CESC Index Report for September

China Exchanges Services Co Ltd (CESC)

Highlights

- CES SCHK100, which represents large cap stocks eligible for Southbound trading under Stock Connect, rose 1.4 per cent and was the best-performing broad-based index that tracks Mainland and Hong Kong Stocks
- Macau's gaming revenue rose 7.4 per cent year-on-year in September. CES G10 surged 15.2 per cent from the previous month and 51.4 per cent from its 2016 low in January
- Performances of the world's major benchmarks diverged, with UK stocks at the top and Mainland A shares trailing behind. CES A80, representing the Mainland's blue chips, ended the month down 1.8 per cent.
- CSRC removed limits on equity investment by QFII and RQFII to facilitate investment by foreign institutions
- Mainland permission for domestic insurance funds to participate in Stock Connect's Southbound trading prompted flows of Mainland funds into Hong Kong stocks
- ADV and open interest of offshore A-share stock index futures retreated in September

1. Performance of CESC indices

According to the National Bureau of Statistics, the Mainland's industrial profits for September grew 19.5 per cent year-on-year, the best growth in the past three years. It is an indicator of continuing stabilisation in the Mainland economy. The People's Bank of China (PBOC) continued to report a net return of funds in the last week of September. That tightened liquidity and caused 1-month Shibor to hit 2.74 per cent, the highest level since 4 August this year. Mainland A shares traded in a narrow range and Hong Kong stocks rose slightly as trading was influenced by the US Federal Reserve's (Fed) suggestion that a rate hike is on the horizon. **CES A80, representing the Mainland's blue chips, rebounded by 0.8 per cent in the last two weeks of September and ended the month down 1.8 per cent.**

CES SCHK100, which represents large cap stocks eligible for Southbound trading under Stock Connect, rose 1.4 per cent (see Table 1) and was the best-performing broad-based index that tracks Mainland and Hong Kong Stocks. Its performance reflected investors' interest in Hong Kong stocks after the announcement of approval for Shenzhen Connect.

Macau's gaming revenue in September rose 7.4 per cent year-on-year, statistics from Macau's Gaming Inspection and Coordination Bureau showed. It was the second straight month of growth after a 26-month decline. Analysis shows Macau's gaming industry has benefited from contributions by mass market players and its recovery has gathered pace. **CES G10 surged 15.2 per cent.** The index hit 3,769, its highest level since August 2015, and ended the month at 3,715. **At the end of the month the index was up 51.4 per cent from its 2016 low in January.**

Table 1	Index Point	Monthly Return	Volatility	Risk-adjusted Return
CES G10	3,715.41	15.18%	11.71%	1.30
CES SCHK 100	4,551.41	1.42%	4.64%	0.31
HSI	23,297.15	1.39%	4.94%	0.28
CES HKMI	5,838.56	1.18%	5.62%	0.21
HSCEI	9,581.93	0.42%	5.95%	0.07
CES 300	3,610.95	-0.35%	3.68%	-0.10
CES 120	5,006.54	-0.46%	3.67%	-0.13
CES 280	5,815.54	-1.76%	3.99%	-0.44
SZSE Component	10,567.58	-1.77%	4.35%	-0.41
CES A80	5,730.21	-1.79%	2.85%	-0.63
FTSE A50	9,598.73	-2.16%	2.58%	-0.84
CSI 300	3,253.29	-2.24%	3.10%	-0.72
SSE Composite	3,004.70	-2.62%	3.05%	-0.86

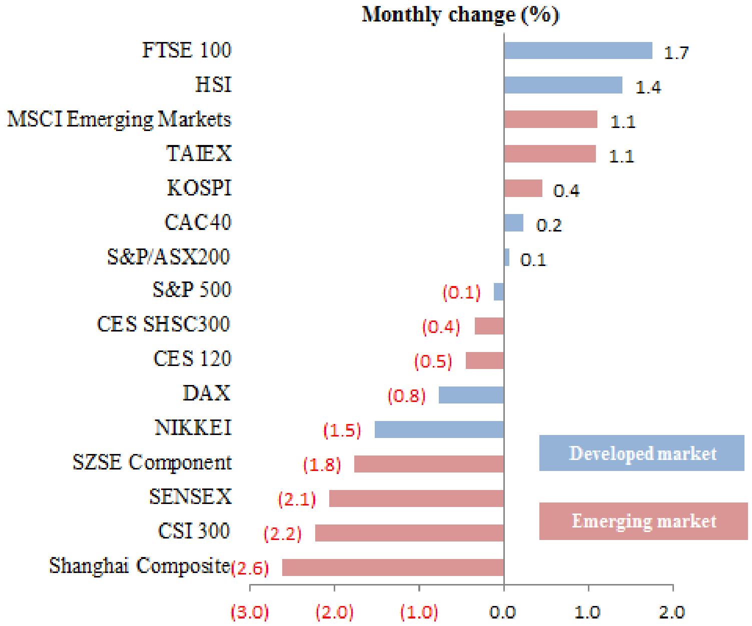
Source: CESC and Wind; data as of 30 September 2016

2. Other stock indices' movements

The performances of the world's major benchmarks diverged, with UK stocks at the top and Mainland A shares trailing behind. FTSE 100 grew 1.7 per cent while Mainland A shares dropped 2.2 per cent (see Chart 1).

In early September, S&P 500 plunged sharply on fears of an early rate hike by the Fed. The index remained steady for the rest of the month after the Fed decided in mid-September to maintain interest rates at 0.25-0.5 per cent. However, Fed chair Janet Yellen reiterated that the case for a rate hike has strengthened. Uncertainty in the US presidential contest also seeped into investment sentiment. Investors in general took a wait-and-see approach before the election.

