



May 12, 2017

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>April 2017</u>	<u>Year-to-date</u>
Hong Kong Partners LP *	0.8%	8.3%
Hang Seng Index**	2.1%	11.9%
Hang Seng Small Cap Index	-0.1%	7.0%
MSCI HK Small Cap Index	0.8%	5.3%

Partners' NAV \$3.2334 after management fee and provisions, but before annual incentive fees of 15% on appreciation.

Our portfolios of small/mid cap Hong Kong-listed companies, with earnings benefiting from operations in China, were little changed last month. The IT and tech indexes in Hong Kong's stock market gained in April (+6.8%) while energy and material stocks declined (3.5%-3.8%). Our 'tech' holdings (smartphone casing manufacturer Tongda, stock code 698hk, IT distributor VST, code 856hk and TV manufacturer, TPV, code 903) increased with the positive tech sentiment. Though we own no material/energy/commodity holdings, we are weighty in the out-of-favor environmental/renewable sector, which was 'quiet' during April.

Last month, the new US Administration announced that China was no longer considered a currency manipulator. After the Trump US election, that 'fear', fanned by the financial media for months, has suddenly disappeared just as another concern has taken its place.

China's stock and bond markets have recently been volatile due to the latest regulatory crackdown and credit tightening in monetary policy to curb excessive leverage in China's financial and real estate markets.

The crackdown, though, is a healthy long term, overdue development. As noted in Bloomberg, April 26th:

... Templeton Emerging Markets Group and Fidelity International are among money managers who've endorsed a raft of measures from Chinese regulators over the past month to curb leverage, boost transparency and prevent excessive speculation. ... Proponents of the clampdown say short-term market turbulence is a small price to pay for reducing the risk of a major financial blowup in Asia's largest economy...

<https://www.bloomberg.com/news/articles/2017-04-27/china-s-financial-crackdown-wins-backing-from-mobius-to-fidelity>

The Shanghai market is now flat for the year, which may be a near term opportunity for investors.

More analysts are turning positive on China; longtime friend, Asianomics' Dr. Jim Walker, postulates China's growth rate is twice the rate in the US which, in turn, supports a higher rate of credit growth but without running the economy into the ground.

Morgan Stanley, in a 112-page report, 'Why we are bullish of China', expects China to '...avoid a financial shock, move to higher value-added activities (thus) propelling the economy, providing significant investment opportunities' (let us know if you'd like to read this report).

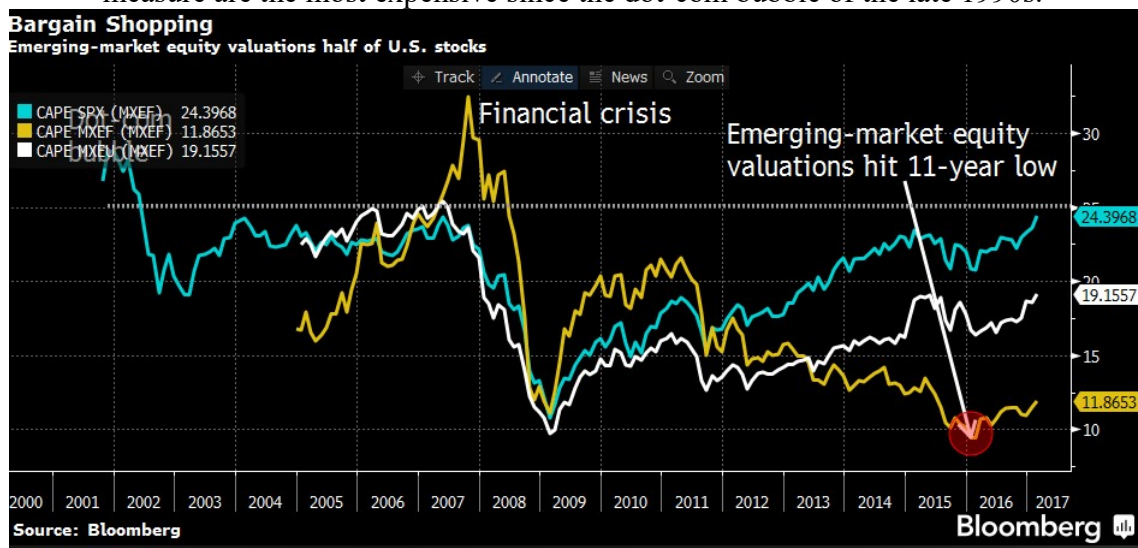
A former University of Virginia endowment officer says Emerging Markets are 'an enormous bargain:'

BULLISH ON GEMS

Bloomberg --

The investor who called emerging markets the "trade of a decade" before their rally last year sees further gains to come.

