S3W6 - Crypto trading words

My very first devoted month of crypto trading is over. Despite the market tumbled by double-digit percentages because of several negative news during the month, I (luckily) had monthly nominal gains on my portfolio.

Actually, I did not have a good start into the landscape - I entered this relatively novel field in May, ill-informed, right before the 'halving' market crash due to Chinese crypto ban. I had my portfolio liquidated twice amid the market crashes (trading tuition fee?), and made painful losses in highly speculative bids of shorting several retail-driven coins (e.g. DOGE, AXS). Those mistakes made me learn a lot. Although I know I am still a relatively inexperienced trader - that I probably don't qualify to write highly technical stuff, but I would still like to share my take on crypto trading - and *expose myself to comments and your different takes*.

If you feel anywhere of this text needs to be clarified or improved, please don't hesitate to tell me!

Contents

1 Overview of crypto market

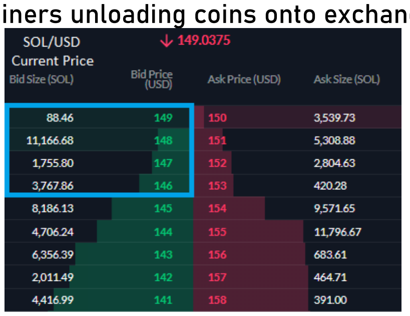
- Blockchain-oriented
  - Cheap method to transfer large amounts (e.g. a few USD of gas fees with billion-dollar transactions)
  - Secure compared to traditional payment options (hashing => crypt: extremely low probability of breach)
  - Innovative platforms and potentially market-disruptive projects e.g. Compound (COMP) - lending platform of cryptocurrencies, Axie (AXS) - Pokemon-inspired NFT game (play-to-earn)

- Spectacular gains amid volatility
  - By capital asset pricing model (CAPM), investors demand higher returns as the risk of cryptocurrencies is very high
  - Wealth protection against massive inflation brought by the arbitrary monetary expansion policies of US (e.g. after the global financial crisis @ 2008, COVID @ 2020)
  - Increasing adoption of institutional investors (e.g. JPM/ MSTR)

- Retail-driven with decentralized news sources
  - Traders might resort to Twitter for immediate information
  - Delayed impact of significant market news: ~10-30 mins after the news' initial circulation
  - Speculative in nature due to the extent of retail participation; some manipulate the market to gain

2 Making money from crypto

- Movement - *Buy low, Sell high*
  - ✧ High volatility (30% upside/downside within a month is very common, even for the more stable large-cap coins like Bitcoin) ▸ 'Time the market', i.e. *Bottom fishers* in order to avoid losses and rack in significant gains
  - ✧ Temporary spikes/plunges of prices (squeezes), e.g. due to miners unloading coins onto exchanges



SOL/USD Current Price ↓ 149.0375

Bid Size (SOL)	Bid Price (USD)	Ask Price (USD)	Ask Size (SOL)
88.46	149	150	3,539.73
11,166.68	148	151	5,308.88
1,755.80	147	152	2,804.63
3,767.86	146	153	420.28
8,186.13	145	154	9,571.65
4,706.24	144	155	11,796.67
6,356.39	143	156	683.61
2,011.49	142	157	464.71
4,416.99	141	158	391.00

e.g. 'miners' sell 15K SOL tokens (worth slightly more than $2m) with market orders => fulfills bid orders (LHS) immediately to absorb liquidity => pushes the prices down to $146 (i.e. 2%)

Opportunity to buy at $146 and wait the price to go back to $149 => Reaps profit

- Yield-farming
  - ✧ Lock up (Stake) your assets in cryptocurrencies (mainly altcoins) to a liquidity pool (i.e. pool of money in decentralized exchanges), to receive benefits (e.g. airdrops, interest rates, up to 100% a year)
    Risk: high risk (and high yields) platforms can explode and you lose your stake
  - ✧ When implied yields of futures are too high (i.e. futures prices at a very high premium (e.g. 10% above current price for a futures due March 2022), short (sell) futures while hedging your exposure with long (buy) perpetuity. You make risk-free gains when yields go down.
    Question: When and what is 'too high'/ 'too low'?

