May 2022

KAIKO | Research

Monthly Market Report

A data-driven deep dive on the month's most significant market events.

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MONTHLY OVERVIEW

May was one of the most bearish months in recent market history following the collapse of the once third largest stablecoin by market cap - TerraUSD (UST). UST's implosion reverberated throughout the entire industry, hitting stablecoins and DeFi protocols particularly hard. Tether registered a $11bn drop in market cap after it de-pegged during the worst of the sell-off, and it continues to trade at a slight discount to the USD. Despite a global recovery in risk sentiment, most crypto sectors underperformed traditional assets by a large margin. However, the industry keeps building and growing: A16Z announced the largest crypto fund ever, Robinhood launched a DeFi wallet, and JP Morgan started a blockchain settlement trial.

Written by Dessislava Aubert, Riyad Carey, Clara Medalie with help from the research team.

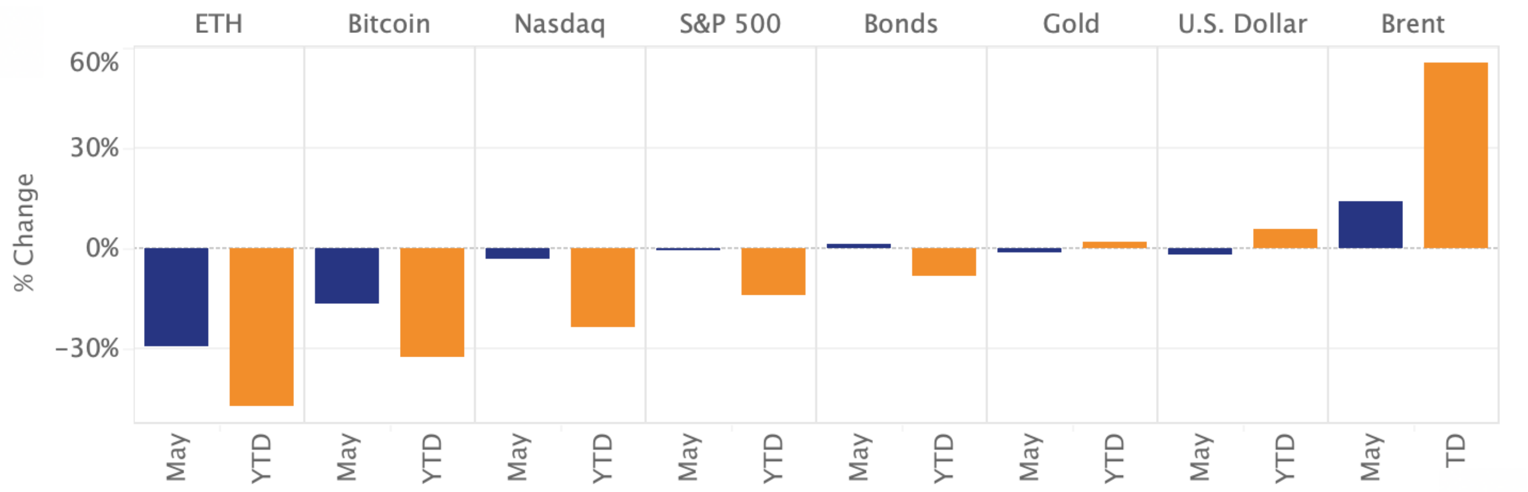
About Kaiko

Kaiko is the leading cryptocurrency market data provider for institutional investors and enterprises. We empower market participants with accurate, transparent, and actionable financial data to be leveraged for a range of market activities. Our institutional grade data services enable seamless connectivity to historical and live data feeds across 100+ centralized and decentralized exchanges. Contact us at here to learn more about our data and research services.

Crypto Markets Underperform Risk Assets

In May, cryptocurrency markets witnessed one of the largest financial collapses in history following the catastrophic implosion of TerraUSD, the algorithmic stablecoin native to the Terra blockchain. Both Bitcoin and Ethereum ended the month deep in the red, underperforming other risk assets by a large margin, which also suffered losses despite a recovery in risk sentiment. ETH is down nearly 50% YTD amid strong DeFi outflows and a drop in NFT activity. BTC and equity indices are both down double digits YTD, while the U.S. Dollar has surged to multi-year highs.

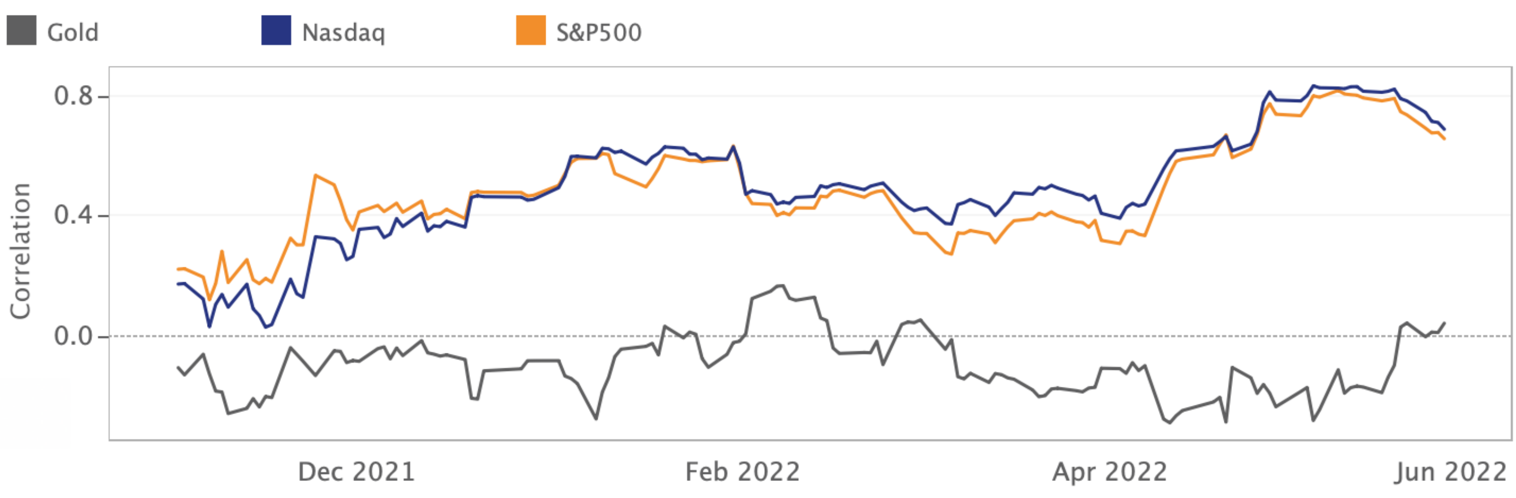
May and YTD Returns



Source: Kaiko asset prices and Refinitiv for Oil: ICE Brent Future, Bonds: AGG, Gold: Comex Gold Composite Commodity Future.

