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Analyst Forward Outlook

Research

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Bitcoin's 'bear market of belief' as spot exchange reserves drop by 25%

- Spot market liquidity is becoming scarcer. We take a quick look at exchange dynamics, and what the future might hold as Bitcoin is now less than 18-months away from its next mining reward halving. As things stand, investors have taken a very different approach in this bear market versus previous years with record annual drawdowns in readily available supplies of Bitcoin. Supply pressures are in the midst at current rates with forward projections indicating exchange supplies will drop to half of that seen in 2020.

Layer-2: More about rewards, less about fees..for now?

- Attention has been shifted towards scaling Ethereum with applications being built on-top of Layer-2 bridges that promise fast and cheap transactions. Top Ethereum scaling solutions have more value parked than some Layer-1 blockchains. But there's more to this than meets the eye..

Ethereum staking inflows hold steady pace

- Early stakers are reaping rewards similar to the time Ethereum moved to Proof-of-Stake in September. Interestingly, the influx of staked Ether, by any means, has grown exponentially after a successful 'Merge'. Still, the trend shows steady pace in staked Ether as the smart contract protocol bobs its head towards becoming a deflationary asset class.

Open interest, positive funding rates see highest consecutive run

- Many traders keep a very close eye on the futures funding rates as a sentiment barometer for market direction. As things stand, October saw over two straight weeks of positive funding rates implying long traders believe that appreciation of the asset will likely be greater than the fees that they have to pay to keep an open position. Which is also why open interest has made a massive growth spurt in the last month. Open interest actually saw month-on-month growth only four times this year.

Stablecoins: Market purpose move in different directions

- Since peak, outstanding Stablecoins have dropped by 12%, approximately $19bn worth. However, markets have captured a great deal of firepower with over $135bn inside the crypto ecosystem across 50 different chains. There is a bias however as to which stablecoins are being used on DeFi, versus issued stablecoins that predominantly reside on centralised exchanges.

Bitcoin continues trading and closing above key trend line

- A key trend line that Copper identified in its September research report continues to be key support for markets as traders come to some established congruency of what the cryptocurrency bottom might be. While Bitcoin dipped below this trend line, it never closed below it.

Bitcoin's 'bear market of belief' as spot exchange reserves drop by 25%

Spot market liquidity is becoming scarcer. We take a quick look at exchange dynamics, and what the future might hold as Bitcoin is now less than 18-months away from its next mining reward halving. As things stand, investors have taken a very different approach in this bear market versus previous years with record annual drawdowns in readily available supplies of Bitcoin.

Spot exchange reserves for Bitcoin have dropped by 25% so far this year alone. Last week saw a major whale remove 48k Bitcoins from spot markets dipping the reserves across spot markets to under 1mn coins according to data tracked by CryptoQuant.

Total exchange reserves, including derivative markets, have seen a 16% drop in 2022 (see charts).

Both figures are the highest annual withdrawal rates on record indicating a very different type of bear market this time round for the major cryptocurrency.

Just 11% of Bitcoin's total circulating supply now sit on exchanges, its lowest point since December 2017. The bear market that followed for that period, after Bitcoin neared $20k for the first time, saw exchange reserves increase to 17% of circulating supply until it bottomed at $3k in 2020 (see chart).

While new supply was just north of 265k Bitcoins year-to-date, over 420k have been removed from readily available Bitcoin on markets. This coincides with the number of Bitcoin's accumulated in wallets holding between 0-100 BTC this year.

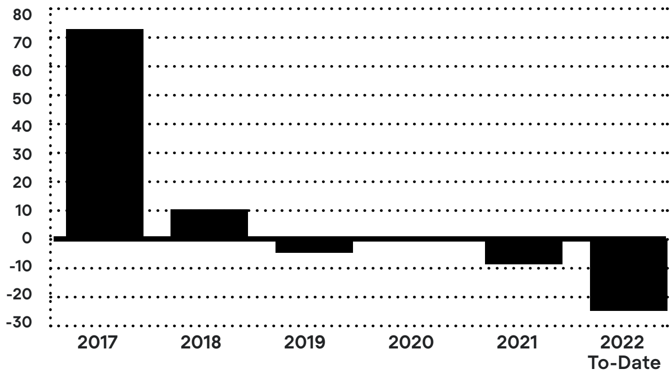
Since Bitcoin dipped below the $30k mark in July 2021, exchange reserves have been down trending relative to circulating supply and has seen an accelerated pace in withdrawals this year.

