

Review of 1Q18 allocation of mainland investors

Short-term cautiousness may persist

The 1Q18 mutual fund reports show that the position of QDII and Stock Connect mutual funds (Connect funds) in equities and in the HK market remain stable in spite of market volatility. Both QDII and Connect funds saw their allocations rise in software and banks and fall in auto. On the other hand, southbound outflows since late March and rotation into defensive sectors indicate mainland investors becoming more cautious for the near term. We expect continued weak flows from mainland investors due to rising uncertainty amid turbulent market environment for 2Q (see [2Q18 outlook](#)); we stick to companies with resilient growth outlooks and that are less affected by rising overseas interest rates, including consumer durables and apparel, select HK local retailers, healthcare, consumer staples sectors, and select oil companies due to low valuations. In mid-to-long term, we continue to like internet leaders, banks, and air transport names.

QDII: weighting of equities still high; concentrated in software

Equity and hybrid QDII mutual funds posted total AUM of RMB68.9bn in 1Q18 (RMB65.1/65.1bn in 3Q/4Q17). AUM in equities stayed high at 84.8% of total assets (84.5/84.4% in 3Q/4Q17). Exposure to HK market climbed 3.7% to 54.7% due to large subscription of HK ETFs; as a result, allocation in the US market was down by 2.4% to 20.8%. Based on top 10 holdings, active QDIIs' allocation became more concentrated in software (weighting +5.9% qoq to 39.4%), banking (+1.7% to 10.1%), energy (+1.4% to 1.6%) and pharma sectors (+1.3% to 7.9%). By contrast, allocation in auto was cut by 6.0% to 2.4%, followed by tech hardware (down 3.1% to 6.5%), semiconductor (-0.9% to 8.2%) and insurance (-0.8% to 7.9%).

Connect funds: strong issuance; HK's weighting slightly down

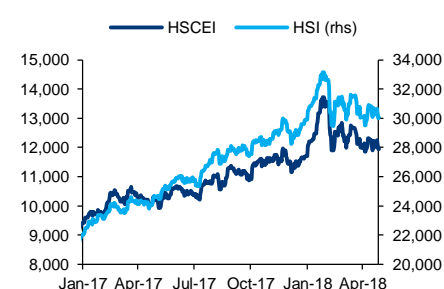
As at 20 April, 52 new Connect funds have been up for subscription (2017: 54), with an aggregate issue size of RMB106bn, double that of last year. We see continuous momentum of Connect fund issuance as a sign of an uptick in interest from domestic investors, but a large proportion of them may not rush into the HK market at once, as only seven out of 52 newly issued Connect funds (RMB17.4bn in IPO size) can actually allocate more than 80% of their stock holdings in HK, while the rest, with a maximum 50% of stocks invested in HK, may be discouraged by the recent market swings. Equity holdings reached USD16.3bn in 1Q18, accounting for 80.1% of total AUM (81.6% in 4Q17). The share of HK-listed stocks in total equity holdings slipped 1.6% to 48.5% (USD7.9bn). Banks (weighting up 8.2% qoq to 24%), software (+2.4% to 19%) and materials (+1.6% to 3%) saw the greatest rises in weighting, while insurance (weighting -4.2% to 19%), auto (-3.7% to 4.5%) and transport (-3.3% to 1.3%) fell the most, based on top 10 holdings.

Southbound flows: inflows recede; rotation into defensives

Overall southbound flows hit the brakes after a buoyant January and turned into outflows since late March. The rapid retreat is, in our view, a combined consequence of profit taking by some domestic investors, stop-loss and strong RMB coupled with wild market swings (as we addressed in [2Q18 outlook](#)). We expect southbound flows to remain weak in the near term given worsening fears of rising overseas interest rates and concerns on the looming Sino-US trade conflict. Southbound investors, since the market peaked in end-January, increased their holdings (measured by change in southbound holdings as a percentage of freefloat market cap) in consumer staples, healthcare and software while selling down sectors such as media, materials, retailing, energy and insurance.

