



December 12, 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:

	<u>Nov. 2020</u>	<u>Year-to-date</u>
Hong Kong Partners LP*	8.4%	-11.2%
Hang Seng Index **	7.6%	-6.6%
Hang Seng Small Cap Index	10.1%	11.9%
MSCI HK Small Cap Index	10.9%	7.1%
HS Mid Cap Index	9.7%	13.2%

Partners' NAV \$2.2987 after management fee and provisions, but before annual incentive fees of 15% on appreciation. The benchmark indexes cited above are not total return results whereby Hong Kong Partners LP's return is inclusive and net of income and fees. Three of these benchmark indexes are provided by HSI Services in Hong Kong and more information can be found at its website: <https://www.hsi.com.hk/eng>. More info on the MSCI Index may be found here: <https://www.msci.com/documents/10199/73920289-8584-47fb-af65-7f57845bfb38>

South Ocean's portfolios gained strongly in November. Our holdings of small/mid cap, Hong Kong-listed stocks surged along with global stock markets on the news of the Covid-19 vaccines. In Hong Kong, a positive sign was also the participation in the market's rally which expanded to lagging areas in retail, material and industrial sectors.

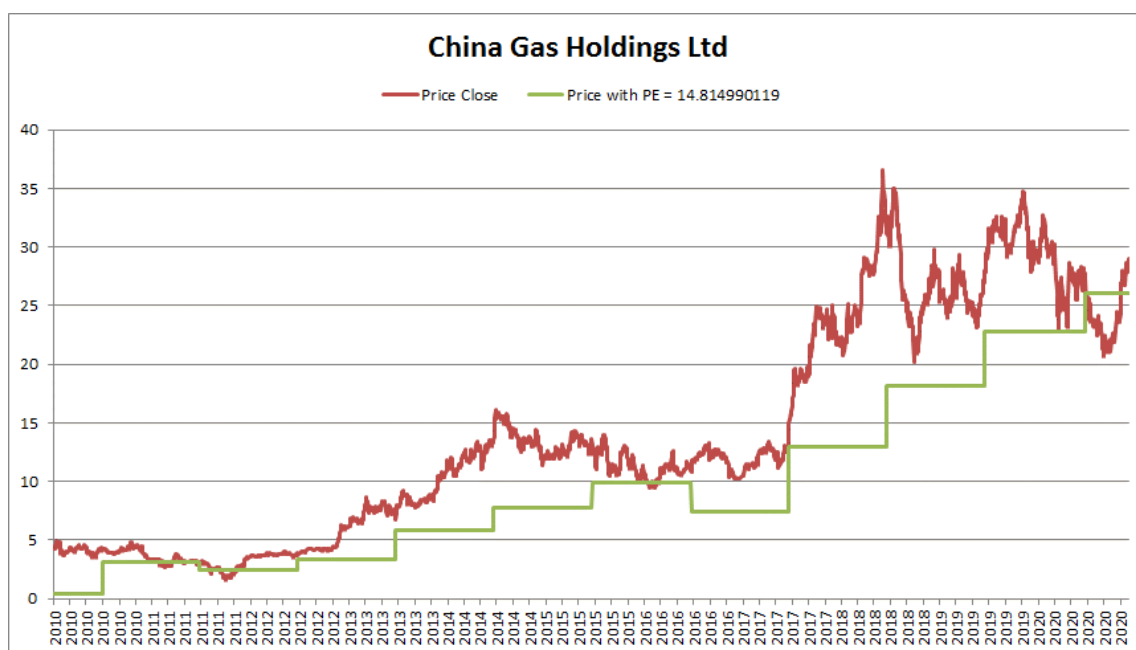
As we highlighted in October's client letter, China has witnessed an acceleration in its economic recovery, far ahead of other major economies. China's October purchasing managers index (PMI) registered the highest level since November 2010. Industrial profits rose 28.2% year-over-year in October, the biggest monthly growth in three years.

Our portfolios of undervalued, fundamentally strong companies, with earnings profiting from operations in China, are beneficiaries of this growth. The rising Chinese Yuan is also a tailwind to earnings reported in Hong Kong dollars. (As an aside, China reportedly has produced 600 million Covid-19 vaccine doses 'ready for use this year' whereas Pfizer has just announced it may have 50 million vaccine doses available, down from 100 million expected).

