



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

Research Paper No. 70: A Review of the Global and Local Securities Markets in 2021 (Featuring Technology Stocks and MSCI China A 50 Connect Index Futures Contract)

4 February 2022

Executive summary

1. In 2021, major indices in the US advanced, with the Dow, Nasdaq and S&P respectively rising 18.7%, 21.4% and 26.9%. Major European markets also gained, with the FTSE, DAX and CAC advancing 14.3%, 15.8% and 28.9%. The three major indices in the US, the DAX and CAC hit successive record highs. Large-scale fiscal stimulus and favourable monetary policies provided support for economic recovery, raising optimism about corporate earnings. However, worries about rising inflation and elevated valuations weighed on the markets.
2. On the Mainland, the SHCOMP and the SZCOMP rose 4.8% and 8.6%, respectively. Prospects for growth-supportive measures and accommodative monetary policies boosted investor sentiment. Signs of economic recovery and positive corporate earnings paced gains. Nevertheless, concerns about tightened regulatory scrutiny over various sectors and uncertainties surrounding property developers' liquidity conditions limited gains.
3. In Hong Kong, the HSI, HSCEI and Hang Seng TECH Index dropped 14.1%, 23.3% and 32.7%, respectively. Market underperformance was largely due to corrections in large-cap Mainland technology stocks. Given the heavy weightings of technology stocks in major benchmark indices, their declines impacted the Hong Kong market. Investor sentiment was also affected by the weak performance of Mainland stocks listed in the US amid stricter disclosure requirements imposed by the US on Mainland companies and possible risk of delisting these companies from the US. There were concerns about the credit situations of Mainland property developers. The spread of new COVID-19 variants also added to market uncertainties. In addition, worries about monetary tightening in overseas markets weighed on the market.
4. On 18 October 2021, the MSCI China A 50 Connect Index Futures (MSCI A-shares futures) contract was launched in Hong Kong. The new product provides international investors with an effective hedging tool to manage their risks in the A-share market through Hong Kong, consolidating Hong Kong's role as a risk management centre for Mainland risks. Trading has been orderly so far and recorded solid growth.

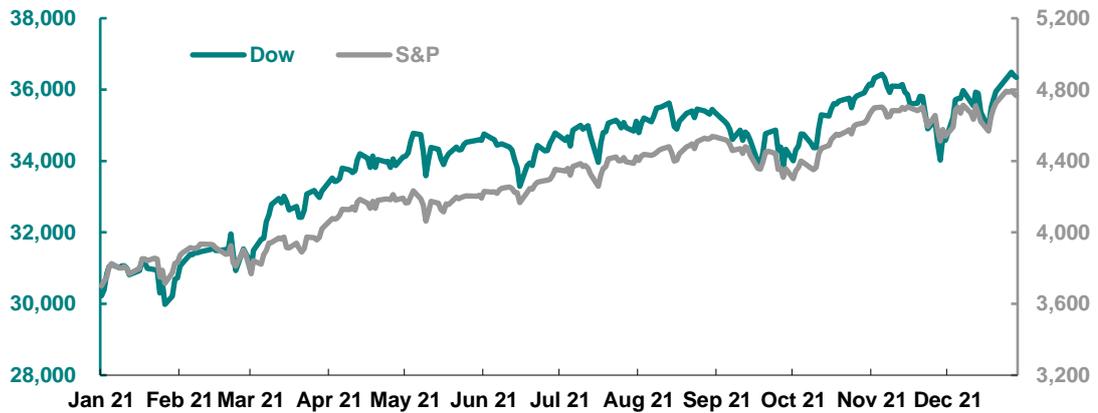
Performance of stock markets

5. Whilst fiscal and monetary policy support pushed some major overseas markets to record highs in 2021, the Hong Kong market remained volatile due to uncertainties surrounding Mainland technology and property stocks. Investor sentiment was fragile amidst the pandemic threat and worries about potential changes in central banks' monetary policies. In addition, there were concerns about the risk of corrections in some overseas markets given stretched valuations.

