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SZHK Stock Connect: A step significant in meaning

- Northbound Shenzhen-Hong Kong (SZHK) Stock Connect will cover ~880 stocks, including constituents of SZSE Component Index and SZSE Small/Mid Cap Innovation Index (mkt cap no less than RMB 6bn) and SZSE-SEHK A+H shares; Southbound SZHK Stock connect would cover ~417 stocks that include the constituents of Hang Seng Small Cap Index (mkt cap no less than HK\$ 5bn) and SZSE-SEHK A+H shares
- Initially, institutional professional investors will have access to ChiNext
- We believe CSRC and SFC will widen the investment pools for physical ETF, REIT, and Staple Securities in 2017; similar expansion will extend to derivatives, options, and futures in 2018
- Mainland investors will have limited small-cap stock choices in HK due to the low free float of these counters; for emerging industries, the list of eligible stocks is even shorter
- A-H share valuation gap is narrowing, although most H-share stocks are still trading at a discount over their A-share equivalent

Shenzhen-Hong Kong Stock Connect (SZHK Stock Connect) will open the Chinese stock market up further to international investors. To enhance the mutual access between Hong Kong and the mainland's stock markets, it has been announced that the Shenzhen-Hong Kong (SZHK) Stock Connect will be jointly established by the CSRC and SFC. The Southbound SZHK Stock Connect will cover ~417 stocks that include the constituents of Hang Seng Small Cap Index with a market capitalization no less than HK\$ 5bn as well as the SZSE-SEHK A+H shares; the Northbound SZHK Stock Connect would cover ~880 stocks, including the constituents of SZSE Component Index and SZSE Small/Mid Cap Innovation Index that have a market capitalization no less than RMB 6bn, in addition to the SZSE-SEHK A+H shares. Institutional professional investors will be able to access ChiNext initially. The daily quota for SZHK Stock Connect is the same as that of the SHHK scheme although according to the announcement, the aggregate quota will be abolished in the former.

The SZHK Connect: a prelude to greater schemes such as ETF, REIT, and SS Connects. After expanding the investment pool for the large-cap stocks and later on the small-cap ones, it is reasonable to believe that CSRC and SFC will widen the investment pools for physical ETF, REIT, and Staple Securities in 2017, and similar expansion will be extended to derivatives, options, and futures in 2018. To accommodate the larger fund pools in both markets, we believe daily trading quota of the stock connect would increase accordingly.

Mainland investors will have limited choices for HK-listed small-cap stocks. In HK, small-cap stocks as a whole is a minor contributor to the daily turnover. Since the beginning of 2016, the Hang Seng Composite Large Cap Index has contributed to ~42% of daily Hong Kong market turnover on average while turnovers of the

