It's Deja Vu All Over Again

Week Ending Sep 20

Ari
Sep 20

	9/20/2022	9/13/2022
BTC	19030	20975
ETH	1353	1585
BTC Implied Yield (Qtly)	0.50%	0.60%
ETH Implied Yield (Qtly)	-1.2%	-4%
BTC 1M Implied Vol	65	74
ETH 1M Implied Vol	86	106
BTC 7 Day Realized	58	72
BTC 1M 0.5 std dev skew	-5.6	-4
Implied 1 Std Dev Move	663	832
Avg Daily Move	300	600
Avg Daily Range	1068	993

Chartbook here!

Hi All,

We are on the other side of the Merge. The good news is that it was basically a non-event from the technology standpoint and that is very impressive. The bad news is that it was an archetypal buy the rumor, sell the fact trading set up. Despite being weak as it fell from $1800 to $1600, ETH wasted little time and continued falling again. We now sit at recent lows and it is easy to fear a continued move down to July lows around $1000. ETH/BTC has moved in substantially, too, from a peak of ~0.085 to now around 0.07.

There is little consolation in the airdrop of ETHW. Last trading in the high 20s just prior to Merge, it is now around $5. That does not seem terribly surprising given that there has been little compelling news surrounding development or stablecoins or other signs of adoption. Or not much crossing my desk anyway.

File under “oof”: Wintermute gets hacked for $160M due to vanity address “hack”. Honestly, I did not have a lot of sympathy for Knight Trading when they imploded, not because it was not tragic — it was, but because it was the second time it had happened to them (they had an options blow-up in about 2001 where they quoted all Nasdaq ETF options at $10,000 when it was trading $28). I feel like they should have convened a risk management & tech team dedicated to avoiding “firm killer” events after that first very very close call (right after being bought by Citi!). But the Wintermute team setting up addresses that, from here, sound like they were trying to be organized rather than vain, and that has a bit of my sympathy. I only know one person there and this is not an endorsement of Wintermute. I note it because it seems like a hard lesson to really translate more broadly. Crypto has a lot of that. It is hard and so you better make sure you are going in with open eyes and outsized returns. On the other hand, when designing automated trading systems there are some helpful guidebooks, like this one from the FIA (Futures Industry Association). Oh, and one of our catch-phrases at DG: “every trade is a credit trade”. As the green chicken notes:

> “There are no solutions; there are only trade-offs.” - Thomas Sowell

Today and tomorrow the FOMC is meeting. Tomorrow is the actual release day. Right now the midpoint of the target rate is 2 3/8% and the Oct Fed Funds futures are indicating 3 1/8%. So exactly 75 bps higher. There is definitely talk of “going 100” and the market is clearly nervous about that. Basically, as I’ve written about before repeatedly, all you need to know about financial conditions you can learn about by looking at the USD. Yes, the dollar index is fiat to fiat. Nevertheless, as I wrote about in “I Just Can’t”, hard assets without industrial uses like gold, silver (kinda), and BTC are hedges against a declining dollar and not inflation.

Price action in the markets looks like another BTRSTF (buy the rumor, sell the fact). Why? Seems like everyone is pre-hedging ahead of the actual news of Fed 75 or 100. Of course, I don’t *really* know. As it stands, the risk in risk assets is holding them and so when there is an event or even a weekend, the weak hands square up and wait for news. This is (one) of the dynamics that drives the BTRSTF trade. Tightening financial conditions means, as Brent Donnelly wrote in an old SpectraMarkets piece that noted TINA (there is no alternative to equities/risk assets) is over which means, duh, *there are alternatives.*

Which brings me to ETH again. Lido Staked ETH generates 4.9% APR. In an environment where the dollar is declining and global yields are zero (or even negative), then 4.9% is fat city. When I can get a 6 month Treasury Bill at 3.7%, 4.9% is incremental pick up in a highly volatile (90%!) asset. Picking up 120 bps over a risk-free asset for staking ETH is not a trade that makes sense for dollar denominated balance sheets (meaning if you earn pay in USD and pay rent and buy things with USD). That's not to say that ETH is a bad asset. Just that yields are going to have to go up or price has to go down until the risk/reward gets back in line.

Digital Gamma published a framework for pricing futures once proof-of-stake was adopted along with some mispricings. You can get it here. Both of our recommendations for selling ETH PoW forwards worked: buying Sep basis -22 and selling Poloniex forwards far higher (and hedging with selling Sep basis as arb). Our Sell Sep-Dec calendar -2 is right there but did come with the option to make money should the event get delayed. And selling Dec-Mar at +11 has worked, too, as it is now about +1.5. Our pricing for proof of stake was a little aggressive but the framework seems to be fine. We just used too low of an estimate for USD interest rates (2.5% rather than 3.25% or so). Even then, basis is a bit higher than I would have expected.

The best trades in basis lately have been, perhaps unsurprisingly, cross market and cross jurisdictional. CME basis has been very directional and volatile compared to the offshore markets. Overall I'm surprised at how low basis is for BTC. I'd expect it to at least match T-Bill rates. Otherwise, holders of BTC can sell their spot (be aware that I am not a tax expert and I'm definitely not *your* tax expert; heck, I don't even give trading advice) to raise dollars, replace with BTC futures, and invest the proceeds in T-Bills. It is definitely not as sexy as 20% cash and carry, but I believe that one can post those T-Bills at CME as collateral.

Also, if you are into more complicated spread trading, then take a look at BTC-ETH vol ratios. Interestingly, the highest vol on the board — 9/23 ETH — might offer good value against 9/23 BTC as compared against other months. ETH vol to 9/23 is 1.2X BTC but

November is 1.27X BTC. This is tricky to pull off all of it. But it can also be a good guide to finding value in options curves.

Things I am reading / listening to / interested in / thinking about:

- Byran Gillam in his daily Blockworks note from Sep 8:

  > That seems to me like a vote of no-confidence in Tether. Binance's auto-conversion of USDC is a promise to always accept it 1:1 vs. bUSD — they have not made the same promise with Tether.
  >
  > If I'm reading that right, Tether should be concerned as their largest use case is as a trading pair on Binance and Binance, if they are losing faith in Tether (or just want the TVL for themselves) could start incentivizing usage of bUSD for trading pairs instead.

  In addition, keep in mind that if withdrawals are made, the 8% hole stays and the first money out gets paid out in full. The last 8% gets … 0?
- Is Russia spiralling toward demise (again??). Zeihan and Malmgren discuss
- What if I gave you a 2 Sharpe strategy; what could that trading profile look like? Honestly I cannot recommend this article enough. Robot James is also a great twitter follow; has been known to spew profanity

Tell me (how) I'm wrong,

Ari

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