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Research Paper No. 53: Half yearly review of the global and local securities markets

19 July 2013

Executive summary

1. After the gains in 2012, most major markets continued to rise in early 2013, with some reaching their record or multi-year highs. However, the markets became more volatile on concerns over a tapering of the monetary stimulus in the US in June.

2. In the US, the Dow, Nasdaq and S&P 500 rose 13.8%, 12.7% and 12.6% respectively during the first half of 2013 on optimism about the US economic outlook. The debt limit was extended and its fiscal cliff problem was temporarily resolved. Major indices once rose to record highs, but retreated later as the US Federal Reserve (Fed) gave an explicit timeline for the withdrawal of stimulus measures. Investors were concerned about an interest rate hike as 10-year US Treasury yield increased to above 2.6%, a nearly two-year high.

3. In early 2013, major European markets rose on encouraging economic data in the Eurozone and the US. Investor sentiment was lifted after the European Central Bank (ECB) cut its interest rate to a record low of 0.5% and affirmed its monetary easing policy until at least mid-2014. Later, the markets gave up some gains as the US Fed indicated its plan to scale back its stimulus measures. During the first half of 2013, the FTSE, DAX and CAC rose 5.4%, 4.6% and 2.7% respectively.

4. In Asia, Nikkei 225 Index rose 31.6% during the period, outperforming most major markets, buoyed by fresh resolve on further monetary easing in Japan. The performance of other major Asian markets ranged from a decline of 6.7% in Korea to a gain of 16.3% in Vietnam during the first half of 2013. In early 2013, investor sentiment was boosted as central banks in Asia adopted accommodative monetary policies. However, the markets corrected later. Amid concerns about the withdrawal of stimulus by the Fed, US Treasury yields rose sharply, pulling back funds from the Asian equity markets.

5. Led by financial stocks, the Mainland market rose initially on news that Renminbi Qualified Foreign Institutional Investor (RQFII) quota approvals might be resumed. Optimism about supportive government measures to stabilise growth provided support. Gains were trimmed later on worries about a dim economic outlook for the Mainland. In June, the market declined sharply amid tight liquidity conditions in the money market. During the first half of 2013, the Shanghai Composite Index fell 12.8%, making it one of the worst performers among major markets.

6. Tracking the decline in the Mainland market, the Hang Seng Index (HSI) and Hang Seng China Enterprises Index (HSCEI) fell 8.2% and 18.6% respectively. Worries over the Mainland's dim economic outlook and the Fed's exit from monetary easing affected investor sentiment. Mainland financial stocks paced losses. Local property stocks also fell amid uncertainties about further measures to curb property prices and possible interest rate movements.

7. The risks and uncertainties facing the Hong Kong market include:

   (a) Movements of capital flows – Major stock markets rose to their record highs in recent months. However, in case of sentiment change, sudden reversals of capital flow may be triggered, causing significant corrections in the stock markets.

   (b) Scaling back of Fed stimulus – If there is an unexpected spike in interest rates caused by the Fed's stimulus withdrawal, volatility in stock and asset prices is likely to increase.

   (c) Global macro risks – The outlook for global economic growth remains uncertain.

(d) Debt sustainability – In the US, investors may be concerned about the country's debt ceiling. In Europe, the sovereign debt problem has been complicated by political uncertainties. In Japan, the high level of public debt may cause surges in yields and sovereign downgrades, which could affect asset prices.

(e) Possible slowdown in Mainland economic growth – Investor sentiment may be affected by worries about a possible economic slowdown and uncertainties about the country's monetary policy outlook.

8. Trading in both the cash market and exchange-traded derivatives rose. Average daily trading in the cash market rose 34% in the period, while that in futures and options increased 16% and 17% respectively from the second half of 2012.

Performance of worldwide stock markets in the first half of 2013

9. In early 2013, major markets once rose to their record or multi-year highs on an improved global economic outlook and abundant market liquidity. However, the markets gave up some gains given worries about the scaling down of the Fed's stimulus measures. The Japanese market outperformed most major markets on optimism about monetary easing. However, the Mainland market was one of the worst performing markets. Concerns about the country's economic outlook and tight liquidity conditions paced losses. Tracking the decline in the Mainland market, the Hong Kong market fell.

