KF Spotlight : Hang Seng Index (HSI) Q1 2021 Market Recap

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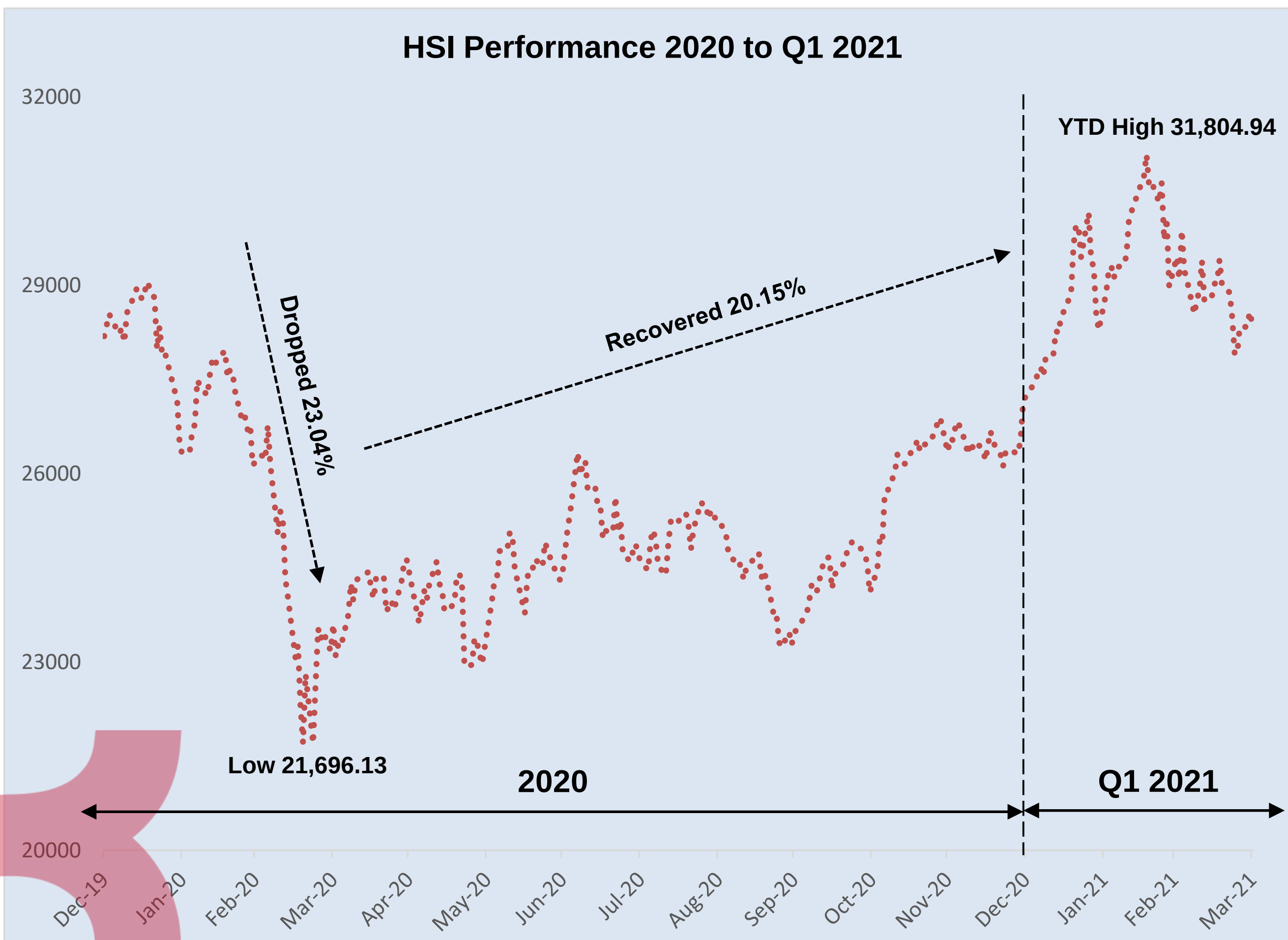
Just like other financial markets around the world, the benchmark Hong Kong stock market index namely, Hang Seng Index, had also experienced a challenging time in 2020 due to the impact of economic shutdown brought by COVID-19 pandemic. The situation improved from late March onwards after the government decided to reopen the economy. As shown in the chart below, HSI had slumped 23.04% in the first 3 months of the year, before recovered 20.15% afterwards.

