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TRADING STRATEGIES

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ECONOMICS

An ill wind: how the experts handle inflation

A global surge in prices has knocked the equity markets off their stride and put many investors on the defensive, yet there is still value to be found

Daniel Thomas

The doyen of astute investment, Warren Buffett, has been warning about the return of high inflation since the bad old days of the 1980s, describing it as a "cruel tax" that "swindles almost everyone". Despite this, the recent surge in prices hasn't deterred him from buying shares. Even as the US inflation rate hit a 40-year high and stock markets fell sharply this year, the venerable chairman and CEO of Berkshire Hathaway ploughed more than $40bn (£33bn) into equities.

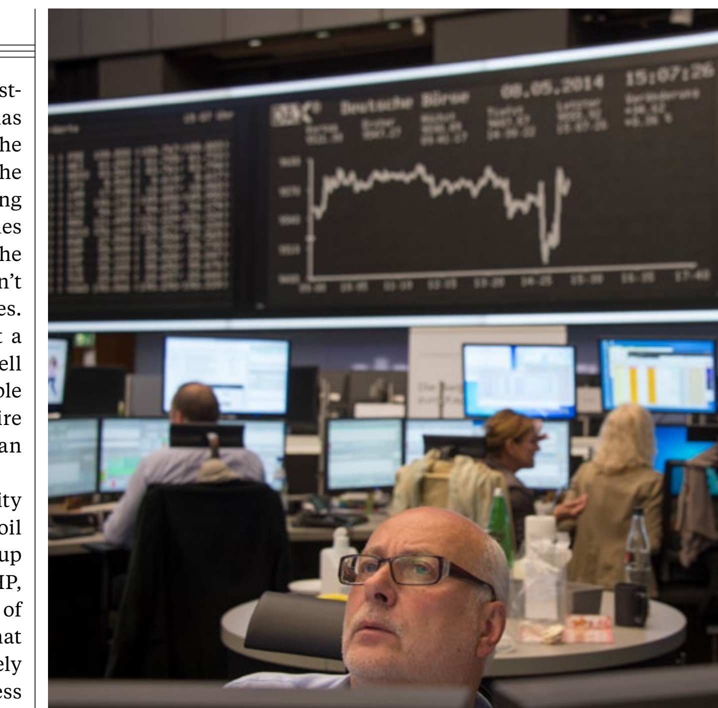
Amid a surge in global commodity prices, Buffett has focused on oil and gas stocks. He's also snapped up shares in tech giants Apple and HP, both of which fit his philosophy of investing in good-value firms that make products that are always likely to be sound performers, regardless of whatever economic headwinds may be blowing.

As food, fuel and energy prices have rocketed since Russia invaded Ukraine in February, the markets have been shaken, obliging fund managers to adjust their trading strategies. Consumers are tightening their belts while central banks are hiking their interest rates, which is restricting growth and so increasing the risk of recession.

These conditions are spooking investors. The benchmark US stock index the S&P 500 lost about 20% of its value between January and mid-May, for instance.

Joe Little is chief global strategist at HSBC Asset Management, which is responsible for assets worth about £525bn. He says it's "completely understandable that investors have been feeling confused and uncomfortable, given that most had never experienced an inflation shock on the scale we've seen over the past 18 months. There are some significant unknowns about the economic outlook. For professional investors, this is where your investment philosophy and process really help you through the uncertainty."

Diversification comes into its own as a protective measure during periods of high inflation, according to Little. Traditionally, investors have relied on the relative stability of bonds to balance out the riskier equities in their portfolios. But the price of bonds will fall as central banks push up their base rates further to tame inflation, so they won't be able to fulfil their usual hedging role. Investors therefore need to look at alternatives, he says, pointing to the merits of more tangible assets such as gold and real estate.


Horacio Villalobos/Getty

As for equities, investors must think even more carefully about the type of companies they buy shares in, warns Victoria Scholar, head of investment at trading platform Interactive Investor.

"For a long time, equity market gains have been underpinned by ultra-loose global monetary policy. But the era of monetary loosening is over, which has serious implications for valuations," she says.

Scholar believes that it's important to differentiate between firms that can pass most of their heightened cost burden on to consumers through higher prices and so avoid margin compression (known as price makers) and those that must shoulder these extra costs themselves (price takers).

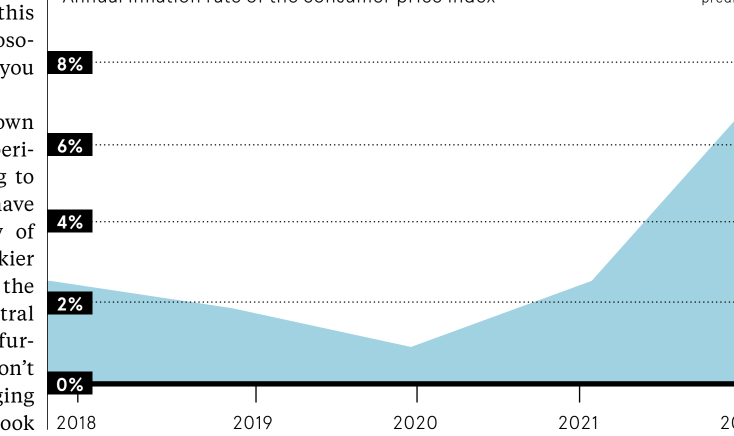
She cites companies in the luxury sector as examples of the former. With the "power to push up their prices without significantly diminishing demand, they could be interesting. But it's also worth noting that we could see weaker demand if growth in the global economy – and China's in particular – slows."

While debt-laden firms are most likely to struggle in the current conditions, those in certain sectors stand to benefit from rising inflation and interest rates, Scholar notes.

"Banks, for example, tend to fare better because of improved net interest margins," she says. "Also, a lot of the current inflation has been driven by gains in the commodities complex on the back of the war in Ukraine, so stocks in fossil fuels and mining have been achieving strong profits."

THE UK'S INFLATION RATE IS SOARING OBR, 2022

Annual inflation rate of the consumer price index *prediction



David Jane is multi-asset manager at Premier Miton Investors, which is responsible for about £14bn of assets. He reports that his firm is becoming increasingly concerned about the risk of recession and is adapting its approach accordingly.

"During a period of high inflation we would expect interest rates to be rising over that time. This means in our fixed-income exposure we'd avoid longer-dated bonds especially," he says. That's because high inflation tends to erode the purchasing power of a bond's future cash flows.

