



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

Research Paper No. 68: A Review of the Global and Local Securities Markets in 2020 (Featuring New Economy Stocks and Stock Connect Inflows)

11 February 2021

Executive Summary

1. In 2020, major indices in the US advanced, with the Dow, Nasdaq and S&P respectively rising 7.2%, 43.6% and 16.3%. The performance of major European markets was mixed, with the DAX rising 3.5% whilst the FTSE and CAC falling 14.3% and 7.1%, respectively. Investor sentiment was boosted by optimism about government policy support, hopes for the resumption of economic activity in light of progress in the development of vaccines and easing political uncertainties after the US presidential election. However, valuation concerns heightened following market rallies. Given the continued spread of COVID-19 and further lockdowns in various parts of the world, uncertainties about the economic outlook remained.
2. On the Mainland, the SHCOMP and the SZCOMP rose 13.9% and 35.2% respectively during the year. The SHCOMP hit a 34-month high whilst the SZCOMP hit its highest level since December 2015. The Mainland economy staged an early recovery from the pandemic. Expectations for further reforms and opening-up in the financial market also paced gains.
3. The Hong Kong market fell, with the HSI and the HSCEI dropping 3.4% and 3.8%, respectively. Uncertainties surrounding COVID-19 added to concerns about the economic outlook. A number of index constituent stocks recorded disappointing earnings as a result of the pandemic. Some losses were trimmed after policy support by major governments and central banks. Looking ahead, investor sentiment depends on how well the pandemic would be controlled as well as the degree of tensions between the Mainland and the US. Following recent gains, possible volatility in overseas markets may also affect the performance of the Hong Kong stock market.

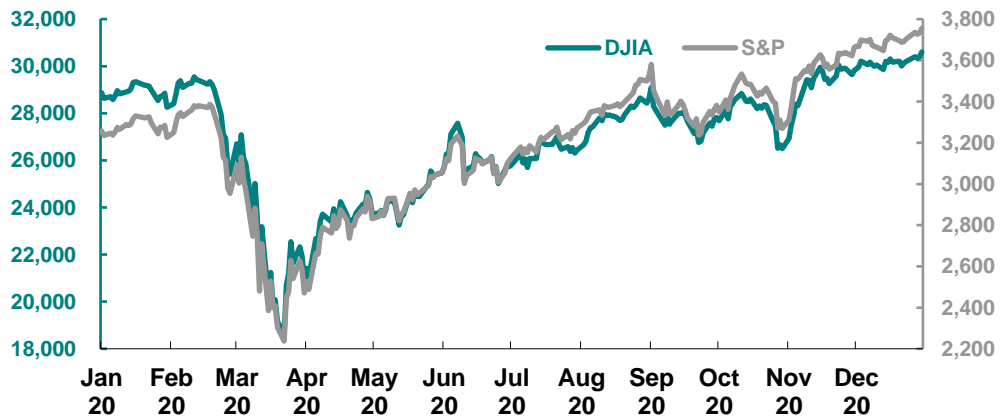
Performance of stock markets

4. After bottoming out in March 2020, global markets rebounded strongly and some hit record highs. Market sentiment was bullish given hopes for fiscal and monetary stimulus in major markets as well as easing political uncertainties following the US presidential election. Positive development of COVID-19 vaccine boosted optimism about economic recovery. Nevertheless, pandemic risk remains high and the economic outlook stays fragile. There are worries that economic fundamentals may be affected by the second wave of COVID-19, which dampens business activity, consumer demand and corporate earnings.

