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Research Paper No. 59: Half-yearly Review of the Global and Local Securities Markets

15 July 2016

Executive summary

1. During the first half of 2016, the Dow and the S&P 500 (S&P) rose 2.9% and 2.7% respectively, while the Nasdaq fell 3.3%. In early 2016, economic data and corporate earnings in the US were weaker than expected. The US market recovered as rate hike concerns receded in March. Investors were more optimistic that the US economy would be able to withstand the impact of higher rates. The UK referendum voted to leave (Brexit) the European Union (EU) on 23 June. This heightened volatility not only in the UK but across global financial markets. The market rebounded later as investor sentiment improved on easing concerns about Brexit.

2. In Europe, the FTSE rose 4.2%, whilst the DAX and CAC fell 9.9% and 8.6% respectively. In early 2016, the markets dropped amid continued uncertainties over the global economic outlook and worries about deflation. Declining oil prices triggered concerns about a rise in bad debts at banks which were more exposed to energy companies. In March, the markets rose supported by stimulus measures by the European Central Bank (ECB). In June, the markets became volatile again amid concerns over Brexit. However, losses were recouped later on easing worries about Brexit and hopes of more stimulus by central banks to support the market and economy. In particular, the UK market rebounded given the support by a weaker British pound, which might translate into stronger overseas revenues.

3. In Asia, the Nikkei 225 Index in Japan dropped 18.2% during the first half of 2016. The Japanese market fell on lingering worries over weak global and domestic economic outlook and sliding commodity prices. A stronger yen also aggravated losses. The performance of other major regional markets was mixed during the first half of 2016, ranging from a 2.3% loss in Malaysia to a 12.2% gain in Thailand.

4. In the Mainland, the Shanghai Composite Index (SHCOMP) and the Shenzhen Composite Index (SZCOMP) dropped 17.2% and 14.5% respectively in the first half of 2016. There were concerns about a weaker renminbi and the uncertain economic outlook. Investors were also worried that the government might adopt prudent monetary policies in spite of a sluggish economic outlook. Concerns over default risks in the corporate bond sector also weighed on the market.

5. In Hong Kong, the Hang Seng Index (HSI) and the Hang Seng China Enterprises Index (HSCEI) fell 5.1% and 9.8% respectively following the decline in the Mainland market. Volatility in the renminbi and commodity prices added to the losses. Uncertainties about the timing of the US interest rate hikes as well as concerns about rising credit risks and increasing bad debts in the Mainland weighed on the market. Sentiment was affected by uncertainties about Brexit. Expectations over central banks' stimulus measures and speculation of the launch of Shenzhen-Hong Kong Stock Connect trimmed some losses.

6. Some of the major risks and uncertainties facing the Hong Kong market include:
    - doubts about the timing of interest rate hikes in the US and a stronger US dollar, which may increase the volatility of oil prices;
    - concerns about the Mainland economic slowdown and renminbi volatility as well as dimmed hopes for government stimulus measures; and
    - political and economic uncertainties in Europe and repercussions on global financial markets after the UK voted 'Yes' to Brexit.

7. Trading in the cash market declined, but trading of exchange-traded derivatives rose. Average daily trading in the cash market fell 22% from the second half of 2015. Trading in futures products rose 16%, while options products trading remained at a similar level as the second half of 2015.

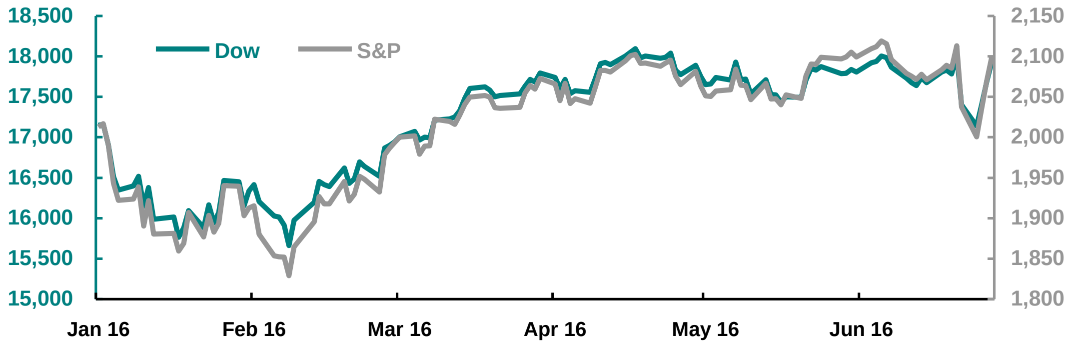
Performance of stock markets during the first half of 2016

8. During the first half of 2016, the Hong Kong market fell amid volatile global and Mainland markets. Worries about the global economic outlook heightened, reflecting uncertainties about US interest rate hikes. Concerns over the slowdown of the Mainland economy as well as volatile renminbi and stock market weighed on sentiment in the Hong Kong market.