At the beginning of May, Bitcoin's correlation with equity indices reached all time highs as both asset classes suffered steep sell-offs. Yet, by the end of the month, this trend reversed sharply following reports of slowing U.S. inflation, rising consumer spending and a repricing of Fed rate hike expectations. Terra's collapse contributed to the divergence in market trends, with correlations now at 2-month lows.

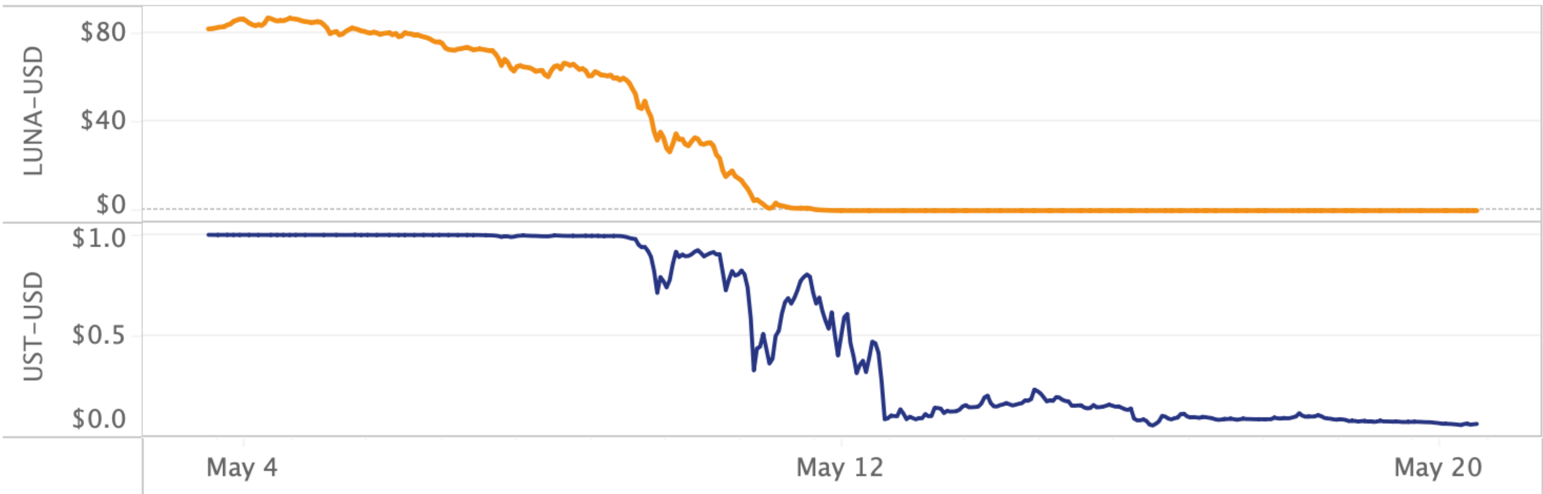
Rolling 30D Correlation With Bitcoin



Terra Collapse Destroys Billions in Value

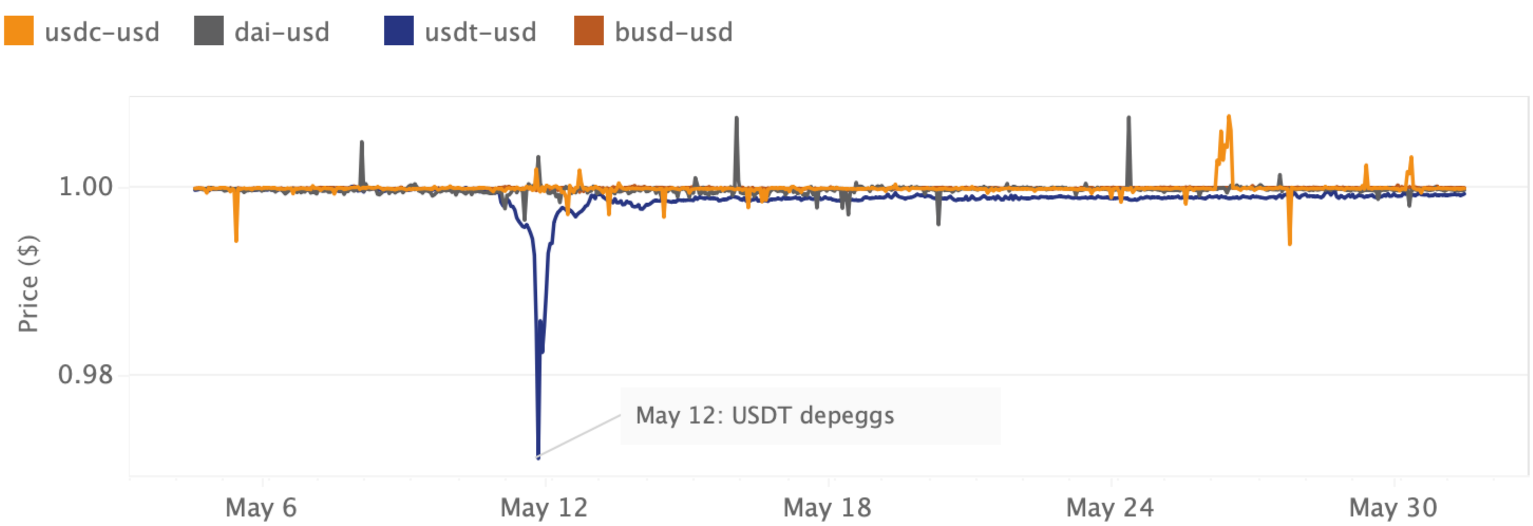
TerraUSD (UST) was one of the fastest growing cryptocurrencies in market history, surging from $2b to $18b marketcap in just 6 months. Yet, the growth was boosted almost entirely by Anchor protocol, a lending protocol on the Terra blockchain offering unsustainably high yields on UST deposits. UST was backed by a mint and burn mechanism using the token LUNA, in addition to more than $3bn of Bitcoin reserves to maintain its peg. This mechanism was put under pressure following a period of significant UST selling, low liquidity, and falling crypto prices, creating a death spiral for both UST and LUNA: as UST de-pegged, traders rushed for the exits to cash out into LUNA, which in turn experienced hyper inflation. The billions in BTC reserves failed to save the peg, and today, both assets are trading at near zero. In total, more than $40bn in network value evaporated, all but destroying this algorithmic stablecoin model.

