

RIVEMONT

Rivemont - Weeks 281-282

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

If there's one topic that's been getting a lot of attention in recent days, it's the significant increase in transaction fees on the bitcoin network. What's behind this sudden trend? The answer lies in a number of parallel elements that have created a perfect storm over the past few days. So let's start by looking deeper into this topic.

Obviously, the transaction fees depend mainly on the number of transactions recorded on the blockchain. Despite a slight drop in the price of Bitcoin over the past two weeks, the fees for recording a transaction that is guaranteed to be included in the next block have exploded. Why did this happen? Because of a

new item called Ordinals, which are actually NFTs based directly on the bitcoin network. Until now, non-fungible tokens have been based primarily on the ETH chain.

Ordinals rely on the use of inscriptions, which are inspired by ordinal theory via the protocol developed by Casey Rodarmor. The goal of Ordinal theory is to give satoshis, the smallest units of bitcoin (1/100,000,000 of a full bitcoin), individual identities that allow them to be tracked, transferred and given special meaning. In other words, the Ordinal protocol assigns each satoshi a sequential number. Once this number is assigned, each satoshi can be registered with data such as images, text or video through a Bitcoin transaction. Once the transaction is confirmed, the data is permanently embedded in the Bitcoin blockchain. Such NFTs are different in that there is no referenceable metadata file describing the NFT. Instead, the entire data file resides in the signature field of Bitcoin transactions. This means that the entirety of Bitcoin NFTs rests exclusively on the blockchain. For fans of NFTs, this brings an extra level of immutability. However, the flip side of the has been clear to say the least since the rise in popularity of these new NFTs.

Indeed, these tokens named BRC-20 suddenly increase the demand of transactions to be validated by miners. At the time of writing, 400,000 of them are still unconfirmed in the so-called mempool. The latter represents the pool of transactions from which miners draw to create a block. Since miners are obviously looking for maximum profitability, they will take the transactions with the highest associated fees to compose each block. According to CryptoQuant, the average fee per transaction has skyrocketed, exceeding \$16 and peaking at \$29 yesterday. On the same day, the total market capitalization of BRC-20 tokens surpassed \$1 billion.



This is wonderful news for miners, as profitability, or the price of hash, has jumped 66% since the beginning of the month. The total fee associated with a block sometimes even exceeds the bitcoin reward of the block itself (12.5BTC). Developers, on the other hand, mostly see these tokens as a threat and a real "spam" on the network. Some even think that it is a concerted attack by groups wishing to harm the network, having monetary resources to slow it down. Remember that these Ordinals holders currently pay these exorbitant fees to exchange their NFTs. Will this be a passing fad that will give miners a windfall profit for a while? Is it a more persistent problem that will lead to the development of new solutions and an increase in the integration of the Lightning network allowing low cost 2nd-layer BTC transactions? One thing is certain, this will be the topic to watch in the short term.

We were talking about a perfect storm at the beginning of this letter. The reason is that a wave of panic occurred in parallel at the end of the weekend on the Binance exchange. The latter started when the exchange stopped bitcoin withdrawals from its platform. Binance said its decision was based on Bitcoin network congestion issues, adding that the company was working on a fix to reopen withdrawals as soon as possible. During the outage, there was much

speculation about the cause of the outage across the community. A major discussion on Twitter Spaces touched on a wide range of technical theories related to Ordinals, a theft of Bitcoin reserves, a new U.S. government attack as well as international political conspiracies. An hour later, Binance announced that bitcoin withdrawals were available again.

This wave of speculation was heavily fueled as record levels of BTCs were withdrawn from the exchange, adding to fears as well as network congestion. Binance transferred more than \$5 billion in BTC over the weekend, which represents nearly 30% of the company's net BTC reserve balance. Binance said afterward that the transfers were nothing to worry about. "We're aware that some data are showing a large volume of outflows from Binance," the exchange said on Twitter. "This 'outflow' [sic] are actually movements between Binance hot and cold wallets due to the BTC address adjustments." Analysis firm CryptoQuant confirmed that this was just an internal reorganization of tokens. In the same vein, in response to the exchange's withdrawal halt, Binance published, "To prevent a similar recurrence in the future, our fees have been adjusted. We will continue to monitor on-chain activity and adjust accordingly if needed. Our team has also been working on enabling BTC Lightning Network withdrawals, which will help in such situations. This is a learning opportunity for us and we'll do our best to prevent this from happening again. Thank you for your patience.

