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Digital Assets - Comments

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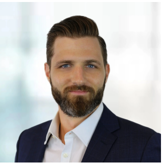
FED LETS THE MARKET DO THE TIGHTENING, DURATION-SENSITIVE MINERS REMAIN UNDER PRESSURE



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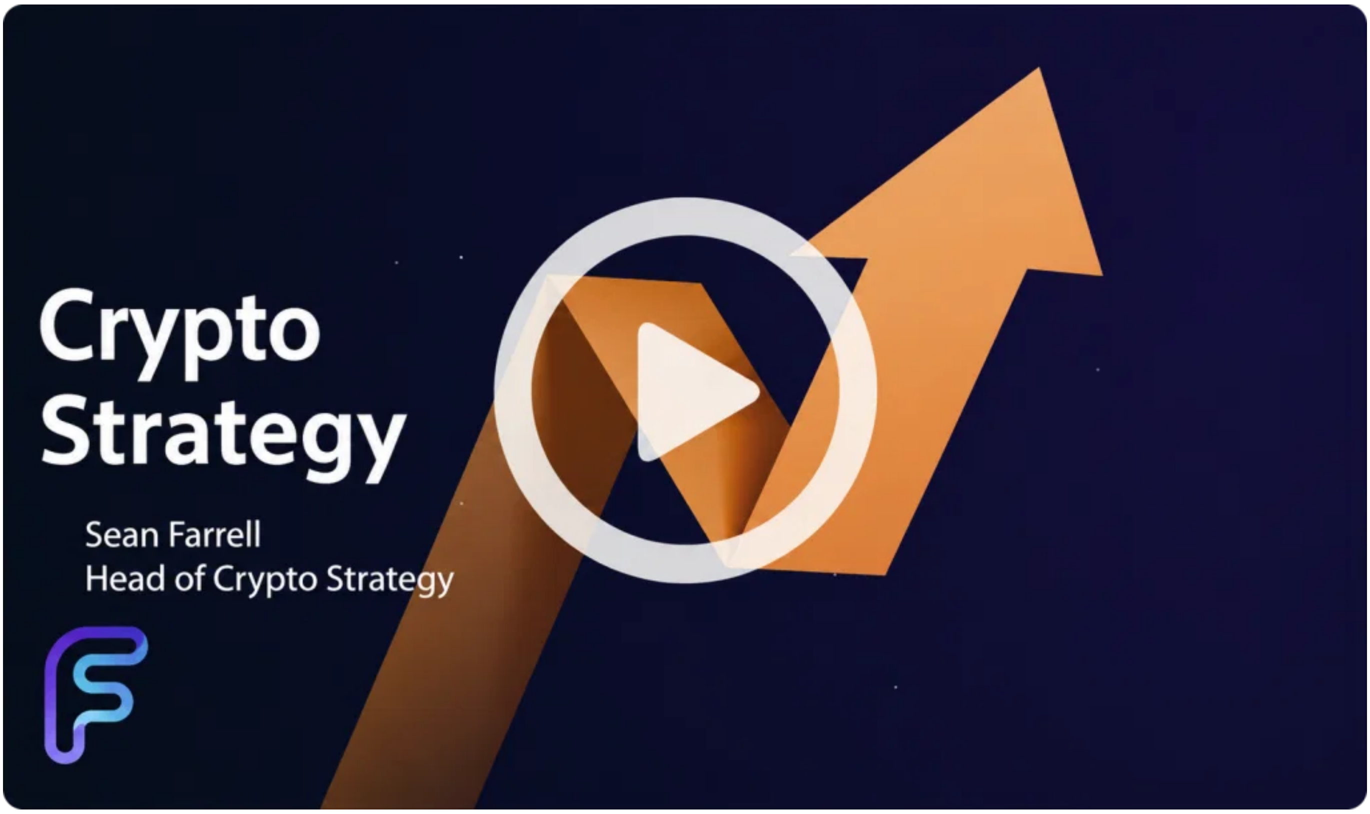

My TLDR on Fed: The Fed held rates steady, but I think the more important takeaway was Chairman Warsh's continued effort to reduce forward guidance and allow market prices to play a larger role in both transmitting and informing monetary policy. Throughout the press conference, he repeatedly pointed to the significant increase in nominal and real yields since the prior meeting and emphasized that markets had already done a meaningful amount of tightening despite no change in the policy rate. My interpretation of the subsequent bond market reaction is that investors heard Warsh effectively say: “The Fed is not going to hike interest rates; the market needs to do it.”

