



SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

Research Paper No.55: Half-yearly review of the global and local securities markets

18 July 2014



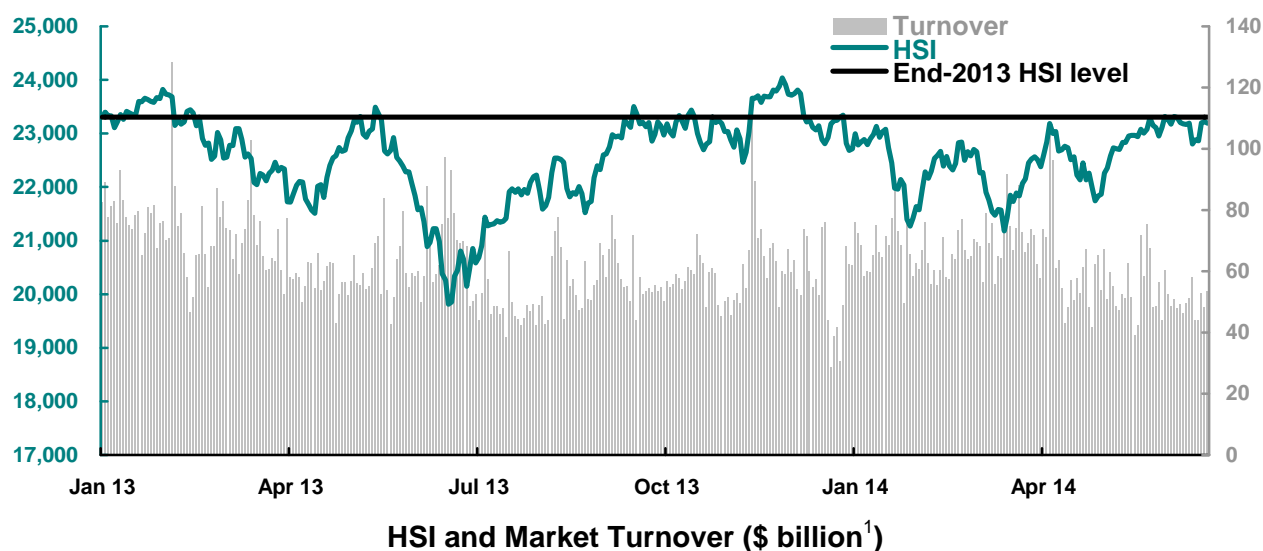
Executive Summary

1. During the first half of 2014, the volatility of the Hong Kong market remained low, but the market continued to face risks stemming from overseas and the Mainland markets. While the US and European markets rose to historical or multi-year highs, investor sentiment was fragile due to worries about the tapering of quantitative easing by the US Federal Reserve Bank (Fed) and the uncertain outlook for the euro zone economies. The bearish market performance and signs of possible economic slowdown in the Mainland also weighed on the Hong Kong market. During the period,
 - the Hang Seng Index (HSI) dropped 0.5% and the Hang Seng China Enterprises Index (HSCEI) fell 4.4%;
 - in the US, the Dow and S&P 500 rose 1.5% and 6.1% respectively to record highs;
 - in Europe, the FTSE fell 0.1%, whilst the DAX and CAC rose 2.9% and 3.0% respectively; and
 - in the Mainland, the Shanghai Composite Index dropped 3.2%.
2. In the US, while the Fed signaled a steady pace of tapering, investors remained concerned about interest rates rising sooner than expected. Expectations are that the Fed's monthly asset purchases might end by late 2014 and interest rates might be raised around six months later. Given encouraging signs in the labour market, it is possible that the Fed will increase interest rates earlier than expected.
3. In Europe, there are growing worries about risks of deflation and subdued economic growth. In the first quarter of 2014, gross domestic product (GDP) in the euro zone grew by a modest 0.2%, whilst the inflation rate in May 2014 dropped to a five-year low of 0.5%, well below the European Central Bank's (ECB) target rate of 2%. In an unprecedented move, the ECB cut the benchmark interest rate to -0.1% in June 2014 and pledged to ease monetary policy further if necessary.
4. In the Mainland, worries about an economic hard landing lingered. Also, several defaults of corporate bonds and wealth management products occurred earlier in the year. In addition, concerns over an increase in share supply in the Mainland's stock market due to the resumption of initial public offerings (IPOs) have dampened market performance.
5. The Hong Kong stock market, being affected by both overseas and Mainland market conditions, has underperformed most major markets. Nonetheless, based on various indicators, such as price-earnings (PE) ratios, systemic risk in the local market does not seem to be very significant. However, if conditions in the Mainland and overseas markets worsen, the local market will be inevitably affected.
 - In the US, investors' perception of liquidity conditions may weigh on the market. In addition, as the market reached record highs, valuation concerns may lead to corrections.
 - In Europe, the effectiveness of the ECB's stimulus remains uncertain and worries about deflation risks may continue to affect investor sentiment.
 - In the Mainland, the stock market outlook will depend on the effectiveness of economic and market reforms. In addition, possible credit events may weigh on the market.
6. Trading in both the cash market and exchange-traded derivatives rose. Average daily turnover in the cash market rose 10% from the second half of 2013. The average daily volume of derivatives increased 3%.