With respect to equities, Jane believes that companies with "real assets" and suppliers of basic raw materials are likely to do better. For that reason, his firm prefers undervalued stocks to growth stocks (comparatively risky punts in firms that are expected to outperform the market average).

At HSBC, Little is more sanguine about the outlook. He believes that the global economy will probably avoid the recession that has been predicted in some quarters.

"While we think that the 'stagflation' tone of weak GDP growth and high inflation will continue for a while, we do see some encouraging signs. Supply chain bottlenecks are beginning to ease, for instance. Our view is that inflation has peaked and will gradually cool off over the next six to nine months," Little says. "It could be that stock market behaviour will look rather different in the second half of this year."

For now, though, HSBC's approach to equities has become more selective, focusing on commodity-linked stocks and price makers. Little also favours undervalued and short-duration cash flow stocks – which are held for weeks or even days – over riskier growth stocks.

Scholar believes that volatility in the equity markets will last the whole year, but she is confident that the tightening of monetary policy by central banks should ease most people's fears that inflation might spiral out of control.

She adds that a common mistake is for investors to "hit the panic button" by liquidating their positions and heading for the exit at times of great uncertainty. Given that high inflation erodes the value of money in the bank, keeping its real rate of return "very much still negative" despite recent interest rate rises, "remaining invested appears to be the best strategy in the long run".

Commercial feature

How investors can trade in topsy-turvy markets

With markets in volatile territory, traders are seeking new and diversified strategies to insulate losses and increase profitability

In a decade filled with uncertainty and surprises, few things have been more inscrutable than the financial markets. Traders have had to learn to navigate volatile markets, exacerbated by global economies being forced to embrace an imminent recession brought on by the coronavirus pandemic, the invasion of Ukraine, and several other geopolitical issues.

"The way it's changed this year compared to the previous two years is that you could often buy into markets when they fell and still make money," says David Jones, chief market strategist at Capital.com. "We've had booming markets – whether stock markets or commodity markets – since March or April 2020."

Investors and traders have enjoyed rising markets in the last few years. In such a market, buying the dip was a popular and sometimes profitable strategy among traders, but in 2022 they are finding that is no longer the case. The broad US stock market, the S&P 500, is down 22% this year alone. "Markets are much more volatile," says Jones. "Blindly buying the dip isn't working this year."

That isn't a surprise to long-term investors, but is a rude wake-up call for anyone entering the markets in the last few years. "It's important to be a lot more defensive now than previously," he says.

However, there are ways investors can still find opportunities in the market, even in the extraordinary situation we now find ourselves, but it requires stepping away from widely used long-only trading strategies where you buy low and sell when prices rise.

Embracing the short sell

Three-quarters of all trades executed by Capital.com users in 2021 were long-only trades, meaning they bought shares in a company hoping the price would rise. It's a general rule of thumb that continues today, even as markets everywhere are falling – more than half of the traders still take long positions. "It's certainly something that's ingrained into plenty of us as investors and traders," says Jones. "You buy first and then sell higher up, hopefully."

However, in an upside-down market, attitudes and approaches need to change. Short-selling – speculating on assets or securities that you predict could lose value – is one way to potentially make money in a challenging economy, where values and profits are being squeezed in every way. With short-selling, you sell a position in a company high, and look to buy when it's lower in value. "But that's quite a change in psyche for a lot of investors and traders," says Jones.

There is also a belief by some that it's unethical or unpatriotic to bet against companies – though that overlooks the dynamics of the market and the idea that every company can lose value as well as gain it. Short-selling was curbed in the United States in the aftermath of the 2008 financial crisis, but remains a valid and legal method of trading that investors may consider in fragile economic times like this. It does, of course, mean that investors lose money if a company performs better than forecasted, so the advice is to be careful with your cash.

Jones says: "With short-selling, it's important to have risk controls in place, but you're limiting your opportunities if you don't look at the idea, particularly in the sort of markets we've had this year. It's one strategy to look at if you thought markets were going to continue to slide from here in the months ahead."

30%

Would have been the loss for traders investing in oil in March 2022

Capital.com

Using stop losses

When markets are in freefall, it's important to apply the brakes. "Using stop losses is really important," says Jones. In mid-May, Tesla was trading at around $900 a share. In mid-June, it was trading closer to $650. Traders who put measures in place to manage their risk were insulated from the full scale of that loss by putting in a stop loss, which is a notice to trading platforms that you want to sell if the value of a position drops below a certain value. "You can say: 'I'm happy to buy at $900, but if it drops 10%, I want to come out'," he adds.

Many retail traders, such as those who use platforms like Capital.com, aren't fully aware of the range of options available to them, including stop losses. Jones advises deploying sensible risk control measures like the stop loss in order to insulate yourself from the challenges markets currently present to investors and traders alike.

Diversifying your portfolio

The challenging market is hitting everyone at present, but one way to try and slow the tide is by diversifying your investments. "It's hard at the moment, because everything is falling," says Jones. "But it's better to spread the risk across different asset classes, companies and investments than to pursue profits from one single area that could quickly go south."

Jones points to the price of oil: if a trader had rushed into oil in March this year when it surged after Russia invaded Ukraine, they would have lost around 30% of their investment. "Diversification is one option – and a very sensible option – when it comes to trading and investing," he says. That includes investing in exchange traded funds (ETFs) and trading derivatives on a host of different markets including commodities, if investors think these will continue to rise in value. Gold, for example, continues to prove popular in challenging circumstances.

> "Blindly buying the dip isn't working this year

There is also another option he suggests, albeit one that seems unusual for traders and investors proactively looking for opportunities to profit. "You could do nothing," he says, "if you thought this was all a little bit too crazy." But thinking longer-term is crucial. "It can be very tempting, when markets are crazy, to be very short-term," he says. "Don't think because markets are crazy, and moving really quickly, that you have to act the same way."

To learn more about short-selling and other retail trading strategies, visit capital.com/trading-explainers

capital.com

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RETAIL INVESTORS

School of hard knocks

It all started so promisingly for the generation of armchair traders that emerged during the Covid lockdowns. How have they responded to the chastening experiences of recent months?

