



BLOG

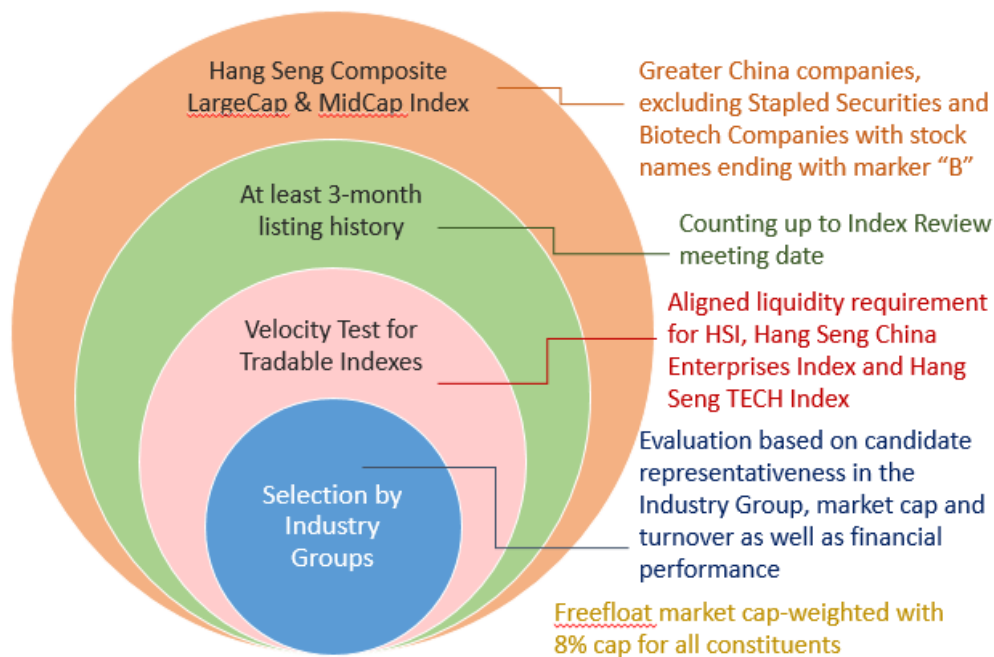
March 2021

The Enhanced Hang Seng Index

New Rules for the Game

On 1 March 2021, Hang Seng Indexes Company announced the consultation conclusions regarding the proposals to enhance its flagship Hang Seng Index ('HSI') to ensure that it remains as the most representative and important benchmark of the Hong Kong stock market. A total of 60 valid responses were received from 55 organisations during the month-long consultation. The proposals were well supported by the market and Hang Seng Indexes Company fine-tuned some details to reflect comments provided by the stakeholders.

Exhibit 1: Overview of the Enhanced HSI Methodology



Source: Hang Seng Indexes Company

The most highlighted change is the expansion in the number of constituents – which will be increased gradually from the current 52 to 100, with the target to reach 80 constituents by mid-2022 as en route stop.

Starting from the May 2021 Index Review, the universe, eligibility criteria, constituent selection and weighting scheme of the HSI will all be re-defined. Greater China constituents in the Hang Seng Composite LargeCap & MidCap Index, excluding the Stapled Securities and those Biotech Companies with stock names ending with the marker “B”, with more than a 3-month listing history and passing the 0.1% velocity test will then be considered eligible and classified into seven Industry Groups. The HSI Advisory Committee will evaluate eligible candidates in each Industry Group based on their representativeness in the Industry Group, market capitalisation and turnover as well as financial performance. To preserve the representation of Hong Kong companies in the index, 20 to 25 constituents will be reserved for companies classified as Hong Kong Companies. An aligned weighting cap of 8% will be applied to all HSI constituents including those with weighted voting rights and/or secondary listed.



Frequently Asked Questions

Why 100?

Starting with only 33 constituents when the HSI was launched in 1969, the number of its constituents increased to 38 in 2007 when it began to include H-shares companies. The HSI then gradually expanded and reached 50 constituents in 2012 when there were around 1,380 listed companies in Hong Kong and the HSI covered roughly 60% of the aggregate market capitalisation at that time. The number of constituents remained unchanged at 50 for more than 8 years and expanded to 52 in December 2020.

The market capitalisation coverage of the HSI gradually decreased from 65.0% as at the end of 2016 to 59.7% in December 2020. After adopting the new constituent selection mechanism, the HSI is likely to include less sizable companies. 50 HSI constituents will not be sufficient to achieve an appropriate level of representation. Our simulation suggested that increasing the number of constituents to between 65 and 80 can improve the overall coverage of the index and achieve a reasonable representation for each Industry Group. Considering the feedback from the consultation and comparing the HSI with other international market benchmarks (see Exhibit 2), the HSI constituent number was finally determined at 100, given the size and number of companies listed in Hong Kong.

