# Research Paper No.74: A Review of the Global and Local Securities Markets in 2023

7 February 2024

# Executive Summary

1. Major US and European markets rose in 2023 on hopes for an end to the interest rate hike cycle of major central banks. During the year, the US' major stock indices – the Dow, Nasdaq and S&P500 – advanced 13.7%, 43.4% and 24.2% respectively. FTSE, DAX and CAC in Europe also gained 3.8%, 20.3% and 16.5% respectively. Nevertheless, Mainland China's SHCOMP and SZCOMP fell 3.7% and 7.0% in 2023 amid uncertainties about the economic outlook.

2. The HSI, HSCEI and Hang Seng TECH index fell 13.8%, 14.0% and 8.8% respectively. The Hong Kong market underperformed in 2023, largely due to external macro factors. Investor sentiment was hit by uncertainties about the monetary policy stances of major central banks. Moreover, from international investors' perspectives, renminbi (RMB) exchange rate may affect the earnings of Hong-Kong listed Mainland firms in Hong Kong dollar terms. Property stocks also paced losses due to liquidity concern about Mainland property developers. In addition, the global economic outlook as well as geopolitical tensions in the Middle East and Ukraine weighed on the market. Nevertheless, optimism over further policy stimulus to support the Mainland economy helped the market recoup some losses. Despite the year-on-year decline, the Hong Kong market remained resilient, as trading was orderly with normal operations in various market segments.

3. The average daily turnover in the Hong Kong stock market fell 15.9% to $105.0 billion[1] in 2023 from the $124.9 billion in 2022. High interest rates prompted investors to re-allocate from stocks to safe-haven assets. The trading drops spread across various types of securities and investors. Nevertheless, both the exchange-traded derivatives and over-the-counter (OTC) derivatives markets recorded growth. In particular, for OTC derivatives referencing Hong Kong stocks and indices, the notional value was around $1.3 trillion as of end-2023 (see Box 1). In addition, Hong Kong is apparently the preferred hub for conducting transactions for OTC equity derivatives referencing securities in regional markets (see Box 2).

4. For Stock Connect, both northbound (NB) and southbound (SB) trading recorded a net buy in 2023, which came in respectively at RMB43.7 billion and RMB292.9 billion. As at end-2023, the cumulative net buy for NB and SB trading reached RMB1.8 trillion and RMB2.5 trillion respectively.

5. Short selling in Hong Kong decreased both in value and as a percentage of market turnover in 2023. As a percentage of overall market capitalisation, short positions also declined. No signs of build-ups of large short positions in individual stocks or concentration of short positions in any particular securities or holders were noted.

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

# Performance of stock markets

## Overseas markets

6. In the US, the Dow, Nasdaq and S&P500 rose 13.7%, 43.4% and 24.2% respectively in 2023. In December, the Dow hit successive record highs, whilst both the Nasdaq and S&P500 notched their highest levels in around two years. In Europe, FTSE, DAX and CAC gained 3.8%, 20.3% and 16.5% respectively, with DAX and CAC making new highs in December.