The US

9. During the first half of 2016, the Dow and S&P rose 2.9% and 2.7% respectively, whilst the Nasdaq fell 3.3%.
10. In early 2016, the market fell on concerns over the global economic outlook. Economic data and corporate earnings in the US were weaker than expected. Oil prices dropped to below US$30 per barrel (a 12-year low) at one point, adding to worries about slowing demand. The weakening of the renminbi also heightened concerns over the Mainland economic slowdown.
11. Since mid-February, the market rebounded. Rate hike concerns eased somewhat as the Fed indicated a cautious approach to interest rate hikes amid mounting global risks. Positive economic data suggested that the US economy had regained momentum.
12. In early June, the S&P approached a record high as oil prices rebounded strongly to over US$50 per barrel. Investors were more optimistic that the US economy would be able to withstand the impact of higher rates.
13. The market slid after the UK voted to leave the EU on 23 June, but rebounded strongly later on easing concerns about the impact of Brexit. Investors anticipated more stimulus by central banks to support the market.
14. Whilst the Fed kept interest rates unchanged as expected in the June policy meeting, it signaled the possibility of up to two interest rate hikes in 2016. However, after the Brexit referendum, the market rebounded given expectations that the Fed might delay raising rates.

Performance of Dow and S&P during the first half of 2016



Source: Bloomberg

Performance of major stock markets

		End of June 2016	% change			PE Ratios
		Index Level	Year-to-date	2015	2014	End-June 2016
Hong Kong and the Mainland						
Hong Kong	-HSI	20,794.4	-5.1%	-7.2%	1.3%	10.32
	-HSCEI	8,712.9	-9.8%	-19.4%	10.8%	6.81
Mainland	-Shanghai Comp	2,929.6	-17.2%	9.4%	52.9%	16.14
	-Shenzhen Comp	1,974.2	-14.5%	63.2%	33.8%	45.29
Asia						
Japan	-Nikkei 225	15,575.9	-18.2%	9.1%	7.1%	18.62
Australia	-AOI	5,310.4	-0.6%	-0.8%	0.7%	25.27
Taiwan	-TWSE	8,666.6	3.9%	-10.4%	8.1%	15.36
Korea	-KOSPI	1,970.4	0.5%	2.4%	-4.8%	16.58
Singapore	-STI	2,840.9	-1.5%	-14.3%	6.2%	11.94
Thailand	-SET	1,445.0	12.2%	-14.0%	15.3%	19.79
Malaysia	-KLCI	1,654.1	-2.3%	-3.9%	-5.7%	18.21
Indonesia	-JCI	5,016.6	9.2%	-12.1%	22.3%	26.86
India	-Nifty	8,287.8	4.3%	-4.1%	31.4%	21.09
Philippines	-PCOMP	7,796.3	12.1%	-3.9%	22.8%	22.97
Vietnam	-VN	632.3	9.2%	6.1%	8.1%	13.74
US						
US	-Dow	17,930.0	2.9%	-2.2%	7.5%	17.01
	-Nasdaq	4,842.7	-3.3%	5.7%	13.4%	30.48
	-S&P	2,098.9	2.7%	-0.7%	11.4%	19.44
Europe						
UK	-FTSE	6,504.3	4.2%	-4.9%	-2.7%	48.57
Germany	-DAX	9,680.1	-9.9%	9.6%	2.7%	21.24
France	-CAC	4,237.5	-8.6%	8.5%	-0.5%	23.20
PIIGS and Hungary						
Portugal	-PSI20	4,453.7	-16.2%	10.7%	-26.8%	28.70
Italy	-FTSEMIB	16,197.8	-24.4%	12.7%	0.2%	42.15
Ireland	-ISEQ	5,642.5	-16.9%	30.0%	15.1%	16.76
Greece	-ASE	542.1	-14.1%	-23.6%	-28.9%	n.a.
Spain	-IBEX	8,163.3	-14.5%	-7.2%	3.7%	20.45
Hungary	-BUX	26,325.6	10.1%	43.8%	-10.4%	n.a.
Middle East and North Africa						
Egypt	-EGX30	6,942.5	-0.9%	-21.5%	31.6%	n.a.
Dubai	-DFMGI	3,311.1	5.1%	-16.5%	12.0%	11.12
Other BRIC markets						
Brazil	-IBOV	51,526.9	18.9%	-13.3%	-2.9%	86.60
Russia	-MICEX	1,891.1	7.4%	26.1%	-7.1%	7.67

