#DeFi

July 4th, 2020 by Maple Leaf Capital

An outsider’s basic framework on ETH + #DeFi value chain

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#DeFi

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Executive Summary

- ETH is a digital commodity today powers and secures transactions and code execution, much like water powering watermills as a “recyclable” resource. EIP-1559, much like alchemy, transforms ETH from water to be more like oil.
- The #DeFi stack, by extension, is therefore utilizing digital commodities as feedstock to explore various modules / functions within and beyond the current finance infrastructure, much like the petrochemical / industrial value chains built on top of oil.
- A well-designed, well-maintained L1 token protocol should track industry growth. Stakeholder base may matter more given need of iterations, and outsized return in Layer-1 would prompt replacements, despite potential security boost and price inelasticity thanks to robust demand.
- Of the #DeFi ecosystem today, we envision AMM and lending protocols to merge overtime. Winners could be ephemeral so we would prefer to avoid tokens with overhang such as COMP, BAL, and CRV (if high valuation), and lean into tokens with pending or hypothesized catalysts such as LEND, BNT, and REN. To extend the alchemy analogy, the phase-change from governance to value-capture is what drives out-sized return (like KNC). ZRX and RUNE require further herculean efforts to get there. We are monitoring Uniswap, Graph, and 1inch potential token issuance closely. Team that consistently executes (such as SNX) deserves a premium.
- We generally feel like more experimentation can be done on formulaic and flexible issuance / buyback / dividend based on protocol usage / adoption as well as discriminating in favor of users / long-term holders. We also generally applaud teams that are thoughtful around tokenization and don’t “blow their load” or monetize too early.
- A combination of blockchain native-fiat, layer-1 digital commodity, layer 2 scaling, and the #Defi infrastructure should have a Lollapalooza effect that collectively brings new use cases to reality, such use case could be otherwise cost-prohibitive and even impossible today.
- If successful with the mission above, we may then live in a future world with high individual sovereignty -- every line-item of the financial statements can be repackaged and sold / owned by anyone; sovereign / nation-state definition will evolve. New violent agents arise. All of which offer their violence-as-a-service for “tax” dollars; and everyone can now be a stakeholder on both a hyperlocal and global level – a user-equity-owner for a local coffee shop’s bond tranche payable in coffee and a game / movie royalty due to participation will co-exist in self or 3rd party custodied wallet.

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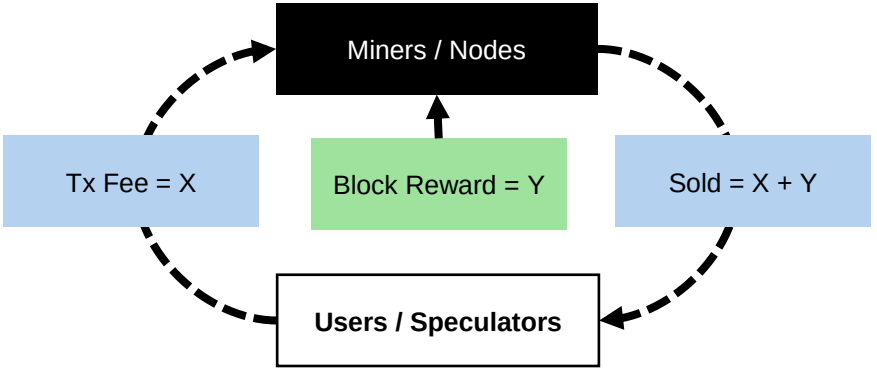
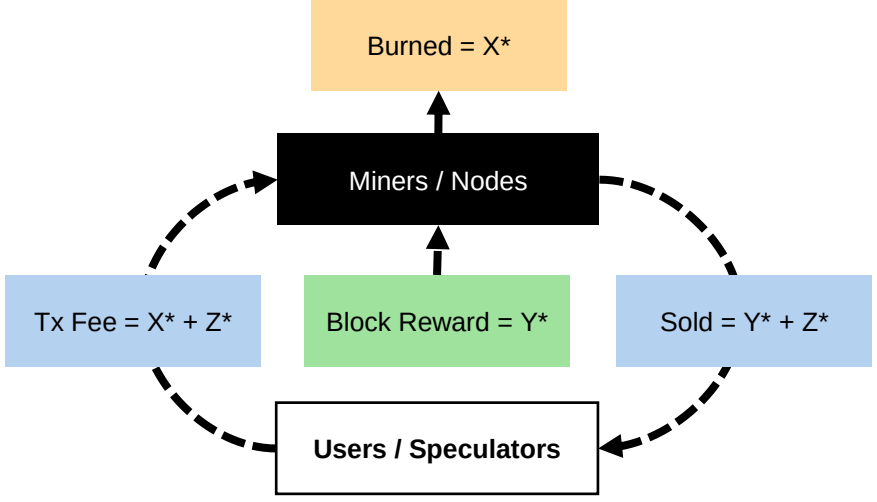
- **Layer 1 token acts as evolvable "energy" commodity that secures and powers smart contracts:** Aside from balances, Ethereum's ledger also stores code that executes accordingly as the nodes (miners) process each block. By design, the caller of said code pays a small amount of Ethereum token as fee ("gas") to incentivize processing. The vested interest of nodes (PoS) or sunk fiat-based cost that requires payback (PoW) with fee + inflation revenue streams keep the network "secure". In short, ETH the PoW token today acts as a commodity that powers and secures transactions and code execution, much like water powering watermills as a "recyclable" resource – nodes and miners sell ETH right back into the ecosystem. EIP1559 proposal changes the mechanism slightly such that such gas fee paid is burned as inflation goes up to compensate nodes / miners – and such a change, like alchemy, transforms ETH from water to be more like oil, whereby spikes in processing demand directly exerts upward pressure to ETH as fees used for transaction are destroyed vs. recycled. Timeline of such change and whether non-ETH (such as wrapped BTC) can be used for fees remain to be seen.

