BITFINEX Alpha

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EXECUTIVE SUMMARY

We start this week's Bitfinex Alpha with a deep dive into the extraordinary collapse of Silicon Valley Bank (SVB) and the de-pegging of USD Coin (USDC). As we explain, the demise of SVB is a classic case of poor risk management in a rising rate environment. The stress being seen on USDC is arguably the same. We don't see a collapse for USDC, but estimate a 'fair' value that is lower than $1.

More fundamentally though, with rates expected to continue rising, investors are migrating to risk-free securities, which ironically is creating additional risk in the financial system. The concentration of capital into short-term securities, instead of lending them out into the broader market, heightens the risk of reduced liquidity in the banking system. For smaller banks with reduced access to sources of funding this becomes a source of stress, with the closure of SVB an example of what can happen. Bank stocks have already begun falling as a consequence.

Despite all this, economic indicators still hint at a robust broader economy. Hiring still remains strong, but the pace of growth is beginning to slow, suggesting that Fed's long-running attempts to tame inflation are starting to work. In the absence of a significant change however, the market is now pricing in a 50 basis point hike at the FOMC meeting next week.

Amidst these macro headwinds, and the SVB and USDC crisis, the Bitcoin price depreciated to $19500 last week, moving below the February low, before rebounding. The Bitcoin options market also took a negative view on future prices in the near-term, with the 25 percent delta skew on options expiring in one week, falling to its lowest since December. Net realised losses on Bitcoin have also spiked, but a deeper look reveals that it is relatively new investors sitting on losses, while longer-term holders remain unperturbed. Indeed, even in the options market, while the 25 per cent delta skew on one week, 30-day and 60-day options are negative, the skew on longer dated options at 90 and 180 days is closer to zero, indicating that any fall in prices is unlikely to be sustained.

In the meantime, the crypto news agenda remains full. In the last week, Silvergate Bank announced that it would wind down its operations and liquidate its assets, following recent developments in the industry; Blockchain.com suspended its asset management subsidiary, Blockchain.com Asset Management (BCAM), citing the prolonged crypto winter; and the New York Attorney General sued cryptocurrency exchange KuCoin for allegedly operating in the state without proper registration. In more positive news, Voyager Digital has been granted court approval to sell its assets and transfer its customers to Binance.US in a deal worth $1.3 billion; and FTX Trading and its affiliated debtors continue in their request to recover funds for FTX users, filing a lawsuit against Grayscale Investments and seeking injunctive relief to release $9 billion or more in value for shareholders of the Grayscale Bitcoin and Ethereum Trusts.

Have a good trading week!

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The Failure of Silicon Valley Bank

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Figure 1. Greg Becker, the president and chief executive of Silicon Valley Bank

On Friday, March 10, Silicon Valley Bank (SVB), a key player in the tech and venture capital community, collapsed, making it the second-biggest bank failure in US history, after Washington Mutual in 2008. The Federal Deposit Insurance Corp. (FDIC) has taken control of the bank through a new entity it created called the Deposit Insurance National Bank of Santa Clara. All of SVB's deposits have been transferred to the new bank.

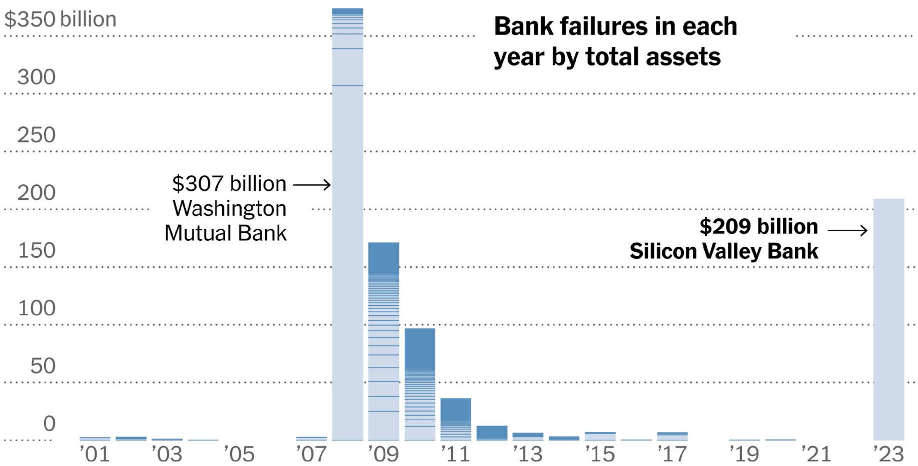

Figure 2. How Silicon Valley Bank's Failure Compares to other major bank collapses (Source: New York Times)

How Banks Make Money from Interest Rates:

The collapse came after Silicon Valley Bank ran out of new avenues to raise capital. To better understand this, let’s take a look at how banks make money from interest rates:

When interest rates rise, most banks benefit because the interest rates they charge clients for loans grow faster than what they pay depositors to keep their money safe. This is kept in check through a profit metric called Net Interest Income (NII).

This metric represents the amount of money a bank receives from lending (to businesses or individuals) minus the amount it pays out to depositors and other sources of funding. The greater the company's profits from lending, and the smaller its payments to its depositors, the higher its net interest income (NII). Although the Federal Reserve sets short-term interest rates, what banks actually offer borrowers when they take out loans is not a representation of the Fed’s targets for borrowing costs but higher.

Consumers' interest rates for mortgage and personal loans rise at a faster pace than the rates that banks offer for deposits. When the Fed raises interest rates at which banks can borrow from the Fed, banks immediately charge borrowers more while putting off the increase in interest rates for depositors. This then leads to an increase in the banks’ NII, with rising interest rates.

However, banks also face higher borrowing costs themselves as interest rates rise. They also get affected by late repayments from customers and counterparties who might not be able to afford the borrowing cost. Problems usually occur when interest rates rise too quickly.

When a bank buys a bond, they are essentially lending money to the issuer of the bond (such as a company). The bond issuer promises to pay the bank interest on the money borrowed and to pay back the original amount borrowed (the principal) at a later date.

However, if interest rates go up, newer bonds issued by the same issuer will offer a higher rate of interest to attract buyers. Since investors can now buy new bonds with higher interest rates, the older bonds that the bank owns become less valuable because they are now worth less compared to the newer, higher-interest bonds.

As a result, if the bank sells the older bonds, they will get less money for them than what they originally paid for them. This means the bank will lose money on the sale of the bond, and this is how rising interest rates can cause a bank's bond portfolio to lose value. If customers withdraw huge amounts of money, usually amidst economic uncertainty, banks will have to tap into their bond holdings and sell them at a loss to raise cash.

That's where SVB ran into problems.

SVB played a significant role in the growth of the technology industry in the United States. Founded in 1983, SVB was one of the first banks to recognise the potential of the emerging technology industry and catered to the financial needs of start-ups and venture capitalists. Start-ups and capital venture firms usually require frequent capital infusions from investors to keep their business running. This worked well when interest rates were close to zero (the rate at which Fed lent to banks) and money was easily accessible – not so much when the Fed started aggressively raising interest rates.

The Fed's tightened monetary policy is just one contributing factor to SVB's demise. **Here is the sequence of events that lead to the second-biggest bank failure in US history:**

1. **Massive increase in deposits:**

Jamie Quint, a general partner at Uncommon Capital, explained in a tweet that SVB experienced a significant increase in deposits between the end of 2019 and the end of 2021, with the net deposit value rising from $61.76 billion to $189.20 billion.

However, SVB was unable to generate the desired yield on this capital as its loan book did not expand fast enough. Therefore, SVB utilised a significant portion of these deposits, over $80bn, to purchase mortgage-backed securities (MBS) for its hold-to-maturity portfolio. These mortgage-backed securities had a duration of 10+ years, and 97 percent of them had a weighted average yield of 1.56 percent.

SVB thus owned a disproportionately large amount of low-yielding fixed-rate assets that weren't due to mature for quite some time.

2. **The Fed raised rates:**

SVB's MBS value experienced a significant decline in value due to the Federal Reserve's relentless increase in interest rates in 2022. The decline occurred because investors can now acquire long-term "low-risk" bonds from the Federal Reserve with a yield that is 2.5 times greater, which is causing the value of existing bonds to collapse.

Moreover, SVB's current customers, comprising many start-ups and tech companies, were also not receiving new funds from VC's and hence deposits at SVG were not rising. It also became more expensive to attract new deposits as savers expected rates at the bank to increase along with Fed's rate hikes. At the end of 2022, deposits were $173 billion, down from nearly $200 billion in March 2022.

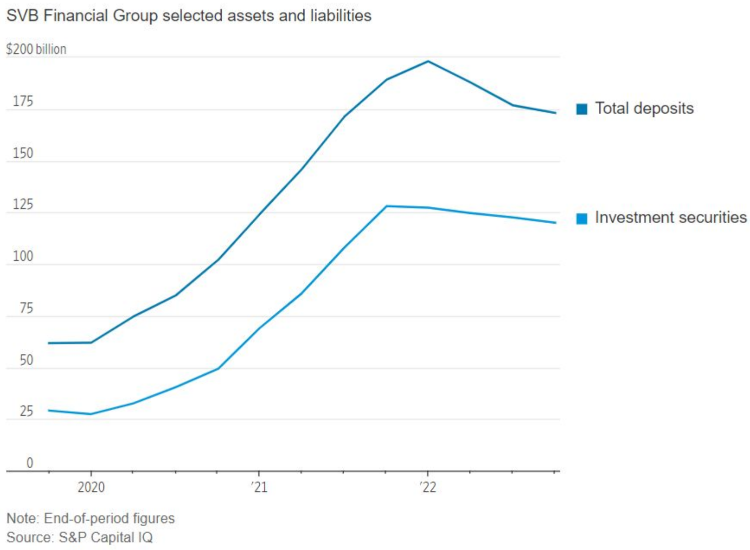

Figure 3. SVB Financial Group Selected Assets and Liabilities (Source: S&P Capital IQ)

3. Moody's threat to downgrade SVB's rating:

Moody's Investors Service, often referred to as Moody's, is a bond credit agency that ranks the creditworthiness of borrowers on the basis of assessed risk and the borrower's ability to make interest payments.

