BITFINEX Alpha

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EXECUTIVE SUMMARY

Post the Bitcoin ETF approvals, the sell-off seen at the end of last week was a direct result of short-term holders realising substantial profits against their average realised buy-in price of around $38,000.

We maintain our stance that the market remains prone to corrections and pull-backs in this early part of the year. We note that immediately preceding the sell off there was an unprecedented transfer of 'in the money' BTC to exchanges.

However, despite this selling pressure, we see a number of factors that continue to show an underpinning to Bitcoin's price. Firstly there has been a significant increase in ERC-20 stablecoins on exchanges, signalling heightened market speculation and investor confidence. Historically, an expansion of stablecoins leads to increased buying.

Secondly, the Bitcoin CME futures contract continues to see high levels of open interest, hitting a new year-to-date high just before the ETF approvals were announced, and even post the event remains at high levels. This suggests that sophisticated investor interest in BTC continues, albeit through derivative instruments rather than direct holdings.

A third underpinning is that long-term holders remain steadfast in their positions, underscoring a market that is resilient yet susceptible to short-term volatility.

In the macro environment, December consumer prices rose more than anticipated, primarily due to increasing rental costs. However, strong job creation and real wage growth continues, with wages growing faster than inflation.

We continue to highlight the balancing act that the Fed has to navigate as it seeks to foster growth, while controlling inflation. Planned rate cuts in 2024 are intended to support the economy, but they must be carefully calibrated to avoid reigniting inflation.

The current market expectations however are positive. Most expect - as do we - a reduction in Fed rates, particularly as over $3 trillion in corporate debt, accumulated at low-interest rates during the pandemic, will confront higher rates in 2025. The Fed will be keen to ensure that it does not place an undue burden on corporate growth. Furthermore, the expiration of the 2017 Tax Cuts and Jobs Act at the end of 2025 necessitates adjustments in monetary policy.

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In such a scenario, the Treasury bond yield curve is no longer inverting and transitioning back to a more conventional structure and a renewed sense of optimism.

Investors have also started shifting assets away from money market funds to longer-term Treasury bills and private equity funds, reflecting a preference for risk. Concurrently, the Federal Reserve is considering a slower reduction of its asset portfolio to maintain market liquidity and efficiency.

News-wise, we've had significant developments. First, the SEC encountered a security breach in its 'X' account, leading to an unauthorised announcement regarding Bitcoin ETFs, which momentarily jolted the BTC price and sparked a broader conversation about cybersecurity vulnerabilities within financial regulatory bodies.

Now the ETF approval has officially come through, we look forward to a substantial widening of the Bitcoin investor base, bringing with it a fresh wave of enthusiasm among investors and market players.

The impact of this approval was evident in the market dynamics. Following the SEC's nod, the BTC price surged, reflecting the market's positive reception of this development. The first day of trading for the 11 new spot Bitcoin ETFs saw a remarkable $4.6 billion in trade volume, underscoring the high investor interest and the potential growth trajectory of these financial products.

Bitfinex Alpha salutes this milestone achievement and remains positive on the future outlook for BTC - albeit we remain vulnerable to pullbacks in the short-term. Happy trading!

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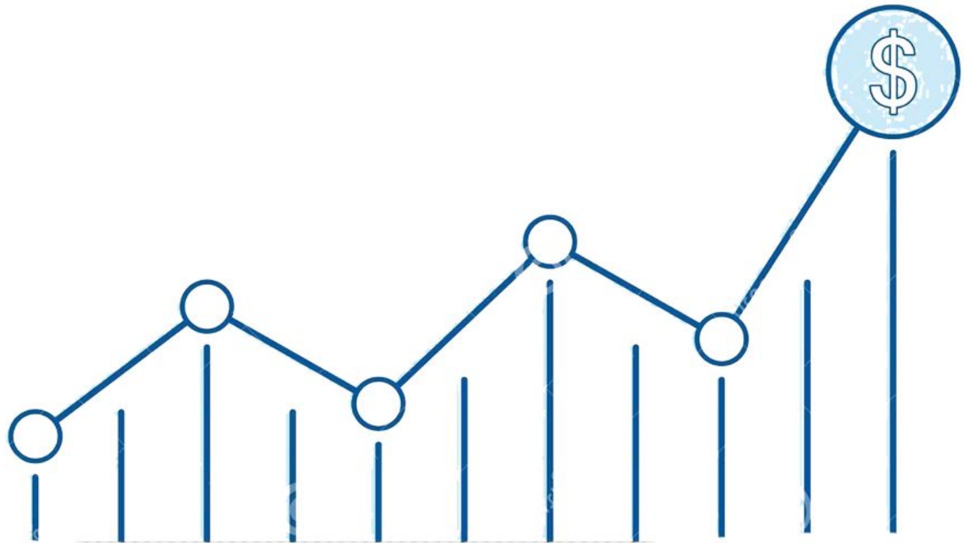

WHAT'S ON-CHAIN THIS WEEK?

Capital Inflows Increases as Market Speculation Increases

There has been a notable increase in dollar-denominated ERC20 stablecoins since the beginning of the year. Starting at around $18 billion at the start of the year, balances have now reached $20 billion (refer Figure below), as capital moves into the asset, with price increases also being seen in various altcoins.

