Ahead of the curve

Week 43, 2022

LUNO

Provided by arcane research

Market Update

Diminishing volatility in BTC
A green week following a massive short squeeze. Last week saw the largest short liquidation volume in crypto since July 26, 2021, contributing to pushing BTC up 6%. ETH saw more substantial gains of 18%, driven by a heftier short squeeze. Throughout the last week, BNB has seen a more stable uptrend, possibly led by more BNB enthusiasm related to Binance's role in Musk's Twitter takeover.

Traders should prepare for volatility in the coming weeks, as the event calendar is crowded with potentially market-moving events. Wednesday's FOMC press conference (see page 9) is this week's key event, but company earnings (MicroStrategy Nov 1, Coinbase Nov 3), economic data, and U.S. mid-terms may also lead markets to move.

Relative crypto strength since FOMC
Wednesday's FOMC press conference will likely lead to volatility in a highly correlated environment between crypto and U.S. equities. Currently, the market is pricing in an 86% probability of a 75bps hike versus a 14% probability of a 50bps hike. The odds for a 50bps hike have increased materially in the last week as chatter about a FED pivot has strengthened. A 75bps hike is still the most likely outcome, but due to rising expectations of a 50bps hike, a 75bps hike is poised to reflect negatively on the market.

Crypto has shown strong relative strength over equities since the last FOMC. ETH and BTC saw massive short-lived selling pressure immediately after the FOMC press conference but recovered comfortably, seeing strong positive returns since the last FOMC. Gold and equity indexes, on the other hand, are in the red. This is a positive sign of relative strength from crypto, and we note slight signs of declining correlations.

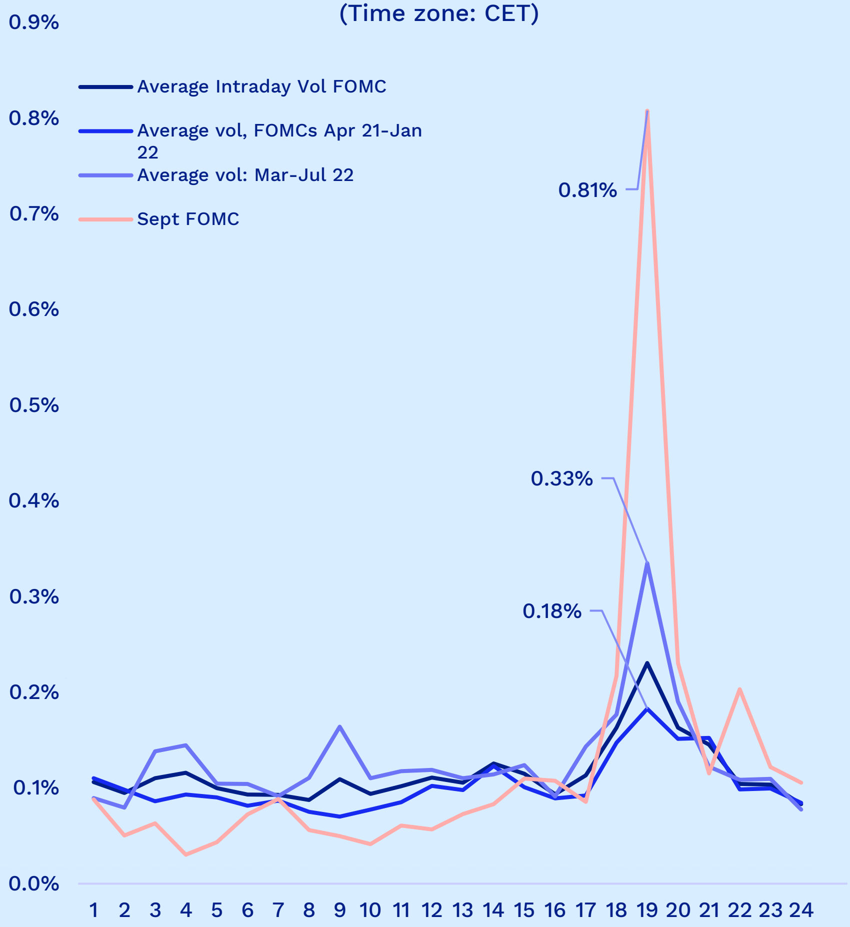
FOMCs tend to lead to elevated correlations across asset classes, which will likely repeat this Wednesday and traders should prepare for volatility, with FOMC press conferences being notorious in leading to volatile markets.

Massive short squeeze, muted market impact
Last week, crypto derivatives recorded the largest short squeeze since July 26, 2021. In BTC derivatives alone, $330m worth of shorts were liquidated on both October 25 and October 26. The crypto market as a whole experienced $1.35bn worth of liquidations these days, with ETH perps seeing exceptionally high liquidation volumes on FTX.

This squeeze has had a small impact on markets compared to the July 26, 2021, squeeze. July 26 saw a daily high-low variation of 15% as markets hastily moved up, whereas last week's moves saw daily high-low variations of 5% and 6%, respectively. Further, momentum has stopped, indicating that traders should brace for longer consolidation if the FOMC does not provide an unlikely surprise pivot.

The short squeeze has seemingly had a lackluster momentum impact on markets as BTC still oscillates well within its consolidation range. This could indicate a) an influx of sellers as BTC trades above 20k and/or b) FTX's liquidation engine impact.

Bitcoin: 60 min rolling volatility on FOMC day*
(Time zone: CET)



Source: FTX API (Minutely trade data during FOMC meetings)
*Dates included: 2021: Apr 28, Jun 16, Jul 28, Sep 22, Nov 3, Dec 12.
2022: Jan 26, Mar 16, May 4, Jun 15, Jul 27, Sep 21.

