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

October 10, 2014

Dear Clients, Partners, and Friends,

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

	Sep 2014	Year to Date
Hong Kong Partners LP *	-4.0 %	3.8%
Hang Seng Index **	-7.3%	-1.6%
Hang Seng Small Cap Index	-3.0%	-6.4%

Partnersô NAV $2.959 after management fee, but before annual incentive fees of 15% on appreciation.

The Hong Kong stock market declined last month due to the social unrest in the Central District (our report here). Though our small/mid-cap stocks of companies doing business in China witnessed no direct financial impact from the disruptions, share prices throughout the stock market were penalized as investor sentiment dived. The Hang Seng Index slumped 11.0%, on high to low daily closes.

The protests have subsided the start of this month and stocks have rebounded. During this volatile period, we added several positions to our portfolios.

For the third quarter, Hong Kong Partners LP lagged slightly (HKP -2.1% vs. Hang Seng Index -1.1%). Though Hong Kong has been the center of focus during the umbrella movement, our system focuses on business fundamentals of companies doing business in China, not Hong Kong. What really matters to us are the quality of the companyôs earnings power and growth rates over time.

Market pundits are frequently distracted by macro geopolitical and political events highlighted in the media that often influence sentiment, but do not operationally affect the companyôs future earnings stream. As such, these events often do not have long-term fundamental impact on the business value (rising markets almost always are worried about something). Indeed, though recent news items are not concerns to be summarily dismissed, they donôt shake our view that our companies will surely witness continued growth in the future.

Two factors held back performance of our portfolios this past summer: The unrest in Hong Kong with the Occupy Central movement caused disruptions to businesses, especially in the retail sector. But, as explained, even shares of companies with no exposure to the disruptions declined abruptly with the sudden descent in investor sentiment.

Second, during the past quarter, three of our top holdings announced dilutive share placements, at varying discounts, to prevailing market prices. Each declared that use of proceeds were to expand (factories) and increase working capital (among other uses). All three were cash-rich, with no long term debt on their balance sheets.

Why collateralized banking or debt financing facilities arenøt utilized for factory expansion and capex instead of õpreciousö equity dilution is a peculiarity in the banking-dominant Asian region.

At present, these three holdings trade below the discounted share placement levels. My friend, David Webb, editor of webb-site.com, pointed out, ñA placing discount is é an involuntary transfer of value from old shareholders to new ones.ò (Davidøs comments on equity placements can be viewed on page 12 of this report: http://webb-site.com/codocs/DMW140926.pdf).

Though these three companies have sound fundamentals, with strong earnings outlook for the foreseeable future, its, nonetheless, exasperating to be temporarily set back with these near term dilutive programs.

On the macro level, the mainlandøs economy has slowed from its torrid 10% annual growth rates of the past 20-30 years.

The country, undoubtedly, faces challenges and issues as it evolves from a centralized, agrarian society to an industrialized nation.

But, make no mistake about its progress!

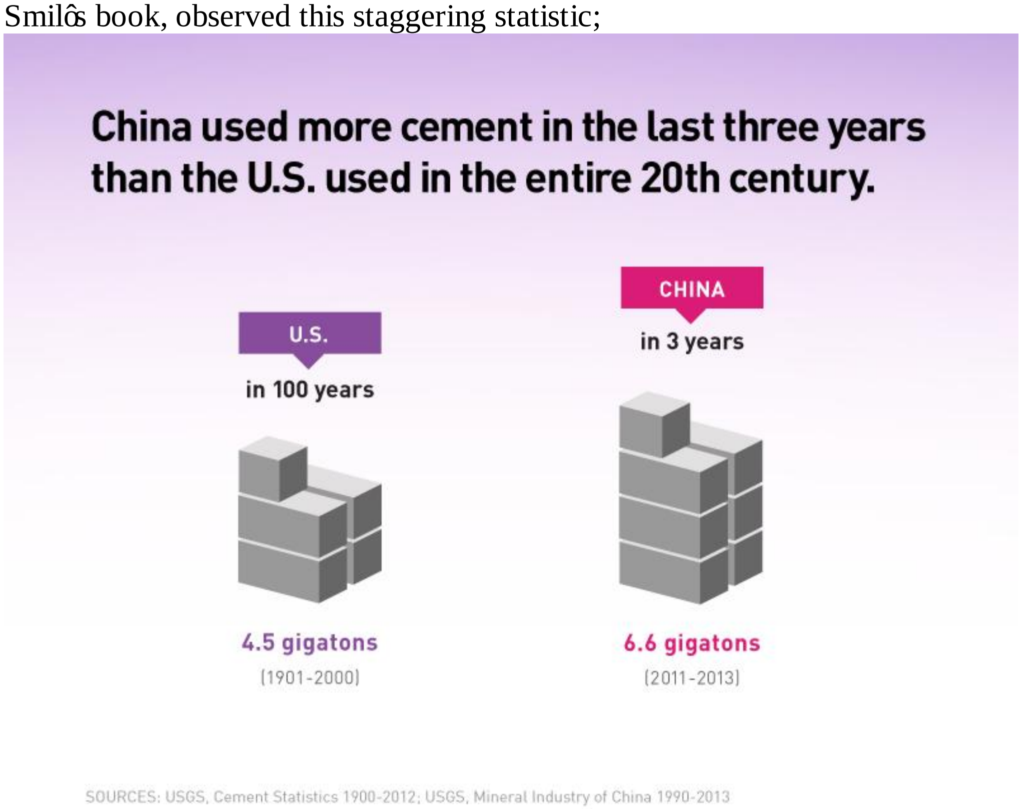
To first highlight one piece of historic evidence, when the early industrialists of America built the Erie Canal in 1825, the new conduit opened cheap, mid-west grains and forest products to the world. As low-priced grains crossed the Atlantic Ocean, much of Europeøs land-holding aristocracy went bankrupt, transforming America in the meanwhile.

