

Market Review

MAY 2022

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MAY 2022 MONTHLY REVIEW

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Introduction

May was marked by the drama of one of the worst crashes in crypto markets in absolute terms, with a loss of over \$600 billion in total market cap¹ over the course of a few days. For context, the crash of March 2020 wiped out \$120 billion. The drop was triggered by the almost-disappearance of two of the top 10 assets in terms of market cap (ranked at the beginning of the month), although macro conditions and sentiment contagion played their part.

This was arguably one of the most significant events in crypto markets in recent years, triggering not only ripple effects across the market, but also intensifying calls for stablecoin regulation and investor protection.

The month will also be remembered as one in which the progress toward Ethereum's shift from proof-of-work to proof-of-stake gathered momentum, building anticipation yet failing to manifest in the price of ETH, as overall de-risking led to a rotation into BTC.

In the report that follows, we take a closer look at the main narrative shifts in May and the events behind them.

These include:

- The implosion of the Terra ecosystem
- The market's rotation into BTC
- The correlation decoupling between BTC and macro indices
- The coalescing timeline toward Ethereum's Merge
- The prominent crypto presence at Davos
- ...and much more.

Nothing in this report is intended to be investment advice—our aim is to update and explain some of the shifting narratives driving crypto markets. We hope you find it useful.

(Note: we use uppercase Bitcoin to denote the network, and lowercase bitcoin or BTC to denote the asset; for Ethereum, we use uppercase to denote the network, and ether or ETH to denote the asset. "Merge" is capitalized when referring to Ethereum's upcoming consensus shift. All \$ are USD unless otherwise specified.)

¹ According to data from [TradingView](#).

May performance

The May performance of the top 10 assets ex-stablecoins ranked by market cap:

Asset			Price USD	Mkt cap bn	May '22	30D RV
Bitcoin	BTC	Currency	\$31,740.94	\$604.42	-17.88%	78.72%
Ethereum	ETH	Layer-1	\$1,995.94	\$235.52	-29.16%	98.71%
BNB	BNB	Exchange token	\$322.19	\$52.18	-18.01%	107.92%
Cardano	ADA	Layer-1	\$0.57	\$20.58	-29.22%	167.72%
XRP	XRP	Currency	\$0.42	\$20.39	-31.64%	113.86%
Solana	SOL	Layer-1	\$47.19	\$15.51	-49.84%	158.96%
Dogecoin	DOGE	Meme coin	\$0.09	\$11.40	-34.91%	118.28%
Polkadot	DOT	Layer-1	\$10.46	\$10.36	-35.32%	160.08%
TRON	TRX	Layer-1	\$0.08	\$7.69	31.01%	144.90%
Avalanche	AVAX	Layer-1	\$27.64	\$7.14	-56.48%	179.42%

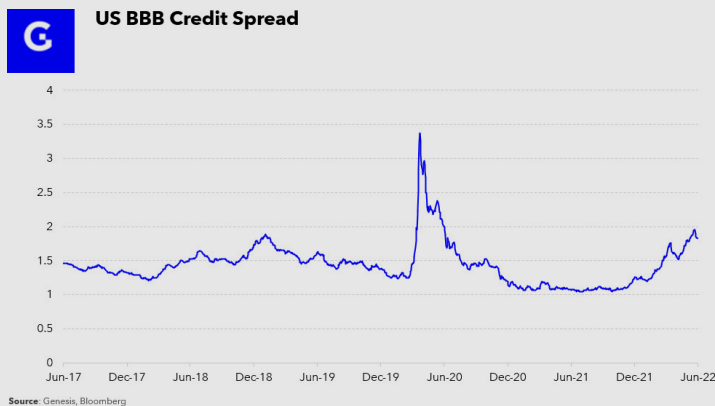
Top 10 assets ex-stablecoins ranked by market cap. Prices at 5/31/22. Source: Messari, CoinGecko

Gathering Winds

Against a background of economic tension, market confusion and geopolitical uncertainty, May saw several unwelcome local records for global markets:

- The US 10-year yield hit its highest level since 2018
- The dollar index hit its highest point since 2002
- US credit spreads and default insurance on North American corporate bonds hit highs not seen since 2020
- The correlations between BTC and leading stock indices reached record highs

(All data via Bloomberg and Coin Metrics.)



The April CPI print reported on May 11 surprised in its stickiness, with the headline figure up 8.3% year-over-year (vs 8.1% expected and 8.5% prior) and the core CPI up 0.6% month-on-month (vs 0.4% expected and 0.3% prior). The pivot from

goods to services did nothing to dampen the trajectory of overall cost-of-living increases, definitively erasing “transitory” from the Fed vocabulary and boosting rate increase expectations. The S&P 500 dropped over 1.3% on the day, the yield curve flattened, and the crypto market lost over \$200 billion² within 24 hours.



However, as the month progressed, strong signs of a weakening economy coupled with a shift in the tone of comments from Fed officials led to an easing of concerns about rates. Toward the end of the month, priced-in expectations had dropped from eight in the remainder of the year (adjusted for the 50bp hike announced at the FOMC meeting on May 4) to seven.

The stock market, by now used to focusing almost exclusively on the potential impact of rate hikes, reacted favorably to this shift, with the S&P 500 recovering most of the month’s losses (down almost 8% at one point) in the latter two weeks.

Yet the last few days of May saw a re-awakening of concerns around inflation, economic growth and the interest rate strategies of the world’s leading central banks, as record

² According to data from [CoinMarketCap](https://coinmarketcap.com), the total crypto market cap dropped from \$1.43 trillion at 01:40 UTC on May 11 down to \$1.16 trillion at 01:40 UTC on May 12.

CPI numbers in Europe as well as poor consumer confidence and new home sales data in the US battled with a possible re-opening of China for control of market sentiment.

The change in momentum coincided with a drop in the 60d correlation between BTC and the S&P 500, which we look at in the “Bitcoin” section below.

Crypto at Davos

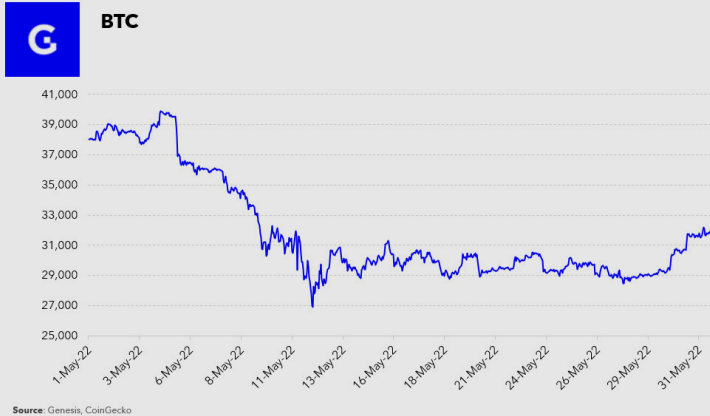
Further narrative shifts were seen at loftier heights, as the annual gathering of global figures at Davos in Switzerland delivered some content surprises.

