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Weekly Market Flash

Bitcoin price action: a sign of normalization?

May 23, 2021

Volatility returned to financial markets this week, with cryptocurrencies collapsing on Wednesday. Bitcoin lost more than -30% at one point during the day, before recovering and stabilizing below the 40k level. These moves contributed to a sense of confusion, or at least a lack of clarity, among investors, with markets appearing trendless – both value and growth sectors were under stress from commodity weakness or pressure on rates. While the newsflow against the crypto universe was material, we tend to read the price action as a definitive sign of normalization, both in terms of upcoming policies and "back to normal life", with the developed economies so advanced in the vaccine distribution process.

Highlights

▪ Bitcoin broke below the 200-day moving average. The break, combined with the typical head and shoulder pattern and the divergence in RSI, are clear signals of a temporary trend reversal.

▪ The release of the Fed minutes, with the most important takeaway being that the Fed may only be a few meetings away from starting to discuss how and when to adjust the pace of asset purchases, constitutes another headwind risky assets.

▪ US stocks witnessed a volatile trading week. Inflation concerns on the one hand and a strong economy on the other hand left investors unsure about the path forward. European stocks were also mixed, while Japan's stock markets ended the week higher.

▪ UniCredit's CEO decided to deliberately skip the coupon on their CASHES securities. While the CASHES were already trading at a discount given the structural uncertainties, prices on the bonds dropped by 7-8 points.

"Our understanding is that the rally in Bitcoin has been sustained by two elements: expectations of monetary debasement by central banks, and a continuation of super easy monetary support in a low rates environment..."

Markets & Macro | Bitcoin price action: a sign of normalization?

Buy-the-dip is not dead yet.

Cryptocurrencies were under attack on multiple fronts during the week, including from:

• There was continuous noise from Elon Musk's tweets, making the assets unstable and unreliable as a store of value

• The People's Bank of China reiterated that digital tokens can't be used as a form of payment, making the currency less attractive as a means of payment

• The recent increase in inflation and inflation expectations. Our understanding is that the rally in Bitcoin has been sustained by two elements: expectations of monetary debasement by central banks, and a continuation of super easy monetary support in a low rates environment (and the implicit support provided to valuations of all growth assets, with flows and benefits to appear in the very distant future)

• News that the Colonial Pipeline attack led to ransom that was paid in cryptocurrencies, increasing fears of further scrutiny from regulators

• The release of the European Central Bank's (ECB) latest Financial Stability Review, which stated that the surge in the Bitcoin price has eclipsed previous financial bubbles like the "tulip mania" and the South Sea Bubble in the 1600s and 1700s

• The US Treasury proposed that crypto transfers worth over USD10,000 must be reported to tax authorities in order to avoid tax evasion, potentially creating a tax liability

Our view: Bitcoin was the symbol of the "Covid world", made of lockdowns, working from home, enormous fiscal and monetary stimulus, a deflation shock and technology/innovation against traditional sectors. The price action this week suggests that this world is (fortunately) over, unless some of the new variants create new damages, and that the new reality is made of higher inflation, sub-optimal growth (once the base effects fade), and a huge debt load having been accumulated over the past year in the order of 20 to 30 points worth of GDP in most countries. As central banks are very slowly preparing the world for policy normalization, it is natural for us to see some of the excesses recede, with the cryptos correcting and equity markets struggling to rally on positive news, macro (economic data) or micro (earnings results). The collapse in cryptos, while affecting financial markets, did not have the contagion effect that some commentators feared. Given the wild movements of the last few months, these instruments do not have a significant enough presence in portfolios to create the typical violent VaR shock forcing investors to liquidate other uncorrelated positions. The impression is that after such a blow, the crypto asset class will offer, for a while, mediocre returns, but as highlighted by our Chart of the Week, it should resume its upward trend in the future.

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Elsewhere, the release of the Federal Reserve (Fed) minutes, with the most important takeaway being that the Fed may only be a few meetings away from starting to discuss how and when to adjust the pace of asset purchases, constitutes another headwind for risky assets. Real yields rose and the US dollar stabilized after the release – a sign that investors are slowly starting to prepare for a reduction of monetary support likely after the summer. Even though economic targets, especially in terms of job creation, remain far from the Fed's objectives (and the rise in inflation is considered transitory for the time being), the possibility of a gradual reduction in liquidity could once again fuel concerns around Fed policy.

