Weekly Hot Take

State of The Secondary OTC Market

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Summary

- The secondary OTC market is a space where people can buy and sell various assets, including locked tokens, equity, or SAFTs, which are hard to trade on public exchanges. Today, the term "secondary OTC market" primarily refers to the buying and selling of locked tokens.

- The main sellers in the secondary OTC market include VCs, project teams, and foundations, who are often motivated by the need to secure early profits or manage selling pressure. Buyers typically fall into two categories: "hodlers" who believe in the long-term potential of the tokens and are attracted by the discounts, and hedgers who seek to profit from price differences through strategic financial maneuvers.

- The secondary OTC market is gaining prominence as it navigates a more bearish sentiment, with tokens often selling at significant discounts due to limited buyer interest. Despite this, the market plays a critical role in managing liquidity and reducing the immediate sell-pressure on public exchanges, thereby contributing to a more stable and resilient crypto ecosystem.

Figure 1 : Current state of the market

Source: imgflip

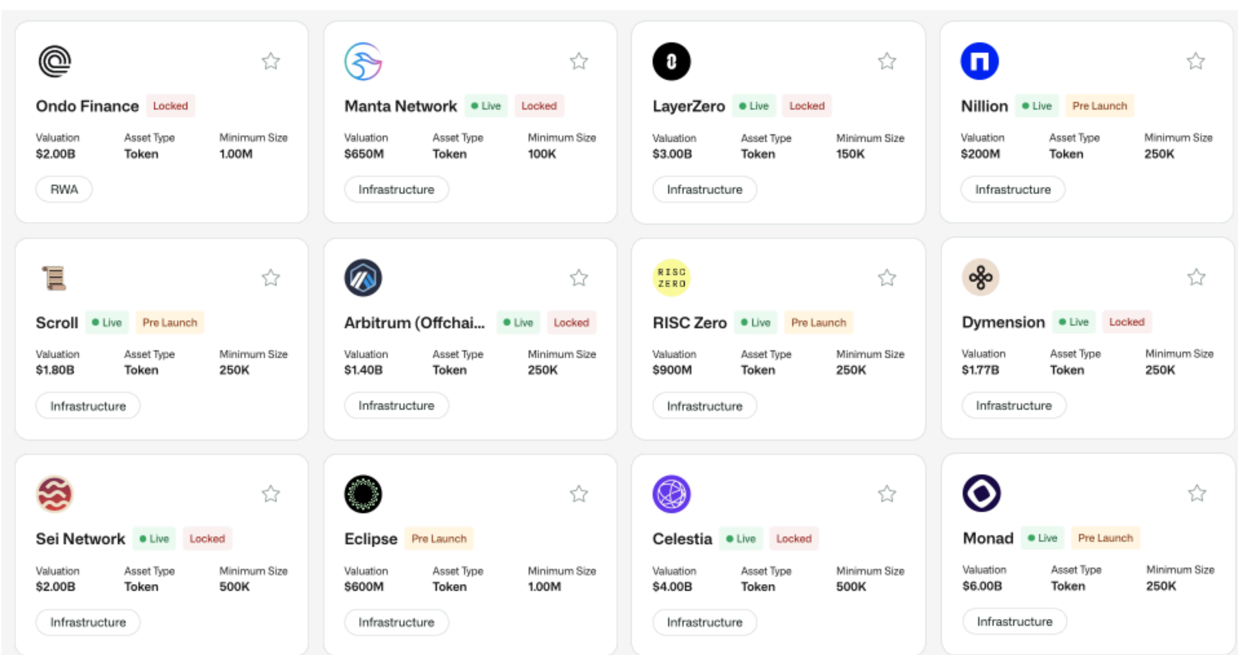
Introduction

The secondary OTC market, though largely inaccessible to most crypto retail investors, is rapidly gaining importance among industry insiders such as VCs, project teams, and foundations. As the dynamics of the crypto market evolve, the secondary OTC market is emerging as a vital space for managing liquidity and securing profits, particularly in a landscape characterized by high valuations and limited liquidity. With that, this report will discuss: 1) what the secondary OTC market is, 2) who the participants are and their motivations, 3) thoughts on the current market status, and 4) insights from Taran, the founder of STIX, an OTC trading platform for private crypto transactions.