All things being equal, with a daily average draw down of -0.05% since July 2021, implies that by the next halving which is set to take place between 1Q and 2Q24, exchange reserves would sit at under 8.5% of total circulating supply, half of what was seen in March 2020 before the previous halving took place and its major run-up to near $70k.

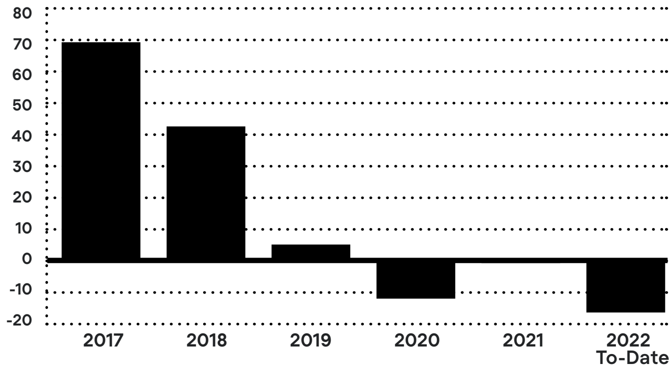
Spot exchange reserves that have been in decline since October 2019, would sit at just over 4% of total circulating supply by the next halving in 2024.

In our September outlook, Copper showed that small retail investors have been price agnostic and steadfast in 'staking sats'. Further downward spirals in price would not be off the back of supply overhang, but macro events that would introduce volatility.

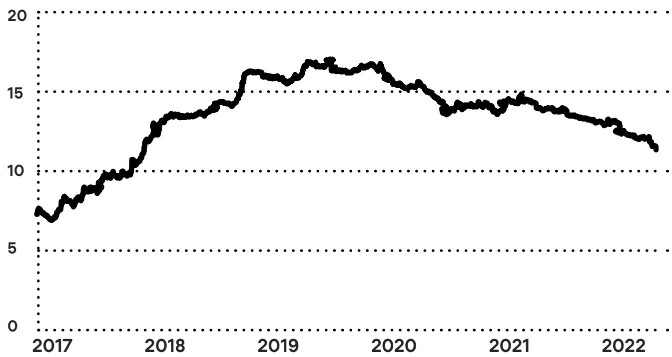
Change in Bitcoin spot exchange reserves (%)



Change in Bitcoin total exchange reserves (%)



% of Bitcoin circulating supply on all exchanges



Large players returning? Bitcoin # of Whales with >1k

Sources: Copper Calc, CryptoQuant, Glassnode

Layer-2: More about rewards, less about fees..for now?

A great deal of attention has fallen on Layer-2 protocols built on top of Ethereum. Two key Layer-2 scaling solutions, Arbitrum and Optimism, have seen a steady month-on-month growth in their userbase as it aids users in bridging their assets into a lower cost transactional environment.

More value is now parked on each L2 than on Solana at the end of October 2022, and catching up quickly to Avalanche.

Arbitrum and Optimism have seen a growth in monthly transactions increase by 1355% and 420% respectively in the past year (see charts).

However, the growth needs a little further assessment as to whether or not this is really about gas fees.

Just over 40% of Arbitrum's Total-Value-Locked (TVL) is in fact on one DeFi protocol, GMX, a perpetual derivative trading platform. The growth of GMX is one of the few that has seen massive demand in comparison to its competitor, dYdX, which it surpassed at the end of October (see chart).

The key difference, and likely what's caused such a flock to move from a very well-established trading application is due to the revenue share model that GMX has that passes on revenue fees.