Today, China is building high-speed railways around the world. Beijingøs ñIron Silk Roadò economic policies were detailed in this article from The Diplomat (May 2014).

New rails will link China all the way to Europeøs Atlantic coast as well as a planned 13,000 km rail from China through Russia/Alaska/Canada and into the US lower 48. Chinese-backed railways could potentially redraw geopolitical maps globally, opening new markets and expanding trade exponentially.

China has plans to build a second Panama Canal, to accommodate far larger shipping vessels of the day.

Bill Gatesô June 12, 2014 blog, commenting about his favorite author, the historian Vaclav Smilôs book, observed this staggering statistic;



http://www.gatesnotes.com/Books/Making-the-Modern-World?WT.mc_id=06_13_2014_smilc_tw&WT.tsrc=Twitter

Chinaӕs developing consumer boom will be felt worldwide. Already, Chinese mainland tourist group tours can be seen not only in the big cities of the world, but also in unexpected areas, such as Yellowstone National Park.

Early visitors to the park in the photo, with, when we visited in July, entrance lines stretching far longer today.

Yet, investors remain highly skeptical of all this progress.

Hong Kong and China stock markets are among the worldsӗ cheapest:

World Indices - Overview 9-Oct

Asia

Name	**Last**	**Div Yld %**	**PE**	**PBook**	**Mcap USD**
TOPIX	1,263.22	1.81	14.2	1.45	4.26T
NIKKEI 225	15,498.53	1.54	18.81	1.9	2.72T
STRAITS TIMES	3,248.70	3.11	13.53	1.47	415.17B
SSEC	2,369.30	2.97	10.19	1.53	2.86T
S&P/ASX 200	5,304.40	6.13	13.03	1.73	1.23T
HANG SENG	23,477.84	3.54	10.15	1.43	1.84T
China H-share	10,469.89	4.31	7.3	1.19	644.09B
KOSPI 200	248.36	1.09	8.16	1.83	929.51B
SENSEX	26,534.59	1.43	15.65	3.1	717.05B
CNX NIFTY	7,929.35	1.39	15.77	3.1	874.72B
CNX NIFTY TR	10,314.44				
JKSE	5,004.98	2.03	14.8	2.67	377.47B
KLSE	1,829.89	3.13	16.41	2.33	319.33B
NZX 50	5,266.04	5.16	14.82	1.63	223.88B
SET	1,551.16	2.96	15.48	2.36	428.54B
TWII	8,975.09	3.18	14.48	1.79	846.72B
PSI	7,209.24	1.55	21.25	3.03	183.01B
VNI	624.96	3.62	11.85	2.32	56.96B
KARACHI 100	30,112.73	4.35	11.32	2.87	59.37B
CSE ALL-SHARE	7,390.24	2.51	15.21	2.04	22.51B

Americas

Name	Last	Div Yld %	PE	PBook	Mcap USD
S&P 500	1,968.89	2.39	18.28	2.57	17.91T
DJI	16,994.22	2.35	15.86	2.87	4.89T
NASDAQ 100	4,041.12		22.5	4.51	4.59T

Europe

Name	Last	Div Yld %	PE	PBook	Mcap USD
STXE 600	328	3.47	15.81	1.74	10.71T
FTSE 100	6,482.24	4.04	15.06	1.73	2.89T
DAX	8,995.33	2.98	14.05	1.63	1.13T
CAC 40	4,168.12	3.41	16.18	1.39	1.43T

Thereôs no speculative fever in the Hong Kong/China bottomed-out markets.

