BITFINEX Alpha

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EXECUTIVE SUMMARY

A still-resilient US economy is giving a glimmer of hope for a soft landing. Despite the Federal Reserve's massive rate hikes that started last year, PMI (Purchasing Manager Index) output figures show that the economy is still growing. A sharp drop in supplier delivery times gave further optimism for moderating inflation - though it also reflects reduced input prices both in the manufacturing and service sectors.

And while the PMI giveth, Personal Consumption Expenditure (PCE) and inflation data, taketh away. PCE, which is the Fed's preferred inflation gauge, climbed higher in February with both core and headline figures above analysts' expectations. Consumer spending also reached its highest level in two years. Market expectations that rate hikes will pause at the peak of 5.25 percent early this year have faded. We now expect rate hikes to continue until the June FOMC meeting and a case for a 50 basis points hike as early as March remains on the table.

In stark contrast to macro headwinds, the Bitcoin market remains bullish. Our short-term prediction proved correct last week when the BTC price dipped to $22,800. While shorter-term data might fluctuate, long-term statistics suggest good market health for Bitcoin and the crypto market in general. We see strong conviction on display by Bitcoin whales that resembles late bear market/early bull market behaviour as we continue to see large inflows into whale-style Bitcoin wallets. As much as 18,000 BTC was accumulated in the past week by long-term hodlers.

Options market sentiment also indicates a slightly bullish bias as we enter the new trading week, with the 25-percent delta skew data for all expiry dates slightly above zero.

Amid this increasingly constructive environment for the BTC price, Coinbase announced the launch of its L2 blockchain, called Base and Ethereum developers announced that its next upgrade - Shanghai-Capella - will take place on February 28th. Binance also continued on its course for regulatory compliance as it recently closed down derivatives positions for 500 customers which then triggered an investigation from regulators. We also saw news that the US Department of Justice indicted the founders behind a company called Forsage for running an alleged Ponzi scheme, that had been presented as a decentralised finance investment platform. The crypto hedge fund, Galois also announced that it was closing its doors, given that half of its assets remain trapped on FTX, while co-founder and former CEO Sam Bankman Fried himself was charged with four new criminal counts.

Happy Trading!

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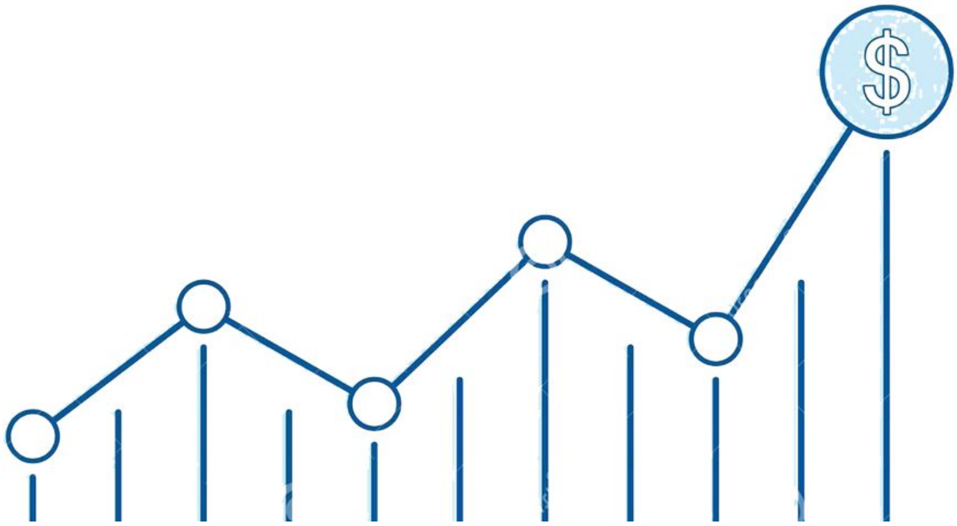


GENERAL MARKET UPDATE

US Economy Stabilises, but inflation may be persistent

Economic activity in the United States improved in February but consumer pricing data still shows symptoms of stubbornly high consumer prices – according to the latest S&P Global Composite US PMI survey.

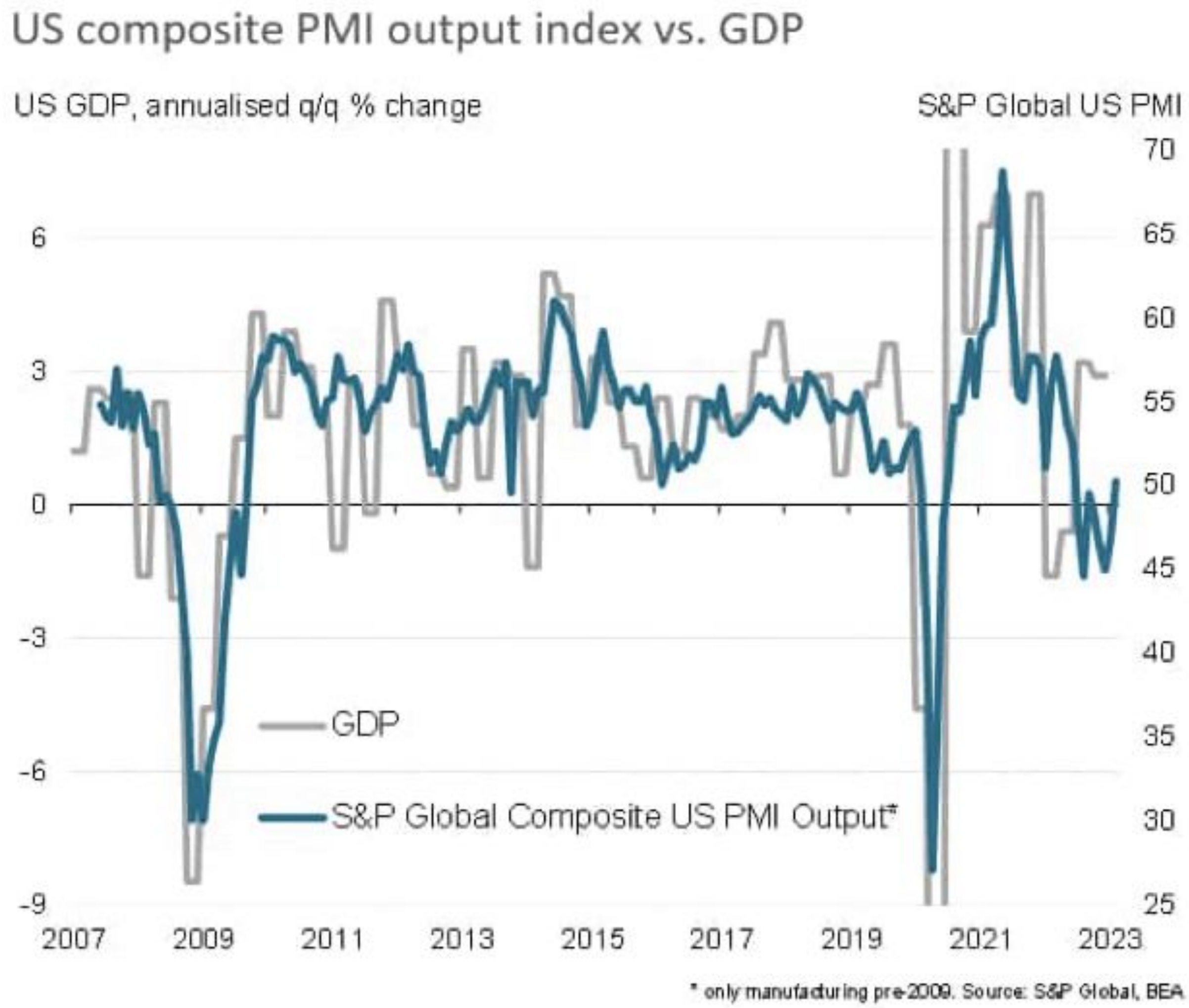


Figure 1. US Composite PMI output and Gross Domestic Product (Source: S&P Global and Bureau of Economic Analysis)