ETH today: Atmospheric circulation of token like water



ETH post-1559: "non-renewable" usage of token like oil



Note: Z* = tip amount. Y* > Y. X* will be somewhat fixed

Layer 1 tokens are evolvable energy commodities (water / oil), and applications on-top are energy / petrochemical / industrial value chains / infrastructure

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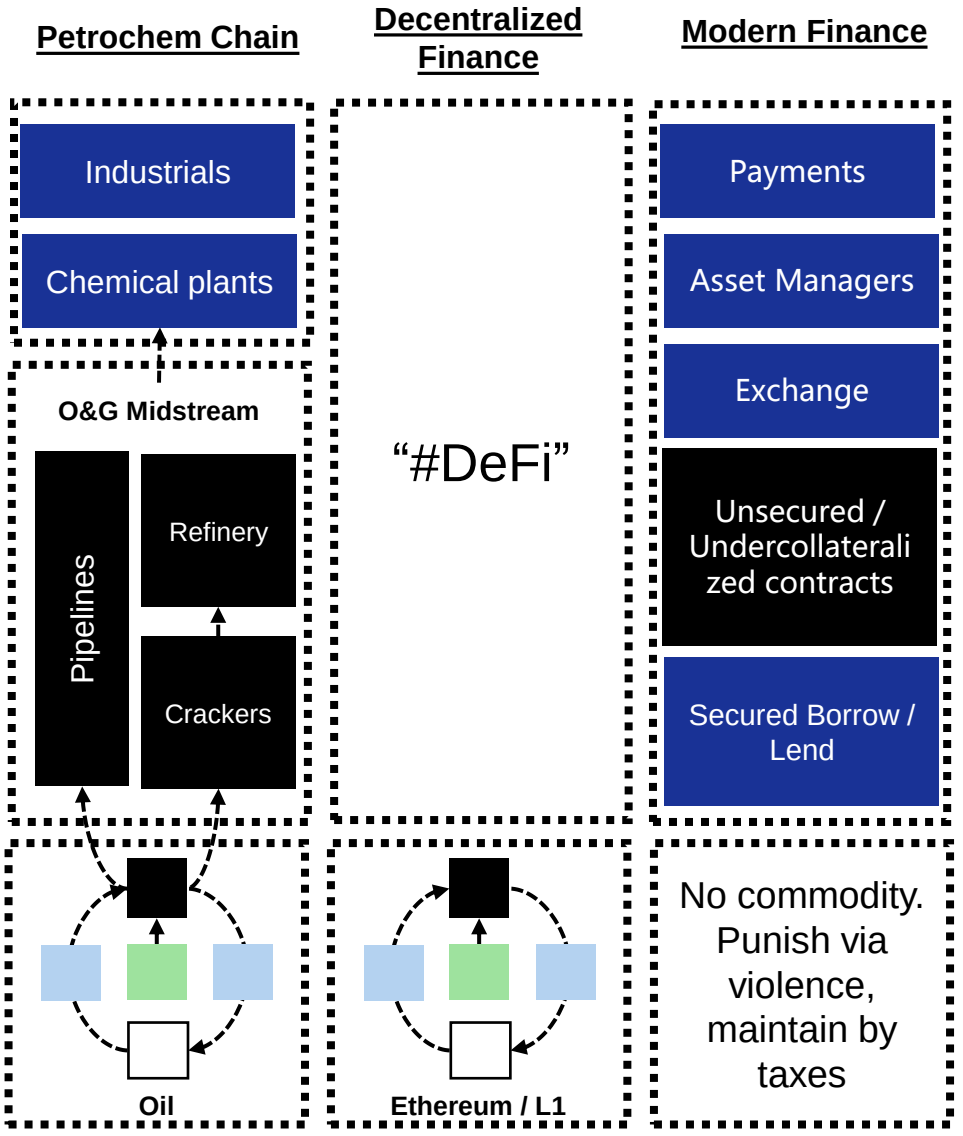
- **#DeFi is one of the petrochemical / industrial value chains built on top of Layer 1 digital commodity, aiming to replicate and innovate beyond existing finance industry functions:** It is worth stressing that what was previously a closed system of value-transfer (i.e. centralized custodian with the aid of violent bodies, maintaining centralized ledgers) now has an alternative, whereby via clever systems design allows for open-market price-discovery on the cost one is willing to pay for value-transfer. In other words, what was a hidden cost over value-transfer, highly optimized and enforced by violent recourse upon breach of contract paid-for by taxes, now has a multitude of open-market-priced alternatives.
- Hence, the current middleware and applications run on top of Ethereum are thereby like crackers, refineries, pipelines, and servicers within the oil value chain, as well as tertiary industries such as engine manufacturers and chemical plants that makes use of oil / refined derivatives of oil.
- The #DeFi stack, by extension, is therefore utilizing digital commodities as feedstock to explore various modules / functions within and beyond the current finance infrastructure.



