AMM: Stablecoin Pools Beating Bond Yields

5.40%
US 1-Year Treasury Yield

3.84%
USDC/ USDT Pool **YTD**

6.60%
USDC/ USDT Pool **Forward APY**

11.00%
LUSD/ USDC Pool **Forward APY**

At the start of this year, the 1-year US Treasury rate was returning a comfortable 4.72%. Certainly not bad, but nothing spectacular either. Investors had been dealt a hard 15; it was a choice between standing against the Blackjack dealer or seizing an opportunity in other asset classes.

The US Federal Reserve continued to be steadfast in its tone – higher rates for longer. Meanwhile, cryptocurrency markets remained depressed after the collapse of FTX, and regulatory pressures added a little more discomfort to the mix.

It was time for flight-to-quality assets.

For those inside the crypto ecosystem unwilling or unable to leave to take advantage of the yields, one option was to park in non-yielding stablecoins as crypto markets faced their hardest bear market ever, coupled with a string of back-to-back headlines of exchange misappropriation, failed hedge funds, and stablecoin blow-ups.

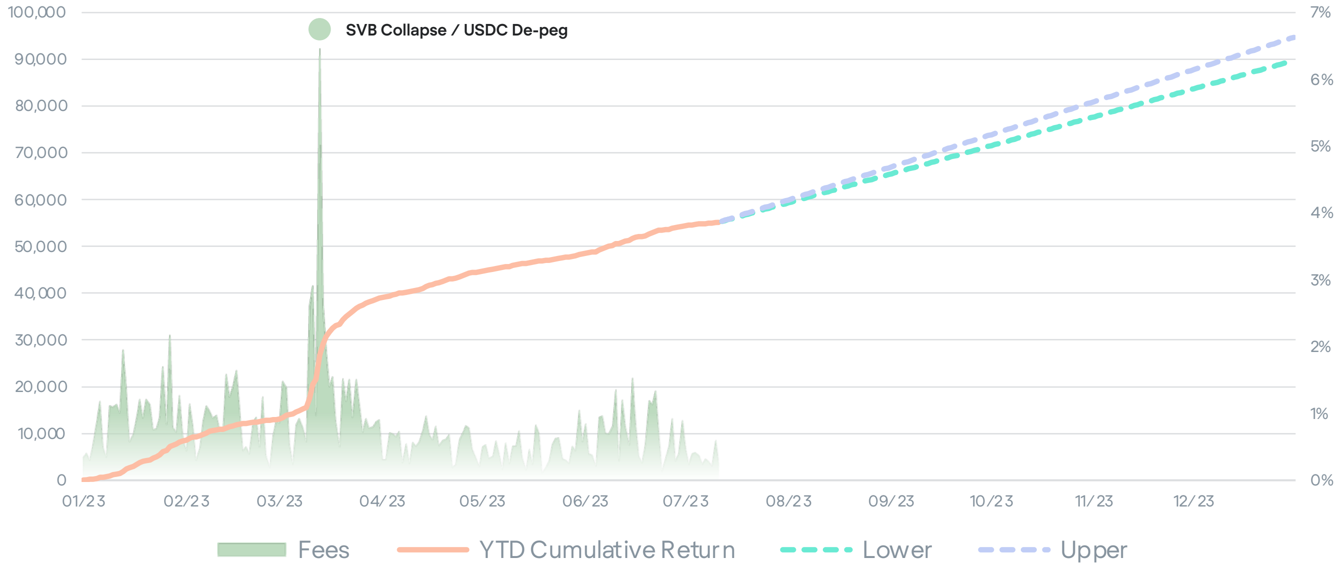
For Decentralized Finance (DeFi) Liquidity Providers (LPs) on Uniswap, the extrapolated yield from treasuries at that time would have been 44% over and above the earnings assessed from the USDC/USDT pool, which was earning 3% per annum. This pool, which earns LPs 1bps on trades, is in fact the largest pool by volume, second only to the wETH-USDC pair.

