Retail Investor Study

Research Report

December 2017

A research commissioned by the Investor Education Centre and conducted by GfK Hong Kong

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Executive Summary

As an organisation dedicated to improving financial literacy in Hong Kong, the Investor Education Centre (IEC) recently conducted a research study comprising both qualitative investigation and quantitative interviews to understand Hong Kong retail investors' attitudes and behaviour towards investing, with a view to inform the formulation of future investor education initiatives.

Key research findings are outlined below:

Retail Investor Participation

- Three out of five adults aged 18-70 had invested in financial products in the past year[1] with close to half (48%) investing in stocks. Foreign exchange followed at a distant second of 27% while investment funds (excluding MPF/ORSO schemes) came at third (14%). Other products saw less than 10% incidence. Investors on average invested in 1.63 out of the eight types of financial products covered in the research.
- Investors held HK$0.43 million of liquid asset on average and allocated 45% of it in the investment of financial products.
- While majority had long-term capital growth in mind, a significant proportion (41%) of investors also aimed for quick profits.

Perception of Investment Products

- When asked to rate different investment products' risk level on a three-point scale of high/medium/low risk level, a vast majority rated derivatives and structured products as high risk products (81% and 70% respectively). Stocks and funds were largely seen as being of medium risk (71% and 63% respectively), with 21% perceiving funds as low-risk and 7% for stocks. Bonds and forex were generally regarded as carrying low risks.
- While risk level appeared to be a common concept among investors, the research also explored whether investors perceived different investment products by the level of complexity - and if they distinguished product complexity and risk level as two distinct concepts. From focus group discussions, it appeared that complexity of products was not

[1] Based on a list of eight types of investment products including stocks, funds (excluding MPF/ORSO schemes), exchange-traded funds (ETF), bonds, foreign exchange, derivatives, structured products and real estate investment trust (REIT).

a well-defined concept and investors generally equated complexity with risk level.

In the survey, when asked to rate different investment products as “complex”, “simple” and “half and half”, majority rated derivatives and structured products as complex products (79% and 72% respectively). Bonds and forex sat at the other end of the spectrum with 51% and 79% categorising them as simple products respectively. Stocks and funds were again in the middle with slightly more investors seeing them as simple rather than complex products.

Regression analysis revealed that the two variables were highly correlated with an R-squared as high as 0.97. Apparently there was a lack of understanding that complexity of a financial product is not necessarily related to its risk level.

Stock Investment

- Almost all stock investors invested in the Hong Kong mainboard and 46% said they had invested in the GEM board in the past year as well. Investment in mainland and overseas stock markets was limited with 8% and 3% incidence respectively.
- Second/third tier stocks were the most popular at 70% incidence in the past year, followed by blue chips at 61%. 38% traded small cap stocks. Except for blue chips which saw an average investment horizon of 3.3 years, investors generally held onto their stocks for less than a year.
- 13% of stock investors invested in IPOs in the past year. One fifth of IPO investors said they sold the stocks on the first day of trading and another 29% did so within the first week. About one third admitted that they often did not read the prospectus at all when investing in IPOs.
- Investors expected an average annual return of 19% from the stock markets, with 44% expecting 20% or more return on investment.
- Online platforms were more commonly used for stock trading (most often channel for 55% of stock investors) but many still kept to traditional channels. Focus group respondents reported they mainly used online platforms for lower fees and more convenience, but they would use phone banking or call their brokerages when there were problems accessing the online platforms.
- Investment advice from friends/family was the top source of information influencing trading decisions (86%), followed by

financial websites (71%) and brokers/bank relationship managers (63%) and then newspapers (54%). Less than half (45%) said they referenced listed companies' annual reports and only 20% paid attention to listed companies' corporate announcements.

- Half of stock investors said they were aware of the high shareholding concentration announcements made by the Securities and Futures Commission from time to time. From focus group discussions, most investors could understand the implication on high volatility. In the hypothetic scenario that the companies they invested in were found to have high shareholding concentration, 45% surveyed investors said they would sell the stocks as soon as possible to minimise potential loss while 41% thought they would monitor the share price movement before making decisions on trading. 12% tend not to take any actions at all.

- Only 9% investors had ever experienced rights issues from companies they invested in, and even less (4%) with open offers. From focus groups, investors generally associated rights issue with small companies with problematic finance and they tend to sell the stocks to avoid their shares from being diluted. Meanwhile, some investors still recalled the rights issues of some sizeable companies in the past decade and said they would consider taking up the shares for reputable companies if a good discount was offered.

- Investors investing in stocks generally did not have much interest in corporate governance issues. Only 16% have ever voted in respect of their shares in a listed company and the top reason cited for non-action being the belief that small shareholders' votes would not make any difference in corporate actions (58%). The perceived time-consuming procedures required for voting was another major deterrent (53%). Further, some 40% said they did not know how to vote.

Fund Investment

- Just as the general investors, those investing in funds also largely perceived funds to be a medium/low risk product (64% and 22% respectively). From the focus groups, some fund investors carried the misconception that funds were managed by professionals and therefore were a safer investment.

- Fund investors mostly regarded funds as mid- to long-term investment with an average investment horizon of 6.3 years. Despite the perceived medium/low risk level of funds, over 40% investors expected 20% or more annual return from their fund investment.

- Investors preferred purchasing funds through traditional channels (e.g. intermediaries) to online platforms (58% used traditional channels only, 17% used online platforms only, 25% used both channels). Many felt they need the intermediaries to explain the product features and risks of different funds (51%) and recommendations from the intermediaries were appreciated (34%). There were also concerns over cyber-security (47%). From focus group discussions, many fund investors admitted that they were not familiar with funds and needed the intermediaries to help them choose which funds to invest in.

- When choosing funds, the top consideration factors were fees and charges, projected returns, major risks and historical performance. Less than half cared about the product features and only one third paid attention to the underlying investments. From focus group discussions, while some investors noted the importance of checking the different asset classes a fund invested in, majority admitted they just assumed the underlying investments were as indicated by the name or theme of funds, for example, a bond fund would be mainly investing in bonds.

- While the importance of underlying investments was often overlooked, many of the investors in focus groups became concerned when it came to their attention that some plain vanilla funds may have significant investment in derivatives. They felt the high risk nature of derivatives contradicted with their expectation of plain vanilla funds' supposed low risk levels.

  In the survey, well over half (63%) of fund investors surveyed regarded funds investing in derivatives as complex financial products (c.f. only 13% considered funds complex in general). And over 90% were of the view that information about the investment in derivatives should be covered in the offering documents. Majority did not expect plain vanilla bond or equity funds to have significant proportion of investment in derivatives.