Source: Bloomberg

Europe

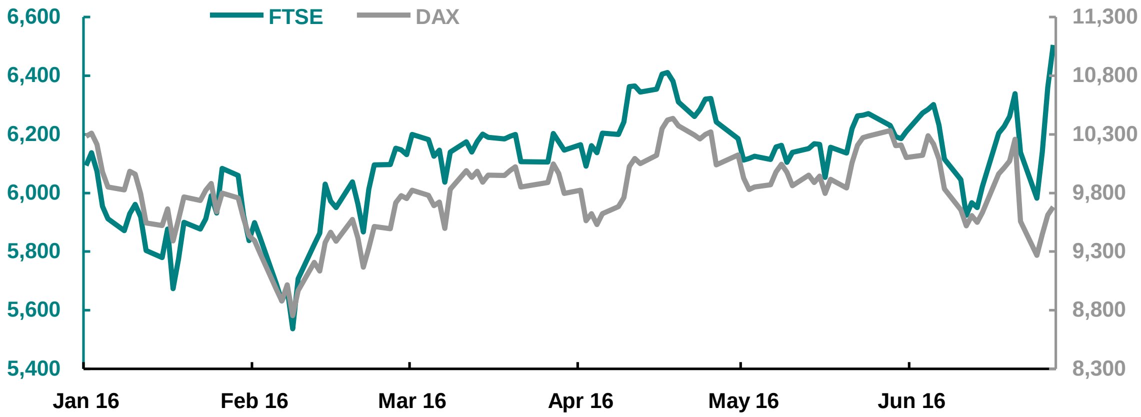
15. In Europe, the FTSE rose 4.2%, whilst the DAX and CAC fell 9.9% and 8.6% respectively. In early 2016, the markets slid reflecting persisting uncertainties over the global economic outlook. Worries about deflation also heightened after the Swedish central bank cut interest rates further to -0.50%, from -0.35%. Declining oil prices triggered concerns about higher bad debts at banks with exposures to energy companies.

16. The markets rose, given stimulus measures by the ECB. In early March, the ECB unexpectedly cut its benchmark interest rate to 0% from 0.05% and expanded its monthly assets purchase programme from €60 billion to €80 billion. It also offered cheap funding to banks in order to support the sector in a low interest rate environment.

17. In April, optimism over likely further monetary easing measures grew as regional economic outlook remained weak. The International Monetary Fund cut its GDP forecast for the Euro area to 1.5% from 1.7% for 2016.

18. In June, the markets became volatile again as the UK voted to exit the EU. There were concerns about the implications of Brexit on regional economies, as well as financial and political stability. The British pound fell to its lowest level against the dollar since 1985. Moody's Investors Service lowered the rating outlook for the UK to negative from stable. Standard & Poor Global Ratings lowered the UK's rating by two notches to AA from AAA, while Fitch Ratings also downgraded its rating by one notch to AA from AA+. Political uncertainties heightened in the UK after the resignation of Prime Minister David Cameron. Later, losses were recouped on easing worries about Brexit and hopes of more stimulus by central banks to support the market and economy. In particular, the UK market rebounded given the support by a weaker British pound, which might translate into stronger overseas revenues.

