Ahead of the curve

Week 47, 2022

luno

Provided by arcane research

Market Update

BTC stays rangebound
The crypto market saw a recovery last week, but overall the market structure remains closely aligned with what we noted last week. Trading volumes are still trending down, and derivatives traders remain cautiously positioned. BTC saw 5% gains in the last week, and a new trading range seems to be forming between $15,000 and $17,000. ETH saw unique sell-side pressure last week driven by FTX hack-related activity but has recovered from last week's losses.

The rolling 30-day correlation between ETH and BTC sits at unusually high levels of 0.96 and has only been higher 3% of the time since December 2016. The only periods affiliated with higher correlations between ETH and BTC occurred in late November 2018, early March 2019, after the Covid crash, and after the 3AC meltdown. The crypto market is thus currently extraordinarily correlated, and BTC is the predominant directional force.

Softening correlations – New regime?
In light of crypto-specific contagion, correlations between BTC and U.S. equities have naturally declined. Correlations have remained soft since the FTX collapse, assessed through both long-term rolling correlations and granular intraday price patterns. Bitcoin did not absorb the positive equity response to the lower-than-expected CPI release of November 10 as contagion occupied bitcoin traders' mindshare, and since, the economic calendar has been quiet.

Bitcoins reduced market cap, reduced liquidity, and 77% drawdown may lead to stickiness of a weaker correlation between BTC and U.S. equities. The lower market cap, currently sitting at $317bn, has led BTC's size to reach a less relevant size related to potential beta exposure to macro headwinds. Further, the reduced liquidity in the markets may disincentivize sophisticated funds to employ macro trading strategies associated with BTC. Lastly, the 77% decline from ATHs may represent levels at or near prices where determined buyers seek to build exposure regardless of the economic climate.

However, the last few weeks have been slow related to economic data. Activity will gradually pick up in the coming weeks. Nonfarm payrolls and a Jerome Powell speech this week may provide clues whether the structural correlations have calmed. We'll have to wait until the December 13 CPI release and December 14 FOMC press conference to assess whether the correlated relationship has firmly softened.

Zooming out
BTC's bear market has now lasted at lengths comparable to the bear markets of 2014-15 and 2018. This cycle has for now seen a max drawdown of 77% in BTC from peak to trough, with the current bottom occurring 376 days after the peak of November 10, 2021. In the 2014 bear market, BTC's peak-to-trough drawdown of 85% lasted for 407 days, while the 2018 top to bottom of 84% lasted for 364 days. Thus, while the current drawdown duration has been at comparable lengths to previous cycles, the depths are higher for now.

BTC Drawdowns (X-axis: Days from peak)

Source: Tradingview (Bitstamp)

Spot Market

BTC stays rangebound

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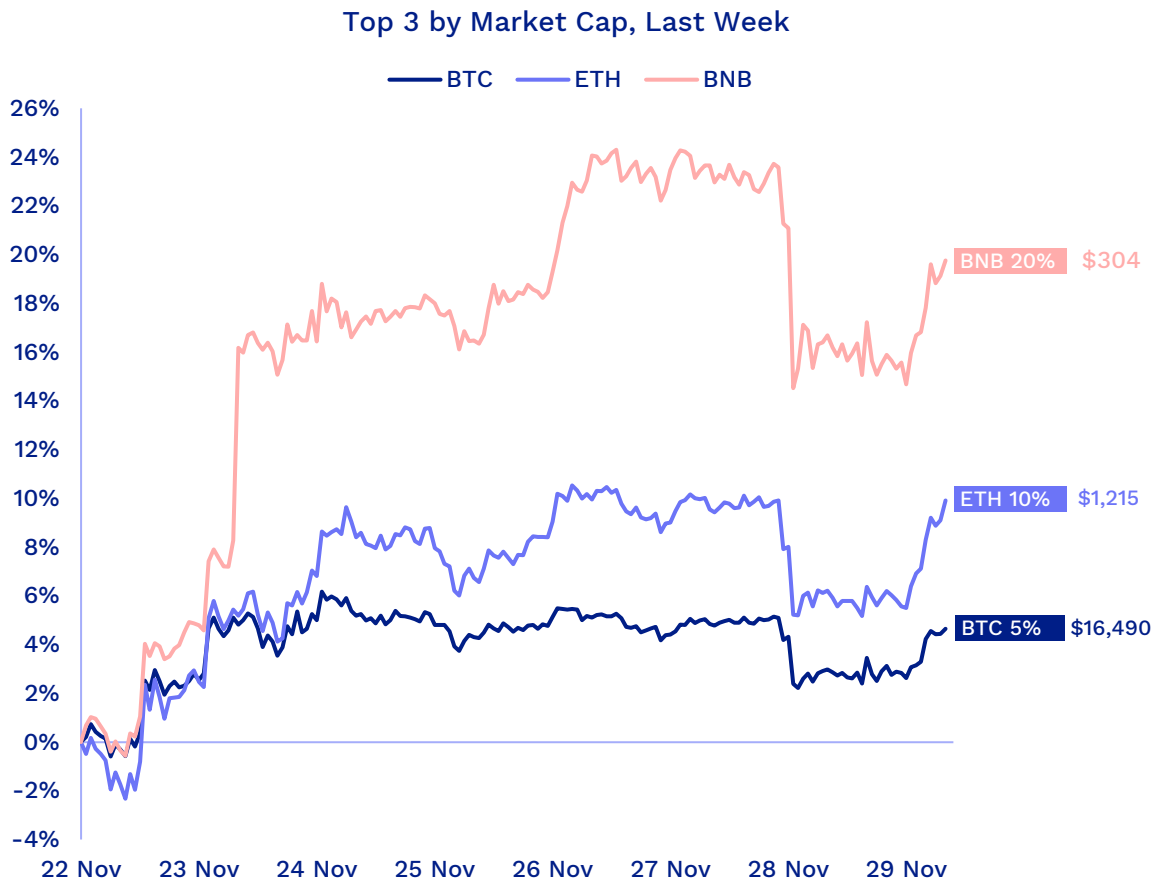
- We note that correlations between BTC and equities have weakened in the last three weeks. This is natural due to the layers of uncertainty added to the market following FTX's insolvency. As the economic calendar gradually becomes more hectic, we may see if the recent meltdown has caused a structural trend shift in the correlated relationship between BTC and equities, as we comment in detail later.

