

Ahead of the curve

Week 44, 2022



Provided by **arcane**
research

Market Update

Knives sharpened

Crypto is facing downside as tensions are growing between FTX and Binance, leading to a growing fear in the market. As we await two potentially market-moving events, crypto markets are rigged to be shaken up by external forces this week. U.S. mid-terms may trigger volatility, whereas the Thursday CPI release will likely shake up markets in a highly correlated manner.

Don't be shaken out by headlines – crypto markets are still in a lull

Crypto is predominantly flat. This is not trivial. While stress is fuming amidst a hectic battle between two exchange behemoths, BTC sits firm within its trading range. Volatility stays low, and derivatives remain idle. Escalating tensions between Binance and FTX or surprising CPI numbers may awaken the market. However, with the exceptions of FTT and various altcoins, the crypto market remains well within its extended trading range.

Binance vs. FTX: Clash of the Titans

Friction between the two most influential crypto exchanges has escalated throughout 2022. It has reached hostile levels in the last couple of days following the release of a Coindesk article related to Alameda Research's (FTX subsidiary) assets and liabilities. We elaborate on the necessary details on page 6. The key takeaway from the entire ordeal is that FTX is facing an ongoing bank run caused by Binance and its CEO, Changpeng Zhao (CZ), actively selling FTT and racing concerns related to the financial health of FTX.

FTT has fallen from \$26 to lows of \$15 over the last seven days, experiencing an initial push south following a Coindesk article. FTT has since experienced massive news-driven volatility. Speculative interest in FTT has exploded amid the drama. Open interest relative to market cap sits at 7.65% compared to 2.8% last week. The growing open interest has been accompanied by massively negative funding rates at Binance and Bybit, suggesting a substantial demand for shorting FTT. This could be a potent environment for a squeeze.

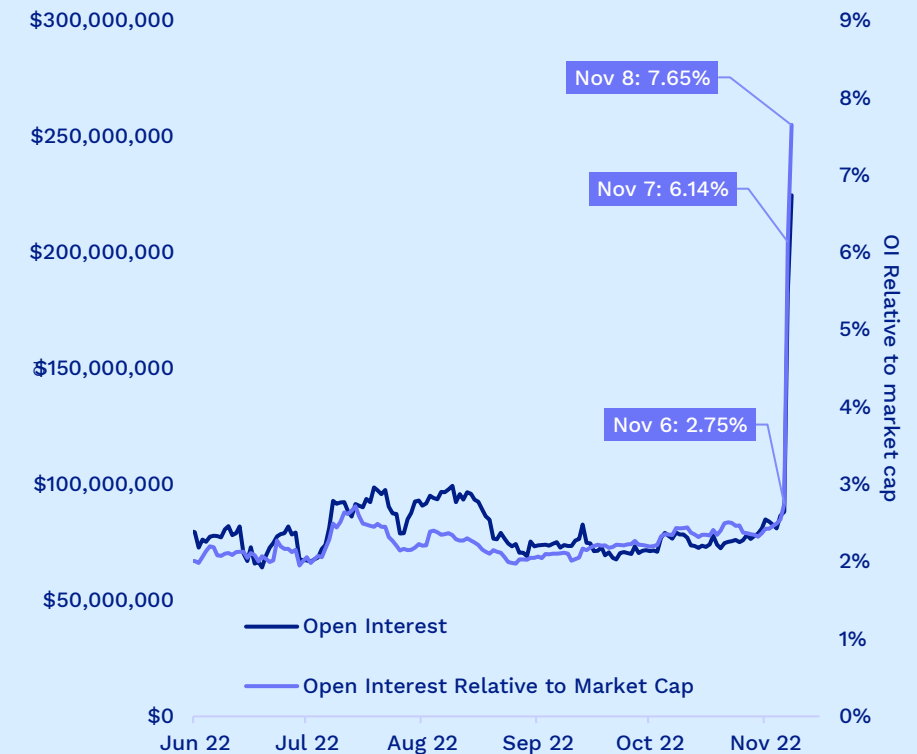
We view the risks of FTX insolvency as minimal and comparisons between FTT and the LUNA/UST mechanism as fundamentally wrong, as the structure of FTT, is utterly different from the demand dependency of LUNA/UST. However, we view it as likely that this event might have a long-term reputational impact on FTX and possibly generate hedging-related selling pressure in BTC.

Correlations and important macro events

Bitcoin's correlation to U.S. equities, gold, and the U.S. dollar is visibly higher during U.S. market hours than during non-U.S. market hours. The chart and data in figure 2 clearly suggest that BTC sees more independent price patterns outside U.S. market hours, with correlations generally tending to be 0.20-0.30 higher during U.S. market hours.

The tightly correlated environment will likely remain this week as we're in for a huge macro week with a new CPI release and U.S. mid-terms. Last month's CPI release led markets to extreme correlations. Interestingly, as we note on page 7, correlations tend to be lower than the norm before important macro events but then surge amid the event. Traders should also brace for a similarly correlated environment this Thursday.

