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Research Paper No. 48: A review of the global and local securities markets in 2010

27 January 2011

Executive Summary

1. In early 2010, major stock markets fell. Concerns over the European sovereign debt problem weighed on investor sentiment. Major markets hit recent troughs in mid-2010. Investors were worried over the large budget deficits and government debts of European countries collectively known as PIIGS, namely, Portugal, Ireland, Italy, Greece and Spain. The sovereign debt ratings of Greece, Portugal and Spain were lowered by Standard &Poor's (S&P). After the announcement of a rescue fund to support these European countries, investor sentiment stabilized. Subsequently, major markets recovered on upbeat corporate financial results and better-than-expected economic data. Optimism over quantitative easing in the United States also lent support to the markets.
2. By the end of 2010, the Dow, Nasdaq and S&P 500 had risen 11%, 16.9% and 12.8% respectively from their end-2009 levels. The FTSE and DAX had also risen by 9% and 16.1% respectively, although the CAC had dropped 3.3%.
3. In 2010, the Shanghai Composite Index was the worst performing in Asia. It fell by 14.3% from its end-2009 level. After the strong rallies in 2009, the Mainland market slid in 2010 amid worries over a policy shift towards combating overheating. With the threat of untamed inflation, there were concerns that more tightening measures such as interest rate hikes and price controls might be implemented.
4. As at the end of 2010, the Hang Seng Index (HSI) rose 5.3% from the end-2009 level, while the Hang Seng China Enterprises Index (HSCEI) dropped 0.8%. In early 2010, tracking losses in overseas markets, the Hong Kong market slid. Later, the market rebounded, amid optimism over quantitative easing measures in the US and resilient economic performance on the Mainland. However, in late 2010, local investor sentiment was dampened by concerns over more monetary tightening measures in the Mainland and measures to cool down the local property market.
5. Looking forward, the global market outlook may hinge on the direction and extent of liquidity flows and the pace of recovery of major economies. Investors may continue to eye the European sovereign debt problems and the Mainland's policy stance on curbing inflation. Geopolitical tensions in the region may also add volatility to the stock markets.
6. The average daily trading volume on the local cash market was $69.1 billion[1] in 2010, 11% higher than in 2009. In the first nine months of the year, trading was stable and the average daily turnover was $63 billion. Trading increased significantly thereafter, and was particularly active in October and November, when the average daily turnover rose to $98 billion. On the derivatives side, the average daily trading volume was 466,082 contracts, 18% higher than in 2009.
7. Hong Kong was the largest IPO centre in the world in 2010, with a total of 94 IPOs, raising a total of $445 billion. In 2009, 65 IPOs (raising $248.2 billion) were listed here. In 2010, the Hong Kong market diversified with more new listings by issuers from major international markets.

Performance of worldwide stock markets in 2010

8. In early 2010, major stock markets fell, clouded by European sovereign debt problems. Subsequently, global stock markets recovered on upbeat corporate earning result and better-than-expected economic performance. Optimism over quantitative easing measures by major central banks also lent support to the markets.

[1] Unless otherwise specified, figures given in the report are denominated in Hong Kong dollars.

