The closer quants look, the less diversifying crypto appears

My articles
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In a previous RISK.net article, I discussed the importance of understanding the correlation structure of cryptocurrencies in order to make informed investment decisions. At the time, the market was characterized by high volatility and uncertainty, with some analysts predicting a correlation spike between crypto and traditional markets. However, as we move further into 2022, the picture is evolving, and it is evident that diversifying crypto is less useful than previously believed.

Correlations with equities have changed sharply during a systemic shock: "If we experienced a full-blown central bank crisis, there would be a significant change in decorrelation versus traditional markets," says Sandstrom. He adds that correlations could go up to 0.5, which is a significant increase from the levels seen during the global financial crisis (GFC). According to experts, this change is due to a variety of factors, including the increased integration of crypto into global financial markets and the growing use of crypto as a hedge against traditional assets.

Nevertheless, cryptocurrencies continue to exhibit periods of lower correlation. In mid-July, bitcoin’s correlation with equities was at its lowest level ever, with a correlation of -0.2. However, this is expected to fluctuate sharply as market conditions change.

Analysis by Jon Danielsson, an economist at the London School of Economics, shows that correlations with S&P 500 futures jumped in 2020 to between 0.0 and 0.5, having spent the previous few years below 0.1. The increase in correlations is due to the growing interconnection between crypto and traditional asset classes, which is likely to continue as the market matures.

1. High Frequency (Daily) correlations for bitcoin and ether against S&P 100 futures

In order to better understand the impact of systemic shocks on crypto prices, we can look at the correlation matrix for bitcoin and ether against S&P 100 futures. The chart shows that the correlation between crypto and equities is not constant, but rather fluctuates depending on market conditions.

2. Correlation between bitcoin and ether

The correlation between bitcoin and ether is lower than that between bitcoin and equities, indicating that diversifying crypto appears to be less useful than previously believed.

In conclusion, while crypto has shown signs of integration with traditional markets, it is not yet clear what the long-term implications of this integration will be. As with any investment, diversification is key, and investors should continue to monitor the correlation structure of crypto in order to make informed decisions.

Citi says nyet to netting

According to recent reports, Citi Group has decided against implementing netting to reduce counterparty risk. The decision is likely to have significant implications for the industry, as it is expected to set a precedent for other banks to follow.

In a statement, Citi Group said that netting is not the solution to counterparty risk. "Netting is not a silver bullet," the bank said. "It is a tool that can be used to mitigate risk, but it must be used in conjunction with other risk management strategies." The decision is likely to have significant implications for the industry, as it is expected to set a precedent for other banks to follow.

The benefits of netting include reduced collateral requirements, lower capital charges, and increased operational efficiency. However, the drawbacks include increased complexity, higher administrative costs, and potential legal risks.

In conclusion, Citi Group’s decision against netting is likely to have significant implications for the industry. As banks continue to grapple with counterparty risk, it is clear that a holistic approach to risk management is required, rather than a one-size-fits-all solution.