

CESC Annual Index Report for January



China Exchanges Services Co., Ltd. (CESC)



Highlights

- CES SCHK100, a Hong Kong blue chip index, outperformed other Mainland and Hong Kong broad base indices by surging 7.6 per cent in the month
- Macau's gaming revenues rose year on year for the sixth consecutive month. They were up 3.1 per cent while the CES G10 climbed 4.9 per cent
- The RMB's exchange rate against the US dollar stabilised and bolstered the A-share market. CES A80, which tracks A-share blue chips, rallied 3.6 per cent
- HKEX plans to roll out Mainland government bond futures and more RMB products this year
- HKMA reported RMB deposits shrank 36 per cent in Hong Kong in 2016. The news was followed by more calls for a diversified range of RMB investment products to attract capital
- MSCI warned the inclusion of A shares in its indices may be halted if the Mainland continues capital controls
- The average daily turnover of Mainland A-share index futures traded in Singapore ended the month down 45 per cent year on year, but open interest rose 8.5 per cent from December

I. Performance of CESC Indices

CES SCHK100, a Hong Kong blue chip index, outperformed other Mainland and Hong Kong broad base indices by surging 7.6 per cent in January 2017 as the Mainland and Hong Kong markets moved upwards.

The RMB's value against the US dollar rebounded nearly 1 per cent. **The currency's stabilisation boosted the A-share market. CES A80, which tracks A-share blue chips, rallied 3.6 per cent in the month** (see table 1).

Table 1	Index Point	Monthly Return	Volatility	Risk-adjusted Return
CES SCHK 100	4,577.99	7.61%	2.68%	2.83
HSI	23,360.78	6.18%	2.88%	2.15
CES HKMI	5,784.47	4.87%	3.24%	1.50
CES G10	4,129.89	4.86%	6.46%	0.75
HSCEI	9,804.05	4.36%	3.06%	1.43
FTSE A50	10,361.64	3.93%	1.96%	2.00
CES 120	5,238.41	3.68%	1.47%	2.51
CES A80	6,123.20	3.58%	1.96%	1.82
CES 300	3,742.75	3.26%	2.00%	1.63
CSI 300	3,387.96	2.35%	2.01%	1.17
CES 280	5,939.79	2.34%	2.14%	1.09
SSE Composite	3,159.17	1.79%	2.08%	0.86
SZSE Component	10,052.05	-1.23%	4.53%	-0.27

Source: CESC and Wind; data as of 31 January 2017

Since the launch of Shenzhen Connect, investment through the scheme has continued to grow and Mainland capital kept flowing into Hong Kong stocks in January. According to HKEX, there was a net inflow of RMB9.6 billion into A shares under Stock Connect, up 43 per cent from December. A net inflow of nearly HK\$19.3 billion into Hong Kong stocks under the Southbound link of the programme was reported for the month.

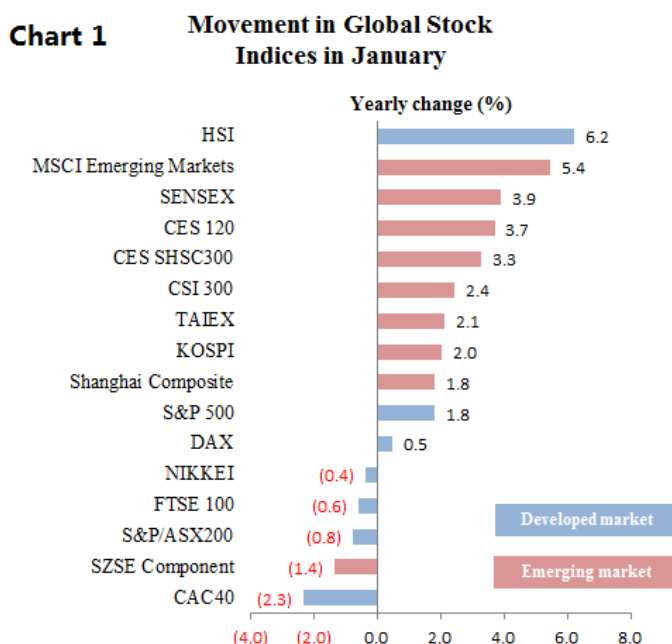
According to an announcement of the Macau government, **January saw a gross gaming revenue of MOP19.3 billion, up 3.1 per cent year on year. It was the sixth consecutive month that the gaming revenue rose year on year increase.** During their Lunar New Year holiday break from 27 January to 2 February, about 637,800 Mainlanders visited Macau, up 9.5 per cent from the same holiday last year. Gaming stocks listed in Hong Kong rebounded during the month. The **CES G10 climbed 4.9 per cent.**

II. Other stock indices

Led by Hong Kong stocks, emerging markets outperformed developed markets. Driven by Southbound funds, the average daily net buy under the Southbound link of the Stock Connect programme exceeded HK\$1.2 billion, and the Hang Seng Index rose 6.2 per cent. (see chart 1)

US stocks performed steadily with the Dow Jones breaking through 20000 in the middle of the month. Volatility, however, increased in major US stock indices. In particular, there was a reversal of Donald Trump related gains as sentiment was affected by a strong US dollar, higher interest rates and rallies in the developed markets. The reversal reflected market concerns over the uncertainty of Trump’s policies.

