Haym Salomon @SalomonCrypto

Aug 24 • 20 tweets • SalomonCrypto/status/1562577628741046272

(1/19) Finance Fundamentals: Liquidity

Liquidity is the most important vital sign of an asset, market or economy. From liquidity flows stability; with stability a society can build, invest and grow.

Read on to learn about the metric at the nucleus of modern finance.

(2/19) Practical definition of Money:

Money is a system of value that facilitates the exchange of goods in an economy. Using money allows buyers and sellers to pay less in transaction costs compared to barter trading.

Cash, physical and digital, is the manifestation of money.

(3/19) Liquidity refers to the efficiency or ease with which an asset can be converted into cash without affecting its market price.

Assets range from very liquid (large cap stocks, US treasuries, $ETH, etc) to illiquid (rare collections, most real estate, many NFTs).

(4/19) For example, let's say Alice wants to buy a $20k car. She has a jewelry set worth $25k, but she is unlikely to find a buyer in any reasonable timeframe.

Jewelry is an illiquid asset and Alice is illiquid; she cannot buy the car even though she could technically afford it.

(5/19) There are 2 types of liquidity: market & accounting.

Market liquidity: the extent in which a market allows assets to be bought/sold at stable prices

Accounting liquidity: the ability of an entity to meet its financial obligations

(6/19) The essential characteristic of a liquid market is that there are always ready and willing buyers and sellers.

Speculators and market makers are key contributors to the liquidity of a market or asset.

(7/19) Market liquidity affects the investment profile and price of an asset. Investors require higher returns on assets with lower market liquidity to compensate them for the risk (not being able to retrieve their capital when they need it) associated with holding these assets.

(8/19) Market liquidity is a key factor in determining the spread (delta between the buy and sell offer) an asset has.

High liquidity = large number of buy/sell orders = increased probability that a deal will be found at offered prices = tighter spread = more efficient market

(9/19) Every market for every asset has its own liquidity, but we can analyze aggregate market liquidity:

Forex (currency trading): $6.6T/day
US Treasury Market: $670B/day
$BTC: $27B/day
$ETH: $16B/day

(10/19) Accounting liquidity is the ability to meet obligations when they come due without incurring unacceptable losses.

Managing liquidity is a constant process that requires bankers/cash managers/households to monitor and project cash flows to ensure liquidity is maintained.

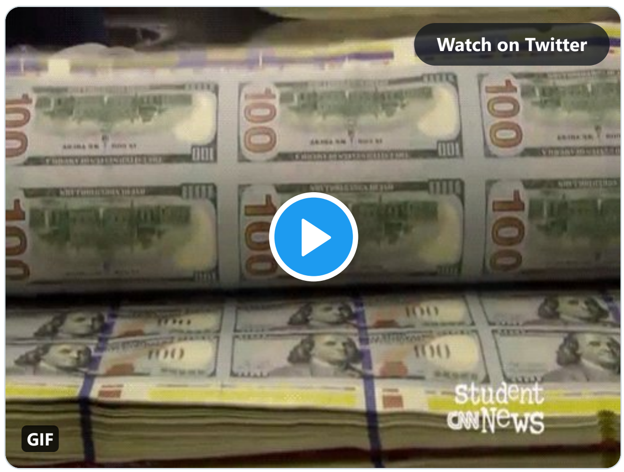
Haym Salomon
@SalomonCrypto · **Follow**

(1/22) Trad-Fi University: Working Capital 101

A basic explainer of a concept that keeps the world turning (and has almost 0 presence in crypto)

Read this thread, retweet, and then reply with an idea of how to apply this concept to crypto

Get it right & we'll make billions



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(11/19) All cash obligations, including debt payments, expenses, tax and legal judgements, need to be accounted for.

The real world implications of failing to pay 1 months mortgage and employee are massive… but they have equal implications for accounting liquidity.

(12/19) If that entity is illiquid, it cannot pay its debts. When building a portfolio, (hopefully) the entity will diversify into a range of assets, at least some of which that are liquid.

The liquid portion has one primary job: be there when it is needed.

(13/19) If illiquidity is not remedied, an entity can become insolvent

Solvent entities have more assets than its debts - a positive net worth. Insolvency is when the entity owes more than it owns - a negative net worth

Insolvency can lead to bankruptcy

Insolvency vs Illiquidity: The Similarities & Differences
Illiquidity can lead to insolvency, but the two terms don't mean the same thing. Learn how insolvency and illiquidity are related and different.
https://lanterncredit.com/small-business/insolvency-vs-illiquidity

(14/19) Accounting and market liquidity are deeply linked; an asset's market liquidity directly affects the accounting liquidity of an investor.

Thus, liquidity - a phenomena with many facets - is central to the stability of a financial system.

(15/19) Look at the actions of the @federalreserve in March 2020 in response to the Covid crisis:

First, they made open ended promises that they would be willing buyers if there were sellers. Then they provided massive loans to states and local govs.

What did the Fed do in response to the COVID-19 crisis?
The Hutchins Center explains how the Fed reacted to the economic effects of the COVID pandemic.
https://www.brookings.edu/research/fed-response-to-covid19/

(16/19) Former Fed Vice Chair: "The Treasury market is the foundation for trading in many other securities markets in the U.S. and around the world; if it's disrupted, the functioning of every market will be impaired."

Liquidity is the critical vital sign for financial systems.

(17/19) But here's the thing: liquidity is not a cause, it is an effect. Liquidity doesn't attract hungry buyer and sellers, individual traders and entities must decide to trade in that asset, on that market.

Building economies is about attracting buyers and sellers.

(18/19) There are many ways to attract buyers and sellers

Things like speed, cost and stability are table-stakes. Things like property rights, privileged actors and incentives have more variety

But, in the end, the markets that are most credibly neutral have the most liquidity

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(1/15) Credible Neutrality: the Wellspring of Legitimacy

To build a system people actually use, you must build a system people actually believe in.

You must build a system that has legitimacy.

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(19/19) Today, we are building a new economy: an internet economy.

@ethereum will provide the backbone for a financial system that will power a new age of information and commerce.

Liquidity is Ethereum's vital sign and its ultimate growth metric.

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(1/17) **@ethereum** Endgame: The Internet Economy

Trying to understand crypto, Ethereum and De-Fi in the context of history?

Read on to learn how I think the world is changing.

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