Ahead of the curve
Market Update

News traders rejoice
Last week it was DeepSeek, this week it is Trump's tariffs. BTC dropped from ~$100,000 as low as $91,178 on Coinbase during a liquidation cascade, before ultimately recovering to close green at $101,460. ETH fell 24% over a two-hour period while ETHBTC hit 0.023 during the panic. U.S. labor data releases this week potentially offer more volatility, while MicroStrategy will release Q4 numbers. Further tariff headlines are expected as China retaliates and speculation grows surrounding EU tariffs.

CME traders maintain defensive positioning
CME premiums remained soft throughout the week, while BTC open interest declined further to sit at 166,475 BTC as of yesterday's close, the lowest CME OI recorded since November 5. Following last month's roll, the term structure also indicates cautious behavior in farther-dated contracts, with daily next-month premiums hovering at 0.8%. Notably, ETH premiums stay elevated compared to BTC, largely driven by VolatilityShares 2x leveraged long ETH ETF.

Offshore traders face huge liquidations
Yesterday saw one of crypto's largest-ever liquidation events. While liquidation data came in at $2bn, Bybit announced more transparency to share all liquidation data, a frequently highlighted theme by K33. If Binance and OKX follow suit, liquidation data may become a more valuable data set when interpreting market sentiment and risk profiles. Perp funding rates trailed below neutral throughout the week, hitting negative levels during yesterday's liquidations as notional open interest reached lows not seen since October 8. Such considerable deleveraging potentially softens volatility in the near term.

Tariff announcement delivers major crypto volatility
Trump announced tariffs on major trading partners this weekend, sparking fears of a potentially major trade war. Canada and Mexico are facing tariffs of 25%, while China is hit with 10% tariffs. Canadian energy products will also incur a 10% tariff. Perhaps a victim of 24/7 markets, BTC immediately dropped following the weekend announcement, but then recovered to Friday's close following Monday's announcement that Canadian and Mexican tariffs will be delayed by 30 days. The early days of Trump's term have been marked by major headline-induced volatility, particularly for crypto. The associated liquidation cascades and whipsaws favor a hands-off approach to leverage.

Altcoins hit the hardest during "trade war" selloff
While BTC saw considerable liquidations, altcoins saw a bloodbath. ETH dropped 24% over a two-hour period, while XRP plunged 30%. ETHBTC broke 0.03 to hit lows of 0.023 during the forced selloff. Open interest in altcoin perps fell from $53.8bn to $44.4bn, while altcoin market cap (excluding stablecoins) fell from $1,156bn to $1,088bn. The market therefore erased 12.4% of its relative leverage over the span of two days. ETH perps also had their largest ever notional decline as open interest fell by 560k ETH in just 24 hours.

BTC continues to absorb the majority of capital flowing into the crypto market while BTC dominance has steadily increased since the market bottomed in late 2022. Altcoin ETFs and the possible inclusion of staking rewards into ETF products may buck this trend, but we favor prioritizing BTC allocations in any designated crypto portfolio for now.

Digital Assets

Signals from the market

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By the numbers

BTCUSD $99,250
7d: **-3%**
30d: **1%**

ETHUSD $2,767
7d: **-13%**
30d: **-22%**

Open Interest (BTC futures and perps)
$48.5bn
488,000 BTC (**-1.9%** last seven days)

Average daily BTC spot volume
$5.5bn (**-5%** last seven days)

BTC 90-d correlations (weekly change included)

ETH	Gold	S&P 500	DXY
0.70 (-0.08)	0.00 (-0.01)	0.39 (-0.02)	-0.00 (0.02)

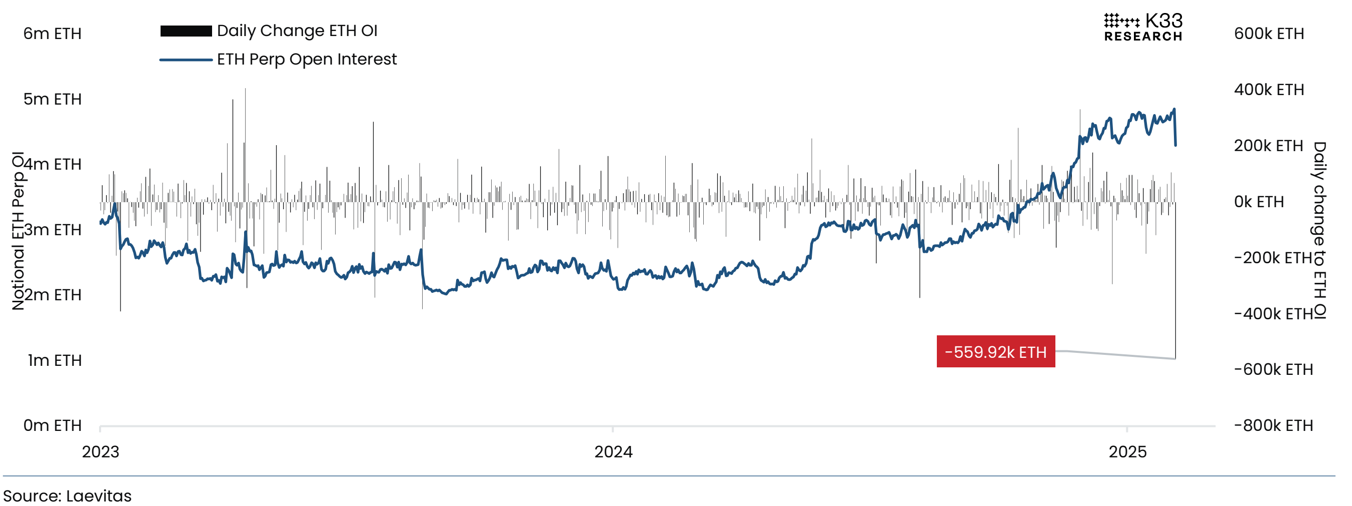
Percentage of Total Market Capitalization
Weekly change in percentage points

