SPECTRA MARKETS

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am FX

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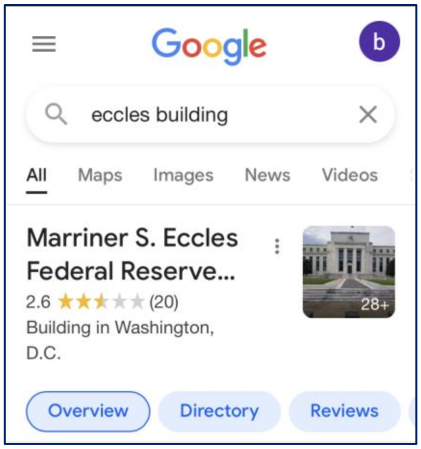


Sometimes you can't catch a break

Current Views

Sell 01NOV and buy 15NOV 1.3550 GBP put

Price 21bps off 1.3730 spot

Long 06DEC 0.7500 AUD digis

spot ref. 0.7285, cost 20%
Took profit on half at 0.7468 spot (42%)

Rabbit Hole #2
Bitcoin Proxy Mania

Welcome to Rabbit Hole #2. Today I briefly discuss the accurate belief that futures ETFs are inherently bad investments. Then, I do a deep dive into US-listed bitcoin proxies in an attempt to find better alternatives.

10-minute read, 2,400 words

Bitcoin!™

There has been a ton written this week about why futures ETFs are generally a bad investment. Futures ETFs are useful for short-term trading, but usually do a poor-to-abysmal job of tracking the underlying asset. They deliver disappointing long-run returns and serious tracking error because of negative carry, management fees, hedging and transaction costs, and cash balances. UNG and USO, for example, are famous for delivering horrendous returns as they fail to track anything close to the price of the commodity they are named after.

The bitcoin futures ETF is also likely to be a bad investment, but there are countless reasons an investor might want crypto exposure via a US-listed security. Some of those reasons are dumb, and some of them are valid. As a general rule, if you want exposure to something, you buy that thing. But in the case of crypto, there are so many inconveniences, custodial questions, regulatory and compliance hurdles, mandate issues, and practical considerations that there are times when a listed proxy might be the best, or only choice.

How bad are futures ETFs, anyway?

Before I explore the expansive world of listed BTC substitutes and proxies, let's have a quick look at the top futures ETFs to see just how bad they have been, and why. In the second section of today's Rabbit Hole, I will take a look at a huge list of listed BTC proxies and see how they correlate and perform relative to BTC and ETH. Prepare yourself for some extra large, somewhat colorful grid-patterned numberscapes.

Here is a meme that describes the whole situation surprisingly well:

Don't like memes? How about some data?

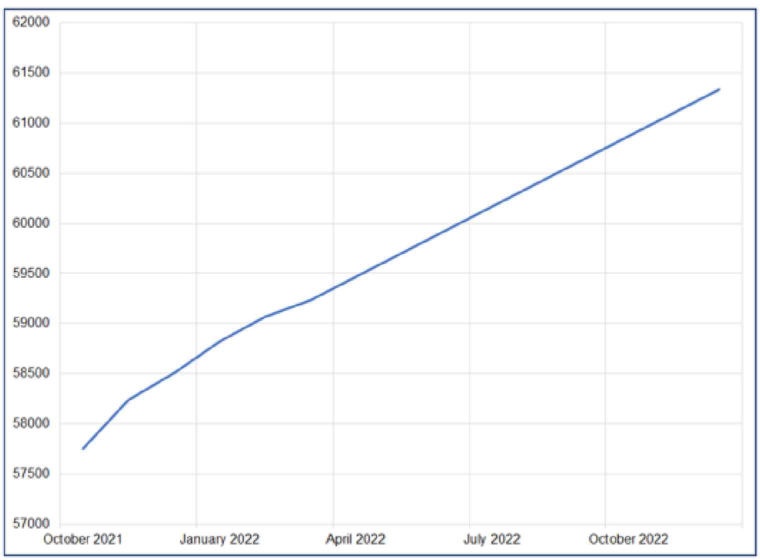
Performance of the largest commodity futures ETF vs. underlying spot

