恒生指數
HANG SENG INDEXES

BLOG

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Down one tier, up one notch: Achieving more diversification at a sector level

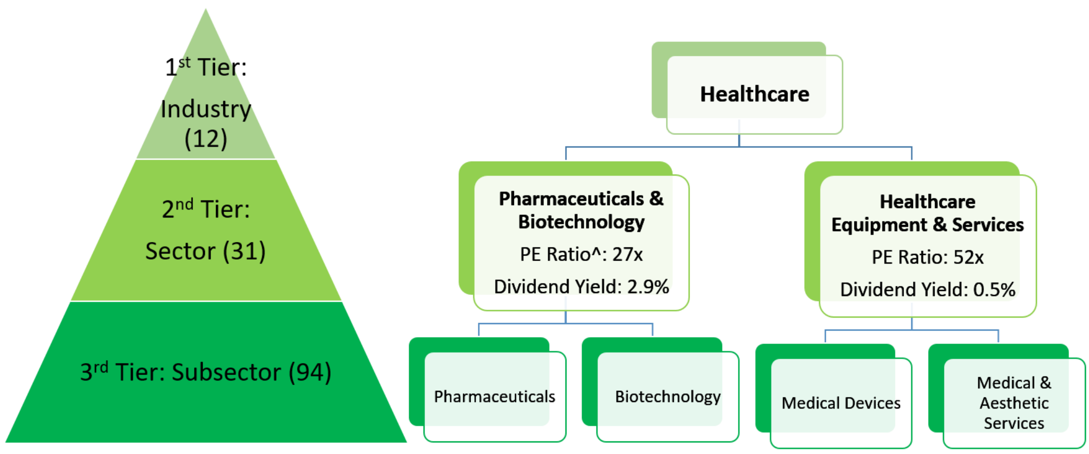
Identifying top companies on a more level playing field

Last time we highlighted how the Industry Top Methodology, which has been used to compile the Hang Seng China A Industry Top Index since its launch in 2009, has provided investors with a solid-performing benchmark by ensuring that the index portfolio strikes a fine balance between representativeness and capturing growth.

In today's rapidly evolving world, more enterprises are embracing increasingly complex business models as they venture into different areas of business whenever and wherever opportunities emerge. This is making the assessment of companies and the selection of top contenders ever-more challenging tasks, particularly when reviewing a broad universe that includes a large number of highly diverse candidates, both in terms of business activity and operating style.

By leveraging the Hang Seng Industry Classification System ('HSICS'), our comprehensive industry taxonomy, we designed the Sector Top Methodology to target 'tier 2' sectors and select the top companies that operate in comparable environments and that face similar challenges and opportunities. To take Healthcare as an example, the sector is further divided into two sub-sectors based on a number of fundamentals (Exhibit 1). The distinct differences in the basic fundamentals of these two groups mean that companies in the two groups might display different levels of cyclicality with respect to the broader economy and react differently to market events despite belonging to the same larger industry sector.

Exhibit 1. Tier structure of HSICS and Example of Classifications & Key Fundamentals*



