ISSUE 2. SEPTEMBER 2023

Market Update

Monthly review of market developments

1 Who we are

We are a group of part time Master's students specialised in Banking, Finance and Analytics at King's College London, with students joining from all corners of the world.

2 Why we do this

Inspired by our diverse community, we created this project in order to join our experience and knowledge and apply it to the formation of a unique perspective on markets. We do so by capturing intriguing stories and combining them with detailed market research and data analysis. In such way we support each other to develop stronger analytical skills and become better investors. We are excited to share our analysis with the Finance community, or with anyone who shares the same passion!

3 What it does for you

Our comprehensive analysis spans across multiple crucial domains including the Macro Economy, stocks, bonds, commodities, cryptocurrencies and real estate. Through the in-depth study of these sectors, we aim to offer a holistic view of the financial world which enables our readers to make informed decisions and gain a strong understanding of the complex dynamics at play.

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Grasping the Big Picture: Does It All Add Up?

By: Chun Wang Adrian Ip & Thomas Petters

Powell's hawkish remarks in Jackson Hole, Fitch downgrading the credit rating of US, a three-week losing streak for S&P and Nasdaq and the National Catfish Month celebration have rounded up an eventful August. Both retail and professional investors are anticipating a recession, a topic discussed by many since as early as last year when the inflation figures surged and yield curve inverted, but when will it materialize?

In this month's article, we explore why the U.S. has avoided a recession thus far and examine recent developments in the economic landscape.

Starting from the 1970s, the ten-to-two year yield-curve spread becomes negative before each economic recession (see figure 1), and it steepens as soon as recession begins (shaded areas). Despite the enduring inverted yield curve and weak readings of leading economic indicators, the economy has defied recessionary expectations and remained relatively robust since the Fed started its tightening cycle in 2022. To comprehend why, we must first define the cornerstones of a recession. The official technical definition provided by the NBER is always done ex-post, which doesn´t make it helpful for real-time decision-making. Nevertheless, the key elements that define a recession offer valuable insights, as we can look at certain datapoints in real time.

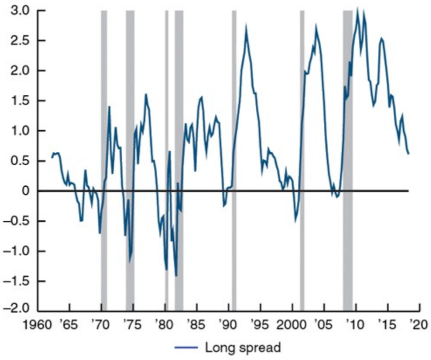


Figure 1. Source: Federal Reserve Bank of Chicago

The Overall, a recession signifies a sustained drop in consumer spending, decreasing incomes relative to changes in consumer prices, layoffs and a significantly lower level of employment. While the employment rate is central in the [NBER`s definition](), it is of little use in assessing a recession because it is the slowest moving and therefore most lagging economic indicator.

Investors typically rely on "leading indicators" tied to interest rates, like policy rates, yield curves, as well as housing and durable goods demand, to predict recessions. The logic is that interest rate tightening slows down economic activity and the sectors that are most sensitive to changes in the interest rates should provide early signals. While there have been some cracks locally, broad economic data hasn't confirmed a widespread deterioration among these indicators yet. This discrepancy is often attributed to the lag between leading indicators and the broader economy. Still, we should examine this more closely.

The two key factors influencing the current economic landscape and making it particularly complex are likely to be the discrepancies between structural and cyclical changes in the United States.

From the 1950s, the U.S. has transformed structurally from a manufacturing economy to a service economy, reducing the overall sensitivity to interest rate hikes. There has also been a transformation in the private sector's balance sheet, with short-term government-related assets (MMFs, T-Bills) partially replacing private sector debt instruments. In addition to these short-term asset shifts, there has been a substantial debt reduction within the private sector, with a notable focus on reducing housing-related liabilities. These shifts have altered the monetary policy transmission mechanism, making it more resilient to rate hikes and let the private sector, at least for some time, be a net beneficiary of tight monetary policy. Amid the highly accommodative monetary policy following the COVID shock, numerous corporations secured cost-effective long-term funding and are now achieving attractive yields on their substantial cash reserves.

From a cyclical perspective, the massive fiscal and monetary response to COVID-19 played a pivotal role in the overall economy. Congress approved a sum of $5 trillion in COVID stimulus packages that flooded the U.S. economy with substantial amounts of money, which continues to serve as a predominant source of spending and income in today's economy, particularly in the consumer services sector. Moreover, unspent excess income is in cash backed by short-term government securities, which earn interest for higher earning individual and well capitalized corporations as rates rise. Further, newly established programs like the "Inflation Reduction Act of 2022" or the CHIPS Act serve as a "historic down payment on deficit" and once again provide massive fiscal support for the U.S. private sector.

These factors collectively create a slow moving late-cycle environment that's more resilient to policy tightening, relative to other cycles we've experienced in recent history. Monitoring consumer behavior and savings rates will be essential in predicting the future course of the current economic cycle. In anticipation of a deterioration of the economic situation, we must acknowledge that this process may take a long time and may be slower than expected by most market participants. Regarding the Fed's interest rate policy, the likelihood of a 'higher for an extended period' scenario is growing, yet it's gradually taking hold in investors' perceptions.

