CAPTUR RESEARCH

ALPHA BOOK

JANUARY 2023

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2023

2022 was an awful year for markets worldwide; the crypto markets were sadly no exception. Sander Kok is optimistic for 2023, mostly on the product side. We can expect progress crypto-wide, he writes, especially in infrastructure and gaming. Will crypto truly go mainstream – without speculation as its primary purpose?

Our market essay discusses whether we will soon see a change in trend. "The trend is your friend, they say. I prefer to see the trend as a friendly guide that can suddenly slap you in the face if you don't pay attention." Better listen up. What signs do we see to go long or short? And did the S&P already bottom? Data from 1950-2018 shows the average bottom comes fifteen weeks after inflation has peaked. S&P's latest came in at sixteen.

This month's issue also features an article about high-inflationary tokens and whether now is a good time to short. Which ones are prime candidates? How does the token price typically behave around unlock dates?

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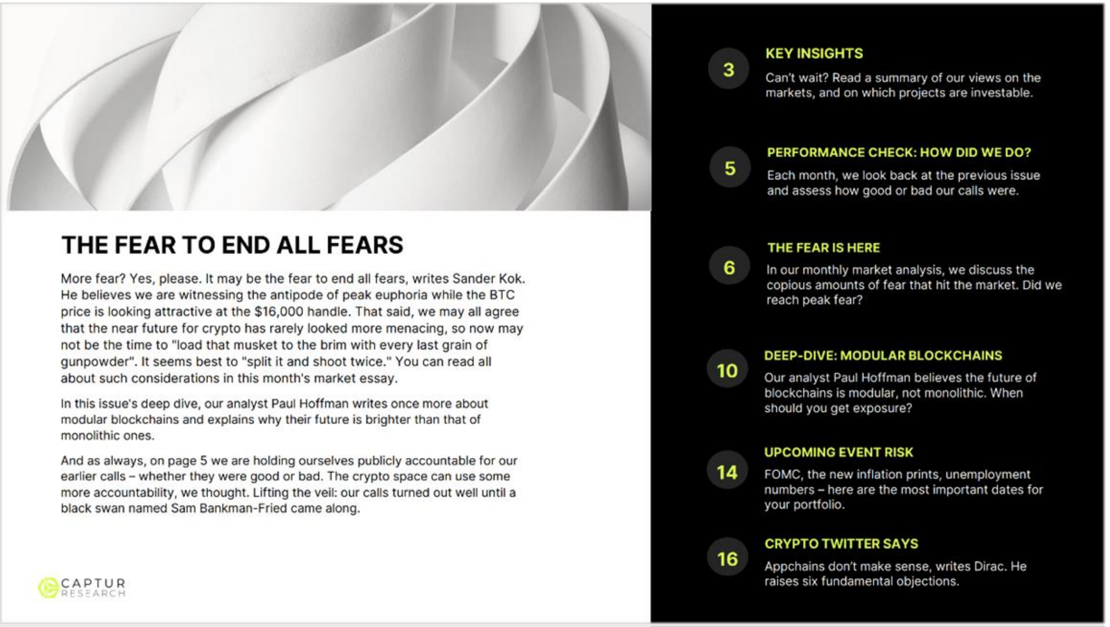
KEY INSIGHTS

- We see some hesitant signs of an impending trend change in crypto: price compression, ETH making higher lows (not BTC, though), a failed breakdown followed by a failed breakout, and, most importantly, the market's response to bad news seems to be getting weaker.
- We are expecting volatility to return in January and February, owing to impending news from Grayscale.
- Our base case is BTC will revisit the lows at around $15,900 and then move back to $16,700. There are fewer and fewer sellers around – and fewer and fewer *convinced* sellers at that. BTC and ETH will mainly have sellers who intend to buy back lower. They are waiting for bad news to hit – which may not happen or may not have as poor consequences as expected, increasing the probability of having to buy back in at a higher price.
- Investors are correct to worry about the Grayscale and Mt. Gox unlocks. The latter will certainly happen by January 10, but contrary to popular opinion, we believe creditors will sell only half of their coins. As for Grayscale, an unwind of their GBTC trust would take BTC below $10,000, but we are expecting a partial unwind, if there is an unwind at all. January should be volatile due to news regarding this topic.
- 2023 will likely be a spectacular year for crypto products. We see positive developments mainly in gaming and infrastructure. The first, mainly for the vast sums invested in 2021; the second, mainly for the same and for the early signs of progress over the past months in layer-2 technology. Ethereum is actually scaling now. In a few years, network congestion will be a thing of the past and should no longer hamper adoption.
- Despite the bear market, gaming projects are still raising consistently from VCs.
- If we see a mini bubble next year, the source would likely be regulatory clarity on DeFi. This clarity does not have to be all positive – even bad regulation that is less bad than expected could be enough.
- We will likely see a new macro narrative soon, as inflation has peaked and recession worries take over. In most scenarios, the Fed will switch on the money printer in H2.
- The average number of weeks it takes the S&P to bottom after inflation has peaked is 15 weeks, going by data from 1950-2018. S&P's recent bottom clocked in at 16 weeks.

PERFORMANCE CHECK: HOW DID WE DO?

Accountability isn't the most poetic of words, but we think crypto needs to hear it more often. Each month, we look back at the calls from our previous issue. We are, to our knowledge, the only research company to do so, hoping more people in the space will follow.

- We were correct to buy BTC at an average of $15,900.
- We were also correct to offload half above $18,000, as the current price is $16,473. (You could witness that one live on Twitter.)
- We were correct to say that the S&P recovery was losing steam as it neared resistance. (Which is why we took profit.)
- We did not make any other calls.



THE FEAR TO END ALL FEARS

More fear? Yes, please. It may be the fear to end all fears, writes Sander Kok. He believes we are witnessing the antipode of peak euphoria while the BTC price is looking attractive at the $16,000 handle. That said, we may all agree that the near future for crypto has rarely looked more menacing, so now may not be the time to "load that musket to the brim with every last grain of gunpowder". It seems best to "split it and shoot twice." You can read all about such considerations in this month's market essay.

