SOUTH OCEAN 南海管理有限公司
MANAGEMENT, LTD.
HONG KONG

February 14, 2017

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:

	Jan 2017
Hong Kong Partners LP	1.8%
Hang Seng Index	6.2%
Hang Seng Small Cap Index	2.1%
MSCI HK Small Cap Index	2.3%

Partners' NAV $3.0376 after management fee and provisions, but before annual incentive fees of 15% on appreciation.

January was an abbreviated month of trading in the China markets as the lunar Chinese New Year's celebration began earlier than usual. Late in the month, large capitalized Hong Kong share prices gained sharply after the Dow Jones Industrial Average passed through the 20,000 level. Though the Hang Seng Index jumped (+1.4%) that day, volumes were extremely light at the end of the month as the market headed into the holidays.

At South Ocean, we manage focused portfolios concentrating on a small number of small/mid cap stocks listed in Hong Kong we have researched carefully. Our top 10 holdings, all companies benefiting from operations in China, often amount to over 50% of total portfolio value. During certain periods, our concentrated holdings can and do produce movements that diverge from those of the blue-chip indexes, but we've managed to sustain better than index results over the longer term (of note, our Hong Kong Partners LP has gained 15.9%, net, versus 10.2% for the Hang Seng Index and 7.4% for the US Vanguard Large Cap ETF in the ten years ending December 2016).

Our equity investments are geared towards basic needs in China. For instance, a long-term, core holding in our portfolios is Beijing Enterprises Water Group (BEWG:371 HK, 7.9% holding, HK$48.5 billion market cap or US$6.3 billion), the leading wastewater treatment operator in China. Water shortages are severe in over 400 Chinese cities. Most ground water on the Mainland is polluted with heavy metals, and is not safe for human consumption. China is spending US$80 billion a year over the next four years to meet mounting urban water needs, resolve water shortages and to advance infrastructure.

BEWG owns and operates over 300 wastewater plants in China. As a leader in municipal waste water treatment, the company enjoys strong government backing (Beijing Enterprises owns 44%) and solid execution (net income has grown each of the past 5 years by greater than 30% compounded). In addition to wastewater treatment, the company is expanding into river/lake rehabilitation, ecological system restoration, integrated environmental water services and industrial wastewater treatment. Beijing Enterprises Water Group trades at 13.2 times consensus 2017 earnings, below its average annual P/E of 24.9 times.

Besides water treatment investments, China is leading the way forward in total infrastructure expenditures—investing more than North America and Western Europe combined since the Great Recession of 2009. Our renewable/environmental holdings are also beneficiaries of this government spending.

Today, there's concern about what the Trump administration will propose regarding trade and tariffs with China. Though other emerging markets are far more vulnerable to American protectionism, China remains the focal concern in the financial media. Yet, the Middle Kingdom has already advanced a long way towards reorienting its economy towards more internal drivers. "The services sector accounts for 52 percent of the economy, and that is highly likely to be an underestimation, given the poor collection of data from the private sector," according to this CNBC article.
http://www.cnbc.com/2017/01/24/trumps-protectionism-may-hit-emerging-markets-but-not-china.html

We pointed out the possibility, in last month's commentary, of the Hong Kong market being primed for a strong, multi-year advance. Recently, a few strategists are beginning to recommend an overweight investment posture towards Chinese equities. Though sentiment remains largely negative towards China-oriented stocks, the Mainland's economic, supply-side reforms continue to gain traction.

We envision an attractive stock market environment developing.

Sincerely,

Brook McConnell

President
Email: brook@south-ocean.com Website: www.south-ocean.com
Hong Kong

An interesting statistic; according to Bloomberg, China's railways probably carried about 356 million passengers -- more than the population of the U.S. -- during the Lunar New Year holiday, which extends for over a month…

…and, trains carry far more travelers than airlines in China…

Though China has more than 60% of the world's high speed railroads, can you imagine being stuck in this crowd (20 second video, click: Up to 100,000 travellers stranded at train station in China)?