



BLOG

August 2020

The New Chapter of Hang Seng Index

Hang Seng Index August 2020 Review Result

Following our announcement in May that weighted voting right companies ('WVRs') and secondary-listed companies would now be eligible for inclusion in the Hang Seng Index ('HSI'), the market has been abuzz with discussions of how the constituents of the HSI might change following the August Index Review, given the large size and active trading of a number of WVRs in Hong Kong.

On 14 August, the hotly anticipated constituent changes were announced: Alibaba, Xiaomi and WuXi Bio would join the HSI, while Sino Land, Want Want China and China Shenhua would be leaving. All changes will take effect on 7 September.

To provide some context as to the significance of this development, the swapping out of three existing HSI constituents with three new ones represents the largest number of constituent changes since 2007 when the HSI was still in the process of expanding its total number of constituents to 50.

The Impact of the Upcoming Constituent Changes

As Alibaba is a secondary-listed WVR, only the portion of shares registered in Hong Kong will be considered for both constituent selection and index calculation. After applying a 45% freefloat-adjusted factor to Alibaba, its weighting could still hit the 5% cap that applies to secondary-listed WVR companies in the HSI. Based on 14 August 2020 data, the three incoming constituents would have an aggregate weighting of 9.4% (Exhibit 1).

Exhibit 1: Indicative Index Weightings of HSI New Joiners

Company ¹	Sector	Share Class	Market Cap (HK\$bn)	Freefloat-adjusted factor	Indicative Weighting
Alibaba	E-Commerce & Internet Services	P-chip	1,187.1 ²	45%	5.0%
Xiaomi	Telecommunication Equipment	P-chip	369.3	65%	2.7%
WuXi Bio	Biotechnology	P-chip	210.2	75%	1.7%
Total					9.4%

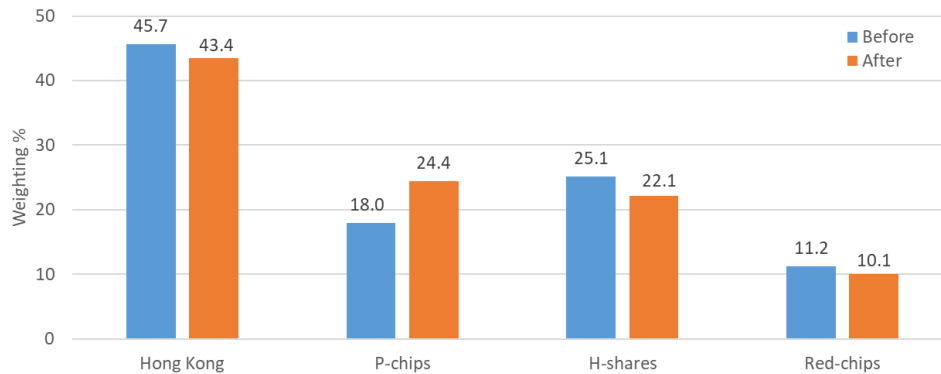
Source: Hang Seng Indexes Company; Data as of 14 August 2020

¹ Sorted in order of market cap; ² Calculated by only counting shares registered in Hong Kong



