



# BLOG

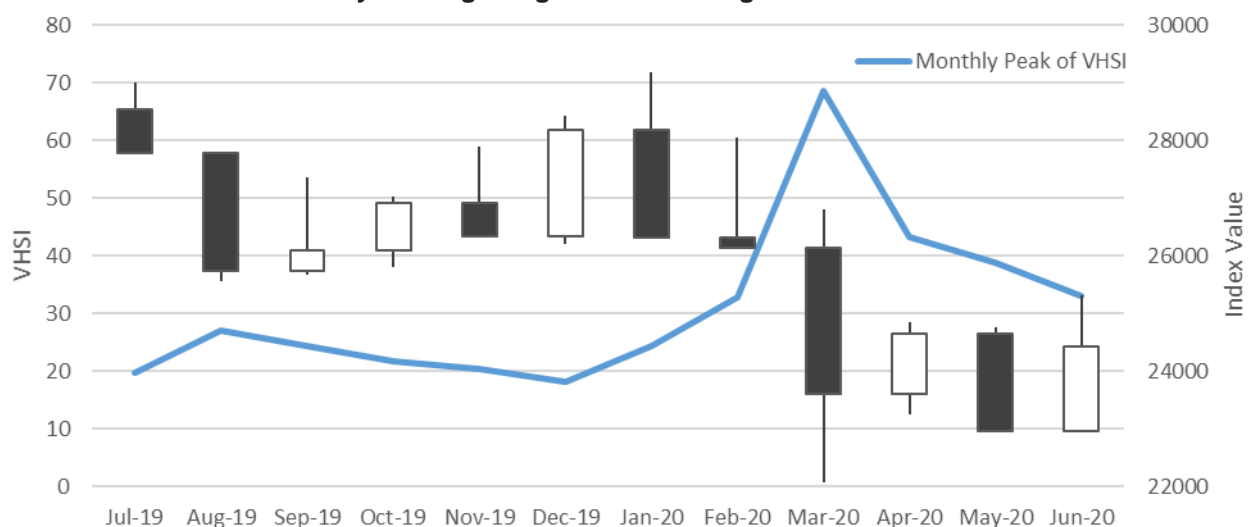
August 2020

## Trading of Index Futures spiked along with Market Risk

With the COVID-19 pandemic resulting in social distancing measures and the broader adoption of work-from-home policies around the world, many physical spaces and public places have been uncharacteristically quiet during the first half of 2020. However, anyone who has been watching the financial markets since the beginning of the year has experienced a virtual rollercoaster ride as markets repeatedly rose and fell on news related to the pandemic and global geopolitical tensions.

By the end of June, the Hang Seng Index ('HSI') had somewhat recovered from its dramatic downturn in March. But it would be unwise to take this as a return to more 'normal' levels of market movements, as many of the earlier uncertainties remain.

**Exhibit 1. Historical Monthly Trading Range of HSI and Highest Value of VHSI**



Source: Hang Seng Indexes Company Date: As of end of June 2020  
Colour of Boxes: White: Close > Open; Black: Close < Open

Exhibit 1 above shows the monthly Open-High-Low-Close of the HSI and the monthly peak values of the HSI Volatility Index ('VHSI'). These two metrics allow us to gauge the market risk from different perspectives – namely, the observable market swing and the implied volatility of options linked to the HSI. The HSI experienced a sharp decline amid COVID-19 worries in March, moving in a range of 4700 points. At the same time, we saw a surge in the VHSI to 68.64. The behaviour of indexes during this time clearly indicate the existence of significant and tangible market risk.

Facilitated by supportive government actions following the initial outbreak of COVID-19 in Hong Kong, business activity in many sectors was able to resume, the overall level of public fear moderated (at least, as measured by a retreat in the 'Fear Gauge') and the market began its recovery. However, the experience of 2Q 2020 in Hong Kong is instructive for better understanding the reactions and investment appetite of investors amid heightened market risk.

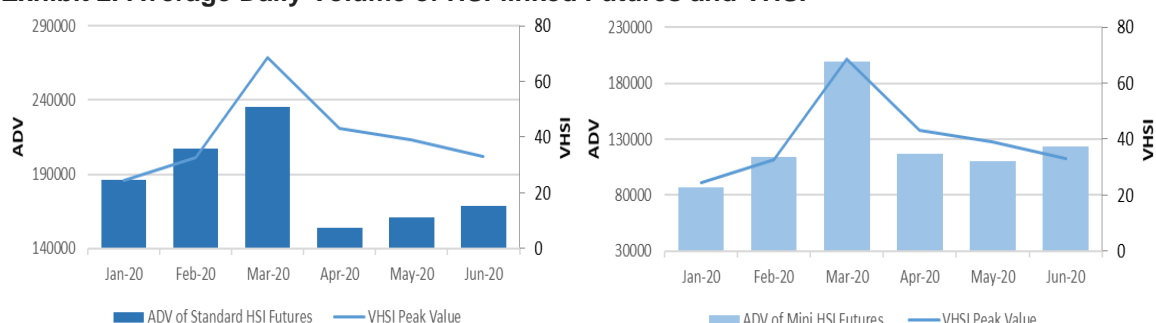


### Market risk and the changing appetites of retail investors

In our blog post in June about local Leveraged and Inverse Products ('L&I Products') we noted that, based on observable flows of funds into and out of various exchange-traded products, certain local investors appear to have considerable appetite for risk. This activity by investors suggests a preference for shifting away from instruments with a lower multiplying ratio towards those with a higher multiplying ratio.