In this issue's deep dive, our analyst Paul Hoffman writes once more about modular blockchains and explains why their future is brighter than that of monolithic ones.

And as always, on page 5 we are holding ourselves publicly accountable for our earlier calls – whether they were good or bad. The crypto space can use some more accountability, we thought. Lifting the veil: our calls turned out well until a black swan named Sam Bankman-Fried came along.

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BOTTOMING

MONTHLY MARKET ANALYSIS – READING TIME: 9 MINUTES
By Sander Kok

2022 had one direction: downwards. Are we there yet? The question is irrelevant. Nobody knows if we've bottomed. We can, however, to some degree, determine if the current trend is losing momentum. If it is, the time may have come to finally press green.

But you know betting on trend changes often costs money. The trend is your friend, they say. They are probably right – though I prefer to see the trend as a friendly guide that can suddenly slap you in the face if you don't pay attention.

So, what is our friendly yet fickle guide muttering as we linger near the lows? He has a habit of doing that, you know; he mumbles some inaudible words before changing direction. It usually means nothing, but sometimes it does. We better listen up, or we won't know if he is about to change course, and we'll just stand there once again.

The signs

First, do we see a change in market structure? The answer for Bitcoin is no. But Ethereum put in a higher low in November and has been doing so since. The caveat: this has only happened on smaller timeframes (Fig. 1). On the monthly, Ethereum looks as bad as Bitcoin.

A second potential sign of an impending trend change is failing breakouts and breakdowns, as it proves momentum loss. In late November, we actually saw one of these: a failed push off the cliff. We bought this, by the way, as you may have read in last month's issue. The breakdown was followed by a 19% run; unfortunately, the last part of that run constituted a failed breakout to the upside, and we are now back in the range. This, to me, is not enough to call for trend exhaustion, though my intuition says we should attach more importance to the first failed move than to the second. The main reason is this first failure was more unexpected. The second failure was consensus and thus has a higher likelihood of putting more market participants offside if we move back up.

My guess is BTC will range here for a while; we will revisit the lows at around $15,900 and then move back to $16,700. There are fewer and fewer sellers around – and fewer and fewer *convinced* sellers at that. Altcoins have been massacred; Bitcoin and Ethereum not as much. Moreover, as I discussed in last month's issue, these two assets will mainly have sellers who intend to buy back lower. They are waiting for bad news to hit – which may not happen or may not have as poor consequences as expected, increasing the probability of having to buy back in at a higher price. That is quite different from altcoin holders dropping their bags at any price, as we have seen lately.

You could read this as a case for altcoin capitulation already having happened, making it a great time to buy, but I think there is still too much froth in certain areas. Some of it is discussed in my other piece *Shorting inflationary tokens* (p. 11). In short, I do think some altcoins are severely undervalued now, but altcoins as a class are not.

What other signs of potential trend exhaustion do we see? A reliable indicator is how the market reacts to news. In both Bitcoin's and Ethereum's cases, the impact of bad news was conspicuously weaker than before. This, I think, is the best argument we have for an impending trend change.

The market's response to bad news as a leading indicator is also something I discussed in last month's piece, which makes you think, did much happen in the interval? The answer is, of course, no. And that, by itself, is a sign of trend

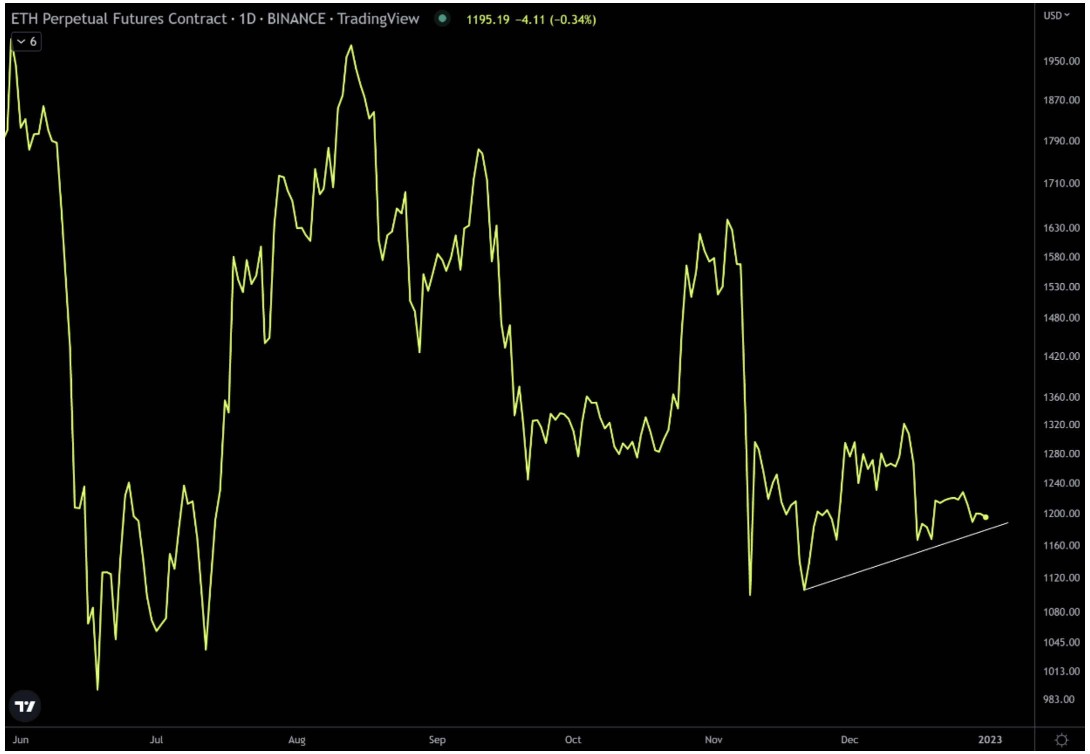


Figure 1: ETH is putting in higher lows on the daily. It is doing so near support. (Not shown.)

exhaustion. Over the past two weeks, volatility has died down, price has compressed, and market participants are waiting; waiting for the price to start trending (Fig. 2). While we are staring at the guide's lips, trying to understand what he wants, most traders will only position themselves after he has moved his feet. They will walk once he starts walking. While price compression does not necessarily signal an upcoming trend change, it does signal exhaustion. Typically, the direction of the next big price move will dictate the trend for the coming weeks or months because most market participants wait for clarity before pressing green or red. It must be said that waiting for the guide to move is typically the safest way to trade, but in the current conditions, we can expect multiple fake-outs; the guide will move in one direction and then change course. Conservative traders beware. Your approach may get your account chopped up.

