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

January 12, 2011

Dear Clients, Partners, and Friends,

The results for South Ocean Managementôs Delaware LP, Kong Partnersô L.P., before incentive fees, were as follows:

	Dec 2010	Year-to-Date
Hong Kong Partners LP *	-2.1%	22.6%
Hang Seng Index **	0.1%	5.3%
BNP Peregrine Greater China Index	-0.6%	2.1%
MSCI HK Small Cap Index	3.2%	35.2%

Partnersô NAV for Dec 3.4979 after management fee, but before annual incentive fees of 15% on appreciation.

It was very slow last month in the Hong Kong stock market, which saw declining volumes as the year ended. In our concentrated portfolios of small/mid cap, Hong Kong-listed stocks, two holdings announced share placements early in the month ï LED chip developer AV Concepts (5.1% position, US$148 million market cap) and Chinaôs leading metals recycler, China Metal Recycle (5.4% position, US$ 1.4 billion market cap) ï which temporarily depressed our overall monthly results (both shares have since rallied to 52-week highs).

A good friend and investor from the UK, who has accompanied us to visit companies here in Hong Kong, recently remarked of our strategy:

Value based strategies are proven to generate the best long term returns, and if you can couple that with top quality management, then you have a winning combination, in any market, any sector…

Even after a rather difficult year, we are satisfied with our results and remain optimistic with the valuations and outlooks of our fast growing, China-centric companies.

Sincerely,

Brook McConnell
President
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2010 was a tough year in the stock markets to keep steady one's emotions. There was much anxiety and consternation for investors.

In late April/early May, we took partial profits in our fully invested portfolios just as worries about Greece sent markets tumbling 20% globally. Subsequently, through-out the summer, there were dire, pessimistic warnings from economists such as Roubini and Shiller, along with market strategists such as Robert Prechter and Societe General's Albert Edwards, about falling home sales, record European budget deficits and the debasement of the U.S. dollar. One famous market forecaster, Harry S. Dent, Jr. (remember his call, Dow 36,000, in the 1990s?), widely predicted on Youtube in early 2010 the market was going to crash below the lows of 2008 by August: July 2010 youtube:
http://www.youtube.com/watch?v=BiuGrpusI7A&feature=related
Then, after the markets rallied in the autumn, he turned and said the market is going to go up to its old highs: Nov 2010 youtube.
http://www.youtube.com/watch?v=RYRAHxwKy34&feature=related
(Rather remarkable, all these guys, but I digress.)

We re-invested profits taken in the spring, in spite of all the emotions and turmoil over the summer. We bought shares of companies with tremendous valuations and earnings prospects. For instance, we began buying in July steel control flow maker, Sinoref Holdings (code 1020), an extremely depressed new issue, at 3 times expected earnings. The shares doubled in about two months, but not because we believed that was going to be the immediate result! Our outlook was for, at least, 12-18 months holding of this share, a long enough time frame by which to allow our favorable earnings outlook to come to fruition. It is during those times of distressed emotions, especially, that good companies can be picked up at cheap prices. As a result, we (HK Partners LP) made the top ten in performance of all EurekaHedgeös 674 Absolute Return funds in October ï in fact, the only China-related fund manager in the top ten of fund managers - with a 9.1% net return for the month.

Today, though markets seem less distressedé

é the overall lackluster stock market performances in the BRIC emerging markets for 2010 (+3%, with Shanghai -13.3%) versus develop markets, US, Japan and Germany was exactly opposite to the economies of these markets. As Andrew Lapthorne, global quantitative strategist at **Société Générale**, recently commented in the Financial Times, ñIt proves: donöt listen to economists when investingé The money has gone into Brics but performance-wise it has not been the best year.ò

With that in mind, some general market observations:

But before that, we need to explain: We are not market forecasters. We are not market timers/traders; rather, we investigate fundamentals, meeting executives/founders of companies when investing, with a longer term outlook. We are not óguessingô which way the market will head. We seek companies with businesses geared towards China and sound managements. We build concentrated portfolios and continually ask, what are the risks relative to potential rewards of owning any stock? We accept (though we donöt always like) market risk when investing our client assets (as well as our own monies, alongside) and remain entirely focused in the Hong Kong market (which, needless to say, has a world class stock exchange, globally accredited accounting rules and a strong legal system).

