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Research Paper No. 52: A review of the global and local securities markets in 2012

18 January 2013

Executive summary

1. After the corrections in 2011, most major markets rebounded in 2012 as central banks injected liquidity into the banking system. Improved economic data provided support to the markets, some of which even rose to their multi-year highs. However, the markets became more volatile by late 2012 on uncertainties over the fiscal cliff problem in the US and the European debt problem.

2. In the US, the Dow, Nasdaq and S&P 500 rose 7.3%, 15.9% and 13.4% respectively in 2012 as optimism about an economic recovery outweighed worries overhanging the lingering Eurozone debt problem. After the announcement of the third round of quantitative easing (QE3), the Dow reached its highest level in five years in October. In December, the Federal Reserve (Fed) announced the fourth round of quantitative easing (QE4). However, uncertainties about the fiscal cliff problem trimmed some gains.

3. The European markets gained, tracking the rise in the US market. The successful debt restructuring in Greece provided support. The European Central Bank (ECB) cut the benchmark interest rate to a record low in July and launched the Outright Monetary Transactions (OMT) programme, a potentially unlimited bond-buying programme in September. While the credit ratings of Spain and France were downgraded, concerns over the Eurozone debt problem had eased after Spain formally requested a bailout fund. In 2012, the FTSE, DAX and CAC rose 5.8%, 29.1% and 15.2% respectively. The PIIGS markets (namely Portugal, Ireland, Italy, Greece, and Spain) rose 2.9–33.4%, with the exception of the Spanish market, which fell 4.7%.

4. Major Asian markets advanced amid liquidity inflows. Optimism about the outlook for Asian economies prompted institutional buying in regional equity markets. By the end of 2012, major Asian markets recorded gains, ranging from 8.9% in Taiwan to 35.8% in Thailand.

5. In early 2012, the Mainland market declined given worries of a possible slowdown of the economy, uncertainties about the monetary policy outlook and concerns about corporate earnings. However, the market rebounded strongly towards the end of the year. Investor optimism over supportive policies by the new leadership paced gains. Economic data improved, which also boosted hopes for a bottoming out of the economy. In 2012, the Shanghai Composite Index rose 3.2%.

6. After losing some 20% in 2011, the Hong Kong market rebounded in 2012. The market advanced amid supportive policies in the Mainland and improved economic data in the US. Quantitative easing by major central banks and fund inflows provided support. Tracking the gains in major overseas markets, the Hang Seng Index (HSI) fluctuated upwards to a 16-month high at 22,656 points by the end of the year. The HSI outperformed most major markets. By year-end, the HSI and Hang Seng China Enterprises Index (HSCEI) gained 22.9% and 15.1% respectively.

7. Despite the strong performance, there are risks and uncertainties facing the Hong Kong market, which include:

   (a) *Reversal of capital inflows:* During the year, Asian markets had accumulated gains given capital inflows. However, market sentiment remains fragile amid uncertainties about the US and European debt problems. Reversals of fund flows may cause corrections in the markets.

(b) *Risks of inflation and increase in interest rates:* The global market performance has been strong under a low interest rate environment. However, if the inflation rate rebounds unexpectedly, this may increase the risk of interest rate hikes and cause corrections in stock and asset prices.

(c) *Global macro risks:* The market outlook may be affected by unresolved global macro risks such as the debt ceiling in the US, the Eurozone debt problem, continued recession in Japan as well as possible economic slowdown in China and other emerging markets. The concern is that deterioration in the global economic environment could negatively impact market confidence. This may lead to corrections in the stock market as fund managers re-allocate investment portfolios.

8. Trading in both the cash market and exchange-traded derivatives fell in 2012. The average daily trading in the cash market fell 23%, while that in futures and options dropped 8% and 19% respectively from 2011.

Performance of worldwide stock markets in 2012

9. Major stock markets around the world rebounded in 2012 amid abundant global market liquidity after the corrections in 2011. Some markets even rose to multi-year highs. However, uncertainties over the fiscal cliff problem in the US and the European debt problem capped the gains.

- The US benchmark indices once advanced to their highest levels in more than four years, supported by quantitative easing and the low interest rate policy. Improved economic data provided support. However, gains were trimmed by concerns about the fiscal cliff problem.

- Most major European markets advanced given easing concerns about the debt problem in Greece and optimism about the ECB's bond-purchase programme. However, worries about a possible economic slowdown weighed on sentiment.

- In the Mainland, the Shanghai Composite Index once fell to a four-year low on concerns about the risks of a slowdown for the economy, uncertainties about the government's monetary policy stance and worries about corporate earnings outlook. In late 2012, the market rebounded strongly given optimism about supportive policies by the new leadership and improved economic data.

