ALT 5 – DIGITAL ASSETS WEEKLY

Macro pressures ripple through the crypto infrastructure

NEW YORK, NEW YORK, US, May 13, 2022 /EINPresswire.com/ -- ALT 5 Sigma Inc. a global fintech that provides next generation blockchain powered technologies for tokenization, trading, clearing, settlement, payment, and insured custodianship of digital instruments releases its Digital Assets Weekly.

• Crypto stresses start with the same macro backdrop pressuring risk assets…

• .leaving digital assets more exposed to crypto-specific developments

• Stablecoin losses have implications for regulation, valuation, and critical analysis

Dramatic declines in digital assets this week, including major and alt coins, as well as some (previously) stablecoins, have left mark on sentiment and the P&L of market participants. The fuller implications will only be felt over time but there are some takeaways that are likely to impact trading and price action over the near-term.

The latest declines in digital assets are clearly tied to more crypto-specific developments, which are highlighted below. But the shifting macro backdrop continues to be a key catalyst for markets.

Macro matters

The underlying force driving the selloff in crypto and other financial assets is diminishing global liquidity, in our view. High inflation is prompting policy tightening by the Federal Reserve and other central banks. The result is that the liquidity which boosted the prices of financial assets for roughly 1-1/2 years starting in the Spring of 2020 has started to recede, reducing some portion of support for financial assets, including that for crypto assets.

Importantly, decline in global liquidity is hardly complete. It is true that interest rates have already adjusted markedly higher, although that process is further along in places such as the US versus that in Europe or Japan.

However, the excess liquidity stemming from central bank asset purchases (quantitative easing) remains largely in place and will only be drawn down in the coming 1-2 years. The withdrawal of that liquidity could also create headwinds for financial assets going forward.

The fiscal drag from reduced covid-related spending

Also, fiscal stimulus (government spending) has also declined dramatically relative to the first year-plus of the pandemic. That is especially evident in the US, where covid-related spending was proportionally higher than in some other countries.

Analysis by the Brookings Institution shows reduced fiscal spending subtracted nearly 3% from US GDP in Q1 and was likely to reduce growth by 2%-3% in the remainder of this year. That outlook highlights some of the downside risks to economic growth (alongside Fed tightening and high inflation) that are also pressuring crypto and other financial assets.

Stablecoin stumble

Digital assets have had their own specific challenges. Some decentralized finance (defi) protocols that benefitted and relied on the continued rise in the price of the tokens used to stake or collateralize those projects have been left exposed as underlying token prices have fallen.

The collapse of the TerraUSD (UST) and the token LUNA, which is used in an algorithm to hold UST's value at 1:1 to the US dollar, has shaken the crypto landscape. The complex situation started with outsized withdrawals of UST from decentralized finance (defi) protocols last week. UST had been a popular token to "stake" on defi protocols, some of which paid yields near and above 20% annualized.

The Luna Foundation Guard (LFG), which supports UST and LUNA, had been very publicly buying bitcoin as a backing asset of LUNA for several months. But the recent decline in the price of bitcoin also reduced the value of that backing. Perhaps related to the reduced bitcoin valuation, those withdrawing UST that would normally accept LUNA on a 1:1 basis to TerraUSD no longer wanted the LUNA token but instead wanted US dollars. Moreover, the LFG reportedly lent (or spent) all its bitcoin in an effort to support LUNA. The bitcoin selling did not support LUNA, but it added to the latest wave of bearish sentiment in bitcoin.

The spiral of selling left both UST and LUNA dramatically lower. By week's end, UST was quoted at 10-cents, down from near $1 the week before, and LUNA was quoted at less than 1-cent, down from above $80 the previous week (data according to coincap).

Contagion in crypto

Moreover, the collapse of UST and LUNA not only generated contagion, weighing on bitcoin and other major crypto assets, the bearish sentiment also spilled over into other stablecoins.

Tether (USDT) is the largest stablecoin by market capitalization and also pegged at 1:1 to the US dollar. This week it briefly traded below 96-cents, causing the organization's chief technical officer to tweet that tether is honoring USDT redemptions at $1, and had made $600 mln in repayments to USDT holders during the market selloff.

Unlike TerraUSD, Tether is a collateralized stablecoin, backed by liquid assets such as short-term Treasury securities, commercial paper and cash. That means it has the ability to redeem outstanding tokens with US dollars on a 1:1 basis.

TerraUSD is an algorithmic stable coin based on a protocol that sold UST for LUNA, and vice versa, in order to hold UST's 1:1 peg. However, collateral backing for LUNA was limited relative to its outstanding tokens, leaving both it and UST exposed when prices—and investor confidence in the both tokens—began to fall.

The distinction between collateralized and uncollateralized stablecoins clearly matters when market stresses develop and crypto prices more broadly are falling, and ultimately favors the former over the latter. That was demonstrated in the relatively modest losses and quick recovery in USDTs price versus the continued weakness in UST. It may also be a warning shot to other algorithmic stablecoins.

Major crypto assets had already been under some pressure ahead of these events, along with the decline in risk assets broadly against the deterioration in the macro backdrop. But these crypto-specific developments have accelerated the declines in digital assets broadly.

Key takeaways

Although bitcoin and ether stabilized and recovered modestly at the end of the week (and some alt coins registered more sizeable gains), it is not clear that the impact from these events has completely played out. On reflection, there are several takeaways to consider thus far.

First, the collapse in TerraUSD caused significant losses among investors, including individuals. That is the type of event that will almost surely draw more regulatory scrutiny. Ultimately that should be a positive and welcome development, although the shape and timing of such measures remains highly uncertain.

Second, there is now much more bad news in the price of digital assets than there was just a few months ago (or a week ago). That does not mean a bottom is in place, particularly given the difficult macro backdrop. But it does leave crypto assets at more attractive valuations.

Third, it would be constructive if the episode encourages a more critical analysis of protocols, projects and use cases within the digital asset space by both institutional and especially individual investors. If so, the projects which score high on those criteria could well benefit on a relative value basis.

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ABOUT ALT 5 Sigma

ALT 5 Sigma is a global fintech that provides next generation blockchain powered technologies for the trading, clearing, settlement, payment, and insured custodianship of digital instruments. ALT 5 was founded by financial industry specialists out of the necessity to provide the digital asset economy with security, accessibility, transparency, and compliance. ALT 5 provides its clients the ability to buy, sell and hold digital assets in a safe and secure environment deployed with the best practices of the financial industry. ALT 5 Sigma's products and services are available to Banks, Broker Dealers, Funds, Family Offices, Professional Traders, Retail Traders, Digital Asset Exchanges, Digital Asset Brokers, Blockchain Developers, and Financial Information Providers. ALT 5's digital asset custodian services are secured by Fireblocks.

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