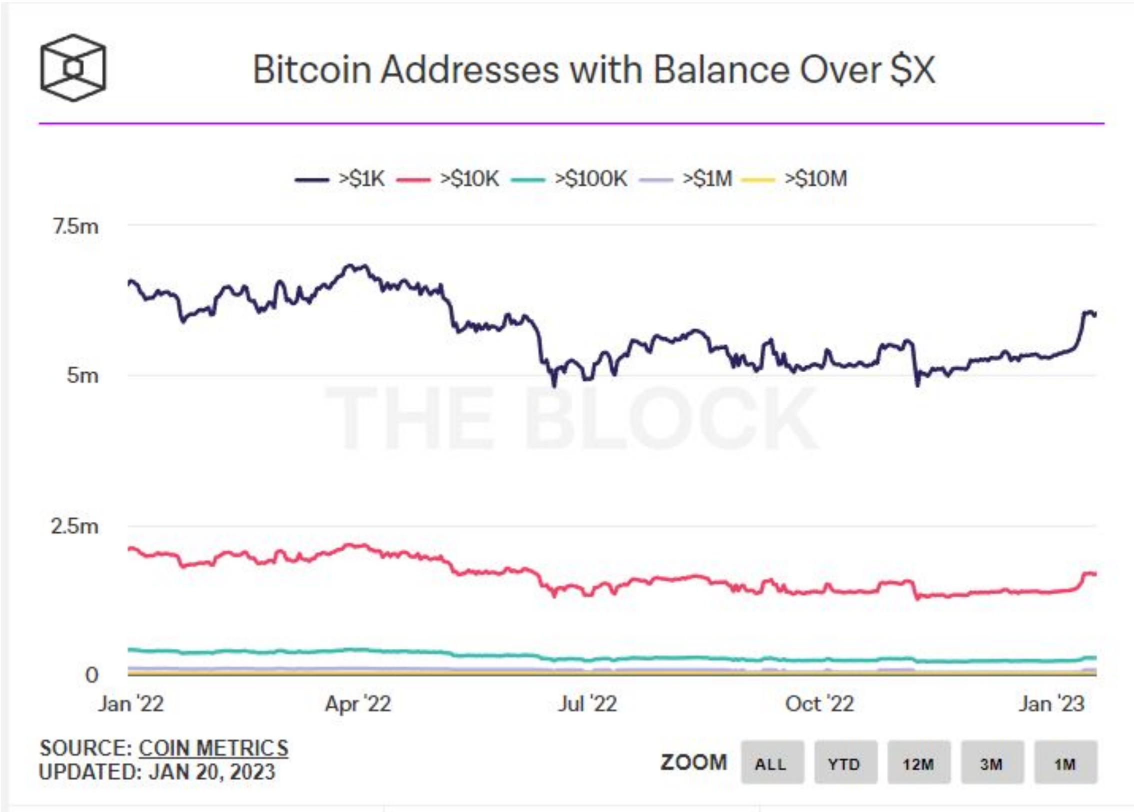


Figure 14. Bitcoin addresses with balances over various benchmarks (source: The Block)

Bitcoin accumulation was mostly led by large wallet sizes (>$1M) throughout November and December. These wallets and large players absorbed the supply that came post the FTX collapse and the plethora of other bearish events. The increase in the number of wallets with $1k and $10k has upticked since the second week of January. This is a sign that smaller investors are just joining the BTC rally while whales are firmly holding their spot positions.

Bitcoin Miners Sense Relief

The miner capitulation that had sent mining stocks into an 80 percent drawdown, leading to the insolvency of several of them, has finally cooled off.