- One was the number of crypto-focused panels, with discussions on remittances, payment rails and CBDCs.
- Another was the number of times crypto came up in panels about the global economy.
- A third was the [volume of ads](#) for crypto services and the much larger branding presence.

For some attendees, the jump in crypto interest stemmed from bitcoin’s [seizure resistance](#), while billionaires [talked about](#) digital gold. Panelists [debated](#) whether or not bitcoin was money. Some companies [proposed new uses](#) for blockchain. Digital asset enthusiasts [tried to figure out](#) how to channel aid to Ukraine. Crypto markets [were cited](#)—by the World Economic Forum, no less—as one of the main areas of concern. Unlike in previous editions, everyone—from heads of powerful institutions to passers-by on the street—had a crypto-related opinion.

Crypto, it seems, has moved from being on the fringes of Davos to occupying part of the center stage.

2 Bitcoin



The bitcoin price dropped approximately 17% over the past month, a lesser drop than in May 2021, but nevertheless, its second-worst May performance to date.

Market Metrics: Is a Bottom Close?

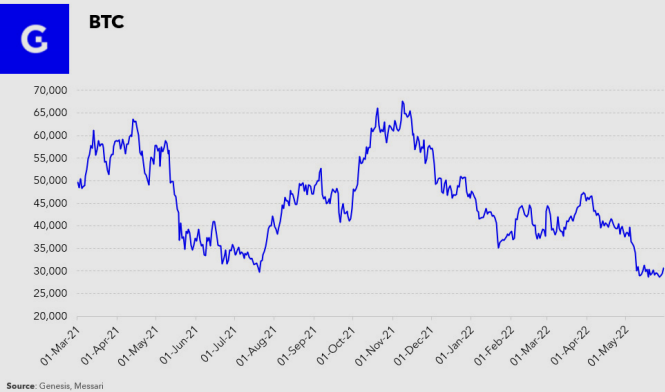
A key feature of the crypto markets in May was the sharp increase in bitcoin's market dominance³ as asset prices fell across the board and investors rotated into the sector's "blue chip" asset. In the second half of the month, bitcoin's dominance—also known as BTC.D—broke through 46% to the upside for the first time since October 2021.



(chart via [TradingView](#))

Given its relatively low volatility compared to other crypto assets⁴, BTC usually underperforms in strong markets and outperforms in weak markets. October 2021 was an exception to this, as investor excitement about the listing of the first bitcoin-linked ETF in the US had pushed its price up to \$52,700, giving the asset a strong outperformance.

The previous 46% breakthrough to the upside, in July 2021, is more relevant: the crypto market was weak, overall market cap had dropped by over \$1 billion⁵ since early May, and BTC had fallen by almost 50% in the same period. Yet July 2021 turned out to be the local low—BTC's price went on to more than double over the next four months.



This does not necessarily mean that BTC's dominance is signaling a market bottom at this stage—negative sentiment from the Terra implosion, DeFi weakness and regulatory concerns is playing a prominent role in the recent slump. However, other metrics are hinting that—based on historical precedent—a bottom could be near.

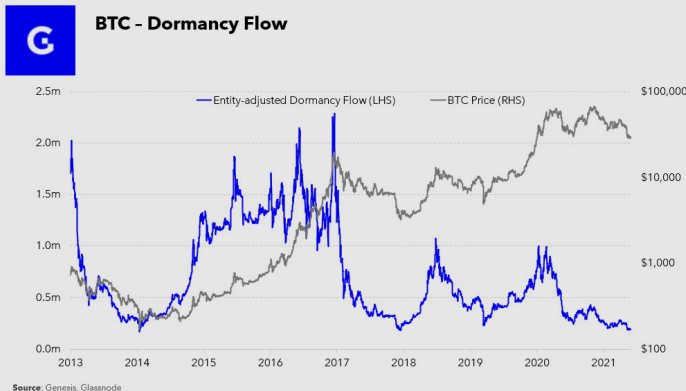
One is **"dormancy flow,"** which measures the average time held of each coin sold on a given day,

3 BTC's market cap / total crypto market cap, expressed as a percentage
4 30d volatility for BTC ~80%; for SOL, AVAX, ADA and DOT ~150–170%, according to data from Messari
5 According to data from [TradingView](#)

annualizes it and puts it in the context of overall activity and the total BTC market cap.

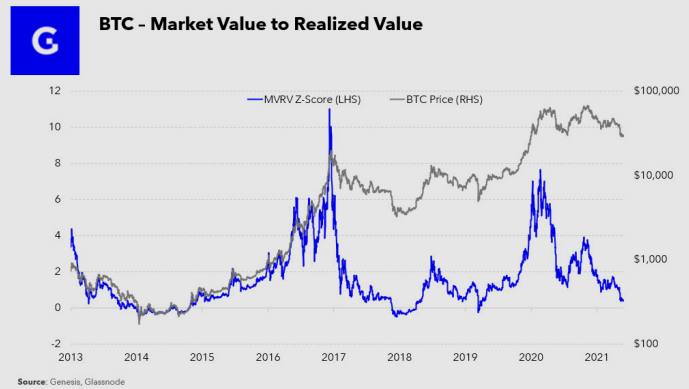
Dormancy flow⁶ is based on “coin days destroyed” (CDD), which measures the aggregate number of days held for coins moved on a given day. When the number is high, longer-term investors are selling to newer investors. When it is low, they are more likely to be buying from newer investors.

When compared to overall market size and activity, this figure can suggest where the current price is relative to on-chain economic activity. In the past, the metric dropping below 250k has signaled a market bottom. In May, the figure dropped below 200k. This does not mean that the price could not drop further. But it does indicate that market value is relatively low compared to investment activity.



Another metric that compares market value to accumulated investment value (also referred to as “realized value”) is the **MVRV Z-score**.⁷ This subtracts the aggregate acquisition cost of all BTC holdings from the market capitalization (to get the implicit aggregate “profit”) and divides by the standard deviation of the market cap (to standardize).

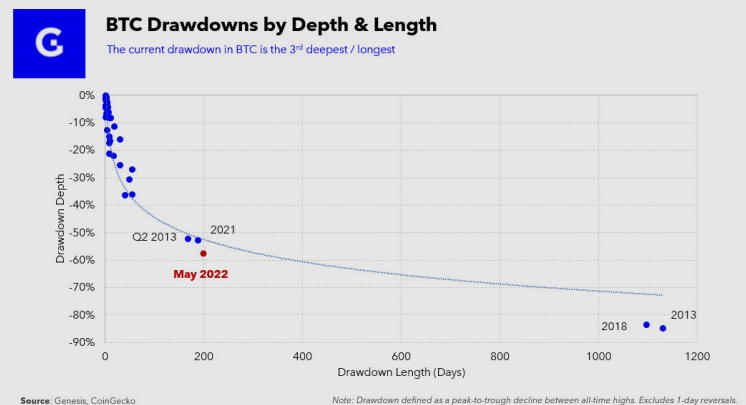
This shows a market value that is close to historical lows for the ratio. In the past, the MVRV Z-score dipping below 0 has signaled that a bottom is near—at the end of May, the 7-day moving average value reached 0.41.