The flash US PMI (Purchasing Managers Index) Composite Output Index rose to 50.2 in February, from 46.8 in January 2023– the highest increase in eight months, according to an S&P Global report issued on Monday, February 21. The S&P Global Composite PMI Output indicator is a survey-based measure that reflects the performance in service and manufacturing sectors through changes in new orders, output, employment and supplier deliveries. The term “flash” is used in reference to an early estimate of the data, released a week prior to the final PMI reading. The latest ‘flash’ PMI data shows that the manufacturing and service sector is recovering.

The headline PMI suggests that despite the headwinds of Fed's rate hikes and consumers being squeezed on their budgets, the business climate has improved as inflation moderates and supply constraints have alleviated.

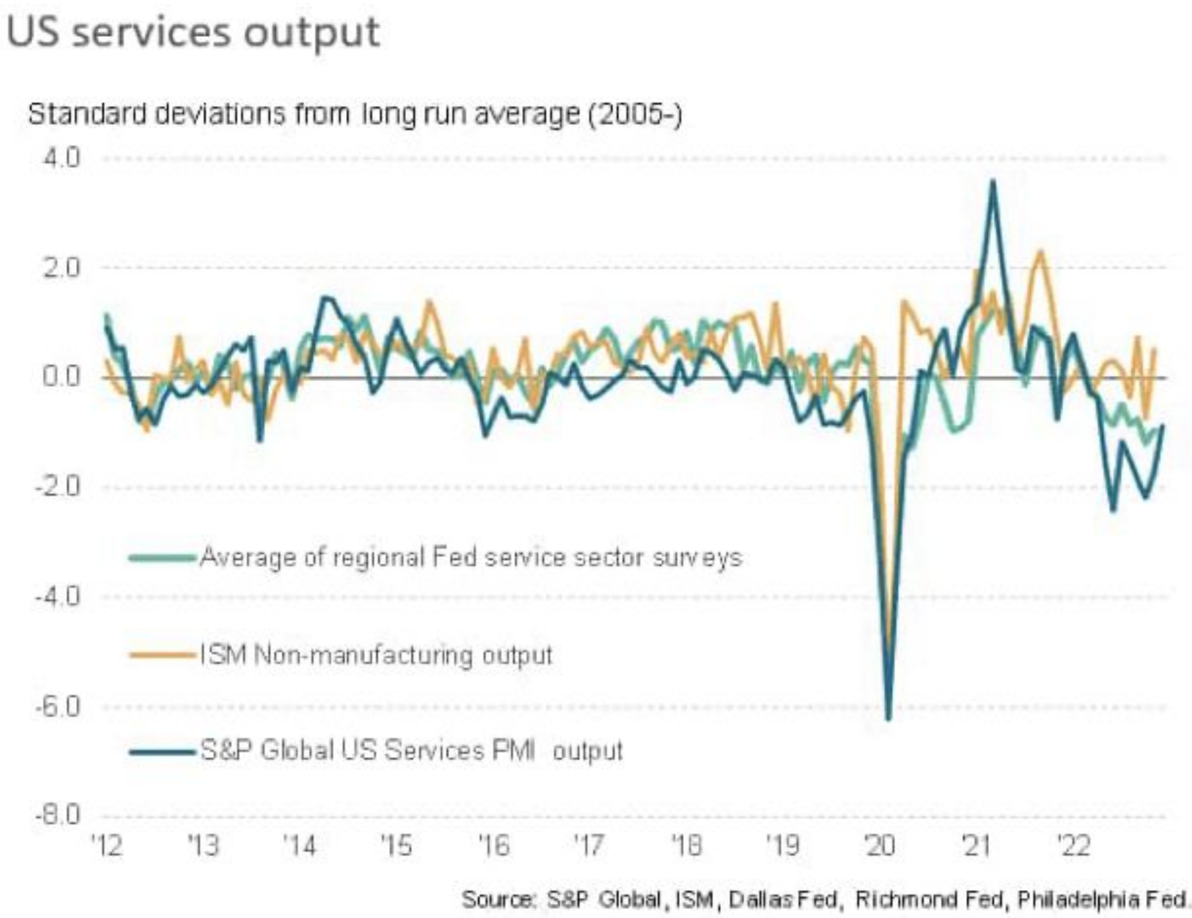


Figure 2. S&P Global Services Output PMI (Source: S&P global, ISM, Federal Reserve)

The service sector has recently saw a notable improvement in business activity for the first time since June 2022, increasing to 50.5 points in February from 46.8 points in January. It’s important to note though, that the S&P Global Services PMI output for the US is still below its long run average since 2005, as seen on Figure 2. Moreover, February's improved performance may be attributable, at least in part, to cases of unseasonably warm weather that encouraged activity in many outdoor businesses which mostly belong to the service sector.

