

Introducing the Hang Seng Index

When the world believes in China again, the first place it will buy is Hong Kong

TO SINGAPOREANS, Hong Kong is a shopping destination, a weekend getaway, and a place to eat some dim sum.

To the business world, Hong Kong's low taxes, system of law and free trade policies have contributed to the former British colony's status as an international financial centre in Asia rivalling Singapore.

Even as China liberalises its financial markets, Hong Kong remains a destination for global investors to shop for Asian stocks.

Stocks in the city were generally not caught up in the dizzying valuations seen in the China A-share market. Nor did its regulators interfere in market mechanics after stocks tanked by ordering funds to buy stocks, or substantial shareholders not to sell their stakes.

In short, Hong Kong is seen as a market which follows Western free-market principles.

This makes institutions more likely to trade there - for now.

Hanging over the city, however, are worries about its political future within China. Widespread protests erupted during the last quarter of 2014 over the right of citizens there to choose a non-Beijing-appointed chief executive.

With the rise of China and the opening up of its economy, Hong Kong's relevance as an economic and financial gateway to China is seen to be at stake.

There are also fears of a property market crash after prices spiralled beyond the reach of most ordinary people in the years since the global financial crisis.

Some have even speculated that the Hong Kong dollar's longstanding peg to the US dollar will be at risk as China allows its currency to be more market-determined.

Most importantly, the China slowdown has also affected perceptions of Hong Kong, with many institutional investors shying away from big positions.

Opportunity

Yet if one wants to look for Asian businesses of scale that will endure over the next few decades, one cannot overlook the territory.

In Hong Kong, the Hang Seng Index (HSI), which has been around since 1969, is the most widely followed index tracking the performance of companies there.

It currently contains 50 of Hong Kong's largest and most liquid companies.

About half the value of the index is made up by financials, which are banks, insurance companies, and the Hong Kong stock exchange.

The rest of the index is split between a number of well-known technology, property, telco, energy, utilities and consumer stocks.

Some names might be familiar to Singaporeans, like HSBC, AIA Group, and Bank of China.

Then there is computer and smartphone maker Lenovo, Macau casino stocks Galaxy Entertainment and Sands China, and Internet giant Tencent, which owns search engine QQ and messaging service WeChat.

Meanwhile, MTR Corp runs the city's subway network and also earns substantial profits from property development and renting out shops in the subway network.

There's also the China subsidiary of Taiwan's Want Want.

Want Want, famous for its rice cake snacks, was actually listed on the Singapore Exchange before it delisted in 2007. It relisted its subsidiary, Want Want China Holdings, in Hong Kong the following year.

Other names might not be as familiar to Singaporeans.

Hengan, for example, is the top sanitary napkin manufacturer in China.

CLP Holdings supplies electricity to most of Hong Kong, and has been a low-volatility stock offering a decent dividend.

And there's China Resources Enterprise, which rallied magnificently earlier this year after announcing that it will sell all its non-beer businesses like supermarket chains back to parent China Resources Holdings.

It will focus on its profitable beer business. The company makes Snow Beer, one of the top beer brands in China.

Currency risk

It is not difficult to buy Hong Kong stocks on the HSI through a broker in Singapore, but there are a few things to note.

First, you are taking on foreign exchange risk, in addition to the usual risks that come with buying stocks.

Shares are typically denominated in Hong Kong dollars, which is in return pegged to the US dollar.

The US dollar might rise as the US Federal Reserve gradually raises rates.

Singaporeans holding Hong Kong dollars have generally benefited in the past year from its appreciation against the Singapore dollar.

However, the effect of a rising dollar is mixed. Any company exposed to Asian currencies which depreciated against the US dollar will report falling profits, especially if much of its earnings come from other parts of Asia.

The Chinese yuan has been appreciating against the Hong Kong dollar through the last few years, making Hong Kong goods competitively priced to Chinese tourists.

But the recent yuan devaluation has made Hong Kong retailers less competitive, because its currency is now more expensive even as downtown rents remain high.

At the same time, if interest rates rise from historically low levels, capital will flow back to the US, causing the US dollar to appreciate more and exacerbating the woes of Hong Kong exporters.

When China eventually liberalises its financial markets and allows for the free flow of the yuan around the world, it is possible that the Hong Kong dollar might be pegged to the yuan.

Any whispers of the US dollar peg being reviewed will throw Hong Kong stocks into much uncertainty.

Currency issues aside, a second risk of investing in Hong Kong is the exposure to a foreign legal, regulatory and tax environment.

H-shares, which are China companies listed in Hong Kong, currently attract a 10 per cent dividend withholding tax.

The third issue you have to note is how your broker charges a different assortment of fees as it is providing nominee services to hold your foreign shares.

This can be a S\$2 monthly fee per counter you are holding on to, or a dividend collection fee.

Keep in mind that you also have to convert Singapore dollars to Hong Kong dollars to buy Hong Kong stocks. You can select to pay in Singapore dollars the day you buy to avoid having to call your broker to fix an exchange rate. Either way, you are unlikely to get a favourable rate.

