Introduction

Since the genesis of dYdX Chain on October 26, 2023, dYdX Chain has generated $232B in trading volume and distributed $39M in USDC to dYdX Chain validators and stakers.

On August 12, 2024, dYdX Trading announced the dYdX Unlimited software featuring significant improvements to the dYdX Chain open-source software, such as permissionless market listings, MegaVault, the potential for revenue sharing, and an Affiliate Program, among other things.

Despite product achievements, the DYDX token has been facing challenges due to high inflation and a significant amount of token unlocks. We believe that dYdX Unlimited presents a unique opportunity to optimize dYdX Chain and DYDX tokenomics for the protocol's long-term viability and success. Our proposals aim to (1) improve liquidity on dYdX Chain markets, (2) increase the attractiveness of the DYDX token, and (3) encourage holding and staking DYDX, all with a view to increasing the security of the dYdX Chain and driving sustainable growth in the dYdX ecosystem.

To achieve this goal, we recommend implementing revenue sharing, enhancing DYDX token utility, and reducing DYDX emissions, all while supporting the immediate growth requirements of the dYdX Chain. Implementing these changes will significantly enhance dYdX's competitiveness and reduce DYDX inflation. This will turn the DYDX token into a more robust asset, therefore benefiting the overall security and resiliency of the network.

We published our Analysis and Proposals on dYdX Chain and DYDX Tokenomics on the dYdX Forum on 22nd October 2024 which has garnered constructive participation and discussions.

Our extensive analysis of the proposal can be found in our research report.

Based on the community's feedback, we are splitting up the proposals based on subject matter. The four separate proposals (and threads) are as follows:

1. Reduce the Trading Rewards "C" constant from 0.90 to 0.5.

2. Protocol Revenue Distribution:

a. 50% of all protocol revenue routed to the MegaVault.

b. 10% of all protocol revenue routed to the Treasury subDAO.

c. Recommendation that above an $80M level of annual protocol revenue, the Treasury subDAO could consider a Buy & Stake program.

1. Reduce the active set from 60 to 30 validators.

2. Cease support for the wethDYDX Smart Contract (i.e., the Bridge) on the dYdX Chain side.

Summary of Recommendations

1. Protocol Revenue Distribution:

a. 50% of all protocol revenue routed to the MegaVault.

b. 10% of all protocol revenue routed to the Treasury subDAO.

c. Recommendation that above an $80M level of annual protocol revenue, the Treasury subDAO could consider a Buy & Stake program.

Protocol Revenue Distribution

a. 50% of all protocol revenue routed to the MegaVault.

We propose routing 50% of the dYdX Chain's protocol revenue to MegaVault upon its launch. This initial investment aims to enhance dYdX's competitiveness against protocols like Hyperliquid.

Liquidity is essential for a perpetuals DEX like dYdX, because it ensures efficient price discovery, minimizes slippage, and stabilizes markets, all of which contribute to a better trading experience.

We are proposing to route 50% of protocol revenue to the MegaVault because liquidity is a fundamental component of dYdX's competitive advantage, and the TVL of the MegaVault should be as high as possible, while also balancing returns to stakers in exchange for the provision of network security.

We acknowledge that this is a significant amount of protocol revenue, however, as a decentralized perpetuals exchange, the dYdX Chain protocol and the community should aim to maximize liquidity on dYdX.

Note, we acknowledge the importance of providing a minimum return to validators and stakers to ensure network security and discuss this in greater detail in our research report.

b. 10% of all protocol revenue routed to the Treasury subDAO.

We are proposing that 10% of all dYdX Chain's protocol revenue be directed to the dYdX Treasury subDAO.