Despite the growth, there is something to be said about the overall demand for L2 bridges thus far, and where it's actually coming from.

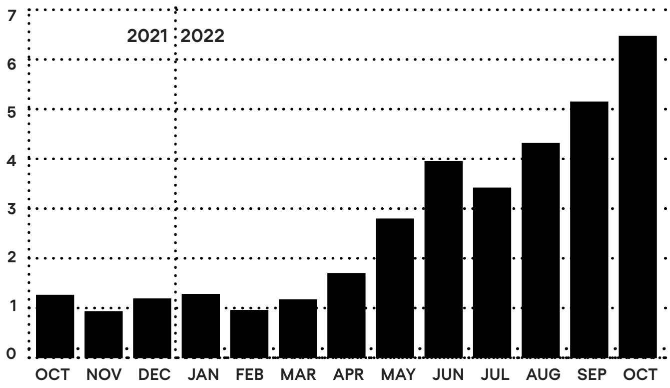
Uniswap, the automated liquidity provider on Ethereum, has indeed deployed their offering across all major scaling chains including Polygon, Arbitrum and Optimism. Combined, the L2 scaling solutions represent less than 5% of Uniswap's total TVL.

Lending protocol Aave, also deployed across the bridges has around 16% of it's total TVL on the scaling solutions. These numbers have seen little growth. In fact, 45% of the TVL in Optimism seems to have come on the back of liquidity mining rewards from Aave when the program launched in August and seen little movement since then.

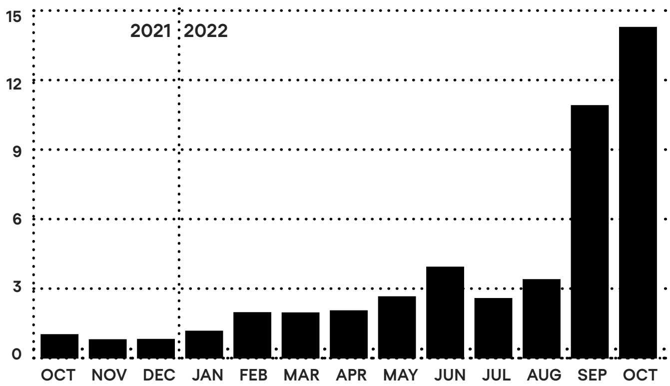
There is a growing narrative as of late that Ethereum Virtual Machine zero-knowledge (zkEVM) rollups could be the answer for increased security, easier deployment of applications, and a user-experience similar to what is currently being seen for users on the mainnet.

But will adoption grow without the requisite yields?

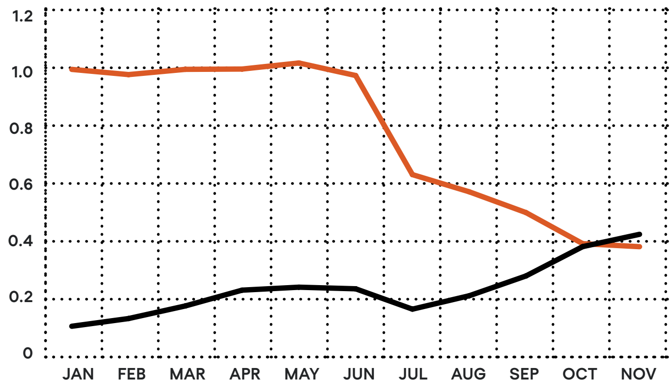
Optimism: Number of transactions (mn)



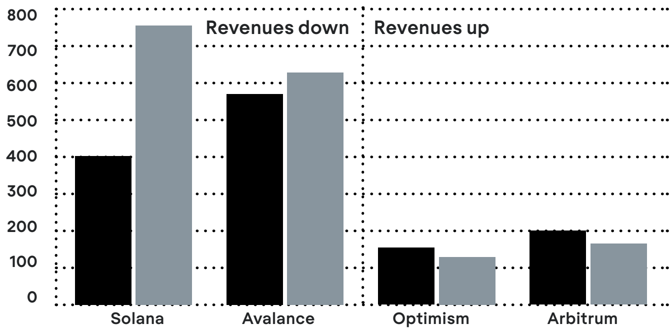
Arbitrum: Number of transactions (mn)