BTC	ETH	Stablecoins	Rest
60.2% (2.2%)	10.4% (-0.5%)	6.0% (0.5%)	23.4% (-2.2%)

Last week of top 50 by market cap

	Ticker	7d	YTD
Gainers			
1	OM	27%	54%
2	HYPE	12%	9%
3	XMR	4%	19%
Losers			
1	TRUMP	-41%	169%
2	NEAR	-24%	-29%
3	POLY	-23%	-30%

Figure 1: ETH Perps: Notional Open Interest vs. Daily Change



Source: Laevitas

Don’t cry in the casino
February Outlook

Digital Assets

February Outlook

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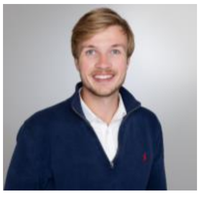


The first few weeks of Trump's presidency have proven volatile. Positive crypto regulations are on the books, and a stockpile might take form, but tariffs and uncertainty are wreaking havoc on the markets. Amidst this uncertainty, your February mantra should be to avoid leverage at any cost.

January Madness
We’re wrapping up an incredible and wild month. Trump launched a memecoin days before beginning his second term, and he has pulled forward initiatives to look into both regulation and a national digital asset stockpile. Bitcoin magically resurfaced to all-time highs on the inauguration day before facing rugged conditions in the following weeks. Markets, far broader than just the crypto markets, are coming to terms with the new administration, and frantic days of big volatility are upon us all.

Trump = Volatile
Volatility is a natural side effect of Trump’s return to the Oval Office. This weekend’s tariff developments made that abundantly clear. The market quickly resolved to panic mode and de-risked, as traders were uncomfortable taking on risk in unknown terrain. In all likelihood, global trade will stiffen further in the weeks to come with more tariffs in the books, and with that, traders should brace for new headline-related market swings in the foreseeable future.

… but everything points toward Trump being positive for crypto
While we’ve seen a fair share of messy markets over the past weeks, the new administration cannot rationally be viewed as anything other than long-term bullish for the crypto sector. Virtually the entire administration holds a positive view of the crypto industry, and the regulatory outlook is very rosy. Further, the new administration has solidified the legitimacy of Bitcoin. Asset managers such as BlackRock made strides in improving the reputation of crypto in 2024. Now, a favorable policy outlook is making similar strides, leading the Czech central bank governor to aim for BTC reserves and Fed Chair Powell to remark that banks are perfectly able to serve crypto customers.

We’ve already seen SAB 121 being revoked, and within the next half year, Trump’s digital asset working group will provide a report recommending regulatory steps ahead in addition to offering a recommendation on a national digital asset stockpile. Bitcoin is truly moving in a fundamentally positive direction, and advising anything other than holding long-term BTC exposure is ill-advised at best and ignorant at worst.

Positive long term, but careful in the near term
Last month’s outlook was titled “Things Take Time”, and I stand by that message. The Digital Asset working group will spend 180 days sketching out its report; for now, we don’t know what they’ll recommend.

There is an overlooked risk of U.S. BTC reserves shrinking from 198,109 BTC to 34,103 BTC between now and the report’s due date, as the treatment of current reserves has received no clarification from Trump. I land on this number simply by removing the 94,636 Bitfinex BTC, which may (should) be returned, and the 69,370 Silk Road BTC cleared for sale by the DOJ. Any movement of these coins is likely to be met by a furious market. In order to solidify a sizeable reserve upon the decision date, a public announcement on the status of the Silk Road coins would be both timely and reassuring.

This is definitely not the time to be leveraged
Further, 180 days is a long period in any market and an eternity in the crypto market. Trump causes two phenomena in global markets: friction and unpredictability. Tariffs spilled over to crypto, leading ETH to see a brief and violent crash of 24% in 2 hours, with altcoin open interest imploding by 12% within the same window.

Headlines, sentiment, and leverage are extreme volatility catalysts for the time being, and the crypto market is extremely sensitive. Intraday reversals are frequent, and within the jerky price pattern rests liquidated ghosts falling under the burden of bad risk management. In light of the current neurotic state of markets, you want to avoid marching into the unknown with liquidation risks hanging above you. Stay wise and chill in spot.

Personally, I took it a step beyond avoiding leverage on inauguration day, selling BTC for USD. I’ve added some exposure back but intend to wait and see before deploying more capital. A temporary reversal toward former all-time highs of $75,000 is fully within reach in the coming months. It would be archetypical crypto, and also fill the post-Trump election CME gap.

Simply put, I am not fond of the near-term uncertainty from tariffs and other potential policy curveballs and aim to hold my risk at moderate levels. While Trump was consistent in his first term, pointing fingers at the S&P 500 to showcase his success, the time for him to impose measures that spook markets is now, as he can still blame inheriting issues from the old administration.

That said, through lenses longer than the coming months, the situation looks rosier than ever for BTC, and this is not the time to sit un-exposed.

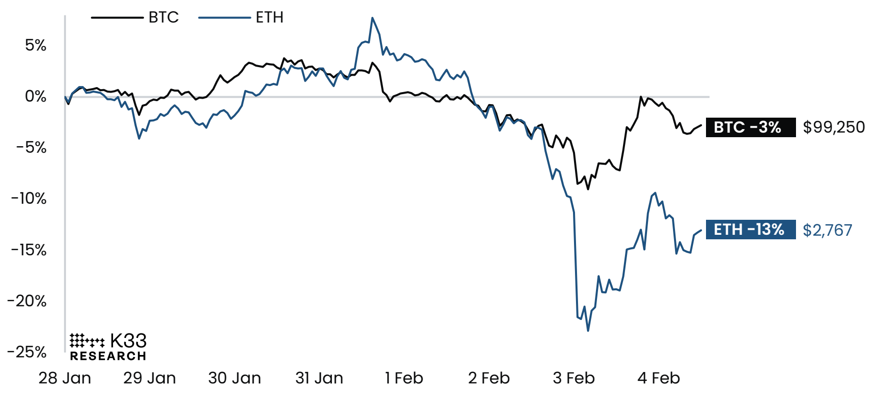
Spot Market

Plenty of headlines to trade
Big headlines continue to impact crypto markets with force. Last Monday saw DeepSeek's AI breakthrough cause significant volatility; this Monday saw enormous volatility on the backdrop of Trump tariffs. After spending last week hovering at $100,000, enduring the FOMC with moderate volatility, BTC saw a temporary but violent sell-off, hitting lows of $91,178 on Coinbase before reversing all losses and closing the day green at $101,460. While these events jack up intraday volatility, weekly performance remains stable, with BTC seeing a 3% decline as we conclude the week.