MEETING PROBABILITIES											
MEETING DATE	325-350	350-375	375-400	400-425	425-450	450-475	475-500	500-525	525-550	550-575	575-600
20.09.2023				0,0%	0,0%	0,0%	0,0%	0,0%	78,5%	21,5%	0,0%
01.11.2023	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	38,0%	50,9%	11,1%
13.12.2023	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	3,5%	39,2%	47,3%	10,1%
31.01.2024	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,5%	8,6%	40,3%	41,9%	8,6%
20.03.2024	0,0%	0,0%	0,0%	0,0%	0,0%	0,2%	3,1%	18,8%	40,8%	31,2%	5,9%
01.05.2024	0,0%	0,0%	0,0%	0,0%	0,1%	1,4%	9,5%	27,8%	36,9%	20,9%	3,5%
12.06.2024	0,0%	0,0%	0,0%	0,0%	0,8%	6,0%	19,9%	33,0%	27,8%	11,0%	1,5%
31.07.2024	0,0%	0,0%	0,0%	0,5%	4,2%	15,2%	28,6%	29,5%	16,6%	4,7%	0,5%
18.09.2024	0,0%	0,0%	0,4%	3,5%	13,0%	25,9%	29,3%	19,2%	7,1%	1,3%	0,1%
07.11.2024	0,0%	0,3%	2,5%	9,9%	21,7%	28,2%	22,5%	11,1%	3,2%	0,5%	0,0%
18.12.2024	0,2%	1,9%	8,0%	18,7%	26,6%	24,0%	14,0%	5,2%	1,2%	0,2%	0,0%

TOTAL PROBABILITIES				
MEETING DATE	DAYS TO MEETING	EASE	NO CHANGE	HIKE
20.09.2023	22	0,00 %	78,50 %	21,50 %
01.11.2023	64	0,00 %	38,00 %	62,00 %
13.12.2023	106	3,47 %	39,18 %	57,35 %
31.01.2024	155	9,14 %	40,35 %	50,52 %
20.03.2024	204	22,05 %	40,84 %	37,11 %
01.05.2024	246	38,78 %	36,91 %	24,31 %
12.06.2024	288	59,78 %	27,77 %	12,45 %
31.07.2024	337	78,15 %	16,65 %	5,20 %
18.09.2024	386	91,47 %	7,09 %	1,44 %
07.11.2024	436	96,23 %	3,23 %	0,54 %
18.12.2024	477	98,64 %	1,19 %	0,16 %

Figure 2. Source: FedWatch Tool by CME Group, Powered by QuickStrike®, Data as of 28th August 2023

The impact of debt issuance in a higher for longer scenario

In H2 2023, the U.S. Treasury plans to issue more than [$1.8 trillion in new debt], with significant implications for liquidity and macroeconomic dynamics. While debt issuance by the U.S. Treasury was mainly focused on short durations during the first half of this year, a larger issuance of longer dated government debt could become a pivotal driver of the macroeconomic cycle.

In general, Treasury borrowing reflects ongoing or planned government spending. This spending can precede borrowing due to the government's role as a currency issuer. Therefore, when the Treasury borrows, it covers deficits caused by spending exceeding revenue.

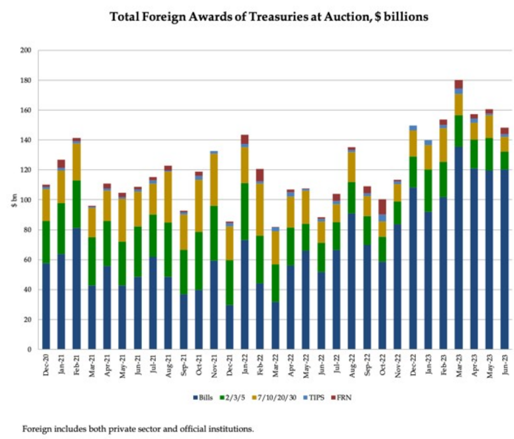


Figure 3. Source: https://home.treasury.gov/system/files/221/TreasuryPresentationToTBACQ32023.pdf

This has two main effects: it stimulates nominal spending and bolsters liquidity in the financial system because government deficits translate into private sector surpluses, which are stimulating the economy in the short term. Nevertheless, deficits can carry long term costs as they necessitate funding from the private sector, foreign investors, or central bank monetization. Regarding liquidity, Treasury borrowing creates high-quality assets. U.S. government securities rank atop the liquidity hierarchy, approaching cash in terms of safety. Depending on duration and yield, these assets can have a positive or negative impact on overall liquidity. If the interest rates on long duration government debt are attractive enough for market participants, they represent a serious competition for all other asset classes. Thus, liquidity levels are shaped by both the quantity and maturity of government issuance, with short-term issuance leaning towards stimulation and longer maturities having a more adverse impact on liquidity for risk assets.

CBO estimates show that the U.S. government is planning to further run high deficits, with a substantial portion coming from long-duration securities. While deficits likely boost nominal spending and possibly impact market expectations, the shift to longer-term issuance raises questions about how easily the private sector can absorb these securities. Since the FED is currently trying to reduce it's balance sheet, rather than absorbing new issuance, newly issued debt can only be absorbed by foreign investors or the private sector in form of saving, selling other assets or borrowing, which is not supported by the underlying interest rate environment.