Research Objectives

The high-level objective of the research is to understand Hong Kong retail investors' attitudes and behaviour towards investing, with a focus on stock and fund investments.

The key areas of investigation include:

1. **Retail investor participation**: To measure the incidence of investing in different investment products, investment objectives as well as the amount of liquid assets invested into the financial markets.
2. **Perceptions of investment products**: To investigate investors' perceptions of different types of financial products in terms of product complexity and risk level.
3. **Investment habits**: To understand investors' use of trading channels, investment horizon and expectation on return when investing in stocks and funds respectively.

Research Methodology

The research study consisted of qualitative and quantitative phases.

Phase one - qualitative research

A total of four focus groups were conducted between August 15th and 22nd, 2017. Each focus group comprised of eight investors, with a well mix of different socio-economic background and investment experience.

Phase two - quantitative research

A survey via face-to-face interviews across the 18 districts was first conducted among 500 adults aged 18-70 in August 2017 to establish the incidence of investing in the financial markets. Soft quotas on gender, age and working status were imposed following the Census data to reflect the profile in the population.

Another survey via face-to-face interviews was then conducted during September 22nd – October 15th, 2017 with a total of 1,002 retail investors. Target respondents were selected via street-intercepts across the 18 districts. The target respondents were Hong Kong residents aged 18-70 years old and had invested in any of the listed financial products[2] in the past 12 months. Quota control on gender, age and working status was adopted to reflect the investor profile as established in the incidence check.

A booster sample of n=273 fund investors were interviewed at the later stage to achieve a total of n=500 investors who held or traded funds in the past year.

[2] Based on a list of eight types of investment products including stocks, funds (excluding MPF/ORSO schemes), exchange-traded funds (ETF), bonds, foreign exchange, derivatives, structured products and real estate investment trust (REIT).

Key Research Findings

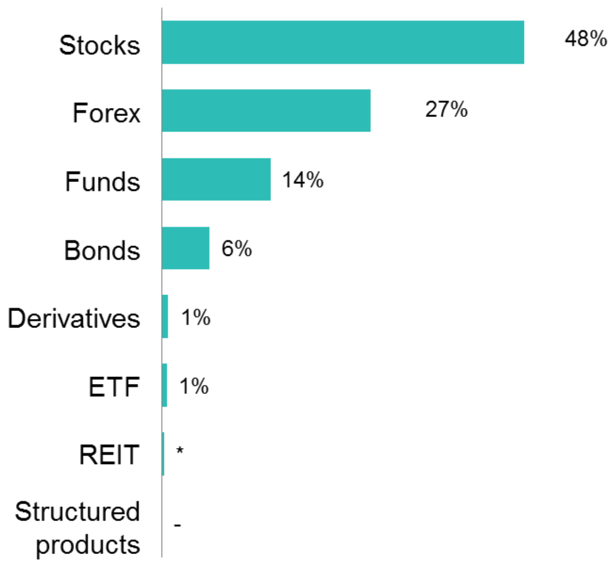
1. Retail Investor Participation

Penetration of investment products

About 3 in 5 Hong Kongers made an investment in the financial markets in the past year, with close to half investing in stocks.

Per the incidence check conducted among a sample of general population, 59% of adults aged 18-70 had invested in at least one financial product in the previous 12 months. Stocks were the most popular investment vehicle (48%), followed by forex (27%), funds (14%) and bonds (6%).

Figure 1.1 – Investment in Financial Products in the past 12 months



** denotes <0.5%; - denotes =0%*
Base: Individuals aged 18-70 (n=501)

Net worth and investment objectives

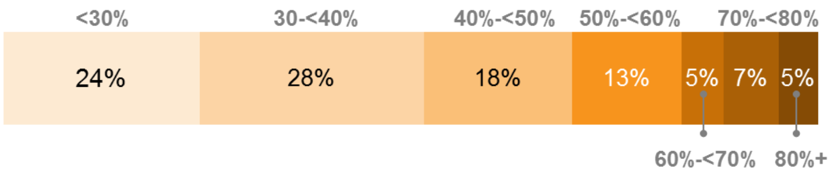
Investors held HK$0.43 million of liquid asset on average and allocated 45% of it in investment of financial products.

About one fifth of investors had liquid asset of one million or above and 30% of investors invested more than half of their liquid assets in financial products.

Figure 1.2 – Amount of Liquid Asset Held

Base: All respondents (n=1,002)

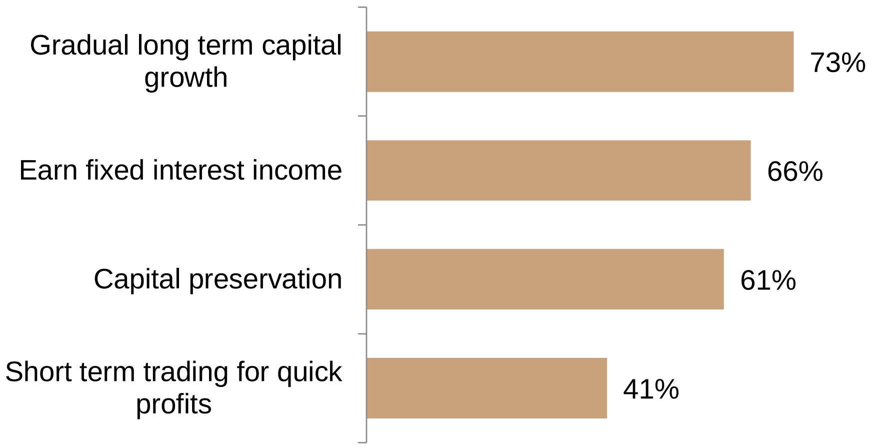
Figure 1.3 – Proportion of Liquid Asset Invested into Financial Products



Base: All respondents (n=1,002)

Long term capital growth, fixed interest income and capital preservation were the more common investment objectives, still, a significant proportion of 41% aimed for quick profits.

