

ALT 5 – DIGITAL ASSETS WEEKLY

Inflation disrupts markets and crypto correlations

NEW YORK, NEW YORK, US, May 6, 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.

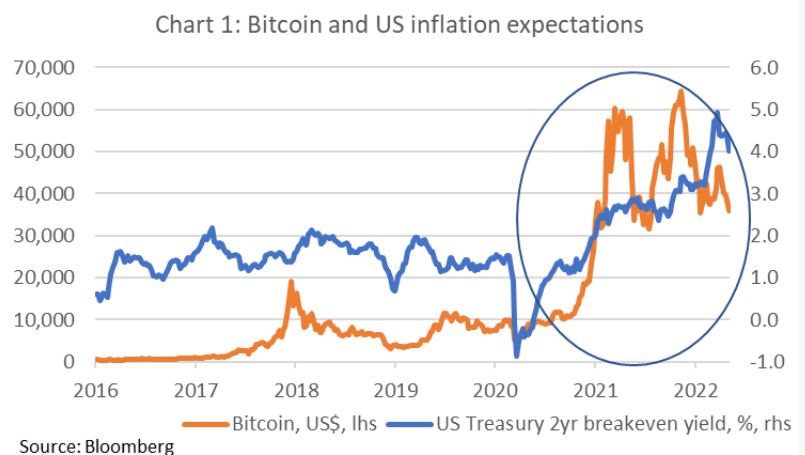
- Crypto assets remain subject to swings in risk appetite
- Bitcoin-inflation correlations are low...
- ...but that understates the importance of inflation as a driver of crypto prices and risk assets

The great liquidity drain

Crypto assets have been caught in the vortex of broader financial market declines as the interpretation of the Federal Reserve's policy change and guidance this past week instigated renewed selling. There are at least two elements of the Fed outcome—and outlook—that have implications for crypto assets. First, the actual turn in policy to higher interest rates and the announced plan to reduce its balance sheet will reverse some of the excessive liquidity in the financial system that had lifted the prices of many assets, including crypto, for the first 1-1/2 years of the pandemic.

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Bitcoin rose as covid-induced inflation increased

Central bank tightening and growth risks

The second element is twofold. There is some question as to whether the pace of tightening will be fast enough to actually bring inflation lower, suggesting that inflation could remain more problematic and/or even more tightening may be required in the future, neither of which is positive for financial assets. Beyond that the Fed will be tightening into a slowing US and global economy, raising the risk of causing a recession. The term stagflation has been and will be getting more use in the coming weeks.

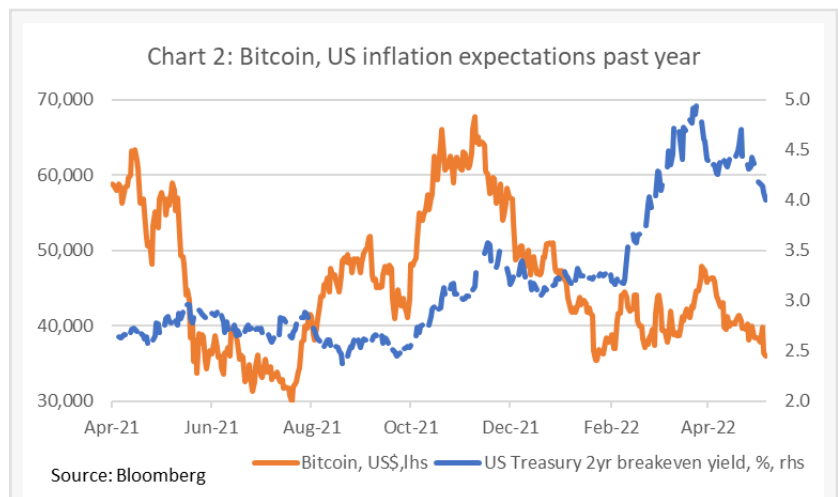
Macro continues to overwhelm most other factors impacting crypto prices

The upshot is that the upcoming reduction in excess liquidity combined with heightened risk to economic growth from Fed tightening, high inflation, geopolitical risks and covid are the dominating forces in financial markets and overpowering the impact of other drivers. For crypto, that has diminished the impact (and probably some of the inflows) from otherwise important factors such as the increased adoption of digital assets by institutional and individual investors.