- In Hong Kong, the market rebounded amid improved corporate earnings, optimism about supportive policies in the Mainland and improved economic data in the US. The HSI outperformed most major markets.

Performance of major stock markets

		End-2012	% change			PE ratio
		Index level	2012	2011	2010	End-2012
Hong Kong and the Mainland						
HK	-HSI	22,656.92	22.9%	-20.0%	5.3%	11.63
	-HSCEI	11,436.16	15.1%	-21.7%	-0.8%	9.54
China	-Shanghai Comp	2,269.13	3.2%	-21.7%	-14.3%	12.56
	-Shenzhen Comp	881.17	1.7%	-32.9%	7.5%	25.57
Asia						
Japan	-Nikkei 225	10,395.18	22.9%	-17.3%	-3.0%	26.78
Australia	-AOI	4,664.59	13.5%	-15.2%	-0.7%	19.49
Taiwan	-TWSE	7,699.50	8.9%	-21.2%	9.6%	25.05
Korea	-KOSPI	1,997.05	9.4%	-11.0%	21.9%	19.42
Singapore	-STI	3,167.08	19.7%	-17.0%	10.1%	12.03
Thailand	-SET	1,391.93	35.8%	-0.7%	40.6%	17.32
Malaysia	-KLCI	1,688.95	10.3%	0.8%	19.3%	15.47
Indonesia	-JCI	4,316.69	12.9%	3.2%	46.1%	17.32
Philippines	-PCOMP	5,812.73	33.0%	4.1%	37.6%	18.72
Vietnam	-VNINDEX	413.73	17.7%	-27.5%	-2.0%	11.51
US						
US	-Dow	13,104.14	7.3%	5.5%	11.0%	13.16
	-Nasdaq	3,019.51	15.9%	-1.8%	16.9%	20.35
	-S&P 500	1,426.19	13.4%	-0.0%	12.8%	14.51
Europe						
UK	-FTSE100	5,897.81	5.8%	-5.6%	9.0%	15.25
Germany	-DAX	7,612.39	29.1%	-14.7%	16.1%	14.72
France	-CAC	3,641.07	15.2%	-17.0%	-3.3%	12.46
PIIGS and Hungary						
Portugal	-PSI20	5,655.15	2.9%	-27.6%	-10.3%	N/A
Italy	-FTSEMIB	16,273.38	7.8%	-25.2%	-13.2%	N/A
Ireland	-ISEQ	3,396.67	17.1%	0.6%	-3.0%	16.90
Greece	-ASE	907.90	33.4%	-51.9%	-35.6%	N/A
Spain	-IBEX	8,167.50	-4.7%	-13.1%	-17.4%	24.36
Hungary	-BUX	18,173.20	7.1%	-20.4%	0.5%	19.01
Middle East and North Africa						
Egypt	-EGX30	5,462.42	50.8%	-49.3%	15.0%	17.48
Dubai	-DFMGI	1,622.53	19.9%	-17.0%	-9.6%	11.73
Other BRIC						
Brazil	-IBOV	60,952.08	7.4%	-18.1%	1.0%	21.00
Russia	-MICEX	1,477.87	5.4%	-16.9%	23.2%	5.89
India	-Nifty	5,905.10	27.7%	-24.6%	17.9%	16.24