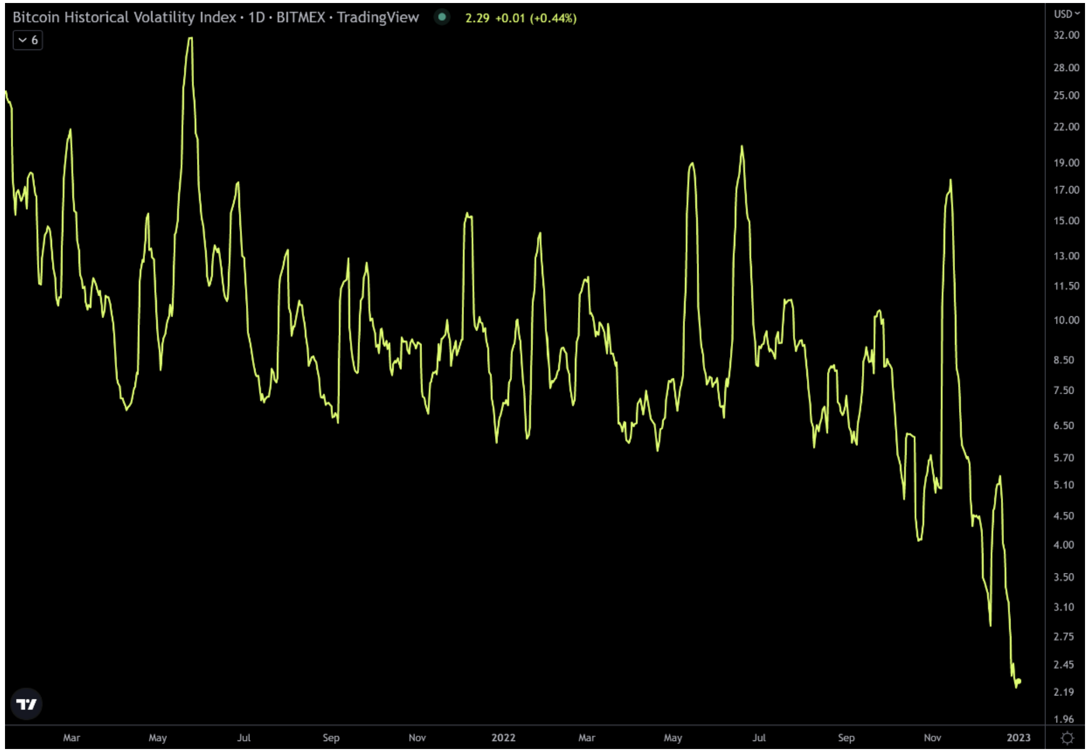


Figure 2: The Bitcoin Historical Volatility Index sits at a low. The next big price move will likely dictate the trend for the coming weeks or months.

In summary, there are some hesitant signs of an impending trend change, but perhaps not enough to write mother about. This would have been different if it weren't for two catalysts.

Mt. Gox and Grayscale

I mentioned traders waiting for bad news to hit in the hopes of buying back lower. The news they are waiting for concerns two potential unlocks. The first is certain to happen: the Mt. Gox trustee's deadline for repaying 136,000 BTC is set in stone on January 10th. These coins are currently worth $2.24b. Market participants expect the large majority of these coins to be sold immediately.

I beg to differ. Most Mt. Gox creditors will be relatively well-informed about market conditions and Bitcoin's fundamentals than your average retail buyer. They were extremely early to adopt this new technology; that says a lot. They have an intrinsic interest in Bitcoin. They are curious. They like risk. They may also have sold part of their claim to other parties or hedged their exposure over the past years. I expect around half of the bitcoins to get sold. This is still a lot, but it should be priced in by now.

Then there is Grayscale. I discussed this problem at length in the last issue. The gist: Grayscale being forced to unwind their trusts (due to Genesis' insolvency) would make BTC fall below $10k, as billions of dollars in coin would hit the market. Grayscale's Bitcoin trust (GBTC) currently holds nearly $11b in coins but has a market cap of only $5.5b. The two numbers should logically converge, but the trust's legal structure prevents investors from redeeming their GBTC for Bitcoin. The latest on Grayscale is their intention to launch a tender offer for GBTC if the court rules against turning their fund into an ETF.

In a letter to his investors, Grayscale's CEO revealed the company is considering the tender offer for 20% of the GBTC shares, subject to SEC approval. In case of no approval, Grayscale would not dissolve GBTC, as crypto investors feared, "but would instead continue to operate GBTC without an ongoing redemption program until [they] are successful in converting it to a spot bitcoin ETF." The CEO added he expects the court's decision "early next year," so this January or February.

With these forces at play, it seems silly to focus on technicals – it even seems silly to focus on fundamentals and macro. But it would also be silly to ignore all these, particularly since they give the clearest view of what to expect when the Mt. Gox and Grayscale narratives end.

2023 and beyond

The following metrics should give an idea of where crypto stands going into 2023. I mainly discuss BTC and ETH, as these are the only projects strong enough to drag up the market. If they rise, other projects will follow. If they fall, the others will fall. I will first quickly discuss recent and upcoming projects and then focus on BTC and ETH.

