Q3 2023 Bitcoin Report

Bitcoin

We bid farewell to another quarter in the world of Bitcoin; we draw ever closer to the impending halvening. Bitcoin has experienced a modest bounce since the lows of 2022. Over the past few months, institutions, regulators, and miners have all taken center stage, shaping the prevailing market themes. These themes serve as guiding beacons for investors as we navigate the path forward toward the next halving. For those riding the Bitcoin wave, it's been an exhilarating journey with the protocol's resilience on full display.

Bitcoin cycles often provide volatility in both directions but no matter the price, faith in the protocol remains unshakable. Even today, far from the all-time highs, one in four millennials and 14% of adults own Bitcoin. This is a significant jump from years ago when most people never owned any Bitcoin. The cyclical nature of Bitcoin, coupled with its unyielding monetary policy, continues to inspire users to dedicate their time and resources to integrate it into their lives.

Bitcoin is more than just the numbers and charts on our screens. It represents a revolutionary protocol that relies on a community of dedicated individuals working to advance the network. Our goal today is to bring you the news that made heads turn this quarter.

Note From Mike Belshe

The world's first decentralized digital asset network is still standing strong after over a decade. This resilience surprises many, but not us, who have been here for some time. When I first dove into Bitcoin, the community was a fraction of the size it is today. The movement has now spread and gone global. The genesis of Bitcoin created an entire industry that has captured the world's imagination and curiosity, but it's far from over.

Amidst the Federal Reserve's ("Fed") tightening policies and higher interest rates, Bitcoin once again finds itself weathering a storm of doubters, skeptics, and people eager to see it fail. We're living in challenging economic times that only reinforce the principles that made Bitcoin great. The orange coin is a perpetual barometer of trust in the existing financial systems. We saw this with the banking issues over the last year; Bitcoin rose as fears regarding the banks bubbled to the surface.

We will continue to cheer on Bitcoin's progress in developing financial access for all internet users and investors. The world deserves sound money that doesn't require trust to manage a currency. BitGo will continue delivering confidence where it's still needed for institutional custody and self-custody. We've faced adversity and lessons this cycle, but Bitcoin's industrial players will be more robust by the end of it with more substantial protections for all participants.

Mike Belshe

CEO, BitGo

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BitGo

A New Epoch Approaches

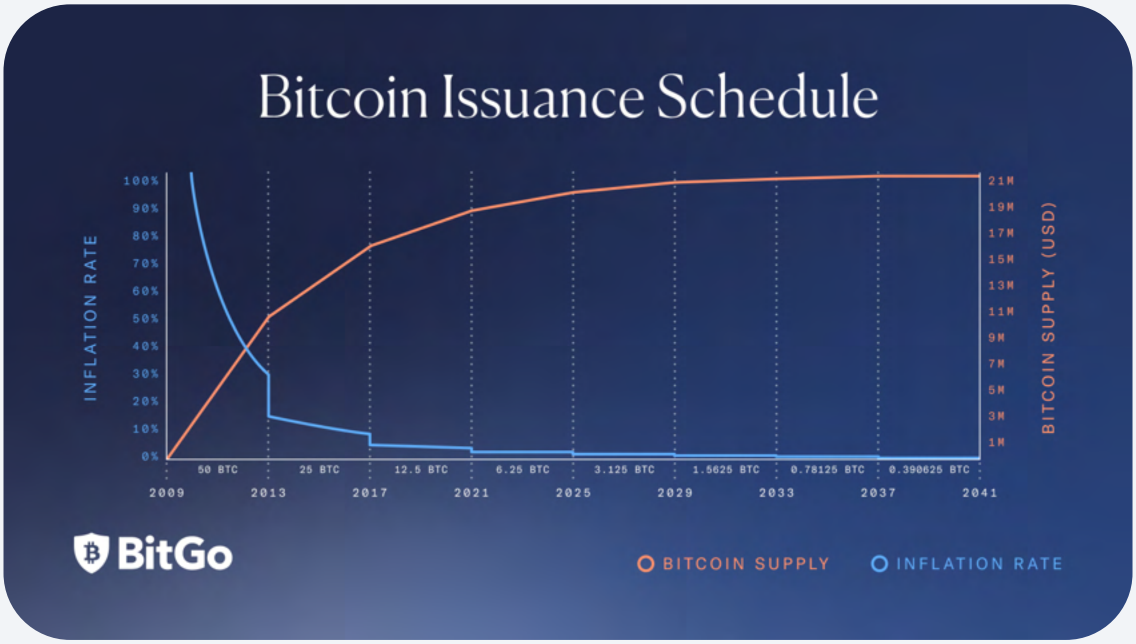
MOVING CLOSER TO A NEW EMISSION ERA FOR BITCOIN.

