SOUTH OCEAN 南海管理有限公司

MANAGEMENT, LTD.

HONG KONG

June 9, 2021

Dear Clients, Partners, and Friends,

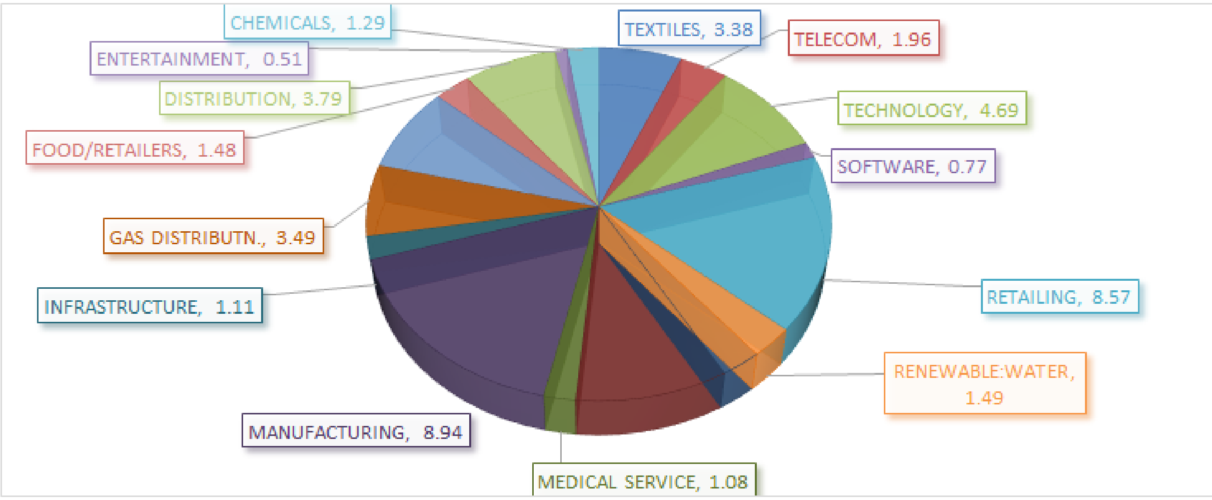
The results for South Ocean Management's Delaware LP, Hong Kong Partners' L.P., before incentive fees, were as follows:

	May 2021	Year-to-date
Hong Kong Partners LP*	1.7%	18.5%
Hang Seng Index**	1.5%	7.1%
Hang Seng Small Cap Index	1.5%	16.0%
MSCI HK Small Cap Index	-0.8%	21.0%
HS Mid Cap Index	3.5%	11.0%

Partners' NAV $2.7625 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.

South Ocean Management, Ltd.'s value-oriented portfolios of fundamentally strong Hong Kong-listed companies benefiting from growing operations in China have out-performed year-to-date. The *18.5%* (net) year-to-date return of Hong Kong Partners LP (HKP) compared favorably with that of the Morningstar 49 Hong Kong equity mutual funds average return of 5.3% (through the month of May). According to EurekaHedge, our year-to-date through April results rank HKP #2 out of 73 funds in the population. South Ocean has captured these returns by adhering to a disciplined approach of seeking value in the small/mid capitalized sectors of the Hong Kong stock market.

Our holdings are generally less followed, smaller companies that span a diverse cross section of industries:



Smaller companies can grow faster and often, when their market capitalizations rise to reach the radars of large, institutional investors, the share prices take off (I relate several such stories in my book, now available on Kindle free: Insights of an American Investment Manager in Hong Kong).

China's trade with the US has increased the past 4 months, highlighting inextricable economic relations between the two countries.

> *In the first four months of the year, China's trade with the US rose 50.3 percent year-on-year to 1.44 trillion yuan ($222.8 billion), making the US its third largest trading partner after the Association of Southeast Asian Nations (ASEAN) and EU economies, according to data from the General Administration of Customs on Friday. China's exports to the US rose 49.3 percent while imports gained 53.3 percent, and the trade surplus with the US was 653.89 billion yuan, an increase of 47 percent.*

The post Market Talk - May 21, 2021 first appeared on Armstrong Economics.

