



January 17, 2018

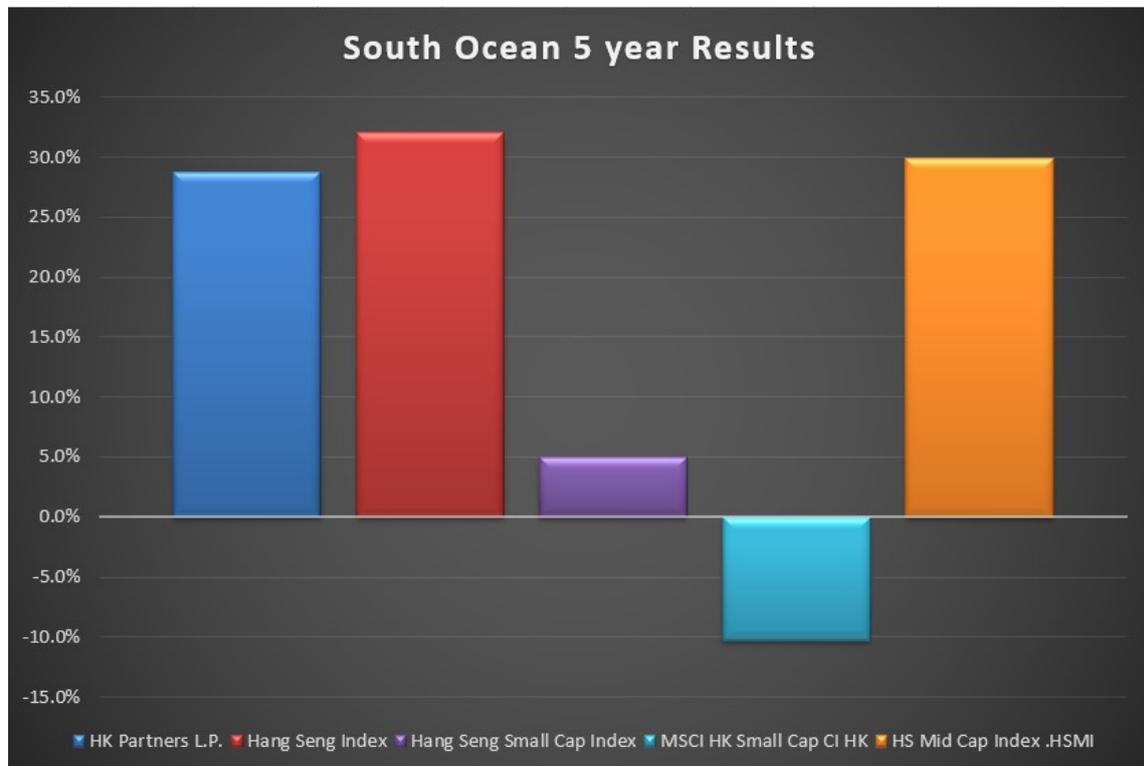
Dear Clients, Partners, and Friends,

The results for South Ocean Management’s Delaware LP, Hong Kong Partners’ L.P., before incentive fees, were as follows:

	<u>Dec 2017</u>	<u>Year-to-date</u>
Hong Kong Partners LP	0.7%	8.2%
Hang Seng Index	2.5%	36.0%
Hang Seng Small Cap Index	3.8%	19.2%
MSCI HK Small Cap HK	0.0%	14.3%
HS Mid Cap Index	2.7%	33.5%

Partners’ NAV \$3.2307 after management fee and provisions, but before annual incentive fees of 15% on appreciation.

Since initiating our proprietary discipline of investing in Hong Kong-listed stocks of companies doing business in China, with solid fundamentals and undervalued prices relative to our intrinsic value calculations, results have been favorable:



Our Banquet System screening process uncovers stocks that are generally not found in the mainstream. For example, of the main indexes in Hong Kong, we own one holding in the Hang Seng Small Cap Index (201 constituent stocks, market capitalization HK\$1.9 trillion, US\$ 201 billion), 7 holdings in the Mid Cap index (185 constituent stock index, market cap of HK\$5.7 trillion, US\$740 billion) and one stock we began buying in the 4th quarter last year (laggard PC maker Lenovo) in the Hang Seng Blue Chip Index (50 constituents, market cap HK\$20 trillion, US\$ 2.6 trillion). After screening for stocks to own, we spend most of our time and effort with due diligence, review and analysis of these undiscovered and/or out-of-favor, uncommon values.