The Hang Seng Index rose just 5% last year, despite a gain of 12.5% for the S&P500 in 2010. Normally, Hong Kong, with its many trade ties to the US, as well as its currency pegged to the US$, follows the US markets. The SARôs blue chipôs underperformance relative to the majority of Hong Kong-listed equities, as well as the US bourses, was mainly due to underperformance of five of the top ten constituents in the blue chip index. These five stocks are in the financial sector, where we do not own any shares. The ten largest capitalized index stocks represent around 70% of the indexôs total market cap of HK$ 14.7 trillion (US$1.9 trillion).

Large cap bank stocks suffered and underperformed in an environment of considerable angst towards the banking sector in general. This was especially acute in China where daily media reports were continually confirming run-away property prices, increasing inflation, higher interest rates and assumed ruinous loan originations amidst vast credit expansion. Nobody wanted to own bank stocks exposed to this risk!

Small/mid cap shares, in the mean while, generally excelled. Several sectors saw significant re-ratings. Local retail-oriented stocks, such as Oriental Watch, Sa Sa and Hang Ten (which we own) witnessed advances during the year. The advances were especially sharp as they arose from extremely low valuations at the bottom of the market, in March 2009. For instance, cash-rich, casual sports clothes retailer, Hang Ten Holdings (code 448) sold at 2/3rds its book value, 3 times trough earnings, with a 15% dividend yield when we first starting buying several years ago (Hang Ten has gained 497% in our portfolios).

This new interest in local retail stocks was primarily driven by the fact that Hong Kong, on the doorstep of China, is a magnet for cash-rich Mainland shoppers. The SAR is a duty-free port (some luxury items on the mainland have up to a 17% duty), and Chinese shoppers feel more assured of getting the genuine article in Hong Kong.

Property stocks (which we did not own) gained as Hong Kongôs mortgage rates (all short-term adjustable loans), which have to be ótiedô to US interest rates (to maintain the dollar peg), are as low as 1.25% today. The SAR government, worried about ever rising prices of all property types, instituted a tax on short term residential transactions during the latter part of the year, likely snapping speculatorsô óreason dôetreô in the market. This sector will be hard pressed to see similar gains in the New Year, with the government firmly against further damaging price rises. (The government must be concerned that if interest rates go spiraling upward in the US, what will happen, if all mortgages here are adjustable rate, to the Hong Kongôs property market?)

Auto shares advanced last year (we missed this move) as the car-crazy Mainland amazingly sold more cars than in the US. Beijingôs freeways have become a parking lot, as a consequence. Many government officials will be reluctant to order new Audi sedans in the New Year though. That is because the Internet had become alive with enormous anger towards these officials using taxpayer funds, seen driving around in luxury autos. The Central Government has taken notice and issued stern warnings (Prime Minister Wen recently warned officials to look out for spending on beautiful women and extravagant parties). Auto demand from government branches will likely be subdued this year.

We remain bullish on the small/mid sector of the Hong Kong stock market, even after the rebound and recovery last year. We are finding many new companies to invest, with attractive risk gain ratios.

How do we find these names? It is a numbers game, basically. Famed stock investor Peter Lynch claimed if he visited 10 different companies, heôd maybe find one or two of interest. If he visited 100 companies, heôd likely find 10 to 20 stocks of interest. The more companies you see, the more likely you are to uncover values. Though we canôt visit all 1,300 listed companies in Hong Kong annually, we do narrow that list down, facilitated with our in-house, valuation screens and our network of informed sources here in Hong Kong. We make numerous visits, to hear some of the most interesting business developments/stories in the world (in my humble opinion).

Near term, the market probably needs a rest, to withstand rising interest rates on the mainland as the State Government fights rising inflation in food and property prices. Not a day goes by that we donôt read about some wise talking short sellers saying the end of the world is coming for China. We donôt believe that is as big a risk as is often perceived in the media. Regulators are fearful of surging inflation, yet should price rises alleviate soon, the Mainland index should respond more favorably. So too should Hong Kong.

On a bigger macro level, we have a potential big bang event out there: namely, when Chinaôs currency becomes freely convertible, global investors will be forced to invest far more money in this market. These investors may have up to 13% invested totally in emerging markets presently (most of the worldôs largest investors have less than 10% allocated). Goldman Sachs says the full market capitalization of emerging markets is closer to 31% of the global total. In other words, a doubling of funds allocated into this region of the world might then take valuations to extreme exuberant, ôbubble-likeô levels.

But they are far from it today.

Brook McConnell
Hong Kong, January 2011

*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.