June 22, 2020

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:

	May 2020	Year-to-date
Hong Kong Partners LP	-5.5%	-26.1%
Hang Seng Index	-7.1%	-18.5%
Hang Seng Small Cap Index	-2.3%	-8.6%
MSCI HK Small Cap Index	-2.8%	-19.7%

Partners' NAV $1.9131 after management fee and provisions, but before annual incentive fees of 15% on appreciation.

Hong Kong was under pressure in May as two gorillas (US and China) escalated their fight. First, China instituted an anti-sedition act (Security Law) into Hong Kong and second, the month ended with the US declaration of negating Hong Kong's free trading status (which should have little economic impact as most of Hong Kong's manufacturing base shifted to China decades ago). Those stunning movements/statements, though, unnerved investors. We didn't escape the downturn last month with our small/mid cap, Hong Kong-listed holdings of leading companies geared towards China.

Analysts have recently made blanket cuts to this year's pandemic-hit estimated earnings, further depressing sentiment. These cuts, though not unexpected, probably were mandated across the board by heads of research even though the companies themselves probably couldn't give much guidance for the year's results either.

Hong Kong's Hang Seng Index fell sharply after the surprising Security Law announcement on May 22 (more here) to a level of 9.6x next year's already dampened earnings outlook. Since that announcement, though, the blue-chip index has rallied 1,800 points (as of today's writing) and remains very cheap. Historically, the Hang Seng Index has averaged 14x earnings (with a high reading of ~26 times in 2007). Another way to view this relationship is at 14 times next year's estimates, the Index would advance ~9,000 points from today's levels (or 36% higher).

That much higher valuation is not based on heroic assumptions. Consider several positive factors:

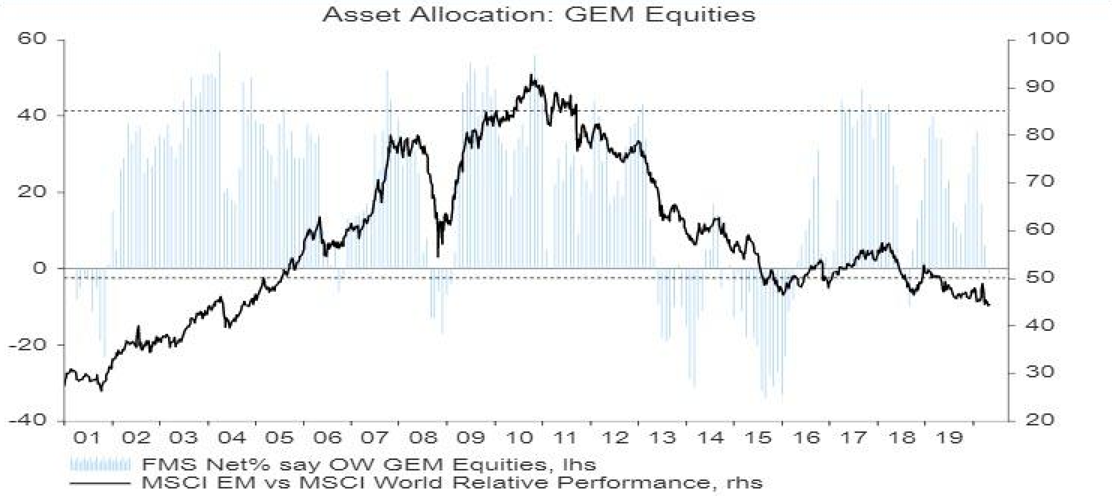
China's policy makers have recently strengthened market and State-Owned-Enterprise reforms along with direct stimulus to small and medium sized firms (background on China's new infrastructure initiative can be viewed here.)

China was the first country to head into economic lockdown this winter when the pandemic hit, and is the first country witnessing a rebound. In fact, according to the International Monetary Fund ("IMF"), China's economy is expected to post positive numbers this year with growth of 1.2% (versus negative 3% for the rest of the world) and a surge of >9% growth in 2021. Those expectations would make China the best performer among major economies.

There are very low levels of US and global investor participation in the China/Hong Kong markets.