Performance of FTSE and DAX during the first half of 2016



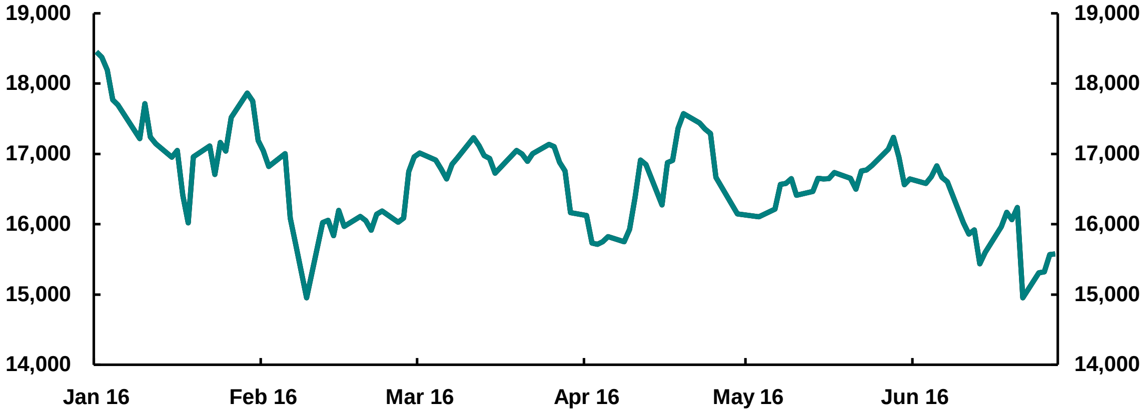
Source: Bloomberg

Asia

19. After four consecutive years of gains, the Nikkei 225 Index in Japan dropped 18.2% during the first half of 2016. The Japanese market fell on lingering worries over weak global and domestic economic outlook as well as sliding commodity prices. In January, the Bank of Japan surprised markets by adopting a negative interest rate policy and kept the size of its asset purchase plan unchanged. Hopes for further government stimulus measures faded. The market dropped further as a delay in the consumption tax hike until 2019 fanned worries over a looming domestic economic slowdown. After the UK voted to leave the EU, the yen strengthened to a two-year high as a result of strong demand for safe-haven investment.

20. The performance of other major regional markets was mixed during the first half of 2016, ranging from a 2.3% loss in Malaysia to a 12.2% gain in Thailand.

Performance of Nikkei 225 during the first half of 2016



Source: Bloomberg

The Mainland

21. The SHCOMP dropped 17.2% in the first half of 2016. The average daily turnover in Shanghai decreased 63% to RMB199.2 billion in the first half of 2016.

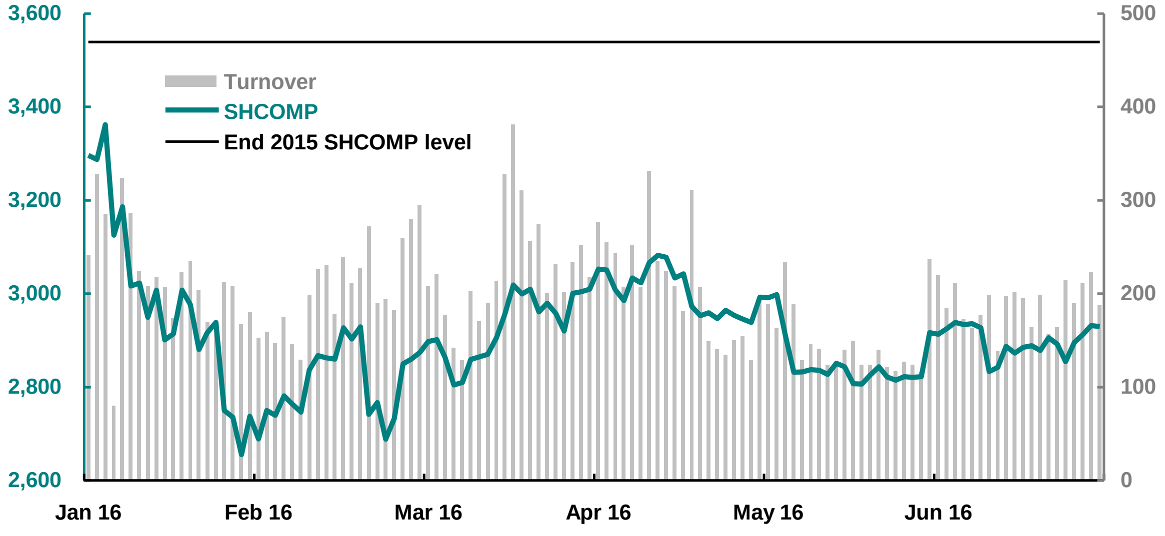
22. With the implementation of the circuit breaker mechanism, trading was halted on two days in early January. The China Securities Regulatory Commission later suspended the circuit breaker altogether. Also, the daily renminbi reference rate was lowered to a five-year low. There were concerns that the renminbi might further weaken amid the uncertain economic outlook.

23. In February, the People's Bank of China (PBoC) announced a cut of 0.5% in the bank reserve requirement ratio (RRR). The market subsequently rose amid remarks by government leaders on stabilising growth. Speculation about stock purchases by state-backed funds and a rebounding renminbi helped to lift market sentiment.

24. In March, Moody's and S&P Global Ratings downgraded the outlook for the Mainland's sovereign credit rating from stable to negative, citing concerns about the debt burden and the pace of reforms. Although the downgrade had limited impact on the market, this raised concerns about the outlook for the Mainland economy.

25. The market declined amid worries about the economic outlook later. GDP growth in Q1 2016 slowed to a 7-year low of 6.7%. Investors were also worried that the government might adopt prudent monetary policy in spite of a sluggish economic outlook. Concerns over renminbi depreciation and default risks in the corporate bond sector weighed on the market. In June, investor sentiment was further dampened by the MSCI's decision to delay the inclusion of A-shares into its emerging market indices.

