



November 13, 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>Oct. 2020</u>	<u>Year-to-date</u>
Hong Kong Partners LP*	2.3%	-18.1%
Hang Seng Index	4.2%	-13.1%
Hang Seng Small Cap Index	-1.5%	1.3%
MSCI HK Small Cap Index	0.8%	-3.4%
HS Mid Cap Index	1.0%	3.2%

Partners’ NAV \$2.1204 after management fee and provisions, but before annual incentive fees of 15% on appreciation. The benchmark indexes cited above are not total return results whereby Hong Kong Partners LP’s return is inclusive and net of income and fees. Three of these benchmark indexes are provided by HSI Services in Hong Kong and more information can be found at its website: <https://www.hsi.com.hk/eng>. More info on the MSCI Index may found here: <https://www.msci.com/documents/10199/73920289-8584-47fb-af65-7f57845bfb38>

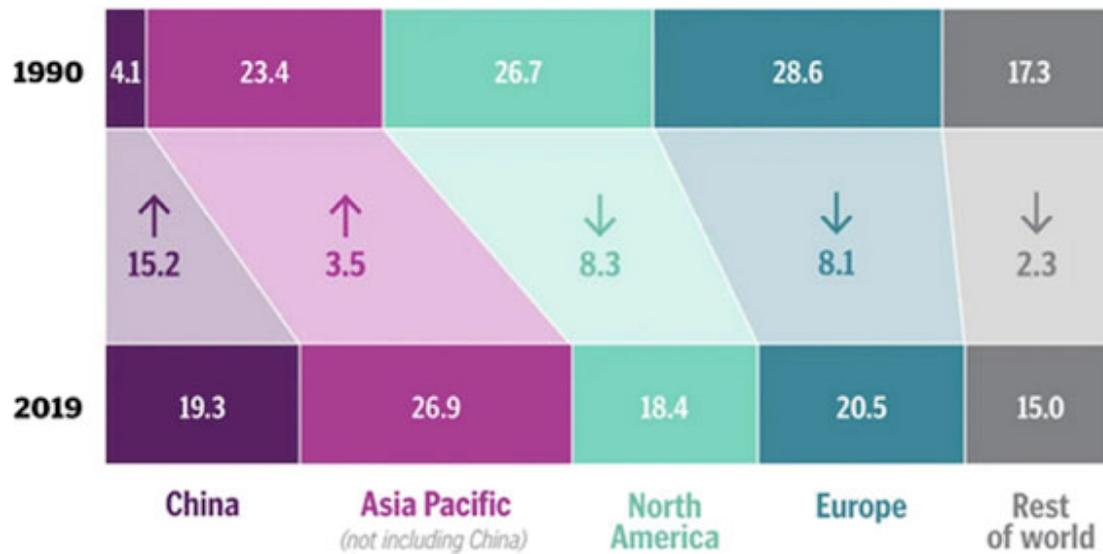
The debate is not Value vs Growth but rather Value vs Quality

South Ocean’s portfolios of small/mid cap, Hong Kong-listed holdings of companies with earnings benefiting from growth in China gained last month. Trading ended last month with stocks selling off sharply in apprehension of the US election results (the Hang Seng Index declined 3.2% the last week of October), but stocks in Hong Kong have, as of this writing, gained all of those losses back and then some.

We added 13 new positions recently (companies mainly operating in the construction/infrastructure sectors of China) of stocks selling below our maximum price to buy discipline (a max price-to-buy restraint benefits us by not over-paying for quality companies we seek to own). We screen for consistently profitable companies selling below our intrinsic value calculation of the future worth of each business. We have been extensively refining our stock selection processes over this past year which is enhancing results.

