HexTrust

Finding Shelter in DeFi During Turbulent Times

Hex Trust Insights

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Nothing in the global markets is immune to the disturbances caused by macroeconomic factors. In particular, with the armed conflict in Ukraine resulting in heavy economic sanctions on Russia, stock prices have plummeted across the world along with crypto asset prices - and both have yet to recover.

Most may believe that in times of such instability, it may be better to sit on the sidelines waiting for the turmoil to pass. However, contrary to belief, an investor might find it more rewarding to invest in such soft markets because the opportunity cost of being idle is higher than the potential yield one could earn. DeFi, with its innovative financial services that operate on public blockchains, definitely provides investors with an ample variety of investment alternatives.

This article is going to dig deep into three main DeFi categories – money market protocols, liquid staking, and yield farming – these currently have the best risk, reward and liquidity profile in the crypto space. The order we are going to talk about these categories reflect the degree of complexity, from easiest to the most elaborate, the investor is expected to face.



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Money Market Protocols

Money market protocols are among one of the instruments with the most conservative risk, reward and liquidity profile in the crypto space. Despite the current low stablecoin yields (~2-3%), protocols like Compound or Aave are still a good alternative to collect income while waiting for the storm to pass. Money market protocols like Anchor protocol are an exception in this category due to the 20% yield it still offers.

You might wonder if the Anchor protocol is immune to the general market dynamic of scarcity of borrowers? Not at all, in fact, the ratio between lenders and borrowers within this protocol is similar to the more established platforms. However, Anchor protocol received a significant injection of reserves in the last week of February and these will support the 20% yield return for a little while. Anchor is very attractive, but what are the pros and cons of an alternative like it at the moment?

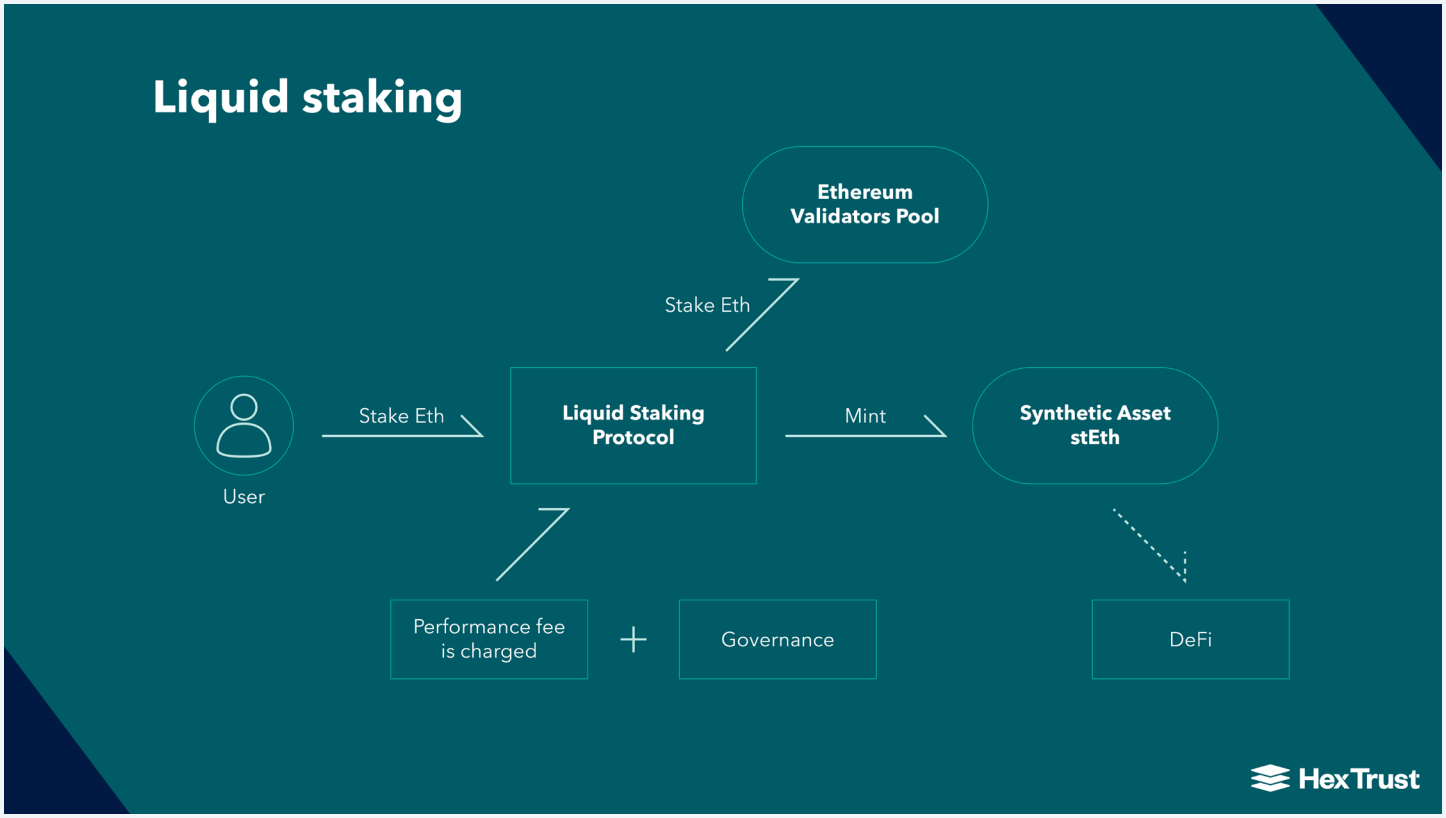
The liquidity of Terra's stablecoin UST is something to be mindful of. The stablecoin is based on an innovative algorithmic method for maintaining the peg with the US dollar, currently attracting investors with significant trading premiums compared to other stablecoins like USDC or USDT. Yet, such remarkable marginal return is not necessarily a positive aspect. Anchor's phenomenal returns within money market protocols are the principal cause of UST liquidity scarcity in the open market. This means that any change of conditions that triggers an outflow (for example an unexpected decrease in the value of LUNA that causes collateral liquidations within the protocol) might cause an oversupply of UST very quickly turning the current attractive premium into a penalizing discount.