ETH's performance last week stands in sharp contrast to BTC. During the Monday crash, ETHBTC fell below 0.03, triggering panic selling that spilled over to forced selling in derivatives. In the span of two hours, ETH fell 24%, and ETHBTC fell to 0.023, with billions of ETH longs facing liquidations. ETHBTC at 0.023 is equivalent to levels from May 2020, before the initial DeFi takeoff on the Ethereum blockchain, and represents a 72.5% drawdown vs. BTC since Ethereum introduced Proof of Stake in September 2022.

We expect news-driven volatility to continue to shake global markets and, with that, BTC. The week ahead will see several important U.S. labor data releases, potentially moving the market's rate cut expectations. MicroStrategy is due to report Q4 numbers, its first earnings call since the bold 21/21 plan announcement, and multiple crypto-related hearings and press conferences are coming in the U.S. Further, tariffs are likely to remain a market-moving theme in the foreseeable future, with China imposing retaliatory tariffs and potential U.S. tariffs on the EU in the books.

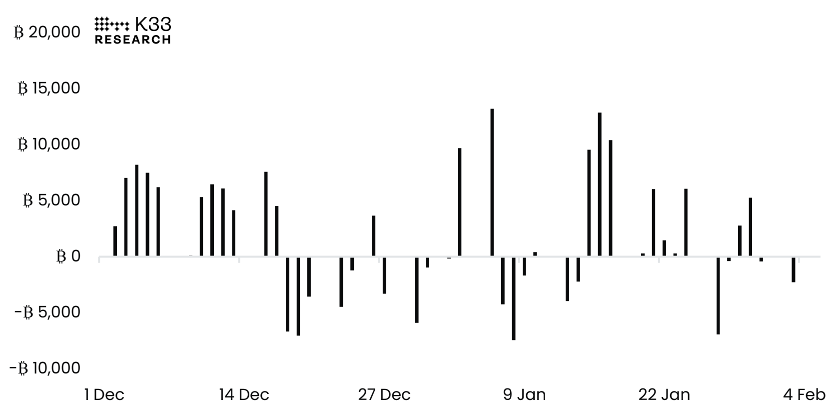
Figure 2: Performance BTC and ETH, Last Two Weeks



Source: Tradingview, (Coinbase, Binance)

ETF traders remain hands off
Recent headline-induced market volatility has been pushed by both spot and derivatives market activity, with ETP traders behaving comparatively in an idle manner. ETPs have seen another week of soft flows, with the net inflow coming in at 4,977 BTC over the past week. Monday's massive volatility saw slight outflows of 2,260 BTC in ETFs, relatively orderly compared to the massive swings in derivatives.

Figure 3: Daily Global Net BTC ETP Flows



Source: K33 Research

Headlines last week

[Banks can serve crypto clients as long as they can manage the risk, Fed Chair Jerome Powell says]

[Czech central bank approves proposal to assess investing reserves in bitcoin]

[Kraken relaunches staking in US roughly two years after settling SEC charges]

[MicroStrategy sees strong demand for preferred stock plan, raises $563.4 million to fuel more bitcoin purchases]

[Indian government considering cryptocurrency policy shift]

[MicroStrategy ends weekly bitcoin buying streak, keeps total holdings at 471,107 BTC]

Calendar

Tuesday, February 4
- U.S. JOLTs Job Openings.
- Digital Asset White House press conference with Sacks, Hill, Scott

Wednesday, February 5
- U.S. ADP Nonfarm Employment Change (Exp: 148k)
- MicroStrategy Q4 Earnings Report
- U.S. Senate Hearing on debanking

Thursday, February 6
- BOE Interest Rate Decision (Exp: 25bps cut)
- U.S. House hearing on Operation Chokepoint 2.0

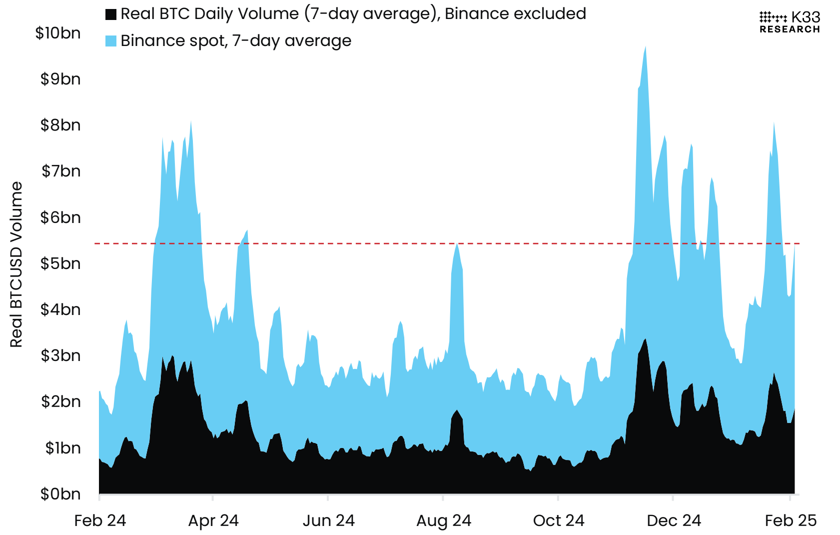
Friday, February 7
- U.S. Nonfarm Payrolls (Exp: 154k)
- U.S. Unemployment Rate (4.1%)

Spot Market

Whipsaw Monday holds volumes high
Events and headlines currently swing volatility and volume curves to the market, and with relative quietness throughout the past week, trading volumes took a breather.While yesterday offered frantic activity, markets reigned docile throughout most of the past week, with BTC staying in firm consolidation amidst reduced ETF activity and no MicroStrategy purchases.

