BITFINEX Alpha

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EXECUTIVE SUMMARY

For over two months, *Bitfinex Alpha* has been forecasting heightened volatility, and recent events have validated this prediction. Bitcoin's 24-hour volatility witnessed a staggering 1200 percent spike within a mere nine hours on October 16th, propelled by the asset crossing the $30,000 threshold. On-chain metrics, such as the Spent Output Age Bands (SOAB), further support the notion of sustained volatility in the coming months.

Bitcoin's brief soar from $28,000 to $30,000 on October 16th was fuelled by unverified rumours of the SEC's approval of BlackRock's iShares Bitcoin ETF application. This surge, however, was short-lived, with the asset retracting to the $28,000 mark, resulting in the largest short liquidations since August 17th, amounting to over $136 million. The initial price escalation was attributed to a flurry of market longs on futures markets, with more than $5.5 billion added within an hour. Yet, this momentum was temporary, with subsequent volatile swings causing in total $187 million in liquidations across long and short positions. Last week's moves underscore the sensitivity of the crypto market to high volume trades, especially during low liquidity periods. The rapid price movements were not solely due to a short squeeze but were significantly influenced by the market's immediate response to the spot ETF news. This highlights the market's susceptibility to major news narratives. Post the $30,000 breach and subsequent dip below $28,000, Bitcoin has already made two subsequent attempts to reclaim the $30,000 mark, and was ultimately successful on Monday 23rd October.

In last week's economic narrative, it's evident that while certain sectors of the US economy have flexed their resilience, others have sent out subtle signals of caution.

Last week, the 10-year Treasury yield inched closer to its five percent mark - a psychologically significant level that's not seen in 16 years. With high treasury yields correlated with interest rate hikes, last week's uptick in yield underlines our expectation that interest rates will be higher for longer.

In the consumer landscape, US retail sales exceeded market expectations. Strong consumer spending not only rounded off the third quarter on a high note but also fueled expectations that the GDP for the third quarter could overshadow the previous one. The labour market also continued to show strength, with unemployment claims for the week ending October 14th plummeting to a nine-month low. Despite the strong unemployment figures, signs of a cooling labour market continue to show.

On the housing front, after the unsettling slump in August, September brought with it a breath of fresh air. This uptick, spearheaded by the multi-family home construction sector, offers a glimmer of hope, though cautionary notes still persist among market watchers.

In a nod to the growing acceptance of cryptocurrencies, luxury car giant Ferrari has teamed up with BitPay to facilitate crypto payments. However, it's not all smooth driving in the crypto world. New York's Attorney General has launched a lawsuit against industry stalwarts: Gemini Trust, Genesis Global Capital, and Digital Currency Group (DCG), alleging a massive fraud of over $1 billion through the Gemini Earn program.

Finally, we discuss the transformation in El Salvador, two years after it adopted Bitcoin as legal tender.

Happy Trading!

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WHAT’S ON-CHAIN THIS WEEK?

Volatility To Remain Higher

***Bitfinex Alpha* has been forecasting higher volatility for more than two months. Isolated high volatility events have increased immensely in comparison to 2022 and early 2023. With 24-hour Bitcoin volatility still at historically low levels, we expect that it will increase over the next few months.**

On October 16th, BTC 24-hour volatility spiked more than 1200 percent within a nine hour period as BTC moved briefly beyond the $30,000 mark. This is the second high volatility event for the asset since the monthly open and was driven by spot Bitcoin ETF news, which was later found to be untrue. (refer Figure below)

Figure 1. Bitcoin 24-Hour Volatility. (source: TradingView)

As volatility continues to attempt to sustain beyond historical averages, we are potentially at the end of one of the longest low volatility environments in Bitcoin's history. Bitcoin is currently trading above its 200-day average 24-hour volatility levels and if this is sustained, it will mean that both isolated event based volatility and daily average volatility is up.

On-chain activity also continues to support the conclusion that higher volatility is here to stay and that it will grow in the coming months. Our analysis of Spent Output Age Bands (SOAB), which track the age of coins when they're spent, and in particular the "age bands" of UTXOs that are most active, we can discern which group of investors is predominantly influencing market changes. For instance, if the UTXOs aged between three and five years show significant activity, it implies that investors who have held their positions for that time span are the primary movers in the market at that juncture.

Recent data shows the three to six month age band cohort has registered an increase of about 120,000 BTC (refer Figure below). What is interesting about this particular age band is that whenever investors belonging to this cohort register an increase in the SOAB metric, such large movements have been precursors to notable market volatility.

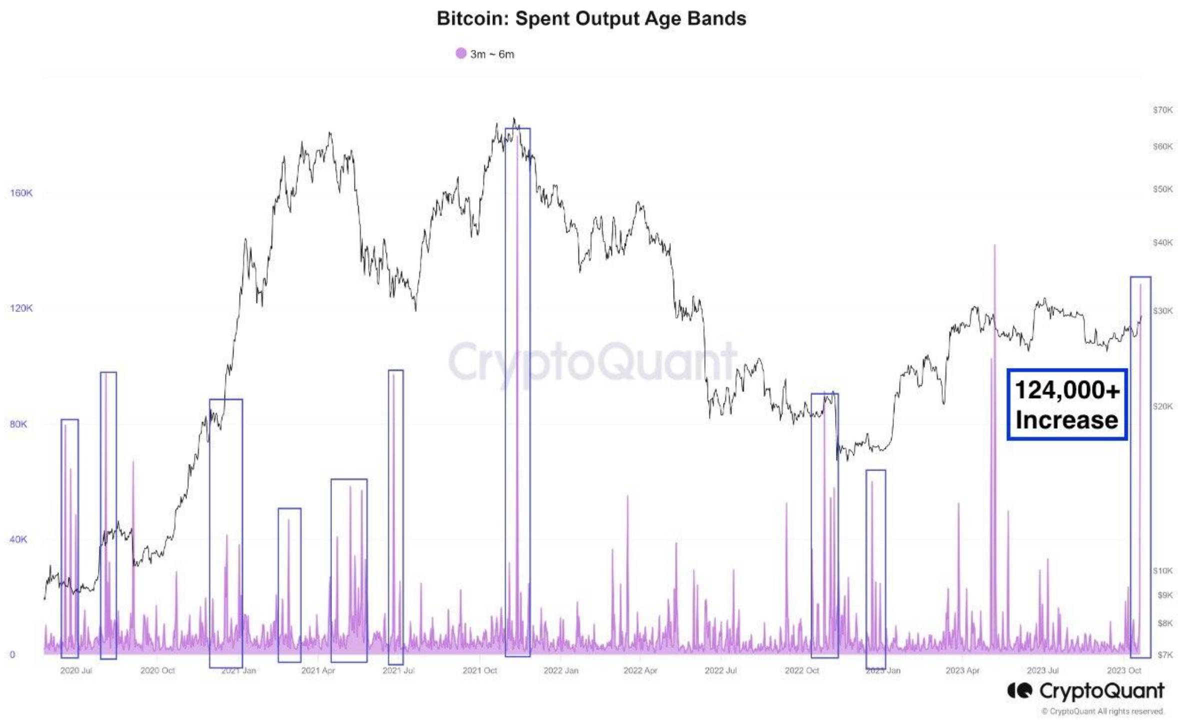


Figure 2. Bitcoin Spent Output Age Band for 3-6 month cohort. (source: CryptoQuant)

BTC pushed past the all important $30,000 level twice this week and that cleared a lot of leverage from the futures market (see following section). Additionally, implied volatility (IV) has dipped a little towards the end of the week but remains above historical volatility (HV) at 43.4 percent while HV is at 30.9 percent also moving lower towards the end of the week.