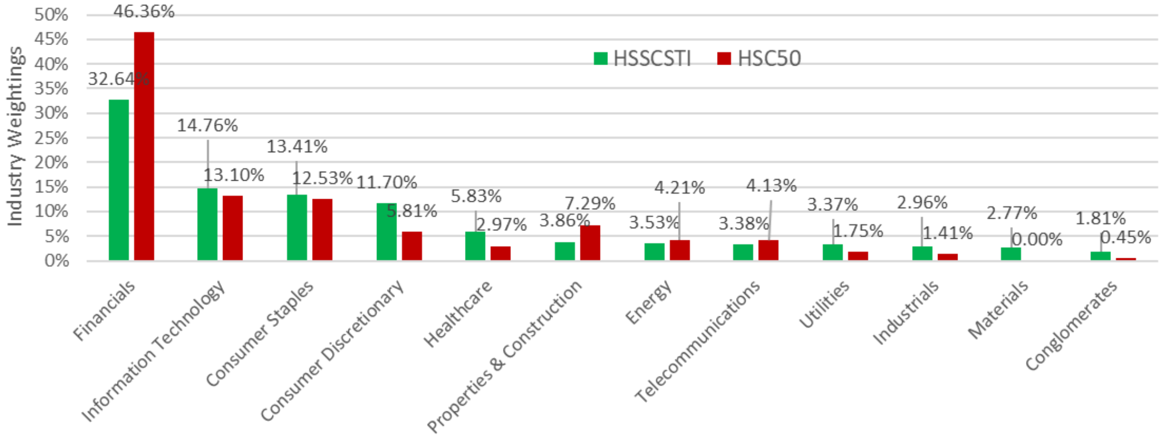
Source: Hang Seng Indexes CompanyAs of end of June 2020
* Average PE Ratio and Dividend Yield of same sector stocks from Hang Seng Composite Index
^ Outliers are excluded in calculation

Extending Success to the Stock Connect Cross-Market Universe

In recent years, investors have shown a strong interest in cross-market index-linked products that invest in both onshore-listed and offshore-listed mainland China and Hong Kong securities. We addressed this surge in investor interest by applying the Sector Top Methodology to the entire Stock Connect universe, which includes securities listed on the Hong Kong market that are eligible for southbound trading and those listed in Shanghai and Shenzhen markets that are eligible for northbound trading, to build a strategic beta that better fits the Greater China concept.

The Hang Seng Stock Connect Sector Top Index ('HSSCSTI') was launched in 2019. According to the HSICS, under the industry level, companies are further categorised into 31 sectors. The methodology selects two leading companies from each of these sectors, which caps the total possible number of constituents at 62. The selected companies form an index basket that offers greater diversification across industry sectors. The index constituents are free-float adjusted, market-capitalisation-weighted with a 10% cap on the weighting of any individual stock to avoid over concentration.

Exhibit 2. Industry Weightings of HSSCSTI and HSC50



Source: Hang Seng Indexes Company Data: as of end of June 2020

Using the Hang Seng China 50 Index ('HSC50'), which comprises the 50 largest mainland China companies listed in both the Hong Kong and mainland China markets, as a reference, we can see the industry weightings of HSSCSTI are more evenly distributed, bringing the exposure to financial stocks down from 46% to 33% (Exhibit 2). The residual weight is spread among other sectors, and indirectly to other non-financial industries, achieving not just a higher level of industry diversification, but also ensuring leading companies from other sectors/industries are represented in the index despite their relatively smaller sizes.

Exhibit 3. Total Return Performance of HSSCSTI and HSC50

Period	2015	2016	2017	2018	2019	1H2020	2015 - 2019
HSSCSTI TRI	0.39%	12.84%	37.81%	-12.08%	24.92%	-1.67%	71.45%
HSC50 TRI	-2.17%	6.64%	34.20%	-11.33%	28.94%	-4.72%	60.06%

Source: Hang Seng Indexes Company Data: as of end of June 2020
TRI= Total Return Index

Compared with the HSC50, which is already a strong-performing index, HSSCSTI outperformed by 11.4 percentage points in its five-year run from 2015 to 2019. The performance chart and table in Exhibit 3 show how HSSCSTI's use of a sector diversification and factor selection methodology produces an enhanced overall total return in the long run. Even during the market challenges created by COVID19 during the first half of 2020, the HSSCSTI managed to trim its comparative downside by approximately three percentage points.

A Diversified Portfolio for Long-term Returns

Employing the Sector Top Methodology, the index portfolio gives each sector its deserved level of representation in accordance with the sector's presence in the fundamental economy, including those more niche areas, while simultaneously providing a degree of protection from sector-specific risks through greater diversification.

By replicating this portfolio, investors will be able to capture growth opportunities from different parts of the underlying economy while enjoying a considerable level of defensiveness across various business cycles. This is reflected in the robust benchmark-beating performance of the index in the past few years.

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