Yesterday offered a considerable acceleration in spot activity, with BTC seeing spot trading volumes hitting $13.3bn amidst BTC's massive $11,422 candle. With BTC still in consolidation, events nurture volatility, with demand otherwise reigning soft as the market awaits the next directional clue.

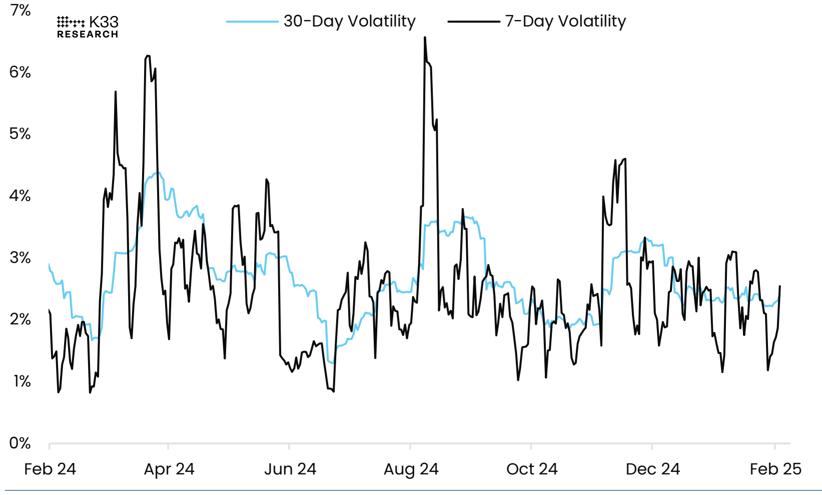
Figure 4: Real BTCUSD Daily Volume* (7-day average)



Source: Tradingview, Bitcoinity *Includes Bitwise 10 exchanges

Neurotic
The market remains neurotic, with erratic trading arising from headlines and leverage amplifying daily variations. Yesterday, we saw a $11,422 variation in the daily high and low, making it the fourth biggest daily BTC candle in USD terms ever. However, as mentioned over the past weeks, the market has shown extreme differences in granular and daily volatilities, as BTC has tended to reverse extreme volatility within the corresponding trading day, leading 7-day volatilities to remain at a somewhat soft 2.5%.

Figure 5: BTC-USD Volatility



Source: Tradingview (Coinbase)

Fear and Greed

Now: 72 (Greed)
Last week: 72 (Greed)
Last month: 73 (Greed)

Derivatives
CME, Futures and ETFs

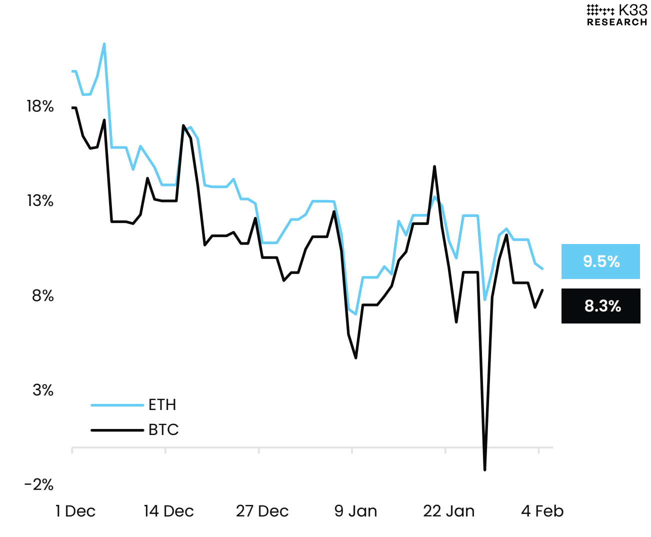
A hectic, unpredictable, and hyperactive market continues to push CME traders into a more defensive bias.

CME premiums have remained soft throughout the week, with last week's negative basis visit partly driven by traders rotating exposure to February contracts. That said, premiums have largely remained in the single digits following the roll. The term structure overall points toward cautious behavior in farther-dated contracts, with daily next-month premiums hovering at 0.8%.

ETH premiums stay elevated compared to BTC. We believe VolatilityShares 2x leveraged long ETH ETF plays a meaningful role in elevating the ETH basis, with the leveraged fund currently representing a massive 56% of all open interest in CME's Ether futures.

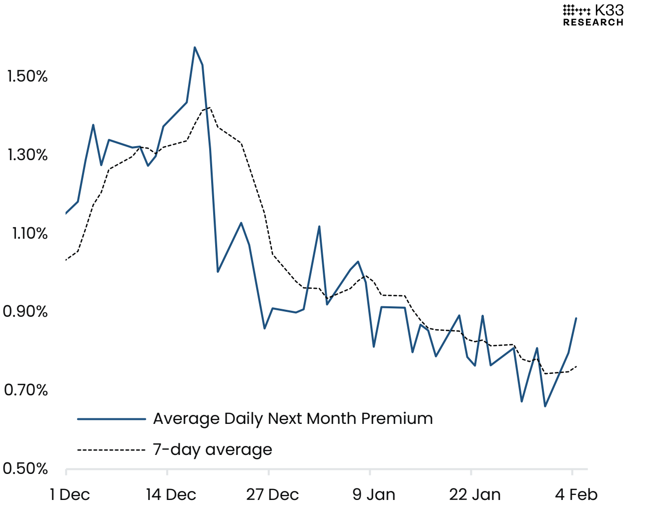
Open interest in CME's BTC futures declined further this week, sitting at 166,475 BTC as of the Monday, February 3 close, the lowest CME OI recorded since November 5. Overall, moderate premiums and soft open interests paint a picture of a risk-averse bias on CME following frequent market volatility eruptions in the weeks following Trump's inauguration.