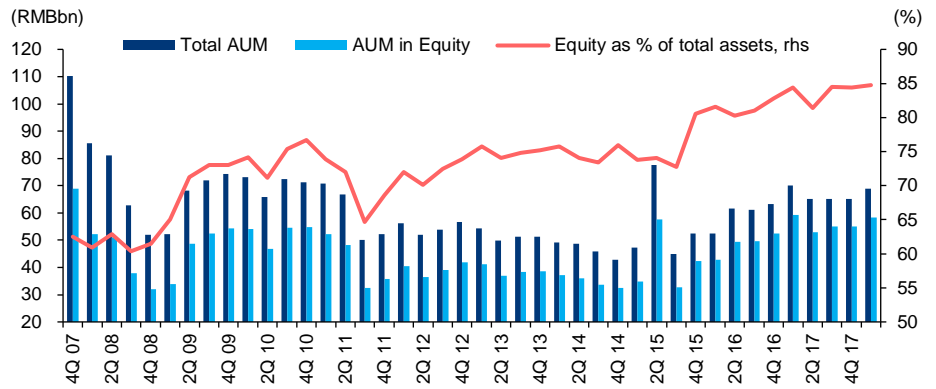
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Index Price Performance



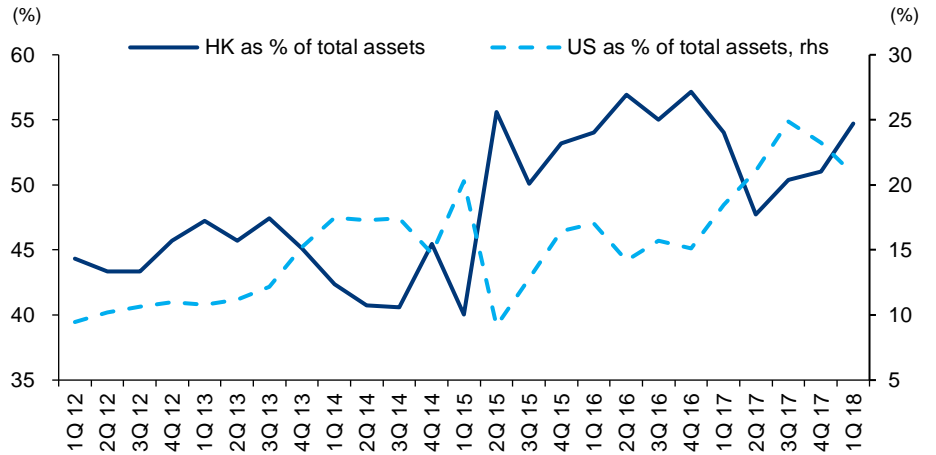
Source: Bloomberg, Huatai HK Research

Fig.1. Equity allocation of QDII (equity and hybrid) at 84.8% in 1Q18



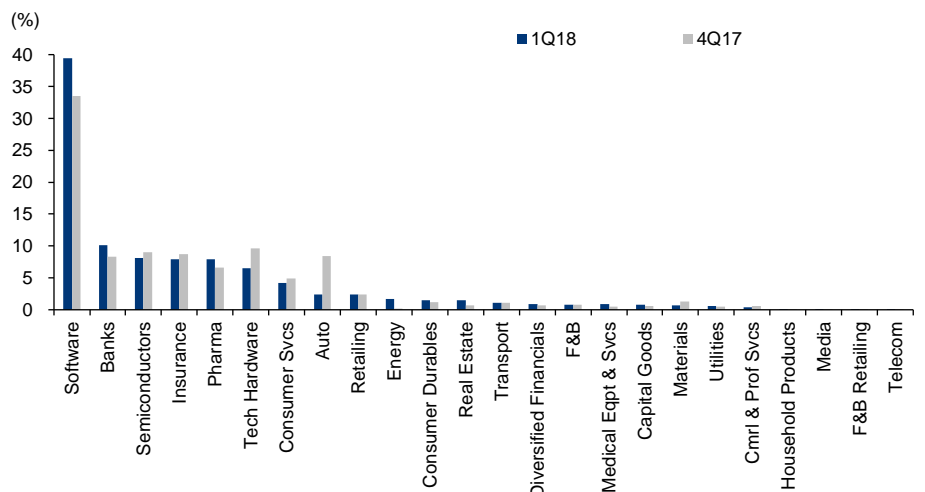
Source: Wind, Huatai HK Research