Figure 1.4 – Investment Objectives



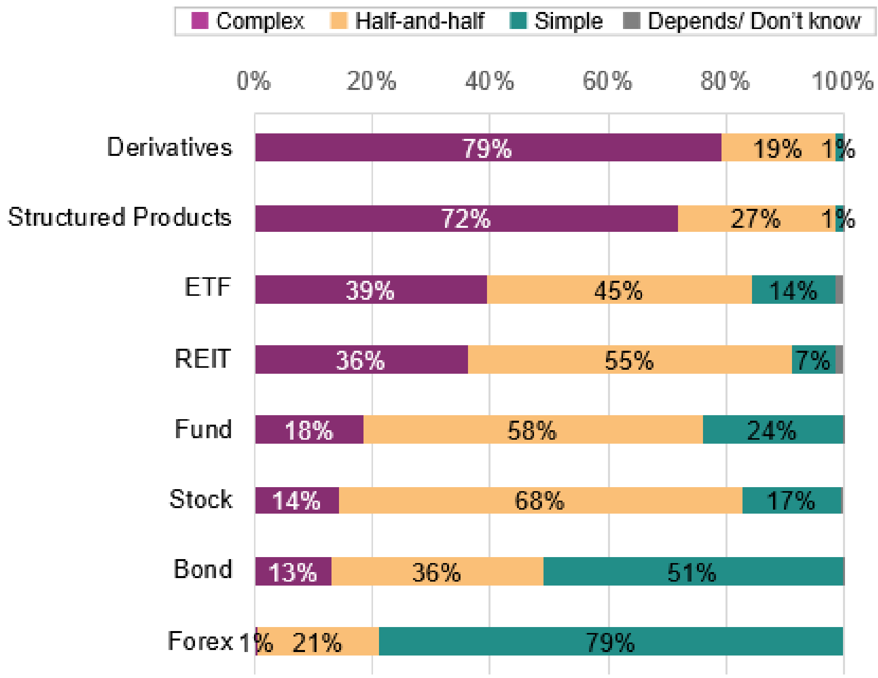
Base: All respondents (n=1,002)

Perceived complexity and risk level

Complexity of products was not a well-defined concept in investors' mind and many equated it with risk level.

When asked to rate different investment products as "complex", "simple" and "half and half", majority rated derivatives and structured products as complex products while bonds and forex were mostly seen as relatively simple. Funds and stocks were perceived to be in the middle but skewed towards the simple side.

Figure 2.1 – Perceived Complexity of Different Investment Products

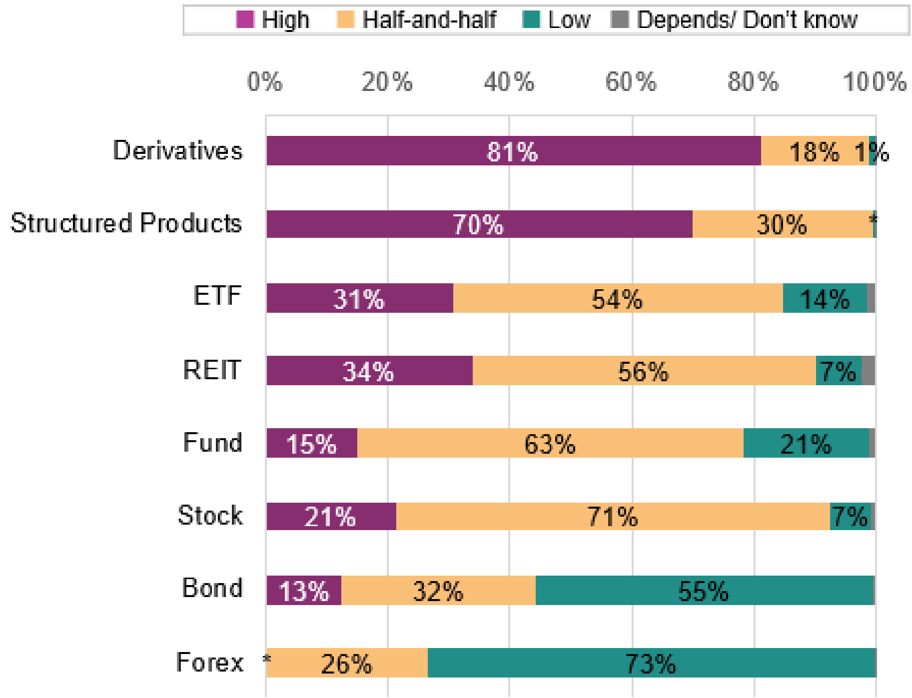


Base: All respondents (n=1,002)

Perceptions on risk level largely follow the same pattern as perceived complexity, with most investors regarding derivatives and structured products as high risk products. Bonds and forex were again seen as low risk products while funds and stocks were largely in the middle ground.

Nevertheless, from focus group discussions, investors were generally aware that each product type could be further divided into different risk levels, e.g. stocks are divided into blue chips or small caps which have different levels of risk. Some of the more sophisticated investors could also point out that derivatives could be used for hedging purposes.

Figure 2.2 – Perceived Risk Level of Different Investment Products

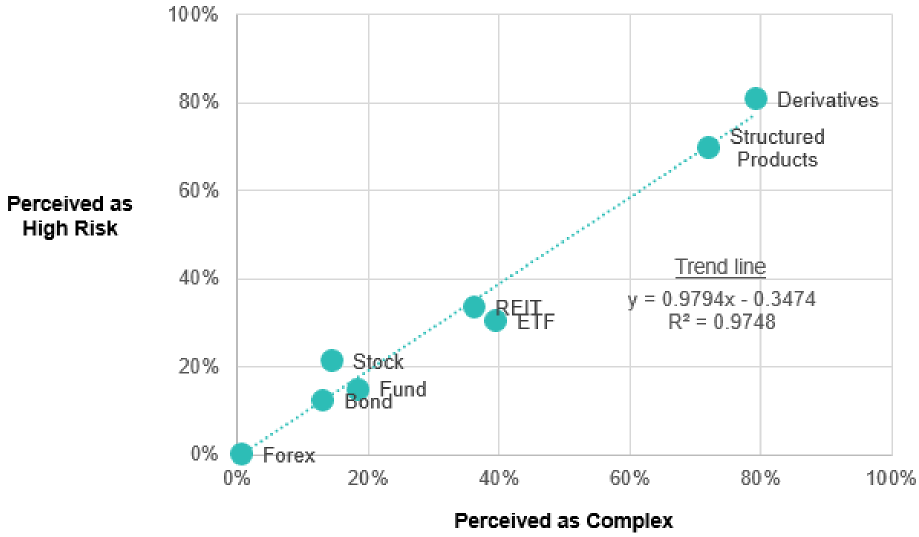


** denotes <0.5%*
Base: All respondents (n=1,002)

Perceptions on the level of complexity and risk were highly correlated.

Regression analysis revealed that the two variables were highly correlated with R-squared as high as 0.97 (with 1 indicating the regression line perfectly fits the data).