What is the Secondary OTC Market

The secondary OTC (over-the-counter) market is a private trading space where buyers and sellers directly negotiate and execute transactions for assets like tokens, equity, or investment contracts such as SAFTs (Simple Agreement for Future Tokens), outside of public exchanges. Most of the assets listed on secondary OTC markets can't be traded on regular exchanges like Binance or OKX for a variety of reasons. Since many crypto projects have tokens that are locked up for a certain period, the secondary OTC market provides investors and teams with a way to sell these assets before they become tradable (unlocked). Today, the term "secondary OTC market" mostly refers to the buying and selling of locked tokens for TGE or even pre-TGE projects, and this essay will focus on the buying and selling of locked tokens for TGE projects.

Figure 2 : What the secondary OTC market look like



Source: STIX

Why is it Becoming an Active Market?

The primary driver behind the boom within the secondary OTC market is the strong incentive for stakeholders to sell their holdings. Currently, many top 20 tokens are being traded at nearly a 50% discount with a one-year lock-up, while some tokens from projects outside the top 100 are trading at discounts as steep as 70%. For example, a token priced at $1 on an exchange like Binance may be available for just $0.30 on platforms like STIX, with a lock-up period of one year and an additional two years of monthly vesting.

This trend is consistent with the recent market environment characterized by high FDV-low float, and increasing hate on VC coins. As discussed in the essay "Is FDV a Meme?," there has been an overwhelming number of new projects entering the market, but without a corresponding influx of participants or liquidity to support this vast supply. Consequently, token prices naturally fall as more tokens are unlocked. Moreover, many of these tokens provide minimal value to the market and are often overvalued in relation to their actual user base and utility. Acknowledging this, project teams and VCs who initially invested in these projects are choosing to sell at a discount now, rather than risk selling at potentially lower prices in the future.

Figure 3 : Current deals available in the market

Project	Discount (to current price)	Deal FDV	Lock-up	Vesting
A	-53%	1.1B	12M	12M
B	-69.06%	1B	6M	24M
C	-61.07%	380M	12M	36M
D	-60%	1.3B	12M (from TGE)	36M
E	-60%	330M	12M (from TGE)	20M
F	-60%	1.5B	12M (from TGE)	36M

Source: Presto Research

Who are the Buyers and Sellers, and Why?

Sellers and Why

Teams

Even with discount rates of 50~70%, project teams often find themselves in a profitable position. Many of these teams consist of small groups, typically 20-30 people, who have built projects over just 2-3 years. Despite the relatively short development period and limited initial investment, these projects are frequently valued at $3 billion or more in FDV. In the Web2 world, it is almost unheard of to create a company valued at $1.5 billion with such a small team in such a short time frame. Given these circumstances, many projects are tempted to sell their tokens at a discount, recognizing the opportunity to secure profits now rather than risking a potential decline in value later.

VCs

VCs are in a similar situation. The recent market conditions have led to rapid and significant increases in valuations, often with seed rounds occurring just six months after pre-seed rounds at three times the valuation. In some cases, VCs have even raised multiple rounds simultaneously, offering different valuations for investments made at the same time. As a result, unless they invested at the latest stage, just before the TGE, many VCs find themselves still significantly in profit even after accounting for a 50% discount in the secondary market. This environment has encouraged VCs to sell, capitalizing on the opportunity to lock in their gains. Moreover, with the current market environment, Limited Partners (LPs) in VC funds have started to focus more on DPI (Distributions to Paid-In Capital) metrics, which further motivates VCs to realize returns, reinforcing the trend of selling in the secondary OTC market.

Foundations

Foundations may have slightly different motivations for participating in the secondary OTC market. While some may recognize the overvaluation of their tokens and seek to sell quickly, others might approach the market strategically. A common strategy involves selling unlocked tokens to investors at a discount, paired with a year-long lock-up. This approach reduces immediate selling pressure in the public market while still allowing the foundation to raise necessary funds for operations. In many cases, this type of transaction can be seen as one of the more positive or "bullish" uses of the secondary OTC market, as it balances the need for operational funding with the goal of maintaining market stability.