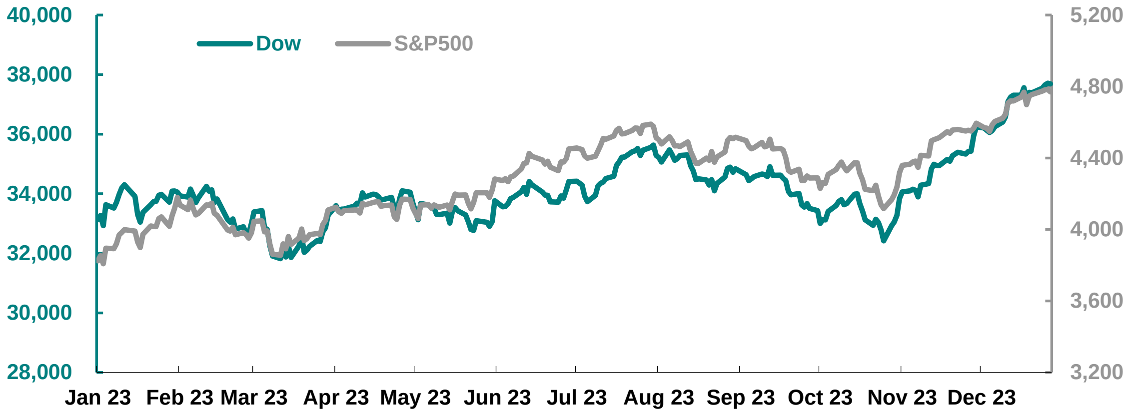
7. Inflationary pressures in the US and Eurozone moderated, prompting a deceleration in monetary tightening by major central banks. In the US, after seven rate hikes totalling 425 basis points (bps) in 2022, the Fed raised interest rates four more times by a total of 100 bps during February – July 2023. The 10-year US Treasury yield once surpassed 5% to reach the highest level since July 2007, before retreating to below 4% near year-end. In Europe, following the four rate hikes totalling 250 bps in 2022, the European Central Bank (ECB) raised interest rates six more times for a total of 200 bps during February – September 2023. Optimism was growing about the end of the interest rate hike cycle and upcoming rate cuts.

8. Technology stocks in the US outperformed, supported by encouraging corporate earnings and favourable prospects for the artificial intelligence sector.

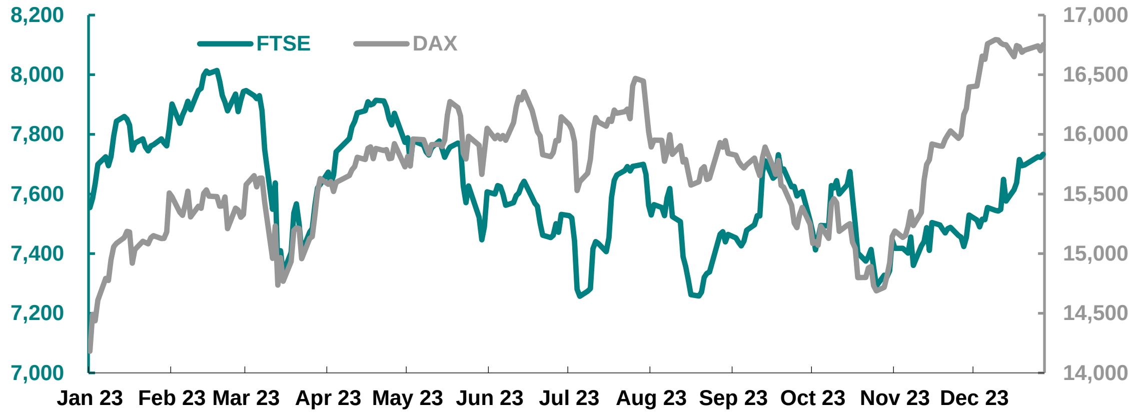
9. On the other hand, worries about the US debt level weighed on the market. Fitch downgraded the US sovereign rating from AAA to AA+ and Moody’s downgraded its outlook for the US’ credit rating from “stable” to “negative”.

10. Investor sentiment was also affected by geopolitical uncertainties in Ukraine which continued for a second year, and in the Middle East, where military conflicts broke out in late 2023.