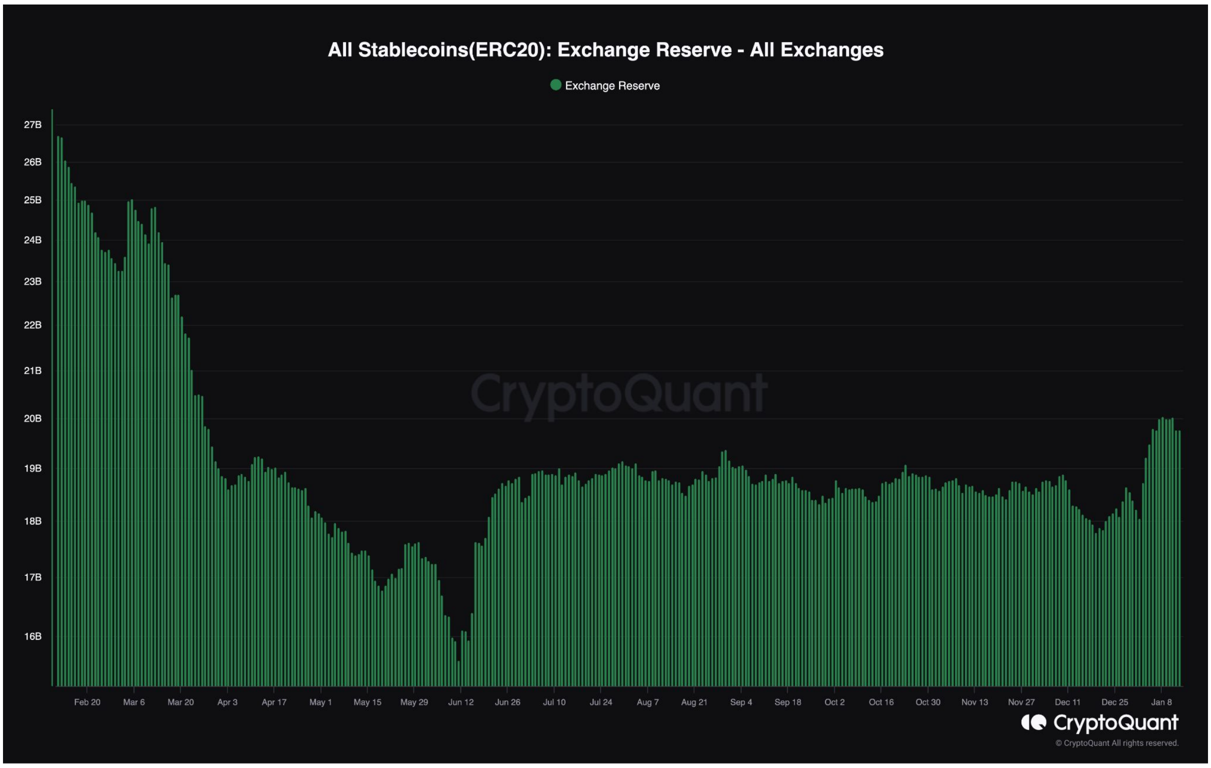

Figure 1. ERC-20 Stablecoin Exchange Reserve. (source: CryptoQuant)

Normally, it is assumed that stablecoins being minted or moved onto exchanges is considered to be a bullish sign as large entities prepare to make large purchases.

The growth in the supply of stablecoins is also playing a pivotal role in enhancing the liquidity of the BTC market, and exerting a positive influence on BTC price. As the quantity of circulating stablecoins increases, investors are frequently leveraging this augmented liquidity to buy BTC. This trend amplifies the demand.

This recent surge in the overall stablecoin supply (refer Figure below) can be seen as a barometer of investor confidence, which in turn, is invigorating interest in Bitcoin.

Figure 2. Total Supply Of All ERC-20 Stablecoins. (source: CryptoQuant)

Additionally, the excitement around Bitcoin spot ETFs is anticipated to further bolster the influx of capital into the broader cryptocurrency ecosystem. Despite a downward trend observed since the end of 2022 and continuing through 2023, early indications in 2024 suggest the reverse. This shift could signal an increase in risk appetite among investors, which in turn is likely to benefit digital assets across the board.

Monitoring the developments in Bitcoin's CME futures open interest (OI) is instructive. Last week saw, the OI reach a new year-to-date high, having exceeded $6 billion (refer Figure below), marking the highest level ever recorded. This rise in open interest has been consistent, aligning with the decisions on the Bitcoin ETF applications.

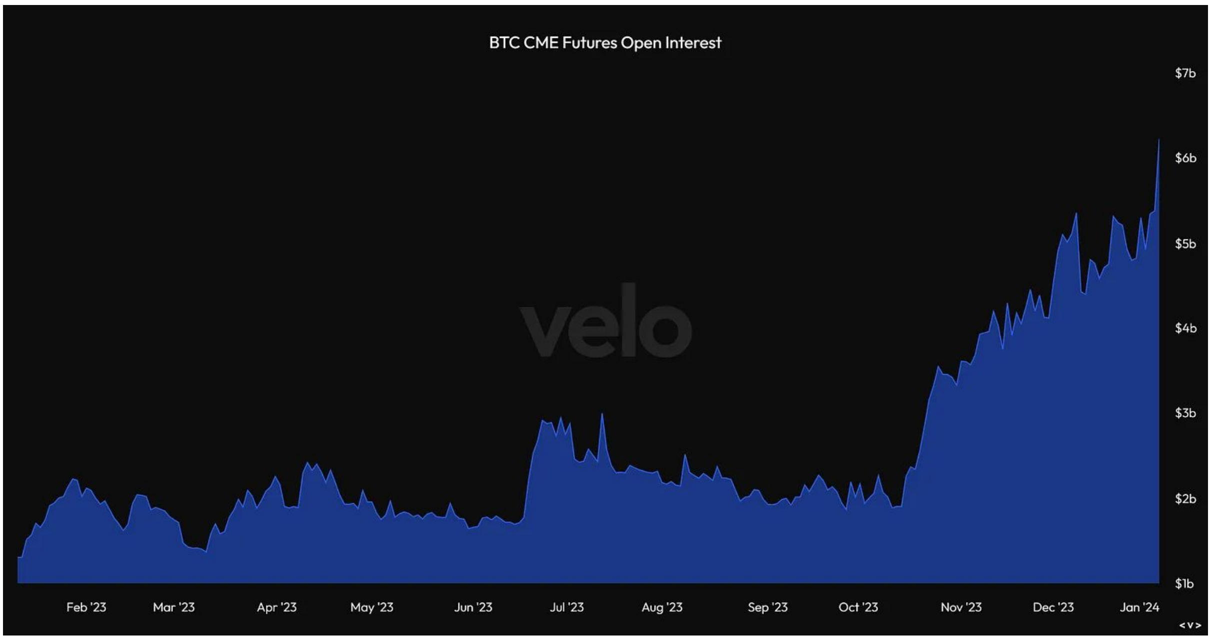

Figure 3. BTC CME Futures Open Interest. (source: VeloData)

However, OI has reduced significantly post ETF approval and positions have closed as seen in the analysis in the following section. The interpretation of this trend is that the market initially had a lack of position closure. If the ETF approval was a "sell the news" event, there would have been an immediate reaction in OI.

One plausible explanation is that market participants were utilising BITO (the ProShares Bitcoin Strategy ETF) and CME futures as instruments for Bitcoin exposure, acting as a liquidity bridge and now continue to keep long-term positions open. This suggests that traders and investors are leveraging these instruments to maintain their Bitcoin market exposure in a more regulated and structured environment, rather than direct holdings of the cryptocurrency. Another explanation is that ETFs have spurred fresh market speculation and injected more liquidity and volatility into the crypto market which is here to remain, however, a lot of the price decline came from spot positions being exited by short-term holders as we cover in the following section. This aligns with cyclical behaviour and our long-standing prediction of a pronounced BTC pullback in early 2024.

Short-Term Holders Realised Heavy Profits

$2.2 billion worth of "in the money" BTC was transferred to exchanges by short-term holders on Friday, January 11th (as per *Glassnode* data), marking an all-time high for this type of transaction, and triggering a drop in the BTC price. This movement suggests that investors who adopted the strategy of "buying the news and selling the event" were able to execute their trades successfully.