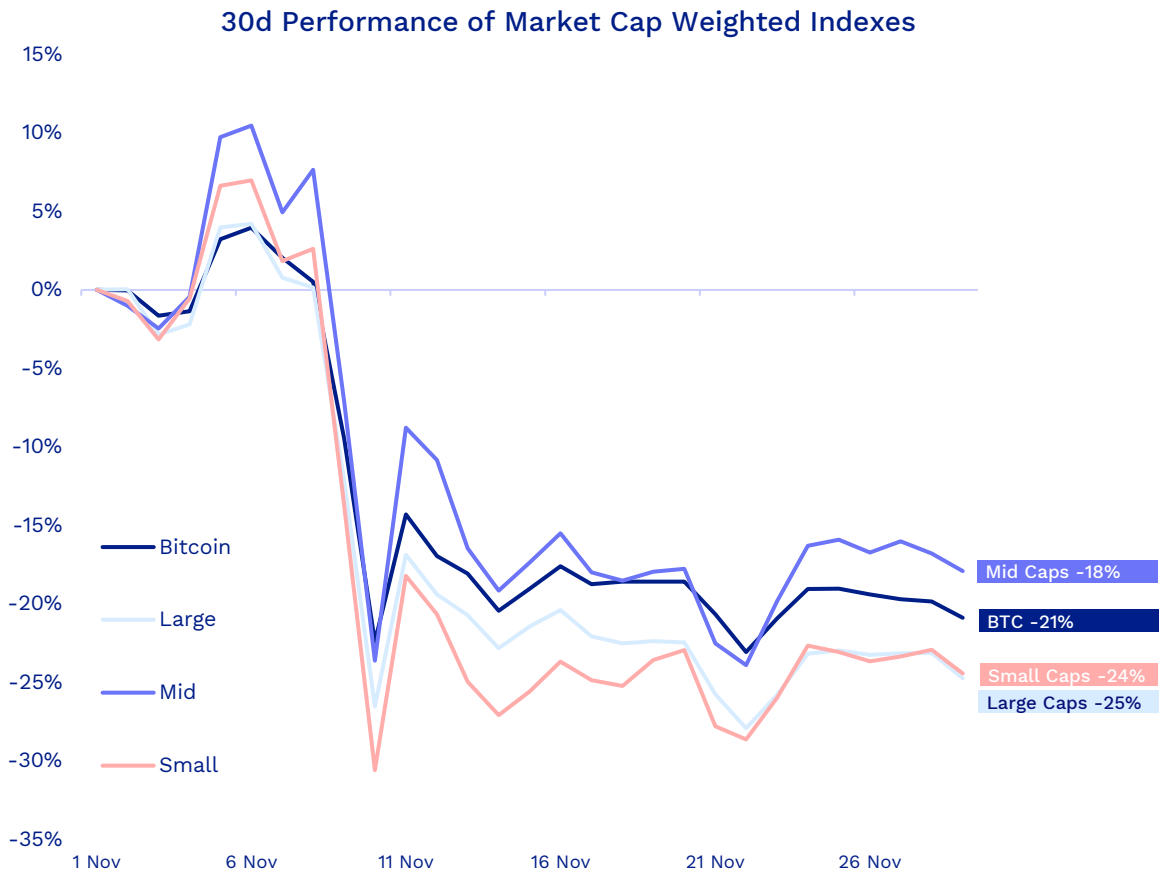


Source: Tradingview, (Coinbase, Binance U.S.)

Flattening crypto markets

- The crypto market has stabilized in the last two weeks, with no notable deviations across any of the altcoin indexes. All November losses originate from the FTX collapse and the associated contagion with the meltdown.

- Prices have since stabilized, with certain exceptions within various altcoins experiencing short squeezes fuelled by reduced liquidity in the market.



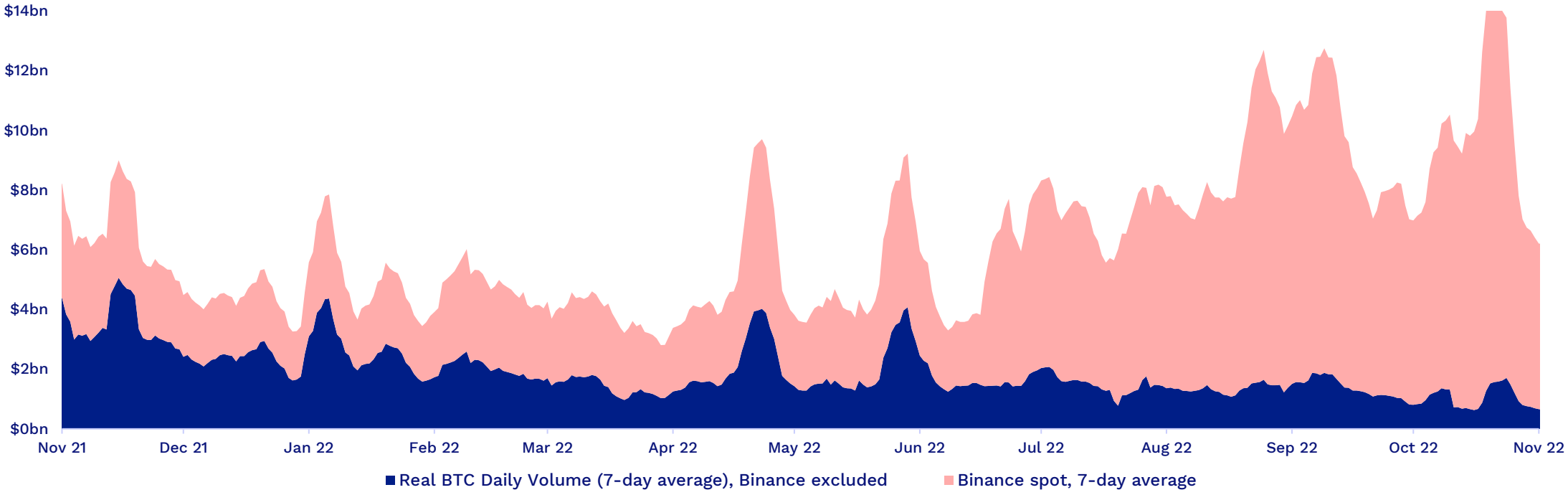
Source: Bletchley Indexes, Tradingview (Coinbase)

