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Why Hong Kong has outperformed YTD — and why foreign investors remain cautious

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Could the China trade make a comeback? That was a question for investors to mull this week as Washington and Beijing signed a trade deal that appeared to formalise an earlier handshake agreement.

Over the past four years, global capital has chased the relative safety and performance of the US tech sector. In contrast, investors have viewed Asia – and India, Taiwan and China in particular – as increasingly un-investable.

The macroeconomic headwinds, regulatory overhang, and geopolitical tensions made it easy for investors to stay away – and many did. The rise of 'GEMs ex-China' strategies has been a clear signal: investors haven't just been underweight China; they have actively excluded it.

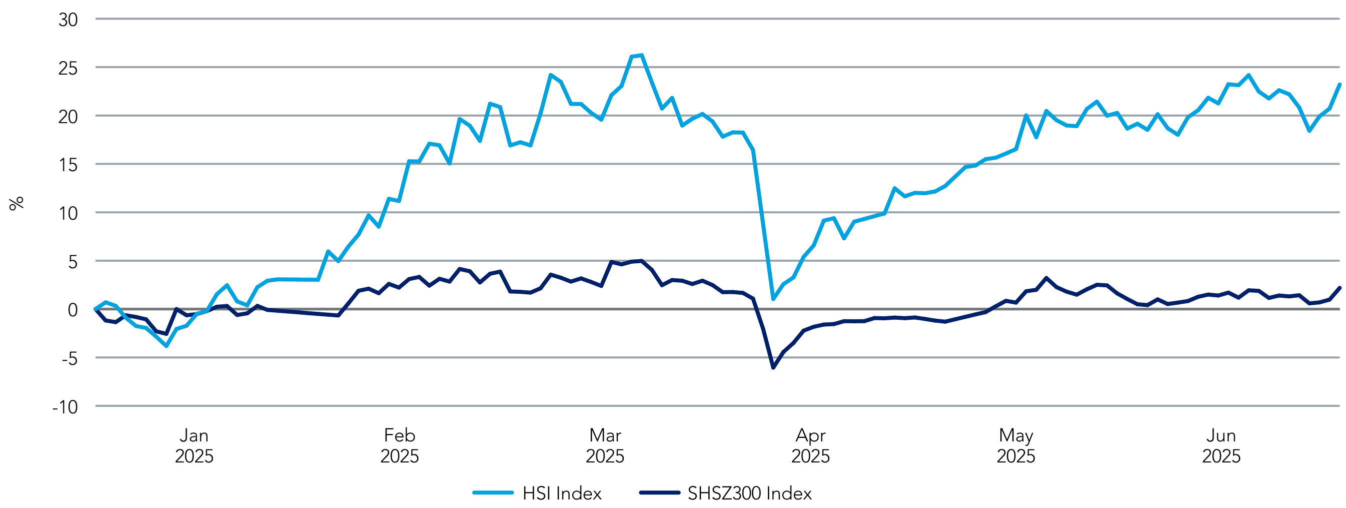
Fast forward to today, however, and the narrative appears to be shifting – at least in Hong Kong. The Hang Seng Index has surged 23.2% year-to-date (YTD), marking its strongest relative outperformance versus the CSI 300, the mainland China blue-chip Index, since 2008, which has delivered 2.2% YTD.[1]

This divergence is striking and speaks volumes about where investor confidence lies within the broader China complex.

Fast reading

- **China remains a contrarian trade**, with global investors still cautious amid macro, regulatory, and geopolitical headwinds.
- **Hong Kong is outperforming**: The Hang Seng Index is up +23.2% YTD[2], its strongest relative run versus onshore China since 2008.
- **Mainland investors are driving the rally**, rotating into Hong Kong via southbound Stock Connect – which allows mainland Chinese investors to access the Hong Kong market – amid concerns over China's domestic outlook.
- **Foreign institutional flows remain light**, with hedge funds leading activity – signalling a tactical, not structural, re-engagement.

