

Banner copy: Hedging with Crypto Structured Products

Meta Description: Tools like Shark Fin, Convert Plus, Dual Investment, and Future Plus, are effective tools to hedge against the volatile crypto market. Find out how.

4 Ways to Hedge Against Volatility with Crypto Structured Products

In just over a decade, cryptocurrencies have burst onto the scene and caused a stir among investors, institutions, and governments. The reason for its popularity as an asset class can be attributed to its volatility — wild price swings akin to a thrilling rollercoaster. Yet, this volatility is a double-edged sword; it can lead to significant profits in a short amount of time but can also result in substantial losses. So how does one protect themselves from this unpredictability? The answer lies in hedging.

Hedging is a common strategy used by investors to manage risk and protect their investments. It can help minimize potential losses in volatile markets and provide some stability to investment portfolios. When employing a hedging strategy, investors take on another position or asset that moves in the opposite direction of the original investment. By doing this, investors can offset any potential losses with gains from the hedging position.

In this article, we'll explore what is market volatility and the importance of hedging. We'll also discuss common hedging strategies and four different crypto structured products that can be used as hedging tools. With this information, investors can be equipped with the necessary information to navigate and thrive in volatile markets.

What is Market Volatility

Market volatility refers to the rate at which the price of an asset increases or decreases for a set of returns. High volatility means that the price of the asset can change dramatically over a short period in either direction. In contrast, low volatility implies that the price changes are minimal.

When it comes to cryptocurrency, volatility is typically higher than other traditional asset classes like stocks and bonds due to factors such as regulatory news, technological advancements, and market sentiment. A case in point was the 2021 ban on Bitcoin mining in China. This caused the price of Bitcoin to tumble 40% from its peak, with altcoins following the lead of the blue-chip cryptocurrency. Above all, the speculative nature of cryptocurrencies adds to their volatility as people buy and sell based on forecasts and speculations rather than intrinsic value. A notable case is that of Dogecoin, a meme coin

that's been intrinsically tied to Tesla CEO, Elon Musk. What initially started as a joke resulted in a meteoric 200,000% climb in 2021. In fact, when Musk declared himself the "dogefather" on Twitter in April 2021, the price of DOGE pumped by more than 30% in a few hours.

What is Hedging

In light of the crypto market's inherent volatility, understanding what is hedging and its relevant strategies is critical for any investor. Essentially, it is a risk management strategy used in trading to offset potential losses that may be incurred by investments in a portfolio. It involves taking an opposite position in a related asset or investment to balance any losses that may be experienced in the initial investment.

In simple terms, hedging is like buying insurance for your investment. For example, one might purchase an insurance plan to protect their car or home from potential damage. Similarly, hedging helps protect investments from potential losses. By taking on a hedging position, investors are essentially creating a balance where any losses in one investment can be offset by gains in the other.

The Importance of Hedging in Crypto Investment

Hedging is crucial in crypto investment for several reasons. First, it manages risk by protecting against potential losses. This is particularly important given the high volatility of cryptocurrencies. Secondly, hedging can also enhance profitability. By hedging, investors can lock in profits or limit losses, allowing them to maintain a more steady return on investment. Lastly, hedging allows for better planning. With a hedge in place, investors can more accurately predict their returns, making financial planning easier.

How does it work? It mainly involves taking a position in a derivative contract such as futures, options or swaps, or investing in a stablecoin to offset potential losses in your crypto portfolio. For instance, if you hold Bitcoin and worry about its price falling, you might open a short position with a Bitcoin futures contract. As the price of Bitcoin falls, it would gain in value, thereby offsetting the loss in your Bitcoin holding.

Common Hedging Strategies for Crypto Investors

Under the derivatives trading umbrella, investors can employ various strategies to effectively hedge their investments. Let's explore some of the most common ones.

Overview of Common Hedging Strategies

Some common hedging strategies in the crypto space include:

- **Options Contracts:** These give the holder the right, but not the obligation, to buy or sell an asset at a predetermined price within a specific timeframe. They can be used to hedge against potential price drops or rises. If you believe the price of a cryptocurrency will fall, you could purchase a put option which increases in value as the price of the underlying asset falls.

