



# BITCOIN RISK REPORT

## MARCH 2023 OUTLOOK

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## KEY DRIVERS

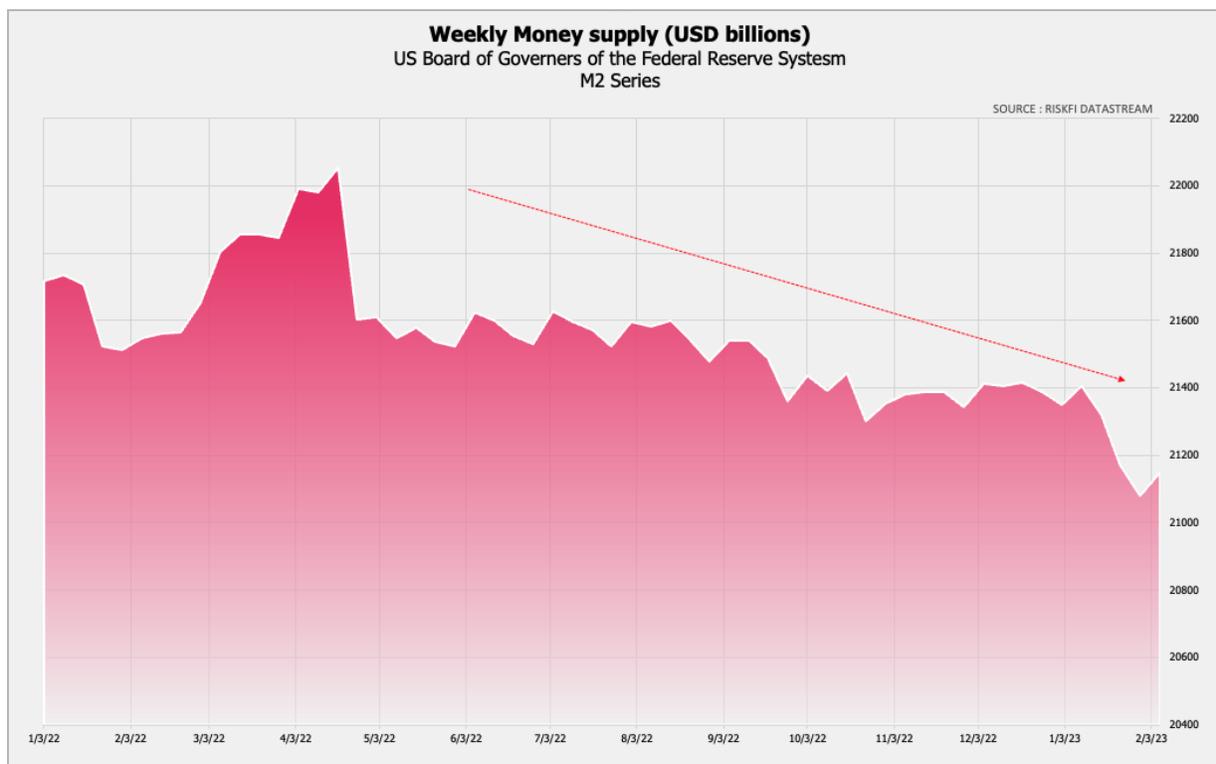
### MONETARY POLICY - FED'S FIGHT WITH INFLATION

The US economy is experiencing a higher inflation rate of 6.4% in January. This is a deep cause for concern for the overall economy as it has resulted in an inverted yield curve. The Federal Reserve (FED) is taking steps to address this issue.

The yield curve inverts when the short-dated treasury bonds have a higher yield, compared to the longer dated ones. It is expected the FED will continue to hike interest rates in the future to tame inflation.

The reserve money supply (M2 money) trend has been decreasing for the last ten months. But we saw a small increase in the first week of February 2023 (chart below). This suggests that the FED is continuing to take a cautious approach to monetary policy in order to combat inflation. By keeping the money supply low, the FED is effectively reducing the amount of money available to consumers and businesses, which can help to moderate inflationary pressures.

RiskFi will closely monitor the economic indicators like inflation, the yield curve, and money supply. These indicators provide key insights into the direction of the economy and potential impacts on Bond and Equity markets and consequently on Bitcoin.



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## MARKETS - EQUITIES COMING IN TERMS WITH REALITY

In February of 2023, the S&P 500 experienced a decline. January had a moderate rally in equity indices. This was likely due to a shift of capital from equities to bonds, as the bond markets, particularly the US 10 Y Treasury yields, saw an increase.

This shift in investment indicates investors are overlooking the possibility of a recession and are focusing on the potential for increased inflation. The decline in the S&P 500 suggests that the market is adjusting to the right price, rather than being driven purely by sentiment or animal spirit as it may have been in January.