Again, history does not necessarily repeat. And on-chain signals should not be taken at face value, as they can be influenced over time by shifts in market structure such as custody technology, derivatives development and layer-2⁸ activity. Nevertheless, previous patterns can shed light on current market dynamics, help to put recent moves in a larger context, signal factors to keep an eye on, and serve as a reminder that cycles require time to play out.

The Drawdown in Historical Context

BTC is currently down over 50% since its previous all-time high in November 2021. This is significantly worse than the average post-2013 drawdown of 15% and the length of the drawdown so far (over 200 days and counting) makes it the third longest since 2013.



Only during the bear markets of 2013 and 2018 were the drawdowns more severe, lasting multiple years before recovery to a new all-time high. And though a

⁶ Market cap divided by the 365-day moving average of [CDD*price/# coins transferred]. See more [here](#).

⁷ For more information on MVRV, see [here](#) and on how the z-score is calculated, see [here](#).

⁸ Layer-2 refers to networks that run on top of base layer blockchains (called layer-1s), abstracting computation (and thus removing the main scaling limitations of block space and fees), but relying on the base blockchain for security.

50% decline is certainly worthy of concern, it is also nothing out of the ordinary given the high annualized volatility of this asset.

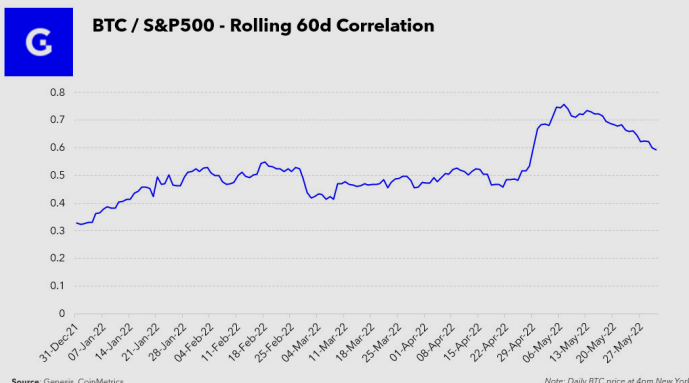
Unlike traditional asset classes, there is still little consensus on methodologies for estimating intrinsic value of BTC and ETH. This wider dispersion of opinion is one of the reasons prices in crypto markets have historically fluctuated more widely than in equities. This volatility gives rise to both harsher drawdowns than in traditional assets, as well as stronger historical gains. Despite nearly 50 drawdowns from all-time highs since early 2013, BTC has gone from \$135 to over \$30k during the same period.

Every drawdown is qualitatively unique and should be taken in the context of the prevailing narrative. Other than ever-present cyclical pressures, previous market slumps were driven by different factors than the current one. Macro conditions, for instance, play a much larger role in crypto markets today than a few years ago, and the UST implosion is (at least to date) a unique crypto event.

Nevertheless, context is useful in forming a thesis as to where the floor of the current drawdown could be.

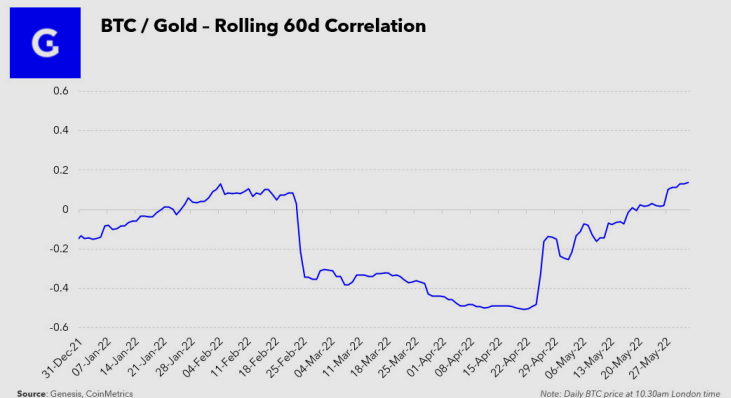
Correlations

For months, we have been watching the correlation between BTC and the S&P 500 climb, cementing the narrative that BTC had effectively become a macro risk asset. In [last month's market review](#), we discussed the drivers of this shift. This month, we take a look at how the correlation trends seem to be turning.



After reaching an all-time-high in early May, the 60d correlation between BTC and the S&P 500 turned with the market crash. The crypto-specific nature of the market slump (driven by the Terra ecosystem implosion) reinforced the narrative divergence, which continued even as the dust settled and signs began to emerge of a slight sentiment recovery.

The correlation between BTC and gold also turned during the past month, from notably negative to neutral/slightly positive, as rising real yields weighed on the metal's performance.

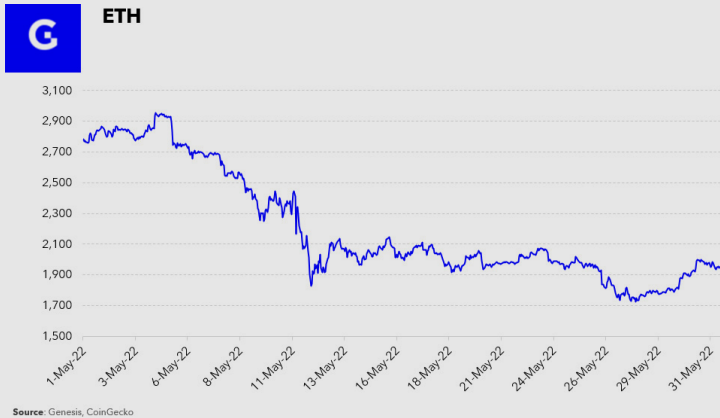


While both of the above charts reflect the 60d correlation and hence carry a degree of smoothing, they do hint at a narrative divergence in markets that in turn reflects the behavior of many macro portfolios. The correlation jump since mid-2021 coincided with the crypto market entrance of macro institutional investors who tend to see bitcoin as a risk asset. As bitcoin was increasingly treated as a risk asset, it increasingly behaved like one, pushing the correlation up. Now, as macro institutional investors are to some extent de-risking portfolios by exiting high volatility assets such as bitcoin, they will start to have less influence over BTC's price.

This correlation correction does not necessarily mean that BTC is no longer considered a macro risk asset – its correlation is still relatively high. It does, however, point to a greater distinction of narratives. The market is still dealing with the crypto-specific fallout from the implosion of the Terra ecosystem, but the distinction is unlikely to always be negative. Strong tailwinds such as [new fund raises](#), [progress on the Ethereum merge](#), [deeper institutional](#)

[acceptance](#) and [continued application growth](#) could shift sentiment in the other direction, highlighting crypto's relative youth, growth potential and technology angle, while traditional markets grapple with worsening economic conditions and a still-uncertain rates outlook.