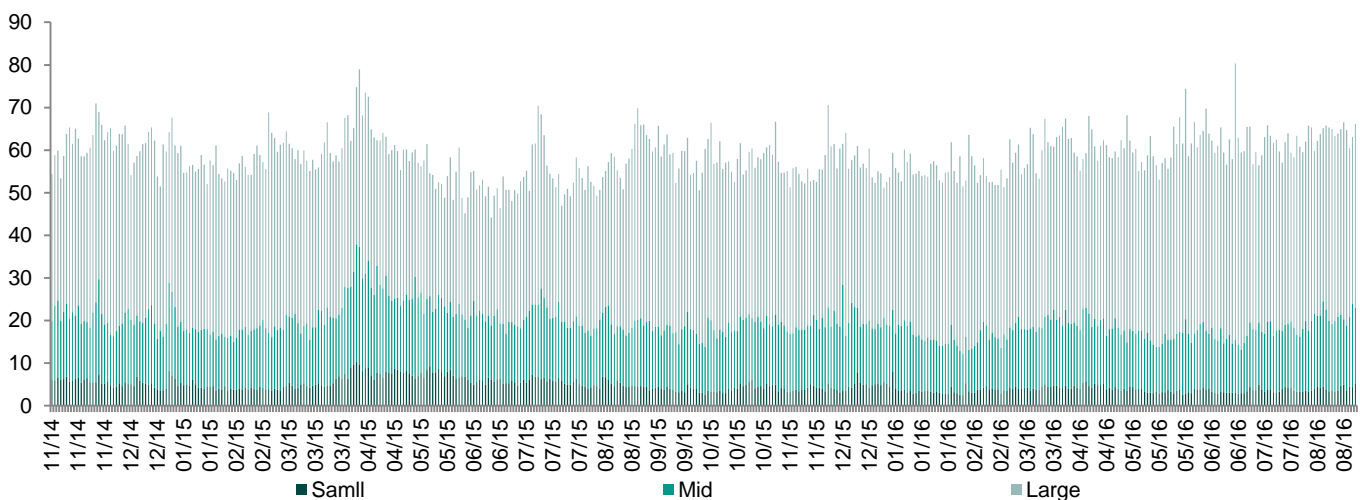


Hang Seng Mid Cap Index and Hang Seng Small Cap Index have represented 14% and 4% of total. Hence, under the SZHK Stock Connect, mainland investors will have rather few choices for HK-listed small-cap stocks due to their low free floats.

For emerging industries, the list of eligible stocks for southbound trading is even shorter. As of Aug 24, among the 203 constituent stocks in the Hang Seng Composite Small Cap Index, 109 met the SZHK Stock Connect's criterion of having a listed market cap no less than HK\$ 5bn. Most of the eligible stocks are from traditional industries such as real estate (17.43%) and apparel & retail (10.09%). Presence of emerging industries is low- only 9.17% of the eligible stocks are related to the bio-tech, healthcare, or pharmaceutical sectors while 8.25% are related to IT products or services.

A-H share valuation gap is narrowing, but most A-shares are still trading at premium to their H-share equivalent. Hang Seng AH Premium Index (HSAHP Index) closed at 126.23 on Aug 24, indicating that the A-shares in the index was traded at a 26.23% premium to their H-share equivalent. From Nov 2014 when the SHHK stock connect was first launched till Aug 24 in 2016, HSAHP Index was averaged at 131.22 (or A-shares were traded at a 31.22% premium to the corresponding H-shares). Although the valuation gap between A-and H-shares is shrinking, among the A+H shares under the SHHK and SZHK stock connect schemes, only Jiangsu Express (177 HK), Ping An (2318 HK), and Anhui Conch (914 HK) were traded at a premium to their A-share counterparts as of Aug 24. For the remainders, the lowest H/A-share valuation discount was 3.3% while the highest one was 84.6%. This may present some investing opportunities for mainland investors.

Exhibit 1: Contributions of the Hang Seng Small, Mid, and Large-cap Indices to HK market turnover (%)



Source(s): Bloomberg, ABCI Securities

Exhibit 2: Top 20 constituents of Hang Seng Small Cap Index by listed share market cap

Ticker	English name	Mkt Cap of listed shares (HKD bn)	GICS industry name	GICS sub industry name
245	China Minsheng Financial Hol	21.12	Trading Companies & Distributo	Trading Companies & Distributo
884	Cifi Holdings Group Co Ltd	16.17	Real Estate Management & Devel	Real Estate Development
696	Travelsky Technology Ltd-H	13.91	IT Services	Data Processing & Outsourced S
338	Sinopec Shanghai Petrochem-H	13.60	Chemicals	Commodity Chemicals
680	Nan Hai Corp Ltd	13.52	Media	Movies & Entertainment
3813	Pou Sheng Intl Holdings Ltd	13.33	Specialty Retail	Apparel Retail
777	Netdragon Websoft Holdings L	12.62	Software	Home Entertainment Software
2199	Regina Miracle International	12.13	Textiles, Apparel & Luxury Goo	Apparel, Accessories & Luxury
658	China High Speed Transmissio	11.77	Electrical Equipment	Heavy Electrical Equipment
3606	Fuyao Glass Industry Group-H	10.90	Auto Components	Auto Parts & Equipment
1515	Phoenix Healthcare Group Co	10.66	Health Care Providers & Servic	Health Care Facilities
2678	Texhong Textile Group Ltd	10.62	Textiles, Apparel & Luxury Goo	Textiles
1448	Fu Shou Yuan International	10.23	Diversified Consumer Services	Specialized Consumer Services
2331	Li Ning Co Ltd	10.18	Textiles, Apparel & Luxury Goo	Apparel, Accessories & Luxury
729	Fdg Electric Vehicles Ltd	9.99	Electrical Equipment	Electrical Components & Equipm
1883	Citic Telecom International	9.87	Diversified Telecommunication	Alternative Carriers
1963	Bank Of Chongqing Co Ltd-H	9.54	Banks	Regional Banks
416	Bank Of Jinzhou Co Ltd-H	9.53	Banks	Regional Banks
1628	Yuzhou Properties Co	9.46	Real Estate Management & Devel	Real Estate Development
2666	Universal Medical Financial	9.30	Health Care Providers & Servic	Health Care Services