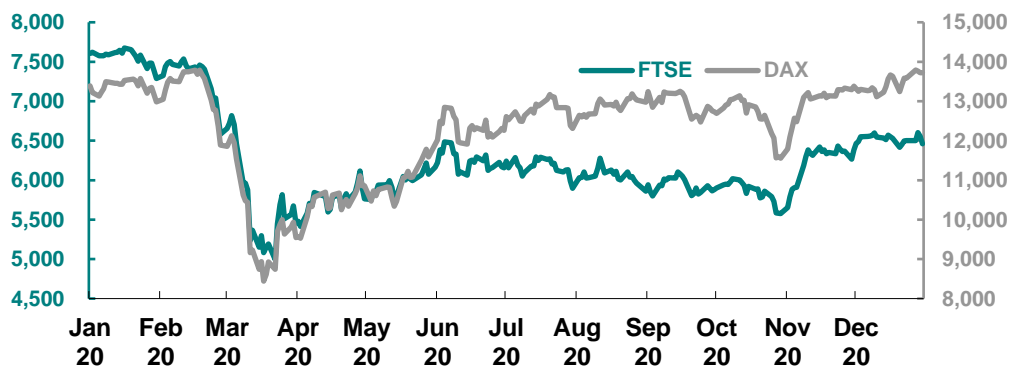
Overseas markets

5. In 2020, major indices in the US advanced, with the Dow, Nasdaq and S&P rising 7.2%, 43.6% and 16.3%, respectively. The performance of major European markets was mixed, with the DAX rising 3.5% whilst the FTSE falling 14.3% and the CAC dropping 7.1%. Markets were highly volatile, but major indices rebounded strongly following sharp declines in March 2020.
6. Accommodative monetary policies and fiscal stimulus supported market sentiment. The Federal Reserve (Fed) pledged to maintain a low interest rate environment and use the full range of monetary tools to support the economy. The Bank of England and the European Central Bank announced the expansion of asset purchase plans.
7. Following the news of positive trials and approvals of COVID-19 vaccines as well as the start of vaccinations in several countries, there was growing optimism about an economic reopening, offsetting some of the worries about surging infections and the discovery of a new variant of the virus.
8. Political uncertainties eased after the US presidential election. The new US administration was expected to adopt a multilateral approach to trade and other issues, mitigating some concerns about tensions with the Mainland.
9. Nevertheless, valuation concerns grew as stock markets rallied despite an uncertain economic outlook given the continued spread of COVID-19 and lockdowns in various parts of the world. The extended disruptions to business activity dented hopes for a swift economic recovery.