Buyers and Why

Hodlers

The first type of buyer in the secondary OTC market consists of those who believe in the long-term potential of the token. These individuals, often referred to as "hodlers," are committed to the project's success and are willing to buy tokens at a 50% discount, fully intending to hold them for several years. For these buyers, the opportunity to purchase tokens at a significant discount is attractive because they plan to maintain their exposure to the project over the long term, anticipating that the token's value will increase as the project matures. The high discount rate provides them with an advantageous entry point, allowing them to accumulate more tokens at a lower cost.

Hedgers

The second type of buyer is driven by the opportunity to profit from the discount through strategic financial maneuvers. These buyers, known as hedgers, use perpetual swaps and other financial instruments to lock in profits from the discounted tokens. By purchasing tokens at a 50% discount and simultaneously shorting them, they can secure a return equivalent to the discount. Additionally, they can earn funding fees, which can further increase their returns if the fees are positive. This approach allows hedgers to capitalize on the price difference between the secondary OTC market and the public market, making it a lucrative strategy for those skilled in managing financial risks.

Why Can’t Sellers Be Hedgers?

While it might seem logical for sellers, such as VCs and project teams, to hedge their positions like buyers instead of selling at huge discounts, several factors make this approach impractical, such as regulatory hurdles and liquidity constraints.

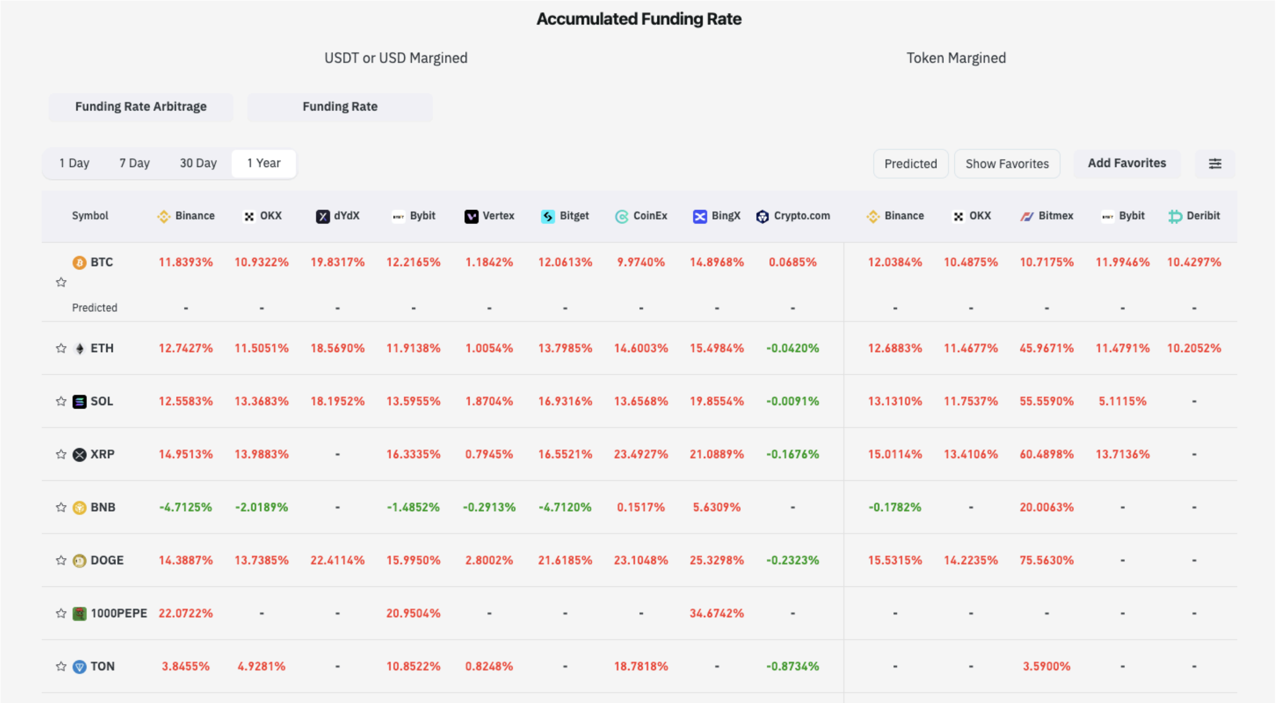
When it comes to regulatory challenges, VCs often face strict rules that limit their ability to engage in certain financial activities, such as shorting tokens—an essential component of an effective hedging strategy. Beyond these regulatory constraints, hedging itself requires a substantial amount of capital to avoid the risk of liquidation. Sellers would need to post significant collateral, often exceeding the value of the tokens they are trying to hedge, because, while the downside of a token’s price is limited, the upside is potentially unlimited. This creates a scenario where the financial requirements for hedging are prohibitively high, especially considering that most of the wealth of VCs and project teams is tied up in the tokens themselves rather than in liquid cash. Moreover, hedging is not as straightforward as it might seem. There are numerous complexities to consider, such as counterparty risks—like the potential for platform failures or bankruptcies, as seen with FTX—and the risk associated with funding fees, which could suddenly turn negative, further complicating the strategy and potentially leading to unexpected losses.

