



February 14, 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>Jan 2018</u>
Hong Kong Partners LP	1.8%
Hang Seng Index	10.2%
Hang Seng Small Cap Index	9.6%
MSCI HK Small Cap Index	4.7%

Partners' NAV \$3.2892 after management fee and provisions, but before annual incentive fees of 15% on appreciation.

Our small/mid cap holdings of Hong Kong-listed companies continued to rise with the exuberant Hang Seng Index in January. The larger capitalized, Hang Seng stocks rose on continued inflows from foreign passive investment strategies.

Top 15 performing constituents in Hang Seng Index Year-To-Date, through Jan 30, 2018

Top 15	a/o Jan 30 2018	YTD %	
.HSI	HANG SENG INDEX	9.0	
2318.HK	PING AN	10.9	Real Estate/Finance
2007.HK	COUNTRY GARDEN	11.7	Real Estate/Finance
0700.HK	TENCENT	13.7	Internet
1928.HK	SANDS CHINA LTD	14.6	Gaming
0857.HK	PETROCHINA	14.7	Energy
3328.HK	BANKCOMM	15.5	Real Estate/Finance
1398.HK	ICBC	15.6	Real Estate/Finance
0004.HK	WHARF HOLDINGS	17.4	Real Estate/Finance
1088.HK	CHINA SHENHUA	19.0	Energy
0386.HK	SINOPEC CORP	19.5	Energy
0388.HK	HKEX	20.1	Real Estate/Finance
3988.HK	BANK OF CHINA	20.6	Real Estate/Finance
0688.HK	CHINA OVERSEAS	22.7	Real Estate/Finance
0939.HK	CCB	23.1	Real Estate/Finance
1109.HK	CHINA RES LAND	37.4	Real Estate/Finance

An early January deferral of implementing a capital gains tax in China on real estate transactions probably contributed to much of that sector's gains for the month.

We have resisted chasing the rising price trend in large caps and are not invested in this narrow sector. For one reason, fundamentals are not cheap for these stocks. Internet giant Tencent, for example, doubled in price in 2017. Last month, the shares gained another 13.7%. Tencent sell at 57x trailing earnings, with a current market capitalization of HK\$4.3 trillion /US\$550 billion today. The high stock valuation is a function of heightened future growth expectations, an increasingly difficult objective given its much larger base today. Tencent is a terrific company, but the stratospheric valuation is too risky for us to consider investing.

Today, small and mid-cap stocks have more value compared to large cap stocks which have rallied to levels far above their fundamental value. Flows from US investors have typically bought into Hong Kong large cap stocks through passive flows and exchange traded funds over the past year or so.

Out-of-favor small/mid cap stocks that we own benefit from faster growth of earnings and smaller bases. Further, as their capitalizations rise due to above average growth, a much wider universe of large investors become interested stakeholders, an important performance factor. Our concentrated portfolio of holdings receives a significant boost and rerating.

The companies we own have stable cashflows, low valuations relative to expected earnings growth and proven track records. These characteristics, along with market leading positions/brands and focused managements, promise substantial returns for patient shareholders.

Earnings season will begin in March for December year-end financial reports. We will be investigating and analyzing results, which we expect to be positive catalysts for our holdings.

Sincerely,

Brook McConnell
President

Email: brook@south-ocean.com Website: www.south-ocean.com

Hong Kong