The fears from the Credit Crisis of 2008 still reside deeply in wealthy investorsô psyche today. Many investors remain sidelined, in the ósafetyô of cash (see following article).
(As a side note, since the end of the Credit Crisis, March 2009, our Hong Kong Partners LP has gained net 102.3% (through Sept 2014) vs. +69.0%% for the Hang Seng Index and versus NOTHING FROM CASH! Of course, past performance is no guarantee of future results.)

With the pending Hong Kong/Shanghai stock connect (see our April client letter commentary, It is Different This Time) and further economic stimulus easing measures on the mainland forthcoming, the risk/gain features of our equity market is quite favorable today.

From the enormous scale of the combined New Silk Road and Maritime Silk Road projects alone, creating a massive loop linking three continents, Chinaôs progress wonôt go unnoticed for long.

Anyone for Chinese dim sum at New Yorkôs Waldorf Astoria?

Sincerely,

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For world’s wealthy, years after financial crisis cash is still king

Wednesday, 18 June, 2014, 3:21pm
BusinessüMoneyüWealth
ASSET ALLOCATION

Reuters in Geneva

The worldôs richest people are clinging to stockpiles of zero-yielding cash despite a surge in financial markets and increasingly sophisticated attempts by private banks to entice them into investing.

Private banks have had to repair trust following the financial crisis of 2008-09, which sent their wealthy clients scurrying for cover and taking on ever larger positions of cash.

Nearly six years on, wealthy investors have a preference for cash rather than risk big bets on stock and bond markets.

ñThe cosy and safe world we thought to live in before the financial crisis not just from a financial point of view but also from a geopolitical point of view has proven to be not that cosy and safe,ò Georg Schubiger, the head of private banking at Swiss bank Vontobel, said at the Reuters Global Wealth Management Summit on Tuesday.

Cyprusôs seizing of deposits above 100,000 euros (HK$1.05 million) last year and political tensions between Russia and Ukraine are two of the major factors keeping wealthy clients from putting their money into play.

The super-wealthy retained huge stockpiles of zero-yielding cash throughout the recent surge in financial asset prices, including a roughly 30 per cent rise in the MSCI all-country index over the past 18 months.

Investment advisers estimate up to 40 per cent of their money remains uninvested and is still parked in deposits.

A benchmark survey by CapGemini and RBC Wealth Management had average cash or deposit holdings among global wealth investors at almost 28 per cent ï more than the 26 per cent held in equities or some 20 per cent in real estate.

Private banks rely on transaction fees and commissions to finance their spending, so their profit suffers when clients shun securities markets.

Although periods of client inertia are not unheard of, it is worse for private banks now, because the inactivity coincides with a sharp rise in spending to comply with tougher regulation.

Many larger players, such as UBS and Credit Suisse, have spent years building up centres of investment expertise in an attempt to better inform and advise their clients, and to do so more quickly and effectively than in the past. These so-called ñmachine roomsò are aimed at winning back trust but also coaxing clients back into investing.

ñIt is true we have disappointed many, that we have caused an economic crisis, and we all have to bear the consequences of it,ò Juerg Zeltner, head of UBSô private bank, said.

ñBut what is also true is that these clients é need our help, they need our advice.ò

UBS has cautioned investors for nearly three years that it is vulnerable to the lack of client activity, amid worries about a host of issues from European and US debt woes to Middle East political tension.

While large cash piles are a concern for private bankers, they are also costly for the wealthy: between bank fees, inflation and near-zero interest rates, cash is effectively loss-making.

Even if the wealthy begin making larger bets in securities markets again, this can pose a risk to private banks if trust has been dented, according to experts.

ñWhat is interesting is that we do see when a client has lost with one firm and has rebalanced into cash, once they feel the need to get back in the market, they often move the cash out of the bank and into a new relationship,ò Seb Dovey of London-based wealth consultancy Scorpio Partnership said.

The wealthy have dipped their toes back into equities but wonõt return in force until an ñofficial thumbs-upò for Europeõs banks from the European Central Bank, Coutts investment officer Norman Villamin said.

More on this:

Property most popular investment among Asia's wealthy families: survey [3]

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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.

**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.