

Strategy Report

Preview of new blue chips & Southbound stocks

The HSI Company will announce results of the 2021 Q4 review of the Hang Seng Family of Indexes after market close on 18 Feb 2022. We expect three to four stocks from Consumer and IT industries to be added to the HSI, bringing the number of constituents to 67-68.

- **Expect 3-4 new constituents.** The HSI Company is behind schedule in increasing the number of HSI constituents to “80 by mid-2022”. That said, they explained that “prudent selection is more important than rushing”, and thus we expect to see 3-4 new HSI constituent in this review, similar to recent quarters.
- **Under-represented industries: Consumer & Healthcare.** The HSI Company aims to achieve a balanced industry representation. Since the implementation of HSI enhancements in May 2021, market cap representation of those under-represented industries has been on the rise, but Consumer and Healthcare industries are still under-represented.
- **Expect no loss-making stocks to be added due to prudent selection.** As the HSI Company stressed “prudent selection”, we expect no loss-making Healthcare stocks will be added into the HSI in this quarterly review. For the same reason, we do not expect other loss-making large caps such as Kuaishou or JD Logistics to be included at this stage.
- **Potential inclusions: Baidu, Smoore, Nongfu Spring, SMIC.** In this quarterly review, we expect new constituents to come from IT and Consumer sectors, in descending order of likelihood: Baidu (9888 HK), Smoore (6969 HK), Nongfu Spring (9633 HK) and SMIC (981 HK). Dark horses include China Feihe (6186 HK), Zhongsheng (881 HK) and China Gas (384 HK).
- **Changes to Southbound eligible stocks:** Since this is also a half-yearly review of the Hang Seng Composite Index, there will be changes in Southbound eligible stocks too. We listed 17 stocks, led by Li Auto (2015 HK), that may become eligible Southbound stocks. We also listed some stocks that may be removed from Southbound.

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Market Data

Hang Seng Index	24,557
52-week High / Low	31,183/22,665
3-month avg. daily t/o	HK\$125.8bn

Source: Bloomberg

Indices Performance

	HSI	HSCEI	HSTECH
1-month	4.6%	4.3%	1.4%
3-month	-1.2%	-2.7%	-11.1%
6-month	-6.1%	-7.4%	-16.7%

Source: Bloomberg

12-month HSI Performance



Source: Bloomberg

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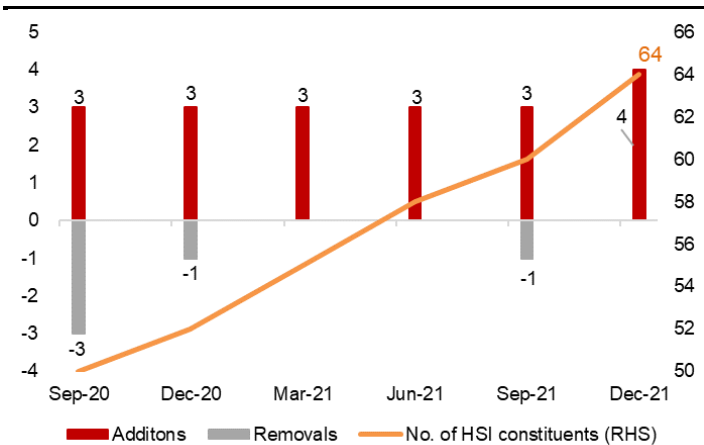
New HSI constituents likely from Consumer & IT industries

Hang Seng Indexes Company Limited (HSI Company) will announce the results of the 2021 Q4 review of the Hang Seng Family of Indexes after market close on 18 Feb 2022 (this Friday). The changes will be effective from 7 Mar 2022 (Monday).

Expect 3-4 new constituents as “Prudent Selection is Important”

Since the 2020 Q2 review of the HSI, the number of HSI constituents have been increasing from the originally fixed 50, and now stands at 64 (Fig. 1). The HSI Company stated in Mar 2021 that the number of HSI constituents is “targeted to reach 80 by mid-2022”, but there are only two quarterly reviews to go by mid-2022, and it is unrealistic to expect the HSI Company to hasten the process to add 16 stocks in the next two reviews.

