



February 15, 2019

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 2019</u>
Hong Kong Partners LP	4.8 %
Hang Seng Index	8.1%
Hang Seng Small Cap Index	7.5%
MSCI HK Small Cap Index	6.0%
HS Mid Cap Index	8.7%

Partners’ NAV \$2.5587 after management fee and provisions, but before annual incentive fees of 15% on appreciation. Selling evaporated in Hong Kong’s stock market at the beginning of January, thus ending last quarter’s rout, after the Federal Reserve reversed course on raising interest rates. Our portfolios of small/mid cap, Hong Kong-listed companies, benefiting from operations in mainland China, rose with the rebound.

In January, the Hang Seng Index rose 2,100 points to close at 27,942. The fourth quarter low for 2018 was 24,540 which was the low for the year.



The blue-chip index has advanced 3,400 points (13.8%) from that point, but remains below the year ago (all-time) high set at 33,484.

We ended January with 25% cash and 75% in long term commitments to companies that will prosper with China’s economic development. We believe our cautious stance is a reasonable exposure to the geopolitical trade-war risks and economic/earnings slowdown

concerns which are very much at the forefront of investors' concerns today. We do not use leverage and have conservative earnings assumptions about our companies' growth prospects. That puts our portfolios at very cheap levels today. Our weighted average price-earnings ratio for 2018 expected earnings is 6.8 times (most companies will start reporting their 2018 year-end results in March) and 6.2 times this year's expected earnings.

To counter its economic slowdown, China has embarked on massive infrastructure projects (see 10 new rail and bridge projects and videos [here](#)). Worries of a 'hard landing' are muted for now. We are confident in the prospects of our undervalued, fundamentally strong holdings.

Sincerely,

Brook McConnell
President

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PS: we view China's infrastructure commitments as necessary budget expenditures. For instance, newly built trains traverse between important cities and provinces of China and they are super-fast. Journey times are cut from 6 hours to 2 hours.

Over 4,000 bullet trains run in China, carrying 4 million passengers every day, according to the China Railway Corporation. Chinese high-speed rail (HSR) service began operation in 2008, running at speeds from 250 km/h to 350 km/h (217 mph). China's HSR network is expected to exceed 38,000 kilometers by 2025, and 45,000 km (or 27,961 miles) in the longer term, far more rail lines than in the rest of the world **combined**. As of the end of 2018, the total length of China's high-speed railways rose to 29,000 kilometers, more than two-thirds of the world's total.

If you have ever been disposed to travel during Chinese New Year's on the mainland, you would certainly believe the spending as direly necessary.

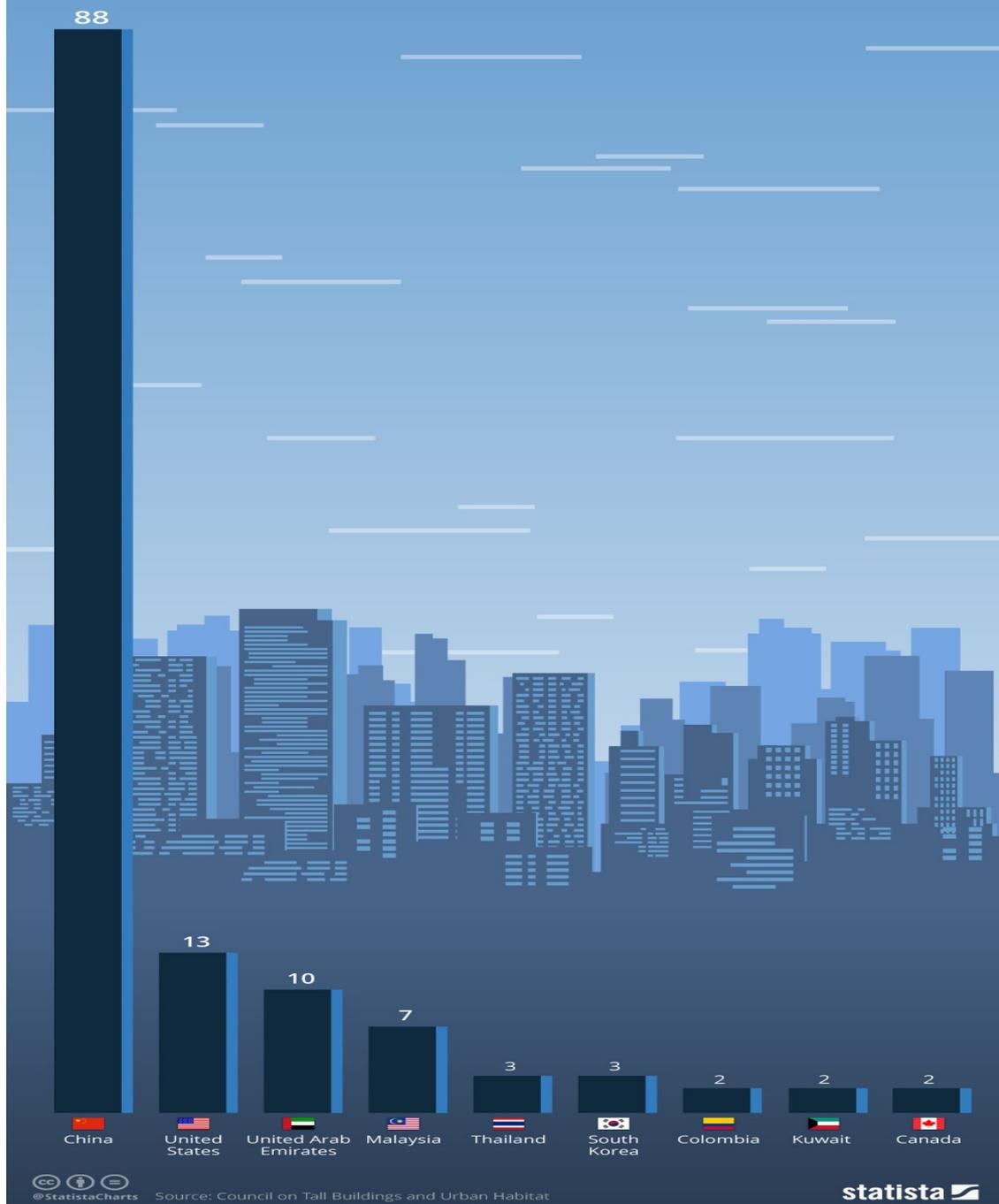
As an illustration of the continued, massive build-out of China's transportation, energy, housing, education and high-tech undertakings are its new skyscrapers.

*China is at the forefront of the boom in skyscraper construction, building 88 in total this year. After China, the U.S. comes a distant second in the 2018 skyscraper league with 13 completions while the UAE comes third with 10. Due to China's skyward ambitions, Asia is the global hub of skyscraper construction, accounting for 76.2 percent of all completions this year (see **chart below**).*

<https://www.statista.com/chart/12382/china-dominates-skyscraper-construction/>

Skyscraper Construction: Nobody Comes Close To China

Number of buildings completed that are 200 meters in height or greater in 2018



That's quite a remarkable build-out and it benefits under-developed China in the long run! As former Prime Minister of China, Zhu Rongji, once commented, "I don't mind spending \$1 today for long term projects that will return \$3 to me tomorrow."