			ETF return			Spot return			ETF over/under performance vs. spot		
Symbol	**Holdings**	**ETF Name**	**1y**	**3y**	**5y**	**1y**	**3y**	**5y**	**1y**	**3y**	**5y**
USO	Near-month NYMEX crude	US Oil Fund	97%	-53%	-38%	102%	19%	64%	-4%	-72%	-102%
BNO	DEC Brent Crude futures	US Brent Oil Fund	105%	-2%	48%	104%	6%	71%	1%	-7%	-23%
UNG	NOV and DEC NG futures	US Natural Gas Fund	52%	-28%	-50%	182%	80%	96%	-130%	-108%	-146%
CPER	Futures via optimization process	US Copper Index Fund	51%	64%	109%	53%	65%	116%	-2%	-1%	-7%
Ultralong ETFs that target 2X daily return of the underlying											
UGL	DEC GC futures	Ultra Gold	-19%	65%	42%	-7%	44%	39%	-12%	21%	2%
AGQ	Silver futures and index swaps	Ultra Silver	-22%	48%	-10%	-5%	60%	32%	-17%	-12%	-42%

Investors cannot hold spot oil or natural gas, so there is no ETF arb. You see how badly these products drift from the underlying spot performance. The more frequently the futures curve is steeply in contango, and the more difficult (or impossible) spot vs. ETF arbitrage is, the worse the ETF performs[1].

The chart at right shows what the bitcoin futures curve looks like today. It tends to slope upwards. Not good for ETFs that like to play the front end!

CME bitcoin futures curve



What is an investor who wants US-listed crypto exposure to do?

So we know futures ETFs are ~~gambling~~ day trading vehicles, not investments. Now what?

The analysis that follows will consider only the price performance of various BTC proxies and quasi-substitutes and I will ignore any tax, regulatory or company-specific concerns. If you're worried about the quality of MSTR management, for example, you are not going to get any insight here. **My goal here is to answer: What listed stuff performs like bitcoin and what doesn't?**

I crowdsourced my list of BTC proxies on FinTwit and the list should be close to exhaustive. I didn't include every suggestion, but I took most of them. Some like FPAC and CIFR did not make the cut because they are too new and there is not sufficient data for proper crunching.

I first give you the mega table of complete numerical output, and then I'll drill down on what it all means.

[1] I have no idea why the Ultra Silver is so bad relative to the Ultra gold. Liquidity, maybe?