Figure 1: Change in Number of HSI Constituents



Source: HSI Company, CMBIS

In fact, the HSI Company explained in a [blog post](#) in Dec 2022 that “*the slower-than-expected pace of constituent addition was due to the prudent stock selection*”, and that “**Prudent Selection Is More Important Than Rushing to 80 Constituents by mid-2022**”, and “*the threshold for picking new blue chips should not be lowered merely for achieving the target of 80 stocks.*” (Fig. 2)

Figure 2: HSI Company is in no rush in adding new blue chips

Prudent Selection Is More Important Than Rushing to 80 Constituents by mid-2022

The HSI is the leading benchmark to gauge the performance of the Hong Kong stock market. It focuses on size, liquidity and financial fundamentals to form a blue-chip barometer of the Main Board of the Stock Exchange of Hong Kong. As of end-November 2021, the AUM passively tracking indexes of the Hang Seng Family of Indexes was about USD44.5 billion. Among which, the exchanged-traded products linked to the HSI was about USD22 billion, substantially representing 49.4% of the total.

To keep pace with the changing market landscape, the HSI consultation was carried out in December 2020 and the enhancements in index methodology were implemented during the 1Q21 index review (i.e. announced in May 2021, with constituents changes effective in June 2021). On principle, the major improvements involve lifting index representativeness through a more balanced coverage of seven industry groups, and boosting diversification upon industries and share classes.

To achieve so, the number of index constituent was originally targeted to increase from 55 to 80 by mid-2022 (i.e. after 5 index quarterly reviews). Yet by 6 December 2021, only nine constituents were net added after 3 index reviews. The slower-than-expected pace of constituent addition was due to the prudent stock selection in the index review process. During the enhancement implementation, given the selection of high-quality constituents is more important, we consider the threshold for picking new blue chips should not be lowered merely for achieving the target of 80 stocks.

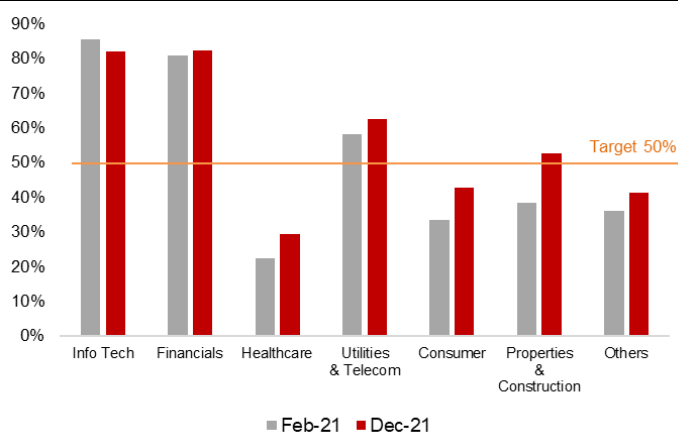
Source: HSI Company's blog, CMBIS

Under-represented industries: Consumer & Healthcare

In selecting HSI constituents, HSI Company evaluates each eligible stock's market cap, turnover, financial performance and representativeness within each industry group. It also aims to achieve a **balanced industry representation**, by targeting to achieve a market cap coverage of not less than 50% for each industry group. Since the implementation of HSI enhancements in May 2021, market cap representation of those under-represented industries has been on the rise (Fig. 3). **Consumer and Healthcare industries are still under-represented**. Therefore, in terms of industry representation, we believe Consumer and Healthcare stocks to be prime candidates for inclusion into the HSI.

However, non-constituent Healthcare stocks with the largest market caps are loss-making (Hansoh Pharma is profitable but turnover is too low, in our view). As the HSI Company stressed "prudent selection", **we expect no Healthcare stocks will be added** into the HSI in this quarterly review. For the same reason, we do not expect other loss-making large caps such as Kuaishou or JD Logistics to be included at this stage.

Figure 3: Market Capitalisation Coverage by Industry Group



Source: HSI Company, CMBIS; as of 6 Dec 2021
 "Others" refers to Energy, Materials, Industrials & Conglomerates

Potential inclusions: Baidu, Smoore, Nongfu Spring, SMIC

We rank HSI candidates by their market value, and showing their average turnover as well in Fig. 4.

In this quarterly review we expect the HSI to include 3 or 4 new constituents, in descending order of likelihood: **Baidu (9888 HK)**, **Smoore (6969 HK)**, **Nongfu Spring (9633 HK)** and **SMIC (981 HK)**.

Dark horses include China Feihe (6186 HK), Zhongsheng (881 HK) and China Gas (384 HK).

We expect no removals of constituents from the HSI in this review.