LUNA and UST Collapse



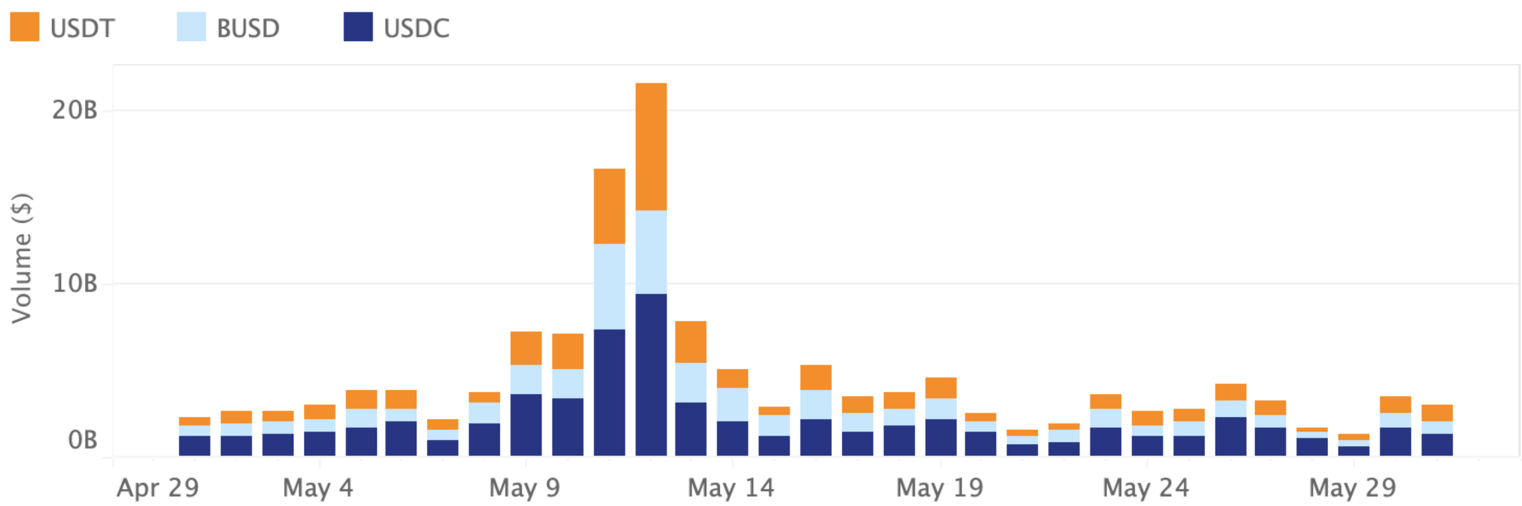
UST's collapse triggered a brief loss of confidence for Tether, the largest asset-backed stablecoin. Since the start of May, Tether's circulating supply has plummeted by $11 billion and the stablecoin continues to trade at a persistent discount to he U.S. Dollar after de-pegging to as low as $.96 on some exchanges.

Tether Trades at a Discount



As UST and USDT de-pegged, stablecoin volumes on centralized exchanges surged to an all time high of more than $20B as traders sought to rotate funds out of "riskier" stablecoins and into safer options such as USDC. Throughout the month, USDC's marketcap surged by more than $5 billion, while other stablecoins registered large redemptions. For a time, USDC and BUSD traded at a premium to USDT, enabling traders to profit off of price discrepancies. Typically, stablecoin trading pairs on CEXs experience relatively low trade volumes, and by the end of May volumes re-adjusted to pre-UST collapse levels.

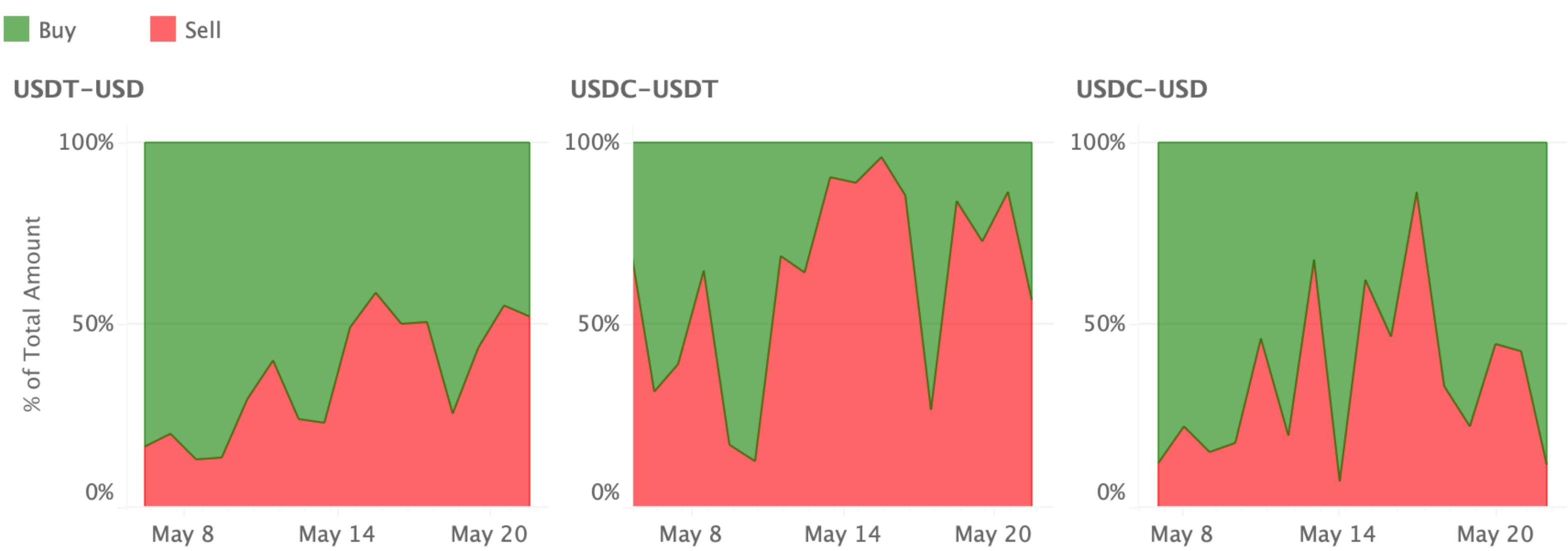
Stablecoin Trade Volume Surges to All Time Highs