South Ocean's overlooked, quality holdings are relatively cheap:

	Trailing P/E	2017	Yield
HS Index	14.2	12.5	2.8%
Small Cap	12.6	10.9	2.3
Mid Cap	13.8	11.5	2.3
HK Partners	12.2	9.8	3.1

The Hang Seng Index gained 36% gain last year, with Internet giant, Tencent, contributing 20% of that move (we do not own Tencent in our portfolios). In the Hang Seng Small Cap Index, a narrow subdivision has propelled the index's return; primarily, small real estate/financially-oriented stocks and a scattering of material stocks (areas we have no concentration in our portfolios. As mentioned above, we own just one holding that is in the small cap index, leading smart meter manufacturer, Wasion Holdings, code 3393hk). There are many small mainland real estate-oriented companies in the index which are highly favored by mainland China investors that are investing through the Hong Kong/China stock connect program. This group has been the most active sector in the index. Indeed, last year, the financial sector weighting swelled from a 14% weighting of the small cap index to a 27% weighting today.

A few cyclical/material metal stocks also outpaced. This group, which has been trading in the doldrums since 2008, roared back into favor in the second half last year. Iron ore trading/steel manufacturer, China Oriental (code 581hk, a stock we do not own), for example, gained 237% in price and was a top performing Hang Seng Small Cap Index constituent.

Cyclical stocks are difficult to value due to the extreme volatility of earnings and excessively long cycles between profitability and losses.



We do not try to time the cycles and, therefore, did not participate in last year's bounce.

(As an aside, like many 'old economy' companies in the PRC, China Oriental has ventured into real estate development and sales of properties. Most State-Owned-Enterprise-listed companies in China have gone into property development, to 'bolster' their mediocre returns. Much of the credit growth in China since 2008 has been capital earmarked and invested in real estate. The resulting price rise in mainland real estate values has been a concern for the government. Beijing's aim today is not to bring down total nationwide leverage, but to reduce financial risk while maintaining credit support for the real economy).

We own one holding involved in housing construction in China, Hong Kong-listed China State Construction (CSC, code 3311hk, 3.5% position, market cap HK\$52 billion, US\$6.6 billion). An A-rated company on our Banquet System, CSC has demonstrated 5 years of improving net income and cashflow from operations. Its parent company, one of the world's largest construction firms, is listed on the Shanghai stock exchange. CSC receives support from its parent in garnering China construction projects. Overall, construction will remain robust for CSC in the greater China markets. For perspective, China will have built 105 Skyscrapers in 2017, the US built 189.... ever (buildings of 200m or taller).

Ultimately, the government's modernization plan is to fully integrate 70 percent, or roughly 900 million people, of the country's population into city living by 2025. A little over one half of that number have migrated and 'social' public housing construction, a forte and focus of CSC, will continue to be strong.

Though the shares of CSC have been lagging the market, the company reported new orders secured last year of HK\$103.14 billion (US\$ 13 billion), up 23.1%, as was targeted by the company.

Investors have been highly concentrated in 2017 in a select few large cap stocks. Historically, small cap stocks outperform large caps. Younger companies can

grow earnings faster. The Hong Kong/China stock markets have good momentum with solid economic prospects entering 2018. As this cycle continues and market leadership broadens beyond the biggest, large cap growth stocks, we are positioned to gain in the new year.

We trust all our Partners and friends had a good Christmas and New Year holiday. With our own capital invested alongside our Partners, we look forward to a prosperous 2018.

Sincerely,

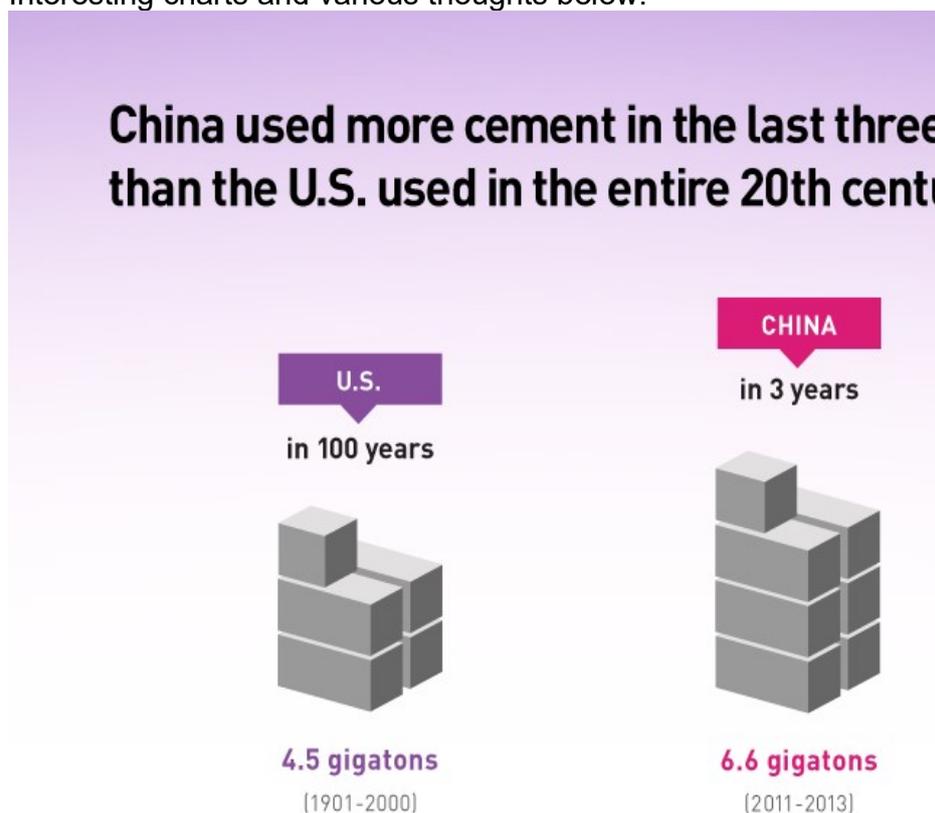
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Interesting charts and various thoughts below:



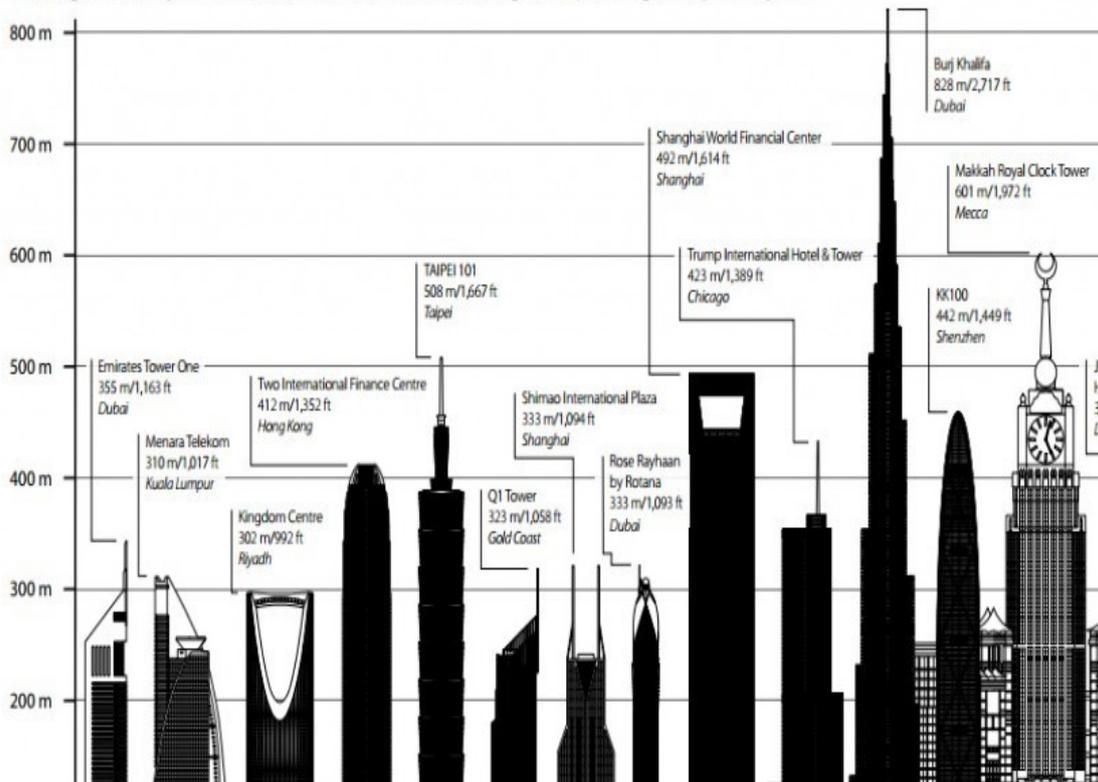
One of the big problems with putting down so much concrete is that it deteriorates. In the coming decades, the United States and China alone will need to spend trillions of dollars replacing and disposing of concrete laid down in the past generation. There are

also environmental problems, including all the carbon dioxide that's released during production.

[Skyscraper curse](#) anyone?

World's Tallest Building Completed Each Year

Starting with the year 2000, these are the tallest buildings completed globally each year.