In the week before the collapse, Moody's informed SVB Financial, the bank's holding company, that it was facing a potential downgrade of its credit rating.

4. SVB sells bond portfolio at a loss:

On Wednesday, March 8, SVB announced it had sold $21 billion worth of securities at a loss of around $1.8 billion after taxes. The bank's goal was to reset interest earnings with the current higher yields and to have balance-sheet flexibility to weather possible outflows without halting its ability to fund new loans. Additionally, they intended to sell $2.25 billion in common equity and preferred convertible stock to fill SVB's funding hole.

Data by Unusual Whales also showed that since the beginning of 2023, there was significant selling of SVB stock by company insiders, including its CEO, Greg Becker, who sold $3.57 million worth of SVB Financial stock within the last two weeks alone.

Powered by unusualwhales.com

Ticker	Name	Amount	Owned After	Filing date	Trans date	Trans Code
SIVB	BECKER GREGORY W	-1.60K	92.6K	2/28/2023	2/26/2023	S
SIVB	BECKER GREGORY W	-899.00	104K	2/28/2023	2/26/2023	S
SIVB	BECKER GREGORY W	4.45K	101K	2/28/2023	2/26/2023	M
SIVB	BECKER GREGORY W	-4.00K	4K	2/28/2023	2/26/2023	M
SIVB	BECKER GREGORY W	-4.00K	0	2/28/2023	2/26/2023	M
SIVB	BECKER GREGORY W	-4.45K	8K	2/28/2023	2/26/2023	M
SIVB	BECKER GREGORY W	4K	105K	2/28/2023	2/26/2023	M
SIVB	BECKER GREGORY W	-6.28K	94.2K	2/28/2023	2/26/2023	S
SIVB	BECKER GREGORY W	4K	96.6K	2/28/2023	2/26/2023	M
SIVB	BECKER GREGORY W	-3.67K	100K	2/28/2023	2/26/2023	S

Figure 4. A majority of sales of SVB Financial stock was by insiders since the beginning of 2023 (Source: Unusual Whales)

5. SVB's stock collapse:

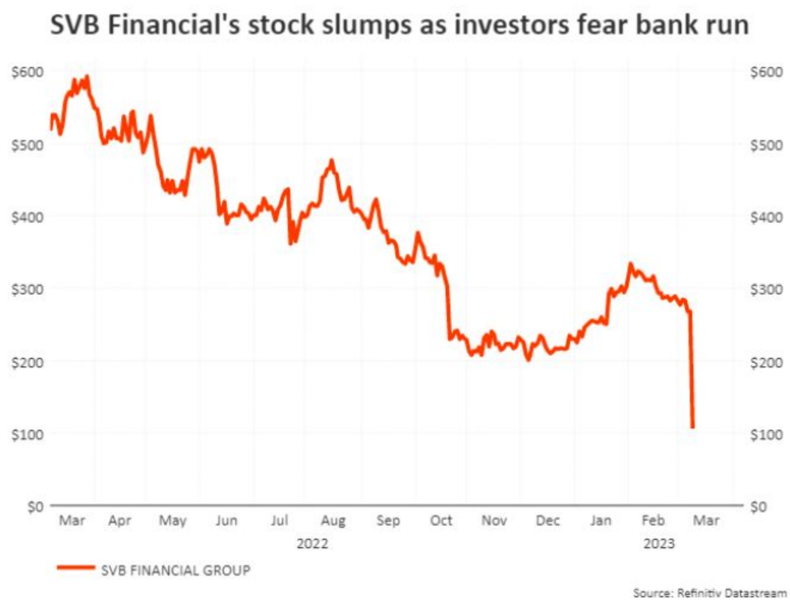

Figure 5. SVB Financial's Stock Slumps as Investors Fear bank Run (Source: Refintiv Datastream)

Following the SVB statement on Wednesday night, that it had sold securities on the balance sheet at a loss, the bank's situation worsened further. Venture capital firms had reportedly begun pressuring their portfolio companies to move their funds out of SVB. Investors who thought that SVB had enough liquidity to avoid selling its Available-For-Sale(AFS) securities portfolio started pulling their money from the bank, which led its stock to collapse by 60 percent and wiped out over $80 billion in value from the bank's parent company's shares.

6. SVB goes into receivership:

On Thursday, March 9, customers attempted to withdraw $42 billion of deposits, but SVB ran out of cash. SVB failed to find alternative funding and the Federal Deposit Insurance Corporation (FDIC) declared that SVB was closed and placed under its receivership.

What will happen to the depositors' funds?

Several of the bank's deposits are more than the maximum amount insured by the Federal Deposit Insurance Corporation (FDIC). SVB estimated that the amount of deposits that are above the FDIC insurance limit was $151.5 billion by the end of 2022.

The FDIC announced in a statement on Friday, March 10 that clients will have full access to their insured deposits by Monday morning, March 13. About 2.7 percent of SVB deposits are less than $250,000, while the rest of 97.3 percent above $250,000 are not insured. FDIC said that uninsured depositors will receive a "receivership certificate" where they can get future dividend payments when FDIC sells off SVB's assets.

	Company Name	Ticker	4Q22 (%)	2021 (%)	2020 (%)	2019 (%)	2018 (%)
1	Northwest Bancshares, Inc.	NWBI	64.5	65.0	66.3	71.6	72.5
2	NBT Bancorp Inc.	NBTB	55.8	52.9	55.0	51.8	53.6
3	WesBanco, Inc.	WSBC	53.8	55.3	58.1	60.1	62.1
4	Glacier Bancorp, Inc.	GBCI	53.0	51.3	56.6	62.8	65.3
5	Regions Financial Corporation	RF	52.5	49.9	50.1	53.3	54.1
6	First Hawaiian, Inc.	FHB	52.2	38.5	41.2	43.1	40.8
7	Independent Bank Corp.	INDB	51.5	51.8	52.4	57.5	56.9
8	Capital One Financial Corporation	COF	50.6	54.1	57.6	60.3	61.3
9	First National of Nebraska, Inc.	FINN	50.4	45.4	49.2	55.4	55.8
10	Commerce Bancshares, Inc.	CBSH	50.2	44.2	46.3	53.2	52.5
11	First Citizens BancShares, Inc.	FCNC.A	50.2	45.6	49.3	55.1	56.1
12	Webster Financial Corporation	WBS	50.1	56.8	58.8	62.2	64.5
13	Community Bank System, Inc.	CBU	50.1	49.0	51.6	55.4	56.7
14	Simmons First National Corporation	SFNC	50.0	42.5	47.0	47.2	49.0
15	First Bancorp	FBNC	49.8	46.8	50.8	55.4	60.8
16	First Interstate BancSystem, Inc.	FIBK	49.6	46.9	51.1	57.1	57.6
17	Umpqua Holdings Corporation	UMPQ	49.5	45.6	48.1	50.6	53.0
18	First Financial Bancorp.	FFBC	49.3	46.8	50.5	56.7	57.1
19	Banner Corporation	BANR	49.2	49.0	50.7	56.1	60.0
20	Fulton Financial Corporation	FULT	49.2	48.4	49.9	54.0	53.0
21	United Bankshares, Inc.	UBSI	48.9	49.8	52.4	50.5	51.7
22	Washington Federal, Inc.	WAFD	48.7	49.2	54.7	63.6	66.5
23	International Bancshares Corporation	IBOC	47.6	46.7	50.3	52.7	52.6
24	Merchants Bancorp	MBIN	47.2	36.7	26.5	47.5	40.3
25	First Busey Corporation	BUSE	46.7	44.8	46.8	51.9	58.6

Figure 6. Bank Deposits Less than $250k as a Percentage of Total Deposits (Source: S&P Global Market Intelligence) Part 1/4

