

F

Research Paper No.54: A review of the global and local securities markets in 2013

17 January 2014



Executive Summary

1. In the US, the Dow, S&P and Nasdaq rose 27%, 30% and 38% respectively during 2013. The US market rose on rising hopes for a continuation of stimulus measures by the Fed and improving economic outlook in the US. The Dow and S&P rose to their record highs whilst the Nasdaq also rose to a 13-year high. The market remained volatile given worries about tapering of stimulus and the debt ceiling problem. The US Fed announced a modest tapering plan, and reaffirmed its commitment about maintaining an accommodative monetary policy. However, investors remained cautious about the implications of the tapering on the economy and possible shift in fund flows. The US Senate passed a budget deal which would ease automatic spending cuts. However, as the debt limit was raised until early 2014, worries about the problem would likely re-surface later.
2. In Europe, the FTSE, DAX and CAC rose 14%, 26% and 18% respectively. Major European markets rose on better corporate earnings in the Eurozone and robust economic data in the US. The DAX rose to a record high. Market sentiment was boosted given the European Central Bank's (ECB) commitment to loose monetary policies. However, uncertainties about the economic outlook in the Eurozone continued to weigh on the market.
3. In Asia, the Nikkei 225 Index rose 57%. The performance of other major regional markets was mixed, ranging from a 7% loss in Thailand to a 22% increase in Vietnam. In Japan, a weaker yen and the new cabinet's commitment to stimulus plans provided support. However, investor sentiment remained fragile given uncertainties about economic recovery. In other Asian markets, market sentiment was boosted as central banks adopted accommodative monetary policies. However, concerns about possible capital outflows capped the gains.
4. On the Mainland, the Shanghai Composite Index fell 7%. The Mainland market dropped given worries about slower economic growth. Concerns about tightening liquidity conditions in the credit market and worries about resumption of initial public offerings (IPOs) also affected investor sentiment. There were also uncertainties about policies to curb rising property prices. Reform policies released after the Third Plenum in November beat market expectations and provided some support.
5. In Hong Kong, the Hang Seng Index (HSI) rose 3%, but the Hang Seng China Enterprises Index (HSCEI) dropped 5%. Despite the strong rallies of US and European markets, the Hong Kong market underperformed, given worries about the Mainland's economic growth and credit conditions. H-shares dropped, tracking the decline in the Mainland market. The local market once rose sharply after the announcement of Mainland reform measures in November. However, uncertainties remained over the precise pace of the exit of quantitative easing (QE) programme in the US and the Mainland's economic outlook.
6. In 2013, the Hong Kong market posted only a slight gain despite rallies in major overseas markets. Looking forward, the market may face risks and uncertainties including:
 - (a) Reversal of accumulated gains – During 2013, major stock markets rose to their record highs. Investors are concerned that after accumulating substantial gains, the markets are vulnerable to downward corrections. Any disappointing news about economic performance or policy changes may trigger selloffs, and worries about a possible downturn may add volatility to the market.
 - (b) Worries about the tapering of Fed stimulus and the US fiscal debt problem – Given the nomination of Janet Yellen as the next Fed Chairman, it is widely anticipated that a dovish monetary policy might continue in the medium term. However, investors remain cautious about the precise pace for the Fed's tapering. The debt ceiling problem was



only temporarily resolved and further debates in coming months may affect market volatility.

- (c) Movements of capital flows – The global market rally was supported by abundant liquidity given loose monetary policies in major markets. As the local market has recorded capital inflows after the start of the QE of the US, upon a tapering of the stimulus, capital inflows may recede or even reverse. Possible reversals of fund flows from the Asian markets may pose a contagion impact on the local stock market as well. As an open market, the Hong Kong stock market is prone to risks of volatile capital flows.
- (d) Global macro risks – Despite signs of improving economic data, the outlook for global economic growth remains uncertain. In Europe, unemployment rates and debt ratios remain high, and there are worries about deflation risks. Sovereign ratings are still susceptible to downgrades. In Japan, economic recovery remains fragile despite continuous supportive policies. On the Mainland, investors are also concerned about the slowdown in economic growth.

The Hong Kong stock market performance has referenced both the performance of the US and the Mainland markets. Looking forward, as the Mainland economic outlook remains uncertain, and the US Fed will taper its stimulus measures, these developments may weigh on the Hong Kong market.

- 7. Trading in both the cash market and exchange-traded derivatives rose. The average daily trading in the cash market rose 16%, while that in futures and options increased 10% and 9% respectively from that in 2012.



Performance of stock markets during 2013

8. During 2013, major markets rose to their record or multi-year highs on improved global economic outlook, abundant market liquidity and easing worries over an early exit of stimulus measures by the US Fed. The Japanese market outperformed on optimism about government supportive measures and a weaker yen. However, the Mainland market fell given uncertainties about the economic outlook and worries over the liquidity conditions in the market. The Hong Kong market underperformed major overseas markets.