Bitcoin and its proxies

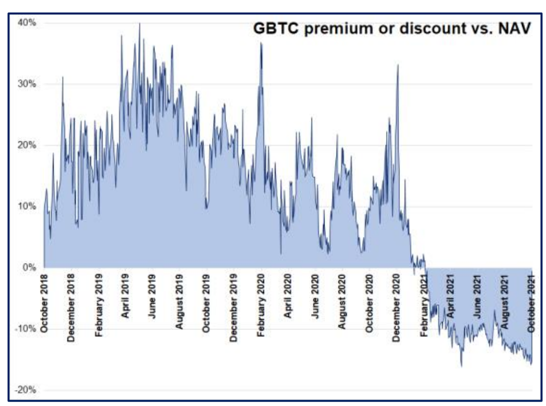
				Returns				Corr to BTC				Volatility			
Ticker	Relationship to crypto	Market Cap ($B)	Short interest	6m	1y	2y	3y	6m	1y	2y	3y	6m	1y	2y	3y
BTC	Bitcoin			0.10	4.27	6.78	8.67	100%	100%	100%	100%	4%	4%	3%	3%
ETH	Ethereum			0.69	8.85	20.50	17.52	76%	70%	76%	73%	5%	5%	4%	4%
GBTC	Grayscale bitcoin trust	32.6		(0.01)	2.70	4.43	5.79	91%	88%	87%	83%	4%	4%	4%	4%
MSTR	Owns BTC	7.9	27	0.18	3.57	4.24	4.85	76%	69%	58%	44%	4%	4%	3%	2%
BLOK	Blockchain ETF	1.3		(0.01)	0.98	1.85	1.81	75%	70%	63%	50%	2%	2%	2%	2%
MARA	Miner	4.9	16	0.38	19.89	29.18	19.05	68%	61%	52%	49%	5%	7%	7%	6%
HIVE	Miner	1.2	1	(0.03)	8.55	18.32	6.23	67%	62%	60%	56%	5%	6%	6%	6%
BITF	Miner	0.9	3	0.53	22.39	12.79		67%	57%	48%		5%	7%	6%	
RIOT	Miner	2.7	18	(0.32)	7.44	15.29	10.01	65%	61%	60%	56%	4%	7%	6%	5%
COIN	Exchange	59.0	4	(0.16)				61%				3%			
HUT	Miner	2.1	4	1.27	14.85	7.73	4.32	54%	57%	57%	54%	5%	7%	6%	6%
BTBT	Miner	0.6	8	(0.09)	1.74	23.23	0.67	50%	48%	32%	20%	7%	7%	6%	6%
CLSK	Miner	0.6	11	(0.10)	0.71	2.04	(0.51)	43%	38%	12%	10%	4%	5%	6%	6%
MOGO	Offers crypto	0.4	3	(0.21)	3.08	0.79		35%	42%	23%		4%	5%	5%	
SQ	Owns BTC	116.3	10	0.01	0.33	3.12	2.32	32%	32%	34%	24%	2%	2%	3%	3%
SI	Bank for crypto	4.2	13	0.28	8.02			31%	42%			4%	5%		
ARKK	Disruption!	20.6		(0.04)	0.13	1.76	1.75	27%	28%	37%	27%	2%	2%	2%	2%
NVDA	Mining hardware	555.1	1	0.42	0.62	3.59	2.65	27%	19%	30%	18%	2%	2%	2%	2%
TSLA	Owns BTC	845.6	4	0.18	0.96	15.40	14.97	23%	23%	26%	18%	2%	2%	3%	3%
PYPL	Crypto payments	315.3	1	0.00	0.34	1.65	2.46	23%	27%	31%	22%	1%	2%	2%	2%
OSTK	Blockchain and crypto lover	3.3	14	0.14	0.07	6.18	2.08	22%	22%	29%	24%	3%	4%	4%	5%
ANY	New entrant to mining	0.5	6	3.04	3.76	5.35	1.94	19%	20%	17%	3%	8%	7%	6%	6%
AMD	Chip maker	136.0	5	0.38	0.37	2.62	3.21	18%	14%	22%	11%	2%	2%	2%	2%
CME	Futures exchange	76.1	1	0.03	0.30	(0.01)	0.16	8%	11%	22%	15%	1%	1%	1%	1%
EBIT.U	CDN physical bitcoin ETF			0.09				90%				4%			
S&P 500	Risky asset	39,590.0		0.07	0.30	0.50	0.61	23%	19%	31%	21%	1%	1%	1%	1%
Gold	Analog version of bitcoin	11,000.0		(0.00)	(0.07)	0.18	0.44	-7%	1%	17%	16%	1%	1%	1%	1%

Returns data expressed as a multiple of original value so 4.27 means: “UP 427%”.
Another example to make sure it’s clear: 0.38 means “UP 38%”.
Volatility = absolute value of average daily change.

Takeaways:

1. GBTC is the most correlated proxy. This makes sense. It has underperformed significantly because it always traded at a premium and now it trades at a discount to net asset value (NAV). At right you can see the chart of the GBTC premium or discount vs. NAV.

   Much as buying GBTC hurt investors who entered at a premium, it could now help those investors who enter at a discount. The risk is that no physical ETF ever comes to the USA, other products flourish, GBTC gets forgotten, and the discount just widens and widens forever.