Overseas markets

6. Major indices in the US advanced, with the Dow, Nasdaq and S&P respectively rising 18.7%, 21.4% and 26.9%. The performance of major European markets was also bullish, with the FTSE, DAX and CAC gaining 14.3%, 15.8% and 28.9%. The three major indices in the US, the DAX and CAC hit successive record highs.
7. Substantial stimulus measures supported economic recovery and corporate earnings. In the US, large-scale fiscal packages were enacted to raise infrastructure spending and mitigate the impact of COVID-19 on the economy. The European Parliament approved a pandemic recovery plan. Market rallies were further supported by an abundance of liquidity as the monetary policies of major central banks remained accommodative.
8. The economic outlook improved during the year. In the US, GDP growth slowed to 2.3% in Q3 2021, from 6.4% in Q1 and 6.7% in Q2, but other key economic indicators, including consumption and employment, remained robust. The European Commission remarked that the economy was moving from recovery to expansion. Despite the emergence of new COVID-19 variants, progress in vaccines and treatments eased some concerns about the impact on economic recovery.
9. Inflation worries heightened amidst supply chain disruptions and rising oil prices. The growth in consumer prices in the US and Eurozone hit multi-year highs. Central banks warned that elevated inflation might not be transitory as previously predicted. The Fed announced its plan to end its asset purchase program by March 2022.
10. Valuation concerns lingered as major indices in the US gained 56% to 136% since end-2018, whilst major European markets rose 10% to 51% during the period. The S&P hit 70 record highs in 2021, the most frequent in recent years.

Performance of the Dow and S&P in 2021



Performance of FTSE and DAX in 2021



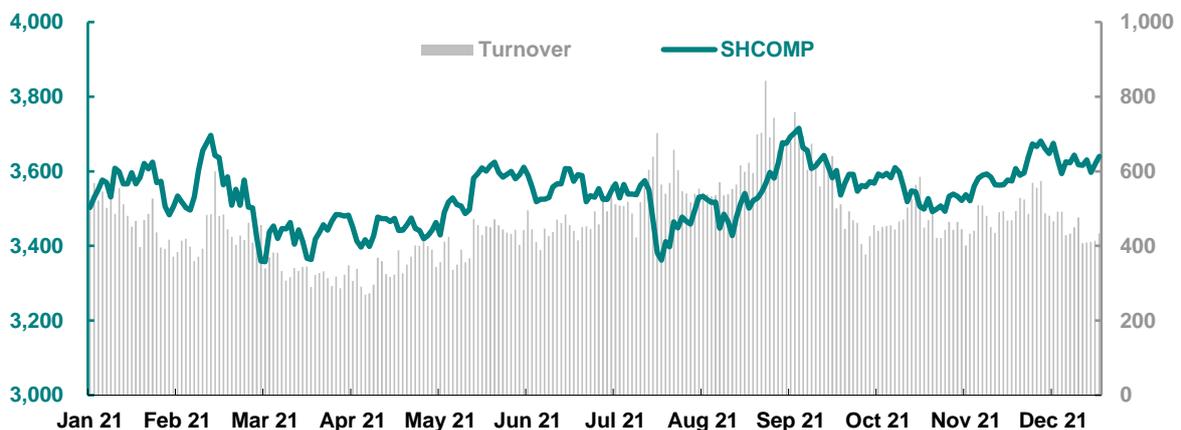
Performance of major stock markets

		Index level	% change		
			2021	2020	2019
Hong Kong and the Mainland					
Hong Kong	HSI	23,397.7	-14.1%	-3.4%	+9.1%
	HSCEI	8,236.4	-23.3%	-3.8%	+10.3%
	HS TECH	5,671.0	-32.7%	+78.7%	+36.2%
Mainland	SHCOMP	3,639.8	+4.8%	+13.9%	+22.3%
	SZCOMP	2,530.1	+8.6%	+35.2%	+35.9%
US					
US	Dow	36,338.3	+18.7%	+7.2%	+22.3%
	Nasdaq	15,645.0	+21.4%	+43.6%	+35.2%
	S&P	4,766.2	+26.9%	+16.3%	+28.9%
Europe					
UK	FTSE100	7,384.5	+14.3%	-14.3%	+12.1%
Germany	DAX	15,884.9	+15.8%	+3.5%	+25.5%
France	CAC	7,153.0	+28.9%	-7.1%	+26.4%