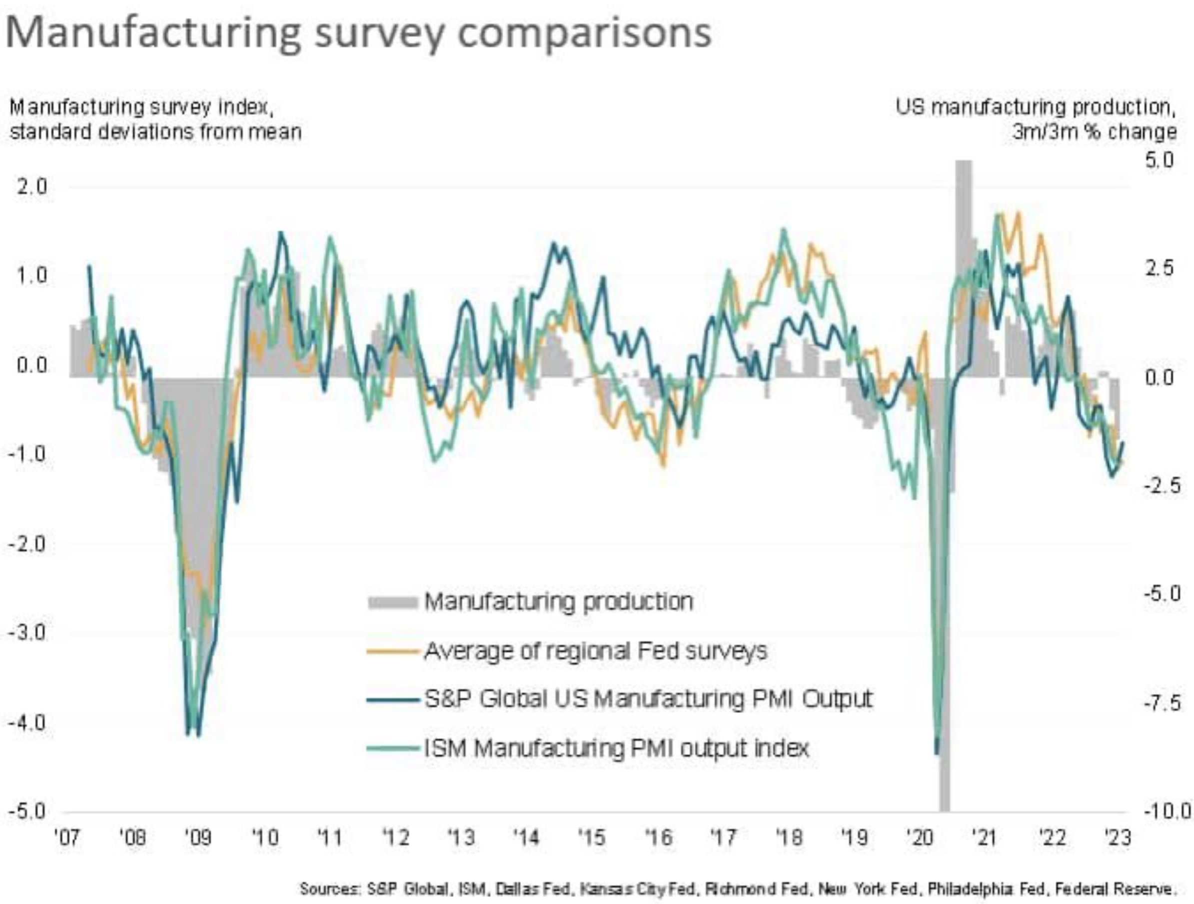


Figure 3. S&P Global US manufacturing PMI Output (Green) and other Surveys (Source: S&P Global, ISM, Federal Reserve)

The manufacturing sector also saw an improvement, with the flash PMI output index increasing for a second consecutive month. The S&P Global U.S. manufacturing sector index edged up to a four-month high of 47.8 in February from 46.9 in January. However, an index number lower than 50 still indicates a contracting economy. Though official manufacturing production data expanded in January, prior months have been negative. The latest PMI data suggests that though improving, there may still be a weak production trend persisting in the next month.

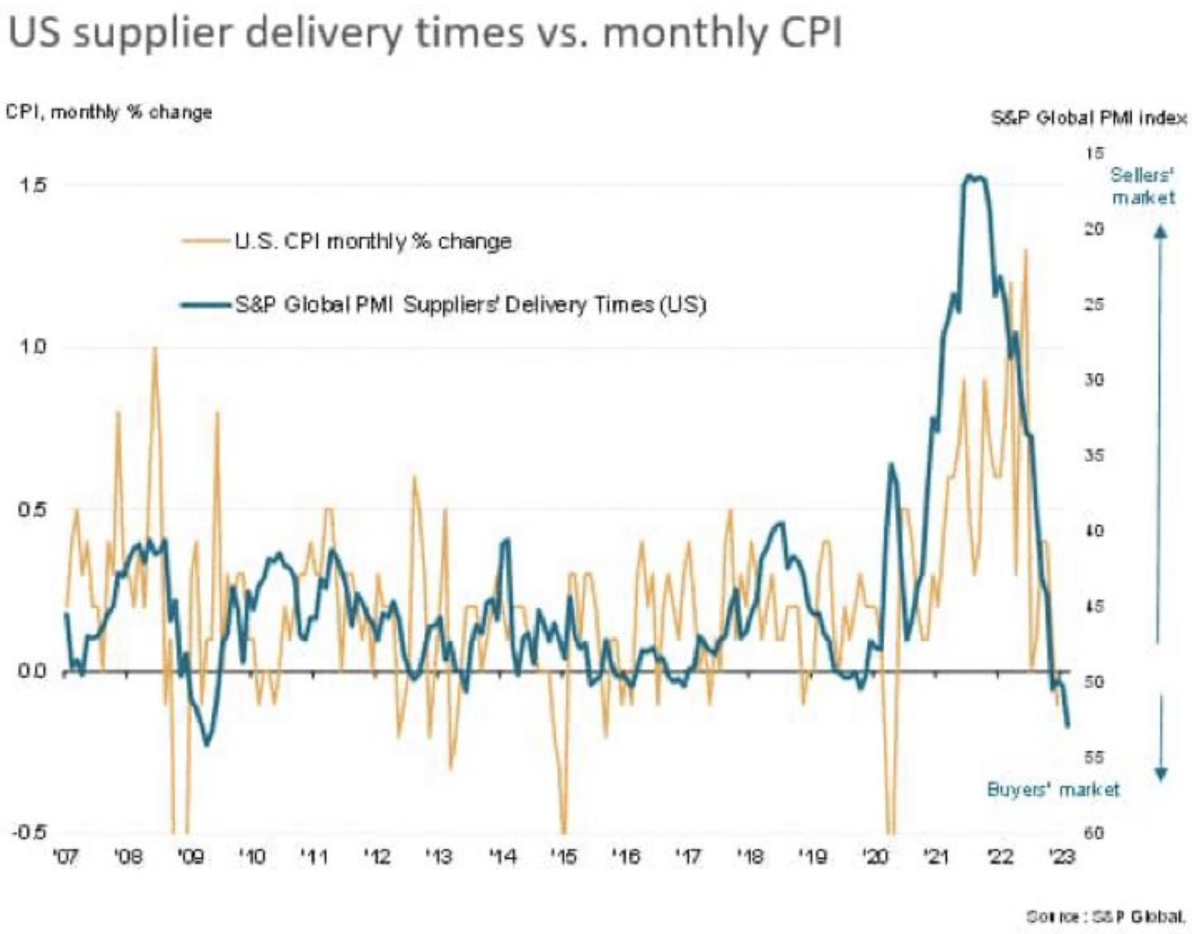


Figure 4. Improvement in delivery times (Source: S&P Global)

Average supplier delivery times also had the sharpest fall since May 2009 as suppliers became less busy meeting the reduced demand for inputs from manufacturers. As a result, the upward pressure in average prices for inputs has started to moderate, as seen on Figure 5.

The slowdown in input prices and improvement in delivery times tells us that buyers are gaining more leverage in negotiating better prices. This then allows them to offer better prices to their own customers. The shift in pricing power from suppliers to buyers indicates that inflation may continue to moderate in the next months for manufactured goods.