Fig.2. Equity and hybrid QDII's exposure to HK increased by 3.7% qoq in 1Q18



Source: Wind, Huatai HK Research

Fig.3. Sector allocation of active QDII (equity and hybrid)



Note: based on top 10 holdings announced

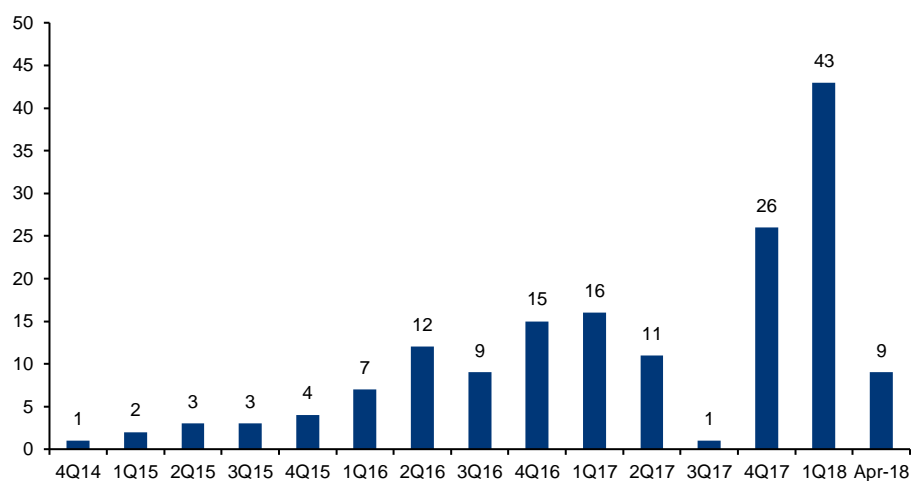
Source: Bloomberg, Wind, Huatai HK Research

Fig.4. Top 20 holdings of active QDII (equity and hybrid)