Figure 6: Soft basis still
CME BTC and ETH Futures Annualized Rolling 1mth Basis



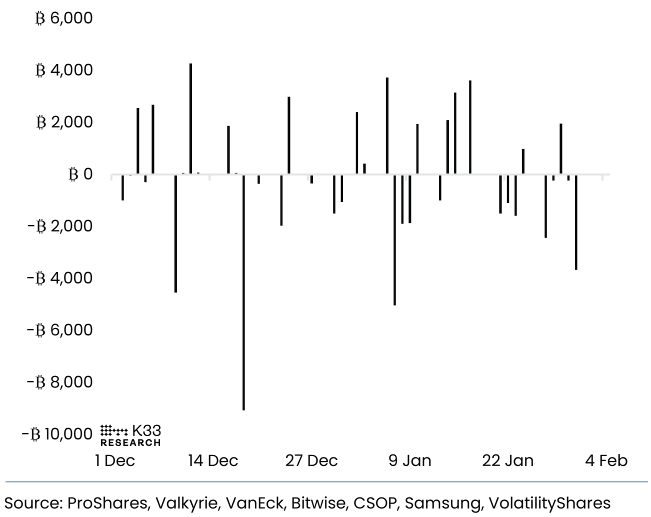
Source: Tradingview

Figure 7: Contango reigns narrow
CME BTC Futures: Average Daily Next Month Premium



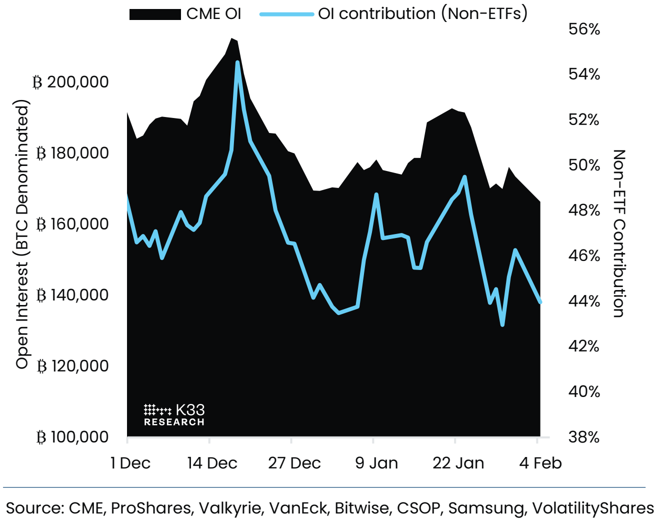
Source: Tradingview

Figure 8: Stagnant activity in futures-based ETFs
Futures-based ETFs: Net Flow – BTC Equivalent



Source: ProShares, Valkyrie, VanEck, Bitwise, CSOP, Samsung, VolatilityShares

Figure 9: Open interest at 3-month lows
CME BTC Futures: Open Interest



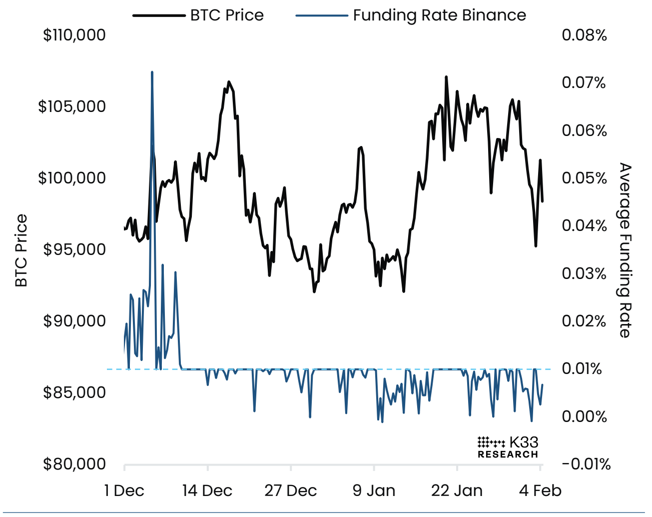
Source: CME, ProShares, Valkyrie, VanEck, Bitwise, CSOP, Samsung, VolatilityShares

Derivatives
Perpetual Swaps and Options

Perpetual swaps
The market has endured multiple liquidation events over the past weeks. Yesterday saw one of the biggest liquidation events in crypto history measured in USD. Liquidation data came in at $2bn, Bybit announced a move toward transparency to share all liquidation data, a frequently highlighted theme by K33. If Binance and OKX follow suit, liquidation data may become a more valuable data set to apply to understand market sentiment and risk profiles.

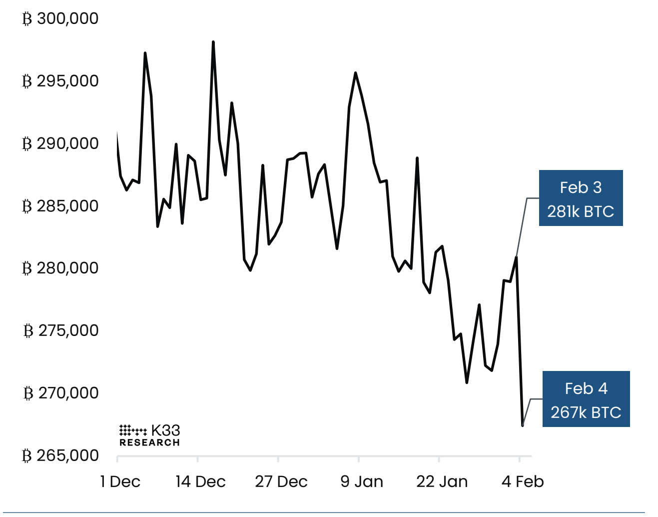
Funding rates trailed below neutral throughout the week, hitting negatives amidst yesterday's crash, with liquidations pushing notional open interest to lows not seen since October 8 of 267,000 BTC. The offshore derivatives market has been thoroughly deleveraged across assets over the past few days, a theme potentially softening volatility from here.

