DELPHI DIGITAL

Market Commentary - January 3, 2019

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Key Takeaways

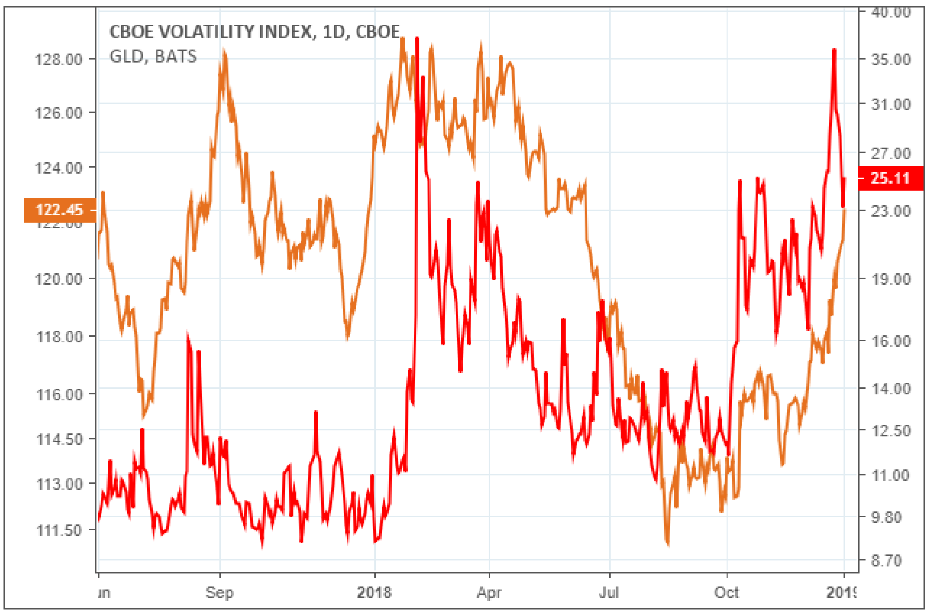
- *Bitcoin's price remains suppressed even as risk assets flirt with bear market territory.*
- *Accessibility and liquidity of traditional safe haven assets, notably gold-based mutual funds and ETFs, provide institutional investors easier, proven alternatives to hedge against market uncertainty.*
- *Price volatility for BTC has jumped alongside the whiplash taking place in equity markets. Gold volatility has remained relatively subdued.*
- *The market for digital assets and cryptocurrencies remains largely unregulated with relatively light institutional participation, evident in declining futures demand.*
- *Longer-term momentum indicators and record margin short positions point to a potential reduction in selling pressure for bitcoin.*

Bitcoin Fights to Catch a Bid as Risk Assets Tumble

Bitcoin has failed to rally with other "safe haven" assets as volatility plagues traditional markets. Despite its long-term potential as an alternative store of value, bitcoin in its current state is perceived as a highly volatile, risky asset. The accessibility and liquidity of today's safe haven investments are notable catalysts for gold's outperformance in recent months.

Gold is one of the most prominent safe haven assets, often cited as a hedge against market uncertainty and the detrimental wealth effects of long-term inflation. The former is the primary reason for gold's most recent ascent as turmoil continues to strike global equity markets. Other safe haven assets (Japanese Yen, U.S. Treasuries) have also seen heightened demand.

Gold Outperforms as VIX Index Spikes



**GLD is the SPDR Gold Shares ETF. The VIX is the Cboe Volatility Index, which measures the market's expectation of future short-term volatility in U.S. equities.*

Bitcoin exhibits several traits native to gold, but its evolution into a store of value will take time. In its current state today, it lacks a time-tested track record, relative price stability, and a large institutional presence.

