April 13, 2010

Dear Clients, Partners, and Friends,

The results for South Ocean Management's Delaware LP, Kong Partners' L.P., before incentive fees, were as follows:

	Mar 2010	Year-to-Date
Hong Kong Partners LP *	4.45 %	5.05%
Hang Seng Index **	3.06 %	-2.90%
BNP Peregrine Greater China Index	6.76 %	-0.85 %
MSCI HK Small Cap Index	9.46 %	9.74 %

Partners' NAV for March was $3.0047, after management fee, but before annual incentive fees of 15% on appreciation.

Our portfolios of fast growing, Hong Kong-listed companies, with earnings geared towards China, excelled in the first quarter.

We compared our returns to Lipper's Mutual Fund Review (through March 31, 2010):

Hong Kong Partners	***5.1%***	***94.3%***	***7.4%***	***4.0%***
Fund Type	Q1 - 2010	1 Year	5 Years *	10 Years*
Large –Cap Core	4.94%	48.45%	1.85%	-0.13%
Large-Cap Growth	4.20%	46.16%	2.64%	-3.11%
Large-Cap Value	**5.79%**	**49.90%**	**0.93%**	**2.77%**
Mid-Cap Core	7.85%	62.22%	3.36%	3.46%
Mid-Cap Growth	7.05%	56.57%	3.73%	-0.65%
Mid-Cap Value	**8.29%**	**64.92%**	**3.43%**	**7.26%**

Multi-Cap Core	5.39%	52.56%	2.33%	1.70%
Multi-Cap Growth	4.88%	52.07%	3.66%	-2.77%
Multi-Cap Value	**6.43%**	**56.02%**	**1.12%**	**3.81%**
Small-Cap Core	8.03%	63.07%	3.03%	6.14%
Small-Cap Growth	7.32%	59.33%	2.78%	-0.78%
Small-Cap Value	**9.48%**	**72.58%**	**3.14%**	**8.79%**
Equity Income	4.69%	46.52%	2.23%	3.26%
Specialty Diversified	3.37%	40.73%	0.56%	2.43%
S&P 500 Index Obj.	*5.34%*	*49.03%*	*1.41%*	*-1.13%*
Long/Short Equity	1.83%	31.45%	2.43%	5.86%
Market Neutral	0.72%	8.09%	1.87%	2.38%
Short Bias	**-8.86%**	**-46.94%**	**-10.41%**	**-6.82%**
* Annualized Data			All returns as of 3/31/2010	

Though we have out-performed, our stocks still remain undemanding. Our weighted average Price/Earnings ratio, on this year's earnings estimates, is 8.2 times. We remain confident in the outlook and prospects for our portfolios.

Sincerely,

Brook McConnell
President
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There never seems not to be a *wall of worry* surrounding China.

News reports on China today blares worries about Tibet, Taiwan arm sales, Google, non-performing loans, currency manipulation, interest rate increases, droughts, high real estate prices, too rapid GDP growth …

With all this much media intensity and concern, is China in a bubble and finished growing?

China's long term fundamentals remain compelling, and that, as we have repeatedly stressed in 18 years of these letters, is where investors should stay focused. Today's headlines are but short term blips on China's economic backdrop and will be replaced by another *Set of worries* in 6 to 9 months. As we pointed out in January, when Japan's GDP/capita reached US$2,000 in 1970 (about where China is today), consumer growth took off for several decades in that country.

