

CESC Index Report for September 2018



China Exchanges Services Company Limited



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Highlights

- CES Stock Connect Hong Kong Premier 50 Index (CESP50) slumped 0.3 per cent as Hong Kong banks raised interest rate first time in 12 years
- CES Innovative Biotech Index (CESIBT) dropped 5.2 per cent as State Medical Insurance Administration announced new rules for drug prices
- Good profit expectations pushed Japanese stocks to 27-year high
- SFC announced green finance strategic framework to develop green financial products
- Foreign investors continued to use Bond Connect
- Finance Ministry resumed issuance of USD and RMB bonds in Hong Kong

I. Performance of CESC Indices

With mixed reports on the market, Hong Kong and Mainland stocks moved in different directions. Leading Hong Kong bank HSBC raised its prime rate to 5.125 per cent from 5 per cent, its first rate hike in 12 years. Concerns about escalating funding costs drove **CES Stock Connect Hong Kong Premier 50 Index (CESP50) down 0.3 per cent**. **CES China A80 Index (CESA80), which tracks Mainland A shares, gained 4.8 per cent** after FTSE Russell said it would include A shares in its global equity indices. (See Table 1)

Table 1	Index Point	Monthly Return	Volatility	Risk-adjusted Return
CES A80	7,009.23	4.8%	6.0%	0.80
CES 120	6,304.51	2.6%	5.9%	0.44
CES SCHK HYL	3,145.46	2.4%	3.4%	0.70
CES 300	4,275.72	1.6%	5.4%	0.30
CES 280	5,576.66	0.4%	5.5%	0.06
CES OBOR	1,552.22	0.3%	4.6%	0.07
CES SCHK 50	3,051.99	-0.3%	5.6%	-0.05
CES HKMI	7,604.83	-0.4%	6.4%	-0.07
CES SCHK 100	5,504.84	-1.3%	5.6%	-0.23
CES High Yield	3,579.68	-2.0%	7.2%	-0.27
CES REIT	3,514.97	-2.3%	3.3%	-0.69
CES CPE	5,552.15	-3.4%	7.5%	-0.46
CES iBioTech	8,114.68	-5.2%	8.9%	-0.59
CES CSC	3,526.17	-7.8%	9.0%	-0.87
CES SCHK E&L	3,349.10	-8.7%	10.0%	-0.87
CES G10	4,551.78	-13.9%	13.0%	-1.06

Source: CESC and Wind; data as of 28 Sep 2018

In a forum in September, the State Medical Insurance Administration discussed the way drugs are purchased by the state and rolled out a purchase scheme based on drug specifications. Drug vendors are required to offer discounts of up to 40 per cent for purchases by state authorities. According to media estimates, regions covered by the scheme account for 60 per cent of the Mainland’s drug sales. CES Innovative Biotech Index (CESIBT) dropped 5.2 per cent.

Risk aversion increases in a volatile market. As investors sought refuge in high yield, low volatility strategies, **CES SCHK High Yield Low Volatility Index (CESYLV)**, which provides hedging against volatility, **advanced 2.4 per cent.**

II. Other stock indices

Emerging markets generally stabilised in September. Mainland A shares significantly rebounded with the Shanghai Composite Index and the Shanghai Shenzhen CSI 300 Index up 3.5 per cent and 3.1 per cent respectively. The depreciation of the Indian rupee sent India’s SENSEX plummeting 6.3 per cent. (See Chart 1)

In line with market expectations, the US Fed Funds rate increased by a quarter point. According to the dot plot projections of the Fed, coming rate hikes will be progressive, with another one to come by the end of 2018, three in 2019 and one in 2020. S&P 500 edged up 0.4 per cent as investors stayed on the sidelines.

Japan’s central bank maintained its loose monetary policy in response to mild expansion in the country’s economy. Unemployment in August sank to an unexpected 2.4 per cent, the lowest since the early 1990s. Japanese companies’ operating profits in the 2017 financial year were the largest in 20 years. A record amount is expected in the 2018 financial year. Operating profit margins continued to improve and pushed stock prices up 5.5 per cent to a 27-year high.

The Indian rupee lost 12 per cent against the US dollar and hit a new all time low. The



rupee and the Indonesian rupiah are the year's worst performing Asian currencies. India's SENSEX plunged 6.3 per cent amid concerns that currency depreciation in emerging countries was spreading to India from Argentina and Turkey.

III. China-related investment activities offshore

SFC announced green finance strategic framework to develop green financial products

The SFC announced its strategic framework to contribute to the development of green finance in Hong Kong and said it will work closely with HKEX on how it can develop and promote the listing and trading of green financial products including bonds, indices and derivatives.

Quoting a report by Morgan Stanley, the SFC said 84 per cent of asset owners plan to incorporate Environmental, Social and Governance (ESG) principles into their investing. However, incomplete ESG information, insufficient disclosure on sustainable investing and other factors pose challenges to the development of green finance.

The SFC said one of its priorities is to enhance listed companies' disclosure of environmental information, with an emphasis on climate-related risks and opportunities. The SFC will also work on ways in which asset managers make clear to investors how and to what extent they factor environmental criteria into their investment processes and risk assessments. These initiatives will complement and build onto existing initiatives to promote green bonds.

Speaking at a forum, Hong Kong Chief Executive Carrie Lam observed that demand for green funding is strong and the Mainland is actively promoting and developing green finance and environmental protection. She said Hong Kong, as an international financial centre, is well positioned to offer the financial services needed for those efforts.

Foreign investors continued to use Bond Connect

Bond Connect continues to facilitate the participation of buy-side global investors in the China Interbank Bond Market. Since the inclusion of Mainland bonds in the Bloomberg Barclays Global Aggregate Index and the full implementation of Delivery versus Payment settlement in Bond Connect, an increasing number of foreign institutional investors have participated in the scheme. According to the Bond Connect Company Limited, as of the end of August 2018, 425 foreign institutional investors have joined Bond Connect, an increase of 110 compared to the end of May 2018.

A breakdown of the foreign institutional investors shows that 59 per cent of the new

accounts were opened by global asset management houses and fund houses for various non-corporate products and the remaining 41 per cent by banks, securities companies and other financial institutions for proprietary trading.

In August 2018, Bond Connect had turnover of RMB81.2 billion, of which 68 per cent was buy trades of foreign institutions. Commercial banks and asset management houses were the most active buy-side institutional investors while large commercial banks and foreign banks were the most active onshore quotation entities. Trading concentrated in policy financial bonds, interbank deposits and treasury bonds. The remaining time to maturity of the bonds was mainly within one year, seven to ten years or one to three years.

Finance Ministry resumed issuance of USD and RMB bonds in Hong Kong

The Ministry of Finance will issue and list US\$3 billion of sovereign bonds in Hong Kong. A further RMB5 billion in RMB-denominated state bonds will also be issued under the state bond programme that began in July.

The ministry resumed issuance of US dollar sovereign bonds in October 2017 after a 13 year break. Demand for the October 2017 issue, worth US\$2 billion, was strong, with orders reaching 11 times the amount on offer and pricing hitting a record low among Asian USD sovereign bond issues of the year. The overwhelming response reflected investors' confidence in Mainland China's economy.

Regular issuance of USD sovereign bonds and RMB state bonds in the offshore market will help establish benchmarks for the pricing of offshore bonds. It will also improve the benchmark yield curves of offshore foreign currency and RMB bonds, providing Mainland enterprises seeking international funding with an important pricing reference.

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