Figure 2.3 – Perceived Complexity vs. Risk Level of Financial Products



Base: all respondents n=1,002

From the focus group discussions, it was also apparent that investors did not distinguish product complexity and risk level clearly. They tend to see the products that they did not understand or were not familiar with as “complex and risky”. Here are the more common consideration factors used to classify the level of risks/complexity:

- Products with more first-hand market news such as stocks were perceived to be less complex and risky than those that have limited market news (eg derivatives, structured products).
- Products with high liquidity and trading volume (eg stocks) were perceived to be simple and less risky.
- Products with open investment time limit (e.g. stocks, ETFs, REITs) with which prices are possible to rebound were perceived to be simpler and lower risk than those with fixed maturity dates (e.g. options, warrants, future, ELN).
- Products with prices set by the market (e.g. stocks, ETFs, REITs) were perceived to be less complex and risky than those with prices set by the issuers (warrants, options, futures).
- Leveraged products (e.g. margin trading on stocks, warrants, options, futures) were perceived to be more complex and riskier.
- Products with underlying structure that is not clearly explained or understood (e.g. ELN, accumulators, leveraged & inverse products are perceived to be the most complex and riskiest).

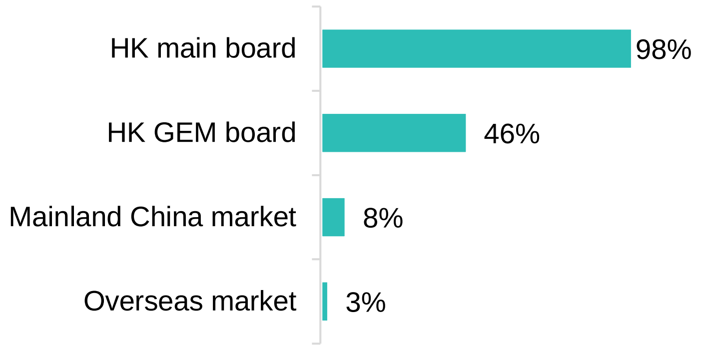
3. Stock Investment

Overview

Most investors invested in the Hong Kong main board and large cap stocks. Less than half invested in the GEM board and small cap stocks.

Limited participation in overseas stock markets with 8% having invested in the Mainland China market and overseas markets in the past year respectively.

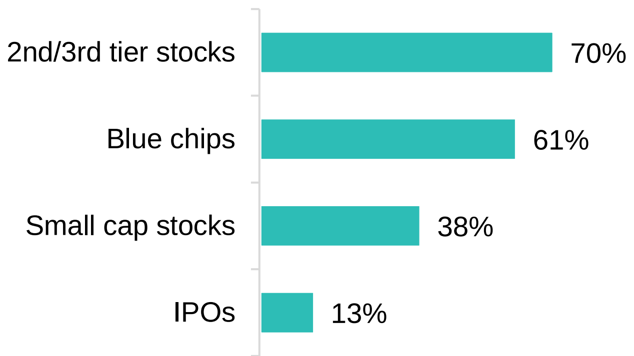
Figure 3.1 – Stock Markets invested-in in the past 12 months



Base: those who have invested in stocks in the P12M (n=791)

Second/third tier stocks were the most popular among stock investors. From focus group discussions, it appeared quite common for investors to have large caps accounted for well over half of their portfolio while a small proportion (generally less than 30%) was invested in small caps for potentially higher returns.

Figure 3.2 – Types of Stocks Invested-in in the past 12 months

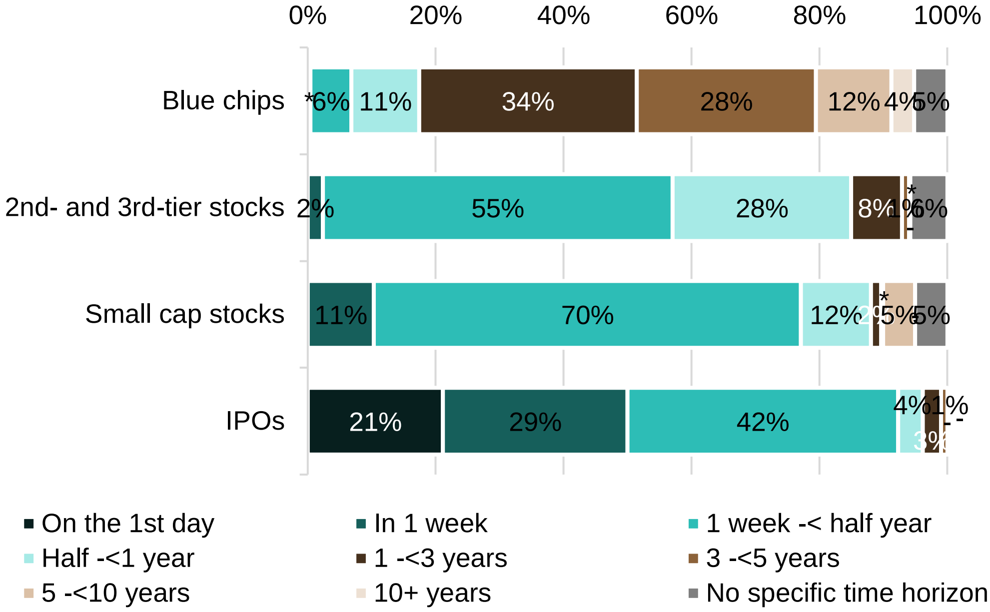


Base: those who have invested in stocks in the P12M (n=791)

Investment horizon

Investors tend to be quite active in stock trading with an investment horizon of less than half a year (except for blue chips which were held for an average of 3.3 years). For IPOs, one fifth of investors sold the allotted stocks on the first trading day.

Figure 3.3 – Investment Horizon by Type of Stocks



Base: those who have invested in blue chips stocks in the P12M n=482, those who have invested in 2nd and 3rd-tier stocks in the P12M n=552, those who have invested in small cap stocks in the P12M n=303, those who have invested in IPO in the P12M n=104

Expectation on return

Riding on the bullish market this year, 61% investors claimed to have profited from the stock market with an average ROI of 13%, which nevertheless still fell short of their expectation of 19% annual return.

