Ahead of the curve
Week 46, 2022

LUNO

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Market Update

Falling activity and falling prices
The crypto market continues to face headwinds as Genesis halts withdrawals while seeking an emergency raise due to illiquid assets on Genesis's balance sheet. In the current shaky environment, BTC has stabilized but reached new multi-year lows on Monday and has seen a 5% downside in the last week.

ETH underperforms BTC and is down 13% over the last seven days, driven by FTX-related market activity. The unidentified FTX hacker who stole funds amid the chaotic meltdown of FTX has started to sell his ether position by swapping ETH to renBTC, exiting to on-chain BTC. The hacker has converted $72m worth of ETH to BTC and has $200m more to deploy. The hacker will likely use coinjoins to obfuscate the origin of the BTC holdings and, over time, convert BTC to Monero before selling Monero to stablecoins on a different exchange to hide his trails.

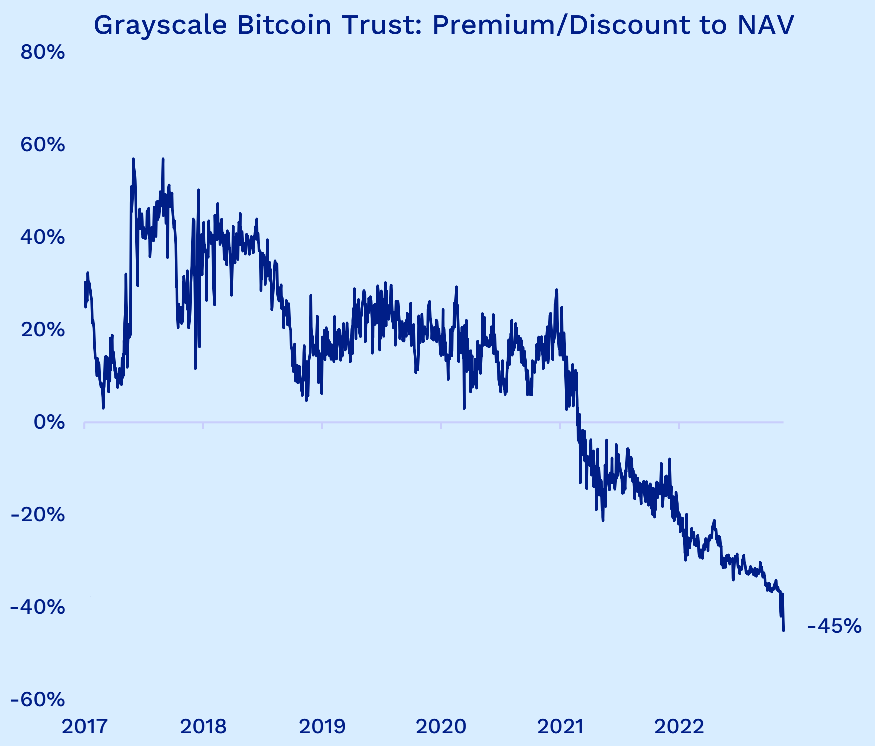
Genesis and Digital Currency Group seeks emergency funding
The digital asset brokerage firm Genesis, owned by Digital Currency Group, seeks financing. Genesis suspended withdrawals, in addition to seeking an emergency loan due to certain illiquid assets on Genesis' balance sheet. Bankruptcy has emerged as a potential outcome if the financing efforts fail. Genesis has reportedly slashed its raise target from $1bn to $500m, indicating that the firm struggle to shore up its liquidity profile.

Digital Currency Group owns a myriad of companies, with Grayscale being the flagship company holding. Grayscale offers crypto exposure through close-ended funds and holds 3.3% of the circulating BTC supply and 2.5% of the circulating ETH supply. Traders are now fearing that bankruptcy will lead to a dissolution of Grayscale's crypto funds. Alternatively, the trusts may be acquired by traditional finance behemoths due to the attractive fee structure.

Grayscale's trusts trade at an all-time high discount to NAV. Due to its close-ended structure, the trust does not trade on par with NAV. Grayscale aims to turn the BTC trust into an ETF in the future. Previously, the trusts traded at a premium to NAV, but since early 2021, the trusts have traded at discounts. GBTC currently trades at an enormous -45% discount to NAV. Based on Grayscale's 2% annual management fee, the market is currently pricing in that the fund will remain close-ended until 2051.

All-time high open interest on CME
CME's open interest has surged to a new all-time high in notional terms of 98,725 BTC, surpassing October 25, 2021, highs of 93,628 BTC. The growth coincides with a growing presence from direct market participants, representing 56% of the open interest, up from 39% on November 3. The growth also coincides with bearish positioning, as elaborated on page 4. CME dominates the BTC futures market, accounting for 56% of the market. This is the highest CME dominance within BTC futures seen in the last year.

OKX is the largest offshore futures venue, representing 25% of the futures OI. OKX also has a material market share in perps, accounting for 20% of the total perp OI. OKX faced a wave of difficulties in 2021 related to Chinese crypto bans, leading its market share to plunge to 5% by December 31, 2021.



