ASSET MANAGEMENT

Digital Pulse Report: Ethereum Staking Dynamics

22 June 2023

Coinbase Asset Management

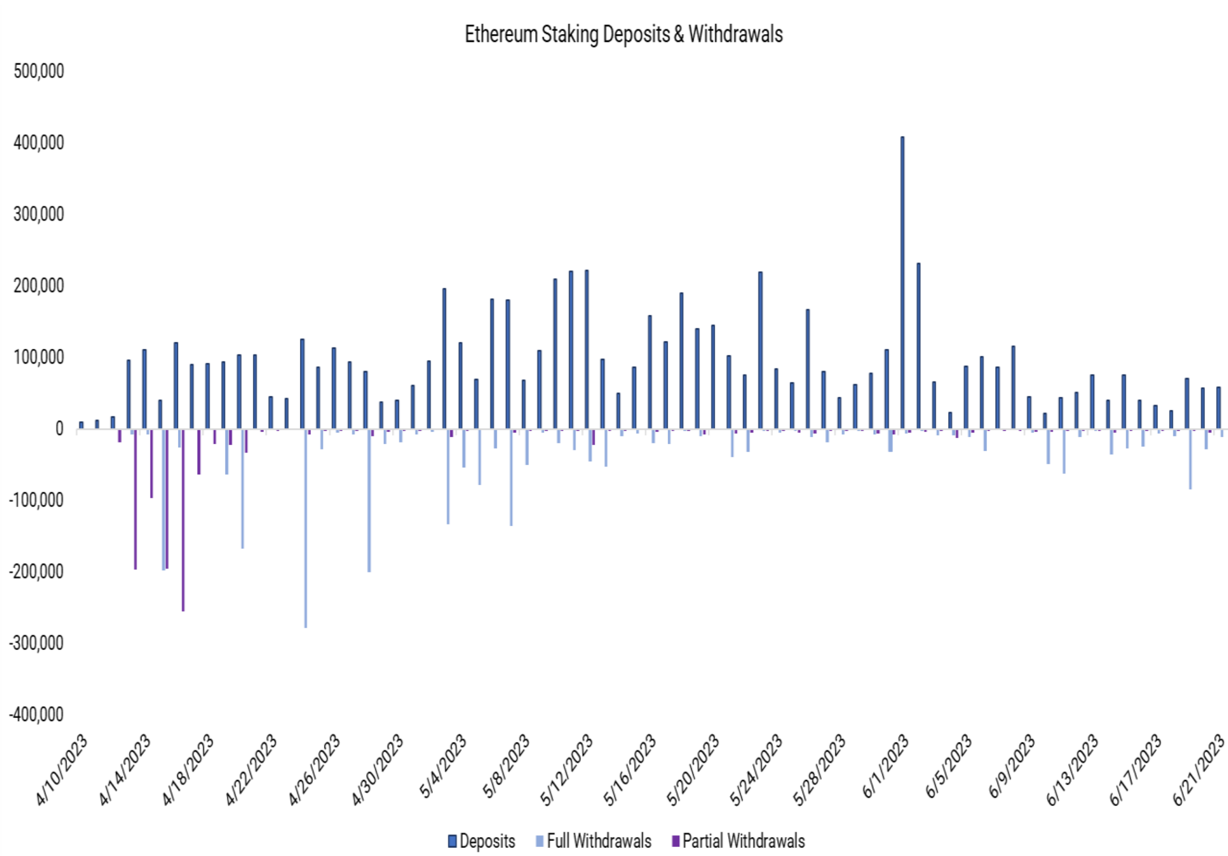
Ethereum Staking Dynamics: Our Digital Pulse for Ethereum remains strong, supported by a vibrant staking ecosystem. Supply-demand dynamics are the focus as Liquid Staking Tokens (LSTs) deliver a simple investor onramp to staking ETH. April's Shapella upgrade of the Ethereum network enabled withdrawals of the requisite 32 ETH staked as principal by each validator, as well as a rolling distribution of ETH-denominated staking rewards. Staked ETH is now liquid, so why do LSTs remain? Users gravitate towards a path of least resistance. LSTs, like centralized exchanges, provide easy access to Ethereum staking and remove requirements for both a minimum allocation of ETH as well as the technical knowledge required to undertake the process. Instead, users of LSTs entrust these tasks to validator pools. In an era of regulatory pressure on centralized exchanges, the dominance of liquid staking has accelerated, surging to 40% of staking inflows since the Shapella upgrade. Along with popularity comes a risk of centralization as the majority of ETH is staked in a few pools or with a limited set of service providers. To improve the efficiency of direct staking and to balance competitive pressures with staking sovereignty, core Ethereum developers have proposed an increase in the maximum ETH principal per validator from 32 to 2048. It would be a material change, with the expectation of reducing the number of validators and large staking service providers run by up to 64x. Nevertheless, the allure of LSTs may remain strong because of the semblance of immediate liquidity. It emphasizes the market preference for instant gratification. This is the dance between supply, demand, and liquidity.

