

# Will southbound stock adjustment still offer excessive returns?

## New aspects in current Stock Connect universe adjustment

The results of the review of the HSCI will be announced on 10 August. We estimate 27 stocks could be added to the Stock Connect, and at least six stocks are likely to be removed. Unlike previous rounds, when newly eligible index constituents were automatically included, three types of securities, including companies with weighted voting rights (WVR), will be barred from Stock Connect for the moment. In addition, we think it is still premature to conclude that last week's southbound inflows signal a sustained rebound in the near term, and against unrecovered risk appetite, excessive returns by exploiting the Stock Connect universe adjustment may not repeat this time; moreover, stocks in danger of being removed might see selling pressure, in our view.

## Stocks potentially to be added and removed

According to the rules of the HSCI and southbound stock universe adjustment, we screened out 27 potential new additions, including large companies such as Ping An Healthcare and Technology, Country Garden Services, and Hopewell Holdings. By market cap, the healthcare, industrials and real estate sectors could see more additions; and by number of companies, the property and consumer discretionary spaces could offer more choices. In the meantime, at least six companies could be excluded because their average market cap no longer meet the requirement, such as Best Pacific International, PAX Global, Digital Domain and Chaowei Power; another seven could potentially be removed due to their insufficient velocity, based on data from Bloomberg. See Fig.1 and Fig.3 for complete lists.

## Three types of companies not included for now

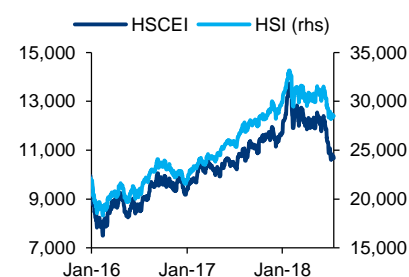
Mainland bourses [announced on 14 July](#) that shares of foreign companies, stapled securities and companies with WVR will not be included in Stock Connect for the moment because mainland investors are not familiar with these types of shares, according to a [news report](#). HKEx responded that it will work with mainland regulators and bourses to confirm a timetable for inclusion of WVR companies in Stock Connect as early as possible. We think this move might put some pressure on new economy companies trying to list in Hong Kong with WVR, but should not reverse the trend given previous reforms aimed to woo new economy companies and more predictable and faster listing process in Hong Kong.

## Fewer low-hanging fruits amid weak sentiment

We've [highlighted before](#) that newly eligible stocks on average started to outperform right after their announcement date in August 2017. This pattern may not hold universally this time, because: 1) market sentiment and liquidity condition have deteriorated compared to 2017; and 2) prices of some names may be pushed high even before their announcement dates as investors concentrate on a few resilient names to defend against market turbulence. The lackluster relative performance of newly eligible stocks during February and March hints at less lucrative room. Among potential newly eligible stocks, Huatai has BUY ratings on Xiabuxiabu, Yongda, and HEC Pharma.

<b>Cheng LV</b> Strategist	+86 21 2897 2057 <a href="mailto:lvcheng@htsc.com">lvcheng@htsc.com</a>
<b>Yi WANG</b> Strategist	+86 21 2897 2057 <a href="mailto:wangyi012893@htsc.com">wangyi012893@htsc.com</a>
<b>Nan LI</b> Strategist	+86 21 2897 2056 <a href="mailto:li_nan@htsc.com">li_nan@htsc.com</a>