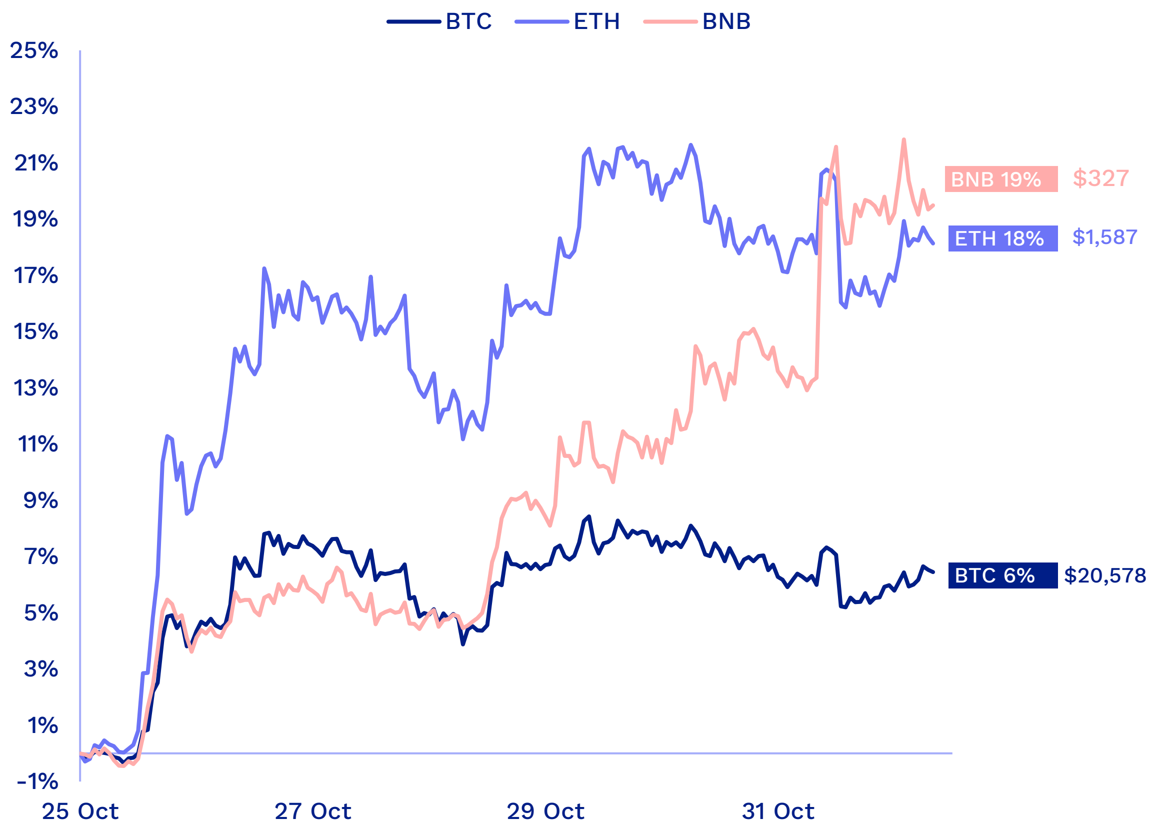
Spot Market

Awakening markets?

A green week driven by a massive short squeeze.

- Last week saw the largest short liquidation volume in crypto since July 26, 2021, contributing in pushing BTC up 6%.
- ETH saw even stronger growth of 18%, driven by a heftier short squeeze.
- Throughout the last week, BNB has seen a more stable uptrend, possibly led by more BNB enthusiasm related to Binance's role in Musk's Twitter takeover.
- Traders should prepare for volatility in the coming weeks, as the event calendar is crowded with potential market moving events.
- Wednesday's FOMC is this week's key event, but company earnings (MicroStrategy November 1, Coinbase November 3), economic data and U.S. mid-terms may also lead markets to move.

Top 3 by Market Cap, Last Week



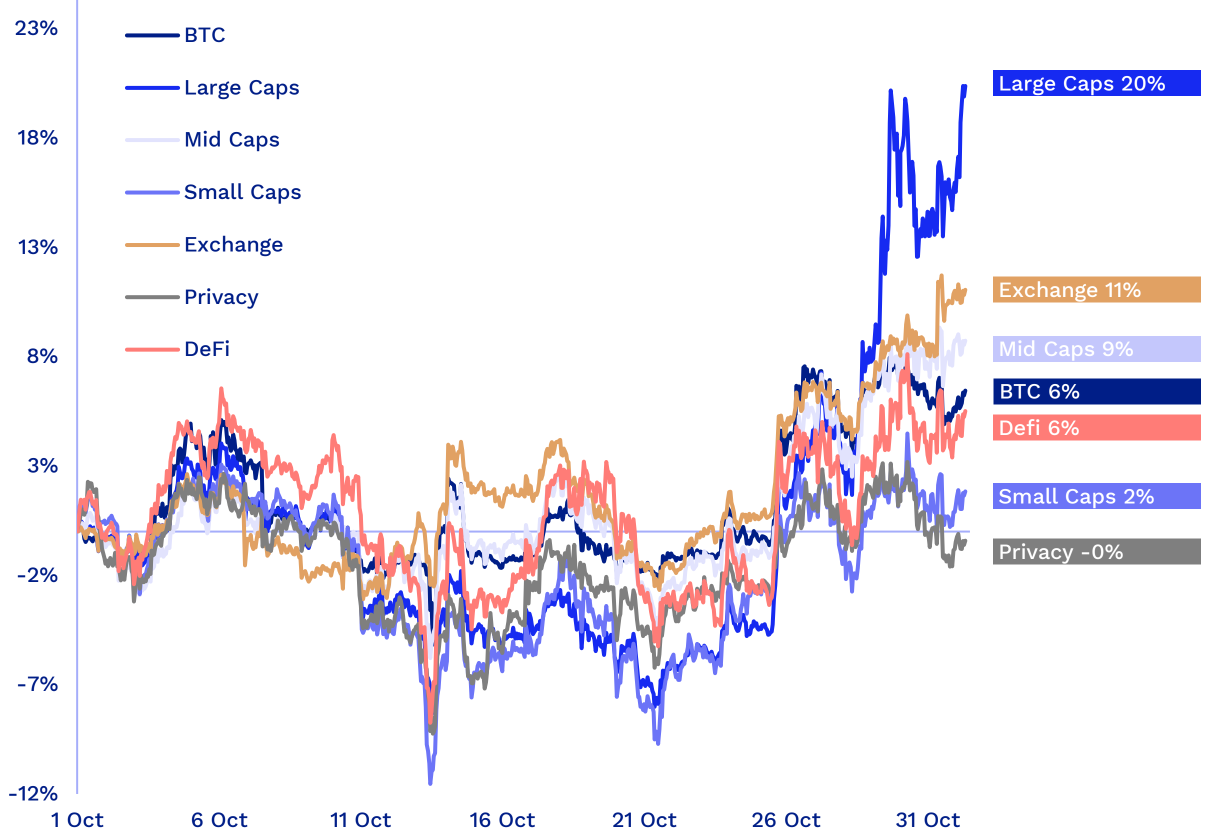
Source: Tradingview, (Coinbase, Binance U.S.)