WEEKLY BEATS

1. Chart of the Week – Ethereum Staking Demand
2. Fundamental Pulse – Neutral
3. Liquid Staking Dominance
4. Staking and DeFi Merge
5. ETH Staking - Growth, Potential & Risks

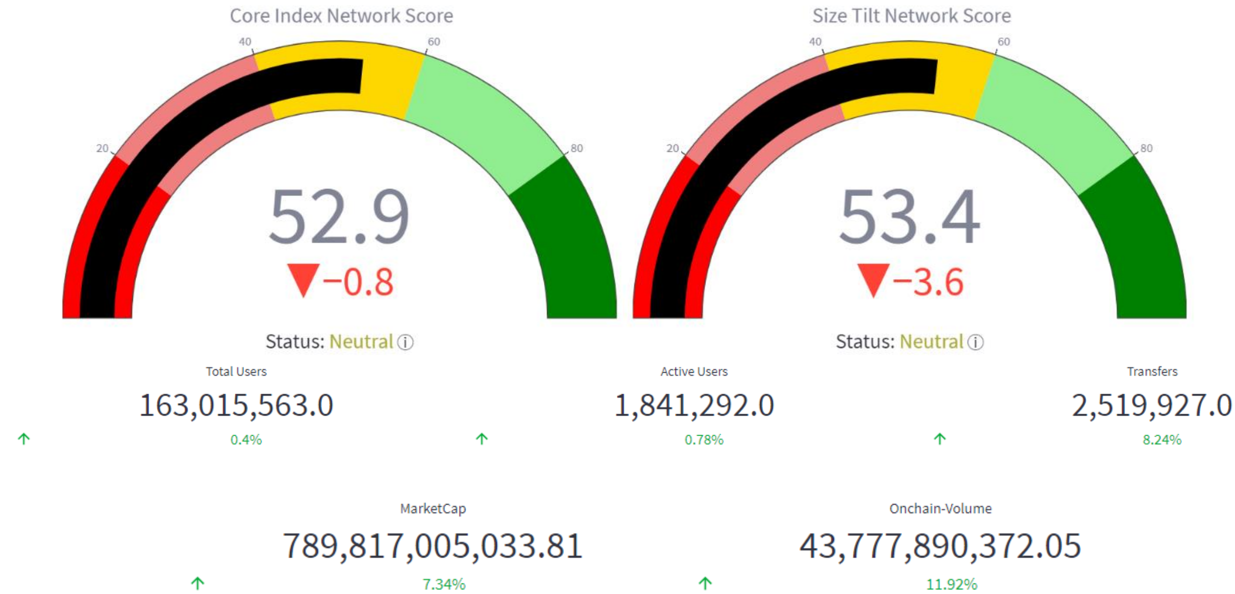
1. ETHEREUM STAKING DEMAND

Staking deposits have outpaced withdrawals since the Shapella upgrade enabled users to withdraw their staked ether. Recent monthly inflows have averaged 2.4 million compared to the 630k average since the September 2022 merge.



Source: Dune Analytics.