Key points:

The Fed held rates steady, which was my base case. There were 3 dissents, with Hammack, Logan, and Kashkari advocating for a 25 bps rate hike

Warsh continued to hammer home the Fed’s commitment to a 2% inflation target (despite not hiking). He reiterated that there is no “soft” target and that one encouraging inflation print is not enough to move the needle in any acute sense.

Perhaps most importantly, Warsh acknowledged that financial conditions have already tightened materially despite the Fed doing nothing. He repeatedly pointed to higher nominal and real Treasury yields and suggested that, in the absence of forward guidance, markets are reacting more directly to economic conditions. This is a concept we have discussed recently. Liquidity conditions have been tightening as real yields have moved higher (net-negative for crypto).

My read of the market reaction is that the bond market interpreted his comments as: “The Fed is going to let us do the tightening, so we need to do it.” Warsh was essentially telling investors that the Fed is not going to spoon-feed the market or automatically validate higher short-rate expectations through an immediate hike. Instead, it is willing to stand back and allow Treasury yields, real rates, credit conditions, and the dollar to tighten financial conditions on their own.

That also helps explain why the selloff was concentrated further out the curve. Had the Fed stepped in and raised rates, the front end likely would have absorbed more of the adjustment. A hike could also have increased the probability of a sharper slowdown in credit creation and growth, creating a more reliable bid for the long end. Instead, the Fed held rates steady while signaling that it was comfortable with market-led tightening, leaving more of the adjustment burden on longer-term yields.

In that context, the long-end move makes sense. If inflation is going to be brought sustainably lower without an immediate Fed hike, the market appears to believe the cost of capital needs to rise where much of the economy actually borrows. Pair that with Warsh’s previously stated desire to normalize the duration of the Fed’s balance-sheet holdings toward shorter maturities, and you have a difficult setup for long-duration Treasuries. The move likely also reflects some combination of higher term premium, fiscal concerns, and Treasury supply.

Near term, this remains a negative for crypto and other liquidity-sensitive assets, but is particularly more damaging to duration-sensitive assets (i.e., miners). Higher real yields tighten financial conditions, raise discount rates, and reduce the attractiveness of long-duration risk. The good news is there is already a lot of damage priced into many names.

Some longer-term perspective: Every additional move higher in the 30-year yield also brings the U.S. fiscal situation further into focus. At some point, policymakers may be forced to intervene either to stabilize sovereign yields or to prevent broader financial conditions from becoming overly restrictive. There are only a few ways to resolve that problem over the long run: (1) meaningful austerity, (2) a sustained productivity boom, or (3) some combination of inflation and financial repression. The third outcome remains the most likely in my view, which is perhaps the best structural bull case for BTC.

Bottom Line: From a crypto allocation perspective, patience remains warranted. It is difficult to knife catch the miners given their sensitivity to long-end rates (although they should be reaching levels for at least a tactical low soon), and as correlations rise, that leaves the broader crypto/crypto-linked equity complex vulnerable as well. With hyperscaler earnings still ahead and the BOJ meeting on Friday Japan time, there are enough meaningful catalysts on the calendar that I think it makes sense to let the market show its hand (capitulation/relief) before getting more aggressive. The lone caveat here is Clarity, which I did not discuss today, but a positive resolution of which is still on the table (see yesterday’s comments for added context).

Tickers in this video: #BTC

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