

CESC Index Report for February



China Exchanges Services Co., Ltd. (CESC)



Highlights

- CES HKMI, which tracks large Hong Kong-listed Mainland stocks, surged 3.3 per cent in the month as Hong Kong and Mainland equities rallied and investors' interest in Mainland-concept finance stocks grew
- Emerging markets outperformed developed markets in the month, with Indian stocks rising 3.9 per cent and Taiwan stocks 3.2 per cent
- Mainland bonds, with an outstanding issue of RMB 63.7 trillion, are expected to be included in the major international bond indices this year
- HKEX's Chief China Economist's Office: tools for cross-border equity risk management are lacking
- Europe's CEINEX listed its first A-share ETF futures, widening the range of offshore derivatives on RMB assets
- The open interest of Mainland A-share index futures traded in Singapore hit a record high of RMB52 billion in notional value, reflecting increasing demand for A-share risk management

I. Performance of CESC Indices

CES HKMI, which tracks large Hong Kong-listed stocks, surged 3.3 per cent in the month as Hong Kong and Mainland equities rallied and investors' interest in Mainland-concept finance stocks grew. (see table 1)

According to *China Securities Journal*, the first batch of Mainland pension funds worth RMB10 billion was expected to enter the stock market as soon as in February. The move was expected to benefit Mainland insurance companies in the long run. Trading in Hong Kong stocks increased sharply on the news, with daily turnovers breaking above \$100 billion. Average daily turnover was \$80 billion in February, up more than 40 per cent from January.

According to the National Bureau of Statistics, the Mainland's official PMI was 51.6 in February, up from 51.3 in January. It was the seventh straight month the PMI was above 50. The China Caixin PMI for February was 51.7, up from 51.0 in January and the second highest figure in the past four years. They all pointed to economic recovery on the Mainland and rising demand for goods and services.

Table 1	Index Point	Monthly Return	Volatility	Risk-adjusted Return
HSCEI	10,297.96	5.04%	3.95%	1.28
CES 280	6,133.16	3.40%	2.40%	1.42
SZSE Component	10,391.34	3.38%	2.64%	1.28
CES HKMI	5,975.10	3.30%	3.69%	0.89
SSE Composite	3,241.73	2.61%	2.26%	1.16
CES 120	5,341.97	1.98%	2.56%	0.77
CSI 300	3,452.81	1.91%	2.41%	0.79
HSI	23,740.73	1.63%	2.67%	0.61
CES 300	3,827.19	1.39%	2.18%	0.64
CES A80	6,189.45	1.08%	2.46%	0.44
FTSE A50	10,440.04	0.76%	2.54%	0.30
CES SCHK 100	4,602.30	0.53%	2.22%	0.24
CES G10	4,065.53	-2.20%	6.57%	-0.34

Source: CESC and Wind; data as of 28 February 2017

Macau's gaming revenue increased 17.8 per cent year-on-year to about MOP23 billion as casinos benefitted from an increase in the number of travellers to the enclave during the spring holiday. It was the seventh straight month with a year-on-year increase and beat market expectations. CES G10, however, fell 2.2 per cent during the month.

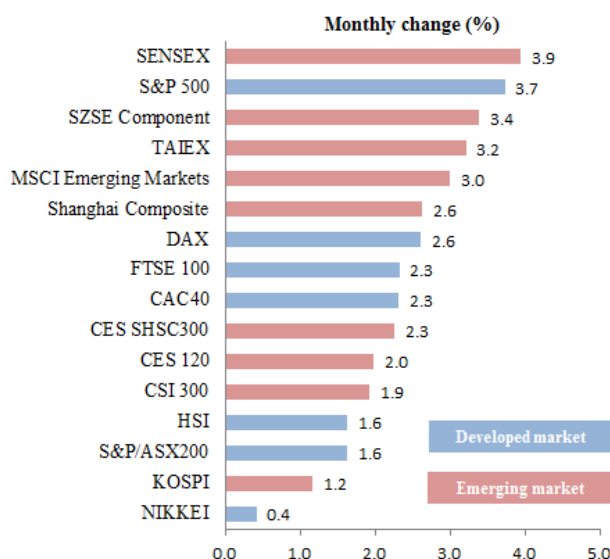
II. Other stock indices

The world's major markets had strong performances in February. **Emerging markets outperformed developed markets generally, with Indian stocks rising 3.9 per cent and Taiwan stocks 3.2 per cent.** The US led developed markets (see chart 1)

The Indian economy grew 7 per cent in the fourth quarter of last year after rising 7.4 per cent in the third quarter, but the most recent gain was still above market expectations. India now has the world's fastest growing large economy. The effect of the government's recall of large banknotes on the country's economy receded. Indian stocks have rallied for two straight months.

Chart 1

Movement in Global Stock Indices in February



Source: CESC and Bloomberg, as of 28 February 2017

US stocks rose 3.7 per cent in February. It was the fourth straight month of their rally. Bullish sentiment spread across the market as investors expected President Trump to deliver on his election promises, including a substantial increase of infrastructure spending, lower corporate taxes and less

financial market regulation.

From Trump's win in the presidential election to the end of February, the S&P 500 gained a cumulative 9.2 per cent and VIX hovered below 15 at the end of that period. Those are signs of possible irrational exuberance in the stock market. Fed Chair Janet Yellen said in mid-February that it was unwise to wait too long to increase interest rates. Several other Fed officials stressed there were sufficient grounds for a rate hike. Increasing expectations of more rate hikes are likely to cause market volatility, particularly in emerging markets.