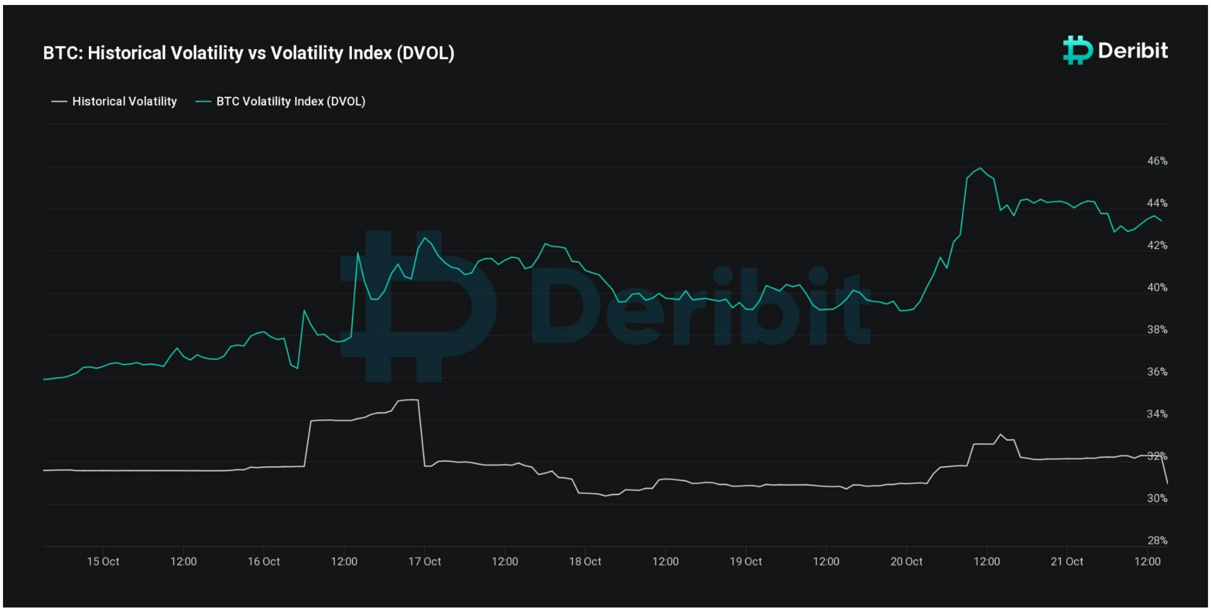


Figure 3. Historical vs Implied Volatility. (source: Deribit Metrics)

While end of the year options continue to see a surge in open interest, the gap in open interest between calls and puts for that period has reduced. The current put/call ratio is around 0.41 clearly stating a more bullish sentiment amongst options traders, but it is also important to not take this ratio at face value as the same trader could be hedging against their call option while shorting or selling spot positions in the derivatives or spot markets. Regardless of the direction, we continue to expect higher volatility in the coming months even if volatility in the short term subsides due to the reduction in leverage in markets and the closing of the gap between the IV and the HV.

The reduction in leverage in the crypto market is seen in the fall of the estimated leverage ratio (refer Figure below). The Estimated Leverage Ratio (ELR) is essentially the open interest on an exchange divided by its reserves. In simple terms, it measures the average leverage being utilised by traders on that platform.

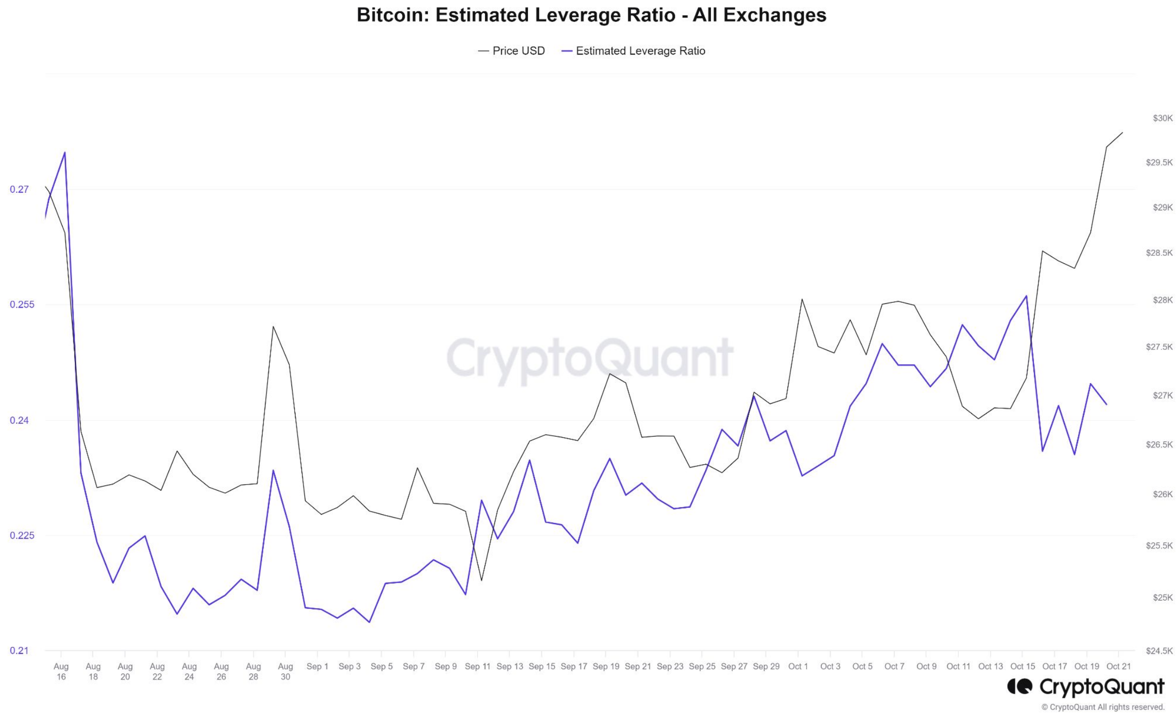


Figure 4.Estimated Leverage Ratio For Centralised Exchanges. (source: CryptoQuant)

High leverage in the market is correlated with increasing volatility. A more refined metric such as the ELR measures leverage in response to the collateral traders might deposit on exchanges for leverage trading. As such, upward spikes in this metric have served as a leading indicator to volatile BTC moves and as seen following the large move up last week, this metric declines sharply before building up again gradually (see Figure above). This allows us to conclude that sharp market movements usually force traders to close leveraged positions, whether booking profits or cutting losses and it takes some time before they build up positions before such a move or market impulse can occur again.

Thus, we expect some short term consolidation and a ranging market before more volatility can kick in.

Largest Cumulative Short Liquidations Since August 17th

Bitcoin briefly surged from $28,000 to $30,000 on Monday, October 16th fueled by unconfirmed chatter about the SEC's approval of BlackRock's iShares Bitcoin ETF application. However, as doubts over the authenticity of the rumour grew, Bitcoin fell back to the $28,000 mark, resulting in a rapid 7.5 percent price swing within minutes. This led to both long and short liquidations where the total short liquidations for the day were the highest since August 17th at over $136 million.

