

DIVERSIFIED ACCESS TO DEFI

INTRODUCTION

This week, we’re examining another sector index: the Kaiko DeFi Index (KSDEFI). This Kaiko index provides exposure to a diverse range of decentralized finance (DeFi) protocols. These include decentralized exchanges, lending platforms, and other key components that define the DeFi sector today. This index allows investors to track the sector’s growth over time. In this report, we will analyze the index’s constituents, investment thesis, diversification benefits, and historical returns.

KEY TAKEAWAYS

▶ Returns have outpaced benchmarks since inception.

▶ Individual catalysts will continue to drive returns.

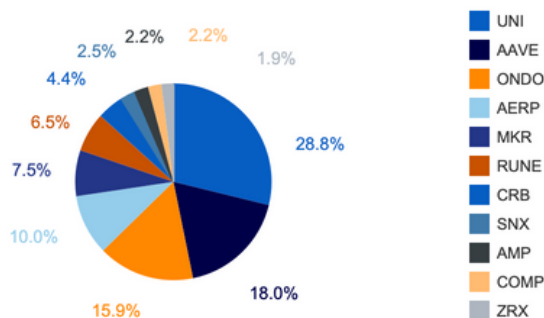
DIVERSIFIED ACCESS TO DEFI

The Kaiko Indices DeFi index offers strong sector exposure while diversifying across key growth verticals.

The largest weighting in the index is Uniswap's governance token UNI, while it also allocates to other DeFi blue chips such as AAVE, MKR, and CRV.

Small-cap DeFi assets like AERO and ZRX are also included in the index, and help capture emerging narratives. Aerodrome Finance (AERO) benefits from Coinbase’s Base chain adoption, while Synthetix (SNX) enables synthetic asset trading. This positions the portfolio for long-term growth.

DeFi Index Weighting



Source: Kaiko Benchmarks - KSDEFI.

As such, the Kaiko DeFi index provides exposure to decentralized exchanges, lending and borrowing protocols, and automated market makers—to name a few.

Additionally, the index broadens diversification by including assets beyond traditional DeFi categories:

- Real World Assets (RWAs): Ondo Finance (ONDO) bridges traditional finance and DeFi through tokenized securities.
- Stablecoin Infrastructure: MakerDAO (MKR) governs DAI, while Curve Finance (CRV) serves as a key liquidity hub for stablecoins.
- Cross-Chain Trading: THORChain (RUNE) enables native asset swaps across blockchains without relying on Ethereum-based bridges.

This structure provides broad exposure to DeFi while mitigating risks tied to a single vertical. Lending protocols, for instance, face smart contract vulnerabilities, collateralization risks, and liquidity crises. The inclusion of stablecoin and cross-chain assets helps diversify these risks, creating a more balanced risk-return profile.

Kaiko DeFi Index (KSDEFI) Performance



Source: Kaiko Benchmarks - KSDEFI and ETH Kaiko Reference Rate.

OUTPACING ETHEREUM

The DeFi index (KSDEFI) has delivered positive returns since inception, despite recent price declines. Notably, it has outperformed Ether (ETH) over the same period.

Although the majority of protocols and projects included in the index are built on Ethereum, the index's returns are not solely dependent on Ethereum's performance. This outperformance may persist into the latter half of 2025, as several assets within the index benefit from strong tailwinds, which we will discuss below. This trend highlights the decreasing correlation between the DeFi index and ETH over time, as the decentralized finance sector continues to expand beyond the Ethereum ecosystem.

INDIVIDUAL DRIVERS

Any continued outperformance for the Kaiko DeFi index will be tied to individual catalysts for constituent assets. Projects that could drive returns in 2025 include UNI, AAVE, AERO, and ONDO. While these are some of the most likely to benefit from strong investment narratives in 2025, growth shouldn't be limited to these four assets. Furthermore, regional factor