Performance of worldwide stock markets during the first half of 2014

7. During the first half of 2014,
- the HSI dropped 0.5% and the HSCEI fell 4.4% (following an increase of 2.9% and a decline of 5.4%, respectively, in 2013).
 - in the US, the Dow and S&P 500 rose 1.5% and 6.1% respectively to record highs, while Nasdaq rose 5.5%. In 2013, the indices gained 26.5%, 29.6% and 38.3%, respectively.
 - in Europe, the FTSE fell 0.1%, whilst the DAX and CAC rose 2.9% and 3.0%, respectively (after gaining 14.4%, 25.5% and 18.0% in 2013 respectively). The DAX once reached a record high, whilst CAC hovered around a 5.5-year high.
 - in the Mainland, the Shanghai Composite Index dropped 3.2%, after declining 6.7% in 2013.



Source: Bloomberg

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



Performance of major stock markets

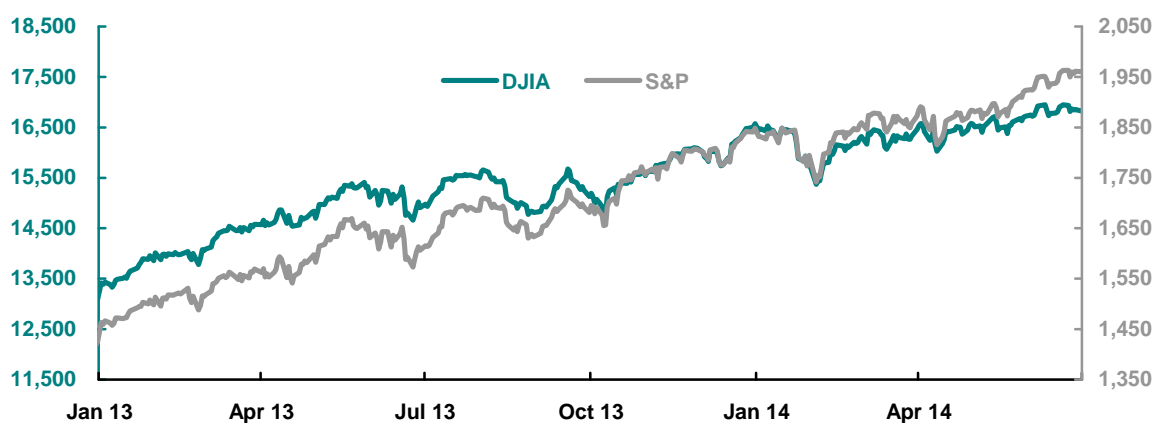
		End of June 2014	Year-to-date	% change	
		Index Level		2013	2012
Hong Kong and Mainland					
Hong Kong	HSI	23,190.72	-0.5%	2.9%	22.9%
	HSCEI	10,335.03	-4.4%	-5.4%	15.1%
Mainland	Shanghai Composite Index	2,048.33	-3.2%	-6.7%	3.2%
	Shenzhen Composite Index	1,096.79	3.7%	20.0%	1.7%
Asia					
Japan	Nikkei 225	15,162.10	-6.9%	56.7%	22.9%
Australia	AOI	5,382.03	0.5%	14.8%	13.5%
Taiwan	TWSE	9,393.07	9.1%	11.8%	8.9%
Korea	KOSPI	2,002.21	-0.5%	0.7%	9.4%
Singapore	STI	3,255.67	2.8%	0.0%	19.7%
Thailand	SET	1,485.75	14.4%	-6.7%	35.8%
Malaysia	KLCI	1,882.71	0.8%	10.5%	10.3%
Indonesia	JCI	4,878.58	14.1%	-1.0%	12.9%
India	Nifty	7,611.35	20.7%	6.8%	27.7%
Philippines	PCOMP	6,844.31	16.2%	1.3%	33.0%
Vietnam	VN	578.13	14.6%	22.0%	17.7%
US					
US	Dow	16,826.60	1.5%	26.5%	7.3%
	Nasdaq	4,408.18	5.5%	38.3%	15.9%
	S&P 500	1,960.23	6.1%	29.6%	13.4%
Europe					
UK	FTSE 100	6,743.94	-0.1%	14.4%	5.8%
Germany	DAX	9,833.07	2.9%	25.5%	29.1%
France	CAC	4,422.84	3.0%	18.0%	15.2%
PIIGS and Hungary					
Portugal	PSI 20	6,802.20	3.7%	16.0%	2.9%
Italy	FTSE MIB	21,283.03	12.2%	16.6%	7.8%
Ireland	ISEQ	4,699.94	3.5%	33.6%	17.1%
Greece	ASE	1,214.31	4.4%	28.1%	33.4%
Spain	IBEX	10,923.50	10.2%	21.4%	-4.7%
Hungary	BUX	18,605.78	0.2%	2.2%	7.1%
Middle East and North Africa					