Marianne Curphey

Office workers are heading back to HQ in their droves, bitcoin has taken a tumble and the stock markets are no longer looking anything like a gold mine. Does this mean that the many thousands of people in the UK who took up trading while at home on furlough have logged off their trading platforms permanently and slunk away from their screens with their tails between their legs?

Not exactly, according to Leon Gauhman, co-founder and chief product and strategy officer of digital transformation consultancy Elsewhen. He believes that a significant proportion of retail investors have emerged from the experience months older and wiser.

"Combined with record inflation, quantitative tightening, increased interest rates and the effects of the war in Ukraine have contributed to a much harsher economic climate," he says. "Credit Suisse estimated that amateur retail traders accounted for 30% of US stock market activity at times last year. That exuberance has evaporated as they've gone from trying to spend free money to needing to budget to eat. This April, for instance, retail trading was down by 20% on the manic activity seen in the early months of 2021."

But the two key forces that drove gen-Z investors to seek other ways to make money – low interest rates and high house prices – still haven't eased significantly. Now that they've had a taste of success, many lockdown traders will continue, seeking knowledge via social media channels such as YouTube and TikTok.

> "Many would have expected retail investors to run for the hills as soon as the market sell-off happened. But they are sticking around, hungry to learn more

Max Rofagha is the founder and CEO of Finimize, a financial community platform giving DIY investors the tools and information they require to make smarter decisions. He notes that, although retail investors have become less active in recent months, they are still trading twice the volume of stocks than they had been before the pandemic struck.

"Many among us would have expected retail investors to run for the hills as soon as the market sell-off happened. Instead, they are sticking around, hungry to learn more and shifting their monthly investments to less risky options, such as index funds," Rofagha reports.

He predicts that the next wave of innovation in this segment will focus on providing information that demystifies the stock market. While headlines describing DIY investors as 'dumb money' were probably unfair, it has become clear that their education needs to be improved.

"Modern investors come with a different set of habits," Rofagha notes. "They need everything to be bite-sized, mobile and social."

Michael Kamerman, CEO of online trading platform Skilling, has been calling on regulators such as the European Securities and Markets Authority to prioritise investor protection as it pushes its financial education plans forward with the aim of teaching the masses.

"Retail traders will often see their favourite celebrity endorse a cryptocurrency on Twitter and be inclined to invest as a result. By doing so, they buy into the clickbait nature of financial influencing online and put themselves at increased risk of nursing potentially large losses," says Kamerman, who adds that he has observed a distinct dampening of enthusiasm among DIY investors in recent months.

David Morrison, senior market analyst at Trade Nation, notes that "volatility is exciting, but also incredibly dangerous. Those who actively bought and sold from the late spring of 2020 until the beginning of 2022 were probably laughing at how easy it was to make money. In fact, there were some notable characters who appeared on TikTok ridiculing old-time investors like Warren Buffett."

A lot of furloughed retail investors were fortunate to start trading just as a bull market was taking hold, but it wasn't long before their lack of experience worked against them.

"Many people did make money over that period, but it's likely that far more didn't," he says. "And then the markets stopped going up. Since the start of this year, trading has been much harder."

While plenty of retail traders went into the markets with their eyes open, many were not prepared for the protracted sell-off. Those that held on have learnt some valuable lessons, according to Morrison.

"They have grasped the importance of money and risk management, as well as how to take probabilities into account when trading," he says.

The surge in retail investment over the past couple of years has left lasting effects on brokers, in terms of both their trading infrastructure and client demands, according to Amanda Harrison, senior sales executive at Adaptive Financial Consulting.

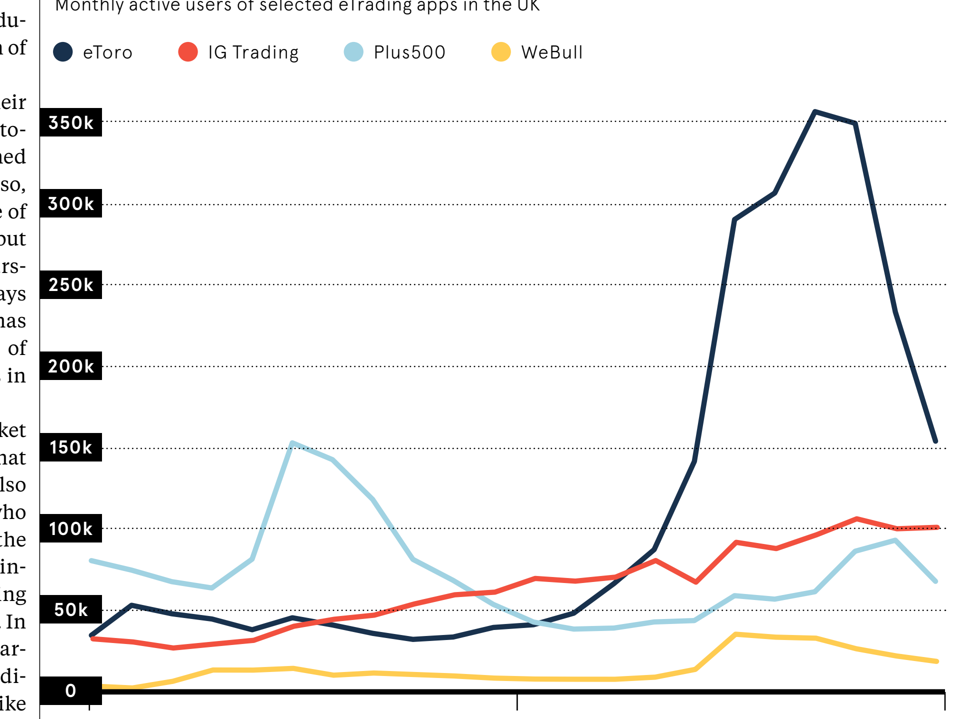
"The arrival of the pandemic instigated a surge in online day trading, which meant that the number of accounts jumped significantly. Many brokers did not have the infrastructure to support the boom, which caused temporary system failures and outages in some cases," she explains.

Having acquired a larger pool of accounts held by relatively inexperienced traders, many of which have gone dormant, brokers are considering ways to use third-party tools to reactivate and educate their client base.

THE NUMBER OF ARMCHAIR TRADERS IS IN DECLINE

Airnow, 2021

Monthly active users of selected eTrading apps in the UK



Sami Osman, co-founder and CEO of Quartr, an app designed to make corporate financial information more accessible, considers the surge in retail investment at the start of the Covid crisis to have been an unprecedented – and wholly necessary – change.

