Global Asset Management
BlueBay Asset Management

Market Commentary

Crypto JOMO, as the fraudsters get their comeuppance

With crypto back in the news for all the wrong reasons this week, the shine is disappearing from the 'digital gold' argument.

11 November 2022 (London): Treasury yields rallied in the wake of a benign US CPI report this week, with core inflation dipping to 6.3% from 6.6% the month before. This has encouraged hopes that the Fed will slow the path of its rate hikes at the December FOMC meeting, with markets now pricing a 50bp increase at that meeting. This may well prove to be correct and it seems increasingly clear that the economy is slowing on several fronts. Looking within the detail on price data, a slowing in rent could result in lower prints in coming months.

However, the labour market remains resilient, as highlighted by last week's payroll report, posing a threat to a secondary inflation impulse should wages start to accelerate. With financial conditions also easing as stocks push stronger, Powell may remain nervous of confirming a pivot too early, for fear of ending the hiking cycle prematurely. In this context, we don't see a compelling risk/reward in taking an active duration stance for the time being.

European yields moved in lockstep with US Treasuries, in the wake of CPI. Should the Fed move neutral, this will feed hopes that the ECB will also end rate hikes in Q1, albeit inflation data may remain worse on the continent for a time. Meanwhile, a turn in the dollar may also help to curb import price pressures. However, it may be premature to conclude that a period of dollar strength has given way to a period of dollar weakness and we are inclined to retain a neutral stance for now.

Meanwhile crypto assets have been back in the news for all the wrong reasons in the past week. The collapse of the FTX platform appears to have left an USD8 billion black hole, further undermining confidence in the space, following prior failures throughout the past year. As ever, our sympathies are with those investors who have been taken in by Ponzi schemes, on the promise of extravagant returns and easy money. All too often it is some of the poorest and least educated who are hardest hit when bubbles like this burst.

From this standpoint, it is sad that policymakers weren't able to act more decisively at an earlier stage, to avert such a predictable outcome. Perhaps it is more surprising to note that some large institutional investors, including some large Canadian pension funds and Middle Eastern institutions have also been caught in the recent debacle, particularly since any such investments should have been caught by anyone adopting an ESG lens within their decision-making process.

After all, it should have been clear that an industry that has been producing nothing, burning cash and offering alluring returns, was destined to fail. Yet, it seems that every generation needs to learn by having its own bubble. Before crypto, we had the dot-com bust and one wonders whether the next one will come around in the year 2040 or thereabouts.

An insightful tweet summarised the rise of crypto as being the birth of fake money, which has been used to buy political power, in order to turn fake money into real money. What recent collapses have also shown is

that when platforms go bust, then there are no assets left behind for creditors. An interconnected ecosystem also means that individual coin failures can become systemic events for others, prompting a loss of confidence without an obvious circuit-breaker.

As the shine disappears from the ‘digital gold’ argument, so the bursting of the bubble could see prices drop considerably further in the weeks ahead, yet it is the aggregate wealth destruction, which could be the most significant factor, that should matter to investors far away from the eye of the storm.

At the peak, cryptocurrencies had a market capitalisation of more than USD3 trillion. Of this total, more than USD2.3 trillion has now been lost. This may act as a restraint on disposable wealth, slowing spending and additionally forcing a number of those who had retired thanks to their crypto profits, or who had been pursuing a career trading coins, back into the workforce looking for a job. Consequently, the collapse in crypto is a factor in tightening financial conditions and one which may contribute to rates peaking below levels currently discounted in markets.

Over the past several weeks, credit spreads have been supported by end-investor demand, with buying interest triggered by yields reaching attractive absolute long-term levels. Some moderation in volatility has also helped risk appetite and with cash balances elevated and supply relatively light for the time of year, cash credit has outperformed relative to CDS, correcting weakness seen back in September when LDI sales from UK funds pushed prices weaker.

However, given an uncertain macro backdrop, we have been happy to reduce overall long credit beta, by purchasing protection in both corporate and sovereign CDS indices. Generally speaking, this has seen us flattening directional credit exposure, having also flattened a lot of the macro direction exposure we have held in macro alpha sources.

We are flat in rates, with the exception of a short position in JGBs and small long positions with respect to Brazil and South Africa, where we are constructive on the outlook for inflation and thereby interest rates.

Looking ahead

It may be tempting to believe that we are now seeing data turn and that we could be set fair for a year-end rally in risk assets. However, substantial uncertainty remains and we are somewhat wary of being drawn into chasing a risk asset rally, only for sentiment to turn much more bearish again, against the backdrop of very limited liquidity. It has been our preference to sell rallies and buy into weakness of late and we are not convinced that this has structurally changed a great deal.

Meanwhile, for those who have wisely steered clear of crypto ‘assets’, there is at least a sense of the Joy of Missing Out (JOMO), which has come to replace past FOMO, and regret. It may seem that a total market cap still north of USD700 billion has further to fall and it will be interesting to see how many of the former billionaires end up on the run from the authorities, like the eponymous Do Kwon in Korea. As for Sam Bankman-Fried of FTX fame, it may appear that he won’t even end up with enough cash in his wallet to afford an (overdue) haircut….

Notes to Editors

Lydia Cambata: +44(0)7578 252424
LCambata@BlueBay.com

About BlueBay Asset Management

BlueBay is an active fixed income specialist, structured to deliver outcomes tailored for investors seeking to enhance the returns of their portfolios. Investing globally for clients across corporate and sovereign debt, rates and FX, we manage over USD 128 billion in AUM, as at 31 December, 2021.

BlueBay embodies the best of alternative and traditional asset management through a diverse investment team focused on alpha generation and a robust investment process. This is coupled with our established

track record across a broad range of specialist strategies including relative return, total return and alternative investment portfolios.

Our collaborative approach to active client engagement enables us to innovate and deliver outcomes tailored to support our clients' objectives and needs.

BlueBay has offices in the UK, Switzerland, Italy, Germany, Luxembourg, Japan and Australia. BlueBay Asset Management is wholly-owned by Royal Bank of Canada and part of RBC Global Asset Management.