2022 TVL: GMX vs dYdX ($bn)



Fast and cheap transactions: Revenues ($k) for October September



Ethereum staking inflows hold steady pace

Ethereum, which finalized the 'Merge' and moved to Proof-of-Stake in September, has shown investors picking up a steady pace in moving their cryptocurrency to earn yield. Since the start of the year, Staked ETH increased by a massive 63%.

Whilst October saw slightly more Ethereum staked than in September, the dollar value at the time of inflows dropped from $910bn to $764bn.

However, a trend is becoming more visible in the past few months after investors saw little interest during the summer period. In July, less than 190k ETH was staked in comparison to over 530k ETH in October.

The steady pace is a boon for current stakers which will see a higher rate of return for a longer period of time, as Copper assessed in its September Forward Outlook report. While Ethereum will unlikely become deflationary this year, issuance has dropped from 3.6% to 0.02% - which is no small difference.

Open interest, positive funding rates see highest consecutive run

Market traders saw two straight weeks of positive funding rates for Bitcoin, the largest consecutive run seen this year on par with July 2022 when Bitcoin rallied from its low this year of $17.6k to $25.2k.

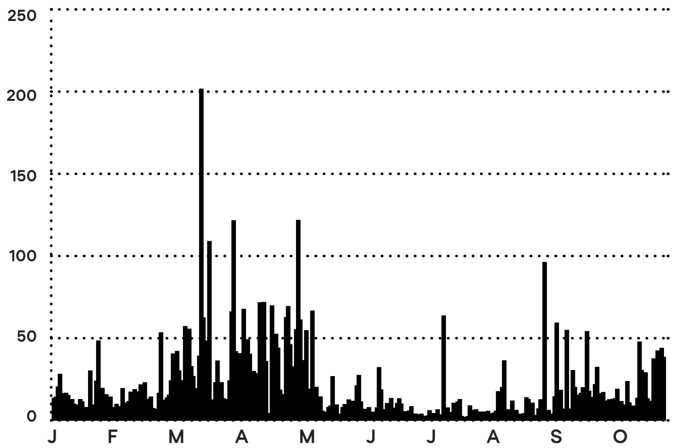
Funding rates have been long used as a barometer by traders to see if there is keen interesting in ponying up to take on long positions.

The rates, however, are nowhere near the levels seen in the past few years, indicating investors are taking a more cautious approach.

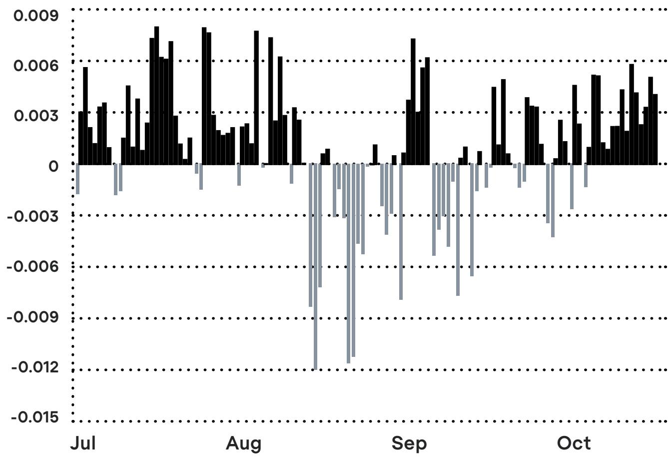
With that said, open interest saw the second largest month-on-month change since markets saw the bottom so far this year.

Ethereum leads the charge seeing a whopping 26% increase in open interest in comparison to Bitcoin that saw just under 10% change.