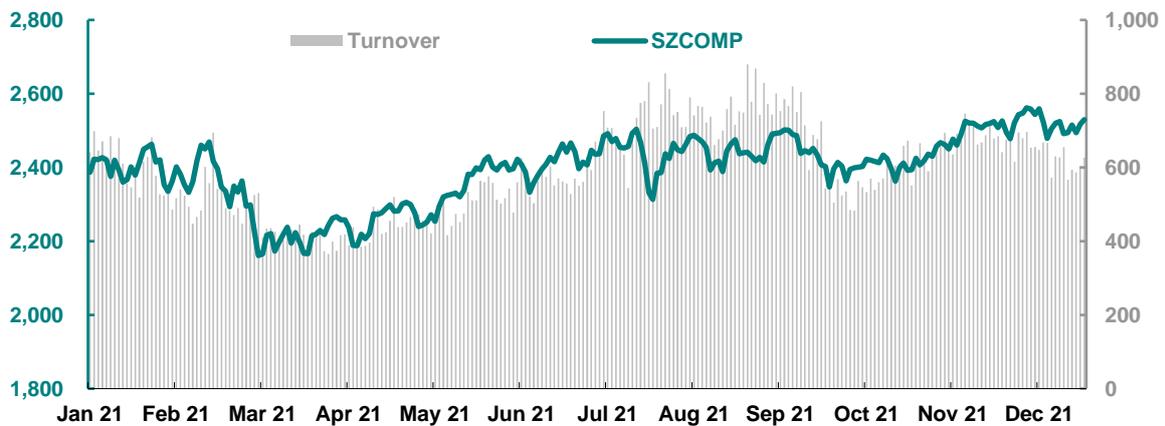
The Mainland

11. In 2021, the SHCOMP and the SZCOMP rose 4.8% and 8.6%, respectively. Both indices hit their highest levels in over five years. The average daily trading in the Mainland market was RMB1,058.3 billion, 24.8% higher than the average of RMB848.2 billion in 2020.
12. Optimism over policy stimulus to boost domestic consumption supported market sentiment. The People’s Bank of China reduced the reserve requirement ratio for banks twice by a total of 100 basis points and pledged to maintain a stable monetary policy. The Shenzhen market outperformed, partly due to the prospect of government policy support for small enterprises.
13. Corporate earnings remained solid in 2021. Robust retail sales and trade data boosted investor sentiment. GDP growth accelerated to a record high of 18.3% in Q1 2021, before slowing to 7.9% in Q2 and 4.9% in Q3.
14. Nevertheless, concerns about regulatory tightening in the technology, education and related sectors as well as caution about the liquidity conditions of property developers limited gains. Power curbs and energy conservation measures raised worries about the negative impact on production lines. Inflation concerns grew amidst supply chain bottlenecks.