Figure 10: Funding rates stay well below neutral
Bitcoin Perpetuals: Funding Rates vs BTC Price



Source: Binance, Laevitas

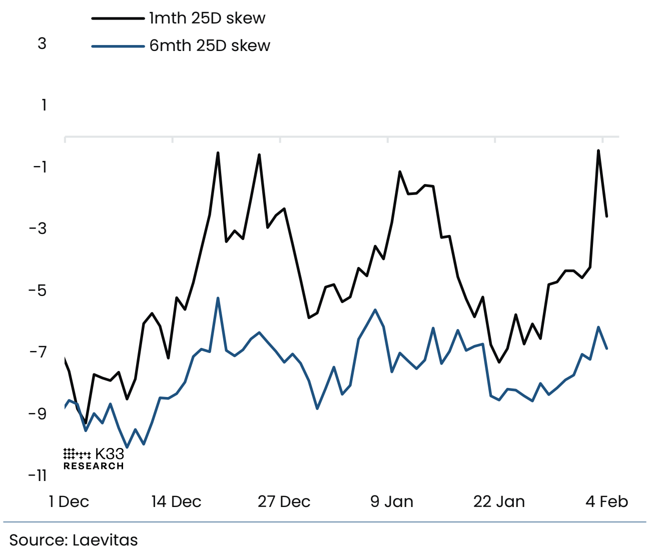
Figure 11: OI at 4-month lows
Bitcoin Perpetuals: Open Interest



Source: Laevitas

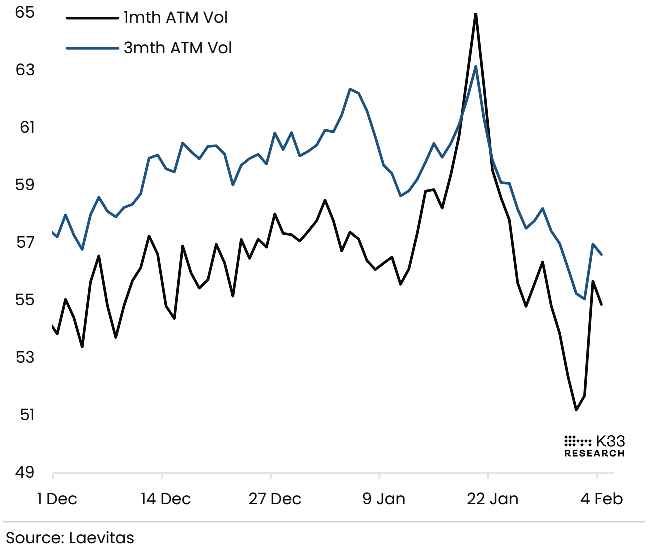
Options
Several significant short-lived crashes and frantic event trading have moved options traders to seek short-term downside protection, leading near-term skews to trend toward zero alongside IVs bouncing higher.

Figure 12: Growing demand for downside protection
BTC Options - 25D Skew (1mth + 6mth)



Source: Laevitas

Figure 13: IV rebounds
BTC Options – Implied Volatility



Source: Laevitas

A deeper dive
Tariffmageddon

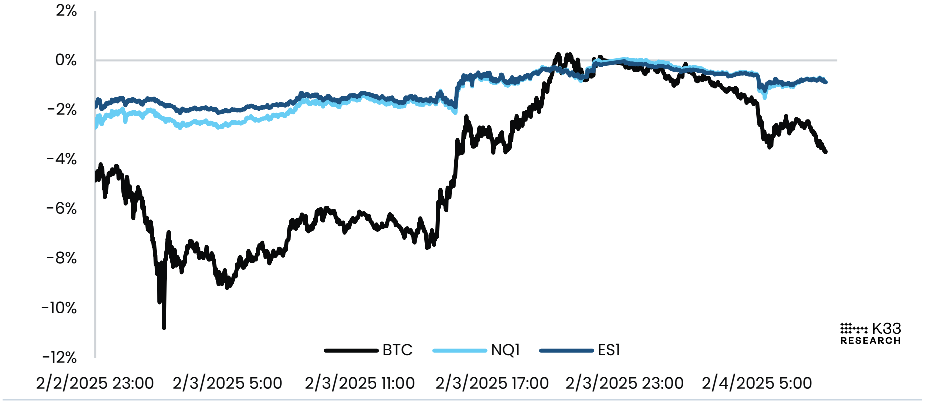
President Donald Trump announced new tariffs targeting major U.S. trade partners this weekend. Imports from Canada and Mexico will face a 25% tariff, while Chinese goods will incur a 10% tariff. Additionally, Canadian energy products, including oil and natural gas, will be subject to a 10% tariff.

This has been perceived as the initiation of a trade war, immediately spooking markets. Crypto took massive early hits amidst a rapid market de-risking as one of the few available liquid instruments to trade following the announcement. The tariffs hitting Canada and Mexico have been postponed by 30 days, but this remains a theme likely to move markets onwards.

This is the second consecutive weekend market shock leading to significant Monday volatility across markets. The 24/7 nature of crypto markets makes bitcoin and other cryptocurrencies very responsive to these weekend shocks, with unique leverage profiles amplifying the directional force. Below, we illustrate the performance from the Friday futures close to today. Per the performance, it is clear that traders rapidly seek to de-risk in BTC, with crypto-native fears and rotations exaggerating the amplitude of the moves. By the end of the day yesterday, BTC closed flat compared to the Friday close.

The extreme event trading environment and the unpredictable nature of sudden headlines is a damning example of the impact of leveraged trading. Gains are quickly erased via whipsaws and liquidations, and the current state of unpredictability in markets heavily favors a hands-off approach to leverage.

Figure 14: CME Futures: BTC vs. S&P 500 and Nasdaq (Return from Friday close)



Source: Tradingview

Relative strength vs major indices

Bitcoin is trading at all-time highs vs. the S&P 500 and hovering near all-time highs vs. the Nasdaq. Thus, while short-term volatility for the time being points toward increased sensitivity and faster de-risking in BTC compared to broad indices, long-term momentum remains on BTC's side. Following BTC breakouts from all-time highs vs the S&P 500 and Nasdaq in early 2021, BTC pushed well above former all-time highs in the next year, with relative strength enduring multiple short-term risk-off events.