Liquid Staking

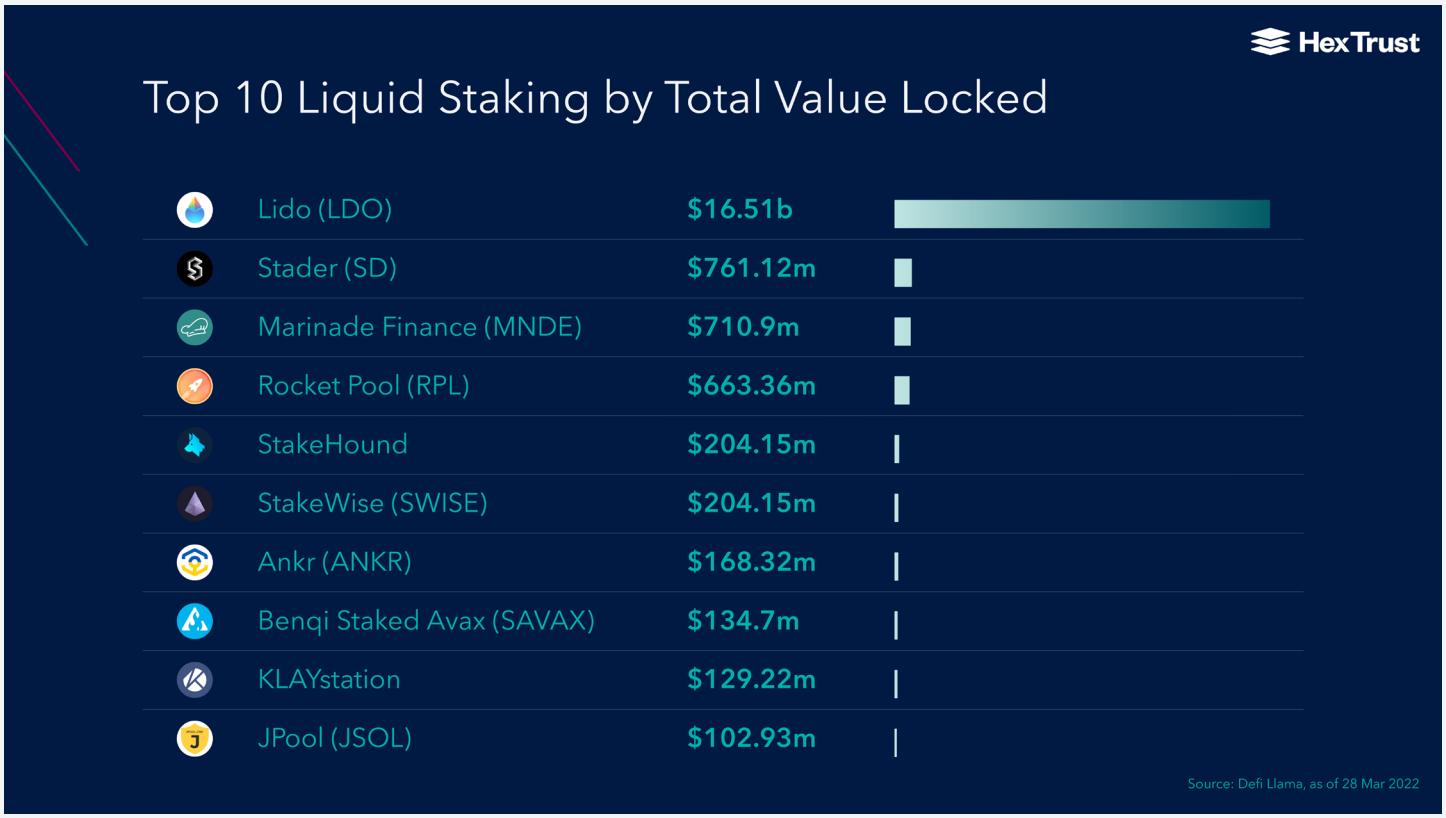
For investors less sensitive to the volatility of their favorite digital asset, liquid staking is a source of yield that should be taken into account. The concept of staking experienced a significant evolution in recent times in particular to overcome the issue created by the staked assets being locked in the blockchain and unavailable to the investor. The advantage of liquid staking is that it can be a source of yield without the issue of not having the assets at disposition because they are locked in the respective blockchain.