Source: Skew, Ycharts

Spot Market

Falling activity and falling prices

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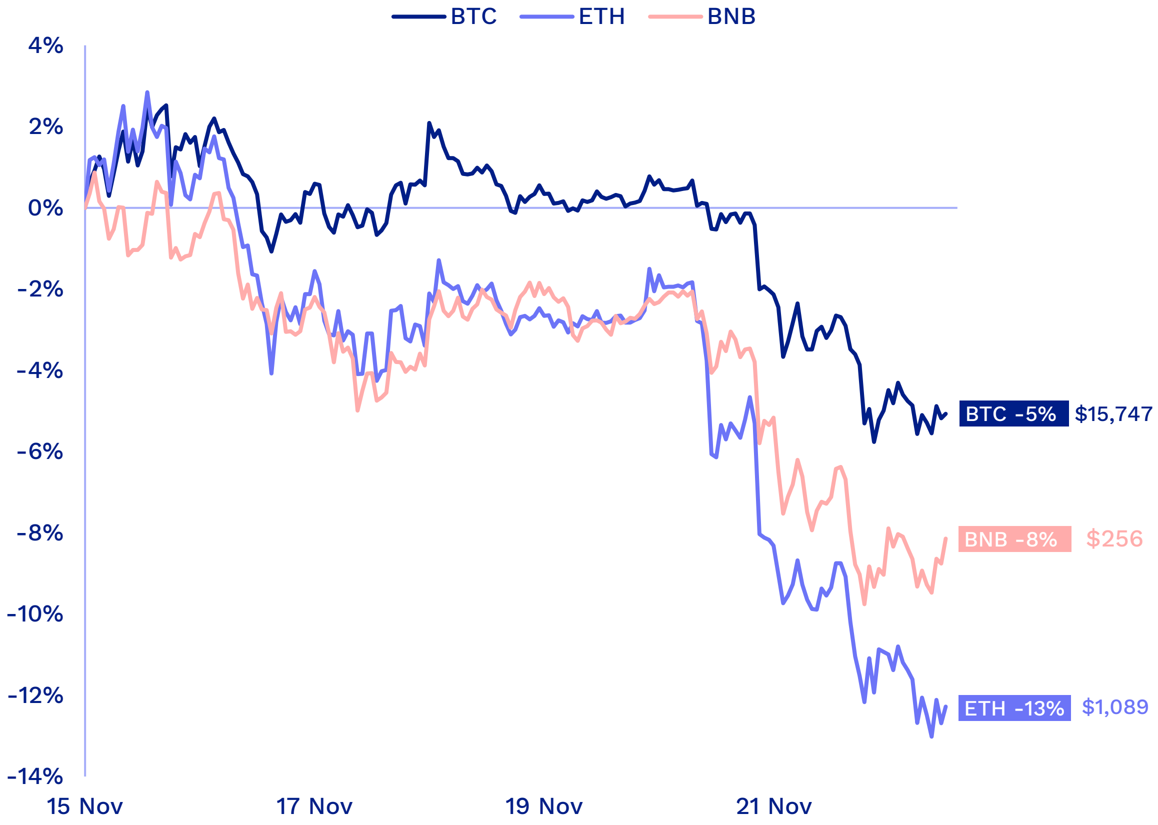
- U.S. markets are closed on Thursday and close early on Friday due to thanksgiving, which could have spill-over effects on crypto markets leading to reduced trading activity. Overall, we are already seeing activity dry up as volumes have declined to 3-month lows.

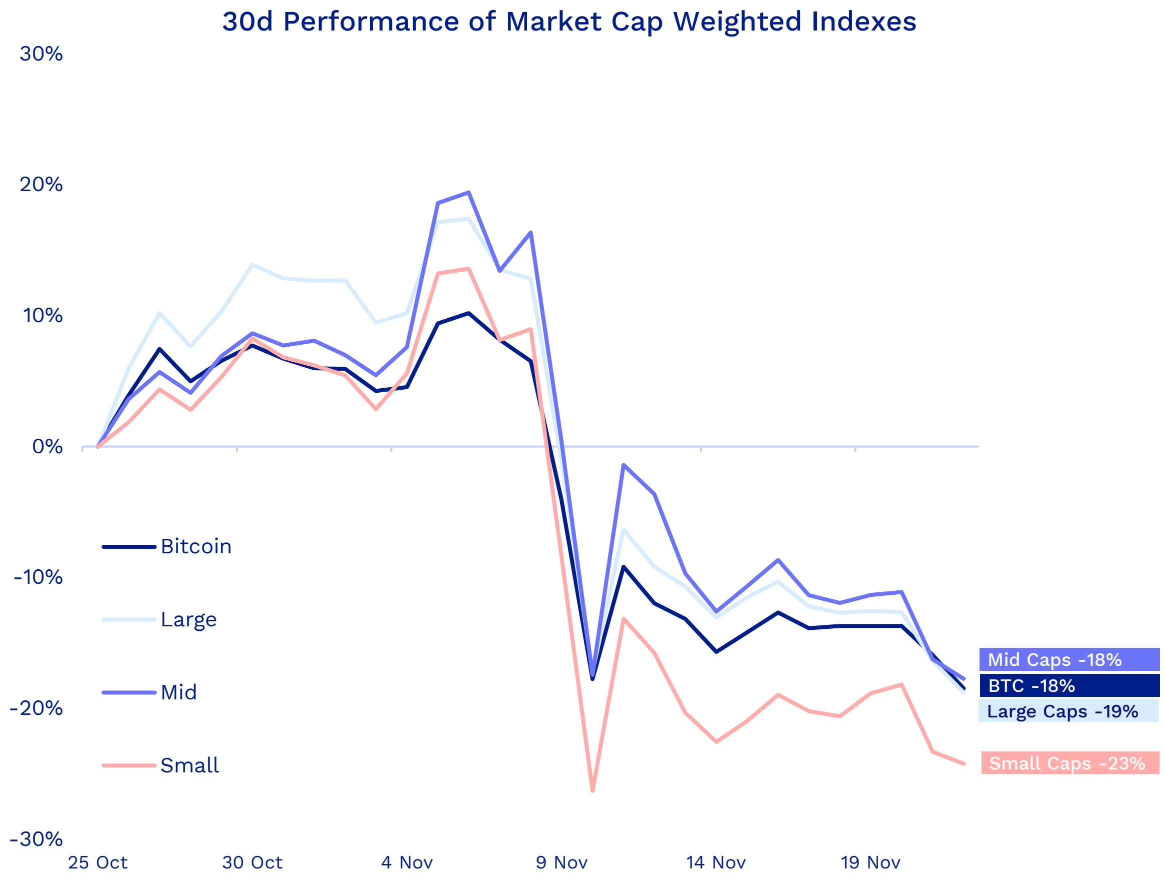
Top 3 by Market Cap, Last Week



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

A correlated downward trending market

- All indexes have moved in strong correlation over the last week. The 30-day rolling ETH-BTC correlation currently sits above 0.95, at levels only seen 3% of the time since December 2016. Similar correlations are evident across all indices.
- BTC, Large Caps, and Mid Caps have experienced losses of 18-19% in the last 30-days, while Small Caps underperform the market, seeing losses of 23%