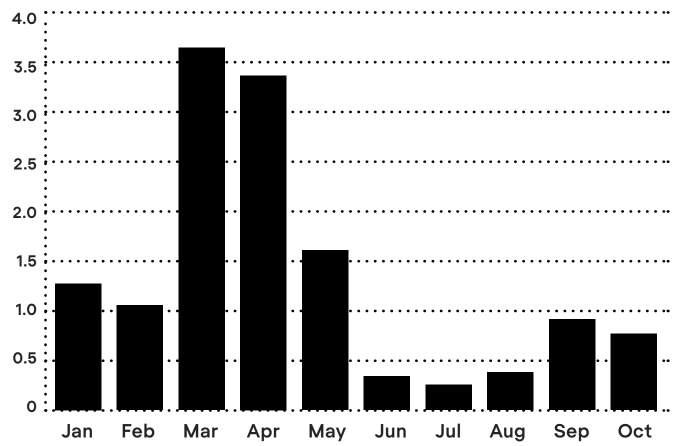
Ethereum Staking Inflows (k)



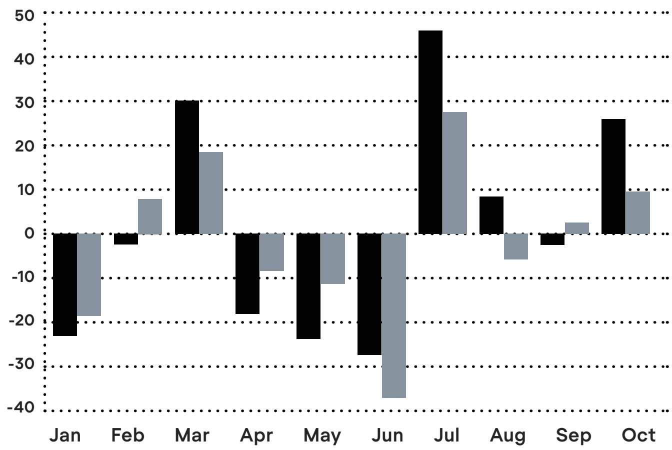
Bitcoin futures funding rates (%)



Ethereum Staking inflows ($bn)

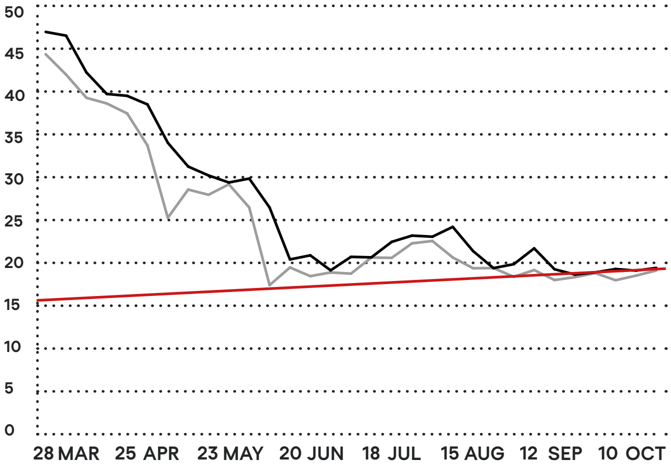


2022 % Change in Open Interest for Bitcoin Ethereum



Bitcoin continues trading and closing above key trend line

2022 Weekly Close Low - BTC/USD ($k)



A trend line identified in Copper's September outlook continues to play a key supporting role for markets as participants continue to try and find overall price clues for Bitcoin (i.e. what other traders are also looking at).

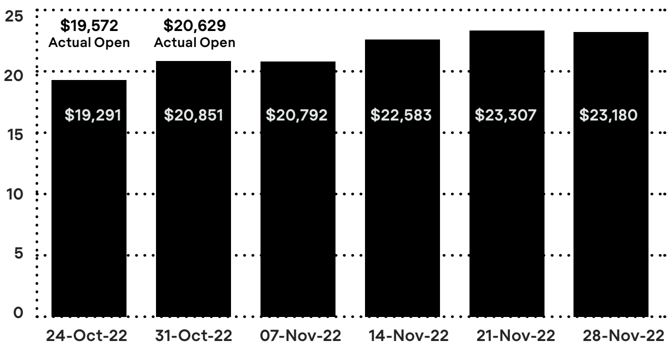
The two key points that established the trend line are between the 2018 low of $3k, and this year's June low when Bitcoin dropped to $17,600.