Performance of Major Stock Markets

		End 2010	% change		PE Ratios
		Index Level	In 2010	In 2009	End 2010
Hong Kong and Mainland					
HK	-HSI	23,035.45	5.3%	52.0%	14.18
	-HSCEI	12,692.43	-0.8%	62.1%	13.47
Mainland	-Shanghai Comp	2,808.08	-14.3%	80.0%	18.1
	-Shenzhen Comp	1,290.87	7.5%	117.1%	37.95
Asia					
Japan	-Nikkei 225	10,228.92	-3.0%	19.0%	29.9
Australia	-AOI	4,846.90	-0.7%	33.4%	19.87
Taiwan	-TWSE	8,972.50	9.6%	78.3%	15.74
Korea	-KOSPI	2,051.00	21.9%	49.7%	14.78
Singapore	-STI	3,190.04	10.1%	64.5%	14.78
Thailand	-SET	1,032.76	40.6%	63.2%	14.78
Malaysia	-KLCI	1,518.91	19.3%	45.2%	17.37
Indonesia	-JCI	3,703.51	46.1%	87.0%	20.89
Philippines	-PCOMP	4,201.14	37.6%	63.0%	13.67
Vietnam	-VN	484.66	-2.0%	56.8%	11.28
US					
US	-Dow	11,577.51	11.0%	18.8%	14.05
	-Nasdaq	2,652.87	16.9%	43.9%	34.53
	-S&P	1,257.64	12.8%	23.5%	15.75
Europe					
UK	-FTSE100	5,899.94	9.0%	22.1%	17.6
Germany	-DAX	6,914.19	16.1%	23.8%	14.38
France	-CAC	3,804.78	-3.3%	22.3%	12.84
PIIGS & Hungary					
Portugal	-PSI20	7,588.31	-10.3%	33.5%	11.49
Italy	-FTSEMIB	20,173.29	-13.2%	19.5%	13.63
Ireland	-ISEQ	2,885.10	-3.0%	27.0%	N/A
Greece	-ASE	1,413.94	-35.6%	22.9%	31.65
Spain	-IBEX	9,859.10	-17.4%	29.8%	9.41
Hungary	-BUX	21,327.07	0.5%	73.4%	11.97
Other BRIC					
Brazil	-IBOV	69,304.81	1.0%	82.7%	13.85
Russia	-MICEX	1,687.99	23.2%	121.1%	9.04
India	-Nifty	6,134.50	17.9%	75.8%	19.38
Regional					
MSCI Asia Pacific Ex Japan		478.88	15.0%	68.4%	15.98
MSCI BRIC		560.46	5.0%	68.0%	N/A
MSCI Emerging Europe		5,299.24	16.3%	68.8%	N/A
MSCI Latin America		4,613.65	12.1%	98.1%	14.83

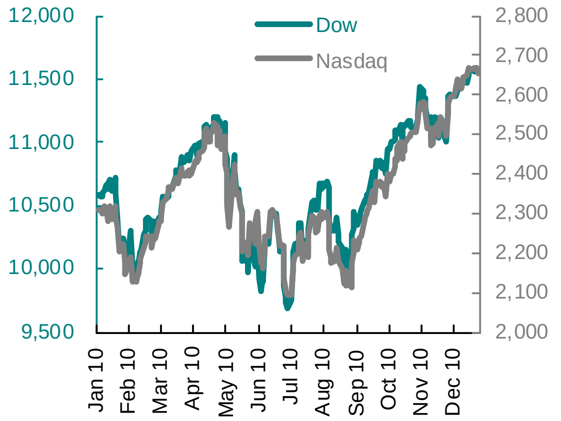
Source: Bloomberg

The US

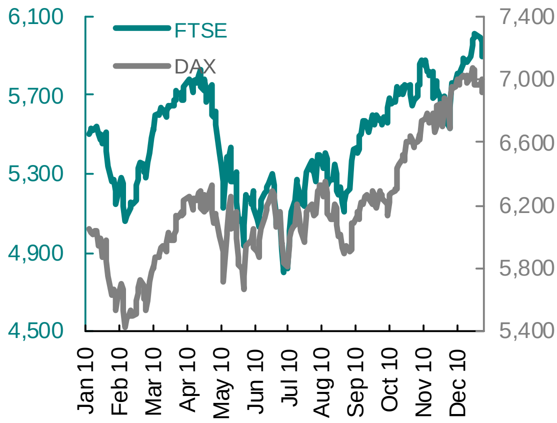
9. In early 2010, the US markets declined, amid worries over slower economic growth. With the launch of the first phase of quantitative easing (QE1) in 2008, global economies escaped severe recession. Nevertheless, economic growth in the US remained sluggish and unemployment rates stayed high. Concerns over a double-dip recession weighed on the markets.

10. Financial stocks underperformed, given the disappointing earnings of major banks and concerns over the impact of proposed reforms for the financial sector. In July, the Dow fell to a recent trough of some 9,700, representing a 7% decline from its end-2009 level.