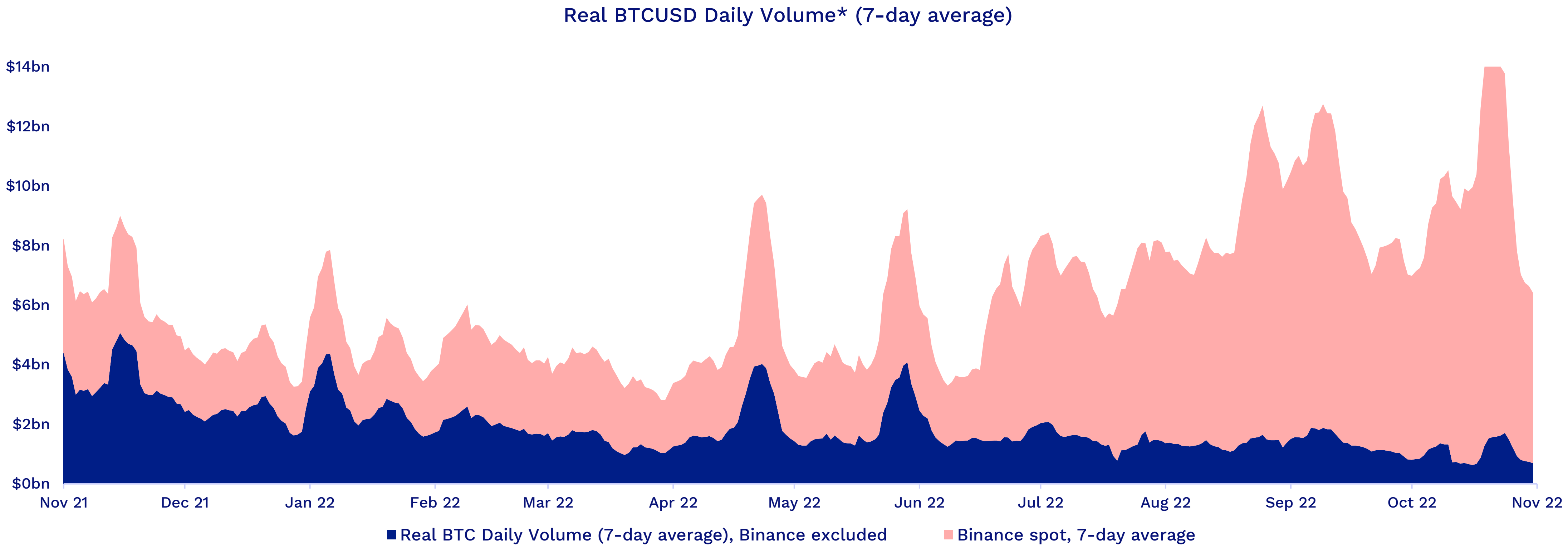


Source: Bletchley Indexes, Tradingview (Coinbase)

Market activity dwindles down

The crypto market has taken a hiatus after the extreme volatility and trading volumes amidst the FTX collapse, evident by the seven day average trading volume in BTC plunging to a 3-month low.

The dwindling activity is typical for BTC after meltdowns, and we saw similar patterns after the collapses of Luna and 3AC in May and June.



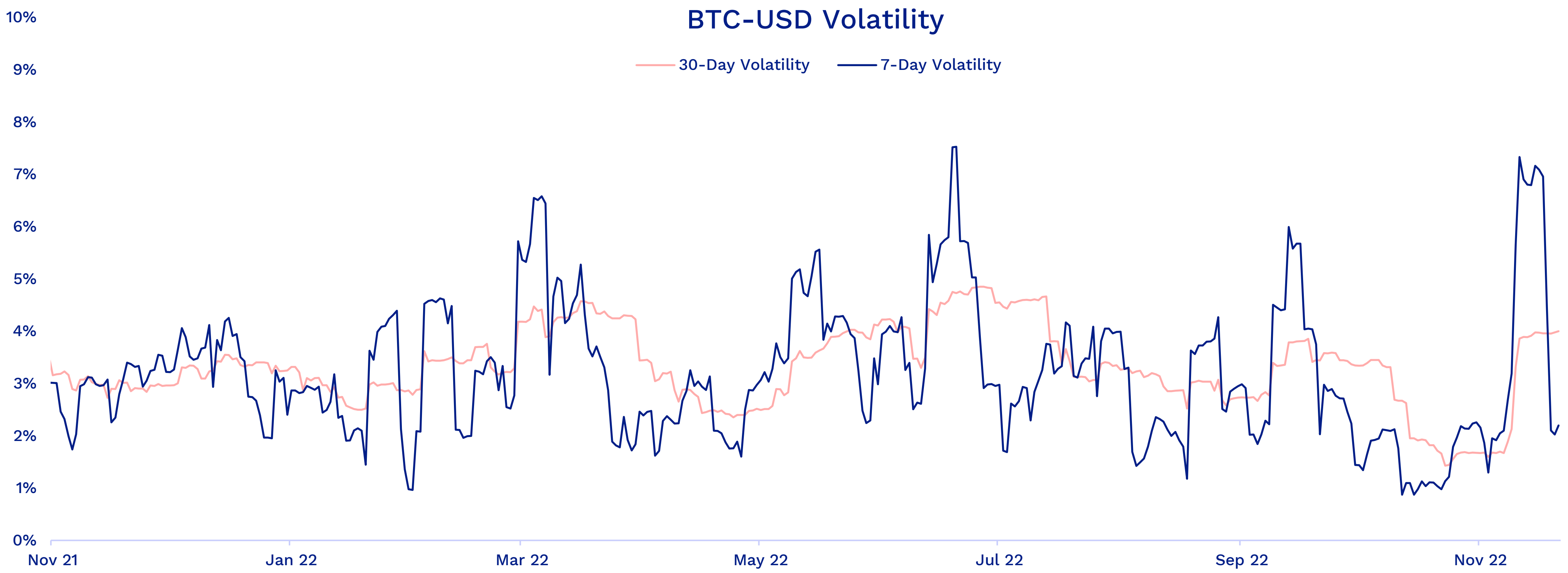
Source: Tradingview

*Includes Bitwise 10 exchanges and FTX

Prices stabilizing

Volatility has stabilized as BTC has found support above 15k for now, leading the 7-day volatility to fall to 2.2%. However, as crypto contagion and uncertainties still ravage the market, several catalysts may ignite volatility in the market in the coming weeks.