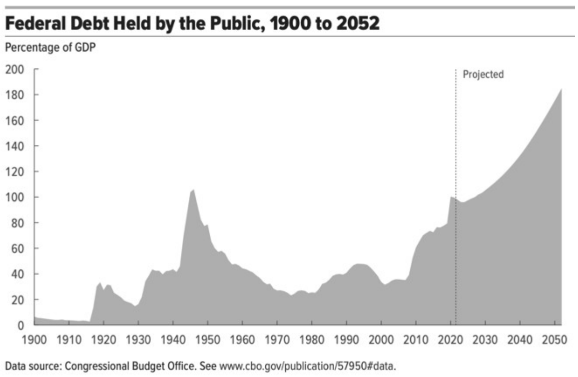


Figure 4. Source: *https://www.cbo.gov/system/files/2022-05/57950-Outlook.pdf*

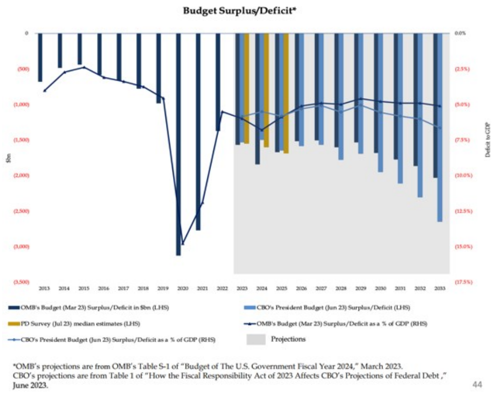


Figure 5. Source: *https://home.treasury.gov/system/files/221/TreasuryPresentationToTBACQ32023.pdf*

Yields for longer dated Treasuries have looked suppressed over the last year, which was reflected in negative term premium and an inverted yield curve since 2022. Anyhow, during the last few weeks longer dated yields have risen in accord with an expected rising volume of long duration issuance. If this trend continues, the Treasury yield curve could flatten due to rising yields at the back end instead of interest rate cuts on the front end. If we look at a steepening caused by rising interest rates at the long end in a historical context, it usually leads to a significant cooling of economic activity due to a significant rise in (re-)financing costs for companies and households. There is further upward pressure on the treasury yields as large foreign holders like China and Saudi Arabia have been cutting their treasury holdings officially to new recent lows.

Can't the US Treasury just borrow less?

While it might appear to be an ideal solution, with reduced government borrowing potentially curbing spending and eventually lowering inflation rates, a recent study by Michael Pettis for the Carnegie Endowment for International Peace has effectively dispelled this hope. The study finds that the main cause for rising debt is a consequence of policies encouraging distortions in domestic income distribution, which reduces the US domestic demand, as opposed to irresponsible behavior by US authorities.

Per data from Statista, the top 10% controls approximately 69% of wealth in US as of Q1 2023, meanwhile the bottom 50% possess 2.4% of the wealth. Households have the option to either consume or save their income. Wealthy households are more likely to save a disproportionately high share of household income when compared to middle class households, opposite is also true where wealthy households would spend a smaller share of their income than middle class households, which reduce the overall consumption. As the aggregate demand of an economy consists of both consumption and investment, if the lower consumption is not accompanied by higher amount of investments, the level of aggregate demand will not hold. However, if the savings were used to invest in more productive investments, the level of aggregate demand would increase in the long run.

The deposits at US domestic commercial banks recorded a rapid growth following the onset of COVID, sitting at a staggering $17 trillion compared to pre-covid at $13 trillion, a 3-year annualized increase of 10% (figure 6), which is money that is simply saved. Using the US housing market as an example, which accounts for 16.7% of US GDP in 2021, most homeowners have 30-year fixed rate mortgages below 5% (ie. below the

Figure 6. Source: Federal Reserve Economic Data

Fed policy rate of 5.25%). House prices remain high because there is less supply from both less new builds and less existing homeowners willing to sell because if they purchase another property would mean they have to give up their more favorable mortgage rate. The rate hike is supposed to curb inflation but due to the record high amount of deposits in the banking system, would likely be dragged on for longer. One way of dry up the money supply is by selling more long-term bonds. However, if the Treasury does not issue more debts and the interest rate keeps climbing, it would lead to a worsening economy and consequently higher unemployment. Correspondingly, it is suggested policymakers must pick their poison between rising debt and rising unemployment.

Conclusion

In summary, investors will need to rebalance portfolios to accommodate the pickup in duration, which could create a headwind for almost every asset class. The impact on equities depends on the interaction between nominal growth, inflation expectations and portfolio rebalancing, while for Treasuries, growth would have to deteriorate significantly to spark a rally given the expected increase of issuance. In conclusion, increased bond supply is likely to pressure bond prices and could also negatively impact equities in H2 2023, nevertheless, a comprehensive view requires consideration of multiple factors.

US Equities Market Update

By: Partha Sharma

Overview

On Friday, the S&P 500 Index concluded with a positive gain of +0.19%, while the Nasdaq 100 Index experienced a slight decline, closing down by -0.11%. The Russell 2000 Index gained by 1.19%. The Dow Jones Industrial Average notched up a gain of 0.34%.

The S&P 500 registered a modest monthly increase of 0.52%, which adds to its notable YTD growth of 17.98%. These figures highlight a sustained upward trajectory over the months and a significant overall rise throughout the year, underscoring a positive sentiment and fostering investor confidence in the broader market.