Source: Kaiko asset prices and volume for the 20 most traded pairs with usdt, usdc and busd as a base asset.

Looking at buy/sell ratios, we can observe how traders reacted to stablecoin volatility during the worst of the collapse. On Bitfinex (the exchange that shares a parent company with Tether), the sell ratio for Tether soared between May 8-20, suggesting heavy outflows. For USDC, sell volume surged in the immediate aftermath of UST's collapse, but over the following week buys far outweighed sells. The most interesting buy/sell ratio lies in the USDC-USDT pair, which suggests that traders profited off of USDT's persistent discount.

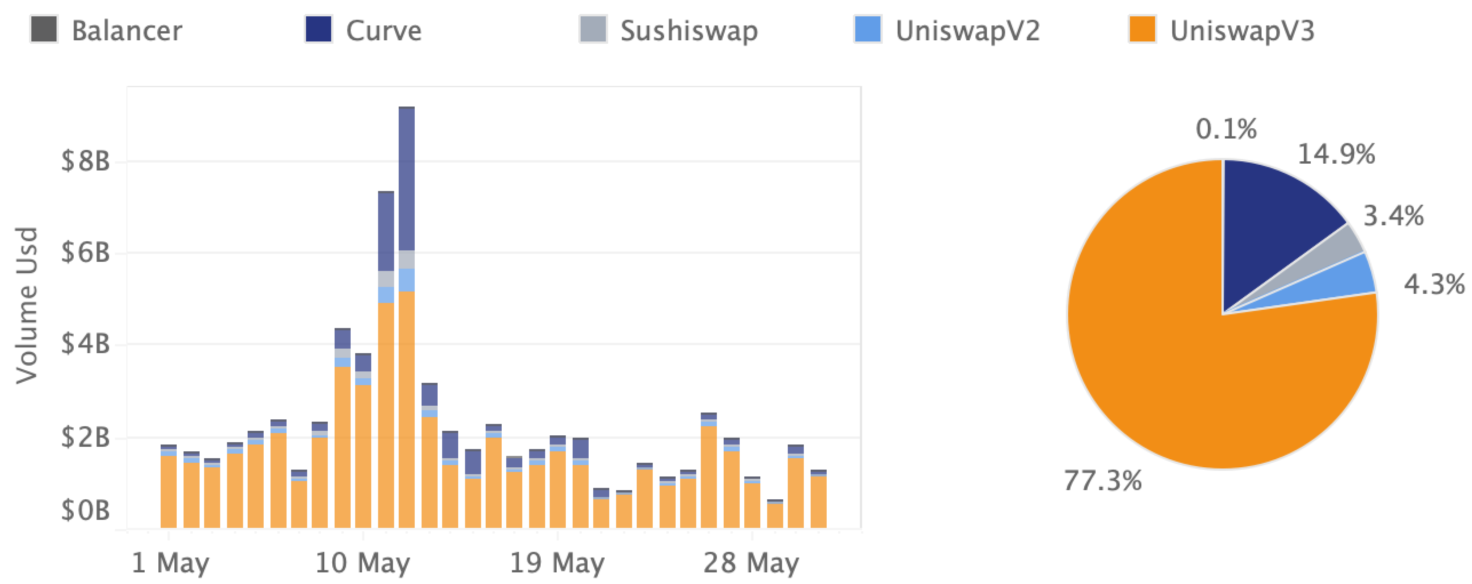
Buy/Sell Volume on Bitfinex



Curve Volume Surges as DeFi Tokens Sink

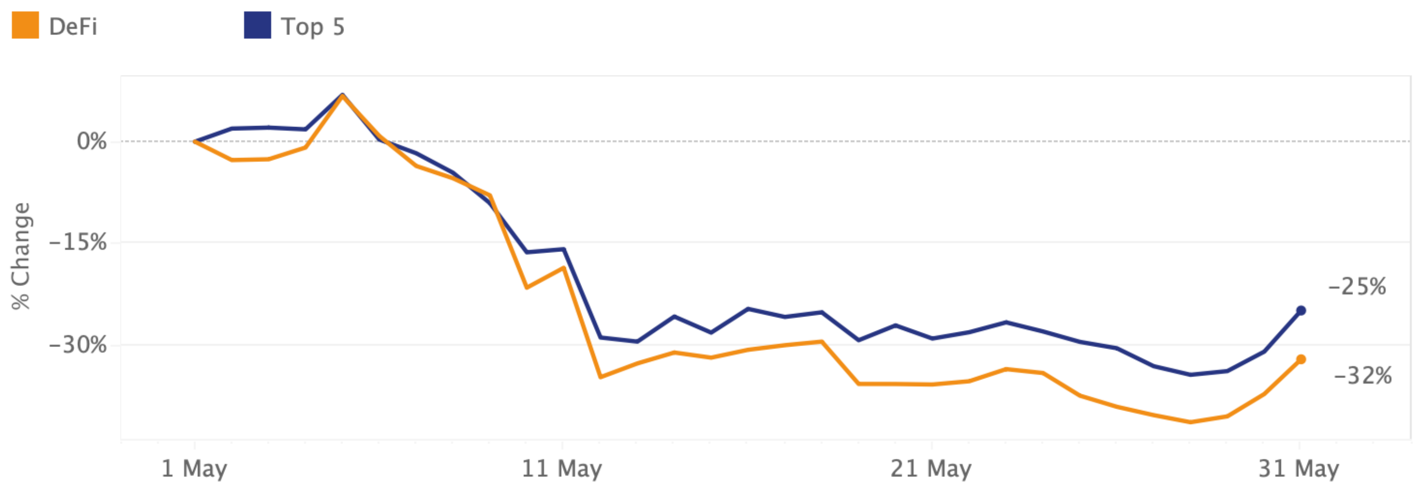
The decentralized exchange Curve played a role in UST's collapse when its popular stablecoin liquidity pools experienced a spike in selling pressure. The DEX experienced all time high volumes of more than $3bn as investors rotated funds into “safer” stablecoins such as USDC. Overall, Curve’s market share rose to 15% in May, up from 5% the month before.

DEX Trade Volume and Market Share in May