## Performance of the Dow and S&P500 in 2023




## Performance of FTSE and DAX in 2023




## Performance of major stock markets

| | | | % change | | |
|---|---|---|---|---|---|
| | | **Index level** | **2023** | **2022** | **2021** |
| **Hong Kong and the Mainland China** | | | | | |
| Hong Kong | -HSI | 17,047.4 | -13.8% | -15.5% | -14.1% |
| | -HSCEI | 5,768.5 | -14.0% | -18.6% | -23.3% |
| | -HS TECH | 3,764.3 | -8.8% | -27.2% | -32.7% |
| Mainland China | -SHCOMP | 2,974.9 | -3.7% | -15.1% | +4.8% |
| | -SZCOMP | 1,837.9 | -7.0% | -21.9% | +8.6% |
| **US** | | | | | |
| US | -Dow | 37,689.5 | +13.7% | -8.8% | +18.7% |
| | -Nasdaq | 15,011.4 | +43.4% | -33.1% | +21.4% |
| | -S&P500 | 4,769.8 | +24.2% | -19.4% | +26.9% |
| **Europe** | | | | | |
| UK | -FTSE100 | 7,733.2 | +3.8% | +0.9% | +14.3% |
| Germany | -DAX | 16,751.6 | +20.3% | -12.3% | +15.8% |
| France | -CAC | 7,543.2 | +16.5% | -9.5% | +28.9% |

## Mainland China

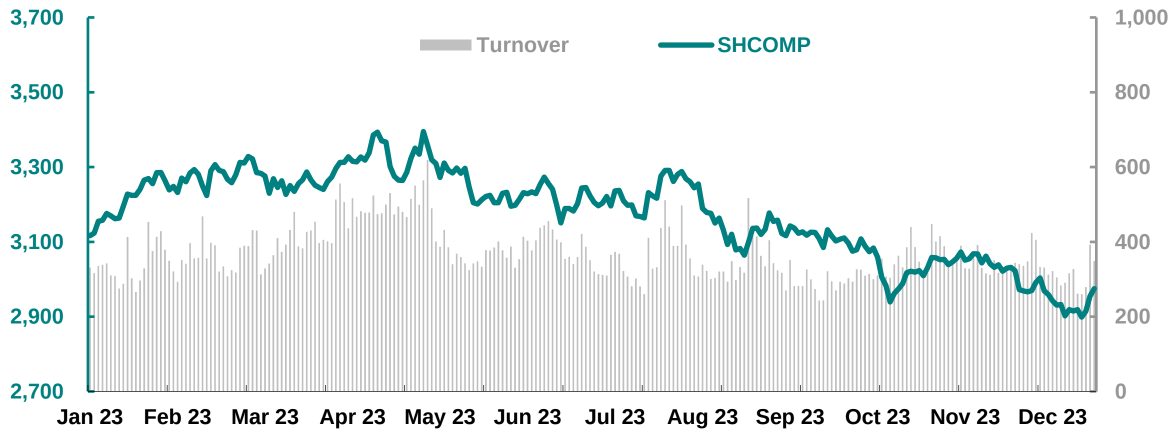
11. In 2023, the SHCOMP and the SZCOMP retreated 3.7% and 7.0% respectively. Average daily turnover in the Mainland market fell 5.5% to RMB874 billion, from the RMB925 billion in 2022.

12. Economic outlook remained uncertain. While GDP recorded encouraging growth rates of 6.3% and 4.9% in the second and third quarters, slowing manufacturing and credit growth weighed on the market. Deflation worries persisted. Moreover, investor sentiment was affected by a weaker RMB, which once hit a 15-year low and depreciated 2.8% in 2023.

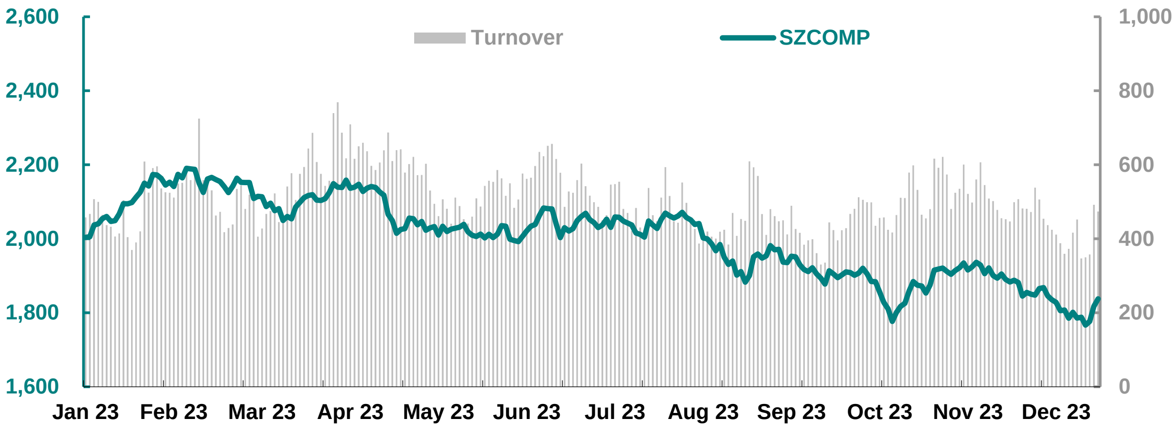
13. Liquidity concerns continued to cloud the property sector. The International Monetary Fund (IMF) warned that the Mainland's property sector downturn could affect broader growth prospects. There were concerns about the spillover effect on the credit conditions of Mainland banks.