Performance of the Dow and S&P during 2020



Performance of FTSE and DAX during 2020



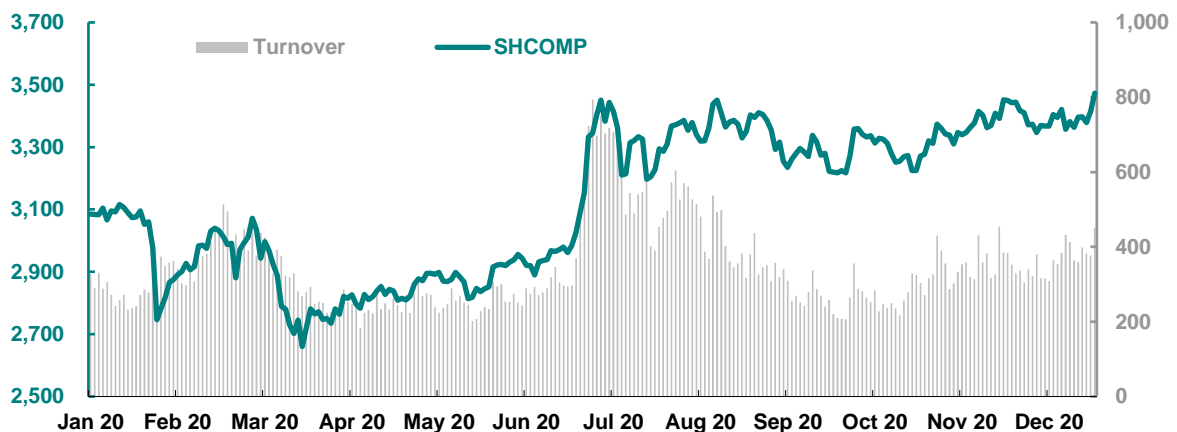
Performance of major stock markets

		Index level	% change		
			2020	2019	2018
Hong Kong and the Mainland					
Hong Kong	-HSI	27,231.1	-3.4%	+9.1%	-13.6%
	-HSCEI	10,738.4	-3.8%	+10.3%	-13.5%
	-HS TECH	8,425.9	+78.7%	+36.2%	-37.6%
Mainland	-SHCOMP	3,473.1	+13.9%	+22.3%	-24.6%
	-SZCOMP	2,329.4	+35.2%	+35.9%	-33.2%
US					
US	-Dow	30,606.5	+7.2%	+22.3%	-5.6%
	-Nasdaq	12,888.3	+43.6%	+35.2%	-3.9%
	-S&P	3,756.1	+16.3%	+28.9%	-6.2%
Europe					
UK	-FTSE100	6,460.5	-14.3%	+12.1%	-12.5%
Germany	-DAX	13,718.8	+3.5%	+25.5%	-18.3%
France	-CAC	5,551.4	-7.1%	+26.4%	-11.0%

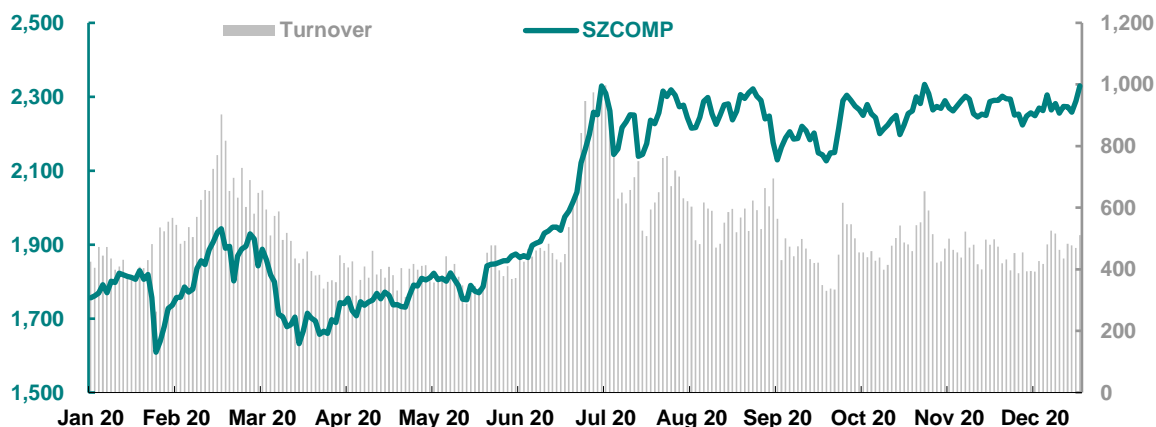
The Mainland

10. In 2020, the SHCOMP and the SZCOMP rose 13.9% and 35.2%, respectively. The SHCOMP hit a 34-month high whilst the SZCOMP reached its highest level since December 2015. The average daily trading in the Mainland market was RMB848.2 billion, 63% higher than the average of RMB520.5 billion in 2019.
11. The Mainland economy staged an early recovery from the pandemic, with GDP growth of 4.9% in Q3 2020. The market rally was further supported by a stronger renminbi, which hit its highest level since June 2018. In addition, investor sentiment was boosted as the Mainland and 14 Asia-Pacific countries signed the Regional Comprehensive Economic Partnership, the largest regional trade agreement ever.
12. Expectations for further reforms and opening of the financial market also paced gains. The Shenzhen market outperformed on the launch of the registration-based IPO system for the ChiNext Board. The ChiNext Index hit its highest level since July 2015. The SZCOMP was also lifted by a series of supportive measures, including a comprehensive reform plan for Shenzhen and the launch of the Wealth Management Connect pilot scheme in the Guangdong-Hong Kong-Macao Greater Bay Area.
13. Nevertheless, investors remained cautious about uncertain relations with the US, which imposed tariffs on Mainland goods and sanctions on some Mainland companies.

