FUNDAMENTAL ANALYSIS AND IT USE IN CRYPTO

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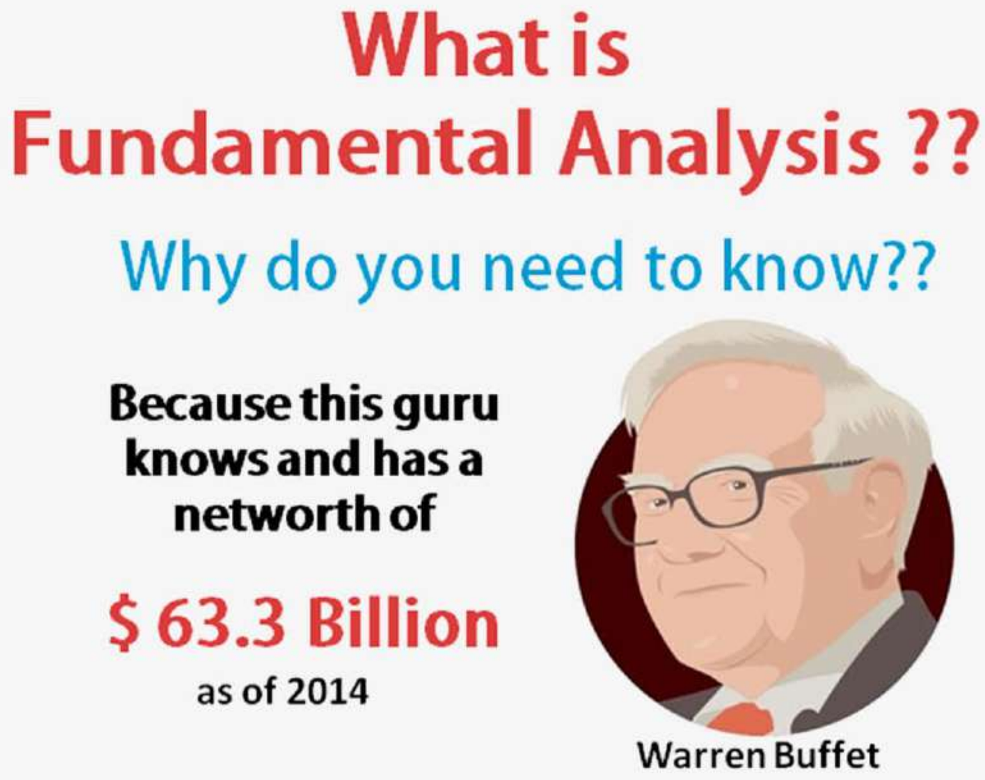

Fundamental analysis is based on predicting the market reaction on important economic releases as well as evaluating the potential consequences of economic, political and social issues on the price of the financial assets. This method has proved to be heavily used by traders as it doesn't take a rocket scientist to notice the extent of fluctuations the price might be subjected to after important fundamental event.

In particular, fundamental analysis gives an insight into how the price will react to a certain economic events. Fundamental analysis may take a shape of different forms. It can be a report on the Gross Domestic Product or Unemployment in certain economy, or it may be a report of the central bank changing its monetary policy.

The release of the economic data changes the economic landscape, and therefore influences the decisions that people take on the market.

There are even situations when the report does not exist, but the anticipation of something happening tomorrow or in a couple of days may induce certain activity and is also considered to be a part of the fundamental analysis.

WHY WE SHOULD NEVER IGNORE THE NEWS?

It is not enough to analyze the markets when you trade, it is also very important to know what makes the markets move. There is always some force behind the any market movements, and the importance of the news is determined by the impact which certain news cause on the marketplace. In order to understand the importance of news, one has to see the movements which certain news create.

Imagine a scenario that some big company in the sphere of software development announced that its profits have largely missed the estimates. What would you do if you were holding some shares of some company ?Well, if you were a real shareholder, the obvious reaction would be taking caution and getting ready for a scenario where you would have to sell off your shares fast. For a cryptocurrency trader, any news having potentially negative impact on the pricing of your precious tokens would be a similar sign to exercise additional caution. That is why maintaining maximum awareness of cryptocurrency fundamental background is crucial to evaluating potential signs of impending price changes.