2. FUNDAMENTAL PULSE – NETWORK PERFORMANCE



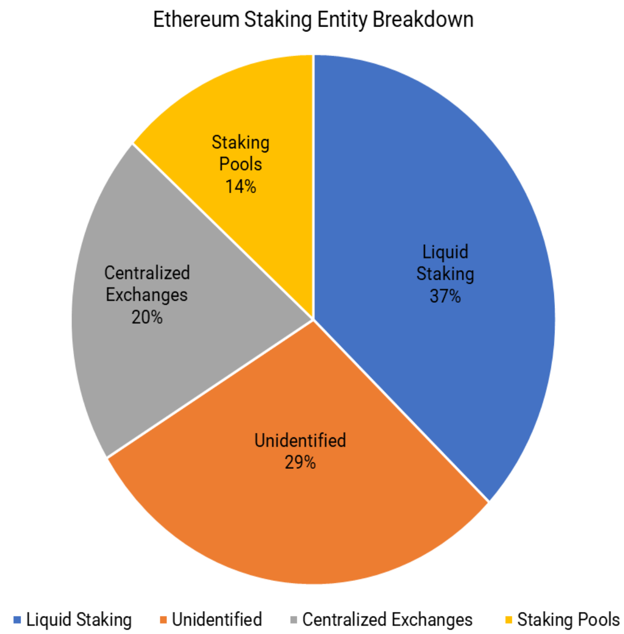
Bitcoin's Pulse shows notable growth in active users and transfer volume this week. However, the velocity metric reveals that this activity primarily involves a smaller supply, underscoring the limited activity in the market.

Assets	Asset Score	7d Change	30d Change	Volume	Transfers	Active Users	User Growth	Valuation	Velocity	Network Distribution
Coinbase Core	53	-1	4	40	78	53	53	46	15	86
Coinbase Size Tilt	53	-4	3	45	72	54	49	48	22	83
Bitcoin	54	5	7	38	89	43	59	44	5	99
Ethereum	50	-12	-4	40	57	77	40	48	32	54
Polygon	40	-20	11	50	25	29	22	44	23	84
Litecoin	63	-4	-5	56	90	85	50	30	42	89
Cardano	69	-4	9	94	57	27	51	87	65	100

*Snapshot from the One River Digital Pulse on 6/21/2023. Seven-day change in the Core and Size-Tilt Index Scores. Notes: Status- High > 60, Neutral 40 to 60, Low < 40. A score of 54.5 means the Index value is better than 54.5% of its values in the past 365 days. Due to incomplete data coverage, index scores exclude Solana. Asset Scores are unique and sensitive to changes in a particular asset. Readers should not compare Asset Scores across assets. See MVIS for more information on the Coinbase Core Index and Coinbase Size Tilt Index.