Profit-taking by short-term holders (STHs) is attractive, when we consider the realised price for this investor cohort is currently at around $38,000, while the spot price has increased significantly leading up to the ETF approval date, surging more than $2,000 in the first ten days of January 2024 alone, and more than $7000 in the past 20 days.

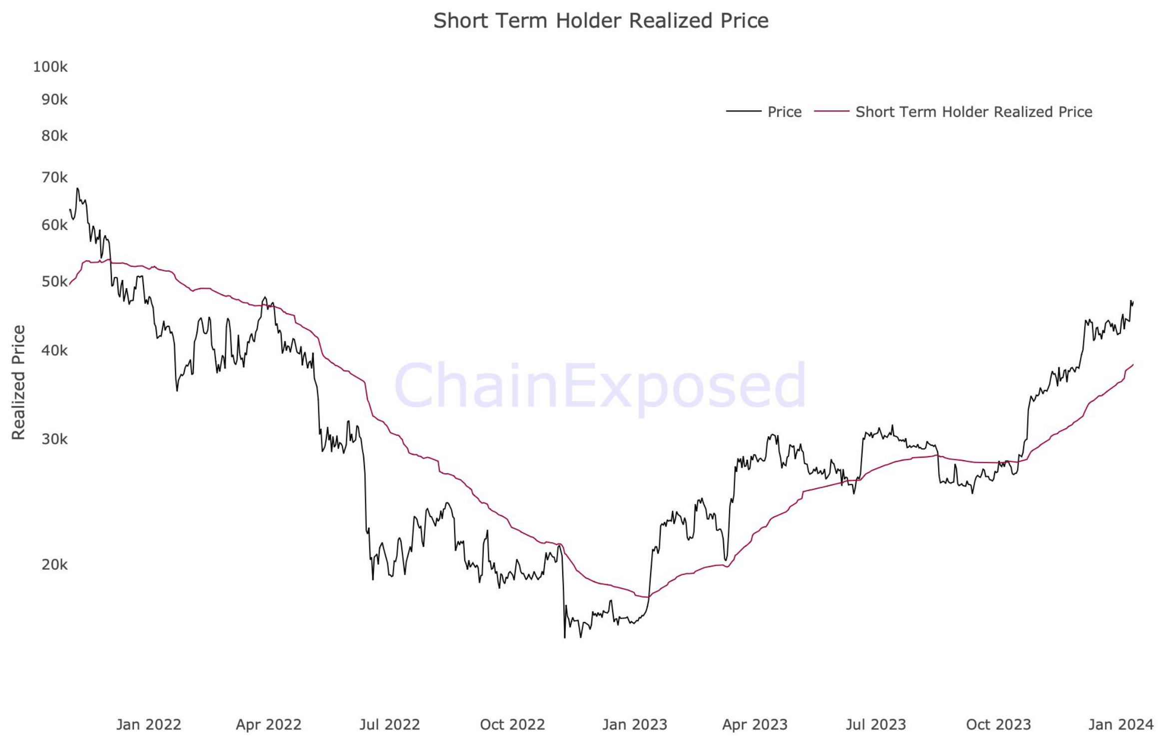

Figure 4. The USD wrecking ball in full swing outperforming major currencies.

The realised price also rose because a particular investor cohort sold large amounts of BTC at prices higher than the historical average. A rapid ascent in the metric as seen above correlates to massive profit-taking. However, the long-term holder (LTH) realised price has barely budged implying that the larger and longer-term investors do not perceive the current market correction and the ETF event as a mid or higher timeframe market top. Despite this influx of BTC being sold, which typically increases sell pressure in the market, BTC has shown notable resilience, sustaining above the pivotal $40,000 level. (refer Figure below)

Figure 5. ***BTC/USD Hourly Chart. (source: Bitfinex)***

BTC made a new cycle high of $48,746 post the ETF approval news. Post the high, we had a 15 percent correction borne of heavy spot selling. This is in line with our 2024 outlook report forecast of a heavy correction early into 2024 and increasing volatility and liquidity after the ETF approval decision was announced.

The response of LTHs to recent market movements has however been notably minimal. Currently, over 70 percent of Bitcoin's total supply has not been transacted or moved for more than a year, slightly below the all-time high of 72 percent for the metric reached last November. This lack of activity from long-term holders indicates a strong holding sentiment, for the time being.

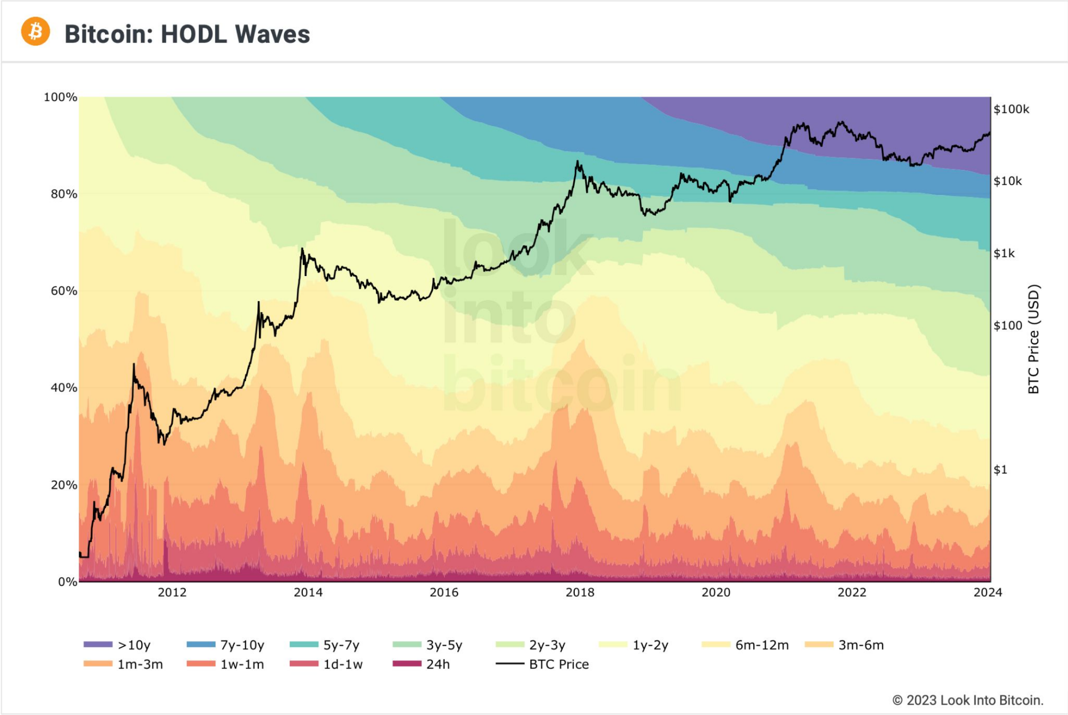

Figure 6. Bitcoin HODL Waves. (source: Glassnode)

While short-term speculators may influence the BTC price in the short term, creating volatility and price fluctuations, the medium and long-term outlook for Bitcoin remains positive, despite our belief that there could still be further corrections. Our optimism is largely contingent on the behaviour of the LTHs. Their holding pattern acts as a stabilising force in the market, counterbalancing the effects of short-term trading and speculation.