14. Nevertheless, the Central Government unveiled policy stimulus to boost the economy. The People's Bank of China lowered the reserve requirement ratio twice by a total of 50 bps. Sovereign bond issuance of RMB1 trillion was approved to support infrastructure projects.

**SHCOMP performance and market turnover (RMB billion) in 2023**



**SZCOMP performance and market turnover (RMB billion) in 2023**




## Hong Kong

Market performance

15. The Hong Kong market underperformed major overseas markets in 2023. The HSI, HSCEI and Hang Seng TECH index fell 13.8%, 14.0% and 8.8% respectively. After hitting a 10-month high of over 22,000 points in January, it fluctuated downwards to a 13-month low of below 17,000 points in December.

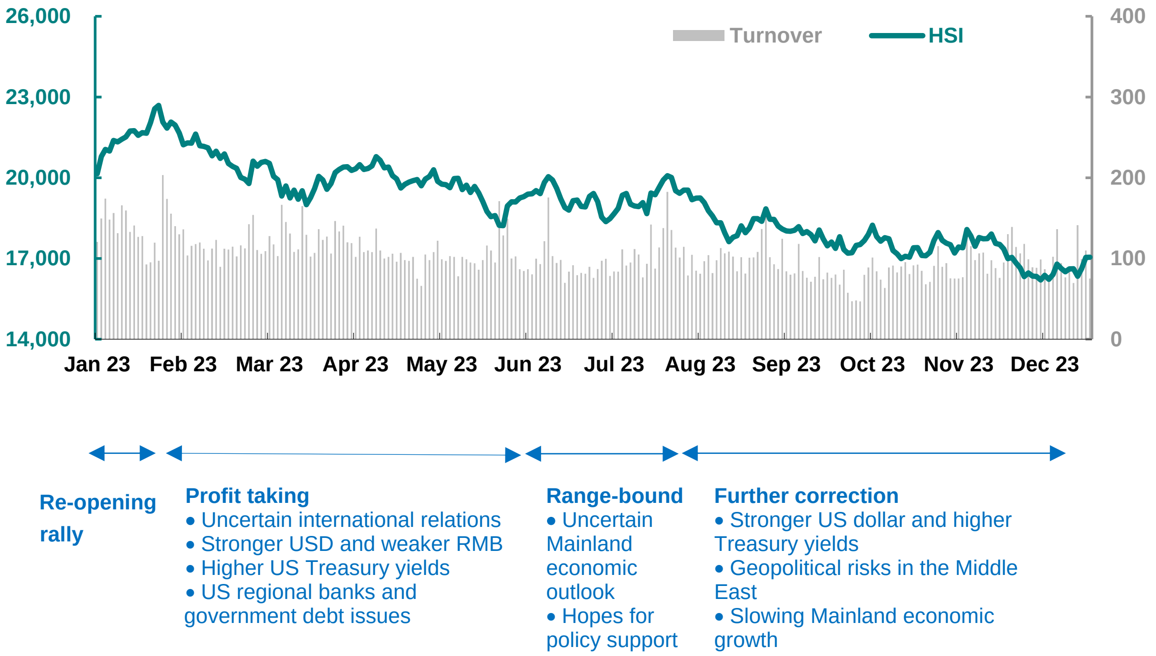
16. Despite the year-on-year decline, trading was orderly with normal operations in various market segments. No irregularity which may affect financial stability was observed.