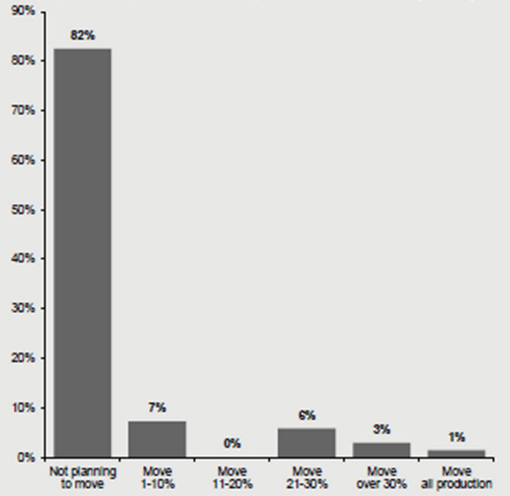
China continues to advance its economy along with many western companies. It has been reported Goldman Sachs, Deutsche Bank and others are on a hiring spree in Hong Kong. Seven JP Morgan tables below outline some of this progress (Note: many (82%) of the Multi-national firms operating in China plan to stay or expand):

Foreign direct investment
USD billions

Trade growth
Year-over-year change

	% of U.S. GDP	# trading partner for U.S.
U.S. exports to China	0.5%	3rd
U.S. imports from China	1.9%	1st

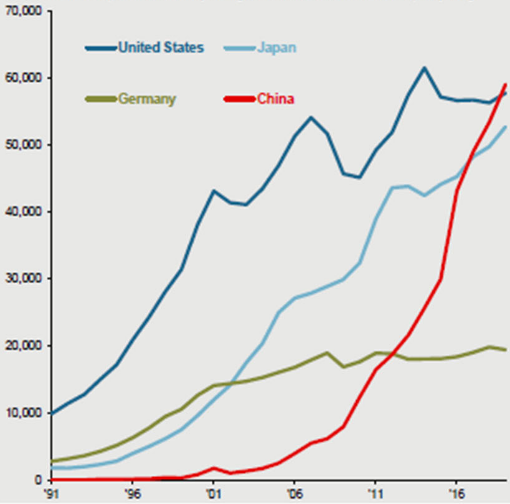
Plans to move production out of China in the next 3 years
Of companies with production capacity in China, % considering moving*



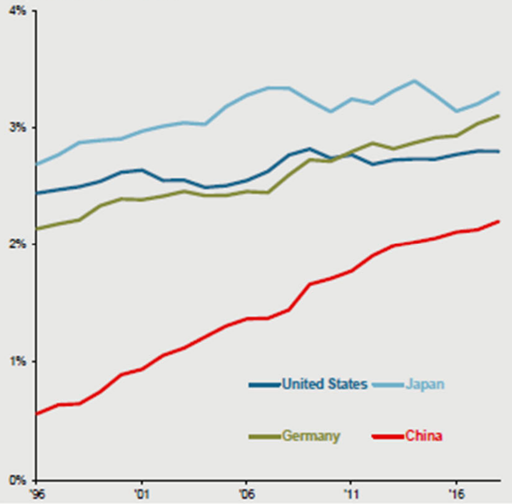
Source: FactSet, J.P. Morgan Asset Management; (Top left) U.S. Census Bureau; (Bottom left) National Bureau of Statistics China, U.S. Bureau of Economic Analysis; (Right) The American Chamber of Commerce in Shanghai.
Percent of GDP and trading partner ranking reflect 2020 figures.
*Survey was taken from November 11 to November 15, 2020. Responses were received from 124 companies.
Data are as of December 31, 2020.