Every ten minutes(ish), Bitcoin's heart beats and propagates a new block filled with transactions. Transaction fees are collected and new Bitcoin are minted permanently onto the blockchain—a reward for securing the network that entices miners globally to participate and secure Bitcoin. When Bitcoin first came online, 50 BTC were produced per block. Today, it's much less.

We are currently in Bitcoin's fourth epoch; a little over eight years from now, the reward for miners processing transactions will be less than one bitcoin per block (0.78125 BTC). The seventh era will have a daily block reward of 112.5 BTC. Compared to today, when ~900 BTC are produced daily. Bitcoin's supply and demand economics will be tested over the next decade as miners get fewer direct block rewards.

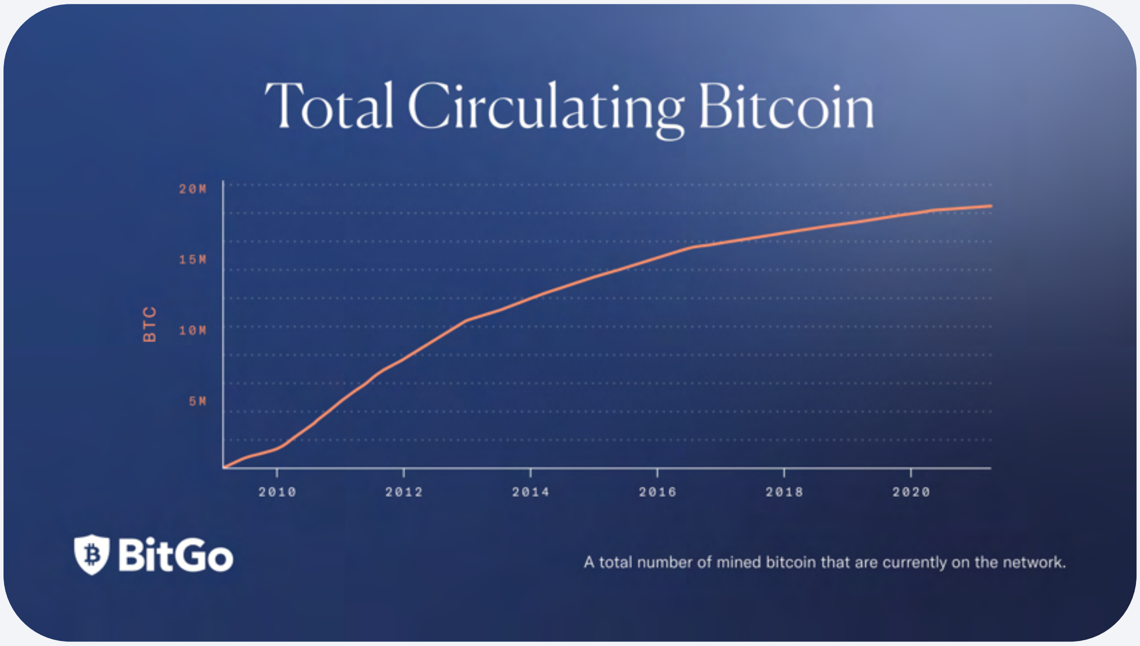
The upcoming halving is anticipated to take place sometime in April 2024. The current Bitcoin block subsidy is 6.25 Bitcoins per block; when Bitcoin reaches the proper block height, the subsidy will drop to 3.125. This rare deflationary event only occurs once every four years or 210,000 blocks; the emission rate for new Bitcoin will be halved—hence the name.

