RIDING THE WAVE: THE CASE FOR CRYPTO MOMENTUM INVESTING

INTRODUCTION

In this week's edition we're focusing on momentum strategies, looking at how investors can capitalise on rising prices. While pioneered in traditional markets, momentum strategies are particularly relevant to digital assets. Trends in the burgeoning digital asset space are often driven by hype and rising prices can reinforce these narratives. This is similar to the thesis behind momentum investing, which we will discuss in more detail later.

We explore all of this and more below, looking at a custom index, the VHASHMOM, and comparing it with the broader market.

KEY TAKEAWAYS

- Crypto markets naturally cater to momentum strategies.
- Capped weighting leads to unexpected winners.
- VHASHMOM has a cumulative annual growth rate of nearly 40% since inception.
- On a risk-adjusted basis, VHASHMOM outperform a broad range of indices.

MOMENTUM INVESTING IN CRYPTO

The momentum premium—extra returns from a momentum strategy—is well-known across traditional asset classes. This strategy has grown in popularity due to its simplicity and effectiveness. Momentum trading takes advantage of investor biases like herd mentality, chasing winners, and overreacting to news.

Crypto markets, driven by sentiment and network effects, offer strong momentum opportunities. Network effects drive value by attracting more users, developers, miners, and investors, reinforcing growth and adoption.

However, the risk of sudden trend reversals is also magnified in crypto markets due to its unique characteristics such as high volatility, liquidity fragmentation, regulatory uncertainty and sudden price shifts. This means that while the crypto market offers opportunities for momentum traders, a reliable crypto momentum strategy must consider the sector's specific risks in order to effectively deliver a momentum premium.

INDEX DESIGN

The VHASHMOM Index (Vinter Hashdex Risk Parity Momentum Index) was specifically designed to capture crypto momentum upside while balancing some of these crypto specific risks, and backs Hashdex's Crypto Momentum Factor ETP—and the soon-to-be launched Hashdex Momentum ETF in Brazil.

By dynamically adjusting asset weights based on momentum and risk parity, the index aims to enhance returns while mitigating exposure to individual asset volatility.

Unlike traditional momentum strategies that can become overexposed to a few extreme performers, Kaiko's approach distributes risk more evenly, with no asset weight exceeding 30%. The rebalancing is done monthly which forces constant rotation among winners.

Characteristics of the VHASHMOM index

Crypto market feature	How VHASHMOM adapts to it
Higher volatility	Uses a risk parity weighting system to balance risk exposure across assets.
Liquidity challenges	Selects top crypto assets tradable on regulated European exchanges.
Sentiment swings	Captures momentum over a 2-month window, compared to the 3–12 months used in traditional strategies.Monthly rebalancing ensures responsiveness to changing market conditions.
Extreme Events	Caps asset weights at 30% to prevent overexposure to a single asset.
Regulatory Uncertainty	Limits selection to assets eligible on SIX, BX Swiss, and Xetra exchanges.

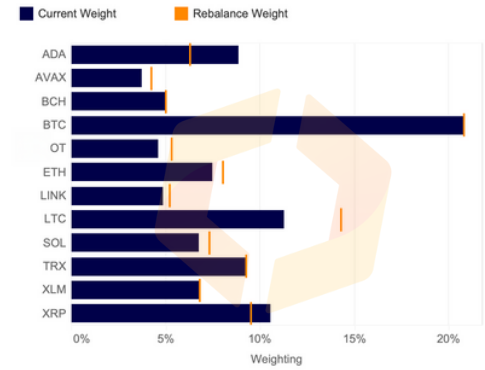
Adam Mccarthy, Research Analyst
adam.mccarthy@kaiko.com

Dessislava Aubert, Research Analyst
dessislava.aubert@kaiko.com

UNEXPECTED WINNERS

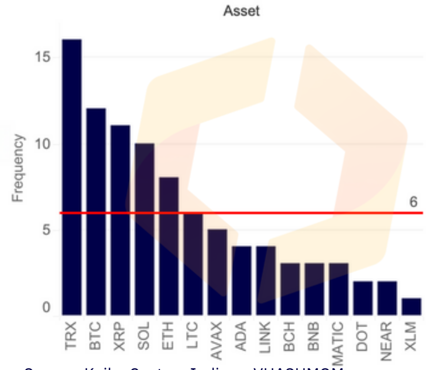
One of the many benefits of this strategy, when combined with weight capping applied to assets, is that it helps capture non-mainstream investment opportunities, as the index doesn't skew toward large-cap assets like Bitcoin. This is particularly relevant for cryptocurrencies, where sentiment and network effects can create self-reinforcing trends.

Pre & Post Rebalance Weight



Source: Kaiko Custom Indices, VHASHMOM.

Frequency of Appearance in the Top 3



Source: Kaiko Custom Indices, VHASHMOM.

As of February, Bitcoin holds the largest weighting in the index, followed by LTC, XRP, and TRX. Comparing the pre-rebalance weights (before rebalancing) with post-rebalance weights (after rebalancing) shows that LTC outperformed, benefiting from increased anticipation of a potential ETF approval, leading to a higher allocation. Polkadot, which is preparing for a major 2025 upgrade aimed at enhancing scalability, flexibility, and developer accessibility, has also gained traction.