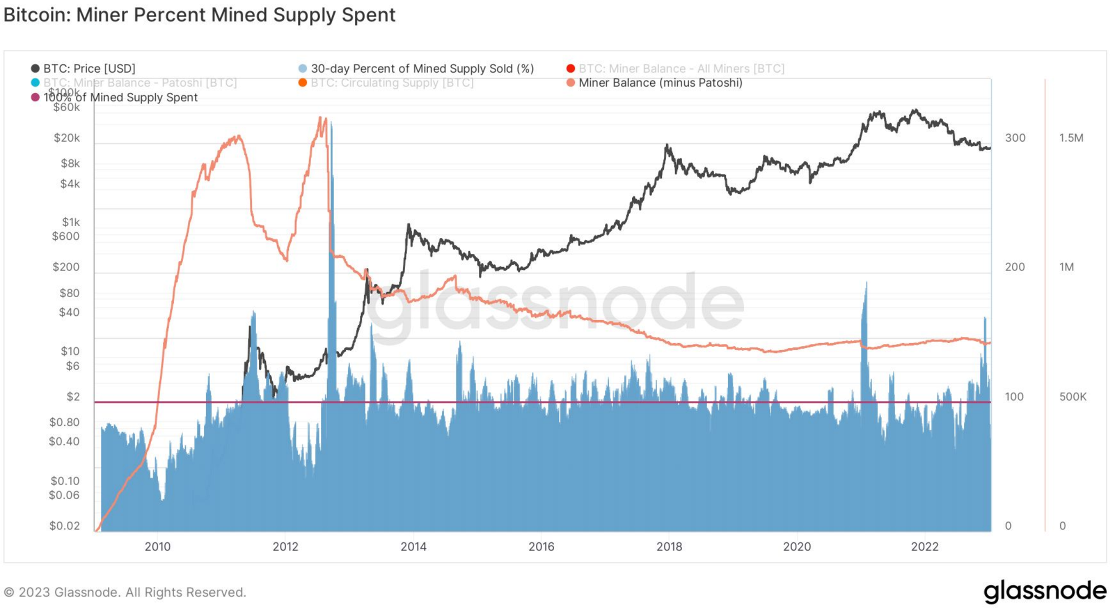


Figure 15. BTC Miner Percent Mined Supply (source: glassnode)

Miner sell pressure has reached its lowest in the last three years as less than 100 BTC is being sold on a weekly basis. The indication is that miners are now either already transitioned or in the process of transitioning to a source of buying pressure.

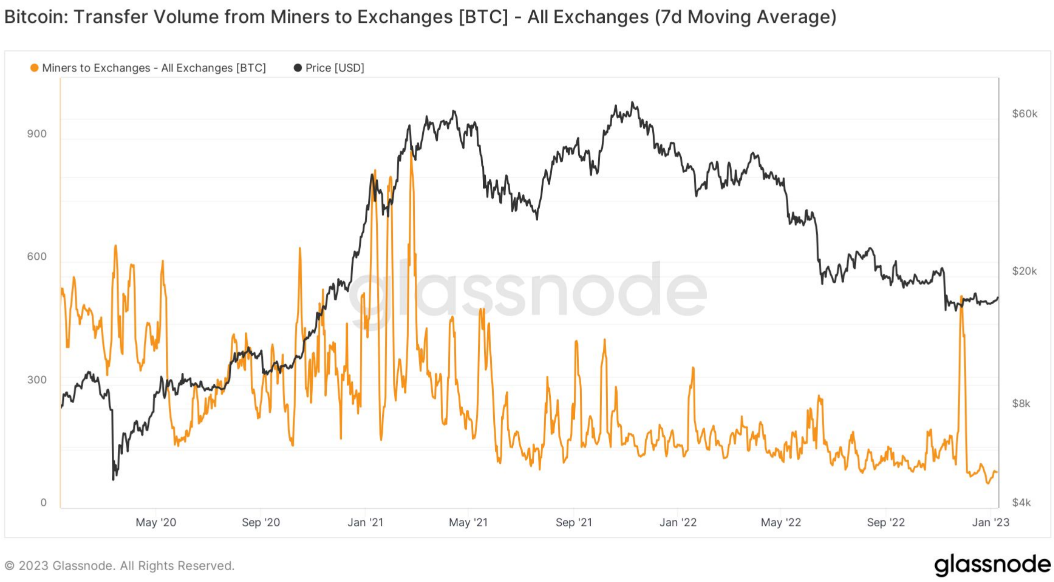


Figure 16. Miner to exchange transfer volume for BTC. (source: glassnode)