2. The Canadian physical ETF (EBIT.U, in gray, near the bottom) looks good, and some American investors can buy it. Logically, it should track BTC very closely. There are other physical bitcoin trackers out there too (Switzerland, etc.) but none in the USA.
3. MSTR and some of the miners are decent proxies. The miners are hella volatile and this has helped them outperform BTC in many cases.
4. In contrast, the blockchain ETF (BLOK) is much less volatile and has performed much worse than BTC. A good proxy should have high corr and roughly equivalent vol. BLOK doesn't fit.
5. There is not enough data to judge COIN but its volatility is very low relative to BTC and it looks like a bad proxy. The low vol can be addressed with leverage if you really want, but it's getting way too complicated at that point.
6. Typical larger caps that enter the conversation when it comes to BTC are not good proxies. TSLA, SQ, PYPL, NVDA, etc. are much too large and run diversified businesses. Their bitcoin dabbles don't move the needle. They might be good companies, they might be good stocks, but they are not good bitcoin proxies.
7. Did you know Ethan Allen furniture changed their ticker from ETH to ETD recently to alleviate confusion because people were buying it thinking they were buying ethereum? That is funny.
8. Gold vs. BTC corr has flipped as investors switch out of BTC and into gold. There is ample evidence to confirm this in the flow data, though I know there are people that do not believe this story. I do.

Now let's zoom in on the data and slice it a bit differently. The next table shows only the proxies with >50% correlation. By the way, I used correlation of daily changes for corr, and average daily percent change for vol. In this next table, I compare the bitcoin proxies to BTC in terms of volatility (column 5) and show differential performance in the rightmost four columns.

The best US-listed bitcoin proxies

					Corr to BTC				% out/underperformance			
Ticker	Relationship to crypto	Market Cap ($B)	Short interest (% of float)	Vol (multiple of BTC)	6m	1y	2y	3y	6m	1y	2y	3y
GBTC	Grayscale BTC trust	32.6		1.2	91%	88%	87%	83%	(11%)	(157%)	(234%)	(288%)
MSTR	Owns BTC	7.9	27	1.2	76%	69%	58%	44%	8%	(70%)	(254%)	(382%)
BLOK	Blockchain ETF	1.3		0.7	75%	70%	63%	50%	(11%)	(328%)	(493%)	(686%)
MARA	Miner	4.9	16	1.9	68%	61%	52%	49%	28%	1563%	2240%	1038%
HIVE	Miner	1.2	1	1.7	67%	62%	60%	56%	(13%)	428%	1155%	(244%)
BITF	Miner	0.9	3	1.9	67%	57%	48%		43%	1813%	602%	
RIOT	Miner	2.7	18	1.8	65%	61%	60%	56%	(42%)	317%	851%	134%
COIN	Exchange	59.0	4	0.7	61%				(26%)			
HUT	Miner	2.1	4	1.9	54%	57%	57%	54%	117%	1058%	95%	(435%)

% out/underperformance is simple arithmetic: (BTC performance – proxy performance)
Example: BTC up 350% and proxy up 100%, %out/underperformance = (250%)

More takeaways:

1. GBTC is a good US-listed bitcoin proxy. It's highly-correlated, similarly volatile, has a decent market cap, and trades at a discount to NAV. Those huge red underperformance numbers are primarily a legacy of the premium. Still, NAV discounts can be a value trap. If the discount leaks wider and wider as no physical ETF is ever authorized by the SEC, GBTC performance could be extremely disappointing.
2. MSTR is highly correlated, about the same vol as BTC, but has underperformed badly. This could be a mean reversion play or it could be that people don't like management. The 27% short interest is a mild bullish kicker. Also, note the market cap of MSTR is very close to the value of its bitcoin, so MSTR is close to a pure play. The residual software business is not important to the story. They own 114,042 bitcoin at $61,250 which is about $7B. The market cap is $7.9B. Keep an eye on opportunities to scoop at a discount to "NAV".

