YIELD FARMING

Yield farming has been a recent hot topic in the crypto DeFi space. To compare to traditional banking, when you deposit money in a bank you're effectively making a loan for which you get interest in return. Yield farming involves lending cryptocurrency an in return you get interest and sometimes fees. Given the amount of competition between investors and high gas prices, yield farming is only profitable if you're willing to put a significant sum of money to work but it has risks as well.

It may sound strange, but you have to remember that unlike established currencies that have lots of money in circulation, cryptocurrencies have to perform a tricky balancing act to grow. A new currency only has value if enough people use it, so there's an incentive to issue new units to grow a user base. But flooding the market would make the currency less valuable.

Many of them make use of the Ethereum blockchain, a blockchain co-founded by Vitalik Buterin. A dApp is a decentralized application that runs a trustless smart contract on a specific blockchain. Compound and Aave are DeFi's primary lending and borrowing protocols, together they have surpassed the $1 billion in funds according to tracker Defi Pulse. Lending capital on a money market is the easiest way to earn a return in DeFi. Deposit a stable coin to either of the two and start earning returns immediately. Aave generally has better rates than Compound because it offers borrowers the ability to choose a stable rate of interest rather than a variable rate, stable rates are higher than variable rates.

Yield harvesting isn't riskless. DeFi money markets employ over-collateralization, meaning a borrower must deposit assets with more value than their loan. When the collateralization ratio (value of collateral/value of the loan) falls below a certain threshold, the collateral is liquidated and repaid to lenders. This setup is optimal for financial speculators who want to obtain leverage. But it also ensures that lenders don't lose money when borrowers default. Risk of theft exists as the digital money you lend out is effectively held by software, and hackers are always trying to find ways to exploit vulnerabilities in code and make away with funds. Some coins that people are depositing for yield farming are also only a few years old at most and could potentially lose their value. Regulators are yet to give a formal opinion on whether reward tokens are or could become securities - decisions that could have a big impact on the coins' use and value. Many high-yield harvesting strategies also carry the risk of liquidation. To maximize returns, many users are adapting complex strategies.

Uniswap and Balancer are the two largest liquidity pools in DeFi, offering liquidity providers (LPs) with fees as a reward for adding their assets to a pool. Liquidity pools are configured between two assets in a 50-50 ratio in Uniswap. Balancer allows for up to eight assets in a liquidity pool with custom allocations across assets. Every time someone takes a trade through a liquidity pool, LPs that contributed to that pool earn a fee for helping to facilitate this. Uniswap pools have offered LPs healthy returns over the past year as DEX volumes picked up. However, optimizing profits requires investors also consider impermanent loss, which is the loss created by providing liquidity for an asset that rapidly appreciates.

Taking advantage of these incentives can be incredibly lucrative. But investors should ensure they aren't earning a dud token. Nobody wants to partake in an incentive scheme that rewards them in a token that becomes worthless.

For the slightly risk-averse who just want to earn a yield on their stable coins, money markets or providing liquidity on Curve Finance is the best option for lower-risk interest. For those who have large cryptocurrency holdings and want to put them to productive use, liquidity pools like Uniswap or Balancer are a good choice. The perfect yield farm for each individual varies based on the amount of capital they have, their investment time horizon, and their desired level of risk.

People have been able to earn interest by lending their cryptocurrencies for several years through apps like BlockFi, as part of a trend of decentralized finance, or DeFi, in which middlemen like banks are replaced with the automated protocols of dApps.