Egypt	EGX	8,162.20	20.3%	24.2%	50.8%
Dubai	DFMGI	3,942.82	17.0%	107.7%	19.9%
Other BRIC markets					
Brazil	IBOV	53,168.22	3.2%	-15.5%	7.4%
Russia	MICEX	1,476.38	-1.8%	2.0%	5.2%
Other Emerging Markets					
Argentina	MERVAL	7,887.33	46.3%	88.9%	15.9%
Chile	SM Select	3,875.73	4.8%	-14.0%	3.0%
Mexico	IPC	42,737.17	0.0%	-2.2%	17.9%
South Africa	FTSE/JSE 40	45,969.81	10.8%	19.2%	22.2%
Turkey	National 100	78,489.01	15.8%	-13.3%	52.6%

Source: Bloomberg



The tapering of stimulus in the US

8. While the Fed had signaled a steady pace of tapering, investors remained concerned about a sooner-than-expected interest rate rise.
9. In the five policy meetings from December 2013 to June 2014, the Fed trimmed its monthly asset purchase by US\$10 billion each time, from US\$85 billion to US\$35 billion. It is expected that the monthly asset purchases may end by late 2014. The Fed also indicated that it might raise interest rates around six months after the tapering ends.
10. Investors have been highly sensitive to news about the pullback of stimulus. In January 2014, the start of the Fed's tapering triggered a sell-off of emerging market assets. Amid worsening economic conditions and a withdrawal of liquidity, the currencies of Argentina, Turkey and South Africa experienced a fall of 7% to 19%. The selling pressure eased after the central banks raised interest rates to slow capital outflows.
11. While the US recorded negative economic growth in the first quarter due to severe winter weather, expectations are that the recovery will pick up given encouraging signs in the labour market. This has raised concerns that the Fed might increase interest rates earlier than expected.
12. Despite the withdrawal of stimulus, the Dow and S&P 500 rose to record highs, amidst a decline in volatility. The CBOE Volatility Index, an indicator gauging investor risk aversion, reached a seven-year low of 11. Therefore, concerns have arisen that after accumulating substantial gains, the market has become vulnerable to corrections. Any disappointing news about economic performance or policy changes may trigger sell-offs and increase market volatility.