Our friends at MARKET INTELLIGENCE REPORT, in North Oaks, Minnesota, had this comment, reprinted with their consent, which we couldn't have made more to the point:

> ***Is China Done Growing?****—I noted the other day that it seems there is a trade which has developed in the market based on the concept that China is a bubble. Thus, according to the shorts, all manner of China related assets should be sold or shorted, from Chinese stocks listed in New York to the Shanghai Index to natural resources, for how can the Chinese possibly buy as much oil, iron ore or other resources if the bubble pops? That conclusion is not wrong, for if China is a bubble and it pops, demand for all those assets will diminish. But is the premise right, that China is a bubble? I ran across a chart the other day from Angus Maddison's "The World Economy: Historical Statistics." It demonstrates how China dominated the world economy until about 1839, when the opium wars began, then China fell into a long relative slide which did not end until Deng Xiaopeng started reforming the economy in 1978. What is interesting about this data is I have had discussions with only one other person who was interested in the years prior to 1839. China was a world economic power if not the largest single country power for decades from the 1600's to 1839. Then the Industrial Revolution moved the balance of economic power to the West for the next 170 years. But now the tide is shifting again. That is something which is missing in much of the China analysis I see and more important, the Chinese mean to get back into a leading position as the world's economic power. This would be nothing new for China. It is the West which may be in for a shock as the balance of power shifts to the East, where historically it has resided. When the U.S. grew into a world power at the end of the last century, we had booms and busts, a depression, a deflation, alongside several years of double digit economic growth- just as China is in the midst of now. There was not a great deal of economic planning in America until after the 1907 crash. In the years between the Civil War and the 1907 crash, (1865-1907), and economy was based on western expansion, land speculation/development and the rising importance of California. Railroads were the new technology of that day, while massive*

> *waves of immigration grew the population. There were not many rules. These were the days of Judge Roy Bean in Texas, no law west of the Pecos and some western justice which consisted of a hanging first and then the trial. Was it a bubble? In the long run, no way. Every American market decline was a huge buying opportunity and as the economy matured, so did the rule book, the markets structure and investor protection, but not until the 1930's. Were there bumps along the way? Absolutely. Several market panics occurred (1873, 1907, 1929), often presaged by excessive bank lending, fraud or both. China has just passed through an episode of rapid bank lending. Unless they have adopted a puritanical code of lending/borrowing conduct, someday we will find out there were frauds in the great China build-out. But will China stop growing? I do not think so and that should make the shorts think hard, which I am sure they are doing anyway, about taking that position. America grew its way out of railroad bubbles, property bubbles, a gold rush and did so for decades during its build-out after the Civil War. Why should China not be able to do the same thing, even if there are segments of the Chinese story which are bubbles? I would much rather be in the position to grow my way out of an economic bust than be in the position which some parts of Europe and perhaps America are in. How will Greece grows its way out of debt, if IMF-imposed taxes are going up, fees are going up, the government's budget is in a straitjacket and the economy on a course to contract? In America, we will have a similar problem in a few years if debt is still being piled on and the ability to grow the economy is further encumbered by debt service. The chart I showed earlier this week demonstrated how adding additional debt to the U.S. economy is not producing additional output of GDP. The days of a credit driven expansion which can push the economy past a bubble bursting may be behind America.*
> *In America, debt is the bubble.*

The enduring development of China astounds the world. Yet, this 'enfant behemoth,' is only in the early transition stages from its failed socialistic experimentation in the last century. The PRC exhibits all the symptoms of a 19th century boom economy in the age of an industrial revolution, rapidly catching up with the modern world.

Continuing this macro view, Martin Armstrong recently penned;

> "In 1929, after Britain had reached its peak of its glory and power, the US was the world's creditor nation just as China is today.
> … the US is unable to pay its debt and Moody is now warning it may lose its AAA status….China is already the largest Internet market in the world and its young better educated than Americans…China is rapidly displacing American economic power.
>
> "The Yuan is undervalued since paper currency is merely a share in the nation, just as in a corporation. As the US$ rose 1929-1932, the Yuan will rise during any economic decline. Investing in China packs capital gains and eventually currency appreciation…the Yuan would rise during sovereign defaults as a currency hedge."

In October last year, we wrote: *We have considerable exposure in our portfolios to Rmb sourced earnings. Though we do not give currency adjusted returns a high credence when deciding to invest, an appreciation of our companies' Rmb-derived earnings might propel further investor interest in our names…*

Today, that currency debate is front page fodder for the media (more from a political angle, with Treasury Secretary Geitner making a surprise visit here and to Beijing last week).

