CRYPTO MARKETS HIT BY PHYSICAL SELLING PRESSURE AND LIQUIDATION OF SYNTHETIC LEVERAGED POSITIONS

Wisdomtree EU
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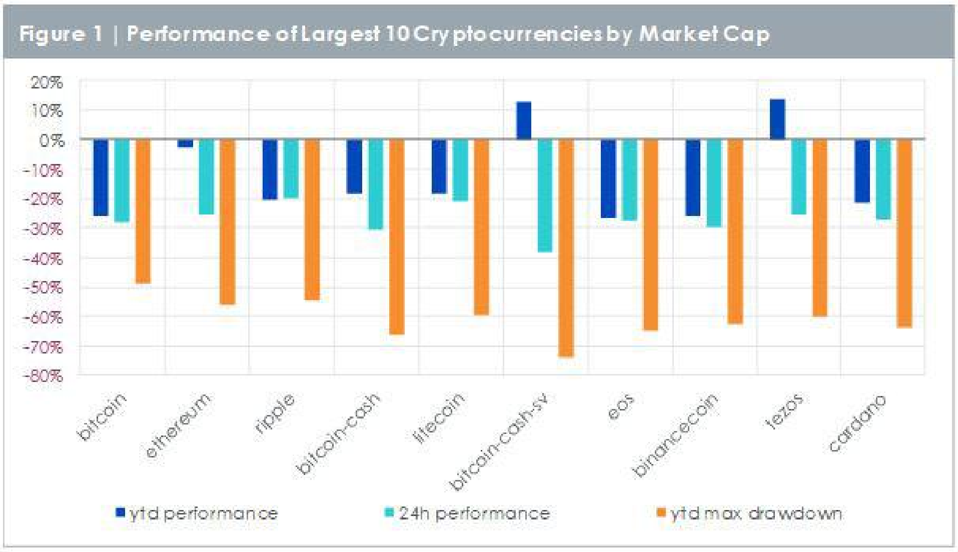
Digital assets have not escaped the liquidity crunch initiated by the COVID-19 panic.

Crypto markets have only become financialised in the last couple of years, so the current panic environment is the first stress test for assessing crypto’s reaction when traditional assets undergo sudden falls of historic proportions.
These last few days are proof that crypto markets can collapse with every other risky asset in time of intense stress. Markets dislocations and very low liquidity were visible on all assets across the board from treasuries and gold to equities and digital assets. It such extreme conditions it can be expected that no asset is immune.
We’ll probably witness a change in the crypto narrative from now on, as many believed cryptos to be a hedge against such events. Now, daily behaviour is one only part of the picture. We’ll be able to better assess crypto’s market reaction on longer time frames in the coming months, once the situation in traditional asset classes settles and possibly bounces back.

What Happened on Crypto Markets?

- Most of the largest digital assets are down 25-35% on the 12th of March, and down more than 50% from year-to-date (YTD) highs.

- The YTD performance is still relatively “normal” on crypto standards, with some assets still having a positive YTD performance.



Source: WisdomTree, CoinGecko. Excluding stablecoins. As of 13 March 2020, 9:00 UTC.

Historical performance is not an indication of future performance and any investments may go down in value.

- Bitcoin (BTC) price went from a high a little over $10,400 on the 13th of February to just under $3,800 on the 13th of March around 2:00 UTC (Binance spot market). (This low is not visible on the chart as it shows daily data points at 9:00 UTC).

Source: WisdomTree, CoinGecko. Excluding stablecoins. As of 13 March 2020, 9:00 UTC.

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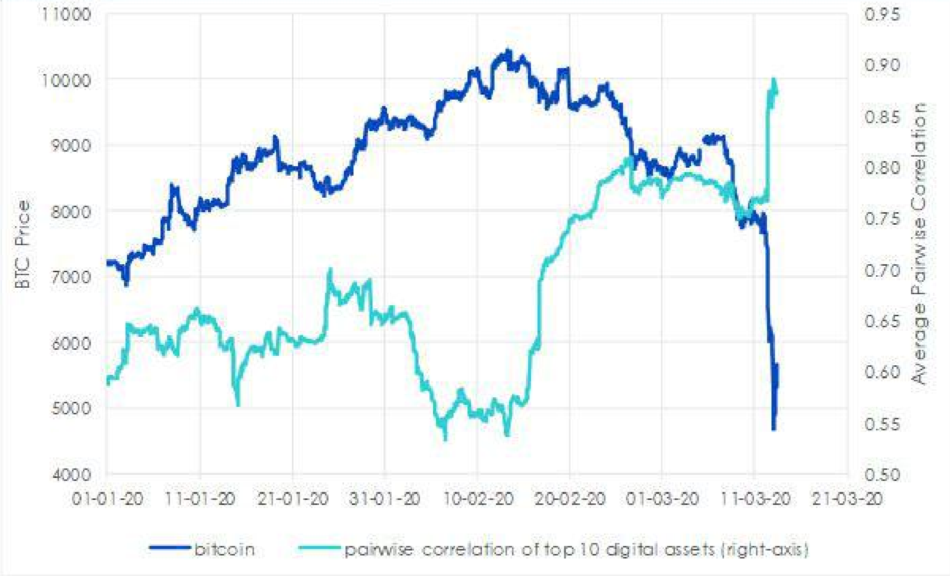
- Digital assets have shown that they can fall like the rest of the risky assets in times of intense stress, i.e. they become highly correlated to one another. Notice how the average pairwise correlation[1] shot up during the last few days, and even more so on the 12th of March to 0.9.