Performance of major stock markets

		End June 2013	% change	
		Index level	Year to date	in 2012
Hong Kong and the Mainland				
HK	-HSI	20,803.29	-8.2%	22.9%
	-HSCEI	9,311.44	-18.6%	15.1%
China	-Shanghai Comp	1,979.21	-12.8%	3.2%
	-Shenzhen Comp	887.68	0.7%	1.7%
Asia				
Japan	-Nikkei 225	13,677.32	31.6%	22.9%
Australia	-AOI	4,775.41	2.4%	13.5%
Taiwan	-TWSE	8,062.21	4.7%	8.9%
Korea	-KOSPI	1,863.32	-6.7%	9.4%
Singapore	-STI	3,150.44	-0.5%	19.7%
Thailand	-SET	1,451.90	4.3%	35.8%
Malaysia	-KLCI	1,773.54	5.0%	10.3%
Indonesia	-JCI	4,818.90	11.6%	12.9%
Philippines	-PCOMP	6,465.28	11.2%	33.0%
Vietnam	-VN	481.13	16.3%	17.7%
US				
US	-Dow	14,909.60	13.8%	7.3%
	-Nasdaq	3,403.25	12.7%	15.9%
	-S&P 500	1,606.28	12.6%	13.4%
Europe				
UK	-FTSE100	6,215.47	5.4%	5.8%
Germany	-DAX	7,959.22	4.6%	29.1%
France	-CAC	3,738.91	2.7%	15.2%
PIIGS and Hungary				
Portugal	-PSI20	5,556.88	-1.7%	2.9%
Italy	-FTSEMIB	15,239.28	-6.4%	7.8%
Ireland	-ISEQ	3,963.33	16.7%	17.1%
Greece	-ASE	847.57	-6.6%	33.4%
Spain	-IBEX	7,762.70	-5.0%	-4.7%
Hungary	-BUX	19,023.96	4.7%	7.1%
Middle East and North Africa				
Egypt	-EGX30	4,752.22	-13.0%	50.8%
Dubai	-DFMGI	2,222.57	37.0%	19.9%
Other BRIC markets				
Brazil	-IBOV	47,457.13	-22.1%	7.4%
Russia	-MICEX	1,330.46	-9.8%	5.2%
India	-Nifty	5,842.20	-1.1%	27.7%

Source: Bloomberg

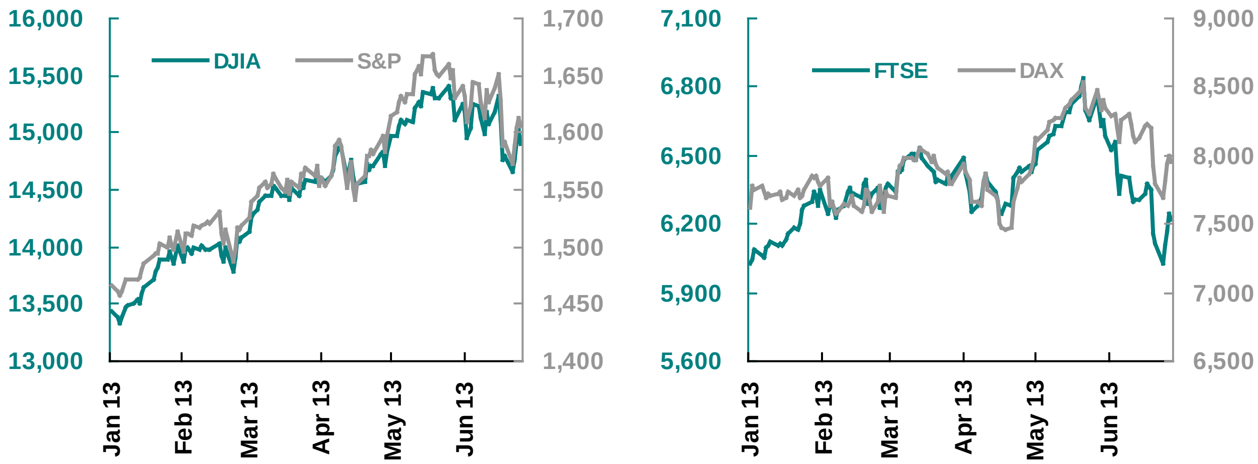
The US

10. During the first half of 2013, the Dow, Nasdaq and S&P 500 gained 13.8%, 12.7% and 12.6% respectively. The Dow and S&P 500 rose for six and seven straight months respectively to their record highs whilst the Nasdaq also rose to its highest level since October 2000.

11. In early 2013, the US market rose given abundant global liquidity. The debt limit was extended and the fiscal cliff problem was temporarily resolved. Optimism about a continuation of the monetary easing policy paced gains. The Fed indicated that it would continue its bond purchasing programme until there was a substantial improvement in the labour market. The implementation of the US government's automatic spending cut from March seemed to have limited impact on the performance of the market.

12. Key economic figures such as home sales, investor confidence and jobs data were stronger than expected. Gross domestic product growth in Q1 2013 was 2.5%, up from 0.4% in Q4 2012. Investors remained optimistic about the US economic outlook. Solid corporate earnings also provided support.

13. In June, the market corrected as the Fed signalled that the scaling down of its bond-buying programme could begin later in the year and end in mid-2014 if the economic situation continues to improve. The Fed might stop buying bonds if the unemployment rate fell to 7%. Market concerns over an interest rate hike were heightened. The 10-year US Treasury yield rose to above 2.6%, a nearly two-year high.