As we move deeper into Bitcoin's future, the halving becomes more of a psychological event as the new supply begins dwindling. Changes in the supply rate in future halvings may have less effect as more total Bitcoin will be in circulation. It will be a battle amongst miners for those precious few Bitcoins remaining to be distributed.



The final Bitcoins will take decades to mine, finally finishing sometime around the year 2100 when transaction fees will be the majority of earnings for miners. Currently, ~92 percent of all Bitcoins that will ever exist have been mined, and the last 8 percent of coins will be slowly created over the next century.

This planned reduction of Bitcoin issuance is a global protocol-level event and one of the few times that Bitcoiners around the world will unite and celebrate. Each cycle brings new social and financial challenges and opportunities to continue innovating with the world's strongest digital asset. Historically, the halving is the pivotal moment typically preceding Bitcoin's infamous bull cycles. Nothing is guaranteed; this is a well-documented historical pattern over multiple cycles. All we can know is that the fresh supply of coins will dwindle over time.



The Return Of Volatility

QUIET MARKETS SELDOM STAY QUIET.

Q2, 2023 started with a bang as institutional asset management giant BlackRock announced they were filing for a spot Bitcoin ETF. Prices promptly doubled from the November lows, and optimism flooded the market. The start of Q3 brimmed with enthusiasm as the idea of institutional investors taking positions in the world's top digital asset buoyed the market after a year of down-only price action.

The market quickly quieted as Bitcoin spent most of Q3 in the lowest period of volatility of all time. Volatility is a time-based measure of movement within markets. Bull markets tend to be volatile on the way up—and bear markets the opposite. Bitcoin didn't move significantly for weeks in Q3; no catalysts emerged. Rapid movement often occurs when volatility reaches extreme levels; this time was no exception.

Source: Buy Bitcoin WorldWide

A sudden 12% markdown in August woke the crypto market, feeding a new wave of fear, uncertainty, and doubt. This part of the cycle leans into sideways price action on the higher time frames. Short-term speculators help drive price discovery, but many simply choose to buy and hold, playing the long-term value proposition of Bitcoin. Bitcoin is a time-based supply and demand asset with a value proposition that builds over time as we move forward through time. Participation and recognition are growing steadily; on a fundamental protocol level, there is nothing but certainty that Bitcoin will continue to perform as designed.

People from across the economic spectrum are interested in Bitcoin, ranging from the average working American to institutional investors. Interest is even growing within the halls of government.

Bitcoin: An Oval Office Asset?

NEUTRAL MONEY IN PARTISAN POLITICAL LANDSCAPES

It's no secret that the American presidential election is starting to ramp up. Over the last few months, we have seen the notable development of candidates talking about Bitcoin and accepting it for campaign donations. RFK Jr. started this trend by speaking about Bitcoin at BTC 2023 in Miami. RFK, Jr. has also purchased ~$400k worth of Bitcoin for his children "to put my money where my mouth is".

RFK, Jr., Vivek Ramaswamy, and Ron Desantis have all begun speaking on and accepting Bitcoin for their campaign donations. Desantis specifically called out the Biden administration for waging a “war on Bitcoin,” likely referring to recent Securities and Exchange Commission (“SEC”) lawsuits against major exchanges.