TYPES OF FUNDAMENTAL EVENTS

The market has a tendency to react based on how people feel. These feelings can be based on their reaction to economic reports, based on their assessment of current market conditions. And you guessed it - there are tons of people, all with different feelings and ideas.

However, you may maximize the accuracy of your predictions by understanding the reactions which certain events cause. For example, a report on the number of tourists visiting New Zealand for a given time period will have much smaller reaction than the Interest Rate Decision from the European Central bank of the Bank of England. That is why it is very important to be good at distinguishing events one from another.

We identify 3 categories of fundamental events

1. High-Impact
2. Medium Impact
3. Low-impact.

LET'S DISCUSS EACH TYPE OF THE EVENT IN MORE DETAIL :

HIGH IMPACT EVENTS constitute the bulk of fundamental analysis, as it is these events that we concentrate most of the attention. These events are watched by traders, speculators and whatever other parties around the world, and cause one of the biggest movements the market ever registered. Given that many people watch, and more importantly, have their own understanding of the events, the volatility can be extremely high when the events are released.

Trading such events can be extremely profitable if you interpret the event correctly, but can be as painful as the dentist dealing with your ailing teeth if your prediction is wrong. Non-Farm Employment Change (Non-Farm payroll) issued by the US labor department is the example of such event. Currency pairs have moved by as much as 100 pips after this report, while Gold was seen declining from $1700 to $1650. Each week has many high-impact events scheduled for release, and every trader has to know how to use them to his advantage.

MEDIUM-IMPACT EVENTS are encountered much more frequently than the high-impact ones however fail to produce the required level of volatility to make the markets move. Such events are usually market with orange or yellow color on the calendar and as a result lack to attract much of the attention.

LOW-IMPACT EVENTS are usually marked with green color. They produce no movements in the majority of occasions and are generally of very little use for traders.

LONG-TERM MARKET MOVERS

There are several fundamentals that help shape the long-term strength or weakness of the major assets on the market. For the purposes of keeping it to the point, below we have compiled the list of most important market movers that every trader should know about.

ECONOMIC GROWTH AND OUTLOOK

We start easy with the economy and outlook held by consumers, businesses and the governments. It's easy to understand that when consumers perceive a strong economy, they feel happy and safe, and they spend money. Companies willingly take this money and say, "Hey, we're making money! Wonderful! Now... uh, what do we do with all this money?"

Companies with money spend money. And all this creates some healthy tax revenue for the government. They jump on board and also start spending money. Now everybody is spending, and this tends to have a positive effect on the economy.

Weak economies, on the other hand, are usually accompanied by consumers who aren't spending, businesses who aren't making any money and aren't spending, so the government is the only one still spending. But you get the idea. Both positive and negative economic outlooks can have a direct effect on the currency markets.

TRADE FLOWS & TRADE BALANCE

We're living in a global marketplace. Countries sell their own goods to countries that want them (exporting), while at the same time buying goods they want from other countries (importing). Have a look around your house. Most of the stuff (electronics, clothing, doggie toys) lying around are probably made outside of the country you live in.

Every time you buy something, you have to give up some of your hard-earned cash. Whoever you buy your widget from has to do the same thing. U.S. importers exchange money with Chinese exporters when they buy goods. And Chinese imports exchange money with European exporters when they buy goods.

All this buying and selling is accompanied by the exchange of money, which in turn changes the flow of currency into and out of a country.

Trade balance (or balance of trade or net exports) measures the ratio of exports to imports for a given economy. It demonstrates the demand of that country's good and services, and ultimately it's currency as well. If exports are higher than imports, a trade surplus exists and the trade balance is positive. If imports are higher than exports, a trade deficit exists, and the trade balance is negative.

So:

- **Exports > Imports = Trade Surplus = Positive (+) Trade Balance (Good for currency)**

- **Imports > Exports = Trade Deficit = Negative (-) Trade Balance (Bad for currency)**

Trade deficits have the prospect of pushing a currency price down compared to other currencies. Net importers first have to sell their currency in order to buy the currency of the foreign merchant who's selling the goods they want. When there's a trade deficit, the local currency is being sold to buy foreign goods. Because of that, the currency of a country with a trade deficit is less in demand compared to the currency of a country with a trade surplus.