Market activity slows down further

The bitcoin trading volume has fallen further this week. Trading volumes outside of Binance reached the lowest 7-day average level in BTC spot markets since February 2021 this Sunday. Due to the sheer dominance of Binance, aggregated volumes remain high. Still, we note that the 7-day average trading volumes have only been lower once since Binance removed trading fees for its BTC pairs.

The reduced volumes illustrate the muted activity in the market at the moment. This is further illustrated in the derivatives slide, where we see no noteworthy developments over the last week.

Real BTCUSD Daily Volume* (7-day average)



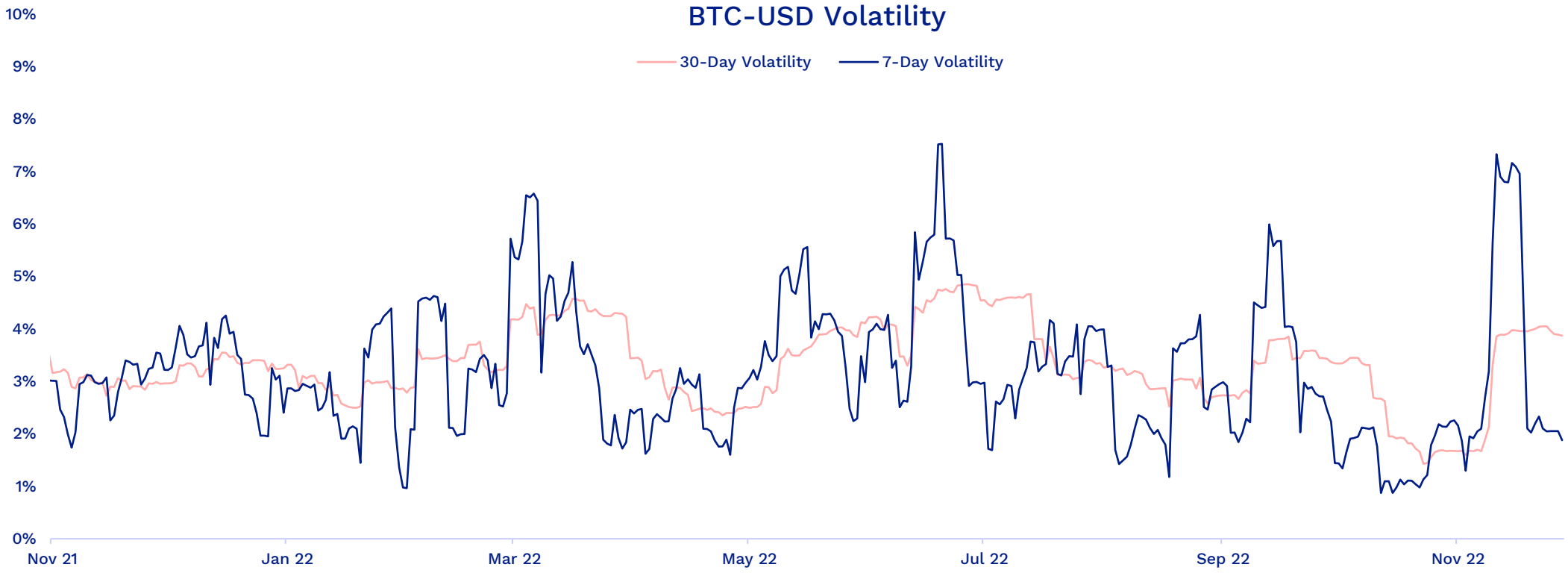
Source: Tradingview

*Includes Bitwise 10 exchanges and FTX

Prices stabilizing

BTC's volatility has rapidly declined, accompanied by reduced activity in the market. The FTX shock was quickly absorbed in the market, leading volatility to skyrocket in mid-November, but now prices have stabilized. While contagion-related uncertainties still loom, prices have stabilized above $15k as BTC's seven-day volatility falls to 1.8%.

Later, we discuss how BTC bottoms tend to be followed by a lengthy low-volatility environment. While it is too early to state that a BTC bottom has formed, particularly related to the unclear situation with DCG and Genesis, the current price pattern is in line with previous BTC behaviour near market bottoms, and a lengthy period of low volatility may follow.