17. Local market performance was largely affected by external macro factors. Concerns about the monetary policy stances of major central banks weighed on the market. In Mainland China, worries over the financial conditions of Mainland property developers and their potential impact on the economy dampened market sentiment. Property stocks paced losses. A weaker RMB also raised concerns about the impact of exchange rate changes to the earnings of Mainland companies listed in Hong Kong and the possible impact on their share prices. This particularly affected the Hong Kong market, which comprises largely Mainland stocks and international investors.

18. Uncertainties about the global economic outlook lingered amid the high interest rate environment. Risk appetite was further dampened by geopolitical tensions in the Middle East and Ukraine.

19. Nevertheless, given easing inflationary pressure, optimism about the end to the monetary tightening cycle of major central banks helped the market recoup some losses. Hopes for further stimulus measures introduced to the Mainland market by the Central Government lifted investor sentiment.

**HSI performance and market turnover ($ billion) in 2023**




## <u>Trading activities</u>

20. In 2023, average daily turnover in the Hong Kong stock market shrank 15.9% to $105.0 billion, from the $124.9 billion in 2022. The turnover decline seemed to be a global phenomenon, as high interest rates in the US prompted investors to re-allocate from stocks to safe-haven assets.

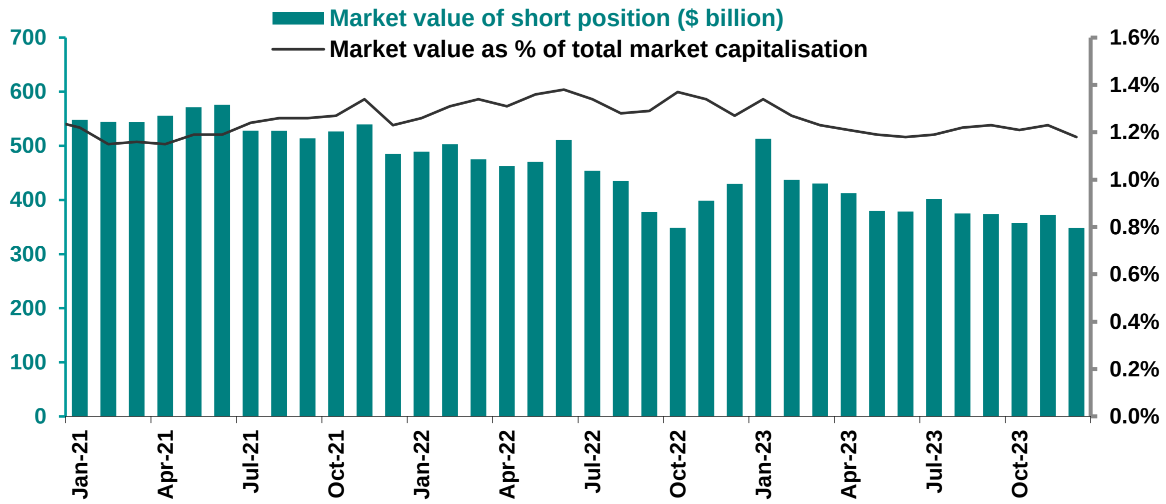
## <u>Short-selling activities</u>

21. In 2023, short selling in Hong Kong dropped in absolute terms and as a percentage of total market turnover. Daily short selling averaged $17.8 billion or 17.0% of total market turnover.

- Of this, $5.7 billion or 31.9% of short selling was attributable to ETFs and L&I products (exchange-traded products, ETPs).
- Excluding ETPs, average daily short selling amount was $12.1 billion or 13.3% of market turnover.