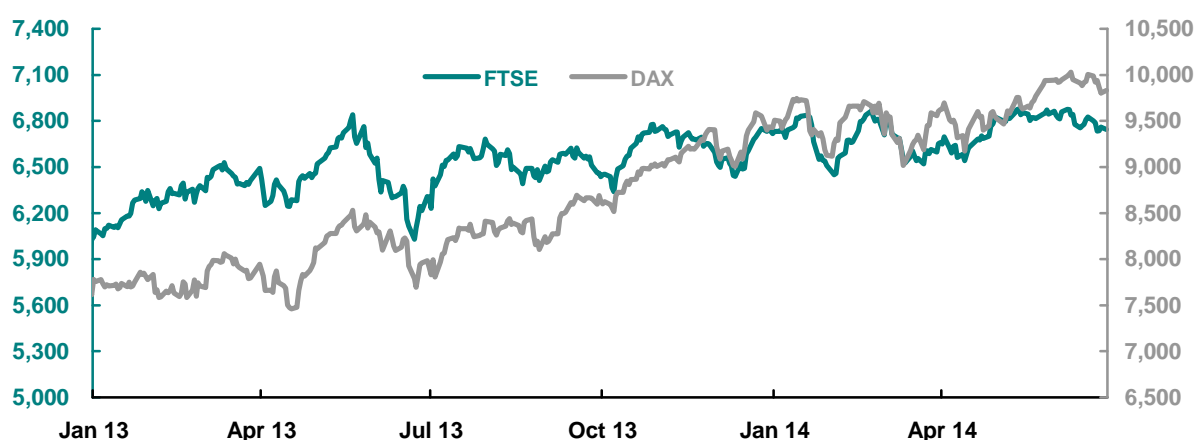
Performance of Dow Jones Industrial Average (DJIA) and S&P 500

Source: Bloomberg



Uncertain outlook of European economies

13. In Europe, worries about risks of deflation and subdued growth have grown. The International Monetary Fund's (IMF) deflation vulnerability index suggests that deflation risk is high for the euro zone.
14. Economic activities in the euro zone were lacklustre. GDP recorded a slower-than-expected growth of 0.2% in the first quarter of 2014. The inflation rate in May 2014 dropped to a five-year low of 0.5%, below the official target of 2%.
15. Geopolitical tensions between Russia and Ukraine posed further downside risks to the euro zone economy. There were concerns that international sanctions against Russia might affect energy supplies and cause capital outflows.
16. In June 2014, the ECB became the first major central bank adopting negative deposit rates. It also launched a new programme of long-term refinancing operations of around €400 billion to provide financing to banks. However, the effectiveness of these measures is not yet known.
17. Despite worries about the economic outlook in the euro zone, the stock markets advanced on hopes of further stimulus by the ECB. The DAX once rose to a record high, whilst CAC hovered around a 5.5-year high. The markets would likely correct in the event of disappointments about the effectiveness, timing and scale of the policy stimulus.