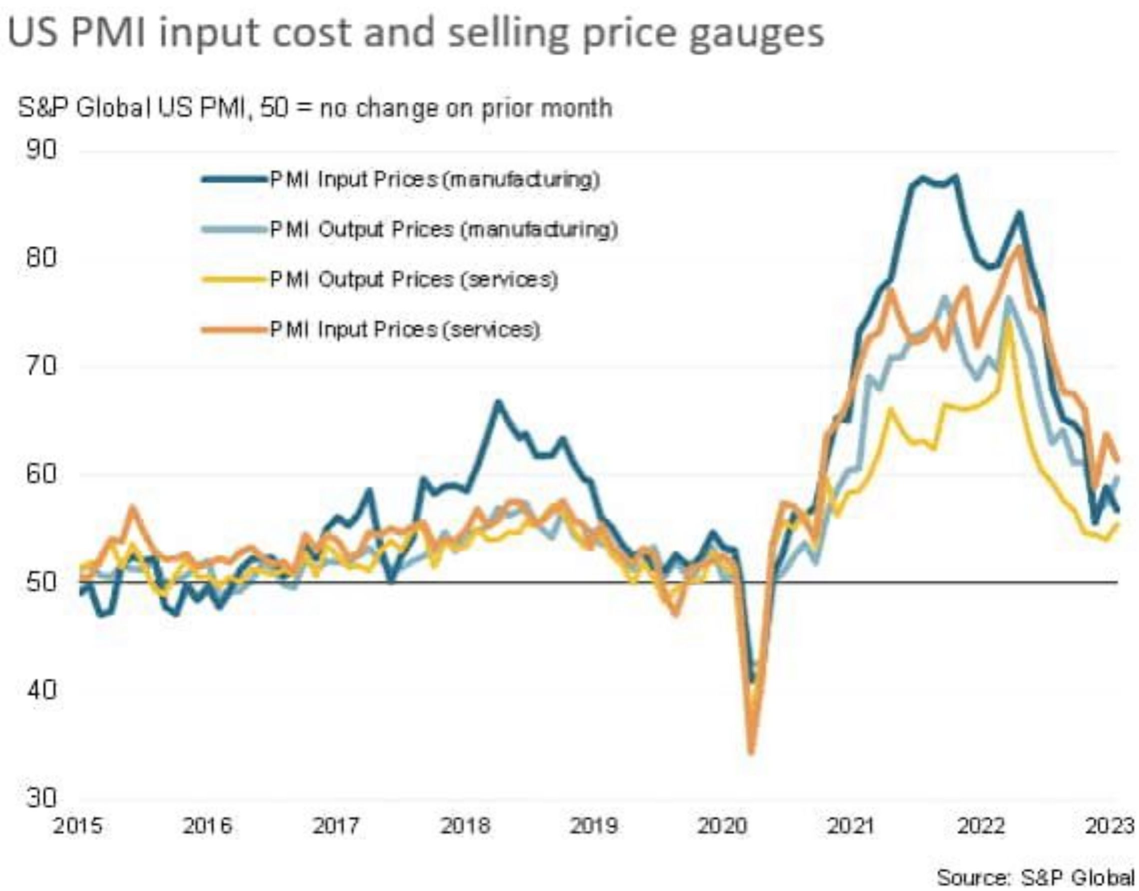


Figure 5. PMI Input Cost and Selling Prices Gauges (Source: S&P Global)

The preliminary data suggests that the US economy is stabilising despite the PMI output for manufacturing and services still being below its long-term average. However, in the manufacturing sector, the rising wages overtake the supply shortages as a driver for inflation, posing some worries among businesses. Though manufacturing input prices eased and supply chains improved (as seen on improvement in delivery times), output prices for goods produced by these factories rose for a second consecutive month as companies covered the upward pressure on wages. Increases were also seen in the PMI output prices in service sector (See Figure 5).

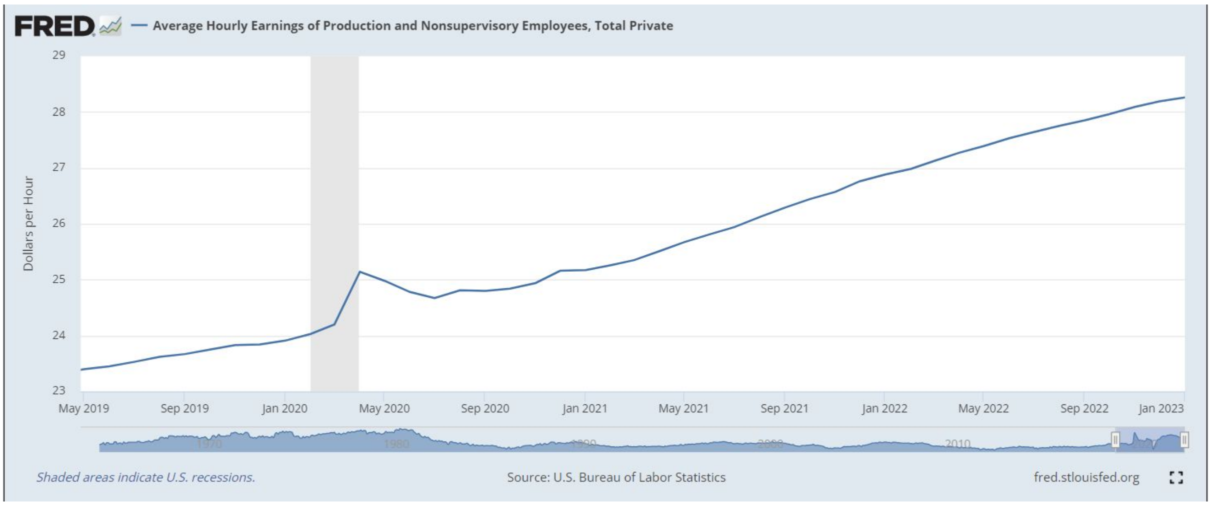


Figure 6. Average Hourly Earnings in Production and Non Supervisory Employees (Source: Bureau of Labour Statistics)

Figure 7. Number of Vacancies per Unemployed workers surged to 2-decade high on 2022

Since mid-2021, the US economy has recovered as businesses reopened after lockdowns. As a consequence, the demand for workers has far outstripped the supply. This ultimately increased worker's bargaining power for higher pay, contributing to the higher wages that continues to persist.

Figure 5 shows that the output price for the manufacturing and services sectors increased rapidly in February which suggests that firms are passing on their input costs. Despite being well below last year's survey highs, the upward pressure on these pricing measures suggest some troubling stickiness to inflation. This is most especially true in the service sector as it is more labor-intensive compared to manufacturing.

Inflation and Spending Came in Hotter Pushing Fed's Peak Rate Higher

	Period	Actual	Forecast	Previous
Consumer Spending (nominal)	January 2023	1.8 percent	1.4 percent	-0.1 percent
Personal Income (nominal)	January 2023	0.6 percent	1.2 percent	0.3 percent
PCE Index	January 2023	0.6 percent		0.2 percent
Core PCE	January 2023	0.6 percent	0.5 percent	0.4 percent
PCE (Year-over-year)	January 2022 – January 2023	5.4 percent		5.3 percent
Core PCE (year-over-year)	January 2022 – January 2023	4.7 percent	4.4 percent	4.6 percent

Figure 8. Summary of Consumer Spending, Personal Income, and Personal Consumption Expenditure Data Released on Friday, February 24

January's Data on inflation and consumer spending came in hotter than expected. This makes a case for more rate hikes in the next three FOMC meetings this year.

