arcane research

Market Research
Nov 8, 2022

Ahead of the curve
Market Update

Digital Assets

Signals from the market

Bendik Schei
Head of Research
bendik@arcane.no
+47 943 09 160

Vetle Lunde
Senior Analyst
vetle@arcane.no
+47 416 07 190

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.

By the numbers

BTCUSD $19,732
7d: **-4%**
30d: **2%**

ETHUSD $1,483
7d: **-6%**
30d: **11%**

Open Interest (BTC futures and perps)
$10.9bn
550,000 BTC (**-4.8%** last seven days)

Average daily BTC spot volume
$10.8bn (**+2%** last seven days)

BTC 90-d correlations (weekly change included)

ETH	Gold	S&P 500	DXY
0.80 (-0.00)	0.34 (0.03)	0.54 (0.00)	-0.47 (-0.01)

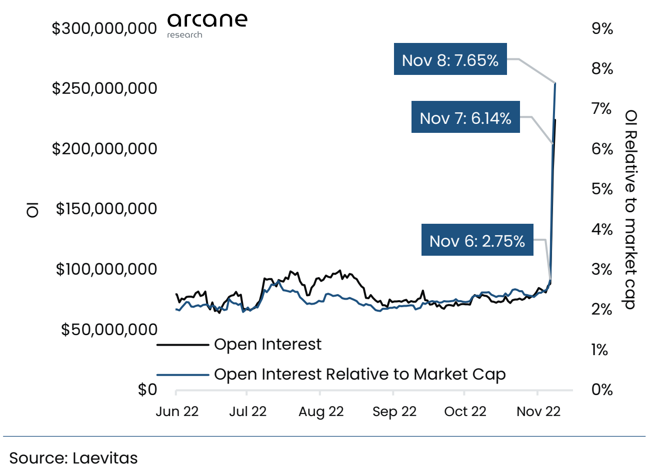
Percentage of Total Market Capitalization
Weekly change in percentage points

BTC	ETH	Stablecoins	Rest
38.6% (-0%)	18.5% (-0.5%)	13.7 % (0.6%)	29.1% (-0.1%)

Last week of top 50 by market cap

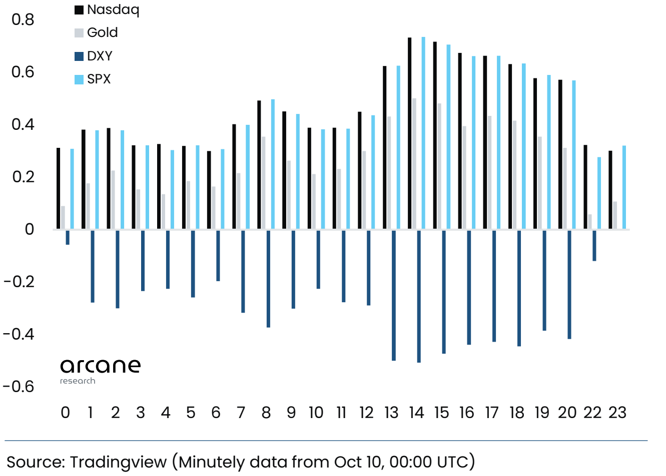
	Ticker	7d	YTD
Gainers			
1	MATIC	29%	-57%
2	OKB	26%	-26%
3	LTC	17%	-58%
Losers			
1	FTT	-30%	-60%
2	DOGE	-19%	-42%
3	AVAX	-13%	-86%

Figure 1: Open Interest FTT, relative to market cap



Source: Laevitas

Figure 2: Average rolling 60 min correlation (Oct 10-Nov 3) (UTC)



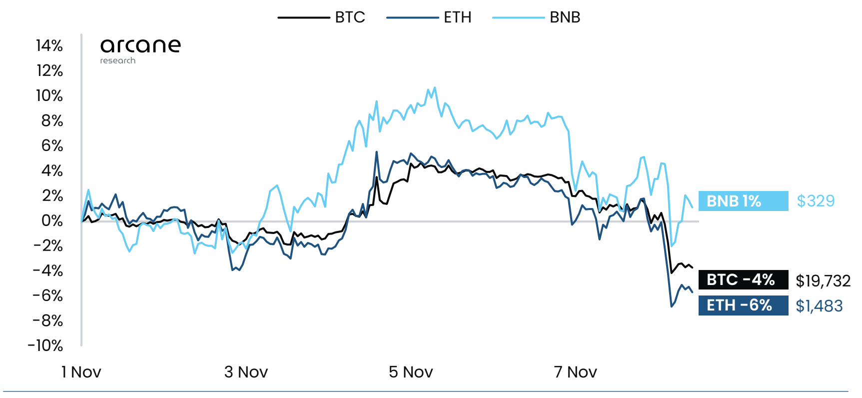
Source: Tradingview (Minutely data from Oct 10, 00:00 UTC)

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 FTX and Binance conflict is covered in detail on page 6.

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 as we illustrate on page 7.