Few thoughts

What Does the Current Market Situation Imply?

The secondary OTC market is currently exhibiting a more bearish sentiment compared to public exchanges, where it struggles to find buyers even when tokens are offered at steep discounts—sometimes as much as 70%. This stands in stark contrast to public exchanges, where investors are often paid to short tokens through positive funding fees. While understanding the intentions of participants in the secondary market is crucial, this trend may reflect a cautious approach by market insiders as they navigate the current conditions.

Figure 4 : Most of the tokens have a positive 1-year accumulated funding rate


Accumulated Funding Rate

USDT or USD Margined | Token Margined

Funding Rate Arbitrage | Funding Rate

1 Day | 7 Day | 30 Day | 1 Year

Predicted | Show Favorites | Add Favorites

	USDT or USD Margined									Token Margined				
Symbol	Binance	OKX	dYdX	Bybit	Vertex	Bitget	CoinEx	BingX	Crypto.com	Binance	OKX	Bitmex	Bybit	Deribit
BTC	11.8393%	10.9322%	19.8317%	12.2165%	1.1842%	12.0613%	9.9740%	14.8968%	0.0685%	12.0384%	10.4875%	10.7175%	11.9946%	10.4297%
Predicted	-	-	-	-	-	-	-	-	-	-	-	-	-	-
ETH	12.7427%	11.5051%	18.5690%	11.9138%	1.0054%	13.7985%	14.6003%	15.4984%	-0.0420%	12.6883%	11.4677%	45.9671%	11.4791%	10.2052%
SOL	12.5583%	13.3683%	18.1952%	13.5955%	1.8704%	16.9316%	13.6568%	19.8554%	-0.0091%	13.1310%	11.7537%	55.5590%	5.1115%	-
XRP	14.9513%	13.9883%	-	16.3335%	0.7945%	16.5521%	23.4927%	21.0889%	-0.1676%	15.0114%	13.4106%	60.4898%	13.7136%	-
BNB	-4.7125%	-2.0189%	-	-1.4852%	-0.2913%	-4.7120%	0.1517%	5.6309%	-	-0.1782%	-	20.0063%	-	-
DOGE	14.3887%	13.7385%	22.4114%	15.9950%	2.8002%	21.6185%	23.1048%	25.3298%	-0.2323%	15.5315%	14.2235%	75.5630%	-	-
1000PEPE	22.0722%	-	-	20.9504%	-	-	-	34.6742%	-	-	-	-	-	-
TON	3.8455%	4.9281%	-	10.8522%	0.8248%	-	18.7818%	-	-0.8734%	-	-	3.5900%	-	-

Source: Coinglass

The Role of the Secondary OTC Market

Despite the bearish sentiment, it's important to recognize that the activity in the secondary market is not solely negative. In fact, the presence of a vibrant secondary market plays a crucial role in the overall health of the broader crypto ecosystem. By facilitating the transfer of tokens between sellers and buyers, the secondary market allows for profit-taking outside of traditional exchange venues. This process can help mitigate the impact of large token unlocks, which have historically been seen as bearish events due to the increased selling pressure they introduce to the market. By enabling these transactions to occur off-exchange, the secondary market reduces the immediate sell-pressure on retail investors when tokens are unlocked. This shift contributes to a more stable and resilient market, where token unlocks no longer necessarily lead to sharp price declines but instead support a healthier, more balanced market environment.