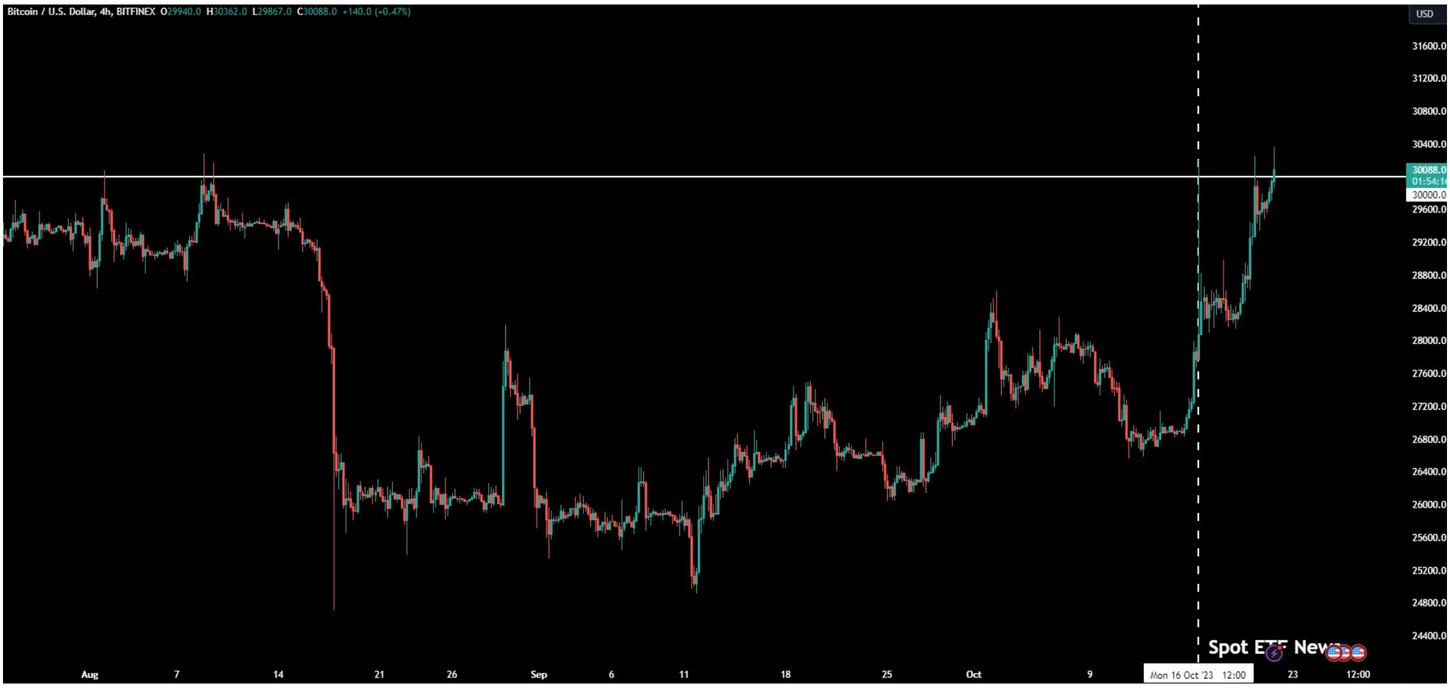


Figure 5. BTC/USD 4H Chart. (source: Bitfinex)

BTC crossed the $30,000 mark for the first time since August 9th, 2023 last week (refer Figure above). The initial move up was driven by news of approval of a spot Bitcoin ETF and the speculation surrounding this topic and huge market interest was manifested in the form of a large number of market longs on the futures markets pushing the price up and eventually above this major psychological level. The number of market longs added within an hour prior to the move up amounted to more than $5.5 billion on the futures market (refer to figure below).

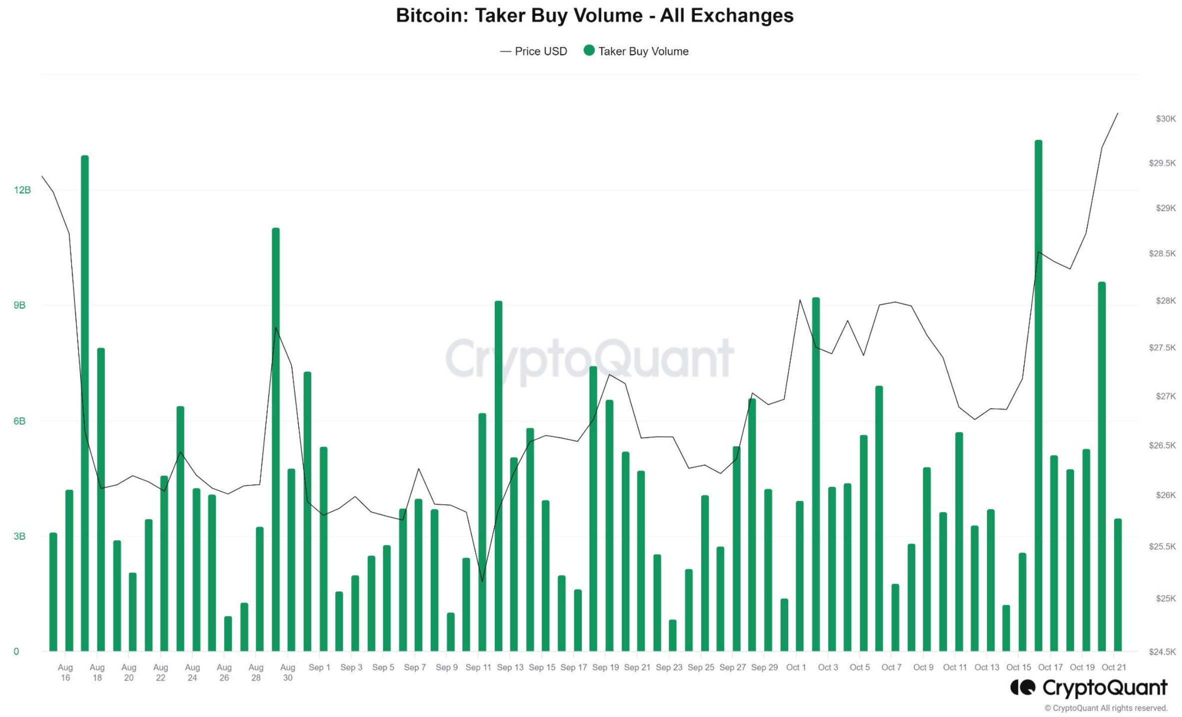


Figure 6. Bitcoin Taker Buy Volume Across All Exchanges. (source: CryptoQuant)

However, this was temporary and most of these positions were closed after a series of volatile intra-day market swings caused more than $187 million in total liquidations across long and short positions, as per *coinglass* data. (refer Figure below)

Figure 7. Total Liquidations Across Centralised Exchanges. (source: Coinglass)

Moments like these are reminders that low liquidity periods are highly sensitive to high volume trades, especially when triggered by major news. The reason for the large market entries being able to move the BTC price more than eight percent within minutes was because of low market depth and forced closures of shorts.

