SOUTH OCEAN 南海管理有限公司
MANAGEMENT, LTD.
H O N G K O N G

September 11, 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:

	Aug. 2020	Year-to-date
Hong Kong Partners LP*	- 0.1%	-16.9%
Hang Seng Index **	2.3%	-10.7%
Hang Seng Small Cap Index	0.7%	8.5%
MSCI HK Small Cap Index	6.8 %	-4.1%
HS Mid Cap Index	1.7%	3.5%

Partners' NAV $2.1515 after management fee and provisions, but before annual incentive fees of 15% on appreciation.

South Ocean Management's Hong Kong-listed holdings of China-geared companies were buffeted throughout August with Covid-19 and US/China tension issues. Gains in the overall market were concentrated in a narrow section. Extremely depressed sectors, such as retailers and construction-related companies, outpaced the market along (again) with Info-tech companies. We trimmed our holdings in the technology, e-commerce stock sectors, with long term gains of over 100%, and exited our Hong Kong Stock Exchange holding (code 388hk) that we bought in the 1st quarter, for a 33.2% gain (*let the Devil take the hindmost*).

The Covid pandemic shutdown during the first half of this year in China affected all companies' operating in China, as reflected in their interim financial reports last month. Businesses were at a standstill, causing supply chain delays and disruptions and stoppages of material deliveries.

Yet with China's rapidly rebounding economy, there are reasons for optimism.

Six out of seven Bank of America China Activity tracker indicators improved in July including electricity and port output, retail sales, export growth and the financial and service sectors. Passenger turnover (rails and air) remained depressed. Many of our companies that reported last month have stated they envision better prospects going forward.

Recently, the China Securities Commission, the CSRC, said that it will expand the scope of investments allowed in the Stock connect link, and allow foreign investors to trade more commodities futures products. Revised QFII rules will also be announced soon to increase foreigners' confidence to invest in China. Presently, foreigners hold only 4.7% of Chinese stocks, way below the more than 30% in markets like Japan and Korea, so there's huge upside potential in these cheap markets. Chinese stocks in Hong Kong trade at a 43 per cent discount to their equivalent in mainland markets, the largest divergence since February 2016.

Even the slightest improvement in sentiment could trigger an upward revaluation of Hong Kong-listed Chinese-focused stocks. Consider the following:

First, after the passage of The National Security Law three months ago, there were fewer protests in the city, which implies fewer interruptions of business activities.

Second, most stock and bond markets around the world have benefited from major central banks aggressively boosting the money supply, and Hong Kong should be no exception.

Next, Hong Kong has been depressed with the increased trade tensions between US and China. Just last month, Chinese companies Tik-Tok, Huawei, Tencent and Alibaba (among others) have been scrutinized with the US “clean network” campaign targeting Chinese-made technology over security concerns. Yet, the *already cheap* Hong Kong market did not crash with these jolting headlines.

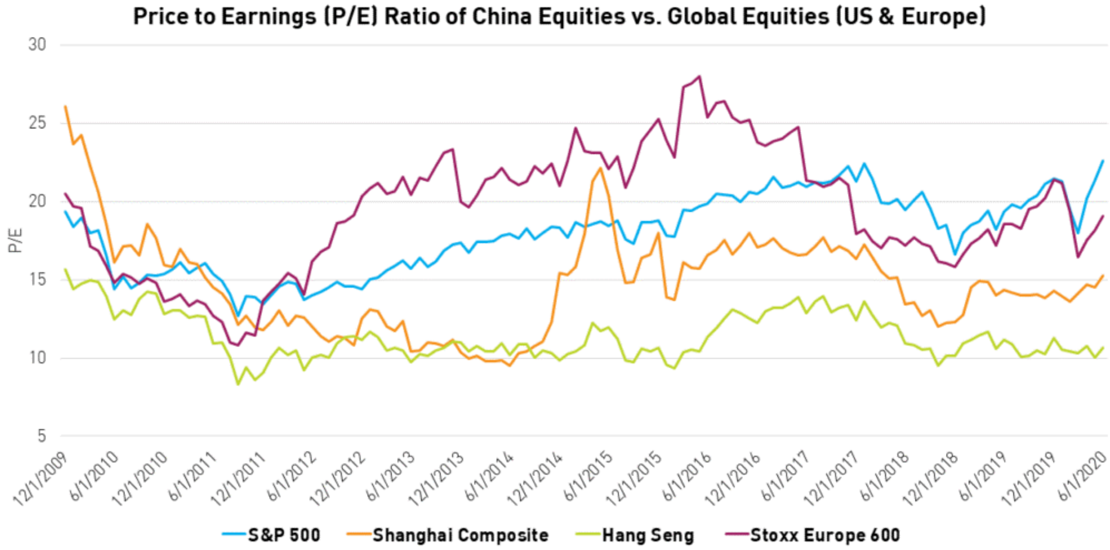
Here are some figures to further that ‘already cheap’ proclamation:

2020 Consensus estimates 31-Aug-20 Valuation Measure	HANG SENG CHINA ENTERPRISES	HANG SENG COMP MID CAP	HANG SENG INDEX	S&P 500 COMPOSITE
Price/ EPS	10.91	11.40	12.76	27.56
Price/ Cash flow	6.64	7.79	9.02	18.89
Dividend Yield	3.00	3.10	2.98	1.63
Price/ Book	1.22	1.05	1.24	3.87
Price/ Sales	0.76	0.42	1.15	2.56
Price/ EBITDA	5.42	3.27	8.95	14.51
EV/EBITDA	4.90	7.64	6.86	14.07
Net Debt/ EBITDA	0.45	2.73	0.48	1.58

Data taken from Refinitiv

Valuations in Hong Kong are far cheaper and dividend yields are twice the S&P 500.