"It gave rise to platforms that facilitate all stages of the trading process," he says. "Until last year, retail traders were more focused on buying a specific stock than studying that company's fundamentals. Then there was a clear shift."

While the economic situation has changed dramatically over the past quarter, the technological trends that helped to power the rise of retail trading are here to stay, according to Gauhman.

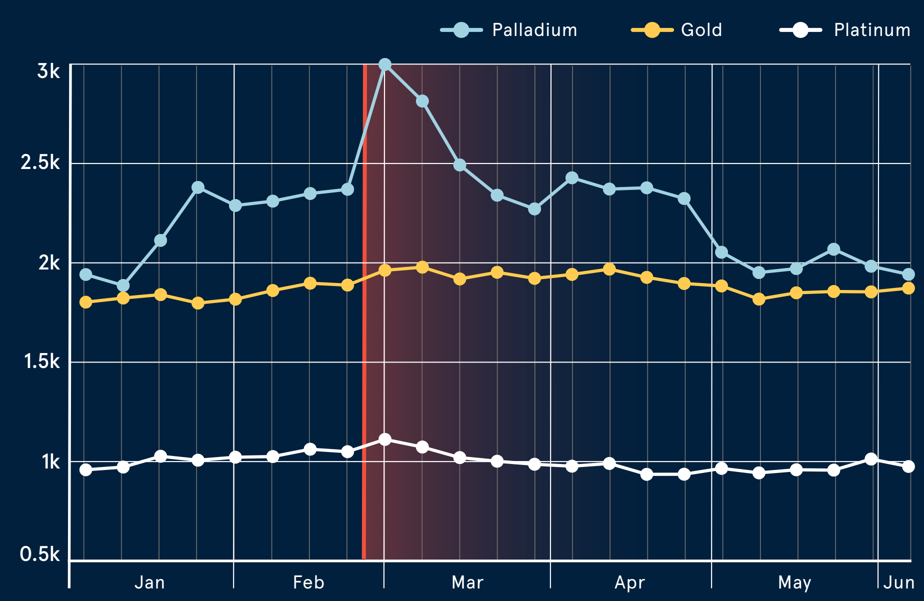
"Deterred by bruising losses, some amateur traders will undoubtedly give up. Others will learn from their mistakes and keep trading," he says. "Wall Street shouldn't breathe easy just yet."

TRADING ASSETS AND MARKET SNAPSHOTS

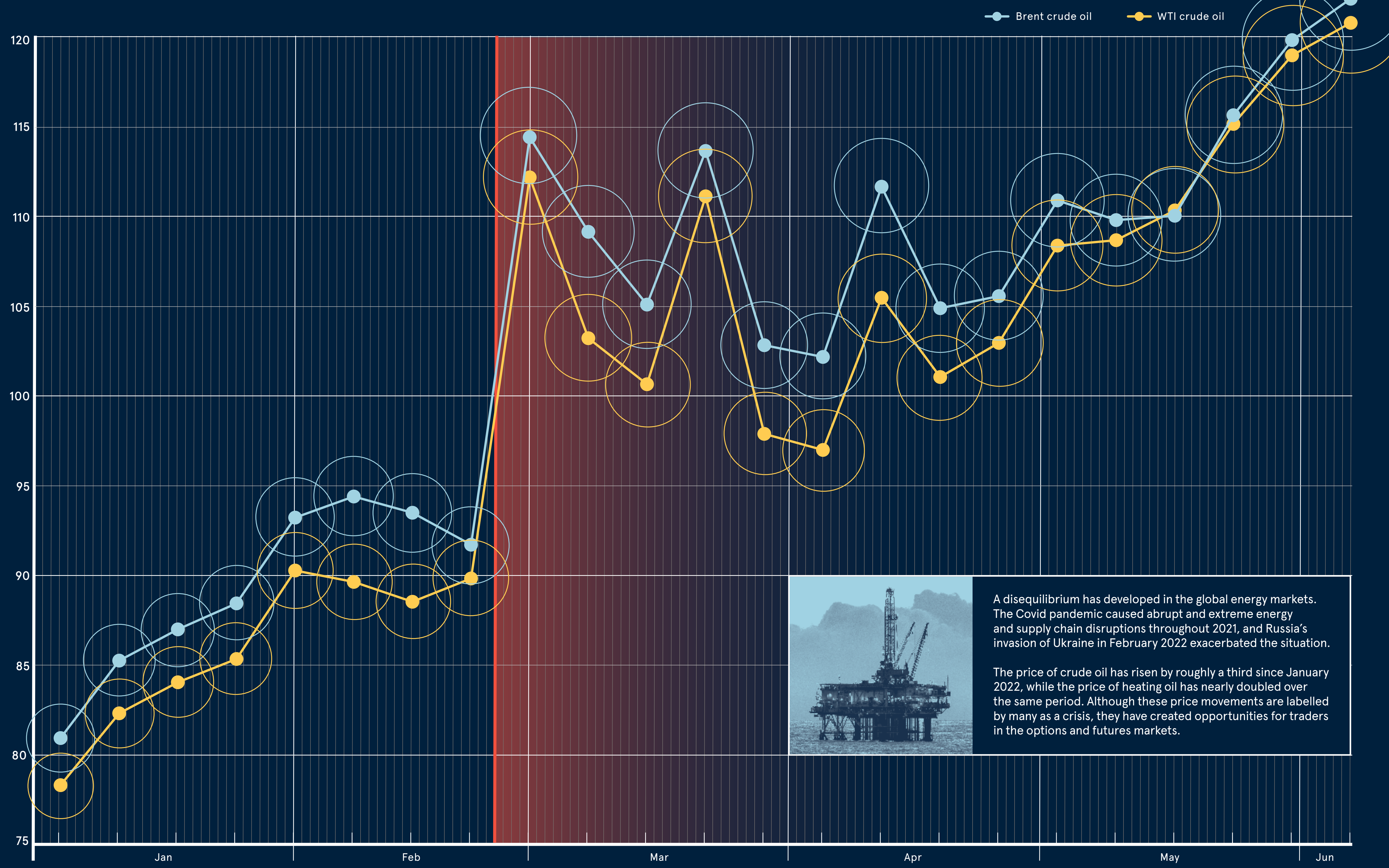
Markets have responded to global events in a variety of ways. The war in Ukraine has taken a toll on wheat and energy commodities, while climbing interest rates and soaring inflation have pushed the price of gold up and crypto down. Indices have also trended downward. The world of trading is complex and volatile, but there are huge rewards for those traders who make the right bets. Here's how common trading assets have fared over the past six months.