Trading hours on the Hong Kong Stock Exchange are shorter compared to Singapore: 9.30am to 12pm and 1.30pm to 4pm.

Yes, there is a lunch break.

Getting a tracker

To get exposed to the entire Hong Kong market, you can buy a number of exchange-traded funds (ETFs). Many of these have stock codes starting with "28" or "30". Some track shares listed in mainland China as well.

To get a diversified Hong Kong exposure, I use the Tracker Fund of Hong Kong, or 2800 HK. The Tracker Fund tracks the HSI benchmark, meaning it invests its assets in HSI companies in the same weightings which they have in the index.

The fund has a dividend yield of almost 4 per cent, and an annual fee of 0.1 per cent. It has been around since 1999.

However, foreign ETFs can be considered specified investment products (SIPs), meaning you have to convince your broker you are qualified enough to understand them.

This is because ETFs may use derivative products to help them replicate the index they are tracking. For example, the prospectus to the Tracker Fund notes it might use some futures and options not exceeding 10 per cent of the fund's net asset value.

If you are not extremely wealthy or financially qualified, you have to pass a 20-question online quiz administered by Singapore Exchange (SGX) to convince your broker to let you trade SIPs.

SGX provides you materials to help you pass the test. Upon passing, you can inform your broker of the quiz results.

To sum up, Hong Kong offers an intriguing opportunity to get exposed to China's rise.

Shares there in general have stagnated in the years after the global financial crisis. Mainland investors prefer trading in A-shares, and international investors have shunned emerging market stocks.

There are nevertheless a number of large and profitable companies listed there.

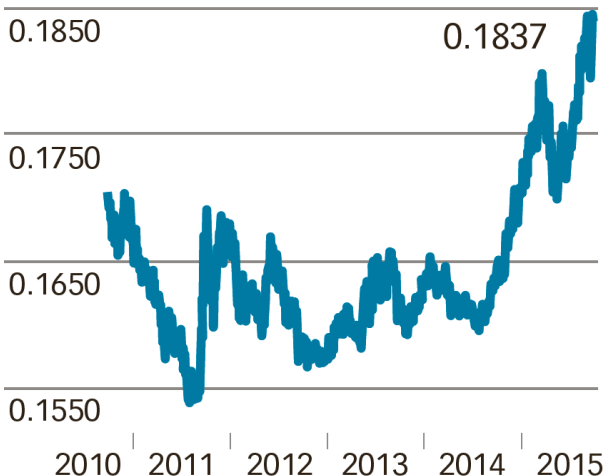
If you are going the stock-picking route and investing in foreign companies for the first time, one place to look would be blue-chip companies on the HSI.

So the next time you go to Hong Kong, go beyond the shopping and eating. You might spot some superior, profitable businesses.

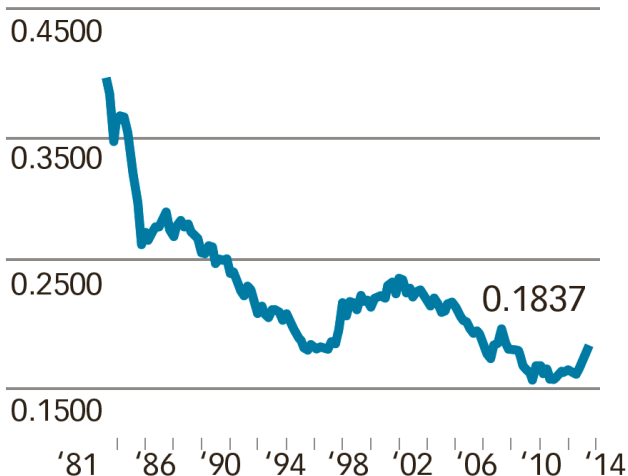
Appreciating in the short run

Hong Kong dollar versus Singapore dollar

5 YEARS



HISTORICAL

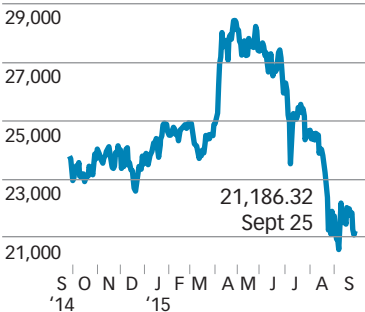


Source: Bloomberg

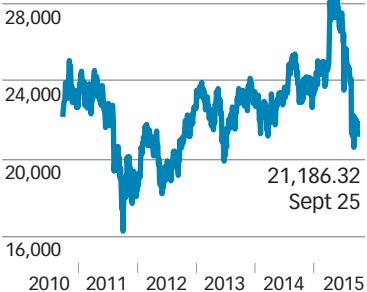
Up long term but going nowhere since the financial crisis