A well-designed, well-maintained L1 token protocol should track industry growth, with cost being somewhat offset by security

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Under such a digital commodity / value chain framework, I believe a few corollaries can be inferred below. Such qualities could make investing in ETH layer-1 killers currently highly challenging, with perhaps redeeming hope that the PMF of application found upon such layer-1 competitor so tremendous that an order of magnitude more developers / users get on-boarded:

1. **Code is alchemy to digital commodities** – Protocol upgrades via consensus give tokens new properties in ways infinitely more flexible vs. physical atoms. Turning water to oil is possible here. The difficulty towards code upgrade to be accepted is similar to how inert / brittle the bond is for chemical compounds.
2. **A good stakeholder structure that drives evolution is the moat, not just the tech**: Given the evolutionary property, a leading commodity (assuming rapid but thoughtful evolution) should remain preferred. In other words, a vibrant, thoughtful, and engaged stakeholder community + an ownership structure that is centralization resilient helps the protocol evolve and keeps it both technically and functionally competitive. Replicating + maintaining the community and ownership structure appears to be highly challenging tasks.
3. **Longer-term, digital value chains should be layer-1 agnostic:** A refiner should be able to take any feedstock, and a car engine should be able to run on both gasoline and diesel. In a nascent industry as such today, however, friction of (a) cost and time spent switching to a different Layer-1 protocol as well as (b) the need to rebuild tools (which are composable on ETH Layer-1) are key competitive advantages to the incumbent Layer-1.
4. **The digital commodity's "Moore's Law":** Keeping security and integrity of the ledger constant / increasing, cost per transaction thanks to such evolution should continue to fall overtime, without sacrificing security, though the overall value of the network increases with use-case expansion. Similar to how oil gets refined into high-grade gasoline, or raw iron ore into alloys, layer-1 tokens via compression improvements and layer-2+ outsourcing should do more with less overtime while maintaining / granularizing security.
5. **The holy-grail search for price-inelastic end-user demand**: If economic value created via digital commodity value chain is so tremendous, then demand for such digital commodity should be robustly recurring and price-inelastic, thereby supportive for a high layer-1 token price (assuming the token mechanism is well-designed to be more like non-recyclable commodities). Additionally, while an expensive layer-1 should indeed prompt replacements, much like expensive gas prices prompt switch to EVs or people driving less, the higher prices making the network more secure is an interesting offset to the equation.
6. **Foundational question: is it better to invest in oil or petrochemical / industrial chain equities? Opinions may differ. My view is that a well-designed L1 offers returns matching industry growth, and big interim SoV premium surge could temporarily defeat its commodity demand and slow progress / adoption, depending on end-demand price inelasticty.**

Overview on #DeFi tokens covered

MLC Reveiwed Projects

USD in mm unless otherwise stated, datasource from Messari, Etherscan, Coingecko

Ticker	Name	Category	Last Price	Mkt Cap Est. Circ	Mkt Cap Est. Dilut	1-liner
MKR	Maker	Lend / Borrow	$482.30	435	435	Uninvestible until tokeneconmics change, hard to scale DAI
COMP	Compound	Lend / Borrow	$178.46	664	1,785	Supply schedule overhang + optionality priced too rich. Uninvestible today
LEND	Aave	Lend / Borrow	$0.15	194	194	Interesting - benefits from COMP mining and go imitate liquiditty mining
	Uniswap	AMM				Kingpin still with flaws, watch for upgrades & token
BNT	Bancor	AMM	$1.41	97	97	V2 upgrade enticing with staking for fee, inflation, and interset, solid setup
BAL	Balancer	AMM	$11.52	415	1,152	Similar to COMP comment, uninvestible today
CRV*	Curve	AMM	$0.35	350	1,061	Likely comes rich when-traded, monitor for biz-dev. Token burn solid
KNC	Kyber	Aggregator	$1.69	307	356	Potential post-Katalyst dip, solid execution and value-capture
ZRX	0X	Deriv / Aggregator	$0.39	270	387	Questionable capture, good infra, wait for hints of token reform
SNX	Synthetix	Derivative	$2.39	258	586	Best-in-class team, rich valuation but could be worth paying for optionality
UMA	UMA	Derivative	$2.13	111	213	Still searching for PMF / as questionable as REP. Liquidity mining catalyst
REN	Ren	Wrapping	$0.17	146	167	Solid value capture but further tweaks needed, cross-chain as catalyst
RUNE	Thorchain	Crosschain AMM	$0.48	81	239	VC project but good value-capture, herculean execution needed for it to work

- One could envision AMM + lend/borrow could merge – while token sits in liquidity pool it can be both lent out as well as traded.
- COMP, BAL, and CRV supply/demand balance likely highly unfavorable so tread carefully; with capital rotation amidst a hot sectors, one may favor pending or hypothesized catalyst plays such as LEND, BNT, and REN. ZRX & RUNE also but depends on willingness of team to change as well as herculean execution.
- One thing to note -- all token mechanics are subject to change. Even for governance tokens, whether the team honors governance functions is completely up to them. Governance -> value-capture jump generally a great catalyst such as KNC.
- One could expect Uniswap, Graph, and 1inch to launch their tokens for further incentives. L2 scaling tokens debate remains.

3 unanswered questions for #DeFi stakeholders

1. For the best risk-adjusted return, do you want to own the water-like commodity (ETH) that may turn oil-like but still has flaws, or do you want to own the “equity” of value chain that sits on top (COMP, MKR, SNX, LEND, KNC, etc), knowing that such value-chain is portable on any commodity?

2. Do the oil-like commodity and the adjacent value-chain have any value, if the use-case on the very top is still highly undefined? It would be similar to buying up parcels and building refiners before steam engines and automobiles are even invented.

3. In a world where projects are generous to issue equity / token to scale up while token-economics is still very much a work-in-progress, are you sure your pick in the value-chain won’t be disrupted?

#DeFi Lending & Borrowing - MKR & COMP un-investible until token-economics catalysts, LEND is the horse to back.

MakerDao ("MKR"): Repayment of Dai (usd) loan incurs a "stability fee' of X% (centrally determined), whereby such fee burns MKR + pays Dai deposited into MakerDao's own savings account (DSR). MKR can also be printed to cover liquidations. MKR is currently basically Compound / Aave where users can only lend limited collaterals and only borrow in its own USD stablecoin DAI, whereby the net rate is expressed in the "stability fee".

Compound ("COMP"): Only voting right for Compound protocol rule changes. Just issued the COMP token and inflation released to users based on assets supplied / borrowed.