24 February 2022, Russian invasion of Ukraine

PRECIOUS METALS ($)



ENERGY ASSETS ($)



A disequilibrium has developed in the global energy markets. The Covid pandemic caused abrupt and extreme energy and supply chain disruptions throughout 2021, and Russia's invasion of Ukraine in February 2022 exacerbated the situation.

The price of crude oil has risen by roughly a third since January 2022, while the price of heating oil has nearly doubled over the same period. Although these price movements are labelled by many as a crisis, they have created opportunities for traders in the options and futures markets.

7.9%

year-on-year rise in the UK's consumer price index, including owner occupiers' housing costs as of May 2022

ONS, 2022

£5.38tn

daily trading volume in foreign exchange markets as of April 2019

BIS, 2019

22.8%

the rise in the Food and Agriculture Organization cereal price index in the 12 months to May 2022

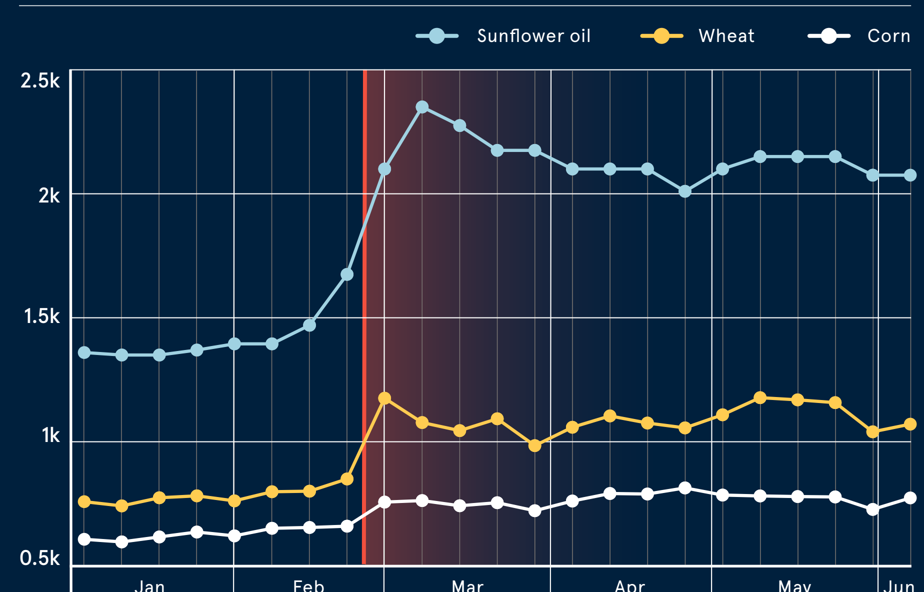
FAO, 2022

70%

of bitcoin's value has been lost since hitting its high in November 2021

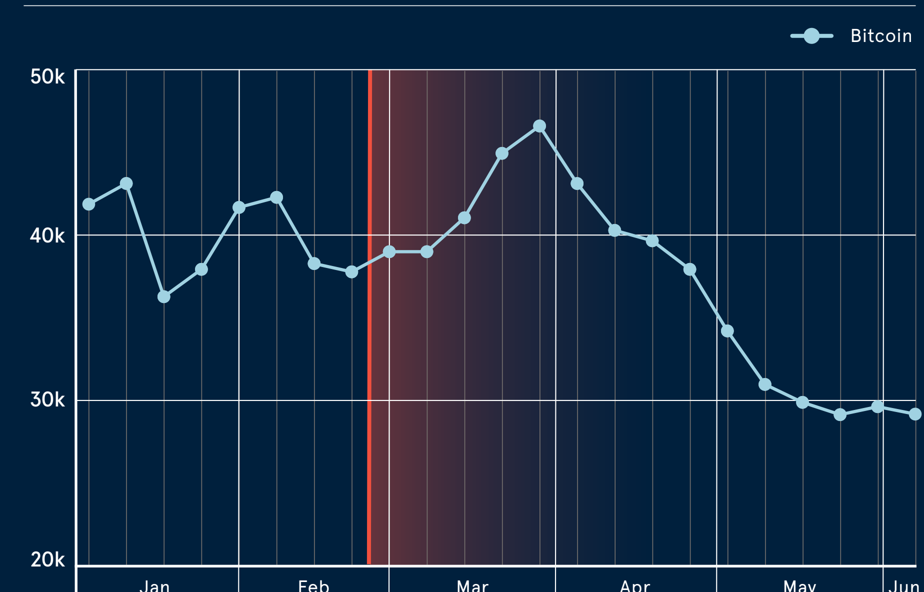
Coindesk, 2022

AGRICULTURAL COMMODITIES ($)

