

Review of 4Q17 allocation of mainland investors

4Q fund allocation indicates strong investor sentiment

Data reported for 4Q17 on mutual funds and southbound fund flows indicate strong investor sentiment. Equity and hybrid QDII's equity position remained basically flat with the historical high, new Stock Connect mutual fund (Connect funds) issuance has accelerated since 4Q17 despite tighter regulatory scrutiny, and overall southbound inflows picked up again in 2018 year to date.

QDII: position remained high, increased allocation in pharma

Equity and hybrid QDII mutual funds reported total assets under management (AUM) of RMB64.6bn in 4Q17 versus RMB65.1bn in 3Q17, suggesting further substitution effect from the Stock Connect channel. The equity position remained high, at 83.9% of total AUM. Based on the top-10 holdings of active QDIIs, software (33.5% of equity holdings) remained the most crowded sector, followed by tech hardware, semiconductors, insurance, and auto. In contrast, the telecom and energy sectors were the least crowded sectors. Active QDIIs increased allocation in pharma names significantly, bringing the sector's weight to 6.6% in 4Q17 from 2.2% in 3Q17, with CSPC Pharma and 3SBio seeing the largest inflows. Consumer services, mainly US-listed education companies, and tech hardware saw the largest weighting cuts.

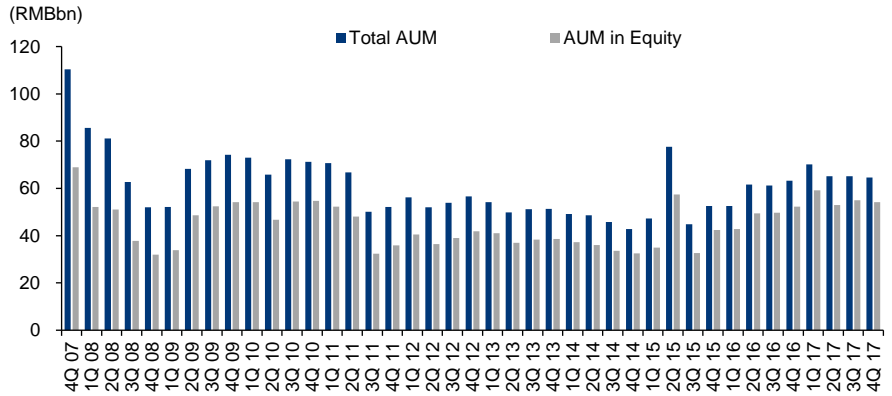
Connect funds: accelerated new product issuance in 4Q17

Launch of mutual funds which can invest in HK-listed stocks via Stock Connect accelerated in 4Q17. Although the regulators have [reportedly](#) paused approval of Connect funds that contain "HK" in their names and can invest more than 80% of their equity holdings in HK, the issuance of Connect funds that can invest up to 50% in the HK market has not been affected. According to data from Wind, 26 Connect funds were issued in 4Q17, another 17 have started open subscription so far this year, and around 110 products are in the pipeline awaiting regulatory approval. Connect funds raised so far in 2018 amount to RMB40bn (RMB53.3bn in 2017). According to the 4Q17 reports, HK stocks' weightings in overall stock AUM stayed almost flat at 50% (USD5.4bn). Although Connect funds account for only a small portion of Southbound investor holdings totaling USD140bn, the acceleration of issuance could suggest increasing interest from retail investors, in our view. Of their allocation in HK, Connect funds are overweight IT, consumer discretionary, and healthcare sectors, and are most underweight real estate, energy, and utilities.

Southbound investors: strong inflows at year-start

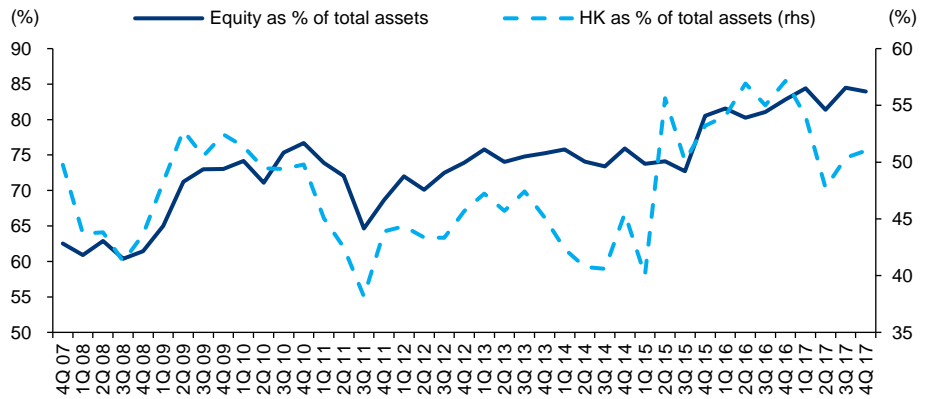
Southbound flows have picked up to a RMB2.9bn daily average so far in 2018 from RMB1.9bn in 4Q17, spurred by incremental flows stemming from allocation needs. Total southbound inflows amount to RMB686.5bn since the launch of Stock Connect. Measured by southbound holdings as a percentage of freefloat market cap, southbound investors increased holdings in semiconductors, healthcare, transportation, diversified financials, and banks between end-September 2017 and 25 January 2018, and lowered holdings in media, and telecom. They are still overweight banks, auto, real estate, healthcare, and materials, and underweight software, telecom, insurance, utilities, and energy.