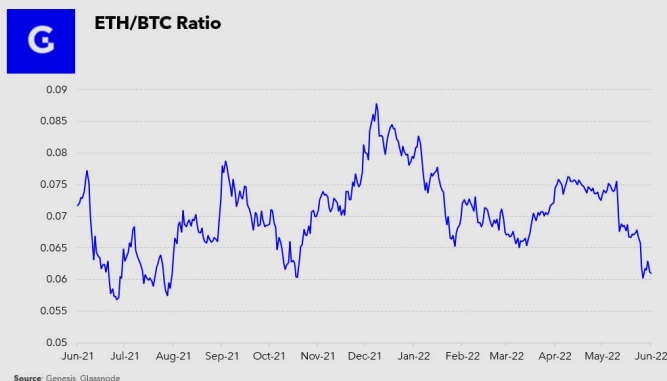
That said, market narratives appear to be fluctuating more than usual in this rapidly changing environment. While 60d correlation with traditional indices is not a perfect metric with which to gauge sentiment shifts, it does point to further change ahead.



The price of ETH dropped almost 29% over the past month, delivering its worst May performance to date.

ETH/BTC

ETH's drop over the month pushed the ETH/BTC ratio to its lowest point since July 2021. Like BTC.D (see "Bitcoin" section above), this metric is watched as a barometer of market sentiment. As the market's "blue chip" asset, BTC tends to outperform (rising BTC.D) in weak markets as investors rotate out of altcoins into more liquid and more "tested" higher-cap tokens.



However, the ETH/BTC metric is different in that ETH can also be considered a "blue chip," albeit a younger one, given its relatively high liquidity and market cap. What's more, ETH has a distinct narrative in the shape of the upcoming Merge, which in theory will boost some of its fundamental characteristics (see below as well as our March market review for more details).

That this ratio reached similar levels to July 2021, when the falling market had touched its floor, is notable given the heightened investor interest in ETH due to its upcoming transformation, and highlights just how weak investor sentiment has been over the month.

The Merge Timeline

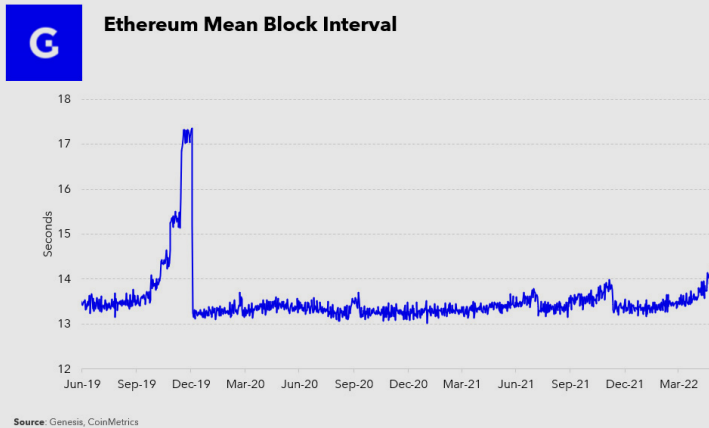
The month of May saw significant, albeit patchy, progress toward the long-awaited Ethereum Merge, in which the consensus algorithm shifts from proof-of-work (PoW) to proof-of-stake⁹ (PoS), with greater clarity on both the expected timing and the process.

On the timing, in spite of assurances during the month that August was an achievable target, developers agreed at the end of the month that a delay in the "difficulty bomb" was a good idea, hinting that a later Merge date is now likely (but not inevitable).

The difficulty bomb is a script baked into Ethereum's code that, after a certain block height is reached, starts to make the block validation algorithm more difficult with the aim of eventually making the PoW network unusable. Without a

⁹ Proof-of-stake blockchains differ from proof-of-work blockchains in that they do not rely on computational energy to confirm consensus. Instead of giving validation power to "miners", they leave it in the hands of token owners who lock up holdings in order to participate in network governance.

delay, this will happen in late August, although activation has already been triggered and the time between blocks is already starting to lengthen.



Assuming total mining capacity remains more-or-less the same, the time between blocks will continue to lengthen, making Ethereum less profitable to mine as fewer new ETH are awarded per day. It will also impact users, who will need to wait longer for transaction finality. It could also impact fees, with some users willing to “tip”¹⁰ miners more to get their transactions included sooner.

If Ethereum’s hash rate starts to drop as miners leave the network, the increase in time between blocks will accelerate. What’s more, this could happen fast, possibly rendering the Ethereum network effectively unusable before the Merge.

The difficulty bomb can be delayed with a network update. However, on previous All Core Developer (ACD) calls, the decision was taken not to do this, for four main reasons:

- Developers felt relatively confident that the Merge would be ready before late August.
- They did not want to distract developer attention from Merge testing.
- They want to time the Merge and the bomb activation as closely as possible, to effectively kill off the proof-of-work layer as soon as

possible after the Merge goes live.

- They did not want to signal another Merge delay to the community.

However, on the May 27 ACD call, developers in principle agreed to delay the difficulty bomb, although it has yet to be determined by how much. This does not mean that the merge *will* be delayed, just that there is less time pressure.

The next phase of preparation is the merge of Ethereum’s main testnets. On June 8, the Ropsten testnet is expected to undergo the shift to PoS. Hiccups in the preparation that became apparent in late May highlight the testnet’s relative instability and this testnet will be deprecated after the mainnet Merge, but its merge is nevertheless significant as the first of an active network with running apps (albeit with thin hashrate and transaction activity).

After Ropsten, it’s the turn of testnets Goerli and Sepolia, with the latter [most closely approximating](#) the current Ethereum PoW network. Once all three have been running smoothly for a few weeks, developers will activate the countdown to the mainnet Merge.

Why ETH’s Future Supply is Hard to Predict

The current daily new supply of ETH is affected by three factors:

- Two ETH issued to miners who successfully process blocks on the proof-of-work chain.
- ETH issued to validators on the Beacon proof-of-stake chain, in [proportion to the square root](#) of the number of validators.
- Ethereum transaction fees. Ever since the EIP 1559 upgrade in [August 2021](#), Ethereum “burns” ETH paid as base fees, permanently removing them from the outstanding supply—the higher

¹⁰ Ethereum transaction fees consist of the base fee set by the algorithm according to flow and congestion (which is then burned) and a variable component to incentivize miners to prioritize certain transactions. For more information, [see here](#).