Index	Weekly (%)	Monthly (%)	YTD (%)
S&P 500	2.55%	0.52%	17.98%
NASDAQ 100	3.73%	1.02%	41.80%
Russell 2000	3.72%	-1.91%	9.46%
Dow Jones Industrial Average	1.60%	-0.86%	5.33%

Source: Finviz.com

The NASDAQ 100 demonstrated a similar pattern, with a monthly increase of 1.02% that further bolstered its impressive YTD growth of 41.80%. This robust performance showcases the strong influence of technology-related stocks within this index, as well as the sustained momentum in this sector throughout the year.

On the other hand, the Russell 2000 faced a decline of -1.91% in its monthly performance, which contrasts with its YTD growth of 9.46%. This divergence suggests some volatility in smaller-cap stocks over the past month, but the YTD data underscores the resilience and overall positive trajectory of these companies in the broader context of the year.

Lastly, the Dow Jones Industrial Average experienced a monthly decrease of -0.86%, resulting in a more modest YTD growth of 5.33%. While the monthly data reflects a short-term dip, the YTD performance indicates a steady but relatively subdued upward trend for this index.

Meanwhile, the Atlanta Federal Reserve Bank President Raphael Bostic voiced his opposition to further U.S. interest rate hikes, asserting that the existing monetary policy is sufficiently restrictive to bring inflation back to the 2% target within a reasonable timeframe. Bostic stressed the importance of cautious and patient guidance from continued restrictive policies to prevent unnecessary economic challenges. Although he does not advocate immediate policy easing, financial markets are anticipating a quarter-percentage-point rate increase by year-end due to sustained inflation, robust economic growth, and low unemployment. Bostic's stance stands apart from the majority of Fed members who had previously leaned toward a policy rate range of 5.5%-5.75% to counter inflation. Bostic's remarks added an element of uncertainty to the market's trajectory, as investors weighed his cautious stance against prevailing economic indicators and ongoing market trends, which manifested in a mix of gains and losses across major indices.

Sector Update

The top-performing sectors over the past month were Energy, followed by Technology. On the other hand, Consumer Staples and Utilities were the laggards. This performance distribution implies that investors have displayed a relatively high risk appetite during this period.

Sector	Weekly (%)	Monthly (%)	YTD (%)
Energy	3.60%	4.54%	3.74%
Technology	4.44%	1.54%	41.59%
Health Care	0.12%	0.53%	-1.68%
Consumer Discretionary	3.04%	0.34%	31.36%
Materials	3.74%	0.07%	7.90%
Industrial	2.12%	-0.09%	10.78%
Communication Services	2.63%	-0.21%	39.82%
Financial	2.06%	-1.03%	1.43%
The Real Estate	1.51%	-1.18%	0.19%
Utilities	-1.56%	-3.24%	-11.15%
Consumer Staples	-0.39%	-4.32%	-3.23%

Source: Finviz.com

Sector in Focus

For much of 2023, the market narrative and focus have predominantly revolved around the performance of technology stocks. However, there appears to be a noticeable shift towards on energy investments. The positive momentum in the energy sector could continue for the rest of 2023.

Source Finviz.com

Conclusion

The S&P 500 displayed a modest monthly increase, while the NASDAQ 100 demonstrated robust growth. The divergent performance of sectors, with Energy and Technology leading while Consumer Staples and Utilities lagged, highlights investors' risk appetite. Amidst shifting dynamics and the spotlight on energy, the market shows signs of evolving trends as the year progresses.

Crude oil developments

By: Evgenia Raevskaya

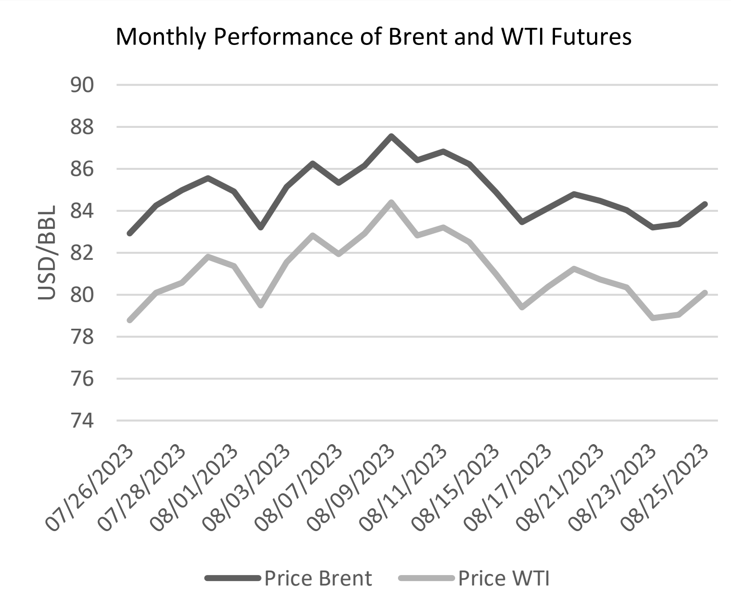
Short summary

Oil prices decline early in August, driven mainly by supply side price adjustments and the strengthening of the USD. Commercial traders are buying the dip.

Overview

After analyzing multiple online reports, we haven't identified substantial new evens that could affect oil prices from the demand side this month. We do not expect to see significant changes in demand from the main crude oil consumers USA, China, and India (constituting 48.3% of global oil demand[1]) amid the August-September period. Therefore, we maintain our view of the demand evaluation from the July issue.