Aave ("LEND"): 0.025% borrowing fee (0.09% flash loan fee), 20% goes to referral integrator, 80% goes to burn LEND. Fixed vs. floating rate a good touch. Flash loan platform exciting as optionality.

Personal take:

- Lending has some economies of scale but is not natural monopoly. Expect users to have 0 loyalty and rate-shop (just like real-world). Innovation likely to occur around preferred rates (rebate by protocol via staking native token), collaboration with AMM for liquidity provision + lending (higher rates), structured products packaged as tokens onto AMM (CLOs), etc.
- MKR as a gen-1 #DeFi token needs to rework its token-economy + add features (AMM a good step). Existence of DSR with centralized rate somewhat defeats purpose of having Dai circulating. Dai may never reach adoption, partially due to Tether + USDC's network effect and partially due to collateral pool limit + rates manipulation both being blunt instruments. I think token is un-investible until model is adjusted. Strong VC backing and centralized model could mean it moves very fast with more real-life / centralized assets as collateral.
- Compound's token-rebate to users coupled with minuscule current float leads to both artificially inflated diluted market cap + lend/borrow volume. Token bakes in optionality in value-capture like LEND / MKR. Betting on this big a project with Aave on its tail means likely underperformance especially given big valuation as-is + small float + continuous big emission. I think Aave is the horse to back here given (a) stark valuation difference, (b) flow from compound during this steroid period, (c) it will likely do something similar re: liquidity mining, and (c) the team is better at leveraging partners in ecosystem + delivering new features beyond cookie cutters. Venturing outside of normal cryptoassets exploring different collateral types.

Dharma, Nuo, Fulcrum, Lendf, etc omitted due to lack of token and/or lack of adoption.

Kava ("KAVA"): On the to-do list. Being not on ETH could mean it loses out on the action and lacks other projects / modules to interact with. Framework Ventures involvement could mean it's worth taking a flyer on / liquidity mining likely coming

#DeFi – Liquidity Pool (“LP”) / Automatic Market Maker (“AMM”) – BAL un-investible, CRV likely comes rich, BNT worth a punt.

Uniswap (no token): Set 2 tokens (50/50), set curve (ratio of exchange), taker pay 0.30% fee, can now act as oracle.

- Watch out for potential token launch and other biz dev incentives. Impermanent loss a real issue.

Bancor (“BNT”) v2: 1 token + BNT, any ratio, adjustable curves + chainlink, variable fee, lendable while deposited. BNT token to be staked as reserve token for the AMM and earn pro-rata trading fee + earn BNT inflation.

- Staking BNT to mine both inflation, fees, and interest could be highly enticing. Value-capture change with pending catalyst + lowest market cap amongst DeFi tokens today makes it a very good setup for long while cycle lasts. Rub is that Bancor team is outside of the typical DeFi mafia (SNX-BAL-CRV-REN), so may not be as hyped. A little slimy still w/ unclear metrics and total token supply.

Balancer (“BAL”): Multi-token (up to 8), any ratio, set curve, user #DeFined fee (0.0001%-10%). Just issued the BAL token and inflation released to users based on assets deposited for liquidity. Only voting right for Balancer rule changes.

- Similar to COMP, BAL is an option on future value-capture. Unicorn status with fully diluted market cap with a small float + heightened release schedule means un-investible only after crash or with pending catalyst for token- economics change. Lack of due process in oracle mechanism change highlights governance weakness.

Curve (“CRV”): 1 or many token but “in-kind” (i.e. USDC to DAI, WBTC to renBTC), taker pay 0.04% fee, set curve. CRV Token pending release with inflation released to users based on assets deposited for liquidity. Fees will be used to burn CRV.

- Value-capture from day 1 via burn + liquidity mining means CRV would likely come to market at a big valuation day 1 (our guess is >1 Bn fully diluted, or >$0.35 / token). Coupled with COMP and potentially Aave could pull DAI out of peg. Longevity of the project uncertain, if launched at big price it’s best mined and not purchased in market.

Personal take:

- All AMMs are fairly similar – users locking their tokens in smart contract and making them available for other users to trade / swap, often with mechanisms to calculate the slippage (emulating orderbook depth) and at various fees. Eventually they will all look like one another (CRV, BNT, and Uniswap as subset of Balancer), I also believe providing liquidity as AMM will eventually also be coupled with interest-earning protocols like what BNT is doing. Centralized exchange integration likely.
- Unlike lend/borrow, exchanges do have network effects as users congregate towards ones with lowest slippage / highest rebate. Liquidity currently remains siloed given intense competition w/ token inflation rebate, but expect niche winner longer-term (may not have emerged yet). Best to buy basket. BAL + CRV too rich. BNT worth a punt. Watch for Uniswap.

#DeFi – DEX Aggregator and Other – KNC better momentum and value-capture but short-term headwind, ZRX needs further reform.

Kyber ("KNC") post Katalyst: "Equity" for the hybrid liquidity aggregator

- *Token mechanics*: More of an aggregator with various sources, makers pay variable 0.25% fee (65% goes to KNC stakers, 30% goes to professional market makers within Kyber, 5% goes to KNC token burn).
- *Personal take:* Katalyst token-economics adjustment is a game-changer to KNC for value-capture. Staked KNC now earns rewards with a burn as additional demand buffer (if only they also get KNC inflation, if any). Economics of fee where makers pay (vs. typically where users pay) is interesting when coupled with the Kyber team integrating their product into every user-facing apps out there – users of Kyber will almost certainly still pay for the fee as maker fee is baked into spread while convenience factor could mean less price sensitivity. Biggest question longer term is whether the curated aggregator layer with market-making service attached (which is what Kyber is) that performs bespoke integration with various applications will beat pure-aggregators (like 1inch) that only deal with DEXs, while market-makers sit on the DEX sizde and don't need interaction with the Kyber middleman. My hunch is a higher-touch KNC model has its place before industry matures, but upon more sophisticate freeware will emerge that makes it easy for app layer to cut out Kyber; Kyber could, however, continue to provide additional service beyond just liquidity aggregation but there's risk also.
- Could see short-term pressure as catalyst played out. Think it's interesting enough a model for eventual allocation.