(THE Big Mac index is based on the theory of purchasing-power parity (PPP)—exchange rates should equalize the price of a basket of goods in different countries. The exchange rate that leaves a Big Mac costing the same in dollars everywhere is our fair-value benchmark).

The transition in China, from a frontier to an emerging nation, is probably feared by people, which "manifests as an audience eager to read about how and why the Chinese bubble will burst."

Our team is constantly reviewing facts and information in the market place, seeking to uncover low-price-to-growth stocks of companies with strong balance sheets and experienced managements. We develop our opinions and investment decisions based on visiting informed decision makers, not from ivory tower economists (I believe it was Peter Lynch of Fidelity who once said, "If you have spent 15 minutes reading economic reports during the year, you've wasted 10 minutes.")

As Bill Miller of Legg Mason aptly put it;

> *…we don't make forecasts and conform portfolios to those forecasts, nor do we have theories which tell us what will be, or must be, as a result of what is or appears to be the case…We are data driven and try to observe and understand what the data seem to indicate**, and leave the theories and predictions about what will or must happen to those with privileged access to the future.***

Our holdings are the most exciting stories we've come across in our careers in investment management. Though we don't own property or financial stocks, we do concentrate in other growth areas in China.

One new company to our portfolios, destined to be another core holding, is leading scrap steel and copper recycling producer, China Metal Recycling (0773 HK, US$1.0 billion market cap).

Sims Metal in Australia (ASX:SGM) is the world's largest metal recycler and China Metal Recycle is the dominant producer in China's fragmented scrap metal industry. China's nascent scrap metal market is already larger than the rest of the world, combined. No likely foreign or domestic competitors are threats as acquiring choice land for processing hubs, especially along riverfronts, from local governments is prohibitive.

With IPO proceeds last year of HK$1.7 billion (US$220 mn), China Metal is positioned to double sales volume this year versus ~HK$6.5 billion in 2008 revenues. No debt and the shares sell at a single digit P/E ratio on this year's estimated earnings. More information available on the website: http://www.chinametalrecycle.com/en/index.html

We have met the Chairman and our notes on China Metal Recycle, along with our other company visit notes, are available to clients. Please let Joyce know.

Below are comments we found supportive and compelling, but not conducive to including in the main body of our letter above. If you're still awake, please read on. Best, Brook

1. Bond King Bill Gross recently said he preferred stocks over bonds: "Investors should "move outside of the United States," in choosing stocks, Gross said. Emerging and developing countries because they are now "creditor countries" that feature strong growth while developed countries are the "debtor countries" and carry weaker growth, he said.

The "typical suspects" to invest in include Brazil, China and India, Gross said.

2. Why Bears Always Have the Best Arguments

***By Paul Kedrosky** · Thursday, December 13, 2007 ·* ShareThis

Even though the stock market has rightly been called the triumph of the optimists, with bulls stomping bears over and over for one hundred years, stock market bears not only haven't gone away, but they generally have the most compelling arguments. Their points seem so damn plausible, level-headed, empirical, and reasonable, while bulls come across as starry-eyed idealists.

Let's consider some reasons why that might be:

1. Things fail more often than they succeed. Pace availability heuristics, it is easier to think of examples of things failing than succeeding, so it gives bears more fodder.
2. Bears have the past, and bulls have the future. Bears get to argue from data, while bulls argue from what might happen.
3. Apocalypse is seductive. There is something about the thought of imminent mass ruin that really gets people's attention, as has happened with the overdone coverage (hello, Matt Drudge!) of the current credit problems in the market.
4. There is a Puritanical urge in America wherein people want to believe they (or better yet, their neighbors) will be punished for their prior success, etc., so it stands to reason that stocks will punish people after they make them a lot of money.
5. Bears have been generally wrong for so long that they have to know how to tell better stories.

http://paul.kedrosky.com/archives/2007/12/13/why_bears_alway.html

3. The propensity of the Chinese to own real estate is colossal (homeownership is high in urban areas). Investment options are extremely limited in China. Between 2000 and 2008, the total size of residential property sold in China was 3.6 bn square meters or roughly 38 billion square feet. Most residential real estate is funded with little mortgage obligation.

