Risks of Low Liquidity Bitcoin Trading

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Bitcoin is heading higher on lower trading volume than one might expect from a rally that has taken the cryptocurrency to its highest value versus the dollar in eleven months. On one hand, the prospect of the Fed tapering or stopping its interest rate increases has both the stock market and the crypto market anticipating a rally. On the other hand, the Bitcoin market is known for self-promotion with the characteristics of pump and dump schemes as well as rampant **wash trading**. What is really going on in the Bitcoin market and what are the risks of low liquidity Bitcoin trading?

Why Is Low Liquidity Bitcoin Trading Risky?

Liquidity is the ability to buy and sell easily when trading stocks, commodity futures, currency pairs, or cryptocurrencies. One nightmare when trading Bitcoin when liquidity is low is that you think you are buying into a rally but are actually buying at the peak such as May 7, 2021 at $58,956 or November 12, 2022 at $64,400 only to see the market immediately plunge. You try to sell but there are no buyers (low liquidity) and you have lost ten or even twenty percent of your investment before you finally get out of the trade. On the other hand, the market may still be going up but if there are very few traders it may be difficult to sell and take a profit.

Why Is Trading Volume So Low?

Markets are driven by investor and trader sentiment in the short term and by underlying fundamentals over the long haul. Throughout the long crypto winter as Bitcoin prices fell again and again investors learned that, contrary to promotional hype, Bitcoin is not an entity totally divorced from the realities of the wider economic and financial world. Although the swings were often wilder, Bitcoin reliably tracked up and down with the Nasdaq market. Bitcoin was not a great hedge against inflation or a store of value in time of war and social unrest. The current **banking crisis** may, in fact, cause the Fed to pause their interest rate increases. Bitcoin enthusiasts have gone back to the mantra that the crypto token will be safe when banks fail and the economy tanks. It would appear that most Bitcoin traders and investors do not believe this as they are still on the sidelines!

Low Trading Volume and Market Volatility

When there are relatively few traders in a market the price jumps are often bigger as there are not enough traders to fill the gaps between buy and ask pricing. The first risk in today's Bitcoin market is that when a relatively few buyers decide to sell and take their profits the market could give back all of its recent gain in an afternoon. The other risk is that this is more likely to happen in a market with fewer traders and lower liquidity.

Technical Analysis Needs High Trading Volume to Make Sense

In the short term, traders generally do not rely on market fundamentals but rather on technical indicators. The fact is that market pricing patterns can help predict subsequent price action. Unfortunately, **technical analysis** needs high volume and high liquidity to work properly. At their core these indicators are based on statistical probabilities and those "probabilities" become nonsensical when volume is too low. In a low volume, low liquidity market a technical Bitcoin trader is reduced to guessing what price swings really mean.

Market Manipulation Thrives in Low Liquidity Trading

A relatively small number of traders or even just one can engage in **manipulation** of the market during periods of low liquidity trading. Pump and dump schemes thrive at such times and wash trading can give the impression of acceptable trading volume when there is virtually none. None of this means that the recent rise in Bitcoin price does not have some realistic underpinnings but it should give pause to traders who have been waiting through crypto winter for a chance to profit again on upward surges of Bitcoin.

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