What remains to be seen is whether bid demand for BTC steps up at current levels or not. STHs have been sitting on substantial unrealized profit margins, averaging around 30 percent in early January. Historically, such high levels of unrealized profits among STHs have often preceded corrections in BTC till the realised price for the cohort is close to being reached. This is currently at $38,000, as stated earlier. This pattern suggests that when short-term holders accumulate significant paper gains, they may become more inclined to realise these profits by selling, leading to increased selling pressure in the market and triggering price corrections.

While we have already corrected, it remains to be seen whether we will reach the realised price for short-term holders or not.

GENERAL MARKET UPDATE

US Consumer Price Surge in December May Delay Expected Federal Reserve Rate Cut

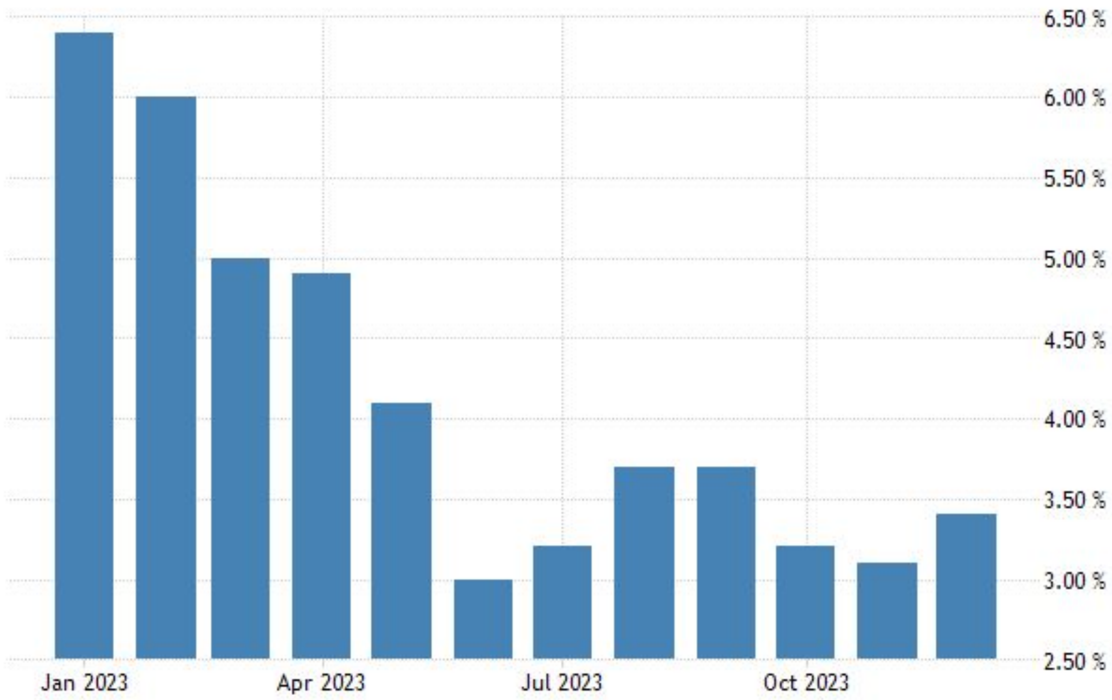

Figure 7. Realised price by age for unspent Bitcoin. (source: Whalemap.io)

The Labour Department reported last Thursday, January 11th, that the Consumer Price Index (CPI) saw a 0.3 percent rise in December, following a modest 0.1 percent increase in November. Notably, over half of this rise in the CPI is attributed to the climbing costs of housing. In the 12 months to December, CPI is up 3.4 percent, an increase from 3.1 percent seen in November, and above consensus forecasts of a monthly CPI rise of 0.2 percent and a year-over-year (YoY) increase of 3.2 percent.

Despite the average inflation rate over three months standing at 1.8 percent and a six-month rate of 3.3 percent, pricing within the service sector, which constitutes 62 percent of the total index, is up five percent YoY. Such data will keep the Fed cautious about loosening monetary policy too early.

Figure 8: Probability of a 25 basis-point Rate Cut by March 2025 Meeting (CME FedWatch Tool)

However, The Producer Price Index (PPI), released on Friday, January 12th, presented a less alarming scenario, offering solace to those worried about the higher-than-expected CPI.

Monthly PPI fell by 0.1 percent in December, the third decline in a row, and in stark contrast with the consensus forecast of a 0.1 percent rise.

The decrease in December's PPI was received positively, particularly when combined with a lowered revision of November's monthly figures. This clearly indicates that disinflationary trends are emerging. Hence, as of Monday, January 15th, expectations for a March rate cut increased to 73.3 percent.

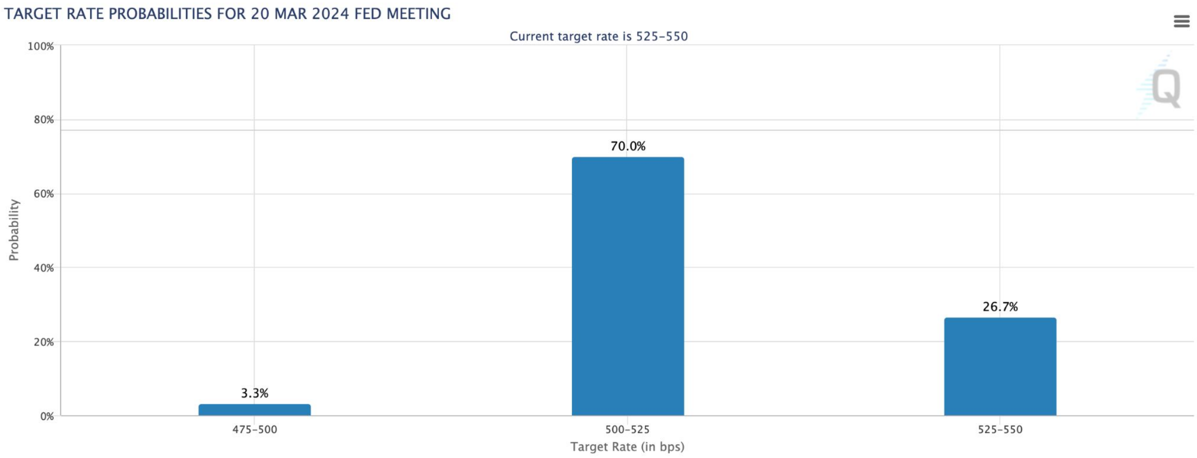

Figure 9. Target Rate Probabilities for March 20 Fed Meeting (Source: CME FedWatch Tool, as of January 15, 2023)

Persistent inflation in the service sector and specific core measures of consumer inflation in December suggest that the Fed is likely to maintain current interest rates at its upcoming January meeting.