The US

9. After gaining 7-16% in 2012, the Dow, S&P and Nasdaq rose 27%, 30% and 38%



Performance of Major stock markets

		End 2013	% change			PE Ratios
		Index Level	2013	2012	2011	End-2013
Hong Kong and the Mainland						
HK	-HSI	23,306.39	2.9%	22.9%	-20.0%	10.57
	-HSCEI	10,816.14	-5.4%	15.1%	-21.7%	8.02
Mainland	-Shanghai Comp	2,115.98	-6.7%	3.2%	-21.7%	10.63
	-Shenzhen Comp	1,057.67	20.0%	1.7%	-32.9%	28.80
Asia						
Japan	-Nikkei 225	16,291.31	56.7%	22.9%	-17.3%	23.54
Australia	-AOI	5,353.10	14.8%	13.5%	-15.2%	25.01
Taiwan	-TWSE	8,611.51	11.8%	8.9%	-21.2%	24.57
Korea	-KOSPI	2,011.34	0.7%	9.4%	-11.0%	17.04
Singapore	-STI	3,167.43	0.0%	19.7%	-17.0%	13.54
Thailand	-SET	1,298.71	-6.7%	35.8%	-0.7%	14.46
Malaysia	-KLCI	1,866.96	10.5%	10.3%	0.8%	18.03
Indonesia	-JCI	4,274.18	-1.0%	12.9%	3.2%	19.48
India	-Nifty	6,304.00	6.8%	27.7%	-24.6%	16.82
Philippines	-PCOMP	5,889.83	1.3%	33.0%	4.1%	17.17
Vietnam	-VN	504.63	22.0%	17.7%	-27.5%	12.59
US						
US	-Dow	16,576.66	26.5%	7.3%	5.5%	16.03
	-Nasdaq	4,176.59	38.3%	15.9%	-1.8%	25.74
	-S&P	1,848.36	29.6%	13.4%	-0.0%	17.44
Europe						
UK	-FTSE100	6,749.09	14.4%	5.8%	-5.6%	16.63
Germany	-DAX	9,552.16	25.5%	29.1%	-14.7%	16.22
France	-CAC	4,295.95	18.0%	15.2%	-17.0%	18.41
PIIGS and Hungary						
Portugal	-PSI20	6,558.85	16.0%	2.9%	-27.6%	N/A
Italy	-FTSEMIB	18,967.71	16.6%	7.8%	-25.2%	N/A
Ireland	-ISEQ	4,539.43	33.6%	17.1%	0.6%	N/A



Box 1: Sustainability of global market gains

Background

15. Accommodative monetary policies by major central banks have provided support to the global financial markets, which have accumulated substantial gains since the financial crisis in 2008. The US Dow and German DAX rose to historical highs and the Nikkei in Japan increased 57% in 2013, the largest yearly gain since 1972. These indices, together with the HSI, have gained over 100% from their troughs in 2009. Worries about possible corrections have heightened.

		End-2013 Index Level	% change from the trough in 2009
Hong Kong and Mainland			
Hong Kong	-HSI	23,306.39	105%
	-HSCEI	10,816.14	64%
Mainland	-Shanghai Comp	2,115.98	14%
Asia			
Japan	-Nikkei 225	16,291.31	131%
Taiwan	-TWSE	8,611.51	103%
Korea	-KOSPI	2,011.34	97%



18. Whilst the US Fed announced its initial plan to trim the size of stimulus, further reductions may continue. The precise timing, pace and magnitude of tapering of other major central banks remain uncertain. Some market participants believe that major central banks may raise interest rates during or after 2015.
19. Investors have been highly sensitive to signals about possible pullback of stimulus. In mid-2013, after the Fed signalled its plan for tapering the QE, Asian markets, including Hong Kong, experienced sharp corrections, given concerns about capital outflows.



Box 2: The US debt ceiling impasse



standoffs remain, unless longer-term solutions are derived to address ultimate cause of the debt problem.

28. While immediate risks for a US default are generally considered limited, concerns about credit risks and uncertainties about the Fed's monetary policy may continue to affect the economic outlook and bring volatility to the financial markets.

Europe

29. Major European markets advanced given optimism about monetary easing. During 2013, the FTSE, DAX and CAC rose 14%, 26% and 18% respectively, following the gains of 6%, 29% and 15% respectively in 2012. The DAX rose to a record high.
30. In early 2013, major European markets rose on robust economic data in the Eurozone and



Asia

33. In Japan, the Nikkei 225 Index was the best performing benchmark index in Asia, posting a



The Mainland

37. Following a rise of 3% in 2012, the Shanghai Composite Index fell 7% during 2013. It once rose to an eight-month high in February given solid economic growth data. Market sentiment was also boosted amid optimism about the possible increase in foreign investors' quotas to invest in the A-share market under the Qualified Foreign Institutional Investor (QFII) and Renminbi Qualified Foreign Institutional Investors (RQFII) schemes. Later, some gains were erased given worries about a possible hard landing amid weaker-than-expected economic data.
38. In mid-2013, the market corrected as rising interbank rates heightened worries over a credit crunch. The overnight Shanghai Interbank Offered Rate peaked at around 13% on 20 June compared to around 2-4% during January to May. Worries about possible measures to combat shadow banking activities added to concerns about tighter credit conditions. In July, the market posted the biggest monthly decline since August 2009.
39. Later, losses were trimmed as interbank interest rate stabilised. Better-than-expected GDP growth also lent support. The market posted a strong gain later as a detailed economic and social reform plan was released after the Third Plenary Session of the 18th





continued supportive policies. On the Mainland, investors are also concerned about the slowdown in economic growth.