J.P.Morgan

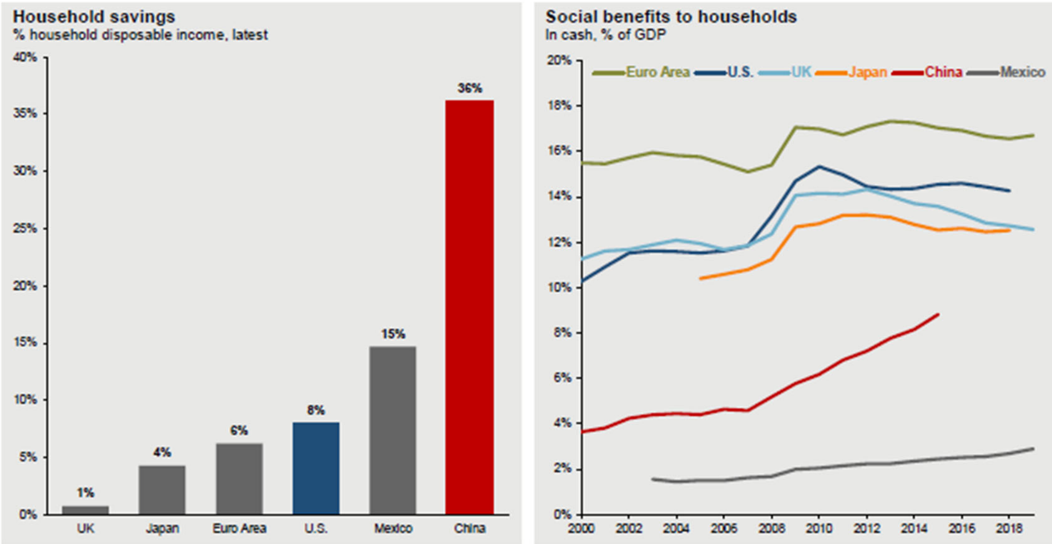
Patent applications
# of Patent Cooperation Treaty fillings at World Intellectual Property Org.



Research and development
Expenditures as % of GDP



Source: J.P. Morgan Asset Management; (Left) Wind, World Intellectual Property Organization; (Right) World Bank.
Patent Cooperation Treaty provides international patent protection.
Data are as of December 31, 2020.



Source: OECD, J.P. Morgan Asset Management.
Social benefits in cash include cash transfers by the government for pension and non-pension benefits.
Data are as of December 31, 2020.

The Hong Kong stock market is cheap, especially relative to the US markets (see last month's commentary here). As China's economy progresses post Covid, we believe the prospects for our holdings are attractive over the next 3-5-year time period.

Copied below is the Preface and Introduction of my recently published book.

Sincerely,

Brook McConnell

President – South Ocean Management, Ltd.

Hong Kong

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

South Ocean Management, Ltd. was started in 1992 in Hong Kong, has ~$14 million under management, with 6 team members. South Ocean is registered with the SFC and SEC regulators.

Preface

I have attempted to present an analysis in this book based on my own experiences as an American living in Hong Kong, visiting Chinese companies, and attending conferences throughout China for nearly three decades. During those studious years of learning, I've written monthly about my findings. It is from a firsthand perspective that I've observed the rise of China's living standards and the stature it has gained as a world power today. There were plenty of doubters along the way and many who quickly moved to grab low hanging opportunities presented in China as it laboriously restructured, yet significantly transformed, its economy.

Just as I finished the final editing of this manuscript, the world turned upside down overnight by the coronavirus pandemic. Though the immensity of the virus impact has swept away all the front-page issues I discuss and disseminate throughout this book, I would wager these same issues and new ones will emerge once the pandemic stabilizes.

Ray Dalio, founder of the world's largest hedge fund (Bridgewater), recently turned to history to summarize his outlook about China. He presents a sequential outline of the world's evolution beginning with the Dutch empire, continuing through the rise and decline of the British empire, and into the US empire. From there he presents the US empire's rise and early decline into the rise of the present Chinese empire. He concludes in *The Changing World Order*:

> "For the first time in my lifetime, the United States is encountering a rival power. China has become a competitive power to the United States in a number of ways and is growing at a faster rate than the US. If trends continue, it will be stronger than the United States in most of the most important ways that an empire becomes dominant. (Or at the very least, it will become a worthy competitor.) I have seen both countries up close for most of my life, and I now see how conflict is increasing fast, especially in the areas of trade, technology, geopolitics, capital, and economic/political/social ideologies. I can't help but wonder how these conflicts, and the changes in the world order that will result from them, will transpire in the years ahead and what effects that will have on us all..."[1]

The storyline of the Chinese economy remains the same. Long term trends in technology, consumption, and market consolidation may be disrupted by trade wars and viruses, but they won't disappear. China will endure and be particularly pertinent to equity investors over the next decades.