Currently, all dYdX DAO initiatives are funded with DYDX from the Community Treasury, requiring participants to sell DYDX for operational expenses. This increases inflation and selling pressure from token emissions. A well-funded Treasury subDAO could directly fund dYdX initiatives, reducing inflation and alleviating selling pressure

The dYdX community recently voted in favour of Karpatkey's proposal to launch a Treasury subDAO. With dYdX Unlimited introducing a revenue-sharing feature, we propose directing 10% of all dYdX Chain's protocol revenue to the Treasury subDAO. This revenue, predominantly in USDC, will complement staking rewards from approximately 40 million DYDX staked by the Treasury subDAO.

c. Treasury subDAO could consider a Buy & Stake program above an $80M level of annual protocol revenue

We propose using excess USDC from the Treasury subDAO's revenue share to purchase DYDX tokens for a Buy & Stake program when annual protocol fees exceed $80 million.

The dYdX ecosystem currently lacks a "buy and stake" mechanism to align token holders with platform growth and enhance market perception. At a $80M fee level, the treasury subDAO would receive $8 million from a 10% revenue share and earn approximately $3.2 million in staking revenue with 40 million DYDX tokens staked, totaling $11.8 million in projected annual revenue.

We have conducted a thorough analysis of these proposals. For more details, please refer to ourresearch report.

FAQ:

Analysis and Proposals on dYdX Chain and DYDX Tokenomics

Allocating half of the protocol's revenue to MegaVault seems excessive at this point. The feature isn't battle-tested and seems to be unprofitable at the moment. There is, without a doubt, benefits to having deeper liquidity but I find it hard to justify allocating 50% of the protocol's revenue to it from the get-go. This should start at a much lower percentage and increase it accordingly, not the other way around.

Analysis and Proposals on dYdX Chain and DYDX Tokenomics

1. Megavault 50% Revenue Share

dYdX is aiming to become the largest exchange in crypto. To achieve this, the dYdX community needs to have a long-term outlook and focus. dYdX needs to remain competitive against competitors, especially centralized exchanges. The DEX landscape is highly competitive, and rivals are constantly innovating with new products. This means dYdX needs to invest heavily in launching new initiatives like MegaVault. To drive long-term growth and increase adoption and protocol activity (which would translate into multiple other benefits, including staking yields), dYdX should focus on boosting liquidity for dYdX Chain markets, especially those new markets that the community will decide to create once permissionless markets are live with the deployment of dYdX Unlimited. As such, we recommended that 50% of protocol revenue beis directed to the MegaVault, at least initially, to ensure that MegaVault depositors are sufficiently incentivised to provide capital that can enable the vault to achieve its ultimate goal of bringing unparalleled liquidity to all dYdX markets.

dYdX MegaVault is not live yet and existing vaults are not representative of the MegaVault strategy performance. Based on the blog from dYdX Trading, an operator will be in charge of the MegaVault strategy, managing allocations to market-specific sub-vaults, adjusting parameters, monitoring and managing risk while it transitions to a more automated product. dYdX will potentially have hundreds of markets once Permissionless Market Listing is enabled with the Unlimited upgrade.

Analysis and Proposals on dYdX Chain and DYDX Tokenomics

Analysis and Proposals on dYdX Chain and DYDX Tokenomics

I believe the proposal addresses key issues like liquidity and inflation well. Routing 50% of revenue to MegaVault can boost liquidity and competitiveness, while 10% to the Treasury subDAO secures operational funding without increasing token emissions. Adjusting staking rewards should help stabilize DYDX's price.

However, I'm concerned that committing too much to MegaVault might be inefficient early on.

MegaVault is a core component of dYdX Unlimited and aims to improve liquidity on dYdX Chain's long-tail markets. It is important to support and bootstrap the product which depends on the TVL it attracts.

MegaVault TVL is paramount for the success of dYdX Unlimited and dYdX Chain in general as it will increase liquidity, especially on long-tail assets.

Looking at a 24-hour period on the 25th of October we can quickly observe how dYdX volume/liquidity ratio per token reduces its performance as we move down from highly liquid assets to less liquid assets on the platform.

dYdX fares very well compared to Binance in majors and very liquid altcoins like PEPE or SEI. Liquidity is significantly worse on long-tail markets like POPCAT or STX for instance.

dYdX ratio

Binance ratio

PEPE

4.72

3.56

SEI

2.89

6.95

APE

7.62

12.04

POPCAT

0.22

4.02

STX

0.12

4.51

Source: Chaos Labs and https://coinmarketcap.com/

Over the same period the liquidity available for POPCAT was no more than $3k with a 100bps slippage on small orders and no liquidity for large orders.

