

INTRODUCTION

In stock investing, the return and risk profile for investors has two components: stock price appreciation and dividend. The conventional stock Index futures such as the Hang Seng Index (HSI) futures and Hang Seng China Enterprises Index (HSCEI) futures are risk management tools based on an index calculated from prices of constituent stocks only. The introduction of total return index (TRI) futures by Hong Kong Exchanges and Clearing Limited (HKEX) aims to meet the trading and risk management needs of investors who adopt a total return strategy. TRI futures are based on an index calculated by assuming the cash dividends of constituent stocks are re-invested into the index's portfolio according to their respective market capitalisation weightings.

The Hong Kong Futures Exchange Limited (HKFE) is offering four TRI futures contracts:

- Hang Seng Index (Gross Total Return Index) Futures (HSIGTRI Futures)
- Hang Seng Index (Net Total Return Index) Futures (HSINTRI Futures)
- Hang Seng China Enterprises Index (Gross Total Return Index) Futures (HSCEIGTRI Futures)
- Hang Seng China Enterprises Index (Net Total Return Index) Futures (HSCEINTRI Futures)

USAGES OF TRIS

Due to the unique nature of indexing, TRIs are widely used by fund managers, actuaries and financial advisers to measure their index-based performances in equity funds and pension funds, as price indexes fail to capture the dividend income of the equity funds over time.

TRIs are commonly used as the underlying index of equity total return index swaps traded in the over-the-counter (OTC) market among banks, insurance companies and investment funds, which enable users to realise the economic benefits of ownership of shares – price appreciation and dividend return – without the cost of capital outlay and expense of the consequences of ownership, such as custodian arrangements and regular reconciliations.

Gross TRI replicates the index portfolio performance when all announced dividends available on the ex-dividend day are re-invested into the constituent stocks portfolio. Net TRI replicates the index portfolio performance with dividend re-investment on an after dividend tax basis. In Hong Kong, all H shares are subject to dividend withholding tax.

The TRIs are compiled by Hang Seng Indexes Company Limited (HSIL) based on the constituent stock weightings of the HSI and HSCEI and disseminated every two seconds. TRIs have a more than 99 per cent correlation to the price indices. However, the index performance differs due to accumulated dividend reinvestment effect as shown in the following charts.

Comparison of 5-Year Movement of HSI, HSIIGTRI and HSINTRI (Index rebased to 100)*



Comparison of 5-Year Movement of HSCEI, HSCEIGTRI and HSCEINTRI (Index rebased to 100)*



PRICE INDEX VERSUS TRI PERFORMANCES[^]

Index	Index Level (30 June 2018)	3-month	6-month	1-Year	3-Year	5-Year	10-Year
HSI	28,955.11	-4%	-3%	+12%	+10%	+39%	+36%
HSIGTRI	79,425.71	-3%	-2%	+16%	+23%	+66%	+92%
HSINTRI	78,209.13	-3%	-2%	+16%	+22%	+65%	+89%
HSCEI	11,073.00	-8%	-5%	+7%	-15%	+19%	-5%
HSCEIGTRI	20,983.38	-6%	-4%	+11%	-5%	+42%	+33%
HSCEINTRI	20,293.77	-6%	-4%	+10%	-6%	+39%	+28%

1-YEAR INDEX CORRELATION MATRIX[^]

Index	HSI	HSIGTRI	HSINTRI	HSCEI	HSCEIGTRI	HSCEINTRI
HSI	1.000	0.999	0.999	0.944	0.944	0.945
HSIGTRI	0.999	1.000	1.000	0.944	0.945	0.945
HSINTRI	0.999	1.000	1.000	0.944	0.945	0.945
HSCEI	0.944	0.944	0.944	1.000	0.999	0.999
HSCEIGTRI	0.944	0.945	0.945	0.999	1.000	1.000
HSCEINTRI	0.945	0.945	0.945	0.999	1.000	1.000

* Source: Bloomberg, as of 23 August 2018

[^] Source: Bloomberg, as of 30 June 2018

WHO ARE POTENTIAL USERS OF TRI FUTURES

- **High net worth investors:** Replicate the total return index performance without the hassle of accessing the constituent stocks, paying the stamp duty and taxes related to stock holding, and dealing with the transaction cost / effort required for dividend reinvestment.
- **Index fund managers:** Reduce tracking error through cash equitisation (ie, by gaining TRI exposure for the cash portion of the index fund).
- **ETF managers:** Manage exposure during the index rebalancing period.
- **Index futures based ETF managers:** Replicate physical stock index portfolio with lower capital cost and transaction cost using TRI futures as the underlying investment vehicle.
- **Hedgers:** Manage downside market risk.
- **Arbitrageurs:** Make profits when there are pricing discrepancies among, price index futures, ETFs and TRI futures.