This book is about those developments.

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[1]Ray Dalio, "The Changing World Order," *The Changing World Order* (blog), LinkedIn, March 25, 2020, https://www.linkedin.com/pulse/changing-world-order-ray-dalio-1f/.

Introduction

On a warm September morning, we drove through the guarded gates of the factory compound and made our way up to the lobby entrance. It was 1992, and this was our first visit into mainland China. Having departed early that morning from the central business district on Hong Kong Island, we were now two hours across the border.

The place was immaculate. Elderly women, with large-brimmed straw hats orbiting their heads, swept the grounds spotless—brooms of bamboo swinging like clock-time to remove any traces of dust. This was the production base for a major manufacturer of floppy disks, and in the early nineties the three-and-a-half-inch plastic square was one of the hottest selling commodities. Back then, every personal computer had an injection port to read these diskettes.

Our hosts led us through the lobby doors and deep into the recesses of the building. Hallway after hallway, pristine and ordered, like some highly-efficient palace. My father and I shared a growing sense of curiosity, as if we were the first Americans ever to enter these corridors. We were on the way to meet with management of the listed Hong Kong company. The first of what would become hundreds of these visits all over the country.

My anticipation was running high. All along the journey that morning, my preconceived visions about what we were headed into dominated my thoughts: a place where the working conditions were full of despair and agony, summoned from the pages of a Steinbeck novel. I readied myself for the inevitable queasiness that would come when we witnessed the scenes of immense toil, misery, and suffering I expected to find inside these factories—the notorious sweat shops I had been reading about years before we even left for Hong Kong.

Finally, we came to a large room upstairs where we met with company managers who smoked Chinese cigarettes and drank tea as they discussed the manufacturing operations. The general manager was a Hong Kong resident who spent his workweek running the factory in Guangdong Province and his weekends back in Hong Kong with family. He spoke clear English, probably from having dealt with Westerners like ourselves, from the days the factory was located in Hong Kong. I tracked what he was saying carefully, but kept wondering what the working conditions would be like once we toured the rest of the compound. An uneasiness was building in my gut.

After the meeting, we moved downstairs and outside to the adjoining factory. As we entered the great hall, that leery and apprehensive feeling shot through me. I swallowed in anticipation of what we were about to see. But upon entering the first assembly floor, I was immediately struck at how it spread out impressively before us. It was huge—about half the size of a contemporary Walmart. Three long assembly lines of young Chinese girls flowed down the open warehouse, all seated at station workbenches and dressed in blue smocks with surgical-knit hair pieces. An assembly belt ran between each of the stations with partially assembled floppy disk pieces being conveyed further and further along.

The factory floor hummed with activity. As we walked down the aisles between the assembly lines, I watched the diligence and skilled maneuvers of the young women working—assembling the springs inside each of the disk cases and then placing the discs back on the assembly belt for the next procedure. Most of them were bent over, deep in their work, like pianists lost in their compositions. Occasionally, they might glance up as we passed, their slightly suspicious, curious eyes tracking us. I watched them watch us and then glance back at each other, acknowledging some hidden message in the space between.

But something was off. Something I simply hadn't expected. These workers didn't seem unhappy! Wasn't this one of the epicenters of the most repressive and authoritarian regimes in the world? Why weren't their faces painted or smudged in soot and sweat? Why weren't their clothes old and tattered? And where were the slave drivers? Men, belted with knives and chains, standing above all the workers, screaming in nasal Mandarin? Maybe the whole thing was kept hidden behind a vast curtain, concealed momentarily for our expected arrival and inspection. Whatever it was, the destitution I expected wasn't the case at all. The storyline had changed and my schema was transforming right in front of me.