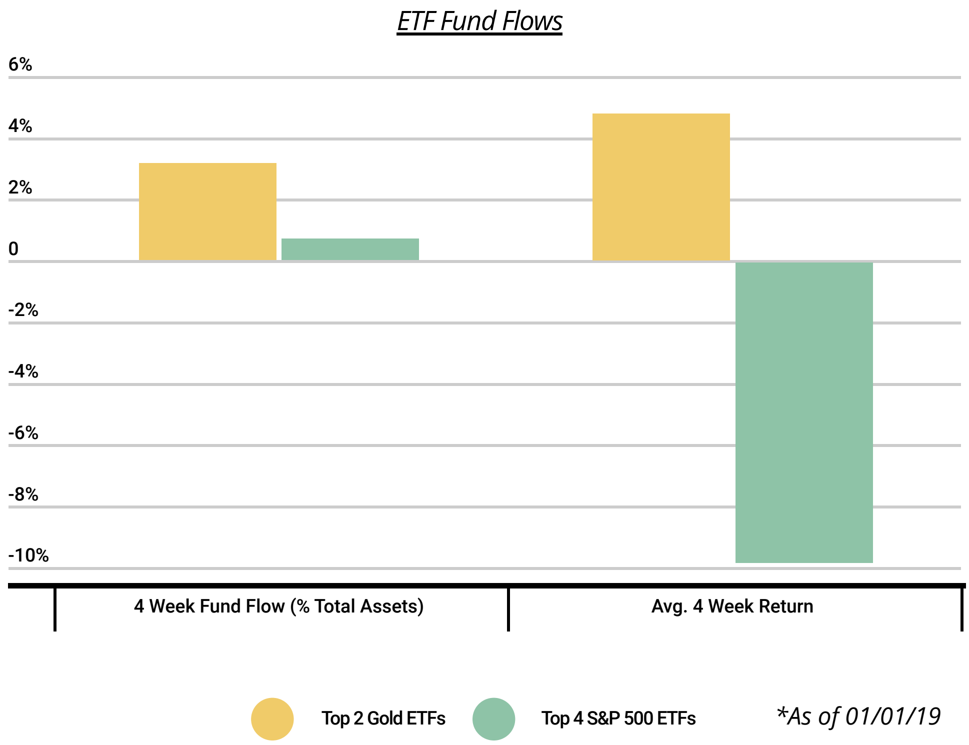
Sources: Cboe, State Street Global Advisors

Institutional Gold Demand

One of the drivers of higher gold prices during periods of elevated market volatility is the significant demand from institutional investors. Managers often allocate to gold to hedge against market uncertainty, shifting away from riskier assets (i.e. stocks), which is precisely the scenario we've seen play out in the fourth quarter. The S&P 500 is down more than 15% from its September high, counter to gold's 7% gain over the same period.

There are several attributes intrinsic to gold which have shaped the flight-to-safety view over time, but institutional demand for gold-based investment vehicles is a key driver of its recent outperformance of crypto assets, most notably Bitcoin. The accessibility to liquid, established gold funds is attractive for institutional investors looking to gain exposure to the precious metal, hence why demand for such products increases as market unrest rises.

The two largest gold-backed ETFs (GLD, IAU) have seen sizable demand over the last four weeks compared to their equity counterparts. Aggregated fund flows into GLD and IAU over the last month represent over 3% of their total assets versus 0.7% for the top four largest ETFs tracking the S&P 500. Institutional ownership, measured by the most recent set of 13F* filings for Q3 2018, of the two largest physically-backed gold ETFs (GLD, IAU) averages ~44%, according to Nasdaq.



**13F filings are quarterly reports filed by institutional investment managers with at least $100 million in equity assets under management to disclose their U.S. equity holdings to the SEC. We'll be watching the next 13F filing deadline (mid-February) to see how these allocations and fund flows have changed given the recent market turmoil in Q4.*

Sources: State Street Global Advisors, Vanguard, Standard & Poor's, Nasdaq, ETFdb.com

