



SeaBridge Longview Strategy First Quarter 2016 Commentary

As the name of this strategy implies, the investment philosophy deployed in these portfolios involves a long-term, disciplined approach with very little style drift. It is a deep value style that tries to identify companies with stable cash flow growth which the market does not recognize or value appropriately due to factors such as complexity and leverage.

Due to the disciplined nature of the style, there will be periods during the cycle where some of the stocks held in Longview will fall out of favor. The narrow breadth that was driving the market in late 2015, with leadership coming from FANG (Facebook, Amazon, Netflix, and Google) stocks, is a glaring example of a rotation away from imbedded value toward momentum growth. Since these companies do not fit Longview investing criteria, the style has lagged. But we believe the internal cash flow growth that made the companies initially appealing is alive and well. Therefore, we view an out-of-favor condition to be a buying opportunity rather than a crisis. We continue to believe that our disciplined approach should deliver excellent compounding of returns over the entire cycle.

The first quarter of 2016 can be broken down into two opposite periods of equal length. During the first month and a half of the quarter, the world was fresh off the first interest rate hike by the Fed in nearly a decade, oil was continuing to plummet, and significant uncertainty grew over the stability of the Chinese currency. People rushed for the "safest" parts of the equity markets with little to no regard for valuation.

During the second month and a half of the quarter, market movement mirrored that of the first half. The trajectory of projected interest rate hikes by the Fed had significantly flattened. Oil seemed to find a bottom and sharply rebounded. Fears over a rapid devaluation of the Chinese currency lessened.

One area of the portfolio that hurt performance during the period reflects the complexity and leverage factors mentioned above. As the market rushed for safety in the first half, companies with leverage were punished first. A grouping of securities in the portfolio that we refer to as "The Malone Complex" certainly fit this bill. John Malone was a main architect of the cable giant TCI (bought by AT&T in 1999). Now Malone has his hand in an array of vehicles with the prefix "Liberty". Most of these entities are still tied to the cable and media industry where Malone made his reputation. They share similar business structures that generally produce stable cash flows the valuation of which Malone would like to maximize through leverage and ever more complex corporate structures. Over four decades Malone has produced a track record of superior long-term compounding (above 20%). But the rotation out of these names in the first half saw share prices falling an average of 15 -20%. When the market shifted gears and advanced in mid-February, these companies bounced 10, 20, and even 30%. Even with the sharp rebound, "The Malone Complex" still detracted a little over 1% from total portfolio performance.

Our allocation to the banks and other interest rate sensitive investments was the largest detractor for the period. The Fed's perceived inability to hike rates according to their previous guidance has weighed on these names and detracted approximately 2% from total performance. We used the selloff to increase our position in Bank of America which traded at a substantial discount to book value.

One area of the market which had been a problem child for almost two years was the best performing area of the portfolio for the quarter. We do not have direct investments in the oil patch but we do own companies who do business with the E&P companies including NOW Inc. (drilling equipment distributor), Calpine (natural gas combined cycle power producer), and Colfax (industrial pump, pipe, fan, compressor, manufacturing). Despite oil's fall in the first half of the quarter, these companies held up fairly well. When oil bounced off the mid \$20s level, they were among best performers in the portfolio, contributing nearly 2% to overall performance.

The portfolio had slightly more turnover than normal as we worked to adjust it during a very volatile market. We trimmed some of our winners such as Post (cereal and eggs) and Cimpres (customized business cards); exited Willis Towers Watson (insurance broker, formerly Willis Group); and trimmed Liberty Broadband (holding company for the pending Charter/Time Warner Cable merger). Generally these trims occurred because the stocks held up well during the selloff. Their resilience gave us the opportunity to increase the position sizes in some of our more undervalued names such as LiLAC (cable operator in Latin America and Caribbean), Bank of America, and Live Nation (concert venue operator).

We initiated a new position in Liberty Global (European cable operation) during the period. We anticipate that, through maximizing operating and financial leverage, John Malone will use the same playbook he has utilized for his U.S. holdings to make Liberty Global the largest cable company in Europe. With the consolidation phase mostly complete, the company is now focused on organic growth and margin expansion. We believe this should result in mid-single digit EBITDA growth. We expect that improving free cash flow and incremental debt will be used for buybacks.

Given the concentrated nature of the Longview's portfolio and the cross currents in the markets, we may face continuing volatility in the markets. However we believe we are well positioned in significantly undervalued companies.

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There are differences among portfolios managed by SeaBridge in each strategy based on client-specific factors. Not all portfolios hold the same securities. Not all stocks held in the portfolio perform similarly. SeaBridge manages portfolios in several styles.