Chart 1 Movement in Global Stock Indices in September



Source: CESC and Bloomberg, as of 30 September 2016

Japan's central bank kept interest rates unchanged without intensifying its negative rate policy or expanding the monetary base, and the central bank maintained its plan to purchase Japan government bonds at an annual pace of JPY80 trillion. However, officials decided to shift the focus of the bank's monetary easing programme from quantitative to qualitative, and to seek to control the yield curve by swapping short-term bonds for long-term debt. The move brought to mind "Operation Twist" adopted by the Fed in 2011. Various economic factors strengthened the Japanese yen as a "safe haven". The currency rose 2 per cent against the US dollar despite a fall of 1.5 per cent in the Nikkei.

After reporting a huge loss of EUR6.8 billion last year, Deutsche Bank had to face the possibility of a fine of up to US$14 billion from the US Justice Department. Large hedge funds raced to pull money out of the bank and its share price slumped a further 11 per cent, adding to a fall of 45.8 per cent in the first nine months of the year. Investors feared the speedy dumping of assets could result in a repeat of the 2008 Lehman incident. Weighed down by Deutsche Bank, German's DAX was down 0.8 per cent.

At a meeting at the end of the month, OPEC agreed for the first time in eight years to a modest cut in oil output. The proposal had key support from the group's leader Saudi Arabia. Daily maximum production is expected to be cut by around 200,000 to 700,000 barrels, according to the preliminary consensus of the cartel. New York's oil price was up 8 per cent when the month ended. Amid climbing oil prices, emerging stock markets such as Russia and Venezuela gained 4.2 per cent and 8.4 per cent respectively, while MSCI's Emerging Markets Index rose 1.1 per cent.

3. Offshore A share-related activities

The CSRC removed limits on equity investment by QFII and RQFII to facilitate investment by foreign institutions

In an attempt to attract more foreign long-term capital, the CSRC said on 30 September it would abolish the lower limits on QFII and RQFII investment in equities to facilitate investment by foreign institutions. The action came several months after moves by SAFE to liberalise cross-border capital flows. In early February, the regulator scrapped the cap on investment quotas for individual QFIIs, introduced a "base quota" where a quota within that range will be subject to record-filing with SAFE, removed the deadline for remitting capital back to the Mainland and shortened the capital lock-up period from one year to three months. Nevertheless, the market thought restrictions on QFII quota allocation and capital flow should also be relaxed. At present, foreign institutions are required to seek approval for their QFII investment quotas. Outward remittance of capital in batches and by instalments remains mandatory and total remittance still cannot exceed 20 per cent of onshore assets.

As of the end of the third quarter, a combined US$81.7 billion worth of QFII investment quotas had been granted to 272 foreign institutions and an aggregate RMB511.3 billion (equivalent to US$76.6 billion) of RQFII quotas had been awarded to 169 foreign institutions.

Mainland permission for domestic insurance funds to participate in Stock Connect's Southbound trading prompted flow of Mainland funds into Hong Kong stocks

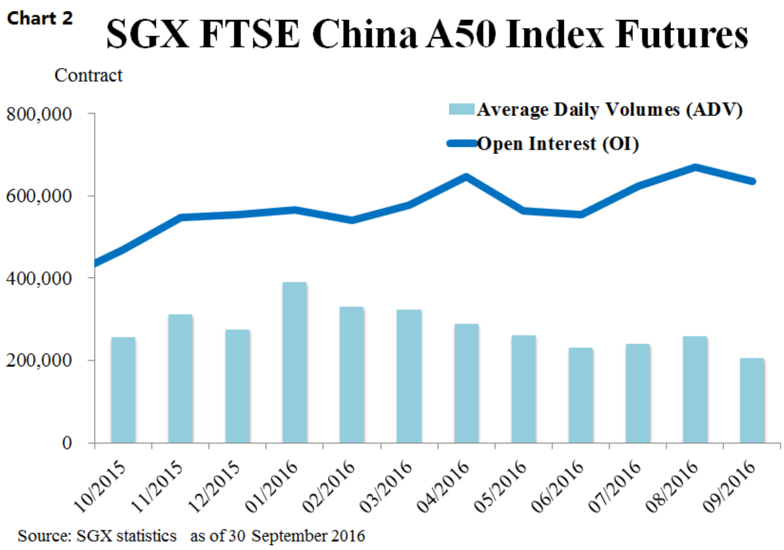
The CIRC said on 8 September it would allow Mainland insurance firms to participate in Shanghai Connect. The move will expand the channels through which insurers can invest in Hong Kong stocks and ease pressure brought by QDII quota restrictions.

At the end of 2015, total foreign investment by Mainland insurers was merely US$36.2 billion, representing 1.9 per cent of total assets, far below the 15 per cent ceiling set by regulators. That suggested much room for further growth. Among foreign investments of Mainland insurers, equities topped the list at 42 per cent, which implied equities would remain dominant in foreign asset allocation by Mainland insurers.

Following some significant price fluctuation in the Mainland capital market, it is believed that a shortage of investment options and expectations of further RMB depreciation will lead insurance funds to continue investing in Hong Kong stocks as they seek to preserve and increase asset values and to achieve better investment returns.

ADV and open interest of offshore A-share stock index futures retreated in September

According to the Singapore Exchange, the average daily volume (ADV) and open interest of FTSE A50 Index futures ended the month down 20 per cent and 5 per cent respectively from their record highs (see Chart 2). Open interest fell to 630,000 contracts, which was still the year's third highest level. The contracts' notional value reached RMB40.6 billion.



FTSE A50 futures have yet to receive approval from the Shanghai and Shenzhen stock exchanges. Financial products related to A- shares require prior approval by the two bourses under Mainland policy.

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