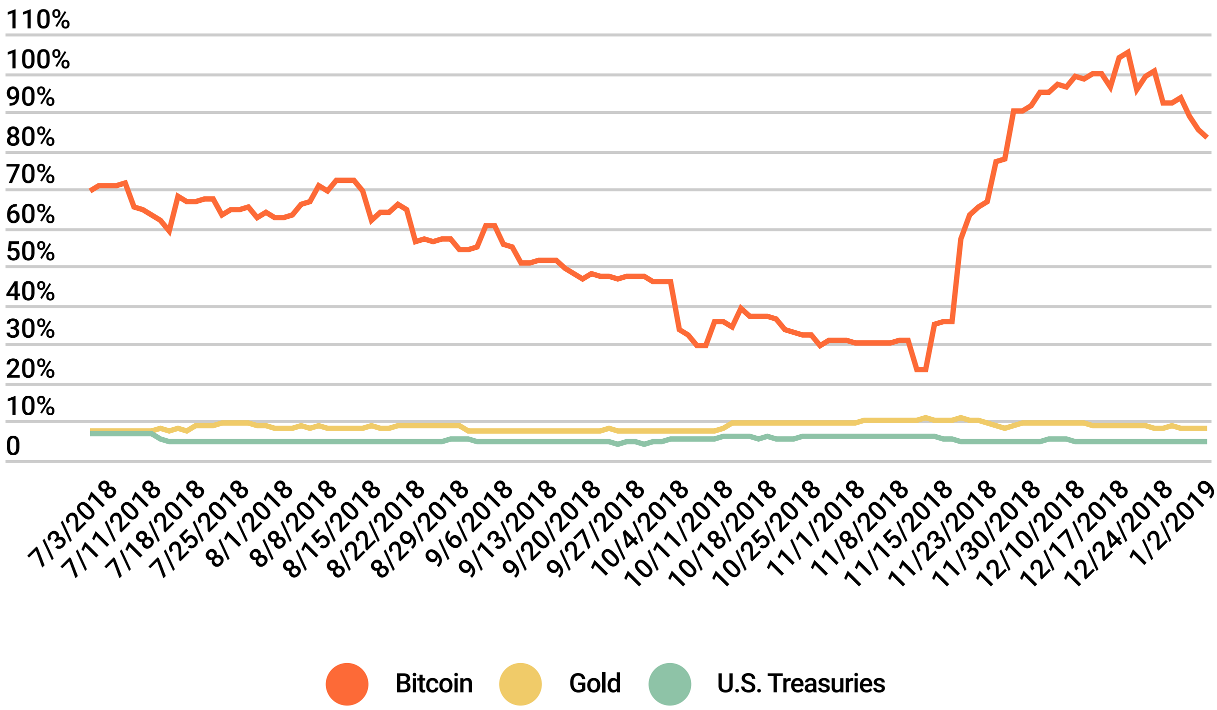
Bitcoin Struggles

Bitcoin, on the other hand, has failed to catch a bid amid the recent jump in market volatility.

Bitcoin Slumps as Turmoil Hits

Price volatility for BTC has jumped in recent weeks, despite trending lower for much of last year following its surge at the end 2017.