Figure 16: Open Interest FTT, relative to market cap



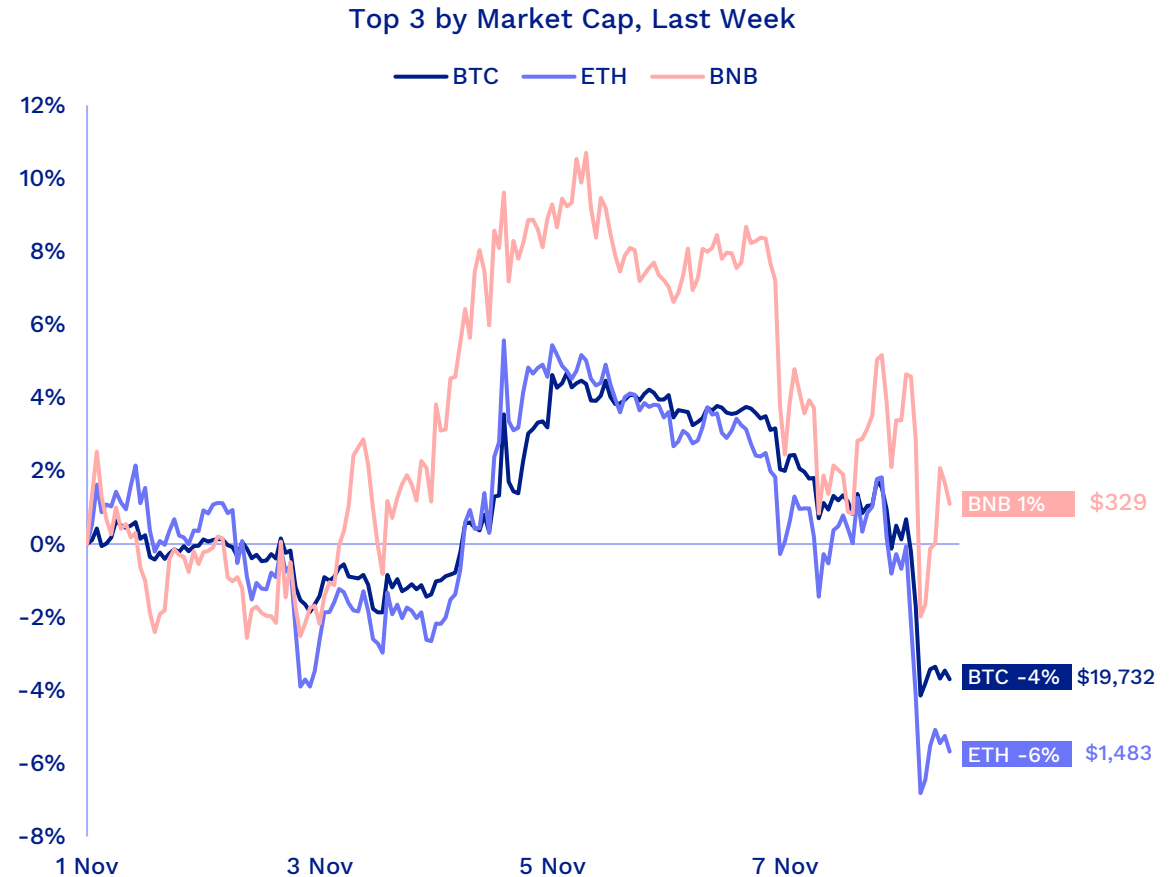
Source: Laevidas

Spot Market



Knives sharpened

- Crypto is facing downside as tensions are growing between FTX and Binance, leading to a growing fear in the market.
- BTC is down 4% in the last seven days, while ETH has experienced more downside, falling 6%.
- BNB sees flat returns, partly benefiting from expectations from speculators that Binance will use FTT proceeds to buy BNB.
- The market is rigged to be shaken up by external forces this week as we await two potentially market-moving events.
- Today's U.S. mid-terms may trigger volatility, whereas the Thursday CPI release, expected to reach 0.6% MoM, could cause volatility in a highly correlated manner.

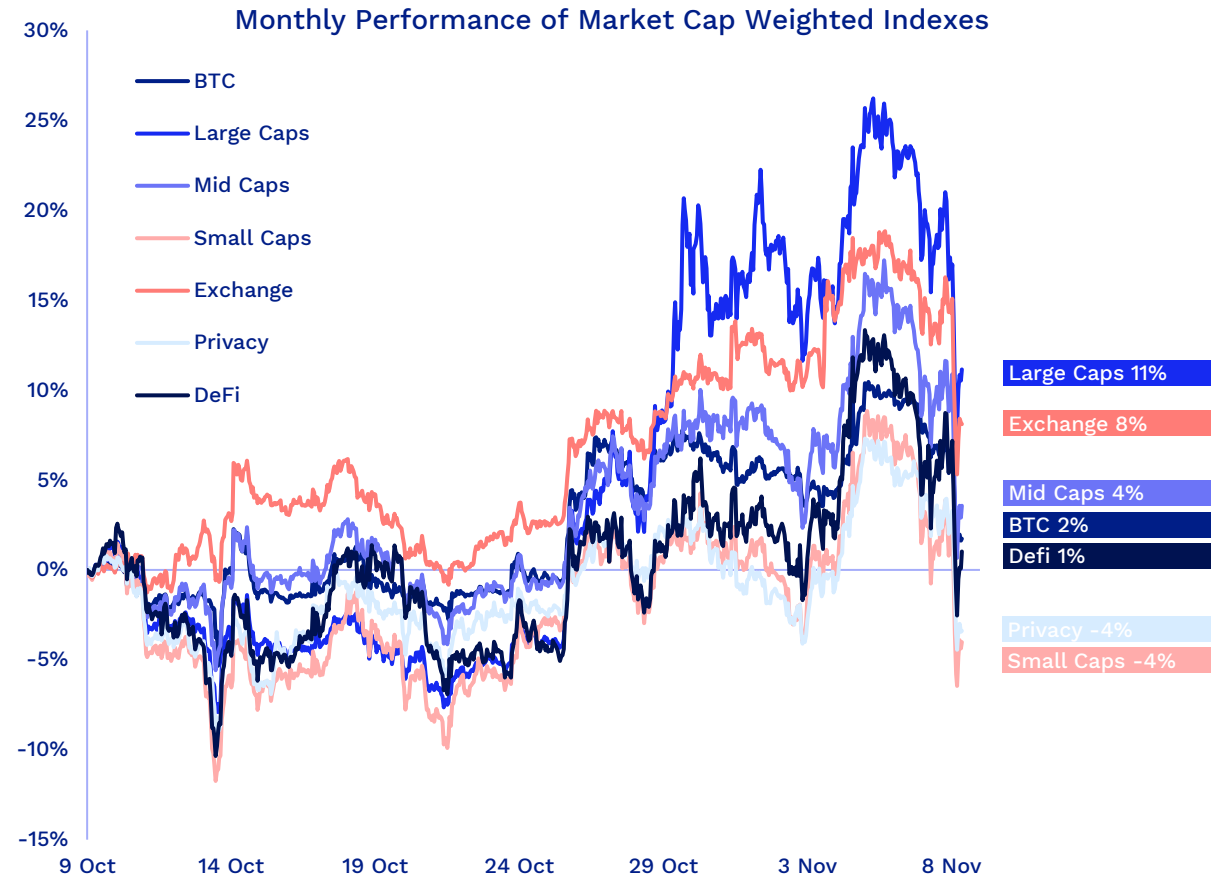


Source: Tradingview, (Coinbase, Binance U.S.)