Figure 15: BTCUSD divided by major U.S. equity indices

Source: Tradingview

K33 RESEARCH

A deeper dive

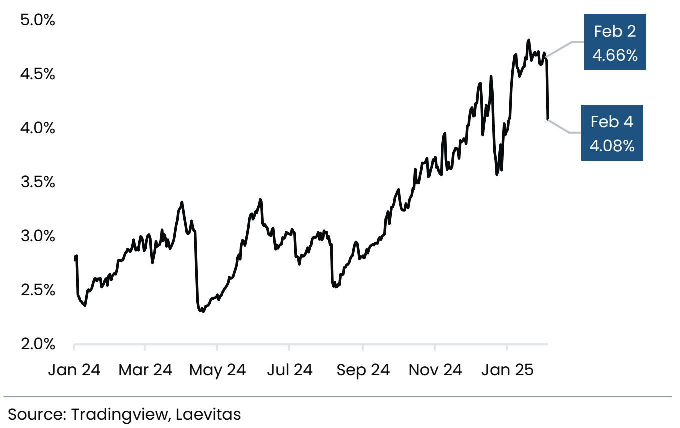
Unwinding the leverage

Moves in altcoins dwarfed the post-tariff escalation crash in BTC. XRP plunged by 30% in two hours, while ETH crashed 24% during the same 2-hour liquidation cascade. The sell-off accelerated when ETHBTC broke below 0.03, with ETHBTC rapidly collapsing to 0.023 following panic selling and forced selling in derivatives.

The sell-off has seen a considerable deleveraging in altcoins. On February 2, open interest in altcoin perpetuals sat at $53.8bn, while the market cap of altcoins (excluding stablecoins) sat at $1,156bn, leading relative open interest to sit at 4.66%. Two days later, we see altcoin open interest sitting at $44.4bn, while the altcoin market cap (excluding stablecoins) sat at $1,088bn, leading relative open interest to sit at 4.08%. Thus, the market erased 12.4% of its relative leverage over the span of two days.

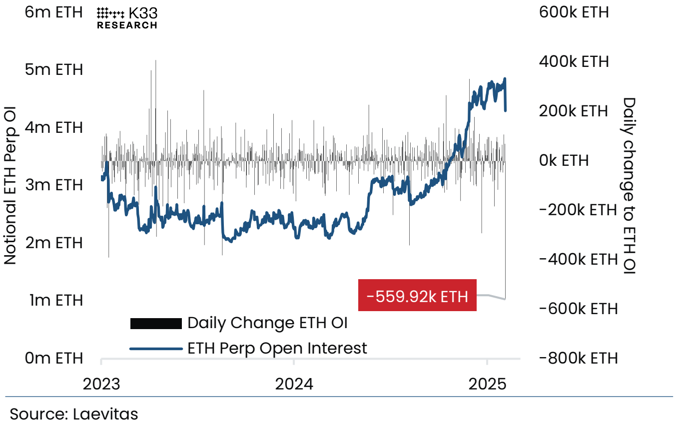
The most significant deleveraging occurred in ETH. ETH's notional open interest has been on a considerable uptrend since August, with notional open interest climbing from 2.8m ETH to 4.8m ETH in five months. Amidst yesterday's crash, ETH perps experienced its largest ever notional decline, seeing open interest plunge by 560k ETH in 24 hours, reducing notional ETH OI to 4.3m ETH. While the decline was aggressive, the current notional OI in ETH still sits higher than any number recorded prior to December 2024.

Figure 16: Altcoin OI relative to market cap (Total 2 – Stable)



Source: Tradingview, Laevitas

Figure 17: ETH Perps: Notional open interest vs daily change



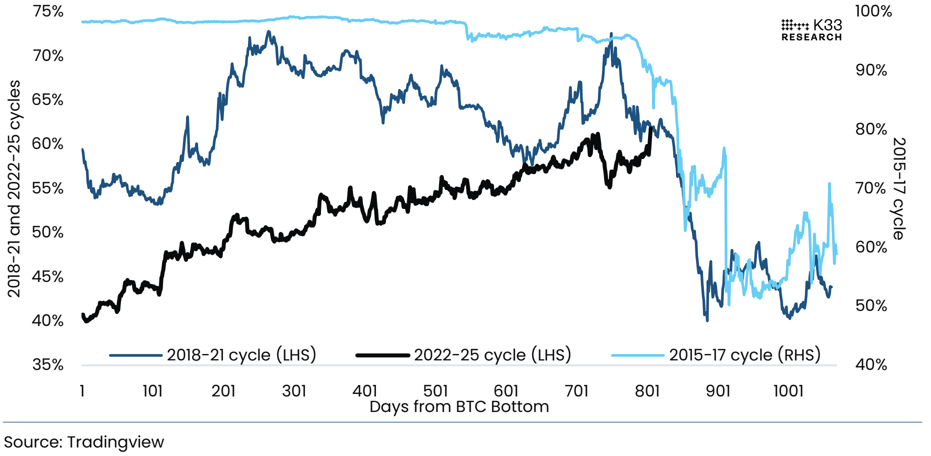
Source: Laevitas

At an altcoin inflection point

Every indicator points toward BTC absorbing most of the capital hitting the crypto markets. BTC dominance has steadily increased since the market bottomed in November 2022. Rewinding to 2020, a similar sentiment was grappling the crypto market, with most major institutional announcements referencing BTC investments. Sentiment suddenly changed 850 days after the 2018 bear market bottom, mirroring the pattern seen during the 15-17 cycle.

807 days into the cycle, this pattern is worth remembering. That said, this cycle's pattern of BTC dominance has seen a far more pronounced growth trend than previous cycles, mainly driven by consistently large ETF flows. A clear break from this trend could emerge should altcoin ETFs be approved and ETH ETF issuers be allowed to introduce staking. Nonetheless, given the considerable trend in BTC dominance, we favor prioritizing BTC allocations in any designated crypto portfolio for now.