Brent and WTI prices had maintained an upward momentum at the beginning of the month, peaking on the 9th of August at 87.55 USD/BBL for Brent and 84.4 USD/BBL for WTI respectively. Following this, the prices have dropped to reach 84.33 USD/BBL (-322 BPS) for Brent, and 80.08 USD/BBL (-432 BPS) for WTI by August 25th. Trading volumes for Brent fell in the last week of August, which reflects no indication of a strong trend. The below charts reflect these changes. We further investigated the combination of the supply side, and currency factors which may be driving oil price changes this month, and possibly into September.



Brent futures performance & trading volumes.

The Strengthening of the US dollar

The July 25-26 Federal Reserve meeting had resulted in another interest rate hike to a 5.25%-5.5% range, with multiple reports indicating that there may be further hikes by the end of September. Following the hike, the US dollar has been strengthening all through the month of August, reaching 104.19 as of August 25th, which inevitably contributes to the decrease of crude oil price.

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[1] Source: The Energy Institute, Statistical review of World Energy report (2022).

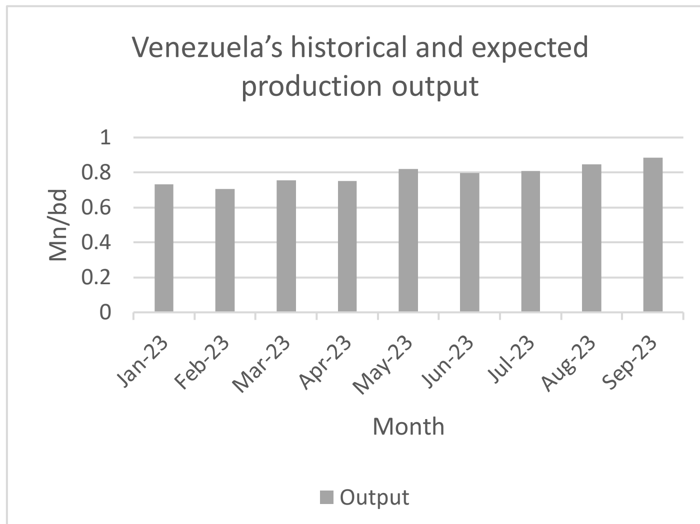
Possible Supply increases from Iran and Venezuela

In combination with a consistently strengthening US dollar, market sentiment was dampened by supply side concerns. In particular the possibility of crude oil supply increase from Iran and Venezuela, who are exempted from the existing OPEC+ limited oil supply deals. This month, multiple media outlets have posted commentary on ongoing negotiations between US and Iran, as well as US and Venezuela, the successful outcome of which could result in easing of sanctions and increase in oil exports from either country.

In order to review the scale of the matter, we referred to historic data of the production output of each country. We combine data obtained from Trading Economics, which reflects Iran's crude oil production from January to July 2023, with forecasts for August and September. This analysis allowed us to obtain a clear picture of historical and expected production performance.

The results are depicted in the graph below. The forecast for August is 3.3 million BPD by 22nd August, according to reported statements by Iran's Oil Minister. The forecast for September is 3.5 million BPD by 22nd September, according to reported statements by the managing director of Iran's state oil company NIOC. In summary, the overall output is estimated to increase by 0.946 million BPD from January to September.

Similarly, we combined historical data and forecast statements to estimate Venezuela's crude oil production performance for the January to September period. According to Minister of Oil and the head of the Venezuelan oil and gas PDVSA, Rafael Tellechea, Venezuela intends to reach a production level of 1 million barrels per day by the end of this year. Production as of July is at 0.81 mn BPD, which constitutes an increase of 0.19 mn BPD by 31st December if the forecasted target is reached. In order to produce the August- September estimates, we have taken a simple average of this value, 0.038 mn BPD as an approximation by how much production output may increase each month. The results are presented in the graph below. The output is estimated to increase by 0.154 million BPD from January to September.



The combined estimated increase in output of Iran and Venezuela is 1.1 million BPD. This increase could indeed to some extend offset the production cuts implemented by the OPEC+ alliance. However, the possible increase in supply is old news, in the context that oil production in both countries had been increasing since January, and reports about negotiations which could bring about a possibility of resuming trade have been circulating for some time. Therefore, the question remains as to how much of the production-related price change had been built into the market expectation, and how much of the current drop in prices is fueled by speculative trading, and increased media coverage of those events.

Commitment of Traders Report

Through the Commitment of Trader's report, it is possible to observe the investments of various market players into the Brent futures contracts. The position of commercial traders is of particular interest, as it reflects the demand of the commercial sector to purchase contracts at various prices. Below is a chart of the Commitment of Trader's report for the months of June to August.

The report chart shows that commercial traders have started to increase their long positions in Brent Futures, from 14th August 2023 to 25th August 2023. This signals that Brent prices may reduce further, in which case the long position of commercial traders will continue to increase. It is important to keep in mind that an increase in long positions of commercial traders also encompasses an expectation that the market would move up in the future, therefore the decisions to go long at current prices occur. Meanwhile large and small speculators are shorting the market, which pushes prices further down.

Possible further supply developments

As of the start of August, Saudi Arabia had extended a unilateral supply cut into September, with the possibility of further prolonging or deepening the supply cuts not being out of question. Russia had also pledged to reduce its exports. Since the OPEC+ strategy of maintaining the upwards shift in oil prices is clear, it may be only a matter of time until the current dip in price reverses following a fresh round of supply cuts.