Despite the surge in DEX activity, the DeFi sector was hit particularly hard by Terra's implosion. The total value locked in DeFi protocols plummeted by over 40% in May, signalling strong outflows from the space. DeFi tokens ended the month as some of the worst performers, underperforming the top five crypto assets. MKR, the native token for lending protocol Maker, fared better than other projects due to the continued stability of DAI, the protocol's overcollateralized stablecoin.

May Returns - DeFi Tokens vs. Top 5 Crypto Assets

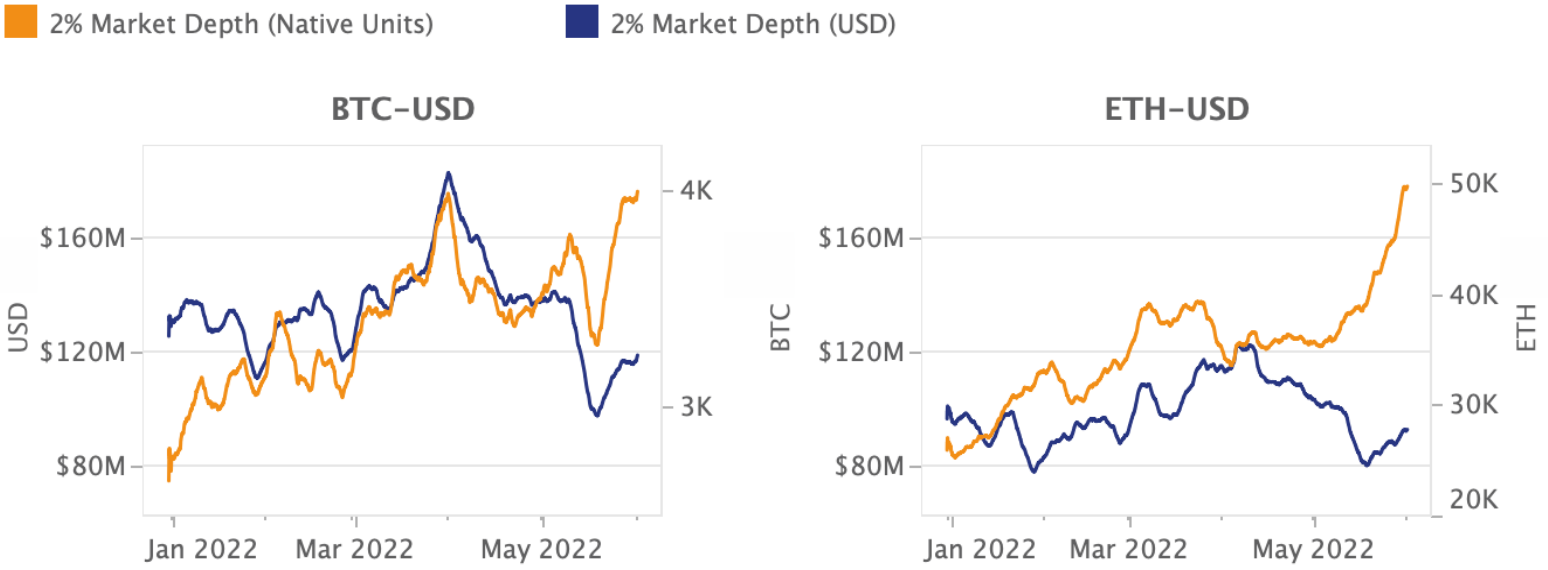


Source: Kaiko valuation data. DeFi: mkr, crv, ldo, aave, uni. Top 5: btc, eth, bnb, ada,xrp.

Market Liquidity Rebounds After Volatility

Market depth for BTC-USD and ETH-USD pairs experienced strong volatility in the midst of Terra's collapse and wider market sell-off. In native units, BTC depth declined to its lowest level since March before quickly recovering to its highest level this year. Meanwhile. ETH depth remained mostly steady before surging, ending the month at more than double where it began the year. However, as a result of slumping prices, both pairs experienced a decrease in USD-denominated market depth, with BTC's being more significant. By this metric, BTC market depth declined to its lowest level this year, while ETH tagged a low not seen since February.