Don't be shaken out by headlines – crypto markets are still in a lull

- Crypto is predominantly flat. This is not trivial. While stress is fuming amidst a hectic battle between two exchange behemoths, BTC sits firm within its trading range.
- Examining price, volatility, and derivatives activity show that BTC is still resting. If the situation between Binance and FTX escalates this week or the CPI release surprises the market, prices may move.
- However, with the exceptions of FTT and various altcoins, the crypto markets remain predominantly flat, for now.
- In the last 30-days, all indexes reign in a mostly flat environment, with the tense FTT dynamics causing mild headwinds and spill-over effects on other digital assets.
- Still, exchange tokens represent one of the strongest performers over the last 30 days, despite experiencing a sharp setback in the previous few days.
- This is caused by relative strength in exchange tokens apart from FTT, with OKB seeing 26% gains in the last seven days and BNB outperforming both BTC and ETH.



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

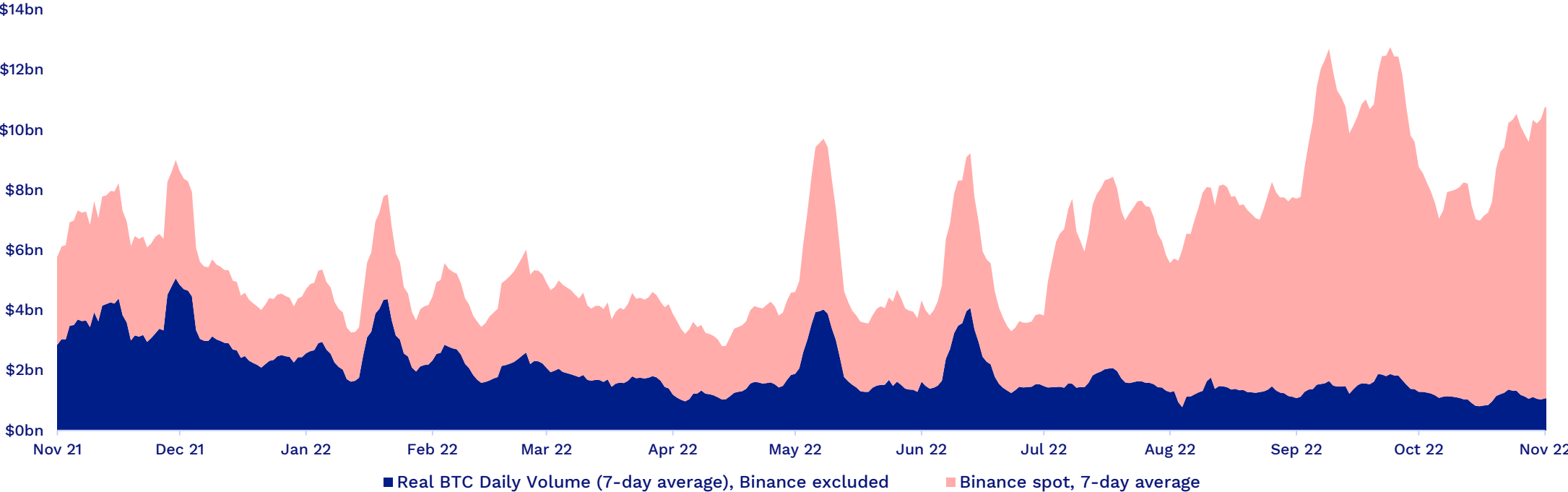


Binance's push to secure its dominance

The 7-day average BTC spot volume is up 2% in the last seven days, as markets remained vibrant in the last week following the FOMC meeting and the Binance vs. FTX feud.

It's worthwhile dwelling on Binance's strategic plays to secure its leadership role. Binance lifted trading fees on BTC spot pairs in July, leading Binance's spot volume dominance to rise from 50-60% to 80-90%. Then, Binance consolidated stablecoin trading apart from USDT into BUSD, leading the dominance of Binance's stablecoin to grow. The hostility between Binance and FTX lately seems to be yet another step taken to consolidate market dominance.

Real BTCUSD Daily Volume* (7-day average)



Source: Tradingview

*Includes Bitwise 10 exchanges and FTX

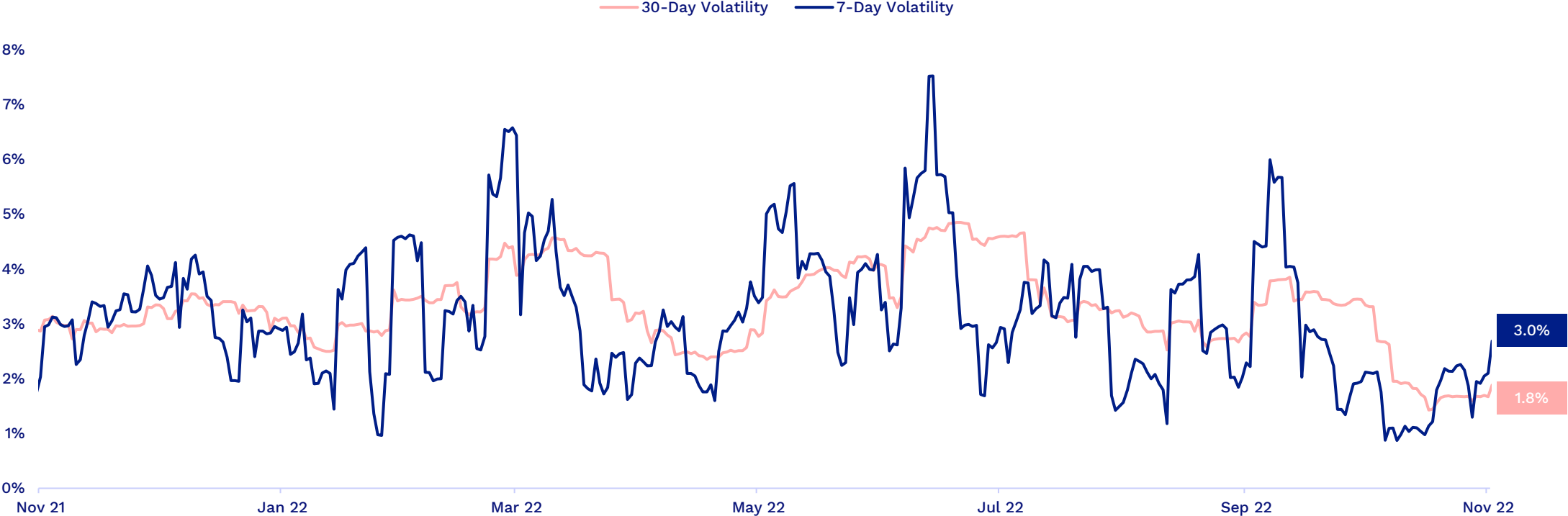


Frantic news cycle – steady market

BTC has revisited prices below \$20k today, but we have yet to see any material changes in volatility. The 7-day average volatility sits at 3%, a reasonably normal level for BTC. The 30-day volatility sees a slight growth to 1.8% but still reigns well below the levels seen in the last 365 days. BTC has consolidated between highs of \$21,500 and lows of \$18,100 in the previous two months.