Figure 4: Top 25 non-HSI stocks by market value

Company	Ticker	Industry	Market Value* (HK\$ bn)	6-m avg. daily Turnover (HK\$ mn)
Kuaishou - W	1024 HK	Info Tech	546	1,975
Baidu - SW	9888 HK	Info Tech	319	529
JD Health	6618 HK	Healthcare	311	553
Smooere	6969 HK	Consumer Discretionary	286	597
Nongfu Spring	9633 HK	Consumer Staples	223	338
JD Logistics	2618 HK	Industrials	200	164
Hansoh Pharma	3692 HK	Healthcare	169	82
Bank of Comm.	3328 HK	Financials	165	102
China Feihe	6186 HK	Consumer Staples	151	210
Trip.com - S	9961 HK	Consumer Discretionary	144	82
Zhongsheng	881 HK	Consumer Discretionary	143	208
SenseTime - W	20 HK	Info Tech	142	Listing history < 6 months
SMIC	981 HK	Info Tech	141	760
Chow Tai Fook	1929 HK	Consumer Discretionary	140	98
China Gas	384 HK	Utilities	131	238
Swire Properties	1972 HK	Properties & Construction	128	47
Bilibili - SW	9626 HK	Info Tech	121	487
Innovent Bio	1801 HK	Healthcare	112	449
Lenovo	992 HK	Info Tech	109	351
Li Auto - W	2015 HK	Consumer Discretionary	108	Listing history < 6 months
XPeng - W	9868 HK	Consumer Discretionary	108	274
Postal Savings Bank	1658 HK	Financials	108	308
Beigene	6160 HK	Healthcare	103	193
CR Mixc	1209 HK	Properties & Construction	100	171
China Hongqiao	1378 HK	Materials	90	207

Source: Bloomberg, CMBIS

*Month-end average from Jan-Dec 2021; for secondary/dual-listed stocks, only showing HK-registered shares

Changes in Southbound eligible stocks

Since this is also a half-yearly review of the Hang Seng Composite Index (HSCI), **there will be changes in Southbound eligible stocks too.**

To be eligible for Southbound trading, a stock has to be:

1. **Constituent of the HSCI, with 12-month average market cap over HK\$5bn, or**
2. **H-shares of A-H dual listed companies.**

In Fig. 5, we listed 17 stocks that may become eligible Southbound stocks effective from 7 Mar 2022. These include:

1. Potential new HSCI constituents, among which many were IPOs in 2H 2021;
2. Weighted voting rights (WVR) stocks which have met the listing history requirement of 6 months plus 20 trading days [Li Auto & Bairong]. While another WVR stocks SenseTime would have to wait for the next half-yearly review since they have not met listing history requirement.

Figure 5: Potential ADDITIONS into Southbound trading

Company	Ticker	Sector	Market Value (HK\$ bn)*
Li Auto - W	2015 HK	Consumer Discretionary	108
GCL-Poly Energy	3800 HK	Industrials	56.4
MicroPort MedBot - B	2252 HK	Healthcare	56.4
Cloud Village	9899 HK	Info Tech	32.6
Chervon Holdings	2285 HK	Consumer Discretionary	27.8
LK Tech	558 HK	Industrials	19.9
Clover Bio - B	2197 HK	Healthcare	14.8
Keymed Bio - B	2162 HK	Healthcare	13.3
China Nonferrous Mining	1258 HK	Materials	12.3
Golden Solar New Energy	1121 HK	Industrials	12.1
EC Healthcare	2138 HK	Healthcare	11.9
Differ Group	6878 HK	Financials	11.9
ANE	9956 HK	Industrials	11.7
Theme Int'l	990 HK	Industrials	11.4
Gushengtang	2273 HK	Healthcare	9.4
Global New Material	6616 HK	Industrials	8.6
Bairong - W	6608 HK	Info Tech	6.6

Source: Bloomberg, CMBIS

*Month-end average during Jan-Dec 2021

In Fig. 6, we listed some stocks that might be removed from Stock Connect due to either 1) market cap having dropped to below HK\$5bn, or 2) potential removals from the HSCI, as they have dropped out of the top 96% of the cumulative market value in HKEX, per our estimates.

Figure 6: Potential REMOVALS from Southbound trading

Company	Ticker	Sector	Market Value (HK\$ bn)*
China Dongxiang	3818 HK	Consumer Discretionary	5.4
Times Neighbor	9928 HK	Properties & Construction	5.1
Wisdom Edu	6068 HK	Consumer Discretionary	5.0
CMBC Capital	1141 HK	Financials	5.1
Maple Leaf Edu	1317 HK	Consumer Discretionary	4.8
VPower Group	1608 HK	Utilities	4.6
Fantasia	1777 HK	Properties & Construction	4.6
Scholar Edu	1769 HK	Consumer Discretionary	2.6

Source: Bloomberg, CMBIS

*Month-end average during Jan-Dec 2021

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