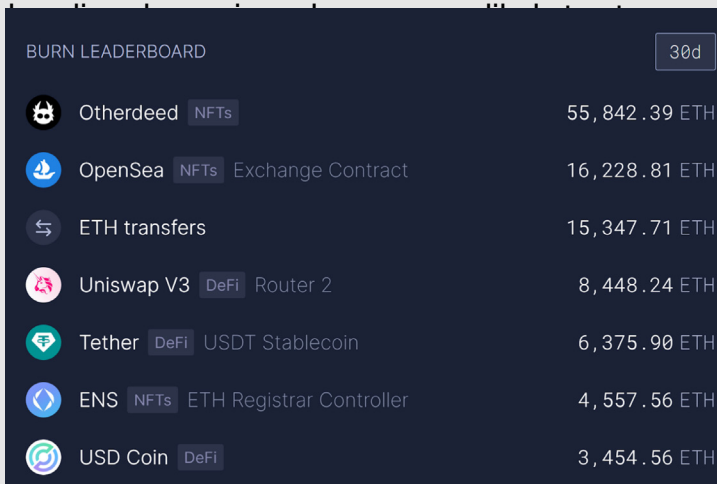
the total fees paid on the network, the more ETH is burned, reducing net new issuance.








After the Merge, no new ETH will be issued to miners (since there will no longer be any mining on Ethereum), so the “fixed” component of new supply disappears. Instead, new ETH supply will be dictated by two variable factors, making the new daily supply potentially even more complicated to predict.

The amount issued to validators as reward for proposals and attestations is currently small, given the low number of active validators, but is likely to materially increase after the Merge as more validators come online. Nevertheless, it is still expected to be a fraction of the previous new issuance as the cost of validating on proof-of-stake is much lower. Current annual supply inflation from mining rewards is approximately 4%, according to data from Coin Metrics; current annualized issuance on the Beacon Chain is [around 0.4%](#) of supply. Even if the number of validators were to double soon after the Merge, annual inflation [would still be](#) less than 1%.

This is likely to be more than compensated by the daily ETH burn, even at today’s relatively low Ethereum fees.

Ethereum transaction fees, which have been



BURN LEADERBOARD			30d
	Otherdeed	NFTs	55,842.39 ETH
	OpenSea	NFTs Exchange Contract	16,228.81 ETH
	ETH transfers		15,347.71 ETH
	Uniswap V3	DeFi Router 2	8,448.24 ETH
	Tether	DeFi USDT Stablecoin	6,375.90 ETH
	ENS	NFTs ETH Registrar Controller	4,557.56 ETH
	USD Coin	DeFi	3,454.56 ETH

(screenshot of [ultrasound.money](#))

However, while NFT sales have shown resilience in the face of market turmoil so far this year, during the month of May they did suffer a notable slowdown, according to data from [CryptoSlam](#), with an almost 50% drop in those based on Ethereum.

Ultrasound.money [predicts that](#) post-merge, ETH’s net annual supply inflation rate would be -1.5% per year. Given the variability of the supply factors, however, the exact figure is complicated to forecast.

Terra: The Big Implosion

May 2022 will be remembered as the month in which the Terra ecosystem imploded.

Terra is a proof-of-stake blockchain with a series of native applications built around its algorithmic stablecoin UST. The value of UST was pegged to 1 US dollar through a balancing mechanism in between UST and the chain's native token LUNA—1 UST could always be redeemed for \$1 worth of (newly minted) LUNA. When the price of 1 UST fell below \$1, arbitrageurs could profit by buying it in the open market and exchanging it for \$1 worth of LUNA (subsequently burned), putting upward pressure on the UST price—the peg is maintained purely by this seigniorage model rather than being backed by a fixed pool of collateral.

A vulnerability of this model is the embedded negative feedback loop given that the price of LUNA is related to the price of UST. A sudden decline in demand for UST could cause a drop in the price of LUNA, which could further decrease the demand for UST due to increased risk in the system, leading to what many have called a [“death spiral.”](#)

To generate demand for LUNA that was independent of the demand for UST, Terra aimed to create an ecosystem with an army of applications that had use cases for both, including staking, borrowing & lending, trading, and investing. In reality, demand grew in a much less diversified manner, with the majority of network activity concentrated in Terra's lending platform [Anchor Protocol](#), which initially offered a fixed ~20% yield (recently modified to a floating rate) on deposited UST. The attractiveness of the fixed rate yield, and the emergence of DeFi

services that supported leveraging UST positions to earn even more yield, generated enough UST demand to push its market cap up 6.5x to \$18.6 billion in just six months from November.



The idea was that, with time, Anchor would become self-sustaining, with enough income from borrowers to pay out to the lenders. However, in order to attract users, the yield was supported by a yield reserve, a stockpile of funds used to pay out (collect) in the event of excess lending (borrowing). This stockpile was ultimately backstopped by Terraform Labs (TFL), the founder of the Terra blockchain. Though TFL had already topped up the reserve in 2021, it [began to run dry again](#) at the beginning of this year, a sign of the persistent imbalance in demand for deposits over borrowing within the protocol.

To quell concerns about the system's sustainability, the Luna Foundation Guard (LFG) was established in January to maintain stability across the Terra ecosystem. As part of its mission, LFG created a UST reserve to act as a source of funds to help maintain the UST peg over the long term. In February, the reserve was again topped up with [\\$450 million UST](#) from TFL via

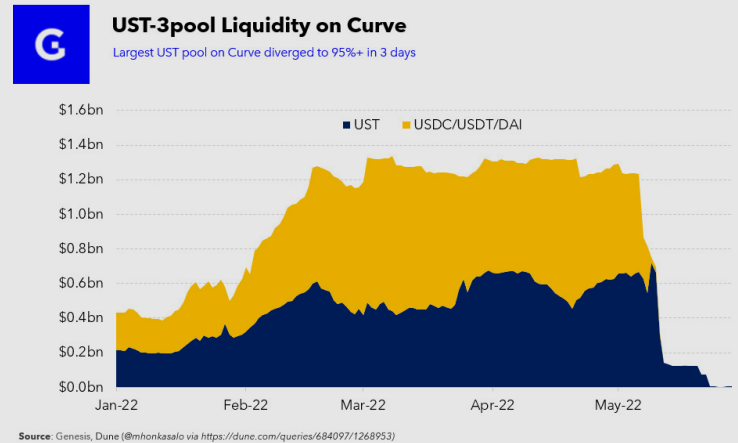
the LFG, indicating the systemic importance of Anchor for UST demand. In March, LFG chose to diversify its UST reserve and proceeded to [add over \\$3 billion worth](#) of BTC and [\\$100 million worth](#) of AVAX to the fund.

Additionally, in an effort to supplant MakerDAO's DAI as the main algorithmic stablecoin, Terra also looked to launch a new heavily incentivized liquidity pool¹¹ on leading decentralized AMM¹² Curve. The main source of UST liquidity on Curve at the time was the UST-3pool liquidity pool, which paired UST with "3pool", itself a liquidity pool made up of USDC, USDT, and DAI (3pool is the largest stablecoin pool on Curve). By launching a new pool named "4pool", UST would be included as a base asset alongside USDC, USDT, and another algorithmic stablecoin FRAX—this would enable UST to be traded directly with the three other stablecoins and exclude Terra's competitor DAI from the equation.