3. LIQUID STAKING DOMINANCE

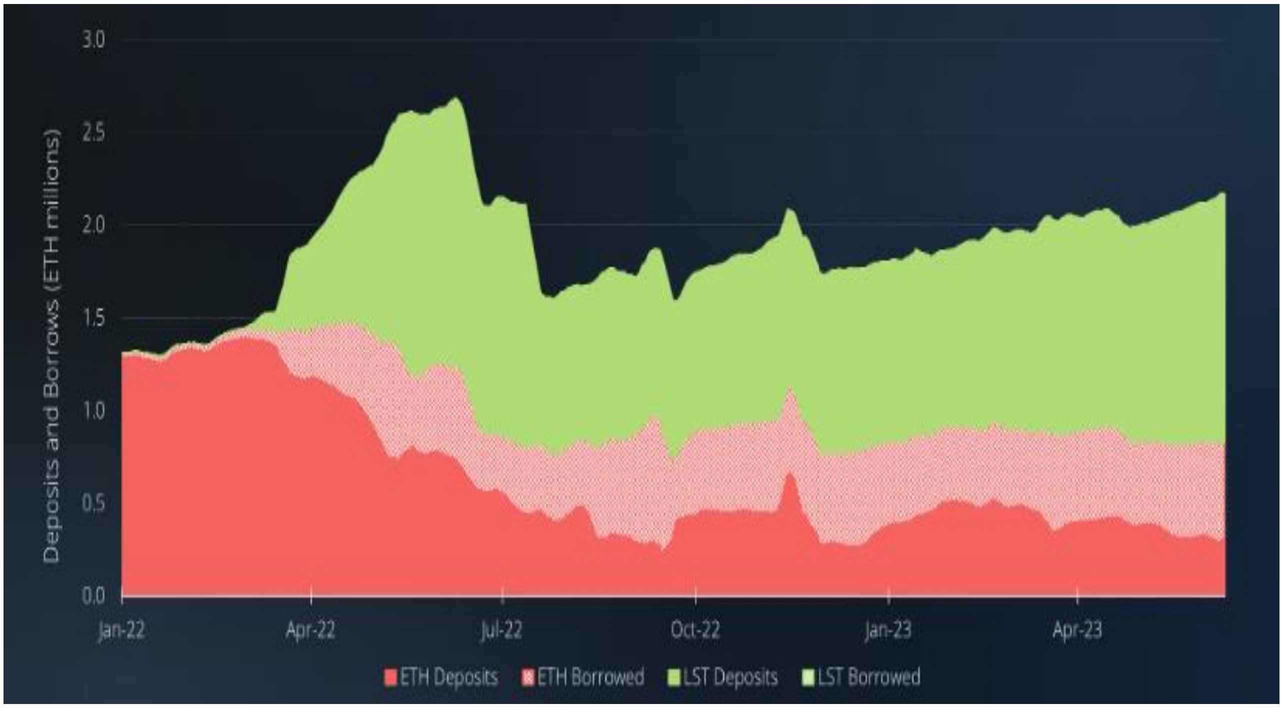
Liquid staking continues to dominate the landscape. Why? The attractive feature is a semblance of immediate liquidity. Lido remains the most dominant liquid staking option, contributing about 41% of the current total inflows into staking.



Source: Dune Analytics.

4. STAKING AND DEFI MERGE

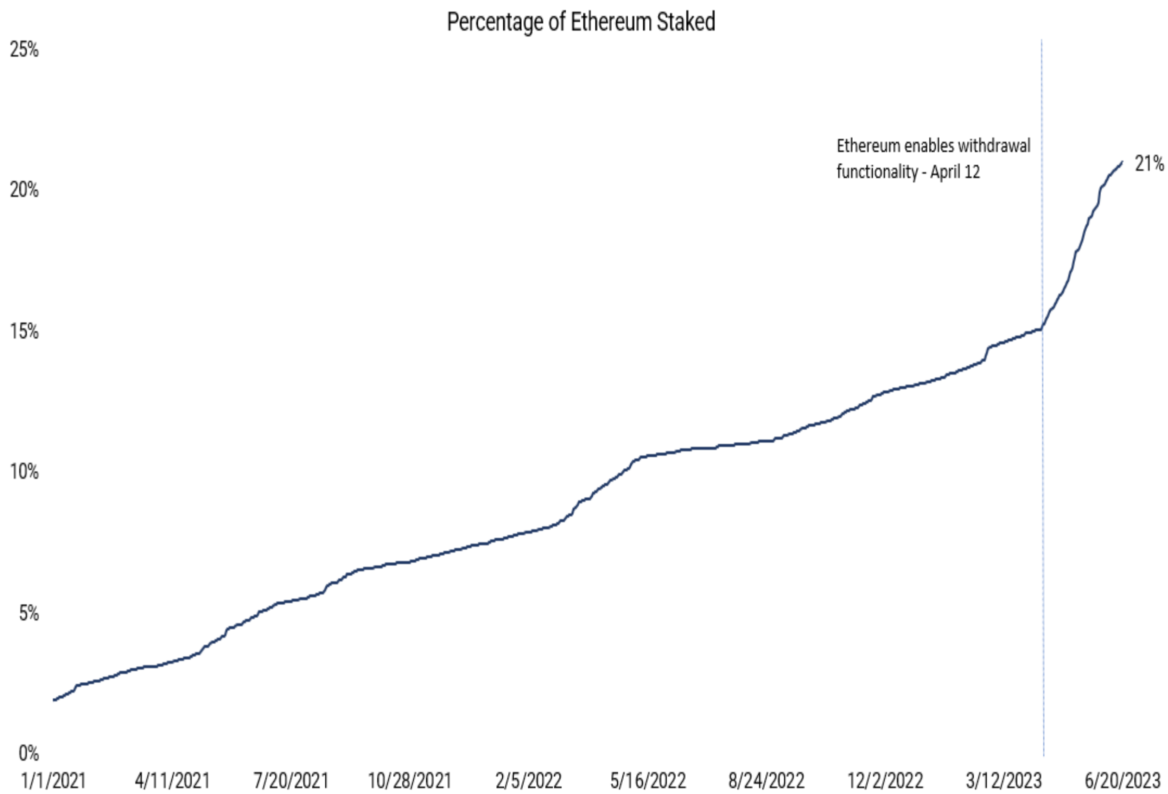
The Shapella upgrade reduced the risk uncertainty surrounding liquid staking tokens. Users have capitalized on the ability to use liquid-staked ether on other platforms for yield generation. Consequently, liquid staking tokens are increasingly preferred as the collateral choice in DeFi as opposed to native Ether (e.g., Aave below).