There is much concern today about a ‘bubble’ in China real estate. The government is, of course, aware and is, in a pre-emptive fashion, adjusting real estate policies, in a moderate fashion, to insure inflation doesn't run rampant…and the markets hate it.

4. *Wednesday, March 03, 2010*

6 Mind-boggling Info about China That May Interest You

http://stocktube.blogspot.com/

#1 » 40% of Chinese small businesses either went bust or almost went bust during crisis

A report mentioned that just after 9 months China claimed its small business sector was surviving the global recession, new figures surprisingly shown that about a whopping 40% of them either failed or close to failing between Nov 2008 and Mar 2009. This is indeed a big headache to the Chinese government who was considering withdrawing the huge stimulus packages late 2010.

While the Chinese Academy of Social Sciences reported 20% of small businesses had crashed and another 20 per cent went "to the brink of bankruptcy" during the climax of the global financial crisis, Chen Naixiang (economist and director of the academy's research center) also reported that most of the 20% businesses on the brink of failure have been revivied thanks largely to the recovering economy.

#2 » Buy Chinese stocks if you wish to finance Chinese government

China has three main stock exchanges – Shanghai Stock Exchange, Shenzhen Stock Exchange and of course Hong Kong Stock Exchange. Of course unlike Hong Kong Stock Exchange, Shanghai Stock Exchange is still tighly controlled by the Chinese government. The Shanghai and Shenzhen Stock Exchanges have over 1,500 listed companies with combined total market capitalization of US$ 2,658.2 billion (2008) rivaling Hong Kong Stock Exchange (US$ 2,121.8 billion) as Asia's second largest stock market behind the Tokyo Stock Exchange (US$ 3,925.6 billion).

However eight of the ten top largest stocks are state-controlled companies:

1. PetroChina (RMB 3,656.20 billion)
2. Industrial and Commercial Bank of China (RMB 1,417.93 billion)
3. Sinopec (RMB 961.42 billion)
4. Bank of China (RMB 894.42 billion)
5. China Shenhua Energy Company (RMB 824.22 billion)
6. China Life (RMB 667.39 billion)
7. China Merchants Bank (RMB 352.74 billion)
8. Ping An Insurance (RMB 272.53 billion)
9. Bank of Communications (RMB 269.41 billion)
10. China Pacific Insurance (RMB 256.64 billion)

#3 » China's GDP may overtake U.S. as early as 2020

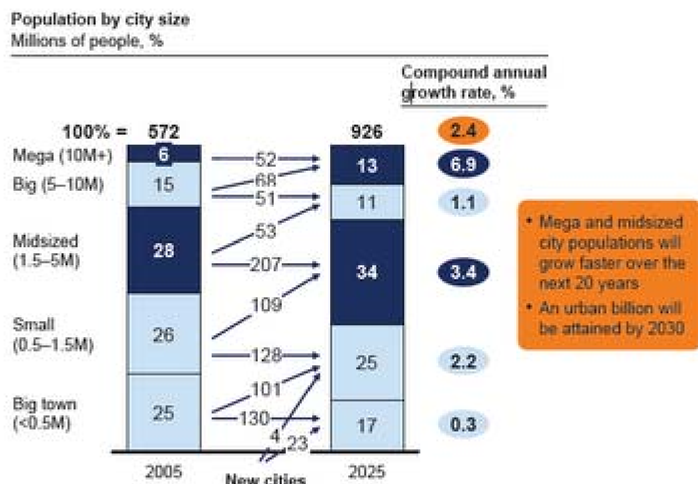
Deutsche Bank’s Chief Economist for Greater China, Jun Ma, told an investment conference in Hong Kong that China's growth will be underpinned by a rapid expansion in emerging market economies, which will account for about 70% of global GDP growth in the coming decade. China will "massively invest" in these emerging economies using its nearly $2 trillion in foreign exchange reserves, extend its leverage by extending loans to the International Monetary Fund and allow the yuan to appreciate in preparation for the currency's potential reserve status.