2021 saw excessive raises for some new projects while others raised more modest sums. The projects in this latter group will soon be on the brink of either abandoning their ambitions or quitting altogether. The better-funded ones still have more than enough runway. Of the many projects that received copious amounts of funding in 2021, a large chunk is still before launch. In a recent interview, a16z's Chris Dixon said that around 50% of the fund's crypto portfolio is still pre-launch. That means two things. First, that a16z is severely underwater. Second, that 2023 will likely be a spectacular year for crypto products. We tend to talk much about price here, but in the end, the strongest force – even stronger than funds like Grayscale selling part of their

PROJECT	FUNDING ROUNDS	TOTAL FUNDING AMOUNT	INVESTORS	DATE
Dogami	Seed Round	$7,000,000	XAnge, Bpifrance	Dec 13, 2022
MetaVersus	Seed Round	$2,000,000	Alphabit Fund, Launchpool	Dec 12, 2022
Balthazar	Private Round	$2,000,000	Kucoin Labs, Vendetta Capital	Dec 09, 2022
EXEVerse	Seed Round	$7,500,000	berkwood capital	Dec 09, 2022
The Mirror	Pre-Seed Round	$2,300,000	Konvoy Ventures	Dec 07, 2022
Roboto Games	Series A Round	$15,000,000	Andreessen Horowitz, Ancient8	Nov 30, 2022
Glip	Unknown Round	$2,500,000	Hashed, Prime Venture Partners	Nov 30, 2022
Hitbox Games	Unknown Round	$1,600,000	Fundamental Labs, Gate.io Labs	Nov 30, 2022
Burn Ghost	Seed Round	$3,100,000	BITKRAFT Ventures, Drive by DraftKings	Nov 29, 2022
Wanderers	Seed Round	$2,000,000	Animoca Brands, GameFi Ventures	Nov 28, 2022
Midnight	Seed Round	$7,500,000	Shima Capital, Woodstock Fund	Nov 25, 2022
Thirdverse	Unknown Round	$15,000,000	Fenbushi Capital, OKX	Nov 23, 2022
Carv	Unknown Round	$4,000,000	Vertex Ventures	Nov 22, 2022
MAD Metaverse	Pre-Seed Round	-	DWF Labs	Nov 22, 2022
NOVA Miningverse	Seed Round	$1,062,000	NFTb	Nov 22, 2022
Xternity	Seed Round	$6,000,000	NFX, Jibe Ventures	Nov 18, 2022
Heroic Story	Seed Round	$6,000,000	Upfront Ventures, Multicoin Capital	Nov 17, 2022
Play Ember	Pre-Seed Round	$2,300,000	Big Brain Holdings, Huobi Capital	Nov 15, 2022
Ultimate Champions	Seed Round	$4,000,000	Binance Labs	Nov 15, 2022

Figure 3: Even in the bleak midwinter, crypto gaming projects keep getting funded.

633,000 BTC – comes from the crypto products themselves. If they get traction, we will hear that old motto ring true again: new technologies get overvalued in the short term and undervalued in the longer term.

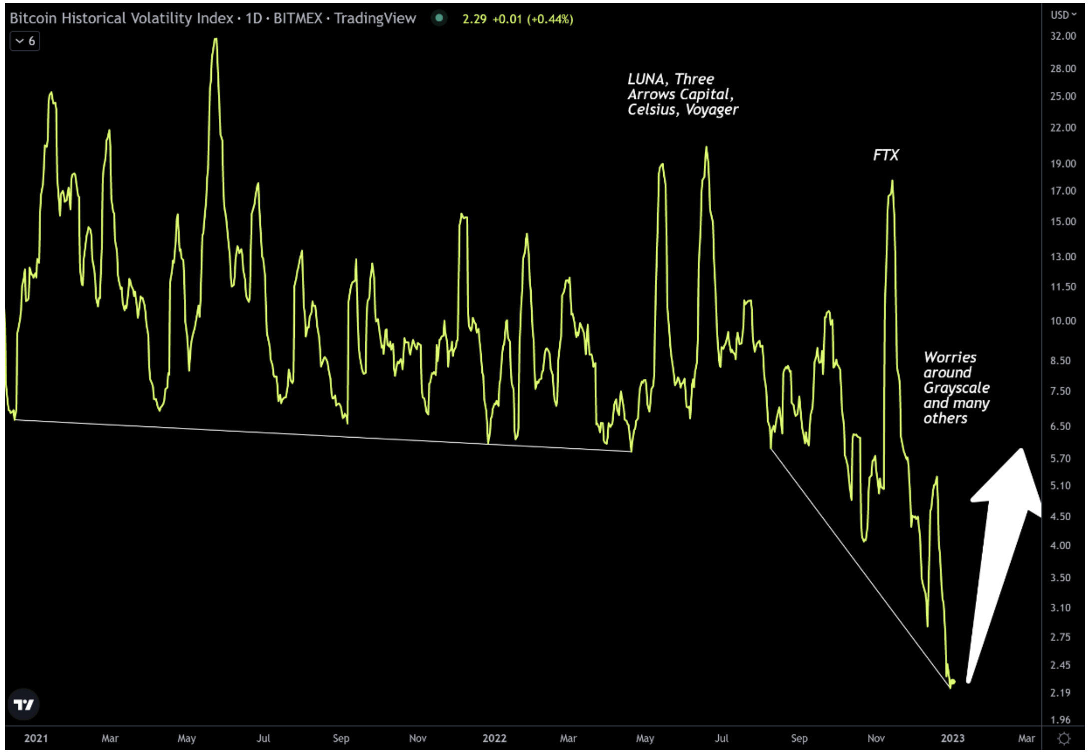


Figure 4: Volatility decreased throughout 2021 and 2022 and then collapsed in the last six months. Last year's most significant volatility events came from large projects, lenders, and funds blowing up. This chart spells opportunity for options traders. We expect a volatility spike in January and February, mostly from news around Grayscale.

In 2023 and 2024, I expect most from two sectors: gaming and infrastructure. The first is for the vast sums invested in 2021; the second is mainly for the same and for the early signs of progress over the past months in layer-2 technology. Ethereum is actually scaling now. In a few years, network congestion issues will be a thing of the past and should no longer hamper adoption.