0x ("ZRX"):

- *Token mechanics*: Only voting right for 0x upgrades (ZEIP)
- *Personal take:* 0x is a gen-1 attempt at helping the ETH ecosystem trade with one another (before all the #DeFi innovation mentioned in this deck. The code that the 0x team shipped is very much a public good that accrues no value to the token at the moment – with attempts like ZEIP-21 that introduces fee to ZRX stakers (who are also market-makers). Nonetheless the project is very much still at an exploration phase when it comes to token-economics. The recent matcha product launch is a very good step to funnel more volume into the protocol – but ultimately ZRX would be in direct competition for market-makers (vs. Kyber), pure aggregators (1inch), and basic DEXs (Uniswap +) – which offers deeper integration, lower fee / better routing, and/or direct access. With valuation similar to KNC now and value-capture post Katalyst minuscule anyways, could see allocation to ZRX, but one may be best served to wait until a more token-holder friendly proposal to serve as a catalyst for rerating.

1inch (No token yet): an aggregator to watch out for. Could be raising and another competitor to KNC and ZRX.

IDEX ("IDEX") – Dislike order-book DEX that requires KYC. Unless team revamps mechanism, IDEX is un-investible.

Loopring ("LRC"), Switcheo ("SWTH"), Airswap ("AST") - on to-do list

#DeFi – Derivative DEX – SNX best-in-class execution may warrant rich valuation, UMA still seeking PMF and awaits catalyst

Synthetix ("SNX") – "Pooled equity" for trading desk that tracks PnL via price-feeds

- *Token mechanics*: Token acting as equity of the "synthetic trading desk" balance sheet –protocol uses oracle to receive outside price feeds, whereby users' profits / loss would be pooled SNX token stakers' losses / profit – so SNX stakers would need to hedge if want to remain neutral. System inflation act as incentive to encourage staking + trading. Paid trading commissions + inflation goes to SNX stakers via dividend.
- *Personal take:* "Pooled trading desk" design elegant. In the future other collateral types (ETH and wrapped BTC mostly) would be added, allowing another "lending / borrowing" venue and adds fees. The ring fence allows for added modules like asset manager pools which adds more fees to SNX stakers. Levered futures + binary options good addition. Un-hedgable risk is just something users have to stomach, and I think L2 can't come soon enough as high gas fees basically kills all actions on the platform. Network effect questionable longer-term but maybe once user side of liquidity gets large enough, the offsetting trades make pool easier to hedge. Needs tremendous amount of distribution into end-channels. Risk is oracle blowing up, Kain gets tired, SEC comes and destroys them, and/or users simply don't care about making 100 bps on say USDAUD. Rich valuation but likely the best team in the space – and good execution introduces all types of upside optionality.

UMA ("UMA") + Augur ("REP") – "CapEx" for oracles / reporters

- *Token mechanics*: Bundled together because the token-economics are rather similar – users make OTC bets on UMA / Augur, and when it comes to result settlement, the UMA / REP holders are called by the users (at a fee) to "verify" the result – holders stake their UMA / REP tokens, submit their result / vote, and receive commission from users if close to the consensus vote.
- *Personal take:* Both platforms could be too ahead of its time. Tokens are more like manual oracle nodes. The ultimate problem to these platforms is that it may not scale / nobody cares – long-tail, highly idiosyncratic bets will have trouble finding counterparties (high-volume, high prominence bets can just be done via the likes of SNX), and even if counterparties are found, (a) token being centralized can't ascertain integrity of poll result (these are VC chains) and (b) the verification submission is highly manual, which means it may not scale. Projects as such are best done via platforms with significant existing user buy-in (like Facebook) than green-field upstarts – and the former would crush the latter immediately. Valuation bakes in significant optionality already (platforms have anemic volume) and tokens could be worthless longer term. Key question is whether the liquidity mining is helping. UMA's Placeholder + Dragonfly + Coinbase investor base means it will get listed.

Futureswap ("FST"), Deversifi ("NEC"), DyDx (no token) - On the to-do list

#DeFi – Cross-chain DEX / Wrapped token – REN subject to optionality w/ mining & cross-chain enabled. RUNE a VC bet.

Ren ("REN") – "CapEx" for wrapping tokens on ETH

- *Token mechanics*: REN as collateral is needed to earn the right as a "darknode" to process transactions. The protocol acts as a custodian for input tokens (BTC, BCH, ZEC only today), and issue 1:1 certificates (much like a gold vault) on ETH redeemable for the input token. Mint & burn fee of ~0.1% from input token to certificate is paid out pro-rata to REN darknodes.
- *Personal take:* renBTC pool is confined by market cap of REN (REN / 3 > renBTC minted, maxed out at ~5k with ~140 mm market cap, ~1.3k supplied today). With wBTC at ~8k+ already the outcome could be like Tether vs. Dai whereby a more centralized version of wrapped BTC wins out (although BitGo is likely more constrained than Tether, can't just issue with air). Team must do whatever it takes to (a) increase swapping velocity and (b) increase penetration of renBTC across ecosystem. Arb demand + yield via lending & liquidity pool + faster transaction speed on ETH could prompt further adoption. Biggest concern is there is enough fee to cover darknode costs longer-term, so the team needs to rework the token-economics further to introduce capital efficiency without sacrificing security. It's part of the mafia (SNX-BAL-CRV-REN), so expect further incentive to continue to drive the token. Could see further value-capture catalysts and more announcements when cross-chains are enabled.