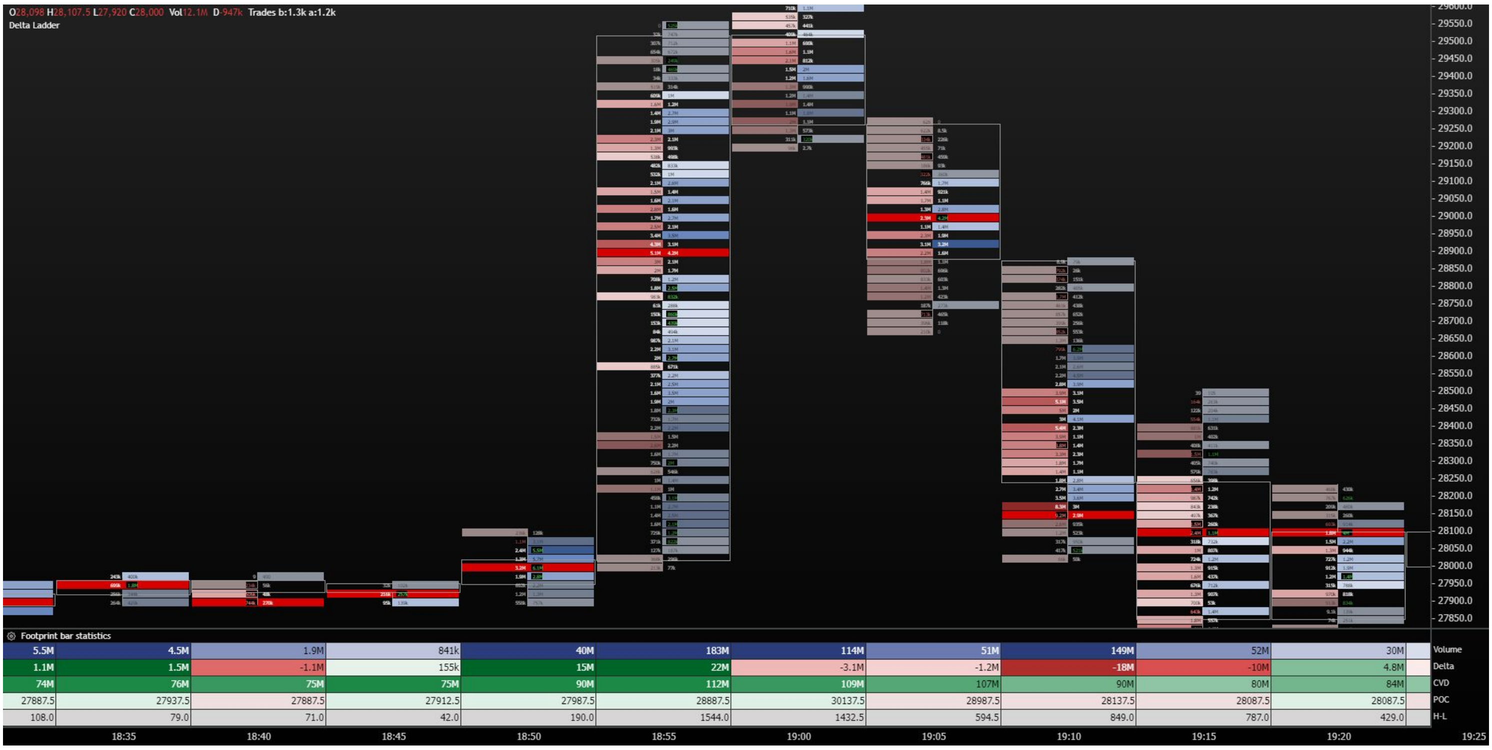


Figure 8. BTC/USD Delta Ladder 5-minute chart from the move up on October 16th. (source: Exocharts)

Order flow data indicates a strong positive delta imbalance in the 10 minutes leading up to Bitcoin's surge past $30,000. Delta represents the disparity between buy and sell market volume. A positive delta indicates a predominance of buying volume over selling volume. Highlighted in green, a positive delta imbalance evident on the candle before the surge past $30,000 demonstrates significantly more market buying than selling. In the futures markets, the cumulative volume delta grew by over 30 percent from the previous reading. The rise was further propelled by shorts covering their positions.

Despite the rapid price movement, it wasn't due to a short squeeze, as indicated by the short-squeeze ratio (see Figure below). The BTC market's immediate response to the spot ETF news was the main driver, highlighting the significance of this event for the market.

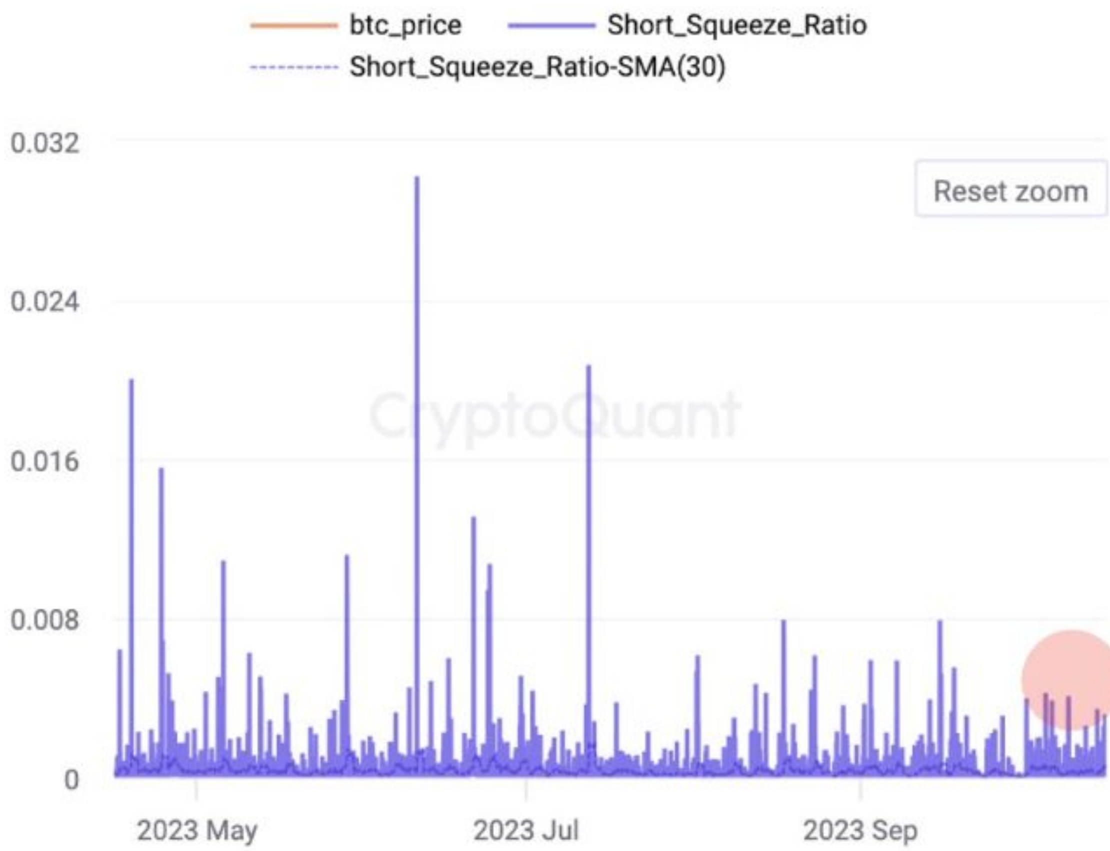


Figure 10. Bitcoin Short Squeeze Ratio. (source: CryptoQuant)

After breaching $30,000 and then dropping below $28,000—triggered by limit selling and a correction from false news—long positions unwound quickly. Since then, the price has already made two attempts to surpass the $30,000 mark again and was ultimately successful as we published on Monday.