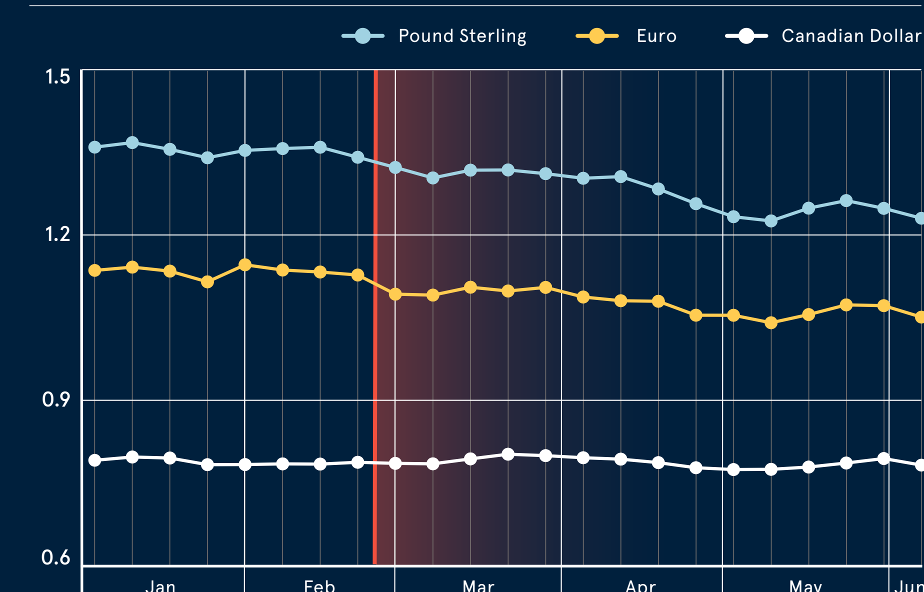


Trading Economics, 2022

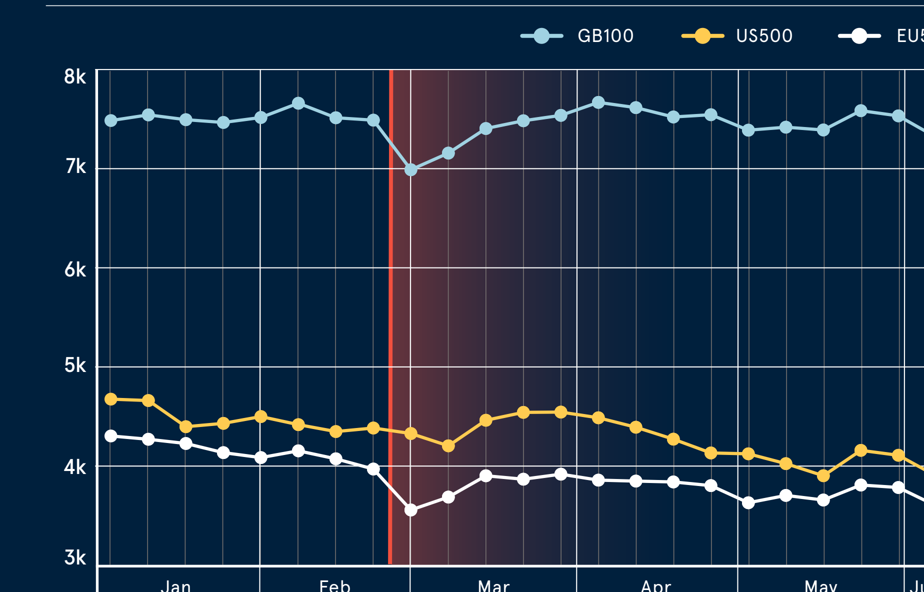
CRYPTOCURRENCY ($)

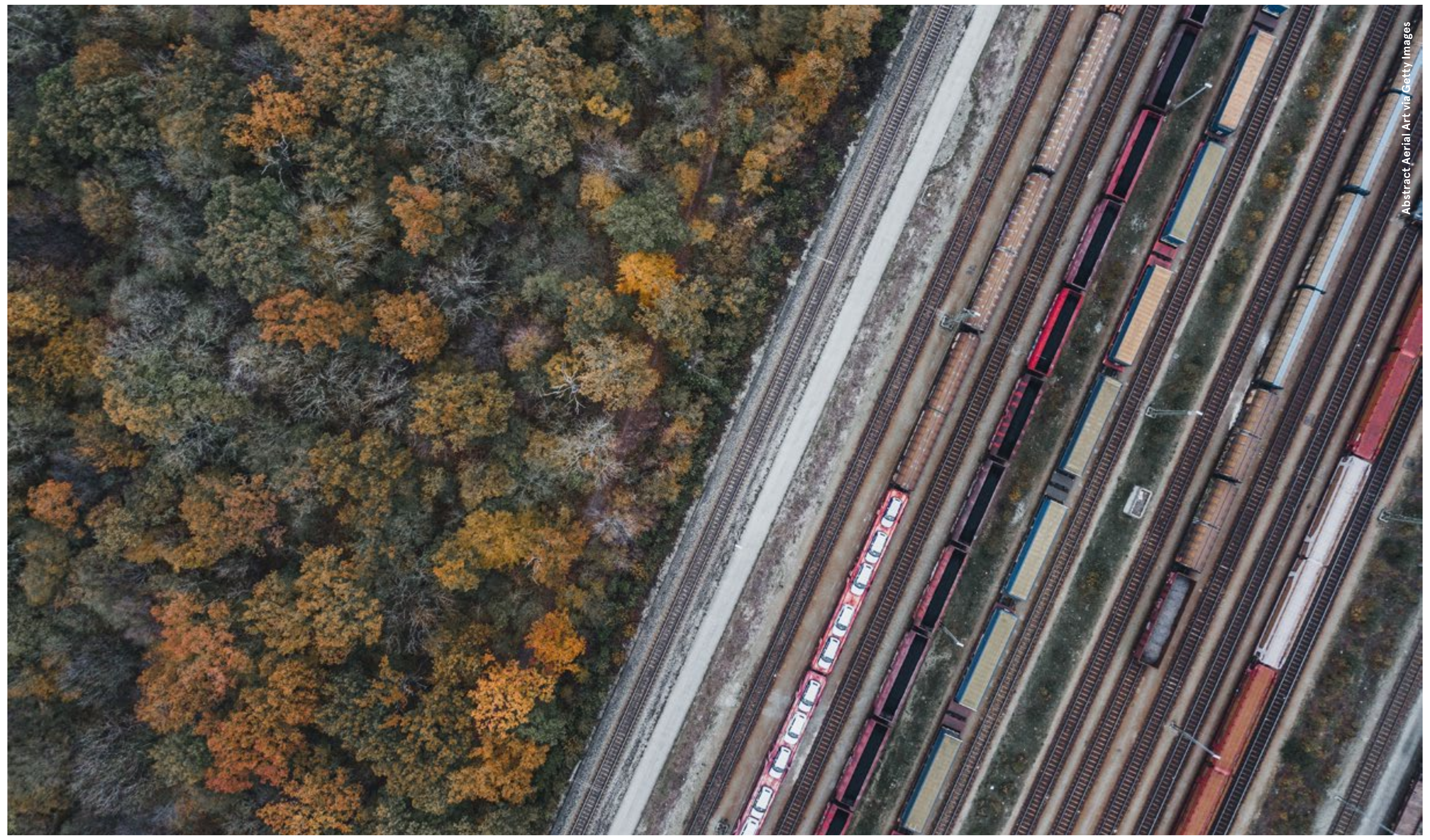


CURRENCIES ($)



INDICES ($)





Abstract Aerial Art via Getty Images

ESG INVESTMENTS

Assessing the merits of ESG investment

Two respected industry insiders offer contrasting perspectives on a much-hyped market based on the notion that purpose and profit go hand in hand

Tim Cooper

How times change. A year ago, asset managers were trumpeting the qualities of environmental, social and governance (ESG) funds, as a slew of data showed that these had beaten their conventional equivalents over several periods. Today, they have toned down their message after months of disappointing performance; negative stories about firms exaggerating the benefits of ESG; and the emergence of influential and increasingly vocal sceptics.