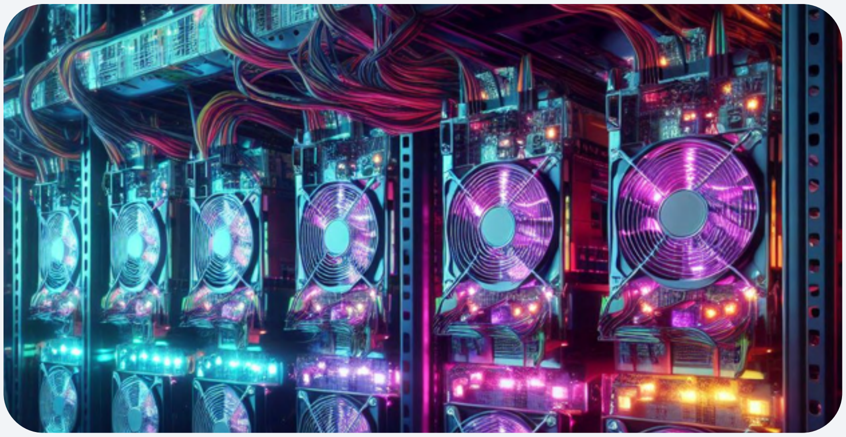
Candidates mentioning Bitcoin early in the electoral process is relatively new. Still, it’s not the first time Bitcoin has been in the race with Andrew Yang taking a Bitcoin-friendly stance during the 2020 election. We’ve seen prior presidents mention Bitcoin with President Barack Obama referring to Bitcoin as a pocket “Swiss bank account.” On the other side of the aisle, President Donald Trump has called it a scam and otherwise admonished it.

Years ago, the only words we’d heard about Bitcoin in the halls of Congress were about the now-defunct Silk Road and money laundering. Today, sitting representatives are advancing the interests of Bitcoin by asking SEC chair Gary Gensler to approve a Bitcoin ETF. Times have changed, and Bitcoin is making waves on all levels of society.

The increased presence of digital assets in the election cycle showcases that Bitcoin has become a household name. The halving famously occurs during the American election cycle by design, and this election will intensely focus on monetary policy. Inflation has been top of mind as housing prices, grocery costs, and the price of gasoline at the pump have steadily risen over the last few years. How Bitcoin fits into the political realm is still unfolding, but more voters are aware of it than ever before in this economic backdrop.

Mining

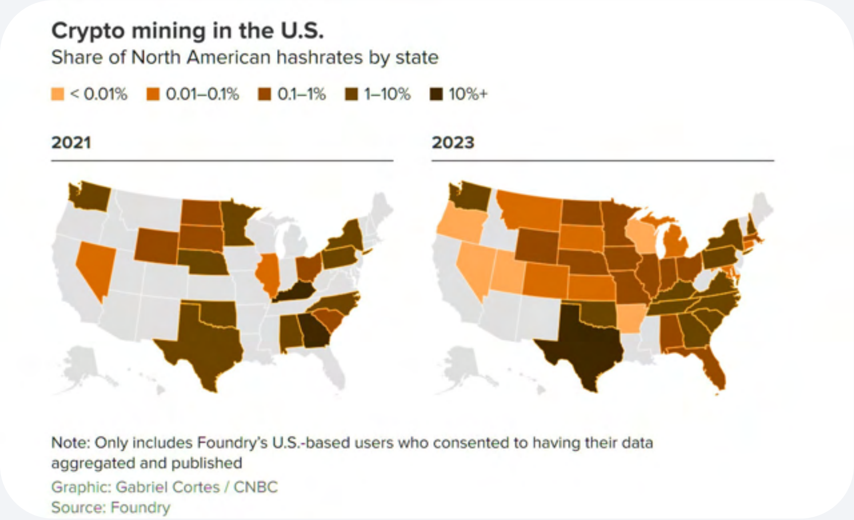
HIGH-TIME PREFERENCE INFRASTRUCTURE INVESTING



Bitcoin's mining hash rate climbed to new highs of around 400 exahashes per second. A higher hash rate means more miners are coming online to process blocks for the network, signifying continued network growth, trust, and participation. Miners have continued the upward trend since the start of the year.