## CRYPTOCURRENCY CONTAGION - THIS TIME IT COULD BE THE STABLECOIN TETHER (USDT)

The recent news on [Wall Street Journal](#) about embezzlement and Ponzi scheme involving stable coin Tether (USDT) is worth paying attention to. USDT has a market cap of \$71 Billion USD and if it has pegging issues there is a potential for a contagion. It is a widely used stablecoin and its collapse can have a catastrophic consequence on the entire digital asset ecosystem, including BTC's value.

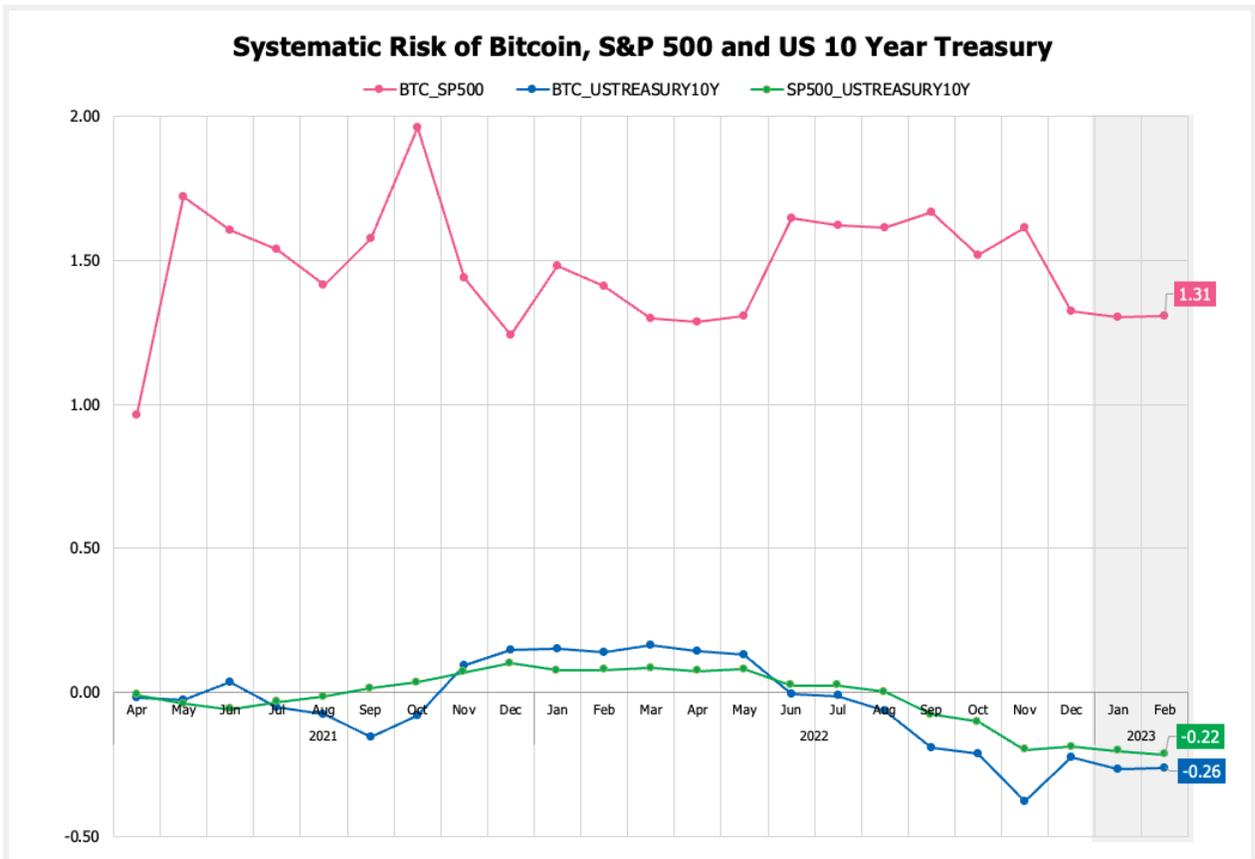
Stablecoins play a crucial role in the cryptocurrency market, providing a stable asset that can be used as a medium of exchange and a store of value. If a widely used stablecoin like USDT were to fail, it could cause widespread panic in the cryptocurrency market, leading to a loss of confidence in other cryptocurrencies and a sharp decline in their value.

## BITCOIN, S&P 500 & US 10 YEAR TREASURY RATES

Bitcoin's beta of 1.31 from the S&P 500 index indicates that it has a higher level of systematic risk than the overall market. This means that Bitcoin is more susceptible to S&P 500 movements.

The US 10 Y Treasury rate has an inverse relationship with Bitcoin in terms of systematic risk, which means that as interest rates rise, Bitcoin's systematic risk decreases. This is because rising interest rates often signal investors shifting their investments away from riskier assets like Equities (and Bitcoin) and towards safer assets like Treasury bonds.

