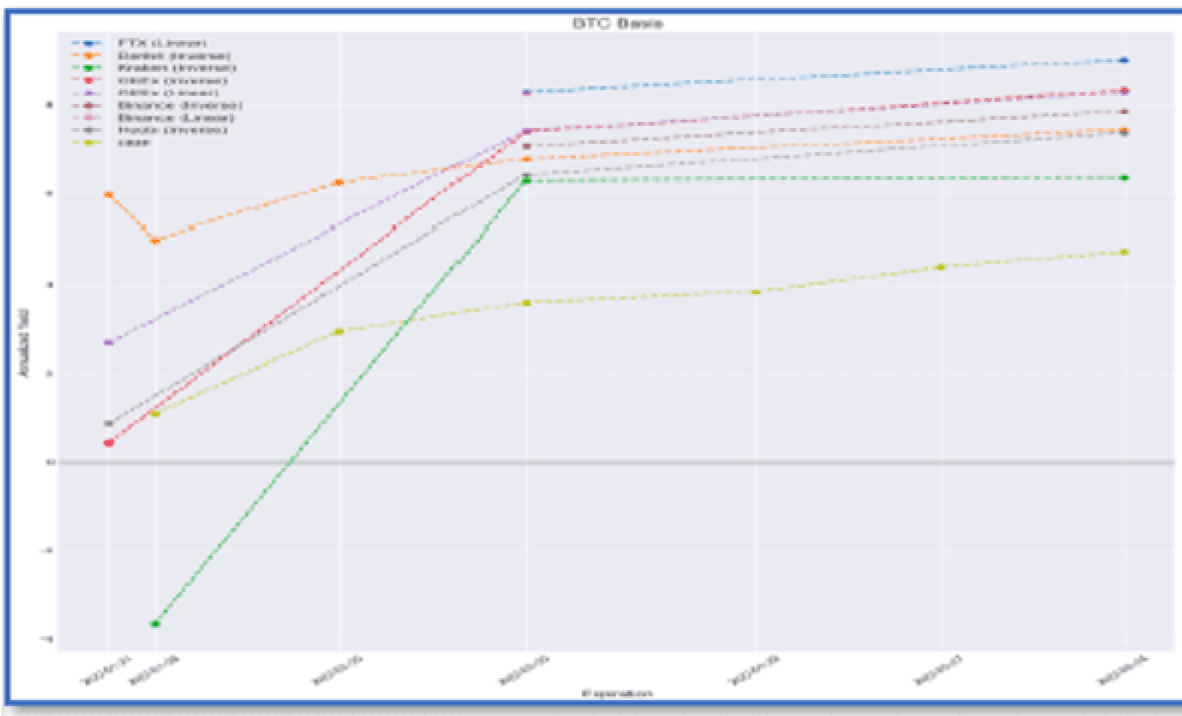
Digital γ Gamma

Week Ending Jan 11

Hi All,

Please check out our new chartbook format. Our long time codebase gave us some trouble. We took advantage of the situation and have made changes that we had wanted to do for some time. First, the chartbook is no longer 3 separate documents. It is now a single document with data for BTC basis, ETH basis, and BTC options. We consolidated all of the futures curves into a single graph, added prices, Binance perpetual open interest, and Binance perpetual financing rates. We will be gradually making additional changes going forward. Please give us your thoughts.



Probably like the rest of you, I take advantage of news curation. Today I was reading the Valkyrie Market Brief that two miners, Bitfarms and Hive Blockchain, are either purchasing additional BTC or simply not selling mined BTC. Maybe I'm too anchored in TradFi and don't get it, but I feel like these firms have a good business and should focus on that. As it turns out, here at Digital Gamma we have some experience from the gold world. Gold miners thought that they were good at trading gold, too. That did not work out overly well and the industry is still reeling from a 1999 fiasco. In that particular case it was that a large producer by the name of Ashanti decided that after years of declining gold prices, that they should hedge not only their production but also their reserves. Well it turns out that whilst a firm can sell its production forward, there is still a requirement to post variation margin against those forward sales. To really bring this full circle to things today, the central banks (the Europeans) were actively unloading their holdings of the barbaric relic and it was this selling that was weighing so heavily on the precious. Unsurprisingly, once much of the European CB gold was in stronger hands and many of the gold mines had "hedged" their forward production, the price of gold bounced. This led to a margin call for Ashanti – which of course, they did not have. So just like Bitmex would do, their banks liquidated them. Which led to a huge price spike that everyone in crypto would recognize. I did not trade during that time but Paul did so if anyone wants some firsthand stories, reach out.

Given the topic, it is worth mentioning that there is a large levered long in Microstrategy. Their average price of BTC is 30K. Microstrategy is basically a future on BTC. I have not looked at the terms of their bond offering so keep that in mind when I say that MSTR debt is a short put on BTC struck at their average price. Incidentally, Bloomberg reported that their $400M offering (which was after MSTR sold $1B of convertible bonds) is more than the company's entire cash flow since 2016. So this is really rocket ship BTC. Worth noting that this is not new news.

This is a massive convexity hold for the market. Is it at 30K? I don't know. But it is a huge risk for Microstrategy, its bondholders, and our industry. Discussing with Paul today, he noted that should this become a problem, this will be something that crypto critics will jump all over and scare many others away.

I'm not telling you that BTC or ETH or gold, for that matter, is going down. I'm reminding you of what you already know: that there is real risk out there.

Overall, quarterly futures are not qualitatively different in implied yield than from last week. Amazingly, despite pretty good movement, implied volatility is clattering along the bottom in the 60s for shorter dates. Risk reversals better bid for puts than they were, but I think that there is the potential for hedges to get put back on. If hedging is something that you are interested in doing, remember that one can buy puts as protection, but call substitution (buying calls and selling the asset) is another choice that may cost less. I have it on good authority that calls have gamma, too.

Best,
Ari

Chartbook

DISCLAIMER: Do your own research. Nothing herein is investment or trading advice. All information here is given on a best efforts basis and there is no guarantee of accuracy.

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