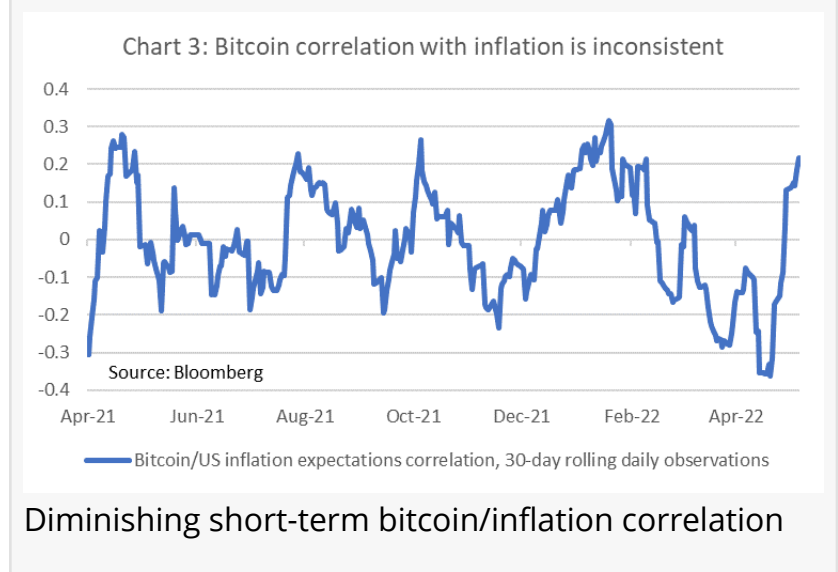
These dynamics have also shifted correlations, increasing crypto's co-movements with risk assets. That is most obvious in the increased correlation with the tech-heavy Nasdaq Composite. The outsized macro impact may also be overwhelming and diminishing the influence that other factors, such as inflation, might otherwise have on crypto prices.

Upcoming US CPI data keeps inflation in focus

Inflation will be a focus in the coming week as well alongside the release of the US April CPI report. As it stands, a Bloomberg survey shows the market expects headline and core CPI to come in at 8.1% y/y and 5.9% y/y respectively, following readings of 8.5% and 6.5% in March (both of which represented 40-year highs).



But bitcoin has not matched most recent inflation surge



Diminishing short-term bitcoin/inflation correlation

Bitcoin as an inflation hedge

As the covid pandemic started and progressed, the desire for an inflation hedge increased alongside concerns of currency debasement stemming from expansive monetary and fiscal policies. That was particularly the case in the US, which remains the world's primary reserve currency by a large margin, but was also a concern as policy makers globally responded to the covid crisis with monetary and fiscal stimulus.

Bitcoin was touted as a credible inflation hedge due to features such as its finite supply, growth in trading volume and adoption, low correlation to other assets and its longer term trend of price appreciation (the latter two have admittedly evolved differently).

The reality is that bitcoin's relationship with inflation, at least with US inflation, has not been consistent. Chart 1 shows bitcoin overlayed with US Treasury 2-year breakeven yields, which is a measure of inflation expectations in two years' time. As shown, bitcoin moved higher as US inflation rose through the pandemic. And it remains considerably above its pre-pandemic levels (some 5-6 times, depending on when measurement starts). That certainly outperforms other traditional inflation hedges such as gold or US equities over that timeframe.

Zooming in on that view, however, shows the bitcoin/inflation relationship is more mixed. Chart 2 shows the same instruments over the past year, with bitcoin pulling back while inflation expectations accelerated beginning in Q4 2021.

Similarly, Chart 3 shows the actual correlation between the two series, with the coefficient swinging between modestly positive and negative levels, and not indicative of any close relationship.

This does not mean that inflation will not matter to bitcoin, or perhaps more importantly won't matter to bitcoin going forward. Correlations change over time. And we expect other correlations to emerge (or re-emerge) as the outsized influence of the liquidity/macro backdrop on bitcoin is diminished. But it seems like that will take more time to unfold.

What about the near-term?

So what matters now? Does inflation go up, down, sideways? If it goes up, clearly the problem becomes bigger and markets will not like the central bank response (even faster tightening) or the impact on growth (inflation acts as a tax on growth, reducing the amount of money that people and businesses can otherwise spend on more productive endeavors.

Alternatively, if it flattens out—near current high levels—that is still an unfavorable development, and likely produces a similar, if somewhat less intense, impact on crypto prices and financial assets than a continued rise of inflation.

And if inflation declines it should have the effect of relieving some downward pressure on crypto prices, as it would suggest central banks will be able to tighten policy less aggressively, leaving interest rates at lower level (i.e., more market-friendly) and reducing some downside risk to growth.

That won't be definitely answered by next week's CPI data but rather by the accumulation of data points over time. Nonetheless, all data is taken into consideration as it is made available. And higher frequency releases such as the CPI report can indeed impact prices over shorter horizons. To the extent that the data shapes the outlook more towards one of the three options highlighted above, we would look for markets to respond accordingly.

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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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