October 25, 2022

GSR OTC Trading Commentary

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GSR OTC Trading Desk

MACRO + CRYPTO SUMMARY

The last few weeks witnessed a bevy of macro data releases. The first was a higher-than-expected PPI report, followed by somewhat mixed FOMC minutes. A day later came the hot CPI release, which was 0.1% above expectations and showed a hefty 8.2% year-over-year increase in headline inflation, causing risk off in the markets. The DXY and yields increased, market participants priced in a 20% chance of a 100 bps Fed hike in November, and gold, crypto, and stocks fell materially. Negative performance reversed, however, when the ECB put out a lower-than-expected terminal rate projection, which caused stocks to rip higher and erase the losses following the CPI report. Makes total sense. I mean, it is not like central banks are bad at forecasting or anything.

The broader markets have been rather unremarkable since then, with a slight risk on bent and a few bouts of action here and there. The BOJ once again intervened in the currency markets to prop up the JPY, causing some punchy-looking hourly candles. The UK said goodbye to newly-elected Prime Minister Truss after just 45 days in office, giving way to Rishi Sunak, who now gets a go. And finally just this past weekend, Chinese President Xi tightened his grip on power, causing stocks in the country to crash (the Hang Seng fell 6% to a 13-year low) and the pressure on CNH to continue (CNH hit a record of 7.31).

Market participants will now turn their attention to next week's FOMC meeting. Even though there are theoretically a lot of pressure points in the markets, the general pattern in the FX and crypto markets has been that of sharply sinking realized volatility, which may persist at least until the Fed meeting.

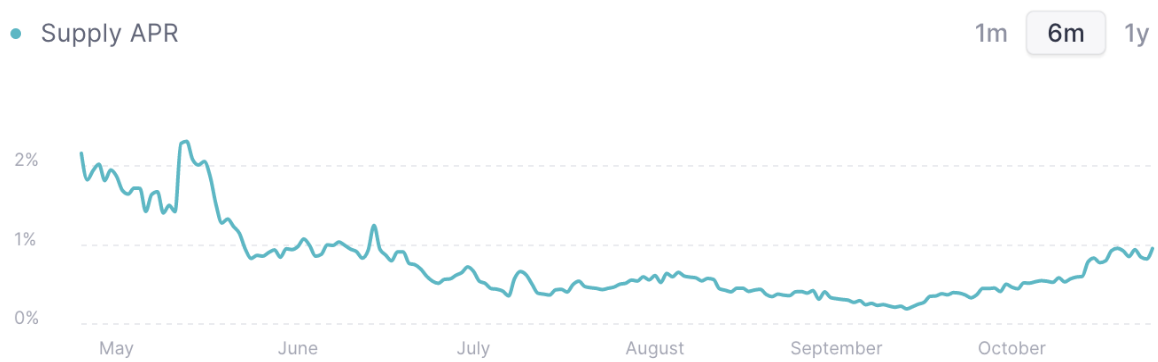
RATES, FUNDING AND BASIS

As touched on in previous OTC commentary, the disconnect between the "risk-free" rate in crypto and in traditional financial markets continues to grow. Persistent hot inflation readings and hawkish central bank rhetoric have resulted in the 3 month USD T-bill rate pushing north of 4%, while stablecoin deposit rates for USDC in DeFi are sub-1%.