Source: Tradingview (Coinbase)

Derivatives

CME futures catching up

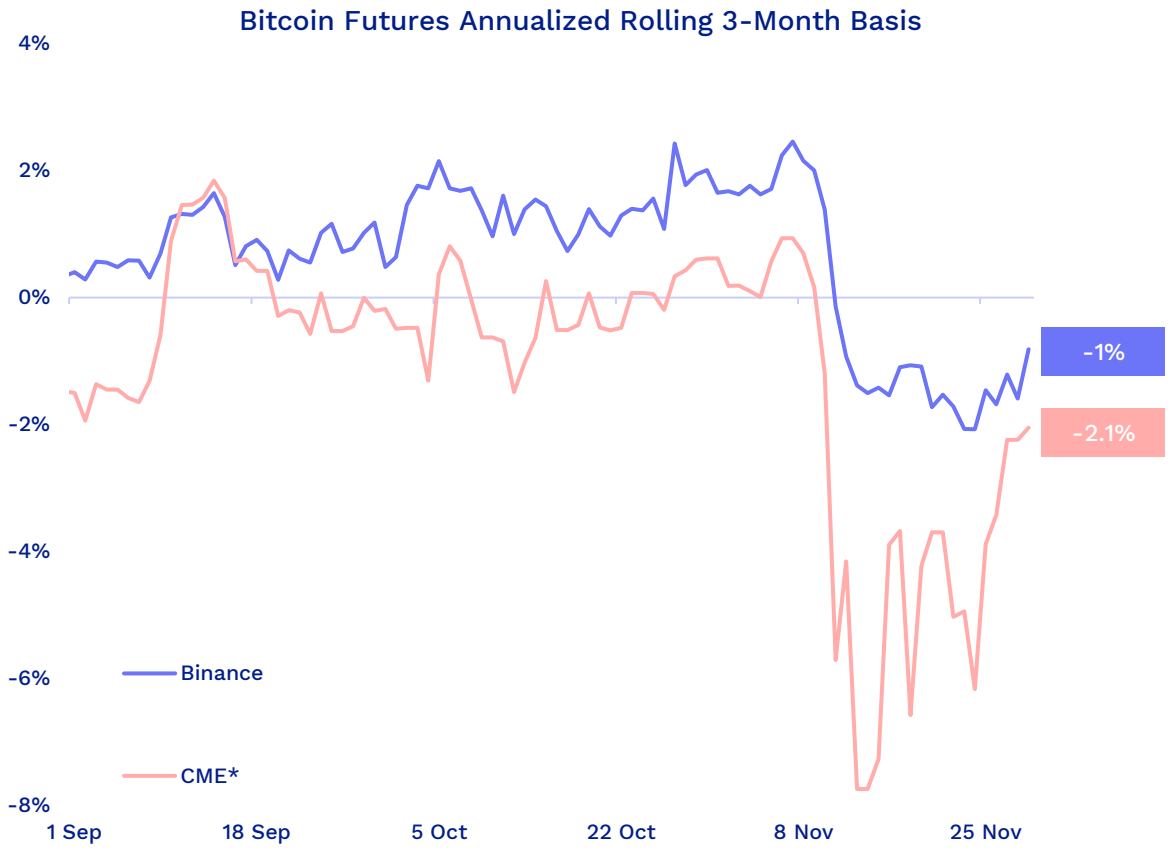
- The gap between CME's 3-month futures basis and Binance's basis is narrowing as CME's basis recovers. This suggests that market conditions are gradually normalizing.

- Nevertheless, Binance and CME futures still trade below the spot market, indicative of a negative and cautious sentiment among leveraged traders.

Futures term structure normalizes

- CME's BTC futures term structure has normalized after the November contract roll, but futures still trade in backwardation.

- The current CME term structure suggests that institutional traders maintain a conservative positioning in BTC, with few notable changes from last week.



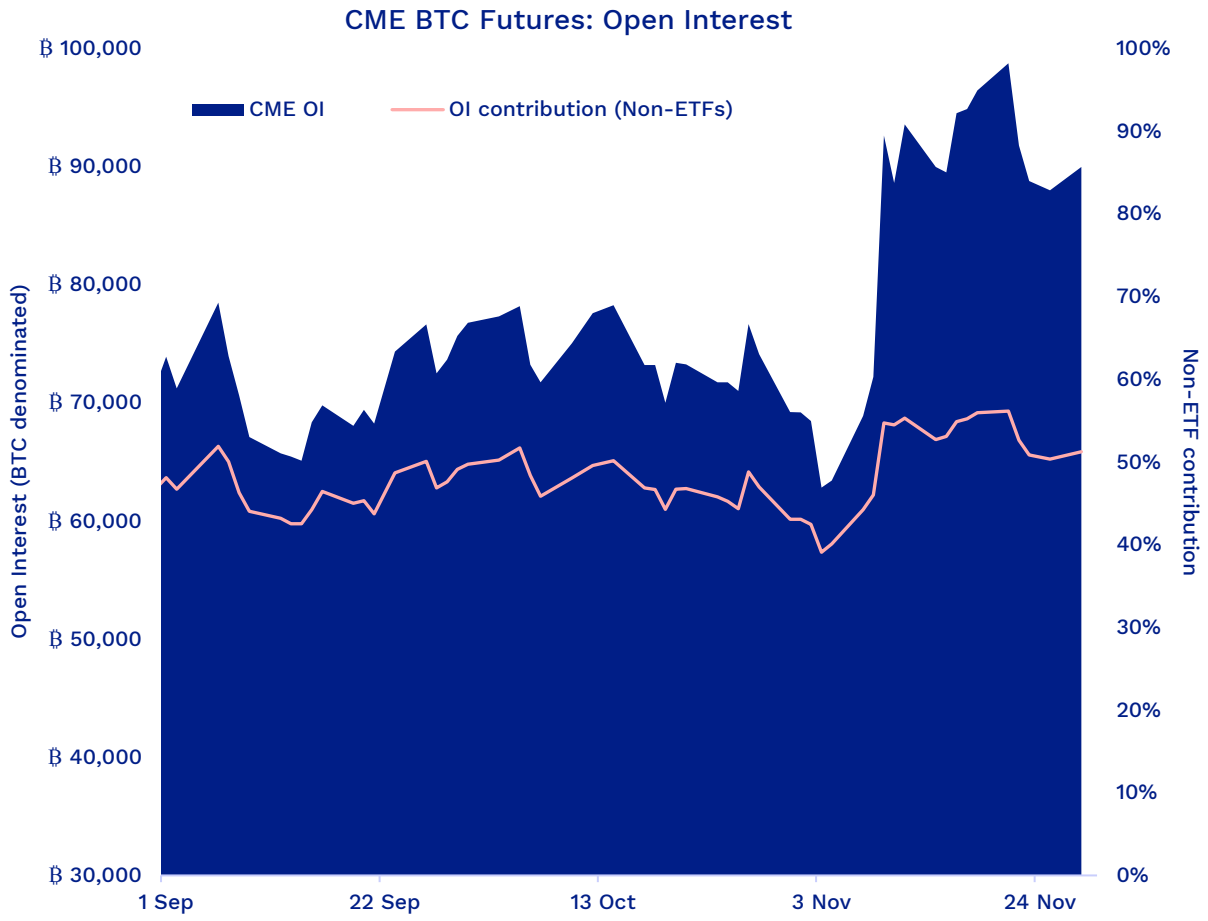
Source: Skew, Laevitas, Tradingview, CME