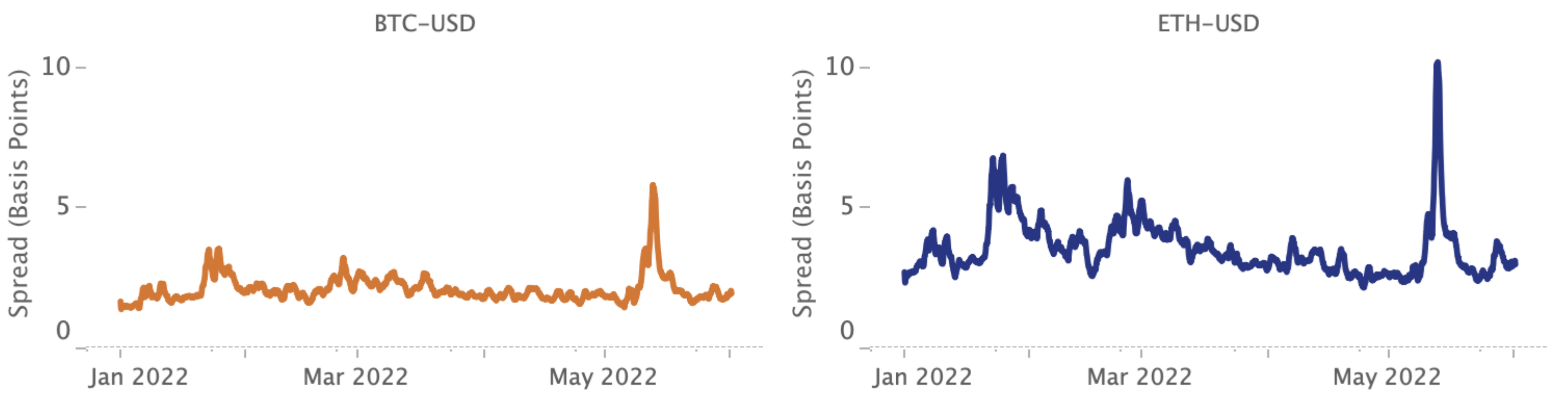
BTC and ETH Market Depth



Source: Kaiko order book data for BinanceUS, Bitfinex, Bitflyer, Bitstamp, Bittrex, Coinbase, Gemini, Itbit and Kraken, 7D MA.

Spreads also experienced their strongest bout of volatility this year. Average BTC and ETH spreads more than tripled during the worst of the sell-off, but have since recovered. Overall, ETH's spreads experienced more volatility which may be related to the coming Merge, when the network will transition to proof-of-stake. This transition has sparked debate and concern on a number of technical issues, recently reflected in the deviating ratio between ETH and Lido Staked ETH (stETH). As of this writing, there remains a 2% discount on stETH.

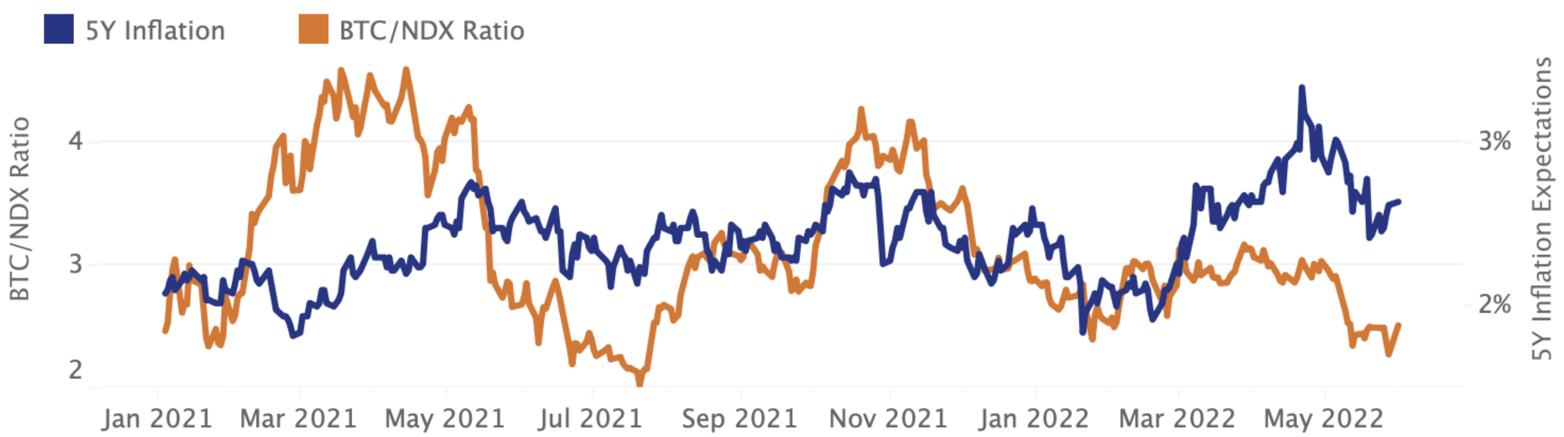
BTC-USD and ETH-USD Spreads



Tough Macro Environment Weighs on Crypto

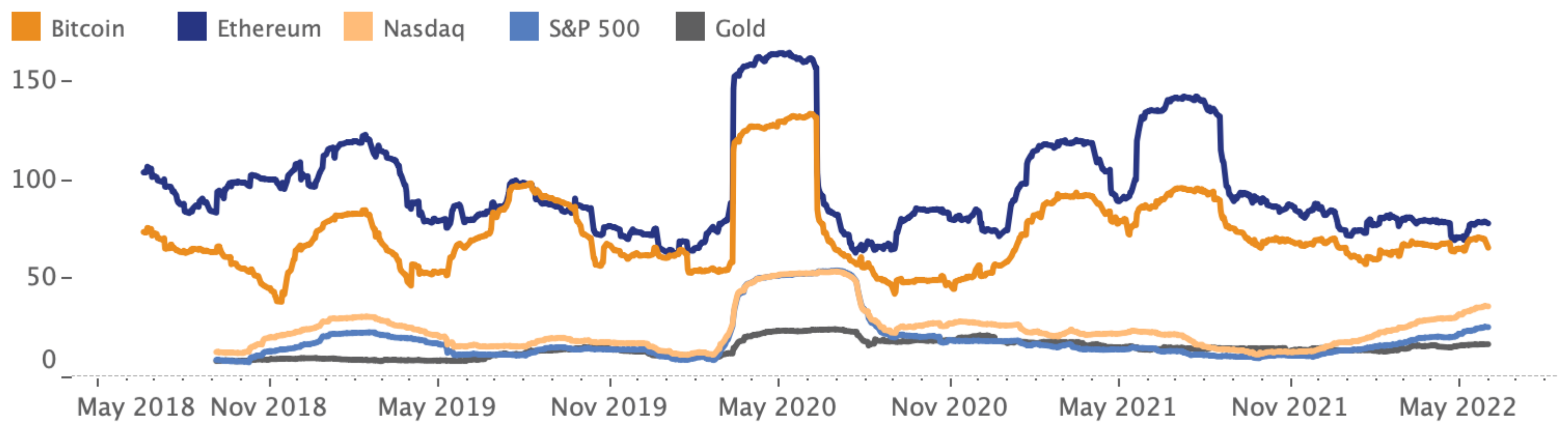
Inflation continues to be top of mind for governments and investors, with 5-year inflation expectations hitting a multi-year high above 3% in April. Equities and crypto have each experienced strong sell-offs, although crypto appears to be disproportionately affected by the tough macro environment, best visualized by the Bitcoin/Nasdaq ratio which dipped to its lowest level since summer 2021. Bitcoin strongly underperformed tech stocks in May, although the ratio has since stabilized and inflation expectations recovered following a less hawkish-than-expected Fed meeting.

