Uniswap v3 Guide

BuildrWealth

Uniswap is the 2nd **largest decentralized exchange** that runs on an Automated Market Maker system. An AMM uses a complex algorithm to allow trades to be executed as opposed to having an order book.

Uniswap v3 allows investors to provide concentrated liquidity. Concentrated liquidity allows users to specify a range for their liquidity thus allowing their capital to be used more efficiently.

- **Normal Liquidity:** 0 → ∞ (every pair)
- **Concentrated Liquidity:** 1,000 → 2,000 (example)

It isn’t logical to provide liquidity for **USDT/USDC** at a 0 → ∞ (USDC per USDT) range because both of these assets are stablecoins. With concentrated liquidity, you could provide liquidity at a 0.995 → 1.005 (USDC per USDT) and earn a **much greater yield**. The same scenario applies to blue-chip assets like **ETH/USDC**.

Now let's talk about what ends up killing most pools, **impermanent loss**. Impermanent loss happens when the price of your deposited assets changes. Impermanent loss only becomes **permanent loss** when you exit your position.

In concentrated liquidity pools, your assets are **shifted into each other**. As the price starts to approach the upper end of your range, assets will be shifted into the **higher-value asset**. As the price starts to approach the lower end of your range, assets will be shifted into the **lower-value asset**.

- Say we’re in an **ETH/USDC** pool with a range of 1,000 → 2,000 (USDC per ETH).
- As ETH approaches $2,000, ETH will be shifted into USDC.
    - When at $2,000, **USDC** will make up for **100%** of assets in the pool.
- As ETH approaches $1,000, USDC will be shifted into ETH.
    - When at $1,000, **ETH** will make up for **100%** of assets in the pool.

Impermanent loss occurs when one asset is shifted into the **other asset**. Assume we invest **$10,000** in an **ETH/USDC** with a range of 1,000 → 2,000 (USDC per ETH) while the current price is 1,500. We would put up **3.33 ETH** (worth $5,000) and **5,000 USDC** (worth $5,000).

- When the price of **ETH** is at $2,000 we will have **10,660 USDC** (worth $10,660).
    - If we were **holding** our initial ETH and USDC we would have $11,660. We have **less capital** than if we were to just hold our initial assets.
- When the price of **ETH** is at $1,000 we will have **7.5 ETH** (worth $7,500).
    - If we were just **holding** our initial ETH and USDC we would have $8,330. We have **less capital** than if we were to just hold our initial assets.

In an **ideal situation**, the fees earned will **outweigh** the impermanent loss.

- Imagine the pool yielded **50% in 6 months** (100% annually) with equal amounts in ETH & USDC. We would have $5,000 in fees earned thus outweighing impermanent loss and negative price action for ETH.

The higher the liquidity the better, but at the same time the volume needs to **outweigh the liquidity**. What this means is that we want to look for pools that have a higher **7-day volume** (blue-chip pairs) or **24-hour volume** (volatile pairs) than total liquidity.

- Super-blue-chip pairs such as **ETH/USDC**, **WBTC/USDC**, & **MATIC/USDC** usually have a higher **24-hour volume** than overall liquidity.
  - Example: $200m in liquidity & $1b in 24-hour volume.
- Other normal-blue-chip pairs such as **ETH/UNI** & **ETH/LINK** usually have a higher **7-day volume** than overall liquidity.
  - Example: $30m in liquidity & $50m in 7-day volume.

In exotic pairs like **SHIB/ETH**, **LDO/ETH**, & **GRT/ETH** it's important that the 24-hour volume exceeds the overall liquidity. You're taking on **more risks** so you want to make sure you get **paid more**.

To actually find pools I usually use the **Uniswap Info** page and search for assets that I'm bullish on.

After I've located the asset, I'll look at the different pairs for that specific asset. This could include **CRYPTO/STABLECOIN** pairs or **CRYPTO/CRYPTO** pairs.

I then use **basic technical analysis** (support & resistance or supply & demand) to find ranges for each pair and simulate the position on a tool called **DeFi-Lab**.

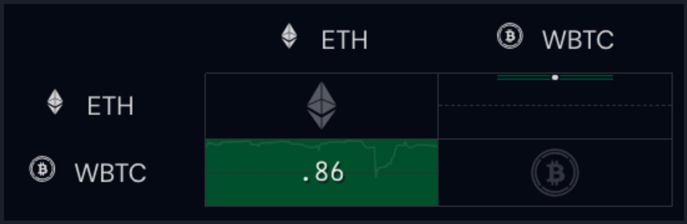
The **tighter** your range is & the **more volatile** the underlying assets are, the more you will have to rebalance your pool. Rebalancing **finalizes impermanent loss** and costs gas fees meaning some of your yield is eaten up.

In pools like **ETH/UNI**, **ETH/MATIC**, or **ETH/USDC** it's important to play the long game and have a broader range. You won't have nearly as much impermanent loss and won't have to **rebalance** nearly as often.

Now, what makes a range broad or tight? The below examples assume an increase from bottom to top (1,000 → 1,400 is a 40% range).

- **Tight:** less than 10%
- **Semi-tight:** 10-25%
- **Semi-broad:** 25-40%
- **Broad:** more than 40%

With that being said it's also important to look at the correlation between the underlying assets. I like to use the CryptoWatch correlation tool.



If the assets are **highly correlated** (anything above 0.8) I'll usually use a **semi-tight range**. If the assets are **semi-correlated** (0.6 to 0.8) I'll usually use a **semi-broad range**. If I'm planning on investing in a **CRYPTO/STABLECOIN** pool I'll usually use a broad range.

- For pairs like **ETH/USDC** & **MATIC/USDT**, I'll usually use a broad range.
- This allows me to have **upside potential** on the underlying crypto without incurring too much impermanent loss.

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My goal with **CRYPTO/CRYPTO** pools is to keep them as close to 50% of each asset as possible. Meaning if I initially put up 50% of each asset, and it moves to 40% of one asset over the course of **1 month** and idles there I will usually exit the pool, and re-enter with a new range that allows me to stay 50/50. But let's say it briefly shifts to 40% of one asset for **a week or two**. Then I'll usually just let it play out until it goes back near 50/50.

With that being said my goal in **CRYPTO/STABLECOIN** pools is a little bit different, ideally, to secure the most gains you want to enter near the **local bottom** price of the crypto asset. This means you would end up putting up 80% in CRYPTO and the other 20% in STABLECOIN. As the price approaches 50/50 and idles there I would rebalance my pool back to 80/20. The reason why is as the price approaches the upper end of the range, we have less exposure to CRYPTO, meaning that we don't make as much money from the price of CRYPTO going up.

That wraps up the **complete Uniswap v3 guide**. Obviously, there is a lot more to learn, but most of that comes with experience and actually having your foot in the door.

If you want our team to walk you through **step-by-step** how we make over **$10,000/month** from DeFi Passive Income, book a call with our experts today.

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