Figure 3 | Rolling 240-Hour Pairwise Correlation Between Largest 10 by Market Cap vs. BTC Price



Largest 10 are the same as in Figure 1.

Source: WisdomTree, CoinGecko. Excluding stablecoins. As of 13 March 2020, 9:00 UTC.

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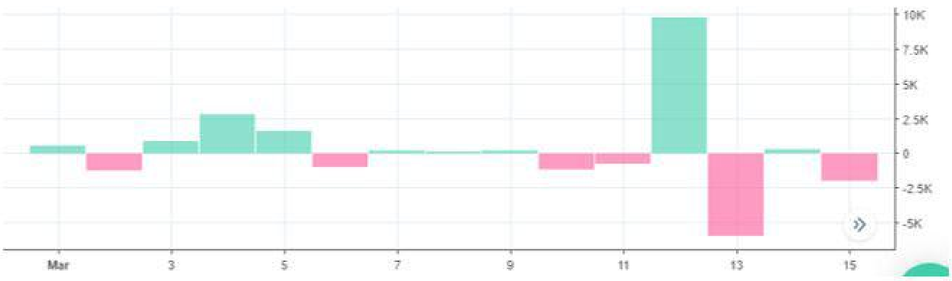
Why did the market fall by this extent?

Trading is still dominated by retail investors. Less sophisticated investors are more prone to fear and greed behaviour and were probably prone to intense panic selling as the price was dropping quickly. Furthermore, large amounts of digital assets have been sent to exchanges to be traded, as shown in the chart in figure 4. Other exchanges also show a large net inflow on that day.

Figure 4: Net BTC flows to Binance, in BTC



Source: TokenAnalyst. As of 15 March 2020.

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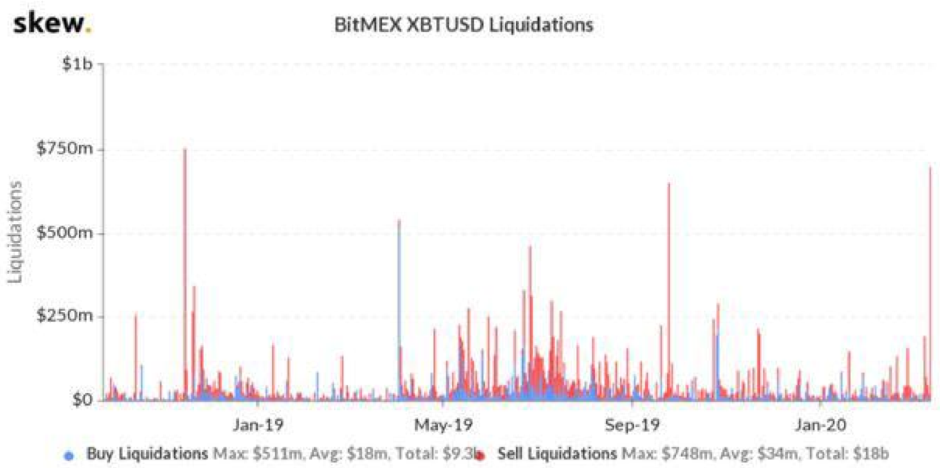
Furthermore, the derivatives market has become much more active than the spot market over the past couple of years. These leveraged positions get liquidated in the case of strong inverse movements. This tends to create a cascade effect were liquidations add to the selling pressure, sending the price lower, prompting more liquidations, etc… USD loans backed by BTC have suffered a similar fate and have been liquidated, which mechanically added to the selling pressure.



Source: Skew. As of 12 March 2020. BitMEX one of the leading exchanges in the derivative market. XBTUSD: bitcoin-USD market.

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[1] Pairwise correlation refers to the correlation of all possible pairs amongst the 10 selected assets.

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