Note: As of end of Aug 24, 2016

Source(s): Bloomberg, ABCI Securities

Exhibit 3: Hang Seng China AH Premium Index



Source(s): Bloomberg, ABCI Securities



China Economic Indicators

	2015							2016						
	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul
Real GDP (YoY %)	7.0	---	---	6.9	---	---	6.8	---	---	6.7	---	---	6.7	---
Export Growth (YoY %)	2.8	(8.3)	(5.5)	(3.7)	(6.9)	(6.8)	(1.4)	(11.2)	(25.4)	11.5	(1.8)	(4.1)	(4.8)	(4.4)
Import Growth (YoY %)	(6.1)	(8.1)	(13.8)	(20.4)	(18.8)	(8.7)	(7.6)	(18.8)	(13.8)	(7.6)	(10.9)	(0.4)	(8.4)	(12.5)
Trade Balance (USD/bn)	46.6	43.0	60.2	60.3	61.6	54.1	60.9	63.3	32.6	29.9	45.56	49.98	48.11	52.31
Retail Sales Growth (YoY %)	10.6	10.5	10.8	10.9	11.0	11.2	11.1	10.2		10.5	10.1	10.0	10.6	10.2
Industrial Production (YoY %)	6.8	6.0	6.1	5.7	5.6	6.2	5.9	5.4		6.8	6.0	6.0	6.2	6.0
PMI - Manufacturing (%)	50.2	50.0	49.7	49.8	49.8	49.6	49.7	49.4	49.0	50.2	50.1	50.1	50.0	49.9
PMI - Non-manufacturing (%)	53.8	53.9	53.4	53.4	53.1	53.6	54.4	53.5	52.7	53.8	53.5	53.1	53.7	53.9
FAI (YTD) (YoY %)	11.4	11.2	10.9	10.3	10.2	10.2	10.0	10.2		10.7	10.5	9.6	9.0	8.1
CPI (YoY %)	1.4	1.6	2.0	1.6	1.3	1.5	1.6	1.8	2.3	2.3	2.3	2.0	1.9	1.8
PPI (YoY %)	(4.8)	(5.4)	(5.9)	(5.9)	(5.9)	(5.9)	(5.9)	(5.3)	(4.9)	(4.3)	(3.4)	(2.8)	(2.6)	(1.7)
M2 (YoY %)	11.8	13.3	13.3	13.1	13.5	13.7	13.3	14.0	13.3	13.4	12.8	11.8	11.8	10.2
New Lending (RMB/bn)	1,280.6	1,480	809.6	1,050	513.6	708.9	597.8	2,510	726.6	1,370	555.6	985.5	1,380	463.6
Aggregate Financing (RMB bn)	1,833	742	1,082	1,300	476.7	1,020	1,815.1	3,425.3	824.5	2,404.0	751.0	659.9	1,629.3	487.9