The Fed's preferred inflation gauge - the personal consumption expenditure (PCE) index - rose by 0.6 percent both for headline and core (excluding food and energy), according to data released on Friday, February 24th by the Bureau of Economic Analysis (BEA). Year-over-year (YoY) headline inflation is 5.4 percent, and core inflation is 4.7 percent. The Core PCE exceeded analysts' expectations of 0.5 percent month-over-month (MoM) and 4.4 percent YoY.

MEETING PROBABILITIES							
MEETING DATE	450-475	475-500	500-525	525-550	550-575	575-600	600-625
3/22/2023	0.0%	73.0%	27.0%	0.0%	0.0%	0.0%	
5/3/2023	0.0%	0.0%	69.3%	29.3%	1.4%	0.0%	0.0%
6/14/2023	0.0%	0.0%	21.7%	56.8%	20.5%	0.9%	0.0%
7/26/2023	0.0%	0.0%	14.7%	45.5%	32.2%	7.3%	0.3%
9/20/2023	0.0%	0.0%	14.7%	45.5%	32.2%	7.3%	0.3%
11/1/2023	0.0%	2.0%	19.0%	43.7%	28.8%	6.3%	0.3%
12/13/2023	0.7%	8.2%	27.9%	38.3%	20.6%	4.1%	0.2%

Figure 9. FOMC meeting probabilities for Federal Reserve Interest Rate (Source: CME group)

The previous market expectation that the Fed's policy tightening cycle will pause early this year is fading as inflation seems to be deeply entrenched across the US economy. In the beginning of the year, the market anticipates two more rate hikes that will peak at 5.25 percent on May. Now, the market expects the Fed to continue raising interest rates until the June 2023 FOMC meeting. The probability of a 5.5 percent peak rate in June 2023 rose to 56.8 percent as of February 24th compared to 0.6 percent, just a month ago.

TARGET RATE (BPS)	PROBABILITY(%)			
	NOW *	1 DAY 24 FEB 2023	1 WEEK 17 FEB 2023	1 MONTH 25 JAN 2023
425-450	0.0%	0.0%	0.0%	0.2%
450-475 (Current)	0.0%	0.0%	0.0%	11.2%
475-500	0.0%	0.0%	2.7%	56.0%
500-525	21.7%	21.7%	34.4%	32.1%
525-550	56.8%	56.8%	52.9%	0.6%
550-575	20.5%	20.5%	10.0%	0.0%
575-600	0.9%	0.9%	0.0%	0.0%

* Data as of 25 Feb 2023 05:36:36 CT

Figure 10. FOMC Meeting Probabilities for June 2023: The Probability of a 5.5 percent peak target rate increased significantly from a month ago (Source: CME Group)

With consumer spending also up 1.8 percent, the increase is the most significant in over two years. The *Wall Street Journal* had a forecast of a 1.4 percent increase. However, the surge was driven by unusually strong auto sales last month and is unlikely to be sustained.

Income also grew by 0.6 percent, mostly from a one-time, 8.7 percent increase in Social Security benefits - the most significant cost-of-living increase in four decades.

Americans went on a spending spree last month. Their spending power comes from the extra savings socked away from the pandemic when people had reduced spending opportunities, while the government also bolstered bank accounts with the relief checks that was given to every citizens. However, if American consumers continue to deplete their savings at the same rate for the past two quarters, we expect a brutal hit on their spending power later this year.

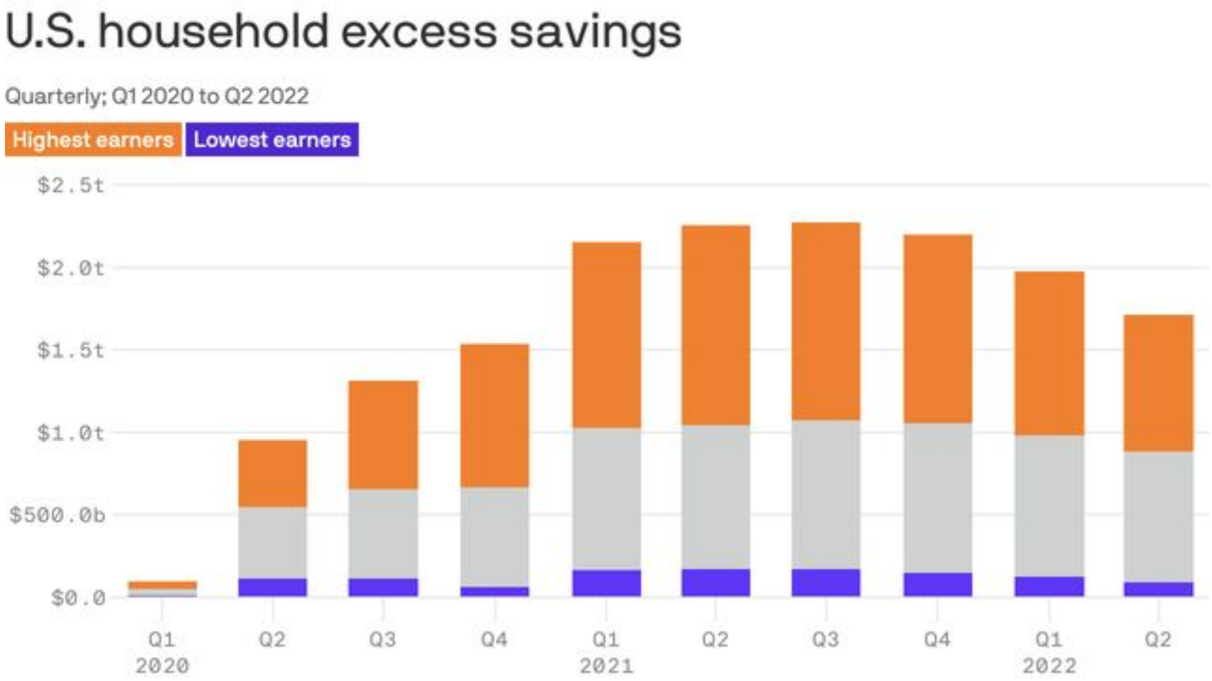


Figure 11. The Depleting Savings of American Households

Before the Consumer Spending and PCE inflation data was released week, the preliminary S&P Global PMI data had given some hope of a "soft landing" scenario as the economy showed resilience despite the substantial rate hikes. A soft landing is a scenario when the economy slows down without entering a recession. However, the red-hot inflation and spending data for January indicated that the overall demand remains robust. This is not good news for the Fed, which is trying to bring down demand.