Figure 3: Top 3 Market Cap, Last Week

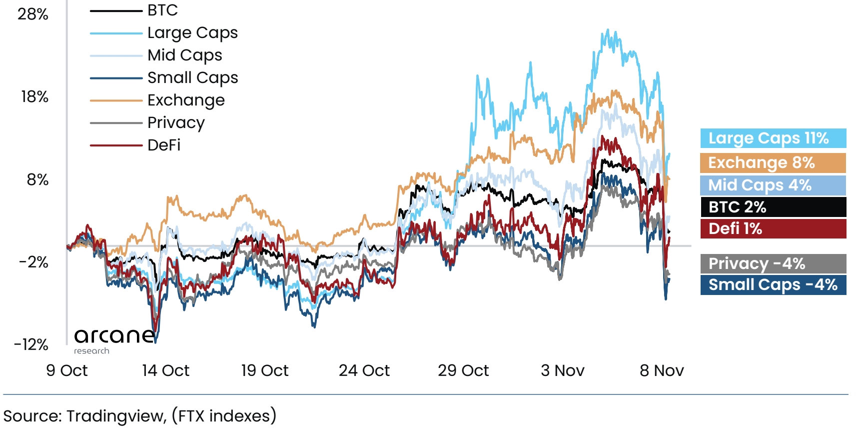


Source: Tradingview, (Coinbase, Binance U.S.)

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.

Figure 4: 30d Performance of Market Cap Weighted Indexes



Source: Tradingview, (FTX indexes)

Headlines last week

FTX weekly stablecoin outflows surge as Binance piles on the pressure

Crypto Billionaires' Brawl Triggers Contagion Fears in Markets

Fidelity Opens Waiting List for Retail Crypto Product

Crypto Exchange Deribit Loses $28M in Hot Wallet Hack, Pauses Withdrawals

Block reports $14.7 million net loss in Q3, $1.76 billion in bitcoin sales

Coinbase MTUs beat estimates, trading volumes miss

Nomura Unit Preparing to Trade Crypto, Boost Staff by 45%

Calendar

Tuesday, November 8
- U.S. Mid-terms

Thursday, November 10
- U.S. CPI (Exp: YoY 8%, MoM: 0.6%)

Friday, November 11
- U.K. GDP (Exp: MoM: -0.4%)
- German CPI (Exp: YoY 10.4%)

Spot Market

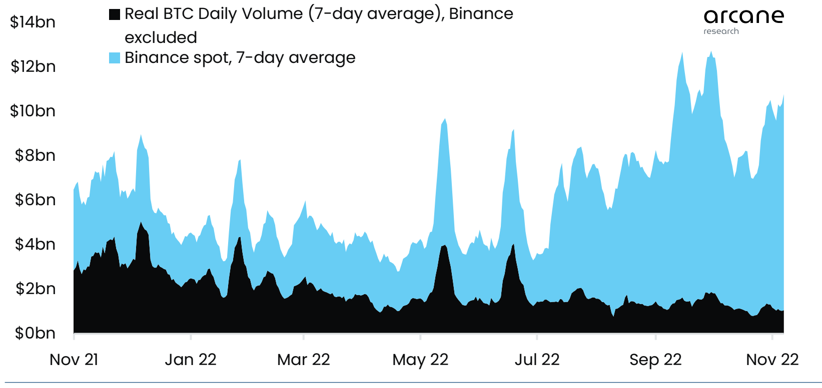
Fear and Greed

Now: 31 (Fear)
Last week: 30 (Fear)
Last month: 22 (Extreme Fear)

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.

Figure 5: Real BTCUSD Daily Volume* (7-day average)

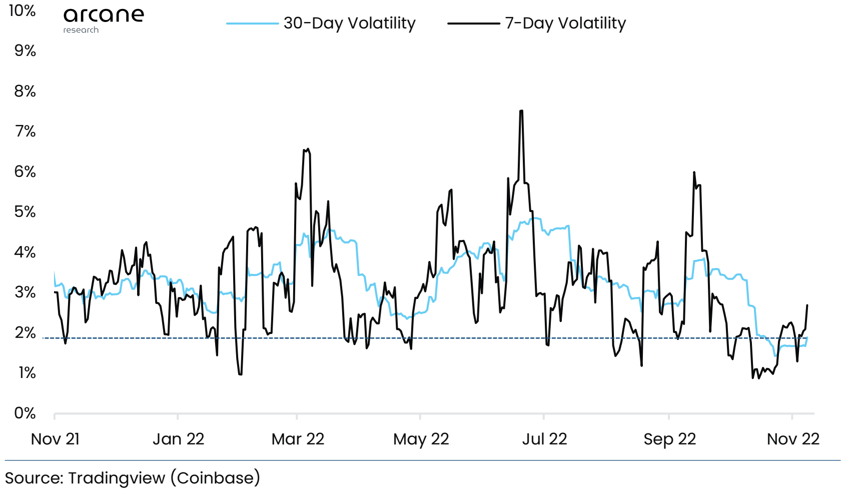


Source: Tradingview *Includes Bitwise 10 exchanges and FTX

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, as we illustrate on page 5. This still generates a promising opportunity for options-based volatility trades.

