



February 12, 2015

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:

Jan. 2014

Hong Kong Partners LP	0.4%
Hang Seng Index	3.8%
Hang Seng Small Cap Index	-0.2%

Partners' NAV \$2.844 after management fee, but before annual incentive fees of 15% on appreciation.

January was a volatile, erratic month of trading for our small/mid cap portfolios of stocks listed in Hong Kong.



Hong Kong-listed companies will soon announce year-end/interim financial results and have entered black-out periods, thus economic news has been filling the void.

China's slowing growth is a chief concern. Manufacturing suffers from over-capacity, efforts to rein in debt are curtailing local governments' investment and the housing market continues to decline. China's economy grew 7.4% in 2014, the slowest pace in 24 years as the country transitions from an investment/export led economy to a consumption-based economy.*

Last week, in early February, the Peoples Bank of China announced a 50 basis point cut in the bank reserve ratio requirement, the first cut in two years. The announcement actually

spooked markets as it implied a more than expected slowing economy by Beijing. Immediately thereafter, a 20% plunge in China's imports was reported for January, the steepest drop since the global credit crisis five years ago. This highly publicized announcement deepened concerns as China's continued inventory de-stocking of major commodities, a trend that has been in progress since late summer, herded investors into retreat.

Under the weight of these concerns, small/mid cap sectors of the stock market have been under pressure.



Rebasing chart year-to-date: Red line is the blue-chip Hang Seng Index, green line, Mid-cap index, purple line is the Small-cap index

We own just three holdings listed in these indexes, out of about two dozen positions in our portfolios. Our holdings are niche growth companies we think we know well and have bought cheaply; companies benefitting from new 4G cellular build-out, suppliers to smartphone manufacturers, state electric grid construction, electricity production, water treatment operators, along with leading producers in retail, textile and sports programming.

On the first day of trading in February, our long suspended holding in vegetable producer, Chaoda Modern Agriculture, resumed trading to a flood of institutional sell orders. The company's business has been negatively affected after 3 ½ years of suspension by the Hong Kong Stock Exchange. Chaoda has no debt, with operations and management intact. With the shares deeply depressed, we added to our position after the first week's flurry of trading.

We are fully invested today and are quite confident in our undervalued holdings.

Sincerely,

Brook McConnell

President

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Hong Kong

*China's transformation from an export driven economy to a consumption economy was distinctively highlighted in a research weekly recently from 13D Research:

We think the fundamentals driving China's secular growth story in domestic consumption—in this case automobiles and tourism—are unchanged. Recent weakness in oil prices is helping boost growth expectations in those sectors...

China now has about 300 million licensed drivers, a figure that is almost equivalent to the entire U.S. population. Moreover, this number is increasingly quite rapidly, at a rate of more than 100 million new drivers every four years. Despite this, more than 70% of the Chinese population, or about 1 billion people, do not drive—representing a huge untapped market....

Seen from the map in this article in the New York Times last month, China's mega construction ambitions are the epitome of growth in today's sluggish world (click link below for the full article).

In China, Projects to Make Great Wall Feel Small



DALIAN, China — The plan here seems far-fetched — a \$36 billion tunnel that would run twice the length of the one under the English Channel, and bore deep into one of Asia's active earthquake zones. When completed, it would be the world's longest underwater tunnel, creating a rail link between two northern port cities.

Throughout [China](#), equally ambitious projects with multibillion-dollar price tags are already underway. The world's largest bridge. The biggest airport. The longest gas pipeline. An \$80 billion effort to divert water from the south of the country, where it is abundant, to a parched section of the north, along a route that covers more than 1,500 miles...

http://www.nytimes.com/2015/01/13/business/international/in-China-projects-to-make-great-wall-feel-small-.html?_r=0