The Valkyrie Bitcoin Miner ETF ($WGMI) posted an impressive 376 percent price swing from the December 2022 lows following both the price appreciation of Bitcoin and investment inflows into the industry. One of the world's largest asset managers, Vanguard, entered the mining space by investing ~$500 million into Bitcoin mining stocks. This resource allocation serves as a significant vote of confidence in the long-term staying power of Bitcoin and industrial-scale mining.

Bitcoin energy production reached a critical threshold of 50 percent renewable energy, easing concerns over future energy consumption for digital assets. Sourcing energy has been a contentious point of debate for some time as concerns over the environmental impact of mining grabbed headlines. U.S. domestic miners press forward with their expansion efforts as they seek stranded and underutilized energy sources. More miners continuing to come online is an optimistic development for the long-term network growth and security of Bitcoin.



El Salvador continues to pave the way for the nation-state Bitcoin concept as they partner to expand domestic mining. Volcano Energy unveiled plans for an initiative in El Salvador—a public-private collaboration to infuse $1 billion into establishing a prominent facility to develop one of the globe's most extensive mining farms.

“Volcano Energy said the funds would go toward an estimated 241 MW power generation park using solar and wind energy in the northwestern municipality of Metapan, which will eventually power the bitcoin mining farm.”

Tether is also joining miners in Latin America with plans for their newest venture being shared by their CTO Paolo Ardoino. Tether has started sharing pictures of their long-term design plans and existing structures that have already been constructed. Investment at this stage in the Bitcoin cycle signals an immense conviction in mining incentives continuing to play out even as Bitcoin moves closer to cutting the issuance rate of new coins next year. Over time, miners will fight tooth and nail for fractions of a Bitcoin with each block as the issuance of new coins decreases with each halvening cycle.

Mining company Riot received a record $31 million in energy credits from the state of Texas to cut their power use during an immense heat wave. The strain on the power grid during high demand times has focused on high-energy consumers such as Bitcoin miners to cut back with incentives.

“Riot made more from energy credits in August than it did from actual bitcoin mining.”

While it may seem counterintuitive to celebrate miners being shut off, it shows increased collaboration between local governments and miners to benefit their communities. Miners are now drawing enough power to get the attention of regulators. This dance of demand versus need for others will develop more over time but is another sign of infrastructure being refined.

Bitcoin also saw one of the highest miner fees in history, totaling ~$500k. This was revealed to be Paxos, PayPal’s partner in the digital asset industry. The transaction in question was only $2,000, but the fee was far beyond the average $1-$2 typically spent on transactions. F2Pool, the miner who received the fee, was kind enough to recognize this mistake and graciously returned the fee.

When Bitcoin ETF?

NOT SOON ENOUGH BUT GETTING CLOSER

BlackRock ignited the market last quarter with its foray into the Bitcoin space, and its CEO Larry Fink continues to speak up about the impact of Bitcoin. Bitcoiners worldwide collectively hold their breath, waiting for a Bitcoin spot ETF. Interest in such a financial instrument has existed since the early days when Bitcoin was a niche idea buried deep in obscure corners of the internet. Bitcoin ETFs give much simpler exposure to the traditional finance community without the overhead of self-custody.

Multiple spot-based Bitcoin ETF applications are now up for consideration as their deadlines for approval approach. The SEC has approved a handful of futures based ETFs such as $BITO. However the market desires a vehicle based on the underlying asset similar to $GLD for Gold. Several organizations want to bring this investment vehicle to the market. Still, the SEC has in the past rejected prior applications. BlackRock's involvement inspires the industry because they have rarely failed to bring an ETF to market; the SEC delayed their decision on spot bitcoin ETFs to close the quarter. More time is required before an ETF takes complete form in the marketplace, but optimism remains high.

The Bitcoin community has had access to Grayscale Bitcoin Trust ($GBTC), which has tracked the price of Bitcoin since 2015. GBTC has been actively working towards converting their trust to a spot ETF and currently holds over 3 percent of all Bitcoin. Grayscale has been in the news, propelling the ETF narrative by announcing hiring for their ETF team. The courts handed Grayscale a significant win in late August, ruling the SEC must review Grayscale's bid to convert their trust into a spot ETF.