But trouble began on the weekend of May 7, with strong [directional flow out of UST](#) as Anchor suffered [billions of dollars of withdrawals](#), combined with heightened volatility in LUNA and BTC. This was exacerbated by three factors:

1. What [seemed like](#) a coordinated sale of UST on Binance and a [liquidity drain](#)¹³ of UST in its leading Curve pool (UST-3pool)—this led to lower-than-normal liquidity due to the in-progress transition into the new 4pool, which made it easier for the UST price to depeg.
2. An [apparent short sale](#) of approximately \$3 billion worth of BTC, which pushed the BTC price down further, adding to market jitters.

3. A drop in perpetual future funding rates¹⁴ and a spike in trading volumes [suggest that](#) LUNA was also being shorted.



On May 8, LFG [decided to](#) lend \$750 million worth of BTC to OTC trading firms so they could help defend the peg, and \$750 million worth of UST to accumulate more BTC once the market stabilized. Conditions continued to deteriorate, however. On Monday, May 9, the price of UST—which is supposed to be pegged at \$1—had slipped below \$0.70 as nervousness about the stablecoin's resilience picked up. A flood of sell orders with few buyers on the other side dried up spot market liquidity, pushing the UST price down even further. Early UTC morning on Wednesday, May 11, it reached \$0.30.

This coincided with a weakening of overall market sentiment triggered by a worse-than-expected US CPI number, released on Wednesday, May 11, which hit all risk markets. The resulting sharp drops in crypto asset prices weakened confidence in the UST peg even further. By the end of Thursday, May 12, UST was below \$0.20.

¹¹ In a "liquidity pool", users deposit pairs of assets in exchange for rewards, usually in the form of native application tokens.

¹² AMM = automated market maker, or decentralized exchanges (also known as DEXes), in which pools of assets rebalance the supply to maintain arbitrage-driven equilibrium pricing.

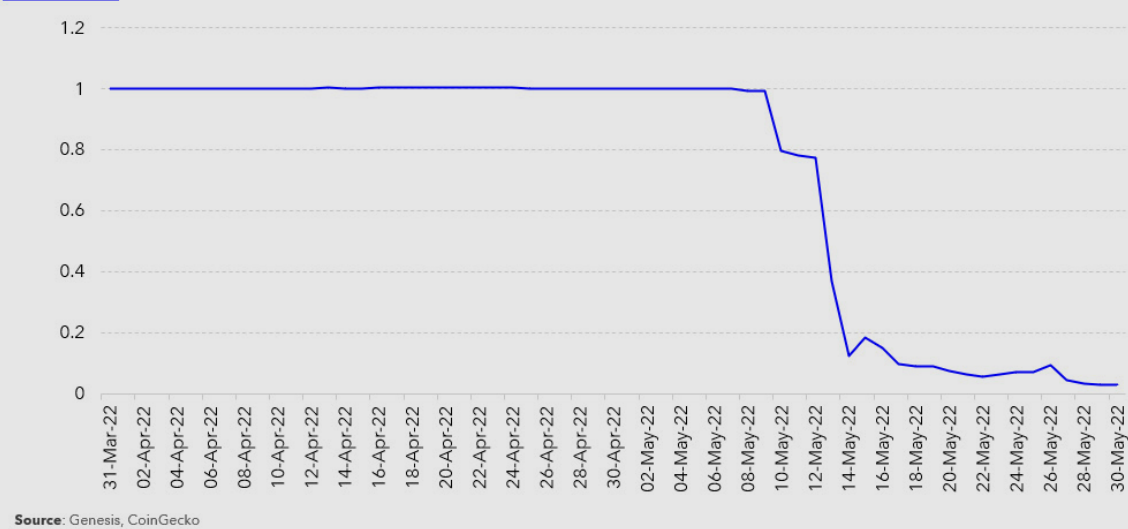
¹³ \$85 million UST was deposited into the Curve pool, and in exchange \$85 million of USDC was taken out, removing that possible exit for others hoping to swap UST for USDC—to rebalance, the liquidity pool would need an inflow of demand for UST. While there was [some of this](#), it ultimately was not enough.

¹⁴ Perpetual futures are futures contracts with no set expiry date that keep the contract price in line with the underlying asset price via a mechanism known as the funding rate, in which long position holders pay short position holders (and vice versa) according to the net balance of contracts outstanding. If there are more short positions open than long positions, the funding rate will be negative.



UST Price

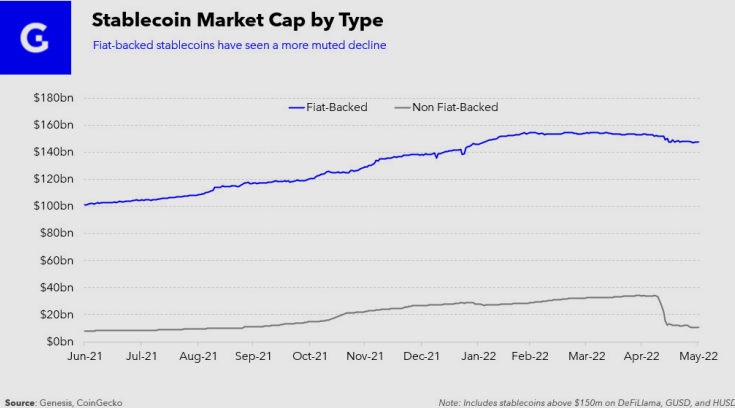
After a long period of stability, UST ended May below 5 cents



Meanwhile, not only was LUNA being hit by what appeared to be a short sale, but it was also being pummeled by a rapidly escalating supply as investors tried to use the redemption mechanism to exchange their UST for LUNA. Supply shot up from approximately 340 million at the beginning of the week to over 6.5 trillion by the time the Terra blockchain [was halted](#) on May 12. The price of LUNA entered the week at just over \$64, and exited at below \$0.0002, a market cap loss of over \$20 billion.

The fallout has seen the Terra community [vote through a proposal](#) to create a new chain, with the launch of Terra 2.0 which enables projects to continue building on the network, but without the algorithmic stablecoin at its core. Its native token is now the new Terra LUNA, with the original being rebranded to Terra LUNA Classic.