Uptober after all

Surrealism has returned to crypto markets this week.

- Surrealism has returned to crypto markets this week. While BTC and exchange tokens outperformed the rest of the market up until October 26, Elon Musk's Twitter takeover contributed to pushing the Large Caps Index to become the winner of October, seeing gains of 20% in the last month.
- In sum, large caps have seen massive strength on the backdrop of a substantial short squeeze and narrative-related memecoin strength, a perfect storm. Dogecoin's 144% push in the last seven days is the key contributor to the large-cap strength.
- The Doge strength is caused by enthusiasm related to Musk's confirmed Twitter takeover, and the push had spill-over effects on SHIB driven by spread-related trading strategies. Additionally, ETH and BNB have a substantial weighting in the Large Caps Index.
- Outside of Large Caps, most other indexes trade in a strongly correlated environment, with the Exchange Token Index, Mid Caps Index, BTC, and Defi Index seeing gains ranging from 11 to 6 percent.
- Small caps and privacy coins represent this month's poorest performers, with the Privacy Index pushing slightly in the red in October as the sole crypto index.

Monthly Performance of Market Cap Weighted Indexes



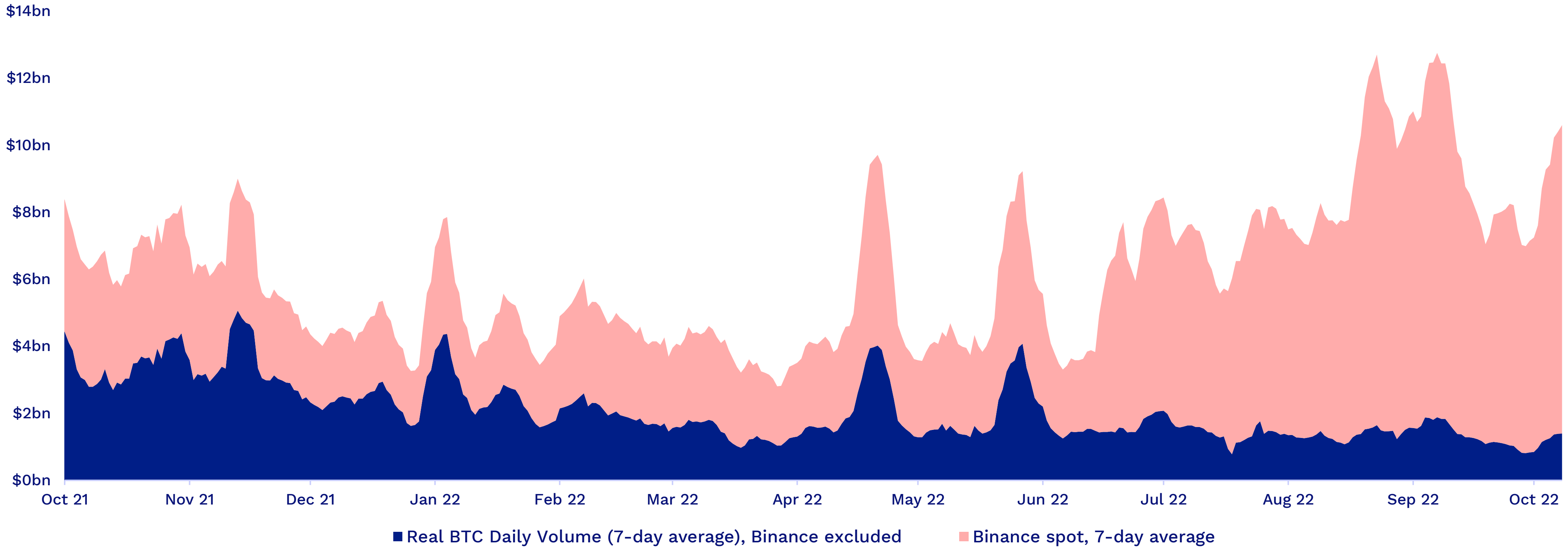
Source: Tradingview, (Coinbase, Binance U.S.)

Short squeeze revitalizes the market

The seven-day average BTC spot volume is up 46% in the last seven days, as last week's strength and short squeeze reignited activity temporarily in the market. However, trading volumes have again softened in recent days as BTC has stabilized at $20,500.

We expect volumes to pick up again this week due to the hectic event calendar onwards. The FOMC press conference, in particular, is likely to contribute to maintaining vibrant activity in the market.