SHCOMP and market turnover (RMB billion) in 2021



SZCOMP and market turnover (RMB billion) in 2021



Hong Kong

Market performance

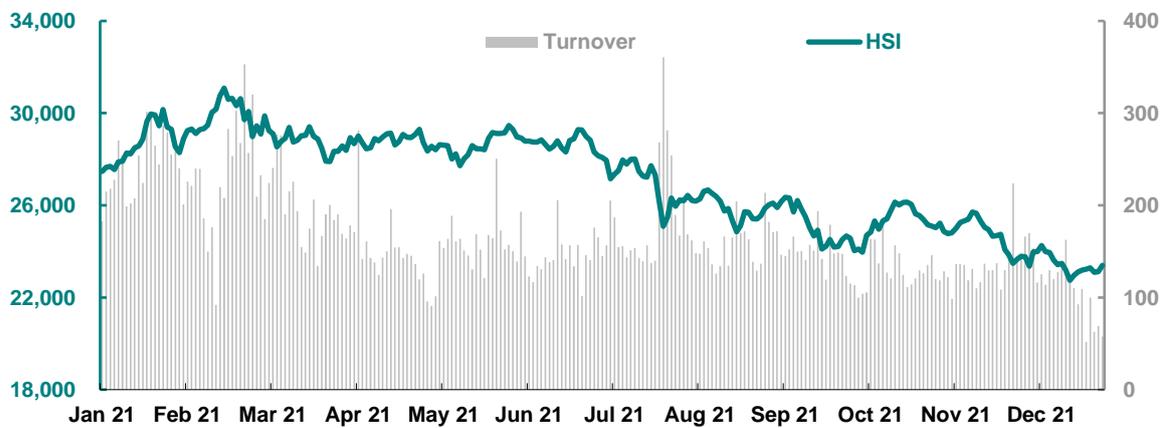
15. In Hong Kong, the HSI, HSCEI and Hang Seng TECH Index respectively fell 14.1%, 23.3% and 32.7%. The market was volatile, with the HSI hitting a 21-month low in December 2021.
16. The correction was mainly driven by the underperformance of large-cap Mainland technology stocks in industries subject to tightened regulatory policies on the Mainland. As large-cap Mainland technology stocks have heavy HSI weightings, the drops in their share prices impacted the Hong Kong market. Investor sentiment was affected by the declines of Mainland stocks listed in the US given stricter disclosure requirements imposed by the US and the risk of delisting Mainland companies from the US.
17. Uncertainties surrounding Mainland-based property stocks also influenced market sentiment. There were concerns about the credit conditions of Mainland developers with liquidity issues. Spillover to other sectors has been limited so far.
18. In addition, investors were sensitive to a possible scale-back of stimulus measures by major central banks. In the US, the Fed began monetary tapering. Investors were concerned about sooner-than-expected monetary tightening.
19. Pandemic risks persisted amidst the emergence of new COVID-19 variants. Renewed lockdown measures and travel restrictions in various parts of the world as well as concerns about supply chain disruptions raised worries about the path of global economic recovery.
20. As overseas markets made substantial gains, growing concerns about stretched valuations prompted some profit-taking activities and in turn affected the local market.
21. Trading in the local stock market was active in 2021 and hit a new record of \$361.2 billion on 27 July 2021. The average daily trading rose to \$166.7 billion, 29% higher than the \$129.5 billion in 2020, partly driven by strong southbound (SB) trading through Stock Connect.
22. Mainland stocks (including H-shares, red chips and privately-owned enterprises) remained the most actively traded. Their share of total market turnover was 73% in 2021

(68% in 2020), whilst HSI stocks (excluding Mainland stocks) accounted for about 6% (9% in 2020).

Market outlook and risks

23. Looking ahead, pandemic risk will continue to affect the global economic outlook. Uncertainties about the timing of interest rate hikes grow given rising inflationary pressure. Valuation concerns in overseas markets may add to market volatility. On the Mainland, the liquidity conditions of property developers and the economic outlook may also affect investor sentiment.