The persistent low volatility in BTC is reflected in declining implied volatilities in BTC options. On Saturday, the 3mth IV reached a three-year low, as options traders still forecast low volatility onwards. This still generates a promising opportunity for options-based volatility trades.

BTC-USD Volatility



Source: Tradingview (Coinbase)

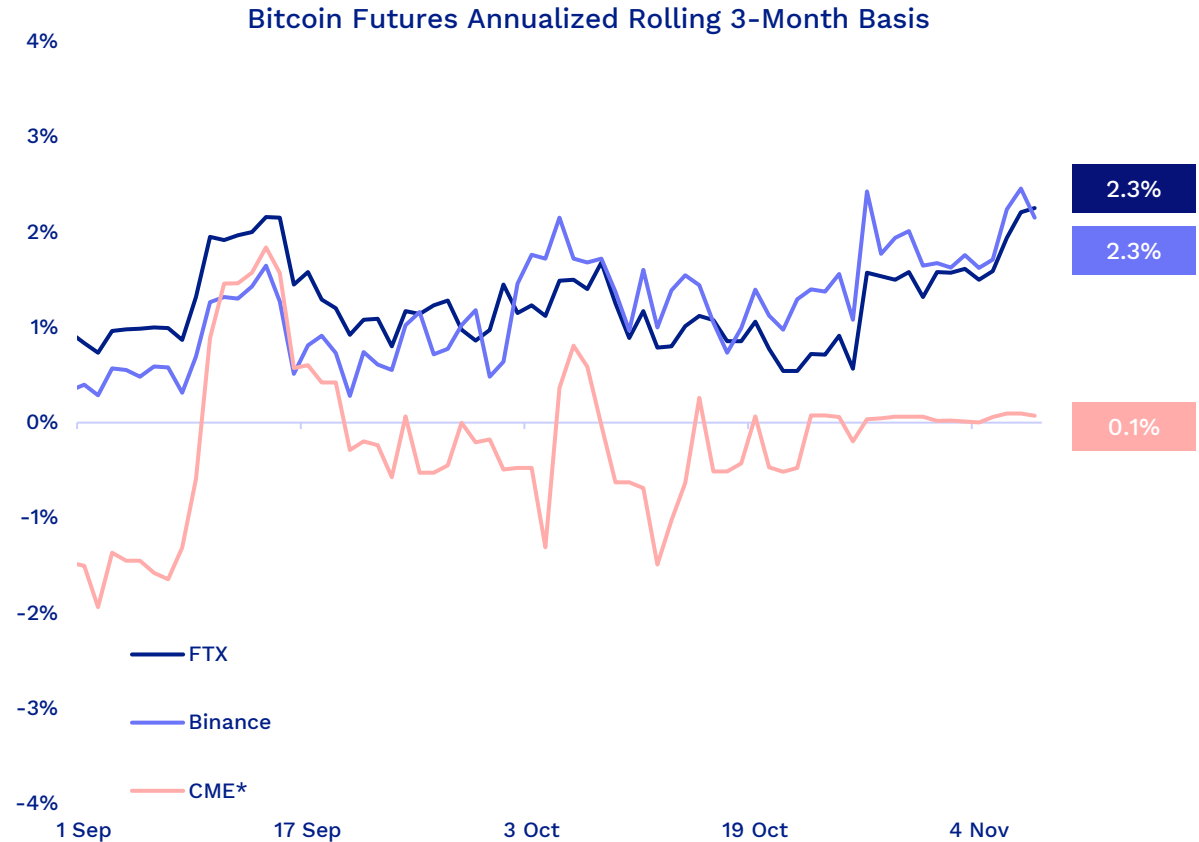


Derivatives



Slight basis growth offshore

- Futures still trade in a flat environment with few indications of bullish positioning evident from futures premiums.
- Nevertheless, we note a slight growth on both FTX and Binance, despite the turbulence experienced lately. Still, the open interest of Binance's futures is only 5.5% of the size of Binance's perp market. Likewise, FTX's futures OI represents 30% of the size of FTX perps.
- Thus, it does not take vast flows to lead futures premiums to move, and uncertain times may lead to less intensive cash-and-carry trading as opportunities or fires emerges elsewhere.
- CME's BTC futures stay in slight backwardation, and no noteworthy activity is evident in CME futures as institutional traders remain idle. The important directional activity in BTC is, for now, related to offshore markets.
- Overall, institutional activity in the market remains very idle, illustrated by CME's BTC basis reigning completely flat since Oct 25.