Circuit Judge Neomi Rao stated:

"Grayscale maintains its proposed bitcoin exchange-traded product is materially similar to the bitcoin futures exchange-traded products and should have been approved to trade on NYSE Arca. We agree."

"The SEC did not explain why it was treating these products differently, making the Grayscale denial "arbitrary and capricious,"

The SEC now has to review their application again and rule on it. We will likely hear more on this in the coming months.

The Future(s)

LEVERAGED TRADING CAN FINALLY COME HOME

Coinbase has been cleared to start offering futures trading by the CFTC. Exchanges like Bitmex, ByBit, and Binance have traditionally provided futures. Americans, in particular, have long been blocked from using these platforms. New leverage vehicles have emerged recently in the form of futures based ETFs, but none have been as accessible as the existing platforms.

In the wake of FTX, leverage platforms such as ByBit have increased their Know Your Customer (KYC) requirements as greater scrutiny arrived on the international stage. The trend of globally compliant KYC requirements has been ramping for some time starting with BitMex. Americans and others have been forced off these platforms but still desire access to trade Bitcoin futures. The availability of domestic futures trading for Bitcoin is another sign of infrastructure being built within the industry.

Fair Value Accounting

DIGITAL ASSET ACCOUNTANTS EVERYWHERE—REJOICE!

Finally, this month, the Financial Accounting Standards Board (FASB), responsible for U.S. financial standards, has unanimously voted to establish long-awaited new accounting rules for digital asset companies and businesses with Bitcoin holdings. These rules, expected to be published by the end of 2023, are expected to require companies to report their crypto holdings at fair value, capturing real-time asset values, including rebounds after price declines. This much-needed change finally puts digital asset companies on level footing with traditional financial companies, allowing Bitcoin assets and liabilities to be marked to market fairly and eliminating confusing balance sheets that did not reflect the actual value of Bitcoin on balance sheets.

The rules will become mandatory for all public and private companies for fiscal years starting after December 15, 2024 with the option for early adoption. These changes come as major companies like Tesla and MicroStrategy have entered the crypto market, prompting the need for more explicit accounting standards.

Michael Saylor, the largest corporate holder of Bitcoin, shared his thoughts:

"This upgrade to FASB accounting rules eliminates a major impediment to corporate adoption of $BTC as a treasury asset."

Developer News

A QUICK PEEK UNDER THE HOOD TO CHECK ON THE ENGINE OF BITCOIN

Bitcoin development sometimes feels like it moves at the speed of a glacier. This slow process is a feature—not a bug. There is no persistent drive to add new functionality to Bitcoin if it can compromise the other features that make it a resilient asset. Despite this, there's always something new being worked on, and this quarter was no exception.

Musig2 Signing

BitGo became the first commercial wallet to offer Musig2 transaction signing, a significant improvement for multi-party signing. Musig2 eliminates the on-chain fee-penalty for using multi-signature scripts, and is 40 percent cheaper than native Segregated Witness two of three multi-signature. Musig2 also provides a notable privacy improvement as it makes it impossible to tell who signed a transaction because all of the signatures are aggregated into a single key. You can read more about Musig2 and technical development here at BitGo in our Bitcoin Optech Field Report and press release.

Musig2 is an off-chain key aggregation scheme that abstracts multi-party signing away from the blockchain. Musig2 is simpler than TSS from a cryptographic and implementation standpoint because it is not a threshold signature scheme and leverages Schnorr signatures' cryptographic properties.

Drivechains (BIP 300/301)

The topic of Drivechains has recaptured the community's attention, igniting old discussions from years past over what can be built on top of Bitcoin. You may recall early Drivechains, pioneered by the 2014 / 2015 Rootstock project (now known as RSK), which utilized Drivechains to merge-mine an Ethereum-compatible blockchain on top of Bitcoin.