The Federal Reserve has been clear that the risk of doing too little outweighs the risk of doing too much. Last Friday's spending and inflation data signals that the economy is still hot which strengthens the case for more massive rate hikes. Hence, we expect the Fed to raise interest rates three more times in the March, May, and June FOMC meetings. The risk of a 50-basis point hike in March remains on the table as critical economic metrics in January prove that inflation will remain sticky this year.

WHAT'S ON-CHAIN THIS WEEK?

Long-Term Hodlers Accumulating

Long-term hodlers have collectively accumulated approximately 18,000 BTC over the past week.
The Long-Term Holder Supply has continued to push higher. Long-term hodlers constituting a sizable portion of the BTC supply is a crucial on-chain feature of bear market bottoms, and is a positive signal, taking place amid a 40 percent increase in price, since the start of this year.

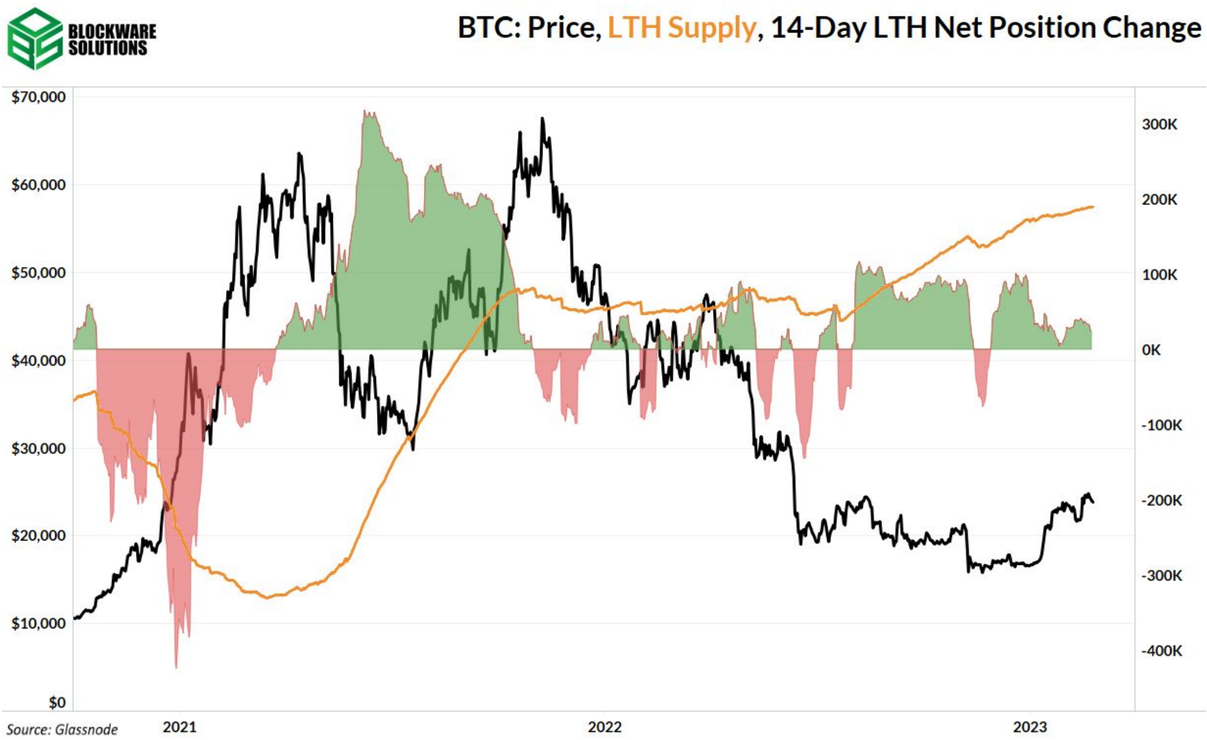


Figure 12. BTC Long-Term Holder Supply - orange line. (source: blockware intelligence)

Last week, we witnessed a dip in the price of Bitcoin to $22,800, as *Bitfinex Alpha* predicted based on the options market positioning discussed last week. We also saw large wallet inflows or whale inflows last week.

Figure 13. Whale-size wallet on-chain inflows for Bitcoin. (source: Whalemaps)

As per *Whalemaps* data, whale wallet inflows recorded on Friday, the 25th of February alone, were close to 6,000 BTC. Inflows at this level were last recorded at this metric on the 14th of February before the run-up to $25000 per BTC.

It is important to note that while this is not an immediate buy signal, it does indicate that whales and long-term holders still have confidence in Bitcoin price appreciation. Historically, whales have continued to accumulate through even 100 percent moves (for example when the price rose from $3k-6k in 2019) during the end of the bear market; such was the case during the 2019 bear market rally and the 2020 flash crash when the pandemic sent risk assets crashing.

Options Market Sentiment Bullish Again

The 25-percent delta skew of all Bitcoin options remained slightly above zero on Friday, February 24th, implying a modestly positive market bias for the next trading week. Bitcoin options expiring in seven, 30, 60, 90 and 180 days collectively remained positive until the weekly close. The delta skew metrics have been a great tool to monitor market sentiment for more “experienced” market participants.

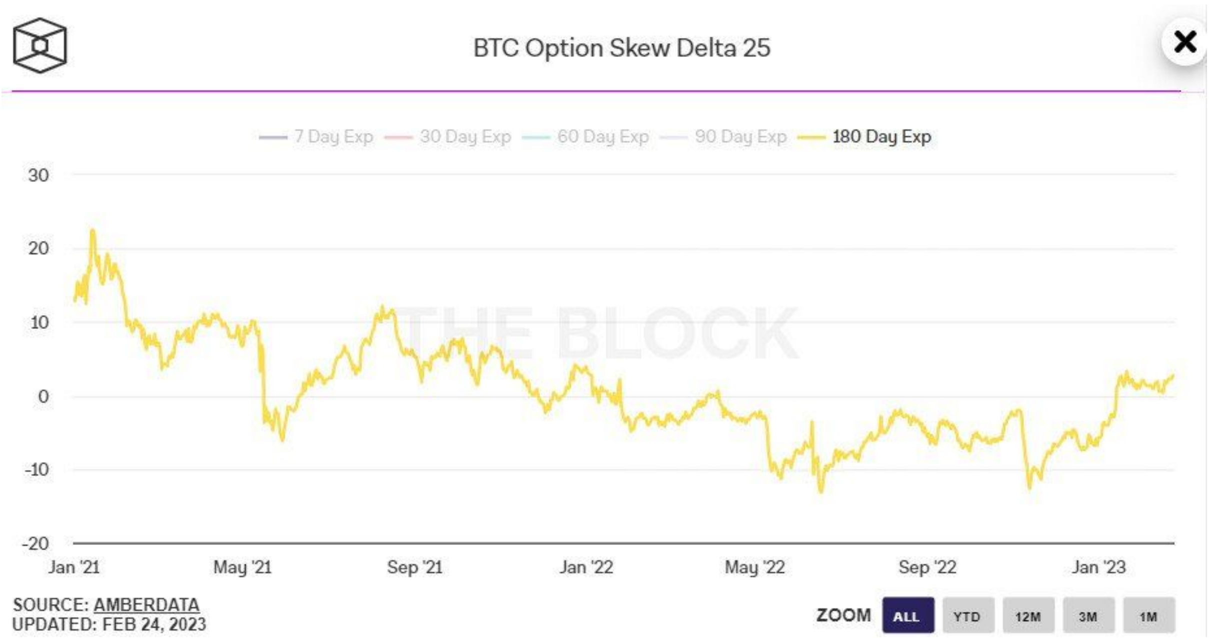


Figure 14. BTC Option Skew Delta 25 with 180-day expiry. (source: The Block)

In fact, the 180-day 25-percent Delta skew was last at 2.74, which is very close to the metric’s highest so far this year of 3.28. This suggests that the sentiment across options desks is trending bullish again after a week of remaining neutral; this was accompanied by BTC price dipping to $22800.