Through this crisis, the price of bitcoin has only recorded a slight decline while remaining in its present trading channel. In hindsight, this is possibly the most encouraging element.

In industry news, the first thing to note is that U.S. exchange Bittrex has filed for Chapter 11 bankruptcy protection. The move comes weeks after the SEC accused the exchange of raking in at least \$1.3 billion in illicit revenue. The exchange said it had more than 100,000 creditors with liabilities and assets estimated at between \$500 million and \$1 billion. In the same vein, the company assured that its international subsidiary was not affected by the bankruptcy. Just a week ago, Bittrex claimed that all investor funds were safe.

Let's hope that's really the case.

On our side of the border, according to an article published on May 8 by Miller Thomson, the law firm representing QuadrigaCX users, the interim distribution of funds related to the bankruptcy proceedings will begin "in the coming weeks." According to the Ontario Securities Commission, QuadrigaCX owes its affected customers an estimated \$160 million. In addition to the loss of access to cold wallets, the OSC claims that Cotten, the company's supposedly deceased CEO, realized \$86 million in losses on cryptocurrency transactions on the QuadrigaCX platform, losses that were then covered by user funds. Since then, bankruptcy trustee Ernst & Young has recovered assets worth \$34.3 million. "We have not identified any assets other than those identified by Ernst & Young," the CSO writes.

Attorneys for Sam Bankman-Fried of the defunct FTX exchange have released their first full legal argument in response to fraud charges brought against him by prosecutors. In the documents filed in a Manhattan federal court on Monday, SBF seeks to dispute several charges and claims that the law firm Sullivan & Cromwell, which is representing FTX in the bankruptcy proceedings, acted as an agent of the federal government in building the criminal case against him. As a reminder, SBF faces 13 charges ranging from money laundering to wire fraud. His legal team is now working to have ten of those charges dismissed. The filings claim that four of the charges, including foreign bribery, campaign finance and bank fraud, violate aspects of the extradition process between the U.S. and the Bahamas, where Bankman-Fried was arrested in December.

Coinbase's financial results helped the company's stock climb 13% when they were unveiled last Friday. The company raked in \$736 million in revenue in the first three months of the year, a 22% increase over the previous quarter, while reducing operating expenses by 24% during that period. Also related to Coinbase, a U.S. court ordered the Securities and Exchange Commission to respond to the exchange's complaint about how it applies securities laws to digital assets. The Third Circuit Court of Appeals said in a filing Wednesday

that the SEC must file its response within 10 days. Coinbase can then file a response seven days later.

A few weeks after the Shanghai upgrade of the Ethereum blockchain, what conclusion can we draw? The most important finding is that the net amount of Ethereum put into play is positive, indicating that there are more addresses depositing their Ethereum than there are withdrawing it. Some players who deposited their tokens prior to the update are still looking to withdraw them, but ultimately this suggests that people are still optimistic enough about betting on Ethereum and getting that extra ETH-denominated return to do so. That's doubly interesting, because those tokens deposited in staking contracts mean fewer tokens on exchanges that can be sold on markets.

While sentiment over the past two weeks has deteriorated with a drop of about 8% from the \$30,000 mark, there is some data pointing to a possible reversal here. Indeed, investors withdrew \$23 million from funds shorting bitcoin at a record pace last week. However, it is the consumer price index data this morning at 8:30am that is currently getting all the attention. Indeed, the past year has often seen a pullback in a general "risk-off" trend ahead of such data. Stocks and bitcoin prices have therefore been on the decline. Falling inflation data could reverse the trend and push investors back into risk-on assets.

Should the data prove negative for bitcoin, we expect to find strong support around \$26,000. If the scenario is on the contrary positive, it is the \$28,400 area that should pose a first resistance in BTC's road to a retest of \$30,000.

Rivemont Investments, manager of the Rivemont Crypto Fund.

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