A recent Bank of America Global Fund Manager Survey found the most crowded trade of the 200 managers surveyed was US Treasuries, US tech & growth stocks. A net 44% of investors, though, are beginning to allocate to Emerging Market equities (up from net 18% underweight in March). This is the highest allocation in five years as a record number of investors (net 83%) find U.S. stocks to be overvalued (near 17-year highs).

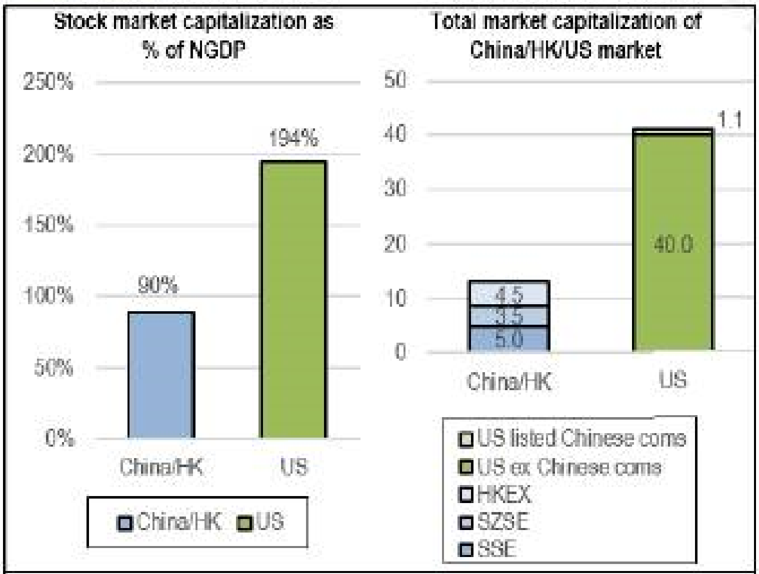
Exhibit 44: Net % AA Say they are overweight GEM Equities



Source: BofA Global Fund Manager Survey

One indicator of undervalued/overvalued markets is advocated by Warren Buffett. He likes to compare the total value of stocks to the total Gross National Product of a country. Credit Suisse compared the US versus China in the following chart:

[China Market Strategy: Market capitalisation of Chinese, HK and US market]



Source: Wind, Credit Suisse estimates

China stocks are significantly cheaper, both absolutely and relatively, using this indicator.

A study revealed that U.S. investors are an immaterial source of financing for Chinese companies, accounting for less than 5 percent of the entire market cap of all Chinese companies (which is around US$ 11 trillion). That sum includes the market cap of both those listed inside and outside of China.

It is likely both foreign and domestic institutions (especially underweighted US firms) will be raising their capital allocations to the region. The 2021 estimated price-to-earnings ratio of 10.3 times for the Hang Seng Index is the lowest among major markets in the world, compared to 20 times for S&P 500, and 15.7 times for Europe's Euro Stoxx 50 index.

We have remained guarded with our portfolio picks because the range of possible earnings outcomes this year are wide and make valuation judgements difficult. That said, we continually screen for opportunities with our proprietary intrinsic value program and found one special situation which we began to buy.

That situation is due to the impending threats to Chinese listings in the US.

Legislation in the US was introduced to delist Chinese ADRs that don't conform with U.S. accounting regulations (see my Market Message from Montana comments here). That threat may be beneficial to the Hong Kong Stock Exchange (HKEX: code 388hk, HK$ 344 billion market capitalization, US$ 44 billion) as more China companies seek secondary listings nearer home. HKEX is an A-rated company on our intrinsic value screen, with strong fundamentals. Management has reiterated hopes for more China-concept players to list in Hong Kong. Citigroup noted the Hong Kong IPO plans of Chinese concept stocks JD.com and NetEase, both being listed in the US. Should Hong Kong's stock exchange gain more listings, mainland Chinese investors would also have access to investing in their country's best companies through the Shanghai and Shenzhen stock connect programs.

We own leading companies with solid balance sheets and earnings outlooks that should grow stronger once world economies revive. Our portfolios are cheap and sell at only 6.2 times (weighted average) projected 2021 consensus estimates.

Sincerely,

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