Rank	Pool	Fee Tier	Volume $bn	Type
1	USDC-WETH	0.05%	68.057	Stable/Asset
2	**USDC-USDT**	**0.01%**	**21.758**	**Stable/Stable**
3	USDT-WETH	0.05%	14.55	Stable/Asset
4	WBTC-WETH	0.05%	9.141	Asset/Asset
5	USDC-WETH	0.01%	8.82	Stable/Asset
6	**USDC-USDT**	**0.05%**	**5.33**	**Stable/Stable**
7	USDC-WETH	0.30%	3.594	Stable/Asset
8	**DAI-USDC**	**0.01%**	**3.464**	**Stable/Stable**
9	WBTC-WETH	0.3%	2.682	Asset/Asset
10	DAI-WETH	0.05%	2.336	Stable/Asset

Fast forward to today, this very same pool has already earned a cumulative 3.84% Year-to-Date, with just a little less than half the year left on the calendar, outpacing even the current treasury yields, which stand at 5.4% (see chart).

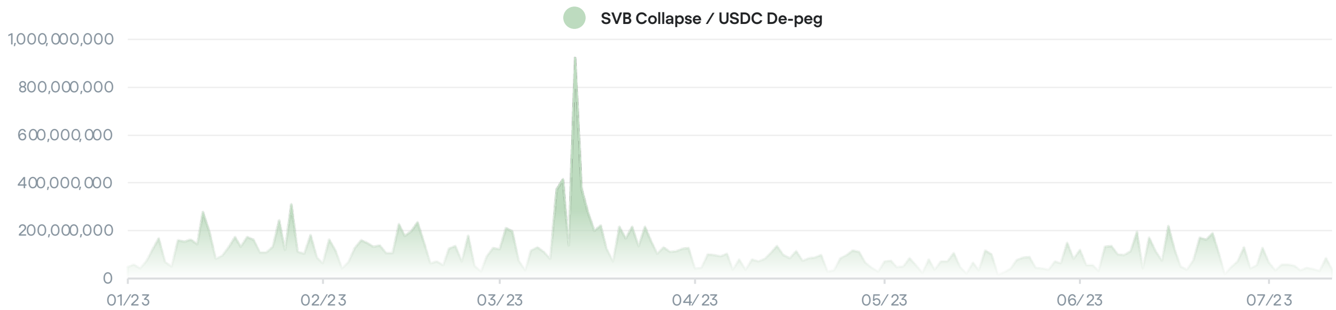
Those who have been LPs from the start of the year in this pool can expect anywhere between 6.2% and 6.6% based on the daily average returns excluding the outlier returns during the SVB banking crisis.

Uniswap USDC/USDT Pool Fees, Returns & Extrapolated Returns



Source: Copper Calculations, Dune, Uniswap
Notes: Upper Average (0.016% 1-Jan to 7-Mar) Lower Average (0.014% 18-Mar to 11-Jul)

Uniswap USDC/USDT Pool Volume



Source: Dune, Uniswap

Now, granted, volumes had an extremely heavy helping hand from the saga that unfolded with Silicon Valley Bank (SVB) in March, which resulted in Circle's USDC de-pegging significantly for the very first time.

Uniswap saw trading volumes on USDC/USDT skyrocket, contributing to nearly 15% of this year's volume for the pool between the 8th and 17th of March, when finally, SVB filed for Chapter 11.

Based on the daily average returns post-SVB, ceteris paribus, this pool is looking at a 2.4% return until the end of the year, lower than current bond yields.

However, this isn't the only stablecoin pool in town.

Asset composition risk was in focus for USDC, which held approximately 8% of its total assets in cash with SVB. This led to the stablecoin losing its peg before returning to parity as regulators intervened and secured depositors.

