Crypto · Managing crypto risk · lesson 7 · 6 min read

Correlation to one: the portfolio that is a single bet

> **CRYPTO CORRELATION RISK**
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> A diversified-looking crypto portfolio is usually a single bet: the flow layer moves nearly all coins together, so cross-correlations run higher than any other market's, and in a broad sell-off they converge toward one - every coin falling together exactly when diversification was supposed to help. Holding ten coins is holding one bet at ten names, and the risk plan must count it as one.

The commodities track counted clusters; the equities track found real diversification. Crypto offers the least diversification on the platform - because the flow layer of module 1 moves almost everything together, and in stress the correlation goes to one.

Why crypto barely diversifies

With no valuation anchors, coins have little to differentiate them beyond narrative - so the flow layer dominates, and ten coins across five narratives are still mostly one exposure to crypto-wide sentiment. The cross-correlations run higher than equity sectors', per module 2's rhyme lesson, and they are procyclical in the worst way: in a broad sell-off, the narrative distinctions collapse and everything falls together, so the diversification that looked real in calm markets vanishes exactly when it was needed. Crypto's ten-coin portfolio is the equity one-sector book, except the sector is the entire asset class.

Counting the real exposure

By the flow layer first: most of a crypto book's risk is its total crypto exposure - not its allocation across coins, which is a second-order tilt on one large bet.The stablecoin illusion: coins parked in stablecoins feel like cash and diversification - but stablecoins carry their own peg risk (lesson 8), so 'diversified into stables' is a different exposure, not an absence of one.The correlation-to-one stress test: the honest risk number is what the book loses if every coin falls together, because that is what a broad sell-off delivers - the crash correlation, not the calm one, sizes the exposure.

The plan's response

Total crypto exposure is the risk budget's real subject - capped as a whole, not diversified into false safety across correlated coins. The equity sector-heat lesson, at its extreme: the cluster is the asset class, so the heat is the total position, and a book that reads diversified across coins is one bet the plan must size as one. Diversification within crypto is a tilt, not a hedge - and the only real diversification from crypto risk is holding less crypto, which is the honest thing the marketing never says.

Check your understanding

1. Why does a ten-coin crypto portfolio behave as a single bet?

a. The coins share a blockchain

b. The flow layer moves nearly all coins together, and in a sell-off correlations converge to one - so ten coins across five narratives are mostly one exposure to crypto sentiment

c. Exchanges bundle them

Answer: b. No anchors to differentiate coins means the flow layer dominates. The diversification that looks real in calm markets vanishes in the stress it was meant to help with.

2. What is the only real diversification from crypto risk?

a. Holding more coins across more narratives

b. Holding less crypto - within-crypto allocation is a tilt on one bet, not a hedge, because the cluster is the whole asset class

c. Moving into stablecoins

Answer: b. The honest thing the marketing never says: total crypto exposure is the risk, and only reducing it reduces the bet. Coin allocation is a second-order tilt.