Performance of major overseas markets during January – June 2013

Source: Bloomberg

Rising Bond Yields in Major Markets

14. Given worries about the US Fed's monetary stimulus withdrawal, yields of US Treasuries rose since late April. Following the Fed's indication on 19 June of the scaling down of its bond-buying programme if economic fundamentals continue to improve, the yield on 10-year US Treasuries hit a nearly two-year high of above 2.6%. By end-June, 10-year government bond yields of major markets including Japan, Germany, the UK and France also were around 24-75 basis points higher than in end-April.

15. In the past years, demand for US Treasuries was boosted by the Fed's quantitative easing policies and investors' safe-haven buying amid the European debt problem. Recently, concerns grew about the tapering of the stimulus measures by the Fed. Market participants conjectured that some funds might have shifted from bonds to equities. This triggered rises in yields in major bond markets.

Yields of 10-year government bonds

	End-June 2013	**End-April 2013**	**Change from end-April 2013 (bps)**
US	2.486	1.672	81.4
UK	2.443	1.690	75.3
Japan	0.853	0.609	24.4
Germany	1.728	1.215	51.3
France	2.347	1.711	63.6
Italy	4.545	3.891	65.4
Spain	4.767	4.135	63.2

Source: Bloomberg

16. As the US dollar yield curve is the global benchmark for the pricing of capital and risks, the rise in US Treasury yields will increase interest rate risk and borrowing costs in the US and other markets. The volatility will have implications on corporates, investors and policymakers as well as asset prices.

Europe

17. Major European markets advanced during the first half of 2013, with the FTSE, DAX and CAC up 5.4%, 4.6% and 2.7% respectively. The DAX once rose to its record high.

18. In early 2013, major European markets rose on encouraging economic data in the Eurozone and the US. Strong German manufacturing data lent support. Market sentiment was buoyed by news that European banks would repay the ECB crisis loans early and the repayment amount was larger than expected.

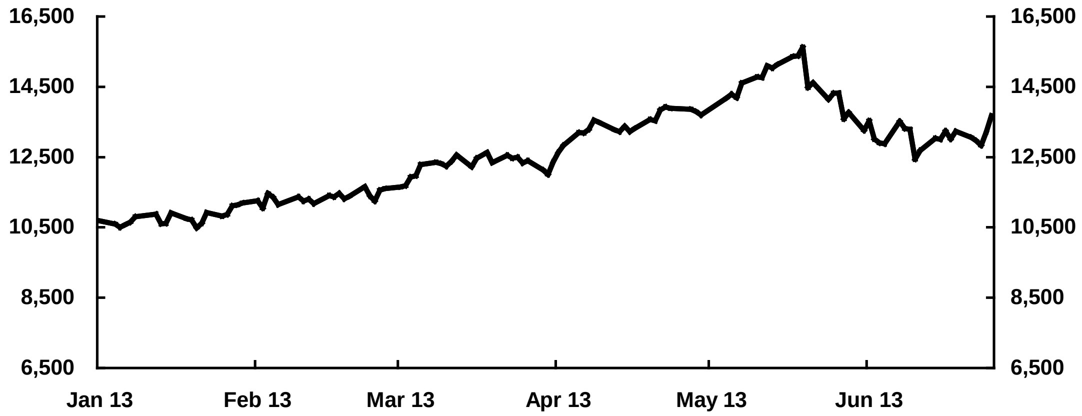
19. In March, the markets gave up some gains as worries over the Eurozone debt problem grew. There were concerns that Cyprus might require a larger amount of bailout fund than estimated. Later in the month, Cyprus agreed on the bailout deal and avoided a default. However, large depositors had to bear the cost of bank recapitalisation. Investors were concerned that the Cyprus bailout deal would become a template for future bailouts of other debt-laden countries and lead to bank runs in those countries. Political uncertainties in Italy also weighed on sentiment, but worries eased after the formation of a new coalition government in April.

20. In May, the markets rebounded. The ECB cut its interest rate by 25 basis points to a record low of 0.5% and affirmed its monetary easing policy until at least mid-2014. Later, the markets dropped as the Fed indicated its plan to scale down its stimulus measures, and tight money market conditions in the Mainland sparked concerns of a credit crunch which could further slow down economic growth.

Asia

21. The performance of major Asian markets (other than Japan) ranged from a loss of 6.7% in Korea to a gain of 16.3% in Vietnam during the first half of 2013. Initially, investor sentiment was boosted as central banks in Asia adopted accommodative monetary policies—Central banks in Australia, Thailand, Korea, Vietnam and India all cut their interest rates, some to their record lows. However, worries over North Korea's nuclear confrontation with the US and South Korea affected investor sentiment. The markets corrected in June. Amid speculation on the Fed's stimulus withdrawal, the yield on US Treasuries rose, pulling back funds from the Asian equity markets. This was exacerbated when the Fed signalled the possible start to the tapering of its asset purchase programme later in the year. Yields on US Treasuries spiked, and major equity and bond markets fell. In the Mainland, a spike in interbank lending rates raised the spectre of a credit crunch, adding to the rout. Markets calmed following reassurances from the Fed and the People's Bank of China (PBOC).