Our base case is that volatility will soon flatline as soon as the current uncertain conditions ease. Market participants should prepare for quiet markets as we enter 2023, with few weekly changes, similar to the low volatility environment experienced in October. The 2018 bear market saw 120 days of no noteworthy volatility as markets bottomed, while the 2014-15 bear market saw 270 days of no material market activity.



Source: Tradingview (Coinbase)

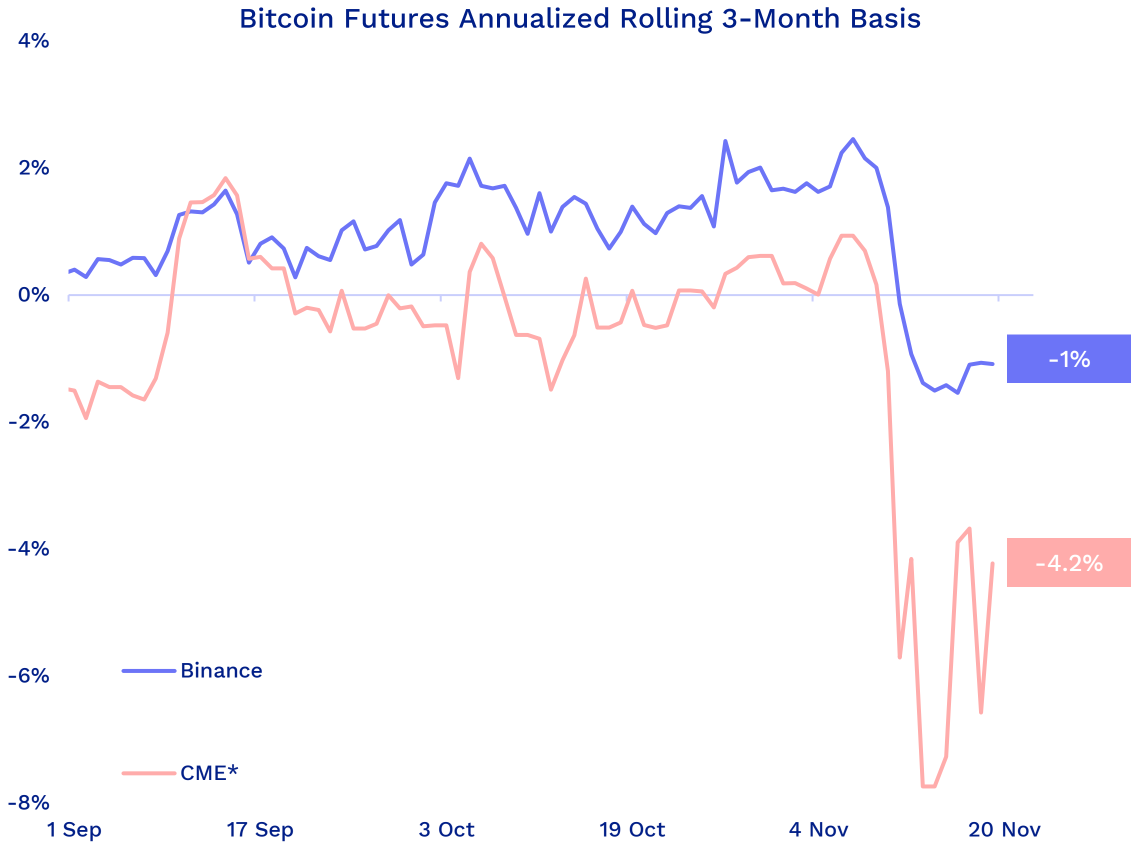
Derivatives

CME is still trading sharply below spot

- Futures traders remain bearishly positioned, as futures still trade at substantial discounts to spot, with few material changes over the last week.
- CME's basis has seen a slight recovery, but the 3mth annualized basis sits at -4.2% and has trailed below -3% ever since November 11. CME's BTC futures have never seen such sustained massive discounts, indicating that CME traders are bracing for further downside in BTC.

Futures term structure in growing backwardation

- The futures term structure in CME remains in strong and growing backwardation, as the December contract currently trades 1% below the November contract.
- The widening backwardation is partly caused by the approaching settlement date for the November contracts this Friday. Nevertheless, the current futures term structure is unlike anything seen in CME's BTC futures before the last few weeks.

