DeFi

Bybit Learn
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How to Invest in DeFi Using the 5 Key Performance Indicators (KPI)

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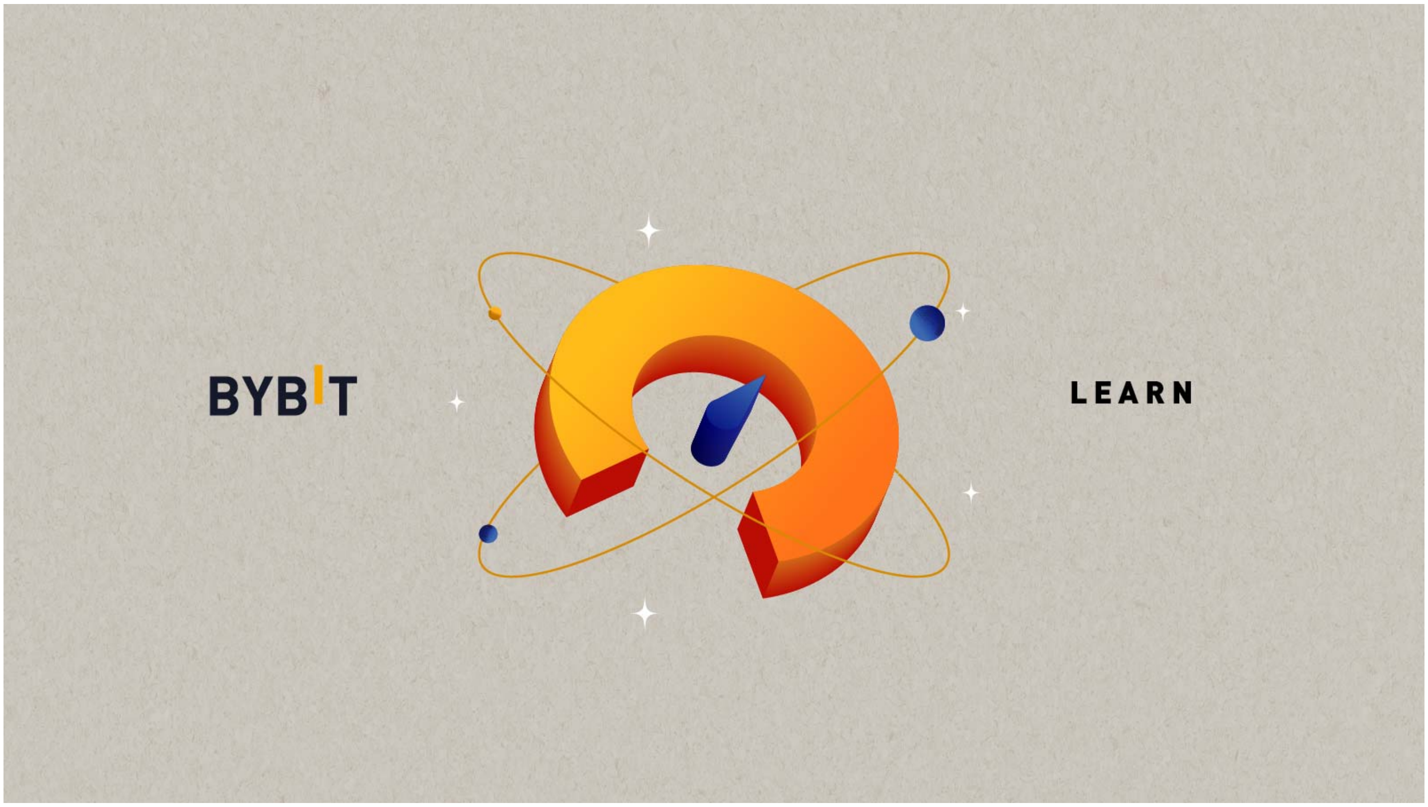

With the rise of smart contracts platforms like Ethereum, a wave of decentralized finance (DeFi) has entered the financial market, making the concept popular among investors.