POLITICAL EVENTS

The years 20016 and 2017 have definitely been the years where more eyes were glaringly watching their respective country's governments, wondering about the financial difficulties being faced, and hoping for some sort of fiscal responsibility that would end the woes felt in people's wallets. Instability in the current government or changes to the current administration can have a direct bearing on that country's economy and even neighboring nations. And any impact to an economy will most likely affect exchange rates.

A good example to show the extent of negativity that political tribulations have on the value of currencies would be Brexit. The GBP fell against all of its major counterparts following the results of the popular vote in 2016 , sustaining the biggest daily loss since infamous Black Wednesday in 1992.

Now, 1.5 years since Brexit vote, uncertainty still prevails on the marketplace as major policy makers have not yet agreed upon which direction UK will take in relationship with EU. This is because there is overwhelming agreement among economists that leaving the European Union will adversely affect the British economy in the medium- and long-term. Without shadow of a doubt the economic growth will slow down as partially severing economic relations with the EU will enact strong barriers to trade, investment, immigration and thus have a negative effect on the GBP and European equity markets in the long-term. However, there is still substantial uncertainty over how large the effect might be.

As such, political events, especially those that affect the markets to one extent or another should be closely watched and analyzed by traders. Such approach might greatly help to develop a long-term approach to particular market.

Other recent examples of long-term market movers include European Sovereign Debt Crisis, Initiation of trade Sanctions against Russia and Subprime Mortgage Crisis of 2008.

SHORT-TERM MARKET MOVERS

Having developed some understanding of how the markets are impacted in the long-term it is just about time that you understand what effects them in the short-term. The importance of short-term market movers should not be underestimated as these events are released on the daily basis and basically provide the bulk of the fundamental analysis for every trader. While long-term events can help develop a strategy for long-term investment provide ideas fo diversification of trader’s portfolio, short–term events provide instant opportunities for traders and speculators who are willing to capitalize on hourly or daily fluctuations of prices.

Below you may see the average range of EUR/USD price movements following the release of crucial economic reports. Left part of the table shows range within first 20 minutes after the event while average daily range is to the left.

FIRST 20 MINUTES	AVERAGE RANGE (PIPS)	TOTAL DAILY RANGE	AVERAGE RANGE (PIPS)
Nonfarm Payrolls	124	Nonfarm Payrolls	193
FOMC Decisions	74	FOMC Decisions	140
Trade Balance	64	TIC Data	132
Inflation (CPI)	44	Trade Balance	129
Retail Sales	43	Current Account	127
GDP	43	Durable Goods	126
Current Account	43	Retail Sales	125
Durable Goods	39	Inflation (CPI)	123
TIC Data	33	GDP	NO

Based on this information is obvious that the most significant movements of EUR/USD occurred in the first 20 minutes after the economic release. Non-Farm payrolls and FOMC Decisions were the most important pieces of US economic data in 2017.

This guide strives to make things simple and comprehensive so we will not analyze major short-term events in detail due to the fact they will unlikely give any benefit for cryptocurrency investors.

WHAT IS TRADER SENTIMENT?

We have learned about fundamental events, both short term and long-term. But there is one more thing that the above-mentioned things create - the trader sentiment.

The trader sentiment is the general attitude of investors towards a particular financial instrument or a particularly larger market in a broader sense of the word. Markets sentiment is the feeling of a tone of the market, to say simple the crowd psychology as revealed through the activity of the assets traded on the market. Rising prices in the long-term indicate the BULLISH market sentiment while falling prices indicate a BEARISH market sentiment.

The sentiment is based both on fundamental and technical conditions of the market, and in general identifies the EXPECTATIONS which traders have toward specific asset in the LONG-TERM.