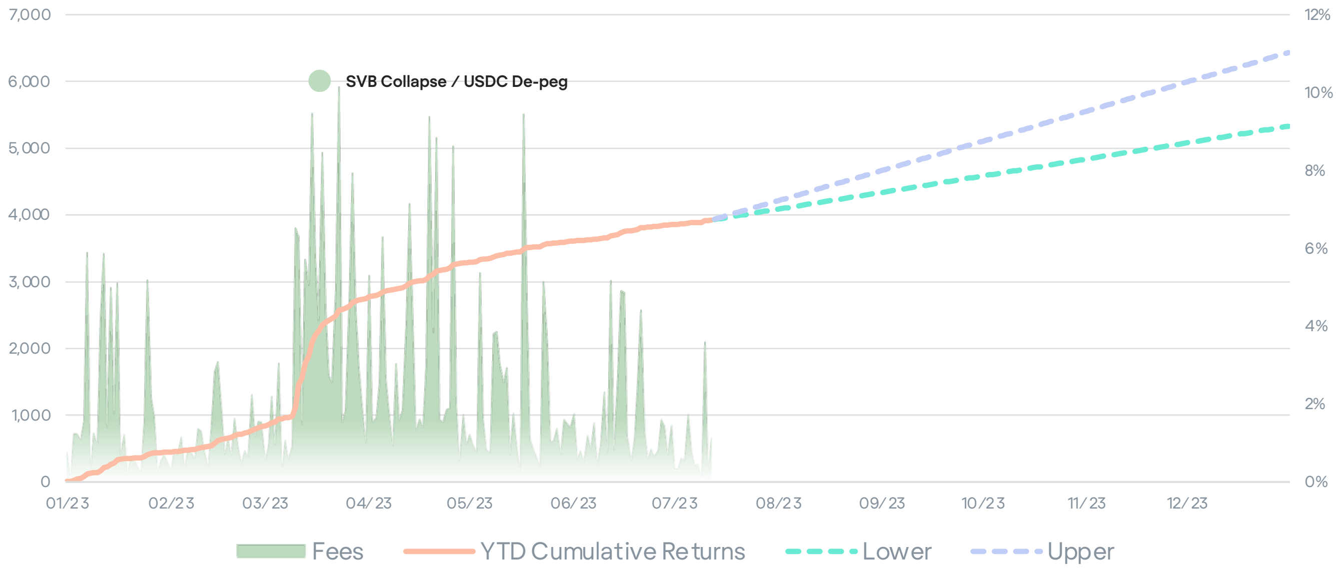
But DeFi had its answer with Liquity, a protocol that mints LUSD tokens that aim to maintain parity against an overcollateralized pool backed by Ethereum.
Copper Research →

The LUSD/USDC pool on Uniswap has rewarded its LPs with a cool 6.7% YTD, factored by a smaller liquidity pool that has the higher tier fee rate of 5bps, in comparison to the 1bps on USDC/USDT.

Daily average returns have slowed down in the last quarter. Based on these averages, excluding the SVB period, a possible annual return could fall anywhere between 9.1% and 11% - almost double the returns on a 1-year treasury bill (see chart).

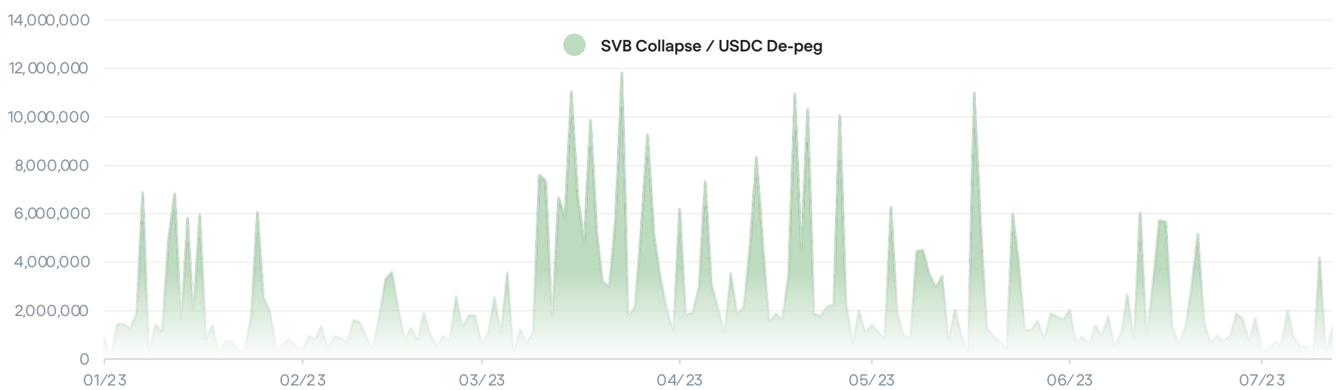
Of course, not all stablecoin pools are earning. The DAI/USDC pool has returned less than 0.25% year-to-date.

