



February 9, 2021

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>Jan. 2021</u>
Hong Kong Partners LP*	0.1%
Hang Seng Index**	3.9%
Hang Seng Small Cap Index	7.5%
MSCI HK Small Cap Index	5.7%
HS Mid Cap Index	2.4%

Partners' NAV \$2.3344 after management fee and provisions, but before annual incentive fees of 15% on appreciation. Please refer to footnotes at the end of this commentary for descriptions of the Fund's indexes and Fund risk disclosures.

"Nothing sedates rationality like large doses of effortless money."

- Warren Buffett, after the burst of the tech-infused stock market bubble of 1997-1999.

It was volatile trading month in Hong Kong during January, with Information Technology-oriented stocks leading the rally until the third week of the month when the market swung lower. South Ocean's portfolios of small/mid cap holdings of Hong Kong-listed companies benefiting from operations in China have almost no exposure to tech-related shares. In fact, our top 5 holdings (~17% of total portfolio value) operate in more mundane business lines:

CHINA SANJIANG -2198hk – a profitable small cap (HK\$3.2 billion market capitalization, US\$413 million) refiner of ethylene and surfactants, headquartered in Jiaxing, China. The company manages to keep average selling prices of its refined products strong relative to the average purchase prices of its major feedstocks. (stock gained 11.16% for the month).

3SBIO -1530hk - These shares came into our screen recently near historic lows where we began purchasing. The company (HK\$17.8 billion market cap, US\$2.3 billion) has a promising product line of biomedical products. (+2.26% for the month).

PLOVER BAY TECH -1523hk – another small cap (HK\$1.1 billion US\$137 million), with no analyst coverage. They make electronic wireless routers for the pending 5G Internet of Things market. (+7.61% for the month).

TRADITIONAL CHINESE MEDICINE –570hk – a well-managed, mid cap (HK\$21.7 billion, US\$2.8 billion), running Chinese Medicine stores, announced it is being taken over

by a large pharmaceutical company. (+11.98% for the month, suspended trading as of this writing).

CHINA LILANG -1234hk - men's clothing retailer in China seeing a turnaround in operations post Covid slowdown on the mainland. (-1.13% for the month).

One long term holding, property/auto glass manufacturer, Xinyi Glass (code 868hk, HK\$ 76.8 billion market cap, US\$ 10.0 billion), which gained 108.8%% in 2020, endured profit taking during the first month of 2021.

Please note: we may be buying more or selling these names. They are not meant as recommendations.

We seek to own less followed, small/mid capitalized stocks that have higher growth and quality metrics than the overall market. And though these stocks are not without risks, our proprietary screening process demands a maximum price to pay, offering some margin of safety. Smaller, out-of-the-limelight stocks require a bit of work analyzing and need to be vigilantly monitored.

In screening for uncovered values in the HK market, we grant there may be long holding periods to allow our appraisals of a company's future potential to become recognized. We are not tempted to chase the latest hot trends in the markets and may go through periods of lagging performance. We are patient in our longer-term outlook. For instance, the electric vehicle market is front and center today and even a few very average performing car company stocks in Hong Kong have risen sharply on investors' lofty expectations. My partner and I once visited an executive of a large Chinese auto company 6-7 years ago. I asked him about a new company called BYD that was just planning to make electric vehicles (EVs) in China. He waved his hand and said casually, 'All auto companies, Brook, have electric vehicles on their drawing boards and are waiting for the market to develop before introducing any models to the show rooms.'

Though the outlook for EVs is bright (especially autonomous-driving autos) there is increased risk in the shares of companies that have inflated prices as investors have been tantalized with very optimistic outlooks. As one [analyst](#) aptly put it: *Even companies that can produce strong earnings growth may make poor investments if they are purchased at a price that offers little or no margin of safety.* Today, China has 500 electric vehicle registered car companies and most haven't even produced one prototype model (think of the overabundance of railroad stocks in the 1800s and the amount of bond and stock wallpaper many of those worthless certificates eventually created).

Incidentally, we do have a small position in one of only two silver mining companies listed in Hong Kong. Silver usage in EVs (as well as other renewable systems) will likely be twice the amount used in internal combustion engine cars.

I cover in the latter chapters of my book, [Insights of an American Investment Manager in Hong Kong](#), our process on how we view stocks we want to own and those we don't. Additionally, we are not timing or trying to figure out which direction the market is heading. Though we often come across highly touted names that are likely overvalued (in our estimation), we don't try to make money shorting, either.