U.S. 3 Month Treasury Yield

Source: CNBC, GSR

USDC Supply APR on Aave

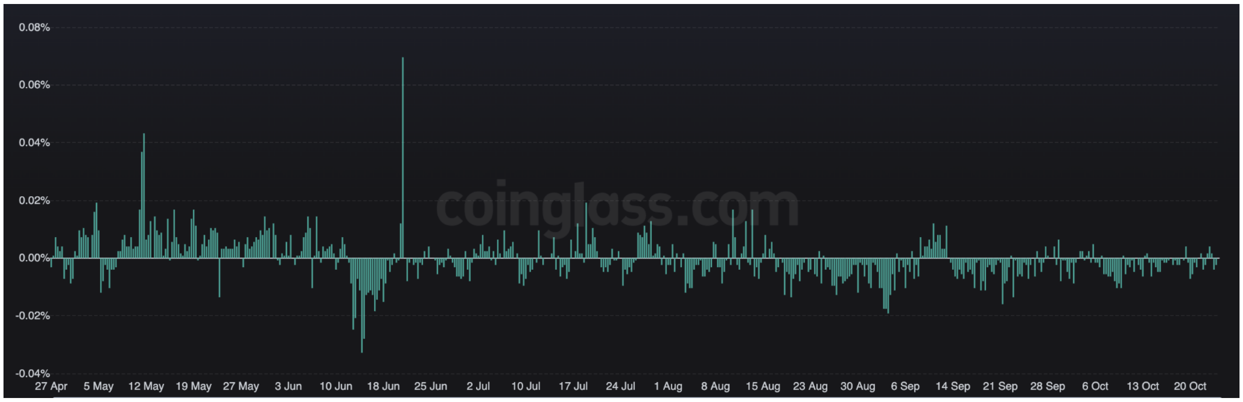


Source: Aave, GSR

The continued widening of this spread may ultimately result in some amount of arbitrage capital leaving crypto in the form of stablecoin redemptions to attain the higher yields on offer in traditional finance. Given the above, the fact that a spread of this magnitude persists speaks to the substantial portion of capital in the space seeking a “safe-haven” outside of traditional financial markets.

In perpetual swaps, BTC and ETH rates have remained marginally negative, which is consistent with the aforementioned low stablecoin rates in DeFi. The persistence of negative funding rates speaks to the bearish net positioning in the market from hedging and speculative interests. As the bear market has dragged on, participants have stepped up hedging programs, which in turn pressure funding rates lower.

BTC Eight-Hour Perpetual Funding Rate



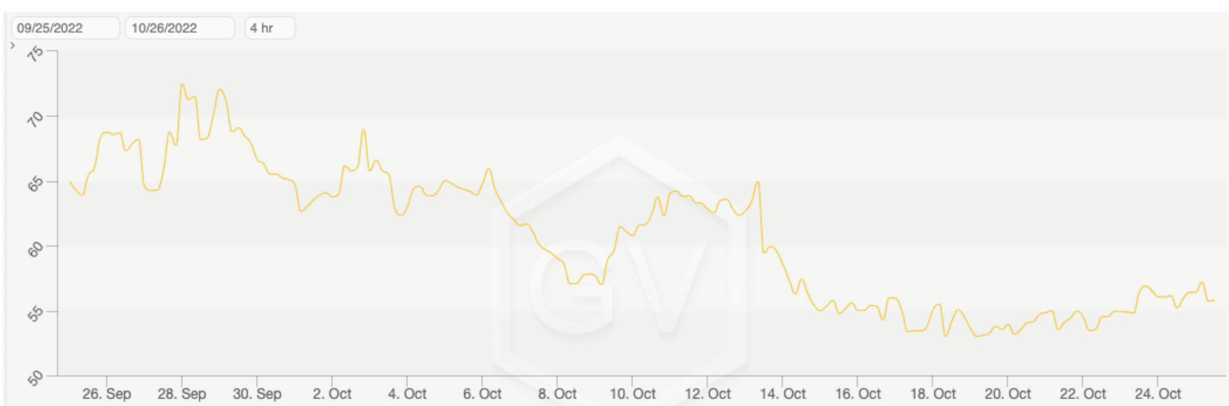
Source: FTX, GSR

DERIVATIVES

BTC Derivatives

BTC implied volatility continues to trend lower with 30 day IV at 56% and 7 day IV at 46%. Until there is a convincing break away from the current $19,000 range for BTC, the decline in implied volatility may continue, and one could even argue that current levels are overpriced compared to realized volatility, with realized volatility at just 20%.