It's easy to see why DeFi is getting so much hype, since it aims at facilitating cheaper and faster financial transactions with a more transparent framework.

In the sea of investment opportunities, it's crucial to have a standard against which to measure a project's performance. This is the purpose of key performance indicators: they allow you to identify which project will be lucrative in the future.

Did you know that the DeFi market recently hit a historic all-time high with over 100 billion total value locked in DeFi?

The question is, how can you get a piece of this thriving industry? In this guide, we'll list some of the key performance indicators to use for obtaining fundamental analysis to measure a project's intrinsic value.

Understanding DeFi Investments

DeFi is a term describing financial services accessible to anyone on a public decentralized blockchain network. It allows users to create self-executing smart contracts on blockchains. The highlight of DeFi is the freedom from interference by centralized authority, which traditionally controls a transaction.

The freedom of DeFi has also given rise to the use of non-fungible tokens, which fetch hype from retail investors and institutions. Looking at current trends in the DeFi space, it's easy to say that the industry is set for accelerated market growth. In 2019, the market capital for DeFi products was only $700 million and grew to a market valuation of over a 100 billion, according to industry data.

Compared to traditional finance, DeFi aims to reconstruct financial services like trading, lending, payment, and insurance with a more decentralized approach via blockchain. DeFi uses distributed consensus within the smart contracts that allow peer-to-peer transactions without involving a central authority. For example, DeFi enables a more efficient cryptographic verification process in lending and borrowing through the smart contract integration that defines and monitors the loan.

What Are the DeFi Technology Use Cases?

While there are plenty of DeFi alternatives to traditional financial services, the use of this technology stretches beyond lending and transacting. Here are some of the use cases:

- **Asset management**: Staking, buying, selling crypto, and loan for interest rate are among the popular uses for DeFi.
- **Assets tokenization**: Help to enable organizations to dematerialize assets in the form of tokens that are legally compliant via a decentralized blockchain that are digitally accessible for investors.
- **Decentralized autonomous organizations (DAOs)**: Administer core financial operations including the assets, fundraising and governance implementation.
- **Decentralized Exchanges**: These exchanges lower the risk of market manipulation and offer a faster settlement at lower exchange fee.
- **Insurance**: It provide automated insurance claims with transparent and secured audits.
- **Peer-to-peer (P2P) borrowing and lending**: Using the autonomous interest-based protocols that allow two parties to borrow and lend assets to earn interest.
- **Payment solutions:** Eliminating central authorities to offer a faster, efficient and more transparent payment systems to the unbanked population.
- **Savings:** Flexible saving plans to earn compound interest in real-time without a long-term commitment.

Crypto vs. DeFi Products

Cryptocurrency and DeFi go hand in hand. DeFi products are aimed at recreating traditional

DeFi products operate without a centralized authority, such as an exchange, trade union, or bank. Cryptocurrency is the driving force of DeFi products since most of them don't use fiat currencies.

Suppose a DeFi product recreates the traditional "personal loan" given by banks. A DeFi lender gives you a loan in cryptocurrency and earns interest on it. The interest rate is lower and more attractive than a conventional bank's.

Moreover, a borrower's chances of getting the loan are also significantly higher, since they often only have to offer crypto asset collateral, such as an NFT.

Key DeFi Indicators You Should Know

Now that you understand the basic concepts, let's discuss how to invest in DeFi by considering key performance indicators.

Here are some DeFi Indicators to know about:

1. Total Value Locked (TVL)

Total Value Locked, staying true to its name, means the total number of tokens in a DeFi protocol. The total value locked in a protocol can be measured using crypto or USD.

In a particular marketplace, TVL is the sum of total liquidity in the liquidity pool. TVL is often used in combination with the market cap, which is calculated by multiplying the value of tokens by their price in USD.

As a rule of thumb, the lower the TVL, the more undervalued a DeFi project is. However, there's more to consider besides the TVL when making a decision.

2. Token Supply on Exchanges

While DeFi aims to decentralize financial operations, it's still essential for you to check the supply of tokens on centralized exchanges. If an abundance of tokens is held at the exchange, it points towards a significant sell-off in many cases.