11. Subsequently, the Dow rebounded strongly, amid signs of improving economic outlook and upbeat financial results. The announcement of the second phase of quantitative easing (QE2) also boosted investor sentiment. QE2 weakened the US dollar, giving support to commodity prices and resources stocks. In December 2010, the Dow rose above the 11,500 level, reaching a two-year high. Tech and bank stocks advanced. During 2010, the Dow, Nasdaq and S&P 500 rose 11%, 16.9% and 12.8% respectively from their end-2009 levels.



Performance of the Dow and Nasdaq



Performance of the FTSE and DAX

Source: Bloomberg

Europe

12. In early 2010, European markets fell amid concerns over the large budget deficits and high levels of government debts of some European countries. S&P lowered the sovereign debt ratings of Greece, Portugal and Spain. In May, Eurozone finance ministers and the International Monetary Fund (IMF) announced a rescue fund to support these countries. The countries themselves also announced fiscal tightening measures aimed at reducing their fiscal deficits. Although the measures helped restore investor confidence in financial markets, some expressed concerns that they might hurt the growth prospects of the economies.

13. In mid-2010, European markets started to rebound. Investor sentiment improved on optimism over quantitative easing by major central banks and robust corporate earnings. Strong gains in US stocks also lifted the markets.

14. However, in October, concerns over European debt problems loomed again after Ireland's credit default swap (CDS) spreads reached a record high and Greece reported a higher-than-expected budget deficit. In November, the Irish Government accepted a bailout plan of €85 billion from the EU and IMF. Given concerns that the burden of the Irish government would increase, S&P downgraded Ireland's sovereign debt rating. In December, Ireland was also downgraded by Fitch (by three notches, from A+ to BBB+) and Moody's (by five notches from Aa2 to Baa1). Investors worried that other Euro zone peripheral countries would also require financial assistance similar to that of Ireland. Credit ratings of some other European countries were put under review. Thereafter, CDS spreads of some other PIIGS countries also rose to new record highs. By the end of 2010, the FTSE and DAX had gained 9% and 16.1%, while the CAC had fallen 3.3%, compared to their respective end-2009 levels. The PIIGS markets all retreated, recording losses ranging from 3% to 35.6%.

Asia

15. The performance of Asian markets was volatile. Some expressed concerns that sovereign debt problems in Europe might affect Asian economies, some of which relied on exports to Europe and trade financing from European banks. Political uncertainties in the region (e.g. conflicts in

Thailand, the change in leadership in Japan and Sino-Japanese relationship) also weighed on sentiment. Although optimism over the region's economic growth propped most Asian markets, causing them to advance in late 2010, gains were capped by resurfacing worries over European debt problems and geopolitical tension on the Korean Peninsula. Compared to their end-2009 level, the performance of benchmark indices in Asia ranged from a loss of 3% in Japan to a gain of 46.1% in Indonesia.

The Mainland

16. After strong rallies in 2009, the Shanghai Composite Index slid in early 2010 amid worries of a policy shift towards combating overheating. Bank stocks were hardest hit by monetary tightening measures. Investors were also concerned about policies to curb high property prices. The Shanghai Composite Index hit a trough of 2,363 on 5 July, representing a 28% decline from its end-2009 level.

17. The market rebounded afterwards to over 3,100 on solid economic data and robust corporate earnings. Economic growth in the Mainland was strong. In 2010, GDP growth was 10.3% (YoY). However, the market declined later amid worries of rising inflationary pressure. The consumer price index rose to a 28-month high of 5.1% in November and slowed to 4.6% in December. With the threat of untamed inflation and the potential risk of asset bubbles, the central bank raised the reserve requirement ratio six times in 2010, by 50 basis points each time, to 18.5%. The one-year savings deposit rate was also raised twice, by 25 basis points each time, to 2.75% this year. By the end of 2010, the Shanghai Composite Index had dropped 14.3% from its end-2009 level.