Source: Bloomberg

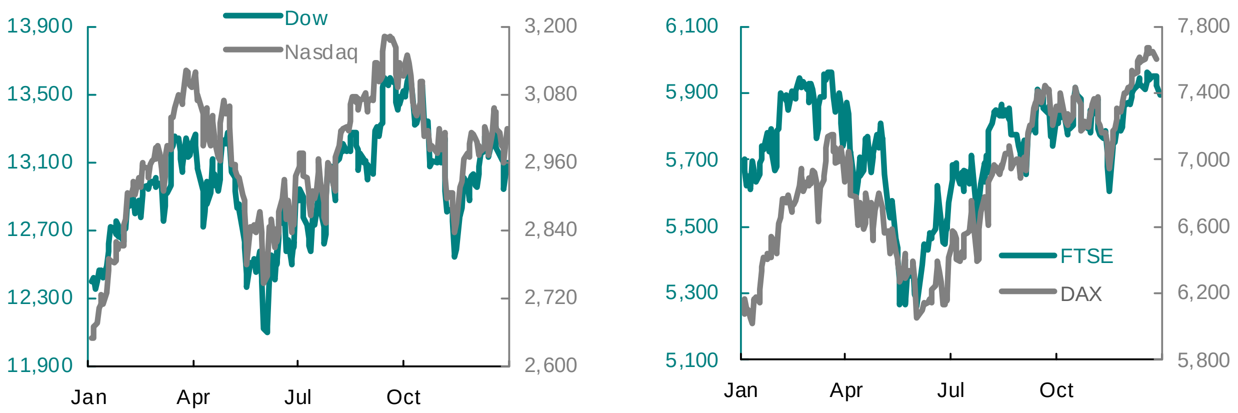
The US

10. By the end of 2012, the Dow, Nasdaq and S&P 500 rose 7.3%, 15.9% and 13.4% respectively as optimism over the economic outlook outweighed worries overhanging the lingering Eurozone debt problem.

11. In early 2012, investors were optimistic about an economic recovery in the US. Key figures such as job data, manufacturing orders, retail sales and new home sales were encouraging. Both the Dow and S&P 500 reached their four-year highs while the Nasdaq rose to its highest level since February 2001. The market then corrected and bottomed in May amid uncertainties in Eurozone political developments and financial stability.

12. The market recovered strongly as optimism returned on the news of central bank action across the world adopting stimulus measures to boost economic growth and combat the Eurozone debt crisis. In September, the Fed announced QE3, under which it would buy US$40 billion worth of mortgage-backed securities every month until the labour market improved significantly. The Dow rose to its highest level in five years in early October.

13. After President Obama was re-elected in early November, investors were optimistic that the loose monetary policy might continue. In December, the Fed announced QE4, a new round of Treasury bond purchase programmes, and pledged to keep the interest rates low provided that the unemployment rate was above 6.5% and the inflation rate was below 2.5%. However, gains were trimmed by concerns over the fiscal cliff problem, which would likely trigger automatic tax increases and spending reductions if a deal on reducing the budget deficit could not be reached by the end of 2012. Credit rating agencies warned that the US was also faced with the risk of a credit rating downgrade if it were to fail to raise its debt ceiling in early 2013.



Performance of major overseas markets in 2012

Source: Bloomberg

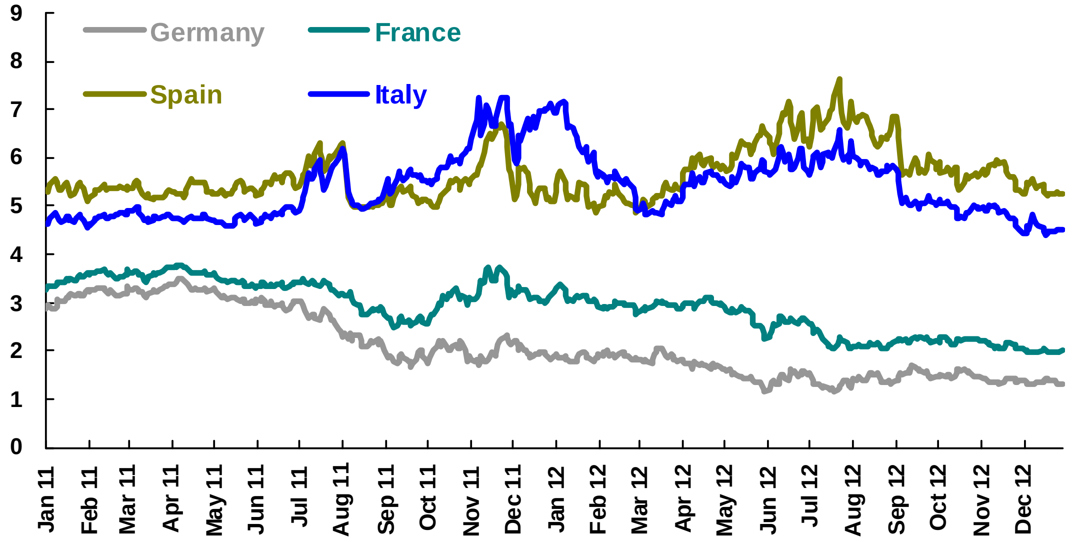
Europe

14. After the losses in 2011, most major European markets rebounded in 2012. The FTSE, DAX and CAC rose 5.8%, 29.1% and 15.2% respectively. However, the performance of the PIIGS markets was mixed, ranging from a loss of 4.7% in Spain to a gain of 33.4% in Greece.

15. In early 2012 the European markets rose due to Greece's successful debt restructuring plan which seemed to ease worries over the European debt issue. However, this was rather short-lived as European markets saw a decline on growing concerns over the stability of the banking sector in Spain. The Spanish bond yield rose to 7% in June, a level which investors perceived as a potential trigger for international bailout.