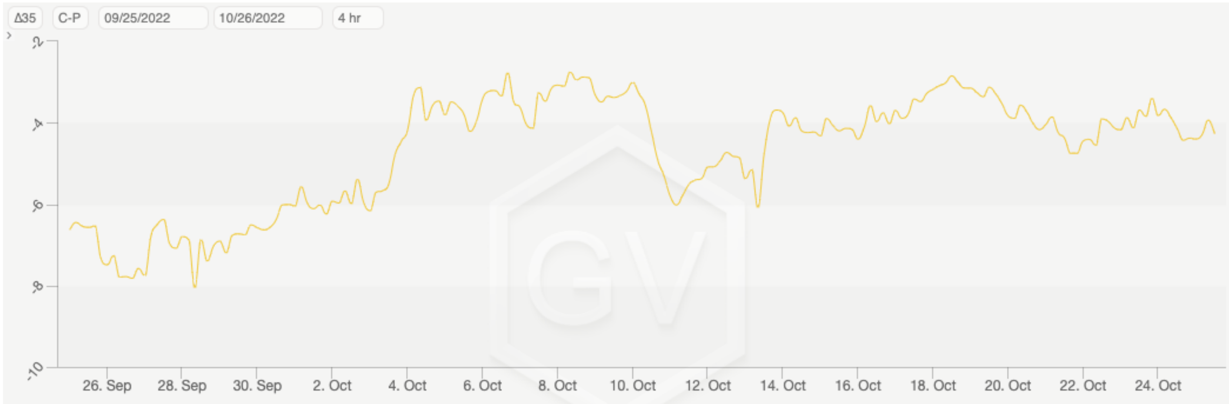
BTC 30 Day ATM Implied Volatility



Source: Genesis Volatility, GSR

Call skew (measured C-P) at the 35 delta level has been trending higher recently, up from -8.0% to roughly -3.8%, indicating an increased demand for calls potentially due to expectations of an upside breakout given strong support at $18,000.

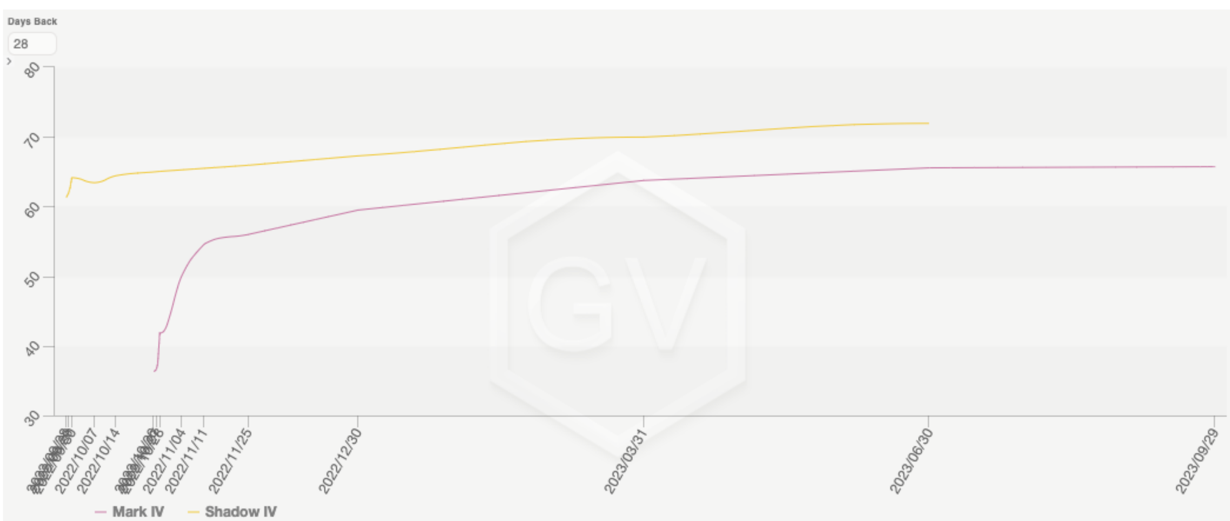
BTC 35 Delta Call Skew



Source: Genesis Volatility, GSR

While term structure is in contango and realized volatility in the near-term continues to remain suppressed, implied volatility suggests a potential reversion higher into year-end as the 30DEC22 expiry trades at an 8 IV premium to the 04NOV22 expiry.