22. For the market as a whole, the market value of reportable short positions fell both in absolute terms and as a percentage of market capitalisation. Based on the data submitted to the SFC, aggregated short positions declined to $348.5 billion as of end-2023 (versus $429.8 billion as of end-2022). Short positions accounted for 1.18% of market capitalisation, compared to 1.27% as of end-2022.

**Short positions in the Hong Kong stock market**




## Market outlook and risks

23. Looking ahead, the Hong Kong market may remain largely influenced by external macro factors. The monetary policy stances of major central banks will likely affect global market performance. At the same time, the economic outlook and magnitude of policy stimulus in Mainland China will affect market sentiment. In addition, investors are keeping an eye on the development of international relations and the possible implications.

## Stock Connect

24. Stock Connect continued to account for an important share of turnover. During 2023:

- daily NB trading (including buy and sell trades) averaged RMB108.3 billion, or 6.2% of turnover in the Mainland market (compared to RMB100.4 billion, or 5.4% of market turnover in 2022); and
- daily SB trading (including buy and sell trades) averaged $31.1 billion, or 14.8% of turnover in the Hong Kong market (compared to $31.7 billion, or 12.7% of market turnover in 2022).

25. Both NB and SB trading recorded net buys in 2023:

- RMB43.7 billion via NB trading (compared to RMB90.0 billion in 2022).
- RMB292.9 billion via SB trading (compared to RMB339.4 billion in 2022).

26. ETF Connect also recorded net buy both ways in 2023:

- In 2023, daily NB trading averaged RMB499.8 million while daily SB trading averaged $2,692.9 million (RMB66.7 million and $908.1 million respectively in 2022).
- During the period, the net buy was RMB1.5 billion for NB trading, and $7.9 billion for SB trading (RMB1.5 billion and $4.7 billion respectively in 2022).

## Exchange-traded derivatives

27. In 2023, average daily turnover of exchange-traded derivatives increased 3.4% year-on-year.

- Turnover of futures products rose 2.5%.
  - HSI futures and HSCEI futures were the most actively traded contracts, accounting for 22.9% and 30.8% of total futures turnover respectively. Turnover of HSI futures fell 9.1% whilst that of HSCEI futures rose 2.0%.
  - Turnover of Hang Seng TECH Index Futures surged 44.3% from the previous year, partly due to increasing hedging needs amid high volatility in technology stocks.
- Turnover of options products went up 4.2%. Stock options remained the most active, accounting for 81.5% of total turnover of options products. From 2022 levels, turnover of stock options rose 2.9% and that of Hang Seng TECH Index Options increased 143.8%.

**Box 1: Profile and monitoring of the OTC equity derivatives market referencing Hong Kong stocks and indices**

Market size

- The total notional value of OTC equity derivatives referencing Hong Kong stocks and indices was about $1.3 trillion or 4% of the stock market capitalisation as of end-2023. The share was smaller than about 10% for the US market.

- By product type, delta one products[2] were the most common (about 60-80% of the total notional value), followed by plain vanilla options (about 10-20%) and other complex products (about 10-20%).

Profile of market players

- There was no significant concentration at the holder level.
  - The OTC positions spread across a large number of counterparties (over 1,600).
  - The notional values of positions held by most counterparties were relatively small. The majority of the counterparties had positions of less than $0.01 billion.
- In terms of investor types, active players included investment banks, asset managers (such as mutual funds, pension funds and hedge funds), securities firms and other financial institutions.

OTC positions by underlying

- Similarly, no significant concentration was observed at the underlying level.
  - The OTC positions spread across a large number of securities referencing Hong Kong indices and stocks.
  - Major indices (eg, HSI, HSCEI, Hang Seng TECH index) and top index constituent stocks together accounted for about half of the total notional value of the whole market referencing Hong Kong stocks and indices. The majority of the Hong Kong listed securities had positions of less than $0.1 billion.

Individual OTC positions

- Most individual OTC positions were small, with around 93% having notional value below $10 million.