Uniswap LUSD/USDC Pool Fees, Returns & Extrapolated Returns



Sources: Copper Calculations, Dune, Uniswap
Notes: Upper Average (0.016% 1-Jan to 7-Mar) Lower Average (0.014% 12-May to 12-Jul)

Uniswap LUSD/USDC Pool Volumes



Source: Dune, Uniswap

Yielding Future

As the global macro landscape continues to likely remain with high interest rates, or at the very least, not zero, an opportunity is currently amiss with being able to capture yields from treasuries and participating in the DeFi ecosystem through collateralized minted stablecoins.

That's not to say this hasn't been executed. In fact, Ondo Finance, which has over $150mn in its short-term US government bonds fund on Ethereum, has done just that. Its OUSG token can be used through Flux Finance, which was initially developed by Ondo, to borrow other stablecoins while earning yield. And its OMMF token will offer the same yielding features but will actually represent $1 – meaning a yielding stablecoin.

A recent report by Bank of America's Digital Asset arm highlighted Ondo as a key competitor to other stablecoins, although it did have the caveat that, without clearer regulation, growth could stall for the time being.

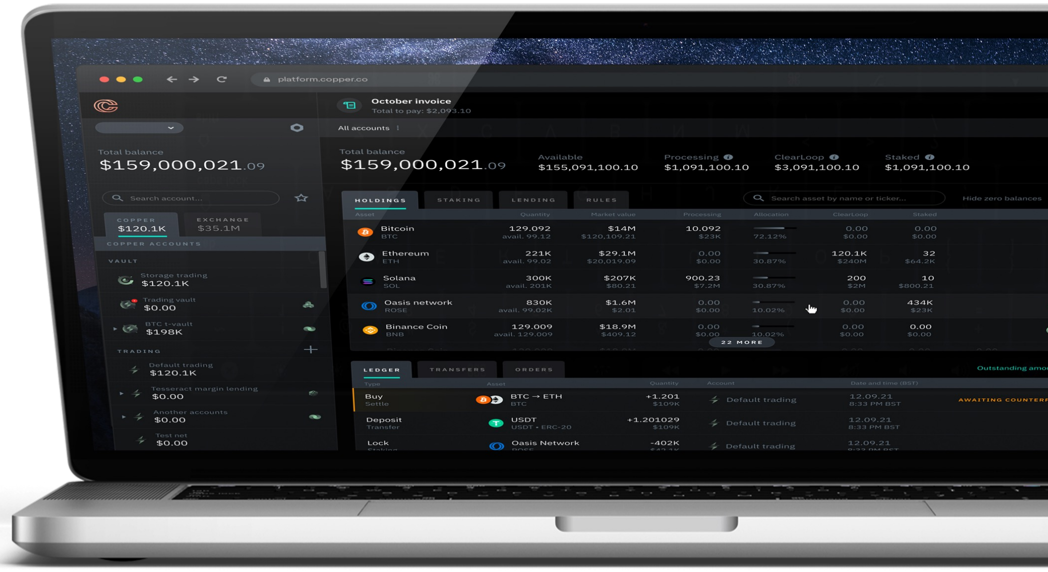
BofA said, "We expect tokenized assets like Franklin Templeton's BENJI token and Ondo's yet-to-be-launched OMMF token, which are intended to maintain a stable $1 value, to take market share over the longer term from stablecoins like Tether's USDT and Circle's USDC. Stablecoins like USDT and USDC aim to maintain a $1 peg and enable investors to reduce exposure to more volatile digital assets, lock in gains from trading, and transfer funds between exchanges or between exchanges and wallets.

However, USDT and USDC are not yield-bearing, and the issuers have resisted distributing interest income to token holders, given that the SEC would likely designate a yield-bearing stablecoin as a security."

Adding Up

Every basis point counts, and it's not difficult to understand that competing with 5-6% coupons is a challenge. Ultimately, however, automated market maker stablecoin pools are indeed beating bond returns.

Between the inter-dynamics of Uniswap and Liquity's LUSD, which would allow investors to maintain exposure to Ethereum that has seen a near 50% price increase year-to-date, there is plenty of evidence that DeFi does work. And it works very well.



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