Industry Snapshot: Entertainment and Gaming

By: Cameron Bruce

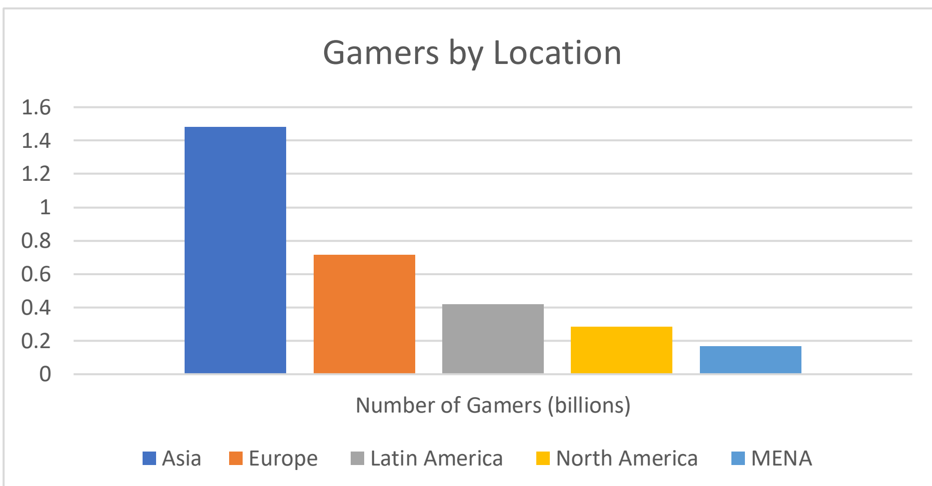
Entertainment Industry Segments

The entertainment industry covers Movies/Cinema, Television, Music, Publishing, Radio, Internet, Advertising and Gaming. Entertainment is becoming increasingly reliant and aligned with technological advancements. Growth and maturity within the entertainment industry varies greatly between each segment but seems to share monetisation similarities with subscription based products at the forefront.

Gaming Trends

- Ages 45 years and over now equate to more gamers than 18 and under
- Gaming has become recognised as beneficial for specific mental health issues such as loneliness and social anxiety
- Mobile gaming is the fastest growing gaming sector across all gaming and contributes highly to the vastness of age, gender and gamer demographics
- There are roughly 3.32 billion gamers worldwide

Chart showing number of gamers by 5 chosen locations: Asia, Europe, Latin America, North America, MENA



Gaming and The Saudi Public Investment Fund

Gaming growth within MENA is the highlight this month. Investors have an eye or two on the Saudi Public Fund and are aware of the magic growth wand that comes with Saudi investment. The Saudi Public Fund have highlighted gaming as a huge opportunity within MENA and own Savvy Games Group that has invested $38billion into international gaming companies and streaming platforms. Savvy are now the largest outside stakeholder of Nintendo (8.3%) and are capable of injecting the gaming segment with millions of new users.

Conclusion

Gaming is a great segment for investors looking to diversify their portfolio. There are an increasing number of emerging gaming companies experiencing high growth and potentially trading publicly in the future. Outsider confidence is increasing and governments are soon to realise its importance in society for more than entertainment uses, for example the healthcare sectors' acceptance and want for gaming is fascinating. Gaming continues to record tens of millions of viewers during live competitions and boasts competition earnings for players in excess of $20 million, the segment is known to push boundaries and if aligned with tech firms, might provide high growth public companies for investors to benefit from.

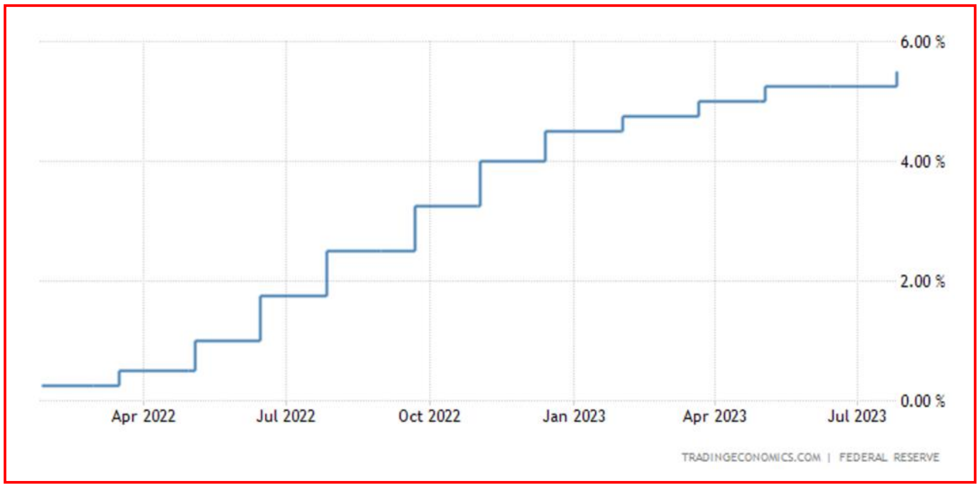
How long will the crypto winter last?

By: Estella Zaengle and David Peisakhov

The current crypto winter is driven by three main factors.