The Real “New World Order” Is Coming To Life [4]

Posted with permission and written by Rory Hall, The Daily Coin [4]

<https://www.zerohedge.com/news/2017-11-02/real-%E2%80%9Cnew-world-order%E2%80%9D-coming-life>

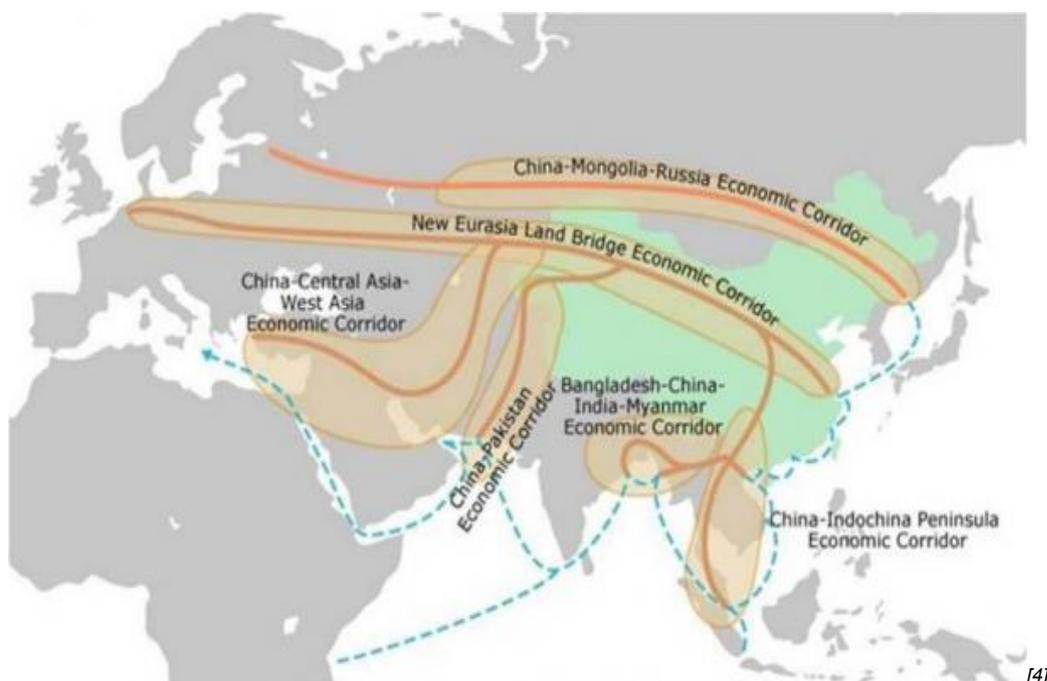
If you want to see what is going to change the lives of your children and grandchildren, look no further than the map published below. This is WHERE the future will be, regardless of the naysayers. The Belt and Road Initiative is going to transform the world and, once this project is 25-30% complete – within the next 5-7 years – the impact will be felt globally.

Natural resources will be funneled into the Eastern countries, or they will simply never leave from the country they mined or extracted. Global employees will disappear from Western market places as their services will be needed in the East and so it will go right down the line. Buckle up kids, as we are going to be faced with a very bumpy ride unless the criminal scum holding onto yesterday suddenly have their “come to Jesus” moment and realize they are outside looking in.

As reported by [ZeroHedge](#): [5]

*Dear Mustafa,
I arrived in Karachi at 5.30am this morning on the direct PIA flight from Heathrow. The city of 26 million people had not yet woken up and I made it to the Sind Club in under 20 minutes. But as I write this now I can hear the horn-filled throb of city life on all four sides of the Club walls; this city pulsates with growth.*

If you [click on the map](#) [6] I attach here you will see one of the main reasons – the Chinese Economic Corridors – otherwise know as ‘One Belt...One Road’. Pakistan lies directly on one of these routes, but look at this map carefully as it will change our world and world order, wherever we live.



Let's look at some facts on 'One Belt...One Road':

- It connects 65 countries and 4.4 billion people.

- *In 2016 Chinese companies signed 8,158 contracts in 61 countries worth \$150b.*
- *In 2016 China's trade with the One Belt...One Road countries reached \$953b.*

Over the next 10 years, China will spend \$2 trillion on 'One Belt...One Road' infrastructure, and, more amazingly, they are not asking the investee countries and corporates to pay it back; 80% of the money spent will be a perpetual bond, with only the interest needed to be paid. The principal is never returned.

What is also very clear from the map is that China has no interest in controlling the seas. In fact they have taken a conscious decision to bypass the seas, to bypass the 7th, 8th and 9th US fleets that currently ring the Eurasian landmass. The US navy can sail the oceans to their heart's content, the action is now on land. And to that end the first test train from China arrived directly in London in July this year; it took 20 days less than by sea. This is all pretty revolutionary stuff.

China is attempting 'the project of the century.'

And as I am served a cool lemonade at the Club, a final remnant of the British empire, it is another empire – the American empire – that may be taking its last few sips of leadership.

See you in London next week. Chris

No since in acting like this is not happening or that China is going to run out funds or somehow not be able to complete this project – you would be 100% wrong in that assessment. The Belt and Road Initiative is going to place China back at the head of the global economy; exactly where she was until the West all but destroyed the nation with the opium wars beginning in the early part of the 1800's. China, up until that time, was the world's only super-power and the world's largest economy. China occupied these positions before these positions were measured/known – she just was and the world knew it. The day for her to reclaim the throne is coming - what it will mean for the rest of the world, at this time, is unknown.