Real BTCUSD Daily Volume* (7-day average)



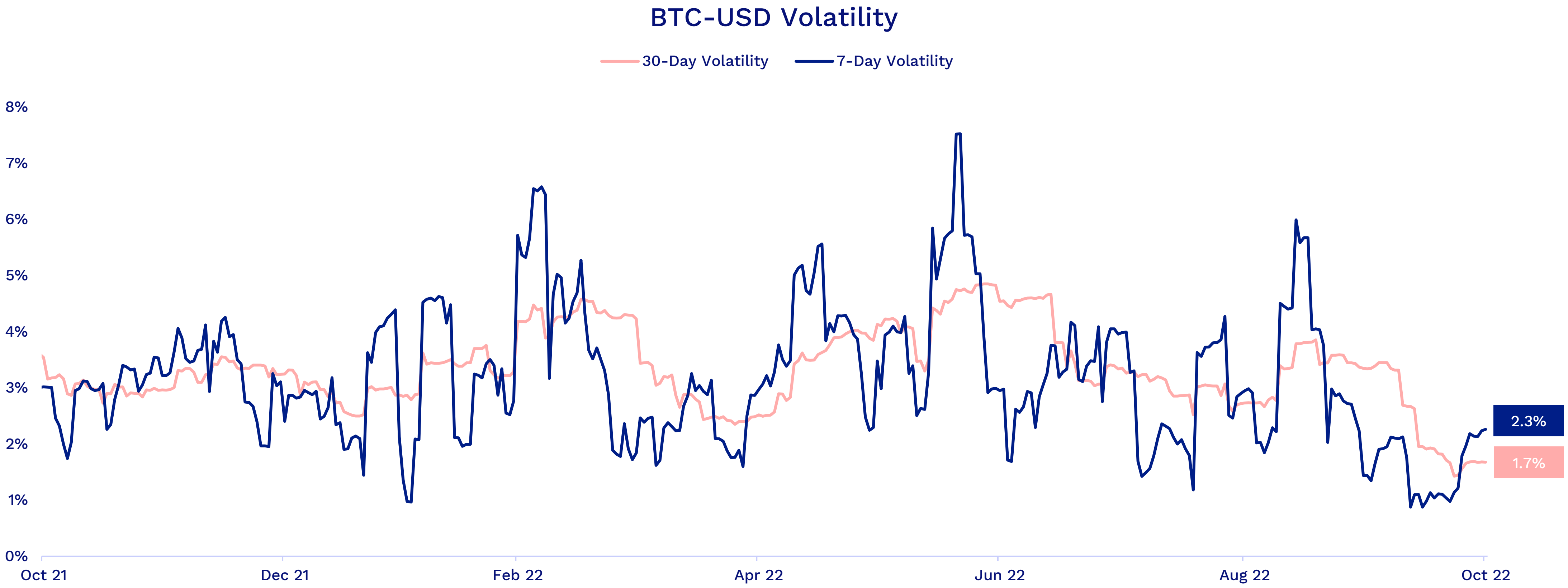
Source: Tradingview

*Includes Bitwise 10 exchanges and FTX

2-year low daily volatility

Following the strong recovery last week, prices have again stabilized at $20,500, leading the 30-day volatility to stay low. The short squeeze failed to facilitate a substantial change in momentum, and the directionless state of BTC remains sticky.

BTC's 30-day volatility currently sits at 1.7%, still at 2-year low levels. The 7-day volatility has grown to 2.2%, which is still substantially lower than the yearly average 7-day volatility of 3.1% and the yearly median volatility of 3%. In sum, BTC's volatility stays in shallow terrain, despite last week's chaotic short squeeze.



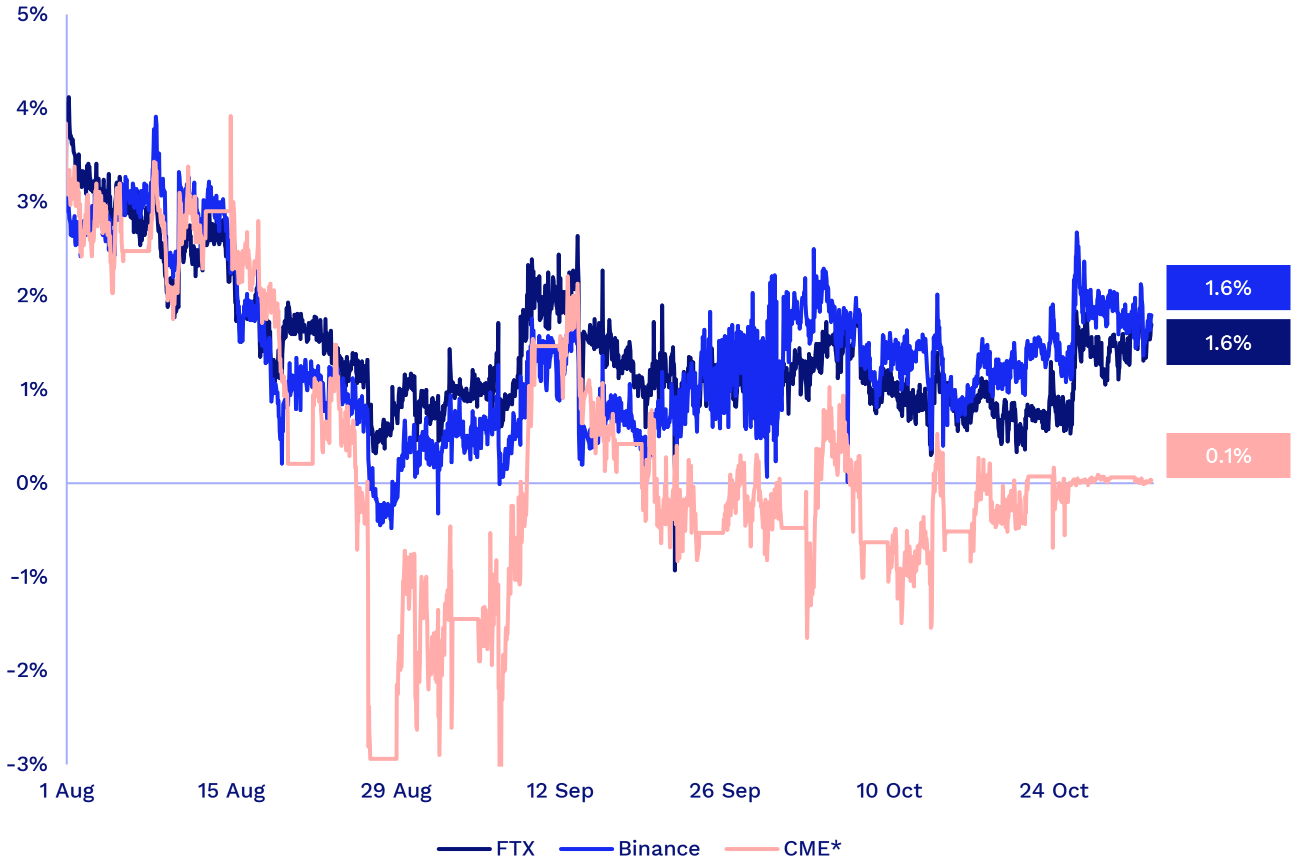
Source: Tradingview (Coinbase)

