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Edited copy of letter sent to individual clients of SeaBridge Investment Advisors for the First Quarter 2016.

"The sky is not blue, but the clouds are parting"

2016 started with a market collapse. The quarter ended with markets rallying and U.S. stock values generally recovered. During the quarter our value portfolios, Core Global and Asia, were strong. Yield Growth, Inflation Fighter, International, and Longview bounced back from the lows and are recovering well at quarter end. What happened?

As the calendar turned to the new year several things were troubling investors:

- Markets were fully valued and the Fed had raised interest rates at their December meeting.
- Recoveries in Europe and Japan were sputtering and their central banks' responses seemed inadequate. Easing by their central banks as the Fed tightens led to currency weakness and Dollar strength, bleeding growth away from the U.S. recovery.
- The Chinese economy was slowing, and money was fleeing the country.
- Emerging markets were heading for a crisis arising from weak commodity prices and a strong Dollar – in which many of their debts were denominated.
- Oil prices fell into the $20's, raising fears of a major bankruptcy panic in the oil patch this summer.

As the market tobogganed downward into mid-February, several things changed:

- The European Central Bank announced a massive program of monetary ease. But surprise, the Euro strengthened against the Dollar rather than weakening.
- The Fed, probably stunned by the speed of the market slide, started making noises that they might not be tightening credit as much in 2016 as they had implied, further weakening the Dollar.
- Talks between Russia and Saudi Arabia made the world realize that oil prices could go higher, and huge short positions in oil began to unwind.
- China injected liquidity into their economy and announced fiscal support programs. The RMB began to strengthen against the Dollar, and outflows diminished substantially.
- Employment and housing reports showed that the U.S. recovery was on track – slower than we would like, but progressing.

As psychology turned, investors realized that some of the cyclical stocks which had been falling for two years had gotten very cheap, and the "safe stocks" (utilities, telecom, and consumer staples) had become very expensive during the flight to safety.

For the quarter, the market statistics were: the S&P 500 rose 1.35% and the Russell 3000® Index was up 0.97%, while the MSCI All Country World Index gained 0.38%, the MSCI World Index ex the U.S. was down 0.26%, and the MSCI AC Far East ex Japan Index was up 2.27%.[1]

As the market turn became clear, we removed most of the hedges which had been in our portfolios for nine months. Over the nine months we did not make any money on them but they had reduced the volatility of portfolios somewhat during the August 2015 and January-February 2016 market dives. We reinvested some of the cash we had been holding, and placed some of the balance into bonds, which we had been avoiding as long as the Fed was raising interest rates. More details on your investment strategy are attached. Note that copies of all of the investment commentaries are on our website www.SeaBridge.com.

Why is this change in circumstances not a "blue sky" outlook?

- The U.S. recovery seems solid, but so far is slower than we would like.
    - The consumer is still paying down debts rather than spending gasoline savings.
    - Demographics are a drag – baby boomers are retiring, cutting workforce growth.
    - Wages are just beginning to rise, and the wealthy are saving, so not all income growth gets spent.
    - Our education system is not creating enough workers to fill technical jobs, and the undereducated cannot find work.
- So, we have made a turn and, with recovery, we could have blue skies by summer – but we are not there yet, and the world outside the U.S. (where stocks are cheap) remains fragile.
- Overseas, things are better than they were in January, but the deflationary forces are strong. China seems to have their immediate problems under control and growth continues at 5+%, but the challenge of shifting from an investment economy to a consumption economy remains large. The European market is very cheap, but almost every country is besieged with problems and the glue holding the EU together is being tested severely. Japan is still having problems breaking the deflationary mindset of its citizens, although companies are rich with cash, which they are mostly keeping for themselves.

So, we have a recovery, but it is not as strong as we would like, and the rest of the world is still fighting strong deflationary forces.

Our job is to find the companies that can prosper in the world as it is, and we welcome that as a change from January where everything seemed to be falling apart.

Best wishes,

Garnett L. Keith, Jr.

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[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.