Q&A with Taran, the Founder of STIX

Who are you, and what is STIX?

I'm Taran, Founder of STIX, an OTC trading platform for private crypto transactions. It was founded in early 2023 to build a structured solution for those who want to trade secondaries in crypto. Our primary sellers are team members, early investors and treasuries wanting to sell concentrated, locked token positions. Primary buyers are whales, family offices and hedge funds, amongst others.

How do you see the role of the secondary OTC market evolving in the broader crypto landscape?

Recent drawdowns in new alts have shown that the protocols skyrocketed in price in early 2024 primarily due to their low floats (demand outweighed supply). However, once the markets turned risk-off in Q2, those same alts took a massive hit and a majority have fallen 75+%. Many of these have been seeing massive continuous unlocks, which have almost immediately been sold off on the market, causing further price impact. Examples include Arbitrum, Starknet, Worldcoin, Wormhole, amongst others.

In Q1 and Q2, the same assets were being block traded OTC, predominantly by early investors to de-risk and allocate into more liquid assets (BTC, ETH etc), at 70-80% discounts to the highs. This data made it apparent that most alts were over-valued by at least 5x, with further downside upon introduction of new floating supply.

Our motivation to bring transparency to OTC prices in 2024 (see here) has brought attention to how important the OTC markets actually are. There are also multiple opportunities for buyers to buy distressed positions as well as for sellers to sell OTC without causing market impact.

There's a third party to these trades: the project team. Teams could decide to block OTC trades for a variety of reasons (see here).

Secondaries are important for:

- Removing motivated sellers from your cap table, preventing them from selling on the orderbook
- Introducing new, motivated holders with a higher cost basis
- Increasing the average cost basis of private holders
- Future supply control (introducing new vesting periods, etc)
- Ensuring no under-the-table deals, and having complete visibility over OTC trades

What major trends or topics are you seeing in the secondary OTC market right now?

Two major trends:

1) Treasuries for protocols that haven't excessively raised are now looking to build up their cash positions. We have supported multiple protocol treasuries to structure OTC raises, where buyers are buying in at a lucrative price (vested over a certain period), and treasuries are building up their cash reserves. This allows diversification, de-risk and ensures the team has enough runway to outlast their competition.

2) There exists a clear arbitrage for smart trading firms: buy at a lucrative price OTC and manage hedges on exchanges, usually also eating funding rate. This funding rate / OTC arbitrage exists across 100s of alts, and is a very lucrative market-neutral trade for sophisticated trading firms.

Do you think the buyer's market trend will continue? What's your short-term and long-term view?

- I do not see the funding rate / OTC arbitrage closing anytime soon for most alts, as they all have 2-3y left in their vesting period and a majority have positive funding rates.
- Secondaries are very cyclical: in 2023 the vast majority of OTC volume was for pre-launch assets, primarily due to heavily venture-funded protocols not launching yet. Now that they've all mostly launched, the market has shifted to trading locked token blocks, which are overall less riskier as the spot/perp markets are all mostly established for them and there's a lot of data to analyse.
- Because of continuous monthly unlocks, sellers also have an opportunity to continue de-risking on exchanges, and aren't necessarily pushed to trade OTC. However, the assets which are still in their cliff period (Ethena, Layerzero, IO.net, Aethir, etc), there's still an opportunity for buyers to hunt for the best deals.
- If alts see a run in September and October, lots of sellers will reach out to us at STIX to want to exit as they've already realised that de-risking is always smart. Lots of sellers who didn't want to sell OTC in Q1 would now look to exit at better prices than Q2/Q3. However, I do not see buyers massively optimistic about these premiums, and that's why I think that the buyers' market will continue into 2025.

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