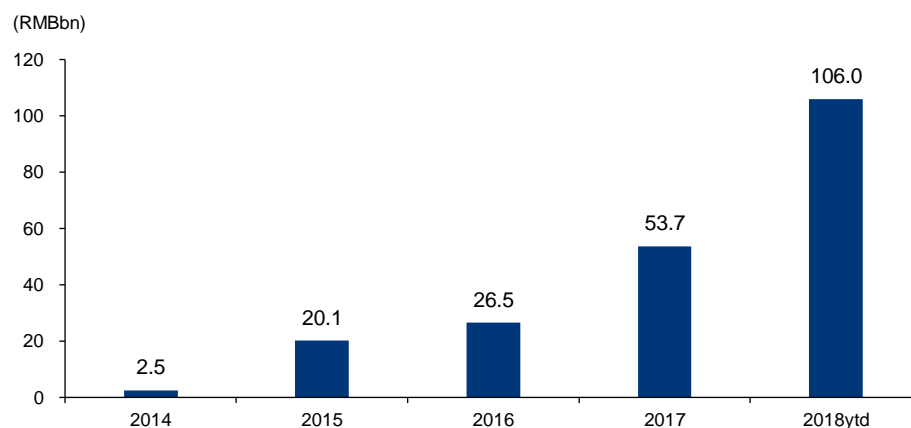
Ticker	Name	Industry group	Holdings (RMBbn)		
			3Q17	4Q17	1Q18
700 HK	TENCENT	Software & Services	2,912	2,808	2,624
BABA US	ALIBABA GRP-ADR	Software & Services	2,056	1,679	1,953
2318 HK	PING AN	Insurance	895	898	1,038
939 HK	CCB-H	Banks	519	750	657
2330 TT	TSMC	Semiconductors & Semiconductor Equipment	347	581	605
1398 HK	ICBC-H	Banks	327	299	581
NVDA US	NVIDIA CORP	Semiconductors & Semiconductor Equipment	463	541	566
1093 HK	CSPC PHARMACEUTI	Pharmaceuticals, Biotechnology & Life Sciences	141	446	554
2018 HK	AAC TECHNOLOGIES	Technology Hardware & Equipment	689	669	428
BIDU US	BAIDU INC-SP ADR	Software & Services	555	521	416
005930 KS	SAMSUNG ELECTRON	Technology Hardware & Equipment	352	378	329
TAL US	TAL EDUCATIO-ADR	Consumer Services	1,082	197	324
AMZN US	AMAZON.COM INC	Retailing	5	187	244
1530 HK	3SBIO INC	Pharmaceuticals, Biotechnology & Life Sciences	181	294	232
1114 HK	BRILLIANCE CHINA	Automobiles & Components	428	541	220
FB US	FACEBOOK INC-A	Software & Services	16	233	217
GOOGL US	ALPHABET INC-A	Software & Services	8	194	178
857 HK	PETROCHINA-H	Energy	23	-	174
3968 HK	CM BANK-H	Banks	95	120	165
1299 HK	AIA	Insurance	209	207	132

Note: based on top 10 holdings announced

Source: Bloomberg, Wind, Huatai HK Research

Fig.5. Stock Connect mutual funds issuance gathers pace in 1Q18

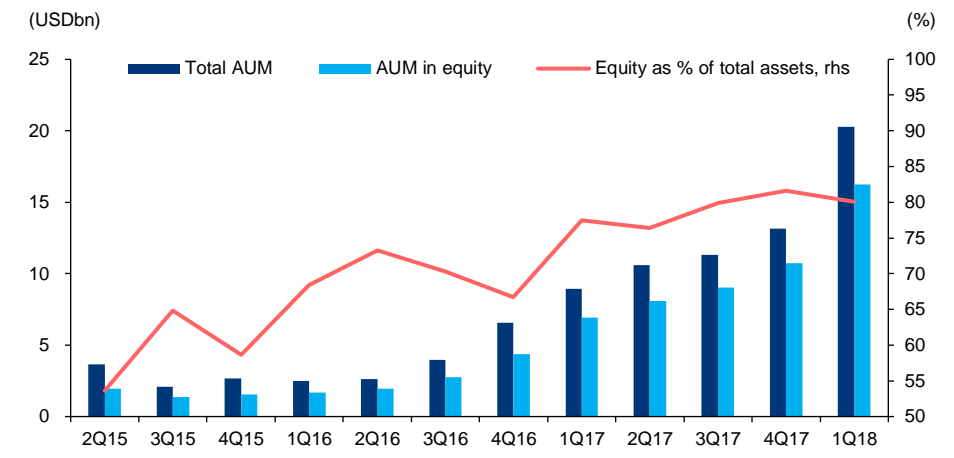
Source: Wind, Huatai HK Research; data as of 20 Apr