The Macroeconomic Environment

FED hiking cycles. The FED started raising interest rates in March 2022. This first hike of 25 BPS market an ongoing series of interest rate hikes that aimed to tame inflation. The last interest rate hike in July was 25 BPS to 5.25-5.5%. Consequently, borrowing costs are at their highest level since January 2001. Therefore, capital becomes more expensive, and less capital is invested in high-risk assets such as the crypto market. If we now stay in the US for illustrational purposes, however similar effects can also be observed in other economies around the globe, we can observe that personal consumption expenditures increased over proportionally compared to disposable personal income (which is the personal income after current tax).



In numbers this means for the US in July 2023 that **disposable personal income** (DPI) increased $7.3 billion (less than 0.1 percent) and **personal consumption expenditures** (PCE) increased $144.6 billion (0.8 percent) (Source: bea.gov). This sheds light on the current situation that many retail investors are facing: High energy and living costs while income is only increasing slightly. This decreases capital available for investments or speculations in risky markets. Since the crypto market is still largely retail driven and many retail investors are part of investment fund schemes that are now up and coming, it is clearly facing the effects of interest rate hikes. Here, it is also important to note that institutional investors face similar issues but from a different perspective: Borrowing gets more expensive and so do investments. Consequently, there is generally less spare capital for risky investments available.

Recession Fears due to the aggressive hiking cycle of the FED which was followed by the major central banks such as the Bank of England, the EZB and the SNB, major economies went into recession – examples include Germany and China amongst others. During cycles of economic uncertainty, investors are known to move away from risky assets as the general default risk increases. This is also true for some crypto projects – particularly the ones that are similar to securities and form small businesses that work on technological advancements.

Persisting Regulatory Uncertainty and Effects of Regulations on Traditional Market Players

Regulations are generally aimed to protect investors operating in a market. However, particularly in emerging markets such as the crypto or digital asset market, they can also shake up the market and reshape it significantly. This is not necessarily a bad thing in the long run as both retail and institutional investors will profit from a marketplace that aims to provide fair trading rules that build on lessons learned from historical crisis in traditional markets. However, it will take time and effort to adapt to the changing market environment while preserving the crypto market's unique entrepreneurialism. This means a huge challenge to the digital asset market. Consequently, certain products may not be traded anymore until a new regulated way of trading them is created and some market participants may vanish while others emerge.

Below, we will give a summary of the current regulatory framework in some of the key regional markets that developed legal frameworks for investors and companies operating in the digital asset market:

The United States. In July, a crypto bill was passed by the House Financial Services Committee. The bill defines whether a cryptocurrency is a security or a commodity and expands the Commodity Futures Trading Commission's (CFTC) oversight of the crypto industry, while clarifying the Securities and Exchange Commission's jurisdiction. In the past, many crypto investors and companies in the US struggled with the agency's perceived overreach. The bill is an attempt to provide more clarity to the definition of tokens.

In the past months, the SEC has steadily asserted its authority over the industry, arguing that most cryptocurrencies are securities and subject to investor protection rules. That effort escalated in June when the SEC sued Coinbase and Binance for failing to register some crypto tokens. Most crypto companies dispute the SEC's jurisdiction and have pushed Congress in recent months to write laws clarifying that cryptocurrencies are more akin to commodities than securities (source: Thomson Reuters).

United Kingdom. Regulated by the FCA, who has oversight that firms involved in transactions in the digital asset market have effective AML programs and anti-terrorist financing procedures in place. However, the crypto assets themselves are not regulated yet. The only exception to the rule are security tokens. Security tokens are tokens with specific characteristics that provide rights and obligations akin to specified investments, like a share or a debt instrument. These are the only FCA-regulated crypto assets.

European Union. The Crypto assets (MiCA) Regulation is an upcoming regulatory framework that will enter into force mid-2024 to early 2025. It was ratified by the European Parliament earlier this year with the goal to regulate digital assets, their issuers and service providers that are operating in the EU market.
Potential effects of MiCA (Markets in Crypto-Assets Regulation) on the crypto market include:

1. **Clarity and Trust**: MiCA aims to provide clear regulations, increasing trust and potentially attracting more institutional investors.
2. **Consumer Protection**: Enhanced rules can protect consumers and foster broader adoption.
3. **Market Access**: A unified EU framework can encourage competition and innovation.
4. **Stricter Compliance**: Stringent AML and KYC requirements may deter some privacy-conscious users.
5. **Stablecoin Impact**: Regulation on stablecoins may limit their growth.
6. **Market Consolidation**: Smaller businesses may struggle to comply, leading to market consolidation.
7. **Compliance Costs**: Higher operational costs may be passed on to consumers.
8. **Tokenization**: MiCA promotes tokenization of assets, fostering innovation.
9. **Global Influence**: MiCA's impact may extend beyond the EU, influencing global crypto markets and regulations.

Switzerland is known for its crypto-friendly environment, particularly the town of Zug is often dubbed "Crypto Valley." Key characteristics of the regulatory framework in Switzerland include:

1. **Regulatory Authority**: Switzerland is overseen by the Swiss Financial Market Supervisory Authority (FINMA), which provides guidelines for crypto and ICOs.
2. **Cryptocurrency Classification**: Switzerland categorizes cryptocurrencies into payment tokens (like Bitcoin), utility tokens, and asset tokens, each with specific regulatory implications.
3. **Licensing**: Crypto businesses may require licenses from FINMA, especially those offering financial services.
4. **AML and KYC**: Crypto service providers must implement anti-money laundering (AML) and know-your-customer (KYC) measures.
5. **Taxation**: Cryptocurrencies are treated as assets, subject to wealth tax.
6. **Legal Framework**: Swiss law recognizes blockchain transactions and smart contracts.
7. **Regulatory Sandbox**: Switzerland offers a sandbox for startups, allowing them to operate with regulatory relaxations.
8. **Crypto-Friendly Banks**: Some Swiss banks are open to serving crypto businesses while a few even specialize in crypto clientele.