Derivatives

A flattening CME futures curve

- Futures still trade in a very flat structure, with no material changes in the 3mth basis over the last few months.
- The basis on Binance and FTX closely aligns, and both exchanges saw futures premiums pushing up during the short squeeze. Since premiums have stabilized and futures trading activity remains idle.
- The CME futures basis has been flat over the last week, trading at an annualized premium of 0.1% to spot, signaling conservative positioning from institutional market participants.
- The idle state of CME futures reflected in prolonged backwardation.
- Institutional traders seem to maintain a cautious market view, as the next month's expiry tends to trade below the front-month contract.
- While the flat basis and prolonged tendency of CME futures to trail in backwardation suggest a negative sentiment among institutional traders, it contributes to leading long BTC ETFs to incur lower rolling costs, leading to lesser underperformance vs. the underlying.

Bitcoin Futures Annualized Rolling 3-Month Basis

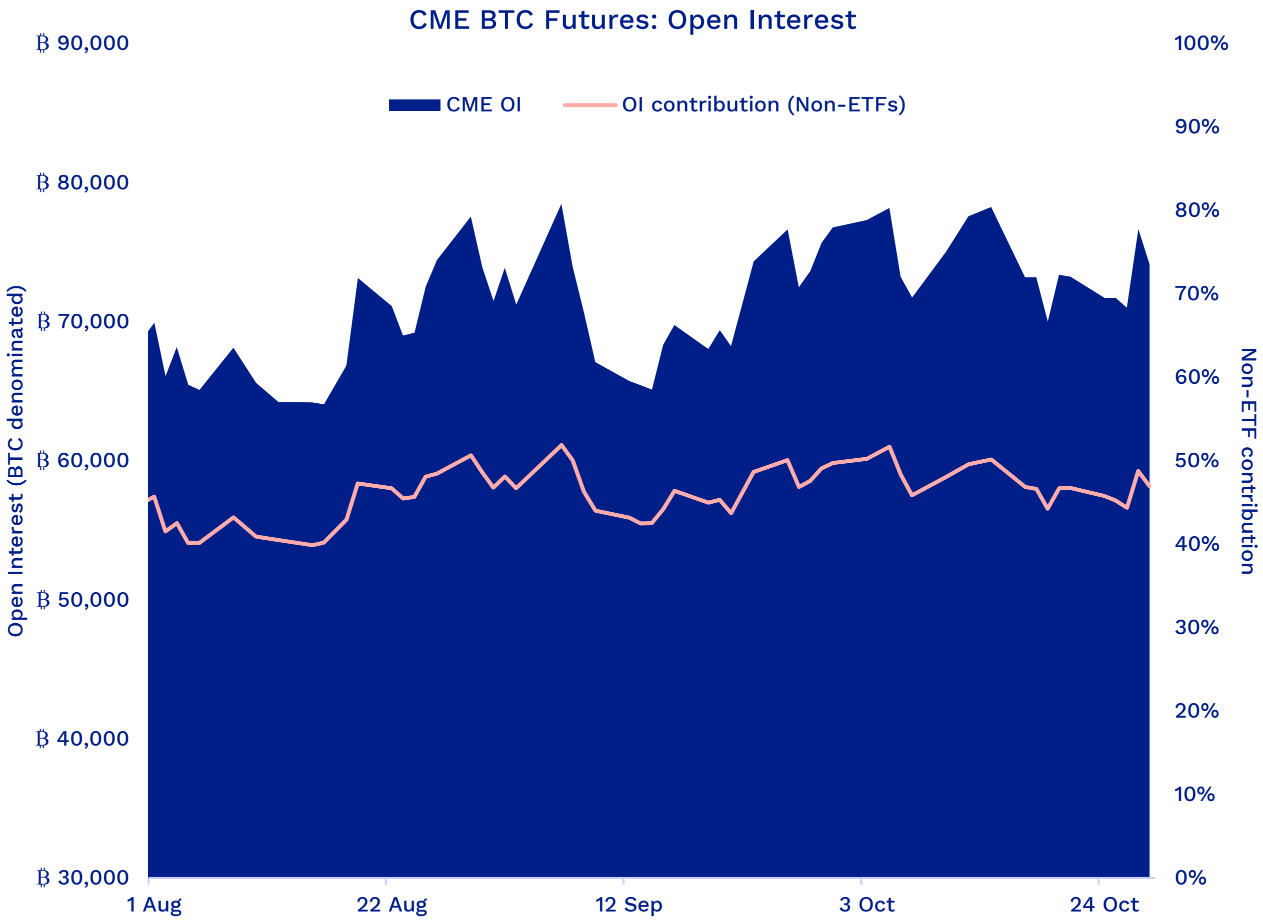


Source: Skew, Laevitas, Tradingview, CME

*Closed Saturday - Sunday

Institutional traders remain inactive

- Active futures traders on CME remain inactive in the market, suggesting a conservative sentiment from institutional traders.
- CME's open interest has stabilized at 70,000 BTC, and recent strong inflows to ETFs continue to account for more than 50% of the open interest in CME's BTC futures.
- This implies that CME traders are relatively inactive in the market, likely due to BTC still oscillating firmly within its prolonged trading range as a hectic news cycle approaches.