*Closed Saturday - Sunday

CME's BTC OI falls 9%

- The open interest on CME has fallen 9% in the last week, from highs of 98,725 BTC to 89,955 BTC. Nevertheless, the open interest on CME still sits 30% higher today compared to October 31, indicating that institutional participation in the market stays elevated.

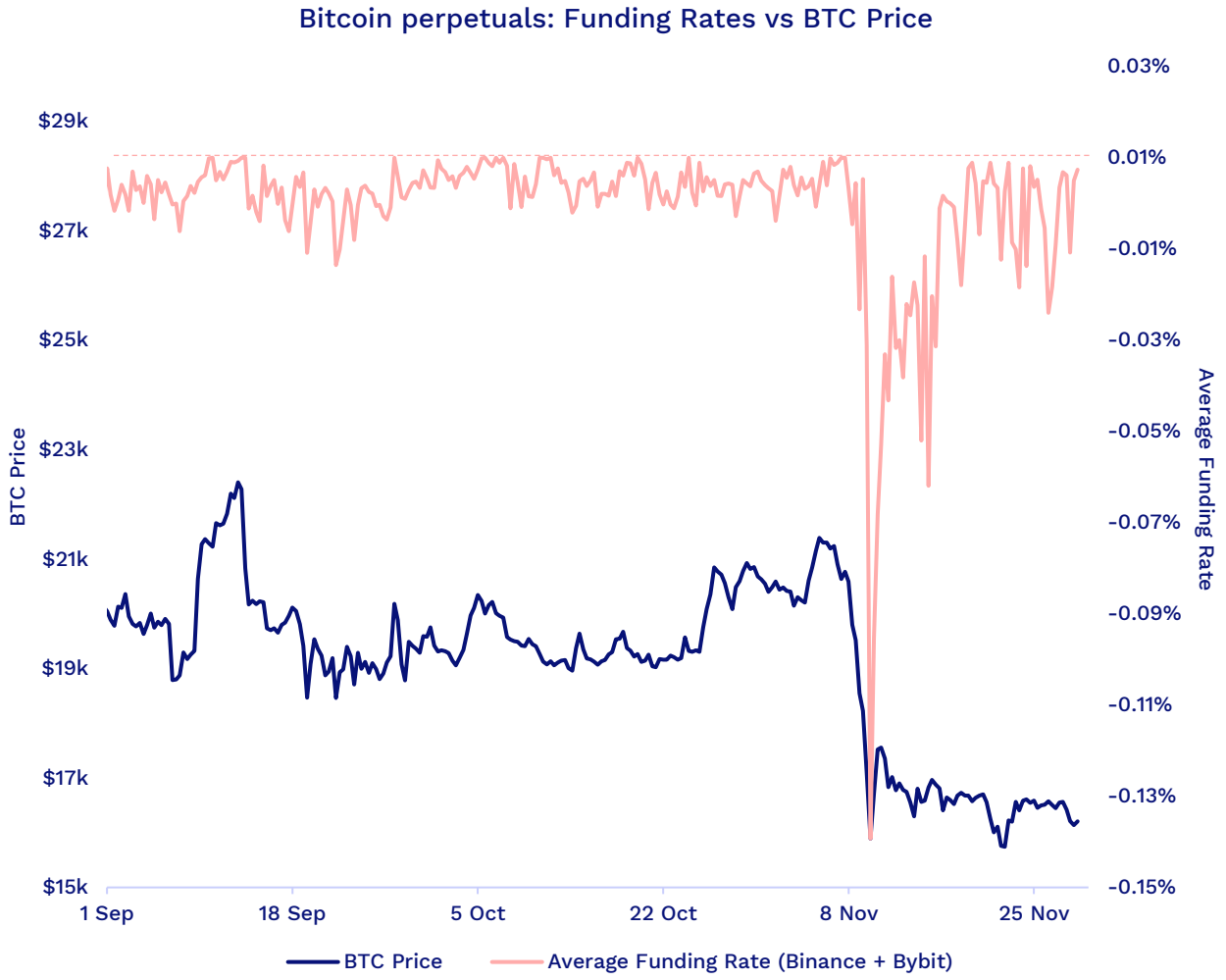
- In sum, the institutional sentiment aligns with last week's observations, with an elevated OI, accompanied by muted basis and backwardation suggestive of bearish positioning among institutional market participants.