	Company Name	Ticker	4Q22 (%)	2021 (%)	2020 (%)	2019 (%)	2018 (%)
26	Atlantic Union Bankshares Corporation	AUB	46.4	45.4	48.3	51.5	58.6
27	M&T Bank Corporation	MTB	46.4	33.7	37.6	40.9	41.4
28	Old National Bancorp	ONB	45.9	49.9	51.8	56.2	58.4
29	Citizens Financial Group, Inc.	CFG	45.4	43.1	42.8	47.8	52.3
30	SouthState Corporation	SSB	45.0	45.9	50.9	47.6	53.5
31	United Community Banks, Inc.	UCBI	44.8	43.7	48.7	55.4	58.1
32	Trustmark Corporation	TRMK	44.7	42.8	43.5	49.6	49.0
33	Eastern Bankshares, Inc.	EBC	44.5	36.3	44.7	51.0	53.0
34	The PNC Financial Services Group, Inc.	PNC	44.5	41.3	40.4	44.4	46.9
35	Fifth Third Bancorp	FITB	44.1	36.8	37.6	41.1	45.5
36	Berkshire Hills Bancorp, Inc.	BHLB	44.1	40.7	50.2	56.0	59.1
37	F.N.B. Corporation	FNB	43.3	44.2	46.4	52.2	56.7
38	Customers Bancorp, Inc.	CUBI	43.1	19.3	26.3	35.3	36.7
39	Sandy Spring Bancorp, Inc.	SASR	43.1	38.1	42.6	45.7	50.3
40	Associated Banc-Corp	ASB	43.0	41.7	41.4	42.7	45.5
41	Wintrust Financial Corporation	WTFC	42.9	41.2	44.4	48.7	50.0
42	First Merchants Corporation	FRME	42.8	40.1	42.5	46.7	49.4
43	Truist Financial Corporation	TFC	42.8	41.9	43.1	44.8	45.8
44	Wells Fargo & Company	WFC	41.6	40.6	40.2	39.2	40.9
45	Huntington Bancshares Incorporated	HBAN	41.1	63.2	63.4	66.5	63.4
46	Prosperity Bancshares, Inc.	PB	40.9	40.0	45.4	43.7	47.4
47	Renasant Corporation	RNST	40.8	39.3	43.2	47.4	49.6
48	First BanCorp.	FBP	40.7	39.1	46.1	53.5	56.9
49	Heartland Financial USA, Inc.	HTLF	40.6	37.8	41.1	40.2	44.5
50	PacWest Bancorp	PACW	40.0	29.6	32.4	32.7	26.2

Figure 7. Bank Deposits Less than $250k as a Percentage of Total Deposits (Source: S&P Global Market Intelligence) Part 2/4

	Company Name	Ticker	4Q22 (%)	2021 (%)	2020 (%)	2019 (%)	2018 (%)
51	KeyCorp	KEY	40.0	37.4	40.0	41.3	45.1
52	OceanFirst Financial Corp.	OCFC	39.9	35.2	43.0	45.6	49.9
53	Silvergate Capital Corporation	SI	39.7	0.6	1.4	22.1	6.6
54	Synovus Financial Corp.	SNV	39.6	34.4	37.6	45.5	48.4
55	Hancock Whitney Corporation	HWC	39.5	38.2	40.3	43.3	45.5
56	First Financial Bankshares, Inc.	FFIN	39.2	39.4	43.0	45.2	47.1
57	Bank of Hawaii Corporation	BOH	39.0	39.8	41.5	41.9	43.3
58	First Horizon Corporation	FHN	39.0	36.2	40.6	46.6	48.1
59	Ameris Bancorp	ABCB	38.5	38.6	44.2	50.1	49.7
60	Popular, Inc.	BPOP	38.5	34.6	38.7	40.9	44.5
61	Home Bancshares, Inc. (Conway, AR)	HOMB	38.5	38.7	38.9	39.4	43.1
62	Cadence Bank	CADE	37.6	41.0	50.2	52.7	55.6
63	Pinnacle Financial Partners, Inc.	PNFP	37.6	35.7	41.9	43.2	41.4
64	U.S. Bancorp	USB	37.4	37.6	36.5	36.9	37.5
65	Cathay General Bancorp	CATY	36.9	34.4	43.2	47.0	46.8
66	Columbia Banking System, Inc.	COLB	36.7	36.7	40.3	44.8	46.4
67	Valley National Bancorp	VLY	36.4	34.9	42.6	50.5	47.0
68	Bank OZK	OZK	35.7	38.4	52.3	46.1	40.3
69	Enterprise Financial Services Corp	EFSC	35.7	33.7	46.6	46.5	42.2
70	Pacific Premier Bancorp, Inc.	PPBI	35.2	28.4	30.9	37.7	41.6
71	TowneBank	TOWN	34.8	33.6	39.2	43.2	44.9
72	Zions Bancorporation, National Association	ZION	34.3	28.3	33.0	37.8	38.2
73	FB Financial Corporation	FBK	34.1	32.7	35.5	48.6	48.1
74	Independent Bank Group, Inc.	IBTX	33.8	30.7	35.9	38.3	35.2
75	JPMorgan Chase & Co.	JPM	32.0	29.4	29.8	31.1	30.3

Figure 8. Bank Deposits Less than $250k as a Percentage of Total Deposits (Source: S&P Global Market Intelligence) Part 3/4

	Company Name	Ticker	4Q22 (%)	2021 (%)	2020 (%)	2019 (%)	2018 (%)
76	Bank of America Corporation	BAC	30.8	29.0	30.8	31.8	31.2
77	Dime Community Bancshares, Inc.	DCOM	30.6	29.1	23.2	28.4	29.0
78	Farmers & Merchants Bank of Long Beach	FMBL	30.6	29.1	33.0	37.6	38.4
79	Cullen/Frost Bankers, Inc.	CFR	30.3	29.0	31.9	36.3	35.6
80	Eagle Bancorp, Inc.	EGBN	30.2	37.3	41.3	42.7	37.1
81	Hope Bancorp, Inc.	HOPE	30.0	30.4	35.2	45.1	50.6
82	BankUnited, Inc.	BKU	29.2	28.5	32.0	36.7	35.0
83	Comerica Incorporated	CMA	28.7	24.1	31.5	32.2	32.0
84	Hilltop Holdings Inc.	HTH	28.6	20.0	29.4	34.0	36.9
85	W.T.B. Financial Corporation	WTBF.B	28.0	26.0	27.2	32.7	35.4
86	BOK Financial Corporation	BOKF	26.1	25.5	31.2	34.8	34.7
87	Western Alliance Bancorporation	WAL	23.2	19.0	20.8	26.2	27.5
88	Texas Capital Bancshares, Inc.	TCBI	20.8	14.3	18.2	20.4	22.8
89	East West Bancorp, Inc.	EWBC	20.5	20.1	22.6	32.2	26.5
90	CVB Financial Corp.	CVBF	20.4	18.9	20.5	26.6	28.8
91	First Republic Bank	FRC	19.8	14.4	18.7	23.6	22.7
92	First Foundation Inc.	FFWM	18.9	20.0	22.4	22.1	22.1
93	UMB Financial Corporation	UMBF	17.7	16.0	20.5	28.6	30.4
94	ServisFirst Bancshares, Inc.	SFBS	16.2	15.1	17.4	19.9	20.4
95	Citigroup Inc.	C	15.0	15.9	16.6	16.8	15.0
96	Signature Bank	SBNY	6.2	4.8	7.4	11.5	11.6
97	State Street Corporation	STT	4.3	4.5	4.7	2.7	0.4
98	Northern Trust Corporation	NTRS	4.0	4.5	5.6	7.5	6.8
99	SVB Financial Group	SIVB	2.7	2.3	2.3	3.5	4.0
100	The Bank of New York Mellon Corporation	BK	2.3	2.9	4.2	3.3	5.0

Figure 9. Bank Deposits Less than $250k as a Percentage of Total Deposits (Source: S&P Global Market Intelligence) Part 4/4

SVB's Impact on the crypto industry:

After the fallout, numerous crypto companies reported their exposure to the bank.

- Crypto lender BlockFi said it had $227 million in unprotected funds in Silicon Valley Bank, according to a bankruptcy document seen by *The Block*. Moreover, the filing shows that $227 million is not insured by the Federal Deposit Insurance Corporation (FDIC) since it is in a money market mutual fund.

- Circle, the issuer of the world's second-largest stablecoin USDC, said on March 10, that SVB is one of six banking partners Circle uses for managing about 25 percent portion of USDC reserves held in cash. Circle added that it will initiate a wire transfer to remove its funds from SVB.

  Several hours later, Circle announced that the wire transfer was not yet processed and that $3.3 billion of USDC reserves were still with SVB. As a result, USDC lost over 10 percent of its value, trading at one point at $0.8774. We have covered this in detail in the following section.

- The Avalanche Foundation, which supports the Avalanche blockchain, also announced that it has "a little over" $1.6 million exposure to Silicon Valley Bank.

What differentiates SVB and can this happen to other banks?

After what happened to SVB, it is possible that other banks could also face similar issues. Though other banks are also dealing with losses in the value of their bond portfolios, a diversified portfolio of securities holdings potentially protects them. The problem that SVB faced was that they never considered hedging the interest rate risk from their bond investments. A diversity of customer base would also have been helpful to reduce the chance of trouble when one sector cuts deposits.