We expect the path to achieving the Fed's two percent inflation target is going to be nonlinear, with ongoing inflation in the service sector and persistent housing costs presenting challenges. Nevertheless, the overall deceleration in core inflation has contributed to an increase in real wages, which rose by 0.8 percent from the previous year. This growth in real wages is expected to provide some support against the anticipated slowdown in overall economic activity in the near term.

US Consumer Credit Hits Record High, Surpassing $5 Trillion in November

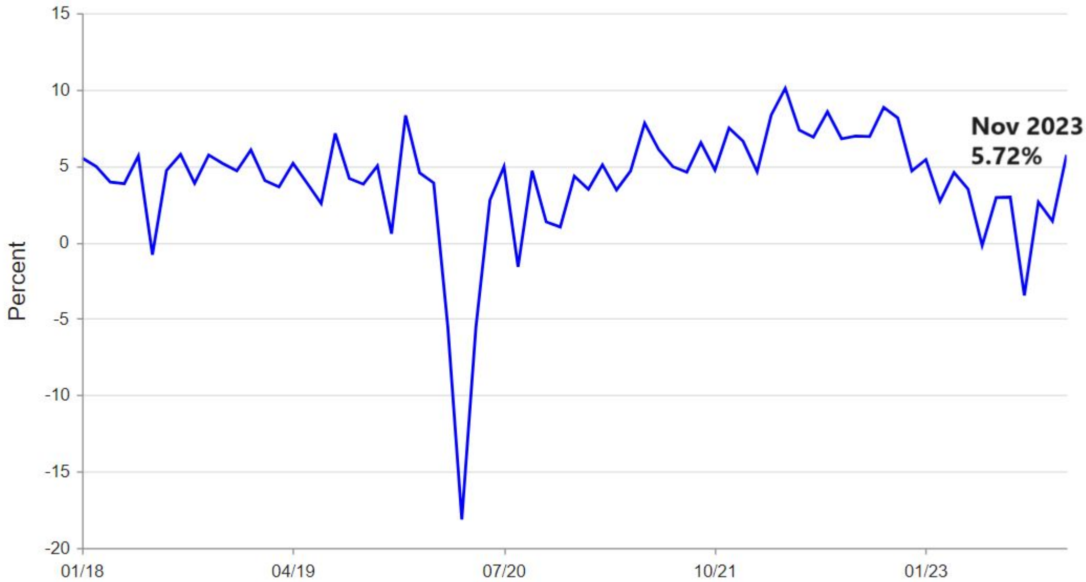

Figure 10. Percent Change in Total Consumer Credit (Source: Federal Reserve)

In November, consumer credit in the United States experienced a significant surge, with an increase of $23.7 billion, a notable rise from the $5.8 billion uptick seen in the previous month, according to a report released by the Federal Reserve last Monday, January 8th . Consumer credit is now up 5.7 percent on an annualised basis, up sharply from a revised 1.4 percent reported for October. This growth, the most substantial since November 2022, has resulted in total consumer credit exceeding $5 trillion for the first time. Notably, these figures have not been adjusted for inflation.

The expansion in consumer credit surpassed the consensus forecast of $8 billion.

A closer look at the data reveals that revolving credit, which includes credit card usage, escalated significantly, recording a 17.7 percent growth rate, a stark contrast to the 2.7 percent increase in the previous month. This marks the most substantial rise since March 2022. On the other hand, non-revolving credit, which primarily consists of auto and student loans, showed a more moderate growth rate of 1.5 percent, up from 0.9 percent in the prior month.

This type of credit tends to be less volatile. It's important to note that the Fed's data does not encompass mortgage loans, which constitute the largest portion of household debt.

The sharp increase in consumer credit growth is likely attributed to the onset of the holiday shopping season, and looking at the broader trend, consumer credit has in fact been declining as it responds to both tightening monetary policy and stricter bank lending standards. If the Fed reduces rates this year (as is expected), there is a likelihood that consumer borrowing will increase in 2024.

Balancing Act: The Federal Reserve's Crucial Role Amid Economic Shifts and Fiscal Challenges

A Pivotal Role in Economic Stability

Fed monetary policy is a critical determinant of the US economy's trajectory. Recently, the economy has shown resilience, particularly in the job market and in terms of wage growth.

Recent data has revealed a stronger-than-anticipated performance in job creation, with the unemployment rate holding steady at 3.7 percent. The consistent addition of jobs across various sectors is a positive sign for the economy. A key factor in the current economic landscape is the rate of wage growth, which is outpacing inflation. With wages increasing at about 4.1 percent and CPI inflation at 3.4 percent, real wage growth is in positive territory.

The Impact of Rate Hikes and the Shift to a Cautious Approach

In an effort to stabilise prices, the Fed has increased the fed funds rate over the past two years, which has helped reduce inflation from its 9.1 per cent, While this is laudable, higher rates also bring with it the risk of a slowing economy. High-interest rates dampen both consumer spending and business investment, which are crucial drivers of the US economy. The Fed's latest decision to hold off further rate increases underscores a cautious approach, acknowledging the unpredictability surrounding inflationary pressures and the need to sustain economic momentum.

The Fed anticipates reducing its policy rate by about 75 basis points in 2024, according to the latest Summary of Economic Projections. This potential reduction is seen as a move to bolster the economy, particularly if inflation continues to align with the Fed’s stability goal. However, the timing and scale of these rate cuts are critical. Premature or excessive reductions could reignite inflation, while delays or minimal cuts could hinder economic growth. The Fed's approach will have to balance these risks to ensure that the reduction supports continued growth without triggering inflationary pressures.

Future Challenges

A significant challenge looming on the horizon is the refinancing of corporate debt, which has been previously secured when interest rates were at historically low levels during the 2020 pandemic.More than $3 trillion in corporate debt needs to be refinanced in 2025, and this will occur at substantially higher interest rates compared to those seen in 2020.

As a consequence, we expect the impending wave of debt maturities to significantly influence policy discussions.

Another aspect to consider is the expiration of the 2017 Tax Cuts and Jobs Act (TCJA) in 2025, when almost all of the individual, estate, and pass-through provisions of the TCJA will come to an end, and will as a consequence, create opportunities for an improvement in tax policies. Changes in tax policy can influence economic growth, affecting corporate investment and consumer spending. The Fed's monetary policy will need to adapt to these fiscal changes to maintain economic stability.