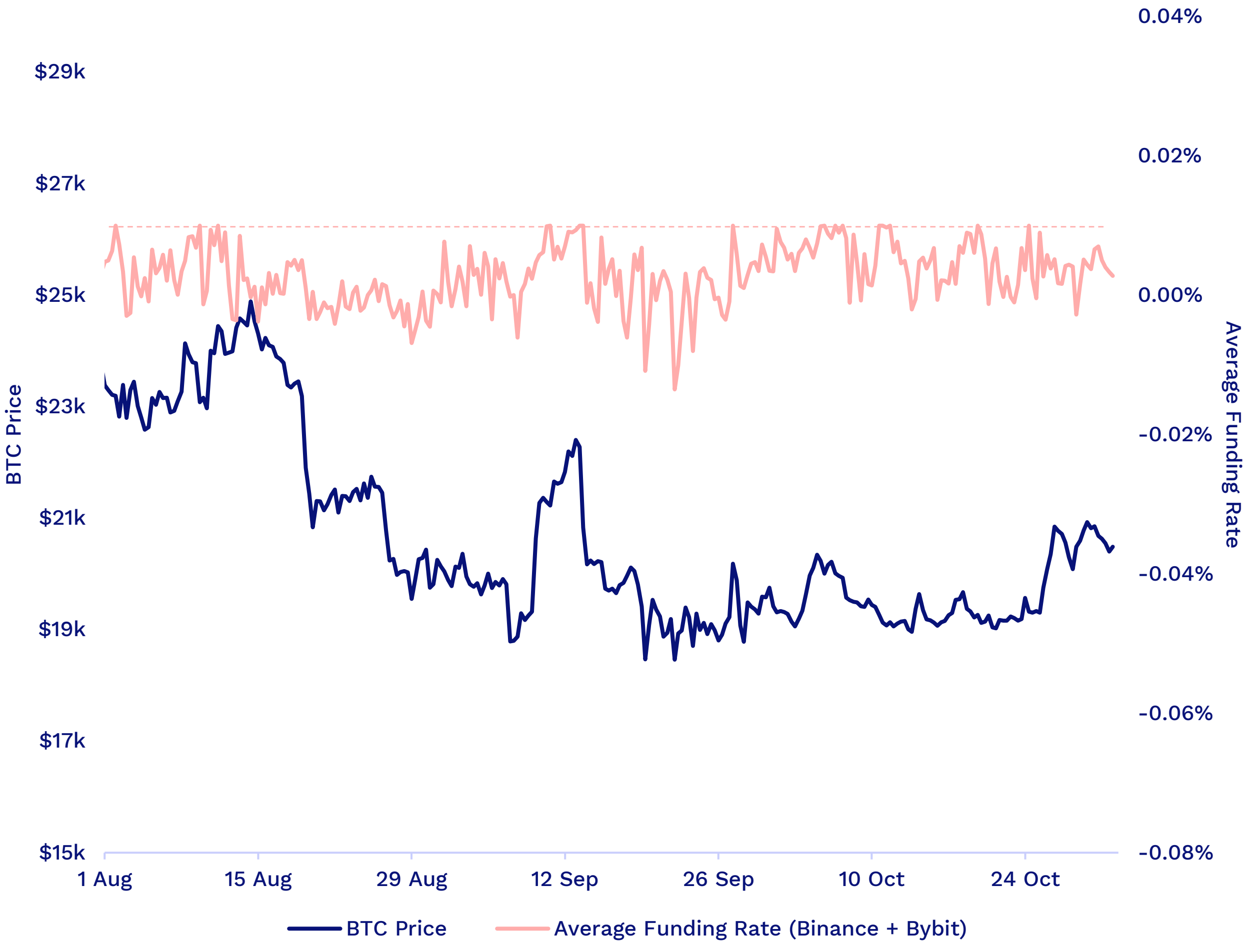


Source: Coinglass, ProShares, Valkyrie, VanEck

Funding rates are still below neutral – A promising signal

- While the crypto market saw strength last week, funding rates continue to trail in a below-neutral environment, differing from previous periods of strength in recent months.
- Both the early August rise towards $25k and the September 12 recovery saw funding rates resuming to neutral territory.
- The below-neutral funding rates are a promising signal from the market as it suggests that perp traders are unconvinced by the recent move and that leverage is far from concentrated in leveraged long positions.

Bitcoin perpetuals: Funding Rates vs BTC Price



Source: Skew, Bybit, Binance

A short squeeze with a soft impact

- The crypto market experienced a massive short squeeze last week. The BTC-denominated open interest in perps currently sits at 434k, down 24% from the intraday peak of 539k BTC on October 13.
- Overall, the decline in leverage in the market is a welcoming development. It seems to be related to last week's short squeeze and long positions being closed, leading funding rates to stay below neutral.
- While the deleveraging is a positive signal, open interest still remains elevated, at nearly 2x the highs of 2021.

Figure 12: Bitcoin Perpetuals: Open Interest

Source: Skew, Bybit, Binance

Bitcoin options: Firming skew and cheap straddles

Firming skews

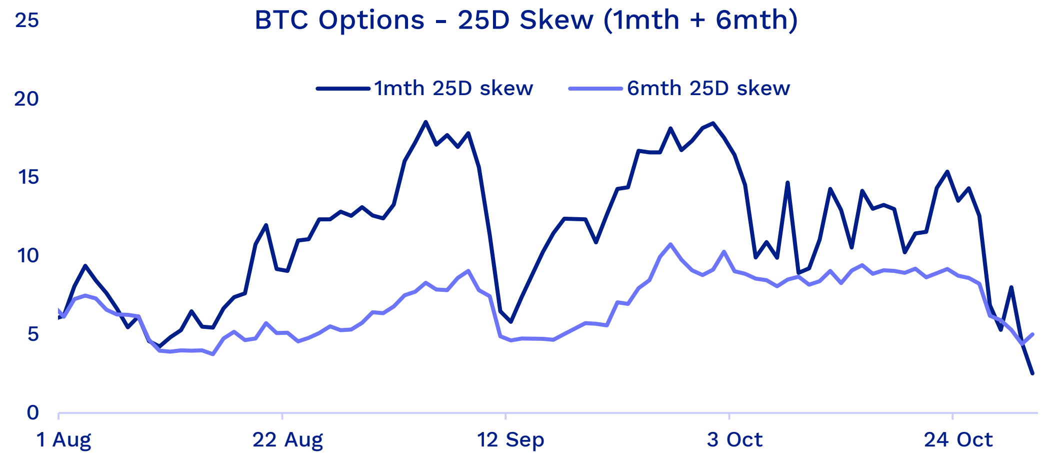
- Options traders are showing early signs of optimism as skews are firming. Throughout the year, out-of-the-money puts have tended to trade at a substantial premium to out-of-the-money calls. However, after the October 25 short squeeze, the 25D skew has trailed lower, reaching its lowest levels since March.

