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

April 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:

	Mar 2019	Year-to-date
Hong Kong Partners LP	0.8 %	6.8%
Hang Seng Index	1.5%	12.4%
Hang Seng Small Cap Index	-0.3%	12.1%
MSCI HK Small Cap Index	0.2%	11.2 %
HS Mid Cap Index	1.6%	16.6%

Partners' NAV $2.6085 after management fee and provisions, but before annual incentive fees of 15% on appreciation.

Our Hong Kong holdings of small/mid cap stocks benefiting from operations in China rebounded strongly in this year's first quarter after last year's rough fourth quarter declines. The property sector of the Hang Seng Index was the primary driver for the blue-chip index, returning 21% for the three months ending March. Because Hong Kong's currency is pegged to the US$, interest rates in the SAR need to match the low rates in the US. Expectations of mortgage interest costs remaining low propelled real estate stocks in the first quarter.

Hong Kong's notoriously expensive real estate is also floated higher by mainland Chinese inflows seeking asylum and tax sheltering in the favorable tax system of Hong Kong (Hong Kong residents enjoy zero tax on capital gains, dividend and interest income and a maximum 16.5% flat tax on wages). We do not own property/finance-related stocks in our portfolios.

What we do own are fundamentally strong companies operating in diverse sectors in China. Our top five holdings, representing 33.1% of total portfolio value, are all long-term holdings except for the Kingsoft position which we initiated in 2018 (see our reasoning outlined in our December client letter here). They performed as follows for the quarter ending March:

	March	Year-to-date
1. Beijing Enterprise Water (0371.hk)	3.2%	21.6%
2. SIS Int'l (0529.hk)	-1.2%	-2.2%
3. FSE Services (0331.hk)	1.7%	8.0%
4. Tongda Group (0698.hk)	0.0%	11.5%
5. Kingsoft (3888.hk)	30.8%	77.0%

Median return of the 5 holdings YTD: +11.5%   **Yahoo Finance links**

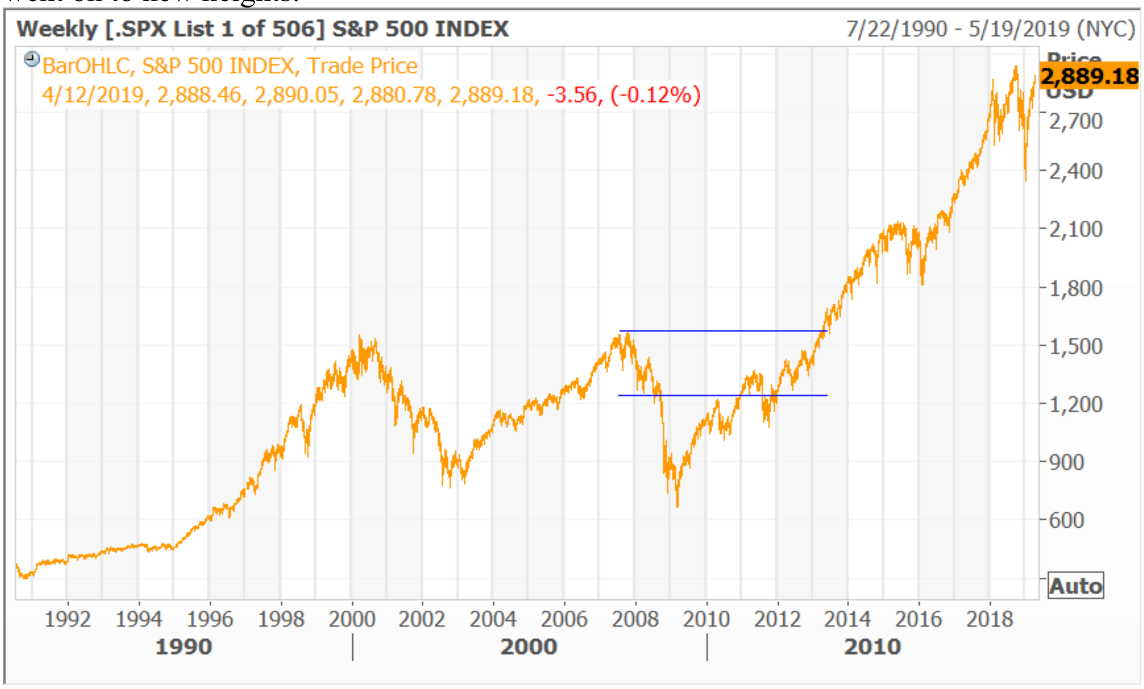
Though we are pleased with the rebound in the first quarter (and outperformance of many of our holdings), we have also been careful with our investing. We kept a higher amount of sidelined cash than normal, which dulled our performance and slightly held back overall results for the quarter. We view this cash position, though, as an important option to invest for bargains during volatile market conditions (we saw an opportunity, for example, in a Hong Kong ETF-like security, code 2800.hk, at the end of last year and realized the short-term opportunity during the January strong market rebound).