Source: Coinglass, ProShares, Valkyrie, VanEck

Funding rates approach neutral levels

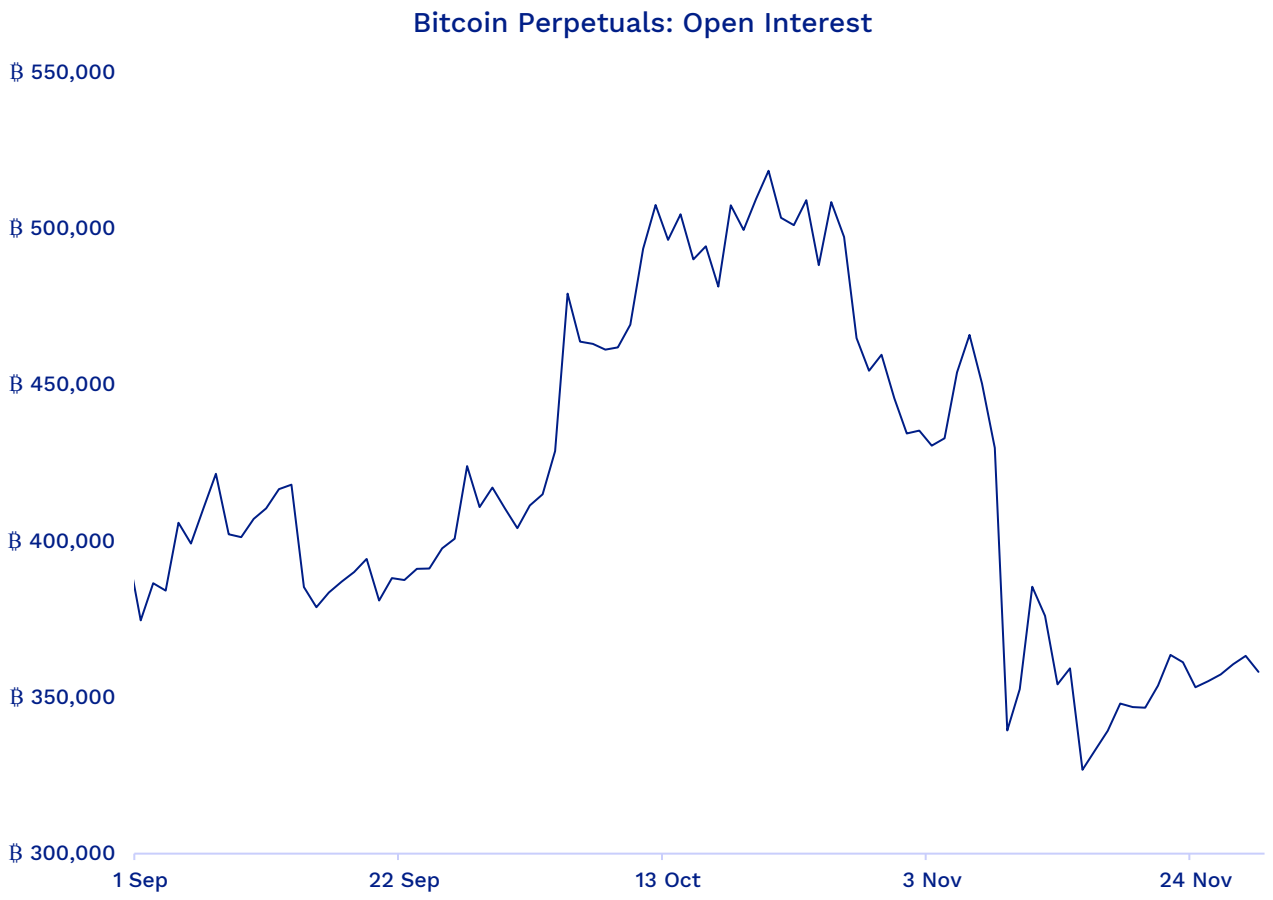
- The muted activity in the market is reflected in perps as well.
- Trading volumes have declined further, similar to trends seen in the spot markets.
- Funding rates still trail below neutral terrain of 0.01% ranging around 0%, suggesting conservative behaviour, also among perp traders.



Source: Bybit, Binance, Tradingview (Coinbase)

Open interest in BTC perps flattens

- The muted activity in perps has caused open interest to stabilize at 360,000 BTC.
- As highlighted previously, the leverage in the market is high compared to 2021 levels,
- The last week's stable market has done little to reduce the accumulated leverage in BTC perps.



Source: Laevitas

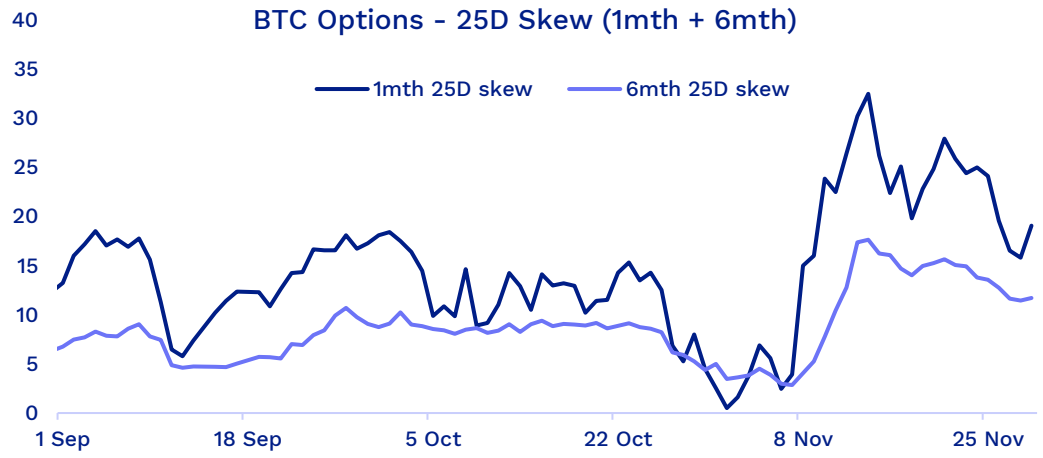
Bitcoin options: Options also mirroring last week – puts stay in demand