Figure 3.4 – Expected ROI of Stock Investment per Annum

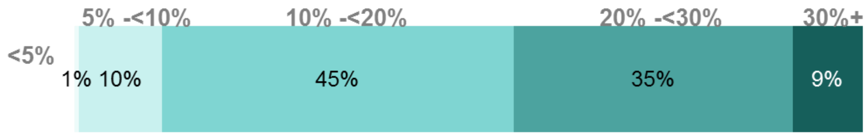
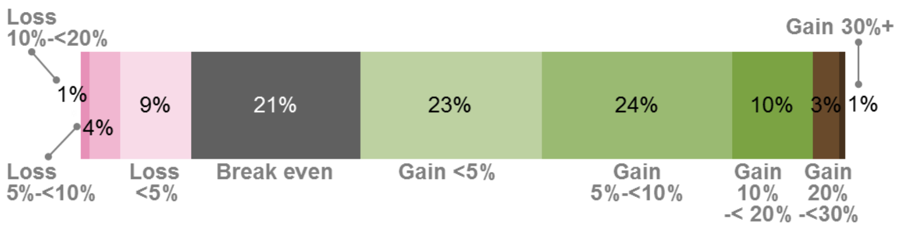


Figure 3.5 – Claimed ROI of Stock Investment in the past 12 months



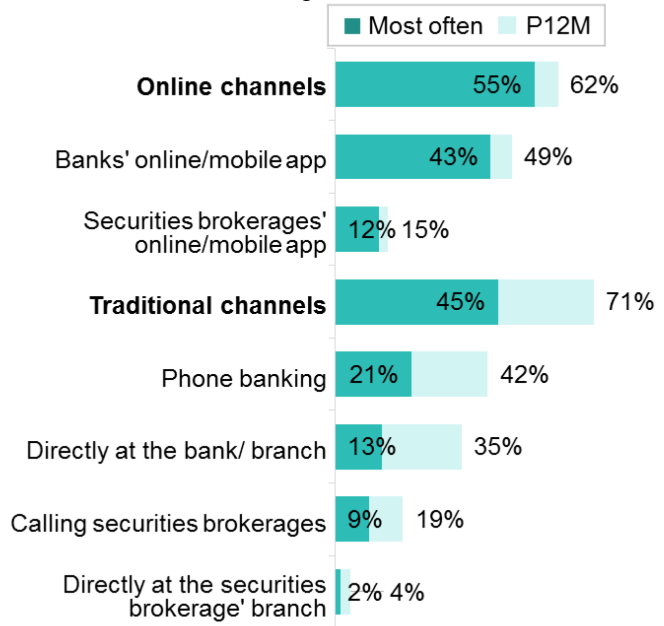
Base: those who have invested in stocks in the P12M n=791

Trading channels

Online trading of stock was common with 55% investors regarding it as a most often used channel. Nonetheless, one third of investors used a mix of online and traditional trading channels, whilst one in five used traditional channels only. Banks were more commonly used than securities brokerages.

From focus group discussions, investors tend to shift usage between online and traditional trading channels e.g. using online trading most of the time for lower transaction fees while using phone banking in case of poor online connection.

Figure 3.6 – Channels Used for Trading

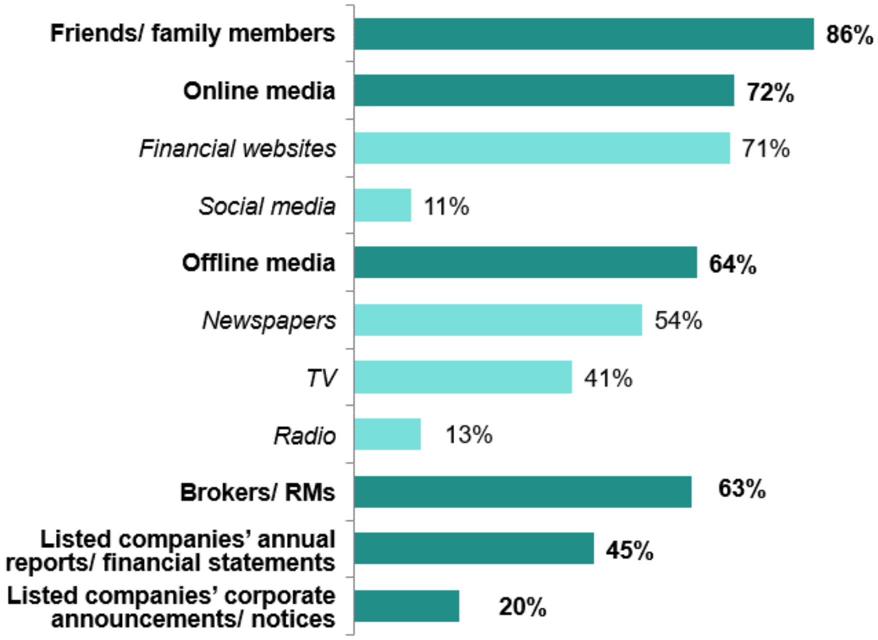


Base: those who have invested in stocks n=791

Information sources

Most stock investors relied on their friends/ family members for advice and less than half studied listed companies' corporate documents.

Figure 3.7 – Key Information Sources Influencing Stock Trading Decisions



Base: those who have invested in stocks in the P12M n=791

High Shareholding Concentration

Half of the investors surveyed were aware that the SFC makes public announcements about high shareholding concentrations of listed companies from time to time.

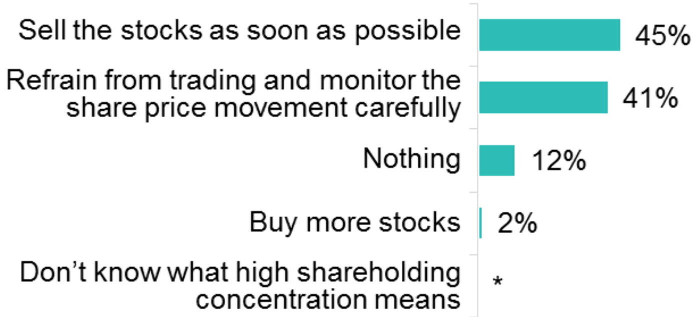
Figure 3.8 – Awareness of the High Shareholding Concentration Announcements made by the SFC from time to time

Base: those who have invested in stocks n=791

From focus group discussions, investors generally did not care much about these announcements because they felt these incidences mainly happen with very small companies which they seldom invested in. However, they could point out that high shareholding concentration suggests potential share price manipulation by the major shareholders, hence big volatility and reduced liquidity.

In the hypothetical situation that they became aware of such news regarding stocks they were holding, 45% thought they would sell the stocks as soon as possible while 41% said they would hold on and keep an eye on the price movement. 12% said they would not take any actions at all.

Figure 3.9 – Likely actions to take if own stocks were found to have high shareholding concentration

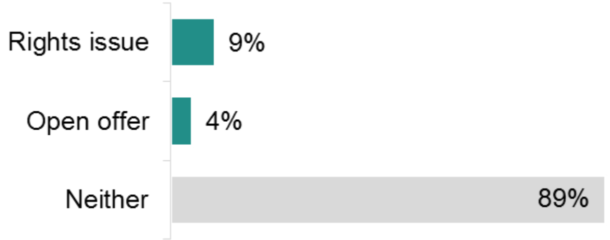


** denotes <0.5%*
Base: those who have invested in stocks n=791

Rights issue/open offers

Less than 10% of investors had ever encountered a rights issue or open offer from the companies they were investing in.