Singapore follows a proactive and clear approach to cryptocurrency and blockchain regulation:

1. **Regulatory Authority**: The Monetary Authority of Singapore (MAS) is the central regulatory authority overseeing financial activities in Singapore, including cryptocurrency-related activities.
2. **Payment Services Act (PSA)**: The PSA, which came into effect in January 2020, provides a comprehensive regulatory framework for cryptocurrency-related businesses and activities. It classifies digital payment token services, which include cryptocurrency exchanges and wallet providers, as "payment service providers" and subjects them to licensing requirements and anti-money laundering (AML) and counter-terrorist financing (CTF) regulations.
3. **Crypto Licensing**: Cryptocurrency exchanges and wallet providers are required to obtain a license from MAS to operate legally in Singapore. They must comply with AML and CTF requirements and report suspicious transactions.
4. **Taxation**: Singapore does not impose a Goods and Services Tax (GST) on cryptocurrencies, treating them as a digital payment method.
5. **Initial Coin Offerings (ICOs)**: While ICOs are not explicitly regulated in Singapore, the MAS has issued guidelines indicating that the classification of tokens (as securities, utility tokens, or payment tokens) would determine the regulatory treatment.
6. **Security Token Offerings (STOs)**: STOs, which involve the issuance of security tokens, may be subject to existing securities laws and regulations.
7. **AML and KYC**: Cryptocurrency service providers in Singapore are required to implement robust AML and KYC measures to prevent illegal activities.
8. **Smart Contracts**: Singapore recognizes the legal validity of smart contracts and blockchain transactions.
9. **Innovation-Friendly Environment**: Singapore actively encourages blockchain and fintech innovation and has initiatives like the FinTech Regulatory Sandbox to facilitate experimentation with new financial technologies.

Market Fear

Market Fear caused by past Events such as the collapse of Terra Luna in May 2022 or the downfall of FTX later in the year. Both events happened very quickly and were not foreseen by many retail investors but also institutional investors, which created great fear in the market. Many market participants exited the market after having faced large losses or a lack of opportunities to hedge their exposures. Before its downfall in 2022, FTX was one of the largest marketplaces for market participants to hedge their delta exposure from option trades. This gap is still to be fully filled by the remaining market participants and new players entering.

Market Capitalization all Crypto Assets, Source: Coinmarketcap. (https://coinmarketcap.com/charts/)

The digital asset market tends to react quickly due to herding effects and its size if compared to stock and commodities markets. Therefore, a crypto winter can start and end quickly, also large price moves can occur quickly if large participants enter or exit the market which can both cause and end a crypto market slowdown.

Tips for crypto positioning useful in any market regime.

1. Short altcoins and be long established cryptocurrencies (compare altcoin basket performance vs BTC performance YTD)
2. Trade w/o direction, e.g. take a view on market volatility (e.g. long / short straddle or strangle) particularly early on before a certain event gets priced in.
3. Investors should invest only 2-5% of their portfolios and buy market dips on high profile tokens (e.g. BTC, ETH) and have a long-term investment horizon (usually 7-10Y minimum)
4. Be prudent when evaluating crypto projects: Look for a real value added, challenge the idea and research the people behind the project in order to eliminate scam projects.
5. Analyze the historic price chart for obvious patterns (fake volume through algorithms) or large fluctuations in 24h volatility before investing to identify scams!
6. Analyze largest wallets that hold a specific token to identify risk of large price movements due to these holders selling their exposure or manipulating market prices (e.g. use coinmarketcap.com)
7. Note down your own risk tolerances on paper (and stick to them to avoid behavioral biases such as myopic loss aversion)
8. Avoid blindly following trading advice from telegram groups / reddit or twitter (risk of scams and potential overheated herding behavior of retail investors may lead to losses)

Tips and Tricks on how to survive a crypto winter.

- Crypto winters are usually more challenging for less experienced investors.
- Long-term bullish investors "buy the dips" which means that they go long on downward movements.
- Generally, market participants (still merely retail investors driven) are overly optimistic on market rebounds: A prudent risk manager or institutional trader would be cautious as markets quickly get overpriced vs the risk they encompass.

Conclusion

The current crypto winter's length is driven by three factors: macroeconomic conditions, regulatory changes, and market fear. The Federal Reserve's interest rate hikes and global economic uncertainties have reduced capital availability for crypto investments. Regulatory shifts, like MiCA in the EU, bring both clarity and challenges. Meanwhile, unexpected market collapses have created fear and uncertainty.

To survive a crypto winter, investors must exercise caution, consider their risk tolerance, and analyze historical data. Navigating this volatile landscape demands vigilance and adaptability. The crypto winter's duration remains uncertain, influenced by a complex interplay of factors, making it crucial for market participants to stay informed and prudent.

Please note: The above points do not represent investment advice. They shall only represent references for further research.

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