

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

April 8, 2015

Edited copy of letter sent to individual clients of SeaBridge Investment Advisors for the First Quart. 2015

"The world is more important to America than America is to the world."

With that sentence, Randall Forsyth launched his lead commentary, titled *The Great Divide*, in the March 16, 2015 issue of Barron's. I have been thinking about this a lot in the last two weeks. Pondering not just whether it is true, but what does it really mean? Is "American exceptionalism" - a society built of democracy, freedom and fairness - over? I would like to think not.

In an economic sense, the U.S. is a "protected economy." We are protected by vast oceans on the East and West, and by friendly neighbors on the North and South. Only about 14% of our GDP comes from foreign trade compared with 26% for China and over 50% for Germany. We are relatively self-sufficient in resources and the past 100 years have built substantial U.S. wealth - enough to fund any effort our collective minds fix upon.

But, in another sense, the past 50 years of post WWII recovery, the rise of China, and general advancing world progress and globalization - meaning integration of productive processes around the world - have left us more influenced by what happens elsewhere than ever in our history. Immediately after WWII, the U.S. had something like half of the world's useable productive capacity. Today our GDP is about 23% of utilized world capacity. Importantly, a good bit of that 23% is not discrete but depends on component inflows for products sold in the U.S. and production chains here that provide components incorporated and sold abroad. Moreover, world currencies relate in "managed floats," which are very influential in setting the relative cost of what gets done where. With huge excess capacity around the world comes a shortage of jobs and a natural temptation to depreciate one's currency to shift unemployment abroad. Currency wars have always been a threat, but they are particularly pernicious now as world interest rates have fallen near zero, so that changes in monetary policy - money printing at the moment - are effectively transmitted directly to relative currency values.

So, coming back to Randall Forsyth's *The Great Divide*, the reason the rest of the world matters more is that foreign economies are three times our size and, to reduce their unemployment, their monetary actions could cause their currencies to fall and the Dollar to rise to the point where our ability to achieve accelerating economic growth is substantially compromised.

All is not lost - our economy is doing better and our unemployment is falling every month. But the hope that domestic growth would trigger capital spending by our industrial sector is thwarted by foreign excess capacity and the prospect of rapidly falling currencies. Falling wage costs elsewhere may reduce the need for more capacity in the U.S.

In our most recent quarter, the U.S. economy had to endure not only a soaring Dollar, but also falling oil investment, port strikes, and bitter winter weather including frozen ship channels in the Great Lakes. As a result, estimates of growth for the quarter are falling toward zero. But, as in 2014, much of the lost production and

spending will likely be pushed to the following two quarters. Falling gasoline prices are giving our consumers a big increase in the money available to spend on other things. Those savings should eventually flow into the spending stream, giving growth a strong boost. However, it will be the end of the summer before we get a good reading on whether our economy is speeding up or slowing down.

In the face of this downshift, in 1Q15 foreign markets rose more than the U.S. stock market: the S&P 500 rose only 1.0% and the Russell 3000® Index was up 1.8%, while the MSCI All Country World Index gained 2.4%, the MSCI World Index ex the U.S. was up 3.6% and the MSCI AC Far East ex Japan Index was up 4.9%.¹

With our unemployment now at 5.5%, we are below the level at which the Fed earlier said it will start to tighten credit. The guess had been that, with our money printing ending last October, raising rates would begin in June. Additional data on unemployment, weak first quarter statistics, plus the conundrum of the unexpectedly strong Dollar have the Fed postponing tightening - or maybe not - depending on to whom you listen. However, few doubt that the Fed's money printing programs in the past four years have lifted security prices, and there is an active debate over whether 2015 earnings will be strong enough to push the equity markets up further when the Fed starts raising interest rates.

In spite of all the uncertainties, we are generally confident of the business outlooks and earnings prospects for the companies we own. But we are not oblivious to the six years of rising markets and the recent Fed policies of pumping liquidity into the financial system. So as we face the rising Dollar and prospect for a change in Fed policies, we have taken several actions. In our strategies largely focused on the U.S. (Core Global and Longview), we are generally holding higher levels of cash than we would without the monetary gearshift ahead. In our international strategies (International, Inflation Fighter and Global Trusts), we have shifted exposure to more foreign stocks. With money printing running strong in both Europe and Japan, we have bought ETFs which hold those markets with the currency hedged out. Hopefully, this lets us benefit from markets being driven up by money printing, without the associated currency depreciation. In our more conservative portfolios (Yield Growth and Cautious Core), we also have bought foreign stock indices with the currency hedged. ETFs that short the U.S. stock indices have also been added to reduce exposure to market volatility while we wait for some of our stock gains to go long term for tax purposes.

Fed Chair Janet Yellen is choosing her words extremely carefully as she describes future Fed actions and she is carefully watching incoming data. She undoubtedly wants to get back to a more normal interest rate situation without disturbing the markets. We will see whether this is possible as the summer approaches.

Best wishes,

Garnett L. Keith, Jr.

Attached are separate commentaries by John Conti on the Core Global Equity strategy and David Descalzi on the Asia strategy.

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 AC) World Index, MSCI AC World Index ex USA and the MSCI AC Far East ex Japan Index) are quoted as being somewhat representative of the broader equity markets for comparison to SeaBridge U.S., global, foreign and Asian 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.

General Disclosures:

Note: this is a copy of a quarterly commentary sent to clients of SeaBridge Investment Advisors. It is presented in order to illustrate the current thinking of the investment manager and is for information only. It should not be treated as investment advice with respect to any potential investment.

The opinions contained in this letter and commentaries on investment strategies are the opinions of SeaBridge Investment Advisors LLC based on analysis of publicly available information. The opinions of other analysts based on these data may differ. There are no guarantees as to the accuracy of the interpretations of current events or future prospects. There may be other factors which have more influence on future growth, economic recovery and market performance than those presented here. There may be errors in the data referenced in this analysis.

This does not represent an offer to sell or the solicitation of an offer to buy any securities or fund. Some types of companies are highlighted in this commentary. This is not a recommendation to buy or sell any stocks. Our opinion of the companies' execution and prospects may change in the future. Our opinion of the economic and market prospects may change in the future and the actions we expect to take in the portfolios may change as our interpretation of events evolves. Any expressed "targets" for portfolios may not be realized in the future.

SeaBridge manages portfolios in a number of different styles. Not all portfolios hold the same securities. Returns realized by our clients may differ depending on the style and objectives of the individual portfolios as well as client-specific factors. Investment involves risk and past performance is not indicative of future performance.

No part of this document is to be re-produced without the written permission of SeaBridge Investment Advisors LLC.