



Talking Points

Shenzhen-Hong Kong Stock Connect: Another Milestone in Market Accessibility

17 August 2016

The event...

- The long-anticipated Shenzhen-Hong Kong (SZ-HK) Connect Plan was jointly approved by the China Securities Regulatory Commission (CSRC) and Securities and Futures Commission (SFC) on 16 August 2016. The intention is to have the SZ-HK Connect launched by year-end.
- There will be no aggregate quota system for the SZ-HK Connect. The aggregate quota in SH-HK Connect has been eliminated, effective immediately.
- The daily quota for SZ-HK Connect will be the same as the SH-HK Connect and will be applied separately. The daily quota for SH-HK Connect remains unchanged.

	Shenzhen-Hong Kong Connect		Shanghai-Hong Kong Connect	
	Northbound	Southbound	Northbound	Southbound
Launch date	Within 4 months from announcement on August 16	Within 4 months from announcement on August 16	Launched on 17 November 2014	Launched on 17 November 2014
	880 stocks*	417 stocks*	567 stocks	318 stocks
Eligible Stock Universe	SZSE Component Index constituents with market cap more than RMB 6bn	Hang Seng Composite LargeCap Index	SSE 180 Index	Hang Seng Composite LargeCap Index
	SZSE Small / Mid Innovation Index constituents with market cap over RMB 6bn	Hang Seng Composite MidCap Index	SSE 380 Index	Hang Seng Composite MidCap Index
	SZSE-HKEx dual listed A shares not in indices above	Hang Seng Composite SmallCap index constituents with market cap over HKD 5bn	SSE-HKEx dual-listed A shares not in indices above	SSE-HKEx dual-listed H shares not in indices above
	ChiNext stocks are only available to institutional investors under HK related regulations at the launch until further notice	SZSE-HKEx dual listed H shares not in indices above		
Investor eligibility	All Hong Kong and overseas investors except for stocks listed on ChiNext Board of SZSE (institutional investors)	Mainland institutional investors and individual investors who have a securities and cash account balance over RMB 500k	All Hong Kong and overseas investors	Mainland institutional investors and individual investors who have a securities and cash account balance over RMB 500k
Aggregated Quota	None	None	Abolished (before RMB 300bn)	Abolished (before RMB 250bn)
Daily Quota	RMB 13bn	RMB 10.5bn	RMB 13bn	RMB 10.5bn

*Subject to market cap requirements and other market related developments that may result in a company not meeting the selection criteria
Source: HKEx, Citi Research

What we think...

- It is no secret that China is making continued progress on financial reform and opening up its capital account. After the SH-HK Connect, the launch of the SZ-HK Connect is another milestone to granting greater accessibility to China's mainland markets for global investors while mutually offering mainland investors access to opportunities on the Hong Kong Stock Exchange. Below are some of the key takeaways:

Continued commitment to address market accessibility

- In June 2016, MSCI made the decision not to include China A-shares in its Emerging Markets index. It indicated the need for Chinese regulators to address some issues prior to China A-shares being included in indices, such as increased market accessibility. In our view, the SZ-HK Connect is further evidence of China's commitment to deregulating its markets and increasing accessibility to global investors. Furthermore, the elimination of the aggregate quota (for both SH-HK and SZ-HK) also shows China's clear intention to ease market accessibility in trading China A-shares.
- After SZ-HK Connect is launched, around 67%¹ of the total A-shares market cap will be tradable across the two Stock Connects, compared to 43% through only the SH-HK Connect. This is based on

¹ Source: Goldman Sachs figures are based on total market cap as of 16 August 2016. In calculating the percentage market cap tradable across both northbound connects, Goldman Sachs excluded ChiNext listed companies, as they will only be open to institutional investors initially.

the eligible stocks of the two Connects (including those that need to meet the market cap requirements) relative to the total A-shares market. Similarly, around 67% of the total market cap of the HKEx will be available to mainland investors via the southbound routes. This is based on the eligible stocks in various Hang Seng Composite Indices, including those that need to meet the market cap requirement in the Hang Seng Composite Small Cap Index. The tradable universes include all the representative companies in both markets and constituents of key local indices.

Broadened universe with ample investment opportunities

- **Northbound:** Shenzhen listed companies are more concentrated in emerging industries, such as information technology, media, and healthcare. These are the service related and high growth industries that are more representative of China's economic structure today. On the other hand, the investment landscape in Shanghai is more geared towards state-owned enterprises in financials and industrials. The SZ-HK-Connect will broaden the investable universe for global investors,² who, up to now, were able to only invest in these types of higher growth industries through offshore markets like HKEx and ADRs in the US.
- **Southbound:** Through the SZ-HK Connect, mainland investors can now invest in Hong Kong listed Chinese equities that were previously not available through the SH-HK Connect. This includes companies listed on the Hang Seng Composite Small Cap Index and dual listed SZSE-HKEx companies.

Stock selection is key

- As bottom-up focused investors, we believe the SZ-HK-Connect will bring new, unique investment opportunities and we shall continue to look for companies with sustainable leadership and competitive advantages that can deliver above average earnings over business cycles at a discount to fair value.

² Investors without QFII quota access

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