As a result of such a sell-off, the token tends to destabilize. Thus, it's imperative to look for these signs while performing due diligence on your cryptocurrency. However, things don't always turn out this way, and you also need to weigh token supply and other DeFi indicators when making a decision.

3. Token Balance Trends/Movement

Keep in mind that it's characteristic of crypto trading to move tokens from personal wallets to exchange accounts, and vice versa.

Only a highly uncharacteristic or significant movement should tip you off when making decisions about DeFi tokens.

4. Inflation Rate

Most DeFi protocols have rules in place to ensure the token supply doesn't cause inflation, leading to the devaluation of the DeFi tokens. However, this doesn't apply to every token.

While some projects don't clearly explain the mechanism of maintaining a limited token supply, others don't even have any coherent information on the subject.

Therefore, when you're selecting a protocol, look at whether a token is susceptible to inflation. If the answer is yes, it's best to stay away.

5. The Growth of Unique Addresses

If a large number of unique addresses are holding a particular token, that could mean it's growing in popularity and is being adopted *en masse*. As an investor, you can use this as a metric to determine the relevance of an asset.

However, it's also important to note that a single user can create many addresses, keeping their funds in separate accounts. That could give the false impression of a token being widely used.

So, be wary when using this metric. It's best to use it along with other key performance indicators, as discussed in this article.

The Possible Ways to Invest in DeFi

Today, there are thousands of cryptocurrencies available that have expanded into the DeFi market, saturating it and making it difficult for investors to differentiate between potentially lucrative projects and quick cash grabs.

That's why you need to use key performance indicators to determine the value of a project.

Once you understand the insight metrics give you into tokens, it's time to learn how to invest in DeFi.

Trading DeFi Assets

you want.

In this way, you don't lose control of your assets. Think of it as exchanging your fiat currency when you go to a different country. The difference with cryptocurrency, however, is that the DeFi version always remains open. Because of the stellar technology available, there will always be someone to accept your trade.

Suppose you have ETH in your wallet and you want to exchange it for Dai so that you can participate in PoolTogether, which is a no-loss lottery. Here's how it works: you use 100 Dai tokens to buy 100 lottery tickets. With this purchase, you get 100 Pool Dai (plDai).

Now, if one of your tickets wins the lottery, the balance of your plDai will increase per the prize pool's amount.

If none of your tickets win, then they're added back to the next draw. You can withdraw the amount equivalent to the Dai you initially used for buying the tickets at any time you want.

With DeFi trading, you can trade your ETH for Dai and partake in the lottery. Once you're done participating, you can trade your ETH back. So, what's the benefit here? Simply put, you may win the lottery.

DeFi Lending

DeFi lending allows borrowers to obtain crypto in a trustless and transparent manner without the interference of an intermediary. A lender can enlist their coins on a decentralized platform, and a borrower can then take the loan directly from them. The process is called peer-to-peer lending, since no third party is involved in the process.

It differs from traditional lending in the following ways:

- No third party is involved, and the process is fully transparent.
- Borrowers have easier access to crypto loans since they don't have to pass credit checks or procure lengthy paperwork.
- Since decentralized platforms have a censorship-free environment, no preferential treatment renders a borrower unable to receive a loan.

How do you earn money from DeFi lending? It's pretty simple. When they borrow, they pay interest; when they lend, they earn interest.

As a holder of the assets, you can lend them to borrowers to earn interest on the loan. When a borrower takes out a loan, they need to over-collateralize (deposit) their assets for the loan they

For example, suppose you want to borrow 1 BTC. In that case, you'd need to deposit a higher value of collateral than the current bitcoin price to receive 1 BTC. So that you won't be liquidated when your collateral drops below the original value. When the contract is over, you'll need to pay back the borrowed BTC and the interest rate to receive your collateral back. Anyone could be a lender in DeFi, and by loaning your crypto assets, you'll get your fund back after the lending period is over, along with interest.