44. Hong Kong is affected by the economic performance of the Mainland and the US, given that Hong Kong is an open economy with close economic linkages with the Mainland, and the Hong Kong dollar is linked to the US dollar under the currency board system and Hong Kong interest rates follow those in the US. For the Hong Kong stock market, it has a large Mainland component in terms of issuers but an international and institutional investor base. As such, the Hong Kong stock market performance has also referenced the performance of both the US and Mainland markets. During periods when the US and Mainland markets moved in opposite directions, the rise in one market was offset by the decline in the other. However, if these two markets move in the same direction, the Hong Kong market will track their movements and experience increased volatility. Looking forward:
- (a) On the Mainland, GDP growth is forecast to slow down from 7.6% in 2013 to 7.3% in 2014, according to the International Monetary Fund (IMF). Although a hard landing seems unlikely, slowing economic growth on the Mainland may adversely affect the Hong Kong market.

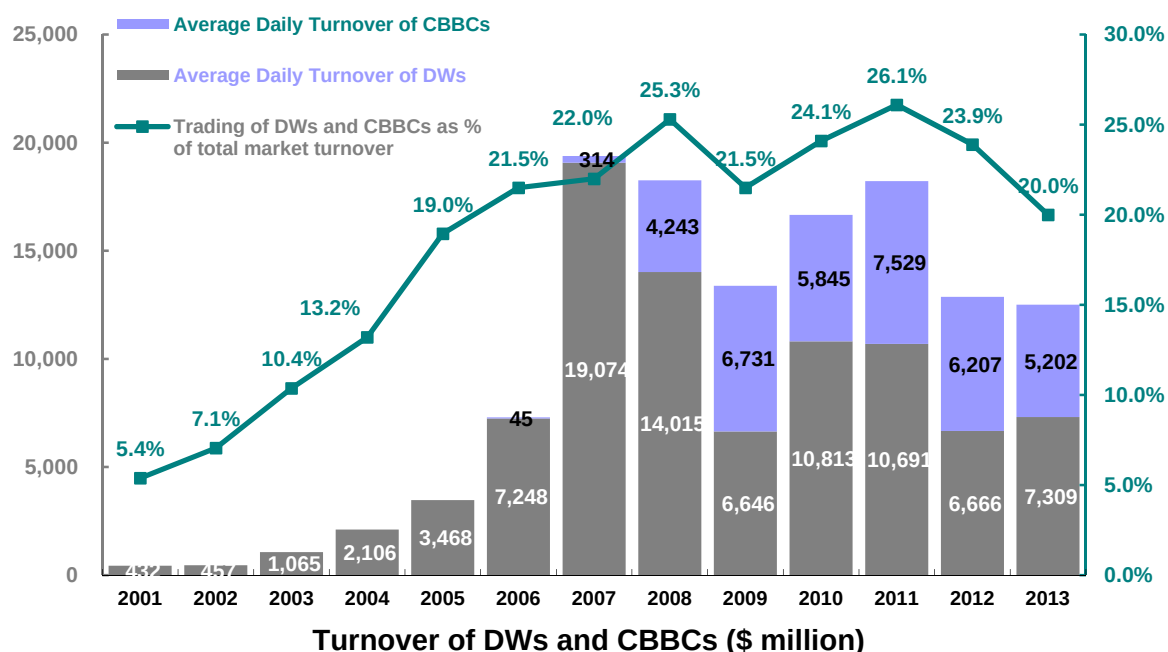


Initial public offerings (IPOs)

49. There were 102 IPOs in Hong Kong during 2013. Total IPO funds raised amounted to \$169.0 billion. This compared to 62 IPOs (\$90.0 billion) in 2012. IPO funds raised by Mainland companies accounted for 91% of the market total during 2013. Hong Kong ranked the 2nd in IPO activities worldwide this year and the 4th in 2012.

Top 10 Stock Markets in the World, by Equity Funds Raised through IPOs (2013)

	Equity Funds Raised through IPO		
	US\$ billion	Worldwide Ranking	Asia Ranking
US (NYSE Euronext)	46.58	1	-
Hong Kong	21.77	2	1



Source: SFC Research

Exchange-traded derivatives

53. During 2013, the average daily trading in exchange-traded derivatives increased 9% compared to the 2012 level. Average daily trading in futures products rose 10%. Among the futures products, HSI futures and HSCEI futures were the most actively traded contracts. They each accounted for about 38% and 41% of all futures trading respectively. Whilst the average daily trading volume of the HSI futures dropped by 3%, that of the HSCEI futures increased by 32% from the 2012 level.
54. Average daily trading in options rose 9% in 2013. Stock options remained the most actively traded options product and trading volume rose 9%, compared to the 2012 level.