Figure 6: BTC-USD Volatility

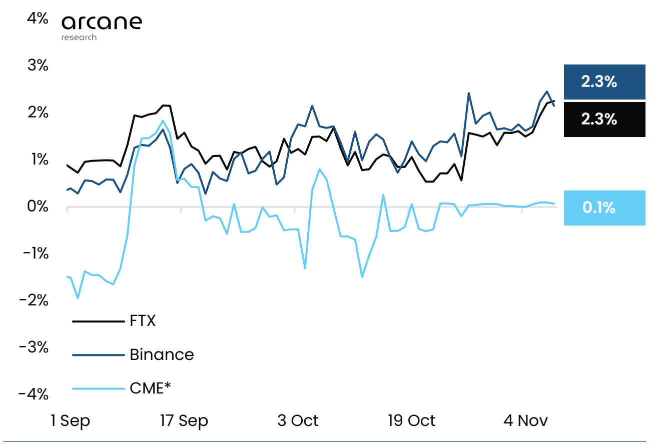


Source: Tradingview (Coinbase)

Derivatives

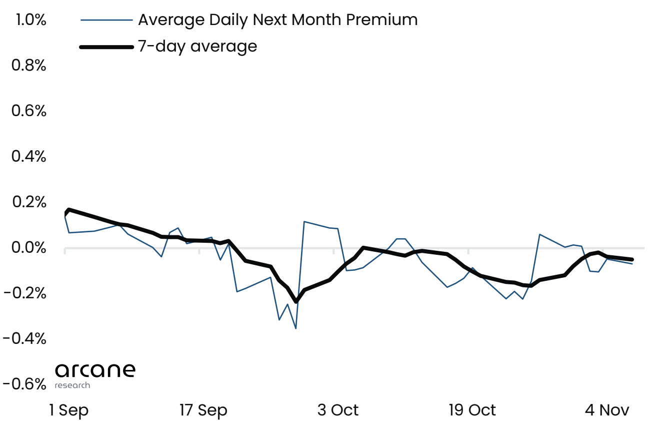
CME, Futures and ETFs

Figure 7: Bitcoin Futures Annualized Rolling 3-Month Basis



Source: Skew, Laevitas, Tradingview, CME
*Closed Saturday - Sunday

Figure 8: CME BTC Futures: Average Daily Next Month Premium



Source: Tradingview

Slight basis growth offshore
Futures still trade in a flat environment with few indications of bullish positioning evident from futures premiums.

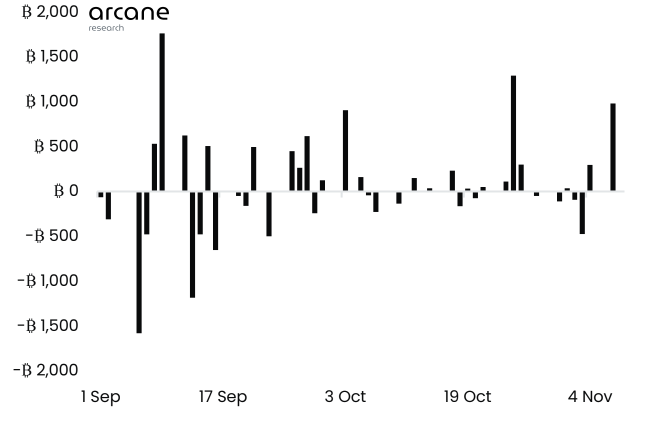
Nevertheless, we note a slight growth on both FTX and Binance, despite the turbulence experienced lately. Still, the open interest of Binance's futures is only 5.5% of the size of Binance's perp market. Likewise, FTX's futures OI represents 30% of the size of FTX perps.

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 emerge elsewhere.

"No" institutional trading activity in bitcoin
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.

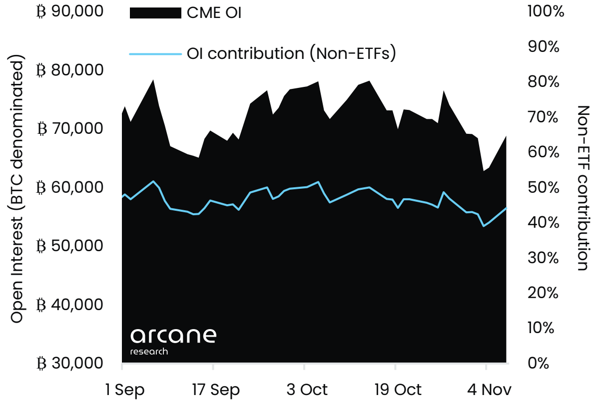
Overall, institutional activity in the market remains very idle, illustrated by CME's BTC basis reigning completely flat since Oct 25.

Figure 9: ProShares: Net Flow – BTC Equivalent



Source: ProShares

Figure 10: CME BTC Futures: Open Interest



Source: Coinglass, ProShares, Valkyrie, VanEck

Short BTC ETF exposure declines to a 3-month low
ProShares has seen a positive net contribution in terms of flows in the last month.