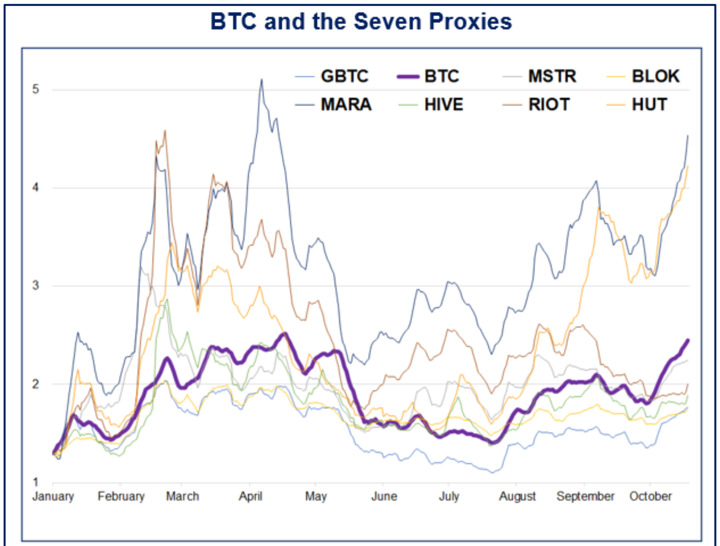
I still remember 2000 and I am cult-of-personality averse, so I find MSTR hard to stomach. But you can decide how much idiosyncratic risk you are willing to bear here. 20 years ago is a long time and the charges against MSTR were settled with no admission of guilt. So history could well be totally irrelevant to the decision on BTC proxies at this stage. And cult of personality leadership seems to work for plenty of companies these days!

3. Miners are high vol, high performance, turbo BTC. Their market caps are tiny still, so it's risky but not insane to extrapolate that they might keep outperforming in a bull market. They look like BTC after a few too many Four Lokos. You can hedge the idiosyncratic company risk by trading a basket.

At right is one more visual to give you a sense of the ebbs and flows of the products in the table above.

It's worth noting that my analysis is backward-looking. I'm not expert enough to tell you what companies will rule the crypto universe in 2032. This Substack: "Square is a bitcoin company" from star bitcoin investor and influencer Anthony Pompliano, for example, may suggest SQ will be a better bitcoin proxy in the future than it has been in the past.

You can look exclusively in a car's rearview mirror and have a reasonable guess at what the road ahead might look like. But you also need to look forward.



They ebb and flow together, with radically different volatility profiles

How to trade it

Every one of these highly-publicized BTC ripper events has been short-term buy the rumor / sell the fact (e.g., launch of BTC futures 2017, Coinbase IPO, Elon on SNL 2021, BTC day in El Salvador…) See charts in the appendix. I don't see why this should be an exception. There is a massive wall of leveraged spec money front-running this launch and the product is likely to meet limp demand. This ETF is a distraction for anyone that really cares about bitcoin and it's a trap for any short-term trader expecting huge inflows.

The bitcoin futures ETF is a solution looking for a problem and a majority of traders and investors finally understand: futures ETFs are bad. The flow will not be big enough to take out the late spec longs and I assume we see a zippy buy rumor / sell fact style correction back towards 52k this week. ATH nearby in BTC so if you go short this morning when the ETF starts trading, your stop loss is clear. If $67,100 trades (ATH plus a bit of wiggle room) that invalidates the buy rumor/sell fact trade.

Pushback to my bearish view is: 1) lending doesn't show massive longs, 2) supply shock ratio not bearish 3) buy rumor / sell fact getting kind of obvious at this point. All fair rebuttals.

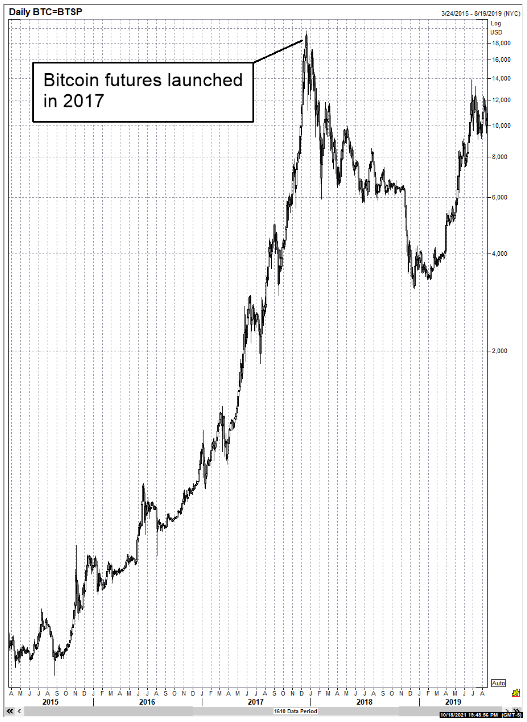
Conclusion

The coming bitcoin futures ETF is likely to be a disappointment for poorly-informed investors who expect it to approximate the performance of the price of bitcoin. Negative carry is financial rot—the exact opposite of the magic of compounding.