The 25-percent delta options skew is a popularly monitored proxy measuring the degree to which trading desks are over or undercharging for upside or downside protection via the put and call options they are selling to investors. Put options give an investor the right but not the obligation to sell an asset at a predetermined price. In contrast, a call option provides an investor with the right but not the obligation to buy an asset at a predetermined price.
25-percent delta options skew above zero suggests that desks are charging more for equivalent call options versus puts. This implies there is a higher demand for calls versus puts, which can be interpreted as a bullish sign as investors are more eager to secure protection against (or bet on) a rise in prices.

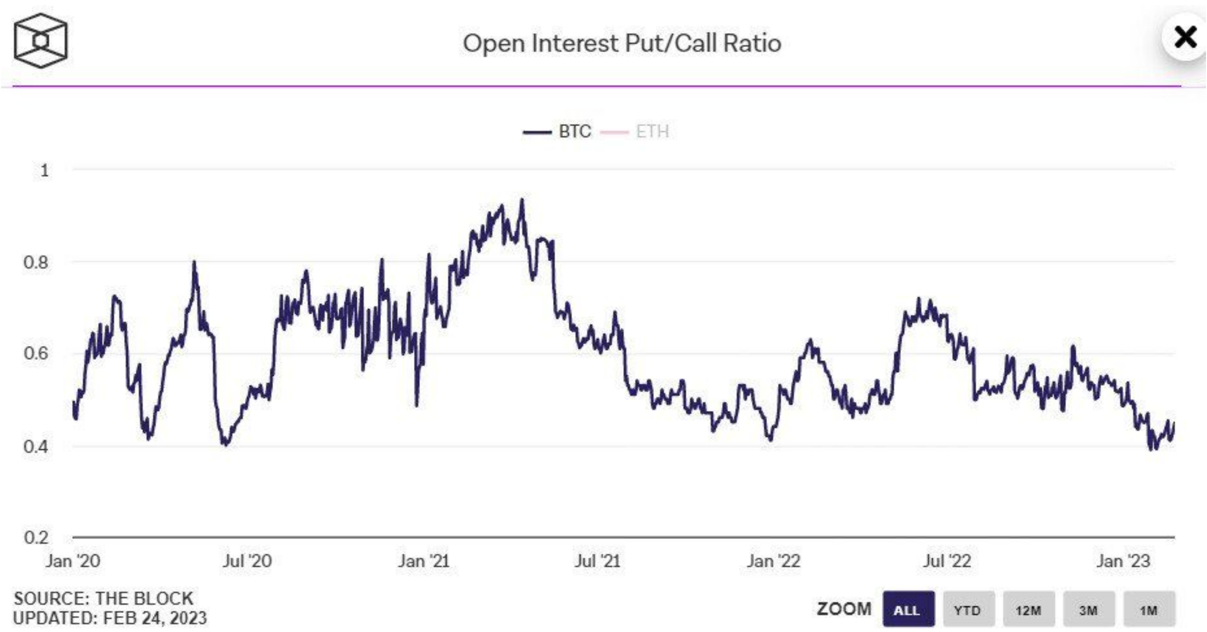


Figure 15. BTC Put/Call Ratio Open Interest. (source: The Block)

Deribit data recorded on Friday reported a put vs call ratio for BTC options at 0.45. This was close to the all-time low recorded for the metric in January 2023, which was just under 0.4.

NEWS FROM THE CRYPTO-SPHERE

Coinbase Launches Layer Two Blockchain

Figure 16. Coinbase has just released a new Layer two blockchain solution called Base

On February 23rd, Coinbase announced the launch of its new layer two blockchain network called Base, which is built on Optimism's OP Stack.

Opimtism's OP Stack is an open-source toolkit for developers that provides various tools for building decentralised applications on layer two scaling solutions.

According to Coinbase, Base is an Ethereum Layer two network offering a secure, low-cost, developer-friendly way to build decentralised apps or "DApps" on-chain. It is designed to deliver the security and scalability of Ethereum at a fraction of the cost, and was built on the OP Stack so that it can remain decentralised, permissionless, and open to anyone.

Additionally, Coinbase made it clear that it has no plan to issue a new network token for Base, and that it will use ETH as the native gas token.

Finally, Coinbase announced the creation of the Base Ecosystem Fund, which will provide investment and support to early-stage projects that are building on Base and meet specific investment criteria.

Ethereum Shanghai upgrade on Sepolia is set for February 28th

Figure 17. The Shanghai-Capella Ethereum upgrade on the Sepolia test network has been officially scheduled.

According to an official announcement by the core developers of the Ethereum blockchain, the Shanghai-Capella upgrade, also known as Shapella, is scheduled to launch on the Sepolia test network on February 28th.

In general, the upgrade aims to enable Ethereum withdrawals from the network, which was not possible during Ethereum's transition to a Proof-of-Stake (PoS) consensus.

To ensure the successful deployment of Shapella on the mainnet in March, multiple phases of public testing have been planned. The upcoming launch on Sepolia is the second public testnet, with the first being the Zhejiang testnet earlier this month.

After the launch on Sepolia, developers will move to the next testnet called Goerli, for the final phase of testing before the mainnet launch, which is expected to take place in early March.

You can read a fuller description of the Shanghai upgrade on the Bitfinex blog here.

Binance Closed Derivative Positions of 500 Australian Users

Figure 18. Binance said it will fully compensate these users for their loss

On February 23rd, Binance announced it had closed the derivatives positions of some Australian customers because they were incorrectly classed as "wholesale investors".

Binance Australia says it has been compliant with local regulations that prohibit retail traders from trading futures and financial derivatives products on the platform. As a result, only its customers who are categorised as "wholesale clients" are permitted to engage with these products on Binance Australia.

Binance said that its decision to close some derivatives positions of its customers was in order to stay compliant, and that the impacted 500 customers had already been contacted and would be fully compensated for any losses.

Following the incident, The Australian Securities and Investments Commission (ASIC) told *Bloomberg* that it's conducting a "targeted review" of the local derivatives business of Binance.

The ASIC spokesperson confirmed that the ASIC is aware of Binance's social media posts stating that it had incorrectly classed a group of Australian consumers as wholesale investors. Adding that Binance Australia "has not yet reported these matters to ASIC in accordance with its obligations under its Australian financial services licence."