Figure 1: How the Hang Seng soared



Source: Bloomberg as at 24 June 2025.

[1] Bloomberg, as at 24 June 2025.
[2] Source: Bloomberg as at 24 June 2025.

Data suggests that the rally in Hong Kong has been driven not by foreign inflows, but by domestic capital – specifically, mainland investors accessing the territory's market via southbound Stock Connect, which allows mainland Chinese investors to access the Hong Kong market (see Figure 2 below).

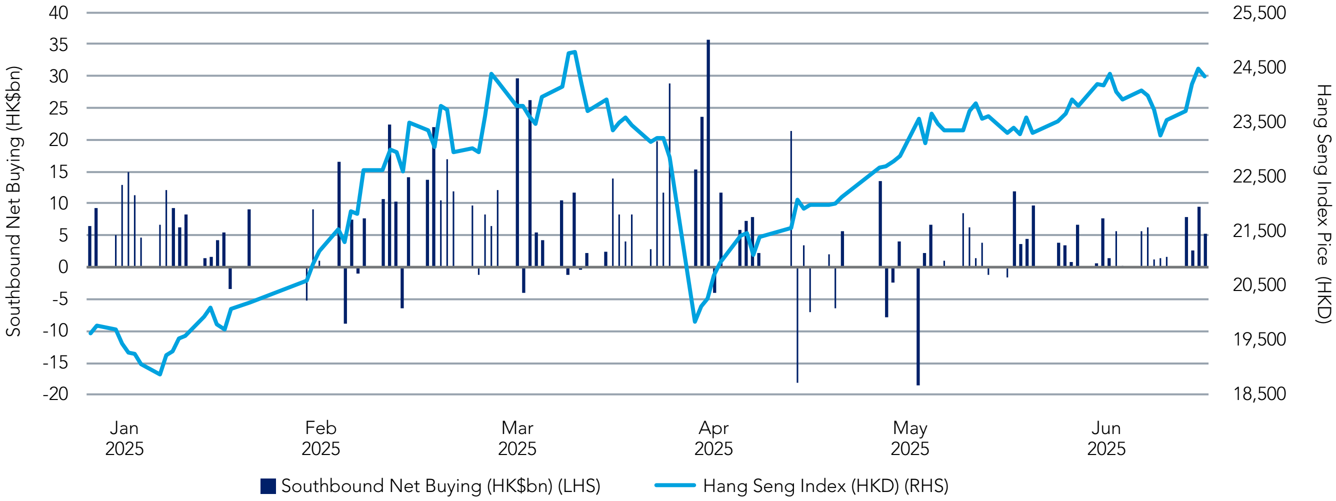
It reflects a mounting concern over China's domestic economy, meaning investors are looking outward, with Hong Kong's tech-heavy listings and recovering IPO pipeline offer a compelling alternative. Mega-caps like Tencent and Alibaba – listed in Hong Kong and the US, but not onshore – have become key vehicles for this rotation. Alibaba's September listing upgrade, which made it eligible for southbound flows, was a pivotal moment.

Yet, despite the rally, foreign institutional investors remain largely on the sidelines. Flows have been predominantly from hedge funds – tactical, short-term capital – rather than long-only money making a structural return, the scars from past drawdowns run deep.

Even the excitement around China's AI ambitions, briefly reignited by DeepSeek's GenAI launch in January, has been tempered by a series of geopolitical flashpoints: 'Liberation' Day' tariffs, and uncertainty as the end of the 90-day tariff pause looms.

In short, Hong Kong is rallying – but it's not a broad-based vote of confidence in China. It's a tactical trade, driven by domestic capital and selective optimism. For foreign investors, the bar for re-engagement remains high.

Figure 2: Hong Kong – southbound fund inflows vs. HIS



Source: Bloomberg, as of 26 June 2025. MacroMicro. Southbound Stock Connect, part of the Stock Connect programme, allows mainland Chinese investors to trade eligible Hong Kong-listed stocks.

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