Figure 3.10 – Right Issue/ Open Offer: Incidence (ever)



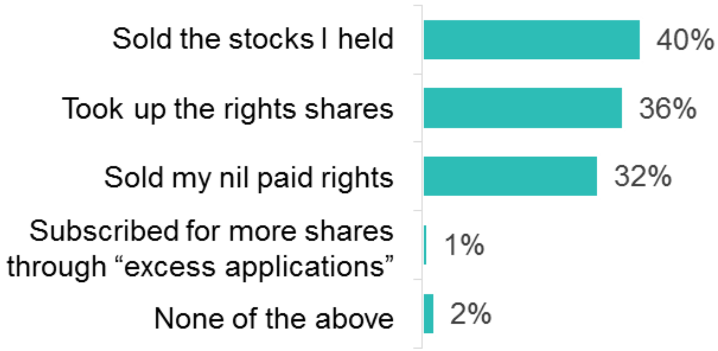
Base: those who invested in stocks n=791

Among those who experienced rights issue/open offers before, 40% chose to sell the stocks while 36% took up the rights shares. One third sold their nil paid rights (for rights issues).

From focus group discussions, many investors were of the view that rights issues were mostly from small companies, which usually signify problematic finance. Therefore they tend not to subscribe to new shares and would sell their shares the soonest possible to avoid their shares being diluted.

Nevertheless, some respondents still recalled the rights issue of well-known corporations in the past decade and reported that for stocks of large companies that they felt confident to continue to hold on to, and especially if a significant discount was offered, then they would consider subscribing to the new shares positively.

Figure 3.11 – Actions Taken in the Events of Rights Issue/ Open Offer



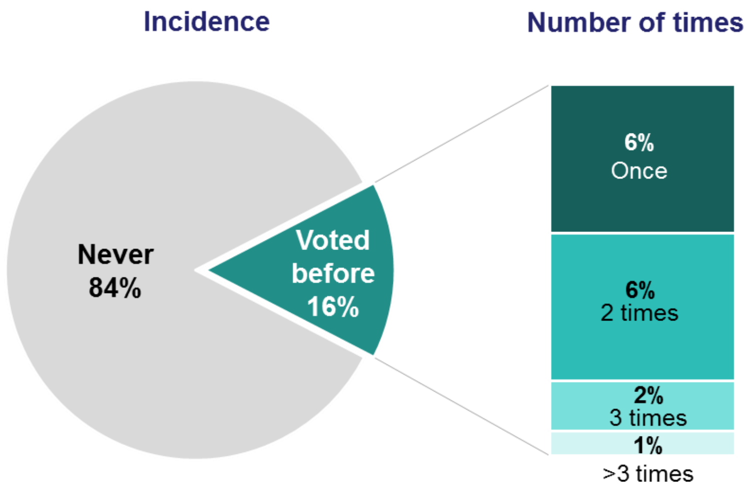
Base: those who have encountered launching of rights issue or open offer n=91

Voting

Voting was not common among the stock investors. Only 16% said they had ever voted in respect of their shares in a listed company (all voting channels inclusive).

Among those who had voted before, majority only voted once or twice.

Figure 3.12 – Voting in respect of one's shares in a listed company



Base:those who have invested in stocks n=791

Most investors did not believe their votes could make any difference and thought that the voting process was time-consuming.

A significant proportion also claimed that they did not know how to vote (40%) or were not aware that minority shareholders could vote (35%). And over one fifth said they simply did not bother with corporate actions and would just sold their shares if they saw issues with a particular corporate action.

Figure 3.13 – Reasons for not Voting

Base: those who never voted before n=664

Among those who voted before, their main motivation was to influence the corporate action which they regarded as affecting their interests as shareholders.

From focus groups, privatization generated the most interest, followed by rights issues.

Figure 3.14 – Motivations for Voting

Base: those who have voted before n=127

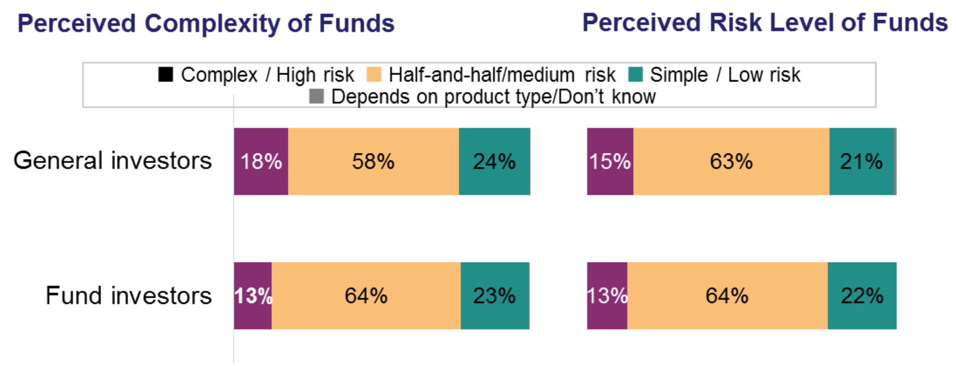
4. Fund Investment

Overview

Fund investors' perception of funds was on a par with general investors', with slightly less fund investors seeing funds as complex/high risk.

From focus group discussions, those investing in funds generally regarded funds as a relatively safe investment (especially with bond funds). Some even had the misconception that because funds are managed by professionals they do not have to actively monitor the performance. Meanwhile, a few investors were aware that some funds could be risky depending on the underlying investments and that "funds are complex products packaged as simple products".

Figure 4.1 – Perceived complexity and risk level of funds



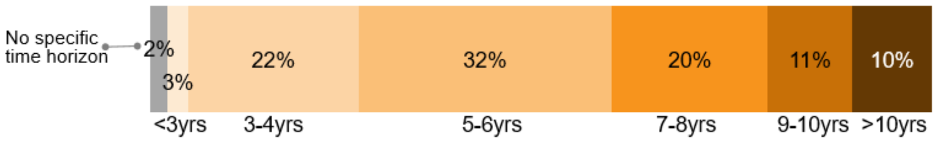
Base: those who have invested in funds in the P12M (main + booster) n=500

Investment horizon & expected return

Despite being regarded as a medium/low risk investment product, over 40% investors expected 20% or more annual return on their funds.