BTC Term Structure



Source: Genesis Volatility, GSR

ETH Derivatives

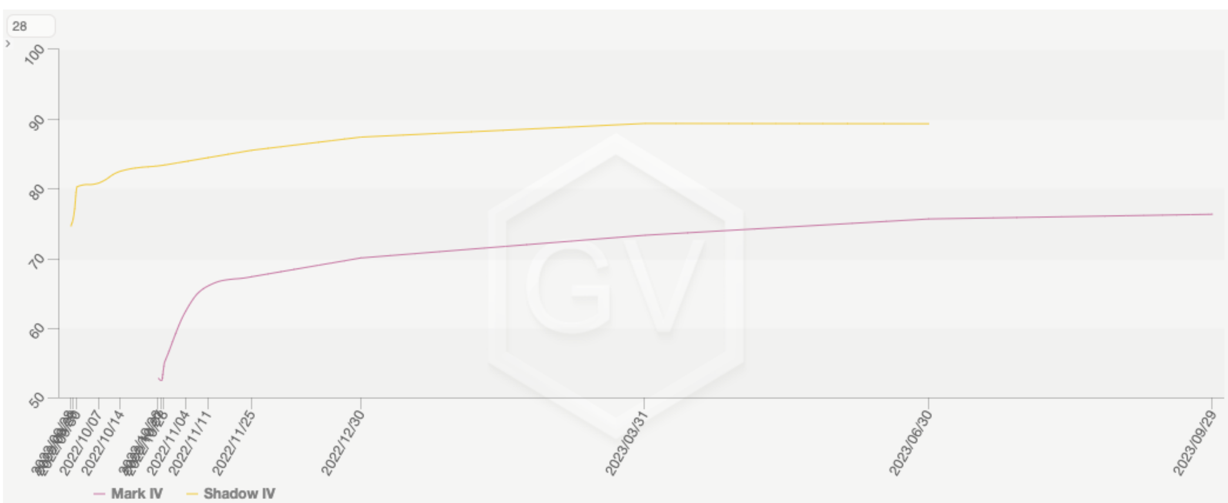
ETH realized volatility is currently at 36%, almost two times that of BTC despite this ratio typically being much lower, usually around 1.3x. 30 day implied volatility is approaching yearly lows, currently at 67% compared to the low of 60% in April.

ETH 30 Day ATM Implied Volatility

Source: Genesis Volatility, GSR

The 35 delta call skew has trended higher, although the 35 delta call still trades at an IV discount to the 35 delta puts and term structure exhibits a similar story to that of BTC.

ETH Term Structure



Source: Genesis Volatility, GSR

ETH Skew

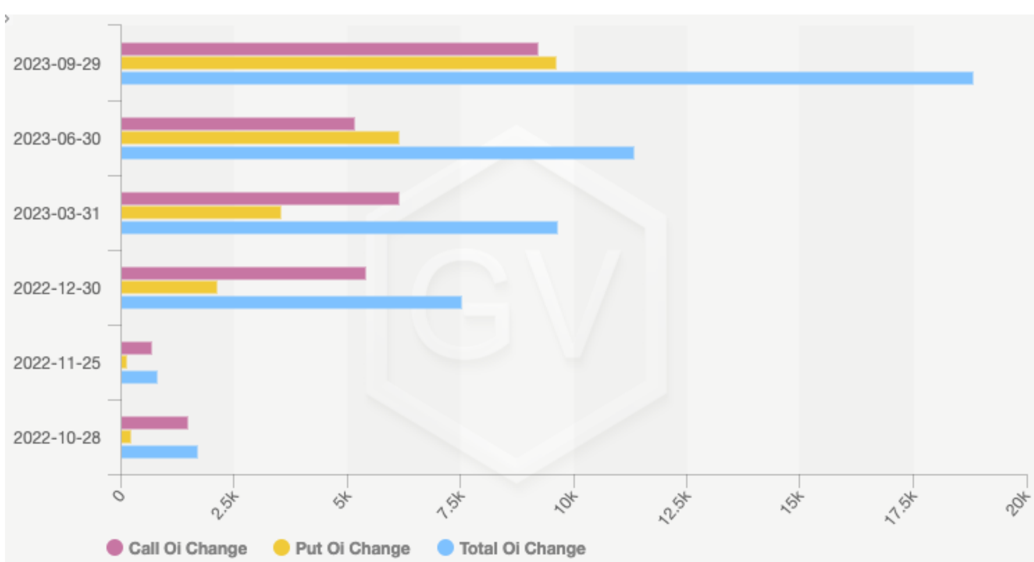
Source: Genesis Volatility, GSR

FLOWS AND LIQUIDATIONS

The past two weeks have been relatively uneventful with mainly range-bound trading and few liquidations. Interestingly, there has been a large amount of open interest in longer dated expiries in the June-September 2023 tenor, both for BTC and ETH.