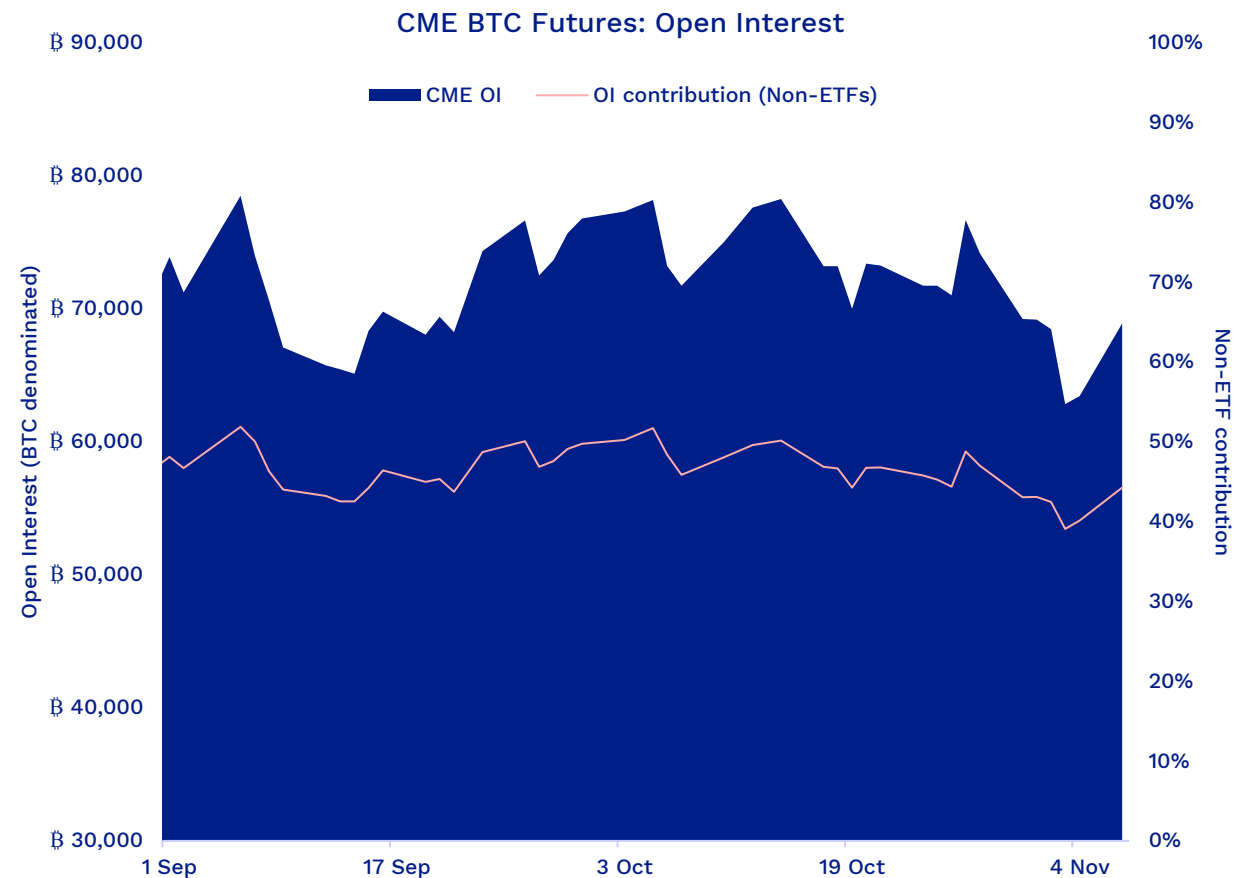
Source: Skew, Laevidas, Tradingview, CME

*Closed Saturday - Sunday



Institutional traders remain inactive

- Last week, the non-ETF-related open interest in BTC futures reached an all-time low of 39%.
- This illustrates that the organic demand from institutional traders to participate in the BTC market remains remarkably low.
- The low institutional presence in the market is further reflected in the unusually flat futures premium environment on CME.