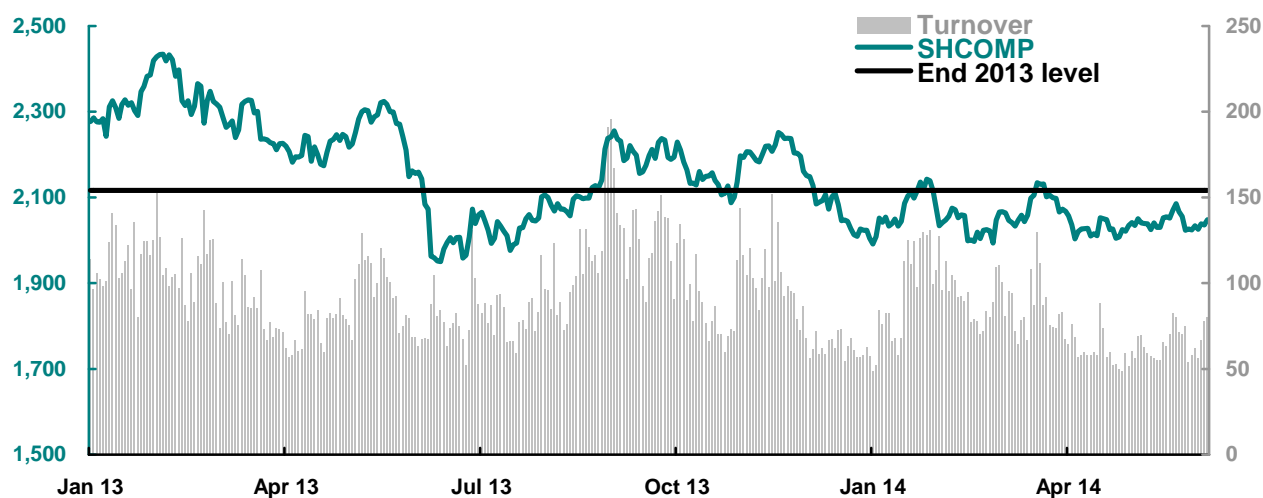
Performance of FTSE 100 and DAX

Source: Bloomberg



Bearish market performance and slowdown in economic growth in the Mainland

18. The Mainland market was one of worst performing markets worldwide so far this year. The Shanghai Composite Index dropped 3.2% during the first half of 2014. Market sentiment was undermined by signs of economic slowdown, increasing credit risk and liquidity concerns amid resumptions of IPOs.
19. To maintain a structural balance for the economy and contain financial risks, the Mainland government introduced supportive measures for certain sectors rather than adopting broad-based stimulus. GDP growth in the first quarter of 2014 was 7.4%, slightly lower than the official target of 7.5% for 2014. The IMF maintained its forecast for the Mainland's economic growth at 7.5% in 2014, but expected growth to slow to 7% in 2015. Worries about a hard landing lingered.
20. Concerns over credit risks in the Mainland heightened. There were several defaults of corporate bonds and wealth management products. Tighter regulation of shadow banking activities might give rise to more defaults. Market analysts believe that smaller or financially weaker privately-owned Mainland companies would likely be affected the most.
21. The China Securities Regulatory Commission resumed the approval of IPOs this year, and the number of IPOs this year is estimated to reach about 100. Although the number seemed smaller than previously expected, concerns over an increase in share supply and a drain of liquidity remained.



Shanghai Composite Index and Market Turnover (RMB billion)

Source: Bloomberg



An assessment of risks facing the Hong Kong market

22. The Hong Kong market, being affected by both overseas and Mainland market conditions, has underperformed most major markets. Nonetheless, based on various indicators, the systemic risk of the local market does not seem to be very significant.
- Since the HSI attained a low level of 18,185 points in June 2012, it has risen by 28% and the HSCEI by 10%. Over the same period, the US market has accumulated gains of 39% to 60%, whilst major European markets have risen 28% to 65%.
 - The valuation of the local market was among the lowest relative to other major markets. The PE ratios of the HSI and the HSCEI were 11 times and 8 times respectively as of the end of June 2014, compared to 13 to 22 times for other Asian markets, 16 to 35 times for US market and 18 to 26 times for major European markets.
 - Turnover in the local market remained moderate. During the first half of 2014, the average daily turnover was \$62.9 billion, compared with \$57.1 billion for the second half of 2013.
23. However, if the market situation in the Mainland and overseas worsens, the local market will be inevitably affected.
- In the US, the timing of the interest rate hike remains uncertain and will be affected by economic and labour market conditions. Whilst the economy may be in a better position to withstand the impact of a rate hike given improving fundamentals, investors' perception of liquidity conditions may weigh on the market. In addition, as the US market reaches record highs, valuation concerns may lead to corrections and affect global market sentiment.
 - In Europe, although the ECB has expanded the stimulus programme to support economic growth and fight deflation, its effectiveness remains uncertain (and very much depends on the specifics of the stimulus). Also, geopolitical tensions in Ukraine and political uncertainties in euro zone countries may increase market volatility.
 - In the Mainland, the stock market outlook will depend on the effectiveness of economic and financial market reforms. In addition, on the back of tighter regulations over shadow banking activities, possible credit events and tight liquidity conditions in the banking system may weigh on the market.
 - During the first half of 2014, some emerging markets made substantial gains. While Argentina, Turkey and South Africa experienced currency depreciation in early 2014, their stock markets rose 46%, 16% and 11% respectively in the first half of 2014. The risk of correction has heightened with growing concern of an outflow of funds from these markets.
 - Military confrontations in Iraq may cause volatility in oil prices, which may in turn affect the pace of global economic recovery. Investors are also worried about the contagion effect of unrest in the region.