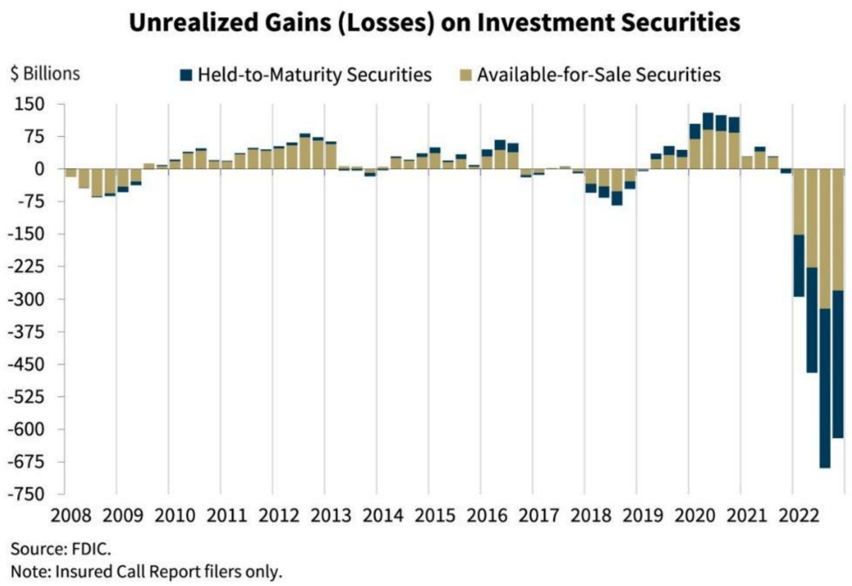

Figure 10. A graph from the FDIC's recent quarterly report showing that banks face a few hundred billion in unrealized losses on securities (Source: FDIC)

Investment Portfolio composition, end of 2022

Ticker	Securities % of Earnings Assets	Treasuries	Agency Debt	State and Political	Agency MBS / CMO	Non-Agency MBS	Agency CMBS	Non-Agency CMBS	ABS	Other	Total
SIVB	57%	14%	1%	6%	64%	0%	14%	0%	0%	2%	100%
CFR	42%	24%	0%	43%	31%	0%	3%	0%	0%	0%	100%
STT	42%	19%	0%	1%	37%	2%	2%	0%	5%	35%	100%
CBSH	41%	8%	0%	14%	32%	7%	3%	3%	28%	4%	100%
BK	41%	28%	5%	0%	30%	1%	3%	2%	1%	29%	100%
BOH	37%	3%	2%	1%	77%	0%	7%	0%	0%	10%	100%
NTRS	37%	5%	6%	6%	15%	0%	19%	3%	11%	34%	100%
BAC	31%	33%	0%	1%	63%	0%	0%	0%	1%	2%	100%
PNC	28%	29%	3%	2%	53%	1%	1%	2%	4%	5%	100%
ZION	28%	2%	7%	9%	67%	0%	14%	0%	0%	2%	100%
KEY	28%	18%	2%	0%	53%	0%	18%	0%	3%	7%	100%
FITB	27%	5%	0%	0%	22%	0%	41%	9%	12%	11%	100%
CADE	27%	12%	12%	4%	55%	0%	14%	0%	0%	3%	100%
TFC	27%	8%	0%	0%	87%	2%	2%	0%	0%	0%	100%
USB	27%	9%	5%	6%	71%	0%	1%	0%	2%	5%	100%
HWC	26%	3%	4%	11%	37%	0%	9%	0%	0%	37%	100%
CMA	25%	14%	0%	0%	61%	0%	19%	0%	0%	6%	100%
SBNY	24%	1%	14%	1%	75%	3%	0%	0%	0%	5%	100%
HBAN	24%	0%	1%	8%	75%	0%	9%	0%	1%	5%	100%
WFC	24%	15%	0%	9%	64%	0%	0%	1%	0%	10%	100%
C	23%	44%	0%	2%	19%	0%	0%	0%	0%	33%	100%
WBS	22%	5%	2%	18%	34%	0%	29%	7%	0%	5%	100%
RF	21%	4%	3%	0%	60%	0%	7%	1%	0%	25%	100%
JPM	19%	47%	0%	4%	25%	2%	4%	2%	1%	14%	100%
CUBI	19%	0%	0%	0%	9%	31%	4%	4%	14%	39%	100%
FNB	19%	4%	6%	14%	59%	0%	17%	0%	0%	1%	100%
ASB	19%	2%	0%	29%	46%	5%	15%	0%	2%	0%	100%
PNFP	18%	4%	12%	50%	7%	0%	13%	0%	5%	8%	100%
SNV	18%	5%	1%	0%	86%	0%	4%	0%	0%	4%	100%
CFG	17%	10%	0%	0%	67%	0%	9%	1%	2%	11%	100%
FULT	16%	6%	0%	28%	20%	0%	34%	0%	0%	11%	100%
FRC	16%	0%	1%	61%	13%	0%	20%	0%	0%	4%	100%
MS	15%	52%	0%	2%	41%	0%	3%	1%	1%	2%	100%
EWBC	15%	13%	16%	3%	28%	7%	10%	7%	1%	17%	100%
WTFC	14%	0%	6%	5%	86%	1%	0%	0%	0%	2%	100%
FHN	14%	0%	11%	6%	60%	0%	17%	0%	0%	5%	100%
MTB	13%	36%	0%	11%	46%	0%	6%	0%	0%	1%	100%
WAL	13%	0%	0%	24%	21%	17%	1%	0%	0%	38%	100%
TCBI	13%	19%	3%	0%	78%	0%	0%	0%	0%	1%	100%
NYCB	11%	16%	15%	0%	24%	2%	27%	0%	4%	11%	100%
GS	8%	98%	0%	0%	0%	0%	0%	0%	0%	2%	100%
Average	24%	15%	3%	9%	46%	2%	10%	1%	2%	11%	100%

Figure 11. SVB Investment Portfolio Composition. (source: MacroAlf)

SVB had over 57 percent of its total assets in its investment portfolio. The average US bank usually limits this to 24 percent. Having an investment portfolio that is a higher percentage of their total assets as compared to other banks is reasonable because they only focused on tech ventures and startups, but the major red flag is the constitution of their investment portfolio itself. Approximately 78 percent of it was in Mortgage Back Securities (MBS) which is 45 percent higher than any other bank of their size.

The fluctuations we have seen in the stock and debt markets over the last 12 months serve as an example of the potential consequences that may arise when the Federal Reserve solely concentrates on combatting inflation through implementing stringent monetary policies. Undoubtedly, the demise of SVB was neither an intended nor a desired outcome of the Federal Reserve's strategy.

Nevertheless, the collapse appeared inevitable as the era of easily obtainable funds comes to an end. The accessibility of low-cost capital had not only fueled the technology sector but also other sectors that are now deemed less feasible due to the possibility of a rise in short-term rates, along with the Federal Reserve's interest rate hikes.

While SVB's legacy as a pioneer in the technology industry is secure, its collapse serves as a stark reminder of the fragility of the financial system and the importance of sound risk management practices. It is a sobering moment for the technology industry too.

USDC Loses Peg and falls by 19 Percent

Coinbase Backed Stablecoin USDC Loses Peg and falls by 19 Percent

USDC, the second-largest crypto stablecoin linked to the dollar, lost its peg to the U.S. currency amid a spike in investor withdrawals after its issuing organisation, Circle Internet Financial Ltd., reported it had $3.3 billion invested in the now-collapsed Silicon Valley Bank. USDC's market cap dropped to $37 billion from $43.5 billion following the announcement by Circle on Saturday, March 11th.

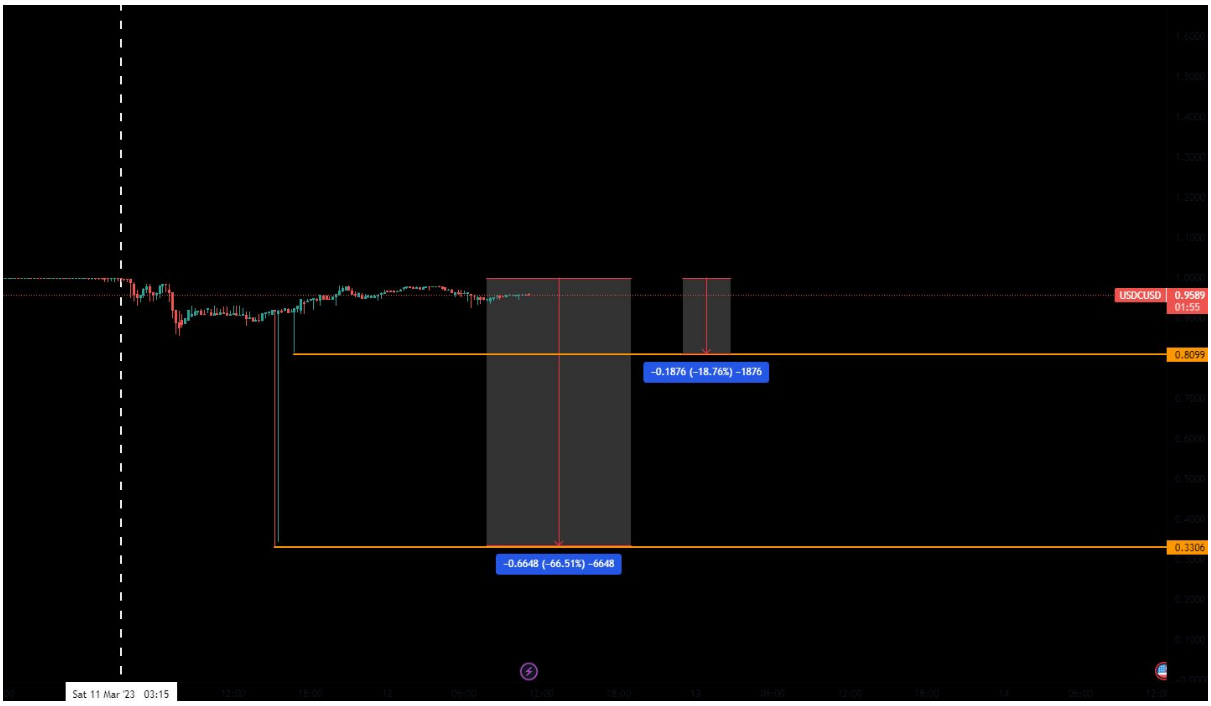

Figure 12. USDC/USD aggregate chart. (source: TradingView)

The stablecoin reached a low of $0.3306 on some illiquid markets and $0.8099 on most liquid exchanges. This means USDC went lower than its intended 1:1 dollar peg in most markets by 19 percent.