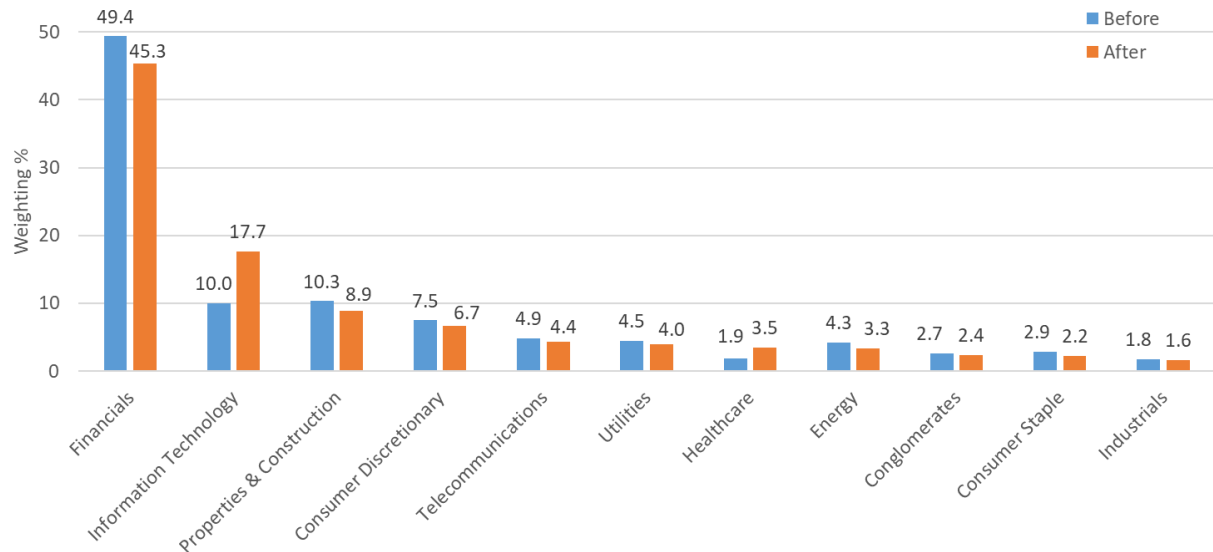
The upcoming constituent changes will help diversify the HSI by diluting the weighting of the Financials sector and putting more weight on the Information Technology segment. The new HSI members all come from emerging 'new economy' sectors. Companies in these sectors commonly have relatively higher valuations and often have not yet started paying dividends, and this will be reflected in the index price-earnings ratio and dividend yield. In terms of constituent type, P-chips will be the largest gainer (Exhibits 2 – 4).

Exhibit 2: HSI Constituent Type Distribution Before and After the Constituent Changes



Source: Hang Seng Indexes Company; Data as of 14 August 2020

Exhibit 3: HSI Sectoral Distribution Before and After the Constituent Changes



Source: Hang Seng Indexes; Data as of 14 August 2020

Exhibit 4: HSI Dividend Yield and Price-Earnings Ratio

	Before	After
Dividend Yield	3.97%	3.49%
Price-Earnings Ratio	10.43x	11.38x

Source: Hang Seng Indexes Company; Data as of 14 August 2020



A New Chapter for the HSI

The addition of Alibaba, Xiaomi and WuXi Bio to the HSI in September will be the first constituent change in the HSI since March 2019. In the time since this last change, the Hong Kong stock market has changed a lot. Sizable newcomers, e.g. unicorns and overseas-listed Chinese companies have, or are planning to, list in Hong Kong. The overall market structure is starting to change and this is creating more room for the new economy segment to rise to greater prominence.

To ensure that the HSI continues to serve as the most representative benchmark of the Hong Kong stock market, we are undertaking a holistic review of the composition of the HSI, which, among other things, will include a review of the index's composition and selection of constituents, the number of constituents, constituent and sector weightings, and industry and geographical representation. We will report our findings and propose recommendations to the Advisory Committee within the next six months. The number of constituents of the Hang Seng Index may increase during this period.

The HSI increased its number of constituents from 33 to 50 back in 2007 when H-shares were first added to the index. During that time, the HSI calculation methodology was also changed to freefloat-adjusted market-capitalisation weighted with a 15% cap on individual constituent weightings (the index had previously been full market-capitalisation weighted). While no significant changes have been made to the HSI methodology over the past 13 years, developments in the composition of the economy and financial markets, particularly in more recent times, mean that all possibilities are on the table. What matters is ensuring that the HSI remains the most representative and reliable barometer of the Hong Kong market.

Exhibit 5: Major HSI Milestones

Year	Event
1969	<ul style="list-style-type: none">• HSI officially launched to the public (with 33 constituents)
1994	<ul style="list-style-type: none">• First Red-chip company (Guangzhou Investment) was included in HSI
2006	<ul style="list-style-type: none">• HSI calculation methodology changed to freefloat-adjusted market-capitalisation weighted with 15% cap on individual constituent weighting• Maximum number of HSI constituents increased to 38• First H-share company (China Construction Bank) to be included in HSI
2007	<ul style="list-style-type: none">• Announced to further increase the maximum number of HSI constituents to be 50
2012	<ul style="list-style-type: none">• Number of HSI constituents reaches 50
2014	<ul style="list-style-type: none">• First real estate investment trust (Link REIT) was included in HSI• Lowering of weight cap from 15% to 10%
2020	<ul style="list-style-type: none">• First batch of WVRs (Xiaomi and Alibaba) and secondary-listed company (Alibaba) to be included in HSI

Source: Hang Seng Indexes Company



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