SeaBridge Investment Advisors, LLC

Garnett Keith, John Conti, David Descalzi, Susan Boyd
450 Springfield Avenue, Suite 301 • Summit, NJ 07901-2610
Tel: (908) 273-5085 • Fax: (908) 273-6297

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## *"Steady as she goes."*

This phrase means different things to different people, but to me it is a command from an 18th century ship skipper to his helmsman when cautiously passing through troubled waters. The waters in1Q14 did not seem terribly troubled, but several tides are swirling:

- First, is the riptide backflow from the market surge in 4Q13? Would the markets likely give back a big portion of the prior year's gains as sobriety returns?
- Second, would repeated reductions ("tapering") in the Fed's money printing frighten the market into a significant pull-back?
- Third, would slowing in China cause a collapse of the real estate or "shadow banking" sectors, creating a "Lehman moment" in Asia?
- Finally, would excess liquidity supporting the U.S. financial system lead to another 1999-2000 speculative bubble, followed by collapse?

None of these happened last quarter but generally each day one or another concern was making the headlines. U.S. growth and employment gains were less than hoped for, but a winter of bitter snow and cold left hope that acceleration was only deferred until Spring. The market sank in January, raising fears that the riptide was gaining power, but it recovered in February and kept trending "flat to up" in March. The end of March saw a sharp reversal of the speculation in high multiple stocks, and there was a sense of growing sobriety at quarter end.

China's president Xi Jinping and premier Li Keqiang are pushing ahead with announced reforms. The direction is toward less investment and more consumption, and without a doubt China's growth is slowing. Public pronouncements still predict 7+% GDP growth for the year, but private commentators are guessing at 6+%. The war on corrupt officials is blazing – this week $14 billion was reportedly recovered from Zhou Yongkang, former Politburo member and head of internal security! Zhou is the most senior Chinese official arrested since Mao's death. China's "shadow banking system," (think of them as finance companies that finance small or questionable companies which cannot get financing from the state owned banks) is being squeezed by the Central Bank, and there are weekly reports of their customers going bankrupt. Investment in fixed assets is being reined in, and over- capacity in the construction supply sectors – steel, cement, and glass – is being shut down. In many cities real estate prices seem to have topped out. Programs to attack pollution are being developed everywhere, but so far the dreadful air quality makes headlines in every day's papers. With all these problems, one would think the economy is collapsing, but in fact growth is being reduced to about 2.5 times the U.S. rate of growth. We cannot assert that a big problem will not arise, but so far the state has been able to keep control of the system while past excesses are being wrung down, if not out.

I have gone on at some length about the reforms in China, because they are probably the most important factor in world balance in the next year. If China can continue its transition, absorb the undoubted bad debts with the State's enormous wealth, better times lie ahead for not only China, but all of Asia and the world. If China's reforms lead to a collapse that is very bad for us all – remember, Japan and Europe are still flirting with recessions, and 7.2% growth in China's $9 trillion economy contributes 40% more uplift for the world than 2.7% growth in our $17 trillion economy. News from China will likely be worrisome in 2014, but so far so good. We are being very careful with reduced China exposures in our International portfolios and, as reported in the attached note, David Descalzi is being very careful about his stock selection in Asia.

I will truncate comments on the Ukraine, Russia and Crimea, not because it is not bad, but because one fears Europe will do little about it due to their dependence on Russian gas and, in the case of Germany, Russia's importance as an auto and machinery customer.

After all the ups and downs, this year-to-date the S&P 500 rose 1.8%, the Russell 3000® Index was up 2.0%, the MSCI World Index gained 1.2% and the MSCI World Index ex the U.S. was up 0.6%.[1]

In the U.S., housing is still recovering (see John Conti's enclosed note on some of the generally unrecognized dimensions of the housing recovery.) The auto industry is pausing – GM is being raked over the coals in Congress for past product quality – but, as warm weather returns and employment increases, the sales totals should make records. Boeing's backlog continues to grow and their downstream supply chain is prosperous. Banks are looking for higher profits as interest rates begin to rise and mortgage losses diminish. So it is hard to get gloomy about the 2014 economic outlook. The stock market remains fully valued, even after a quarter of doing little, and the prospect of future higher interest rates makes one careful.

So for us, "steady as she goes" means keep looking for companies with reliable growth trading at attractive prices and run by trustworthy managements. We hope you and your families have a wonderful Spring as warm weather returns.

Best wishes,

*Garnett L. Keith, Jr.*

*See general disclosures at the end of the document.*

[1] Results for these indices (S&P 500, Russell 3000®, Morgan Stanley Capital International All Country (MSCI) World Index and MSCI World Index ex USA) are quoted as being somewhat representative of the broader equity markets for comparison to SeaBridge U.S., global, and foreign portfolios. The SeaBridge portfolios differ from these indices (in number of securities held, industry, sector and country weightings, etc). Therefore, in any given period, results for SeaBridge portfolios are likely to differ from the results for these market indices.

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