Bitcoin Drivechains are a proposal found within Bitcoin Improvement Proposal (BIP) 300 and 301; they propose the activation of trustless pegs between Bitcoin and up to 256 side blockchains. These sidechains are funded with BTC and operate independently with their own rules and tokens. The concept allows for various sidechains, including clones of existing blockchains and new ones, with applications such as privacy features, DeFi, and stablecoins.

These proposals have faced challenges in achieving consensus within the Bitcoin community due to security concerns and reliance on soft forks. Currently, there is no imminent code or software support for Drivechains. Withdrawals from Drivechain sidechains are intentionally slow to minimize risks. Drivechains offer an alternative to federated sidechains and address scalability and innovation challenges in the Bitcoin network. Nothing will be changed without majority acceptance from the network, and there is still much to discuss on this protocol change.

HODL On

NOT ADVICE—JUST HISTORY

HODLing (holding) has been a famous slogan of the Bitcoin community for a decade, originating from a misspelling in an early forum posting on BitcoinTalk. While this was accidental, it propagated into a viral phenomenon that has persisted. This long-term approach has historically granted returns to those who held onto their assets throughout Bitcoin's history.

This systemic approach to Bitcoin provides a path to secure long-term capital gains for tax purposes but also provides a Bitcoin-centric view on portfolio growth. "Stacking Sats" during market lulls and de-risking during euphoria is common. Some simply never sell and adhere to the continued cyclical nature of the markets while building their portfolio in Bitcoin. Over time, this ethos for the dedicated Bitcoiners of the world has granted financial benefits to the disciplined.

Bear markets tend to provide accumulation opportunities, and on-chain data gives us a peek at the trends of long-term investors. With a four-year cycle in mind, participants historically have bought Bitcoin during downtrends with long-term planning taking hold once a definitive low is established. One optimal way to visualize long-term investors' sentiment is by looking at the amount of Bitcoin that hasn't moved for more than a year. Observing this data, Bitcoiners are starting to sit on their hands instead of transferring their coins to exchanges.

Source: Glassnode

Adoption continues despite what the finance world thinks with wallets holding more than 0.1 BTC trending up. What the future holds for Bitcoin is still developing; we can only observe historical patterns and on-chain data. The green candles of 2020 are no longer here, but the data shows that optimism for the future remains strong despite the current economic climate. Price charts continue to go sideways and to the right as the market holds its breath, awaiting the cycle to advance.

Price Action

UP, DOWN. SIDEWAYS. NEVER BACKWARD.

Bitcoin has been providing bear market chop amid an uncertain financial time. The famous orange coin is still down from the bull market peak and has traded in a ~$16,000 range this year. This cycle has also brought multiple weekly closes below the two hundred weekly moving average. This behavior is a new occurrence for Bitcoin as this moving average has traditionally been bedrock support since 2015. Today’s market is more complex as liquidity is still reeling from the events of 2022 and the rising interest rates of the Fed tightening agenda. Moving averages can only tell us so much; the market needs a solid narrative to reclaim a positive trend and generate a persistent bid.

While Bitcoin has made significant progress shrugging off the 2022 downtrend, much of the altcoin market remains significantly “down bad.” As with prior cycles, many altcoins never return to all-time highs while Bitcoin retains the crown. The flight to quality continues as the value premise of Bitcoin takes form in a market where risk is expensive and unwanted. While altcoins provide outsized gains during certain market conditions, they also absorb much more risk as the bid falls out of the market. Bitcoin remains the perceived market king gauging on marketcap and network effect.

Source: Halving Tracker

We’re not fortune tellers; we can’t even tell you Bitcoin will rise again. No one knows; we can share a historical examination of how Bitcoin behaves during each cycle. Time is the greatest asset of all investors, and Bitcoin has used it from its genesis.

Idle Hands

WHAT CAN ONE DO DURING A BEAR CYCLE?