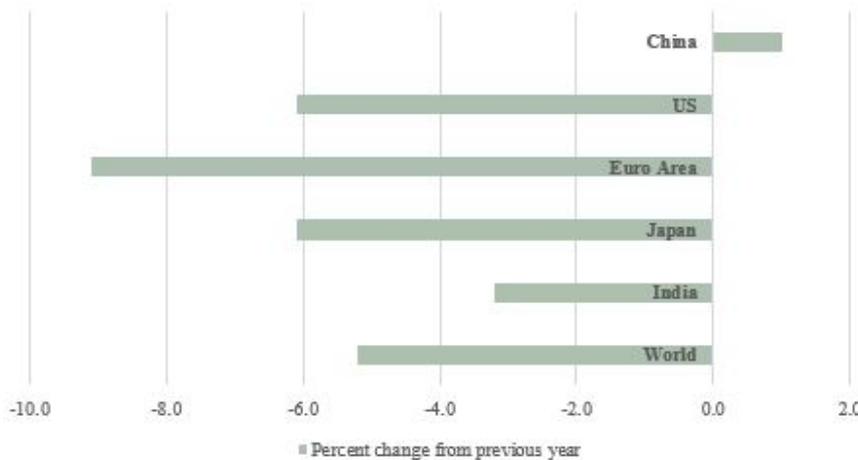
China’s economic growth has exceeded most observers estimates. Expansion of Gross National Product (GDP) of the Middle Kingdom is depicted in the following chart:

GDP based on PPP, share of world (%)



Not only has China’s GDP jumped in the past 19 years from 4.1% to 19.3% of world GDP, but it has, remarkably, come through the pandemic and world downturn better than the rest of the world:

2020 Real GDP change forecasted in June 2020



Source: World Bank

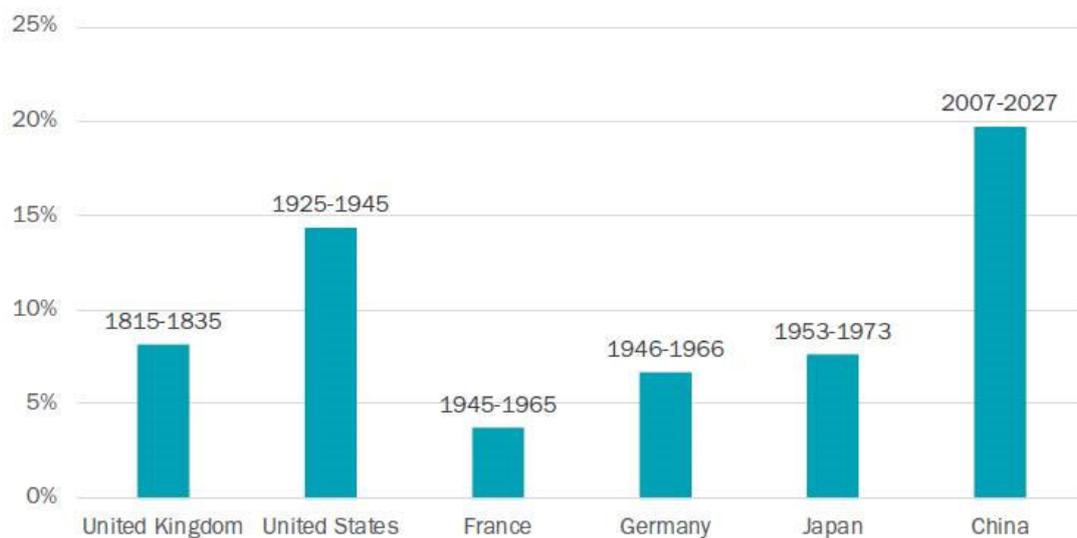
And it’s just starting for China.

In a recent commentary, *The Power of the Chinese Consumer* by Joseph P. Quinlan, Managing Director and Head of CIO Market Strategy, November 2, 2020, China’s middle class is an emerging demand force:

Taking the long view, we believe the future contours of global growth and global earnings are inextricably tied to emerging market consumer demand, *notably demand from China*. The accompanying exhibit underpins our conviction and is obtained from the Brookings Institution.⁴ Exhibit 4 highlights the attractiveness of the Chinese consumer to leading U.S. multinationals; simply put, when it comes to middle class consumption, there's China and the rest of the world. According to Brookings Institution, Chinese middle-class consumers are on track to spend \$7.3 trillion in 2020, head and shoulders above the U.S. (\$4.7 trillion). Total household spending in the U.S., of course, is higher than in China because U.S. households are richer (higher per capita incomes) although the sheer number of Chinese consumers makes its market size larger—much larger. To this point, in 2006, China's middle class was estimated to number 90 million people. But after adding an average of 60 million people to its middle class every year since then, China's middle class now numbers roughly 750 million people. By 2027, according to Brookings, an estimated 1.2 billion Chinese will be considered middle class—a staggering consuming cohort.