Stablecoins

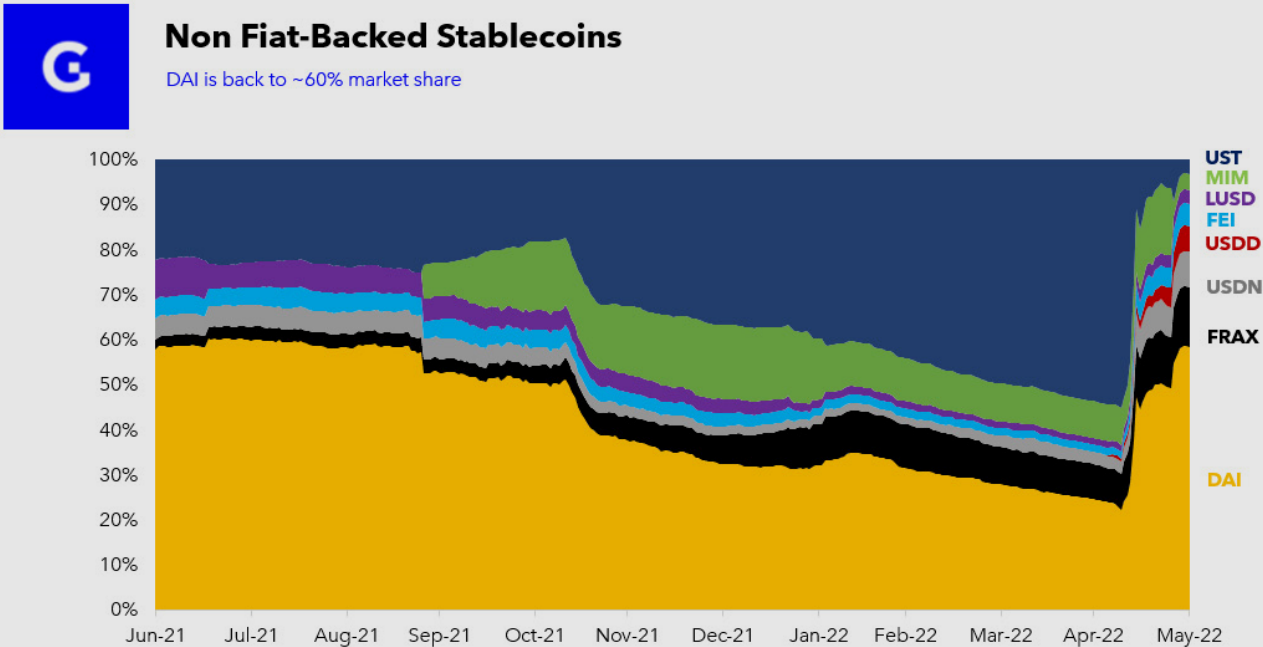


As the largest non-fiat-backed stablecoin at the time, the collapse of UST had a dramatic impact on the stablecoin landscape. Despite stablecoins of all types experiencing outflows during the aftermath (including fiat-backed stablecoin USDT, whose market cap—the largest of all stablecoins—fell over \$10bn in the second half of May), the largest redemptions in percentage terms were felt in the non fiat-backed categories, with FRAX and

DAI losing 45% and 17% of their market caps, respectively.

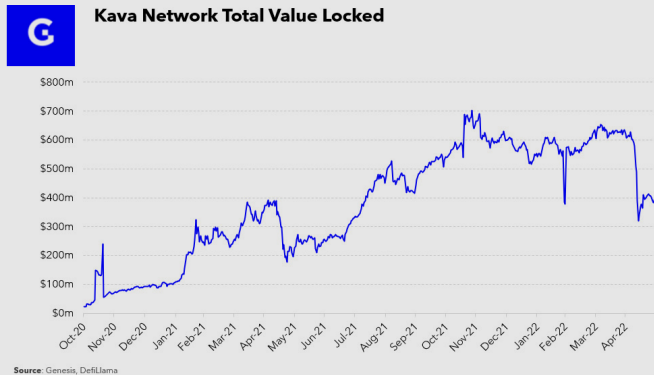
Fiat-backed stablecoins USDC and BUSD saw inflows as they were among those to benefit from concerns over Tether’s peg. Though DAI lost its position as the largest non fiat-backed stablecoin to UST late last year, it has since regained its dominance with its market share back to over 60%.

In terms of performance, fiat-backed stablecoins experienced lower volatility than their counterparts as per usual but no other major stablecoin saw a significant depeg with the notable exception of Waves protocol’s USDN, which saw intraday moves below 40 cents before recovering towards the end of May. The jury is out on whether the UST collapse will turn out to be proof that algorithmic stablecoins are a flawed concept or whether different design choices could be successful in the future. That said, the event has highlighted the importance of understanding nuances in this space and that not all stablecoins are created equal.



DeFi Impact

The repercussions of the implosion of UST and LUNA were felt beyond the Terra network, reaching the leading DeFi platforms and highlighting their inherent strengths and weaknesses.

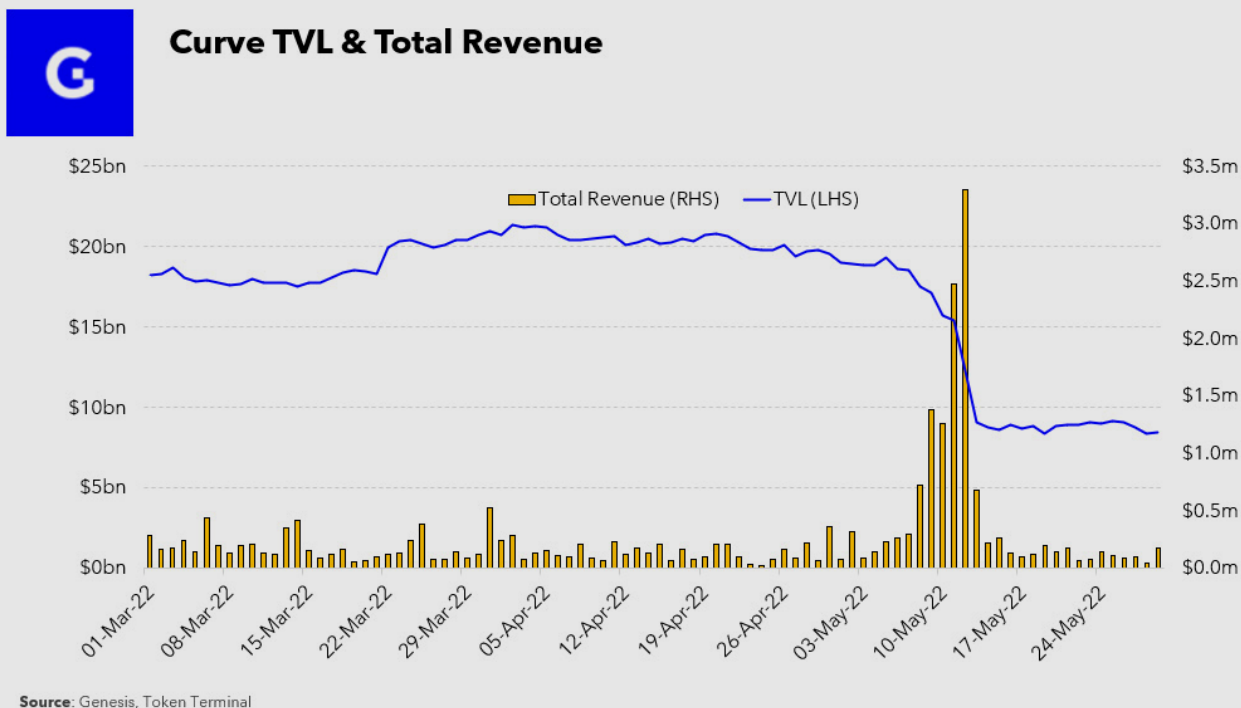


In some cases, developer error led to “permitted” exploits as UST depegged. An example is Cosmos-based Kava Network, which had the value of UST hard-coded at \$1. This allowed users to mint USDX (Kava’s native stablecoin) in exchange for UST deposits at a significant premium before selling them for other assets on Kava Swap. UST was [swiftly de-activated](#) on Kava,

but the heavy USDX selling caused it to [also depeg](#), and by the end of May, its TVL was over 35% lower than at the beginning of the month.