SHCOMP and Shanghai Market Turnover (RMB billion) during the first half of 2016

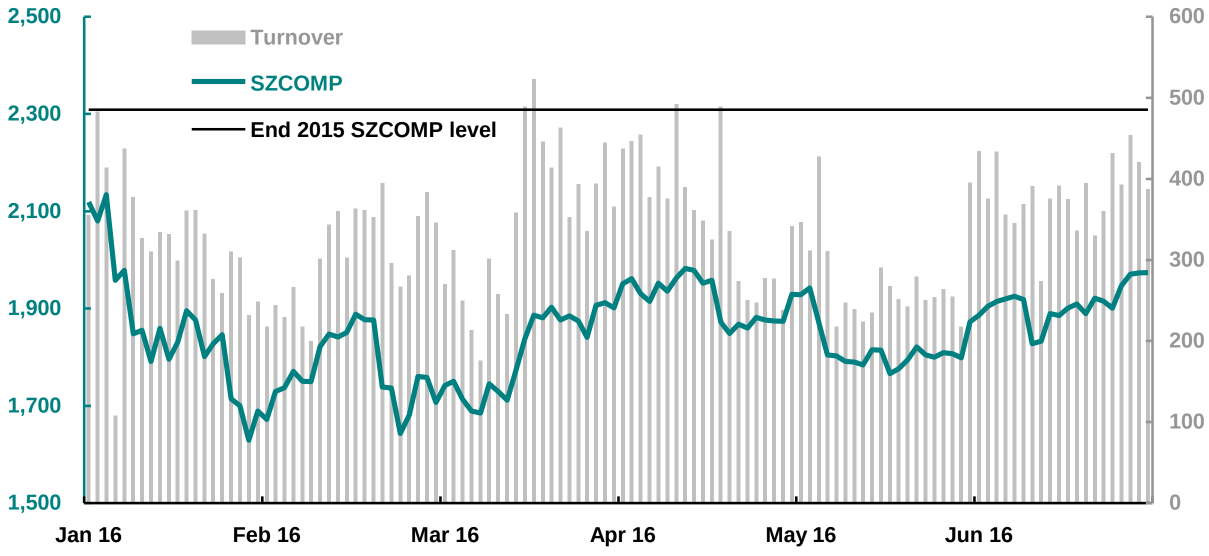


Source: Bloomberg

26. The SZCOMP dropped 14.5% in the first half of 2016. The average daily turnover decreased 34% to RMB332.0 billion.

27. In early 2016, the Shenzhen market dropped sharply on concerns about the Mainland economic outlook. The market was volatile, with small-cap stocks sharply lower on concerns over their high valuations. In March, investor sentiment was boosted by news of the possible delay in the launch of the Strategic Emerging Industries Board in Shanghai, viewed as a potential competitor to the ChiNext Board. Hopes of government support for the market trimmed some losses. In June, while MSCI delayed the inclusion of A-shares into its indices, investor sentiment was boosted by optimism about the possible launch of Shenzhen-Hong Kong Stock Connect.

SZCOMP and Shenzhen Market Turnover (RMB billion) during the first half of 2016



Source: Bloomberg

Hong Kong

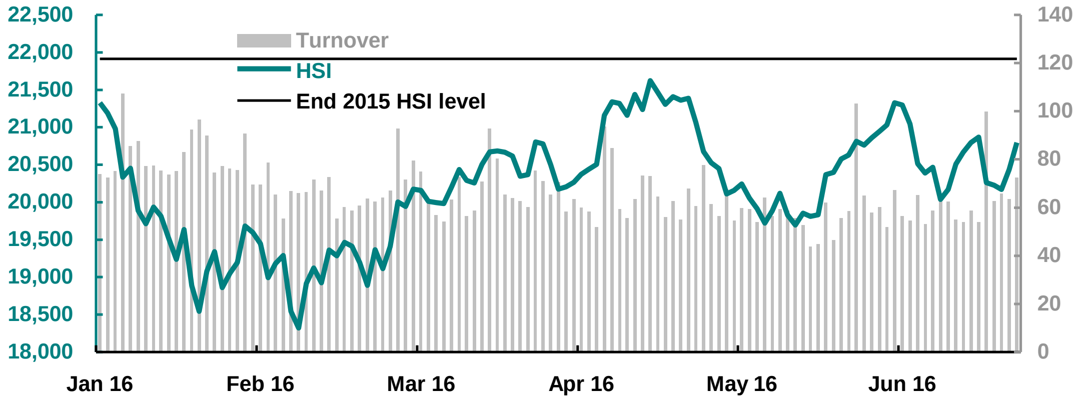
28. During the first half of 2016, the Hong Kong market fell. The HSI and the HSCEI fell 5.1% and 9.8% respectively.

29. In January, the market fell on intensifying worries over Mainland economic slowdown. Volatility in the renminbi and commodity prices also added to losses. Concerns over a weakening Hong Kong dollar weighed on the market. The Hong Kong dollar hit an 8-year low at one point.