Liquid staking also tackles other problems that normal staking has, in particular centralization and complexity. For example, it minimizes the risk of slashing by allowing users to control risk exposure through the stake diversification to multiple validators. Liquid staking is possibly one of the top revolutionizing products in the DeFi space for 2022.

For liquid staking, the overall yield is lower compared to the native one because of the characteristics of this token that is effectively a mirror for native tokens being staked on the blockchain. The difference in yield is simply the premium for liquidity that is required to pay to have availability of the assets at any time. Because it is tokenized, various protocols started to welcome liquid staking assets that can even become valuable as a form of collateral.



Top 10 Liquid Staking by Total Value Locked (TVL) at time of writing



Yield Farming

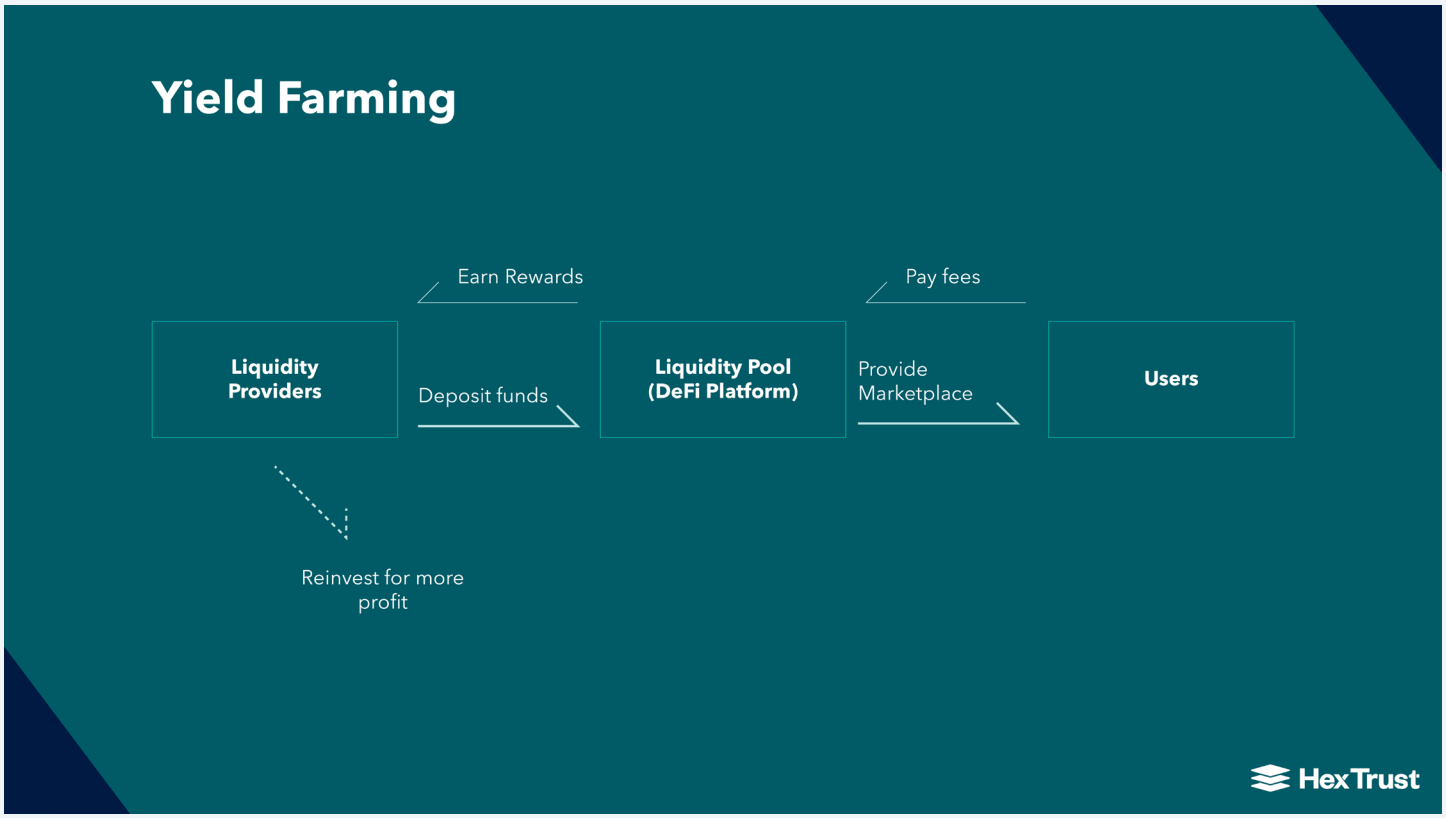
Yield Farming platforms are one of the main components of the DeFi ecosystem. Yield farming refers to encouraging users to lend their crypto assets in smart contract-based pools, thus providing liquidity in return for a share of the pool fees and governance tokens as a reward. The examples below illustrate how yield can be efficiently farmed across DeFi protocols.