Monitoring systemic risk

- Given the diverse nature of OTC derivatives products and contracts, the SFC has been closely monitoring and assessing potential risks to market stability from different perspectives.
  - In addition to data on OTC positions, the SFC closely monitors the purposes of these transactions, the nature of position holders as well as relevant positions held in other market segments (eg, stock market and exchange-traded derivatives market).

[2] Delta measures the sensitivity of a derivative's value to changes in the price of the underlying securities. A delta one product is a product that has a delta of one, giving an investor the same exposure as if the investor was to own the underlying securities.

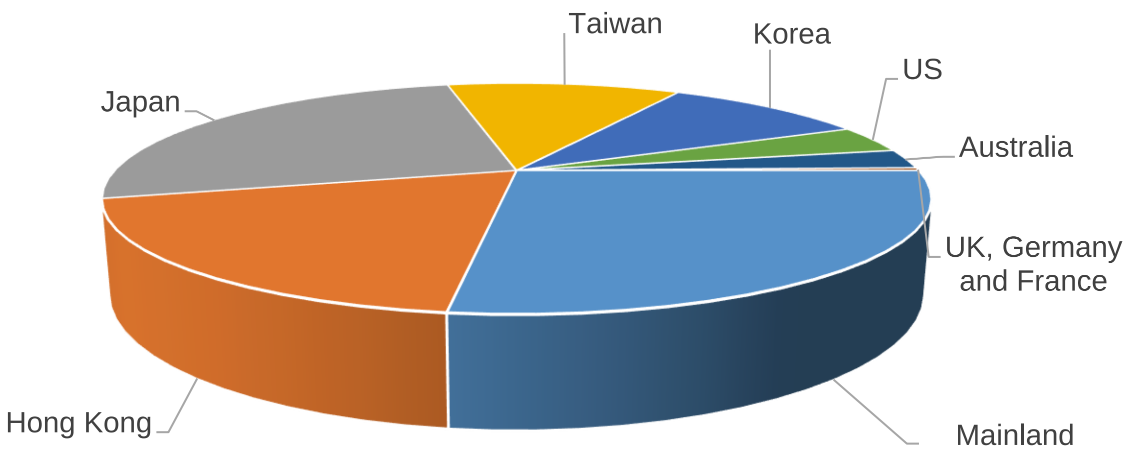
**Box 2: Hong Kong's role as a hub for conducting OTC equity derivatives transactions referencing regional securities**

Hong Kong has played a prominent role as a centre for conducting OTC equity derivatives transactions for trading and risk management of regional securities.

Data from the Hong Kong Trade Repository (HKTR) appears to indicate that Hong Kong is a major hub for conducting transactions for OTC equity derivatives referencing:

- Hong Kong and Mainland stocks which accounted for around 46% of the total positions reported to the HKTR; and
- securities in regional markets (including Japan, Korea, Taiwan and Australia), with a share of almost 50%.

**Gross notional value of OTC equity derivatives positions reported to the HKTR as of end-2023, by listing place of underlying securities**




Remark: The OTC equity derivatives positions refer to those between broker-dealers with their clients such as funds, asset managers and other financial institutions. Intragroup and inter-broker positions are excluded.

Since end-2020, notional value of OTC equity derivatives positions referencing the securities for regional markets have risen by 31%.

Major investment banks choose Hong Kong as a hub for serving international clients in trading and risk management for regional securities.

- They serve international clients' trading and risk management needs by using OTC equity derivatives in Hong Kong. The OTC equity derivatives transactions referencing securities in other markets are conducted in Hong Kong, thus subject to the reporting requirement to the HKTR.
- When clients conduct OTC equity derivatives referencing regional securities, respective branches (eg, the UK or US branch) of major international investment banks first reach out to the Hong Kong desk.

- Major investment banks have been using Hong Kong desks to manage the risk exposures in the region. These traders and risk managers are located in Hong Kong whilst hedging their exposures to regional securities.
- They revealed that Hong Kong has a robust legal system, sound regulatory framework and free access to talent, markets and clients across the region. In addition, they have not observed any changes of such factors over recent years affecting Hong Kong's role.