Major statistics of Hong Kong securities market during the first half of 2014

Trading activity in the local stock market

24. Trading activity in the local stock market was moderate during the first half of 2014. The average daily turnover amounted to \$62.9 billion, 10% higher compared with \$57.1 billion for the second half of 2013.
25. Mainland stocks remained the most actively traded stocks, accounting for 54% of total market turnover—with H-shares, red chips and non-state-owned enterprises accounting for 24%, 11% and 18%, respectively.

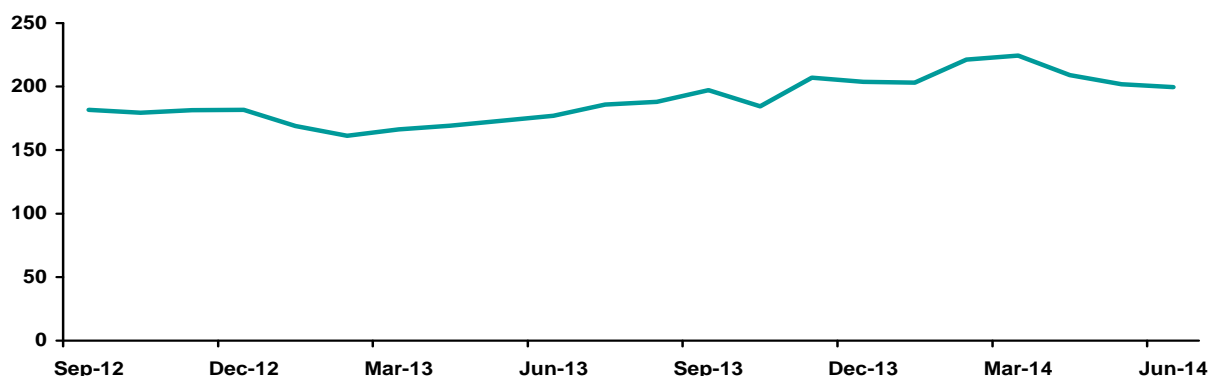
Average Daily Turnover (\$ billion)

	1H 2014		2H 2013		1H 2013		% change over	
							2H 2013	1H 2013
HSI (excl. Mainland stocks)	12.2	(19%)	9.1	(16%)	10.5	(15%)	35%	17%
Mainland Stocks	33.9	(54%)	31.1	(54%)	34.9	(51%)	9%	-3%
<i>H-shares</i>	15.3	(24%)	15.9	(28%)	18.7	(27%)	-4%	-18%
<i>Red chips</i>	7.1	(11%)	6.4	(11%)	7.7	(11%)	11%	-7%
<i>Non-state-owned enterprises</i>	11.5	(18%)	8.7	(15%)	8.5	(12%)	31%	35%
Derivative Warrants	6.7	(11%)	6.0	(10%)	8.7	(13%)	13%	-22%
Callable bull/bear contracts (CBBCs)	4.6	(7%)	4.7	(8%)	5.7	(8%)	-2%	-20%
Exchange-traded funds (ETFs)	2.5	(4%)	2.9	(5%)	4.5	(7%)	-14%	-45%
Others	3.0	(5%)	3.4	(6%)	3.9	(6%)	-12%	-24%
Market total	62.9	(100%)	57.1	(100%)	68.3	(100%)	10%	-8%

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

Short-selling activity

26. During the first half of 2014, the average daily short-selling turnover amounted to \$6.6 billion (or 10.2% of total market turnover), higher than the \$5.5 billion (or 9.7%) for the second half of 2013.
27. As of the end of June 2014, the market value of all short positions amounted to \$199.6 billion, about 1.2% of the total market cap of the reported stocks.