Influenced by Trump’s comment that the US dollar is too strong and UK Prime Minister Theresa May’s remarks about the UK’s Brexit plan, stocks and FX in developed markets fluctuated wildly. The British pound hit a three-month low at one point though it rebounded later with the easing of expectations of a hard Brexit. The FT 500 Index was dragged down 0.6 per cent during the month. Affected by the Trump trades in mid-January, Germany’s DAX Index plummeted 1 per cent. On 25 January, when Trump announced policies to implement his election pledges, the DAX returned to its level at the beginning of the month. The index ended the month with a moderate gain



Source: CESC and Bloomberg, as of 31 January 2017

of 0.5 per cent.

The 10-year US Treasury bond's yield fell to 2.46 per cent from a peak of 2.6 per cent in December. The US dollar was weak, with the DXY down 2.6 per cent. These developments benefited emerging markets, which continued to rebound as pressure eased. The MSCI Emerging Market Index jumped 5.4 per cent.

III. Off-shore A-share related activities

HKEX plans to roll out Mainland government bond futures and other RMB products

Bloomberg announced recent changes to its Bloomberg Barclays Fixed Income Indices. While stalling the inclusion of RMB bonds in its Global Aggregate Index, the company said it would create a transitional index that combines the Global Aggregate Index and the government and policy bank component of the China Aggregate Index to facilitate offshore funds' progressive investment in RMB bonds. In response to rising investor demand, HKEX plans to roll out Mainland government bond futures in the first half of the year to provide an offshore tool to hedge onshore RMB bond exposure.

According to HKEX's plans for 2017, inclusion of Exchange Traded Funds (ETFs) in its mutual market access programme is under consideration. The launch of Bond Connect is also being studied. HKEX is looking into a Bond Connect model built around off-exchange trading with a focus on the institutional bond market. The aim is to provide cross-border cash bond trading and settlement connectivity with the Mainland's major onshore bond market infrastructures. HKEX also plans to widen the range of assets underlying Leveraged and Inverse Products, which are structured as ETFs, explore the development of A-share derivatives and introduce RMB currency options, RMB index futures and gold futures.

HKMA reported RMB deposits shrank 36 per cent in Hong Kong in 2016. The news was followed by more calls for a diversified range of RMB investment products to attract capital

Due to the continuing slide of the value of the RMB against the US dollar and a significant fall in market demand for RMB asset allocation, total RMB deposits in Hong Kong plunged to RMB546.7 billion at the end of the year, down 36 per cent, or RMB304.4 billion, from the same period in 2015, according to the HKMA.

According to SWIFT, international payment in RMB declined sharply in 2016, falling 29.5 per cent year on year. The currency's international usage also dropped. It is now in sixth place. SWIFT said international payment in RMB declined because of a combination of factors, including the Mainland's economic slowdown, volatility of the RMB's value and capital flight controls.

To attract more liquidity to the offshore market, Hong Kong should develop a diversified range of RMB products to provide more choices of investment for offshore RMB liquidity. For example,

the mutual market access programme can be further extended to RMB bonds, commodities and the development of A-share derivatives to attract offshore holding and usage of RMB funds.

MSCI warned the inclusion of A shares in its indices may be halted if the Mainland continues capital controls

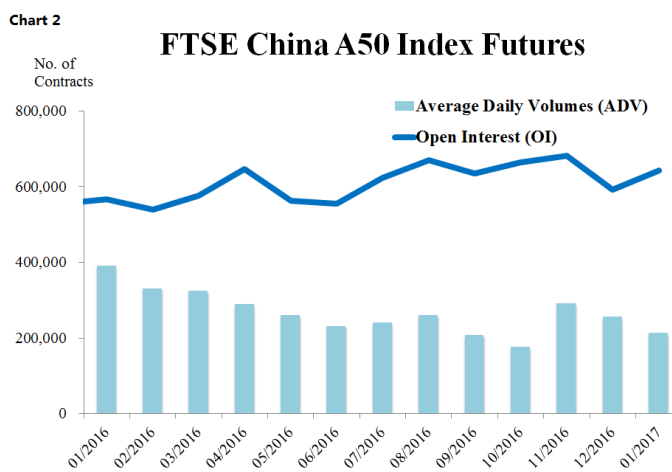
Stringent control measures have been implemented by the Mainland authorities recently to stop capital flight and stabilise the RMB’s exchange rate. Although these control measures are not expected to last permanently, MSCI is concerned the exit of Mainland capital may be restricted in unusual circumstances. MSCI’s chairman and CEO warned that the process of including A shares in MSCI indices may be halted if the Mainland steps up its capital controls.

It is worth noting that after deciding not to include A shares in its emerging market index for the third time. MSCI said in June 2016 that there were differences between it and the Mainland in terms of the development of stock index futures. While MSCI hoped Mainland stock index futures could be traded worldwide, the CSRC saw that as beyond the scope of the Mainland’s stage of market development at that time.

The average daily turnover of Mainland A-share index futures traded in Singapore ended the month down 45 per cent year on year, but open interest rose 8.5 per cent from December

Impacted by the shrinking A-share cash trading, the average daily turnover of FTSE A50 Index futures fell for the third straight month and was down 45 per cent year on year at 210,000 contracts (see chart 2).

Open interest in FTSE A50 Index futures ended the month at 640,000 contracts, or a notional value of RMB46.3 billion, up 8.5 per cent from December, as demand for hedging against A-share holdings increased ahead of the Lunar New Year.



Source: SGX statistics as of 31 January 2017

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