BENEFITS OF TRADING TRI FUTURES

TRI futures are becoming a popular way for institutional investors to replicate the economic return of TRI swaps traded in the OTC market as a result of global regulatory tightening of capital and swap margin requirements.

Other benefits are listed below.

1. **Market transparency** – with screen pricing supported by market makers / liquidity providers and daily marking to the market by the Clearing House.
2. **Lower margin requirements** – Futures margins set by the Clearing House are much lower than the swap margin requirements in the OTC market.
3. **Low transaction cost** – The trading fee of TRI futures is only about one-tenth of a basis point on notional value traded.
4. **Capital efficiency** – Margin offset available in price index futures / price index options / TRI futures group.

In addition, position limits are calculated on a net delta basis in price index futures / price index options and TRI futures group.

INFORMATION VENDOR ACCESS CODE

Information Vendor	Bloomberg LP	Thomson Reuters
HSI Gross TRI	HSIRH	.HSIDV
HSI Net TRI	HSINH	.HSIDVN
HSCEI Gross TRI	HSCEIRH	.HSCEDV
HSCEI Net TRI	HSCEINH	.HSCEDVN

Note: Information vendor access codes are updated on HKEX's website from time to time.

CONTRACT SPECIFICATIONS

Items	Key Contract Terms			
	HSIGTRI	HSINTRI	HSCEIGTRI	HSCEINTRI
Underlying Index	HSIGTRI	HSINTRI	HSCEIGTRI	HSCEINTRI
HKATS Code	HST	HSN	HHT	HHN
Contract Multiplier	HK\$50 per Index point			
Traded Price	Quoted in index points up to 2 decimal places			
Minimum Fluctuation	0.01 Index point			
Contract Months	Short-dated Index Futures: Spot, next calendar month and next 2 quarter months; and Long-dated Index Futures: Next 2 December months			
Large Open Position	500 open contracts per Contract Month			
Position Limit	10,000 position delta for HSI futures, HSI options, HSIGTRI futures, HSINTRI futures, Mini HSI futures and Mini HSI options combined in all Contract Months combined. (The position delta of one HSIGTRI futures or HSINTRI futures contract is based on their relative size versus the HSI futures and the Exchange will announce the number on an annual basis. At initial product launch, position delta of one HSIGTRI futures or HSINTRI futures contract will have a value of 3)		12,000 position delta for HSCEI futures, HSCEIGTRI futures, HSCEINTRI futures, HSCEI options, Mini HSCEI futures and Mini HSCEI options combined in all Contract Months combined. (The position delta of one HSCEIGTRI futures or HSCEINTRI futures contract is based on their relative size versus the HSCEI futures and the Exchange will announce the number on an annual basis. At initial product launch, position delta of one HSCEIGTRI futures or HSCEINTRI futures contract will have a value of 2)	
Trading Hours	Day Session: 9:15 am – 12:00 noon; and 1:00 pm – 4:30 pm; After-hours Session: 5:15 pm – 1:00 am (next day) (Close at 4:00 pm on Last Trading Day)			
Last Trading Day	The second last business day of the calendar month			
Final Settlement Price	5-minute average of the underlying index on the Last Trading Day			
Final Settlement Day	The first Business Day after the Last Trading Day of the Contract Month			
Exchange Fee Per Contract	HK\$30	HK\$30	HK\$10	HK\$10

DISCLAIMER

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RISK OF TRADING FUTURES AND OPTIONS

Futures and options involve a high degree of risk. Losses from futures and options trading can exceed initial margin funds and investors may be required to pay additional margin funds on short notice. Failure to do so may result in the position being liquidated and the investor being liable for any resulting deficit. Investors must therefore understand the risks of trading in futures and options and should assess whether they are right for them.