Source: Messari.

5. ETH STAKING - GROWTH, POTENTIAL AND RISKS

The percentage of Ethereum staked has increased from 15% since the Shapella upgrade to 21% today. With the growing utilization of staked Ethereum in DeFi, this is expected to keep rising. However, there are certain long-term risks to address. The ecosystem's adaptability will be key to its resilience.



Source: Glassnode.

Coinbase Asset Management manages strategies that employ the use of ETH staking. Liquid staking involves risk, including but not limited to network congestion, concentrated validator risk, and the possibility of regulatory risk. All such factors may have an impact on the liquidity of staked assets.

Metric Definitions

1. Volume – The aggregated value of native units transferred between addresses on-chain.

2. Transfer Count – The sum count of transfers between addresses. It becomes more valuable when used in conjunction with Volume.

2.1 Low Transfer Count & High Volume: High volume but transferred by a few addresses.

2.2 High Transfer Count & Lower Volume - Indicates higher retail activity or exchanges amongst small accounts.

2.3 Lower Transfer Count & Lower Volume: Indicates slower network usage and low network demand.

2.4 High Transfer Count & Higher Volume- indicates high network usage. A persistent trend is substantial.

3. Active Users: Number of addresses active in the network as recipients or originators of ledger change. This includes value transfers, signing blocks, and other forms of ledger change activity.

3.1 High Value: High network usage and high demand.

3.2 Low Value: Low network usage and low demand.

4. User Growth Rate: The rate at which new addresses with non-zero balances are added to the network.

4.1 High Value: Indicates users being added to the network at an increasing rate.

4.2 Low Value: Indicates users being added to the network at a slower pace.

5. Valuation: This metric compares the on-chain volume to the realized capitalization representing the value of the network. Realized capitalization is a revised form of market capitalization that accounts for the value of the coin at the time the coin was last spent. A lower volume compared to the high value of the network indicates the network could be overvalued and vice versa.

5.1 High Value: Indicates the network is closer to its real value based on the on-chain volume.

5.2 Low Value: Indicates the network is very close to being overvalued considering the activity on the network.

5.3 Medium value: Asset is reasonably valued—sustainable demand for transactions.

6. Velocity –This indicator shows the turnover of coins in the network as measured by on-chain volume divided by active supply. The primary use of this metric in this instance is to help access an asset's market-relevant supply.

6.1 High Value: There is greater circulation of coins in the network and use for payments.

6.2 Lower Value: There is lower circulation of coins in the network and use for payments.

7. Network distribution – The metric used, the SER ratio, compares the smallest accounts (sum held by accounts with a balance less than 0.00001% of the supply) against the richest accounts (sum held by the top 1% addresses).

7.1 High value: Signifies high distribution of supply and higher decentralization.

7.2 Low value: Low supply distribution and heavy concentration amongst a few wallets.

Disclaimer

One River Digital Asset Management has been acquired by Coinbase and is now Coinbase Asset Management. Additional details on the transaction may be found on the Coinbase blog. References to One River Asset Management anad One River Digital Asset Management may be contained herein during the transition period but are subject to change.

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