Bitcoin/Nasdaq Ratio vs. 5-Year Inflation Expectations



90-day volatility for Bitcoin and Ethereum ticked upwards in May although volatility for both remains lower than it has been for much of the previous year. Meanwhile, in traditional markets, volatility for the S&P 500 and Nasdaq hit highs not seen since summer 2020, when the market was recovering from the COVID-related crash. Gold, too, has experienced an increase in volatility, though it remains much closer to its traditional volatility than the Nasdaq or S&P 500.

90 Day Volatility



Crypto-Related Equities Suffer Steep Losses

Coinbase and Galaxy Digital

Coinbase, the most prominent crypto-related equity, has struggled mightily this year with slowing volume and an increasingly bearish macro outlook for risk assets. The exchange also faces growing competition, with FTX overtaking Coinbase in BTC-USD volume for the first time ever, though Coinbase processed a record number of transactions amid the Terra collapse.

Galaxy Digital, which has a number of crypto-related business segments, is also down over 65% on the year.

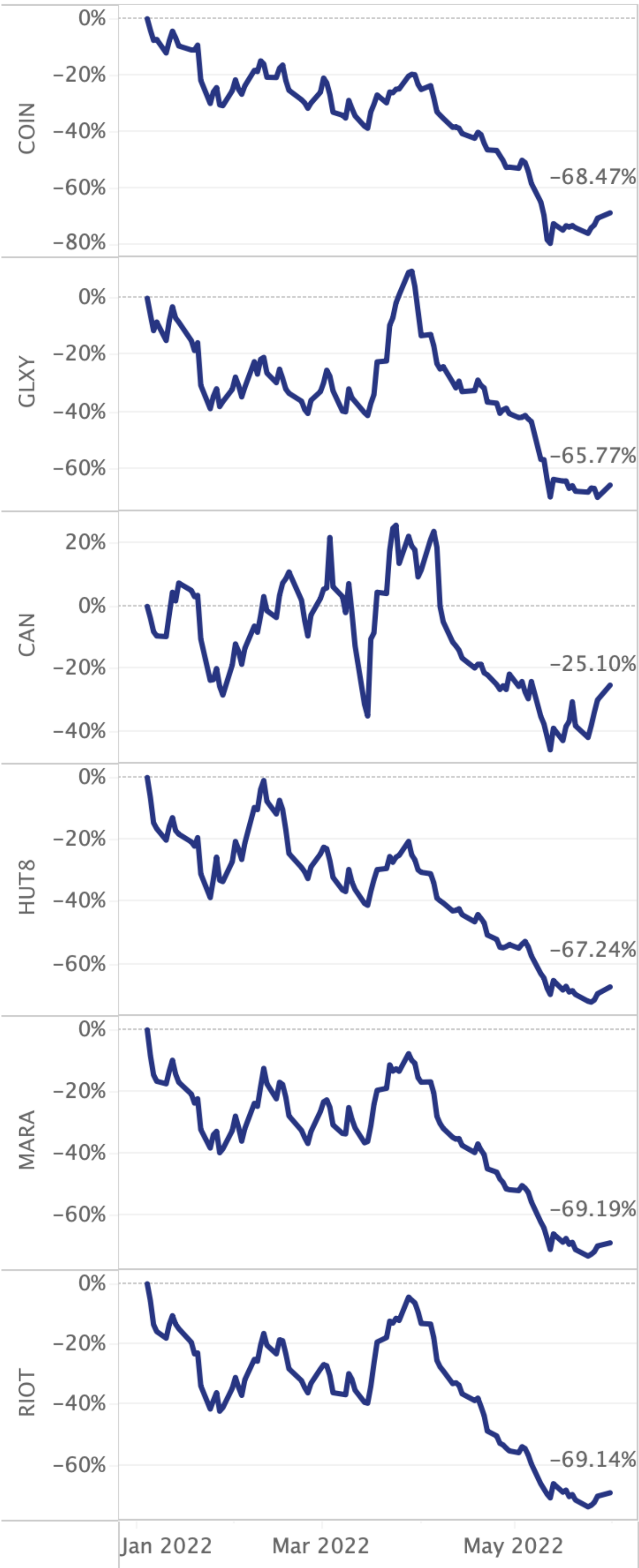
Mining Companies

Mining company equities have also suffered considerably in the latest crypto sell-off. Hut8, Riot Blockchain, and Marathon Digital Holdings are down nearly 70% on the year. For comparison, BTC is down about 35% YTD.

However, the one major exception to this is Canaan (CAN), which is down just 25%. This is likely because Canaan is a China-based company that has already suffered a severe downturn as a result of China's regulatory crackdown on Bitcoin mining that escalated last year. Additionally, Canaan manufactures Bitcoin mining machines, rather than generating most of its revenue from Bitcoin mining itself. Thus, it has proved to be less correlated to Bitcoin's price.

