



September 14, 2022

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>Aug. 2022</u>	<u>Year-to-date</u>
Hong Kong Partners LP*	-1.7%	-13.4%
Hang Seng Index**	-1.0%	-16.2%
Hang Seng Small Cap Index	-2.6%	-17.1%
MSCI HK Small Cap Index	-1.4%	-17.1%
HS Mid Cap Index	-1.7%	-16.5%

Partners’ NAV \$2.1965 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.

“When I was a little girl, I was told when at the beach that if I dug a hole deep enough, we would reach China — so we’ve always felt a connection there.” August 5, 2022, [Nancy Pelosi](#), Speaker of the House of Representatives, in Tokyo after visiting Taiwan.

South Ocean’s holdings of small/mid cap, Hong Kong-listed shares of companies with earnings geared towards China witnessed light trading during August.

The only sectors in the Hong Kong market that produced gains last month were energy (especially coal, due to the severe drought and heat in China) and the defensive sector of telecoms. Our holdings in trade-related, industrial stocks (including shipping/logistics/ports holdings) were laggards amidst global slowdown fears. China continued to grapple with a slowing economy from Covid virus lockdowns (as of this writing, 21 million inhabitants of China’s Chengdu city have been confined to their homes. Imagine locking down the equivalent of 7 Chicago cities!).

Disappointedly, the Biden Administration didn’t lift tariffs on Chinese goods when the tariffs were due to expire on August 23, as was hoped for. US consumers continue to pay the higher prices from the 25% tax on imports:

China's goods exports to the US jumped 7.9 per cent to US\$452 billion in 2020, the first year of coronavirus, official data showed. The flows continued as Biden was sworn into the White House, with a 27.5 per cent rise to US\$576 billion last year and up 15 per cent in the first seven months of this year to US\$347.5 billion...

"The question of what to do with tariffs is now entirely political, not economic," ... "The issue of who actually pays the tariffs – the American importer and ultimately the American consumer – is completely lost in the politics.

"So, for sure, nothing before the midterm elections."

[https://www.scmp.com/economy/china-economy/article/3190187/us-tariffs-china-goods-are-yesterdays-problem-exporters-it?utm\\_medium=email&utm\\_source=cm&utm\\_campaign=enlz-today\\_hk&utm\\_content=20220826&tpcc=enlz-today\\_hk&UUID=dc59edb5-e6f0-4998-b7f1-1e25b9734746&next\\_article\\_id=3190203&article\\_id\\_list=3190148,3190187,3190203,3190201,3190197,3190183,3190162,3190142&tc=6&CMCampaignID=b3e29fd8c7f10a2c7776ff2b3e6d6e79](https://www.scmp.com/economy/china-economy/article/3190187/us-tariffs-china-goods-are-yesterdays-problem-exporters-it?utm_medium=email&utm_source=cm&utm_campaign=enlz-today_hk&utm_content=20220826&tpcc=enlz-today_hk&UUID=dc59edb5-e6f0-4998-b7f1-1e25b9734746&next_article_id=3190203&article_id_list=3190148,3190187,3190203,3190201,3190197,3190183,3190162,3190142&tc=6&CMCampaignID=b3e29fd8c7f10a2c7776ff2b3e6d6e79)

In mid-August, China's central bank surprisingly cut key interest rates to revive demand as data showed the economy unexpectedly slowed in July, with factory and retail activity squeezed by Beijing's zero-Covid policy and the property crisis.

To underscore, and re-emphasize how cheap Hong Kong's market has become, the long term, monthly readings are at extreme levels today:



Not only on an absolute basis is Hong Kong's stock market cheap, but on a relative basis, it is a compelling value:

HANG SENG INDEX consensus estimates			S&P 500 COMPOSITE	
Index Price: 19,597.31	1-Sep-22		Index Price: 3966.85	
Valuation Measures	2022 Est	2023 Est	2022 Est	2023 Est
Price/ EPS	10.2	9.1	18.0	16.6
Price/ Cash flow	6.8	6.7	14.0	12.6
Dividend Yield	3.5	3.7	1.6	1.7
Price/ Book	1.1	1.0	3.8	3.4
Price/ Sales	0.9	0.8	2.2	2.1
Price/ EBITDA	7.0	6.5	11.0	10.5
EV/EBITDA	6.2	5.6	11.6	10.9
Net Debt/ EBITDA	0.3	0.0	1.1	1.0

[Last month](#), we pointed out the Hang Seng Index valuation was at the same low level as it reached during the GFC trough valuation in March, 2009. Using a normal, historic PE multiple of 14x on estimated earnings for 2023 would value the Hang Seng Index next year at **30,220**, 54% above today's level.

Our portfolio owns 9 stocks that sell at less than 3 times trailing earnings (with median returns of equity in excess of 20% and 5-year earnings before interest and taxes (EBIT) compounding at greater than 40%). A handful of our holdings (10) have price earnings ratios of greater than 10 times, but the bulk of our holdings, 22 stocks, trade with trailing price to earnings ratios of between 3 to 7 times (with median historic returns on equity >25% and EBIT compound growth greater than 18%).

Our value-oriented Hong Kong Partners LP's portfolio sells at a weighted average Price to Estimated 2022 Earnings ratio of 7.7 times and 1.1 times book value.

We don't envision these cheap valuations will remain around for long as China begins reviving its economy.

The soured relations between the two super economic powers weighs on investors. Hong Kong stocks have had a harder time this year than expected as it is near impossible overcoming the enormous amount of uninformed political commentary and actions of dangerously out of touch politicians.

The US is scared to death of China and lashes out in clueless ways. Even President Joe Biden exclaimed in February 2021, 'China is going to 'eat our lunch'. As noted in my [Market Message from Montana](#) in May 2020, the primary political message of Republicans during the runup to the 2021 presidential election was "Don't defend Trump; Attack China."

We expect cool heads to prevail, especially as the alternatives to a worsening relationship are unappealing. What is somewhat promising is the forthcoming meeting between President's Xi and Biden at the November G20 meeting in Bali, Indonesia and the granting access to US regulators to inspect and audit the books of US-listed China companies in Hong Kong. Matthews Asia's China economist and analyst Andy Rothman viewed the audit agreement as a positive, stating: "In my view, the agreement also reflects a return to pragmatism by Chinese leader Xi Jinping, suggesting that a more pragmatic approach to COVID and the property market may be coming, which I believe would pave the way for an economic recovery in China."

Yours Faithfully,



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*"Our proprietary investing systems, developed since the early 1990s, capture growth in China, the fastest growing large economy on earth, by owning intrinsically undervalued Hong Kong-listed companies."*

South Ocean Management, Ltd. is a fund management company based in Hong Kong. South Ocean has 6 team members and is registered with the SFC and SEC regulators.

\*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](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.