The China Potential & Using ETFs and Tactical Trading Strategies to Boost Returns

Louis Lu, Head of Quantitative and Alternative Investment Department at CSOP Asset Management, sees huge opportunities for China. He addressed the Hubbis Investment Solutions Forum to explain the why and how of participating in that market, including offering some interesting trading strategies to boost returns, while reducing unwanted volatility.

LU BEGAN HIS SPEECH BY PARAPHRASING DR WILL DURANT, explaining that Durant had observed that over the course of human history, human behaviour had changed, but not human nature. Lu then extrapolated that by taking a historical perspective, quantitative trading strategies can profit from the unchanged human nature Durant had observed.

His presentation included three sections: a brief introduction to the Hong Kong ETF market, 5 seasoned strategies and then some insights into the recent market developments.

Hong Kong ETFs mostly track Chinese assets, with 80 of the Hong Kong-listed ETFs or more than 50% focused on Greater China (including Taiwan and Hong Kong), he reported. In terms of the assets tracked by the Hong Kong ETFs, including non-China ETFs, around 90% are stocks, with the rest in bonds, currencies and commodities.

Of the top 20 most active traded ETFs listed in Hong Kong, nine are issued by CSOP, including four inverse and leveraged products. As of the end of June 2019, CSOP leveraged & inverse products accounted for 98.48% of market turnover, and 82% of assets under management.

Lu shifted his focus to ETF trading strategies. His first strategy was 'Pairs Trading', a contrarian strategy that tries to profit from the principles of mean-reversion processes. In his case example, Lu focused on the statistical arbitrage

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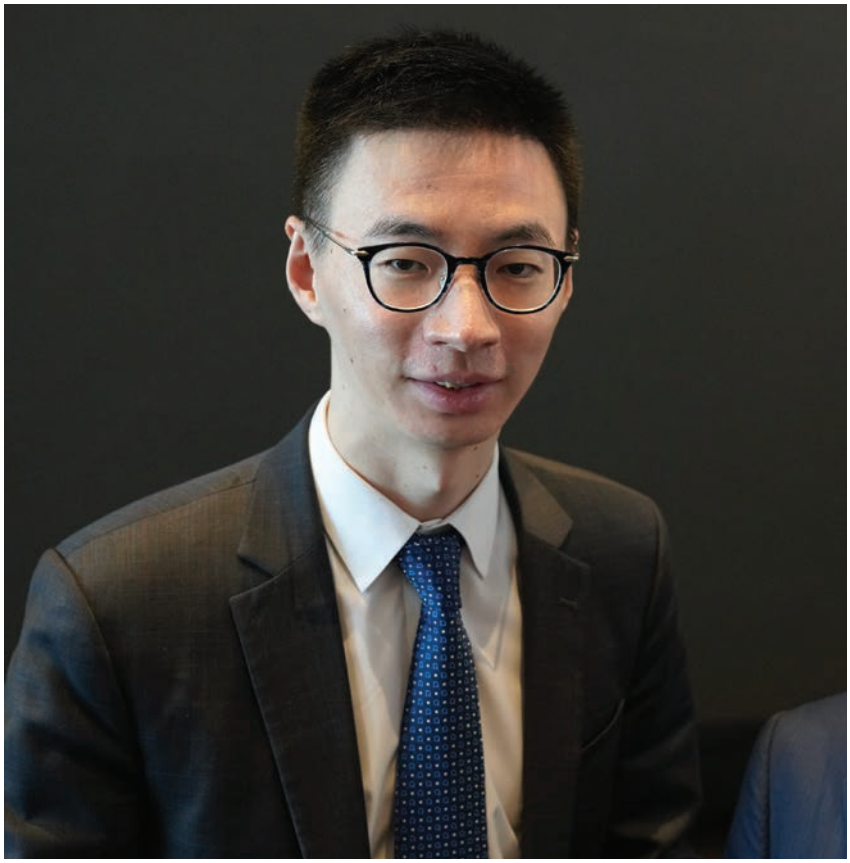

opportunity between China's onshore stocks, or 'A' shares, and offshore stock, or 'H' shares.

CSOP road-tested this strategy from January 2016 to the end of 2017 for two years, in bullish market conditions and achieved a 4.17% annualised return. "That may not be so impressive in a bull market," Lu commented, "But we tested in more difficult conditions during 2018, and we achieved 7.21%. As this strategy is market neutral, the return is not dependent on whether we are in a bear or bull market."

The second strategy he highlighted is pair trades between ETFs tracking different China indexes, such as the FTSE China A50 Index, the CSI 300 Index, and the ChiNext Index (China's NASDAQ index). "We arbitraged by trading 90% of the A50 ETF and 10% of the ChiNext ETF to achieve a higher return with lower volatility than the CSI 300 ETF."

Lu then highlighted the third strategy, which he told the audience was his favourite. "This is called the 'Holiday Effect'," he explained, "and involves buying and selling before and after some certain holidays. If we buy ChiNext ETF one week before the Chinese New Year and sell one week after that, the winning rate is 100%, and the return is around 6.93% on average. If you buy one week before but take a longer holiday, you actually produce a return of 7.8% on average, with a 100% winning rate. So, it pays off to spend more time with the family."

'Sell in May' was his fourth strategy. He argued investors could be better off if only trading for the 6-month period commencing in November and ending in May. He showed several charts that supported his view. He added the result was statistically more significant for Hang Seng Index and HSCEI Index.

His last strategy was a more complicated 'intraday trading' strategy, which consisted of what he terms a "contrarian" sub-strategy in the morning and a "momentum" sub-strategy in the afternoon. He told investors that the introduction of leverage and inverse products in Hong Kong made such intraday trading more feasible for day traders with limited access to the futures contract markets.

Lu closed his ten-minute talk by inviting delegates to consider CSOP ETFs and trading strategies around those to boost their returns while reducing their exposure to volatility. ■

CSOP: China investment with diversity

Headquartered in Hong Kong, CSOP facilitates foreign investment into China's capital markets. Founded in 2008, CSOP was the first Chinese asset manager granted the privilege of operating outside of the Mainland and is currently the world's largest RQFII quota manager and one of the largest overseas Chinese asset managers. With decades of experience in emerging Asia, the company reports that its nearly 70 employees work energetically to research and share their hard-earned insights and investment solutions with investors globally.