Opinion | Improving the Liquidity of "Deep V" Stocks - The Fastest Way is Through the Stock Connect

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Recently, the Hong Kong stock market has once again focused on the liquidity challenges faced by small and medium-sized enterprises (SMEs). 41 Hong Kong-listed companies jointly issued an appeal to the relevant authorities, requesting a reduction in the Southbound Stock Connect threshold, a temporary suspension of the "out-of-Stock Connect" adjustment, a retroactive adjustment for companies that have already been "out-of-Stock Connect", and support for Hong Kong-listed 18A companies (pre-revenue biotech firms) to directly access the Southbound Stock Connect.

This joint action not only reveals the liquidity dilemma faced by SMEs, but also refocuses market attention on the threshold issue of the Stock Connect.

The liquidity problem in the Hong Kong stock market is largely due to its unique investor structure and market environment. The Hong Kong stock market is dominated by institutional investors, while the participation of retail investors is relatively low. Institutional investors focus on market capitalization and trading volume thresholds, leading to the neglect of many SMEs with sound fundamentals but smaller market caps, forming the so-called "Deep V" stocks (deeply undervalued). These stocks have long been trading at low price-to-earnings and price-to-book ratios, with low trading volumes and sluggish stock prices.

The 41 companies that issued the joint appeal are representatives of these SMEs struggling with liquidity constraints. They hope that by lowering the Southbound Stock Connect threshold, they can attract more mainland capital to the Hong Kong market, thereby improving stock liquidity and increasing market participation. This not only helps solve the financing problems of SMEs, but also improves market efficiency and attracts more investor participation.

However, lowering the Southbound Stock Connect threshold is not a simple task. Industry insiders generally believe that this measure involves supporting technological innovation, investor protection, and balancing the interests of various market participants. Particularly regarding the proposal to automatically include 18A companies (pre-revenue biotech firms) in the Southbound Stock Connect, there are different voices in the market. While inclusion in the Stock Connect can improve liquidity, it does not necessarily lead to higher valuations or stock price performance. Therefore, any adjustments need to be gradual and timely.

The liquidity problem in the Hong Kong stock market not only concerns the survival and development of SMEs, but also the overall health and stability of the market. To improve the liquidity environment, the regulatory authorities need to enhance policy flexibility and provide investors with more choices. For example, relaxing the investment restrictions of the Southbound Stock Connect to attract more mainland capital to the Hong Kong market, while also exploring and attracting retail investor participation to increase market activity.

Furthermore, for the neglected "Deep V" stocks, the Hong Kong government and the fund industry could consider setting up dedicated investment funds to revitalize these stocks on the verge of collapse. At the same time, launching relevant stock indices and ETF funds that focus on trading these undervalued stocks can inject new vitality into the market.

In summary, the liquidity challenge faced by SMEs in the Hong Kong stock market is a complex and urgent issue. Through measures such as lowering the Southbound Stock Connect threshold, enhancing policy flexibility, attracting retail investor participation, and establishing dedicated investment funds, we hope to infuse new liquidity into the Hong Kong stock market and promote its healthy and stable development.

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