Jun Ma further added that by early 2020, China’S nominal GDP growth could surpass that of the United States within ten years, a period which will likely be accompanied by a gradual appreciation of the yuan. Ma also expect a final GDP recovery (quarter on quarter basis) to start by middle of 2010 (hopefully this fella is correct).

#4 » By 2025, China will have 10 New York-sized cities

According to a research done by McKinsey Global Institute (MGI) in “Preparing for China’s Urban Billion, China is projected to have a staggering 40 billion square meters of floor space by the year 2025. In another words China will be constructing 20,000 to 50,000 new skyscrapers of which each will be more than 30 floors. This is equivalent to a mind-boggling 10 (ten) New York Cities.

CHINA IS MOVING TOWARD AN URBAN BILLION BY 2030



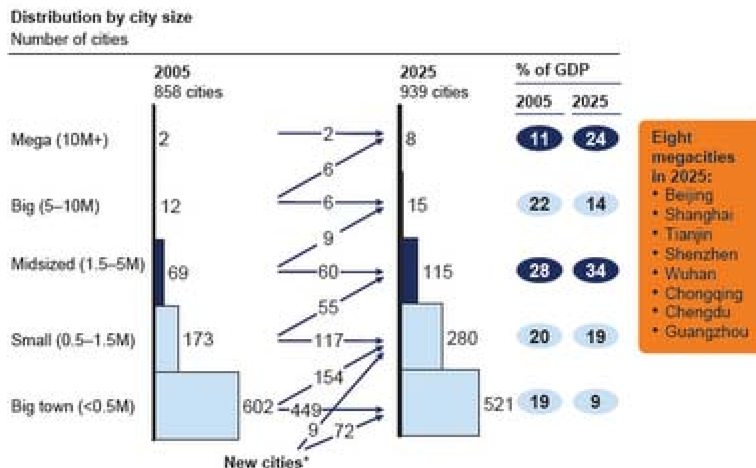
Source:McKinsey Global Institute China All City Model; McKinsey Global Institute analysis

Also by 2025, up to 170 cities in China could meet planning criteria for mass-transit systems – more than twice the current number in Europe. Additionally, China will have up to 5 billion square meters of road and up to 28,000 kilometers of metro rail. China will also need to construct between 700 and 900 Gigawatts of new coal-fired power

between 2005 and 2025.

#5 » By 2030, China's cities will add 350 million people, more than the entire U.S. population

From the same research done by McKinsey Global Institute (MGI), it was projected that China's urban population will expand from 572 million in 2005 to 926 million in 2025 – an increase of 350 million Chinese city dwellers which is larger than today's United States entire population. By 2030, China's urban population will reach 1 billion people.



Urban investment thus will reach over 24 trillion renminbi by 2025 or 93% of total Chinese fixed investment compared with about 79% in 2007. The urban consumption share of GDP will rise from 25% (or 3.9 trillion renminbi) in 2005 to 33% (or 32.7 trillion renminbi) by 2025. The township of Huaxi in the Yangtze River Delta is a great example of how the Chinese government embraced capitalism to lift 300 million people out of poverty during the last 3 decades.

From a farm community with bamboo huts and ox carts in the 1970s, Huaxi is now an industrial and commercial powerhouse with many live in mansions and most have a car with per-capita income of 80,000 yuan (US$ 11,700) making Huaxi the China's richest village.