HSI and market turnover (\$ billion¹) in 2021



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

Growing importance of technology stocks in Hong Kong

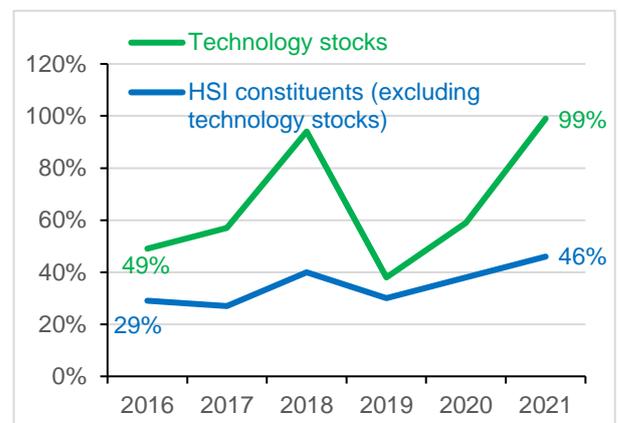
Over the past few years, the structure of the Hong Kong market has changed significantly with the growing importance of technology stocks². The listing of these stocks, including companies with weighted voting rights structures and secondary-listed shares, substantially boosted trading activity. Investor interest has been strong, as these are generally large-cap stocks and well-known brands. In 2021,

- their share of equity market turnover was 35% (9% in 2016), whilst the share of HSI constituents (excluding technology stocks) declined to 27% (45% in 2016); and
- the turnover ratio of the Hang Seng TECH Index increased to 99% (49% in 2016), much higher than the 46% (excluding technology stocks) for HSI constituents (29% in 2016).

Strong growth in the trading of technology stocks



High turnover ratio for technology stocks



Remarks:

Left panel: Percentage represents the share of total turnover.

Right panel: Turnover ratio refers to the ratio between annual trading and year-end market capitalisation.

The significant growth of technology stocks was also observed in the US, where trading for the sector has been very active and recorded more significant increases than stocks in the traditional sectors. In 2021, the average daily trading of the top five technology stocks was around:

- four times the total for the top five stocks from traditional sectors (financial and energy sectors); and
- 10 times the 2016 average, compared to a 46% increase for the top five stocks in traditional sectors.

Technology stocks are relatively volatile with high historical price-earnings ratios in general (Hang Seng TECH Index: 14.9 times; vs the HSI: 9.3 times, as of end-2021) and this may have an impact on the broader market.

² Technology stocks in this analysis refer to stocks included in the Hang Seng TECH Index.

Activity in the Hong Kong securities market

Stock Connect

24. Stock Connect trading was active during 2021:
- the average daily northbound (NB) trading (including buy and sell trades) was RMB120.1 billion, or 5.7% of trading in the Mainland market (RMB91.3 billion or 5.4% of market trading in 2020); and
 - the average daily SB trading (including buy and sell trades) was \$41.7 billion, or 12.5% of trading in the Hong Kong market (\$24.4 billion or 9.4% of market trading in 2020).
25. In 2021, the net buy was:
- RMB432.2 billion via NB trading (RMB208.9 billion in 2020); and
 - RMB382.3 billion via SB trading (RMB603.2 billion in 2020).

Short-selling activities

26. In 2021, short selling in Hong Kong was higher in absolute terms, but declined slightly as a percentage of total market turnover. The average daily short selling amounted to \$22.4 billion or 13.5% of total market turnover in 2021 (\$17.6 billion or 13.6% in 2020).
27. Reportable short positions declined both in terms of market value and as a percentage of market capitalisation. Based on data submitted to the SFC, as at end-2021, aggregated short positions amounted to \$485 billion (\$524.4 billion as of end-2020). Short positions accounted for 1.23% of market capitalisation (1.25% as of end-2020).

Exchange-traded derivatives

28. In 2021, the average daily trading of exchange-traded derivatives was 2.5% higher than in 2020.
- Trading of futures products fell 7.5%. HSI futures and HSCEI futures were the most actively traded contracts, respectively accounting for 32.4% and 29.9% of total futures trading. However, their trading volumes fell 17.1% and 12.3%, respectively. Trading of the Hang Seng TECH Index Futures contract accounted for 3.4% of total futures trading. The MSCI A-shares futures, which was launched in October 2021, accounted for 2.7% of total futures trading.
 - Trading of options products rose 9.4%. Stock options remained the most active, accounting for 86.8% of the total trading of options products. Trading of stock options rose 21.1% from 2020.

MSCI A-shares futures

On 18 October 2021, MSCI A-shares futures were launched in Hong Kong.