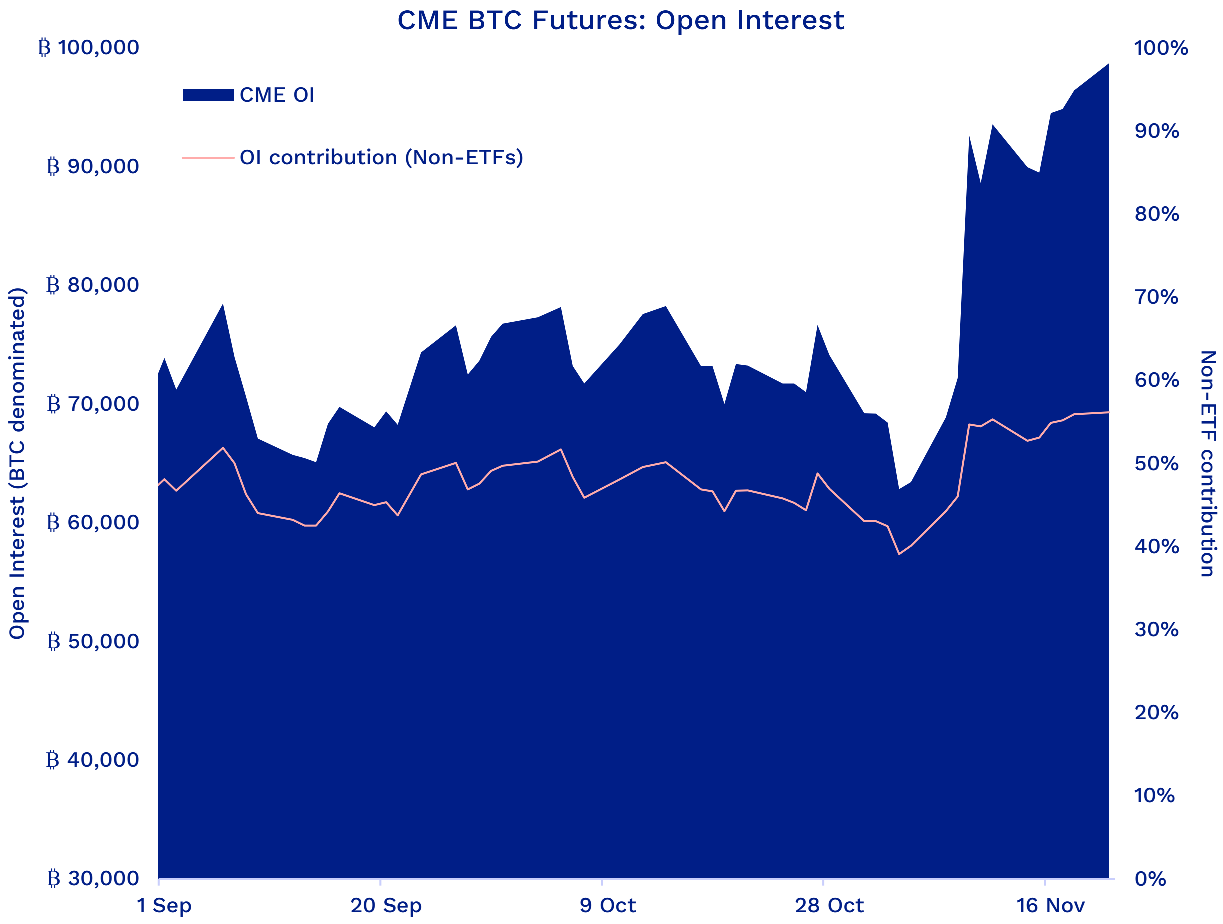


Source: Skew, Laevitas, Tradingview, CME

*Closed Saturday - Sunday

CME's open interest reaches new all-time highs

- The bearish sentiment on CME is accompanied by the open interest pushing to new all-time highs, as we elaborate on page 7.
- Direct futures trading activity is behind the growth, as the non-ETF contribution to the open interest on CME has grown to 56%, near 2022 highs, prior to the launch of BITI.



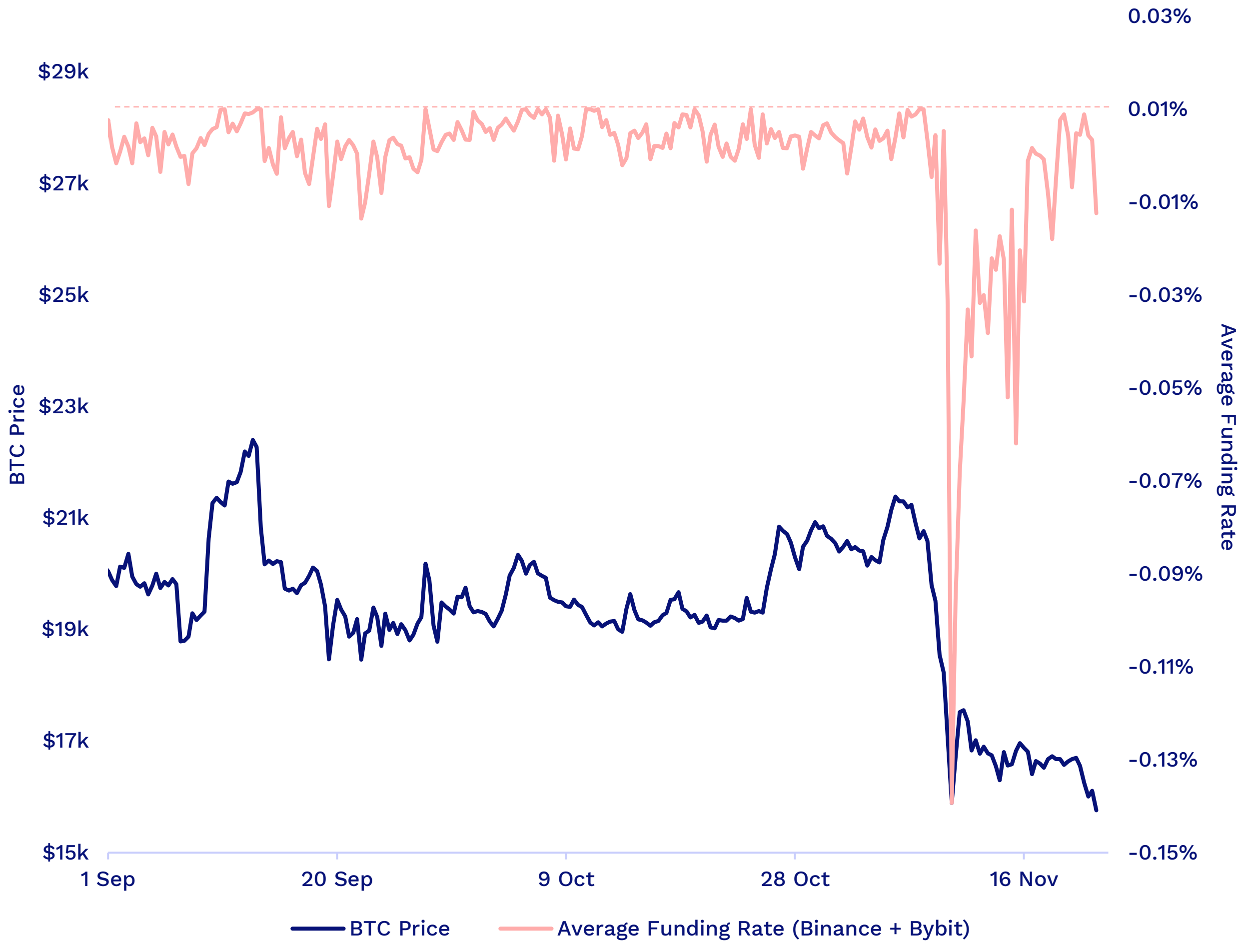
Source: Coinglass, ProShares, Valkyrie, VanEck

Funding rates recover, but activity dies down

- Funding rates recovered to neutral territory over the weekend, predominantly caused by an idle market, as perp trading volumes declined to 1-year lows, aligning with what we see in spot markets.