22. The Nikkei 225 Index rose 31.6% during the period, outperforming most major markets, buoyed by fresh resolve on further monetary easing in Japan. The new cabinet indicated its commitment to boost economic growth by providing further stimulus. In early April, the Bank of Japan announced its plan to inject US$1.4 trillion to buy government bonds and exchange-traded funds (ETFs). Exporters paced gains as the yen weakened to the 103 level. The Nikkei once rose to its five-year high. However, in May, the market became volatile given worries about the US Fed's withdrawal of stimulus and a strengthening of the yen. There were also concerns over the Bank of Japan's credibility and ability in monetary easing. Japanese 10-year government bond yield rose to above 0.9% for the first time in a year.



Performance of Nikkei 225 Index during January – June 2013

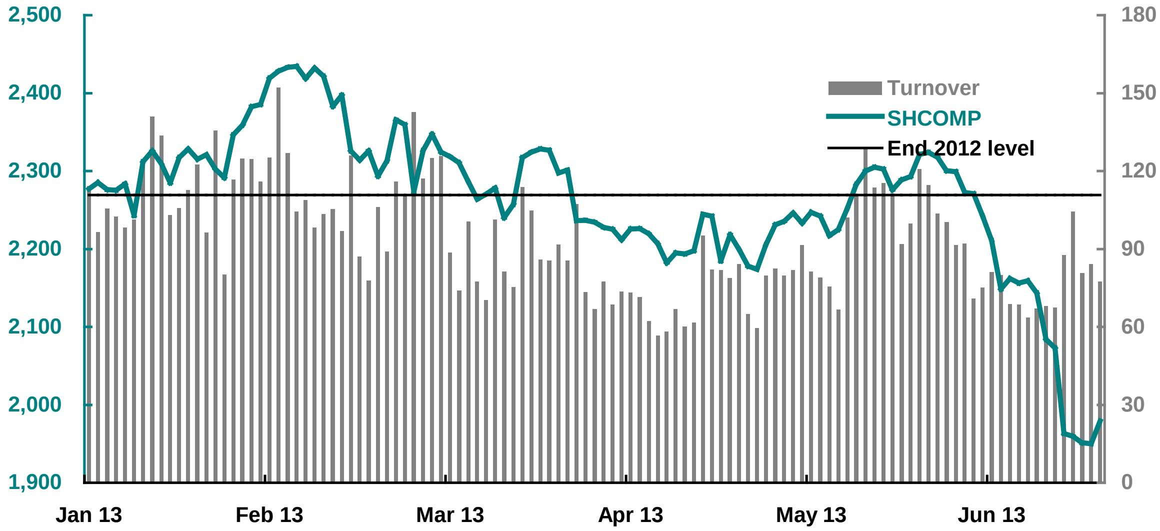
Source: Bloomberg

The Mainland

23. During the first half of 2013, the Shanghai Composite Index fell 12.8%. The Mainland market once rose to its eight-month high in February. Solid economic growth data and optimism about urbanisation provided support. Market sentiment was also boosted by speculation on a possible increase in foreign investors' quotas to invest in the A-share market under the Qualified Foreign Institutional Investor (QFII) and RQFII schemes. The media reported that Morgan Stanley Capital International (MSCI) indices might cover A-shares, spurring hopes of greater foreign investor participation in the market.

24. Later, some gains were erased given uncertainties about the country's economic outlook and weaker-than-expected economic data. There were worries that higher inflation might limit the room for accommodative monetary policies. Concerns over possible tightening measures in the property and banking sectors weighed on the market. The outbreak of avian flu also affected investor sentiment.

25. In June, the Shanghai Composite Index dropped to a four-year low of below 2,000 points as liquidity conditions continued to tighten in the money market, with the overnight Shanghai Interbank Offered Rate (SHIBOR) peaking at around 13% on 20 June compared to around 2-3.5% during January to May. It was reported that the central bank had no immediate plan to lower the reserve requirement ratio to alleviate the situation. Worries about possible measures to combat shadow banking activities added to fears of tighter credit conditions that could result in deleveraging. Conditions eased as the PBOC stepped in to provide liquidity to Mainland banks. Interbank rates remained elevated, with the overnight SHIBOR at about 5% by end-June.



Shanghai Composite Index and market turnover (RMB billion) (Jan-Jun 2013)

Source: Bloomberg

Hong Kong

26. During the first half of 2013, the HSI dropped 8.2% and the HSCEI fell 18.6%. In early 2013, the Hong Kong market rose on an improved growth outlook for the Mainland economy and on optimism that Hong Kong would benefit as Mainland investors would be allowed to invest in overseas markets. The HSI once rose to a 21-month high of above 23,800 points.