DeFi getting regulated into oblivion is partly priced in; if it doesn't happen, not only will DeFi projects multiply – so will Ethereum and its scaling solutions. In fact, if we were to see a mini bubble next year, the source would likely be regulatory clarity on DeFi. This clarity does not have to be all positive – even bad regulation that is less destructive than expected could be enough. Low yields would still be a problem, but the market always prefers certainty over happiness and will gladly forget that fundamental problem for a while.

A second source for a 2023 mini bubble could be the launch of the first successful crypto game. We have seen successful crypto games before, but they never did much for adoption and rode the coattails of rising crypto enthusiasm among the masses. Better would be to see a crypto game do well *outside* the crypto community and *despite* a lack of interest in crypto. That would be monumental. It's also feasible. Perhaps not in 2023, but more likely in 2024, as unlike DeFi protocols, games take years to develop. (Maybe there wouldn't be as much trouble in DeFi if builders also took their time.)

So, that's Ethereum and altcoins. Now, things look less promising for Bitcoin, as its assumed feature as an inflation hedge is yet to prove itself (to put it mildly). But as for Bitcoin adoption, here is an interesting fact. Last year's corporate adoption may have felt disappointing, as we didn't read much about it, but the trend is clear. Below are the numbers of companies that held Bitcoin on their balance sheet.

2017	12
2018	3,479
2019	4,411
2020	282,743
2021	634,451
2022	572,317

It does not set my mind at ease yet, but – well, it does make you think. Especially since 2023 looks set to bring us a new macro narrative.

Macro

Inflation seems to have peaked. What does this mean for markets, historically? Let's look at the CPI peaks from 1950 to 2018 (Fig. 5). Of course, there is more to equities bottoming than inflation peaking, but inflation has been responsible for most of the market moves since late 2021, so we better pay attention when we see a change. The chart suggests the S&P may be behind us. The average number of weeks it took the S&P to bottom is 15 weeks. The S&P's recent lows came after 16 weeks.

At the very least, we will see inflation worries supplaced by recession worries (a consensus view), which should be an improvement in the short term, as rising unemployment and other bad news should induce the Fed to consider cranking up the money printer. For now, we are seeing no signs of a deterioration in the job market, but this can quickly change. One scenario for 2023 could be: inflation slows, Fed goes less hawkish, risk assets like crypto go up, recession fears become a reality, risk assets like crypto go down. A year from now, in December 2023, we may have seen a crypto mini-bubble. What would help particularly Bitcoin, is gold outperforming the market. A flight to gold as a safe haven should also involve a flight to bitcoin, as the two (still) share the same value proposition. BTC going up should also put other

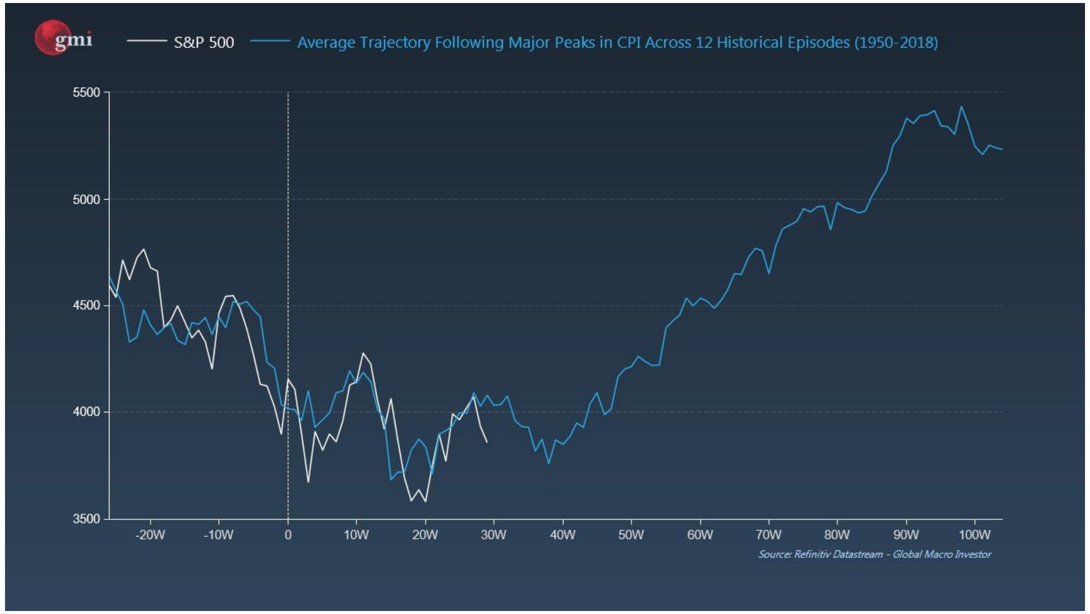


Figure 5: From 1950 to 2018, the average number of weeks it took the S&P to bottom after inflation had peaked was 15 weeks. The recent lows in October came after 16 weeks. (Chart by GMI.)

cryptos back into focus. (Gold going up substantially without BTC would be disastrous, on the other hand.)

Another major topic for macro investors that crypto investors should pay attention to is the results of China opening up after covid. We will see an increase in productivity and spending as the Chinese economy starts spinning, likely followed by higher energy prices (particularly oil) as Chinese demand increases. This should increase inflation. But consumer prices should deflate as we will probably see the reverse of last year's supply shortages. Gluts should help disinflation. Perhaps we will even reach the point where the

Fed will come to fear the specter of deflation in 2024 and fight it with, again, the money printer. (My, are we hooked on the money printer.) ◆ Sander Kok