US Economy: Growth Prospects in a Changing Landscape

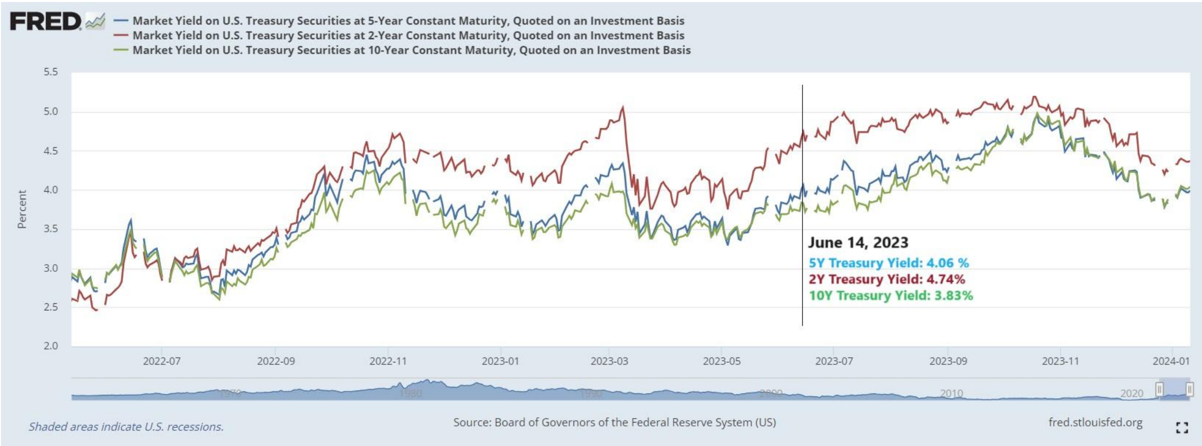

Figure 10. Two-year, Five-year, and Ten-year US Treasury Yields (Source: Board of Governors of the Federal Reserve)

Six months ago, the US economic situation was markedly different. The Fed was still increasing its policy rate, and this was causing a notable imbalance in Treasury bond yields. Specifically, two-year Treasury bonds yielded approximately 4.74 percent, higher than the five-year yields at four percent. Furthermore, 10-year yields were even lower at 3.83 percent, creating an inverted yield curve. This inversion hinted at the possibility of an economic slowdown or even a recession.

However, the scenario has since transformed, as the economy has demonstrated significant resilience to the rate hikes that characterised recent Fed policy. The yield on 10-year Treasury bills decreased in 2023 from 5.0 percent to 3.8 percent by the end of the year, and as inflation started to decrease, with the economy continuing to perform well, the Fed has indicated its plans to reduce its policy rate.

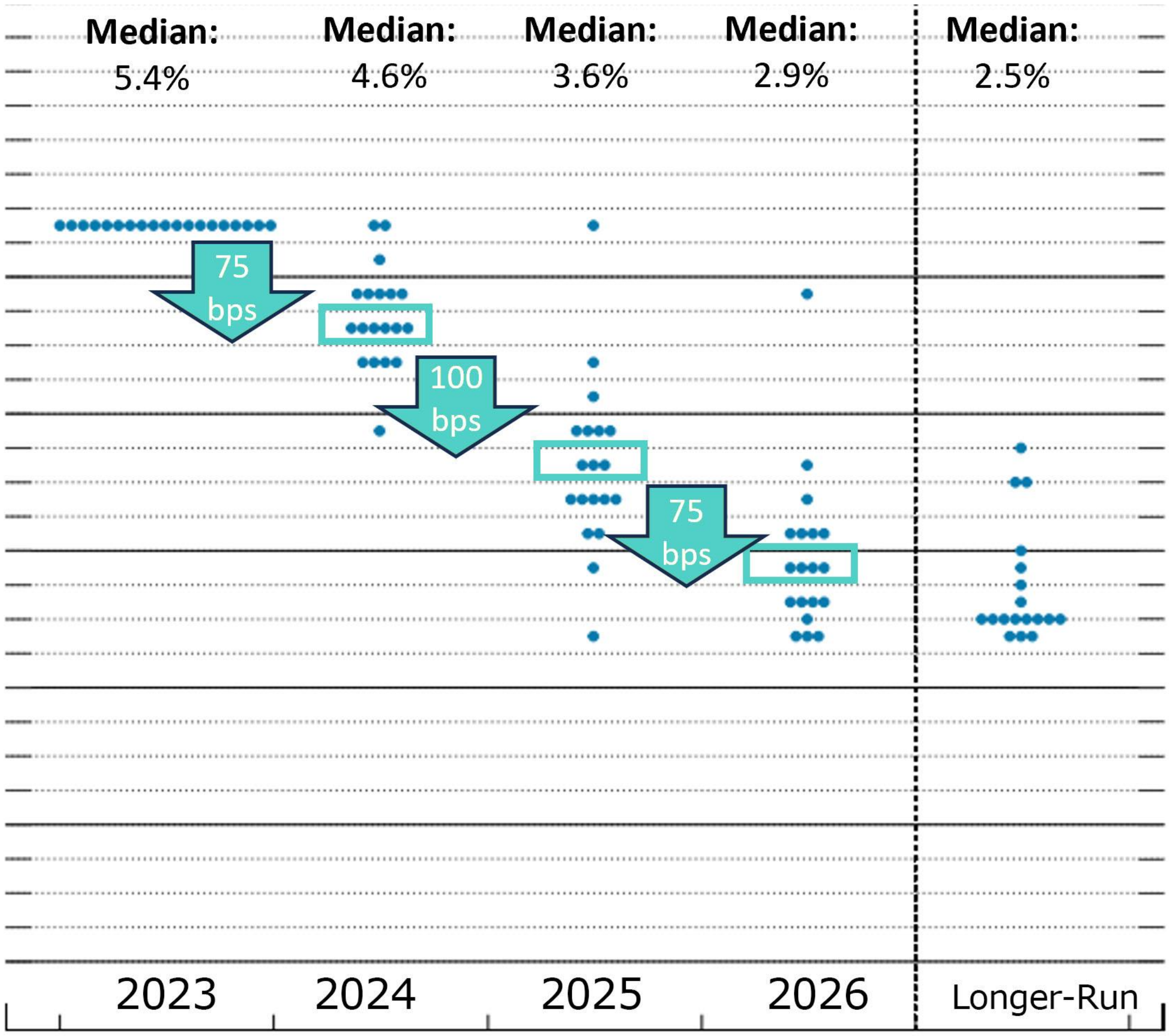

Figure 11. The Federal Reserve Dot Plot in its December 2023 Summary of Economic Projections (The Federal Reserve)

The market now sees fed funds rates dropping to 4.6 percent this year, 3.6 percent in 2025, and eventually reaching 2.5 percent in the longer term, as seen on the Fed's December 2023 dot plot. This adjustment in bond yields is expected to result in a steepening at the front end, with two-year yields falling below those of five and ten-year bonds.