## Index price performance



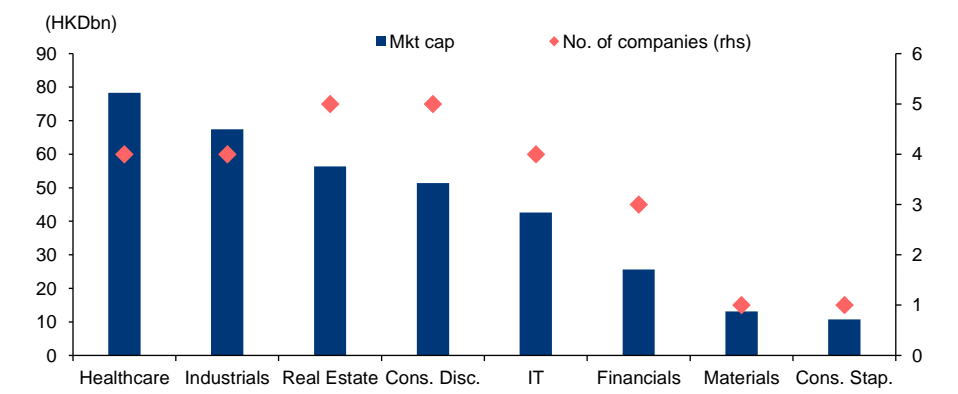
Source: Bloomberg, Huatai HK Research

**Fig.1. Screening results of potential newly-eligible southbound stocks**

Ticker	Name	Industry group	12M avg mkt cap (HKDbn)	3M ADT (HKDmn)	Huatai rating	2018E PE (x)	2018E EPS growth (%)	2019E EPS growth (%)	2018E PB (x)	2018E ROE (%)
1833 HK	PING AN HEALTH	Health Care Eqpt & Svcs	51.1	222.8			56.4	35.5	4.0	-14.3
6098 HK	COUNTRY GARDEN SERVICES	Commercial & Prof Svcs	25.2	743.7						
54 HK	HOPEWELL HLDGS	Capital Goods	25.6	19.1						
1233 HK	TIMES CHINA HOLD	Real Estate	16.9	41.6		4.8	30.1	26.1	0.9	20.2
520 HK	XIABUXIABU	Consumer Services	14.1	36.4	BUY	30.4	15.7	13.2	6.3	22.5
6100 HK	WISE TALENT INFO	Software	16.1	296.3						
59 HK	SKYFAME REALTY	Real Estate	10.1	19.0						
3669 HK	CHINA YONGDA AUT	Retailing	17.0	53.7	BUY	5.6	21.6	28.2	1.2	22.6
2362 HK	JINCHUAN GROUP	Materials	7.1	23.1						
3613 HK	TONGRENTANGCM	Pharma	10.5	15.3		21.8	16.6	14.8	4.3	21.4
1686 HK	SUNEVISION HLDGS	Software	12.2	5.3		28.0	4.3	5.7	5.1	18.1
1717 HK	AUSNUTRIA	Food, Beverage & Tobacco	7.6	22.8		18.6	48.3	37.0	2.0	23.6
1778 HK	COLOUR LIFE SERV	Real Estate	6.7	35.3		15.9	31.7	22.6	3.1	23.1
612 HK	CHINA INVESTMENT	Diversified Financials	8.0	12.8						
1558 HK	YICHANG HEC CH-H	Pharma	6.9	104.1	BUY	18.8	41.9	20.3	5.1	29.5
1608 HK	VPOWER GROUP INT	Capital Goods	11.9	4.0		23.1	10.1	53.8	3.1	14.8
3306 HK	JNBY DESIGN LTD	Consumer Durables & Apparel	6.4	28.2		14.8	20.3	22.7	4.6	33.5
631 HK	SANY HEAVY EQUIP	Capital Goods	5.9	13.4		12.4	137.5	18.4	1.1	8.8
2003 HK	VCREDIT HOLDINGS	Diversified Financials	9.1	41.6						
1806 HK	HUIFU PAYMENT LT	Software	8.5	70.5						
1086 HK	GOODBABY INTERNA	Consumer Durables & Apparel	7.0	13.0		14.8	111.3	22.1	1.4	9.9
3309 HK	C-MER EYE CARE H	Health Care Eqpt & Svcs	10.1	13.8		68.6		27.3		12.0
1916 HK	JIANGXI BANK-H	Banks	7.5	16.4						
2662 HK	CAMSING INTERNAT	Tech Hardware	6.2	8.7						
989 HK	GROUND INTERNATI	Real Estate	8.2	2.8						
6166 HK	CHINA VAST INDUS	Real Estate	6.3	2.9		3.5		25.6		28.4
419 HK	HUAYI TENCENT EN	Consumer Services	5.4	18.5						

Note: data as at 13 July close. Forecasts of non-covered stocks are based on Bloomberg consensus forecasts.