- On Monday, funding rates returned to negative terrain as bitcoin faced downside amidst growing fears related to Genesis' halted withdrawals and the growing likelihood of potential bankruptcy.

Bitcoin perpetuals: Funding Rates vs BTC Price

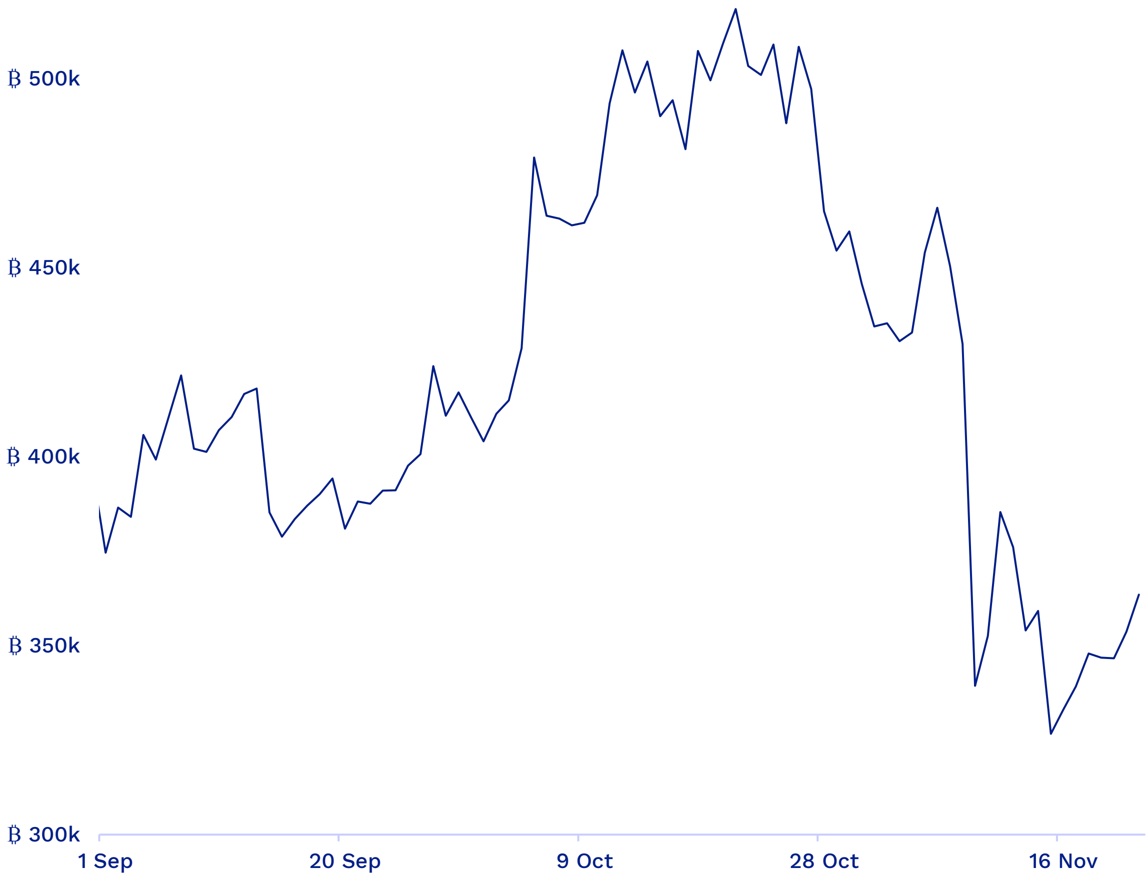


Source: Skew, Bybit, Binance

Open interest in BTC perps flattens

- Alongside declining activity in the market, open interest in BTC perps has stabilized, seeing no material changes in the last week.
- The open interest in BTC perps is heavily concentrated in Binance, representing 47% of the total open interest within perps. The last time we saw similar open interest dominance from one exchange was during the BitMEX hegemony in 2020.
- On page 7, we illustrate Binance's dominance within BTC derivatives and note that futures instruments are gaining market share again.

Bitcoin Perpetuals: Open Interest



Source: Laevitas

Bitcoin options: Options traders seek protection and IV stabilizes

Options traders seek protection

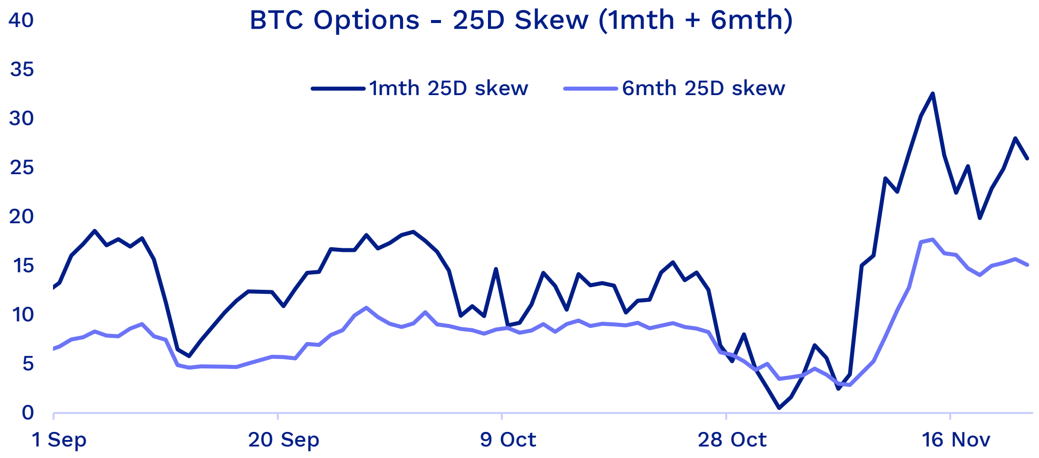
- Options traders still aim for protection, as puts remain rich, with few notable changes from last week as the market has taken a breather.