Christopher Brightman, the chief investment officer at Research Affiliates, who oversaw the endowment at the University of Virginia before joining the firm co-founded by Rob Arnott in 2002, says that while emerging equities cost more now than when he first made the call in February 2016, they remain "an enormous bargain." He cited their valuations relative to U.S. stocks, which by his preferred measure are the most expensive since the dot-com bubble of the late 1990s.



The fund manager says emerging-market shares and bonds have been unfairly beaten down by concern over the outlook for higher global rates and a slump in commodities. While they have gone through busts and booms over the past few decades, investors are being compensated for the risk and have the opportunity to get in early on what should be a multi-year bull market...

"One has to go back and ask how did it ever get so cheap?" Brightman said from Newport Beach, California. "People finally realized that the world economy is not coming to an end, and that's what made a bottom for emerging markets."

<https://www.bloomberg.com/news/articles/2017-03-16/pimco-adviser-s-trade-of-a-decade-beckons-in-emerging-markets>

Citicorp and Goldman Sachs also taking more constructive stances on China:

Admitting you are a bull on China takes bravery. You'll face a barrage of questions about the country's draconian capital controls and unsustainable leverage. Then there's the misdirected investment by Beijing and the resulting overcapacity the economy must absorb.

However, an increasing number of analysts are publicly confessing their bullishness...

Being bullish on China is no longer an outlier view

<https://www.ft.com/content/b0284e7c-092e-11e7-97d1-5e720a26771b>

In a report the first week in May, Wells Fargo Investment Institute said investors should diversify outside the U.S. and look for opportunities in places such as China.

Berkshire's Vice-Chairman [Charlie Munger](#), echoed that sentiment at his company's Omaha annual meeting of shareholders. He said, in answer to a separate question, that China should do well in the long run, despite some growing pains.

"I do think the Chinese stock market is cheaper than the American market," he said. "I do think that China has a bright future."

There is always some 'fear' prevalent for investors, but the risk/gain ratios appear favorable for depressed Hong Kong equities. As compared to the ebullient US markets, Hong Kong is an 'enormous bargain':



S&P 500 is expensive on most metrics vs. history

Aggregate index at 89th percentile of historical valuation; Median stock at 99th

S&P 500 valuation metric	Aggregate index		Median stock	
	Current	Historical %ile	Current	Historical %ile
P/E to growth (PEG)	1.5 x	96 %	1.9 x	100 %
EV / Sales	2.2 x	95	2.8 x	100
EV / EBITDA	11.6 x	89	12.0 x	99
Forward P/E	18.1 x	90	18.2 x	98
Cyclically adjusted P/E (CAPE)	24.8 x	86	NA	NA
Price / Book	3.1 x	82	3.4 x	99
Free cash flow yield	4.1 %	55	4.5 %	40
Median metric		89 %		99 %

Note: Long-term average based on data since 1976 (40 years) for all metrics other than PEG ratio (1982) and free cash flow yield (1990).

Some of our English readers asked about the Chinese article we included in our letter last month, which carried an interview about our strategy. Close friend/associate in Hong Kong, Mr. Percy Au-Young, helped with the following translation;

Sincerely,

Brook McConnell
President

Email: brook@south-ocean.com Website: www.south-ocean.com
Hong Kong

Hong Kong Economic Digest, March 2017:



MARKET FOCUS

FRONT PAGE STORY

MCCONNELL:

Gained 600% in quality stocks with his long-term investment strategy:

McConnell, President of South Ocean Management, is the expert in choosing quality stocks and realizing multiple returns, the method he uses to pick his stocks is similar to Warren Buffet – scout-out and identify quality companies.