Moreover, the price action in equities cannot be reduced to a secondary effect of the crypto crisis. It is evident that once again the new highs in Europe have not led to bullish breakouts of the recent range, mainly due to Wall Street that does not cooperate; the weak US dollar was not sufficient either to support global equities as per its traditional role in easing fears and financial conditions. After the impressive rally in equity indices over the past year, it is also worth noting that it has been six months since the market experienced a 5% pullback. Another reason to fade the attempts of breakout by major equity indices is the lack of market leadership by the US tech sector. As we saw and commented over the past few weeks, tech stocks suffer from "back to travel" (as opposed to "work from home"), and from the exit from the extremely low interest rate environment.

Although so far the assaults on the resistances (4,200 for the S&P 500 index and 4,000 for the Eurostoxx 50 index) have failed, which does not bode well for the trend as it constitutes a loss of momentum, chasing bearish accelerations and the breaking out of the averages has turned out to be a failing strategy too. Buy-the-dip is not dead yet. As a consequence, the "ranging" market appears to be the most likely scenario for the moment, with a major risk of at least a test to the key support level for the S&P 500 index at 4'000.

"The break, combined with the typical head and shoulder pattern and the divergence in RSI, are clear signals of a temporary trend reversal."

Chart of the week

Bitcoin broke below the 200-day moving average. The break, combined with the typical head and shoulder pattern and the divergence in RSI, are clear signals of a temporary trend reversal. Our target at 30k was met faster than expected. At this level the market bought the dip with high volumes in the futures market, finding a temporary bottom.

Figure 1: Bitcoin Breaks 200-DMA

Source: Bloomberg, as at May 21, 2021.

Equities | A clouded fundamental outlook

Q1 earnings season shows limited impact of earnings surprises.

US stocks witnessed a volatile trading week. Inflation concerns on the one hand and a strong economy on the other hand left investors unsure about the path forward. This is clearly demonstrated across a variety of sentiment indicators which retraced from extreme bullish levels. For example, the AAII sentiment survey shows investors becoming more neutral and less bullish on the stock market over the next six months.

"...we are concerned that for the second earnings season in a row, earnings surprises, as one of the major factors for share price movement, were barely present this earnings season."

Figure 2: Global Equity Market Performance

	Value	WTD % Chg	MTD % Chg	YTD % Chg
Dow Jones	34,207.84	-0.43%	1.17%	12.61%
S&P 500	4,155.86	-0.39%	-0.49%	11.28%
Nasdaq	13,470.99	0.33%	-3.45%	4.81%
Euro Stoxx 50	4,025.78	0.27%	2.04%	15.23%
Swiss Market	11,225.58	1.00%	2.04%	7.77%
FTSE 100	7,018.05	-0.23%	0.98%	10.32%
CAC 40	6,386.41	0.18%	2.76%	16.63%
DAX	15,437.51	0.14%	1.99%	12.53%
FTSE MIB	24,975.00	0.84%	3.45%	12.92%
Nikkei 225	28,317.83	0.83%	-1.72%	3.91%
Hang Seng	28,458.44	1.70%	-0.66%	5.22%
CSI 300	5,134.15	0.51%	0.28%	-1.31%

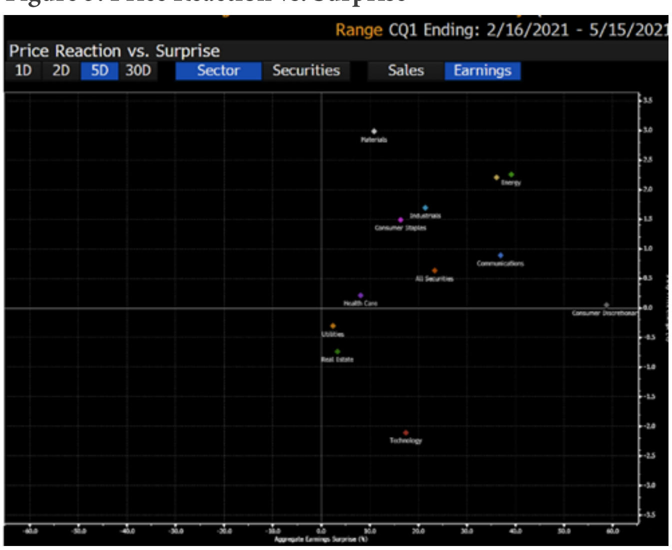
Source: Bloomberg, as at May 21, 2021. Performance figures in indices' local currencies.