Curve is a decentralized exchange focusing on stablecoins with 20 billion in TVL. Convex Finance is the DeFi protocol built on Curve that provides extra rewards to Curve liquidity providers and CRV stakers. Essentially, Convex provides a yield boost for Curve tokens and exchange rewards. The targeted audiences are either those holding Curve Liquidity Provider tokens or those with CRV tokens. Whether you are a liquidity provider or just lending, Convex offers a range of benefits such as Convex-boosted CRV rewards, CVX tokens via Convex liquidity mining, veCRV rewards from Curve exchange, and airdrops for veCRV token holders. The veCRV, vote-escrowed CRV, is a time-locked token that offers up to 2.5 times boost on CRV rewards, given that the amount of veCRV covers the deposited liquidity requirement.

Another passive yield option is staking CRV on Convex, and receiving cvxCRV token as a reward. However, this option is a permanent one as the conversion only happens from CRV to cvxCRV to claim the trading fees. Finally, CVX token is a utility token that, when staked, offers a share of Convex fees.

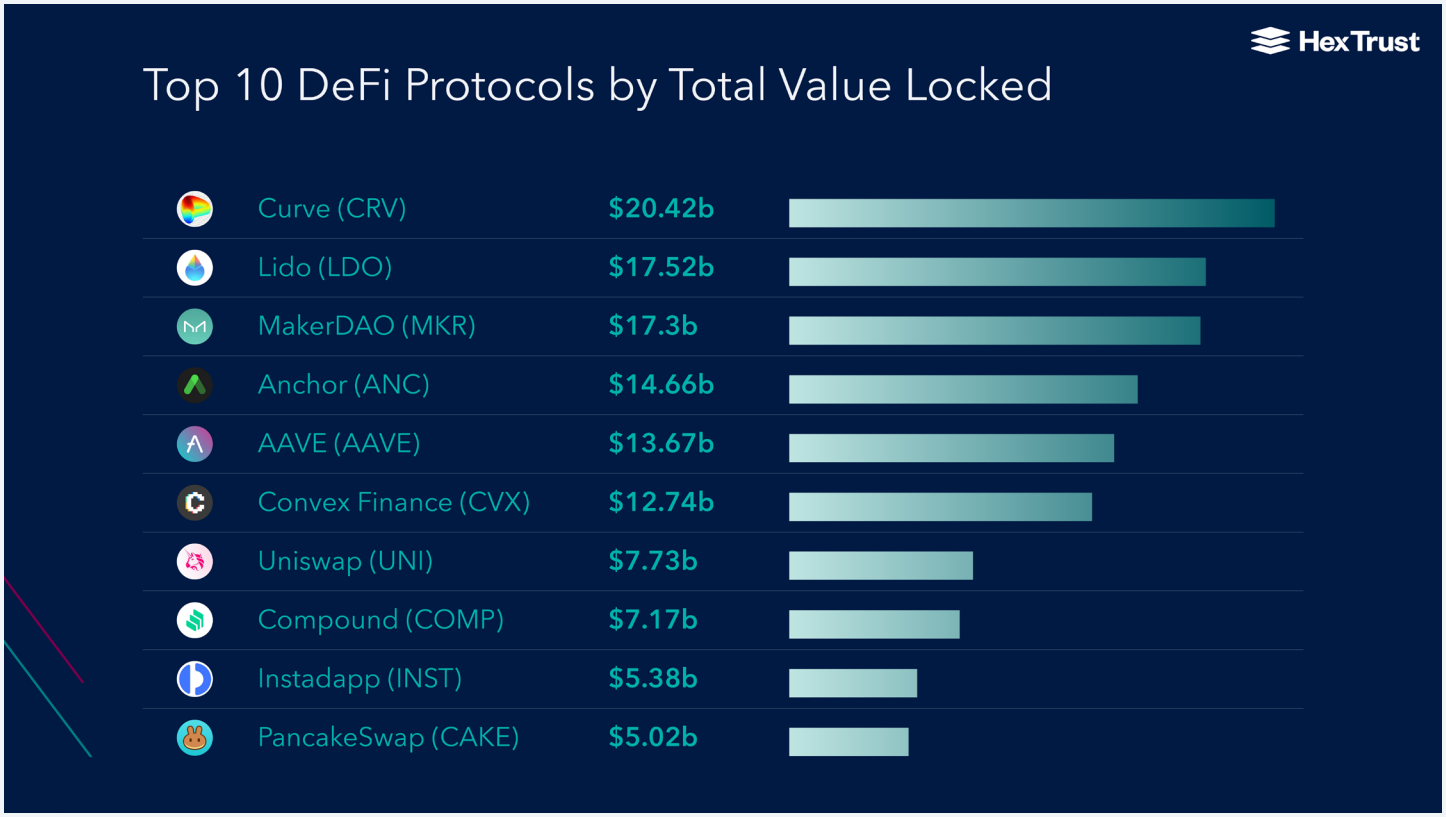
Yearn Finance, with TVL at 3 billion, is a very popular DeFi aggregator that offers two flagship products: Yearn Earn and Yearn Vault. Instead of constant yield hunting, Yearn Finance offers a possibility to use the best existing strategies created by top DeFi users to source yield. Many investors are interested in using Yearn Vaults, which act as a savings account, as the profits generated within the vault are automatically compounded to maximize returns through the optimized DeFi strategies. Up to 250 strategies are available across Ethereum and Fantom.

Yearn uses Curve Finance to boost the vault's yield. Currently, the highest APY is with cvxCRV at 25.17%, where the yield arises from users trading in the liquidity pool. If a user opts to supply cvxCRV for CRV/CVX tokens, the latter ones can be then harvested and sold, which allows users to deposit more for higher yields. The second highest APY of 23.73% occurs from depositing



