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Analyst Retrospective February 2022

Bitcoin, stock markets and the half-life of initial Fed rate hikes

In our January Analyst Retrospective, Copper indicated that Bitcoin would need to hold the $38-40k range to remain within the trend that has developed since 2020. But a hawkish Fed threw a spanner in the works, pushing the cryptocurrency to prices down alongside equities. Markets have rallied up since and Bitcoin is back in favour. But what's really happening under the hood and how might things play out for cryptocurrencies and global markets as the Fed signals a move away from quantitative easing?

While we're not ones to discuss the merits of Bitcoin over gold, something has clearly shifted on global markets that has made the latter option less appealing. With Fed upcoming tightening, and a 40-year inflation high, Gold gave a negative return in January. Maybe Bitcoin is yet to act like a store of value due to its continuous volatile swings, or even as an inflation hedge by traditional definitions and short-term outlook. But then again, neither is gold. There is a shift in market sentiment and it's trickling in across all assets with a single brush. Correlations need not be further discussed as it's apparent that equity downturns drag Bitcoin with it. And why we're discussing it in this report.

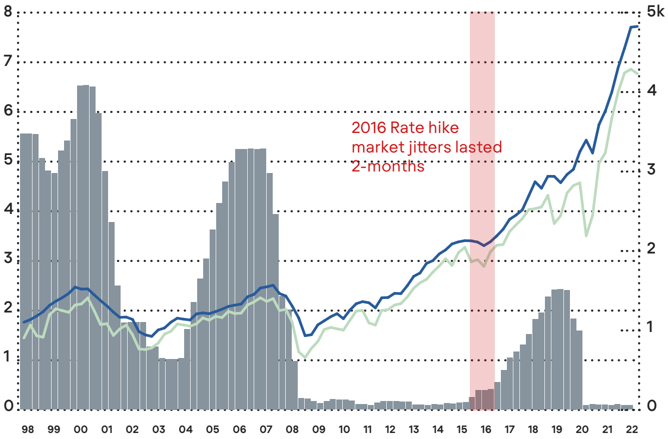
While the Federal Reserve's hawkish tone might have caused jitters, there is an argument to be made that the firepower of the initial guidance to be fairly moot without other global macro events turning bearish (see chart/table 1). In 2016, for example, markets saw some volatility before and after the rate hike, but equities rallied further up in a matter of months.

The Fed rate hike may cause some volatility, but it's questionable if it alone would be a cause for concern. Other factors would have to be in play if one was to consider their potency looking at historical data. And market corrections are seldom seen by the majority ahead of time, and it is only in hindsight that valuations are in fact disconnected from reality. Then again 'transitory inflation' pressures might possibly be a catalyst should company earnings take a hit as the year moves on.

Speaking of reality...

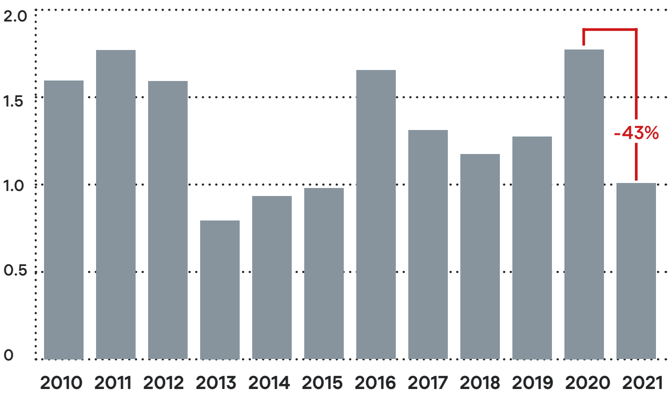
Bitcoin may have rebounded 30% since its low this year, but by several metrics, markets remain soft with traders seemingly unsure what position to take. A glance at lending protocol Compound shows that borrowing of both USDC (with the implied notion of going long) and BTC (with the implied notion of shorting), are both severely down from other cycles (see chart).

1: Quarterly Fed Fund Rates (Upper bound) vs SP500 High Low



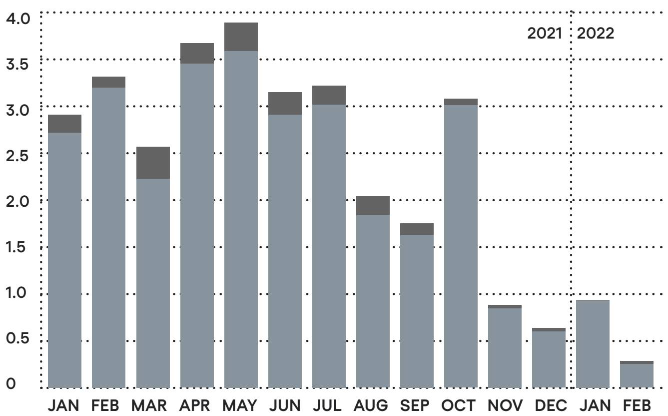
First Rate Hike	Market Peak	Months before peak	Growth
Feb-1999	Mar-2000	13	28%
Jun-2004	Oct-2007	40	42%

2: Gold demand for investment purposes (Tonnes k)



Source: World Gold Council. Investments defined as Gold Bars, Official Coins, Medals/ Imitation Coins and ETFs

3: Compound Finance: Gross loans USDC WBTC



Absolute vs trend?