Moving into 2021, HSI continued to trend higher breaching the 30,000 level in late January. However, market began to retreat following the announcement made by Hong Kong's government to raise the stamp duty on stock trading before recovering in March on news of index overhaul. In this paper, we will examine what are the latest development surrounding the benchmark index and how it will impact the stock market performance in the near term.



Source : Bloomberg

Q1 2021 Review

Higher Interest from Chinese Investors

Hang Seng Index kick off the year 2021 with its best January record since 1989, when the index climbed 14.3%, due to the higher trading interest from the mainland Chinese investors. The inflows from China was largely driven by the Stock Connect program that allows mainland investors to buy shares on Hong Kong's stock exchange. Other than that, the decision by United States to delist Chinese companies listed in their stock exchange has caused Hong Kong's stock exchange as major beneficiary when most of these stocks held a secondary listing in the city. Among of them are Alibaba Group Holding and JD.com.

The News of Tax Hike on Stock Trading

Despite showing some strong performance in January, Hang Seng index produced some price correction in the middle of February, triggered by the large sell off of the technology stocks due to profit taking activities. On top of that, the price drops were also triggered by the news of policy tightening regarding the stock trading in the city. Hong Kong's administration via Finance Secretary Paul Chan announced the government's decision to raise stamp duty from 0.10% to 0.13% on stock trading. The decision was said to be the first increase since 1993.

The Index Overhaul

In early March 2021, Hong Kong stock market regulator announced a big news on index overhaul that is expected to occur around May 2021. The index changes, which will be covered in the next part of this report, has caused the Hang Seng index to bounce back from their previous consecutive drops as the move was seen can make HSI more appealing index.

Source : Bloomberg, South China Morning Post, The Edge Market and CNBC

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On 1 March 2021, Hang Seng Indexes Company announced their decision to enhance their flagship product Hang Seng Index in a move to ensure it remains as the most representative of the Hong Kong Stock Market. The move, which is regarded as the biggest overhaul in 51 years of Hong Kong stock market's history, will take place as early as May 2021 during index review and go through mid 2022.

What Changes Can be Expected?

Before	Changes	After
52 members	Number of Constituents	The number of constituents will be increased to 80 through the regular index reviews by mid-2022 and ultimately to fix the number at 100
Among 12 industries where telecommunication, financials and IT covered 80% in terms of market capitalization as at Dec 2020	Selection of HSI Constituents	The constituents will be selected from seven Industry Groups with target not less than 50% for each group that consists: 1) Financials 2) IT 3) Consumer discretionary and staples 4) Properties and construction 5) Utilities and telcos 6) Healthcare 7) Energy, materials, industrials and conglomerates
Minimum of 3 month listing based on market value rank	Listing History Requirement	The listing history requirement will be shortened to 3 months
Weighting of Hong Kong firms in HSI fell to 42.2% in December 2020 from 45.3% as at end of 2016.	Representation of Hong Kong Companies	Hang Seng Indexes Company will maintain 20 to 25 constituents that are classified as Hong Kong companies in the HSI, subject to re-evaluation every two years
10% for single stock and 5% for secondary listed constituents	Weighting Cap on all HSI Constituents	All HSI constituents, including weighted voting rights and/or secondary listed constituents, will be subject to an aligned weighting cap of 8%

Source : Bloomberg and HKEX

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Do you know?
Hang Seng Index was launched in 1969 with 33 constituent stocks. The index then expanded to 38 in 2006 with the first inclusion of H shares. The following year, the index compiler announced it will gradually expand to 50 constituent stocks, which was only achieved in December 2012.