Outside, in the hallway, the manager from Hong Kong confided in us a few revealing aspects of life there at the factory. Yes, indeed, these three hundred girls inside the first assembly line were happy employees (there were eight assembly lines within the walled factory compound). Foreign factories in China paid wages at twenty-two cents an hour, plus room and board, which was high above domestic factory compensations. Most employees worked eight to ten hours a day, seven days a week, with overtime. Within two years' time, the manager explained, each of these young women could accumulate enough savings to return to their home province and buy a place for themselves. No mortgage. Cash payment only.

News of their affluence, after returning to their families in the hinterlands, would spread like wildfire over a dry plain. Unheard of fortunes were being earned working in southern China factories. Paramount Leader Deng Xiaoping's opening to foreign investment in the Special Economic Zone (SEZ) of Guangdong Province was attracting rural youth like a magnet. This was the start of China's great opening and it was mainly funded with direct investment from established Hong Kong Chinese manufacturers. Hong Kong factory owners were rapidly relocating their entire Western export-oriented operations back to their 'home' towns across the border. The great worker migration had just begun. Countless masses of young men and women from all parts of China's countryside headed to the new economic zones in the south for the long-absent opportunity of 'fantastic' wages and 'exorbitant' riches.

The wealth, he said, was on display. Out in the courtyard parking lot stood a tangle of one-speed bicycles, thousands of them stacked up on top of each another. As soon as enough savings were accrued, workers splurged to buy 'luxury' items. Bicycles were status symbols signifying freedom, joy, and leisure. But one of the biggest thrills for the young women was to gather under a light bulb at night for socializing. In their hometowns, he explained, they had no electricity. Evenings were cloaked in darkness. Chinese teenagers didn't go to malls to carouse at night—there simply weren't any malls. Nothing stayed open after sunset. Roads went unpaved, and no taxis or buses ran. There were no fast food restaurant chains except for a few plastic chairs and tables positioned on the sidewalk outside a family home. There were no bars, no entertainment venues, no movies shown except the occasional state-sponsored film projected onto a white-cloth screen in some small open-air room.

At the factories, however, when shifts ended, the atmosphere turned ecstatic. The girls relaxed, came together to commiserate, tell jokes, and talk about their lives. They were fed well, by their standards, and given comfortable bunk beds in dormitories (room and board was a legal requirement for foreign factories operating in China). Hanging above them in the late hours like a promise in the night, as the young women enlightened each other about the many paths of life, was always a bright-white glow from an iridescent light bulb.

The assembly line workers were mostly dark-haired women in their early twenties. Not only were the women more manageable, the manager explained, but they had the manual dexterity, with smaller hands and fingers, to best undertake the exacting work quickly. Young men were assigned heavier tasks, either employed at loud stamping machines or in the packaging and transportation sections.

Though the dorms for the young women and men were in separate buildings, I knew there had to be commingling. This, I found out, the company spent a great deal of effort and time trying to manage. On walks outside around the buildings, we'd see couples holding hands, but the managers had strict rules keeping workers separate. They wanted to avert any incidents, dramas, or episodes that might bring in the town officials, scrutinizing and disrupting the 24/7 operations.

Later that hazy afternoon, as we started back through the countryside and villages, I felt as though I was wandering along the edges of some dream-like and surreal world. The landscape was one vast industrial construction site, mile after mile of new factories sprawled out before us. These newly built plants churned out millions of manufactured goods for export. The products were sold at extremely competitive prices on world markets from the considerable advantage of cheap labor and land costs offered on the mainland.

Masses of people crowded the countryside. Residents seemed to be everywhere along the roads, pressed close together, shoulder to shoulder. Our driver navigated through the crisscrossing patterns we encountered without slowing down. I sat in the back gripping the arm-rest and looked out the side window, not able to bring myself to watch all the near-misses happening up in front.

On the drive we passed long rows of low-rise, cookie-cutter homes, all fronting east. Peasant farmers crossed over the fresh four-lane roads we were traveling, rakes slung over their shoulders, seemingly oblivious to all oncoming traffic. Occasionally older men mixed among the throngs of people, dressed in drab grey buttoned-up Mao suits, and older women appeared in even drabber pajamas. They'd be standing along the roadside, idly watching the hectic traffic. But many, mostly younger Chinese pedestrians on those one-gear bicycles, were dressed in the latest fashions paid for by factory work earnings. After studying their faces, I decided they must have been heading home, with their plastic orange bags tied onto their bike racks, filled with fresh dinner preparations from the local market. I guessed the insides of their homes were basic with only the simplest of appliances. Air conditioning was just beginning to reach the masses in the hot humid southern Province. Though China's farmers were poor by any Western measure, they were not destitute. Life was tough for the majority of citizens, but a month's worth of rice cost just two yuan (less than thirty cents) which assured sustenance. Their existence was harsh, but it was not intolerable.