CRYPTOCURRENCY FUNDAMENTAL ANALYSIS

Cryptocurrencies are not corporations, but rather representations of value or assets within a network. Its viability is not based on generating a revenue, but rather directly depends on the participation of the community (users, miners and developers). Each cryptocurrency is a manifestation of the different applications of Blockchain technology, and are usually decentralized;

Thus, fundamental analysis on cryptos must be performed with a different methodology. Given the complex nature of cryptos and their underlying technology, it is even more important for us to engage in research to assess the viability and potential of the coins. This ensures that we make better investment decisions and are kept in the loop of things. But more importantly, a good understanding of a coin's fundamentals allows you to form your own opinions and have your own stand, which is rare in the crypto world due to its complexity.

BELOW WE HAVE INDICATED SEVERAL STEPS THAT EVERY CRYPTOCURRENCY INVESTOR MIGHT TAKE TO BOOST UNDERSTANDING OF CRYPTOCURRENCY FUNDAMENTALS

1. LAYING THE FOUNDATION

While investors use fundamental analysis to evaluate different asset classes, such as equities and fiat currencies, several analysts assert that using this approach to evaluate bitcoin is more complex.

For instance, investors can evaluate a company's stock by looking at certain items on its balance sheet, but bitcoin does not produce revenue or earnings numbers. As a result, traders willing to apply fundamental analysis while investing in Bitcoin and other cryptocurrencies should utilize a completely different set of metrics, even though some of the rules applicable to general currency trading can be applied to cryptocurrencies in the equal measure.

2. ANALYZING DEMAND

Several variables affect bitcoin demand, including user adoption, transaction activity and trading.

But bitcoin has managed to gain significant traction as a medium of exchange. Hundreds of companies - including eBay and PayPal - have agreed to accept the digital currency since its inception in 2009.

In addition, the number of confirmed transactions per day has generally followed a steady, upward trend. Transactions started surging in early 2012, rising from more than 7,000 per day at the start of April 2012 to more than 300,000 per day now.

While this data is informative, it is highly advised to check similar data for each cryptocurrency before passing any judgment over its potential and performance.

3. ANALYZING SUPPLY

While demand for bitcoin can be a complex study, supply is a bit more straightforward.

The bitcoin protocol limits the total number of units at 21 million, and 16.3m bitcoins were in circulation at the time of reporting. Further, the rate of new supply is also determined by the bitcoin protocol. This contrasts sharply with the traditional monetary system, in which central banks have the ability to print money whenever they want.

However, there are some caveats that affect bitcoin's supply.

For starters, Satoshi Nakamoto, the pseudonymous creator of bitcoin, supposedly holds roughly 1.1m bitcoins which have not moved since they were mined. And many people in the bitcoin community think they won't ever be, seeing these coins as "dead bitcoins."

That's because for the first several years of bitcoin's existence, units of the digital currency didn't have much monetary value. When the price began moving upward, stories of people throwing away hard drives that held the private keys for their bitcoins were commonplace.

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4. FOLLOWING MAJOR EVENTS

Analysts also noted the key role major events play in determining the price of bitcoin. These incidents are sometimes directly related to bitcoin, such as the hack of a major exchange, or a setback in the community's push to solve the scaling dilemma.

Also, it is highly advised to closely follow all major news and announcements in this field to keep track of such developments as recent crackdown and potential bitcoin mining prohibition by Chinese authorities in December 2017. Any cryptocurrency-related headline news should be analyzed and major trends closely watched.

CONCLUSIONS

By leveraging fundamental analysis, bitcoin traders can get a better sense of the cryptocurrency's true value and get a better sense of whether it's a good time to buy or sell.

However, some analysts criticize fundamental analysis because it reflects more what a security should be worth than what its actual market price is. Relying too much on fundamental analysis, without also using technical analysis, could cause a trader to buy or sell at a less-than-ideal time

To manage this risk, bitcoin traders can combine fundamental analysis with technical analysis. For example, a fundamental analyst might look at several indicators of demand, concluding that bitcoin is underbought, and then leverage technical analysis by reading charts to find the best entry point.

Alternatively, a trader might use technical analysis to determine that it's a good time to sell, and then leverage fundamental analysis to confirm this view by looking at key drivers of demand.