27. The market gave up some gains in June amid renewed concerns about the Eurozone debt problem. Worries over the geopolitical tension on the Korean Peninsula and the outbreak

of the avian flu in the Mainland weighed on the market. Heightened worries over possible tightening of monetary and property market policies in the Mainland also affected investor sentiment. Mainland financial stocks declined on concerns that a slowdown in economic growth might affect the profitability of Mainland financial institutions. Local property stocks also paced losses amid uncertainties about further measures to curb local property prices and possible interest rate movements.

28. In April, the market rebounded somewhat on optimism about an accommodative monetary policy by major central banks worldwide. However, the market corrected in May given worries about the US Fed's exit from monetary easing. The Fed's signalling of a stimulus exit, coupled with weaker-than-expected economic data and tight liquidity conditions in the Mainland, led to the HSI falling to a nine-month low of approximately 19,800 points in June.

29. The major risks and uncertainties facing the Hong Kong market include:

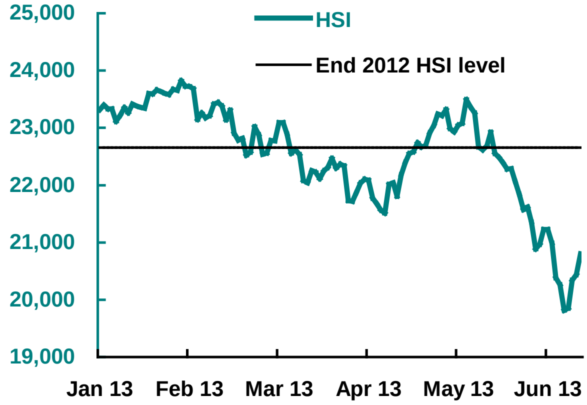
(a) Movements of capital flows – Major stock markets rose to their record highs in recent months, underpinned by abundant global liquidity. As a major recipient of these flows, Hong Kong would be vulnerable to sudden reversals of capital flow, particularly under the current challenging and uncertain economic environment. Significant price corrections in the stock market may occur if investors are attracted to opportunities elsewhere as the global economy recovers.

(b) Scaling back of Fed stimulus – In the US, the Fed has indicated its plan to scale down its bond purchase programme depending on improved economic fundamentals. If the inflation rate rebounds unexpectedly, this may hasten the pace of interest rate hikes. The change in monetary policy will affect the global economic and stock market outlook and cause a shift in fund flows amongst different markets and asset classes. If there is an unexpected spike in interest rates, volatility in stock and asset prices is likely to increase.

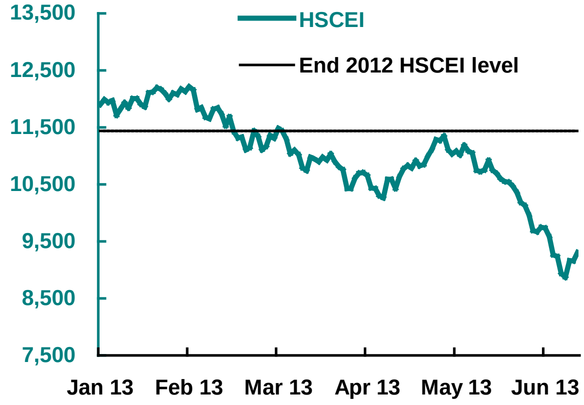
(c) Global macro risks – The outlook for global economic growth remains uncertain. The pace of the US economic recovery may be affected if the Fed prematurely scales back its stimulus measures and the budget sequester is not promptly reversed. In Europe, recessionary pressure remains, particularly in peripheral countries such as Italy and Spain. Geopolitical risks relating to the Korean Peninsula and East China Sea also add pressure to market volatility.

(d) Debt sustainability – In the US, the fiscal cliff problem was only temporarily resolved earlier this year. Investors have concerns about the debt ceiling, which will affect the sovereign rating of the US. In Europe, the sovereign debt problem has been complicated by political uncertainties. In Japan, the high level of public debt has long been a major issue of concern, and further bond purchases by the government to support growth may add to the burden. A worsening of debt problems might cause surges in yields and sovereign downgrades, which could in turn affect asset prices.

(e) Possible slowdown in Mainland economic growth – Investor sentiment may be affected by worries about the country's economic slowdown and uncertainties about its monetary policy outlook. Tight liquidity conditions might further affect economic growth and asset prices. There are also concerns about possible measures to curb property prices, as well as the risks associated with shadow banking and local government debt problems.