SHCOMP and market turnover (RMB billion) during 2020



SZCOMP and market turnover (RMB billion) during 2020



Hong Kong

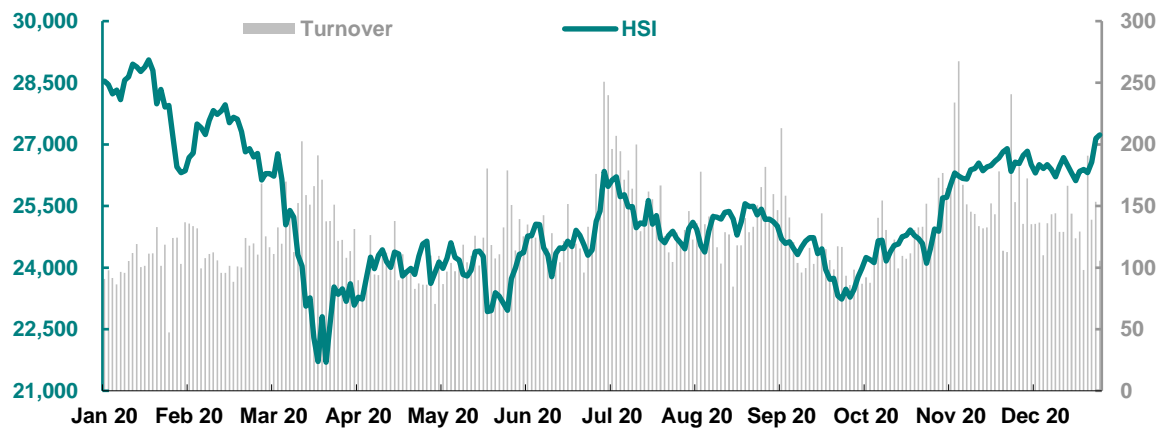
Market performance

14. The Hong Kong market fell during the year, with the HSI and the HSCEI dropping 3.4% and 3.8%, respectively.
15. Uncertainties related to COVID-19 and its economic impact weighed on the market. The worrying epidemic situation lingered in various parts of the world amid continued spread of the epidemic. Despite progress in vaccine development and approvals, it could take some time to see significant progress in mass production, distribution and inoculation worldwide.
16. Tensions between the Mainland and the US escalated. The US included some Mainland technology companies in its trade blacklist and additionally, prohibited US investment in certain Mainland companies including some listed in Hong Kong.
17. Concerns over the economic outlook affected investor sentiment. Hong Kong's GDP contracted for five consecutive quarters, whilst the unemployment rate hit a 16-year high. Corporate earnings were also affected by the pandemic as a result of the slowdown in business activity, disruptions in supply chains and declining consumer spending. A number of index constituent stocks recorded disappointing earnings.
18. Some losses were trimmed on optimism about policy support from major governments and central banks. The Fed hinted that it planned to maintain low interest rates and reiterated its commitment to using the full range of tools to support the economy. In the Mainland, credit expansion and measures to promote infrastructure spending were adopted to propel growth.

Market outlook and risks

19. Looking ahead, investor sentiment would continue to be affected by the pandemic and the development and distribution of effective vaccines as well as fiscal and monetary policies to support the economy. Ongoing tensions between the Mainland and the US would also weigh on global and Hong Kong markets. Volatility may increase on concerns about stretched valuations in some overseas markets as major benchmark indices hit records or multi-year highs.

HSI and market turnover (\$ billion¹) during 2020



Activities in the Hong Kong securities market

Trading activity

20. Trading in the local stock market was active during 2020. During the year, the average daily trading rose to \$129.5 billion, 49% higher than the \$87.2 billion in 2019, amidst the active trading of newly listed companies in Hong Kong and strong southbound (SB) trading through Stock Connect.
21. Mainland stocks (including H-shares, red chips and privately-owned enterprises) remained the most actively traded. Their share of total market turnover was 68% in 2020 (58% in 2019), whilst that of HSI stocks (excluding Mainland stocks) was about 9% (11% in 2019).