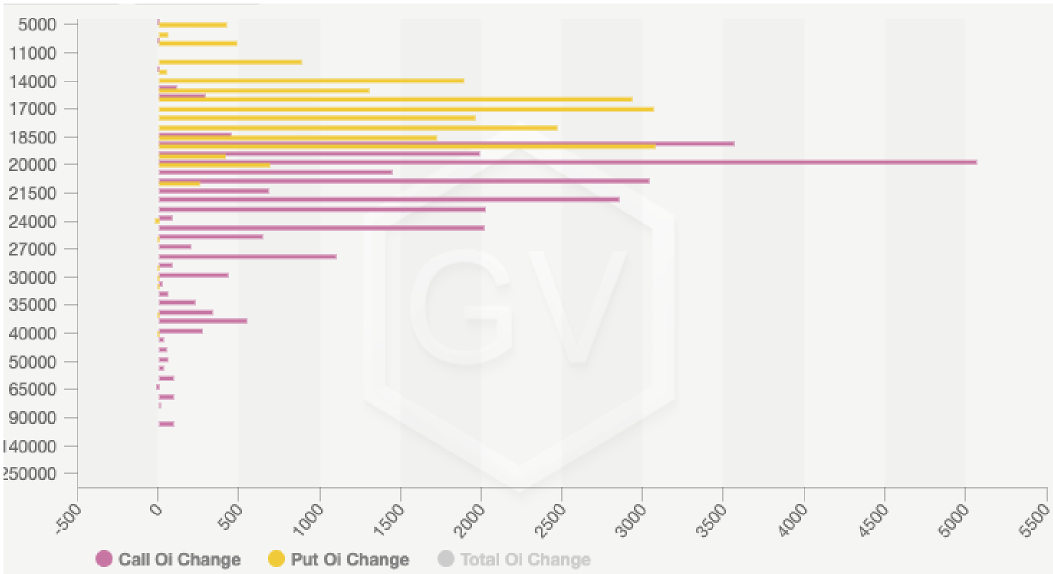
In BTC, calls with 19,000, 20,000, and 21,000 strikes have seen the greatest increase in open interest, while the greatest OI increase for puts has been in the 16,000 to 19,000 strike range. Also note the imbalance between calls and puts for BTC, with particularly large amounts of call open interest blocked at the December 30th expiry.