Performance of the HSI



Performance of the HSCEI

Source: Bloomberg

Major statistics of Hong Kong securities market in the first half of 2013

Trading activity in the local stock market

30. Trading in the local stock market recovered in the first half of 2013, during which the average daily turnover amounted to $68.3 billion[1], 34% higher than the $51.1 billion level in the second half of 2012 and 20% higher than the $56.7 billion level in the first half of 2012.

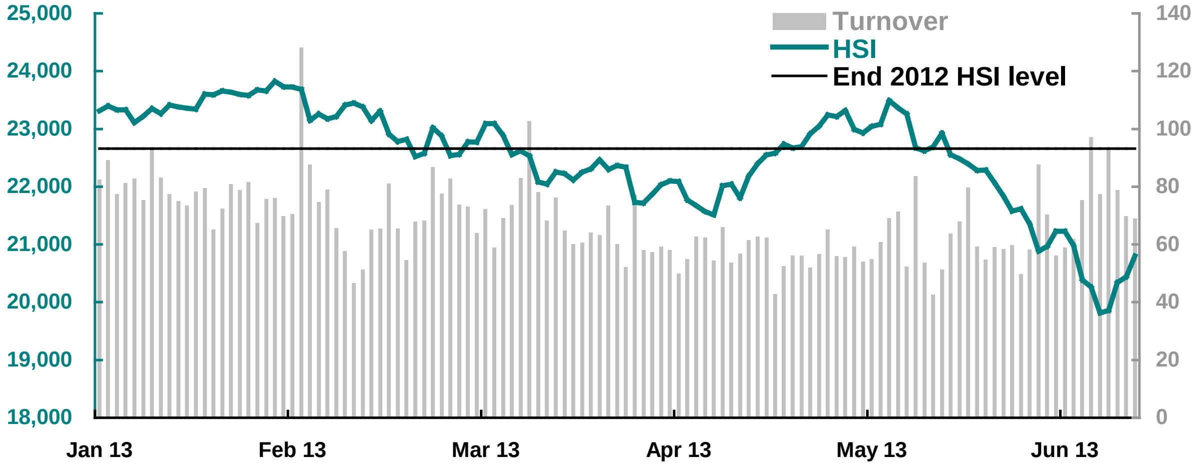
31. Mainland stocks remained the most actively traded stocks. Its share of total market turnover was 39% in the first half of 2013, while that of HSI stocks (excluding H-shares and red chips) was about 15%.

Average daily turnover ($ billion)

	1H 2013		2H 2012		1H 2012		% change over	
							2H 2012	1H 2012
HSI (ex H-shares & red chips)	10.5	(15%)	8.3	(16%)	8.6	(15%)	26%	21%
Mainland Stocks	26.4	(39%)	20.8	(41%)	21.8	(38%)	33%	21%
H-shares	*18.7*	*(27%)*	*14.9*	*(29%)*	*15.7*	*(28%)*	*32%*	*20%*
Red chips	*7.7*	*(11%)*	*5.9*	*(12%)*	*6.1*	*(11%)*	*33%*	*26%*
Derivative Warrants	8.7	(13%)	5.9	(12%)	7.4	(13%)	47%	17%
Callable bull/bear contracts	5.7	(8%)	5.5	(11%)	7.0	(12%)	5%	-18%
Others	17.0	(25%)	10.6	(21%)	11.9	(21%)	48%	43%
Market total	**68.3**	**(100%)**	**51.1**	**(100%)**	**56.7**	**(100%)**	**34%**	**20%**

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.



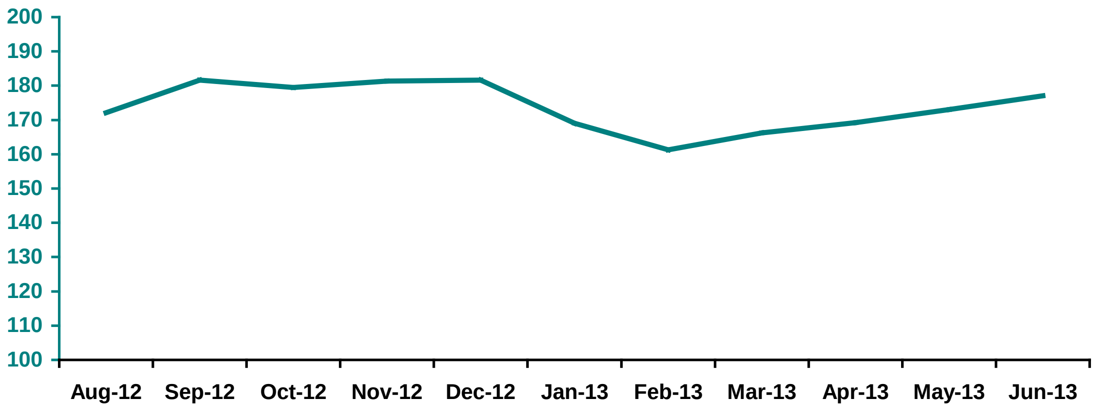
HSI and Market Turnover ($ billion)

Source: Bloomberg

Short-selling activity

32. Short-selling activity rose in the first half of 2013. Compared to the second half of 2012, short-selling was higher in both absolute terms and as a percentage of total market turnover. The average daily short-selling amounted to $6,793 million or 10.0% of the total market turnover during the first half of 2013, compared with $4,641 million or 9.1% of the total market turnover in the second half of 2012.