It's time to ask seasoned experts in the field with differing views on the merits of ESG investment why they've adopted such positions.

The Sceptic

Tariq Fancy, founder of the Rumie Initiative and former chief investment officer for sustainable investing at BlackRock

An outspoken critic of the claims made on behalf of ESG funds, Fancy believes that their outperformance has been greatly exaggerated.

"There's much sloppiness in how fund managers talk about performance – confusing correlation with causation, for example," he says. "We all want to believe that better ESG data leads to better profits and performance. Climate activists also jump on it and say: 'Look – green investing is better.' But it's mostly just marketing in my experience. Many of their claims turn out to be untrue when you look behind the scenes."

Fancy highlights a recent study from the MIT Sloan School of Management showing that ESG ratings from different ratings agencies have a low correlation. This continuing lack of well-defined, widely agreed standards is problematic.

"Such variances fuel all kinds of confusion and make it easy for people with vested interests to selectively quote data that satisfies their argument," Fancy says.

He also refers to the work of fellow sceptic Aswath Damodaran, professor of finance at New York University's Stern School of Business, who has argued that "being good" won't necessarily add value to a company. Indeed, in some cases it will actually be detrimental to the business.

> **We all want to believe that better ESG data leads to better profits and performance... But it's mostly just marketing in my experience**

Fancy has been particularly annoyed by the hype that came from several wealth managers about the performance of their ESG investments during the early phases of the Covid crisis. The main reason why they did so well over that period was that their portfolios happened to be heavy on tech stocks and light on fossil fuels, he argues.

"The biggest nonsense about data and correlations arose when the pandemic started. These firms were saying: 'ESG is outperforming in 2020-21.' During the lockdowns, we couldn't travel and were forced to rely on technology. So, if your fund was overweight Microsoft and underweight Exxon, say, its performance was bound to look good," Fancy says.

The argument is that they cannot realistically claim or even imply that intrinsic ESG-related factors were behind that performance when other, more powerful, forces were at play.

Fancy says part of the problem is that large asset managers are strongly incentivised to claim ESG outperformance, as it enables them to tap into the public's growing awareness of matters of corporate social and environmental responsibility.

"Wall Street CEOs refuse to engage directly with anything I say on the subject, even when I ask them directly," he adds. "It's not in their interests to have that debate."

Fancy accepts there are some "kernels of truth" in the idea that ESG factors can improve returns, but these need to be communicated in a far more nuanced way.

"We have known for a while that good corporate governance is important to returns," he says. "But the relative importance of the environmental and social elements is more industry-dependent. Environmental factors can affect returns more if you are a company trading in, say, green energy or electric vehicles. Also, if you hold physical assets, such as infrastructure or real estate, you should be mitigating climate risks already. But that is not how ESG is being trumpeted from the rooftops."

Fancy's key message for traders is that many ESG-related tools, data and standards are emerging that you can use to cut through exaggerated claims to find the true drivers of performance.

And his overriding message for fund managers? "Be honest about the limits to what ESG can do." ●

The Believer

Mike Fox, head of UK sustainable investments at Royal London Asset Management

ESG is a tool that, alongside measures such as macro analysis and valuations, can support investment decisions and lead to better risk-adjusted returns, according to Fox.

"The best way to look at ESG outperformance is to examine the record of those funds versus that of their non-ESG peers over the longest periods – more than 10 years if you can," he says. "This helps to shake out cyclical factors, such as sector-led bubbles and crashes."

Fox highlights that numerous sustainable funds have posted top-quartile performance in the main Investment Association sectors – for instance, UK All Companies and Mixed Investment 40%-85% Shares. This was accurate over one, three, five and 10 years to 31 December 2021, according to Trustnet. Some sustainable funds topped these tables over several periods too.

"There have been many academic studies on outperformance, but this record is the ultimate test and proof that it works," he says.

ESG factors will not deliver high performance in and of themselves, Fox stresses. As with any investment style, an individual manager's execution can be good, average or poor. But ESG is a set of principles and a framework that, if implemented well, should improve a fund's chances of good performance, he argues.

A whole host of ESG factors could affect returns, from the cost of maintaining stranded fossil-fuel assets such as oil wells to the reputational damage caused by treating workers poorly. But little research establishing causal links rather than mere correlations yet exists. One notable study, by Newcastle University and Kuwait Business School in 2020, found a strong positive association between companies' propensity to make voluntary disclosures about carbon emissions and their financial performance. Such reporting supported activities such as reducing waste, increasing productivity and opening market opportunities.

Fox acknowledges that causation element needs to be "unpicked" further. But he believes the argument that the recent performance of ESG funds has been affected more by the pandemic and the war in Ukraine than by ESG factors is misdirected.

> **Like any investment style, ESG will have times when it outperforms and times when it underperforms**

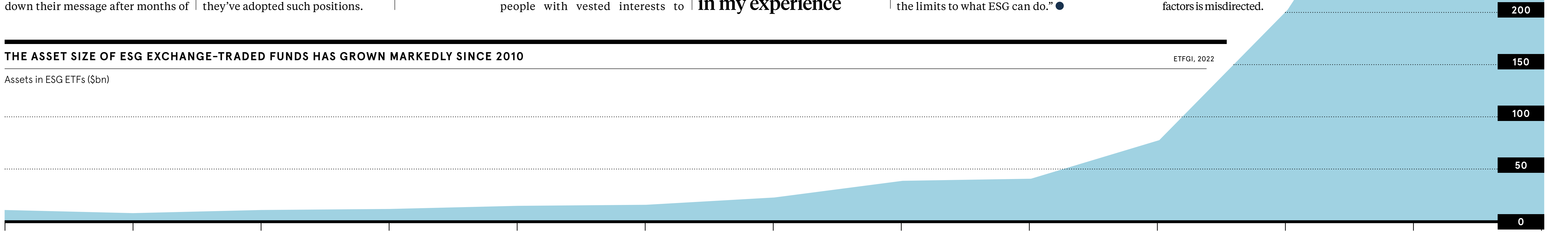
"Like any investment style, ESG will have times when it outperforms and times when it underperforms. We underperformed in 2008 and 2009, for instance. That didn't change our methods, but it did make us cautious about our claims," Fox says. "Funds investing in ESG tend to be in well-established large caps. ESG flows haven't moved their prices yet. Things such as prices over-extending during the pandemic or falling now won't change the world's structure in five or 10 years' time in terms of carbon intensity. We don't know the exact impact that climate change will have on corporate performance, but it won't be good. So it's best to be cautious about this."