We continually screen for cheap stocks to own that meet our strict, intrinsic value buying discipline. We did find several new buys in the later part of last year's stock market decline, but have refrained from chasing stocks in the sudden run up this year. The extent of this year's rise was surprising given China's economic slowdown concerns and trade/tariff worries with the US. The basis for the rise, though, has been more of a revaluation of prices than an earnings upsurge.

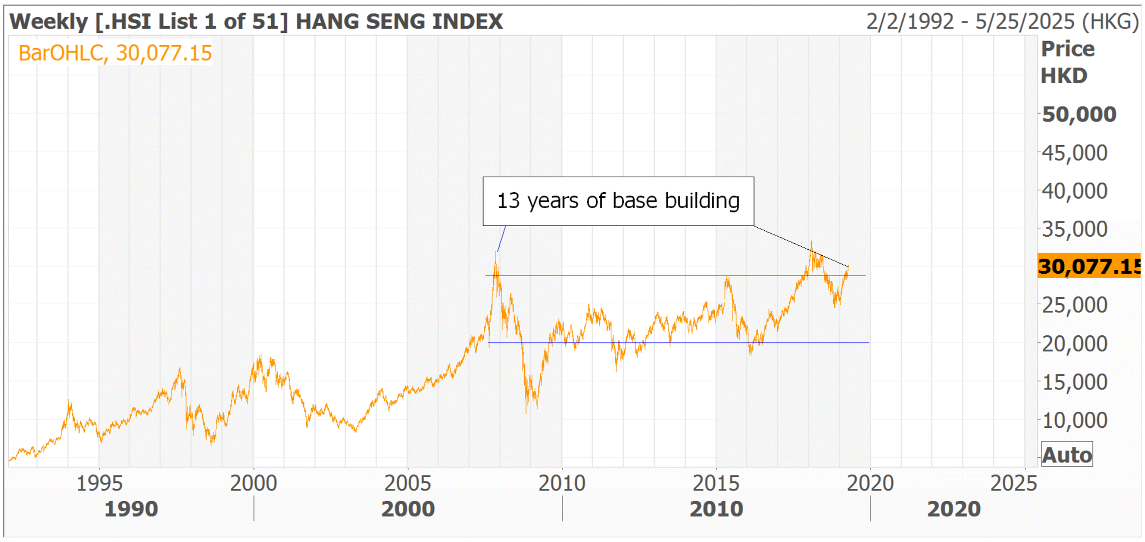
As to progress on the US China trade deal, Trump and China's Vice-Premier Liu He met April 4th in the Oval Office. President Trump announced expectations of a deal within 4 weeks, but a China newspaper was less optimistic, as reported in the South China Morning Post:

> "The fruit is not yet ripe, and if either side makes a hasty move to pick it, that side may have to pay an extra price or it may have to force the other side to pay an extra price," said the editorial which was published on Monday. "It will incur serious problems down the road and weaken the deal's ripeness and fairness." https://www.scmp.com/economy/china-economy/article/3005368/donald-trumps-four-week-time-frame-end-us-china-trade-war

On a broader, macro perspective, Hong Kong has not kept up with US markets. In late 2007, the US markets declined and then recovered by 2013. The S&P 500 Index thereafter went on to new heights:



Hong Kong has been in a massive base building phase over this period:



Its general knowledge that the longer the base building, the more powerful the recoil to the upside. The challenges China has dealt with in reorganizing its domestic economy and foreign trade concerns have been well documented. Low relative and absolute valuation measures on Hong Kong/China stocks present attractive opportunities, especially should there be any positive change to the tone holding investors back today.

That might just be the breakout catalyst to our long standing, unloved market.

Lastly, a not uncommon reaction from a foreign visitor to mainland China in this two minute video here.

Sincerely,

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