- Arbitrage
  - ✧ "Law of one price" : same goods, same price without frictions
  - ✧ Exploit different prices of the SAME crypto on different exchanges to make risk-free gains, e.g. liquidity shortages
  - ✧ Similar arbitrage concepts also occur out of the crypto world (e.g. Labour cost arbitrage, merger arbitrage…)

- Leverage as an amplifier
  e.g. You have $10K in your trading account. You want to make a larger investment than what you have, so you borrowed money from your broker.

  If you wish to make a $30K investment based on $10K capital,
  - You have to borrow 30000 - 10000 = $20000; you are said to be *on margin* (炒孖展) as you borrow money from your broker to hold a larger position than the amount of capital.
  - Your leverage (槓杆) ratio is 30000/ 10000 = 3 times (3x), meaning for each percent of gain (loss) on your investment, you gain/ lose this % of your capital.

Capital = $10000	Gain 5%	Lose 5%	Lose 30%
Investment value of $30000 (buying)	31500	28500	21000
Borrowed amount	20000	20000	20000
Account value	11500 (gained 5% * 3 = 15%)	8500 (lost 5% * 3 = 15%)	1000 (lost 30% * 3 = 90%)

In other words, investing/trading on margin amplifies your gains and losses greatly. You incur more gains (and of course, more losses) as leverage increases. Note that *30% of monthly gains/ losses are common* in the cryptocurrency world. The risks of long-term investing on high (3+ times) leverage ratio should thus be carefully considered.

3 Be an educated trader

Quoting from Warren Buffett, one of the greatest contemporary investors:

Invest in what you know . . . and nothing more.

Going into the crypto space without knowing the underlying risks and market reactions is dangerous. What if our investments drop 80% in value? (That happened to Bitcoin - 2013 to 15) - How would we manage risks?

We'll very likely make avoidable mistakes without knowing what is going on - for example, Elon Musk's market-moving tweets and Chinese's ban news are capable of pushing the market 5% in minutes. Trading in this highly turbulent market, we need adequate knowledge to help identify what are sensible investments, and what are not.

My attempts in keeping myself properly educated are as follows:

- Running, with friends, a crypto news summary initiative of monthly market sentiments and events
- Occasionally pitching and discussing trade ideas with peers
- Picking relevant internships in order to provide myself with an effective out-of-school learning curve
- *To be materialized*: dive deep into technical analysis - analyse past cryptocurrencies' data and predict prices (UST's UROP program?)

4 Placing stop losses

While trading assets in a direction favourable to your trade (e.g. buying => price rise, you gain) could be profitable, you risk making losses from trades when the market goes against you. Sometimes, our trading stance could be terribly wrong and you need to concede - that you are wrong. Imagine the following scenario:

The price of an asset is down 25% from its all-time high (ATH). Having fully investing in the asset since the market is 20% down, you have incurred 6% capital loss.

What would you do?

- Exit the position with stop loss (realized 6% loss)
- Hold your current position
- Buy more at the current price
  (i.e. increase your position by going on margin, say to 3x)

Taking the May crypto crash as an example, the market went down 40% further (i.e. 50% drawdown from ATH) - for example, bitcoin (BTC) plunged from an ATH of $64000 to $30000 in mid-July. The outcomes of the above choices would be, correspondingly, as follows:

- Stop loss exit (realized, 6% loss)
- Holding (unrealized, 35% loss)
- Buying more on margin (liquidated, 90-100% loss)

Here are some additional questions worth pondering related to the scenario:

- **Timing the market**
  What if you have not yet entered the market until it's 50% down?

- **Buying back to avoid loss**
  What if you hit the stop loss, but decided bought back the asset when it's down by more than 20% further, in anticipation that the market would bounce back and to prevent early liquidations?

- **Leveraging risks**
  How much further would the market go down? When to place more leverage without exposing yourself to too much vulnerability - to an extent that you would completely mess yourself up?

- **When what you believe is right turned out being wrong**
  How would you face what you said or did if empirical evidence is against you? Accept your mistake? Hold your beliefs more firmly and further expose yourself - believing that you could handle the negative sentiments and the criticism?

- **Learning from mistakes**
  If your trading strategies or beliefs fail, how would you adjust? How to make things proceed better next time - with risks minimized and returns maximized?