

market notes: QT or not QT? The hated crypto rally.

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12/1/23 – Marcel Kasumovich, Deputy CIO, Coinbase Asset Management

1. Start, dammit! Staring at a blank screen, I need an idea to start. So, I start from the birth of an idea. Firing of synapses in the brain – that's the mechanical explanation for the root of an idea. They're in your head. Populate your mind with the richest set of experiences possible to broaden ideas. Social engagement. "Waste" time. Make more mental dots to connect. And remember the cardinal rule – there are no good or bad ideas, only good and bad execution.
2. Execution is everything. Satoshi designed a protocol inviting a network to build upon it. Uncertainty about its usefulness confuses bitcoin's valuation. Booms and busts are routine with bitcoin suffering six drawdowns of more than 50%. Despite the Coinbase Core Index having more than [doubled in value this year](#), sentiment is defensive. And after this massive rally, investors now want to know when the rise in crypto assets will fizzle. It's a hated rally.
3. Hated rallies are the norm after deep distress in periods of rapid change. It's the power of the bad – the tendency for the mind to fixate on the consequences of negative outcomes as a matter of survival. Ted Lasso provides the brilliant antidote – be like a goldfish and stop beating yourself up over recent losses. Of course, the crypto assets that survived the 2022 carnage are not only resilient, they form a stronger ecosystem with a greater and more certain value.
4. Evidence of a hated rally? Let's open three doors.
5. Behind door #1 – long-term holders dominate. Those holding bitcoin for longer than a year rose to [70.5%](#) this week, a record high (Figure 1). A high share of long-term holdings is typical during the early stages of a bull market, not ones that are losing steam. Speculative excess crests when short-term traders are dominating activity. Long-term holders are sending a simple message – it'll take a much greater price rise for them to sell. Don't count on it anytime soon.
6. Behind door #2 – speculators are silent. More than 93% of lifetime bitcoin supply is in circulation. Investors turn to synthetic bitcoin to satiate demand, like futures, when long-term holders are reluctant sellers. The forward cost of owning a derivative of bitcoin rises with investor demand. Today, being long bitcoin through three-month futures costs an extra 6.5% annualized – juicy for arbitrageurs versus last year, but modest against policy rates.

7. Behind door #3 – beautifully boring volatility. Option markets provide rich detail on speculative investor sentiment – and it is definitively benign. The rise in crypto markets saw increased demand for option structures to benefit from a continuation of the trend. But it's modest. One-month, 25-delta bitcoin calls are a 5% annualized volatility premium to puts, a fraction of periods where investors are scrambling for upside like 2021. It's a sign of investor indifference.
8. Hated rallies are the foundation of a long bull market. Investors missed the FTX debacle as a buying opportunity for bitcoin and ether. And now, after a 2-fold rise from those lows, the focus is on buying a big dip. The coincidence of the halving of bitcoin supply and prospects for Fed easing – combinations that occurred in the three previous halving cycles – merely adds to the case for an extended rally. Hated rallies only end when love reenters the market.
9. It's inviting to see the dovish pivot of major central banks as the love connection to rising crypto assets. It is. But don't get lazy. Hunt for ways where the simple consensus can be wrong. Plumbing. It's always in the plumbing pipes. Crypto asset markets have risen sharply despite the Fed not only hiking rates but also shrinking its balance sheet with fewer bond holdings – a double-tightening. But there are important subtleties with big implications.
10. Quantitative tightening (QT) is associated with tighter liquidity conditions. Obviously. QT typically means that central bank balance sheets are shrinking. One problem – this isn't your typical cycle. The peak liquidity tightening actually happened in February 2023, triggering regional banking strains in March. Since then, liquidity conditions have eased materially despite QT. Liquidity conditions are the easiest on record outside of the COVID bubble!
11. The hated crypto rally is restraining speculative activity – a green light for the bullish trend to continue. Prospects for Fed easing add to it – recession or not. But don't forget liquidity conditions. This year's liquidity easing will flip to tightening next year. Strains would be brief – consensus is desperate to buy the dip, and the Fed stands ready to make it so. Don't be surprised if forward looking markets sail on – Market Gods love a good pain trade.

Figure 1: Want Bitcoin? Long-Term Holders Not Giving It Up!



Source: Glassnode Studio.

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