Historical performance of Hang Seng Index

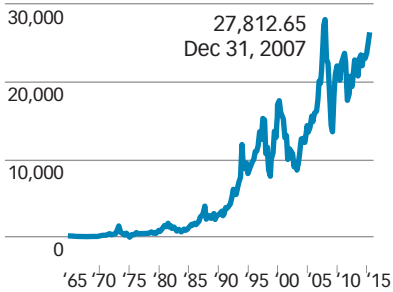
1 YEAR



5 YEARS



HISTORICAL



Gateway to China

The 50 components of Hang Seng Index

BLOOMBERG TICKER	NAME	INDEX WEIGHT	PRICE (HK\$)	P/E	P/B
700 HK Equity	Tencent Holdings Ltd	10.48	131	38.7	10.33
5 HK Equity	HSBC Holdings PLC	9.77	58.75	11.1	0.75
941 HK Equity	China Mobile Ltd	8.24	94.4	14.7	1.79
1299 HK Equity	AIA Group Ltd	6.95	40.6	15.4	1.99
939 HK Equity	China Construction Bank Corp	6.27	5.24	4.7	0.83
1398 HK Equity	ICBC	4.75	4.53	5.6	0.97
1 HK Equity	CK Hutchison Holdings Ltd	3.87	100.8	4.5	0.99
3988 HK Equity	Bank of China Ltd	3.82	3.38	4.6	0.67
388 HK Equity	Hong Kong Exchanges and Clearing Ltd	2.93	181.6	30.9	7.78
2318 HK Equity	Ping An Insurance Group Co of China Ltd	2.89	39	10.6	1.76
2628 HK Equity	China Life Insurance Co Ltd	2.87	27.1	13.7	1.99
16 HK Equity	Sun Hung Kai Properties Ltd	2.30	102.5	9.1	0.65
1113 HK Equity	Cheung Kong Property Holdings Ltd	2.18	56.7	NA	0.84
883 HK Equity	CNOOC Ltd	2.05	8.06	7.0	0.76
2 HK Equity	CLP Holdings Ltd	1.76	65.5	16.0	1.86
857 HK Equity	PetroChina Co Ltd	1.66	5.55	12.7	0.71
386 HK Equity	China Petroleum & Chemical Corp	1.66	4.83	12.2	0.71
11 HK Equity	Hang Seng Bank Ltd	1.54	141.9	10.1	2.04
267 HK Equity	CITIC Ltd	1.46	14.16	4.6	0.78
3 HK Equity	Hong Kong & China Gas Co Ltd	1.45	14.74	22.4	3.16
6 HK Equity	Power Assets Holdings Ltd	1.44	72.85	20.6	1.30
823 HK Equity	Link REIT	1.38	42.3	3.5	0.81
688 HK Equity	China Overseas Land & Investment Ltd	1.37	23.55	6.3	1.22
2388 HK Equity	BOC Hong Kong Holdings Ltd	1.21	22.95	9.4	1.31
1928 HK Equity	Sands China Ltd	0.92	26.75	14.1	5.28
12 HK Equity	Henderson Land Development Co Ltd	0.89	47.25	9.1	0.64
4 HK Equity	Wharf Holdings Ltd	0.85	43.9	4.2	0.43
1044 HK Equity	Hengan International Group Co Ltd	0.84	74.65	22.3	5.01
762 HK Equity	China Unicom Hong Kong Ltd	0.84	9.83	15.8	0.84
1109 HK Equity	China Resources Land Ltd	0.73	18.56	7.1	1.12
19 HK Equity	Swire Pacific Ltd	0.72	85.45	10.1	0.57
66 HK Equity	MTR Corp Ltd	0.71	34.3	12.5	1.19
27 HK Equity	Galaxy Entertainment Group Ltd	0.71	21.35	13.8	2.22
992 HK Equity	Lenovo Group Ltd	0.67	6.55	12.8	2.33
151 HK Equity	Want Want China Holdings Ltd	0.67	6.54	18.7	5.17
3328 HK Equity	Bank of Communications Co Ltd	0.67	5.39	4.9	0.66
1880 HK Equity	Belle International Holdings Ltd	0.67	6.94	9.4	1.83
17 HK Equity	New World Development Co Ltd	0.60	7.83	3.6	0.39
1088 HK Equity	China Shenhua Energy Co Ltd	0.59	12.12	7.1	0.66
101 HK Equity	Hang Lung Properties Ltd	0.56	17.56	6.9	0.59
2319 HK Equity	China Mengniu Dairy Co Ltd	0.53	27.3	16.3	2.03
23 HK Equity	Bank of East Asia Ltd	0.53	25.9	9.9	0.86
83 HK Equity	Sino Land Co Ltd	0.51	11.8	7.5	0.60
836 HK Equity	China Resources Power Holdings Co Ltd	0.49	17.9	8.5	1.15
494 HK Equity	Li & Fung Ltd	0.47	5.66	12.5	2.46
144 HK Equity	China Merchants Holdings International	0.42	23.15	14.0	0.84
322 HK Equity	Tingyi Cayman Islands Holding Corp	0.35	12.52	24.0	2.90
135 HK Equity	Kunlun Energy Co Ltd	0.25	5.55	10.3	0.85
291 HK Equity	China Resources Enterprise Ltd	0.25	14.32	1350.1	0.76
293 HK Equity	Cathay Pacific Airways Ltd	0.24	14.6	12.0	1.04