Thorchain ("RUNE") – "CapEx" for Crosschain Uniswap

- *Token mechanics*: RUNE as collateral needed to (a) earn the right as a nodes to process transactions and (b) provide liquidity. The hope is to be able to swap tokens in different chains (like BTC for ETH). For every $1 of swappable token in the network, protocol dictates at least $3 of staked RUNE is needed. Paid trading commissions + inflation goes to SNX stakers via dividend.
- *Personal take:* If successful, could be the first 1-touch non-custodial swap of tokens across different chains. Could embed Tornado Cash type functions + introduce delayed / scheduled transfer. May compete with REN in instances like (ETH – renBTC – BTC vs. ETH – BTC), and at the same time renBTC / BTC swap on Thorchain would be interesting when launched (could be cheaper to circumvent 0.1% renBTC burn fee). Very likely to initialize with strong token incentive to induce trading & providing liquidity upfront. 3:1 collateral vs. token ratio like REN also constrains liquidity pool size. Had delays in the past and no live products yet – 50 mm float + ~150-200 mm fully diluted market cap not cheap for pre-product anon team. Could pump hard assuming successful launch (thanks to incentives & lock-up), but heightened risk on delays / bugs / non-delivery. Complex system also that needs to account for attack vectors in different chain block time and fees needed for transactions. This one is a one-way bet on the successful execution and could be subject to significant downside risk if botched; wide-span of outcomes.

Keep Network (KEEP) - On the to-do list for its tBTC product

General Thoughts on #DeFi value-capture and token capital allocation: better features could (should) emerge

The value-capture / token-economics build-out in the space remains rudimentary in the eyes of traditional finance practitioners, and we expect further experimentations on the following:

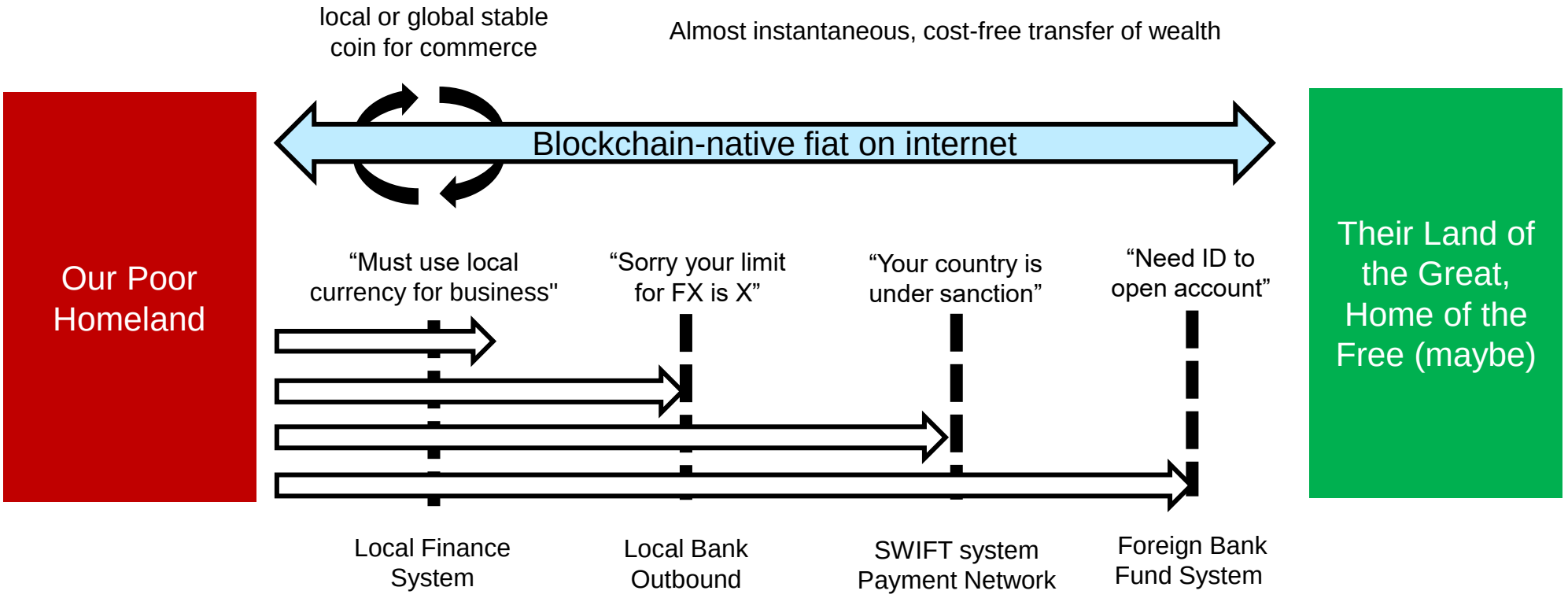
- **Thoughtful formula on issuance / buyback / dividend relationships**: as any capital markets good allocator would know, issuing stock when they are overvalued, buying back stock when undervalued, and sending out dividend when internal IRR no longer meets hurdle rates are the 3 most important decisions a CEO should get right. As of today, the issuance / buyback / dividend mechanism in the space remains highly dogmatic and fixed. Protocols should explore formulas to dynamically balance: (a) accelerate inflation when token is expensive vs. protocol status, or partitioned / tailored to milestones (b) buy back when token is very cheap vs. protocol status, and (c) issue dividend in lieu of buyback when token is in between extremes.

- **Not all token-holders are created equal, so discriminate accordingly**: Token as a bonding mechanism for all stakeholders should therefore discriminate between heavy users / participants vs. passive holders / short-term speculators. Not enough thoughtfulness / experiments had gone into designing mechanisms to increase life-time-value to protocol yet. A few ideas include holding-period dependent value-return, preferred status for redemption given holding periods and participation, or punishment upon inaction.