and providing liquidity in a YFI-ETH pool. There is one more innovative two-asset pool, that is based on CRV and ETH, whose yield relies on providing crvCRVETH to earn commission fees. However, the last vault exposes the user to risk of impermanent losses. Finally, there are no deposit or withdrawal fees from Yearn Finance, which is not very common among protocol aggregators. When a strategy is used, 10% of the fees go to the developer of the strategy.

Top 10 DeFi Protocols by Total Value Locked (TVL) at time of writing



A broad range of risk, reward, and liquidity profiles

From 2% p.a. yields of long standing money market protocols to 30-40% p.a. returns achievable through DeFi yield farming, there are plenty of choices available to investors willing to reduce the price volatility of their crypto portfolios and gain returns waiting for the next bull market. Every day more and more innovative solutions are built to meet the ever-growing demand for safer yields during uncertain times.

It is very important to always bear in mind the evergreen rule that higher yields generally come with higher risks. However, the degree of innovation in crypto is a yield booster that does not necessarily increase the underlying risk of a product to a dramatic extent. Meanwhile, some options within traditional finance these days might hide a disproportionate amount of risk behind the artificially low yields offered. Would anyone really believe that a 2% yield offered on a 10 year government bond from countries not long ago facing financial distress (like Greece, Portugal or Spain) would be less risky than a 2.5% on AAVE protocol?

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Author:
Dario Capodici,
Head of Financing at Hex Trust

Dario Capodici is the Head of Financing at Hex Trust, overseeing Digital Asset Funding, Lending, and Structured Solutions services. He has over 10 years experience in financial services working at major corporations such as Citigroup (Hong Kong), Credit Agricole (London) and Deutsche Bank (Milan). As a seasoned Fixed Income Private Placements trader, Dario has received several "Deal of the Year" awards by industry publications.

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Digital Asset Custody Meets Innovation