33. Based on the data submitted, as at 28 June 2013, the aggregated short positions amounted to $177.1 billion (or 1.3% of the market cap of the reported stocks).



Aggregated short positions[2] ($ billion)

Source: SFC Research

Initial public offerings (IPOs)

34. There were 23 IPOs in Hong Kong during the first half of 2013. Total IPO funds raised amounted to $39.5 billion. This compared to 32 IPOs ($30.0 billion) in the first half of 2012 and 32 IPOs ($59.2 billion) in the second half of 2012. IPO funds raised by Mainland companies accounted for 89% of the market total during the first half of 2013. While Hong Kong topped the list of global IPO activities for three years from 2009-2011, it ranked fourth in 2012 and sixth in the first half of 2013.

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

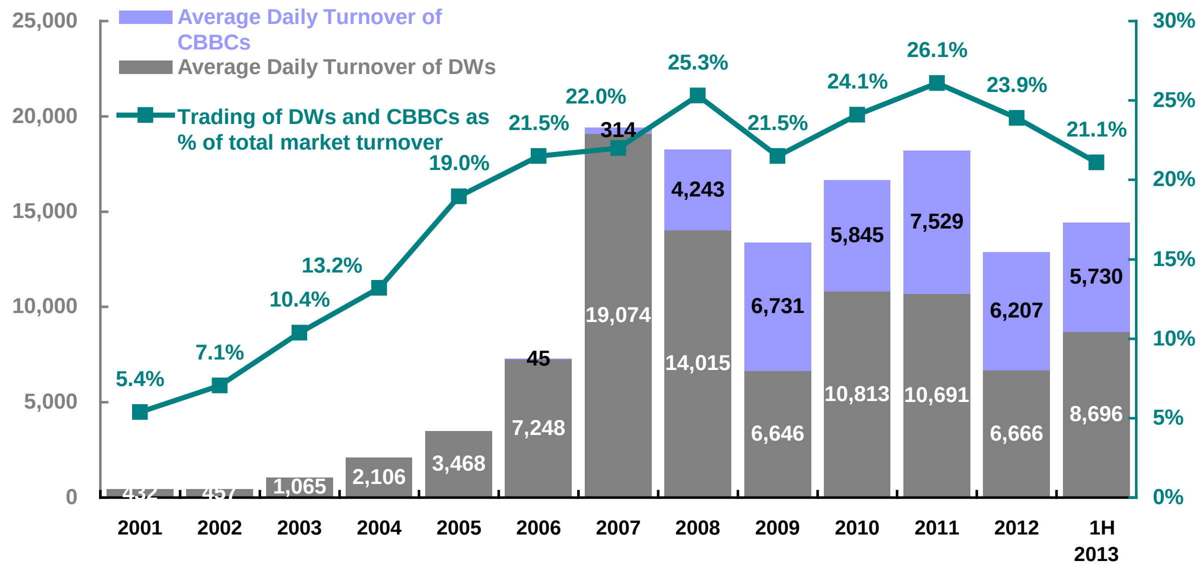
Exchange-traded funds (ETFs)

35. The number of ETFs rose to 110 as of end-June 2013 from 100 as of end-2012. Their average daily turnover was $4.5 billion in the first half of 2013, 80% higher than the $2.5 billion in the second half of 2012. ETFs accounted for 6.7% of the total market turnover during the first half of 2013 (compared to 4.9% in the second half of 2012).

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

36. During the first half of 2013, trading in DWs increased in both absolute terms and as a percentage of the total market turnover. Their average daily turnover rose to $8.7 billion (12.7% of the total market turnover), compared to $5.9 billion (11.6% of the total market turnover) in the second half of 2012.

37. Trading in CBBCs increased in absolute terms, but decreased as a percentage of the total market turnover. Their average daily turnover was $5.7 billion (8.4% of the total market turnover) in the first half of 2013, compared to $5.5 billion (10.7% of the total market turnover) in the second half of 2012.



Turnover of DWs and CBBCs ($ million)

Source: SFC Research

Exchange-traded derivatives

38. During the first half of 2013, the average daily trading in exchange-traded derivatives increased 17% compared to the second half of 2012. Trading in futures products rose 16%, among which HSI futures remained the most actively traded contract, accounting for about 40% of all futures trading. Their average daily trading volume increased by 9% from the second half of 2012. HSCEI futures were the second most actively traded futures contract, accounting for around one-third of all futures trading.