In such a scenario we expect to see an increase in risk appetite, with investments that had previously been deployed to money market funds deployed into private equity and treasury bills.

PE funds in particular will be seeking investment in re-financed commercial real estate and corporate debt as the recession focused narrative that dominated 2023 dissipates.

Figure 12. Overnight Reverse Repo Agreements Treasuries Securities Sold by the Fed (Source: Federal Reserve Bank of New York)

The Fed's reverse repo facility, established during the financial crisis, has played a key role in ensuring liquidity in money markets. However, investors are also now reducing their investments in money market funds, preferring the longer-term yields offered by Treasury bills. This shift is placing additional pressure on the Fed.

Lorie Logan, President of the Federal Reserve Bank of Dallas, said in her remarks at the International Banking, Economics and Finance Association and the American Economic Association, that the US central bank might need to slow down the pace at which it shrinks its portfolio of assets due to the diminishing liquidity in financial markets. While the overall financial system still enjoys ample liquidity, individual banks could face liquidity challenges, particularly as the balance in the Fed's overnight reverse repurchase facility decreases. "Normalising the balance sheet more slowly can actually help get to a more efficient balance sheet in the long run by smoothing redistribution and reducing the likelihood that we'd have to stop prematurely."

The shift in the Treasury bond yield curve, from an inverted to a more traditional structure, reflects growing optimism and a departure from recession fears. This change, coupled with the Fed's plan to gradually decrease its policy rate, signals a positive outlook for the economy. The expected stabilisation and eventual decrease in interest rates are likely to invigorate various sectors, including private equity and real estate. Moreover, the shift in investor preference from money market funds to longer-term Treasury bills indicates a growing appetite for risk.

NEWS FROM THE CRYPTO-SPHERE

SEC X Account Breach Triggers BTC Pump and Raises Cybersecurity Concerns

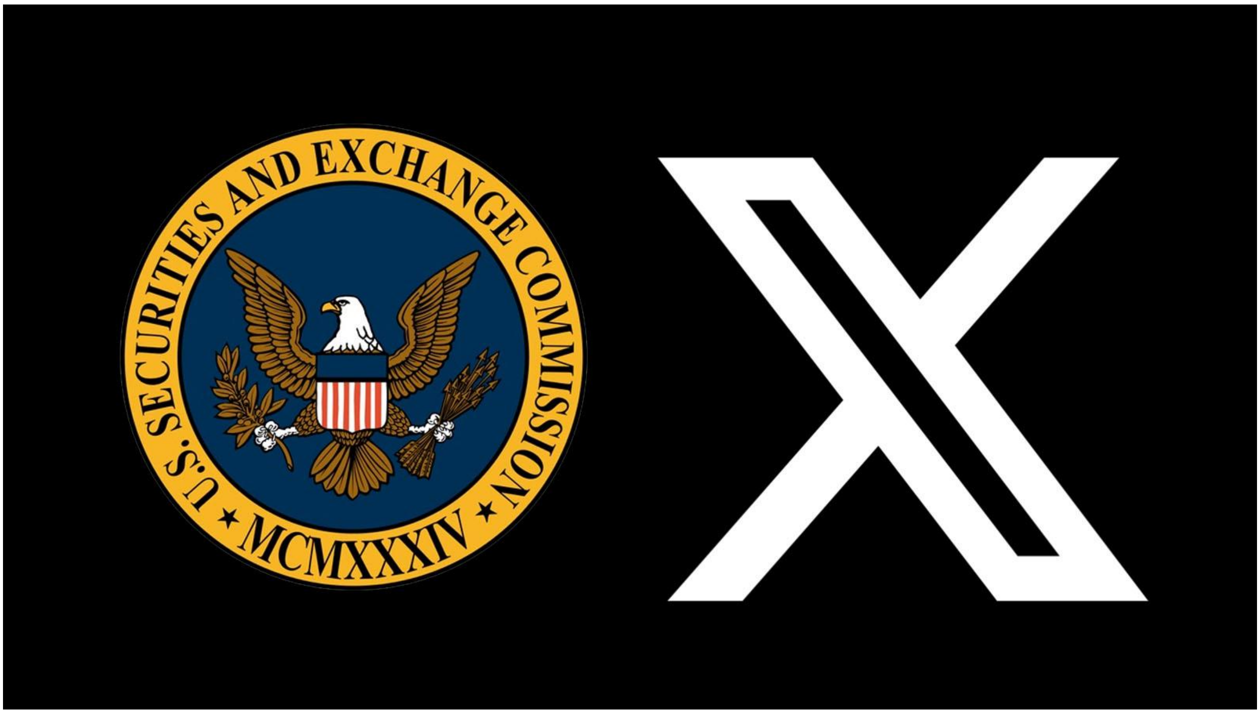

Figure 13. SEC X Account Breach Triggers BTC Pump and Raises Cybersecurity Concerns

- **A security breach on the US Securities and Exchange Commission's (SEC) X account led to a false announcement about the approval of Bitcoin ETFs, causing a temporary surge in Bitcoin prices and raising concerns over cybersecurity**
- **The breach, attributed to an external party, prompted immediate responses from US senators**

In a startling turn of events last Tuesday, January 9th, the SEC saw its official X account hacked, resulting in a spike in crypto asset prices before a subsequent fall, as well as concerns over the security of the SEC’s social media accounts and its broader systems. The SEC said its X account erroneously announced the approval of Bitcoin exchange-traded funds (ETFs), a decision eagerly anticipated for later in the week. This misinformation caused Bitcoin's value to surge over 2.5 percent as the news rapidly disseminated online and across media channels monitoring the SEC's announcements.

Figure 14. SEC's erroneous announcement on X

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SEC Chairman Gary Gensler was quick to address the issue via his personal Twitter account, confirming the inaccuracy of the SEC's tweet, which remained live for approximately 30 minutes. Gensler's intervention led to a subsequent drop in Bitcoin's price. The SEC acknowledged the unauthorised access, attributing it to an unidentified external party who temporarily controlled the @SECGov Twitter handle.

Figure 15. Sec Chair Gary Gensler announcing the inaccuracy of the earlier post on X

This breach prompted immediate action from US senators J.D. Vance and Thom Tillis, who expressed their dissatisfaction in a letter to Gensler. The senators emphasised the breach's conflict with the SEC's core missions, which include investor protection, market efficiency, and the facilitation of capital formation. Their letter, demanding a response by January 23rd, sought clarity on several aspects of the incident, including the possibility of an inside job, its impact on the SEC's decision-making timeline for Bitcoin ETFs, and whether the SEC plans to reimburse the financial losses caused by the erroneous tweet.

The SEC has vowed to collaborate with law enforcement agencies to investigate the incident thoroughly. Meanwhile, preliminary findings by Twitter's safety team suggest that an unauthorised individual gained control of the SEC's Twitter account by hijacking the associated phone number, which lacked two-factor authentication, a critical security measure.