In some cases, a price oracle failed to reflect the true price of tokens that serve as the base of collateralized loans. For instance, decentralized lending and borrowing protocols Blizz Finance (Avalanche) and Venus (Binance Chain) [suffered a significant loss](#) because Chainlink stopped updating the LUNA price when it fell below \$0.10, allowing users to lend LUNA when it was trading at \$0.01 and borrow against it 10x more assets than possible under normal conditions.

Not all was negative, however. Decentralized AMM Curve’s total value locked (TVL) may have sharply dropped in May, but its trading volume and revenue spiked as users scrambled to exit UST positions. In a move designed to [cement the exit](#) of UST from the Curve platform, stakeholders [voted to end](#) CRV incentives for UST-related pools given the the possibility of their being bribed to attract exit liquidity for UST at the expense of new LPs, and of a “malicious entity” using the UST depeg to farm outsized influence in the Curve DAO.



Stablecoin Regulation

Discussions around stablecoin regulation had been gaining momentum even without May's events. Hearings on the topic have been held across a wide variety of [regulators](#) and [legislative bodies](#), with a crescendo of calls for [investigation into](#) and [rules around](#) what many politicians see as potential systemic risk posed by a stablecoin collapse.

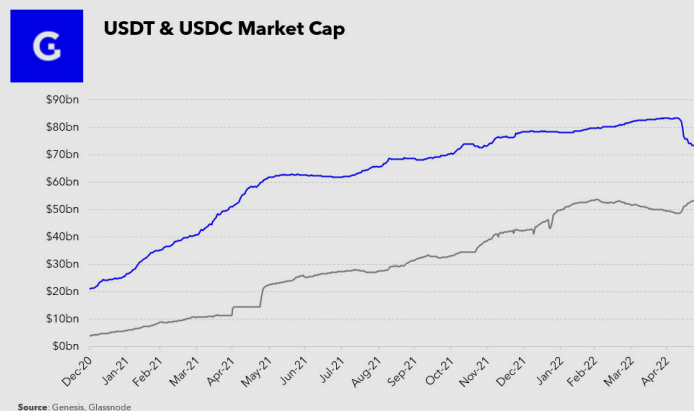
The implosion of what was the largest algorithmic stablecoin at the beginning of the month has no doubt made regulators around the world pay even more attention to this increasingly important corner of the crypto market.

Among the intensified calls for crypto regulation:

- We saw statements by officials from the [US Federal Reserve](#), the [European Central Bank](#) and the UK's [Financial Conduct Authority](#) stressing the need for guardrails against the potential systemic risk posed by stablecoins.
- The UK government [recommended](#) amending existing legislation to address such risks, including giving the Bank of England oversight of the administration of failed stablecoin issuers.
- US Treasury Secretary Janet Yellen [cited the UST depeg](#) as an example of the potential dangers of stablecoins. She recognized that the threat to financial stability was low, but that the growth of the industry meant that could change.
- South Korea's National Assembly held an [emergency seminar](#) to discuss the impact on investors and the role of exchanges. (The CEO of Terraform Labs, the developer of the Terra network, is a citizen of South Korea.)

While additional scrutiny from authorities does raise the risk of over-protectionism and centralizing barriers, greater clarity around stablecoin issuance and backing could bring even more liquidity into the market as trust in the issuers increases and as regulatory concerns abate. This is significant given the intensifying role that stablecoins play in the crypto ecosystem.

The steep increase in the market cap since early 2021 up until the May crash of USDC and USDT (the market's two largest stablecoins) highlights the demand for these types of assets.



The drop in USDT since the UST collapse (see “Layer-1s” above) is a reflection of the relative market confidence in its issuer Tether (based in the British Virgin Islands) compared to that of USDC (issued by the US-based Centre Consortium, founded by Circle and Coinbase).

However, Tether's [latest attestation report](#) shows an improvement in the maturation and quality of the assets backing USDT, although it is as yet unclear what impact the redemptions may have had on the mix. And it is notable that the more than \$10 billion of redemptions of USDT in May were met apparently without a hitch.

CFTC

Amidst the turmoil of the market crash, signs of a totally different significant shift – one that could impact not just crypto but also traditional markets—were largely overlooked.

In mid-May, in full market melt-down, the US House Agriculture Committee [held a hearing](#) to discuss a proposal by FTX.US Derivatives to amend its DCO¹⁵ license to allow it to offer cleared, margined derivatives products directly to retail customers. This would be a notable change to the current system in which FCMs¹⁶ collect margin, ask for top-ups when necessary (usually overnight), and commit to mutualizing losses in the event of a broker default. FTX proposes to bypass the brokers by requiring customers to deposit collateral directly in FTX accounts. Margin requirements would be calculated every 30 seconds, with automated liquidations initially in 10% increments.

May's hearing convened witnesses such as the CEOs of the CME, the Futures Industry Association (FIA) and the Intercontinental Exchange, as well as crypto industry representatives including FTX's CEO Sam Bankman-Fried. The mood was apparently defensive, with Representative David Scott (D-GA), chair of the House Ag Committee (which oversees the CFTC), [calling the](#) FTX proposal “an emerging and worrisome threat.”

The CFTC followed up with a [roundtable on May 25](#), with stakeholders from the derivatives trading industry as well as key crypto market participants. From the outset, the CFTC has shown a willingness to engage on this (DCO modifications do not require public scrutiny, and yet this one is getting that), and its chair Rostin Behnam [has](#)

[acknowledged](#) that the proposal could lead to “more efficient trading execution” and “less risk in the system”.

The FIA [recognizes that](#) the FTX plan is “innovative”, possibly “transformative” yet still lacking in detail. It also stresses the need for human intervention in markets and the potential for a destabilizing liquidation cascade in more automated systems. In addition, it insists that 24/7 account management would be impractical outside crypto —the banking system just doesn't work that way.

Change of the magnitude FTX is proposing will take time, and legacy market participants are obviously going to fight their corner. But the receptiveness so far—while laden with caveats—is encouraging, and signals an awareness that crypto's impact is likely to go far beyond that of new products.

Even more importantly, it highlights how the advantages inherent in much of crypto asset market infrastructure can spill over into other markets. If approved, the FTX proposal could set a precedent for further reforms, and a gradual progress toward greater market liquidity, transparency, resilience and investor choice.

¹⁵ Derivatives Clearing Organization

¹⁶ Futures Commission Merchants

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Genesis May 2022 Monthly Report by:

Noelle Acheson, CFA

Head of Market Insights

nacheson@genesistrading.com

Ainsley To, CFA

Senior Research Analyst

ato@genesistrading.com

Special thanks to:

Julie Ros, Julian Frost

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