#6 » China has cash to buy 20% of S&P500

United States is still worry about China's military strength. Of course there's no way China will reveal her real (military) statistic since it's so fun watching U.S.

sending its intelligence gathering information. Can you still remember the detention of 24 U.S. crews after the collision of U.S. EP-3E Aries II spy plane with Chinese fighter jet over the South China Sea back in 2001? United States demanded the return of its spy plane but China said it would only do so after completing its own inspection and collection of evidence. China was having fun stripping the spy plane naked for whatever military technologies or knowhow that China could use.

But the strength of China may lies on its economy after all. Instead of engaging in wars, China may just start buying countries with its huge crates of cash. China's central bank recorded foreign exchange reserves of US$2.399 trillion as of end 2009 (23% jump compared to 2008) and this was achieved during global crisis, mind you. With this type of money China can buy almost 20% of S&P500, if the Chinese government goes crazy.

5. S&P (ratings raised From "A" to "A+" July 2008) has maintained an "investment grade" rating for China since 2001, which S&P defines as an issuer not having any defaulted full faith and credit sovereign debt outstanding and unpaid.

*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.

**Index Descriptions: The Hang Seng Indexes are a widely recognized capitalization-weighted indexes that measures the performance of the three largest-capitalization sectors of the Hong Kong stock market in descending order. The Hang Seng Index measures the largest 52 market capitalized listed companies in Hong Kong's stock market. The Hang Seng Mid Cap Index represents the next 193 largest capitalized listed companies, the Hang Seng Small Cap Index represents the next 187 largest capitalized listed companies in Hong Kong.

The MSCI HK Small Cap Index is a free float-adjusted market cap weighted index designed to measure the performance of small cap equity securities in the bottom 15% of equity market capitalization in Hong Kong. With 69 constituents, the index represents approximately 14% of the free float-adjusted market capitalization of the Hong Kong equity universe.

The Hong Kong Partners LP (HKP) is benchmark agnostic and its corresponding portfolio may have significant noncorrelation to any index. The portfolios may invest in all sectors (within and/or on other stock markets) and the composition of securities in the portfolio may change periodically depending on market conditions at the time. Securities in the portfolio will not match those in any index.

Index returns are generally provided as an overall market indicator. You cannot invest directly in an index. Although reinvestment of dividend and interest payments is assumed, no expenses are netted against an index's returns. Index performance information was furnished by sources deemed reliable and is believed to be accurate, however, no warranty or representation is made as to the accuracy thereof and the information is subject to correction.

Before investing you should carefully consider the Partnership's investment objectives, risks, charges and expenses. This and other information are in the prospectus, a copy for Accredited Investors may be obtained by inquiring to info@south-ocean.com. Please read the prospectus carefully before you invest.

The principal risks of investing in HKP: Equity Securities Risk. The value of the equity securities the Fund holds may fall due to general market and economic conditions. Foreign Securities Risk. Investments in the securities of foreign issuers involve risks beyond those associated with investments in U.S. securities. Industrials Sector Risk. Companies in the industrials sector may be adversely affected by changes in government regulation, world events, economic conditions, environmental damages, product liability claims and exchange rates. Consumer Discretionary Risk. Companies in this sector may be adversely impacted by changes in domestic/international economies, exchange/interest rates, social trends and consumer preferences. Information Technology Sector Risk. Information technology companies face intense competition, both domestically and internationally, which may have an adverse effect on profit margins. Detailed information regarding the specific risks of Hong Kong Partners LP can be found in the prospectus. Additional risks of investing in HKP include equity, market, management and non-diversification risks, as well as fluctuations in market value and NAV. An investment in a private limited partnership is subject to risks and you can lose money on your investment in the limited partnership.

There can be no assurance that HKP will achieve its investment objective. The LP's portfolio is more volatile than broad market averages. Shares of HKP cannot be bought or sold publicly, there is no active market in the Units and there are restrictions imposed on Limited Partnership unit transfers. Partnership redemptions are handled by Authorized Administrators of the Partnership.