Forsage Founders Indicted in $340M DeFi Crypto Scheme

Figure 19. This is the First Charged Criminal Fraud Case Involving a DeFi Ponzi Scheme according to the Department Of Justice

On February 22, the US Department Of Justice (DOJ) reported that the founders of Forsage were indicted for operating an alleged Ponzi scheme worth $340 million, which was falsely presented as a decentralised finance (DeFi) investment platform.

Forsage used to be promoted as a program on the Ethereum network where members can earn profits through matrix levels. The matrix levels are positions that need to be filled with new members. Participants can join by sending Ethereum to the Forsage smart contract address. When a participant refers new members to join using their unique link, these members will be placed in the participant's downline. As a result, the participant will receive a commission on the amount of Ethereum that the new member purchased a position with, and as the downline grows, participants can earn commissions from multiple levels of the matrix, creating a passive income stream.

According to the Department of Justice, the four Russian founders, Vladimir Okhotnikov, Olena Oblamska, Mikhail Sergeev, and Sergey Maslakov, are allegedly accused of aggressively promoting Forsage to the public through social media as a legitimate and lucrative business opportunity, while in reality, Forsage operated as a Ponzi and pyramid investment scheme that took in approximately $340 million from victim-investors around the world.

The DOJ claims that Forsage founders diverted funds from investors into their own cryptocurrency accounts. Adding that, blockchain analytics confirmed that over 80 percent of Forsage investors received fewer ETH back than they had invested in Forsage's Ethereum program, with over 50 percent of investors never receiving any single payout.

The four Russian founders are each charged with conspiracy to commit wire fraud. If convicted, the defendants could face a maximum penalty of 20 years in prison.

Furthermore, the DOJ urged all investor victims of the Forsage scheme to visit their webpage to identify themselves as potential victims and obtain more information on their rights as victims, including the ability to submit a victim impact statement.

Crypto Hedge Fund Galois Capital is closing due to half assets stuck on FTX

Figure 20. Galois Capital is shutting down

On February 20th, it was reported by *The Financial Times* that crypto hedge fund Galois Capital is closing its doors due to half of its assets being trapped on FTX.

According to a letter seen by *The Financial Times*, Galois' clients will receive up to 90 percent of the money not trapped on FTX, while the remaining ten percent would be temporarily held back until discussions with the administrators and auditor were finalised.

Kevin Zhou, co-founder of Galois Capital, expressed in the letter, how terribly sorry he is about the situation, adding that: "given the severity of the FTX situation, we do not think it is tenable to continue operating the fund both financially and culturally."

Galois Capital confirmed the news stating that it's true that their flagship fund is shutting down, adding that the crypto hedge fund is still proud of being "amongst the few who are closing shop with an inception to date performance which is still positive", in spite of losing almost half of their assets to the FTX disaster.

Sam Bankman-Fried hit with four further criminal charges

Figure 21. Former FTX CEO Sam Bankman-Fried

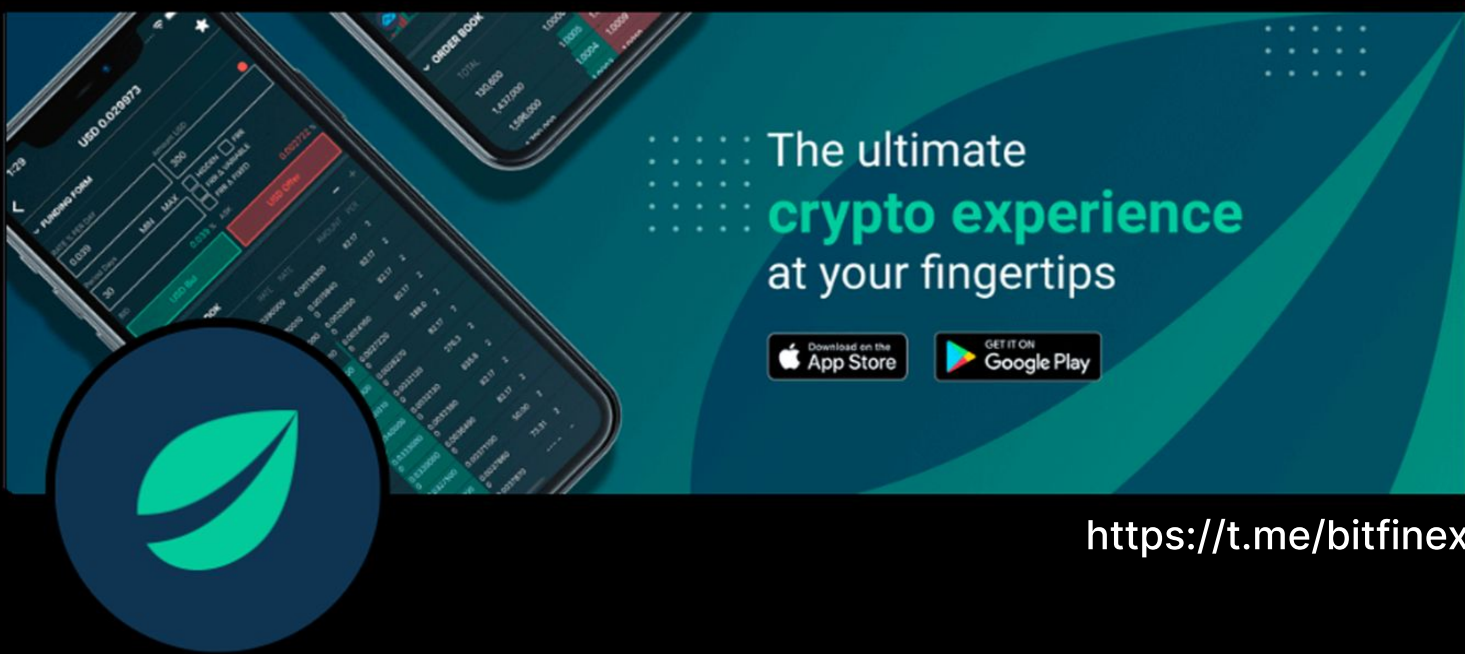
On February 23, it was reported that Sam Bankman-Fried has been charged with new criminal allegations in an expanded indictment.

Sam Bankman-Fried (SBF), has been charged with four new criminal counts related to commodities fraud, illegal political contributions, money laundering, and operating an unlicensed money transmitting business. If convicted, he could face an additional 40 years in prison.

SBF was originally charged with eight criminal counts in December 2022 to which he has pleaded not guilty, adding the four new charges brings the total number of criminal counts against SBF to 12.

The document also alleged that SBF made false and misleading tweets and sought to influence politicians of both major US political parties by donating tens of millions of dollars to campaigns, some of which were allegedly made in the names of others to obscure the true source of the money and evade federal election law.

The new chargesheet includes evidence that appears to come from two of SBF's closest former colleagues, the head of FTX's trading affiliate Alameda, Caroline Ellison, and FTX co-founder Gary Wang.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