



BLOG

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Hang Seng Composite Index – another Benchmark that deserves more recognition

Even a quick glance at the list of our many indexes is enough to highlight the wide diversity they provide. From the plain vanilla Hang Seng REIT Index, which simply tracks all the REITs listed in Hong Kong, to offerings such as the HSI Covered Call Index, which replicates a downside cushioning investment strategy that alters payoff with derivatives, the Hang Seng family of indexes offers a broad range of choice in terms of design, theme and coverage.

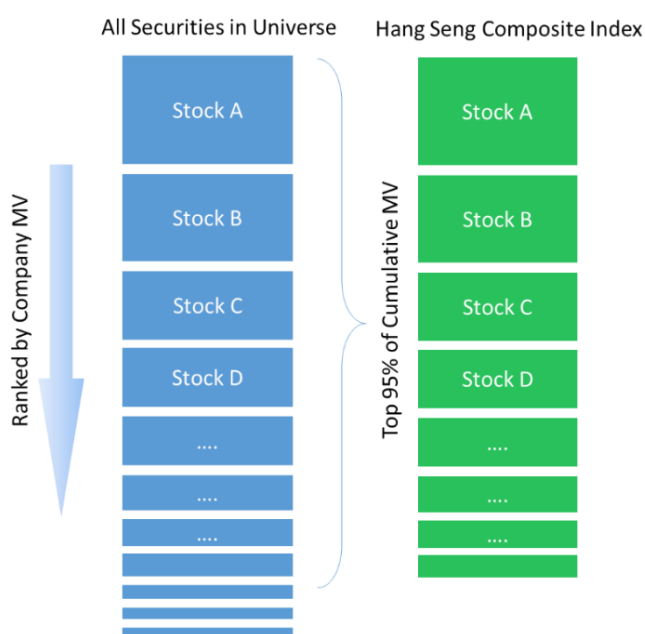
While several of our recent posts have focused on some of our more specialised or newer indexes, this time we are turning the spotlight to one of our broader market indexes, the Hang Seng Composite Index ('HSCI').

Two Benchmarks with Different Approaches

Despite being well established, HSCI is still often confused with the Hang Seng Index ('HSI'), our flagship index that tracks the Hong Kong stock market. This confusion is most easily witnessed in the 'reflexive rallies' when some newly listed stocks are added to HSCI.

HSI is internationally recognised and indisputably the most widely quoted performance indicator of the Hong Kong market. Its 50 constituents are selected using a robust reviewing process to ensure the index remains the most representative benchmark for the Hong Kong stock market.

Exhibit 1. Illustration of the Targeted MV Coverage of HSCI



Launched in 2001, HSCI also serves as a benchmark for the general performance of the local stock market. However, the approach used by HSCI to achieve this objective differs markedly from that used by HSI.

While HSI selects key stocks to create a "sampling portfolio" to represent the overall market performance, HSCI aims to reflect market performance by having a high coverage of the broader market.

As illustrated in Exhibit 1, HSCI aims to cover 95% of the Hong Kong stock market. To achieve this, securities in the universe (which is stocks listed on the main board of the Stock Exchange of Hong Kong ('SEHK')) are ranked in descending order in terms of their market value ('MV'). Those stocks that are in the top 95th percentile of the total market capitalisation will be included in the index provided they meet the turnover requirement.



So while HSCI does not cover the entire stock universe in Hong Kong, given the high MV coverage ratio its portfolio should theoretically sufficiently resemble the composition of the universe and be seen as the market portfolio for benchmarking purposes.

Key Differences between HSI & HSCI

There is no 'one-size-fits-all' standardised methodology for creating an ideal market benchmark index. Whatever criteria are used, the key element for success is that the majority of market observers and participants perceive the index as the benchmark for the particular market covers. Price-weighted or MV-weighted indexes, from 30 constituents to 225, covering 100 largest stocks or 500, all of them might not necessarily be the most optimally formulated indexes, they however are effective as long as market players perceive them to be THE benchmark.