Fig.6. Stock Connect mutual funds issue size 2018ytd almost doubled that of 2017

Note: data as of 20 April close

Source: Wind, Huatai HK Research

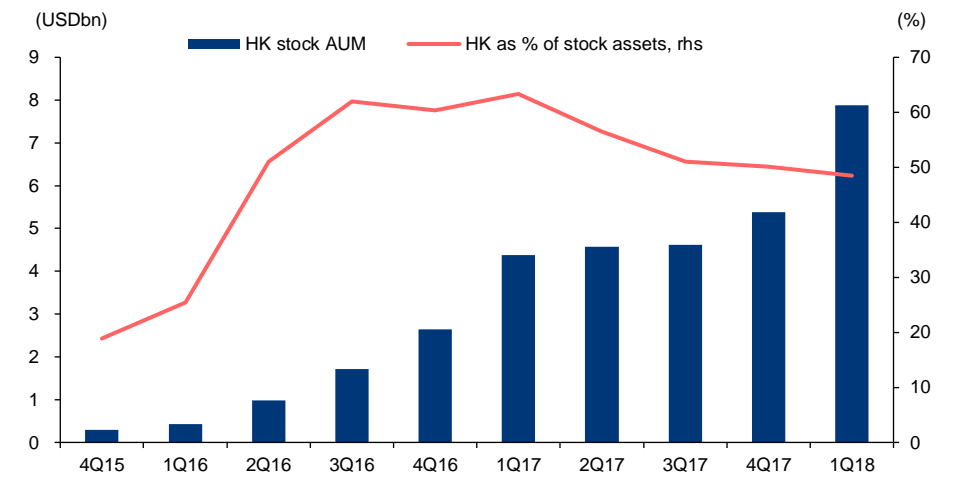
Fig.7. Equity position of southbound mutual funds at 80.1% in 1Q18



Note: excluding funds in process of building positions

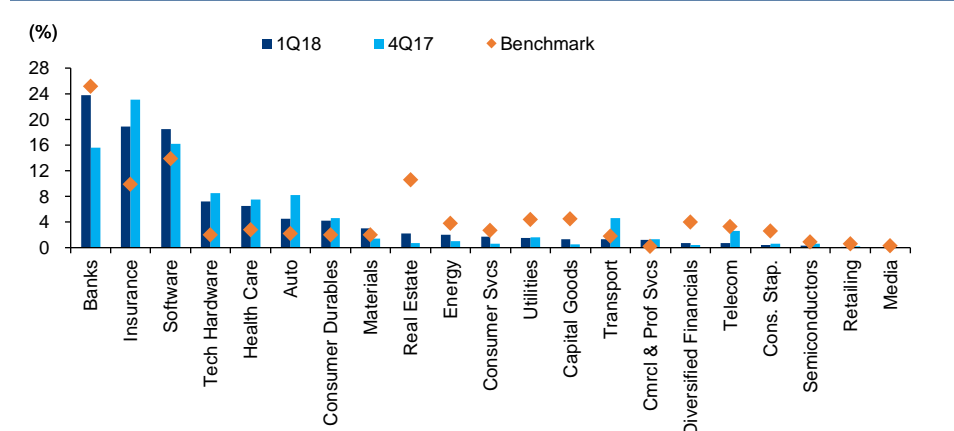
Source: Wind, Huatai HK Research

Fig.8. Weighting of HK-listed stocks in holdings of Connect funds slipped in 1Q18



Source: Wind, Huatai HK Research

Fig.9. Sector allocation of Stock Connect mutual funds in HK market



Note: based on top 10 holdings announced; only HK-listed stocks are included. We use sectors' freefloat market cap as % of overall southbound universe as benchmark.

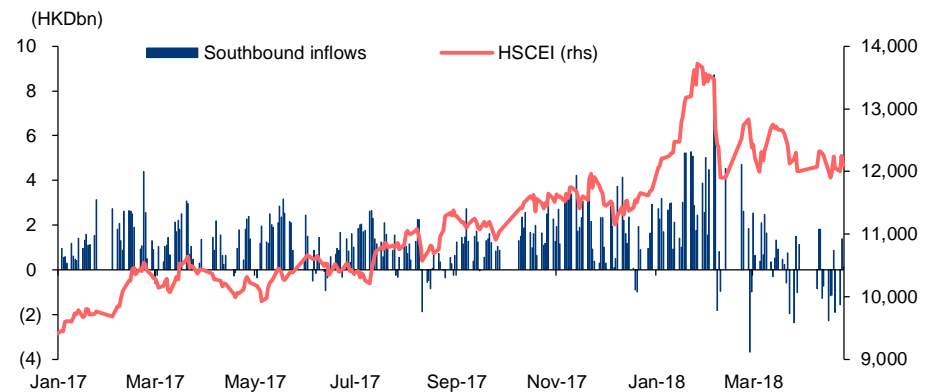
Source: Bloomberg, Wind, Huatai HK Research