There is no perfect US-listed bitcoin alternative. Take a look at the proxies I described today and pick one or many that might suit your needs. Just remember that the proxies are not bitcoin. They are more like what bitcoin would see if she looked in a carnival funhouse mirror.

good luck ⥮ be nimble

APPENDIX: BUY THE RUMOR SELLTHE FACT IN BTC X 3

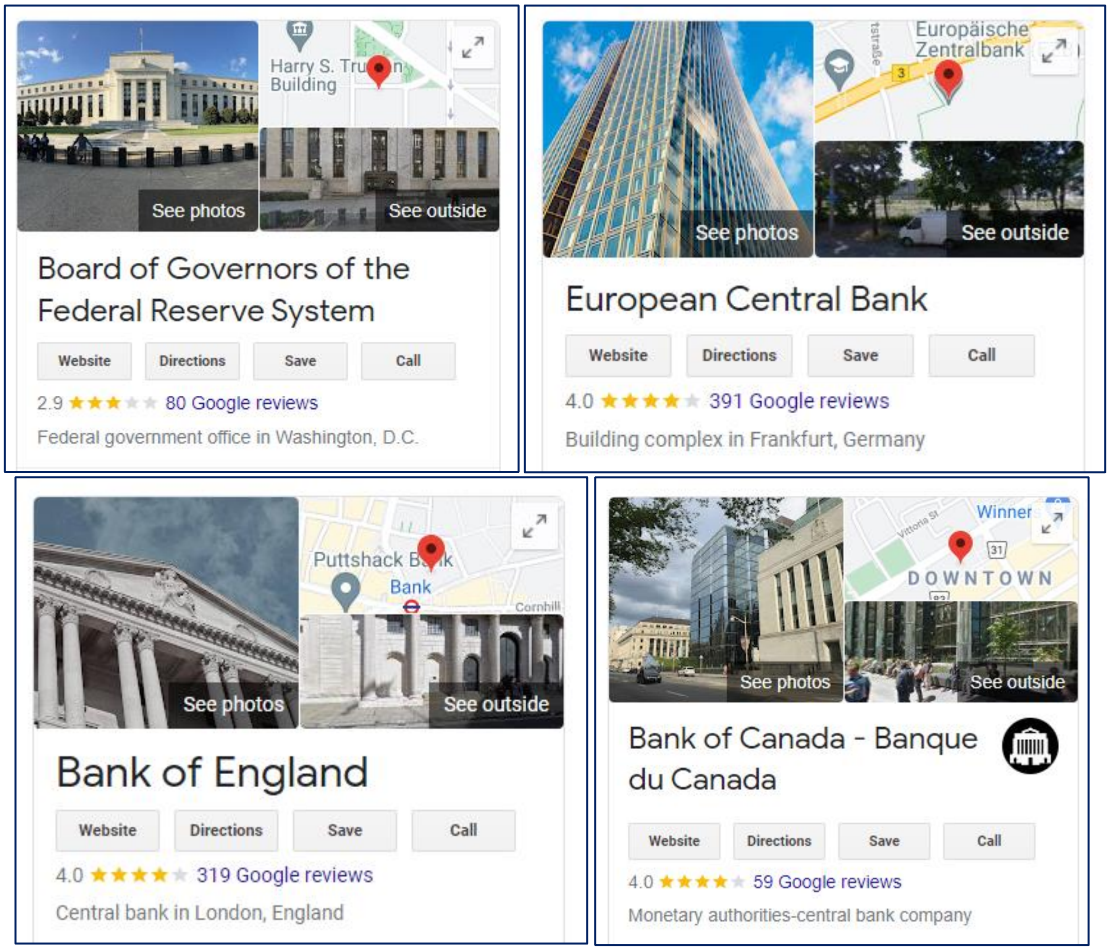


Research article

Can we use alternative data to evaluate central bank credibility?

Donnelly, Brent, *Spectra Markets*

Abstract



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