He bought knitwear manufacturer Shenzhou Int'l (02313) a few year ago, sold it last year for a gain of 6 times. Among his current holdings, Tongda Group Holdings Ltd. (0698),

one of the top five and largest stocks in his portfolio, that has also brought him 6 times profits.

MAIN ARTICLE

McConnell said his investment strategy on stocks is very similar to the way of Warren Buffet, which is to find good quality companies, that have competitive edges over their rivals and are cost leaders in their respective industry. When companies meet these criteria, they would be put up for further consideration to buy.

Shenzhou Int'l and Tongda Group Holdings Ltd. were under-valued companies.

Berkshire Hathaway's annual report has clearly explained their principles on acquisition; when a company has sustainable earning power, simple businesses, competent management, then shareholders should have good returns in profit.

Hong Kong Partners L.P. is under management of McConnell, it has continued to own stocks that have become "multibaggers."

For instance, McConnell paid HK\$6 a share to buy Shenzhou Int'l and sold it at HK\$40 a share (see chart 1). At the time he sold, he explained he thought the value of Shenzhou was too high, but, regrettably, this stock has gone up to HK\$50 a share.

The gains of 600% in profits on Shenzhou Int'l wasn't because of luck, he bought Tongda Group Holdings Ltd., which also brought him 600% in unrealized profits (see chart 2).

The buying cost of Tongda was HK\$0.36 the first time, and he bought more shares at HK0.45. The stock was at HK\$2.74 a share as of March 31, 2017. McConnell said when he bought Tongda, its value was very low. He remembered he paid a visit to its factory in Fujian, he talked to the CFO/management, understood its business model, and he then started to buy Tongda.

Tongda manufactures all kinds of cases for cell phone, electrical device, laptop computers and metal components etc. (see chart 3)

Tongda achieved sales growth in each of the last five years; McConnell told us Apple, Huawei, Xiaomi, OPPO are all the customers of Tongda.

Xinyi Solar has great potential to flip

Since Tongda's share price has risen considerably, the fund would not increase its holdings, said McConnell.

Xinyi Solar Holdings Ltd. (00968) is another quality stock, it can be another multi-bagger. McConnell believes Xinyi Solar can grow earnings per share 20% every year for the next five years. The share price on Mar 31, 2017 was @HK\$2.48, it is possible to reach HK\$6 a share.

Xinyi Glass Holdings Ltd. is the parent company of Xinyi Solar. McConnell bought and sold Xinyi Glass and made good profit on it in the past.

Xinyi Solar manufactures solar glass for solar power generation, also operating solar energy power generation farms; McConnell said Xinyi is using a low-cost concept to operate its business; Xinyi is the pioneer and leader of the industry.

Xinyi Solar has seen net profit grow from 120 million dollars to 2 billion dollars in the past 5 years, the return on equity is over 30%, they have a good management team and healthy balance sheet, that suggests this is a quality company.

In addition, China is at full steam in developing renewable energy; McConnell thinks Xinyi Solar should have further development with this support.

With reference to the consensus estimates from Thomson Reuters, Xinyi group is expected to have net profits grow to 2.3b, 2.7b, and 2.8b in 2017, 2018 and 2019.

Beijing Enterprises Water Group, China State Construction Int'l are companies expecting good profit

The current price of Xinyi Solar is fairly low, he considers to buy more shares when new funds come in to his company, in fact, the P/E of Xinyi Solar is less than 7x, it is lower than the Hang Seng's P/E.

McConnell also holds China State Construction Int'l Holdings Ltd. (03311), and Beijing Enterprises Water Group (00371), both stocks are worth to pay attention.

The population of China is 1.3 billion - about 20% of the entire world, yet China only has 7% of water supply in the world; China has huge demands in dealing with sewage and water supply, thus, Beijing Enterprises has great potential for this reason.

McConnell said China State Construction Int'l is well supported by its Shanghai-listed parent company, it has obtained very profitable construction contracts and good business opportunity, it can benefit from China's ongoing implementation of the "One Belt, One Road" national policy.

Recall last summer, the share price of China State Construction Int'l dropped dramatically, it went down to HK\$10 a share, McConnell got a great chance to buy at that particular time, he described himself very lucky to get into it. Last Friday (Mar 31, 2017) the stock was trading at HK\$13.90, it was up 13.9% at least.

***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.