III. Offshore A-share-related activities

Mainland bonds, with an outstanding issue of RMB 63.7 trillion, are expected to be included in the major international bond indices this year

Mainland bonds ended 2016 with an outstanding issue of RMB63.7 trillion, trailing only US and Japanese bonds and exceeding the prevailing market value of A shares. Since the RMB's inclusion in the IMF's SDR currency basket, there has been increasing interest in Mainland bonds among offshore financial institutions. Currently, 432 overseas institutions have invested a total of nearly RMB800 billion in Mainland bonds.

Deutsche Bank projected that RMB bonds will be included in the major international bond indices in the second half of the year as the RMB's internationalisation continues. Trillions of RMB are expected to flow into RMB bonds in the coming five years. There are market fears, however, that the Mainland capital market's admission restrictions may impede the inclusion of RMB bonds in the international bond indices.

Currently, three major international bond indices are considering the inclusion of RMB bonds. They are Citigroup World Government Bond Index, JPMorgan Chase Government Bond Index-Emerging Markets and Bloomberg Barclays Capital Aggregate Bond Index. As a transitional solution, Bloomberg Barclays launched two new indices ('Global Aggregate + China Index' and 'Emerging Market Local Currency Government + China Index') on 1 March to facilitate non-Mainland investors tracking of and investment in Mainland bonds.

HKEX's Chief China Economist's Office: tools for cross-border equity risk management are lacking

According to HKEX's Chief China Economist's Office, the Stock Connect programme has led to an increase in demand for cross-border equity risk management, but tools designed to manage exposure through the mutual market access scheme are lacking globally.

Among A-share-related indices with derivatives (futures/options) traded in overseas exchanges, only CES China 120 Index (CES 120) covers both A shares and Hong Kong stocks with Mainland

concepts. Other indices cover either A shares (FTSE China A50 Index) or offshore listed Mainland-concept stocks (FTSE China 50 Index and MSCI China Free Index) only. CES 120, however, covers stocks listed in Hong Kong, Shanghai and Shenzhen, many of which are eligible for trading under the Connect programme. It also has a high correlation with the A-share index.

Given these characteristics of CES 120, HKEX's CES 120 futures is an effective tool to manage risks arising from cross-border equity investment, as well as an instrument for exposure to A shares and the shares in Stock Connect. Judging by the success of EURO STOXX 50 Index derivatives and structured products in serving the Eurozone, CES 120 and its derivatives and structured products should be able to bring the same benefits to the mutual market between Hong Kong and the Mainland.

Europe's CEINEX listed its first A-share ETF futures, widening the range of derivatives on offshore RMB assets

On 20 February, China Europe International Exchange (CEINEX) announced the official debut of futures contracts on the db x-trackers Harvest CSI300 Index ETF. Currently, CEINEX has 133 products available for trading, the majority of which are ETFs and RMB bonds.

It was not the first time an overseas exchange listed a futures contract on an A-share ETF. A similar futures contract was launched by HKEX in 2013. At present, the A-share ETFs linked to listed futures are CSOP FTSE China A50 ETF (2822), iShares FTSE A50 China Index ETF (2823) and ChinaAMC CSI 300 Index ETF (3188). (see table 2)

Table 2:

February Volume & Open Interest of A-share ETFs Futures Traded in Hong Kong (Contracts)

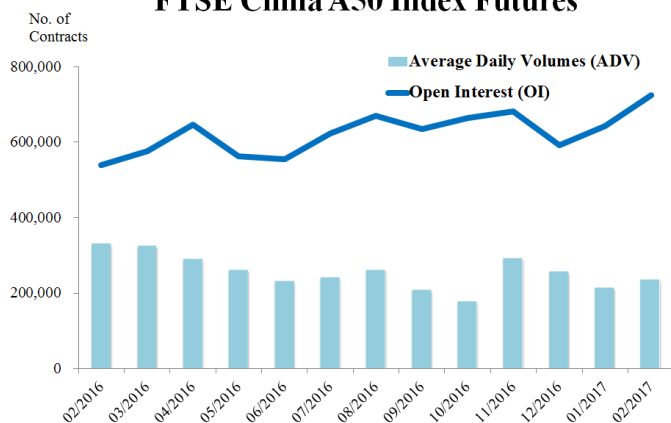
ETF's Stock Code	ETF's Name	Futures' Commencement Day	Volume	Open Interest
2822	CSOP FTSE China A50 ETF	10 June 2013	382	206
2823	iShares FTSE A50 China Index ETF	10 June 2013	397	160
3188	China AMC CSI 300 Index ETF	10 June 2013	9	35

Open interest of A-share index futures traded in Singapore hit a record high of RMB52 billion in notional value, reflecting increasing demand for A-share risk management

Open interest in FTSE A50 Index futures traded in Singapore ended the month at 723,000 lots (see chart 2), or a notional value of RMB52 billion, up 34 per cent year-on-year. It reflected a further increase in demand for A-share risk management. Trading in the futures became active after the Lunar New Year holidays. Average daily turnover was 233,000 lots in February, up 10 per cent from January.

Chart 2

FTSE China A50 Index Futures



Source: SGX statistics as of 28 February 2017

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