Fig.1. AUM of equity and hybrid QDII mutual funds



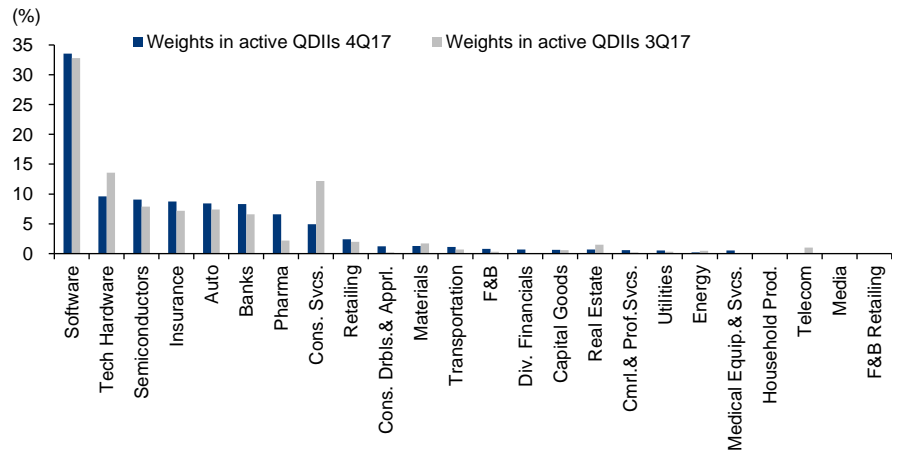
Source: Wind, Huatai HK Research

Fig.2. Weighting of equities and HK market in equity/hybrid QDII funds

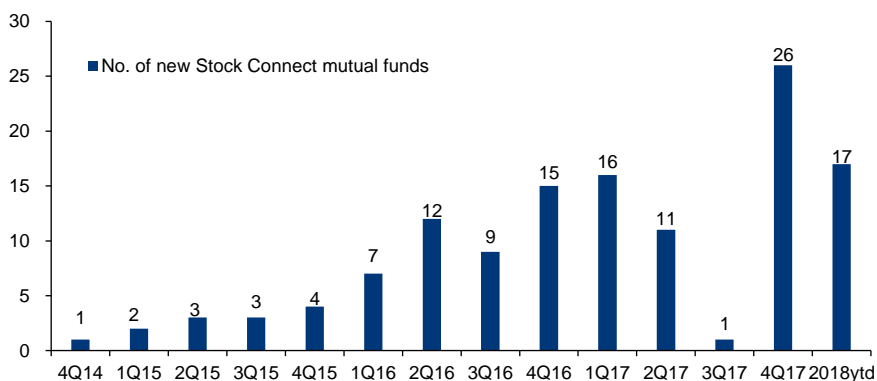


Source: Wind, Huatai HK Research

Fig.3. Sector allocation of active QDII mutual funds (based on top-10 holdings)