16. In mid-2012, the major European markets rebounded after the European Union (EU) agreed on measures to aid banks in the region. In July, the ECB cut the benchmark interest rate to a record low of 0.75%. In September, the ECB announced the OMT programme, which is a potentially unlimited bond-buying programme that targets short-term government bonds. After the announcement, the yields on government bonds across Europe fell and stock markets rose. However, the weak economic data in the Eurozone and the rating downgrades of Spain in October and France in November weighed on sentiment.

17. As the year came to a close, the European markets rallied. This followed Spain's formal request in December for a bailout fund of EUR40 billion from the EU to recapitalise its banking sector. In addition, EU finance ministers agreed to seek a joint strategy for handling failing banks. The DAX rose to a four-year high and the CAC to an 18-month high, given solid economic data in Germany and the Mainland. However, the Spanish equity market underperformed amid concerns about economic recession.



10-year government bond yield for major European countries (%)

Source: Bloomberg

Asia

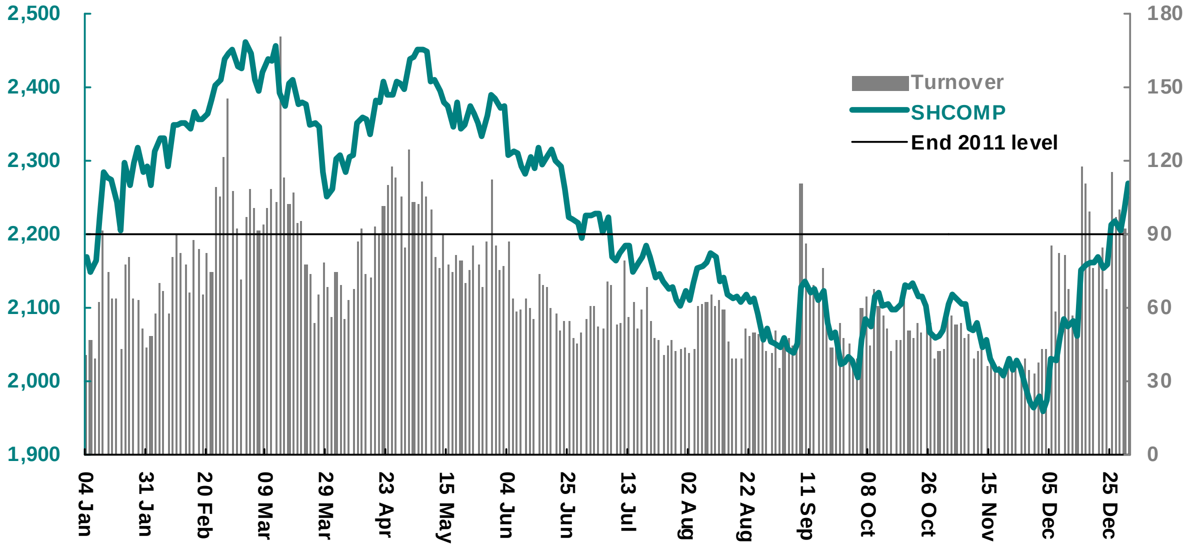
18. Major Asian markets advanced during 2012, supported by strong capital inflows. Unlike the major overseas markets where investor confidence and market sentiment were very much affected by the European debt problem and US fiscal cliff concerns, the Asian markets seemed relatively less affected. Optimism over the positive outlook for Asian economies prompted institutional buying in regional equity markets. By the end of 2012, major Asian markets recorded gains ranging from 8.9% in Taiwan to 35.8% in Thailand.

The Mainland

19. On the back of a 22% correction in 2011, the Mainland market continued to decline for most part of 2012, but made a strong rally by year-end. Investors were initially cautious given risks of a slowdown in the economy, uncertainties about the monetary policy outlook and concerns about corporate earnings.

20. The Shanghai Composite Index once dropped below the 2,000 point level, the lowest since early 2009. Its price-earnings ratio fell to 11 times, the lowest in more than 10 years. Reflecting the bearish sentiment, trading also declined. Concerns about the economic outlook paced losses. The Mainland GDP growth slowed to 7.4% in Q3 2012, the slowest in three years. Uncertainties over the continuity of the government's monetary policy stance also weighed on sentiment.

21. In December, the Shanghai Composite Index staged a strong rebound given optimism over supportive policies by the new leadership. Improved economic data, such as the country's manufacturing index, also boosted hopes of a bottoming out of the economy. Expectation for fund inflows into the stock market lent support. The market erased losses accumulated during the year and managed to close in positive territory for the year. In 2012, the Shanghai Composite Index rose 3.2%.