This is in sharp contrast to the vicious drawdown in 2022 — where miners were selling more BTC than was being mined. For now, miner balances on exchanges (indicating their abating sell pressure) are lower than 2020 and 2021 levels after soaring in late 2022.

The reason behind this move is the Bitcoin hash rate and hash ribbons. This is an indication of miners' efforts to increase profitability, and the number of mining rigs turned on.

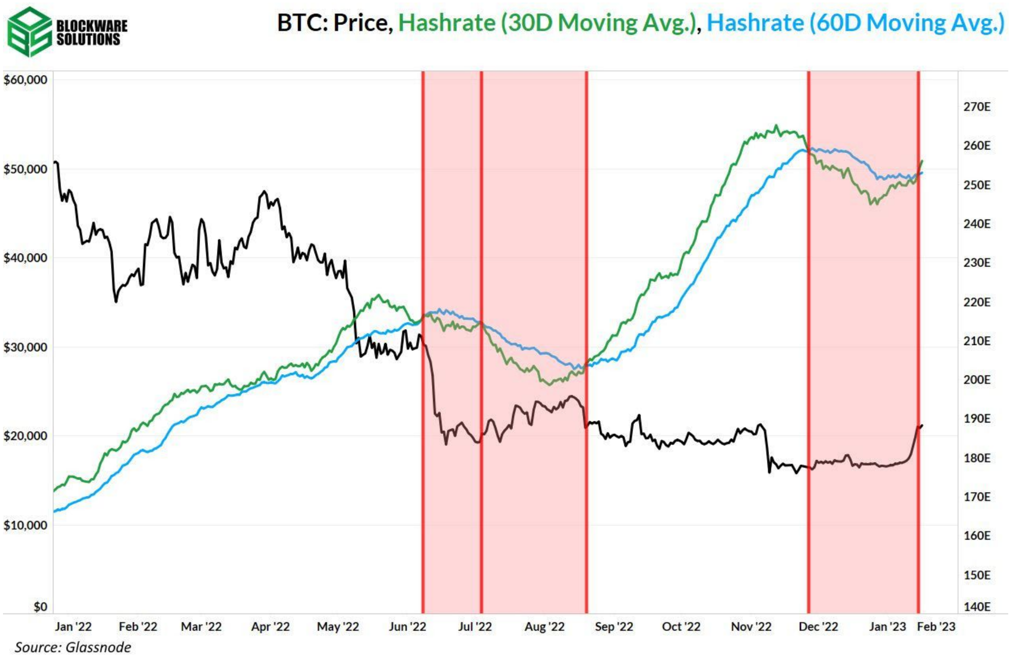


Figure 17. BTC price and hash rates.

NEWS FROM THE CRYPTO-SPHERE

FTX could restart

Figure 18. Current FTX CEO John J. Ray III

On January 19th, in an interview with the *Wall Street Journal*, FTX CEO John J. Ray said he is looking for possibilities to revive the bankrupt crypto exchange FTX.

“Everything is on the table,” Ray said. “If there is a path forward, then we will not only explore that, we’ll do it.” He added.

John Ray, who is known for restructuring troubled companies, such as Enron Corporation, where he helped return billions of dollars to the troubled energy trader’s creditors, said that he is now looking into whether reviving the FTX exchange would recover more value for customers than simply liquidating assets or selling the platform.

In the interview, John Ray also criticised former FTX CEO Sam Bankman-Fried (SBF) saying that his comments were unhelpful and self-serving. “We don’t need to be dialoguing with him,” Ray said. “He hasn’t told us anything I don’t already know,” Ray added.

