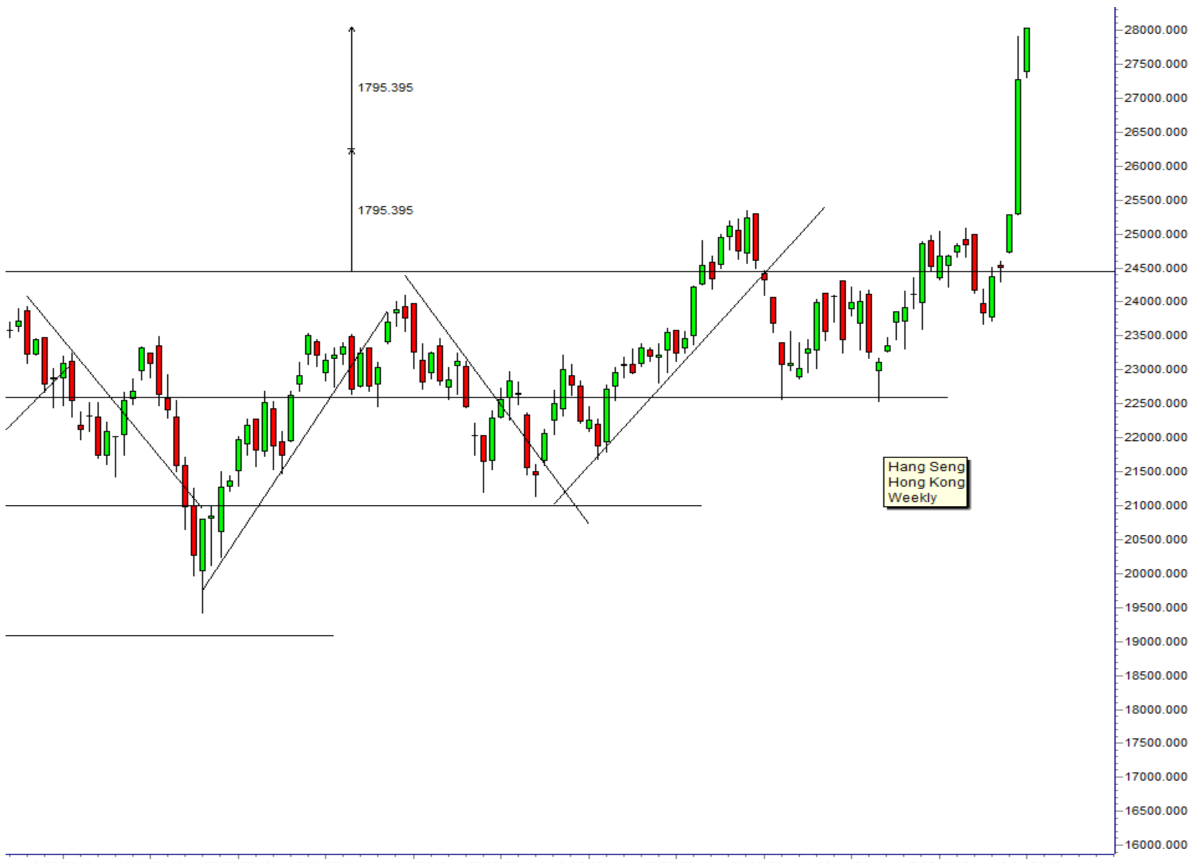
HANG SENG, HONG KONG

By Daryl Guppy

Should we get excited about the Hang Seng? Yes. Should we get worried about the Hang Seng? Yes. This breakout is unstable and unexpected. It’s driven by trend arbitrage. This is the idea that the trend of Hong Kong co-listed Shanghai stocks is different from the trend in Shanghai. The reasoning is that these stocks will catch up and duplicate the Shanghai trend. It’s flawed reasoning because these stocks are not fungible – they cannot be exchanged for Shanghai stocks. So this is a market of limited buyers and sellers. It lacks the liquidity for a sustainable trend. Traders watch for a sudden trend reversal and then go short.

The Hong Kong market was sustained by its status as the only entry point into China. The market was buoyed by the co-listing or dual listing of Shanghai shares. Now there is no need to use Hong Kong because traders can go direct to Shanghai.



Our analysis is reflected in the Hang Seng which has not behaved in the same way as the Shanghai Index. The link between Hong Kong and Shanghai market performance has disappeared.