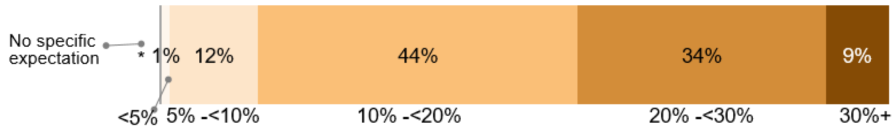
Fund investors held on to their funds for an average of 6.3 years. And they expected an average of 18.6% ROI from their investments.

Figure 4.2 – Investment Horizon of Fund Investment



Base: those who have invested in funds (main + booster) n=500

Figure 4.3 – Expected ROI of Fund Investment



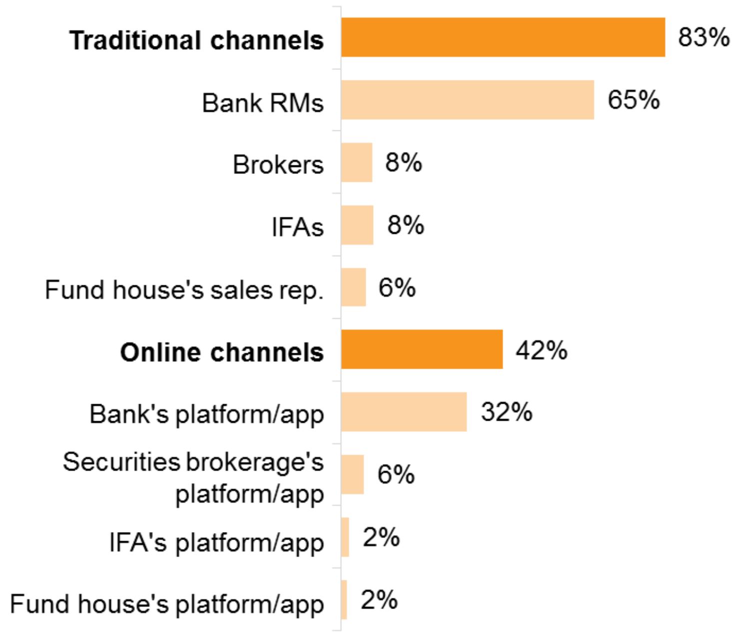
** denotes <0.5%*
Base: those who have invested in funds (main + booster) n=500

Subscription channels

Majority subscribed to funds through face-to-face interaction with intermediaries. Many felt they need the intermediaries to explain the product features and make recommendations to them.

83% said they usually bought funds through intermediaries (mostly bank relationship managers) while 42% also used online platforms. Overall 58% used traditional channels only, compared with 17% going for online channels only, and 25% using both channels.

Figure 4.4 – Channels usually used for fund subscription

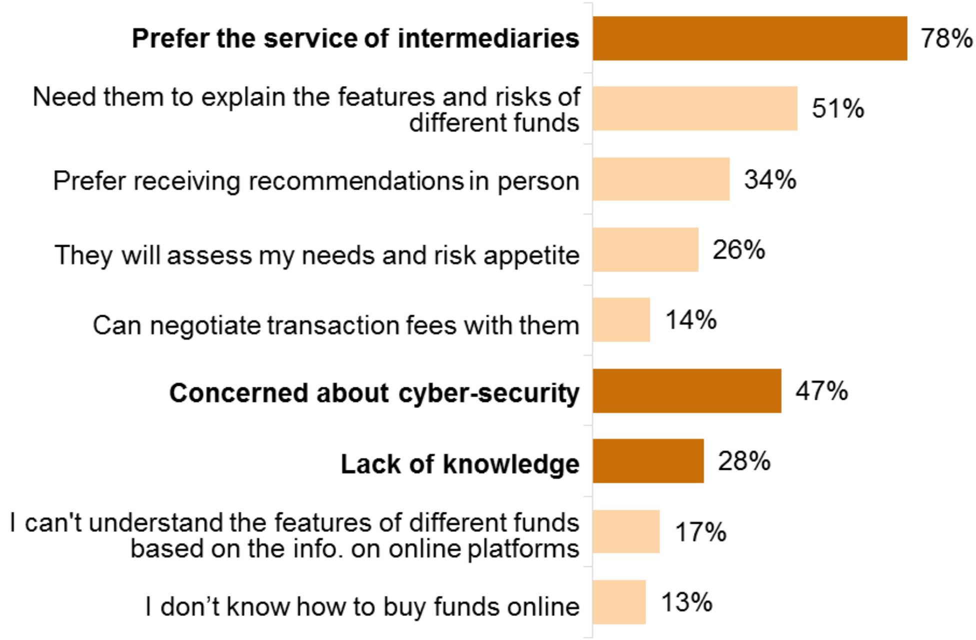


Base: those who have invested in funds in the P12M (main + booster) n=500

About 80% preferred the service of intermediaries, mostly for explaining the features and risks of different funds and making recommendations. A quarter also appreciated assessment of their risk appetite to match with suitable funds. Meanwhile, concerns over cyber-security was also a barrier.

From focus group discussions, many fund investors admitted that they were unfamiliar with funds and relied on recommendations from the intermediaries when making fund choices.

Figure 4.5 – Reasons for not Using Online Trading Platforms



Base: those do not trade funds via online platforms (main + booster) n=292

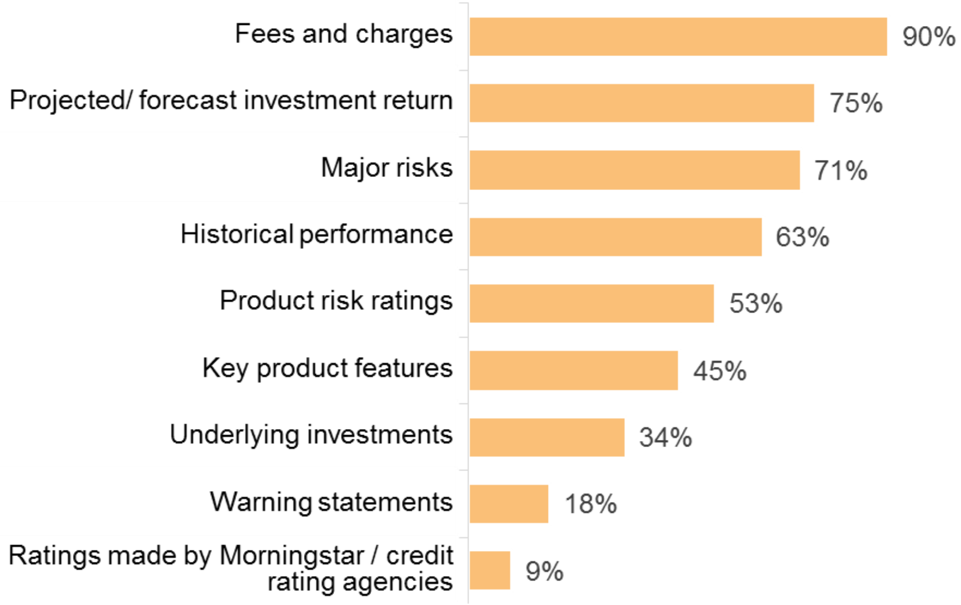
Key consideration factors

Fees and charges, projected returns, major risks and historical performance were the top consideration factors when choosing funds. Less than half cared about product features and only one third paid attention to underlying investments.