John Ray said that while trying to track the companies’ funds, he initially got help from FTX co-founder Gary Wang and former CEO of its affiliated trading firm Alameda Research, Caroline Ellison.

When John Ray was asked about SBF’s claims about the FTX US being solvent, he said, “This is the problem...he thinks everything is one big honey pot.”

SBF responded in a text message to the *Wall Street Journal*: "Mr Ray continues to make false statements based on non-existent calculations. If Mr Ray had bothered to think carefully about FTX US, he would likely have realised that his interpretation is wholly inconsistent with bankruptcy law and that even if one were to subtract $250 million from my balance sheet, FTX US would *still* have been solvent. Rather, Mr Ray sees everything as one big honey pot he wants to keep."

In the interview, John Ray also defended himself against allegations, claiming that he's more motivated by generating fees for himself than solving the FTX dilemma after court filings showed that he's making $1,300 per hour. Ray said, "Crime is very expensive, and it does much damage to people...and one of the damages is that people like me have to come in and fix it."

It is worth noting that prior to this interview, on Tuesday, January 17, FTX said in a press release that even though the company has identified $5.5 billion of liquid assets, both FTX international and FTX US still suffer from a "substantial shortfall" of digital assets. "Based on current estimates of the amount of digital assets associated with the FTX.com and FTX US exchanges...there is a substantial shortfall of digital assets at both exchanges," the company said.

In response, former FTX CEO SBF released a blog post on January 18, stating that these claims are wrong, that "FTX US was and is solvent, likely with hundreds of millions of dollars over customer balances." SBF then shared a balance sheet showing that FTX US is overcapitalised by roughly $350 million.

After the interview with John Ray was released on January 19, SBF said on Twitter that he is "glad Mr Ray is finally paying lip service to turn the exchange back on after months of squashing such efforts!" and that he is "still waiting for him to finally admit FTX US is solvent and give customers their money back..."

It is worth adding that according to a court filing revealed on Friday, January 20, US prosecutors confirmed they had seized roughly $700 million worth of cash and equities connected to SBF, including more than $500 million worth of shares in the trading platform Robinhood.

Genesis filed for bankruptcy

Figure 19. Barry Silbert, founder and CEO of Digital Currency Group (DCG), Genesis' parent

After a press report in the *Financial Times* on January 18, stating that crypto broker Genesis was preparing to file for bankruptcy, it did so the following day, in the US Bankruptcy Court for the Southern District of New York (SDNY).

Prior to that, Digital Currency Group (DCG), Genesis' parent company, informed its shareholders via email on Tuesday, January 17th, that it was suspending dividends until further notice. "In response to the current market environment, DCG has been focused on strengthening our balance sheet by reducing operating expenses and preserving liquidity. As such, we have decided to suspend DCG's quarterly dividend distribution until further notice," the company said.

The *Wall Street Journal* also released news of a potential sale of *CoinDesk*, the cryptocurrency-focused media company owned by DCG.

According to the news, *CoinDesk* hired bankers at Lazard to help it explore options, including a partial or total sale of the company. "Over the last few months, we have received numerous inbound indications of interest in *CoinDesk*," said its CEO Kevin Worth in an interview with The *Wall Street Journal*.

In a new statement published on January 20th, the parent company DCG stated that Genesis has its own separate management team, legal counsel, and financial consultants, and has created a special committee of independent directors to oversee the reorganization of Genesis Capital. The special committee also recommended and made the decision to file for chapter 11 bankruptcy protection. "Neither DCG nor any of its employees, including those on the Genesis board of directors, were involved in the decision to file for bankruptcy." Said DCG.

DCG also stated that it would continue to operate business as usual, as will its other subsidiaries. “DCG owes Genesis Capital approximately $526 million due in May 2023 and $1.1 billion under a promissory note due in June 2032,” DCG added.