Elsewhere, equity positioning, according to Deutsche Bank data, has been declining since mid-April from above historical range levels, driven by "discretionary positioning as put/call ratios have risen while sentiment indicators have declined and fund flows have slowed."

Our view: As the Q1 earnings season comes to an end, we are concerned that for the second earnings season in a row, earnings surprises, as one of the major factors for share price movement, were barely present this earnings season. This was nowhere more evident than in the negative price reaction of the technology sector, which fell by roughly -2% five days following earnings, despite a roughly 17% aggregate earnings surprise.

"The fundamental outlook, as a result, is clouded by macro concerns regarding inflation and by policy changes."

Figure 3: Price Reaction vs. Surprise



Source: Bloomberg, as at May 21, 2021.

The fundamental outlook, as a result, is clouded by macro concerns regarding inflation and by policy changes. As we stated in previous Market Flash editions, China's COVID experience is probably a good template for what to expect for the rest of the world, having gone from virus containment to monetary easing to economic rebound and now into tightening. Beijing is currently battling commodity price inflation via a set of measures aimed at cracking down on speculation and hoarding. Chinese equities continue to feel the weight of the tightening policy, with the CSI 300 index down 1.48% year-to-date.

Fixed Income & Credit | UniCredit skips CASHES coupon

“...at a price of 54 corresponding to a yield of approximately 6%, for clients able to bear some volatility, this could be an interesting entry point.”

Does the 2-year bond offer an interesting entry point?
UniCredit’s new CEO’s first bold decision to deliberately skip the coupon on their CASHES securities has taken the fixed income investor community by surprise. While the CASHES were already trading at a discount given the structural uncertainties, prices on the bonds dropped by 7-8 points. This was an aggressive move because in the past, UniCredit paid the coupon when they could have chosen not to.

Our view: The CASHES were issued in 2008 to recapitalize UniCredit’s balance sheet. The bond was recognized as core capital and priced deep out-of-the money. The instrument will be converted into ordinary shares at maturity (2050) at a share price of €30.8, while the stock is currently trading at €10.1. The interest payments of the CASHES are non-cumulative and the coupon rate is set at 450 basis points plus 3-month Euribor (currently -0.54%). To pay the coupon, the following conditions are needed: make a net profit for the year, pay a dividend, and have a net profit large enough to pay both dividend and CASHES coupon.

In 2018, the ECB reconfirmed to recognize the CASHES at 80% (€2.4 billion) as CET1 capital and the remaining 20% (€600 million) as grandfathered tier 1 capital until December 2021. To preserve this important source of capital, the old management created reserves of €126 million for CASHES coupons. For FY 2020, UniCredit made a “technical” net loss because of the write-down on the Yapi Kredit stake, therefore the decision was to not pay. Clearly a U-turn versus the previous management, which in 2020 even amended its articles to allow a coupon payment notwithstanding the ECB ban on dividends. Incredibly, they continue to pay dividends and do share buybacks.

Currently, the market appears to be pricing the bond with a 2-year coupon skip, anticipating potential M&A activity (purchase of Monte dei Paschi), which would lead to one-off provisions due to restructuring charges. Despite this and considering the construction of the bond, at a price of 54 corresponding to a yield of approximately 6%, for clients able to bear some volatility, this could be an interesting entry point.

Week Ahead | Key events to watch for

Next week will be quiet in terms of economic data and policy-related events. We have to wait for the first week of June in order to see market moving data, namely the two ISM reports and the May payroll report.

- **A couple of data releases will attract attention:** the US Conference Board’s consumer confidence index and the German Ifo business climate indicator.

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