SHORTING INFLATIONARY TOKENS

DYDX, OPTIMISM, AND 1INCH
READING TIME: 6 MINUTES | By Sander Kok

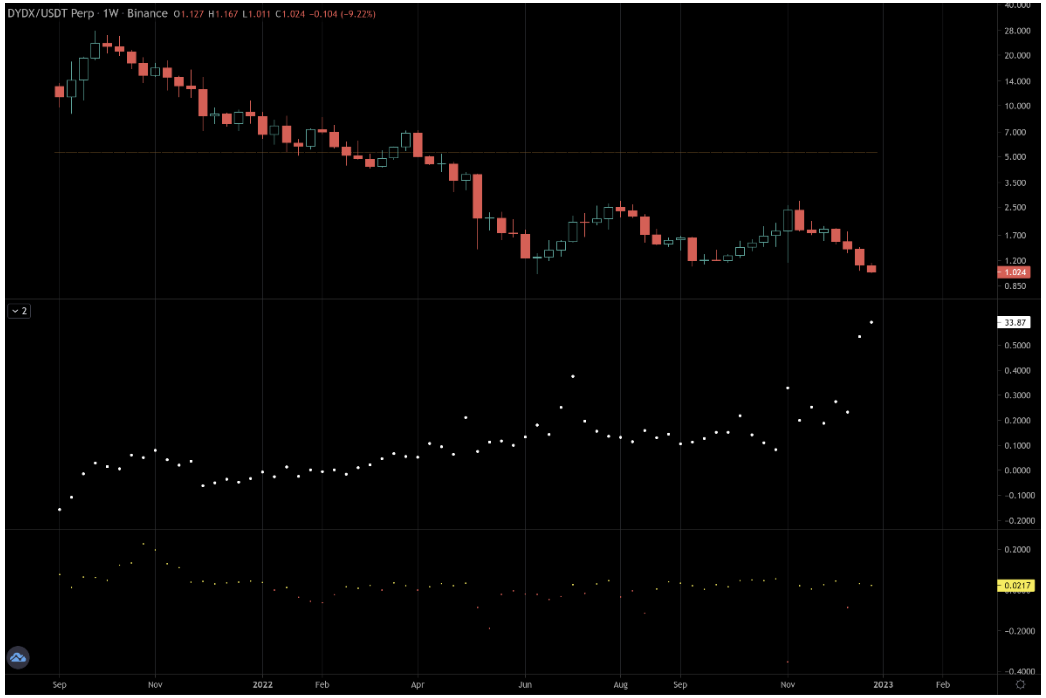


Figure 6: A vast rise in open interest while dYdX is at the lows. Funding is back positive.

While looking for spot longs at this point in the cycle makes sense, you may want to hedge your exposure by shorting some high-inflationary tokens. Let's look at three candidates: dYdX, Optimism, and 1inch.

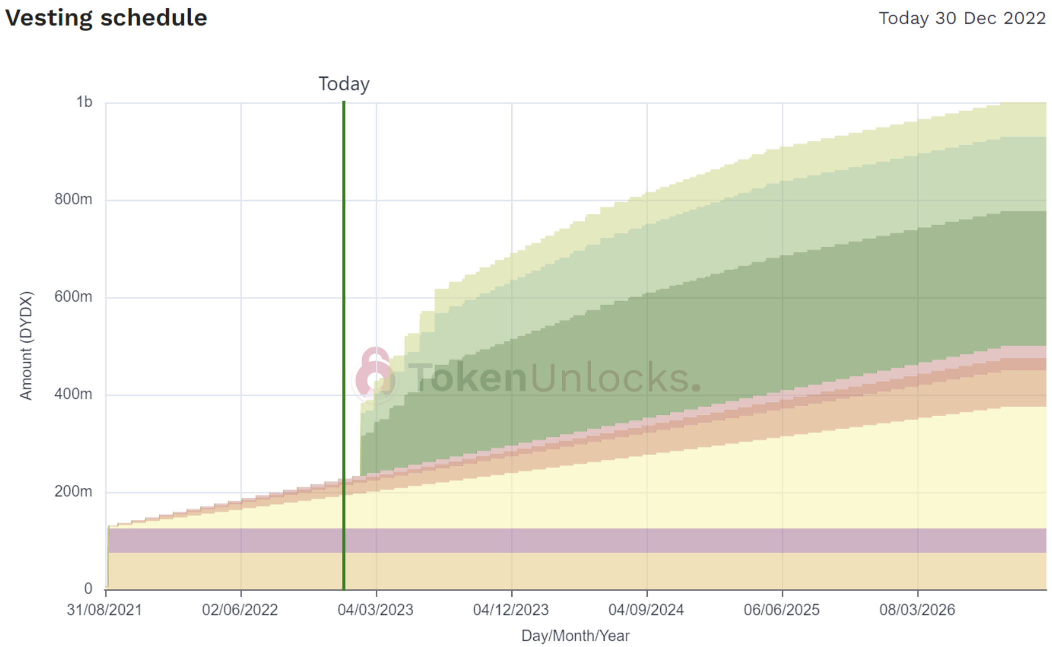


Figure 7: dYdX vesting schedule. (Courtesy TokenUnlocks.)

At a glance, the most suited is dYdX. It has a market cap of $146m and a fully diluted valuation of over $1b. At the time of writing, 77% of the tokens are locked. The popular DEX has a massive unlock coming up on February 2nd; the circulating supply will more than double on that date. In the subsequent six months, the circulating supply will increase by another ~50% so that by the summer of 2023, around 60% of the tokens will circulate. The remaining 40% will unlock by 2027.

At the risk of overthinking a tremendously lucrative shorting opportunity, it is wise to realize that this trade is also glaringly obvious. Whole families are taking it, and this is visible in the ballooning open interest (Fig. 6). dYdX is at the lows now and the trade is still crowded, meaning we are in short-squeeze territory. The funding rate tells a different story, though. It is currently positive, meaning longs are paying for the privilege to be long. It seems that the short trade has become so crowded and, therefore, so dangerous that traders have begun to take advantage. But since this trade has become glaringly obvious as well, and since the amount of capital backing it is even larger than the capital backing the short trade, the open interest has risen to astronomic levels while the funding rate is positive.

There are many ways this could resolve. Two scenarios have the highest probability. First: bulls take this up and build a trap for shorts that would start piling in with their last cents, increasing the potential for more downside. Second: dYdX takes another leg down, perhaps pushed off the cliff by general crypto malaise or macro worries, during which the recent longs are closed, pushing the price yet deeper.