Circle was founded in 2013 and describes itself as a "remote-first" organisation. Its website claims that "every digital dollar of USDC on the internet is 100 percent backed by cash and short-dated U.S. treasuries" and that "USDC reserves are maintained in the custody and administration of prominent U.S. financial institutions, including BlackRock and BNY Mellon".

Circle must now provide evidence to support its assertion that its reserves are fully backed 1:1. This might entail a capital infusion from the business or a potential government bailout of Silicon Valley Bank.

So is USDC bound to follow the path of TerraLuna's UST token and other stables that have lost value or become unpopular?
For this, we must look deeper into Circle's holdings and reserves.

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CIRCLE

USDC Reserve Report

CIRCLE RESERVE FUND ASSETS AS OF JANUARY 17, 2023

U.S. TREASURY SECURITIES

Cusip	Maturity Date	Fair Value ($)[1]
912796XS3	01/19/23	324,962,950
912796ZL6	01/24/23	4,138,167,556
912796ZM4	01/31/23	787,799,142
912796XT1	02/02/23	1,231,845,436
912796ZT9	02/07/23	4,539,298,400
912796XZ7	02/09/23	398,952,400
912796ZU6	02/14/23	4,657,602,465
912796YA1	02/16/23	398,618,800
912796Y60	02/21/23	1,792,614,600
912796T33	02/23/23	1,767,083,500
912796Y78	02/28/23	109,447,250
912796Y86	03/07/23	3,926,513,300
912796YK9	03/09/23	2,981,397,000
912796Z69	03/14/23	1,886,996,400
912796U31	03/23/23	595,275,600
912796YN3	04/06/23	1,980,640,000
912796YU7	04/13/23	2,473,452,500
TOTAL U.S. TREASURY SECURITIES		**33,990,667,299**

Cash held at U.S. regulated financial institutions[2]	53,095,413
Cash due to/(owed by) Circle Reserve Fund due to timing and settlement differences, net[3]	(381,578,916)
TOTAL CIRCLE RESERVE FUND ASSETS	**33,662,183,796**

OTHER USDC RESERVE ASSETS AS OF JANUARY 17, 2023

Cash held at U.S. regulated financial institutions[2]	9,884,188,550
Cash due to/(owed by) the Company due to timing and settlement differences, net[3]	(18,560,385)
TOTAL OTHER USDC RESERVE ASSETS	**9,865,628,165**
TOTAL USDC RESERVE ASSETS AS OF JANUARY 17, 2023	**43,527,811,961**

Circle.com

Figure 13. Circle's reserves valuation and other fund assets in a Deloitte report. (source: circle.com)

Circle has 1-4 month T-Bills accounting for about 77 percent of its reserves. Blackrock manages these T-Bills, which are held at BNY Mellon. The remaining 23 percent is kept in cash at various organisations. One-third of that money was stored at SVB. Over the coming months, SVB will liquidate all its assets, with most analysts projecting a minimum return of 10 percent to 20 percent of the entire asset value.

Thus, even if every bank where Circle has cash holdings fails and returns 70 percent of the cash through asset sales, USDC would still be worth 93c in the worst-case scenario. Thus, we can conclude that USDC could still repeg and has a current "fair" value at $0.93 as a minimum threshold.

GENERAL MARKET UPDATE

Increasing Uncertainty Is Driving Migration to Risk-Free Securities

In anticipation of increasingly restrictive monetary policy and the ongoing political standoff over extending the US debt ceiling, short-term government bonds have become increasingly appealing to investors. This migration to risk-free securities is posing a liquidity threat to the wider financial system.

Capital is flowing into short-term securities now that the two-year US treasury yield is exceeding five percent and the Federal Reserve's (the Fed) repo facility is offering a 4.5 percent return.

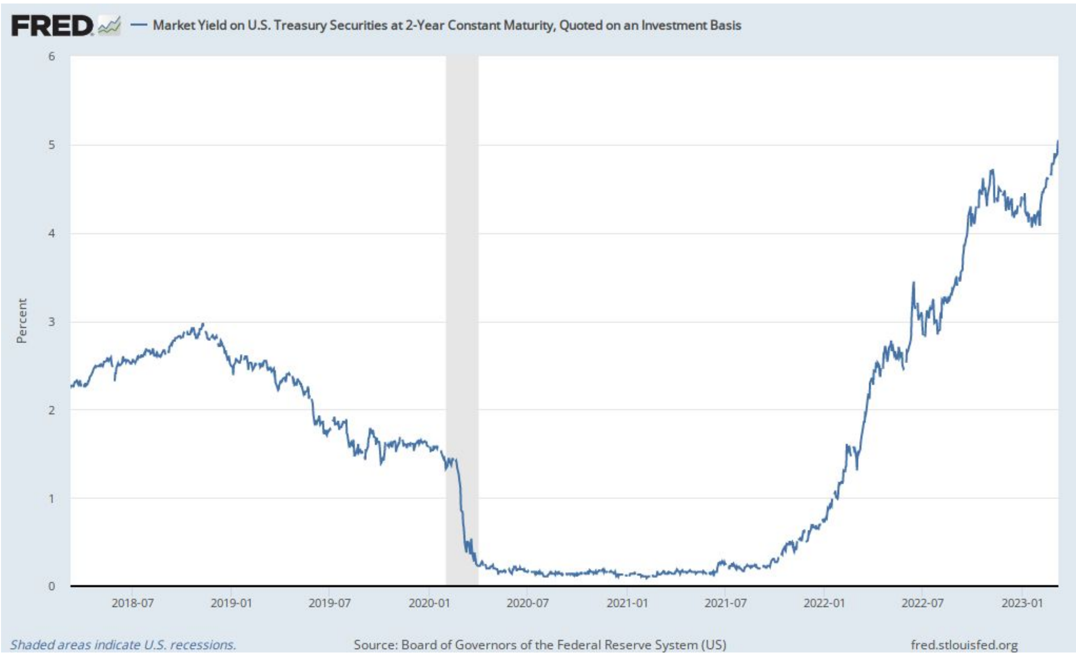


Figure 14. Yield on US 2-Year Treasury (Source: Board of Governors of the Federal Reserve System, US)

The Fed's repo facility provides short-term funding to banks where they can borrow funds by providing high-quality collateral such as Treasury securities. During rising interest rates, financial institutions that need to borrow capital prefer the repo facility to get better rates compared to the broader market. Borrowers do so by selling securities as collateral to another party with a promise to repurchase at a higher price.

Investors tend to prefer short-term bonds in times of economic uncertainty, and to have their funds parked in securities that they can sell quickly if needed. Short-term securities are less sensitive to changes in interest rates than long-term securities. Hence, they present good opportunities for investors who wish to park their capital in safer assets.

Increasing or decreasing demand for short-term vs long-term bonds is an indicator of current investor sentiment and their market outlook. Current demand for short-term bonds suggests that there is uncertainty in the market, and the market is anticipating a hard landing.

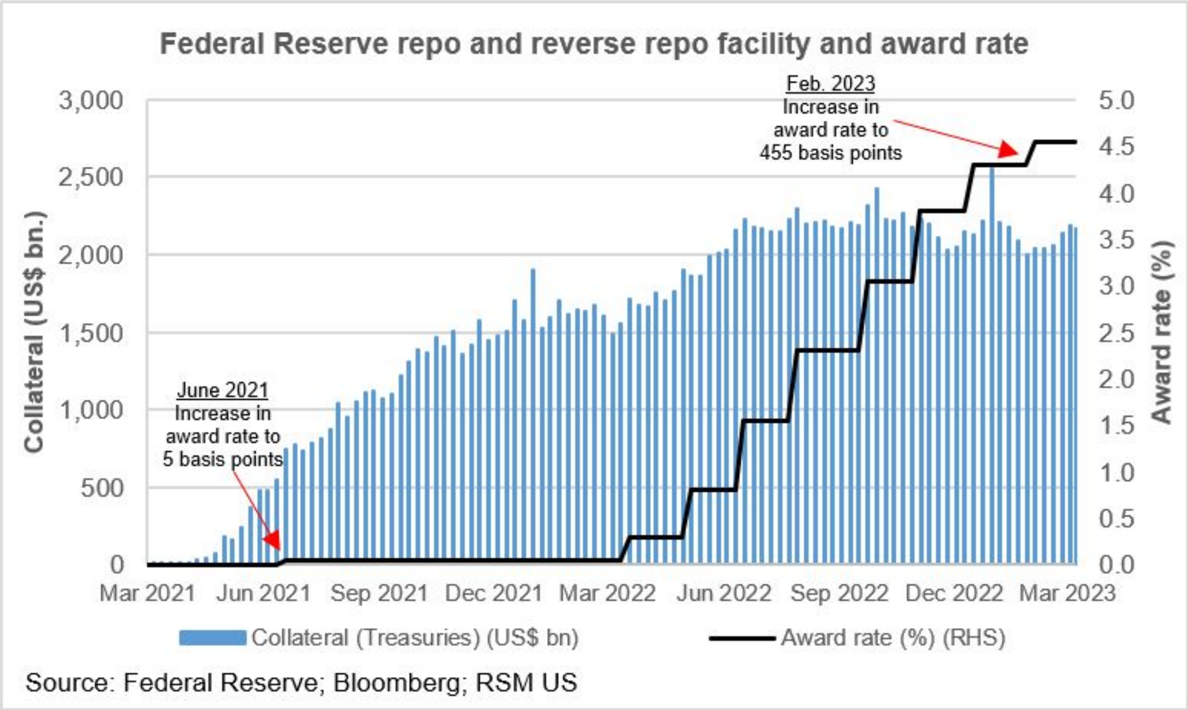


Figure 15. Federal Reserve Repo and Reverse Repo Facility and Award Rate (Source: Federal Reserve, Bloomberg, RSM US)

This migration to "risk-free" securities follows the decline in bank lending, which started trending lower last year, as reported in last week's Bitfinex Alpha. This reflects businesses' reluctance to incur debt due to rising capital costs and the anticipation that demand and revenues will drop as the economy slows down.