¹ Unless otherwise stated, \$ denotes the Hong Kong dollar.

Mainland new economy companies grow in importance

In recent years, an increasing number of large-cap Mainland new economy companies² were listed in Hong Kong.

- The top five Mainland new economy stocks in Hong Kong are among the top 20 stocks in terms of market capitalisation and all are constituents of the Hang Seng Composite LargeCap Index (HSLI).
- The listing of Mainland new economy companies has supported Hong Kong's position as the world's leading listing hub. They accounted for a significant part of IPO funds raised.

Active and increasing trading

Mainland new economy companies contributed a significant share of market trading in Hong Kong. During the second half of 2020, the average daily trading of the top five Mainland new economy stocks, together with their derivative warrants and callable bull/bear contracts, accounted for nearly one-fifth of total market trading.

Looking forward, their trading may continue to increase, driven by:

- **Inclusion in major indices** – Hang Seng Indexes Company Limited included weighted voting rights and secondary-listed companies in the HSI and HSCEI starting September 2020. Since then, among the top five Mainland new economy stocks, three have been added to the HSI and all five have been added to the HSCEI. In addition, some are constituents of major global indices. This helps attract passive funds to invest in Mainland new economy companies.
- **Active Stock Connect trading** – Mainland new economy stocks eligible for SB trading were among the most actively traded stocks in SB trading. Mainland investors showed strong interest in trading these stocks.
- **Increasing liquidity in Hong Kong for secondary-listed companies** – For some Mainland new economy companies with American Depositary Receipts (ADRs) in the US which are secondary-listed in Hong Kong, as more of their ADRs are converted into shares in Hong Kong, this will bring liquidity to the Hong Kong market.

Hong Kong's position as the preferred listing venue for Mainland new economy companies

The successful listing of these Mainland new economy companies has paved the way for similar companies to list in Hong Kong.

In addition to the participation of international institutional investors, listing in Hong Kong also provides Mainland investors with access through SB trading under Stock Connect. This is a unique advantage in attracting Mainland new economy companies to list.

² New economy companies here refer to stocks included in the Hang Seng TECH Index.

Stock Connect

22. Stock Connect trading was active during 2020:

- the average daily northbound (NB) trading (including buy and sell trades) was RMB91.3 billion, or 5.4% of trading in the Mainland market (RMB41.7 billion or 4.0% of market trading in 2019); and
- the average daily SB trading (including buy and sell trades) was \$24.4 billion, or 9.4% of trading in the Hong Kong market (\$10.8 billion or 6.2% of market trading in 2019).

23. As at end-2020, the cumulative net buy was:

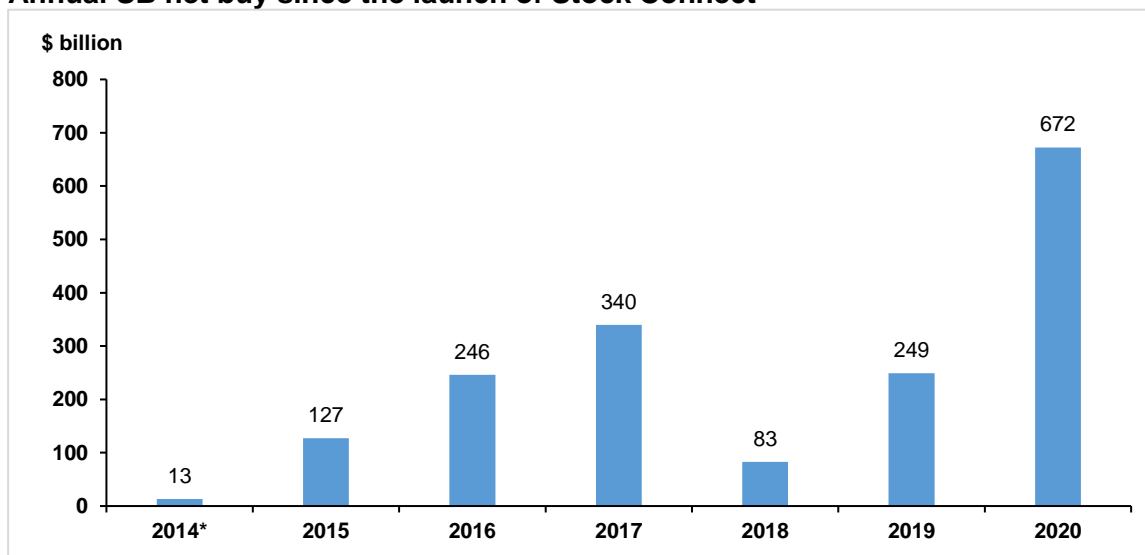
- RMB1,202.3 billion via NB trading; and
- RMB1,520.9 billion via SB trading.