Our in-house intrinsic value screening program evaluates all listed stocks as to their fundamental attractiveness. For example, the software highlighted the shares of coal-to-city-gas converter, China Gas Holdings (code 384HK, market cap: HK\$ 145 billion, US\$ 18.7 billion) at a trough valuation where we initiated purchases in the low \$20/share range (see chart below). The shares were selling at an 11 times price-to-earnings multiple (PE) on estimated 2020 earnings (versus an annual median PE of 17x over the past five years).

On further analysis, the company's five-year 22% compound annual earnings (EBIT) growth, 23.2% (trailing twelve months) return on equity and 17.2% return on capital employed are attractive fundamental metrics. The company recently reported a higher net amount of cash and cash-equivalents being earned by the business (operating cashflow) along with a lower projected capital expenditure budget which, in turn, is significantly increasing the company's free cashflow (by 30% this year and next). Insiders have been buying and the company is optimistic on its new micro LPG pipeline business.

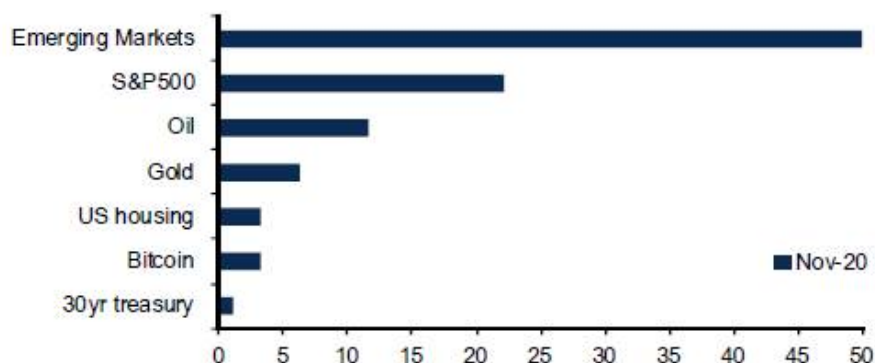
Evaluating China Gas's shares using its five-year low annual PE of 14.8 multiplied by earnings per share, our system identified the share price as being undervalued, selling below its (green) earnings line in the month of October:



The chart displays the company's progressive earnings over 10 years and how the stock price squares with a reasonable (lowest annual multiple) valuation level. Our system helps us focus on attractive risk/gain opportunities in the Hong Kong share market.

Regarding prospects for Hong Kong equities next year, Bank of America/Merrill Lynch's widely followed Global Fund Manager Survey was decidedly bullish on the prospects of Emerging Markets:

**Chart 1: What asset class do you think will outperform in 2021?**



Source: BofA Global Fund Manager Survey

Our stocks are significantly undervalued and have outstanding business prospects. The China markets are at an inflection point and we are glad to be investing our own capital along with our close friends and clients at South Ocean.

The article below had some keen insights on Hong Kong and China (Q&A with Gavekal's CEO).

We are sending our best wishes for a healthy and peaceful holiday season.

Sincerely,

Brook McConnell

President

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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.

## The Renminbi Will Gain Wider Use Globally, Gavekal's CEO Says

By

[Reshma Kapadia](#)

Updated Dec. 5, 2020 11:17 am ET / Original Dec. 4, 2020 9:16 pm ET

[BARRON'S NEWSLETTERS](#)

## The Barron's Daily



Louis-Vincent Gave

### **Louis-Vincent Gave**

**Chief Executive, Gavekal  
Hong Kong**

Louis-Vincent Gave, CEO of Gavekal, is a go-to source for institutional investors trying to interpret global macro risks such as the financial implications of China's rise. Gave, 46, was born in Paris, educated at Duke University, and based in Hong Kong before the pandemic. Gavekal provides independent research and manages \$1.7 billion in Asian fixed-income and equities strategies, primarily for European institutions.

***Barron's:* What investment trends will be most prominent after the pandemic?**

**Louis-Vincent Gave:** If I ask what the most important development was in 2001, most people would say it was 9/11. With the benefit of hindsight, it was China joining the World Trade Organization, which changed the world for the following 20 years. If I ask about 2007, you'd say it was the start of the subprime crisis. With the benefit of hindsight, it was the launch of the smartphone.

**With hindsight, what will people say about 2020?**

So far, the Covid response in the U.S. has been a \$12,800 increase in debt per capita; in the United Kingdom, it's \$7,000, and in Germany and France, \$5,300. In China, it's \$1,200. The Western world responded with massive increases in budget deficits, which could constrain future policy options, while Asia, especially China, hasn't.