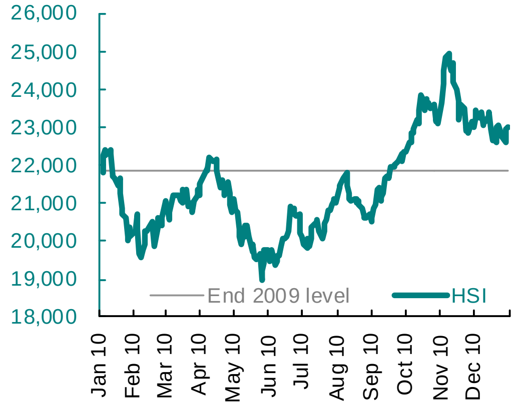
Performance of the Shanghai Composite Index

Source: Bloomberg

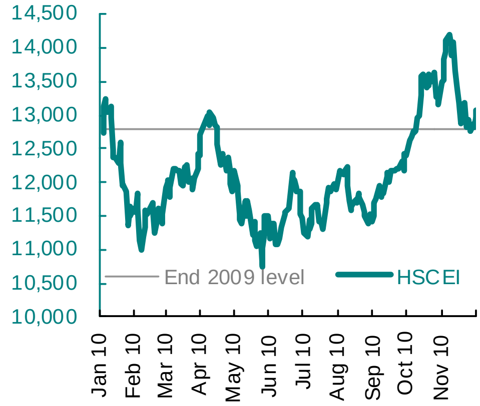
Hong Kong

18. Tracking losses in overseas markets, the Hong Kong market slid in early 2010. H-shares underperformed on worries over monetary tightening measures on the Mainland. Lingering concerns over the European debt crisis also weighed on market sentiment. The HSI reached a trough of 18,985 on 25 May, losing 13% from its end-2009 level.

19. Later, local markets rebounded strongly on optimism over the quantitative easing measures in the US and resilient economic performance in the Mainland. Solid corporate earnings also lifted the market. Property stocks outperformed on higher property prices and robust land sales. The HSI reached a high of 24,964 on 8 November, representing a 14% increase from its end-2009 level. However, these gains were trimmed later amid more Mainland monetary tightening measures and policies to cool down the local property market. The geopolitical tensions on the Korean Peninsula also added uncertainties. By the end of 2010, the gain has been trimmed to just 5.3% above its end-2009 level while the HSCEI dropped 0.8%.



Performance of the HSI

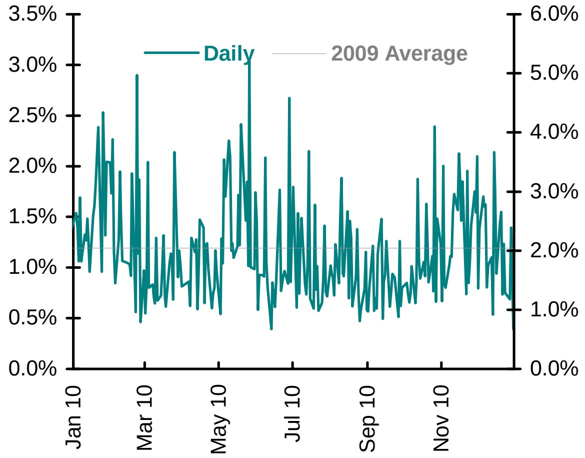


Performance of the HSCEI

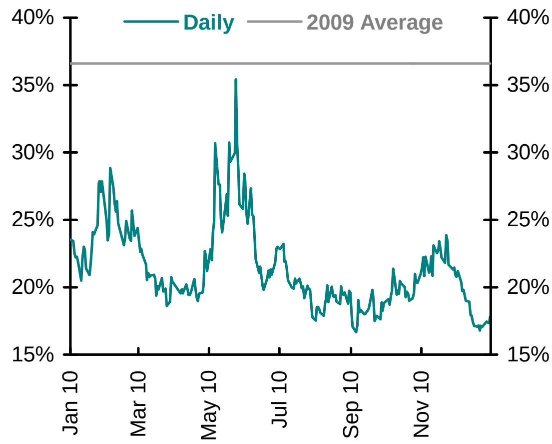
Source: Bloomberg

Volatility dropped in 2010

20. The intra-day volatility of the HSI dropped to an average of 1.2% in 2010 (compared to 2.0% in 2009 and 2.7% in 2008). The implied volatility of the HSI options also retreated and was about 21% as at end-2010.