30. Later, following gains in overseas and Mainland markets, the local market rebounded amid optimism about further stimulus measures by global central banks. The RRR cut by the PBoC in February and easing worries over interest rate hikes in the US lifted sentiment. Financial stocks were higher. Higher oil prices also lent support to energy stocks. Yet, concerns about rising credit risk and increasing bad debts in the Mainland capped gains.

31. In April, the local market fell amid lingering concerns about the economic outlook in the Mainland and uncertainties about the timing of US rate hikes. Investor sentiment was fragile amid volatility in overseas and Mainland markets. In June, sentiment was affected by uncertainties about the UK's vote to exit the EU. Later, the market rebounded amid expectations over central banks' stimulus measures and speculation of the launch of Shenzhen-Hong Kong Stock Connect.

HSI and Hong Kong Market Turnover ($[1] billion) during the first half of 2016



Source: Bloomberg

Risks and uncertainties facing the Hong Kong market

32. The performance of the Hong Kong market will continue to be affected by a combination of risks related to the Mainland and uncertainties in overseas markets.

    - In the US, the timing of interest rate hikes remains uncertain. The US dollar may continue to strengthen, weighing on commodity prices. This may result in capital outflows from emerging markets, some of which rely strongly on commodity exports. Investors are also concerned about the impact of rising interest rates on the US and global economy. As higher volatility will likely continue in overseas and regional markets, the Hong Kong market may be affected.

[1] Unless otherwise stated, the $ in this paper denotes the Hong Kong dollar.

- In the Mainland, investor sentiment is fragile given mixed economic data and the volatile renminbi exchange rate. There are concerns that the renminbi might further depreciate amid worries about the Mainland's economic slowdown. Dimmed hopes for proactive government stimulus measures will likely continue to weigh on the market. Investors are also cautious about high bad debts and rising credit default risks which can affect the Mainland banking sector. All of these will continue to affect the outlook of the Hong Kong market, which is closely linked with the Mainland market.
- In Europe, economic recovery remains fragile and worries over deflation persist. It is uncertain as to what extent the supportive policy would be able to offset the impact of any future US interest rate hikes on the economy. If economic growth stalls, the financial health of some indebted EU nations may be affected. In addition, Brexit has complicated the situation and created further political and economic uncertainties in Europe. This heightened uncertainty of the global economic outlook will add more volatility to global and local markets.

Major statistics of Hong Kong securities market during the first half of 2016

Trading activity in the local stock market

33. Trading in the local stock market decreased. During the first half of 2016, average daily turnover amounted to \$67.5 billion, 22% lower than the \$86.7 billion in the second half of 2015.

34. Mainland stocks remained the most actively traded. Their share of total market turnover was 32% in the first half of 2016 (35% in the second half of 2015), while HSI stocks (excluding H-shares and red chips) accounted for about 18% (14% in the second half of 2015).

Average Daily Turnover ($ billion)

	1H 2016		2H 2015		1H 2015		% change over	
							2H 2015	1H 2015
HSI (ex H shares & red chips)	12.1	(18%)	12.5	(14%)	15.5	(12%)	-3%	-22%
Mainland Stocks	21.5	(32%)	30.0	(35%)	45.7	(36%)	-28%	-53%
H-shares	*15.5*	*(23%)*	*22.0*	*(25%)*	*34.1*	*(27%)*	-30%	-55%
Red chips	*6.1*	*(9%)*	*8.0*	*(9%)*	*11.6*	*(9%)*	-25%	-48%
Derivative Warrants	13.2	(20%)	15.0	(17%)	21.6	(17%)	-12%	-39%
CBBCs	6.0	(9%)	8.1	(9%)	6.7	(5%)	-26%	-11%
ETFs	4.5	(7%)	6.8	(8%)	10.9	(9%)	-34%	-59%
Others	10.2	(15%)	14.3	(17%)	24.9	(20%)	-29%	-59%
Market Total	**67.5**	**(100%)**	**86.7**	**(100%)**	**125.3**	**(100%)**	-22%	-46%

Remark: Percentages in parenthesis denote market share.
Sources: Hong Kong Exchanges and Clearing Limited (HKEX) and SFC Research

Shanghai-Hong Kong Stock Connect

35. Stock Connect was launched on 17 November 2014 to provide mutual trading access between the Shanghai and Hong Kong stock markets. The scheme allows investors of both markets to trade eligible shares listed on the other market, subject to daily and aggregate quotas.