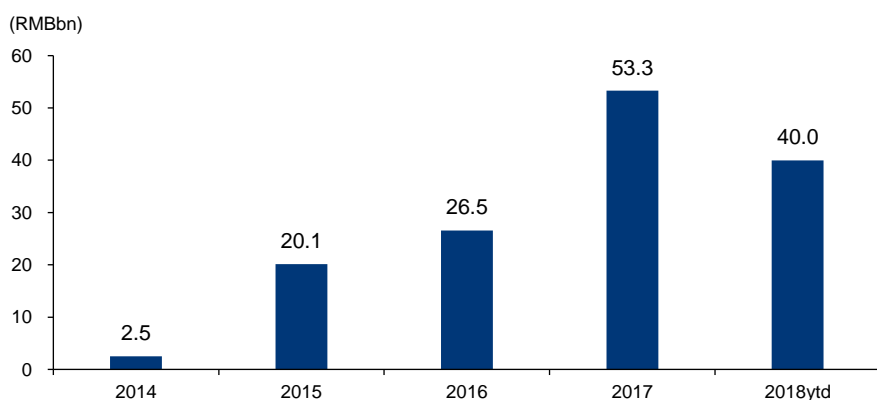


Source: Bloomberg, Wind, Huatai HK Research

Fig.4. Issuance of Connect funds has accelerated since 4Q17

Notes: 1) includes mutual funds that can invest in HK-listed stocks via Stock Connect; count of new stock connect funds is based on the first day of open subscription, different from the method in our [previous note](#), in which the count was based on announcement date; 2) data as at 25 January 2018.

Source: Wind, Huatai HK Research

Fig.5. Issuance size of new Connect funds

Notes: 1) includes mutual funds that can invest in HK-listed stocks via Stock Connect; 2) data as at 25 January 2018.

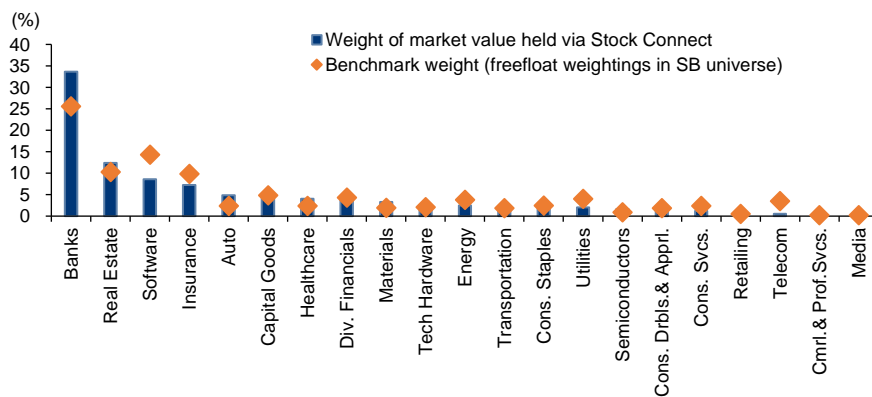
Source: Wind, Huatai HK Research

Fig.6. Summary of southbound investors' holdings

	Market value held via Stock Connect Southbound (USD bn)	% of freefloat held via Stock Connect Southbound
Overall	139.6	6.0
Banks	47.0	7.9
Real Estate	17.3	7.2
Software	11.9	3.6
Insurance	10.1	4.4
Auto	6.8	12.2
Capital Goods	5.9	5.2
Healthcare	5.7	10.3
Div. Financials	5.5	5.5
Materials	4.6	10.3
Tech Hardware	3.6	7.4
Energy	3.4	3.9
Transportation	3.4	7.7
Cons. Staples	2.8	5.0
Utilities	2.8	3.0
Semiconductors	2.3	10.7
Cons. Drbls.& Appl.	1.8	4.2
Cons. Svcs.	1.7	3.1
Retailing	1.0	7.5
Telecom	0.8	1.0
Cmrl.& Prof.Svcs.	0.5	9.6
Media	0.5	8.5

Note: data as of 25 January 2018 (reporting date)

Source: Bloomberg, Wind, Huatai HK Research

Fig.7. Allocation of southbound investors

Source: Bloomberg, Wind, Huatai HK Research

Fig.8. Change in southbound investor holdings

Sector	% of freefloat held via Stock Connect Southbound		Change (%)
	2017/9/29	2018/1/25	
Semiconductors	7.06	10.67	3.61
Healthcare	7.53	10.26	2.73
Transportation	5.20	7.67	2.47
Div. Financials	3.84	5.45	1.61
Banks	6.30	7.90	1.60
Tech Hardware	5.97	7.43	1.46
Insurance	3.16	4.40	1.25
Cons. Drbls.& Appl.	2.98	4.21	1.23
Materials	9.18	10.26	1.08
Energy	2.91	3.89	0.97
Retailing	6.63	7.53	0.90
Capital Goods	4.47	5.24	0.77
Real Estate	6.48	7.22	0.74
Cons. Staples	4.23	4.96	0.73
Software	2.90	3.58	0.68
Utilities	2.30	2.97	0.68
Cons. Svcs.	2.50	3.10	0.60
Auto	11.67	12.24	0.57
Cmrl.& Prof.Svcs.	9.47	9.56	0.09
Telecom	1.06	0.97	(0.08)
Media	8.72	8.48	(0.24)

Note: Above dates are reporting dates, not trading dates.

Source: Bloomberg, Wind, Huatai HK Research

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