Aggregated short positions (\$ billion)

Sources: HKEx and SFC Research



Initial public offerings (IPOs)

28. During the first half of 2014, there were 51 IPOs in Hong Kong raising a total of US\$10.4 billion, compared with 97 IPOs and US\$21.4 billion for 2013. Mainland companies accounted for 68% of the total funds raised.
29. Worldwide, Hong Kong ranked the fourth in IPO activities in January to May 2014.

Top 10 Stock Markets in the World, by Equity Funds Raised through IPOs (January – May 2014)

	Equity Funds Raised through IPO		
	US\$ billion	Worldwide Ranking	Asia Ranking
US (NYSE Euronext)	16.24	1	-
UK (London)	12.10	2	-
US (Nasdaq OMX)	9.24	3	-
Hong Kong Stock Exchange	7.67	4	1
Japan (Tokyo Stock Exchange)	4.92	5	2
Australian Stock Exchange	3.35	6	3
NASDAQ OMX Nordic Exchange	3.28	7	-
Canada (TMX Group)	2.61	8	-
BME Spanish Exchanges	2.34	9	-
China (Shenzhen Stock Exchange)	2.19	10	4

Note: Data is provisional only.
Sources: World Federation of Exchanges and HKEx

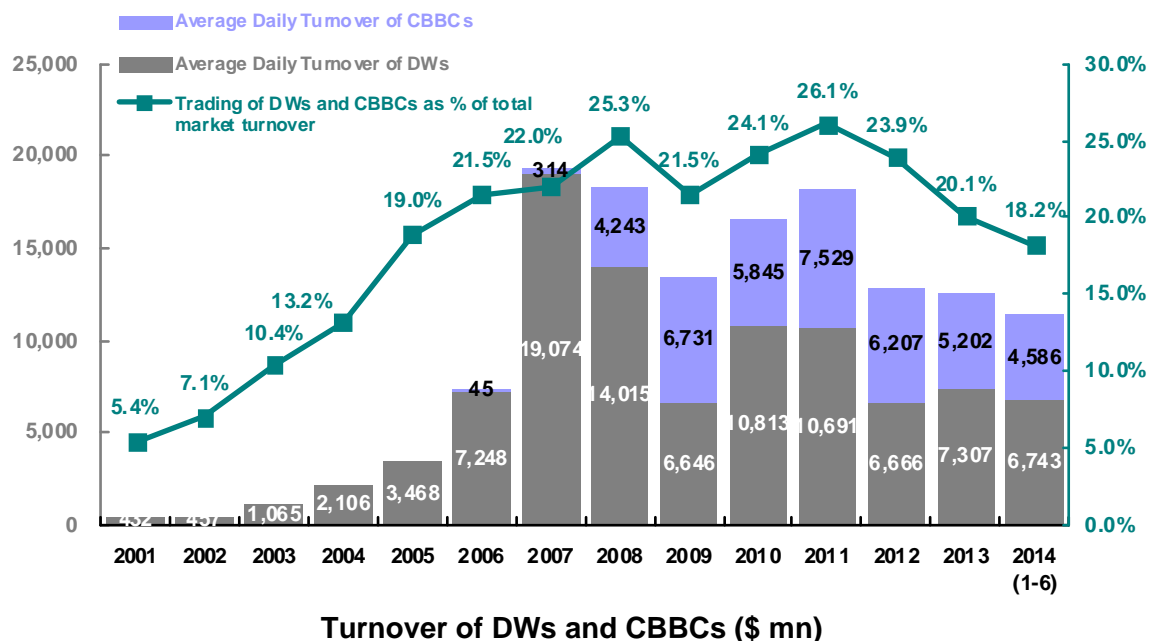
Exchange-traded funds (ETFs)

30. As of the end of June 2014, the number of ETFs stood at 124 compared with 116 as of the end of 2013. The average daily turnover of ETFs was \$2.5 billion during the first half of 2014, 14% lower than the \$2.9 billion recorded during the second half of 2013. ETFs accounted for 4.0% of the total market turnover during the period, compared with 5.2% during the second half of 2013.