Bitcoin's hash rate sits at all time highs, suggesting that demand for mining equipment is still strong despite price action. Ultimately, mining company profits are still closely tied to Bitcoin prices, and we can expect that mining companies will not rebound significantly until Bitcoin recovers.

Crypto-Related Equities YTD Returns



Derivatives Activity Remains Muted

Bitcoin and Ethereum open interest for perpetual futures on Binance declined to its lowest level this year following Terra's collapse. Open interest is a measure of outstanding contracts for a given instrument, and when it declines it suggests that traders are exiting the market rather than purchasing short or long contracts. BTC open interest dipped from about $4bn to just above $2.5bn while ETH dropped from $2bn to 1.25bn. Open interest for both cryptocurrencies has since recovered from yearly lows, though neither is back up to their pre-Terra crash levels.

BTC Open Interest

Binance

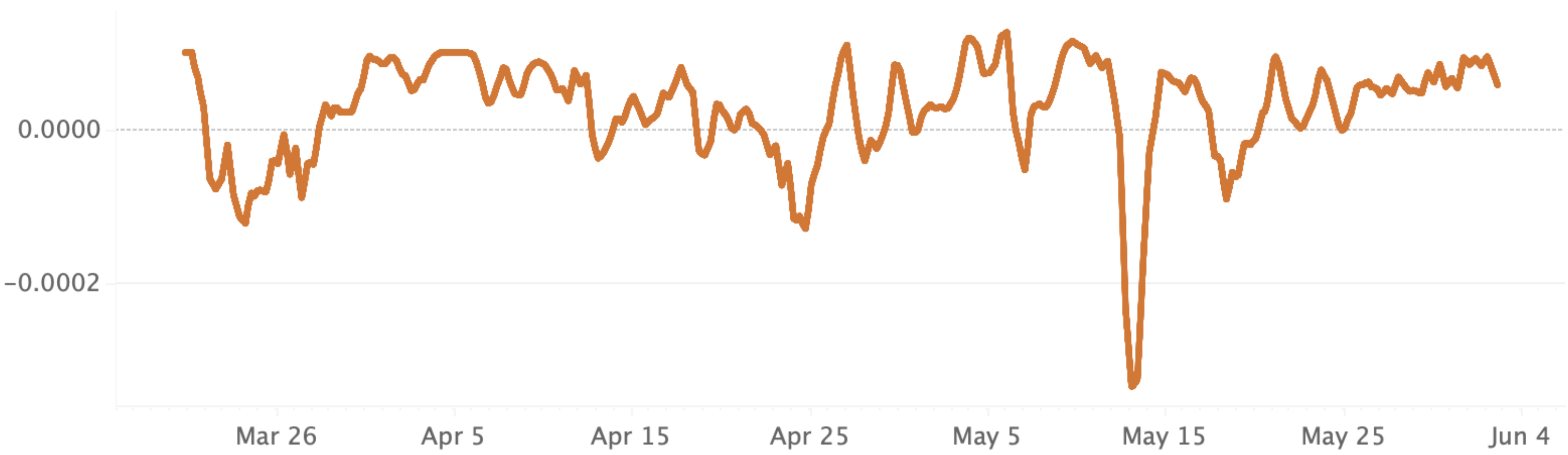
ETH Open Interest

Binance

Funding rates dipped significantly in the wake of Terra's collapse. Funding rates are indicative of overall market sentiment: when they are positive, more traders are opening longs vs. short positions, and vice versa. Unlike open interest, Bitcoin's funding rate recovered quickly and has been ticking higher since late May and as of publication is still slightly positive.

BTC Funding Rates

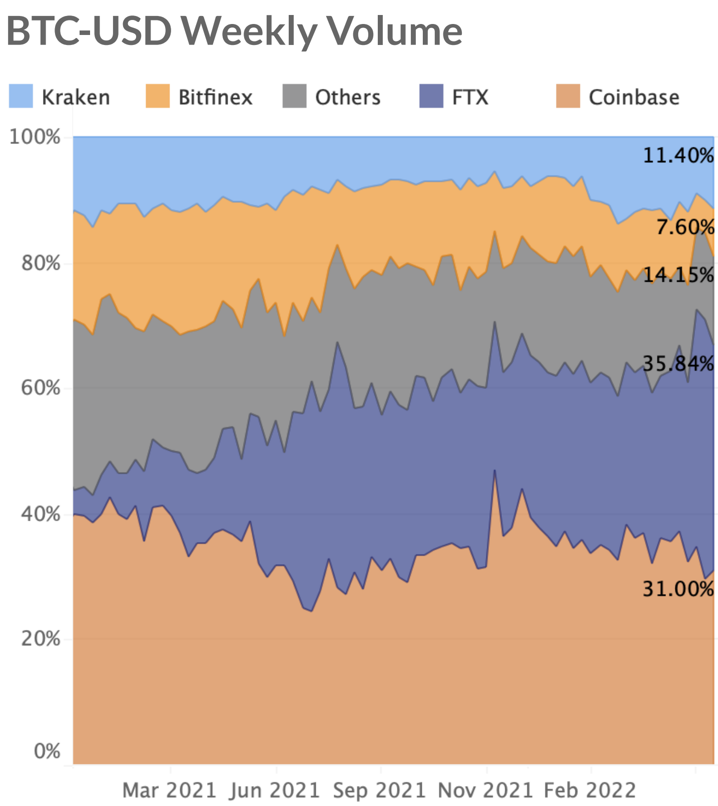
24-hour Moving Average on Binance, Bybit, Bitmex, and Okex



FTX Surpasses Coinbase in BTC Volumes

Volatility in the crypto markets had an interesting side effect this month, as FTX surpassed Coinbase's BTC-USD volume for the first time ever. FTX's growth has been significant: at the beginning of 2021 it accounted for just 4% of market share for the most liquid BTC-USD pairs. In May, FTX peaked at over 41% of total volume on the week of May 22.

FTX has proven to be Coinbase's main competitor when it comes to volume for the BTC-USD pair (Binance stands alone when including BTC-USDT), and it will be interesting to see whether this dominance persists into June. Exchanges in "Others" include FTX.US, Binance US, Gemini, and Bitstamp



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