

Strategy Report

HSI Q3 review: may add IT & Consumer stocks

HSI Company will announce results of the 2021 Q3 review of the Hang Seng Family of Indexes after market close on 19 Nov 2021. We expect three to five stocks from Consumer and IT industries to be added to the HSI, bringing the number of constituents to 63-65.

- **Expect 3-5 new constituents.** In each of the previous five quarterly reviews, three stocks were added to the HSI. The number of HSI constituents is “targeted to reach 80 by mid-2022”. With only three more quarterly reviews by mid-2022, 6-7 stocks need to be added in each of the upcoming reviews in order to reach that target. Considering the pace of addition in the previous five reviews, however, we believe only 3-5 stocks will be added in this quarterly review.
- **Under-represented industries: Consumer, Healthcare & IT.** HSI Company aims to achieve a balanced industry representation. Consumer, Healthcare and Properties & Construction are under-represented in the HSI in terms of market cap coverage. The number of stocks in Consumer and Healthcare are also fewer than those in the simulated portfolio by HSI Company. IT follows next as a likely industry from which a new HSI constituent emerges, as several of the largest stocks yet to be included in the HSI are from the IT industry.
- **Potential inclusions: NetEase, CR Beer, Baidu, Smoore, SMIC.** In this quarterly review we expect the HSI to include 3-5 new constituents, in descending order of likelihood: NetEase (9999 HK), CR Beer (291 HK), Baidu (9888 HK), Smoore (6969 HK) and SMIC (981 HK). Dark horses include JD.com (9618 HK), Nongfu Spring (9633 HK), China Feihe (6186 HK) and ENN Energy (2688 HK). Although we did mention that Healthcare industry is under-represented, we do not expect any additions from this industry in this review, as those candidates have their “flaws” such as loss-making and low turnover.
- **How did new HSI constituents perform before & after reviews?** In the last five quarterly reviews, most of the new constituents gained in the first week after announcements. On the other hand, stocks that were tipped as favourites but ended up not included tended to underperform after announcements. Note that, however, some of these quarterly review dates coincided with market turning points which heavily influenced returns of those stocks.

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Market Data

Hang Seng Index	24,996
52-week High / Low	31,183/23,681
3-month avg. daily t/o	HK\$143.4bn

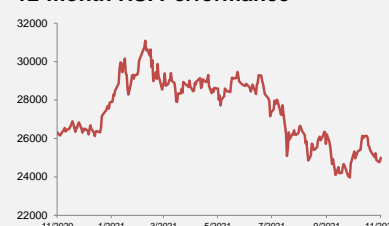
Source: Bloomberg

Indices Performance

	HSI	HSCEI	HSTECH
1-month	-0.1%	0.3%	0.2%
3-month	-6.7%	-7.3%	-8.9%
6-month	-13.2%	-17.3%	-21.1%

Source: Bloomberg

12-month HSI Performance



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New HSI constituents likely from Consumer & IT

Hang Seng Indexes Company Limited (HSI Company) will announce the results of the 2021 Q3 review of the Hang Seng Family of Indexes on 19 Nov 2021 (next Friday). The changes will be effective from 6 Dec 2021 (Monday). Since this is not a half-yearly review and thus **no review on Southbound eligible stocks**, all eyes will be on the changes in HSI constituents.