Shanghai Composite Index and market turnover (RMB$ billion) (2012)

Source: Bloomberg

Hong Kong

22. During 2012, the Hong Kong market rebounded. The HSI gained 22.9%, outperforming most major markets. The HSCEI also rose 15.1%. The Hong Kong stock market fluctuated upwards amid improved corporate earnings reports, optimism about supportive policies in the Mainland and more encouraging economic data in the US.

23. In early 2012, the local market surged, underpinned by gains in overseas markets. Later, the market fell amid worries over the slowdown in the Mainland's economic growth. In early June, the HSI bottomed at 18,185 points on concerns about the debt problems in Europe and risks of an economic slowdown in the Mainland.

24. The market rebounded following the announcement of quantitative easing in the US and the ECB's bond purchase programme. Optimism about supportive measures in the Mainland paced gains. The HSI rose to a 16-month high of 22,656 points by year-end, tracking the rally in major overseas markets.

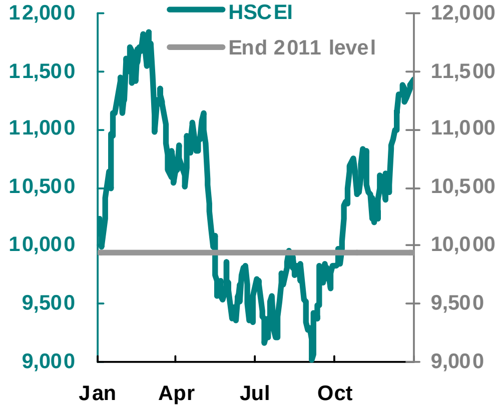
25. Amongst others, the risks and uncertainties facing the Hong Kong market include:

    (a) Reversal of capital inflows – During the year, Hong Kong and other regional markets had accumulated gains given capital inflows. However, as much uncertainty remains over the US and European debt problems, market sentiment may suffer should there be a sudden deterioration in the situation of overseas markets. There is a risk that reversals of fund flows may be triggered, causing price corrections in the stock market.

    (b) Risks of inflation and rise in interest rates – Global market performance has been strong under a low interest rate environment. There is a general expectation that such an environment will continue in the near future. However, if there is an unexpected spike in the rate of inflation, the interest rate hikes that follow may lead to corrections in stock and asset prices.

    (c) Global macro risks – Much uncertainty remains in the global economy and financial markets. In the US, worries about the debt ceiling and economic recovery will continue to weigh on sentiment. In Europe, the sovereign debt problem could be complicated by risks of economic slowdown and social unrest. Market sentiment is also affected by the continuing recession in Japan as well as possible economic slowdown in the Mainland and other emerging markets. A major concern is that deterioration of the economic situation in these markets may affect the health of financial institutions, which may lead to tightening in credit conditions or further deleveraging, and in turn undermine market confidence. This could cause corrections in the stock market as fund managers re-allocate investment portfolios.

Performance of the HSI



Performance of the HSCEI

Source: Bloomberg

Major statistics of Hong Kong securities market in 2012

Trading activity in the local stock market

26. Trading in the local stock market became less active during 2012. The average daily turnover amounted to $53.8 billion[1], 23% lower than that in 2011. The decline was in line with other major markets.

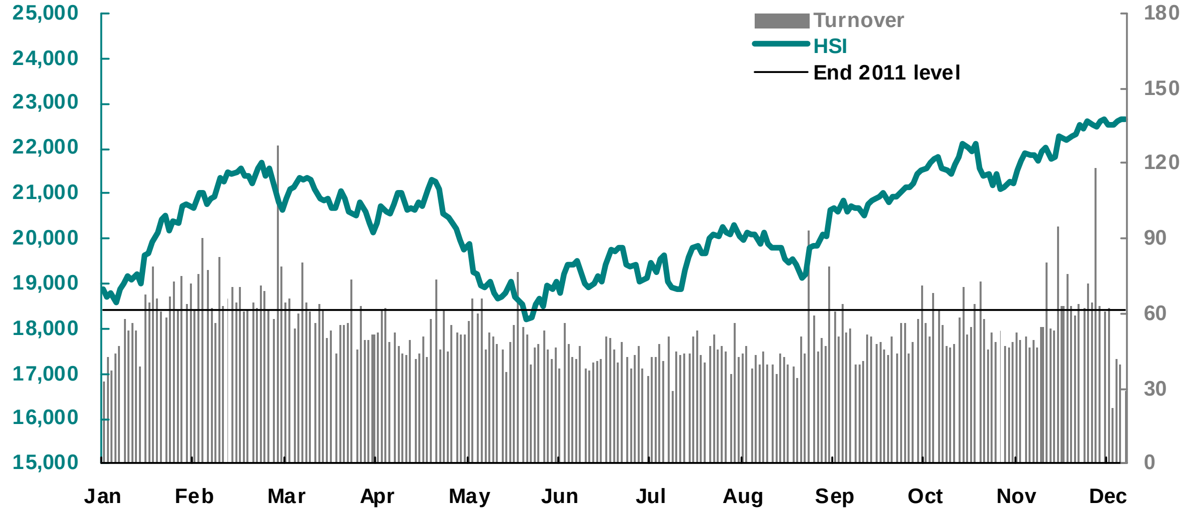
27. Mainland stocks remained the most actively traded stocks. Their share in total market turnover increased to 39% from 37% in 2011. The trading in HSI stocks (excluding H-shares and red chips) was about 16%.