- **Long-term minded programs should be very thoughtful on issuance**: Equity is a very expensive form of financing as the existing owner effectively forgoes slices of future profit. Similarly, blowing your token issuance load early and carelessly means less room for maneuvering future changes (or risk losing credibility and therefor tanks token price) and risk a late comer eclipsing you with a more aggressive and/or thoughtful design.

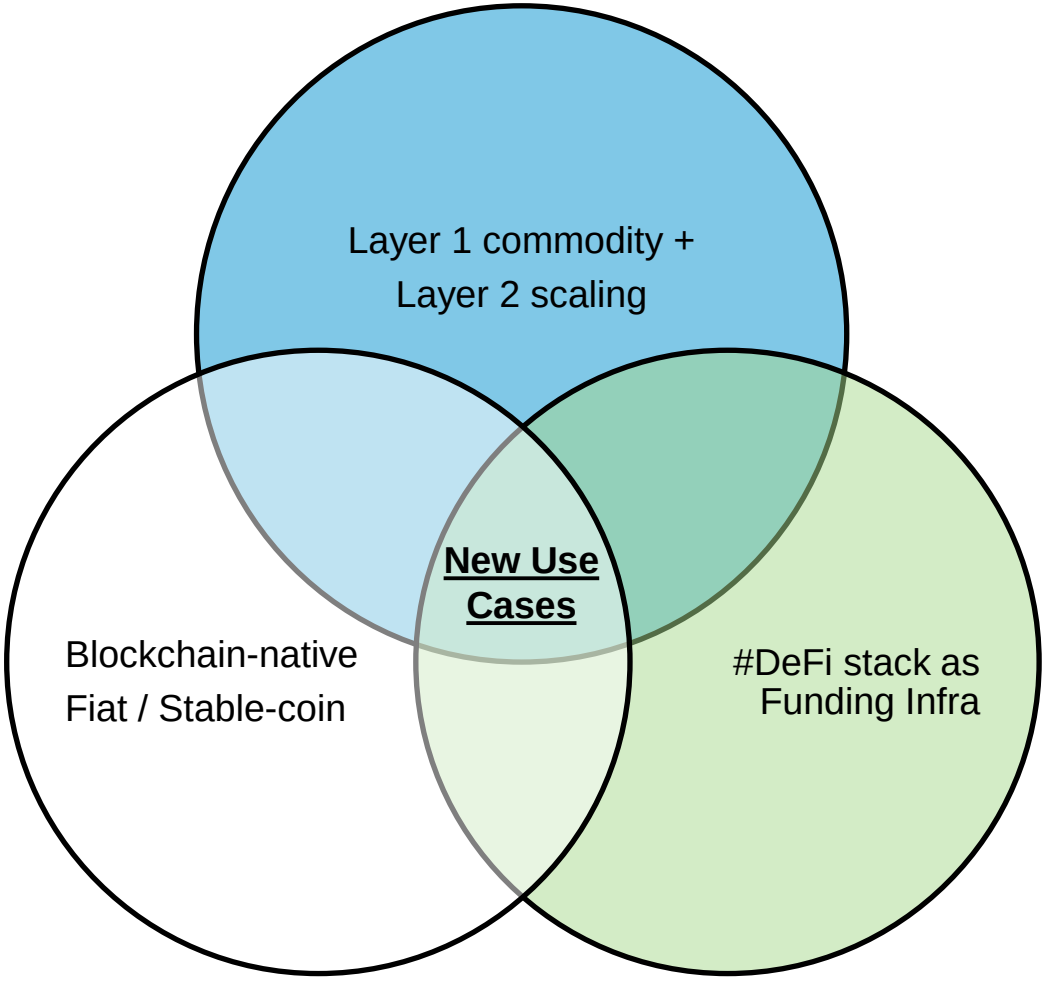
Breakthrough of Blockchain-native fiat (USDT, USDC, Dai, DCEP, Libra, etc) could spell trouble to sovereignty of most non tier-1 nations, similar to colonization of 17-19th centuries.

#DeFi



- USD / RMB stable-coin is a gamechanger invention of sending fiat via layer 1 digital commodity or controlled nodes, all via the existing internet infrastructure.
- Via B2C apps (Facebook, Wechat, etc), any nation's local citizens may now have access and transact in currencies not native to their country. The more "responsible" currency should win eventually. **The winning country effectively "colonizes" the loser country – as such market share gain retards the losing country's ability to tax outright and/or inflation, thereby taking away that government's power.**
- Stablecoin is a gateway drug to the likes of BTC, but the first order impact is likely to increase USD/EUR/JPY/CNY dominance – and any tier 2-4 countries would "hyper-dollarize" first.

The lollapalooza effect: the combo of digital commodity powering blockchain-native fiat with the help of #DeFi infrastructure should give rise to <u>useful</u> digital native commerce beyond speculation.



Lollapalooza Effect, noun: multiple factors are acting together in ways that are feeding back on each other. Lollapalooza effect is an outcome which is far bigger than the sum of the parts.