Intraday Volatility of the HSI



Implied Volatility of HSI Options

Remark:

$$\text{Intraday Volatility} = \frac{\text{(Day High – Day Low)}}{0.5*\text{(Day High + Day Low)}}$$

Source: Bloomberg

Outlook

21. Despite the buoyant performance since mid-2010, major markets still face uncertainties ahead:

a) The US: Despite the implementation of QE1, economic growth in the US remains slow. Inflation has stayed at a low level, but the jobless rate also remains high. Concerns over the effectiveness of QE2 in stimulating demand linger. Ultimately, the pace of US economic revival will affect the growth of Asian exports.

b) Europe: Major stock markets have been clouded by the European sovereign debt crisis throughout 2010. Investors remain concerned over the deficits in some European countries, and worried that the structural problems in Greece and Ireland will not be resolved even with the EU and IMF rescue plans, and that these problems may spread to other countries. Tightening measures, while necessary to restore the financial health of these countries, also may affect economic growth and add uncertainties to the stock markets. The global market outlook hinges on how long the European debt problem persists and to what extent various economies are affected.

c) Asia: In anticipation of the launch of QE2, ample liquidity moved into emerging markets, including Latin America and emerging Asia, where economic growth was resilient. This boosted the prices of various asset classes. The market is worried about a possible asset bubble being created. Moreover, there is fear that capital flows may reverse quickly if market sentiment changes suddenly. Some central banks in Asia have raised interest rates to curb inflation and some governments also introduced measures to discourage capital inflow, such as capital controls and taxes on investments. In addition, export-oriented economies in Asia may be affected by the slowdown in economic growth and decreasing demand from the US and Europe.

d) The Mainland: The Mainland government has started to withdraw economic stimuli and introduce monetary tightening measures to curb inflation. It has also taken steps to discourage excessive liquidity and cool down the property market. After rebounding from the trough in early July 2010, the market has been volatile as investors became more sensitive to the latest economic data and tightening measures. If the economy remains overheated, more tightening measures, such as interest rate hike and price controls, may be implemented. Investor sentiment and market performance may also be affected.

e) Hong Kong: As an open economy with high participation by international investors, any significant flow of funds into or out of Hong Kong may impact the price performance and volatility of the stock market. Investors will focus on economic outlook in the US and the development of the European sovereign debt problem. In addition, as the Mainland remains a closed market, funds are attracted to the Hong Kong market (considered a proxy for investing in the growing Mainland). Hence, any major development in the Mainland is likely to have implications for the Hong Kong market.

22. Looking forward, the global market outlook may hinge on the direction and extent of liquidity flows and the pace of recovery of major economies. Investors may continue to eye the European sovereign debt problems and the Mainland's policy stance on curbing inflation. Geopolitical tensions in the region may also add volatility to the stock markets.

Activities of various securities market segments in Hong Kong

Trading activity in the local stock market

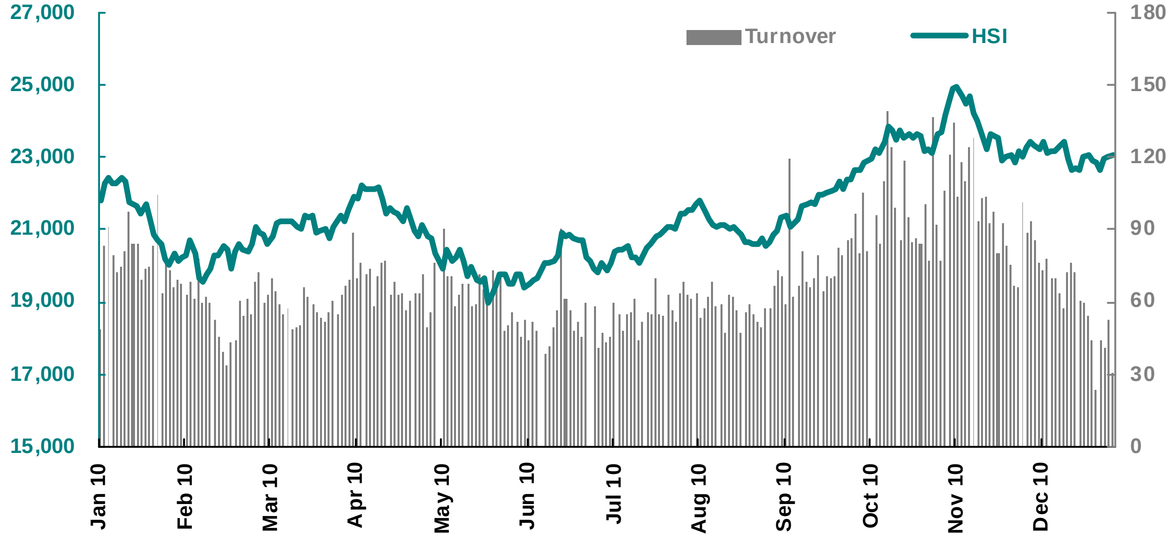
23. Trading activity in the local stock market was moderate during 2010. The average daily turnover amounted to $69.1billion, 11% higher than that in 2009. In the first nine months of the year, trading was stable and average daily turnover was $63 billion. Trading increased significantly afterwards, and was particularly active in October and November, when the average daily turnover reached $98 billion.