GENERAL MARKET UPDATE

US Treasury Yields Recover After Sticky Inflation Data

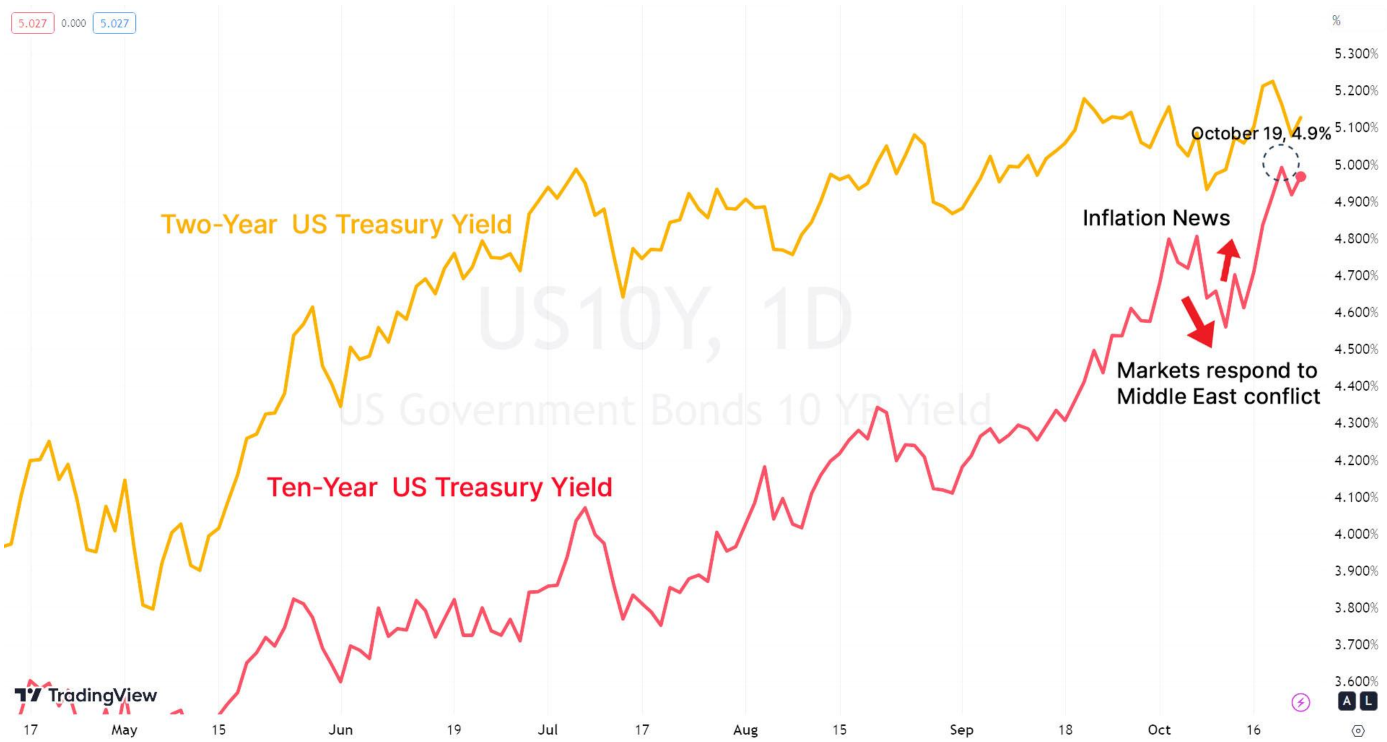


Figure 11. Ten-Year and Two-Year US Treasury Yields (Source: Tradingview)

In September, the two-year and the 10-year treasury yields reached their highest levels since 2007. As covered in last week's *Bitfinex Alpha*, higher than expected inflation data in September has resulted in yields climbing. As of last week they were up again after sliding dramatically following the outbreak of fresh conflict in the Middle East, reaching 5.19 percent and 4.91 percent respectively. High treasury note yields are correlated with interest rate hikes and the bond market is clearly indicating its current expectation that rates will be higher for longer than expected, with the Fed funds futures markets pricing in two additional rate hikes in 2024.

The Conflict in the Middle East

The conflict in the Middle East had a dramatic initial impact on the bond market. Following the initial attack on Israel on October 7th - a Saturday- Cash Treasury markets did not have a chance to react until October 10th (due to a US holiday on Monday October 9th). The 10-year benchmark yields saw their most significant daily decrease since mid-July, and the two-year note yields experienced their steepest daily fall since the end of August. The decline in bond yields helped stocks for a few days as the S&P 500 recovered, as lower bond yields make stocks more attractive for investors looking for higher returns.

The Inflation Reports and Spiking Government Bond Yields

However on October 12th, yields surged due to inflation indices surpassing forecasts. The 30-year government bond yield, a bellwether for long-term economic prospects, reached 4.837 percent, its peak since the 2007 crisis.

Merely a week later, on October 19th, another significant event rattled the bond market. The 10-year Treasury yield, a benchmark for global borrowing costs, spiked by 0.1 percent to 4.91 percent, inching closer to the five percent mark – the highest in 16 years. This movement indicates that investors are bracing themselves for sustained or even increased rates.

The volatility of US Treasuries in the past two weeks spells a period of uncertainty for the market. The surge in the 10-year yield holds particular significance as it hovers close to the psychologically significant threshold of five percent.

In the US, the prevailing robustness of the economy continues to propel Treasury yields higher. To put things into context, in May 2023 interest rate futures were expecting three rate cuts in 2023 and they are now pricing in rate cuts to begin in September 2024.

US Retail Sales Exceed Forecasts, Bolstering Q3 GDP Expectations

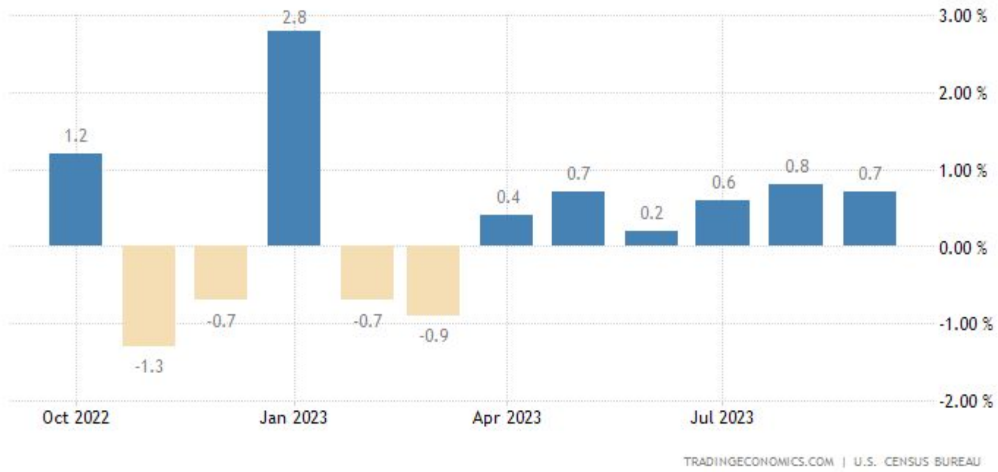


Figure 12. US Retail Sales (Source: US Census Bureau)

US retail sales for September defied expectations, closing out the quarter on a high note, fueling expectations that third-quarter Gross Domestic Product will be significantly higher than the previous quarter.

Released on Tuesday, October 17th, the US Census Bureau's Retail Sales report presented a more robust consumer landscape than many analysts had projected.

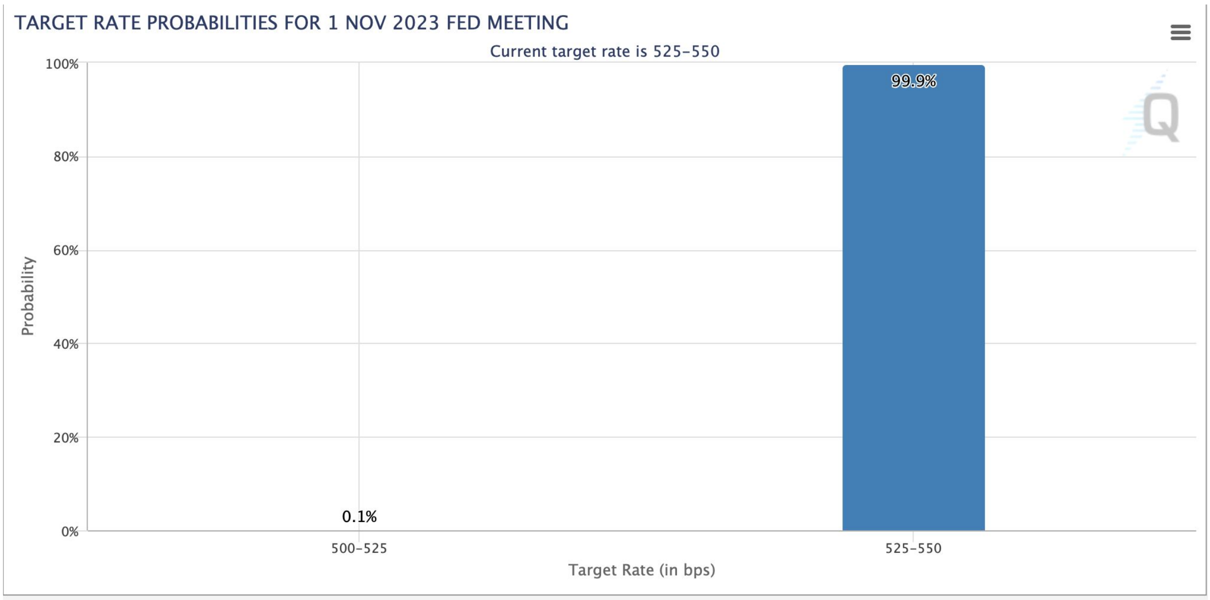
With a month-over-month (MoM) growth at 0.7 percent, September's figures beat the consensus estimate of 0.3 percent. Additionally, data from August, previously pegged at 0.6 percent growth, was adjusted upward to 0.8 percent. These revisions paint a picture of sustained consumer spending momentum, and indicate that a resilient US labour market, plus wage growth at levels not seen in years have instilled confidence in consumers. This strength in earnings and employment has allowed Americans to sidestep broader predictions of a pullback in spending.