BlackRock and Competitors Slash Fees for Spot Bitcoin ETFs

Figure 16. BlackRock and Competitors Slash Fees for Spot Bitcoin ETFs (Image Source: Forbes)

- **BlackRock, along with Ark Invest/21Shares, Bitwise, Fidelity, Valkyrie, Invesco Galaxy, and WisdomTree, are slashing their fees for spot Bitcoin ETFs, with some offering temporary no-fee periods, in a strategic effort to dominate the emerging market**
- **This fee reductions are a response to the approval of spot Bitcoin ETFs by the SEC, in an attempt by the ETF issuers to attract early market share**

In an aggressive move to dominate the emerging spot Bitcoin ETF market, a fee war emerged among all the issuers with several slashing their fees and some announcing zero fee periods for initial periods in an attempt to grab market share.

BlackRock announced it was lowering its sponsor fee from 0.3 percent to 0.25 percent. BlackRock also said that for the first $5 billion of assets in the first year it would introduce an additional temporary discount, reducing to 0.12 percent, according to its recently filed S-1 form last Tuesday, January 9th.

Similarly, Ark Invest/21Shares revised its fee structure, decreasing it from 0.25 percent to 0.21 percent, and said that for the first six months it would maintain a no-fee policy until the ETF reaches $1 billion in assets, as per their latest S-1 form.

Bitwise dropped its fee to 0.2 percent, and said it also plans to waive fees for the first six months or until the fund accumulates $1 billion in assets.

Fidelity reduced its fee from 0.39 percent to 0.25 percent, and also announced a waiver of fees for market participants until July 31. Valkyrie reduced its fee from 0.80 percent to 0.49 percent, Invesco Galaxy from 0.59 percent to 0.39 percent, and WisdomTree from 0.50 percent to 0.30 percent. These firms, like many others, are offering zero fees for a limited period to gain a competitive edge.

Issuers are strategically lowering fees as they are optimistic about fund flows. VanEck projects $1 billion in inflows within the first few days and $2.4 billion within a quarter. Galaxy foresees inflows reaching $14 billion in the first year, while Bitwise predicts the market size could grow to approximately $72 billion over the next five years.

The Launch of Bitcoin ETFs Paves Way for Widespread Cryptocurrency Investment Flows

Figure 17.The launch of Bitcoin ETFs paves way for Widespread Cryptocurrency Investment flows

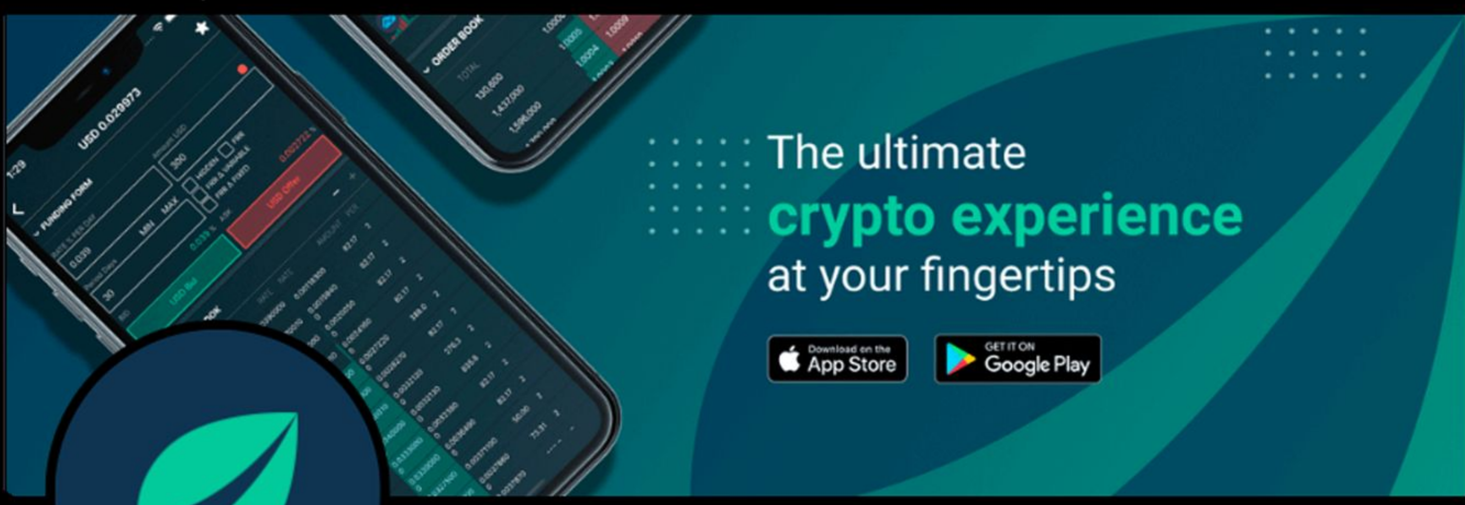
- **The SEC approval of Bitcoin ETFs broadens the accessibility of Bitcoin to investors**
- **Following the SEC's approval over $4.6 billion traded across 11 new spot Bitcoin ETFs on their first day of trading**

The SEC's eventual nod to the introduction of Bitcoin ETFs resulted in a surge in the BTC price, crossing the $47,500 mark, with other crypto assets also rising.

Last Thursday, January 11th, also saw substantial trading volume, with over $4.6 billion transacted across 11 spot Bitcoin ETFs:

- Grayscale Bitcoin Trust ($GBTC) led with a remarkable $2,326,181,000 in trading volume.
- Invesco Galaxy Bitcoin ETF ($BTCO) recorded $45,933,510.
- Fidelity Wise Origin Bitcoin Trust ($FBTC) saw $712,069,200.
- Hashdex Bitcoin ETF ($DEFI) traded $4,540,219.
- WisdomTree Bitcoin Fund ($BTCW) had $6,626,479.
- BlackRock’s iShares Bitcoin Trust ($IBIT) reached $1,035,343,000.
- ARK 21Shares Bitcoin ETF ($ARKB) had $288,794,500.
- Bitwise Bitcoin ETF ($BITB) traded $125,851,400.
- Valkyrie Bitcoin Fund ($BRRR) saw $9,365,127.
- Franklin Bitcoin ETF ($EZBC) had $65,453,230.
- VanEck Bitcoin Trust ($HODL) recorded $26,096,120.

Proponents of a spot Bitcoin ETF have long advocated for a regulated trading product centred around Bitcoin. They argue that such a product would offer both institutional and retail clients a more accessible avenue to engage with Bitcoin's price fluctuations, without the necessity of establishing wallets or investing directly in the digital asset. With the approval of these ETFs, any US investor with a brokerage account can now partake in Bitcoin investment.



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