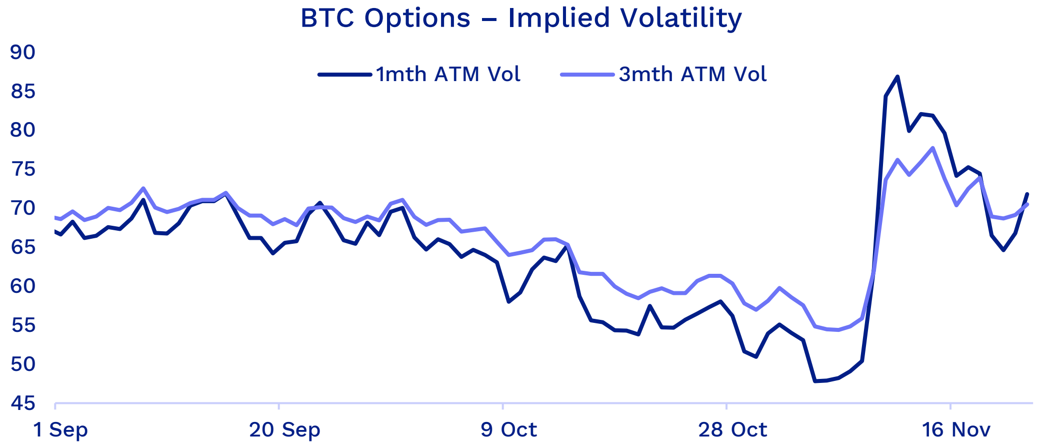
- The 6mth skew stays at all-time highs as options traders still position for long-term headwinds.

Implied Volatility shoots higher

- Implied volatility remains on par with last week's levels, with few noteworthy changes.

- In sum, the derivatives market remains distressed, and we see clear signals of cautiously positioned traders. However, there are few changes from last week, as trading activity has fallen substantially amidst the declining volatility.





Source: Laevitas

The Deep Dive

Genesis crisis and GBTC

The digital asset brokerage firm Genesis, owned by Digital Currency Group, seeks financing. Genesis suspended withdrawals, in addition to seeking an emergency loan due to certain illiquid assets on Genesis' balance sheet. Bankruptcy has emerged as a potential outcome if the financing efforts fail. Per recent rumors, Genesis has slashed its raise target from $1bn to $500m, indicating that the firm struggle to shore up its lending units' liquidity profile.

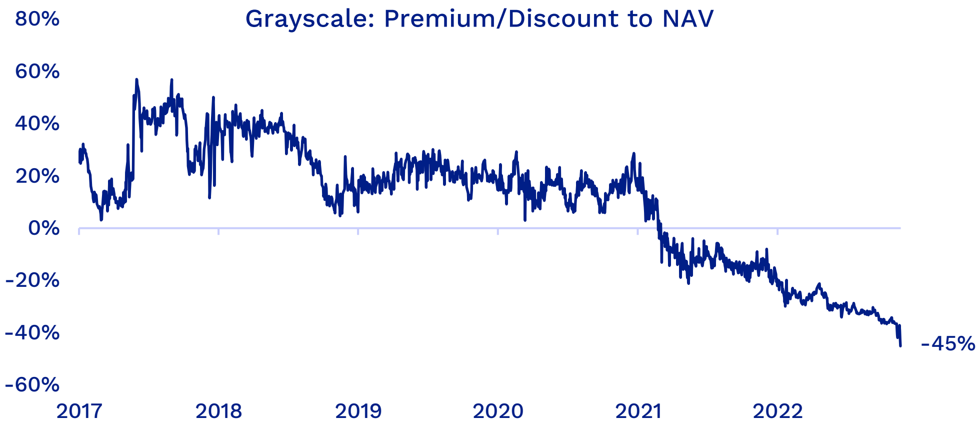
Digital Currency Group owns a myriad of companies, with Grayscale being the flagship company holding. Grayscale offers crypto exposure through close-ended funds and holds 3.3% of the circulating BTC supply and 2.5% of the circulating ETH supply. Traders are now fearing that bankruptcy will lead to a dissolution of Grayscale's crypto funds. Alternatively, the trusts may be acquired by traditional finance behemoths due to the attractive fee structure and size of the fund and the potential opportunity to acquire these trusts at bargain prices.

Grayscale's trusts trade at an all-time high discount to NAV. Due to its close-ended structure, the trust does not trade on par with NAV. Grayscale aims to turn the BTC trust into an ETF in the future. Previously, the trusts traded at a premium to NAV, but since early 2021, the trusts have traded at discounts. GBTC currently trades at an enormous -45% discount to NAV. Based on Grayscale's 2% annual management fee, the market is currently pricing in that the fund will remain close-ended until 2051.

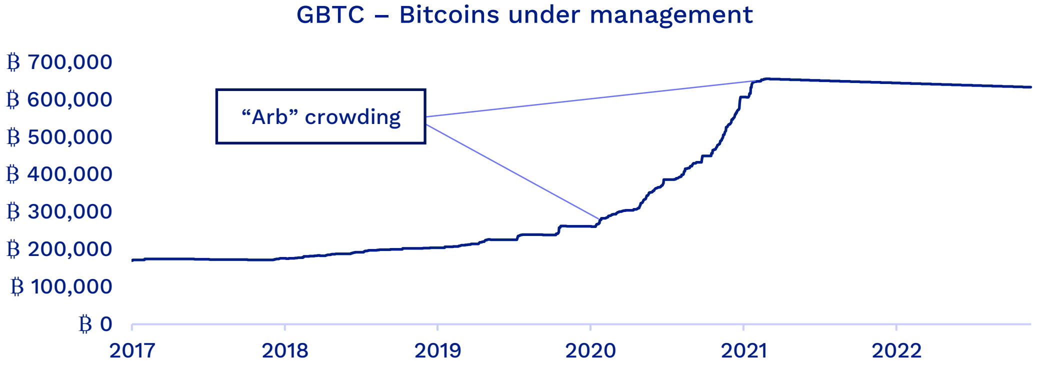
Why the massive discounts? An "arbitrage" becoming painfully wrong

Up until early 2021, Grayscale's BTC trust continuously traded at a premium. Three Arrows Capital and other funds exploited this "arbitrage" by buying BTC, allocating to GBTC in-kind, and selling shares once delivered 6 months later, as we explained in 2020.