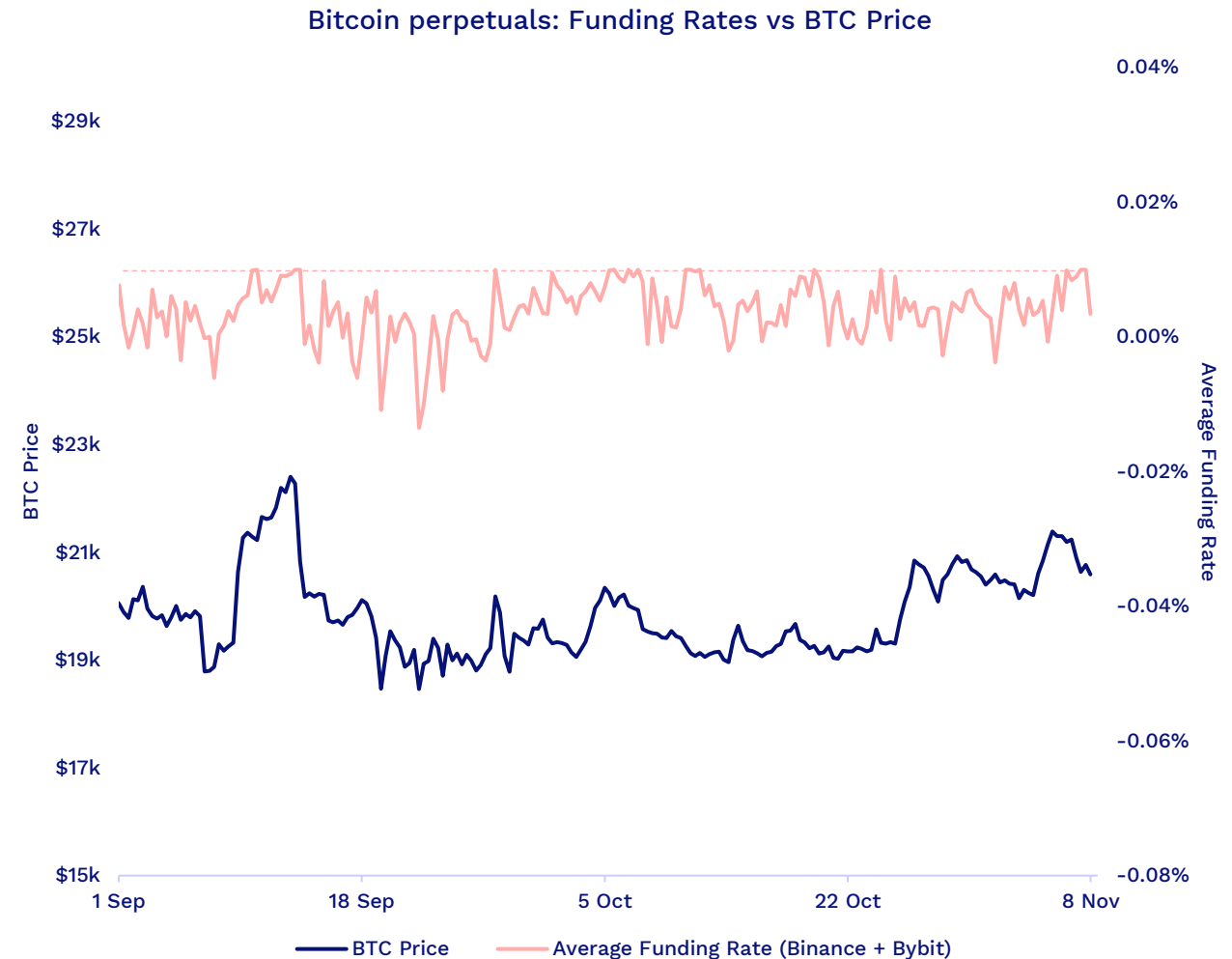


Source: Coinglass, ProShares, Valkyrie, VanEck



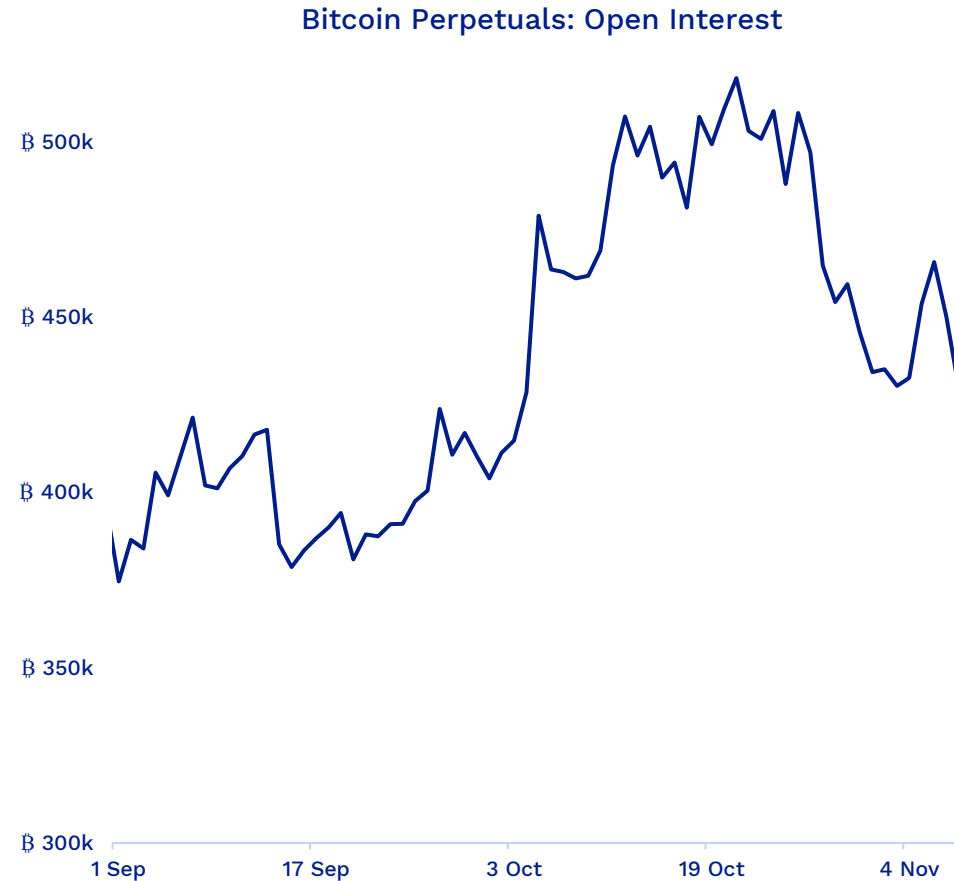
Short-lived demand to long BTC through perps

- Funding rates reached neutral terrain last week as BTC stabilized at \$20,500. The funding rate recovery was accompanied by a slight growth in open interest and relatively sizeable trading volumes.
- This suggests that longs entered the market after BTC maintained strength versus U.S. equities following the FOMC press conference last week.
- However, amid the recent setback in the market following the Binance/FTX feud, funding rates have again fallen below neutral terrain due to longs covering.



Open interest in BTC perps back below 430,000 BTC

- Open interest saw a short recovery following BTC's relative strength after last week's FOMC meeting. However, the shaky state of the market has led open interest in BTC perps to decline towards a 1-month low.
- Despite the current decline in open interest, leverage in the market stays elevated.
- We also note a substantial decline in FTX's market dominance. From October 25th, FTX has seen its share of the open interest in BTC and ETH perps decline from 25% to 14%.



Source: Skew, Bybit, Binance



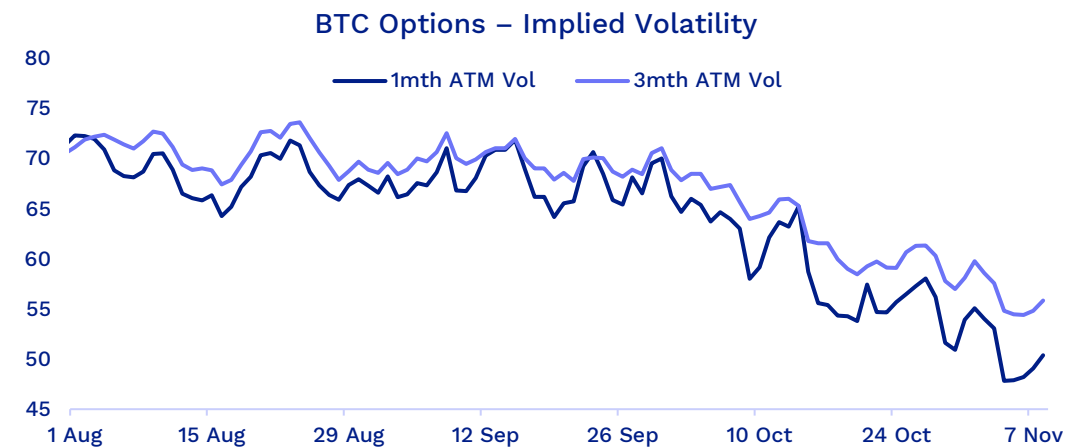
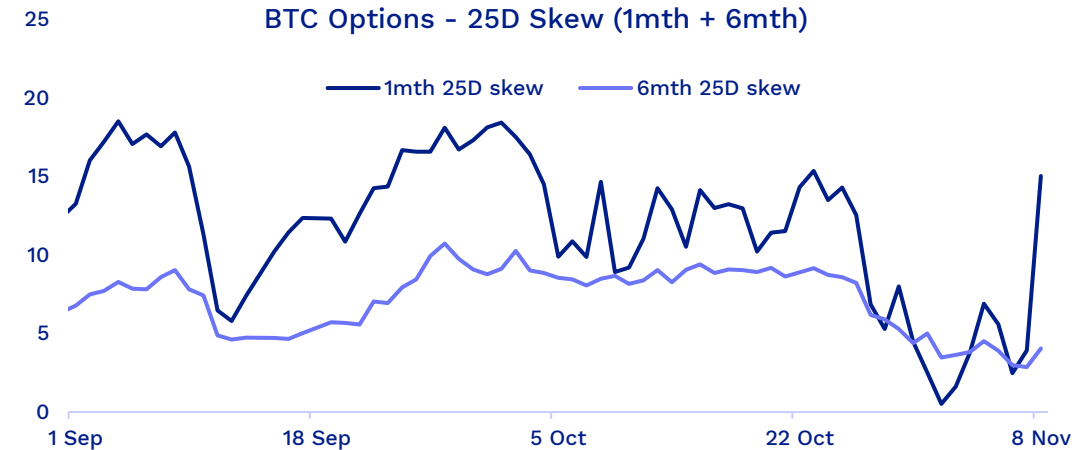
Bitcoin options: Protection amid uncertainty