Bulls have more fun when the numbers are going up, but the foundations of portfolios are always constructed during hard times. The sobering reality of low prices provides ample time to reflect and consider how to prosper during upswings.

- **Custody matters.** Whether a large institution or an ordinary citizen looking to Plan ₿, you should establish your custody path.
    - **Custodians** such as BitGo exist for the purpose of secure regulated storage—keeping your assets for future use or meeting your organization's regulatory needs.
    - **Cold Storage:** Self-managed cold-storage is one of the most remarkable features of Bitcoin. Do you know where your wallets are? Have you adequately backed up your private keys? Do your next of kin know how to access your wealth? The current environment is a great time to organize while Bitcoin consolidates.
- **Time with the charts** - How could you have foreseen the worst bear market in decades? Was there something you missed? Some piece of data that you overlooked? Pondering the data and charts during market lulls allows you to expand your education on markets and prepare for the future.
- **The fundamentals.** A luxury that new cycle participants get to enjoy is the sheer volume of tribal knowledge, reading material, and education available. There are many opportunities to learn about the underlying principles of Bitcoin and the movements surrounding it. Never looked at the Bitcoin whitepaper? To this day it's still a fantastic read.

Whatever your idle hands may find to do, there is no shortage of opportunity. The markets can be novel but, amidst the excitement of markets, there must be a zen to operate with no fear of theft or lapses in security. This cycle saw many get carried away by euphoria, leading to the most humbling education markets ever offer—patience, planning, and reflection.

The Slaying Of The BearWhale

EXPLORING AN EPIC TALE FROM THE YOUNG BITCOIN MARKET.

Our final section is a supplementary on Bitcoin culture and history.

Interest in Bitcoin was fleeting in the early days; the world still considered Bitcoin as "digital Beanie Babies" that were simply not worth anyone's time or investment. Bitcoin was a smaller market in the early days, and exchanges were still relatively illiquid; such conditions led to strange market events.

The Bitcoin BearWhale event occurred on October 6, 2014. BTC was quietly trading around $320 when, abruptly, a ~30,000 BTC (~ USD 10M) wall appeared on Bitstamp at $300. This sale sent a panic through the Bitcoin world as this stash of coins was in no way insignificant, given how small the market was. For the next several hours, Bitcoin was pinned at $300, and the young Bitcoin market was attempting to absorb every single Bitcoin being sold.

Many people viewed the significant selling of BTC at that time as a loss of confidence in the cryptocurrency. Several years later, a Reddit user claiming to be the individual behind the large BTC sale shared their story on the Bitcoin subreddit. After proving ownership of a substantial coin stash that matched the size of the sale in 2014, this individual engaged with the community. They explained that the ongoing debate over Bitcoin's long-term scalability influenced their selling decision. They lacked belief in Bitcoin's ability to upgrade its current transactional capacity.

This individual had acquired most of their Bitcoin at the price of $8 and had held onto it through the turbulent early days of Bitcoin. This sale provided a remarkable gain on their initial investment. This moment in Bitcoin history has become legendary as Bitcoin went on to new highs far beyond $300.

Closing Thoughts

It's easy in the industry to let narratives and prices influence your perspectives. Companies have gone under, ETFs have been delayed, and bad news often retraces positive price action. It may still feel like a bear market, but our sideways price action could also be classified as a crab market. At BitGo, we don't subscribe to such a narrow view. It's a builder's market, an opportunity to innovate and strengthen infrastructure to drive the next wave of adoption. We see no shortage of enthusiasm and zeal to continue developing infrastructure for Bitcoin.

Bitcoin will do whatever it wants on the charts, but the underlying principles that made it the financial titan it is today continue to prevail. Industry players are bringing needed infrastructure to Bitcoin. Custody and trading are slowly separating, and fundamentals are improving. The orange glow on the horizon is Bitcoin, and we're very excited about what 2024 will bring us.

We will talk to you again at the end of the year for our Q4/year in review.
If you'd like to learn more about BitGo, please connect with us.

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