SOUTH OCEAN MANAGEMENT, LTD.
南海管理有限公司
HONG KONG

February 5, 2016

Dear Clients, Partners, and Friends,

The results for South Ocean Managementȗs Delaware LP, Hong Kong Partnersȏ L.P., before incentive fees, were as follows:

	Jan. 2016	Since Dec 14
Hong Kong Partners LP	-13.7%	-8.4 %
Hang Seng Index	-12.5%	-18.7%
Hang Seng Small Cap Index	-15.5%	-21.8%

Partnersȏ NAV $2.5949 after management fee and provisions March 2013*, but before annual incentive fees of 15% on appreciation.

ȑIn other words, the market is not a weighing machine, on which the value of each issue is recorded by an exact and impersonal mechanism, in accordance with its specific qualities. Rather should we say that the market is a voting machine, whereon countless individuals register choices which are the product partly of reason and partly of emotion.ȍ

ˈ **Benjamin Graham**, **Security Analysis: Sixth Edition, Foreword by Warren Buffett**

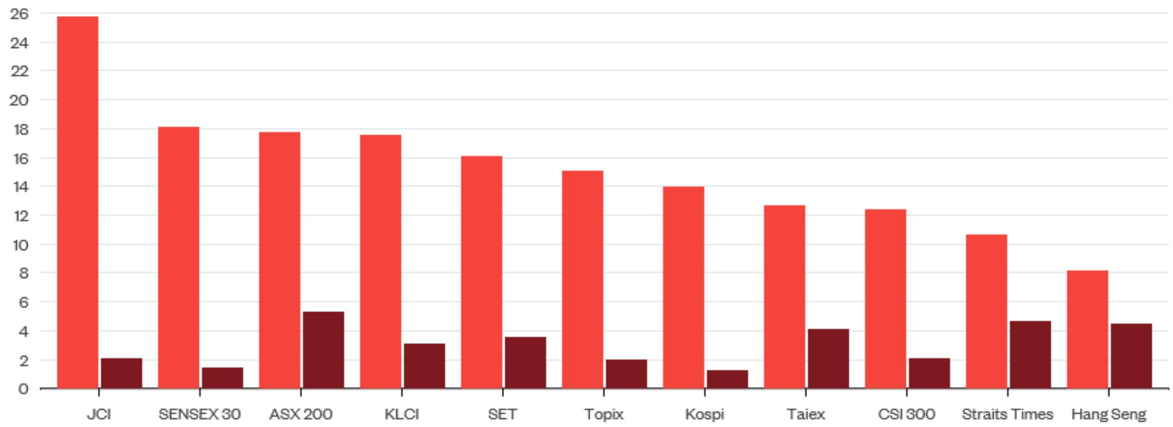
It was brutal in January for our small/mid cap Hong Kong-listed holdings, as intense as during the 1997 and 2008 market declines.

Missteps by Chinese regulators in handling the mainland stock market decline were widely reported and extrapolated to other world markets, which declined in tandem. Refugees overwhelming Europe, oilȗs precipitous decline, Fed rate hike, politics and elections were also reasons given for the global sell-off (Charlie Munger uses the term "Lollapalooza Effect" for multiple biases conspiring to produce irrational investment behavior). Portfolio managers panicked and were frightened of their own shadow. We think the rampant selling, on fears of an economic collapse in China, was overdone (Chinaȗs economy is not melting down, Stephen Roach says).

The widespread pessimism drove prices of Hong Kong stocks down to attractive levels. Many have become potential buys in our proprietary Banquet System software screen during this sell-off (>200 names). We are now fully invested, having added an additional 7 undervalued stocks to our portfolios this year. To give an example, one new name we added (a company we had already visited) had declined to 1.1 times trailing earnings, 0.9x estimated earnings. We starting buying after the chairman and the company were reported aggressive buyers of shares in the open market.

We, of course, donȗt know when the overall market will bottom. According to Bloomberg, though, Hong Kong is the cheapest market in *Asia Hong Kong's dividend yield is only behind Singapore's and New Zealand's and the P/E ratio is the lowest;*

Light red, Price Earnings, dark red, Dividend Yield



http://www.bloomberg.com/gadfly/articles/2016-02-05/hong-kong-stocks-rout-looking-overdone

In further remarks by Bloomberg;

> *… The easiest way for international investors to express a bearish view on the world's second-largest economy (China) is by shorting Hong Kong. Since June 30, 2015, the correlation between short-selling turnover for the Hang Seng and the Shanghai Stock Exchange composite indexes has been stubbornly negative, at a level that implies global investors are using the open market off China's mainland to register their disappointment in Beijing's policies. The (Hong Kong) index has also mostly been moving out of step with the S&P 500, which used to help determine its direction in the past.*

Though this may sound like a heretical, global warming skeptic opinion, we believe the rewards of being invested outweigh the downside risks at this point.

Sincerely,

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