Due to a decline in corporate issuance, financial institutions like banks have a lot of idle cash available that needs to be invested. This is evident from the rising quantity of collateral deposited at the Fed's repo and reverse repo facility. The facility is being used three times as much as it was in June 2021. The so-called reward rate, or the interest paid by borrowers to lenders in the repo market, has increased to 4.5 percent to keep up with the rises in the federal funds rate. Currently, more than $2.1 trillion in capital is sitting in the central bank's repo facility.

If financial institutions prefer to deposit their securities in the Fed's repo market rather than lending them out to the broader market, it can lead to reduced liquidity. Problems are starting to appear, especially in small banks. Small banks in particular are in danger of struggling with liquidity while the Fed implements quantitative tightening, because this leads to a reduction in the size of the Fed balance sheet by selling securities, and also its bank reserves. Bank reserves are money for banks which are used to settle transactions with each other, including in the repo market. We can think of bank reserves as lubricant for the financial system.

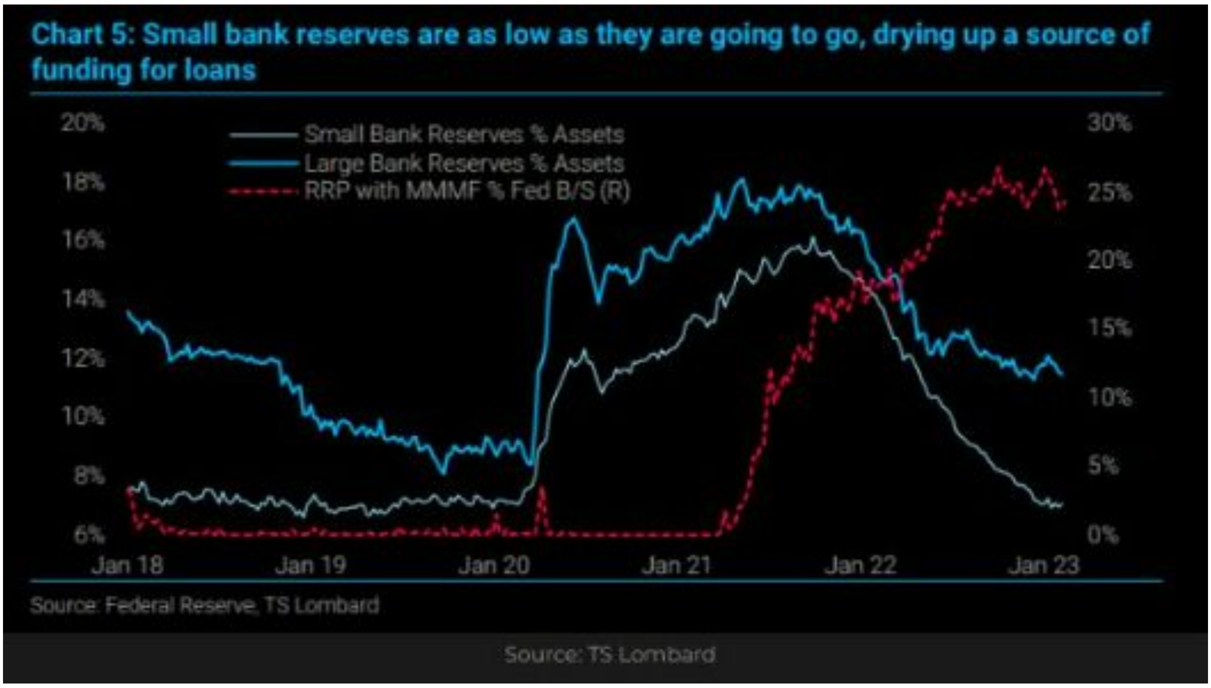


Figure 16. Small Bank Reserves drying up source of funding for loans (Source: TS Lombard, https://twitter.com/MacroAlf)

Smaller banks have fewer resources and may not be able to easily access funding in the broader market, unlike large banks with diverse sources of funding. Furthermore, smaller banks are more affected by higher interest rates during tightened monetary policy, which further limits their access to liquidity.

Figure 17. SPDR S&P KRE ETF (Tradingview)

The challenges smaller banks face are also showing up in bank stocks. KRE, the US regional bank ETF which falls in the small-cap value area according to the Morningstar, dropped more than 7 percent on Thursday, March 9, to its lowest level since January 2021. The immediate catalyst behind this, was the failure of SVB.

In the broader economy, consumers are affected when small banks struggle with liquidity as it reduces access to credit, consequently slowing down economic activities in their communities. Consumers also receive lower returns on their savings which is part of the bank's strategy to manage liquidity risk.

Fed Under Pressure From Yet Another Strong Job Market Reports

The United States added 311,000 jobs in February, pressuring the Fed to further boost interest rates to curb excessive inflation. This is significantly higher than estimates polled from economists by *The Wall Street Journal*, with a forecast of 225,000 new jobs.

Yet, strong job data released on Friday, March 10th, showed that some pressure valves on the labour market show a glimmer of hope for the Fed to take a less aggressive strategy. The employment rate rose slightly to 3.6 percent in February, while the average hourly wage rose to just 0.2 percent last month, the smallest increase in a year.

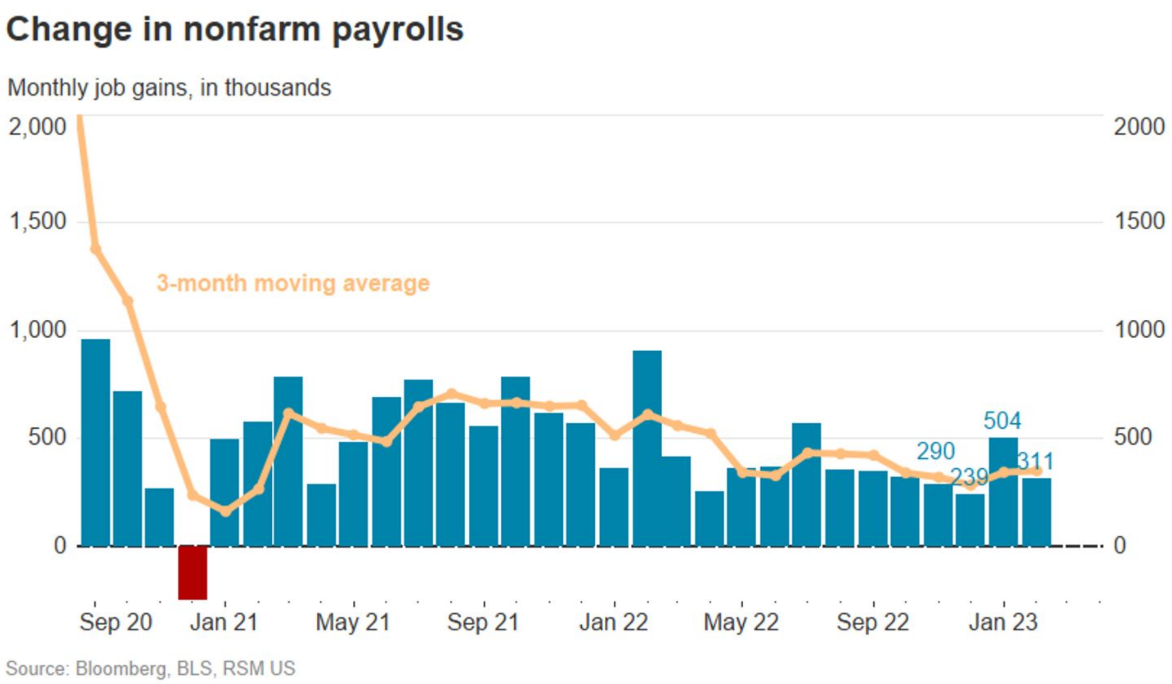


Figure 18. Change in Nonfarm Payrolls (Source: Bloomberg, BLS, RSM US)

	Period	Actual	Previous
Employment Report	February	311,000	225,000
US unemployment rate	February	3.6 percent	3.4 percent
Average Hourly Wages	February	0.2 percent	0.3 percent
Average Hourly Wages (Year-over-Year)	February 2022 - February 2023	4.6 percent	4.4 percent

Figure 19. Summary of Friday (March 10) Employment Report

However, despite some indicators showing that the labour market is cooling, the pace of hiring remains ever-resilient. The latest data has reinforced much greater interest rate hike expectations. Just a week prior to the jobs report, market participants expected a 25 basis points hike, but as of March 12, there is a higher probability of 50 basis points being announced at the March 22nd FOMC.