Monday's positive flow effect is mainly driven by large outflows from BITI, the short BTC ETF. BITI's short exposure currently sits at 3065 BTC, the lowest exposure of BITI since August 18. BITO has seen few noteworthy inflows in the last week, and the positive ProShares flows are predominantly caused by traders closing short exposure.

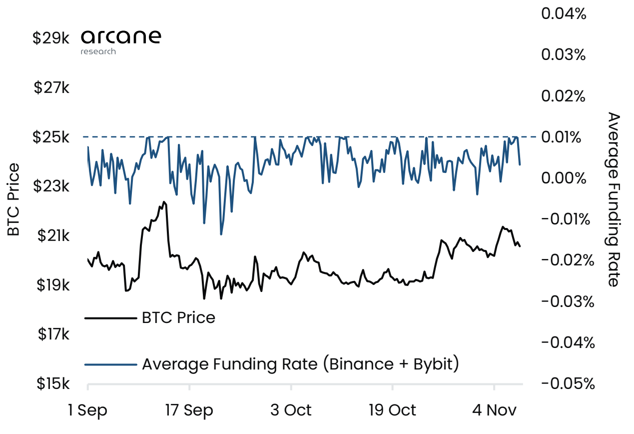
Institutional traders remain inactive
Last week, the non-ETF-related open interest in BTC futures reached an all-time low of 39%. This illustrates that the organic demand from institutional traders to participate in the BTC market remains remarkably low.

The low institutional presence in the market is further reflected in the unusually flat futures premium environment on CME.

Derivatives

Perpetual Swaps and Options

Figure 11: Bitcoin Perpetuals: Funding Rates vs BTC Price

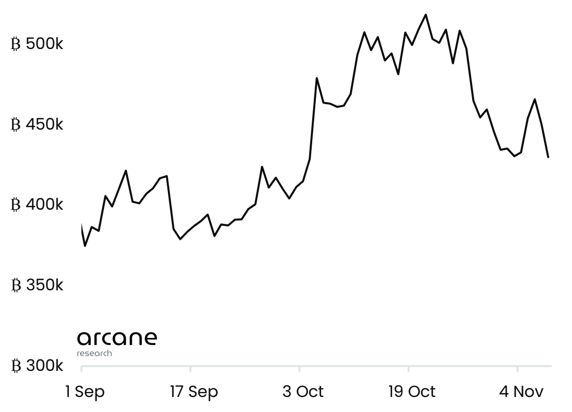


Source: Bybit, Binance, Tradingview (Coinbase)

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.

Figure 12: Bitcoin Perpetuals: Open Interest



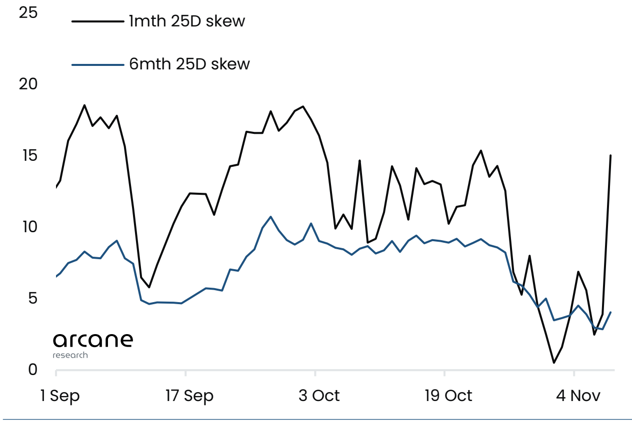
Source: Laevitas

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, <u>FTX has seen its share of the open interest in BTC and ETH perps decline from 25% to 14%.</u>

Figure 13: BTC Options - 25D Skew (1mth + 6mth)

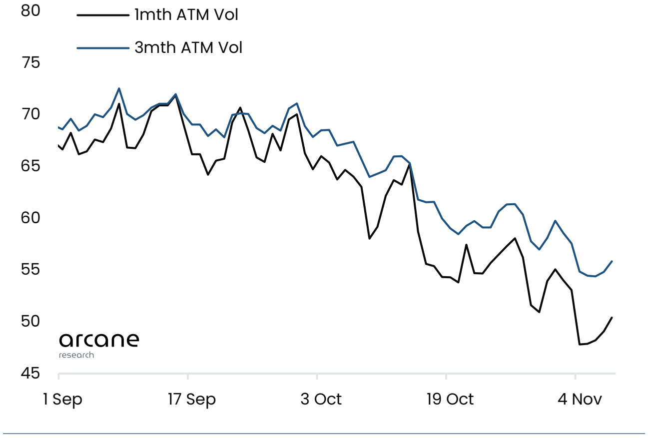


Source: Laevitas

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 the next page.

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.

Figure 14: BTC Options – Implied Volatility



Source: Laevitas

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.

A deeper 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 in the context section on the right-hand side of this page. 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.