24. Mainland stocks remained the most actively traded stocks. However, its share of total market turnover decreased to 39% from 46% in 2009. This was partially due to the increase in the market share of derivative warrants (DWs) to 16% from 11%. Also, some IPOs of non-Mainland stocks attracted strong investor interest and had very high turnover.

Average Daily Turnover ($bn)

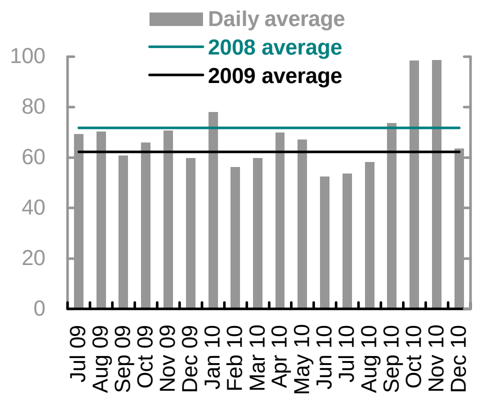
	2010	**2009**	**2008**	**% change over**	
				2009	**2008**
HSI (ex H shares & red chips)	8.4 (12%)	7.9 (13%)	11.2 (16%)	6%	-25%
Mainland Stocks	26.7 (39%)	28.5 (46%)	34.4 (48%)	-6%	-22%
H-shares	*18.9 (27%)*	*20.8 (33%)*	*25.1 (35%)*	-9%	-25%
Red chips	*7.8 (11%)*	*7.8 (12%)*	*9.3 (13%)*	0%	-16%
Derivative Warrants	10.8 (16%)	6.6 (11%)	14.0 (19%)	64%	-23%
CBBCs	5.8 (8%)	6.7 (11%)	4.2 (6%)	-13%	38%
Others	17.3 (25%)	12.5 (20%)	8.2 (11%)	38%	111%
Market Total	**69.1 (100%)**	**62.3 (100%)**	**72.1 (100%)**	**11%**	**-4%**

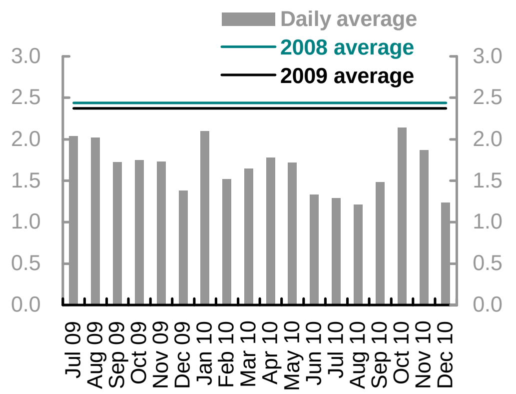
Sources: HKEx and SFC Research



HSI Performance and Market Turnover ($bn) (2010)