Small on-chain addresses (between 0.1-1 BTC) have seen an uptick in holdings of just over 6% (see chart 3). But this is nearly half what was seen at the start of 2020 vs 2021, indicating that Bitcoin is getting expensive (although retail continues to 'stack sats').

Meanwhile, larger addresses holding between 1-10 BTC actually saw a decline of 3% for the **first time ever** year-on-year (see chart 4).

Having said that, this seems to have bottomed out in June 2021 and has increased since then by almost 2% with a total current holding of 8% of the maximum Bitcoin supply.

There is a nuanced point to be made here. Bitcoin may be a limited supply asset, but it does show that investors with significantly larger exposures also have a price target - meaning, there will be Bitcoin for sale when markets rally. Not all investors will sit in the 'Hodler' bracket despite parlaying a larger wad of cash.

Investors may opt to look at this data that suggests the market trend of accumulation continues. On the other hand, the on-chain data might also be saying that Bitcoin will need a great deal more long-term investors for it to make a strong recovery with significant footing that will keep pushing prices higher.

But then again...

Sitting on exchanges now is a great deal of stablecoins. Actually, across both spot and derivative markets there is over $26bn, nearly 10 times the start of 2021. Then again, spot markets saw over $1bn removed, almost half its total since the start of this year.

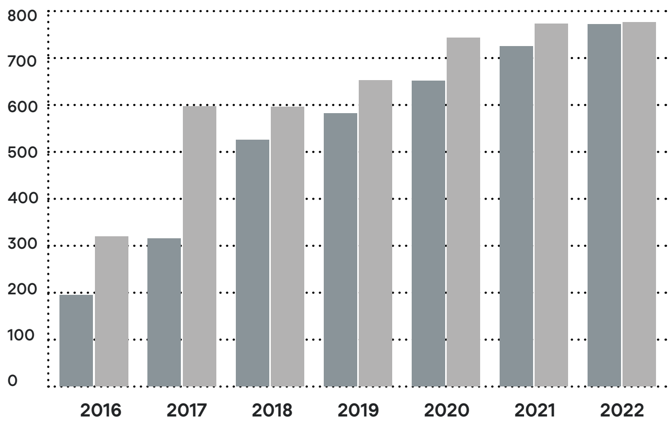
But, then again, exchange supplies have not seen a single month go up either, with each month's maximum supply lower than the previous (see chart 6).

Judgment Call

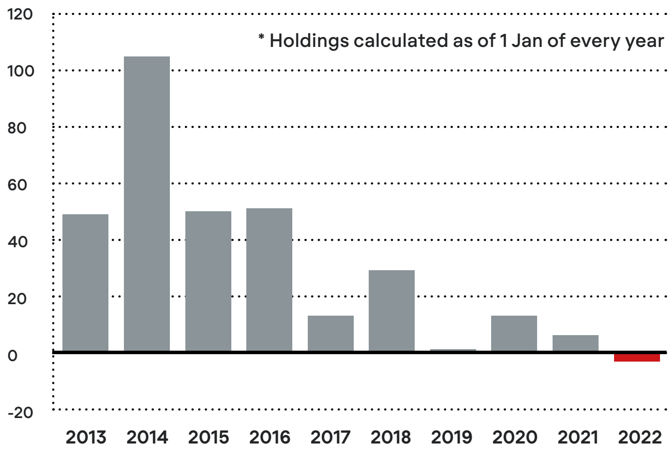
What is clear, is that nothing is actually very clear at this point in time and many investors are opting to sit things out while global markets make a firm recovery.

As for Bitcoin, reliance on retail will unlikely be the driver. Without further investments coming from deeper wallets, markets may face slower growth than seen before. Yet, as far as trends are concerned, the available supply is indeed going down. And should Bitcoin remain in-bound within the trend we mentioned in January, things might rally to new heights in 2022. Global markets remain key, but there could be time before markets feel capital pressures following fed rate hikes.

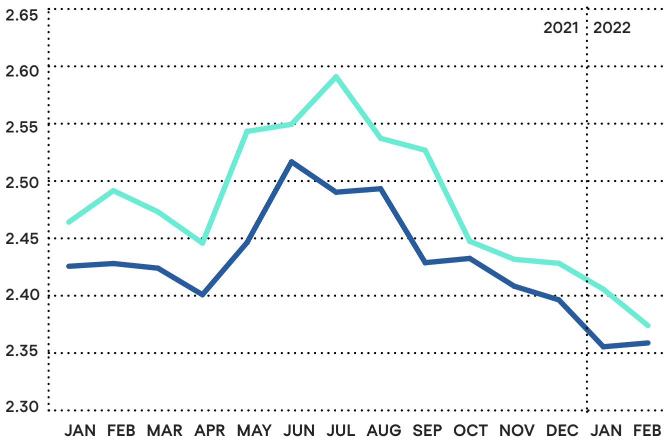
4: On-chain addresses holdings 0.1-1 BTC (k) Max Min



5: % Increase/decrease in addresss holdings of 1-10 BTC vs previous year



6: Exchange Bitcoin Reserves Max Min



Data Sources:

Pricing: CoinAPI
On-Chain: CryptoQuant, Glassnodes
DeFi: Dune Analytics
Other: Federal Reserve, Yahoo Finance, World Gold Council

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