Warren Buffett has said that shorting is “the sort of thing that you can go broke doing”

Short selling has “ruined a lot of people,” he said in 2001 at the annual meeting of his company, Berkshire Hathaway. “It’s tempting,” he continued. “You see way more stocks that are dramatically overvalued in your career than you will see stocks that are dramatically undervalued. ... So you might think it’s easier to make money on short selling. And all I can say is, it hasn’t been for me... In my experience, it was a whole lot easier to make money on the long side.” <https://www.yahoo.com/lifestyle/why-warren-buffett-never-short-180000346.html>

As some hedge funds and short sellers have recently learned, shorting can be dangerous. Risks in shorting can be limitless. We don’t short stocks (especially in less liquid markets such as Hong Kong). Instead, we move to cash when markets dictate (as in 2007’s overvalued market). One colleague/friend in Hong Kong was net short her portfolio heading into the Chinese New Year break years ago. She decided to cover her shorts when the market re-opened, but ran right into a huge rally after the end of the holiday. She was, unfortunately, out of business in the first 6 hours of trading that day.

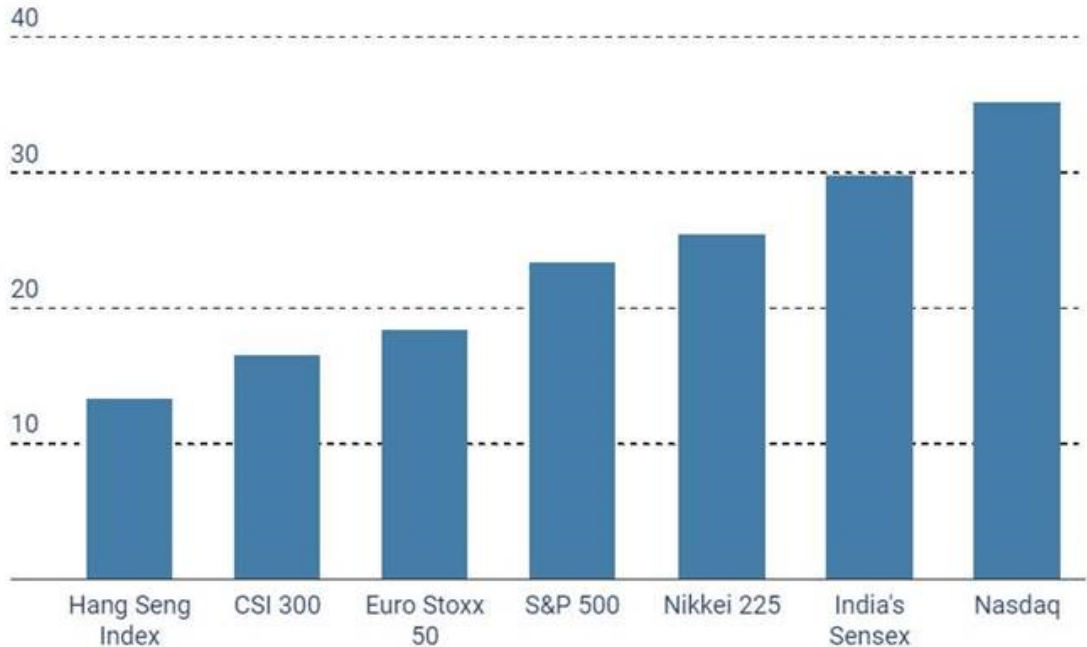
As Buffett’s long-time partner, Charlie Munger, said, **“Being short and seeing a promoter (Reddit?) take the stock up is very irritating. It's not worth it to have that much irritation in your life.”**

Hong Kong remains a cheap market. While not as massively cheap as the 8.6 times earnings multiple it traded in 2020:

...the Hang Seng Index is still the least expensive globally at 13.2 times estimated earnings, according to the Bloomberg data below. That compares with 23.2 times for the S&P 500 Index, while European stocks are valued at 18.2 times. China’s A shares trade at about a 35 per cent premium over Hong Kong stocks on average.

Cheap sale

Hong Kong stocks have the lowest price-earnings multiple (times) vs major peers



Source: Bloomberg

SCMP

Chart as of Jan 20, 2021 https://www.scmp.com/business/markets/article/3119023/hong-kong-stocks-look-earnings-boost-mainland-panic-overcome?utm_source=email&utm_medium=share_widget&utm_campaign=3119023

Hong Kong operates the world's 4th largest bourse at a US\$4.2 trillion market capitalization and is gaining exciting new company listings from China. It is a cheap market with bright prospects.

Sincerely,

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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.