World Economic/Financial Indicators

Equity Indices				Global Commodities					Bond Yields & Key Rates		
	Closing price	Chg. WTD (%)	P/E	Unit	Price	Chg. WTD (%)	Vol (5-Day avg.)		Yield (%)	Chg. WTD (Bps)	
U.S.				Energy					US Fed Fund Rate		
DJIA	18,448.41	(0.56)	17.77	NYMEX WTI	USD/bbl.	47.14	(2.84)	377,036	0.50	0.00	
S&P 500	2,172.47	(0.52)	20.37	ICE Brent Oil	USD/bbl.	49.26	(3.18)	266,985	3.50	0.00	
NASDAQ	5,212.20	(0.50)	39.13	NYMEX Natural Gas	USD/MMBtu	2.83	9.56	114,895	1.00	0.00	
MSCI US	2,069.88	(0.50)	21.03	China Qinhuangdao Port Thermal Coal ²	CNY/Metric Tonne	477.00	2.36	N/A	0.2637	(0.07)	
Europe				Basic Metals					US Treasury (1 Yr)		
FTSE 100	6,814.28	(0.65)	56.80	LME Aluminum Cash	USD/MT	1,631.25	(1.42)	14,835	1.1556	(0.85)	
DAX	10,503.09	(0.39)	23.86	LME Aluminum 3-mth. Rolling Fwd.	USD/MT	1,644.50	(1.35)	25,749	1.5663	(1.18)	
CAC40	4,397.11	(0.08)	22.76	CMX Copper Active	USD/lb.	4,617.00	(3.60)	14,303	0.80	0.00	
IBEX 35	8,591.80	1.67	21.34	LME Copper 3-mth Rolling Fwd.	USD/MT	4,626.00	(3.58)	48,489	2.7440	2.90	
FTSE MIB	16,624.01	1.92	37.48	Precious Metals					China 10-Yr Gov. Bond		
Stoxx 600	341.50	0.40	29.29	CMX Gold	USD/T. oz	1,328.40	(1.32)	173,331	0.00	0.00	
MSCI UK	1,985.31	(0.65)	60.46	CMX Silver	USD/T. oz	18.74	(3.65)	29,364	0.5199	(0.11)	
MSCI France	124.99	0.14	20.76	NYMEX Platinum	USD/T. oz	1,087.30	(2.78)	10,879	0.8254	0.83	
MSCI Germany	134.52	(0.14)	24.08	Agricultural Products					O/N SHIBOR		
MSCI Italy	47.55	2.52	38.10	CBOT Corn	USD/bu	331.50	(3.56)	145,546	2.0440	2.10	
Asia				CBOT Wheat	USD/bu	423.00	(4.89)	63,641	1-mth SHIBOR	2.6970	0.10
NIKKEI 225	16,360.71	(1.12)	20.32	NYB-ICE Sugar	USD/lb.	20.59	4.15	52,467	3-mth HIBOR	0.5654	(0.05)
S&P/ASX 200	5,515.47	(0.20)	24.46	CBOT Soybeans	USD/bu.	973.50	(3.09)	97,583	Corporate Bonds (Moody's)		
HSI	22,909.54	(0.12)	12.17						Aaa	3.25	(5.00)
HSCEI	9,550.04	(0.58)	7.58						Baa	4.20	(5.00)
CSI300	3,307.09	(1.72)	14.72								
SSE Composite	3,070.31	(1.22)	17.28								
SZSE Component	10,693.75	(1.65)	31.52								
MSCI China	61.28	(1.59)	12.54								
MSCI Hong Kong	12,745.65	(0.03)	14.40								
MSCI Japan	789.50	0.55	16.79								

Note:

- Data sources: Bloomberg, National Bureau of Statistics of China, ABCIS (updated on date of report)
- The price is Coal 5500 kcal/kg FOB Spot Price

Currency

	Euro/USD	GBP/USD	AUD/USD	USD/JPY	USD/CHF	USD/CNY	USD/HKD	USD/CNY NDF 12-mth Spot pr.
Spot Rate	1.1292	1.3198	0.7633	100.46	0.9661	6.6699	7.7558	6.8284
Chg. WTD (%)	(0.29)	0.94	0.08	(0.24)	(0.58)	(0.25)	(0.03)	(0.46)



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Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return - 6% \leq Stock return < Market return rate
Sell	Stock return < Market return - 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate from 2009-2013

Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility < 1.5
Low	180 day volatility/180 day benchmark index volatility < 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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