Overall, only five assets have a higher-than-average frequency of appearance in the top three constituents by weighted contribution. This suggests that rather than relying solely on past leaders, the index successfully identifies emerging winners.

Performance since 2021

Metric	BTC	VHASHMOM
Cummulative Return (%)	181.5	304.7
GAGR (%)	28.1	39.7

Source: Kaiko Custom Indices, VHASHMOM & Kaiko Benchmark Rates, BRR.

LONG-TERM OUTPERFORMANCE

The index has significantly outperformed Bitcoin since 2021 registering both higher compounded annual growth rate and cumulative returns. It effectively captured the upside momentum during the 2021/2022 bull run and more recently the post-election rally driven by regulatory clarity and U.S.-centric narratives. This outperformance also underscores the benefits of capturing smart beta by optimizing indices with factors.

In 2025, crypto-specific narratives, such as growing institutional adoption and a friendlier regulatory environment, could provide tailwinds for crypto momentum strategies, even as equity momentum shows signs of exhaustion.

Adam Mccarthy, Research Analyst
adam.mccarthy@kaiko.com

Dessislava Aubert, Research Analyst
dessislava.aubert@kaiko.com

RISK PROFILE

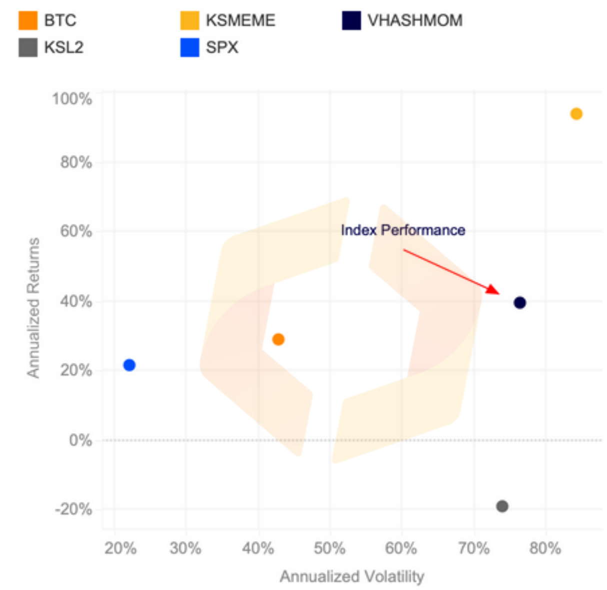
The index also offers competitive risk-adjusted returns.

VHASHMOM's annualized returns since inception are near 40%. This places the index well above other digital assets in terms of returns. It even outperforms broad-based equity indices, such as the S&P 500.

However, despite offering competitive returns these do come at a cost, with annualized volatility above 75%. Only the Kaiko Meme index (KSMEME) has higher volatility since inception, while the Kaiko Layer-2 index (KSL2), which underperformed the market, comes close with 74%.

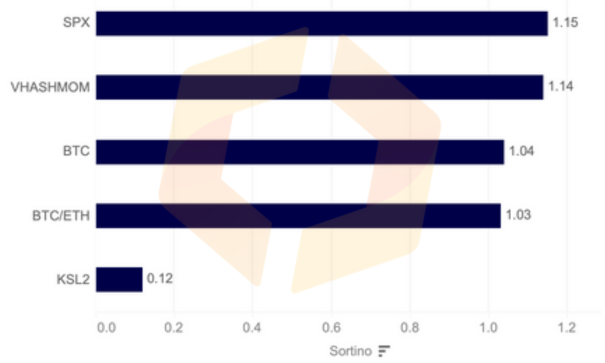
Volatility is more of a feature than a bug in crypto markets and as such we find it useful to consider broader risk metrics when evaluating the performance of an index.

Returns versus volatility



Source: Kaiko Custom Indices performance data, VHASHMOM, and Refinitv.

Sortino Ratio's for Leading Indices



Source: Kaiko Custom Indices performance data, VHASHMOM and Refinitv.

RISK-ADJUSTED OUTLOOK

Using performance metrics like the Sortino and Sharpe ratios allows us to compare the VHASHMOM's risk-adjusted returns versus competitors.

Sortino ratio measures risk-adjusted performance by focusing on downside volatility, while the Sharpe ratio accounts for both upside and downside risk.

Since the Sortino ratio considers only downside volatility, it's often viewed as a better measure of risk-adjusted returns. A ratio above 1 is generally considered good; as such, its fair to say that VHASHMOM offers reasonably good risk-adjusted returns. Especially when we consider that other digital asset indices, such as the Kaiko Layer-2 and the BTC/ETH index have lower Sortino ratios—and lower Sharpe's as well.

CONCLUSION

The performance and associated risk metrics for the VHASHMOM index demonstrates that momentum investing can be effectively applied to cryptocurrency markets when properly adapted to its unique characteristics.

The index's success in identifying and capturing returns from emerging winners, rather than simply following established trends, particularly highlights its value in the rapidly evolving cryptocurrency landscape. This ability to rotate capital into promising opportunities, while maintaining diversification represents a dynamic approach to momentum investing in digital assets.

Adam Mccarthy, Research Analyst
adam.mccarthy@kaiko.com

Dessislava Aubert, Research Analyst
dessislava.aubert@kaiko.com