ALT 5 – DIGITAL ASSETS WEEKLY

Crypto and risk asset correlations reconsidered; Regulations and risk in crypto currencies

NEW YORK, NEW YORK, US, June 10, 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.

• Reduced correlation between crypto and risk assets may be temporary

• The driving force of the global liquidity drain remains in place

• New US legislation on digital assets holds promise

• More on the inclusion of crypto in US 401(k) retirement savings plans

There has been increased attention on the decline in the correlation between crypto and risk assets. Since May, bitcoin has measurably underperformed the Nasdaq Composite Index, falling ~25% versus a 9% decline in the Nasdaq. Part of difference in returns is due to bitcoin's higher volatility, but not all of it.

If in fact the crypto/risk asset correlation were to diminish on a more sustained basis, that would be an important development for bitcoin. It would suggest that bitcoin's fortunes are less tethered to risk assets generally and instead could be a function of more "typical" drivers for crypto assets such as new entrants to the market (institutional and individual) and new innovations in the space.

Why has the correlation between crypto and risk assets fallen?

However, it may be too soon to expect a delinking between crypto and risk assets. From our perspective, the breakdown in the correlation can be linked to two developments.

First, the terraUSD/LUNA collapse hurt confidence in and put downward pressure on crypto assets broadly, resulting in bitcoin's step lower in the first half of May, a move which exceeded what was also a weakening trend in the Nasdaq.

Second, since mid-May, both bitcoin and the Nasdaq have turned more consolidative and for the most part have been moving sideways. Correlations tend to be higher in trending markets—higher or lower—and tend to break down when markets are consolidating. So, in recent weeks, the sideways pattern in both has also seen the correlation move lower.

The underlying driver for markets remains the great liquidity drain

Importantly, our view is that the bulk of the decline in risk assets since late last year stems the reversal of pandemic reflationary policies in the US and around the world. Specifically, the shift towards tighter monetary policy—including policy interest rate hikes and balance sheet reduction—combined with the decline in fiscal stimulus relative to the first 18 months of the pandemic, has resulted in a dramatic decline of liquidity in the global financial system.

That liquidity drain is "deflating" financial assets that benefited from covid-related stimulus policies and, in our view, is largely responsible for the decline in crypto token prices, as well as the selloff in equity and bond prices.

A new regime will evolve, but not yet

Some good portion of that market adjustment has already occurred, evident in the rise in short-term yields which reflects expectations for future central bank interest rate moves. However, given that central bank balance sheet reduction is just getting started in the US, and has yet to start in Europe and elsewhere, it is likely that are at least some additional headwinds to come for crypto token prices and risk assets broadly.

Once markets adjust more completely to that new liquidity regime, those more typical drivers of crypto prices—as well as equity prices—should be the more dominant driver of markets, allowing for a more sustained de-coupling of crypto token and risk asset performance.

Crypto regulation

This week, legislation was introduced to the US Senate that would provide sweeping regulatory clarity to the digital asset space. We will not rehash the details here and it is important to keep in mind that; 1. legislation can change significantly from its original form and, 2. there is likely to be a very lengthy period before this bill become law (if it does at all), in this case at least into the next calendar year.

That said, it is generally understood that constructive, responsible regulation and oversight of the crypto industry would be a positive and welcome development. It would provide legal clarity for financial institutions and others who have stayed away from the market to date, due to the lack of regulations. One key is to strike the proper balance between constructive oversight and onerous regulation, and that remains to be seen.

Treasury Secretary notes that crypto assets are “risky” for retirement accounts

Also on the regulatory front, this week Treasury Secretary Yellen said crypto currency assets are “very risky” options to include in retirement plans. The comment was in response to a question about Fidelity’s plan to include a crypto investment option in the 401(k) plans it administers.

To be sure, crypto currencies are more volatile that equities and investment grade bonds. But risk assessments also need to include actual returns. For example, since prices in crypto tokens and US equities peaked late last year, bitcoin has underperformed FAANG stocks, falling 63% high-to-low versus a decline of 47% for FAANG (defined as Facebook/Meta, Amazon, Apple, Netflix and Google/Alphabet).

Actual returns on assets, not just volatility, should be considered in an assessment of risk

However, looking over a slightly longer horizon, say from the start of 2020 (i.e., prior to the start of the pandemic), bitcoin has appreciated 325% versus a rise of 23% for FAANG stocks (excluding dividends). Moreover, bitcoin will show a larger outperformance using a longer price history.

Past performance is no guarantee of future returns, but this simple assessment demonstrates that some assets which have been deemed acceptable for retirement funds have actually fared far worse than crypto currencies. Historical returns are not the only criteria regulators or anyone should use when considering investment options for retirement accounts. But this is just one example of need for a fuller examination of what a “risky asset” actually entails.

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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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