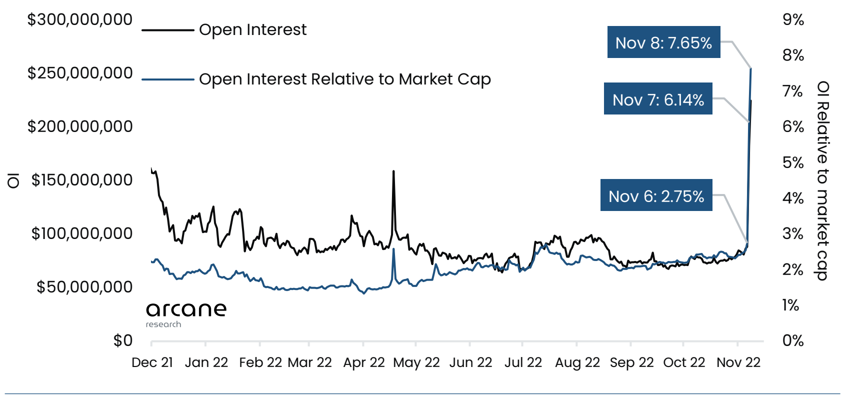
Figure 15: FTTUSD, November 1 - November 8

Source: Tradingview

FTT plunges while leverage doubles overnight
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 16: Open Interest FTT, relative to market cap



Source: Laevitas

Context

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.

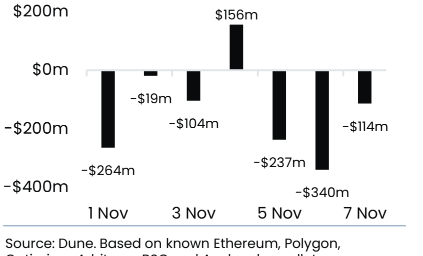
Why now?
1) Sam Bankman-Fried's public backlash related to his thoughts on crypto regulation.
2) The short squeeze in late October led to further pressure as murmuring about unfair liquidation mechanisms at FTX erupted. We remind our readers that Binance's public liquidation data have been underreported 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 publics' 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, FTX and Alameda and the LUNA/UST mechanism are fundamentally wrong, as the structure of FTX 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

A deeper dive

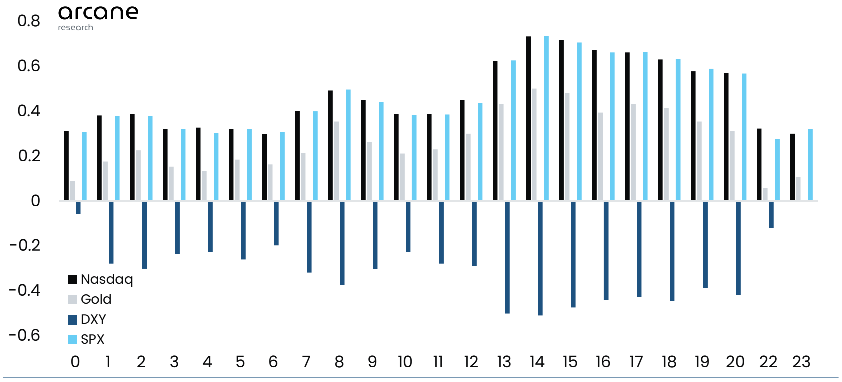
Correlations

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.

Figure 18: Average rolling 60 min correlation (Oct 10-Nov 3) (Time zone: UTC)



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

BTC correlations by US hours Oct 10-Nov 3

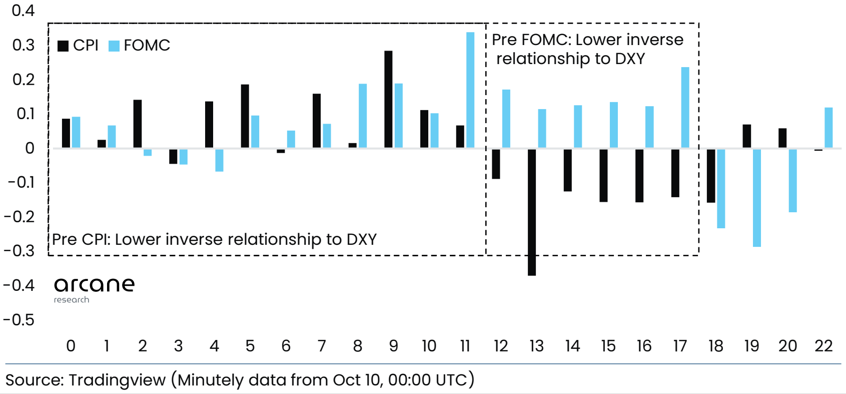
Asset	Non U.S. market hours	U.S. market hours
Nasdaq	0.37	0.65 **(+0.28)**
S&P 500	0.36	0.65 **(+0.28)**
Gold	0.19	0.42 **(+0.22)**
DXY	-0.24	-0.44 **(-0.20)**

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.

