I Don't Want to be a Member of any Club That Will Accept Me

Week Ending May 31

Ari
May 31

	5/31/2022	5/24/2022
BTC	31675	29237
ETH	1953	1947
BTC Implied Yield (Qtly)	3.5%	3%
BTC 1M Implied Vol	65	75
BTC 7 Day Realized	55	70
BTC 1M 0.5 std dev skew	-9.2	-10.5
Implied 1 Std Dev Move	1077	1147
Avg Daily Move	695	1139
Avg Daily Range	1297	1542

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Hi All,

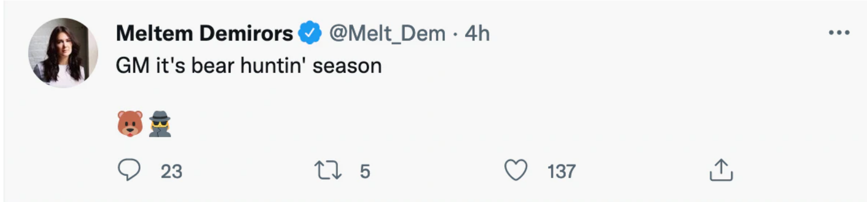
One of the lessons that I've learned from being involved with crypto is that money and law are intimately tied. It is not always evident, particularly when there is a wide amount of freedom involved when transacting. Yet a sudden discontinuity wakes one up to this fact. Russia, of course, found out the hard way that if one breaks the norms (I'm not certain that there is written law stating that one nation cannot invade another) by which fundamental behavior is judged then the law, and therefore money, gets weaponized against you. A long time ago I was on a panel with Ryan Gentry of Lightning Labs and he talked about how BTC functions as a nation state and therefore was at war with other sovereigns. It was not something new, yet Ryan did lay down the lines very clearly. I thought of that when reading about Russia potentially using cryptocurrency for payments (h/t Valkyrie morning email). I've said in the past that when governments talk about going after money laundering, it really means clamping down on activities that the government does not like. Some feel that this use of the dollar is going to go down as a major policy blunder; this is less than clear to me. Russia took extreme action. On the other hand, if "melon balling a nation out of the monetary system" (as Peter Zeihan put it) becomes an action for smaller infractions, then the USD will have serious problems. This is a real possibility as once one has a hammer, the world becomes a series of nails. The same thing happened in the post-war period with threatened nuclear action by the US until the USSR called their (our) bluff.

This may be bullish for crypto. I don't have to like it, though.

The Fed has somewhere between $330B-$450B in unrealized losses on its balance sheet assets. The $330B is from the Fed's own accounting. Looking at the entirety of the balance sheet here, from Nov 2021, one can see $8.4T of assets or about a 5% loss. However, the losses of $330B+ are on a capital base of $40B. There is, of course, something of a guarantee from Treasury to the Fed. Still, that does feel a bit like a political liability with taxpayer money going to pay for QE. I don't know exactly what this means. There is regular political grandstanding and a big game of chicken for extending the debt ceiling for the budget whenever that occurs. Cutting a $400B check from Treasury to the Federal Reserve for asset purchases seems like it is going to put the Govt between a rock and a hard place even it is less than income already received. I could voice my own opinion here on QE but it doesn't matter. What might matter is that it could cause a mess for the dollar and incumbent politicians. On the one hand, it will look bad to bail out the Fed and on the other, it is … a tad messy … to let the Fed default even if the default is just more money printing at a time when they are trying to tighten policy. Obviously the Fed would not have to puke it up in a margin call but they will have to carry the assets while paying higher interest costs. A possible solution might be to force banks to subsidize the Fed via 0% RP. Anyway, this seems bigger than the current coverage is making it out.

Yes, sure, they get to print more money and buy more stuff to earn interest, so who knows. Also worth noting is that the Fed sent over $32B to the Treasury Department in the first quarter which could have been used to bolster its capital to $72B. Not sure that ongoing technical insolvency is a good look. It is also going to potentially mean a revenue source for the government is going away. It's not nothing either – $32B quarterly is $128B annually and that represents ~3.5-4% of 2020 US tax revenue.

As Meltem Demirors said:



It certainly does have that feel to it. BTC is up 9.5% or so. Celsius token has jumped something like 50% from yesterday. First, it seems like there was a lot of nervousness going into the (US) long weekend and that the lack of awful news felt so, so good. Also worth noting is that a Meltem bull market tweet got only 137 likes after 4h (for reference, she tweeted about dropping an ice cream sandwich in the bathtub that received 311 likes). AND the responses to the bear hunting season tweet were pretty negative. From a sentiment perspective, this is a wall of worry to climb, ie, seems bullish.

Please turn to your chartbook on the front page and on page 5. Looking for a hedge? Or just an excuse to get longer BTC? Use a put spread. The table calculates the payout ratio for a 90-100 put spread — that is buy the ATM put and sell the 10% out of the money put — for 6/24. Currently the max payout is almost a 3X gain. You can see on page 5 that this has been climbing. The way to read this data is that the payout grows as volatility falls and as put skew rises. Lower vol is a lower price for the ATM put. Steep skew raises the volatility and, therefore, price for the OTM put. Combined, they make for a “cheap” put spread.

For a market maker or dynamic hedger, this can get squirrelly. Rather than a fixed spread purchase, they are dynamically hedging. That makes risk for them that volatility slows down now but gets very high if BTC gets stressed. That has been the pattern of behavior. But for a static investor that is either betting on a BTC fall or hedging, they are only looking at a fixed dollar investment which is cheaper than usual.

In market action, put skew is in a little bit (more so in the shorter dates). What is particularly interesting is that calls have actually outperformed. Meaning that slightly out of the money calls did not suffer as much in the vol slay relative to ATM volatility. So that was a little surprising. With the relief rally in play, my base case is that 1) DeFi option vault participation will be meeting lighter “buy” flows and 2) moving higher will be moving slower. Overall crypto is something of a positive feedback loop, so this should be constructive to the space as collateral used for borrowing has stopped falling. Also, BTC up 9.5%, equities flattish (Nasdaq actually down), and bonds down (as of this writing). I don’t see anyone writing about lack of correlation. This may be the new pattern: some panic sell everythings and then BTC outperformance in spurts.

A few things worth reading out there:

1. I did not realize that BTC has smart contract capability and here is a solidity transpiler!
2. Have I mentioned lately to read Pettis? Here he talks about what is next for China's economy.

Best

Ari