This dynamic of strong consumer spending continues to be a significant force in driving the US economic narrative.

As of October 17, the Atlanta Federal Reserve's GDP NOW forecast for Q3 growth stands at 5.4 percent, up from the earlier projection of 5.1 percent. This upward revision underscores the potential for a much stronger third-quarter GDP compared to the previously reported 2.1 percent growth for the second quarter.

Beneath the headline figures, the surge in sales was widespread, with eight out of 13 categories reporting increased spending in September. Miscellaneous stores, online retailers, and motor vehicle sales led the way, with gains of three percent, 1.1 percent, and one percent, respectively.

Despite this impressive performance, there is scepticism about whether this spending momentum will extend into the upcoming holiday season. Sales may experience a drop similar to that seen in the previous year's holiday season due to early spending. Additionally, the current economic headwinds could dampen consumer sentiment.



TARGET RATE (BPS)	PROBABILITY(%)			
	NOW *	1 DAY 20 OCT 2023	1 WEEK 13 OCT 2023	1 MONTH 21 SEP 2023
500-525	0.1%	0.1%	0.0%	0.0%
525-550 (Current)	99.9%	99.9%	93.8%	73.7%
550-575	0.0%	0.0%	6.2%	26.3%

Figure 13. Target Rate Probabilities for November 1 Fed Meeting (Source: CME Fed WatchTool)

Given that uncertainty, we expect the Fed to pause in their November meeting - despite the upward pressure on inflation from strong consumer spending. As of October 21, the CME FedWatch Tool shows 99.9 percent probability that the Fed is not going to hike rates this November.

Housing Starts Rebound in September, but Challenges Loom Ahead

US housing starts reported an unexpected seven percent boost in September, as revealed by the US Census Bureau on Wednesday, October 18th. This upswing driven by multi family home construction counters the concerning downturn witnessed in August but not all signs are optimistic.

The quarterly figures for housing starts hint at potential headwinds, with a 4.2 percent decline due to persistent challenges in the housing sector. Despite the monthly recovery, the quarterly dip underscores the lack of supply, manifesting itself in slower new residential starts.

The overall recovery is further dampened by the highest mortgage rates observed in nearly 23 years. This has resulted in a significant drop in mortgage loan applications, according to data from Mortgage Bankers Association. The report revealed a drop of 6.9 percent in applications for home purchases from the prior week, reaching levels last seen in 1995. The surge in mortgage rates can be attributed to the Federal Reserve's brutal interest rate hiking cycle.

Figure 14, Building Permits in the US (Source: US Census Bureau)

While the recent increase in housing starts is a positive sign, building permits, often considered a reliable indicator of future housing starts, fell 4.4% in September. This suggests that the uptick in housing starts in September may be short-lived.

Also underscoring this outlook is the latest report by the National Association of Home Builders' (NAHB) report on home builders confidence last Tuesday, October 17th. Monthly builders' confidence fell by four points, to 40. This is the third straight drop in the index, which is the lowest in eight months.

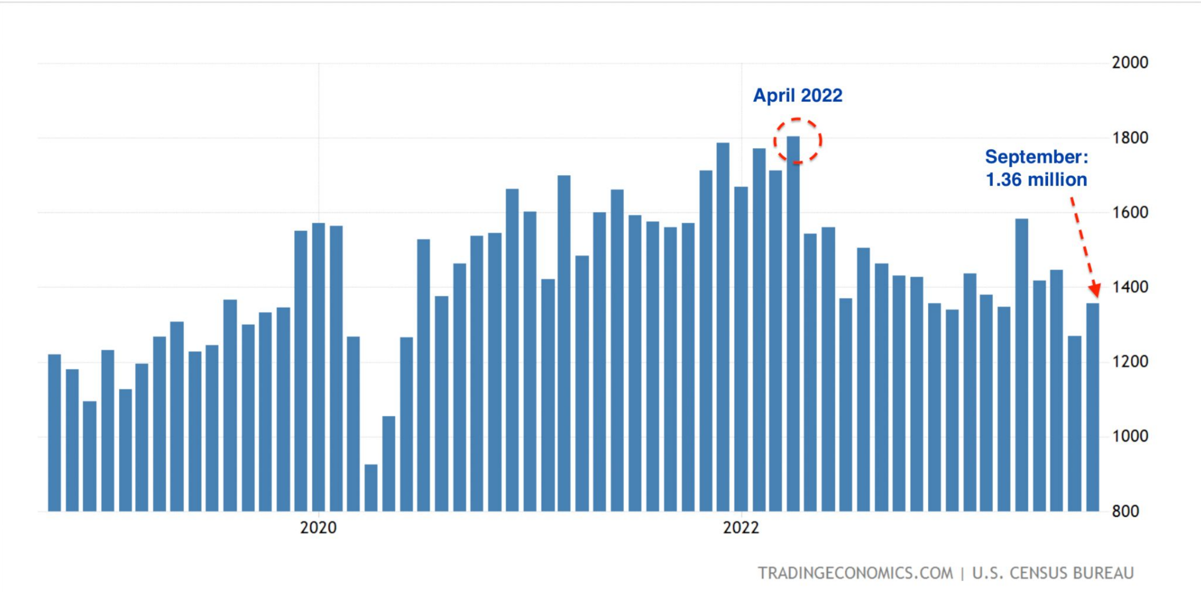


Figure 15. Housing Starts in the US (Source: US Census Bureau)

For the remainder of the year, prospective homebuyers will have to brace themselves for an extended period of high mortgage rates. According to the CME FedWatch Tool the Fed is expected to start cutting rates by July 2024. Even so, mortgage rates will remain elevated because it takes some time for these changes to filter through to the broader financial markets. Hence, we expect housing demand to stay below its recent 2022 peak.

US Unemployment Claims Plummet to Nine-Month Low

The number of Americans filing for unemployment benefits in the week ending October 14th plummeted to a nine-month low of 198,000, defying prevailing expectations of a surge in layoffs amidst high interest rates.

Resolute Job Growth

The Labor Department's report last Thursday, October 19th, showed a significant drop from the revised 211,000 claims registered in the previous week. This is the first time that new jobless claims dipped below 200,000 since mid-January.

This unexpected decline in unemployment claims underscores the resilience of the US labour market. The consensus forecast for claims for the week ending October 14 was 210,000.