It thereby is not surprising that HSI is generally regarded as the leading benchmark for the Hong Kong market. The index was launched in 1969 and has literally grown with Hong Kong. And HSI's status is further supported by the huge collective size of the Mandatory Provident Funds, exchanged-traded funds and mutual funds that now track the index.

However, there are a significant number of more sophisticated investors who look to use the most representative indicator of the market when analysing stocks and performance attributes. For such investors, HSCI's higher MV coverage ratio (MV coverage ratio of HSI: 40.25%) might make it a better choice of benchmark compared with HSI.

HSCI is also important as regards regional market integration and development, as both Shanghai Stock Exchange and Shenzhen Stock Exchange use it as a reference when they determine their lists of stocks that are eligible for trading via the southbound link of the Stock Connect Scheme. Eligible Hong Kong-listed securities can be traded by investors in mainland China, which will boost their trading liquidity and lead to more stable stock prices.

Exhibit 2. Key Information for HSI & HSCI

	Hang Seng Index (HSI)	Hang Seng Composite Index (HSCI)
Launch Date	24 Nov 1969	3 Oct 2001
No. of Constituents	50 (fixed)	476 (variable)
MV Coverage	≈ 40%	≈ 95%
Review Frequency	Quarterly	Half-yearly
Universe*	Greater China Companies listed on main board of HKEX	All securities listed on main board of HKEX
Constituent Selection by Advisory Committee	Yes	No
Ad-hoc Fast Entry	No	Yes - if MV of the stock ranks in top 10 of existing HSCI constituents at market close of its first trade day.

Source: Hang Seng Indexes Company

*Please refer to our website for complete methodology



Choosing the Right Benchmark

Although the ‘ideal’ benchmark design might not always exist, there are several ways to select the most appropriate benchmark for one’s needs. We have identified the key characteristics of HSI and HSCI in Exhibit 3.

Exhibit 3. Key Characteristics of HSI & HSCI

Aspects	Hang Seng Index	Hang Seng Composite Index
Market Coverage	<ul style="list-style-type: none"> Apart from being the most widely quoted index for Hong Kong, HSI is also the most tracked, with total AUM of listed products currently valued at USD 19.8 billion. HSI is a logical candidate for return benchmarking. 	<ul style="list-style-type: none"> HSCI represents the market portfolio by having broad market coverage. The index is referenced by Mainland exchanges for stocks eligible for trading via the southbound link of the Stock Connect Scheme.
Measurable	<ul style="list-style-type: none"> Both offer different return classes for quantifiable returns on a regular basis. 	
Investable	<ul style="list-style-type: none"> HSI-tracking products are available. Constituents are among the most liquid stocks in the market, investors are able to replicate the portfolio easily. 	<ul style="list-style-type: none"> Currently there is no passive product replicating the index. Some small-cap stocks might not have very liquid trading.
MV Coverage Ratio	<ul style="list-style-type: none"> Despite the lower MV coverage ratio, constituents are carefully selected by an advisory committee to ensure the portfolio represents the market. 	<ul style="list-style-type: none"> Higher It provides a broad representation of the entire market.

Sources: Hang Seng Indexes Company & Bloomberg
Date: As of end of August 2020

Based on the above table, each index has its own merits. In view of the enormous amount of AUM that track HSI, it is arguably fair to say that essentially all local investors- and perhaps even all citizens – have a stake in the performance of this index and thus see it as THE Hong Kong benchmark. However, as a larger number of investors become more educated and sophisticated, we will likely see the spread of deeper performance analysis in formulating investment strategies. And selecting the most appropriate benchmark is always the first step of a successful investment strategy.

We offer a suite of data products that cover the key attributes of the constituent stocks of HSCI, such as details about their corporate actions and dividend payment trends, as well as free-float adjusted factors and weightings, that will help facilitate investors with portfolio allocation and performance attribution.



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