Fox's advice for traders wanting to get the best performance from ESG investments is to gain a detailed understanding of the areas they're targeting and to be prepared to "own" their strategy through economic cycles.

"Because you're investing in industries that will become more relevant [such as green energy] and moving out of those that will become less relevant [such as fossil fuels], this will give a better risk-adjusted performance over the long term," he says. ●

THE ASSET SIZE OF ESG EXCHANGE-TRADED FUNDS HAS GROWN MARKEDLY SINCE 2010

Assets in ESG ETFs ($bn)



ETFGI, 2022


Juan Roballo / Alamy Stock Photo

CRYPTOCURRENCIES

Unstable coin

The value of the global cryptocurrency market plummeted by $1tn in May. What impact has this had on traders' methods – and is there a way back for digital currencies?

Jonathan Evans

In the second week of May, cryptocurrency enthusiasts around the world watched their screens in awe as the market collapsed before their eyes. In tandem with the broader economic instability that had started during the final weeks of 2021, crypto values had generally been on a downward trajectory in any case. But their decline degenerated into a meltdown that reminded some traders of the beginning of the global financial crisis in late 2007.

The immediate cause was the implosion of terra – a so-called stablecoin, designed to reduce volatility in the crypto market by maintaining a fixed value over time. But, unlike other stablecoins, terra was not pegged to a stable reserve asset such as gold or the dollar. Instead, its stability was based on algorithms tied to its sister cryptocurrency, luna. When luna's valuation plummeted from about $80 (£66) at the start of the month to a fraction of a cent, terra's followed suit.

Their collapse sparked panic in the market. The price of bitcoin fell to $26,000, down 60% from its November 2021 peak, while ether, the next-biggest cryptocurrency, lost 30% of its value. Coinbase, one of the largest cryptocurrency exchanges, reported a loss of $430m in Q1.

Although the market has stabilised somewhat since the end of May, the valuations of many cryptocurrencies remain notably dented. Some key financial institutions, such as the International Monetary Fund, have cited the latest crash as proof – if more were needed – of the inherent instability of this asset class.

There is an argument that the situation was far worse for individual traders than it was for large-scale investors. Aidan Mott, intel manager at crypto research provider Messari, agrees with this view, noting that such volatility has often resulted in a vigorous rebound for some currencies, particularly bitcoin and ether.

"It's affected retail traders more so than it has larger financial institutions," he says. "Most people using Coinbase or Robinhood don't have the access to the larger liquidity pools or other financial vehicles that large institutions do.

"The biggest volatility for bitcoin and ether has resulted in price increases, which is good for institutional traders. If you have an asset with zero volatility, there is no opportunity to make a profit. It doesn't make sense as an investment."

But choosing the right trading strategy for crypto is easier said than done. Consistency and quantifiability are at the heart of any successful approach. But, given the instability that comes with the territory, what can traders do to maximise their chances of making solid gains over the long term?

Edouard Hindi, chief investment officer at Tyr Capital, recommends that institutional investors adopt a bear-market attitude in light of May's crash.

"Focus on the top 10 coins; don't venture off," he advises. "If you are more risk-averse, you could focus on bitcoin. The general idea runs along similar lines to the standard approach to allocating money during tougher times: focus on attracting yield and concentrate on cash-flow-positive names."

Hindi continues: "What you typically do in this climate is move your money from altcoins to bitcoin. You will see the strength of bitcoin relative to the rest of the alt sphere."

Such tactics reflect the increasing professionalisation of cryptocurrency trading in recent years and the blurring of the boundaries between the traditional financial world and the crypto realm. Hindi expects this trend to continue, with more institutional investors using their expertise in risk management to profit from the instability of crypto markets.

This professionalisation could push retail investors – who have formed a sizeable proportion of crypto holders since bitcoin's inception in 2009 – out of the picture. But such an outcome could serve to reduce volatility and encourage greater uptake by traditional financial players, according to Hindi.

"We're going to see the players change. More institutions will step in, which will stabilise the market because they are less reactive," he predicts. "They understand the risks and will be in it for the long term."

Regulation is another way through which cryptocurrencies can regain the confidence of the professional trading community. Although this has long been mooted in the crypto world, discussions have yet to translate into action on any significant scale. But, less than a day after the terra-luna crash, the US treasury secretary, Janet Yellen, reaffirmed her desire to establish a regulatory framework. If she acts accordingly, she will have the support of President Biden, who in March had signalled his determination to bring some semblance of control to the market.

> **"If you have an asset with zero volatility, there is no opportunity to make a profit. It doesn't make sense as an investment**

Dr Ying-Ying Hsieh is assistant professor of innovation and entrepreneurship at Imperial College London and associate director at its Centre for Cryptocurrency Research and Engineering. She believes that regulation will be a crucial enabler of wider crypto-currency adoption, but is concerned about its potential for restricting innovation.

Although introducing a regulatory framework would require certain aspects of the crypto system to be centralised, Hsieh notes that its highly decentralised nature is a key part of what's made the market so attractive to investors, both retail and institutional.

"Decentralisation is a continuum," she says. "You could decentralise the network. You could decentralise the data. Or, you could decentralise the ownership of the platform. It's not a binary concept. But regulators need to consult the industry about what should and shouldn't be decentralised. They must strike the right balance."

Crypto is known to be risky, but traders like volatility. It gives them a chance to make money, particularly when they apply sophisticated trading strategies using powerful algorithms and other sophisticated tools.

And, as the crypto field gradually becomes more professionalised and controlled, it seems that May's crash isn't turning the pro trading community away. If anything, it's doing the very opposite. ●

THE CRYPTO CRASH

Coindesk, 2022

Bitcoin performance from 16 May to 13 June 2022