Figure 19: BTC/DXY excess correlation CPI, FOMC (Oct 10-Nov 3) (Time zone: UTC)

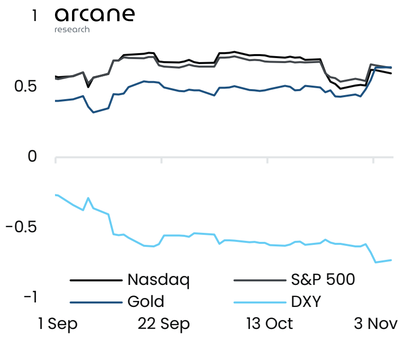


Source: Tradingview (Minutely data from Oct 10, 00:00 UTC)

Market Related Charts

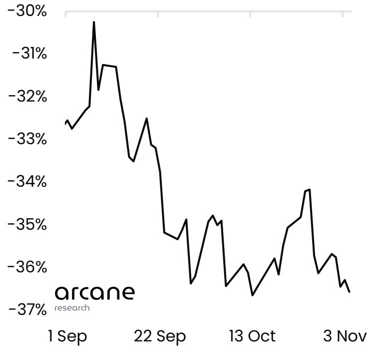
Data updated Monday Nov 7, 2022

Figure 20: BTC 30-d correlations*



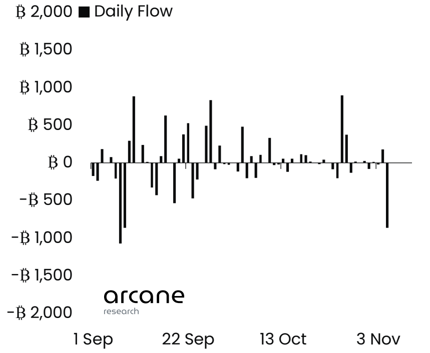
Source: Tradingview *Pearson

Figure 21: Grayscale Premium/Discount



Source: Ycharts

Figure 22: Daily Flows (BTC ETFs)



Source: Bytetree

Figure 23: BTC Dominance

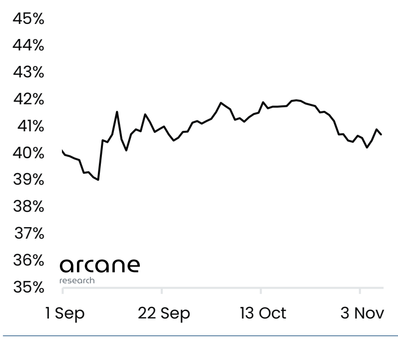


Figure 24: BTC + Stables Dominance

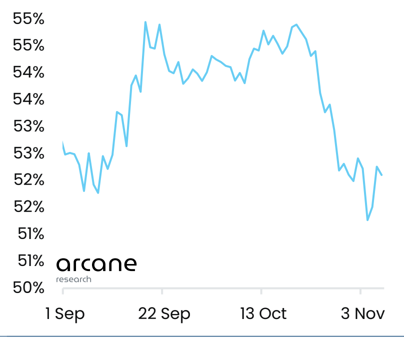
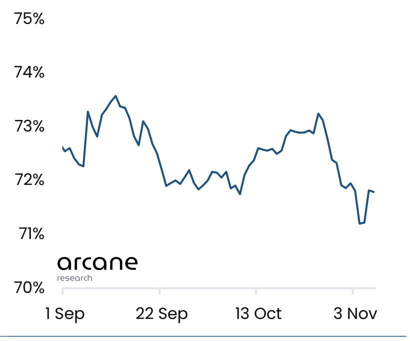
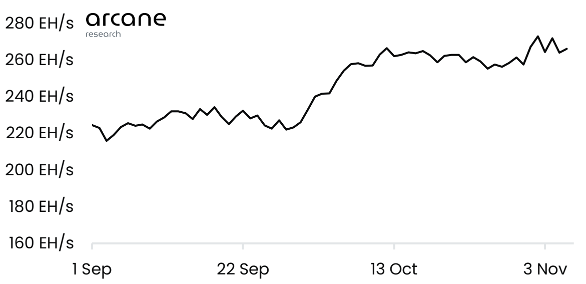


Figure 25: BTC + Stables + ETH Dominance



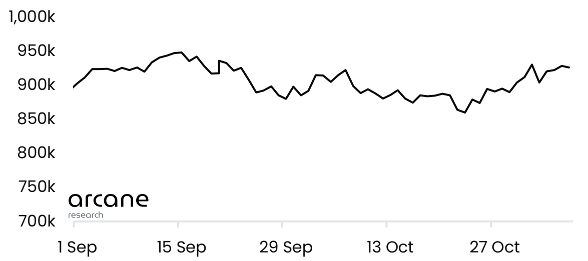
Source: Tradingview

Figure 26: Bitcoin Hashrate (7-day average)



Source: Blockchain.com

Figure 27: Active Addresses (7-day average)



Source: Coinmetrics

Figure 28: On-chain statistics

Powered by BYTETREE	07/11/2022	7d Change
Daily Miner Revenues	$19,160,172	4.92%
Fees per day	$340,890	0.97%
Fees % Revenues	1.78%	-0.07%
Daily TX Volume ($M)	$3,716	7.52%
Transactions per day	268,134	1.74%
Avg TX value $	$13,859.29	5.69%
# Blocks per hour	6.07	3.55%
Avg. # TX per block	1840	1.74%

Source: Bytetree

Why we choose the charts we do

Heavy Bitcoin focus
The crypto market is heavily correlated. Movements in BTC tend to be reflected by sharper moves in altcoins. In many ways, BTC is the lower beta exposure alternative to crypto and the definite market leader. However, don't worry – whenever we find a topic, a coin, or some tendencies worth drilling deeper into – we will. This report will get you the most important information from the crypto market.