Expect 3-5 new constituents

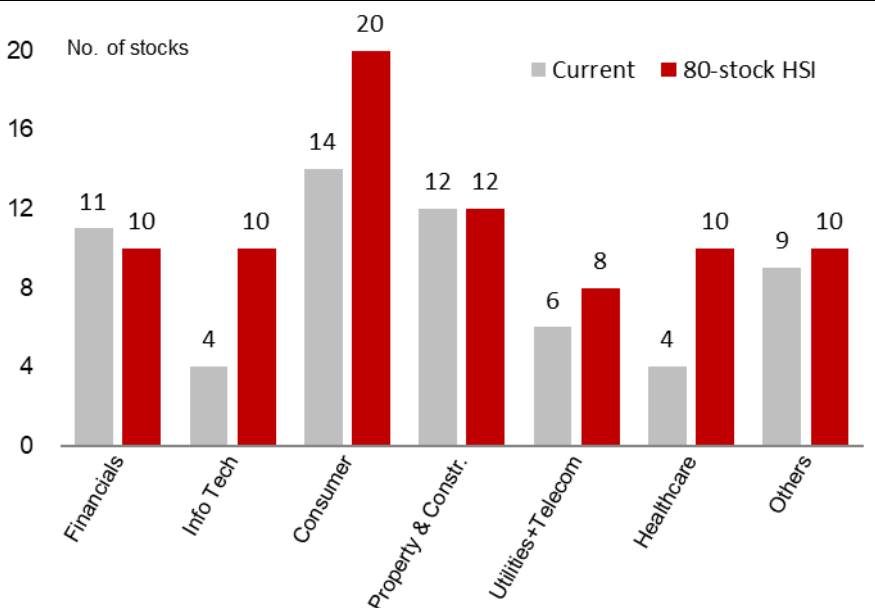
In each of the previous five quarterly reviews, three stocks were added to the Hang Seng Index (and five have been removed in total, bringing the number of HSI constituents from 50 to 60).

HSI Company stated in Mar 2021 that the number of HSI constituents is “targeted to reach 80 by mid-2022”. With only three more quarterly reviews by mid-2022, theoretically 6-7 stocks should be added in each of the upcoming reviews in order to reach that target. Taking reference from the pace of addition in the previous five reviews, however, **we believe only 3-5 stocks will be added in this quarterly review.**

Under-represented industries: Consumer, Healthcare & IT

In selecting HSI constituents, HSI Company evaluates each eligible stock's market cap, turnover, financial performance and representativeness within each industry group. It also aims to achieve a **balanced industry representation**, by targeting to achieve a market cap coverage of not less than 50% for each industry group (see the seven industry groups in Fig. 1). **Consumer, Healthcare and Properties & Construction were under-represented** according to data from HSI Company in Feb 2021. The number of stocks in Consumer and Healthcare are also fewer than those in the simulated portfolio by HSI Company (Fig. 1). Therefore, in terms of industry representation, we believe **Consumer and Healthcare stocks to be prime candidates for inclusion into the HSI.**

Figure 1: No. of HSI constituents by industry (current vs simulated)



Source: HSI Company on 11 Feb 2021, CMBIS
 "Others" refers to Energy, Materials, Industrials & Conglomerates

Info Tech follows next as a likely industry from which a new HSI constituent emerges, as despite having 50%+ market cap representation in the HSI, the number of IT stocks in the HSI is much fewer than that in the simulated portfolio (4 vs 10), and several of the largest stocks yet to be included in the HSI are from the IT industry.

Potential inclusions: NetEase, CR Beer, Baidu, Smoore, SMIC

We rank HSI candidates by their market value, and showing their average turnover as well in Fig. 2.

In this quarterly review we expect the HSI to include 3-5 new constituents, in descending order of likelihood: **NetEase (9999 HK)**, **CR Beer (291 HK)**, **Baidu (9888 HK)**, **Smoore (6969 HK)** and **SMIC (981 HK)**.

Dark horses include JD.com (9618 HK), Nongfu Spring (9633 HK), China Feihe (6186 HK) and ENN Energy (2688 HK).

Figure 2: Top 25 non-HSI stocks by market value

Company	Ticker	Industry	Market Value* (HK\$ bn)	6-m avg. daily Turnover (HK\$ mn)
Kuaishou	1024 HK	Info Tech	640	1,856
JD Health	6618 HK	Healthcare	357	690
Baidu	9888 HK	Info Tech	336	561
NetEase	9999 HK	Info Tech	319	822
Smoore	6969 HK	Consumer Discretionary	297	743
Beigene	6160 HK	Healthcare	230	177
Nongfu Spring	9633 HK	Consumer Staples	222	287
JD Logistics	2618 HK	Industrials	219	Listing history < 6 months
JD.com	9618 HK	Info Tech	209	1,424
CR Beer	291 HK	Consumer Staples	202	544
Hansoh Pharma	3692 HK	Healthcare	197	110
XPeng	9868 HK	Consumer Discretionary	192	Listing history < 6 months
Li Auto	2015 HK	Consumer Discretionary	184	Listing history < 6 months
China Feihe	6186 HK	Consumer Staples	166	505
Trip.com	9961 HK	Consumer Discretionary	154	67
ENN Energy	2688 HK	Utilities	145	341
China Gas	384 HK	Utilities	144	293
SMIC	981 HK	Info Tech	143	1,438
Zhongsheng	881 HK	Consumer Discretionary	136	272
Bilibili	9626 HK	Info Tech	135	528
Swire Properties	1972 HK	Properties & Construction	132	50
Chow Tai Fook	1929 HK	Consumer Discretionary	128	157
Innovent Bio	1801 HK	Healthcare	111	472
Postal Savings Bank	1658 HK	Financials	102	315
Agricultural Bank	1288 HK	Financials	87	350