The value of your cryptocurrency might appreciate or depreciate with time as the market changes. However, if it simply sits idle in your wallet, it won't gather any interest at all.

On the other hand, if you enlist your crypto on the exchange, you can earn interest on the currency and enjoy the price hike if the market goes that way. Another benefit of DeFi lending is that it's permissionless.

This means you could have any amount of coins — and be sitting in any geographical location in the world — and still lend your money.

Here are some platforms you can use for DeFi lending:

Aave

Aave is a noncustodial, open-source liquidity protocol built on the Ethereum network. The protocol uses a DAO that is governed by the AAVE token holders who vote for the changes. Aave has a pool of over 20 ERC-20 assets, including DAI, USDT, USDC and it offers flash loans that you can borrow crypto without collateral using the pool-to-peer lending mechanism. When a user provides liquidity in the liquidity pool, the deposited funds in the protocol are open for lending.

So, if you deposit Dai into the pool, you'll receive aDai. As a token holder (lender), you'll earn interests on the aTokens while borrowers pay interest rates depending on the amount they are borrowing.

Compound

Compound Finance is an autonomous algorithmic protocol in which you can lend your tokens to borrowers, earning interest while being able to transfer, trade, and use for other purposes. While the loans can be paid back and locked assets can be withdrawn at any time.

The difference between Compound and traditional finance is that it allows users to spend the money earned in savings while saving it. For example, locking up your USDT in the protocol can help you tokenize cDai, which earns you interest. But at any time, you can withdraw your cDai for Dai with accumulated interest. Compound allows users to borrow or lend BAT, DAI, ETH, USDC, WBTC and more.

Yield Farming

Yield Farming is simply a way for your existing crypto to make more crypto.

You lend your funds to other users through contracts and get a fee in return for your service. The fee is in the form of crypto, so it increases your earnings.

In yield farming, you're a liquidity provider, adding funds to the platform's liquidity pool. In return, you'll get a reward, which comes from the fees the DeFi platform takes from the users.

Yield farmers tend to use strategic tactics, moving their funds to different protocols to earn higher yields. Considering this, DeFi platforms also offer them economic incentives to stay on their protocols.

However, yield farming also comes with its risks. The most apparent risk is smart contracts. Most protocols are developed by small teams who work with limited budgets.

A more notable risk from yield farming is composability, which is also actually an advantage of DeFi. DeFi protocols can integrate with each other. The ecosystem thus relies on all of the building blocks so that the protocols can work together.

The risk here is that even if one building block is malfunctioning, the whole ecosystem suffers. Because of this, yield farming is considered suitable for advanced crypto experts.

How to Buy DeFi Tokens on Bybit

Bybit offers a significant number of tokens and trading pairs to help users purchase and trade for tokens like Avalanche (AVAX), Aave (AAVE), Chainlink (LINK), Compound (COMP), Dydx (DYDX), Fantom (FTM), Polkadot (DOT), Sushiswap (SUSHI), Serum (SRM), Terra (LUNA), Uniswap (UNI).

1. Register or log in to your Bybit account.
2. Head to "Buy Crypto" page to purchase USDT via your preferred fiat currency.
3. Once you've received your USDT, select "Derivatives" and at the drop down, click "USDT Perpetual Contract," then look for "DeFi" to trade your preferred trading pairs.
4. If you prefer "Spot," hover over the "Spot market" to trade the DeFi-USDT trading pairs.

The Bottom Line

impact everyone — from the tech-savvy to those like grandma who don't otherwise understand what's going on behind closed doors."

Therefore, it's about time to learn how to invest in DeFi and expand your portfolio to include this new wave of tech-led financing.

In doing so, make sure you're using key performance indicators to make the right decisions. While risk is inevitable in DeFi, you can definitely minimize it by studying the metrics beforehand.

On top of that, there are different investing methods, such as DeFi lending, staking and yield farming, giving you a wide range of income opportunities. Hopefully, this guide has given you a clearer idea of how DeFi works, and how to invest in the space without putting yourself at too great a financial risk.