L&I Products allow investors to place directional bets in accordance with their investment needs and market expectations. Index-linked futures provide similar investment opportunities, with the main distinction being that L&I Products may offer a 'built-in' exposure multiplying mechanism.

**Exhibit 2. Average Daily Volume of HSI-linked Futures and VHSI**



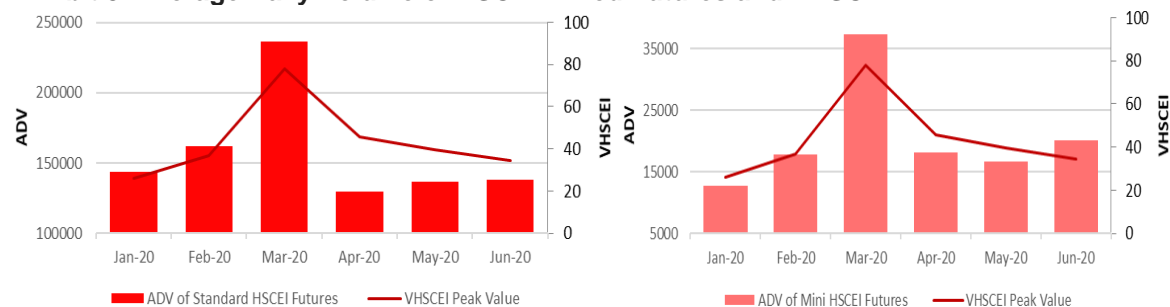
Sources: Hang Seng Indexes Company & HKEX Date: As of end of June 2020

Exhibit 2 above shows the Average Daily Volume ('ADV') of HSI-linked futures traded in the local market, as well as the monthly peak value of the VHSI. During the first half of 2020, there was a mild increase (14%) in the ADV for standard HSI futures. In contrast, the VHSI shot to a multi-year peak as the market experienced significant swings, followed by a significant drop-off in turnover in 2Q 2020.

Turning to look at mini HSI-linked futures, which differ from 'standard' HSI futures in the nominal size of each unit (contract multiplier of HKD 10 versus HKD 50 per index point), these experienced a stronger hike of 75% in the ADV, and also stayed buoyant when the implied market volatility eased from its peak.

Exhibit 3 below shows the trading activity for futures linked to the Hang Seng China Enterprises Index ('HSCEI'), which tracks the 50 largest Chinese enterprises listed in the Hong Kong market, and the HSCEI Volatility Index ('VHSCEI'), the fear gauge for the HSCEI's portfolio. Compared to HSI-linked futures, the pick-up in ADV for both standard and mini HSCEI-linked futures in response to the volatility spike were more dramatic, at 46% and 110% respectively.

**Exhibit 3. Average Daily Volume of HSCEI-linked Futures and VHSCEI**



Sources: Hang Seng Indexes Company & HKEX Date: As of end of June 2020



Although we cannot draw any definitive conclusions about investor behaviour from these findings, it seems reasonable to consider whether the lower barrier to entry offered by mini-futures has enabled more individual retail investors to use such instruments as a hedge or to speculate amid heightened market risk conditions.

Mini-futures products were launched “to meet the needs of retail investors with an interest in the Hong Kong stock market”. The fact that such instruments are beginning to penetrate the retail end of the market more deeply lends weight to the theory that a growing proportion of retail investors are interested in a broader range of investment products and strategies. Any sustained increase in market demand for derivatives will boost the liquidity of such products, which, in turn, should enhance price-discovery and promote the efficiency of the market – an essential element in keeping Hong Kong competitive as an international financial centre.

As the leading index compiler in Hong Kong, Hang Seng Indexes Company is playing a central role by licensing its diverse range of indexes (Exhibit 4) to issuers for derivative products, which provides investors more choice in designing their exposure strategy to reflect their distinct market views, investment needs and outlook.

#### Exhibit 4. Indexes with Linked Futures Issuance in Hong Kong

Type of Indexes	Name
Market Indexes	Hang Seng Index Hang Seng China Enterprises Index (Price Return, Gross Total Return & Net Total Return)
Industry Indexes	Hang Seng Mainland Oil & Gas Index Hang Seng Mainland Banks Index Hang Seng Mainland Properties Index
Strategy Indexes	HSI Volatility Index HSI Dividend Point Index HSCEI Dividend Point Index

Source: Hang Seng Indexes Company



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