Source: Bloomberg, CMBIS

*Month-end average from Oct 2020-Sep 2021; for secondary-listed stocks, only showing HK-registered shares

Although we did mention that Healthcare industry is under-represented, we do not expect any additions from this industry in this review, as those candidates have their “flaws”, e.g. JD Health (6618 HK), Beigene (6160 HK) and Innovent (1801 HK) are loss-making, while Hansoh Pharma (3692 HK) has a relatively low turnover.

We expect no removals of constituents from the HSI in this review.

How did new HSI constituents perform before & after review

We reviewed the returns of new HSI constituents (as well as some tipped to be included) before and after the announcement of the previous five quarterly reviews (Fig. 3).

Most of the new constituents gained (12 out of 15) and outperformed the HSI (10 out of 15) in the first week after announcements. On the other hand, stocks that were tipped as favourites but ended up not included tended to underperform after announcements (see the May 2021 review). Note that, however, some of these quarterly review dates coincided with market turning points which heavily influenced returns of those stocks.

Figure 3: Performance of new HSI constituents before/after quarterly review announcements

Date of announcement		Company	Ticker	Returns		Remarks
				1-week prior to announcement	1-week after announcement	
20/08/2021	Newly included	XinYi Glass	868	-7.82	15.88	In the week prior to the review result announcement, the HSI and especially growth stocks suffered heavy selling due to concerns on regulatory crackdown.
		Li Ning	2331	2.06	10.15	
		China Merchants Bank	3968	-1.07	2.16	
	Tipped to be included	JD Health	6618	-23.7	24.48	
		JD	9618	-11.9	26.26	
		NetEase	9999	-15.49	19.5	
		Smooore	6969	-12.96	4.45	
		Nongfu Spring	9633	-2.97	1.4	
		CR Beer	291	1.81	3.56	
		Kuaishou	1024	-14.99	5	
		Baidu	9888	-13.37	12.73	
		China Feihe	6186	1.99	-1.96	
		SMIC	981	-5.7	4.75	
		Innovent Bio	1801	-14.32	-3.11	
		HSI		-5.75	2.4	
21/05/2021	Newly included	Xinyi Solar	968	18.74	4.55	In the week prior to the review result announcement, the HSI bottomed out after a month-long correction, with growth stocks outperforming.
		BYD Company	1211	13.98	8.42	
		Country Garden Services	6098	3.59	1.16	
	Tipped to be included	JD Health	6618	10.97	-10.14	
		JD	9618	7.68	-2.22	
		NetEase	9999	16.56	-3.69	
		Smooore	6969	17.32	-14.36	
		Nongfu Spring	9633	8.8	7.97	
HSI		1.7	2.67			
26/02/2021	Newly included	Alibaba Health	241	-11.56	-6.35	In the week prior to the review result announcement, the HSI peaked and growth stocks pulled back markedly.
		Longfor	960	10.05	5.87	
		Haidilao	6862	-17.92	-6.05	
	HSI		-5.43	0.43		
13/11/2020	Newly included	Budweiser	1876	9.53	11.34	
		ANTA Sports	2020	0.4	8.37	
		Meituan - W	3690	-6.43	-0.52	
		HSI		1.77	1.16	
14/08/2020	Newly included	Xiaomi - W	1810	-0.65	18.38	
		WuXi Biologics	2269	-5.06	10.47	
		Alibaba - SW	9988	-0.96	2.43	
		HSI		2.66	-0.24	

Source: HSI Company, Bloomberg, CMBIS

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