Source: FactSet, Bloomberg, Huatai HK Research estimates

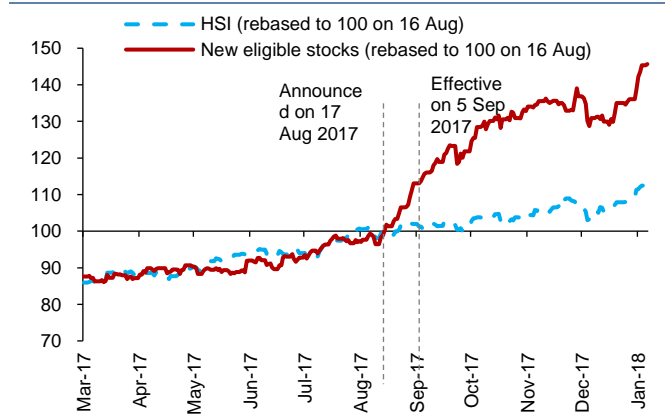
**Fig.2. Number and size of potential new additions by sector**

Source: Bloomberg, Huatai HK Research estimates

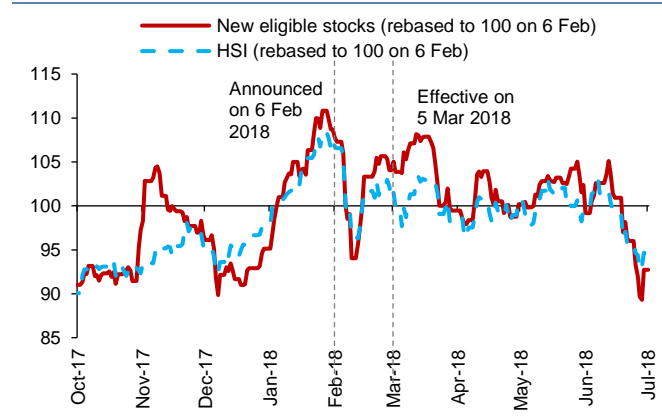
**Fig.3. Stocks potentially to be removed from Stock Connect**

Ticker	Name	Industry group	Avg MV (HKDmn)	Current southbound holdings as % of freefloat	Comment
2111 HK	BEST PACIFIC INT	Consumer Durables & Apparel	4,201	1.4	Highly likely due to market cap size
327 HK	PAX GLOBAL TECHN	Tech Hardware	4,351	5.6	Highly likely due to market cap size
547 HK	DIGITAL DOMAIN	Media	4,745	6.5	Highly likely due to market cap size
951 HK	CHAOWEI POWER	Automobiles & Components	4,842	28.3	Highly likely due to market cap size
579 HK	JNCEC-H	Utilities	4,897	9.5	Highly likely due to market cap size
517 HK	COSCO SHIPPING I	Transportation	4,926	0.4	Highly likely due to market cap size
775 HK	CK LIFE SCIENCES	Pharma	5,711	2.4	Likely due to thin velocity
845 HK	GLORIOUS PROPERT	Real Estate	5,780	0.6	Likely due to thin velocity
480 HK	HKR INTL LTD	Real Estate	6,522	0.1	Likely due to thin velocity
488 HK	LAI SUN DEV	Real Estate	8,243	0.0	Likely due to thin velocity
1115 HK	TIBET WATER RESO	Food, Beverage & Tobacco	8,338	8.6	Likely due to thin velocity
35 HK	FE CONSORT INTL	Real Estate	10,181	0.1	Likely due to thin velocity
43 HK	CP POKPHAND	Food, Beverage & Tobacco	15,907	0.0	Likely due to thin velocity

Source: Bloomberg, Huatai HK Research estimates

**Fig.4. Newly eligible stocks' performance in 1H17 review**

Source: Bloomberg, Huatai HK Research

**Fig.5. Newly eligible stocks' performance in 2H17 review**

Source: Bloomberg, Huatai HK Research

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**Unit 5808-12, 58/F, The Center, 99 Queens Road Central, Central, HONG KONG**

Tel: +852 3658 6000

Fax: +852 2169 0770

Email: [research@htsc.com](mailto:research@htsc.com)

<http://www.htsc.com.hk/>

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