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

31. The average daily turnover of DWs rose to \$6.7 billion (10.8% of total market turnover), compared with \$6.0 billion (10.5% of total market turnover) in the second half of 2013.
32. The average daily turnover of CBBCs fell slightly to \$4.6 billion (7.4% of total market turnover) during the first half of 2014, compared with \$4.7 billion (8.2% of total market turnover) in the second half of 2013.



Source: Bloomberg

Exchange-traded derivatives

33. During the first half of 2014, the average daily volume of derivatives increased 3% compared with the second half of 2013. The increase in the trading of options products was 9%, offsetting the 5% decline in the trading of futures products during the period.
 - HSI futures and HSCEI futures accounted for about 35% and 44% of all futures trading respectively. Their average daily volume dropped 8% and 4% respectively from the second half of 2013.
 - Stock options remained the most actively traded options product. The average daily volume of stock options rose 13% from the second half of 2013.



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

		1H 2014	2H 2013	1H 2013
Futures	HSI Futures	68,280	73,924	86,890
	Mini-HSI Futures	26,317	30,486	33,975
	HSCEI Futures	85,156	88,500	82,427
	Mini-HSCEI Futures	11,219	10,179	8,237
	Stock Futures	1,505	1,383	2,406
	RMB Currency Futures [^]	900	539	599
	Other futures products [*]	1,444	988	802
	Total Futures	194,822	205,999	215,336
Options	HSI Options	28,825	29,871	40,904
	Mini-HSI Options	3,579	4,240	5,272
	HSCEI Options	35,282	36,244	29,385
	Stock Options	263,163	232,396	267,047
	Other options products ^{**}	144	59	275
	Total Options	330,994	302,809	342,882
Total Futures and Options		525,816	508,807	558,218

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

[^] RMB Currency Futures commenced trading on 17 September 2012.

^{*} One-Month HIBOR Futures, Three-Month HIBOR Futures, Three-year Exchange Fund Note Futures, Gold Futures, HSI Dividend Point Index Futures, HSCEI Dividend Point Index Futures, HSI Volatility Index Futures (launched on 20 February 2012), IBOVESPA Futures (launched on 30 March 2012), MICEX Index Futures (launched on 30 March 2012), Sensex Index Futures (launched on 30 March 2012), FTSE/JSE Top40 Futures (launched on 30 March 2012) and CES China 120 Index Futures (launched on 12 August 2013).

^{**} Flexible Hang Seng Index Options and Flexible H-shares Index Options

Sources: HKEx and SFC Research

After-Hours Futures Trading (AHFT)

34. Trading during the AHFT session continued to grow during the first half year of 2014. Three products, namely the Mini-Hang Seng Index (Mini-HSI) Futures, Mini H-shares Index (Mini-HSCEI) Futures and the RMB currency futures, were added to the AHFT session during the period.
- During the first half of 2014, the average daily volume of HSI futures during AHFT sessions was 3,237 contracts or 5.0% of the average during daytime trading sessions, compared with 3,223 contracts, or 4.5%, during the second half of 2013. For the HSCEI futures, the average daily volume during AHFT sessions during the first half of 2014 was 4,649 contracts or 5.8% of the average during daytime trading sessions, compared with 3,770 contracts, or 4.4%, during the second half of 2013.
 - Mini-HSI Futures and Mini-HSCEI Futures were available for trading from 6 January 2014. Their average daily volumes from 6 January 2014 to 30 June 2014 were 1,630 contracts and 974 contracts respectively, or 6.6% and 9.4% of the average during daytime trading sessions.
 - RMB currency futures were available for trading from 7 April 2014. Their average daily volume from 7 April 2014 to 30 June 2014 was 25 contracts or 4.8% of the average during daytime trading sessions.