Market by the numbers
We highlight the most critical market data by numbers in this table. A glance at these data should be sufficient to assess the state of the market superficially.

Open interest is an essential underlying market driver. Crypto tends to be very volatile, and leverage exacerbates volatility. We have had frequent massive liquidation cascades throughout the last years, mostly towards the downside, but we've periodically seen short squeezes emerge. During the March 12th collapse in 2020, cascading liquidations were the root cause of the absolute carnage in the market. You should always pay close attention to open interest if you aim to be an active participant in the market. Our derivatives pages will contribute to delivering you a directional assessment of the data.

The spot volume is an efficient way to gain an overview of the general activity in the market.

Correlations have been growingly important in the last year due to the complicated macro picture post-COVID. It's important to be aware of BTC's, for now, close relationship with U.S. equities and its inverse relationship with the dollar strength index (DXY). However, the current correlation regime is unlikely to be as strong as today forever. Through awareness of correlation trends, you may be able to execute trading strategies before the market catches up to correlations breaking.

The simplified market cap distribution box allows you to assess the general risk sentiment in the market quickly. In general, the "Rest" category may be used as a proxy for risk aversion in the market. Currently, BTC, ETH, and stablecoins represent nearly 75% of the crypto market, which is telling for a risk-averse crypto market.

The two charts on the first page illustrate the two most interesting topics covered in our market analysis. A more thorough examination of these charts is found in the last section of the report, where we dive deeper into two topics that currently seem to drive the market.

Spot Primer

Top 3 coins
We explore the last week's performance of the top 3 cryptocurrencies to asses deviations and opportunities within the safer bracket of digital assets. Currently, BTC, ETH, and BNB represent the three largest. Both ETH and BNB have a thriving DeFi user base and unique drivers of price and demand, which could generate temporary or long-term correlations within crypto to decline as trading opportunities arise or spread trade opportunities.

Indexes
We use FTX's sector indexes to highlight important trends within various crypto categories. These indexes are an efficient tool to assess transitional narrative changes. At a glance, these indexes are efficient in assessing the market, and they are tradeable – so you may act on the information swiftly. However, they have certain issues related to index weighting. Certain old coins may contribute to suppressing or distorting strength, and there are also particular examples of coins being included in indexes where they should not be included. We'll write a more detailed critique of these indexes in the future – and will make sure to keep you notified when it's available.

Volume
The BTC spot volume is an efficient way to communicate the general activity in the market. It may help you identify frantic market bottoms or peaks. Our volume data is based on Bitwise's 10. In 2019, Bitwise explored wash-trading and market manipulation in the spot market, leading to this index. Since new exchanges have emerged, we have thus FTX. In general, our volume assessment likely underestimates the volume to some degree, as legitimate volumes in other exchanges are excluded. However, the volume estimate is a good proxy for general activity in the market.

We differentiate Binance's volume from the remainder of the exchanges due to Binance's removal of trading fees this summer. We believe a substantial amount of the recent trading volume on Binance is related to "in-organic" trades, i.e., high-volume trading strategies that were not economically feasible prior to fees being removed. Of course, removing fees has likely also contributed to moving traders from alternative exchanges over to Binance.

Volatility
Volatility is a topic well worth paying attention to. In specific periods, such as the current – where BTC trails in a shallow volatility regime, new trading opportunities emerge related to options and straddles. This chart is handy to pay close attention to, as it may help you enhance your ability to act on opportunities in the market when activity is low and options are becoming cheap.

Derivatives primer

Why should you care about derivatives flows?
The crypto market is periodically extremely volatile, and activity in derivatives enhances the market reactions. Crypto derivatives are at the cutting edge of financial innovation, the offshore market is periodically wild, and animal spirits tend to take over. Derivatives more or less always carry a clue of overheating in the market or full-on depression. It's highly actionable and worthwhile understanding if you aim to be an active crypto market participant.

The market is also clearly divided. There are two branches worth monitoring – institutional and offshore. Both components periodically lead the market, and assessing sentiment and general risk aversion in these two provides you the tools to understand dangers or opportunities on the horizon.

CME – The importance of a cash-based futures market in BTC
Institutional traders strongly impact BTCs price discovery, as identified both by Bitwise and by us. However, many institutional traders have limitations regarding access to crypto markets or even related to holding BTC. CME provides the most accessible, most efficient access to crypto markets for those traders. CME also has the added caveat of a familiar clearinghouse structure, leading to fewer barriers to entry for crypto exposure for institutional traders.

We assess institutional sentiment by monitoring the futures basis and contract spreads between the front month (upcoming expiry) and the near month (next expiry). In general, a positive and high futures basis on CME indicates a positive sentiment, whereas a negative basis indicates the opposite. We include Binance and FTX basis to compare offshore and CME premiums to highlight different sentiments between institutional traders and retail. While FTX and Binance have institutional traders, they also enable easy access to derivatives for retail, which may provide useful information ahead of periods of distress.