According to a *CoinDesk* report published on January 20, Genesis owes over $3.5 Billion to its top 50 creditors, including Gemini Trust Company ($766 million), trading firm Cumberland DRW ($18.7 million), crypto fund Mirana ($151.5 million), MoonAlpha Finance ($150 million), VanEck’s New Finance Income Fund ($53) million, and the list goes on with other creditors.

According to bankruptcy filings and a report by *Bloomberg*, Genesis has entered court protection with a restructuring plan already drawn up, with hopes to implement it by May 19th, 2023.

The founder of the Russian exchange Bitzlato is under arrest

Figure 20. Lisa Monaco, deputy US attorney general, announced the charges against exchange Bitzlato on Wednesday at a press conference.

The Department of Justice (DOJ) announced on Wednesday, January 18th, that it had arrested Russian national Anatoly Legkodymov, founder of the crypto exchange Bitzlato, on Tuesday night in Miami and charged him for allegedly facilitating money laundering for criminals.

At a press conference, Lisa Monaco, deputy US attorney-general said:

“Today’s law enforcement actions put all of those who seek to exploit the cryptocurrency ecosystem on notice that the Department of Justice will use every tool that we have to attack the criminal use of the dark net and cryptocurrency,” “Today’s actions send the clear message: Whether you break our laws from China or Europe—or abuse our financial system from a tropical island—you can expect to answer for your crimes inside a United States courtroom.” Lisa Monaco continued.

Bitzlato, based in Hong Kong but operates globally, allegedly exchanged more than $700 million in cryptocurrency with Hydra Market, a dark web marketplace shut down by US and German authorities in April 2022, the DOJ said.

French authorities working with Europol, Spain, Portugal and Cyprus have also taken related enforcement actions, including seizing Bitzlato’s cryptocurrency and taking apart its digital infrastructure.

Associate Deputy Director Brian Turner of the FBI said: “We, along with our federal and international partners, will work relentlessly to disrupt and dismantle these criminal enterprises. Today’s arrest should serve as a reminder that the FBI will impose risk and consequences upon those who engage in these activities.”

The U.S. Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN) also issued an order that identifies the virtual currency exchange Bitzlato as a “primary money laundering concern” in connection with illicit Russian finance.

Russian Legkodymov made his first appearance Wednesday at a federal court in Florida and was ordered to be detained. According to the DOJ, 40-year-old Legkodymov is charged with conducting an unlicensed money-transmitting business and could get up to five years in prison if convicted.

Silvergate reports a net loss of $ 1 billion in Q4.

Figure 21. Silvergate CEO Alan Lane at a press conference.

On January 17th, the crypto-focused US bank Silvergate issued an earnings report stating that the bank recorded a net loss of $1 billion in the fourth quarter of 2022, compared to net income of $40.6 million in the third quarter of 2022.

According to the report, the company saw significant outflows of deposits during the quarter due to several high-profile bankruptcies that led to a transformational shift in the digital industry.

“These dynamics created a crisis of confidence across the ecosystem and led many industry participants to shift to a “risk off” position across digital asset trading platforms.” The report stated.

Silvergate claims that it had to utilise wholesale funding and subsequently sell debt securities to accommodate sustained lower deposit levels and maintain its highly liquid balance sheet. In addition, the company said that it’s preparing for a “sustained period of lower deposits” and is taking several actions in the future including reducing its workforce, managing its expense base and evaluating its product portfolio and customer relationships.

Silvergate CEO, Alan Lane, commented on the matter: “while we are taking decisive actions to navigate the current environment, our mission has not changed. We believe in the digital asset industry, and we remain focused on providing value-added services for our core institutional customers. To that end, we are committed to maintaining a highly liquid balance sheet with a strong capital position.”