Average daily turnover ($ billion)

	2012	2011	2010	% change over	
				2011	2010
HSI (ex H shares & red chips)	8.5 (16%)	9.6 (14%)	8.4 (12%)	-12%	1%
Mainland stocks	20.8 (39%)	25.9 (37%)	26.7 (39%)	-20%	-22%
H-shares	*14.9 (28%)*	*19.0 (27%)*	*18.9 (27%)*	*-22%*	*-22%*
Red chips	*5.9 (11%)*	*6.9 (10%)*	*7.8 (11%)*	*-15%*	*-24%*
Derivative warrants	6.7 (12%)	10.7 (15%)	10.8 (16%)	-38%	-38%
CBBCs	6.2 (12%)	7.5 (11%)	5.8 (8%)	-18%	6%
Others	11.7 (22%)	16.0 (23%)	17.3 (25%)	-27%	-32%
Market total	**53.8 (100%)**	**69.7(100%)**	**69.1(100%)**	**-23%**	**-22%**

Remark: Percentages in parenthesis denote market share.
Sources: HKEx and SFC Research

1 Unless otherwise specified, the currency referred to in this report is the Hong Kong dollar.



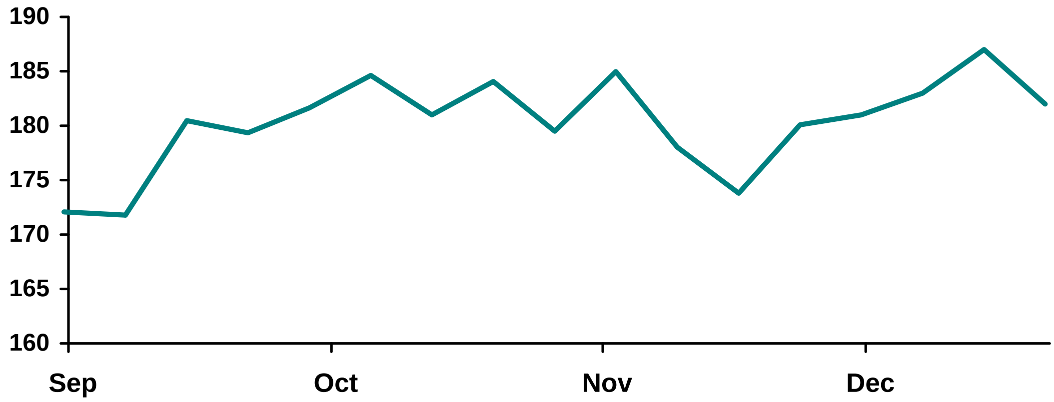
HSI performance and market turnover ($ billion) (2012)

Source: Bloomberg

Short-selling activity

28. Compared to 2011, short-selling turnover was lower in absolute amount but higher as a percentage of total market turnover. The average daily short selling was $4,860 million, or 9.0% of the total market turnover during 2012, compared to $5,427 million, or 7.8% in 2011.

29. The short positions reporting regime was launched on 18 June 2012, and thus began the collection of weekly short position data. Based on the data submitted, as at 28 December 2012, the aggregated short positions amounted to $182 billion (or 1.2% of the market cap of the reported stocks).



Aggregated short positions[2] ($ billion)

Source: SFC Research

Initial public offerings (IPOs)

30. There were 60 IPOs during 2012. Total IPO funds raised amounted to $89.8 billion, compared to 89 equity IPOs ($259.8 billion) in 2011. IPO funds raised for Mainland companies accounted for 90% of the market total during 2012. Hong Kong topped the worldwide ranking in IPO activities for three years during 2009-2011, and ranked fourth after the NYSE (US), Nasdaq, and Tokyo in 2012.