39. Trading in options rose by 17% in the first half of 2013. Stock options remained the most actively traded options product, and trading volume rose 19% from the second half of 2012.

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

		1H 2013	2H 2012	1H 2012
Futures	HSI Futures	86,890	79,406	86,446
	Mini-HSI Futures	33,975	31,727	37,931
	HSCEI Futures	82,427	65,509	64,209
	Mini-HSCEI Futures	8,237	5,773	6,947
	Stock Futures	2,406	1,487	1,140
	3-Month HIBOR Futures	-	--	1
	Renminbi Currency Futures ^	599	290	--
	Gold Futures	-	--	0
	Other futures products*	802	783	907
	Total Futures	**215,336**	**184,849**	**197,581**
Options	HSI Options	40,904	35,687	39,554
	Mini-HSI Options	5,272	5,343	4,677
	HSCEI Options	29,385	27,552	23,734
	Stock Options	267,047	225,102	231,856
	Other options products**	275	142	63
	Total Options	**342,882**	**293,826**	**299,884**
Total Futures and Options		**558,218**	**478,750**	**497,465**

Remarks:

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

^ Renminbi Currency Futures commenced trading on 17 September 2012.

* One-month HIBOR Futures, Three-year Exchange Fund Note Futures, HSI Dividend Point Index Futures, HSCEI Dividend Point Index Futures, HSI Volatility Index Futures (launched on 20 Feb 2012), IBOVESPA Futures (launched on 30 Mar 2012), MICEX Index Futures (launched on 30 Mar 2012), Sensex Index Futures (launched on 30 Mar 2012), FTSE/JSE Top40 Futures (launched on 30 Mar 2012) and USD/CNH Futures (launched on 17 Sep 2012)

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

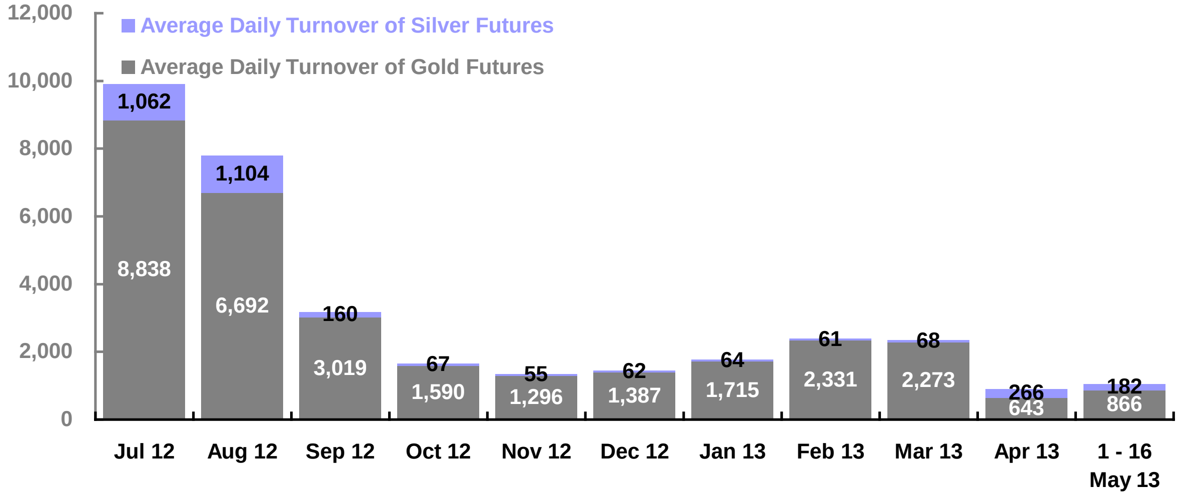
Sources: HKEx and SFC Research

After-Hours Futures Trading (AHFT)

40. The AHFT session on HKEx commenced trading on 8 April. The HSI and HSCEI futures contracts are available for trading during 5:00-11:00pm (HK time). From 8 April to 30 June, the average daily turnover of the HSI and HSCEI futures during the AHFT session amounted to 3,277 contracts and 2,574 contracts respectively, which were about 3.9% and 3.3% of the trading during normal trading sessions. This compared with around 15-37% in major overseas markets. The average intraday volatility for AHFT was 0.8% for HSI futures and 1.0 % for HSCEI futures, compared with 1.4% and 1.9% during the normal trading sessions respectively. More than 100 brokers have participated in the AHFT trading, including both local and international brokers.

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

41. During 1 January – 16 May 2013, the average daily turnover of gold futures and silver futures on HKMEx were 1,614 contracts (5,042 contracts in 2012) and 124 contracts (799 contracts in 2012) respectively. HKMEx ceased trading from 17 May 2013.



Turnover of Gold and Silver Futures on HKMEx (Number of Contracts)

Source: SFC research