From focus groups, investors reported that fund fact sheets were usually referenced in the sales process by the intermediaries but they tend to avoid the heavy text in the offer documents.

And while some investors noted the importance of checking the different asset classes a fund invested in, majority admitted they just assumed the underlying investments were as indicated by the name or theme of a fund, for example, a bond fund would be mainly investing in bonds.

Figure 4.6 – Information deemed important when choosing funds

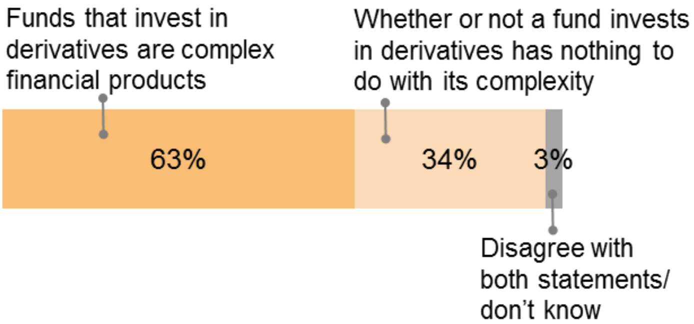


Base: those who have invested in funds (main + booster) n=500

Perception towards Funds Investing in Derivatives

Echoing the perception of derivatives as complex and high risk products, two thirds of fund investors regarded funds investing in derivatives as complex.

Figure 4.7 – Perception towards Funds Investing in Derivatives

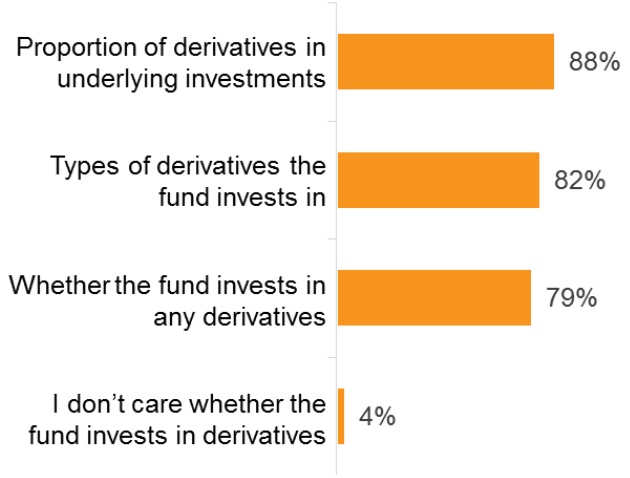


Base: those who have invested in funds (main + booster) n=500

From focus group discussions, it appeared that many fund investors were not aware that some plain vanilla bond or equity funds may have significant exposure to derivatives. They felt the perceived high risk nature of derivatives contradicted with their expectation that funds carried lower risks, especially for bond funds.

In the survey, over 90% of surveyed fund investors thought the offering documents should cover information about the derivative elements in funds – 88% wanted to be informed the proportion of derivatives in the underlying investments and 82% preferred knowing about the types of derivatives the fund invests in.

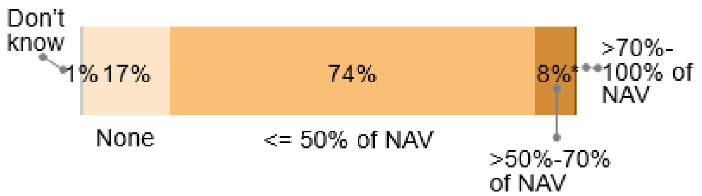
Figure 4.8 – Information about the Derivatives in Funds Deemed Necessary to be Covered in Offering Documents



Base: those who invested in funds in the P12M (main + booster) n=500

74% of surveyed fund investors thought plain vanilla (bond or equity) funds should have less than 50% of exposure to derivatives, while 17% did not expect any exposure to derivatives at all.

Figure 4.9 – Expected Exposure to Derivatives for a Plain Vanilla Bond or Equity Fund



** denotes >0.5%*

Base: those who invested in funds in the P12M (main + booster) n=500

Concluding Remarks

Hong Kong is an international financial centre and retail investors' participation in the financial markets is among the highest in the world. And yet this research has revealed a number of inadequacies among Hong Kong investors when it comes to making informed investment decisions. Key weaknesses include:

- **Insufficient research and analysis before investing** - 2017 saw a buoyant investment sentiment and Hong Kong people were active in investing in financial products with rather aggressive expectations on return. In making their investment decisions, advice from others was more relied upon than investors' own efforts in research and analysis. Investors need to have a stronger mindset that investing is an important part of long-term financial planning and requires effort. They should also be cautioned against taking on increased risks when investing their profits.
- **Misguided impressions of various investment products** – While investors were generally alerted to derivatives and structured products as high-risk investments, many appeared to have under-estimated the potential risks associated with some investment vehicles, such as bonds, foreign exchange and funds. In particular, research findings focusing on fund investment showed that fund investors tend to overlook the importance of underlying investments and there appeared to be an over-reliance on intermediaries when choosing funds to invest in. Investors need to understand each of their investments in terms of product features and potential risks. Further, investors should be educated to distinguish the different concepts of product complexity and risk levels.
- **Lack of engagement in corporate actions** – Majority of stock investors in Hong Kong were disengaged in corporate actions. More effort is required to instil a sense of rights and responsibilities for stock investors to follow corporate actions and vote in corporate elections. Investors need to recognise the power accorded to shareholders which entitle them to influence decisions on significant issues that may affect the value of their shares. Again, education on adopting a more long-term view on investment may contribute to better engagement.

Investor education has always been an important part of IEC's mission in raising financial literacy levels in Hong Kong. Based on the research findings, the IEC will strive to address the weaknesses identified by encouraging more prudent and responsible attitudes towards investing, as well as promoting better understanding of different investment products, through the provision of comprehensive investor education programmes and resources.

Further, the IEC would continue to promote holistic personal financial planning and seek to empower Hong Kong people to make informed financial decisions.

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