

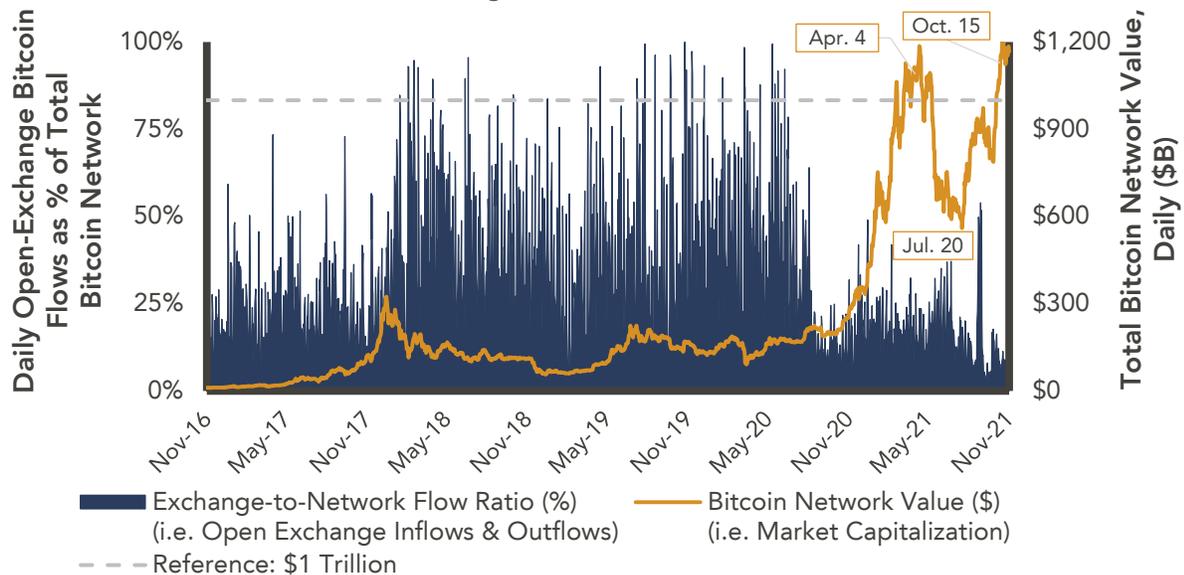
Chart of the Week

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Bulls on Parade: What's Driving the 2021 Digital Asset Rally?

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Bitcoin transfer flows on retail exchanges are riding five-year lows, suggesting institutional OTC sales have driven Bitcoin's value through 2021



Source: Glassnode on-chain data as of November 17, 2021

The first bitcoin futures ETF — the ProShares Bitcoin Strategy ETF — was approved on October 15th, making it easier for investors to access the most well-known cryptocurrency. Not surprisingly, Bitcoin's network value (the market capitalization) surged on the announcement, reaching \$1.13T (equating to \$61,571 per coin). However, this was not the first time Bitcoin's capitalization crossed \$1T: as the orange line in the chart shows, Bitcoin's total value has crossed this threshold several times since 2020, with significant volatility along the way.

Certainly, the ProShares ETF approval has provided more access to investors, and the October run-up can at least be partially attributed to this new channel. However, there also appears to be an evolving demand dynamic in terms of investor type, which could create broader acceptance of cryptocurrency as an asset class in the coming years. We can examine this trend by looking at the types of transactions on the bitcoin network to see what has changed over the last five years.

Illustrated in blue and on the left axis is bitcoin's daily exchange-to-network flow ratio: this measures bitcoin transfers on open exchanges (both inflows and outflows) as a percent of total network transfers. The total network is a classic ledger of accounts, the blockchain technology which serves as the foundation for all cryptocurrencies;

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transfers are debits and credits to and from accounts. Transfers are classified as either open exchange (retail investors), or over the counter (i.e., wholesale, OTC — more akin to institutional investors). As the ratios in blue approximate open exchange flows, the remaining network transfers approximate OTC flows. Overlaying exchange flows and network value propounds the degree to which exchanges drive or do not drive asset appreciation. To that point, the data illustrated above suggests three points:

1. Historically, retail participants via open exchanges drove Bitcoin demand. Daily exchange-to-network flows surged from mid-2017 through mid-2020, averaging ~35.2%, with a high of 99.4%.
2. Around August 2020, the drivers of demand shifted. Daily exchange-to-network flows decreased and have sustained five-year lows, averaging ~15.4% in 2021, with a low of 0.8%.
3. OTC transfers correspond with the 2021 rally, averaging ~84.6% of network transfers. Although it is not definitive, this implies institutional wholesale transfers are the dominant driver of Bitcoin's value appreciation through 2021.

Taking this analysis a step further, it appears that more institutional money is driving demand for bitcoin. In the past, the infancy of the asset class coupled with the radical volatility of returns was enough to frighten most institutional investors off. If the trend suggested by this chart continues, however, bitcoin and other cryptocurrencies may become a more common holding across institutional portfolios. ■

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