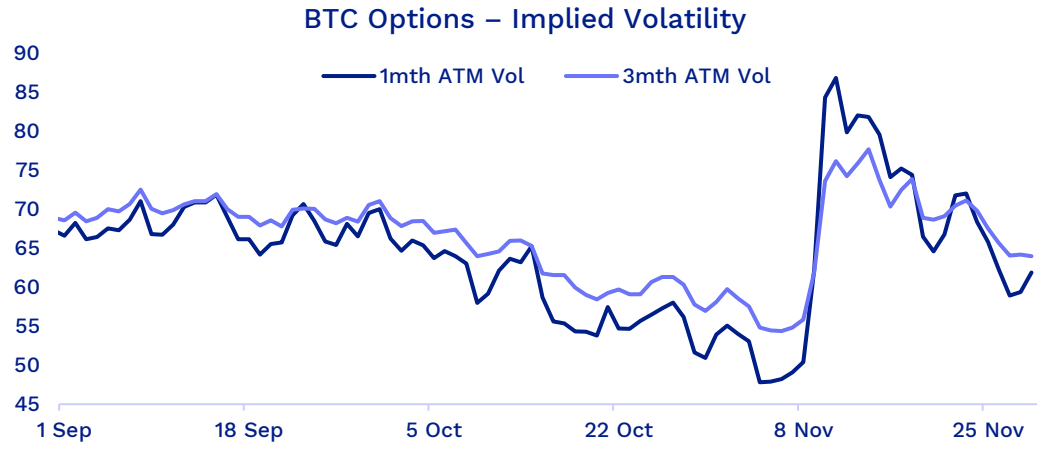
Options traders seek protection

- Options are the icing on the cake, wrapping up this monotonous passage of resemblances to last week. Neither the 1mth nor the 6mth skew sees any notable deviations from last week, as skews still suggest that puts and downside protection remains in focus among options traders.

Implied volatility stabilizes

- Implied volatility has seen a slight decline over the last week, with the three-month IV falling below 70% and the one-month IV declining towards 60%. IVs have now declined toward September levels due to realized volatility falling after the market absorbed the FTX shock. Current IV levels are on par with the yearly average in 2022.





Source: Laevitas

The Deep Dive

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Softening correlations – new regime?

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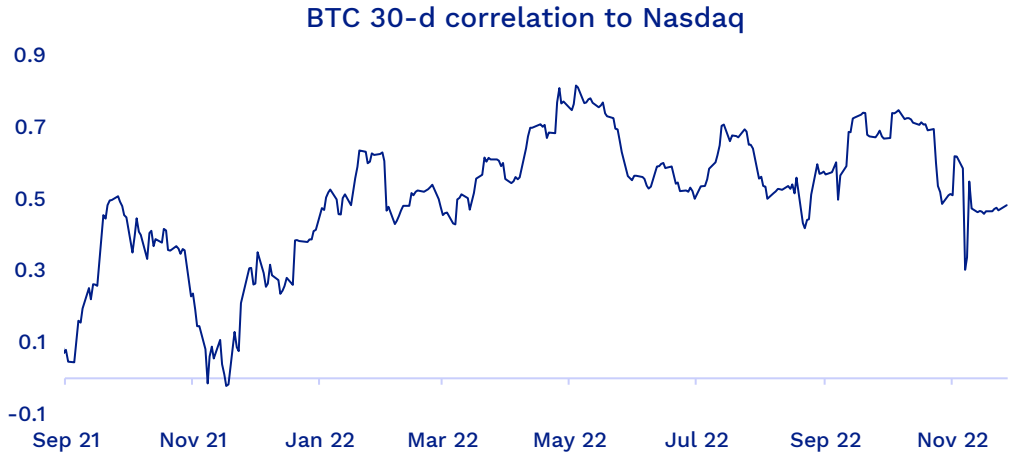
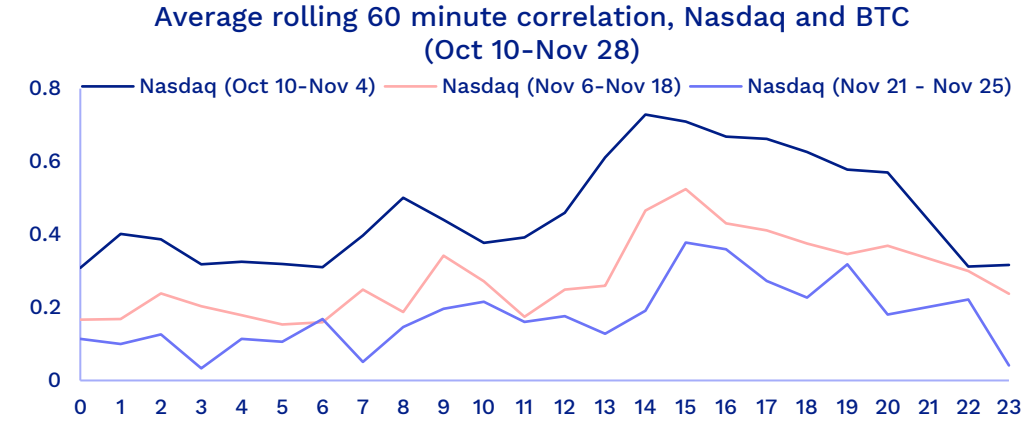
Firming correlations

The rolling 30-day correlation between BTC and Nasdaq currently sits at 0.5, down from 0.75 in early October. Intraday correlations have also evidently softened since the FTX collapse, and the trend seems to hold through also last weeks as the market activity has slowed down. However, one should be aware that last week was particularly slow across markets due to thanksgiving.