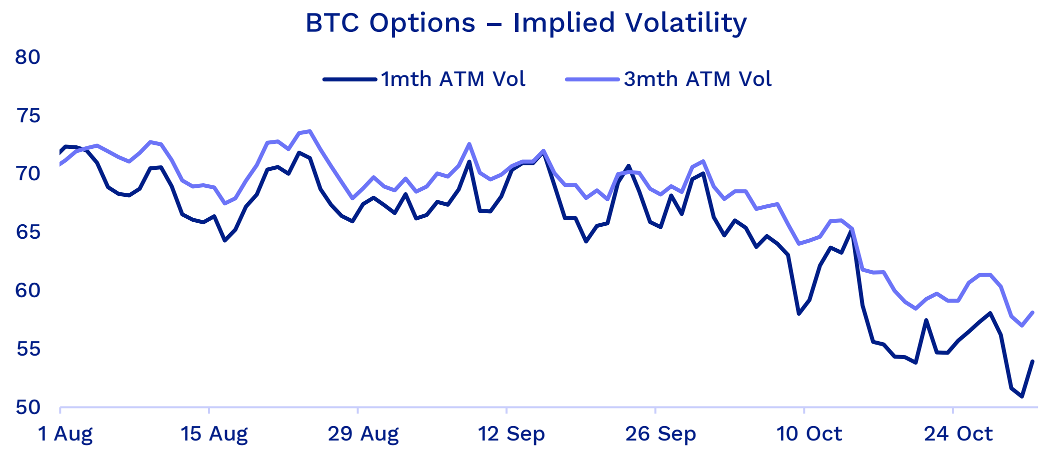
- Overall, options traders still predominantly position towards more downside protection, but the normalizing skew indicates some positive tendencies in the market.

Implied Volatility: Straddles are cheap

- It's currently cheap to make a contrarian volatility bet. Alongside the muted volatility in BTC spot markets, options IVs have seen a strong downward trend throughout October. On Sunday, the 3mth IV reached lows that's only been visited five times since April 2020.

- The low IVs are a suitable environment for contrarian bets on re-appearing BTC volatility. The timing could be great for straddle strategies purchasing far-dated expiring puts and calls.





Source: Laevitas

The Deep Dive

The Federal Open Market Committee (FOMC)

Relative crypto strength since FOMC meeting

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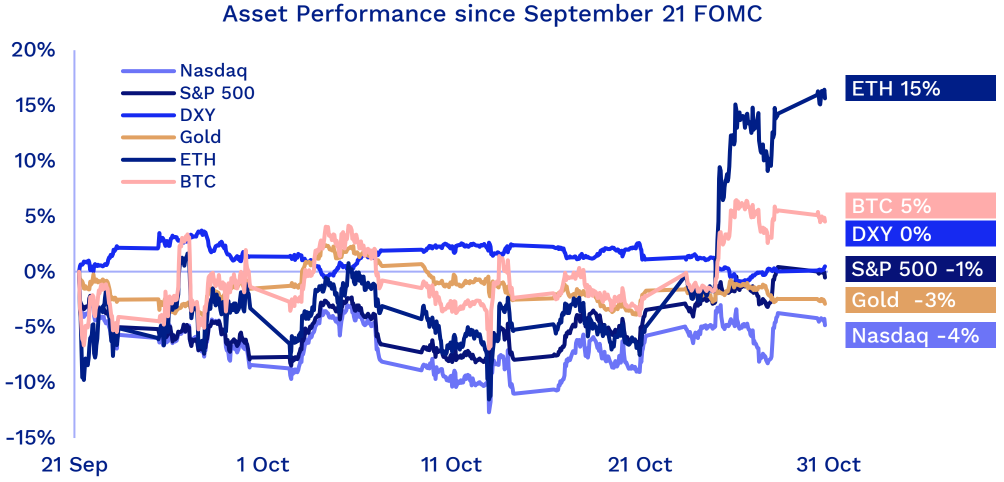
Since the last FOMC meeting, crypto has outperformed broad financial markets. ETH and BTC saw massive short-lived selling pressure immediately after the FOMC meeting but recovered comfortably, trading in the green since the last FOMC meeting. Gold and equity indexes, on the other hand, are in the red. This is a positive sign of relative strength from crypto, and we note slight signs of declining correlations (figure 19, page 12). FOMCs tend to lead to elevated correlations across asset classes, which will likely repeat this Wednesday.