That's it for the short term. For the longer term, dYdX is an excellent project, and chances are high that large parts of the locked tokens have already been sold over the counter during the bull market, perhaps even multiple times. Since this would have happened at ever larger discounts, the unlocks, though bearish, may not be as bearish as they seem.

If I were to short this token, my take-profit would be around an FDV of $800m. A possible long entry would be around a $500m-$700m FDV, as I rate this project a bit higher than its main competitor, GMX, which has an FDV of $560m (and does not have high inflation).

Another obvious candidate for shorting is Optimism. At the time of writing, 76% of OP are locked. The market cap is $195m and the fully diluted valuation is $3.89b.

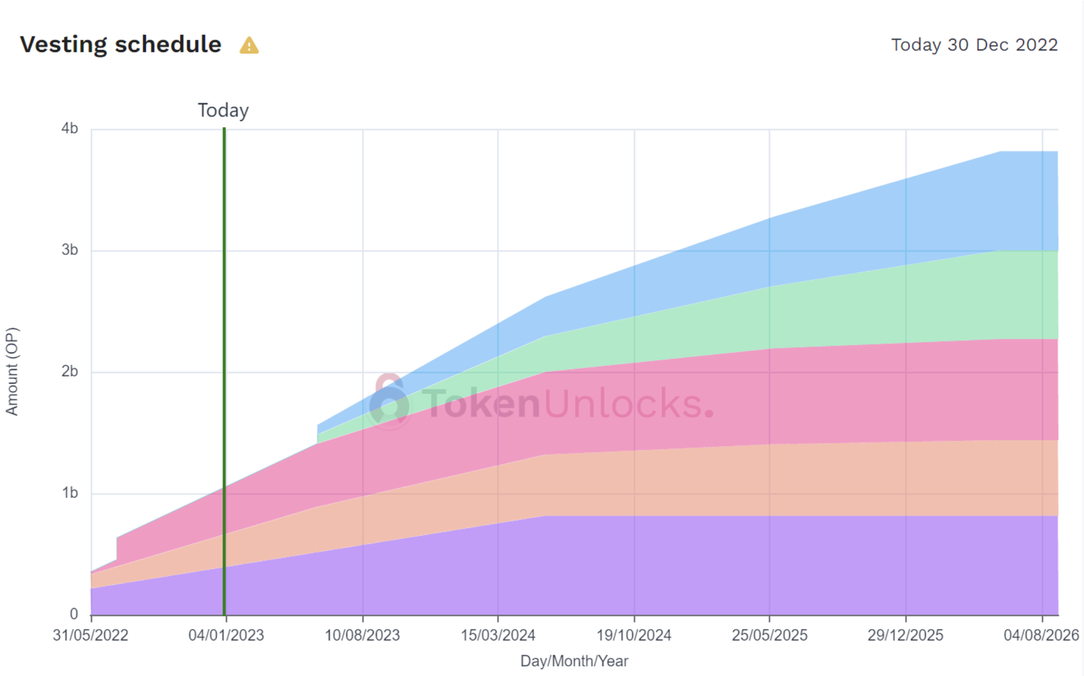


Figure 4: OP vesting schedule. (Courtesy TokenUnlocks.)

While layer-2 solutions for Ethereum look set to be a major theme in 2023, the vesting schedule spells persistent selling pressure. The exact vesting depends on governance decisions, but the chart above shows the correct amount of tokens set to unlock. By next summer, the number of tokens in circulation will grow by 50% to ~1b. By the spring of 2024, that number will hit ~2.5b and then steadily rise during the following two years to nearly 4.5b OP. Currently, over $2.1m worth of OP unlocks linearly every day.

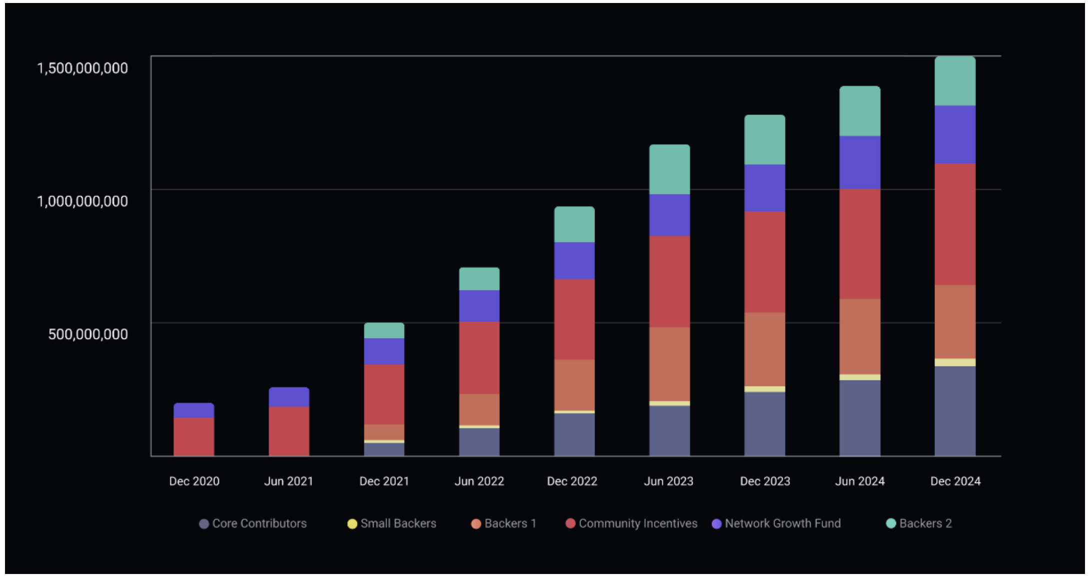


Figure 6: 1inch vesting schedule. (Courtesy 1inch.)

If 2023 indeed becomes the year of layer-2s, I can see Optimism being successful despite the unlocks, but these will greatly limit price appreciation. If you take this trade, be aware of the upside risk of L2s doing well and the fact that the project's governors – token holders – can choose to reduce the inflation. They cannot reduce it by more than half, however, as some key smart contracts are locked. Still, if a narrative like "Optimism reduces its inflation" takes hold during optimism around the protocol, we may see some late shorts get squeezed. Speaking of late shorts, the funding rate and open interest are at healthy levels. I do not expect much fireworks coming from that any time soon.