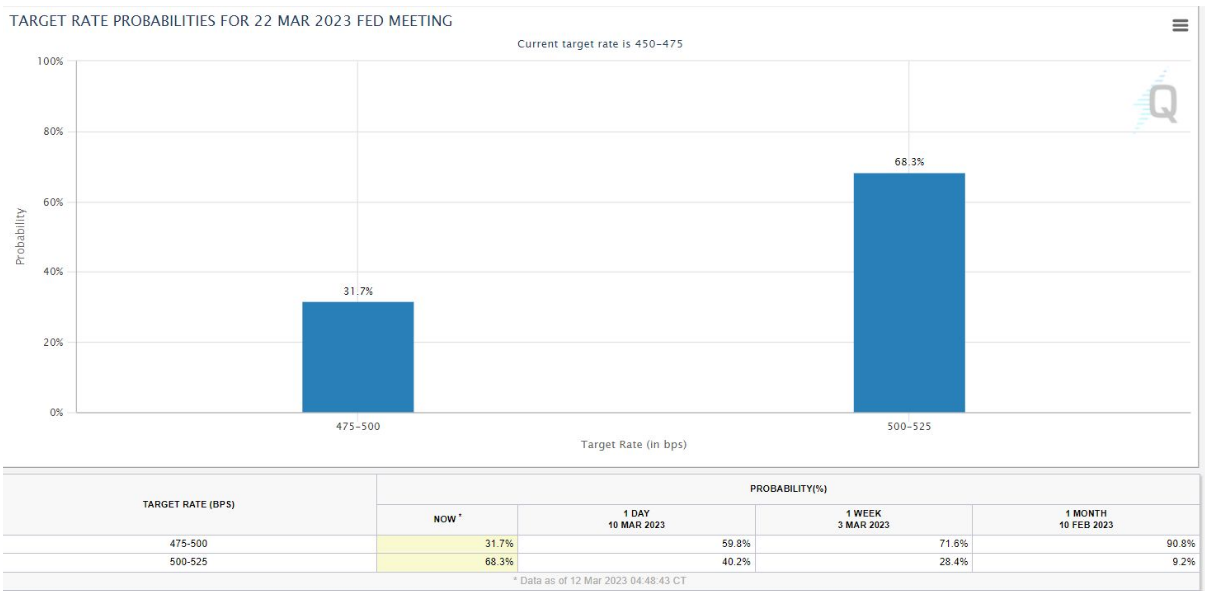


Figure 20. Change in Rate Hike expectations in just a week: Target Rate Probability for the 22 March 2023 FED meeting, Data retrieved on March 12 (Source: www.cmegroup.com)

The February Consumer Price Index, to be released this week, will be an important deciding factor for how much the Fed should hike. If the headline CPI shows that the US economy remains hot, the Fed will surely intensify its efforts to restore stability in prices through greater rate hikes.

WHAT'S ON-CHAIN THIS WEEK?

Market-wide Pullback As Bitcoin Crashes Below February Low

Figure 21. BTC/USD 4-Hour Chart. (source: Bitfinex)

On Thursday, March 9th, BTC price depreciated to $19,500, crashing below the February low amidst macro headwinds. Thursday's move that sent prices 10 percent lower was part of the predicted deeper pullback for Bitcoin that was discussed in last week's edition of Bitfinex Alpha. While there are multiple technical levels below the current price to offer support, there is always the possibility of further downside in the short term.

Long-term indicators still indicate strength in the crypto market, and hence, the current pullback might be close to forming the higher low expected for the past three weeks. BTC's price is currently over 22 percent below its current yearly high of just over $25,000.

Intra-week, the Bitcoin options market reported its most pessimistic near-term outlook on price in 2023. As BTC was trading at $20,700 (prior to its move to $19,500), the 25 percent delta skew on Bitcoin options expiring in one week, fell to around negative six (-6.0) on Thursday, March 9th, the lowest since December 2022.

Figure 22. BTC Option Delta Skew seven-day 25-percent. (source: The Block)

The 25 percent delta options skew is a popularly monitored proxy for 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. 25 percent delta options skew below zero suggests that desks charge more for equivalent put options than calls. This implies there is a higher demand for puts versus calls, which can be interpreted as a bearish sign as investors are more eager to secure protection against (or bet on) a rise in prices.

Long-Term Market Health Remains Intact

Figure 23. Net Realised Profit and Loss for Bitcoin. (source: thuancapital)

Bitcoin's net realised profit and loss indicator suggests that the market has returned to a regime of significant realised losses. It is important to remember that we are still in the latter stages of a bear market and not the beginning of a bull market. It would be premature to state that the market has turned completely bullish, however the current rise in net realised losses still pales in comparison to the peak seen during the Luna crash or the FTX implosion. This is a testament to the increase in the inherent strength of the market in comparison to 2022.

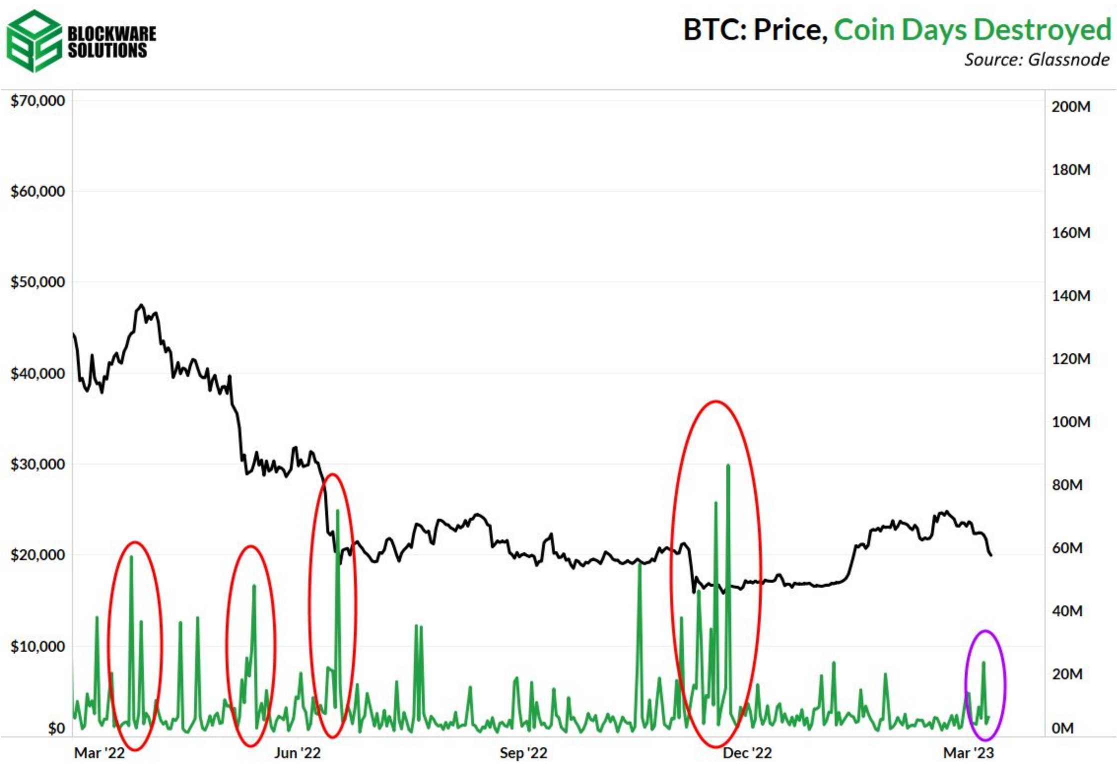


Figure 24. Coin Days Destroyed vs BTC price. (source: blockware intelligence)

Coin Days Destroyed (CDD) also suggests that a local bottom might be close or already in. CDD is the sum of the number of coins moved in a day, multiplied by the number of days since each coin was last moved. Moments of widespread capitulation have historically been correlated with prominent CDD rises that are circled in the figure above. When we compare that to the most recent rise in net realised losses, we can see that the coins that are currently moving are younger coins, and long-term HODLers are, once again, unconcerned. A local bottom may have arrived, as CDD has already reversed to some extent.

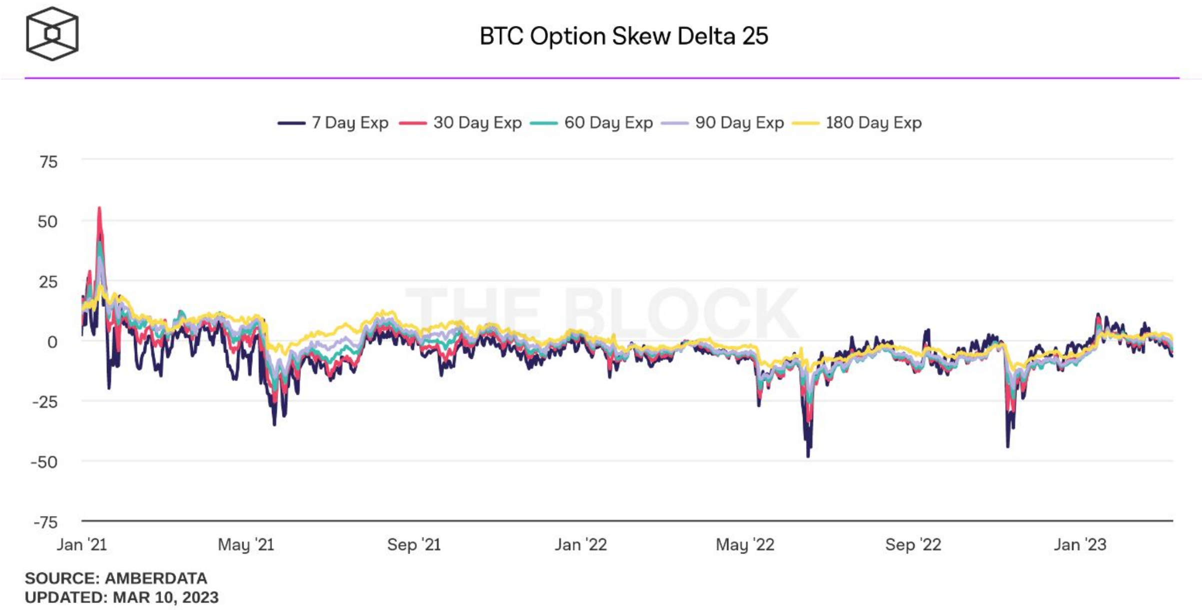


Figure 25. BTC Options 25 percent Delta Skew across multiple days. (source: The Block)

While the 25 percent delta skew of options expiring in 30 days and 60 days also falling to their lowest levels of the year of around negative three (-3) and negative two (-2), respectively, the 25 percent delta skew of options expiring in 90 and 180-days have been holding up, with both remaining close to zero. That suggests that investors are taking the view that the current headwinds faced by the market (crypto banks failing, US regulator's increasing scrutiny and the Fed's continued tightening efforts) are unlikely to send Bitcoin lower on a sustained basis from current levels.