This trade got highly crowded during the 2020 bull run, and 3AC, among others, lent BTC from Genesis, invested in-kind in GBTC, aiming to sell GBTC at a premium after the 6-month lock-up. From January 2020 until March 2021, Grayscale's trust grew from 260,000 BTC to 655,000 BTC, spiking massively in late 2020. The scope of this "arb" was unsustainably high, leading shares to flood the market far beyond the organic demand to buy GBTC and discounts to widen. The growth was also credit-fueled, leading Genesis, among others, to be caught offside, being the counterparty of loans based on collateral trading further and further away from its underlying asset.



Source: Skew, Ycharts



Source: Skew, Grayscale

Futures relevancy recovering

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Per last week's CFTC commitment of traders report, commercial traders reduced long exposure and increased short exposure, suggesting that hedging-related trades constitute a substantial share of the most recent flows. This is unsurprising, given the contagion and uncertainty within crypto at the moment. Meanwhile, institutional speculators increased their long exposure. This may be driven by hedge funds seeking to take advantage of the CME discount versus spot ahead of the settlement of the November contract this Friday.

Futures dominance growing

CME's growing market share has led futures to gain market dominance in BTC derivatives. However, the futures market share was unusually low, sitting at 25% on October 6, and has now returned to levels on par with the norm from 2022, currently representing 33% of the open interest in BTC derivatives.

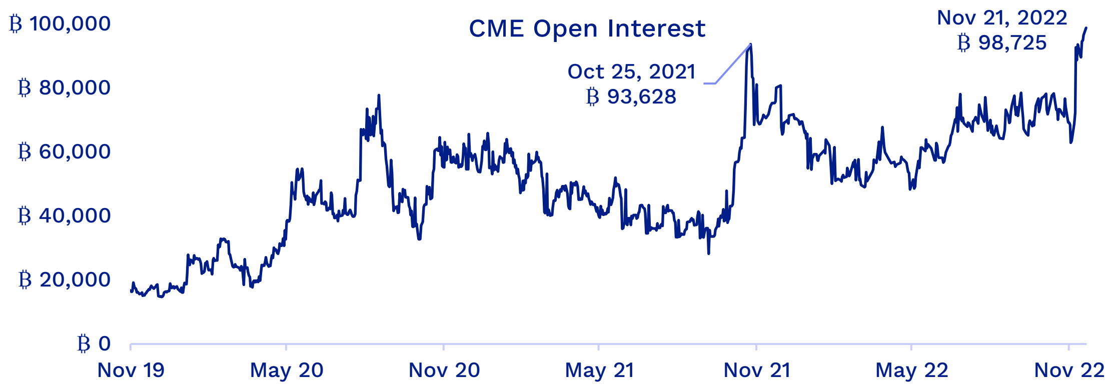
Overall open interest stays high. Open interest has fallen substantially in perps but remains at levels higher than prior to Q3 2022.

CME and OKX dominance growing

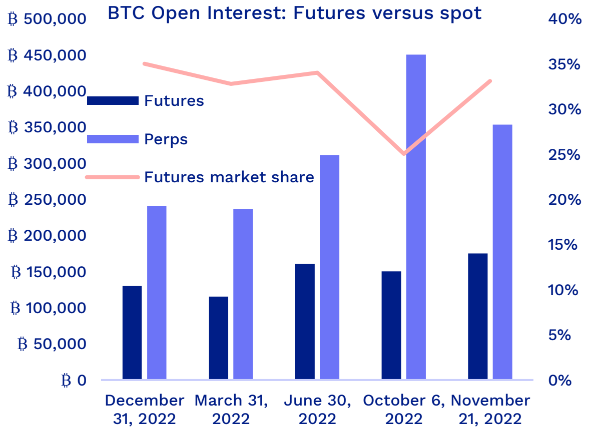
CME dominates the BTC futures market, accounting for 56% of the market. This is the highest CME dominance within BTC futures seen in the last year.

However, when including open interest from perps, Binance's dominance in the market is clear, representing a third of the open interest in BTC derivatives, whereas CME is the third largest derivatives exchange, representing 19% of the total OI in BTC derivatives.

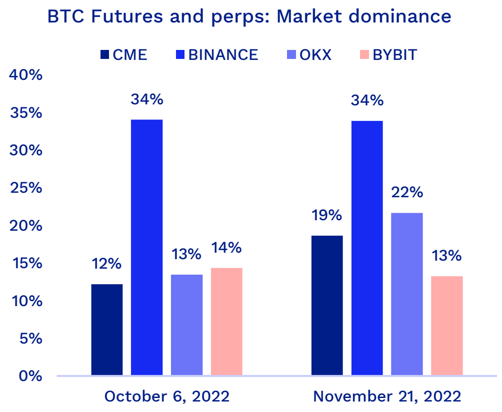
OKX is the largest offshore futures venue, representing 25% of the futures OI. OKX also has a material market share in perps, accounting for 20% of the total perp OI. OKX faced a wave of difficulties in 2021 related to Chinese crypto bans, leading its market share to plunge to 5% by December 31, 2021. Amidst recent turmoil, OKX has managed to reclaim its relevancy, once again being one of the most relevant derivatives exchanges in crypto, representing 22% of the total open interest in the market.



Source: Skew, CME Group



Source: : Skew, CME Group, Laevitas



Source: : Skew, CME Group, Laevitas

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