Continued Signs of Cooling

Despite favourable unemployment data, there is an underlying concern that the labour market is showing signs of cooling. US wages are showing moderate growth. Moreover, the Fed's Beige book published on October 18th, revealed that employees are not changing jobs as frequently as in the past and are not pushing as aggressively for substantial pay raises. This is consistent with our analysis early this October.

Nevertheless, the prevailing economic conditions continue to paint a picture of overall growth. Businesses are enjoying robust demand for their products, which has contributed to the limited number of layoffs. This can however, be a temporary scenario where demand metrics are skewed positively by holiday spending.

The Fed pays keen attention to how labour demand influences wage growth, a crucial factor in core service inflation. If we see wage growth moderate further, the Fed may cut rates sooner than is currently expected. Until such a scenario unfolds, we anticipate that interest rates will remain higher-for-longer.

NEWS FROM THE CRYPTO-SPHERE

Ferrari Embraces Cryptocurrency Payments, Testing Waters for Expansion

Figure 16. **Ferrari Embraces Cryptocurrency Payments, Testing Waters for Expansion**

- **Ferrari has partnered with BitPay, which will immediately convert crypto payments and ensure they come from legitimate sources**
- **This facility is only available for Ferrari vehicles in the US, with plans to expand to Europe, backed by their commitment to carbon neutrality by 2030**

Ferrari has greenlit cryptocurrency payments for its cars in the US, eyeing an expansion into Europe due to client demand. While most prominent corporations remain wary of cryptocurrencies, Ferrari sees potential. A precedent in this space was set by Tesla in 2021 when it accepted Bitcoin as payment, only to halt it later due to concerns it said it had over the environmental impact.

Enrico Galliera, Ferrari's Chief Marketing and Commercial Officer, said however that software innovations in Bitcoin mining, and a lean towards green energy, lessened the company's environmental concerns. Galliera reiterated Ferrari's ambition to be carbon neutral by 2030, and that the move to embrace crypto came from both market demand and feedback. With over 1,800 US deliveries in the first half of the year, Ferrari sees strong demand up to 2025 and aims to explore this growing market further.

In order to enable crypto payments, Ferrari has partnered with crypto payment processor BitPay, which supports payments in Bitcoin, Ether, and USDC. Galliera emphasised the importance of stable pricing, stating that customers wouldn't face additional fees when paying with digital currencies.

BitPay will instantly convert cryptocurrency payments into fiat to ensure price stability. Furthermore, BitPay will verify that these virtual transactions originate from lawful sources and aren't linked to criminal activities.

Cryptocurrency Firms Face $1 Billion Lawsuit by New York Attorney General

Figure 17. New York's Attorney General, Letitia James (Source: CNBC)

- **New York's Attorney General filed a lawsuit against Gemini Trust, Genesis Global Capital, and Digital Currency Group (DCG) for allegedly defrauding investors out of over $1 billion through the Gemini Earn program**
- **In response, Gemini countered the accusations, positioning themselves as victims. Genesis denies any wrongdoing but commits to cooperating with the legal proceedings and focusing on its ongoing Chapter 11 proceedings**

New York's Attorney General, Letitia James, filed a lawsuit against major cryptocurrency firms, Gemini Trust, Genesis Global Capital, and Digital Currency Group (DCG), accusing them of defrauding over 230,000 investors out of more than $1 billion. This sum includes losses suffered by approximately 29,000 residents of New York.

At the heart of the allegation is Gemini Earn, a collaborative initiative between Gemini and Genesis. Gemini Earn is alleged to have portrayed itself as a low-risk investment opportunity where users could loan their cryptocurrency assets to Genesis and receive interest payments, sometimes as high as eight percent. However, James contends that the companies misrepresented the risks, leading to substantial losses for the investors.

“These cryptocurrency companies lied to investors and tried to hide more than a billion dollars in losses, and it was middle-class investors who suffered as a result,” stated Attorney General James.

Following the collapse of FTX, and subsequent market downturn, Genesis temporarily halted customer withdrawals in its lending division, attributing the decision to market instability. The company later declared bankruptcy. The lawsuit also sheds light on how aware Gemini was to the inherent risks tied to Genesis' loans, as well as the company’s ties with Alameda Research, which was controlled by Sam Bankman-Fried (SBF), who himself is currently defending allegations of fraud and conspiracy charges in New York's federal court.

According to James, “Gemini [also] hid the risks of investing with Genesis and Genesis lied to the public about its losses.”

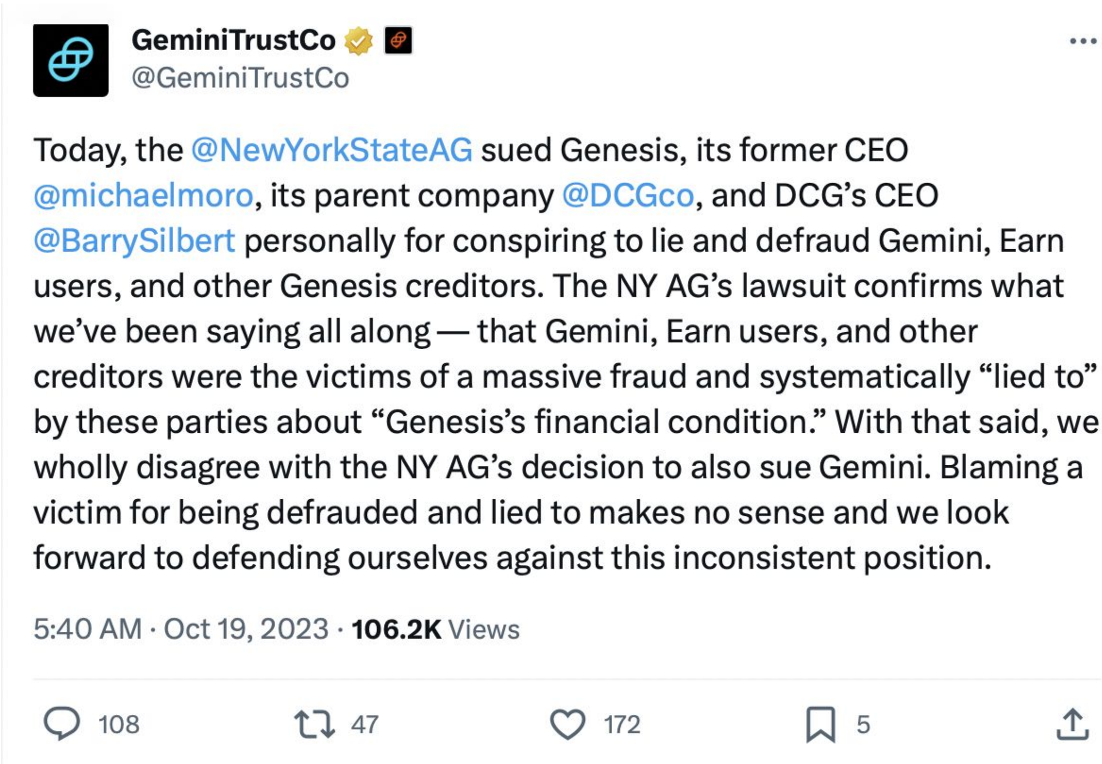


Figure 18. [Gemini response] to New York State AG’s Lawsuit

Reacting to the allegations, Gemini took to X (previously known as Twitter), countering the claims and positioning themselves as victims of a massive fraud. "Blaming a victim for being defrauded and lied to makes no sense and we look forward to defending ourselves against this inconsistent position.," read the statement.

Genesis, while denying any wrongdoing, stated its intention to cooperate fully with the legal processes. They emphasised their commitment to adhering to the law and focusing on securing the best outcomes for their creditors in the ongoing Chapter 11 proceedings.