- **Futures Contracts:** These are agreements to buy or sell an asset at a future date at a predetermined price. Futures can be used to hedge against both upward and downward price movements. If you are worried about a major price drop, you can take a short position in a futures contract which will increase in value as the price of the underlying asset decreases.
- **Stablecoins:** These are cryptocurrencies that are pegged to a stable asset, like the US dollar. They can be used to hedge against volatility in other cryptocurrencies. If you anticipate a downturn in the market, you could convert your volatile cryptocurrencies into stablecoins until the market stabilizes. Some examples include Tether's USDT and Circle's USDC.

Hedging With Crypto Structured Products

Now that we've covered hedging strategies, let's look at four crypto structured products that are suitable for hedging. These products derive their underlying principles from derivative contracts but combine them with innovative price protection mechanisms to manage risk and capitalise on market movements with enhanced yield.

Product #1: Shark Fin



Shark Fin is a relatively low-risk product and comes in two options: Bullish and Bearish Shark Fin. It is highly popular among investors as it provides principal protection, a guaranteed return, and a bonus return if investors' prediction on the market is accurate. The return is typically capped at a certain level, hence the name 'Shark Fin' as the payout structure resembles the shape of a shark's fin. This product can be an effective tool for hedging as it offers downside protection while still allowing for potential upside gains.

Let's say an investor predicts downward movement in the price of BTC. They could subscribe to a Bearish BTC Shark Fin. If the expiration price of BTC falls within the return range, they would receive a bonus return on top of their guaranteed return and investment amount. Conversely, if the expiration price of BTC falls beyond the return range, they will still receive their guaranteed return and investment amount.

<Find out more about Shark Fin>

Product #2: Future Plus

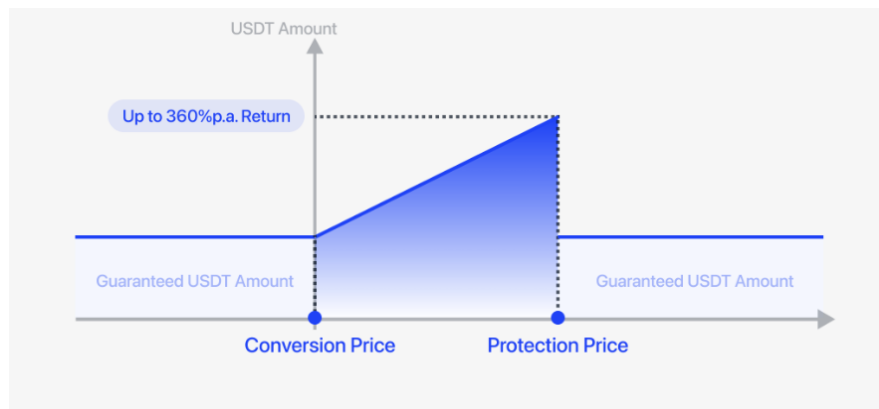


Future Plus draws its principles from futures trading, which involves buying or selling an asset at a predetermined price at a future date, with the potential for leveraged returns. However, the key benefit is that the downside is limited and there is no risk of liquidation. Additionally, investors can choose to either hold the position until maturity or terminate it early, thereby enjoying an additional layer of flexibility. Overall, these features allow investors to capitalise on favourable market movements while still providing downside protection.

Let's say an investor believes that the price of Ethereum will increase in the future but also wants to protect against potential losses. They could subscribe to a Bullish ETH Future Plus. If the price of ETH increases at or above the Breakeven Price at the expiration date, they would receive a return based on the price difference and their investment amount. However, if the price of Ethereum decreases, they will incur a capped loss, which will be deducted from their investment amount.

