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

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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:

	June 2019	Year-to-date
Hong Kong Partners LP	0.2%	0.0%
Hang Seng Index	6.1%	10.4%
Hang Seng Small Cap Index	2.3%	3.6%
MSCI HK Small Cap Index	2.0%	2.1%
HS Mid Cap Index	3.9%	8.4%

Partners' NAV $2.442 after management fee and provisions, but before annual incentive fees of 15% on appreciation.

South Ocean's portfolios of small/mid cap, Hong Kong-listed companies, benefitting from operations in China, were quiet in the month of June. Expectations by Hong Kong investors of lower US interest rates lifted the heavily weighted property and finance sectors of the Hong Kong stock market (we own no property developers nor banks in our portfolios). For the month, our worst performing holdings were two online gaming stocks, Kingsoft (code 3888hk, US$ 2.9 billion market cap, 4.2% holding) and Netdragon (code 777hk, US$ 1.3 billion market cap, 3.2% holding), both of which had gained over 50% year-to-date.

Our top performing positions were long-time holding Beijing Enterprise Water Group (code 371hk, US$ 6.1 billion market cap, 8.4% holding) and a newly purchased equity, sports clothing retailer Xtep Int'l (code 1368hk, US$ 1.5 billion market cap, 7.9% holding). Both companies derive a majority of earnings from domestic sales and business in China, and are not trade war-affected exporters.

Though most stock markets globally rebounded in June after the trade war sell-off that pressured all bourses in May (in fact, the Dow Jones Industrial Average rallied 7.2% in June, its best June performance since 1938), Hong Kong stocks were tempered from ongoing concerns of the US/China trade war and the Extradition Bill protests.

Throngs of citizens marched into major foreign consulates in Hong Kong in late June, demanding leaders to fully scrap a proposal that was unacceptable to Hong Kong residents. Chief Executive Carrie Lam set off mass protests with a plan to allow those accused of a crime on the mainland to be sent there for trial. After the protests, she put the bill on ice, but her popularity plummeted. The Chief Executive said she would suspend the extradition bill indefinitely following protests that included two million people (out of a total Hong Kong population of 7.5 million), but stopped short of withdrawing it (just yesterday, the CE announced the bill was 'dead').

The unresponsive reaction by the Hong Kong government and its snubbing of public opinion was badly judged and backfired. Those issues were detailed in this article.

In a meeting at the G-20 summit in Osaka, Japan on June 29, President Donald Trump and Chinese President Xi Jinping agreed to resume trade talks that had broken down in May.

The US will lift some restrictions on telecom equipment supplier Huawei Technologies Co. Ltd.'s ability to do business with U.S. companies and will postpone tariffs threatened on an additional $300 billion annually in Chinese imports. In exchange, Xi agreed China will buy more U.S. agricultural products. Details will be spelled out later.

This agreement amidst the ongoing trade war concerns came as a surprise. In the lead-up to the meeting, many commentators wholly misjudged the outcome (Jim Cramer of CNBC's Squawk on the Street, was 'shocked'). In actuality, though, there's little choice for a wide range of US companies other than China for producing many consumer items (Reuters). Former Australian Prime Minister Kevin Rudd said "To be blunt about it, I think the Chinese will see the United States as having blinked a bit." The China expert and fluent Mandarin speaker concluded, "I think the takeout message from Osaka will be…President Trump really wants a deal," (his CNBC's "Squawk Box" interview of 9 minutes here).

Pessimism and confusion towards China related stocks were at their greatest prior to the G-20 meeting. Research firm, BTIG, noted the China A-share ETF's (Xtrackers Harvest CSI 300 China A-Shares ETF code ASHR) short interest was at an historic high. Even positive developments and fresh gestures by China have largely been ignored by investors:

> *Premier Li Keqiang said at the World Economic Forum in Dalian on Tuesday that China is still a competitive location for investment, even as some companies look to move production out of the country to avoid tariffs and damage from the trade war with the U.S… China will bring forward plans to remove foreign ownership limits on financial companies, as it speeds up efforts to open the $44trn industry to overseas competitors. Full foreign ownership of securities firms, futures businesses and life insurance companies will be allowed by 2020… China would allow foreign financial services companies into its market a year earlier than previously promised, and that it would rewrite many rules on foreign investment. "This shows China's commitment to opening up," the Premier said.* https://www.nytimes.com/2019/07/02/business/china-li-keqiang-economy-trade.html

BTIG further observed:

> *Yet with the upward reweighting of China A shares in MSCI's Indexes set to continue phasing in in August and again in November, incremental demand for Chinese equities in general would appear to be forthcoming. And with the potential for further slowing in the Chinese economy, the People's Bank of China (PBOC) has shown its willingness to do "whatever it takes" to provide liquidity to financial institutions specifically, and the economy broadly.*

We own companies benefiting from growth in China. Their share prices have been under pressure since the trade wars began over a year ago. Our small/mid capitalized holdings have discounted the worst-case economic scenarios. There's plenty of catalysts amongst all the misperceptions and 'geopolitical machinations' for an upcoming rally in China-related shares.

Sincerely,

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