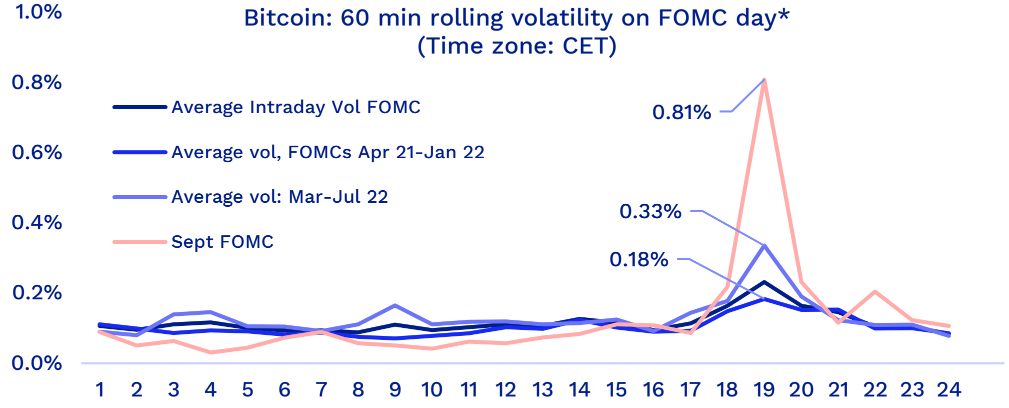
Expect volatility

During FOMC meetings, volatility tends to surge. The September 21 FOMC meeting was the most volatile FOMC meeting to date, as BTC saw average minutely price fluctuations of 0.81% during the press conference. FOMC days have tended to become more volatile recently. From April 2021 to January 2022, before FED's hiking cycle, FOMC volatility was softer, reaching 0.18% during the press conference. The FOMC meetings from March to July saw higher volatility, reaching 0.33% on average per minute. The September FOMC meeting was uniquely volatile, caused by the massively negative initial response followed by a strong recovery.

While FOMC meetings are notoriously volatile, they are also notoriously difficult to trade. Intraday volatility is a characteristic feature, but even the September 21 reaction retraced, and BTC experienced daily losses of -3%, but intraday high-low swings of 9%.



Source: Tradingview (Hourly returns from Sep 21, 18:00 CET)



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The short squeeze

Massive short squeeze, muted market impact

Last week, crypto derivatives recorded the largest short squeeze since July 26, 2021. In BTC derivatives alone, $330m worth of shorts were liquidated on both October 25 and October 26. The crypto market as a whole experienced $704m and $618m worth of liquidations these days, with ETH perps seeing exceptionally high liquidation volumes on FTX.

We've long focused on the risks of squeezes. However, this squeeze has had a minimal impact on the BTC price. The July 26 squeeze saw a daily high-low variation of 15% as markets hastily moved up, whereas the October 25 and October 26 moves saw daily high-low variations of 5% and 6%, respectively. Further, momentum has stopped, indicating that traders should brace for longer consolidation if the FOMC does not provide an unlikely surprise pivot.

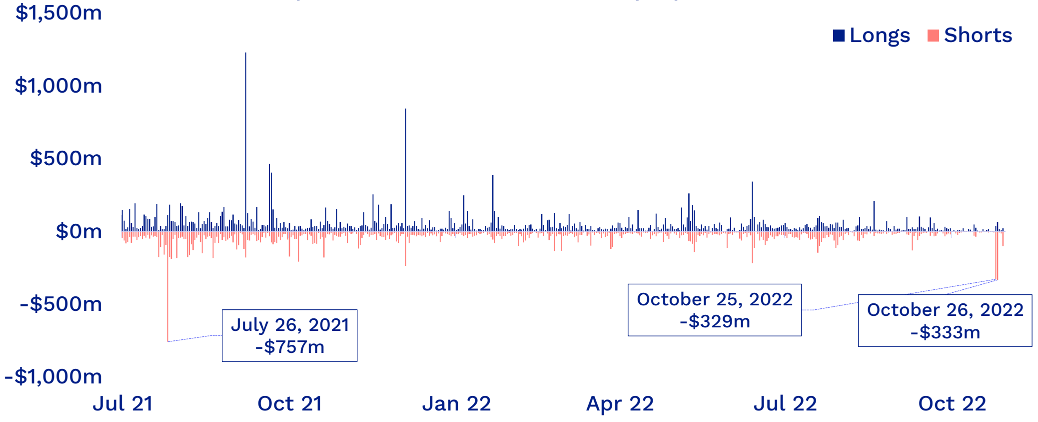
This could indicate a) an influx of sellers as BTC trades above 20k and/or b) FTX's liquidation engine impact. FTX's handling of liquidations may have a softer impact on the market than other offshore venues due to partial liquidations.

Liquidation volumes are higher than reported

The liquidation volume is underestimated. Last year, both Binance and Bybit changed their APIs, restricting liquidation API calls to one push per second, citing that changes were made to create a "fair trading environment". This has had direct implications on the aggregated liquidation data. We aim to highlight these API restrictions following CZ's tweet, using the restricted liquidation data and comparing it to more transparent competitors.

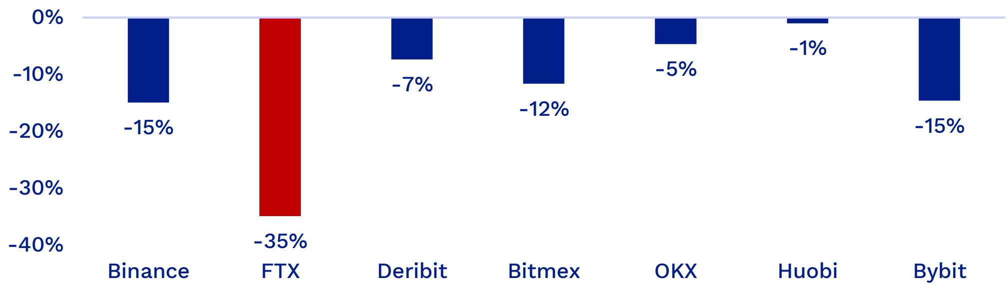
There are no direct ways to estimate the liquidation volume on Binance or Bybit. However, one may use a back-of-the-envelope approach, looking at how open interest changed over the day. On Binance, ETH OI peaked at 1.87m ETH and declined to 1.5m, down 24%. BTC OI fell from a 205k peak to 180k, down 14%. This is slim compared to FTX's OI plunge of 34% but still suggests that Binance's liquidation volume was far higher than the reported 5% of global liquidation volume.

Bitcoin liquidation volume – Offshore perps and futures



Source: Coinglass, Laevitas

Open Interest BTC perps, percentage change from Oct 25, 16:30 CET



Source: Laevitas

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