Fig.10. Top 20 holdings of Stock Connect mutual funds

Ticker	Name	Industry group	Holdings (based on top 10, RMBmn)				
			1Q17	2Q17	3Q17	4Q17	1Q18
700 HK	TENCENT	Software & Services	2,387	2,513	2,274	2,889	3,982
1398 HK	ICBC-H	Banks	825	782	727	738	2,423
939 HK	CCB-H	Banks	1,102	964	971	1,241	1,720
2601 HK	CHINA PACIFIC-H	Insurance	49	55	72	767	1,555
2318 HK	PING AN	Insurance	262	525	943	1,446	1,531
2018 HK	AAC TECHNOLOGIES	Technology Hardware & Equipmen	399	539	1,158	1,379	1,361
966 HK	CHINA TAIPING IN	Insurance	194	566	589	966	1,246
2020 HK	ANTA SPORTS PROD	Consumer Durables & Apparel	365	505	728	850	908
3968 HK	CM BANK-H	Banks	141	294	268	488	880
3888 HK	KINGSOFT CORP	Software & Services	349	339	214	419	759
1093 HK	CSPC PHARMACEUTI	Pharmaceuticals, Biotechnology	115	133	221	398	750
1336 HK	NEW CHINA LIFE-H	Insurance	59	543	444	1,432	743
998 HK	CITIC BANK-H	Banks	8	-	14	17	726
3988 HK	BANK OF CHINA-H	Banks	521	452	535	292	693
2899 HK	ZJIN MINING-H	Materials	37	10	8	201	578
2333 HK	GREAT WALL MOT-H	Automobiles & Components	-	1	6	6	538
2238 HK	GUANGZHOU AUTO-H	Automobiles & Components	931	924	916	471	492
763 HK	ZTE-H	Technology Hardware & Equipmen	8	89	61	19	473
27 HK	GALAXY ENTERTAIN	Consumer Services	105	84	70	101	467
1177 HK	SINO BIOPHARM	Pharmaceuticals, Biotechnology	21	24	4	101	434

Note: based on top 10 holdings announced; only HK stocks included

Source: Bloomberg, Wind, Huatai HK Research

Fig.11. Southbound fund started to net sell since late March

Note: data as of 24 April close

Source: Wind, Huatai HK Research

Fig.12. Southbound investors increased holdings in and cons. stap. and healthcare

Sector	% of freefloat held via Stock Connect Southbound		Change %
	2018/2/2	2018/4/25	
Cons. Stap.	5.1	5.9	0.9
Health Care	10.1	10.6	0.5
Software	3.6	4.1	0.5
Capital Goods	5.2	5.5	0.3
Utilities	2.9	3.2	0.2
Consumer Svcs	3.3	3.5	0.2
Cmrc & Prof Svcs	9.7	9.9	0.2
Consumer Durables	4.3	4.5	0.2
Auto	12.3	12.4	0.1
Semiconductors	10.5	10.6	0.0
Diversified Financials	5.6	5.5	(0.1)
Banks	8.2	8.0	(0.1)
Transport	8.5	8.3	(0.2)
Tech Hardware	7.5	7.2	(0.3)
Telecom	1.1	0.8	(0.3)
Real Estate	7.3	6.9	(0.4)
Insurance	4.4	3.8	(0.6)
Energy	4.5	3.9	(0.6)
Retailing	7.5	6.5	(0.9)
Materials	10.7	9.6	(1.1)
Media	8.3	6.2	(2.1)

Note: data based on reporting date rather than trading date

Source: Bloomberg, Wind, Huatai HK Research

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