36. The northbound daily quota is set at RMB13 billion, and the southbound daily quota at RMB10.5 billion. During the first half of 2016, daily quota usage ranged between:
    - RMB0.004 billion (0.03%) and RMB4.5 billion (34.5%) for northbound; and
    - RMB0.02 billion (0.2%) and RMB5.7 billion (54.3%) for southbound.

37. The northbound aggregate quota is set at RMB300 billion, and the southbound aggregate quota at RMB250 billion. As of 30 June 2016, cumulatively:

- The northbound aggregate quota usage was RMB134.7 billion (44.9%); and
- The southbound aggregate quota usage was RMB192.1 billion (76.8%).

38. As of 30 June 2016, there were 567 eligible stocks for northbound trading and 317 eligible stocks for southbound trading. During the first half of 2016:

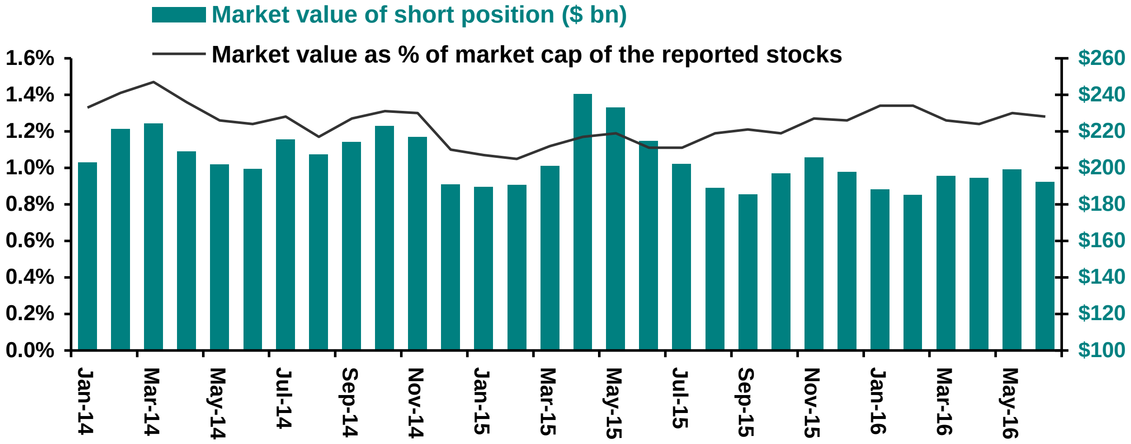
- Northbound average daily trading was RMB3.0 billion, or 0.8% of the Shanghai market trading; and
- Southbound average daily trading was RMB2.2 billion, or 1.9% of the Hong Kong market trading.

Short-selling activity

39. Compared to the second half of 2015, short selling was lower in absolute terms but higher as a percentage of total market turnover. Average daily short selling was $8.4 billion, or 12.5% of total market turnover in the first half of 2016. In the second half of 2015, average daily short selling was $9.0 billion, or 10.5% of total market turnover.

40. Based on the data submitted, as at 30 June 2016, aggregated short positions amounted to $192.3 billion (or 1.3% of the market cap of the reported stocks).

Market value of short positions during the first half of 2016



Sources: HKEX and SFC Research

Initial public offerings

41. There were 38 IPOs in Hong Kong during the first half of 2016. IPO funds raised totaled $43.6 billion. This compared to 124 IPOs ($261.3 billion) in 2015. IPO funds raised by Mainland companies accounted for 91% of the market total during the first half of 2016.

