



August 11, 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:

|                           | <u>Jul. 2020</u> | <u>Year-to-date</u> |
|---------------------------|------------------|---------------------|
| Hong Kong Partners LP     | 3.3%             | -16.8%              |
| Hang Seng Index           | 0.7%             | -12.8%              |
| Hang Seng Small Cap Index | 8.2%             | 7.7%                |
| MSCI HK Small Cap Index   | 1.0 %            | -10.6%              |
| HS Mid Cap Index          | 9.1%             | 1.7%                |

Partners' NAV \$2.1543 after management fee and provisions, but before annual incentive fees of 15% on appreciation.

### 'China rocks!'

*'China rocks, in my opinion. The energy in China is great... there's like a lot of smart, hardworking people. And they're really — they're not entitled, they're not complacent.'*

Tesla boss Elon Musk on China. Aug. 3, 2020

South Ocean's portfolios of small/mid cap, Hong Kong-listed companies are geared toward growth in China's economy. Our tech-related stocks, most purchased years ago at depressed prices, were out-performers in our portfolios once again. Last month, foreign net buying in Hong Kong's stock market was heavily skewed towards TECH-related names. We have begun trimming these positions and currently have in excess of 20% sidelined cash.

The large cap, Hang Seng Index, (which is trading around book value or near record-low valuations), books about 2/3<sup>rd</sup> of its revenues from the mainland. In the Mid-cap index, material stocks (aluminum, cement, etc.) have recently ticked up (albeit from extremely low bases) as China's domestic demand for basic materials surged after the Covid virus-related work stoppages earlier this year. China's largest aluminum company, Chalco, for instance, rose 37% in July after years of a subdued stock value...



Because it's difficult to 'time' purchases in cyclical stocks (as demonstrated by the years of underperformance of Chalco), we own just one basic material company, leading property and auto glass manufacturer Xinyi Glass (code 868hk, market cap HK\$ 49.8 billion, US\$ 6.4 billion). Xinyi Glass gained 19.6% last month...



With the company's new production plant coming on stream in Malaysia for overseas auto glass sales and glass prices stabilizing, we continue to hold this long-term position.

Our portfolio holdings have an average [return on equity](#) ratio of 17.2% versus 13.4% for the Hang Seng Index (50 constituents, ex-financials). These long-term positions sell at an average earnings yield of 14.3% (versus a 3% yield on China's 10-year bond). Our weighted average portfolio Price/Earnings ratio on this year's down-rated estimated earnings is just 8.0 times.

Our fundamentally strong, leading companies are not expensive and offer exposure to the improving mainland economy. As China's [manufacturing](#) index shows a continued rebound and improvement, a majority of our holdings will announce first half financial reports in August.

And, here's why Tesla's Musk danced in [Shanghai](#).

Sincerely,

Brook McConnell

President

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PS; China/Hong Kong notes

**Tesla** has delivered its first cars **made in China**, marking a major milestone for the electric vehicle maker. It comes as Elon Musk's company aims to secure a significant slice of the world's biggest car market. ...Dec 30, 2019

In 2017, Elon Musk said that **Tesla would** eventually **build 10-20 Gigafactories** around the world. So, the current score **is** three down (Nevada, New York, Shanghai), seventeen to go. Jul 22, 2020

How big will the Gigafactory be?

**15 million square feet**

When it's fully complete, Tesla's Gigafactory in Sparks, **Nevada**, will be the largest building in the world, sprawling over 15 million square feet on a plot of land more than **three times larger** than Central Park. Apr 15, 2019

As I write from our home in Montana, Hong Kong is suffering a third wave of the Covid-19 virus this summer:

<https://youtu.be/mXjC9Kd-hAo>

...and is preparing a makeshift hospital at the idle AsiaWorld Expo Center. Three-minute video clip here:

<https://youtu.be/Cf03a8YvvTY>

Due to increased measures to contain the outbreak, the Hong Kong Government banned indoor seating at restaurants, causing undue hardships for working citizens at lunch breaks.

The Government had to do a U-turn:

<https://youtu.be/geLkDHxLhI4>

(Double click the above blue links to access the SCMP videos).