Nexo agrees to pay $45 million to the SEC

Figure 22. Gary Gensler, chair of The Securities and Exchange Commission (SEC)

On January 19, The Securities and Exchange Commission (SEC) reported that it charged the crypto lender Nexo for failing to register the offer and sale of its retail crypto asset lending product, the Earn Interest Product (EIP).

To settle the SEC charges, Nexo agreed to pay a total of $45 million in penalties divided as follows: $22.5 million penalty to the SEC and cease of its unregistered offer and sale of the EIP to US investors, and another $22.5 million in fines to settle similar charges by state regulatory authorities.

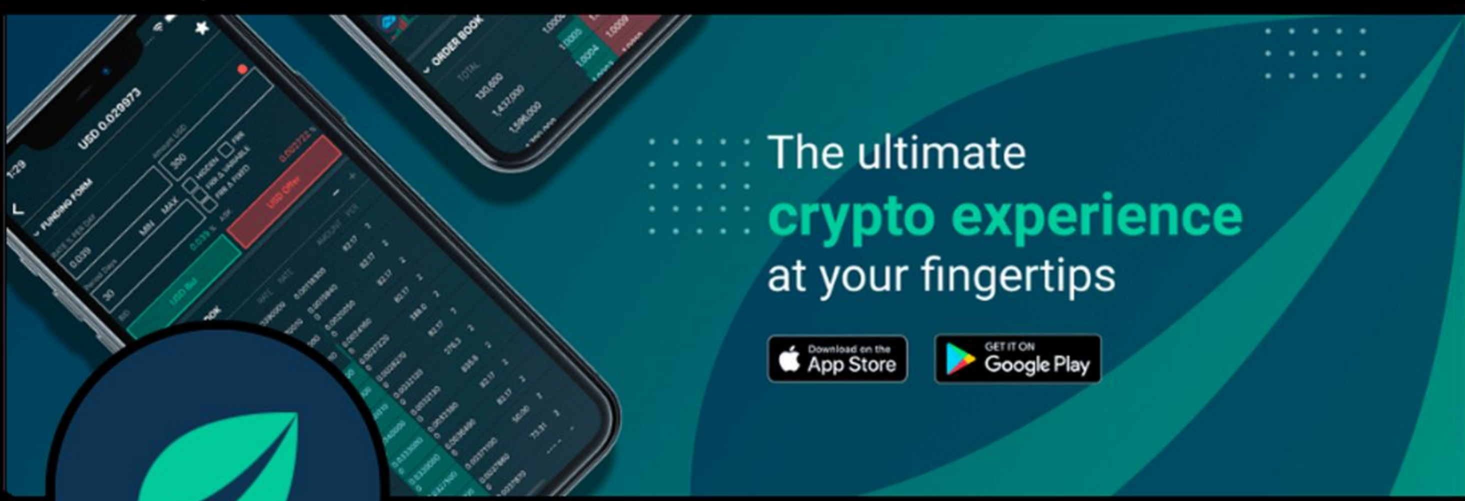
According to the SEC order, “Nexo exercised its discretion to use investors’ crypto assets in various ways to generate income for its own business and to fund interest payments to EIP investors.”

SEC Chair, Gary Gensler, said: “we charged Nexo with failing to register its retail crypto lending product before offering it to the public, bypassing essential disclosure requirements designed to protect investors.”

“We are not concerned with the labels put on offerings, but on their economic realities. And part of that reality is that crypto assets are not exempt from the federal securities laws,” said Gurbir S. Grewal, Director of the SEC’s Division of Enforcement.

Nexo then shared a statement on January 20, that the settlements are on a no-admit-no-deny basis, and that The US Federal Regulators do not contend that Nexo engaged in any fraud, or misleading business practices.

Antoni Trenchev, Co-founder of Nexo, commented on the matter: “we are content with this unified resolution which unequivocally puts an end to all speculations around Nexo’s relations to the United States. We can now focus on what we do best - build seamless financial solutions for our worldwide audience.”



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