From October 10 to November 4, BTCs 60-minute rolling correlation to the Nasdaq averaged 0.72 as U.S. markets opened and remained above 0.6 until markets closed. In the last few weeks, correlations have been far softer, trailing in the 0.2-0.4 range during U.S. market hours. By assessing granular correlations, we may get a sense of more nuanced correlation relationships in the market. We will monitor this trend closely as we approach a more hectic macro environment.



Source: Skew, Ycharts



Source: Tradingview (CME, Coinbase). Timezone UTC. X-axis shows hour of day

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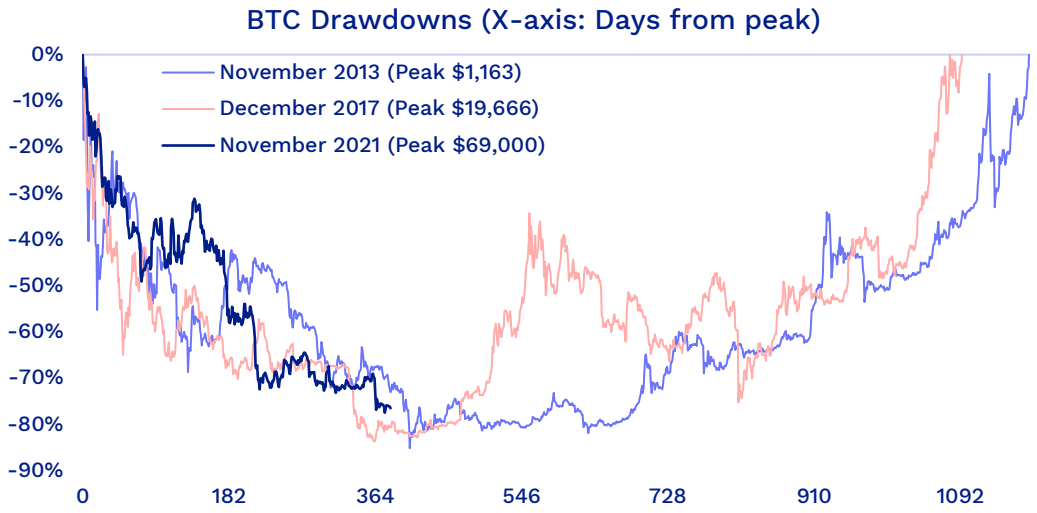
While history rarely repeats, BTC's cycle patterns are interesting to study. Periods of BTC strength are affiliated with massive hype, leading to bad risk management and massively painful drawdowns as market conditions sober.

Identifying bottoms in BTC is challenging, as the market is largely driven by psychology, with few prominent fundamental drivers. Fundamental drivers tend to lead the early stage bull market stages, i.e., the Silk Road adoption in 2013, the ICO wave in 2017, and the institutional wave in the wake of heightened inflation expectations in 2020. Bottoms emerge after an influx of forced selling, with prices being supported by determined buyers seeking to accumulate at suppressed prices. These periods have previously been long-lasting. After bottoming in 2018, BTC spent 120 days in a very flat environment, whereas the 2015 bottom saw 270 days of no material activity. Purely based on previous cycle patterns, investors should thus brace for slow days in the market whenever BTC bottoms.

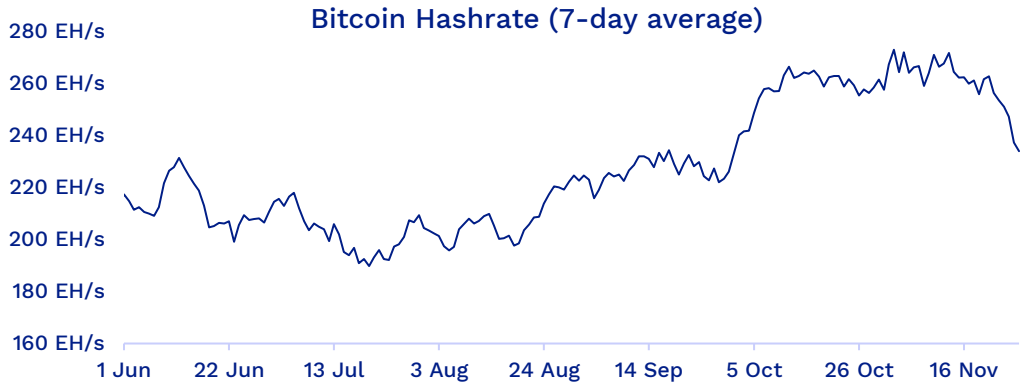
New miner capitulation?

Miners are notorious beneficiaries of market strength while being similarly exposed to distressing conditions during market weakness. Miner capitulations are the name of the game in BTC cycles. Earlier this fall, we argued that a miner capitulation ala 2018 is highly unlikely. We reassess and clarify our view in light of recent events.

The hashrate has declined substantially in the last week, and miners are selling more aggressively. The declining BTC prices is likely to cause pain for indebted miners. Nonetheless, we believe that a miner capitulation will have a negligible impact on BTC prices, in contrast to what we saw in 2018. The substantial selling in May and June occurred on top of more sizeable selling from Celsius, 3AC, and their counterparties. The miner selling in May and June also reduced the impact of new rounds of miner selling pressure today. Still, bitcoin miners will likely experience a very challenging period ahead.



Source: Tradingview (Bitstamp)



Source: : Skew, Grayscale

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