Source: SFC Research



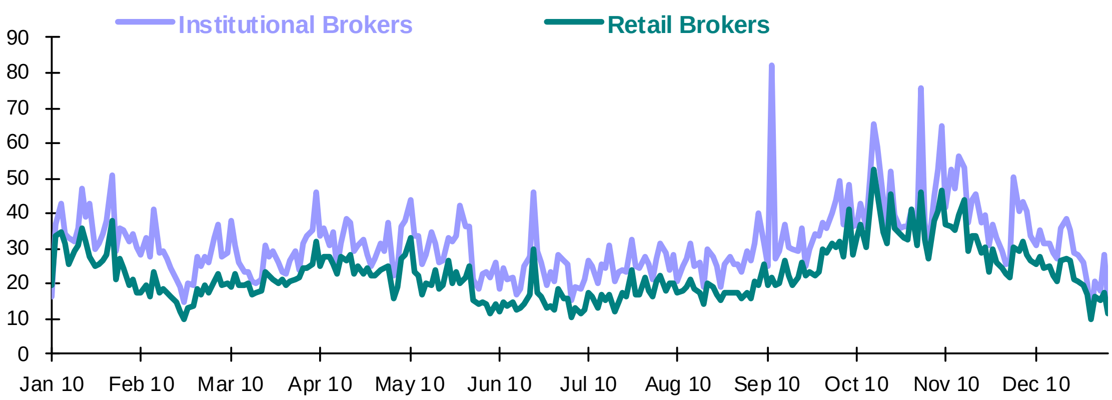


Trading value of Hong Kong Market ($ bn)

Trading volume of HSI constituent stocks (bn shares)

Source: Bloomberg

25. By broker type, the proportion of equity trading by institutional brokers increased year on year to 58% in 2010 from 56%. Retail brokers made up 42% of the trading volume, compared to 44% in 2009.



Daily equities trading by broker type during 2010 ($bn)

Source: SFC research

Short-selling activity

26. Short selling was active during 2010. Compared to 2009, short-selling turnover was higher in both absolute terms and relative to total market turnover. For the year, the average daily short-selling turnover was $4,306 million, or 6.2% of the total market turnover, compared with the average daily short-selling turnover of $3,432 million or 5.5% of the total market turnover in 2009.

Initial public offering (IPO) activity

27. IPO activity was high during 2010. A total of 94 IPOs were listed in Hong Kong, raising a total of $445 billion. This made Hong Kong the largest IPO centre in the world. In 2009, 65 IPOs were launched in Hong Kong, raising $248.2 billion.

28. Some IPOs launched were sizable. In particular, 2010 saw the listing of AIA and Agricultural Bank of China, respectively the largest and third largest IPOs so far in Hong Kong. These two companies raised a total of $252.6 billion via their IPOs, accounting for 56.8% of total IPO funds raised in Hong Kong in 2010.

29. The Hong Kong market also diversified with more new listings by issuers from major international markets. In 2010, 49% of IPO funds raised were for Mainland enterprises[2], compared to 83% in 2009. With less significant reliance on Mainland IPOs, Hong Kong attracted companies from various markets, including Brazil, France, Germany, Mongolia, Russia, the US and the United Kingdom, to list on its stock market in 2010.

Exchange-traded funds (ETFs)

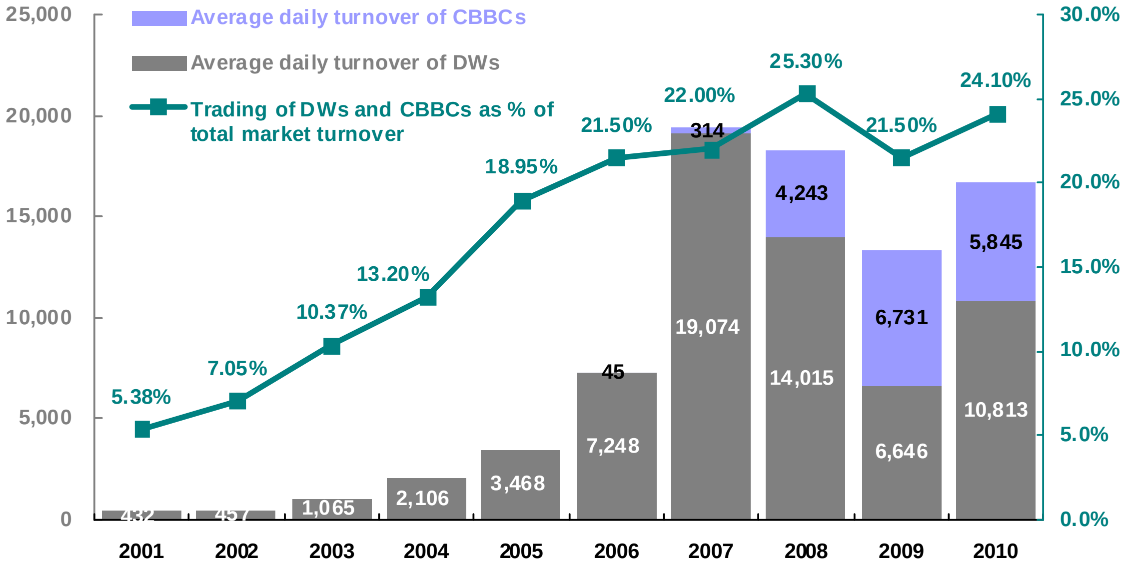
30. The number of ETFs rose from 43 as at the end of 2009 to 69 as at the end of 2010. During 2010, their average daily turnover was $2.4 billion, higher than the level of $2.0 billion in 2009. Their share accounted for 3.5% of the total market turnover in 2010. The annual trading of ETFs in 2010 was the highest so far in Hong Kong.