- This new product provides international investors with an effective hedging tool to manage their risks in the A-share market through Hong Kong, consolidating Hong Kong’s role as a risk management centre for Mainland risks.
- The sector-balanced underlying index comprises 50 large-cap A-shares from different sectors. These 50 index constituents are available for trading via NB Stock Connect.

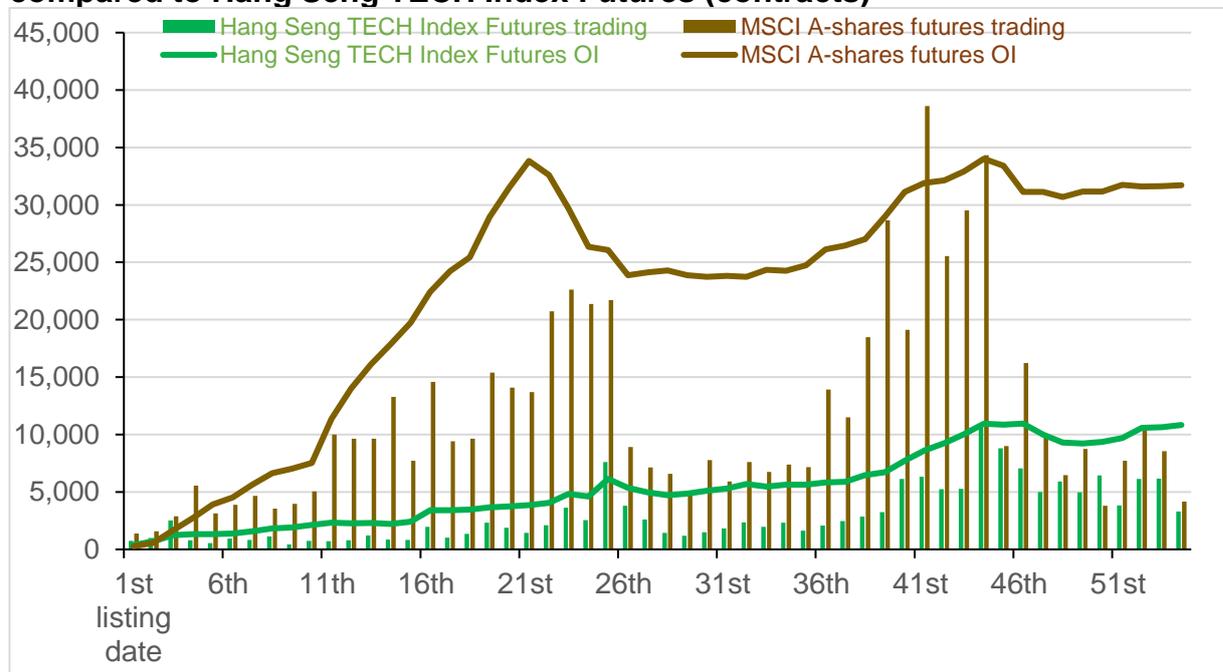
The MSCI A-shares futures contract has become the top index futures contract amongst the HKEX’s MSCI index derivatives products in terms of both trading and open interest.

- During 18 October – 31 December 2021, the average daily turnover of the MSCI A-shares futures was 11,558 contracts, with a notional value of US\$794 million (around \$6.2 billion).
- As of end-2021, open interest rose to 31,710 contracts, with a notional value of US\$2,167 million (around \$16.9 billion).

The growth of the MSCI A-shares futures seemed to have outpaced another fast-growing index futures, the Hang Seng TECH Index Futures which has been launched for about a year.

- The trading and open interest of the MSCI A-shares futures have generally exceeded the levels of the Hang Seng TECH Index Futures during the corresponding periods since the debuts of the products.

Trading and open interest (OI) of the MSCI A-shares futures since launch, compared to Hang Seng TECH Index Futures (contracts)



Major investment banks increasingly participated in the trading of MSCI A-shares futures. They are major position holders and major participants in NB trading of Stock Connect.