Figure 18: Bitcoin Dominance from Bear Market Bottoms

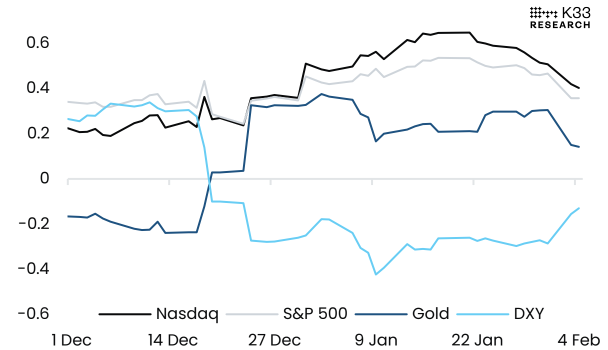


Source: Tradingview

Market Related Charts

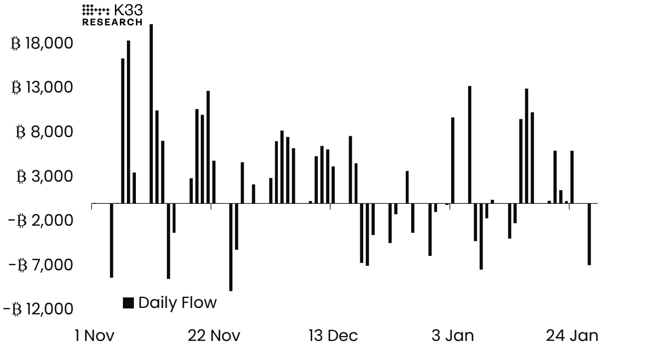
Data updated Tuesday, February 4, 2025

Figure 19: BTC 30-d correlations*



Source: Tradingview *Pearson

Figure 20: Daily Flows (BTC ETFs)



Source: K33 Research

Figure 21: BTC Dominance

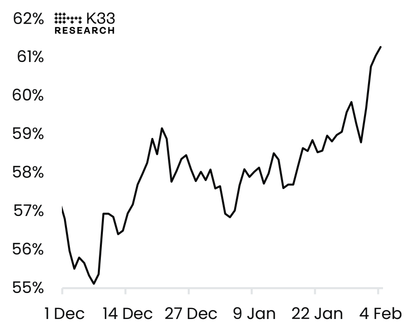


Figure 22: BTC + Stables Dominance

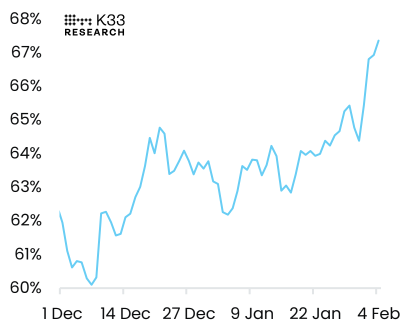
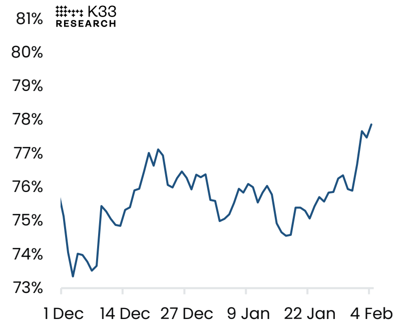
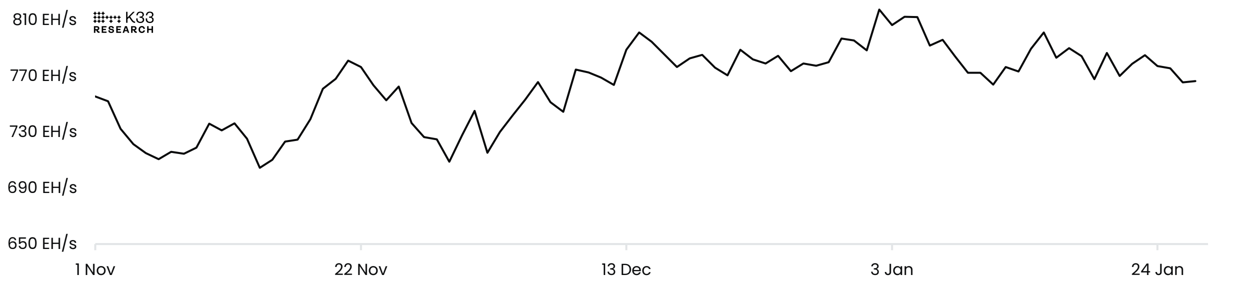


Figure 23: BTC + Stables + ETH Dominance



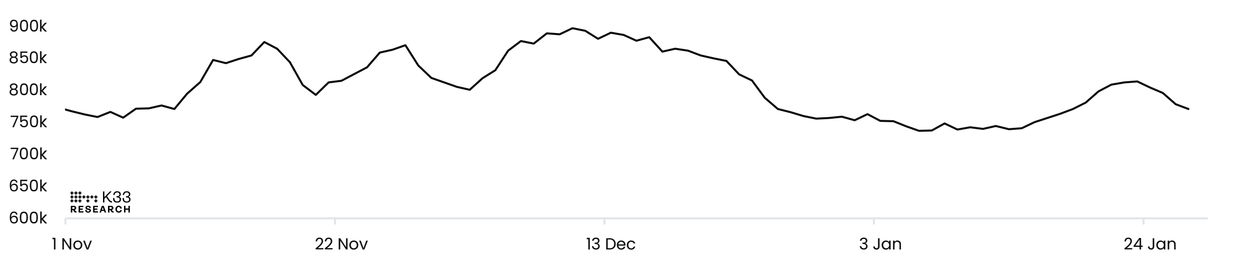
Source: Tradingview

Figure 24: Bitcoin Hashrate (7-day average)



Source: Coinmetrics

Figure 25: Active Addresses (7-day average)



Source: Coinmetrics

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 the Bletchley Indexes to gauge and assess market activity across BTC and altcoins grouped by market cap size. Documentation for the index weights may be found at through this link.

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. 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’s basis to compare offshore and CME premiums to highlight different sentiments between institutional traders and retail. While 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.

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