Source : South China Morning Post

What Can Be Expected From These Changes?

Better Diversification

The decision to increase the number of constituents to 100 from 52 and expanding the selection of constituents from the seven industry group would provide diversification benefit to many investors, and thus could prevent overconcentration risks which would be beneficial for passive investors.

Increased Volatility

In the past years, HSI used to face lot of criticism, for its heavy bias towards the financial sector, which currently formed 43% of the index. Despite of this, the higher weightage of this sector has at least provided some stability to the index due to its strong establishment. With the recent move, some sector like technology stocks would experience increasing weightage and this would increase volatility of HSI in the short term due to its challenging business exposure.

Attracting More Capital

Under the new changes, an inclusion of new listing will be made faster and easier since the listing history is reduced to 3 months. This would increased the valuation of the index as more new economy stocks are expected to join.

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Factors to Watch in Q2 2021

COVID 19 vaccine development

Hong Kong's economy was adversely affected in 2020 due to the economic shutdown brought upon by the COVID-19 pandemic. According to data from Hong Kong Tourism Board (HKTB), Hong Kong registered a reduction of 93.6% of visitor arrivals in 2020. The situation had caused devastating impact to many major industries of Hong Kong's economy especially tourism, catering, hotel and retail. With the launch of COVID-19 vaccines, it is expected that the global economy including Hong Kong to recover significantly in 2021. As to date, Hong Kong has commenced its vaccination programme on 26 February 2021 where the first roll out are targeted among high risk groups. With the recovery of real economy, Hong Kong stock market is also expected to recover significantly in 2021.

US- China Trade Dispute

Last year saw the trade tension between the two major economic powerhouse of China and United States escalated into a new level when United States passed a legislation that could force Chinese companies listed in United States exchange to be delisted if not able to meet US audit requirements. Since then, there were a huge inflow of US-listed Chinese stocks to Hong Kong especially the technology stocks where this sector had outperformed many other sectors. Under the new administration of new President Joe Biden, the future relationship between the two countries are still remain to be unclear. If the relation persist to be sour, we would expect more US-listed Chinese stocks would return to Hong Kong and this would trigger the upside potential of Hang Seng Index in 2021 in the near term.

The Expansion of Stock Connect Program

Back in 2014, a mutual market access program was introduced to link the Shanghai Stock Exchange (SSE) and Hong Kong Exchange and Clearing Limited (HKEX) where mainland Chinese investors able to trade Hong Kong and Chinese companies listed in Hong Kong, and also allow foreign investors to trade China A shares listed on the mainland in a less restrictive manner. The program was then extended in 2016 to include Shenzhen market. On 31 March 2021, Hang Seng index regulator expanded the program by introducing Hang Seng Stock Connect Hong Kong Top Shareholding 50 Index and Hang Seng Stock Connect China A Top Shareholding 50 index. The expansion program is expected to attract more capital inflow to HK and hence boosting the liquidity of Hong Kong stock market.

A Short Term Price Outlook

Source : Trading View

All the positive price action in the second half of 2020 was carried forward in 2021 as HSI kick-off the year relatively well, able to break up the 30,000 level in January. The price retreated afterwards in the end of January when MACD bearish crossover was formed, while RSI indicators had also shown overbought signal for couple of days. After hitting the support level around 28,000, prices bounced back to reach the YTD high level of 31,183.36. However, price dropped again in the end of February as RSI showed an overbought signal while MACD returned to its bearish crossover signal.

Regardless of the bearish technical indicators recently, we maintain our positive outlook on HSI in the near term as MACD is poised to break the signal line for some bullish signal. Hence, we foresee that HSI will trend higher with a strong resistance level of 30,000 level. Overall, we expect that HSI will trade in a range of 27,000 to 30,000 level.

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