China's middle class will dominate world consumption:

FIGURE 2: BIGGEST CHANGE OVER 20 YEARS IN SHARE OF MIDDLE-CLASS CONSUMPTION EXPENDITURES, 2011 PPP



Source: Maddison Historical Statistics; International Monetary Fund; author calculations.¹²

FIGURE 1: TOP 10 COUNTRIES BY TOTAL MIDDLE-CLASS EXPENDITURES IN 2020 (TRILLION USD, 2011 PPP)

Country	Middle-class consumption
China	\$7.3
United States	\$4.7
India	\$2.9
Japan	\$2.0
Russian Federation	\$1.6
Germany	\$1.5
Indonesia	\$1.2
United Kingdom	\$1.1
Brazil	\$1.1
France	\$1.0

Source: Brookings Institution Table above shows consumption by the middle class only. Total household consumption in the United States is higher than in China because of consumption by rich U.S. consumers.

Joseph P. Quinlan, managing director and chief market strategist at U.S. Trust, Bank of America Private Wealth Management, comments further:

Emblematic of this spending power, China now accounts for one-third to one-half of all global car sales and 40% of the global smartphones market. In 2019, Chinese citizens took a staggering 300 million vacation and business trips, with more than half (116 million) of those trips abroad. Over 90% of Chinese own their own home, with homeownership among Chinese millennials (roughly 70%) much higher than the comparable figure in the U.S. (35%). Meanwhile, Gen Z accounts for 15% of all household spending in China, compared with 4% in the U.S. China e-commerce accounts for 40% of global e-commerce, while the country remains out front in terms of mobile money—90% of Chinese consumers rely on mobile money as their primary form of payment. All of the above is neatly summarized in a recent essay from Bridgewater’s Ray Dalio in the entitled, “Don’t be blind to China’s Rise in a Changing World” and, when it comes to investing in either the U.S. or China, “allocate money to both countries.” Also consider allocating capital to Western multinationals leveraged to the Chinese consumer, one of the most powerful consuming cohorts in the world. *The Power of the Chinese Consumer*
Joseph P. Quinlan, Managing Director and Head of CIO Market Strategy, BofA

Other investors agree...

Charlie Munger, C-chairman Berkshire Hathaway [Fish Where the Fish Are: Chinese Equities](#)

Ray Dalio, [Bridgewater's Dalio supports Ant IPO suspension, bullish on China](#) and Ray Dalio on [why Chinese capitalism is on the rise—and why American capitalism is in desperate need of a fix](#)

Jeremy Grantham CEO GMO [favors China](#)

Mark Mobius Mobius Capital (formerly Templeton) [Mobius on China Stocks](#)

Jim Rogers (formerly Quantum Fund) [China On the Rise & Will Inevitably Eclipse The U.S.](#)

South Ocean has been investing in the growth of China through Hong Kong-listed, China-geared stocks since the early 90s. We believe China will continue to surprise investors to the upside.

Sincerely,

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*Hong Kong Partners LP risk disclaimer:

- Hong Kong Partners LP (The "Fund") primarily invests in the Hong Kong equity market with a Greater China focus.
- The Fund invests in China-related companies which involve certain risks not typically associated with investment in more developed markets, such as greater political, tax, economic, foreign exchange, liquidity and regulatory risks.
- The Fund is also subject to concentration risk due to its concentration in Hong Kong, particularly China-related companies. The value of the Fund can be extremely volatile and could go down substantially within a short period of time. It is possible that a substantial value of your investment could be lost.
- You should not make investment decision on the basis of this material alone. Please read the explanatory private placement memorandum for details and risk factors