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Source: Chaos Labs

The same token was doing $300M and $14M volume respectively for Binance and Hyperliquid, with Hyperliquid offering 2bps slippage for orders larger than $100k.

We propose to allocate 50% of the protocol's revenue towards MegaVault to quickly attract TVL to Megavault. We acknowledge that the 50% revenue share will have an impact on the staking APR, but we view this as a key investment for the long-term success of dYdX. Also, the revenue share should be reassessed a few months after launch once statistics around its performance are available. It is important to note that the dYdX community may increase or decrease the 50% Megavault revenue share at any time via a governance proposal.

Analysis and Proposals on dYdX Chain and DYDX Tokenomics

I think if we want to incentivize liquidity, we need a hybrid model

. For example, a user could become an LP in the MegaVault if they lock a certain amount of dydx tokens for a period of time

. The longer the lock, the higher the percentage

they might earn on their capital and/or have higher available limits as an LP

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We appreciate all the interesting suggestions around providing liquidity to the MegaVault. The current design of the MegaVault as mentioned in the Deep Dive: MegaVault blog post only accepts USDC. This makes it infeasible to implement suggestions around locking DYDX token, in the short term due to software design limitations, placing the idea beyond the scope of the current proposal.

We encourage the community to have further discussions around MegaVault's design which can be evaluated by the community and the dYdX team as potential upgrades to the software for the future.

Analysis and Proposals on dYdX Chain and DYDX Tokenomics

My concern is that if we allocate around 60% of staking rewards to the MegaVault and the Treasury subDAO, the staking yield would drop from

around 12% to 4.8% (assuming other factors remain the same). Why would these new conditions make buying and staking DYDX more appealing than the current setup?

Analysis and Proposals on dYdX Chain and DYDX Tokenomics

1. Inflation, Staking Yield Reduction and Token Benefits

Our report refers to the inflation of the liquid circulating supply. Our reference to inflation includes DYDX token unlocks, DYDX that is transferred out of the community treasury for DAO operational expenses and growth campaigns, and DYDX distributed as trading rewards. It is important to clarify that inflation does not refer to staking rewards on the dYdX Chain in our report (given that staking rewards are denominated in USDC and derived entirely from protocol fees). The increase in circulating supply from the various initiatives listed above under inflation creates significant selling pressure for the DYDX token.

Relying too much on token emissions can dilute token holders. While stakers have earned 12.5% staking APR since November 2023, their net worth has eroded by 52% due to the token's performance. The initiatives proposed in our report aim to increase DYDX token's attractiveness and competitiveness by reducing circulating supply inflation, and increasing its utility, all while supporting the growth requirements of the dYdX Chain.

We acknowledge that while the APR for staking DYDX tokens may decrease soon, we believe it will remain competitive in the long term. We do not anticipate any risks to protocol security. Currently, the total value locked (TVL) on the dYdX Chain stands at $184M in USDC, with 237M DYDX tokens staked to validators. Assuming a token price of $1, the dollar value of staked DYDX still exceeds the TVL in USDC. Although changes in DYDX token price or an increase in TVL could occur, it would be extremely difficult—if not impossible—to acquire and stake enough DYDX to pose a threat to the network. Additionally, we expect the Treasury subDAO to stake approximately 40M DYDX in the near future, helping to offset any potential unstaking due to reduced APRs.

If we take into account growth incentives, the protocol is distributing more than its net revenue to stakers, which is not sustainable in the long term. This has been highlighted by Stakehouse Financial in their Treasury SubDAO proposal. Under our proposal, the protocol revenue would be rebalanced and stakers would capture a significant portion of the revenue, adjusted for growth expenses.