We monitor aggregated ProShares flows, meaning inflows and outflows to both ProShares' long BTC ETF (BITO) and short BTC ETF (BITI) on the CME page. In the chart, inflows to BITI will be calculated as a negative flow impact, while inflows to BITO will be calculated as a positive flow impact. The opposite is true for outflows from the ETFs mentioned above. ProShares are by far the largest U.S. BTC ETF provider, holding a substantial amount of BTC contracts on CME. Retail and institutions have access to BITO and BITI. Periods of strong aggregated flows to BITO may substantially impact CME's basis. An interesting scenario that has yet to emerge would be one scenario with neutral flows but a rising CME basis. In this scenario, one can assume that certain institutional players actively add long BTC exposure.

We further monitor CME's open interest and the contribution of ETFs to the open interest to assess the degree of activity in CME futures.

Perpetual swaps
Perpetual swaps are the most frequently traded derivative in crypto markets. It's an everlasting futures-like instrument, utilizing funding rates to secure that perp prices align with spot markets. There are certain intricate nuances to funding rates, for instance, varying funding intervals and varying neutral funding rate thresholds. In normal conditions, Binance and Bybit's funding rate sits at 0.01% every eight hours – meaning longs pay shorts a fee. This structural element in crypto derivatives may lead to a natural structural contango. They may be utilized for cash and carry strategies (albeit in a non-arbitrage fashion, assuming that funding rates will average around neutral terrain).

During roaring markets, funding rates tend to be pushed towards extreme highs due to enormous demand to go long, leading perps to trade at a substantial premium over spot. By assessing funding rates, you may be able to act on market moves and liquidation cascades prior to a liquidation cascade. Similarly, funding rates may sit in extremely negative terrain during bear markets, foreshadowing potential short squeezes.

We monitor open interest in perps to better gauge the risks of soaring volatility and market instability. We monitor open interest in notional value, i.e., in BTC, to have a clear eye on the relative leverage in the market. Currently, the open interest sits at all-time highs in notional value. This is a dangerous trend, and we view it as likely that this will generate a dramatic reaction when BTC breaks out of its prolonged consolidation. Cascading liquidations may occur in both directions, so the open interest is best used as a proxy for how volatile a spike may be.

Options
We monitor two options charts. The 25-delta skew, which is a metric comparing the implied volatility of a 25-delta put option vs. a 25-delta call option, normalized by at the money implied volatility. Counter-intuitively, when the 25d skew is positive, traders are paying more for puts than calls and may be assessed as cautious/bearish behavior in the options market. The opposite is true when skews are negative. Skews trending in a certain direction may also elaborate on repositioning from options traders and is worth paying attention to. We show the 1-month skew for contracts expiring by the end of the month, and the 6-month skew, for contracts expiring half a year from now to assess differences in positioning across maturities.

The implied volatility illustrates options traders' forward-looking assessment of volatility – or the options pricing. Implied vols in BTC are rarely trailing below 60 for long, and this has previously been a good time to enter straddle strategies.

Disclaimer

- Ahead of the curve (the "Report") by Arcane Research is a report focusing on cryptocurrencies, open blockchains and fintech. Information published in the Report aims to spread knowledge and summarise developments in the cryptocurrency market.
- The information contained in this Report, and any information linked through the items contained herein, is for informational purposes only and is not intended to provide sufficient information to form the basis for an investment decision nor the formation of an investment strategy.
- This Report shall not constitute and should not be construed as financial advice, a recommendation for entering into financial transactions/investments, or investment advice, or as a recommendation to engage in investment transactions. You should seek additional information regarding the merits and risks of investing in any cryptocurrency or digital asset before deciding to purchase or sell any such instruments.
- Cryptocurrencies and digital assets are speculative and highly volatile, can become illiquid at any time, and are for investors with a high risk tolerance. Investors in digital assets could lose the entire value of their investment.
- Information contained within the Report is based on sources considered to be reliable, but is not guaranteed to be accurate or complete. Any opinions or estimates expressed herein reflect a judgment made as of the date of publication and are subject to change without notice.
- The information contained in this Report may include or incorporate by reference forward-looking statements, which would include any statements that are not statements of historical fact. No representations or warranties are made as to the accuracy of these forward-looking statements. Any data, charts or analysis herein should not be taken as an indication or guarantee of any future performance.
- Neither Arcane Research nor Arcane Crypto AS provides tax, legal, investment, or accounting advice and this report should not be considered as such. This Report is not intended to provide, and should not be relied on for, tax, legal, investment or accounting advice. Tax laws and regulations are complex and subject to change. To understand the risks you are exposed to, we recommend that you perform your own analysis and seek advice from an independent and approved financial advisor, accountant and lawyer before deciding to take action.
- Neither Arcane Research nor Arcane Crypto AS will have any liability whatsoever for any expenses, losses (both direct and indirect) or damages arising from, or in connection with, the use of information in this Report.
-
- By accessing this Report you confirm you understand and are bound by the terms above.
- Arcane Research is a department within Arcane Crypto AS, org. 994 608 673, and can be contacted at research@arcane.no or bendik@arcane.no.