The grinding and impoverished living conditions in China would be quite difficult, if not totally incomprehensible, for non-Chinese foreigners to digest. As a rule, a Westerner's first visit into the country was typically a wrenching shock, akin to arriving at the spaceport town of Mos Eisley on the planet Tatooine, where the famous Star Wars' bar-room scene took place. Nevertheless, conditions and life were improving at an astoundingly rapid pace in the large coastal urban areas, particularly in the newly created special economic zones in southern China.

The young women who worked in the factories, dressed in smart uniforms, were the precursors to China's rejuvenation and renaissance. The resurrection of a lost generation, encumbered by the unfortunate 'iron rice bowl' experiment under Mao, was visible everywhere. China was in the early stages of becoming a major, global manufacturing powerhouse.

My first trip into the Peoples Republic of China was an eye-opener. The floppy disk factory was our initial foray into seeking investment values outside the US. China factories were making profits and the low labor wages were actually quite generous for mainland Chinese workers. Share prices of the listed Hong Kong companies—those just beginning to move their operations into China—were also cheap by almost every standard of valuation. Advancing profits looked assured with the improved cost structures of cheap land and labor.

My father and I both concluded we wanted to be a part of this historic evolution. We began laying plans to invest in this yet-discovered growth opportunity by launching an investment firm in the financial district of Hong Kong. It was like a light bulb coming on above our heads.

Dad had been a well-known, successful investment professional on Wall Street. My previous career was an eight-year stint as a stockbroker with PaineWebber and five years with a Wall Street money management firm in New York City. He was sixty-seven and I was forty when we considered moving to Asia. The old man was a tough customer, a smart money man, and all along had been my mentor and best friend.

What Dad astutely observed that day was that the Western-trained, Hong Kong manufacturers were the most logical beneficiaries of what China was offering: abundant low-cost land and anxious-to-work workers, all with implicit government backing. As they would know best, founders and managers based in Hong Kong were undoubtedly the ones to follow as they spoke the language of the land in all its connotations. Over the ensuing years, we visited hundreds more of these listed companies in order to develop confidence and deeper understanding of this new empire.

I wrote this book with the intent of recording our company's origins, as well as providing insight into our investment strategies for those interested in investing with us. During the writing process, it became apparent that my impressions and observations about living in the modern enclave of Hong Kong were a natural outgrowth of such an intent. These last twenty-seven years have been an on-the-job history course for one of the most dramatic rebirths and increases in living standards ever recorded in mankind's history. My firsthand impressions and observations stem from actual events and people I encountered throughout my fortunate time living in the Far East. They may not be wholly accurate, nor flattering, as they're drawn from the memory of an outsider during the nearly three decades I spent there. But if nothing else, they are honest commentaries of the many encounters and insights I gained living in a foreign land, and I've tried to be impartial to both sides of the philosophical and economic spectrum that covers the East and West. The future for China is compelling; I will describe just how compelling an investment it is through the course of this book.

I am indebted to my late father for his enthusiasm, guidance, support and wisdom. He imparted much to my learning while we built a life and business together far from our native homeland.

We were exhilarated and enthusiastic with what we were beholding, and that perspective hasn't changed. The Special Administrative Region (SAR) of Hong Kong, with its contemporary conveniences and advanced infrastructure, was ostensibly the most advantageous center to start building our new venture.

*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.
The S&P 500 Index is a market capitalization- weighted index of 500 widely held stocks often used as a proxy for the stock market. It measures the movement of the largest issues. Standard and Poor's chooses the member companies for the 500 based on market size, liquidity, and industry group representation. Included are the stocks of industrial, financial, utility, and transportation companies.

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.