While the weekly lows did indeed dip below this trendline, the close and open price remained above this indicator now entering seven straight weeks of support (see chart).

In our report last month, Copper's research team found interesting price floors depending on how extreme correlations where to BTC against the S&P 500 and the US Dollar Index (DXY).

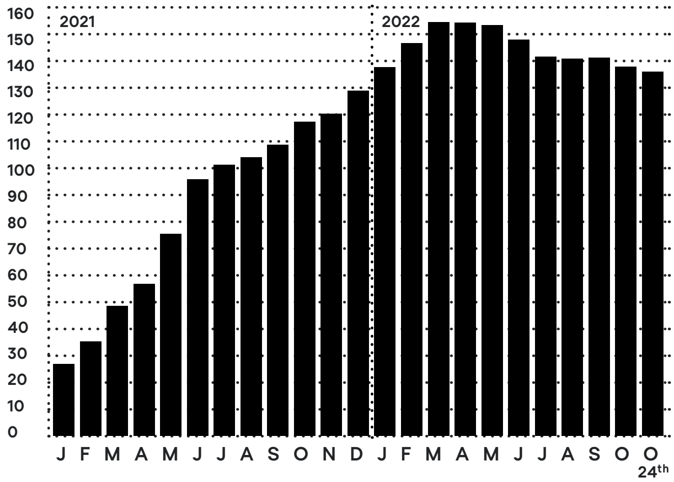
The implied weekly open price was 1.4% higher for the week of 24-Oct and -1% on 31-Oct (see chart below). As with many forward projection models, these are only based on historical findings. And although the success rate remains high and deviations small, macro events focusing on rate hikes will likely weigh-in.

Implied BTC/USD open price based on SP500/DXY Corr. Model



Stablecoins: Market purpose move in different directions

Total outstanding stablecoins ($bn)



Total outstanding fiat-backed stablecoins have dropped below the starting point of this year towards the end of October, sitting just above $136bn across 14 major pegged coins and over 50 different chains (see chart above).

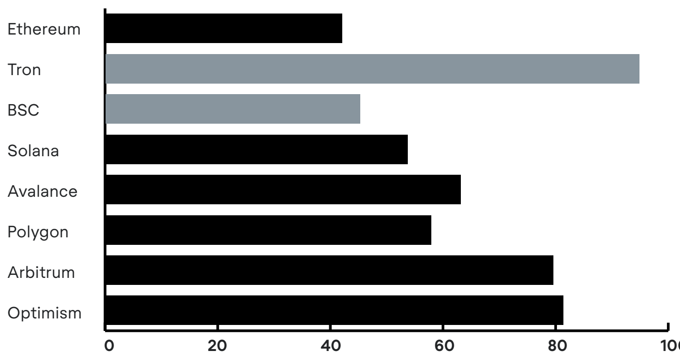
Since peak, stablecoins have seen a total reduction of over $19bn, a 12% decline. Still, there is plentiful of fire-powder for markets - Bitcoin and Ethereum exchange reserves combined stand at less than $71bn - a bit over half the value of outstanding stablecoins.

While Tether USD (USDT) continues to dominate across all ecosystems at 50% of the market share, there is a bigger bias with specific stablecoins on certain chains.

Although USDC has seen a 21% decline in outstanding stablecoins, the Circle-issued pegged dollar continues to dominate across most major chains (see chart below).

BUSD issued by major derivative exhange Binance has seen a whopping increase of 50% since the start of the year. However, over 70% of the outstanding BUSD stablecoins actually reside on centralised exchanges, and mainly, on Binance itself.

Stablecoin Dominance % by ecosystem



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