Exhibit 2: Comparison of International Stock Markets

Stock Exchange	Market Cap (US\$bn)	No. of Listings	Flagship Index*
New York Stock Exchange	24,493	2,873	S&P (500)
NASDAQ	19,335	2,987	NASDAQ (100)
Shanghai Stock Exchange	6,499	1,813	SSE (180)
Japan Exchange Group	6,347	3,754	NIKKEI (225)
Hong Kong Stock Exchange	6,475	2,545	HSI (52)
Shenzhen Stock Exchange	4,901	2,373	SZSE Component (500)
London Stock Exchange Group	3,670	2,340	FTSE (100)

* () indicates the existing number of constituents

Source: The World Federation of Exchanges

Data as of 31 January 2021

Why Seven Industry Groups?

Some industries (i.e. Consumer Staples, Utilities, Telecommunications, Industrials, Conglomerates, Energy and Materials) are relatively small and individually account for less than 5%, in terms of market capitalisation, of the overall market. As the HSI constituent number is limited, it will be more practical and meaningful to group less sizable industries together for the constituent selection process. (1) Financials, (2) Properties & Construction, and (3) Consumer Discretionary and Consumer Staples are traditional core industries in Hong Kong. (4) Utilities and Telecommunications are critical infrastructure for the society. (5) Information Technology and (6) Healthcare are emerging and growing new economic sectors. The above six major Industry Groups, together with the seventh Industry Group which includes Energy, Materials, Industrials and Conglomerates, were identified as the final Seven Industry Groups for selecting the HSI constituents. The combination of the Industry Groups will be reviewed at least every two years to ensure it can reflect changes in the Hong Kong market structure in a timely manner.

What Are the Considerations for Future Constituent Changes?

After 15 March 2021, the HSI will be composed of 55 constituents and is aiming to reach 80 constituents by mid-2022. Some guiding principles will be applied to manage the transition. As one key objective of the methodology enhancement is to make the HSI a more diversified and balanced portfolio, the index will target to cover at least 50%, in terms of market capitalisation, of each Industry Group. When deciding the possible number of constituents for each Industry Group, size distribution and number of the listed companies, as well as the overall weighting distribution by Industry Group compared with the market, will be the key considerations.



The Potential Improvement

Not only will the HSI constituent number be nearly doubled after the changes, but also its characteristics will also be enhanced. From the simulated portfolio of 80 constituents, the HSI would be more diversified and its sectoral distribution would be more aligned with the market. Financials and Information Technology would remain be the two largest industries in the index. Besides, constituents from the Consumer Discretionary and Consumer Staples, and Healthcare industries would account for more weighting. Representation of Hong Kong Companies in the index would also be sustained.

With the expanded constituent number, it is estimated that the overall market coverage of the enhanced HSI for both market capitalisation and turnover would probably be improved by around 15 p.p. – ensuring that the HSI would remain as the most representative benchmark of the Hong Kong stock market. The index would be less concentrated as a result of lowering the constituent weight cap from 10% to 8%. With a larger constituent number, more diversified portfolio and smoother constituent weighting distribution, we can expect that the volatility of the enhanced HSI would be similar to the current level, although the index would probably include constituents from the emerging sectors with a shorter listing track record.

With a history of more than 50 years, the HSI will kick-off its new journey beginning from the May 2021 Index Review. We hope that the HSI, together with the Hang Seng China Enterprises Index and the Hang Seng TECH Index, will continue to be widely recognised as our flagship indexes of the Hong Kong stock market.



Disclaimer

The information contained herein is for reference only. Hang Seng Indexes Company Limited (“Hang Seng Indexes”) ensures the accuracy and reliability of the information contained herein to the best of its endeavours. However, Hang Seng Indexes makes no warranty or representation as to the accuracy, completeness or reliability of any of the information contained herein and accepts no liability (whether in tort or contract or otherwise) whatsoever to any person for any damage or loss of any nature arising from or as a result of reliance on any of the contents of this document, or any errors or omissions in its contents and such contents may change from time to time without notice.

The information contained herein does not constitute any express or implied advice or recommendation by Hang Seng Indexes for any investments. Investment involves risks. Prospective investors should seek independent investment advice to ensure that any of their decisions is made with regard to their own investment objectives, financial circumstances and other particular needs. Prospective investors should also note that value of securities and investments can go down as well as up and past performance is not necessarily indicative of future performance.

© Hang Seng Indexes Company Limited 2021. All rights reserved.