ELEMENT

Our Weekly Thoughts

ELEMENT DIGITAL ASSET MANAGEMENT

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At press time, the price of bitcoin is hovering around the $6.3k level, down roughly 5% since yesterday at the same time and down 17% in the past week. Bitcoin was one of the more steady performers this past week as the entire marketplace is down roughly 21% in that time period, with some small caps even losing a third of their market cap in the past few days. This wave of red was kicked off this past weekend, after news of an exchange hack and a CFTC price manipulation probe flooded the twitterverse. Couple that with the breach of some key technical levels and an uptick in short interest across margin trading exchanges and what we have today is a market that has for right now effectively lost its legs. Though we recognize that this market is still nascent and full of structural issues, we aim to let our fundamental thesis inform our views (and not emotion). As long term investors, our thesis is that the value of digital assets will move into the trillions of dollars within the next few years and in the process create opportunities for significant, uncorrelated returns. That being said, we've concocted a number of fringe theories as to what is causing the current weakness (some of which we dive into below). Anyone that has skin in the game will surely agree on same level with us. Here are our thoughts for the week:

1. There's definitely something odd about this marketplace right now. It doesn't make sense to us that this market would have such an adverse reaction to a minor exchange in Asia being hacked. For the price of bitcoin to be approaching its year to date lows as well as its break even cost for mining indicates to us that there is something fundamentally off currently. The price action almost has the feel of a mass liquidation given the amount of offers blowing through the bids on lit exchanges. We don't entirely know who or what entity could be selling at such velocity but we do believe there is a seller out there that will be unmasked in the next month.

2. Price manipulation exists and it needs to be eradicated. Today the University of Texas at Austin published an academic study that claims Tether was used to manipulate the price of bitcoin in the past. By using cluster analysis, the researchers were able map relationships between different participants on the bitcoin and tether blockchains around the times tether was distributed. The analytical process used was fairly logical. So kudos to the researchers for combining data from the public blockchains and scientific methods to arrive at conclusions most of us in the digital asset space had long suspected for some time. We repeat. <u>We suspected this for a long time</u>. This bit of news is nothing that we haven't heard. At the risk of crossing our anarchist brethren, we've long argued for regulation to come into this space in an effort to ward off bad actors that are capable of manipulating prices. Like we said before, we are thesis driven investors. Our thesis involves us projecting a fair value price. This fair value price incorporates everything we know about the present and what we believe about the future. So at the end of the day, the only way a fair value price will be realized is if the asset is trading in an ecosystem that allows for the discovery of fair value.

3. ICOs represent a short term opportunity cost for the broader crypto market. With nearly $10B invested in nearly 430 deals this year alone, its evident to us that the ICO market remains overheated and frothy. The expansion of the global supply of cryptocurrencies is rapidly expanding (as indicated by number of projects plus the inflation schedules of coins). Given that world investors only want to allocate a fixed amount of capital to the space, any increase in global supply reduces the price of all individual cryptocurrencies. At the same time, there's little to no method for cryptocurrencies to reduce the overall supply unlike equities where companies can engage in share buybacks.

3. It's worthwhile to pay close attention to not just regulations but the regulator themselves. Last week, SEC Chairman Jay Clayton's comments on CNBC during an interview were slightly more negative on the token market. This could be a signal of something to come. If the SEC does officially state that they will view any and all utility tokens as securities, the 2nd and 3rd derivative ramifications would be huge. The market right now has NOT priced that in completely so the resulting move in cryptocurrency prices could be a bit troublesome in the short run.

4. Derivatives aren't the cause but they certainly aren't helping the cause. A rough spot check of Bitmex activity from this past weekend showed us that about $480m of long positioning was liquidated within 24 hours. This liquidation included their futures contracts and their perpetual swap product. This type of activity is tracked and used as signals for algorithmic trading bots. So we believe the activity on this exchange could have had an impact on market sentiment. The poor saps that put on 100x leverage in the past few days have been catching multiple falling knives and getting their egos handed to them. In a falling market, market psychology goes into overdrive as individual traders are more pressured to make up losses while at the same time dealing with a belief that they can call the market bottom. We saw this dynamic also play out this week with the margin positioning deltas on Bitfinex. The visual below is a graph of Bitfinex long margin positions in green and short margin positions in red, plotted over time. In the past few days, there's been additional $20m of short positioning added on margin with a subsequent reduction of $10m of long exposure. This positioning is entirely retail driven, so it is less likely the cause of the market sell off….and more so just the result.

(Our own personal view is that retail traders should all together stop trading with leverage the moment a market like this manifests. If there's one thing the crypto market has taught us is that just when we think we understand how it all works, something new comes along to force us to have to re-evaluate our original assumptions.)

5. 2018 FIFA World Cup. This is the "fringiest" of our fringe theories here but maybe the commencement of the world's largest sporting event means global traders and investors (likely also soccer fanatics) have just decided to sit the next few weeks out? In any case, the first game begins at 11am EST tomorrow between Russia and Saudi Arabia.

Thanks for reading everyone. Questions or comments, just let us know.

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ELEMENT DIGITAL ASSET MANAGEMENT

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