Rivemont - Weekly Update #274

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Rivemont is the portfolio manager responsible for the investment decisions of the Rivemont Crypto Fund.

On paper, bitcoin is an asset that should perform particularly well as a safe haven in an inflationary environment. It is therefore a bit of a disappointment to have seen it essentially trade as a risk asset over the past year. When U.S. banks fail, however, the value proposition of cryptocurrency cannot be illustrated in a clearer way. This could not have been more demonstrated this week, with the asset's price hitting a high for 2023 yesterday.

Let's take a look back at the reasons for this significant rise this week. After the failure of Silvergate Bank, it was the renowned Silicon Valley Bank that literally suffered from a run to the bank last week. The bank's problem is that its assets backing customer deposits are mostly low-yielding long-term bonds. As interest rates have climbed at a rapid pace over the past year, these assets have lost a lot of value, no longer worth what the bank paid for them. The bank was sitting on more than $17 billion in potential losses on these assets at the end of last year. Then, last week, the bank faced a $42 billion tidal wave of deposit withdrawal requests. It was unable to raise the cash needed to cover the outflows, prompting regulators to step in and close the bank.

In short, we had a reminder of the risks of the banking system with its fractional reserves, which caused many to migrate to bitcoin as a hedge.

This banking crisis, caused by the rapid rise in interest rates, has also led many analysts to believe that next week's hike may prove to be smaller, if it happens at all. The probability that the Fed will raise interest rates by 50 basis points at its meeting next week fell to 0% from 40% on Friday, according to CME's FedWatch tool. The probability that the Fed will pause interest rate hikes fell from 0% to 34%. To that end, consumer price index data dropped yesterday, exactly in line with expectations, at 6% year-over-year. Everyone is holding their breath in relation to Jerome Powell's decision next week.

"Bitcoin's rally to a new yearly high as Silicon Valley Bank falls and inflation remains stubborn shows that investors are turning to bitcoin to find stability in very uncertain market conditions," Alex Adelman, co-founder of bitcoin rewards app Lolli, told CoinDesk. "While many have viewed bitcoin as a hedge against inflation and have followed its price movements accordingly, bitcoin's relationship to traditional finance is more complex," Adelman said, adding that bitcoin functions as an "alternative to the traditional financial system as a whole."

Another related story to Silicon Bank's failure involves Circle's stablecoin USDC. Indeed, Circle is the bank's largest custodian, with $3.3 billion in deposits. Fears of the crisis led USDC to lose its peg to the dollar over the weekend, with the price falling as low as $0.82 per dollar. This was a tempting bet for speculators. The announcement by the US government that the depositories' funds would be 100% guaranteed quickly brought the stable currency back to its normal peg.

Are we finally witnessing the decoupling of cryptocurrencies from traditional assets? While this was certainly the case in this specific context of the week, we shouldn't jump to conclusions. Even though bitcoin is up of more than 50% year-to-date, compared to a 9.6% rise in the Nasdaq Composite and a 2% rise in the S&P 500, the correlation between cryptocurrencies and stocks remains palpable. "I would say it's still early days, as I expect all risk assets to move in tandem if the Fed changes course," said Lucas Outumuro, director of research at IntoTheBlock. "But a few weeks down the road, the correlation could start to fade as the main macroeconomic hurdle eases."

While bitcoin's correlation with the S&P 500 and Nasdaq remains positive, it has declined since Jan. 31, when bitcoin's correlation with the S&P 500 was 0.85 and with the Nasdaq was 0.92.

The chairman of the Commodities and Futures Trading Commission (CFTC) has taken a strong stance on the digital asset market. Rostin Behnam told the Senate Agriculture Committee on Wednesday that Ethereum, the second largest cryptocurrency after bitcoin, is a commodity. His opinion appears to directly contradict that of SEC Chairman Gary Gensler, who said last month that "anything other than bitcoin" falls under securities law. Without naming names, the chairman has repeatedly hinted that this would include Ethereum, especially after the network adopted a proof-of-stake consensus mechanism. "We would not have allowed the Ether futures product to be listed on a CFTC exchange if we were not convinced that it was a commodity," he added, noting that his agency had "serious legal arguments" to back up its case.

If Morgan Stanley's most recent report is to be trusted, bitcoin is not trading as a currency, but as a speculative asset. It's hard to disagree with that position, at least relative to the past year. Morgan Stanley notes that bitcoin was designed as a way to hold value in a private digital wallet without needing an intermediary to store the value for them or to enable transactions. In practice, however, "bitcoin is not insulated from the traditional banking system," as its price is supported by "USD bank liquidity, making it a speculative asset rather than a currency," the report says. Bitcoin's reaction to the negative news flow has changed in recent days, rising nearly 20 percent on Monday after the Federal Reserve and Treasury said they would support the banking sector, the note observes. However, last week, at the height of the uncertainty, it fell with risk assets and bank stocks, trading as a speculative asset. In short, we are possibly in a positive transition for bitcoin, but it is hasty to speak of a complete decoupling.

BTC/USD has been breaking above the key 200-week moving average, acting as a strong resistance since it broke in June. This average was lost again yesterday, so it will be a key level to watch in the near term. Breaking it and regaining it as support could really launch a new bull market for bitcoin.

On March 13, Glassnode's exchange flow data recorded the largest influx on exchanges since May 2022. That means there is more supply on the markets and potentially more selling pressure. In short, the rally has led many to want to secure some profit.

It is again the macroeconomic factors that will need to be followed closely in the coming days. Just a few days ago, many were agreeing on a further 50 basis point increase. Will the effects of last year's hikes on the banking system make the Fed flinch? Will we see a 25 basis point increase - the most likely scenario - or no increase at all? This decision could signal the direction of the markets in the near term.

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