Similarly, there is an inverse correlation between the systematic risk of US 10 Y Treasury bonds and the S&P 500 index. This means that when the S&P 500 index experiences a decline, the systematic risk of Treasury bonds tends to increase, as investors seek out safe-haven assets.



## STRESS TESTING

### CURRENT SCENARIO

Equity effect has a strong influence on the volatility of Bitcoin. RiskFi recommends investors calibrate a **Stressed monthly loss of 18%** on Bitcoin based portfolios. This is driven by the “**Equity effect**” in “**Current Macro**” scenario.

SCENARIO	SENSITIVITY	DIRECTION	MINIMUM LOSS	STRESSED LOSS	EXTREME LOSS
CURRENT MACRO (1 SEP 2022 - 28 FEB 2022)	Commodity effect	INVERSE MOVE	-1%	-6%	-7%
	Rates effect	INVERSE MOVE	-1%	-7%	-9%
	Equity effect	DIRECT MOVE	-5%	-18%	-20%

### HISTORIC SCENARIO

The historic scenario analysis is a tool for risk mitigation. It illuminates potential risks investing in Bitcoin during periods of prior macroeconomic stress. Investors can gain insights into the potential extent of Bitcoin losses if a similar event were to occur again in the future.

SCENARIO	SENSITIVITY	DIRECTION	MINIMUM LOSS	STRESSED LOSS	EXTREME LOSS
2022 - Russia Ukraine war (1 FEB 2022 - 6 JUN 2022)	Rates effect	INVERSE MOVE	-2%	-9%	-10%
	Commodity effect	INVERSE MOVE	-2%	-10%	-12%
	Equity effect	DIRECT	-5%	-25%	-27%
2022 - TERRA LUNA (1 JAN 2022 - 12 MAY 2022)	Crypto Contagion effect	DIRECT	-6%	-24%	-26%
2020 - Covid Crisis (1 FEB 2020 - 1 SEP 2020)	Rates effect	INVERSE MOVE	-5%	-25%	-34%
	Commodity effect	INVERSE MOVE	-1%	-27%	-33%
	Equity effect	DIRECT	-3%	-39%	-62%
2008 - Mortgage Crisis (1 AUG 2000 - 31 DEC 2010)	Equity effect	DIRECT	-4%	-34%	-43%

Some of the stressed macroeconomic shock events in the past to assess the potential losses in Bitcoin for one month

## HYPOTHETICAL SCENARIO

RiskFi has built a few forward-looking scenarios that measure severity of losses. Portfolio managers can use these based on their own risk tolerance.

RISK SCENARIO	DESCRIPTION	SEVERITY
<b>COLLAPSE OF TETHER (USDT)</b>	The Stablecoin Tether or USDT with a market value of \$71 billion has been in the news for Ponzi schemes and embezzlement of funds. A collapse of USDT will have a strong contagion effect due to its widespread use as a stable coin in the Cryptocurrency ecosystem. Investors need to keep a close watch and allocate risk reserves in case of severe stresses caused by USDT's failure.	<b>HIGH STRESS</b>
<b>INCREASING US INFLATION</b>	FED'S decision to increase the rates to tame inflation will have adverse effects on S&P 500 index, directly impacting the Bitcoin valuation.	<b>MEDIUM STRESS</b>
<b>US HOUSE PRICES DECREASING</b>	The collapse of the housing market in the US will have impacts on S&P 500 and Bitcoin valuation. Although this may not have a possible impact on Bitcoin for March 2023, it will continue to have a significant impact in the long term.	<b>LOW STRESS</b>
<b>DEEP RECESSION 2023</b>	A steep decrease in Supply chain prices (PMI), increases the possibility of recession. This will impact corporate earnings negatively, increasing the possibility of Bitcoin valuation to fall due to a higher Systematic risk with S&P 500.	<b>MEDIUM STRESS</b>
<b>EXCESSIVE BITCOIN LEVERAGE</b>	Bitcoin can is often used as leverage in DeFi and centralized crypto exchanges that can impact its price deviations. Bitcoin has seen drawdowns during the Terra/Luna, Celsius, and FTX collapses. Such failure of exchanges/actors have to be considered for effective risk taking.	<b>EXTREME STRESS</b>
<b>COLLAPSE OF BINANCE AND CRYPTO CONTAGION</b>	Binance, the largest centralized crypto exchange, remains opaque on its Balance sheet. With large leverage on Bitcoin and a considerable amount of consumer funds under custody, a collapse of Binance will have a contagion effect. This is an extreme stress even for Bitcoin and crypto in general.	<b>EXTREME STRESS</b>

These qualitative Macro and Cryptocurrency industry stresses are forward looking, i.e they "may" pose a severe stress on Bitcoin

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