Asset	Protocol Type	Catalyst	Outlook
UNI	DEX	Fee switch	In 2024, Uniswap's fee switch proposal played a key role, as its implementation is expected to generate additional revenue for the protocol and UNI holders. These developments influenced the token's price dynamics throughout the year, as they could theoretically increase demand for the asset. Additionally, early 2025, Uniswap launched Unichain, its own blockchain with the objective of improving cross-chain liquidity on the exchange. If adoption continues, it could be a key growth driver in 2025.
AAVE	Lending & Borrowing	Fee switch	The lending and borrowing platform Aave is considering a proposal similar to Uniswap's. The Aave-Chan Initiative has published a proposal to distribute protocol revenue among AAVE holders. Such proposals add a new dimension to holding a governance token, as the potential to earn income from the asset naturally increases demand.
AERO	Automated market maker	Growing Layer-2 usage	Aerodrome benefits from its central role on Coinbase's Layer-2 blockchain, Base. The Base ecosystem has grown exponentially since its inception, and with the largest U.S. exchange driving its growth, it is expected to continue expanding. AERO stands to gain from this momentum, driven by both regulatory developments and increasing brand awareness.
ONDO	Tokenization platform	Tokenization trend	ONDO is a key player in Real-World Asset (RWA) tokenization, providing exposure to yield-generating assets such as U.S. Treasuries and corporate bonds. Unlike traditional crypto assets, RWAs are directly influenced by interest rate movements and tend to be less volatile, positioning ONDO as a potential hedge during market downturns.

In addition to these individual catalysts for growth, there is also a regional element at play. Several assets in the DeFi index (UNI, AERO, ONDO) are classified as U.S.-linked according to our regional classification. While they weren't included in the EAGLE index, they remain eligible for inclusion and will likely benefit from U.S.-specific drivers as positive regulatory evolutions.

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KSDEFI's Rolling Volatility



Source: Kaiko Benchmarks - KSDEFI.

RECALIBRATING OUTLOOKS

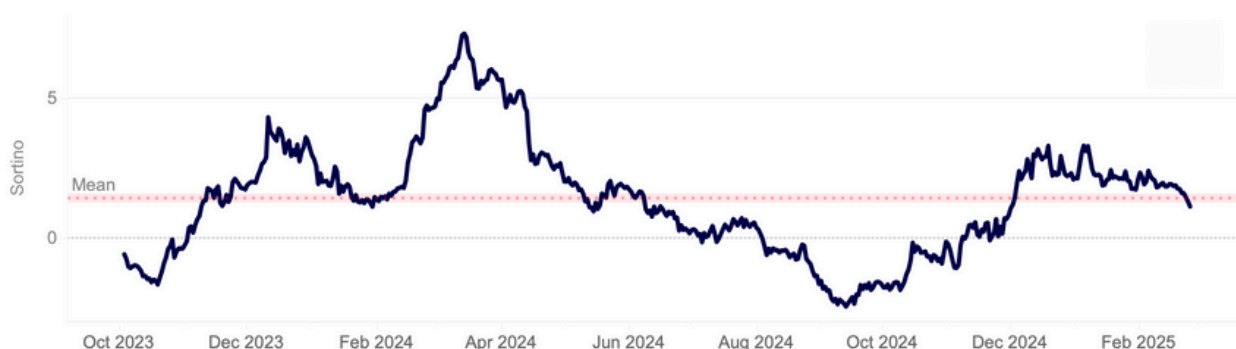
The 6-month rolling volatility of the Kaiko DeFi Index has been rising since the latter half of 2024, mirroring trends across the broader digital asset market and traditional financial markets.

This uptick in volatility followed the U.S. elections and the regulatory uncertainty that emerged after Donald Trump's victory. A portion of this increased volatility can be attributed to risk repricing and an improving market outlook. For example, the recent dismissal of the SEC's case against Uniswap was an anticipated development post-election, contributing to heightened activity in spot markets.

RISK-ADJUSTED OUTLOOK

The Kaiko DeFi index's rolling Sortino ratio has at times been well above average, and spent plenty of time in a highly desirable range above 5. Currently the ratio is around 1.1 which is still considered a good investment, and is above its mean since inception.

DeFi Index Sortino Ratio



Source: Kaiko Benchmarks - KSDEFI.

The Sortino ratio measures risk-adjusted performance by focusing solely on downside volatility, unlike the Sharpe ratio, which considers both upside and downside risk. The increased market exuberance since the election has likely contributed to a lower Sortino ratio.

Additionally, the current market cycle has been largely concentrated in BTC. As market participants adjust their outlook in response to dismissed court cases and ongoing project developments, a rotation into other assets is expected.

CONCLUSION

Since the DeFi summer of 2020, the full potential of on-chain finance has yet to be realized. Regulatory constraints in key markets have been a significant hurdle, but they are only part of the challenge. DeFi has also faced structural issues, including high user friction due to fees and security concerns. However, with regulatory scrutiny easing, the sector now has abundant opportunities for growth.

Going forward, DeFi is likely to be less of a zero-sum game, as the success of individual assets is not mutually exclusive. Aave and Uniswap, for instance, can both successfully implement fee switches that benefit token holders, while the rise of Real-World Assets (RWA) could simultaneously drive growth for Ondo Finance.