El Salvador's Journey in Bitcoin Adoption

Figure 19. El Salvador's Journey in Bitcoin Adoption

In 2021, El Salvador made history by becoming the first country to recognize Bitcoin as legal tender. This audacious move drew international media to the Central American nation of just 6.3 million people. Since then, the country's panorama has transformed significantly, with many seeing Bitcoin's adoption as the catalyst. While sceptics may see the progress as mere serendipity, it's clear that Bitcoin contributed to reshaping El Salvador's reputation and catalysing a shift in its citizens' perspective.

Adoption Challenges

Many critics have expressed publicly that El Salvador's "Bitcoin Experiment" was a failure. In January 2022, when the price of Bitcoin had fallen more than 50 percent from its peak in November 2021, the International Monetary Fund (IMF) urged El Salvador to reverse its decision in adopting Bitcoin as its legal tender. Yet, President Nayib Bukele stayed firm on his commitment to his Bitcoin initiative.

While Bitcoin has catalysed a positive shift in El Salvador, the nation's evolution is even more noteworthy when considering how the country has grappled with hardships for decades . For years, El Salvador has been synonymous with soaring crime rates and rampant gang violence. Yet, today's generation is determined to shed this notorious image. Central to this transformation has been the forward-thinking leadership of its current officials.

Positive Transformation

Investors drawn to El Salvador

El Salvador's embrace of the digital economy has positioned it as a leader in financial innovation. This move has magnetised investors, catalysing a notable uptick in its economic expansion. The launch of El Salvador's digital assets law, coupled with attractive tax incentives for tech firms, were pivotal to the country's recent deal with Google; in which the tech giant has pledged to establish some of its cloud services within the nation. This development highlights the increasing trust in El Salvador's commercial landscape and its emerging prominence as a tech centre in Latin America.

Earlier this year, Bitfinex became the world's first international digital asset platform to receive approval to be licenced as a Digital Asset Service Provider under El Salvador's Digital Assets Issuance Law.

Improving Financial Education Amongst Citizens

Prior to its decision to make Bitcoin legal tender, El Salvador faced a stark lack of financial education. Data from Statista shows that in 2021, only 36 percent of the country's adult population had bank accounts

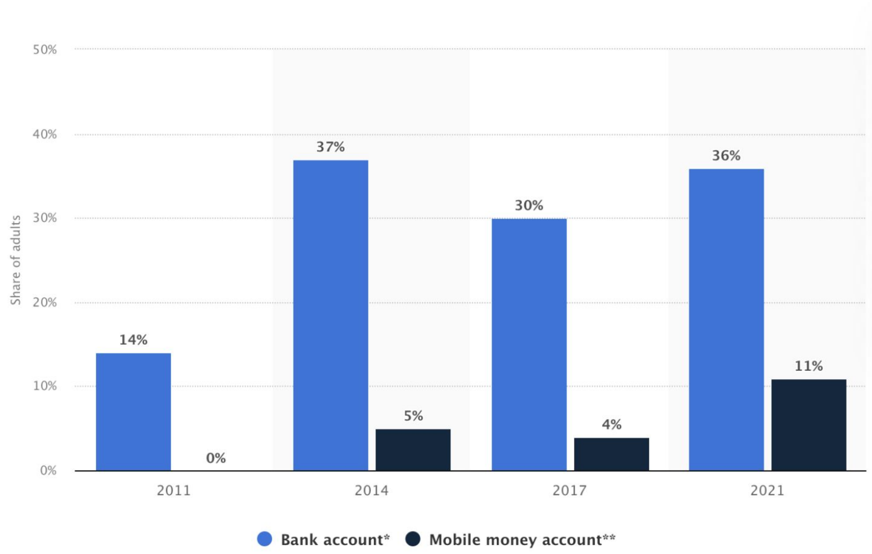


Figure 20. Share of Adults owning a Bank account, Source: Statista.com

However, since its Bitcoin adoption, El Salvador has seen significant efforts to educate citizens about Bitcoin, with the establishment of dedicated education centres and specialised diploma programs. In September 2022, the country initiated a pioneering project to integrate Bitcoin-related content into school curricula, collaborating with "Mi Primer Bitcoin" (MPB), a prominent Salvadoran nonprofit educational initiative.

Figure 21. Nayib Bukele's Social Media Post on El Salvador's Tourism Recovery (Source: @nayibbukele)

President Bukele has previously highlighted the role of Bitcoin in revitalising its tourism industry in August 2022 as seen in the figure above.

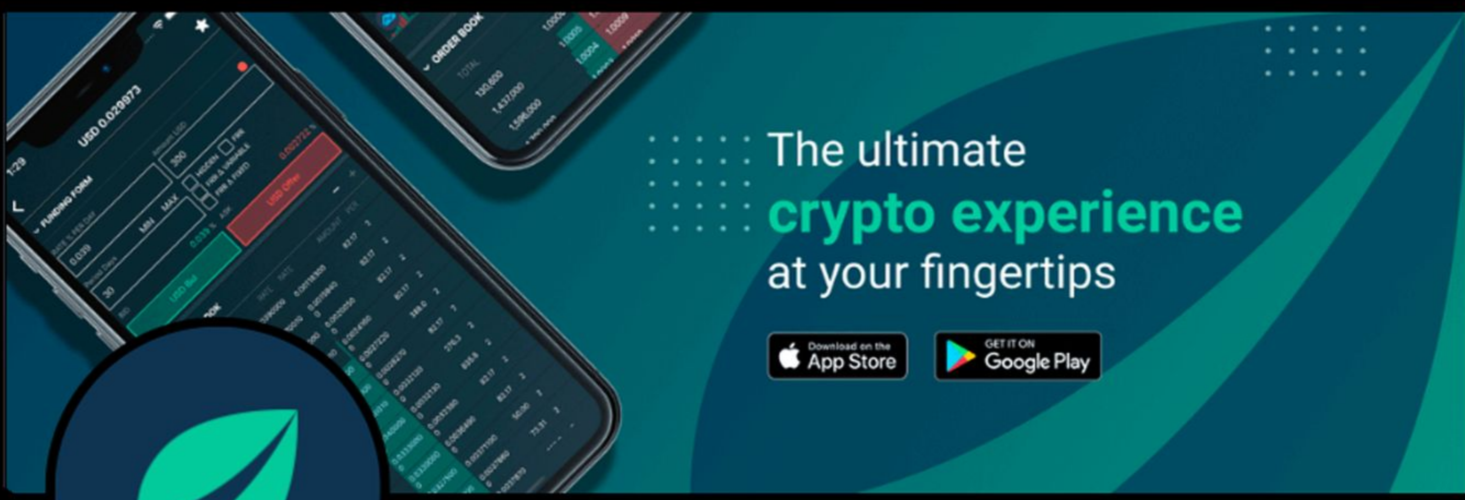
Mining Pools

In June 2023, Tether invested in El Salvador's renewable energy project "Volcano Energy", aiming to support Bitcoin mining farms using solar and wind power. This initiative aims to harness renewable energy in El Salvador for Bitcoin mining. On October 4th, El Salvador launched its first local Bitcoin mining pool named Lava Pool, in collaboration with Luxor Technology, under the Volcano Energy Initiative.

Moving Forward

According to a study, El Salvador has emerged as a dominant player in the Bitcoin arena, just trailing behind the United States in the list of countries with highest interest in Bitcoin. However, a significant number of Salvadorans remain sceptical about Bitcoin. A study by National Bureau of Economic Research NBER detailed that the main reasons Salvadorans don't use Bitcoin is because they "do not understand it."

This sentiment mirrors a core belief embedded within Bitcoin's philosophy: genuine, impactful change doesn't happen overnight. It is the culmination of persistent effort, unwavering dedication, and a forward-looking vision that transcends short-term gains. After all, Bitcoin's rise and global acceptance are testament to years of steadfast support from its advocates, who are convinced of its transformative potential.



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