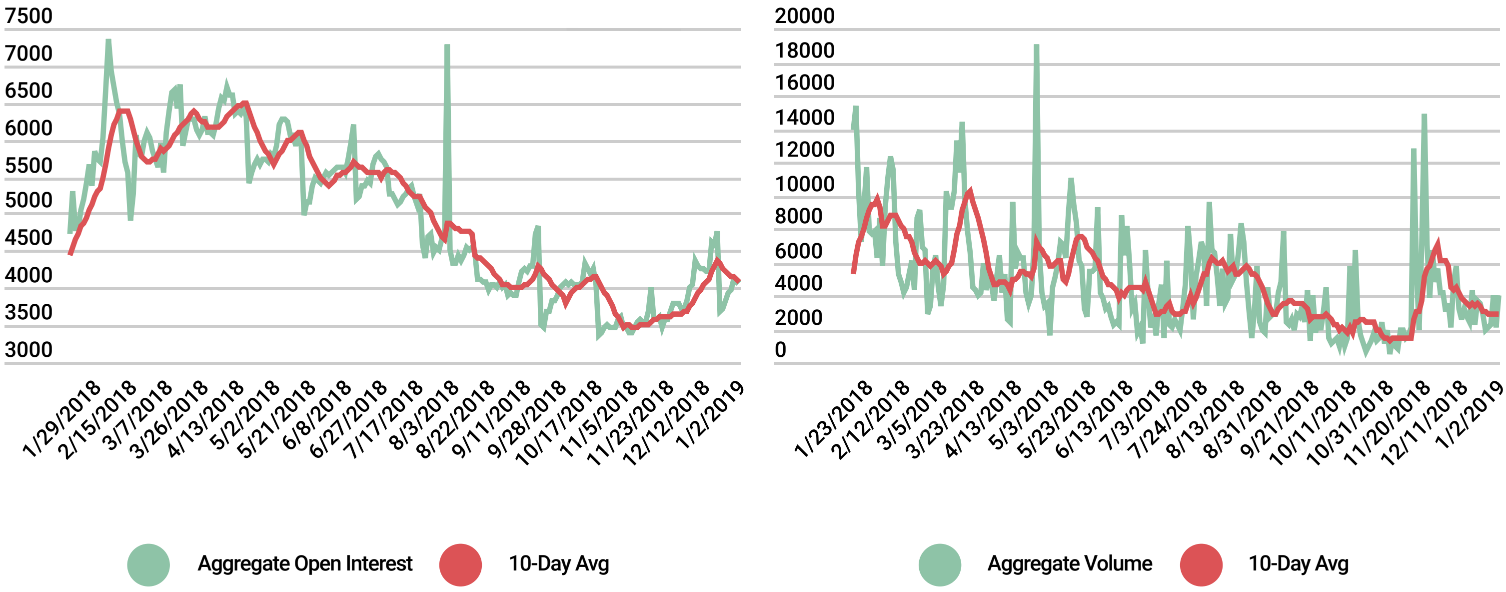
Volatility Between BTC and Safe Havens Widens



**30-Day Historic Volatility*

Demand for bitcoin futures, once viewed as the gateway to crypto markets for institutional investors, waned in the second half of 2018 as the price of BTC continued to trend lower. Price volatility for the world's largest crypto asset decreased throughout much of last year, but hefty margin requirements (+40%) likely deterred some potential speculators as well.

Lackluster Futures Demand -Cboe Contract Volume & Open Interest



Currently, there are not any Bitcoin-backed investment vehicles as accessible and liquid as there are for gold or other safe haven assets. We are confident these types of products will eventually emerge, however, even if we're not overly optimistic the SEC will give a Bitcoin-backed ETF its blessing in the immediate-term.

Will Selling Pressures Subside?

We are starting to see signs selling pressure for BTC may be abating, helping form our view that a price bottom may be on the horizon. Total margin short positions on Bitfinex, for example, hit a new high in early December as BTC prices plunged. The recent reduction in margin shorts coupled with an increase in margin longs have contributed to a modest recovery in Bitcoin's price. A strong move to the upside for BTC could result in further short covering in the near-term.

Short Covering Offering BTC a Modest Lift

**BTC margin short positions inverted on chart*

There are a number of reasons to be skeptical when using short-term technical indicators in this nascent market, but taking a longer-term perspective the recent drop in BTC's relative strength is notable in our view. The 14-week relative strength index (RSI) recently dipped into oversold territory (<30) for the first time since January 2015. This marked the bottom of the previous cycle as BTC rallied +70% in the subsequent two months after reaching its January 2015 low near $175.

BTC Price Oversold on Weekly Basis

Bitcoin's breakdown into oversold territory does not mean prices can't decline further, but it is worth watching to see if a bottoming process begins to take form. A recovery in relative strength, marked by higher lows on the RSI, would lend further support for BTC.

This signal was an early indicator a bottom was forming following the last parabolic price move in Bitcoin.

Final Thoughts

While we do see a number of positive catalysts for Bitcoin on the horizon, we do not believe the recent repricing of risk assets serves as a strong driver for a significant move higher in BTC given the lack of streamlined investment processes for institutions. The perception of the digital asset market is likely to remain further out the risk curve by much of the institutional investor class for the foreseeable future.

Sources: Bitstamp

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