Exchange-traded funds

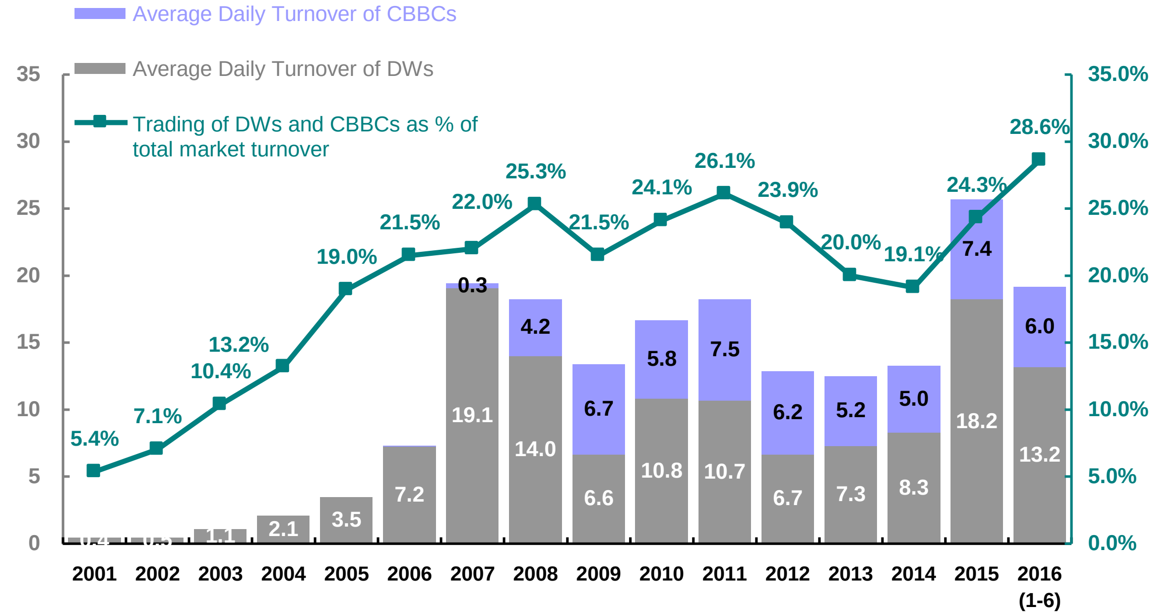
42. The number of exchange-traded-funds (ETFs) rose to 143 as at end-June 2016 from 133 as at end-2015. Their average daily turnover was $4.5 billion in the first half of 2016, which was 34% lower than the $6.8 billion turnover in the second half of 2015. ETFs accounted for 7% of total market turnover in the first half of 2016 (compared to 8% in the second half of 2015). The average daily turnover of A-share ETFs was $2.1 billion, contributing 46% of total ETF turnover (compared to $4.3 billion and 63% in the second half of 2015).

Derivatives warrants and callable bull/bear contracts

43. In the first half of 2016, trading of derivatives warrants (DWs) decreased in absolute terms but increased as a percentage of total market turnover, due to less active market trading. The average daily turnover of DWs fell to $13.2 billion (19.6% of total market turnover), compared to $15.0 billion (17.3% of total market turnover) in the second half of 2015.

44. In the first half of 2016, trading in callable bull/bear contracts (CBBCs) decreased in absolute terms and as percentage of total market turnover. The average daily turnover of CBBCs decreased to $6.0 billion (8.9% of total market turnover), compared to $8.1 billion (9.4% of total market turnover) in the second half of 2015.

Turnover of DWs and CBBCs ($ billion)



Source: SFC Research

Exchange-traded derivatives

45. In the first half of 2016, average daily trading in exchange-traded derivatives increased by 7%, compared to the second half of 2015. Average daily trading in futures products rose 16%. Among futures products, HSI futures and HSCEI futures were the most actively traded contracts, representing about 38% and 40% of all futures trading respectively. The average daily trading volume of HSI futures rose by 40% compared to the second half of 2015, whilst that of HSCEI futures rose by 5%.

46. Average daily trading in options in the first half of 2016 remained at a similar level as the second half of 2015. Stock options remained the most actively traded options products but their trading volume fell by 5%, compared to the second half of 2015.

Average daily trading volume of derivatives traded on HKEX by product type (contracts)

		1H 2016	2H 2015	1H 2015
Futures	HSI Futures	138,433	98,587	72,875
	Mini-HSI Futures	52,639	45,050	36,118
	HSCEI Futures	145,893	138,658	131,474
	Mini-HSCEI Futures	22,297	28,377	32,488
	Stock Futures	1,183	2,275	3,656
	3-Month HIBOR Futures	0	0	1
	Renminbi Currency Futures	2,194	1,347	766
	Other futures products	3,298	1,072	1,350
	Total Futures	**365,936**	**315,366**	**278,728**
Options	HSI Options	38,526	29,495	31,398
	Mini-HSI Options	5,243	3,875	4,508
	HSCEI Options	78,775	72,910	50,559
	Stock Options	292,861	308,486	442,928
	Other options products	87	112	256
	Total Options	**415,491**	**414,878**	**529,649**
Total Futures and Options		**781,427**	**730,244**	**808,377**

Remark: Figures may not add up to totals due to rounding.
Sources: HKEX and SFC Research

After-hours futures trading

47. Trading of HSI and HSCEI futures during the after-hours futures trading (AHFT) session relative to the daytime session was active during the first half of 2016.

- The average daily trading volume of HSI and HSCEI futures was 26,822 contracts, about 10.4% of the volume during the daytime session (16,177 contracts and 7.3% in the second half of 2015).
- The average daily volume of mini-HSI futures and mini-HSCEI futures was 13,726 contracts, about 22.3% of the volume during the daytime session (8,356 contracts and 12.8% in the second half of 2015).
- The average daily volume of renminbi currency (USD/CNH) futures was 258 contracts, about 13.3% of the volume during the daytime session (191 contracts and 16.5% in the second half of 2015).