SB inflows hit a record high in 2020

SB net buy during the year reached \$672.1 billion.

- This was 170% higher than the net buy of \$249.3 billion in 2019 and 7.1 times higher than the \$82.7 billion in 2018.
- SB net buy during 2020 made up nearly 40% of the cumulative SB net buy since the launch of Stock Connect until the end of 2020.
- SB net buy was recorded for 22 consecutive months from March 2019 to December 2020.

Annual SB net buy since the launch of Stock Connect



*Since the launch of Stock Connect on 17 November 2014

Strong SB net buy in large-cap stocks

Mainland investors showed strong interest in buying large-cap stocks through SB trading. The top 20 stocks accounted for nearly 70% of the total SB net buy in 2020. Of these 20 stocks, 17 were constituents of the HSLI.

Relatively low valuations, growing interest in new economy and well-known stocks

Among other factors, strong SB inflows could be attributed to:

- **Attractive valuations** – The price-to-earnings ratios of the HSI and the HSCEI were about 15 times and 11 times respectively, which was low compared to other major stock markets (CSI 300: 20 times, SHCOMP: 18 times, SZCOMP: 50 times and the Dow: 25 times).
- **AH premium** – SB net buy has been strong given the price premium for A-shares over H-shares, which implied lower valuations for H-shares.
- **Uniqueness of new economy stocks** – There were SB inflows to leading new economy stocks with a strong Mainland presence but which were not listed on the Mainland market. Altogether, the top five net buy new economy stocks recorded a SB net buy of \$226.5 billion (more than 30% of the SB total).
- **Portfolio diversification** – Stock Connect provides a channel for Mainland investors to broaden the scope of their investments and reduce risk through portfolio diversification.

Short-selling activities

24. During 2020, short selling in Hong Kong was higher in absolute terms, but declined as a percentage of total market turnover. The average daily short selling amounted to \$17.6 billion or 13.6% of total market turnover in 2020 (\$12.6 billion, or 14.5%, in 2019).
25. The market value of reportable short positions rose but remained relatively stable as a percentage of market capitalisation. Based on data submitted to the SFC, as at end-2020, aggregated short positions amounted to \$524.4 billion (\$456.8 billion as of end-2019). Short positions accounted for 1.25% of market capitalisation, similar to the percentage share as of end-2019.

Exchange-traded derivatives

26. During 2020, the trading of exchange-traded derivatives was 6.1% higher than the 2019 level.
 - Trading of futures products fell 1.7%. Amongst futures products, HSI futures and HSCEI futures were the most actively traded contracts, accounting for 36.2% and 31.5% of total futures trading, respectively. Trading in HSI futures fell 19.8% from 2019. Nevertheless, trading of HSCEI futures rose 4.9%. It was partly because of stronger demand for these products to manage the risk of Mainland-related portfolios.
 - Trading of options products rose 12.2%. Stock options remained the most actively traded options products, accounting for 78.4% of total options trading. Trading of stock options rose 19.0% from 2019.