BTC Historical OI Change By Expiration



Source: Genesis Volatility, GSR

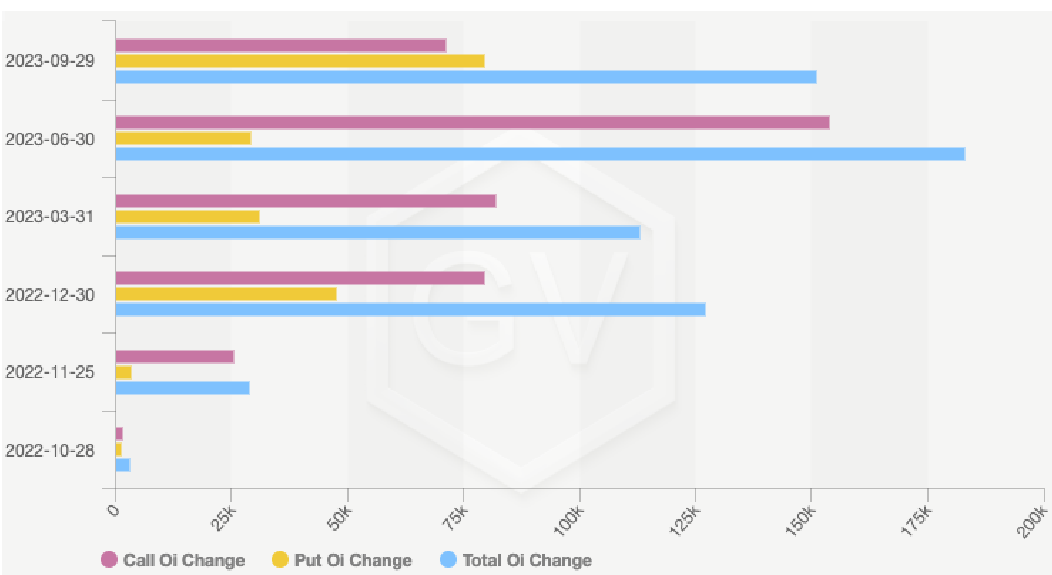
BTC Historical OI by Strike



Source: Genesis Volatility, GSR

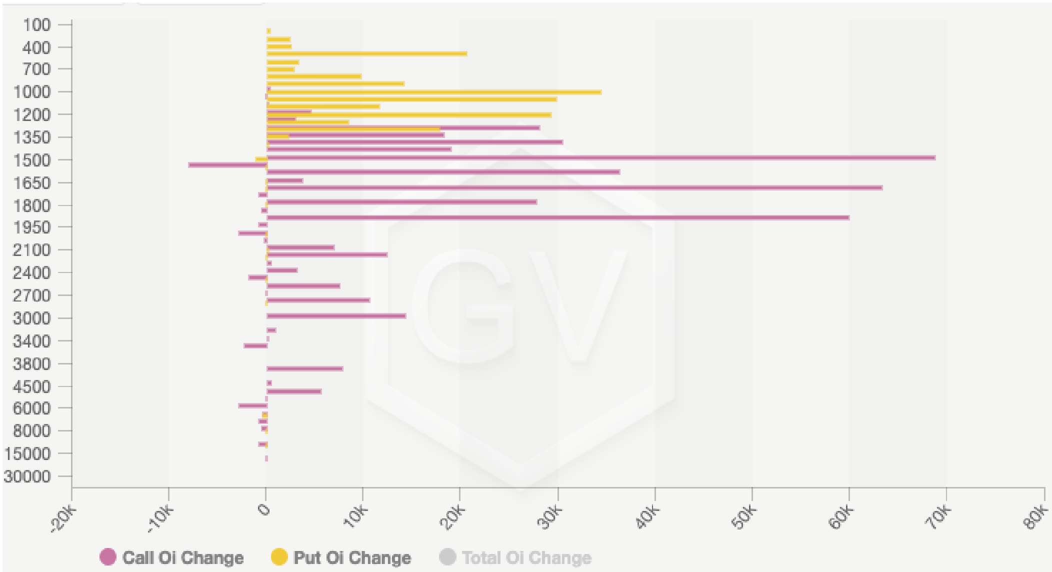
In ETH, the greatest increase in open interest has been in the 1,500, 1,700, and 1,900 strikes for calls, and in the 500 and 1,000 strikes for puts. There is also a noticeable imbalance in open interest with calls being dominant in all tenors other than September 2023.

ETH Historical OI Change By Expiration



Source: Genesis Volatility, GSR

ETH Historical OI Change by Strike



Source: Genesis Volatility, GSR

Liquidations have remained relatively tame with the most notable exceptions over the past two weeks occurring on October 12th and 13th where a combined $260m in longs and $160m in shorts were liquidated. Last week saw a tick up in average long liquidations, but this is relatively unnoticeable compared to the larger liquidations in September and October.

DeFi

Recent events in DeFi have reminded us that it is necessary to continuously evaluate the risks of participating in such protocols. Mango Markets was the latest victim of an exploit that saw the protocol completely drained of its insurance fund (after the exploiter returned some of the funds). It is necessary to continuously evaluate risk parameters with each and every asset with platforms that allow cross-collateralization in a range of assets, as one bad apple may bring down the rest. In Mango's case, their native MNGO token had fallen enough in price and liquidity for the oracle price to be manipulated, allowing the exploiter to use unrealized PnL from another account to withdraw all assets from the platform. Subsequently, we also saw the same style of attack on Moolah Markets, a borrow-lend platform on the Celo blockchain.

Elsewhere, Aptos successfully launched last Tuesday, with its APT token instantly becoming one of the most traded across all exchanges. On-chain DeFi applications are now scaling up, likely making it an opportune ecosystem for trading and other DeFi strategies.

Authors

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About GSR

GSR has nine years of deep crypto market expertise as a market maker, ecosystem partner, asset manager, and active, multi-stage investor. GSR sources and provides spot and non-linear liquidity in digital assets for token issuers, institutional investors, miners, and leading cryptocurrency exchanges. GSR employs over 300 people around the globe, and its trading technology is connected to 60 trading venues, including the world's leading DEXs. We have a culture of approaching complex problems with tenacity and imagination. We build long-term relationships by offering exceptional service, expertise and trading capabilities tailored to the specific needs of our clients.

Find out more at www.gsr.io.

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