The following chart of Price-Earnings ratios makes some comparisons to western markets:



Data from Bloomberg as of 6/30/2020. Index returns are for illustrative purposes only. Indexes are unmanaged and one cannot invest directly in an index. Indexes do not reflect fees or other costs associated with investing. Past performance does not guarantee future results. Price to Earnings Ratio: Price per share divided by earnings per share at a single point in time based on the latest earnings release. See below for term and index definitions.

Hong Kong and China stock markets have lagged world bourses.

Research firm 13D made this comment:

> Attractive valuations also provide downside support. As shown in the following chart, the price-to-book value ratio of the Hang Seng China Enterprises Index (HSCEI Index, HKD 10,202) fell to a low of 0.96x in June, and has risen only modestly to 1.0x during the recent global market recovery, according to Bloomberg.
>
> The HSCEI or H-share Index, now has a dividend yield of 3.9% and a ROE of 12.5%... Furthermore, the HSCEI's book value per share grew from HK$4,989 in 2008 to HK$9,649 in 2019—implying a CAGR of 6.2% per year during the 11 years. Even if this growth rate is cut in half in the future, and assuming a flat P/BV, then investors could reasonably anticipate a 3.1% annual gain in book value per share, plus a 3.9% dividend yield, implying an annual total return of 7.0%. This is roughly ten times the current 10-year U.S. Treasury yield of only 0.7%.

As I've commented in many past letters, import tariffs make no sense. As quoted in a recent SCMP article, [US-China trade war: who is really bleeding more from Donald Trump's tariffs]?:

> ... Americans are also increasingly questioning whether the US has benefited from making China a cold war enemy, and wondering if their government is spending too much time and effort to force change in China, while leaving plenty of urgent matters at home unattended.

> Take the centrepiece of Trump's economic policy – the US-China trade war – as an example. Two years of tit-for-tat tariff exchanges have led to a dramatic decline in trade flows between the two countries.
>
> But did Americans at least get a bigger slice of the shrinking pie? Not according to research from the Federal Reserve Bank of New York, which showed that nearly all the costs of higher import duties were borne by US firms and consumers...

Another reason we remain confident in the long-term prospects for China came from Credit Suisse on September 1:

> "We believe the opening of China's capital markets is amongst the most important long-term themes in the region. The first testing ground of this trend is the Stock Connect programme: Southbound flows have reignited liquidity in Hong Kong and are now the key marginal driver of stock prices."

Lastly, a recent article in SeekingAlpha made a keen observation:

> It is common even for a most seasoned investor to think that perhaps he or she could time the market and enter it at a 'right' time. Many have attempted to do so and many high prices have been paid over the years. For example, year-to-date as of June 30th, the best 10 days of returns for the China internet sector, as measured by the CSI Overseas China Internet Index, have accounted for nearly 50% of its year-to-date return. However, the probability of anyone guessing one day correctly is low, let alone guessing all ten days correctly

https://seekingalpha.com/article/4371843-portfolio-insights-why-china-is-not-trade

Sentiment is key and turns on a dime with Hong Kong investors. We believe there are a myriad of reasons to be optimistic. Our portfolios are almost fully invested and our weighted average portfolio price-earnings ratio is just 6.9x this year's estimates.

Sincerely,

Brook McConnell
President
Email*:* *brook@south-ocean.com* Website: *www.south-ocean.com* Hong Kong

PS: Opinion: When I listened live (online) to Secretary of State Pompeo's speech at that Southern California library this summer, I was dumbfounded.

It was complete and utter "rubbish" (as my UK friends would put it).

This 16-min video below is by an US expat, Cyrus Janssen, in Hong Kong. He has summarized, in my opinion, a resounding yet straightforward, comprehensive, accurate depiction and rational response to all that was said by Pompei.

Watch "The Truth About Michael Pompeo and China" on YouTube

https://youtu.be/seiIj_hKKEU

Janssen, like myself, is not an anti-American, nor pro-Communist. Rather we have lived and observed, firsthand, what are clear repudiations to what is being propagated and repeated in the US today. I concur with his assessment that the Chinese (especially university intellectuals), who used to look up to America, have turned against Western-inspired ideas and exclaim, hold on, what's going on there?

Here are the 4 Tech giants in Congress mentioned in the video: 2 min video when asked about The Communist Party stealing their technology...
Facebook, Amazon, Google and Apple respond to Congress about whether China steals US technology
https://youtu.be/v6whxZm1ubQ

Brook McConnell

*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.