[2] The publication of the data on aggregated short positions started on 7 September 2012

Top 10 Global stock markets by equity funds raised through IPOs (2012)

	Equity funds raised through IPOs		
	US$ billion	**Worldwide ranking**	**Asia ranking**
US (NYSE)	24.9	1	
US (Nasdaq OMX)	23.4	2	
Japan (Tokyo)	12.5	3	1
Hong Kong	**11.6**	**4**	**2**
China (Shenzhen)	11.1	5	3
Malaysia (Kuala Lumpur)	7.5	6	4
Mexico	6.6	7	
UK (London)	5.6	8	
China (Shanghai)	5.3	9	5
Singapore	4.0	10	6

Remark: The amount of funds raised by REITs has also been included.
Source: HKEx

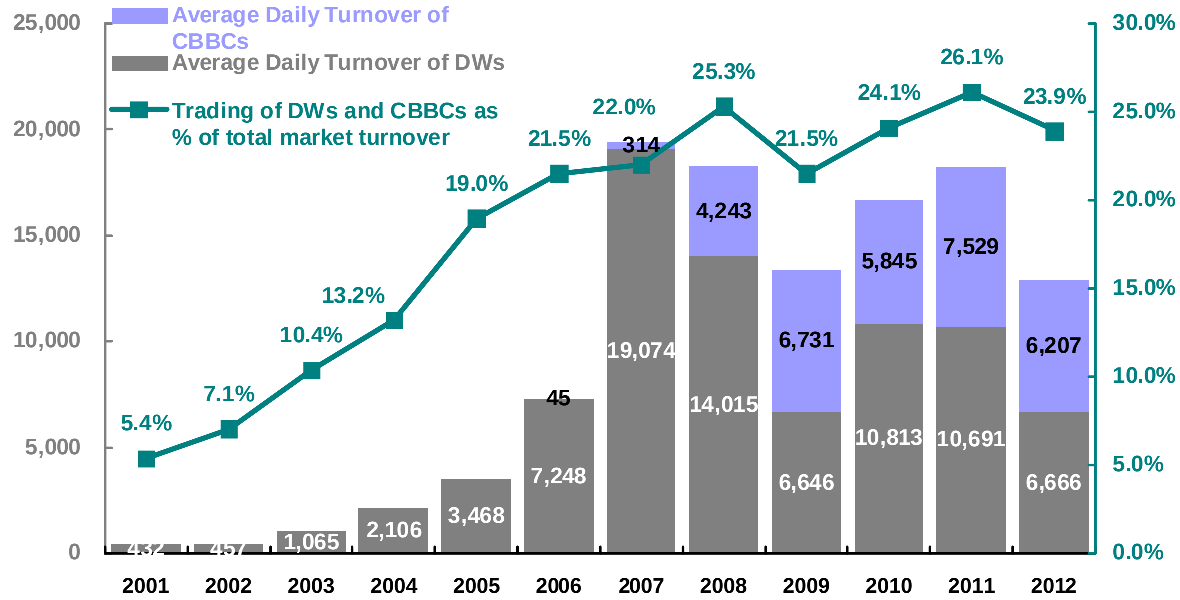
Exchange-traded funds (ETFs)

31. The number of ETFs rose to 106 as of end-2012. Despite an increase in the number of ETFs, their average daily turnover was $2.1 billion during 2012, lower than the turnover of $2.2 billion in 2011. ETFs accounted for 3.9% of the total market turnover, marginally higher than that in 2011 (3.5%).

Derivative warrants (DWs) and callable bull/bear contracts (CBBCs)

32. During 2012, trading in DWs decreased in both absolute terms and as a percentage of total market turnover. Trading in DWs fell to $6.7 billion (12.4% of total market turnover), compared to $10.7 billion (15.3% of total market turnover) in 2011.

33. The trading in CBBCs decreased in absolute terms, but rose as a percentage of total market turnover. Trading in CBBCs fell to $6.2 billion (11.5% of total market turnover), compared to $7.5 billion (10.8% of total market turnover) in 2011.



Turnover of DWs and CBBCs ($ million)

Source: SFC research

Exchange-traded derivatives

34. Trading in exchange-traded derivatives decreased 15% in 2012, alongside the decline in cash market trading. Trading in futures products fell 8% during 2012. Among futures products, HSI Futures remained the most actively traded contract, accounting for 43% of all futures trading. Compared to 2011, their average daily trading volume decreased by 12%. The second most actively traded futures were HSCEI Futures, accounting for almost one-third of all futures trading. As of end-2012, open interests of HSI and HSCEI Futures were 139,344 and 181,909 contracts respectively, compared to 86,409 and 106,277 contracts as of end-2011.