Western policy makers have no choice but to embrace yield-curve controls; they can't let interest rates go back up. You had Japan and Europe in the yield-curve control gang. The big change now is that the U.S. has joined them. Once the European Central Bank went down this [path], the euro tanked. Once we are on the other side of Covid-19 and it becomes clear the U.S. has no other choice, the dollar will collapse.

### **What will be the best investment opportunity post-Covid?**

Investing in Asian fixed-income markets, in local currencies. Governments there have broadly been more efficient at dealing with Covid-19. Central-bank balance sheets and government spending haven't grown out of control. Just as water flows downhill, capital is attracted to positive real [inflation adjusted] rates. Today, these are mostly found in Asia.

### **What is the most pressing public policy issue the U.S. will face?**

How to fund runaway debt. For now, everyone's answer is through modern monetary theory [which posits that governments that control their own currency can spend freely]. Once the debt is monetized by the central bank, there are no historical examples, outside of Japan, where that doesn't lead to massive and very fast inflation, massive currency debasement, or both.

### **What does that mean for the dollar's reserve-currency status?**

I look at currencies like computer operating systems. Most Gavekal clients use Microsoft because everyone else uses it. The dollar is Microsoft. Go back to 2005-06, when Apple was trading at nine times earnings and viewed as making a niche product. In 2007, Apple said it would create a parallel system and went straight to the consumer, who took [Apple] not because it was cheaper but because it was easier.

### **So the renminbi is Apple.**

We are seeing the rollout of Chinese fintech solutions across Southeast Asia, the Middle East, and Africa through WePay and Alipay. Then, tack on the digital renminbi and look forward to a future where an Indonesian businessman goes to Singapore and pays for his taxi with Alipay and the transaction isn't settled through Swift or the dollar but through digital renminbi. The pushback I get is that no one is going to trust the digital RMB—or, who wants the Chinese government to know how and where you spend your money? That's a big roadblock, but if you told me 10 years ago people would put Alexa in their homes voluntarily....

### **Aren't you worried about China's debt or social instability?**

For the past 10 years, I've been told that Chinese debt was about to implode and there would be riots in the street. In the past 10 years, we have seen riots in France and the U.S.—and in Hong Kong—but China has been remarkably stable. We have been told that the Chinese government would have no choice but to nationalize big parts of the economy and the renminbi would collapse. That scenario has unfolded in Europe and the U.S. [The U.S.] has increased debt by \$4.2 trillion, three-quarters of which was funded by the Fed. Meanwhile, the renminbi has been the strongest currency year to date and over 10 years.

### **What is a key concern for Asia-based investors?**

The decoupling of the U.S. and China is a massive change, and Taiwan is an important fault line. Taiwan wasn't too much of an issue when the U.S. and China got along and all China produced were cheap plastic toys and bicycles. But this year, the market cap of the global semiconductor industry is above that of the energy sector. [Taiwan Semiconductor Manufacturing](#) [ticker: TSM] said it is already manufacturing a generation of chips that [Intel](#) [INTC] has said it won't be able to fabricate until as late as 2023. If you think semiconductors matter more than energy, Taiwan Semi is one of the most important companies in the world.

### **What are the longer-term ramifications of President Xi's crackdown in Hong Kong?**

The core thesis is that Xi is a transformational president—the first imperialist president since the Ming Dynasty. If you are Xi and you hear your companies won't have access [to U.S. markets], Hong Kong sounds like a great way to internationalize the renminbi and do a digital renminbi. Most Westerners saw the intervention as the death of Hong Kong, but China guaranteed Hong Kong would be China's capital markets for the foreseeable future. [Xi] has no choice but to make it a success, which is why the Hong Kong dollar is stuck at the high end of its [trading] band.

### **Chinese internet stocks have been hit by increased regulatory scrutiny, including the scuttling of the oversubscribed planned public offering of Ant Group. Does this mark a turning point for these companies?**

Since the [suspension] of the Ant IPO and new antitrust [guidelines], we also had a state-owned coal company default on one billion renminbi, or \$150 million. One big issue for China has been a trade surplus of \$60 billion and enormous inflows into China tech and bonds driving the renminbi higher.

In the Western world, we would raise rates [to deal with potential bubbles]. In China, they have regulatory weapons. They managed to cool the tech stocks in China and inflows into Chinese bonds. They got their message through.

### **You have been living in Vancouver during the pandemic. What is the one place on Earth that you'd most like to visit when the pandemic ends?**

I have to get back to my Hong Kong and Beijing offices. I miss my colleagues and my friends there.

**Thank you.**

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**\*\*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](mailto: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.