The third and final shorting candidate I want to discuss is DeFi aggregator 1inch. Its market cap is $292m and its fully diluted valuation is $561m. I am

Figure 5: 1inch token's price action with the unlock dates shown in red.

discussing this token because all token unlock websites I visited show incorrect data. Above is the vesting schedule according to the official 1inch documentation. As a side note, the unlock schedule is hardcoded in the vesting smart contract, so we should not expect any surprises from governance.

1inch's vesting schedule looks different from most others in that the unlocks do not happen linearly but rather spasmodically. The next unlock will occur next June 1st, causing an increase in circulating supply by ~250m tokens.

The red lines on the chart above are the unlock dates. The first unlock took place amid the bull market and was perceived as bullish – traders had probably been overly bearish going into the event. The second unlock occurred when the bull market was cooling – DeFi was no longer the center of attention as market participants were busy picking sides in the layer-1 wars. This unlock was met with a sharp price decline. The same happened with the third and fourth unlocks, which occurred during the bear market. If history is any guide, we should see more downside around the next unlock date.

We should revisit this topic this spring; perhaps, a bit more will be clear about DeFi and regulations. In the end, all longs and shorts in DeFi projects come with considerable down- and upside risk, owing to US regulators still taking their time to provide investors with clarity. ◆ Sander Kok

UPCOMING EVENT RISK FOR JANUARY

January 4

FOMC

Meeting Minutes

January 6

UNEMPLOYMENT

US Unemployment Rate Released (previous: 3.7%; expected: 3.7%)

January 12

CPI

US Consumer Price Index Print (expected: 0.1% m/m; core 0.2% m/m)

January 18

PPI AND RETAIL SALES

US Producer Price Index Print (expected: 0.3% m/m; core 0.4% m/m) and retail sales (previous: -0.6%; expected: -0.7%)

January 26

Advance GDP q/q

Annualized change in the inflation-adjusted value of all goods and services produced by the economy (previous: 2.6%; expected: 2.8%)

January
27

PCE

US Core PCE Price Index m/m (previous: 0.2%; expected: 0.2%)

CRYPTO TWITTER SAYS

"Many compare Solana's current trials to what the Eth community went through in the 2018 bear market.

One crucial difference is that, unlike then, Solana teams now have multiple options of other ecosystems to build on (often accompanied by generous "grant" incentives too).

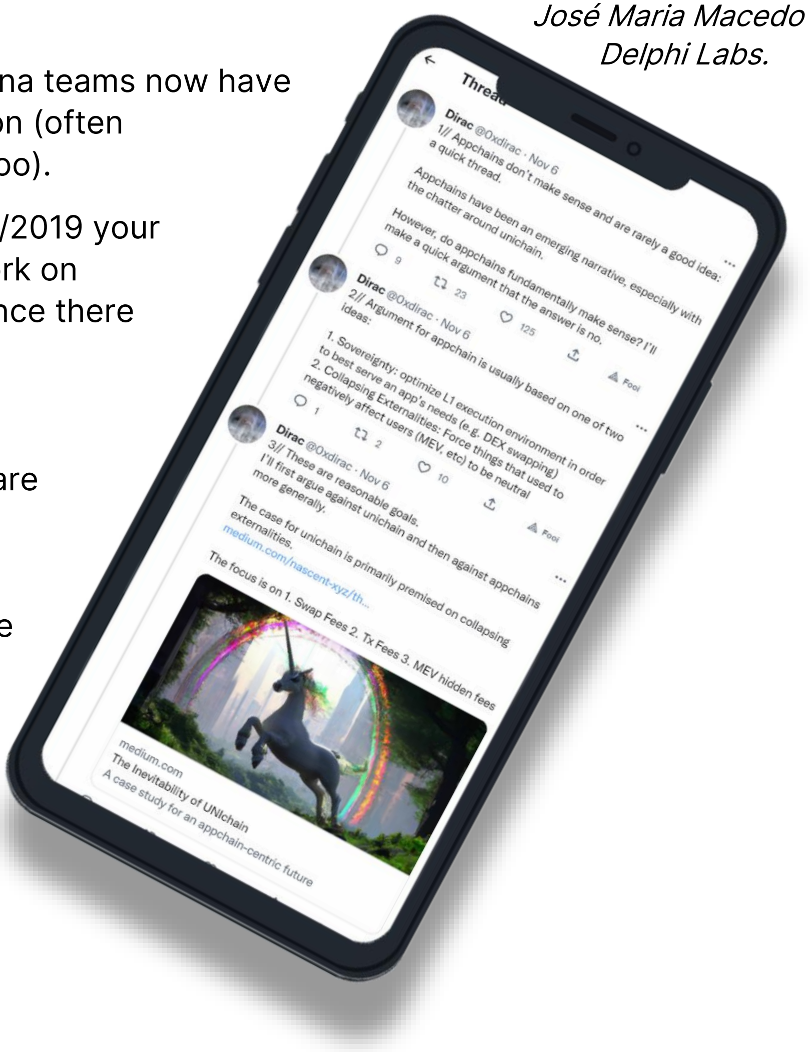
Assuming you believed in your project, in 2018/2019 your options were ride or die. You either made it work on Ethereum or you quit the project altogether, since there weren't really any legitimate alternative L1s.

Nowadays, the calculus is very different.

The only projects that need to stay on Solana are those built to take advantage of its particular characteristics (i.e. scalability).

Even these increasingly have alternatives in the form of Sui/Aptos, L2s and emerging app-chains like Sei.

To be clear, I'm optimistic Solana will survive and eventually thrive again. Differentiated tech + strong dev community + significant existing traction.



I also think it's much easier to bet on this than it was to bet on Ethereum in 2018."

—José Maria Macedo (@ZeMariaMacedo)

José Maria Macedo is founding partner of Delphi Ventures and head of Delphi Labs.

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