35. Trading in options dropped 19% during 2012, largely driven by a decline in trading in stock options. Whilst stock options remained the most actively traded options product, its trading volume fell 25% from the 2011 level. Open interests of stock options fell 24% to 4.0 million contracts as of end-2012.

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

		2012	2011	2010
Futures	HSI Futures	82,905	94,036	84,462
	Mini-HSI Futures	34,810	41,933	33,336
	HSCEI Futures	64,863	61,116	49,919
	Mini-HSCEI Futures	6,356	7,516	3,985
	Stock Futures	1,315	1,809	961
	3-Month HIBOR Futures	1	2	4
	Gold Futures	0	15	23
	Other futures products*	837	263	27
	Total futures	**191,176**	**206,688**	**172,717**
Options	HSI Options	37,597	43,452	34,197
	Mini-HSI Options	5,014	3,888	1,939
	HSCEI Options	25,666	15,364	11,690
	Stock Options	228,438	302,750	245,485
	Other options products**	103	133	55
	Total options	**296,818**	**365,586**	**293,365**
Total futures and options		**487,994**	**572,275**	**466,082**

Remark: * 1-Month HIBOR Futures, 3-Year Exchange Fund Note Futures, Hang Seng China H-Financials Index Futures, FTSE/Xinhua China 25 Index Futures, HSI Dividend Point Index Futures, HSCEI Dividend Point Index Futures, HSI Volatility Index Futures (launched on 20 February 2012), IBOVESPA Futures, MICEX Index Futures, Sensex Index Futures, FTSE/JSE Top40 Futures (These four futures were launched on 30 March 2012) and USD/CNH Futures (launched on 17 September 2012).

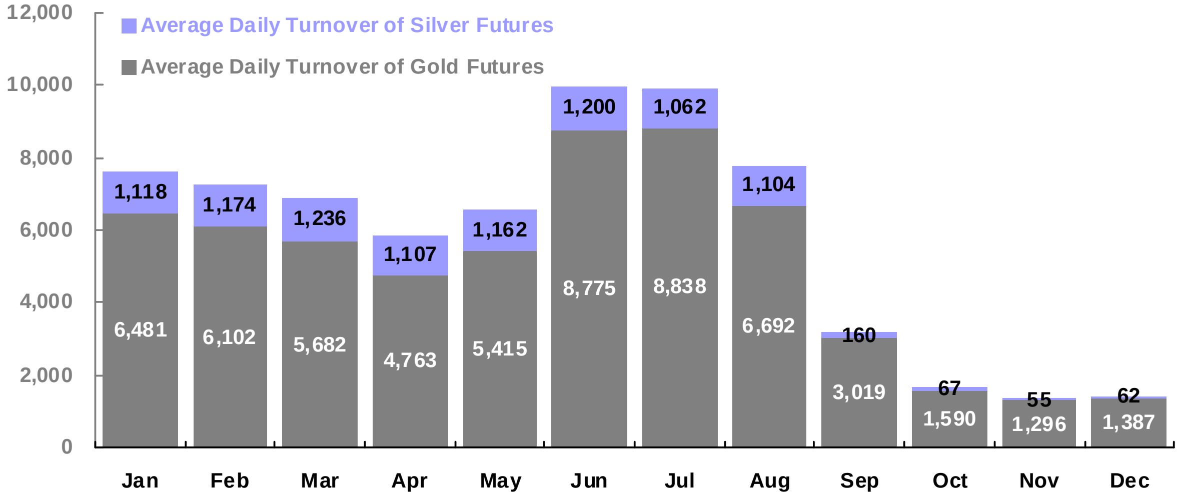
** Flexible Hang Seng Index Options and Flexible H-shares Index Options

^ The average daily trading volume was based on the number of trading days after the product was launched.

Sources: HKEx and SFC Research

Trading in gold and silver futures on the Hong Kong Mercantile Exchange Ltd (HKMEx)

36. During 2012, the average daily turnover of gold futures and silver futures on the HKMEx reached 5,042 contracts (4,229 contracts in 2011) and 799 contracts (1,228 contracts in 2011) respectively. On a monthly basis, however, trading in gold futures and silver futures had been falling since their peaks in July and June respectively.



Average daily turnover of gold and silver futures on the HKMEx (2012) (number of contracts)

Source: SFC Research