Protection amid uncertainty

- Short-term 25d skew has seen a sharp rise over the weekend as options traders seek downside protection amidst the growing uncertainty related to the battle between FTX and Binance, as elaborated on page 15.
- Albeit unlikely, the implications of default from Alameda would likely have dramatic spill-over effects on the rest of the market. Thus the tendency of growing downside protection in options seems rational to hedge for a worst-case scenario.

Implied Volatility: Options still cheap

- While the skew soars, implied volatility remains low. The 3mth implied volatility reached a three year low this weekend. In other words, options remain cheap as options traders price in low volatility in the foreseeable future.
- Structurally, this remains an opportune environment to position for a change in momentum in BTC through straddles.



Source: Laevidas



The Deep Dive



Binance vs. FTX: Clash of the Titans

FTX and Binance in a big public corporate war

Friction between the two most influential crypto exchanges has escalated throughout 2022. It has reached hostile levels in the last couple of days following the release of a Coindesk article related to Alameda Research's (FTX subsidiary) assets and liabilities. We elaborate on necessary details on the next slide. The key takeaway from the entire ordeal is that FTX is facing an ongoing bank run caused by Binance and its CEO, Changpeng Zhao (CZ), actively selling FTT and racing concerns related to the financial health of FTX.

CZ of Binance has compared FTT to Luna, questioned FTX's reserves and Alameda's ability to fund an OTC purchase of FTT, while Alameda Research's CEO Caroline Ellison attempted to purchase all Binance FTT for \$22 in an OTC deal. While Alameda's substantial exposure to illiquid altcoins and the ownership concentration of FTT are alarming, the LUNA comparison is quite the stretch. In sum, it has contributed to headwinds in FTT, SOL, and other FTX-exposed tokens, in addition to spanning a new wave of fear in the market. We view the risks of an FTX insolvency as exaggerated but view this as a very plausible source of prolonged adverse reputation effects hitting FTX, halting their ability to secure further growth onwards.

FTT plunges while leverage doubles over night

FTT has fallen from \$26 to lows of \$15 over the last seven days, experiencing an initial push south following Coindesk's article. FTT has experienced massive news-driven volatility driven by 1) Binance's FTT holdings being on the move, 2) Caroline's suggested OTC purchase at \$22, and 3) CZ's response by elaborating on how the selling process would likely take months, making comparisons between FTT and Luna. FTT stabilized at \$22 after the Caroline statement, but the price level was shattered overnight as FTT plunged to lows not seen since Feb 2021.

Speculative interest in FTT has exploded amid the drama. Open interest relative to market cap sits at 7.65% compared to 2.8% last week. The growing open interest has been accompanied by massively negative funding rates at Binance and Bybit, suggesting a substantial demand for shorting FTT. FTT seems rigged for volatile squeezes onwards, and Alameda Research and FTX is likely to experience a massive setback following these tumultuous days.

Figure 15: FTTUSD, November 1 - November 8



Source: Tradingview

Figure 16: Open Interest FTT, relative to market cap



Source: Laevidas



Binance vs. FTX: Clash of the Titans

What is FTT?

FTT is FTX's exchange token. Token holders are rewarded through fee rebates when trading. FTX also burns token supply based on trading volume. FTT investors are exposed to FTX's trading activity via the burning process, creating a secondary demand to hold FTT.

Why does Binance hold FTT?

Binance invested in FTX in 2019. In 2021, Binance exited its FTX investment and was compensated with \$2.1bn in BUSD and FTT. The percentage share of the FTT compensation is unknown.

Binance to sell FTT

On Sunday, CZ publicly announced Binance's intention to sell its FTT stake, aiming to do it in a way that minimizes market impact. Caroline Ellison of Alameda Research publicly proposed an OTC purchase at \$22.

Why now?

1. Sam Bankman-Fried's public backlash related to his thoughts on crypto regulation.
2. The short squeeze in late October led to further pressure as murmuring about unfair liquidation mechanisms at FTX erupted. We remind our readers that Binance's public liquidation data have been underreported since April 2021.
3. Last week, Coindesk shared a report showing that Alameda Research's balance sheet as of June 30 was heavily concentrated in FTT and illiquid altcoins. Caroline responded that Alameda has more than \$10bn of assets not reflected in the report.
4. Good timing. The market is in a flat and boring environment. Binance has already reaped the benefits of removing trading fees, seeing a growing market share in the spot market. Now is a perfect time to further consolidate market dominance by pressuring FTX and the general public's trust in FTX's financial well-being.

What's the relevancy for the market?

