DeFi Platforms

Background

Decentralised finance ('DeFi') is a term used to describe a suite of blockchain-powered protocols and apps (collectively, 'projects') that allow users to engage in financial activities without needing central intermediaries (e.g. lenders, insurers, asset managers).

These projects are typically built by venture-backed teams. Once a team believes its protocol or app is sufficiently developed, it usually launches a native governance token to align the economic interests of all relevant stakeholders (e.g. users, team members, venture investors). This tokenisation process also helps projects become more decentralised.

BTC Snapshot[1]	$ ('000)
12-month high	47.1
12-month low	16.4
Price (29 Jan 2024)	42.2
Key Market Metrics[1]	
BTC Dominance	48.6%
ETH price	$2,270.00
Total Crypto Market Cap	1.705T
DeFi Platforms Market Cap	75.3B

DeFi broke out in mid-2020, the start of a near-year-long period known as 'DeFi Summer' in which significant wealth was distributed to DeFi users through token airdrops and elevated yields subsidised by token inflation or protocol treasuries. (While DeFi Summer was instigated by Ethereum-based DeFi projects, enthusiasm for DeFi spilled over to alternative blockchains such as Solana and Avalanche.)

DeFi Market Landscape

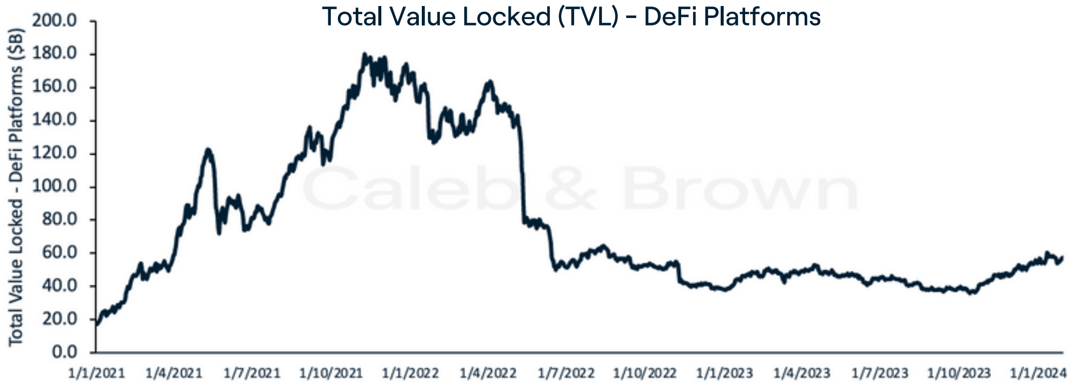
Today, nearly all blockchains—including layer-two (L2) chains (e.g. Optimism, Arbitrum)—have their own DeFi ecosystems.[2] At a minimum, each ecosystem consists of lending protocols and decentralised exchanges (DEXes). Support for stablecoins is also critical to encourage liquidity, the lifeblood of any DeFi ecosystem. (The stablecoin market is dominated by centralised offerings (e.g. USDC), which some argue contradicts the meaning of DeFi.)

The design of a blockchain can materially impact the extent to which a DeFi project is adopted. For example, DeFi aggregation protocols on Solana (e.g. Jupiter) can access a wider range of liquidity sources at a significantly cheaper cost, helping users access the best possible pricing. While aggregators exist on Ethereum (e.g. 0x API, 1inch), their usage—relative to trading directly on an individual DEX—is significantly less than their Solana-based counterparts.

Since DeFi Summer ended, the sector has badly underperformed the market. At the time of writing, the value of the DeFi sector (i.e. the combined market cap of all DeFi tokens) is $75.3B, or just 4.4% of the entire crypto market.[3] Interestingly, this percentage has held within a narrow range of 4.0–4.8% since May 2022.

One of many likely reasons for this underperformance is token unlocks due to the dilutive effect they can have on price (i.e. more tokens periodically distributed to stakeholders, a substantial portion of which is often sold).

Regulatory uncertainty is another key reason that has almost certainly contributed to DeFi's multi-year underperformance. In its purest form, DeFi is seemingly at odds with financial laws related to areas such as anti-money laundering and counter-terrorism financing (AML/CTF). Regulators worldwide have become increasingly vocal about the need for DeFi to be regulated. This ongoing uncertainty, coupled with the threat of enforcement action, has arguably deterred developers and venture capital from entering DeFi, slowing the pace of innovation.



Past performance is not indicative of future results.[2]

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1. Coingecko Price Data: https://www.coingecko.com/en/coins/bitcoin
2. DeFi Protocols: https://defillama.com/top-protocols
3. Coingecko Market Capitalisation Data: https://www.coingecko.com/en/categories/decentralized-finance-defi

DeFi Platforms to Watch

Uniswap (UNI)

Uniswap is a DEX built on Ethereum and other blockchains. It is easily the largest DEX by volume and has recently expanded into the wallet and aggregation markets through Uniswap Wallet and UniswapX, respectively. The protocol's treasury does not earn any revenue. All swapping fees go to liquidity providers.

Announced last June, Uniswap v4 is expected to be one of this year's most significant releases in DeFi. The release of v4 must happen after Ethereum's 'Dencun' upgrade, which should take place in late Q1 or early Q2.

The main benefit of v4 will be greater customisability enabled by so-called 'hooks'. A hook is a piece of code that will be able to perform a designated action at key points throughout the lifecycle of a Uniswap liquidity pool (e.g. before or after a user swaps tokens in a given pool). Anyone will be able to build hooks and have the ability to take a fee from swaps that go through their hook.

Lido (LDO)

Lido is a liquid-staking protocol on Ethereum and Polygon, where users deposit ETH or MATIC and receive a liquid-staking token ('LST') in the form of stETH and stMATIC, respectively. Primarily due to first-mover advantage, Lido dominates the liquid-staking market—the largest category of the DeFi sector by total value locked (TVL).

Since staked ETH withdrawals were enabled last April in Ethereum's 'Shapella' upgrade—officially completing Ethereum's merge to a proof-of-stake blockchain—liquid staking has grown considerably. Lido has captured most of this growth, with TVL now at 9.3M ETH, almost double what it was in late January 2023.[4]

Liquid staking should continue growing strongly this year. One of the many reasons for this is the clear market demand to use LSTs as collateral to borrow and earn additional yield. stETH is by far the most deeply integrated of all LSTs, giving it a sizeable competitive advantage.

Maker (MKR)

Maker is a protocol on Ethereum that issues DAI, a stablecoin designed to stay close to $1. The protocol, which is governed by holders of the MKR token, generates annualised revenue of $176.5M, at the time of writing.[5] MKR and DAI will soon be renamed as part of 'Endgame'.

Endgame is a multi-phase plan proposed by co-founder Rune Christensen last May to overhaul and improve the governance and tokenomics of the Maker ecosystem. Awareness of Endgame should increase in Q1 once Maker announces its rebrand and opportunities to earn additional yield and future airdrops.

One notable aspect of the Endgame proposal is overhauling MKR tokenomics. Among other changes, MKR will soon be redenominated at a ratio of 1:24,000. At the time of writing, MKR is trading at $1,953.[6] After applying this redenomination ratio, all else being equal, MKR's updated price will be $0.083. (For several years, the large per-unit cost of MKR has arguably capped its price performance due to the presumed effect of unit bias.)

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4. Liquid Staking Tokens: https://defillama.com/lsd
5. MakerDao: https://defillama.com/protocol/makerdao
6. Coingecko Price Data: https://www.coingecko.com/en/coins/maker