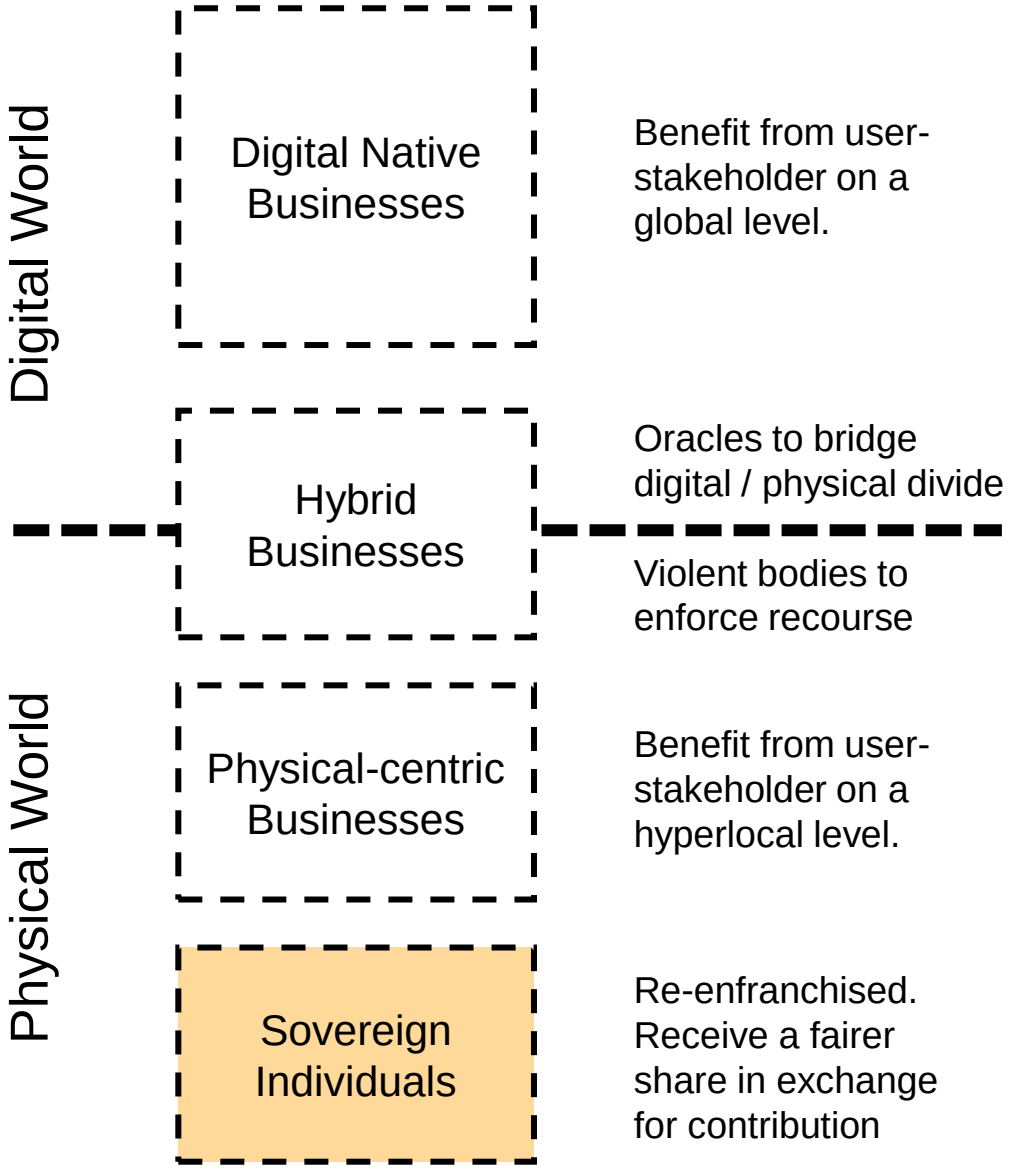
MLC believes that the combination of:

- Blockchain-native USD/EUR/JPY/RMB as medium of exchange,
- Layer 1 + Layer 2 as digital commodity that powers permissionless applications,
- #DeFi infrastructure as “finance stack” to offer various types of financial services

… will collectively foster real commerce and enable new use cases otherwise cost-prohibitive and even impossible today. While the only visible use-case today is degenerate leverage + gambling, one may remain hopeful on what digital-native commerce can emerge from this experimentation

3 predictions for the “perfect” future … if this works

#DeFi



1. Every line-item of the financial statements can be repackaged and sold / owned by anyone.

2. Sovereign / nation-state definition will evolve. New violent agents arise. All of which offer their violence-as-a-service for “tax” dollars.

3. Everyone can now be a stakeholder on both a hyperlocal and global level – a user-equity-owner for a local coffee shop’s bond tranche payable in coffee and a game / movie royalty due to participation will co-exist in self or 3rd party custodied wallet.

Risk Summary / Real Talk

Is liquidity mining the new paradigm?

- When you give gamblers equity of the casino, don't be surprised they gamble more and bring their friends, all the meantime your casino sees gangbuster revenue. When every casino in town does it, you will eventually run out of gamblers.

Isn't this a Ponzi and a bubble?

- What's good with beer without foam? Also when people are drunk they are often more innovative to an extent anyways. Capital and vision attract talents, talents give it many shots on goal, most fail, and the few that succeeds create the future we live in. If a vision can't incite bubbles, is it even a worthwhile, investible vision to begin with? Equity was 1st invented by the Brits to fund pirates for bounty sharing. It is going to take multiple cycle of iterations, and the hope is what emerges becomes fair but incentivizing that can actually fund real business operations / create value.

What could pop the bubble?

- Ban hammer from SEC, etc. These are all pseudo-securities, always keep that in mind.
- High layer-1 fees prices out users which will eventually drive metric decline.
- When #DeFi market cap as a whole require too much capital to sustain, and the capital drain from existing ecosystem + outside funding finally come under this equilibrium point.
- #DeFi code is complicated, there could be systemic risk in both code and leverage prone to liquidation at various prices, glitches / mistakes, and hacks. A big one is enough to kill it.

What are some longer-term risks to be mindful of?

- Premature tokenization and profit / fee-sharing could hamstrung a project's ability to be flexible.
- The winners today may very well not be the winners of the future. It took >20 tries to get a Google.
- A real risk is no commerce of value may come of this. If so, the whole stack would be worthless.