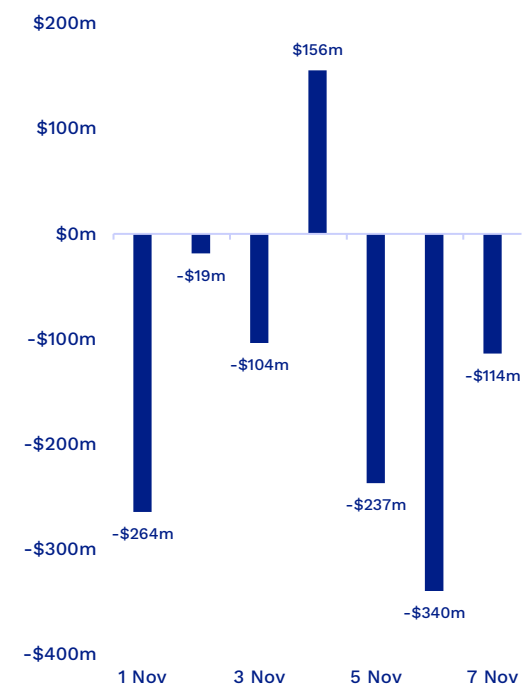
With the Luna, Celsius, and 3AC contagion collapse fresh in mind, it's clear that an FTX insolvency would reflect very badly on the market. The current fear, in isolation, may cause selling pressure related to protection in bitcoin, ether, and other digital assets. Markets would be destined to go south if an actual insolvency occur.

What's our take on the situation?

Risks of insolvency are minimal, and comparisons between FTT and the LUNA/UST mechanism are fundamentally wrong, as the structure of FTT is utterly different from the demand dependency of LUNA/UST.

However, a rational response to the uncertainty is to avoid having all funds concentrated at one exchange and to act cautiously. Insolvency is an improbable outcome. Nevertheless, we view this situation as a contributor to a long-term severe negative reputational impact for FTX. We're already witnessing massive outflows from FTX, suggesting a current run on the exchange. Remember how BitMEX never reclaimed its dominance after the 2020 headwinds?

Figure 17: Daily FTX flows



Source: Dune. Based on known Ethereum, Polygon, Optimism, Arbitrum, BSC and Avalanche wallets



Correlations

Softer correlations outside of U.S. market hours

Bitcoin's correlation to U.S. equities, gold, and the U.S. dollar is visibly higher during U.S. market hours than during non-U.S. market hours. We've calculated the average hourly correlations by using minute price data, running a rolling 60-minute Pearson correlation, and examining the correlation relationship by using Nasdaq and S&P futures, which trade at similar hours as CME's BTC futures.

The chart and data clearly suggest that BTC sees more independent price patterns outside U.S. market hours, with correlations generally tending to be 0.20-0.30 higher during U.S. market hours.

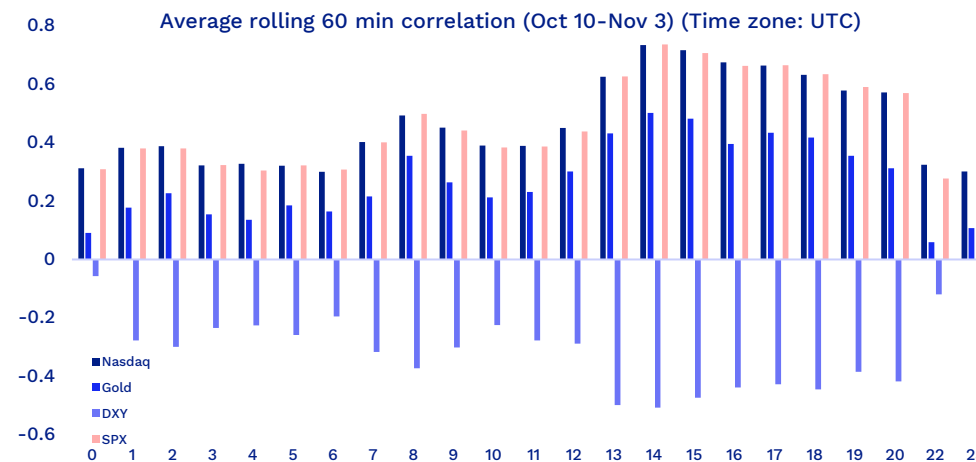
The tightly correlated environment is likely to remain this week as we're in for a huge macro week.

Dampened inverse correlation relationship with DXY pre-FOMC meeting, CPI different

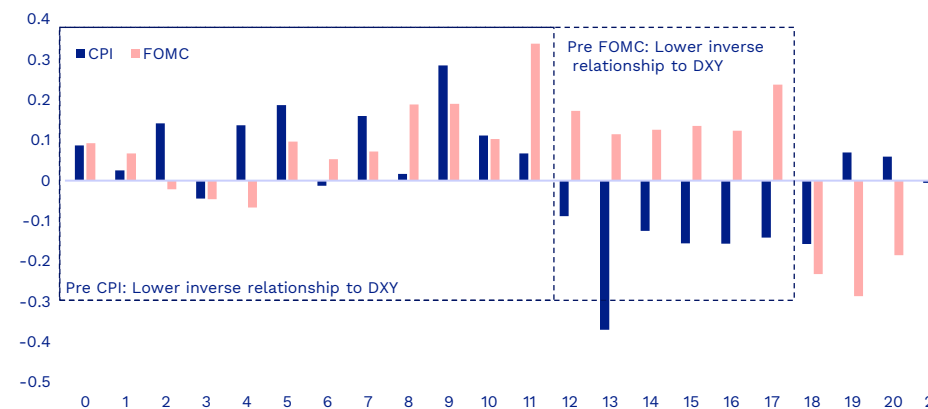
Last month's CPI release led markets to extreme correlations. The chart below illustrates BTC's excess correlation to the dollar strength index during last month's CPI release and last week's FOMC meeting. The CPI release occurred pre-market open and led to massive growth in BTC's inverse correlation relationship to the dollar strength index. Traders should also brace for a similarly correlated environment during this Thursday's CPI release.

We note an interesting observation of BTC tending to be less correlated to other assets than the norm before big macro events. The CPI release and last week's FOMC meeting saw BTC behaving less inversely correlated to the DXY than usual up until the event, suggesting some unique pricing patterns in BTC before critical economic events.

We acknowledge that this analysis is highly granular. Assessing correlations within such short time frames may cause spurious conclusions, as well as weak interpretable data. Still, we highlight the tendency and will examine and build on this data set with time as we get more meat on the bone.



Source: Tradingview (Minutely data from Oct 10, 00:00 UTC)



Source: Tradingview (Minutely data from Oct 10, 00:00 UTC)



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