NEWS FROM THE CRYPTO-SPHERE

Silvergate bank is shutting down operations and liquidating

Figure 26. Silvergate shuts down operations and liquidates its bank

On March 8th, Silvergate Capital Corporation, the holding company for the crypto-focused Silvergate Bank, announced its intent to wind down operations and voluntarily liquidate its bank.

Silvergate stated that, due to recent developments in the crypto industry and regulatory scrutiny on the sector, the company believes that the optimal course of action is an orderly shutdown of their bank operations and voluntary liquidation adding that all deposits will be fully repaid.

In addition, on March 3rd, Silvergate Bank made the decision to discontinue the Silvergate Exchange Network (SEN), which was considered one of its main offerings allowing customers of various crypto firms to use US dollars to purchase and trade Bitcoin, Ether, and other digital assets.

Prior to suspending SEN, Silvergate said last week that it was unable to file its annual 10-k report and that the bank is at risk of being less-than well capitalised. Spooked by this news, severa; investors and business partners moved to distance themselves from the bank, terminating partnerships with Silvergate.

It is worth adding that SEN was advertised as a service that operated around the clock, and its discontinuation has made it more challenging to buy and sell digital assets quickly.

According to crypto analytics firm *Kaiko*, recent liquidity data shows that Silvergate's demise disproportionately affected US-based exchanges and market makers, resulting in decreased liquidity for BTC and ETH in US exchanges compared to international ones.

Blockchain.com blames crypto winter for suspending its asset management subsidiary

Figure 27. Blockchain.com founder and CEO Peter Smith

Blockchain.com, a significant player in the crypto financial services industry, has made the decision to suspend its asset management subsidiary, Blockchain.com Asset Management (BCAM), according to reports on March 9th.

Launched in April 2022, BCAM aimed to attract institutional investors with a strategy that tracked the price of Bitcoin versus the Dollar. However, a spokesperson for the company revealed to *Bloomberg* that the prolonged crypto winter had prompted the suspension of this institutional product.

The subsidiary, based in London, has applied to be removed from the UK companies register as of Monday, according to a filing obtained by *Bloomberg*.

BCAM was created in partnership with Altis Partners and had planned to offer "algorithm-based, risk-managed exposure" to Bitcoin alongside a product handling decentralised finance token exposure, according to Charlie McGarraugh, its Chief Strategy Officer, in a previous interview with *Bloomberg*.

Kucoin sued by New York Attorney General

Figure 28. New York Attorney General Letitia James

On March 9th, Letitia James, the Attorney General of New York State, sued KuCoin, a cryptocurrency exchange based in the Seychelles, for operating in New York State without proper registration and falsely representing itself as an exchange.

The lawsuit seeks to prevent KuCoin from operating in the state and to block access to its website until it complies with the law.

The petition also argued that Ether (ETH), just like the collapsed coins LUNA and TerraUSD (UST), is a speculative asset that relies on the efforts of third-party developers in order to provide profit to the holders of ETH. As a result, KuCoin was obligated to register before offering these cryptocurrencies for sale.

This action is one of the first times a law enforcement official is claiming in court that ETH, one of the largest cryptocurrencies, is a security.

The lawsuit also claims that KuCoin allegedly sold unregistered securities in the form of KuCoin Earn, its lending and staking product and that the exchange has previously failed to comply with a subpoena issued by the Office of the Attorney General (OAG) to provide more information about its digital asset trading activities in the state.

Finally, Attorney General James urged affected New Yorkers to report deceptive conduct in the virtual assets market and encouraged cryptocurrency industry workers to file whistle-blower complaints with her office.

Voyager Gains Court Approval to Sell Assets to Binance US.

Figure 29. US bankruptcy judge approves Binance.US $1.3 billion deal for Voyager

On March 7th, it was reported that bankrupt cryptocurrency lender Voyager Digital was given court approval to sell its assets and transfer its customers to Binance.US in a deal worth $1.3 billion.

US Bankruptcy Judge Michael Wiles approved Binance.US' plan to acquire Voyager. Binance.US will pay $20 million in cash to Voyager and take on customers' deposited crypto assets.

The deal still faces additional hurdles, including scrutiny from the Committee on Foreign Investment in the United States (CFIUS), which is investigating national security risks associated with foreign investment in Voyager.

Voyager could also walk away from the deal, as it needs up to four weeks to review new questions about Binance.US' commitment to the acquisition, regulatory compliance, and the security of customer deposits.

If the deal is finalised, Voyager customers can make withdrawals for the first time since their accounts were frozen last summer.

FTX Debtors Sue Grayscale Investments

Figure 30. John J. Ray III, CEO and Chief Restructuring Officer of the FTX Debtors

On March 6th, FTX Trading and its affiliated debtors, collectively known as the FTX Debtors, filed a lawsuit against Grayscale Investments in Delaware State Court.

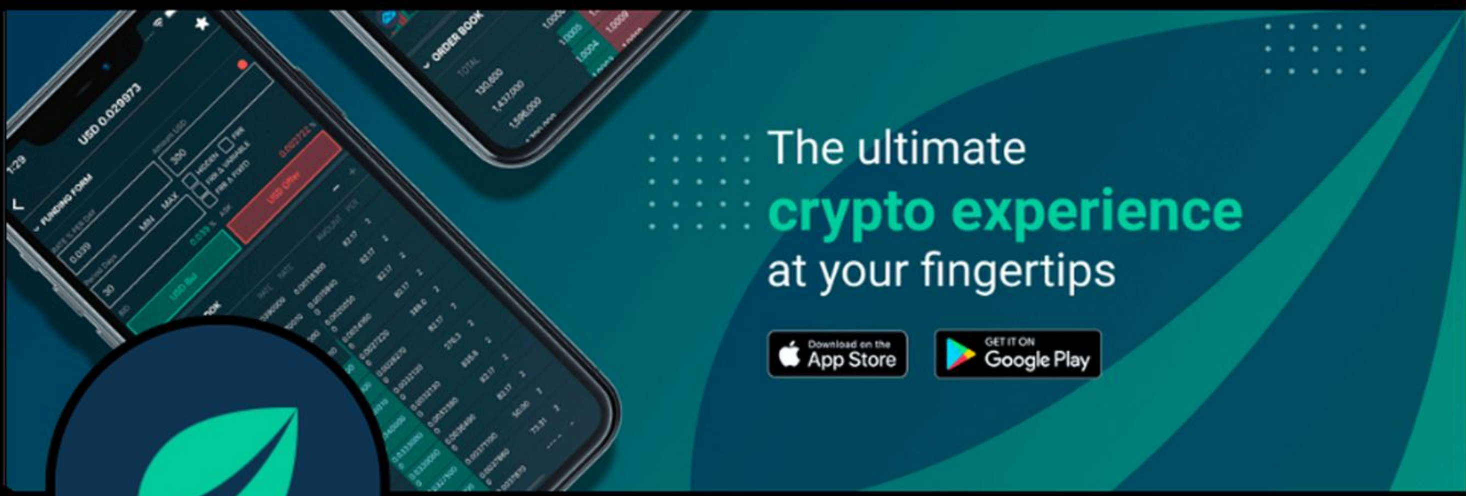
In addition, the FTX Debtors also made claims against Grayscale's CEO, Michael Sonnenshein, and its owners, Digital Currency Group, and Barry Silbert.

FTX Debtors are seeking injunctive relief to release $9 billion or more in value for the shareholders of the Grayscale Bitcoin and Ethereum Trusts and to realise over a quarter billion dollars in asset value for the FTX Debtors' customers and creditors.

The lawsuit claims that Grayscale has extracted over $1.3 billion in management fees in violation of trust agreements, preventing shareholders from redeeming their shares. As a result, the Trusts' shares are trading at a 50 percent discount to the net asset value.

FTX Debtors believe that if Grayscale reduced its fees and stopped preventing redemptions, the value of their shares would increase by approximately 90 percent.

John J. Ray III, CEO and Chief Restructuring Officer of the FTX Debtors, has stated that they will continue to take action to maximise recoveries for FTX customers and creditors and to unlock value that they believe is being suppressed by Grayscale's actions.



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BITFINEX Alpha