<Find out more about Future Plus>

Product #3: Convert Plus

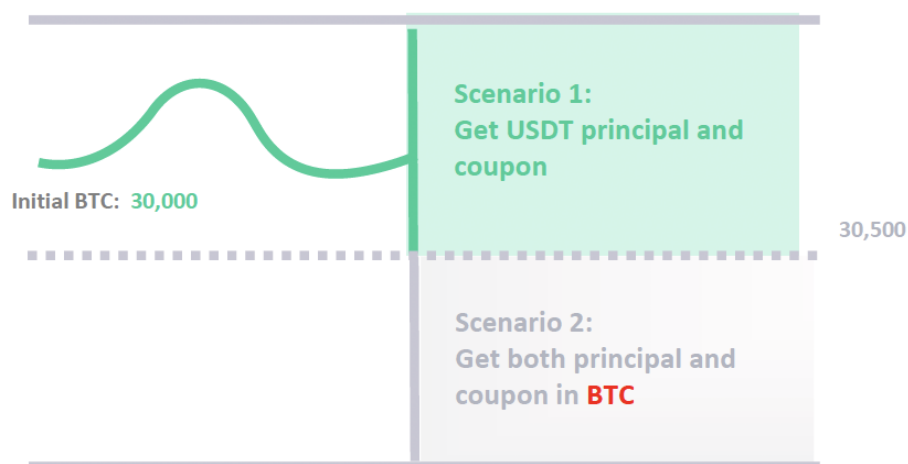


Convert Plus combines flow products with exotic options. There are two different options: Buy Coins and Sell Coins, where investors can lock in the price of the asset for a trade (or conversion) to be initiated. At the same time, it provides the potential for investors to earn additional returns should the price movement of the underlying asset move within the predefined return range.

For example, an investor wants to employ a hedging strategy with stablecoins, thus converting BTC into USDT. They then subscribe to a Sell Coins Convert Plus product, with BTC as the underlying asset. In this case, the return range is between 29,850 USDT and 30,500 USDT with a tenor of 3 days. Should the price of BTC fall within the return range, the investor's BTC will be converted to USDT. In addition, they will receive an additional return based on the difference between the Expiration Price and the Spot price.

<Find out more about Future Plus>

Product #4: Dual Investment



Dual Investment is a product where the investor holds two different cryptocurrencies, typically Bitcoin and a stablecoin. There are two versions of Dual Investment Products — Buy Low and Sell High — which investors can choose depending on their view of the market.

Let's illustrate the return scenarios for a Buy Low Dual Investment Product. If the price of the underlying asset, Bitcoin hits or exceeds the Target Price, the investor's payoff is converted to USDT, and they will receive an additional coupon. Should the price of BTC fall below the Target Price, the investment will not be converted and the investor will receive their principal and coupon in BTC. All in all, Dual Investment offers a way to hedge against volatility while still participating in potential market rises.

<Find out more about Dual Investment>

To sum it up, these crypto structured products can be effective tools for hedging in the cryptocurrency market. They provide investors with various options to protect against downside risk while still allowing for potential upside gains. However, it is important to thoroughly understand the terms and conditions of these products and their associated risks before investing.

In a Nutshell

To conclude, navigating the volatile crypto market can seem daunting, but with the right knowledge and strategies, it's entirely possible to hedge against risk and potentially turn a profit. From understanding what hedging is and its importance to exploring common hedging strategies and structured products, we've covered a lot of ground.

Hedging plays a crucial role in managing risk in the volatile crypto market. It acts as an insurance policy for your investors, protecting them from significant losses during market downturns while enabling them to make profits in both rising and falling markets.

Considering Crypto Structured Products for Hedging?

If you're a crypto investment platform seeking to expand your product offering and boost liquidity, consider incorporating some of the hedging strategies and structured products we've discussed. Shark Fin, Future Plus, Convert Plus, and Dual Investment are just a few examples of the tools that Darwinbit offers. Remember, the secret to building a successful investment platform lies in a holistic product strategy that encompasses a strong potential for capital appreciation alongside robust risk management for principal protection. Successful investing isn't avoiding risk altogether, but managing it effectively. With the right tools and strategies in place, your customers can navigate the crypto market's volatility with confidence.