DWs and Callable Bull/Bear Contracts (CBBCs)

31. In 2010, Hong Kong ranked first in the world in the trading of securitised derivatives, including DWs and CBBCs. Trading of DWs increased in both absolute terms and as a percentage of total market turnover during 2010. Trading of DWs rose to $10.8 billion (15.6% of total market turnover), compared to $6.6 billion (10.7% of total market turnover) in 2009.

32. The trading of CBBCs decreased in both absolute terms and as a percentage of total market turnover. Trading of CBBCs decreased to $5.8 billion (8.5% of total market turnover), compared to $6.7 billion (10.8% of total market turnover) in 2009.

[2] Mainland enterprises include H-shares, red chips and non-H share Mainland private enterprises.



Turnover of DWs and CBBCs ($mn)

Source: SFC research

Exchange-traded derivatives

33. The average daily trading volume of derivatives was 466,082 contracts, 18% higher than in 2009. Trading in futures products fell slightly during 2010. Among futures products, HSI futures remained the most actively traded, accounting for nearly half of all futures trading. Compared to 2009, its average daily trading volume increased by 0.8%. The second most actively traded contract was HSCEI futures. As at the end of 2010, open interests of HSI and HSCEI futures were 88,816 and 94,734 contracts respectively.

34. In the options market, trading rose during 2010. Stock options remained the most actively traded options product and its trading volume rose 28.8%, compared to its volume in 2009. It is worth noting that the growth in trading volume of the HSI and HSCEI options products was strong, rising 58.6% and 48.4% respectively.

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

		2010	2009	2008
Futures	HSI Futures	84,462	83,750	89,368
	Mini-HSI Futures	33,336	37,494	32,761
	HSCEI Futures	49,919	50,077	59,428
	Mini-HSCEI Futures	3,985	3,232	1,726
	Stock Futures	961	1,098	1,058
	3-Month HIBOR Futures	4	10	98
	Gold Futures	23	27	62
	Other futures products*	27	1	4
	Total Futures	**172,717**	**175,690**	**184,505**
Options	HSI Options	34,197	21,686	15,723
	Mini-HSI Options	1,939	1,158	646
	HSCEI Options	11,690	7,924	6,642
	Stock Options	245,485	191,676	225,074
	Other options products**	55	0	2
	Total Options	**293,365**	**222,445**	**248,087**
Total Futures and Options		**466,082**	**398,134**	**432,592**

Remark: HSI Dividend Point Index Futures and HSCEI Dividend Point Index Futures were launched on 1 Nov 2010

* One-Month HIBOR Futures, Three-year Exchange Fund Note Futures, Hang Seng China H-Financials Index Futures, FTSE/Xinhua China 25 Index Futures, HSI Dividend Point Index Futures and HSCEI Dividend Point Index Futures

** FTSE/Xinhua China 25 Index Options, Flexible Hang Seng Index Options and Flexible H-shares Index Options

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

Sources: HKEx and SFC Research