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Edited copy of letter sent to individual clients of SeaBridge Investment Advisors for the First Quarter 2017.

At the end of the first quarter 2017, we find ourselves in a world of uncertainty with challenges in the areas of politics, economics, trade, ideology, war and terrorism. Surprisingly, in the midst of all this, equity markets have performed well. Let's review some of the developments and outlook for the future.

In the U.S. on the **political front**, President Trump began his administration with an intensive flurry of executive orders apparently designed to deliver on as many campaign promises as rapidly as possible. One of the most hotly debated orders limited arrivals from several Middle Eastern countries, but it was stalled by the courts. The ban on arrivals from these countries has been particularly unwelcome by technology businesses, who seek qualified technical workers all over the world. On March 24, President Trump failed to bring in the necessary votes for the House healthcare reform bill which raises questions about his ability to achieve a number of other legislative initiatives – most importantly tax reform. Surprisingly, after an initial drop following the healthcare misfire, the market stabilized and rallied.

Meanwhile, in the U.K., Prime Minister Theresa May has been working hard to define "BREXIT means BREXIT". On March 29, she initiated Article 50 of the Lisbon Treaty, which triggers a two-year negotiation process by which Britain will formally leave the European Union. Prime Minister May has warned, "no deal for Britain is better than a bad deal." The two-year withdrawal clock is now running and uncertainty about what the impact will be is likely to continue through that period.

Turning to Asia, following concerns about capital flight early in 2016, China has jolted their economy with strong fiscal spending and plenty of money availability. The Plenum of the 19th National Congress of the Communist Party takes place in October. Between now and then there will be backroom struggles to determine who represents which factions in the Standing Committee of the Politburo. This is a period where economic distress would be most unwelcome by President Xi, and the People's Bank of China is undoubtedly making sure distress does not happen via very supportive economic policies. China's debt continues to escalate, and observers differ on whether that will become a problem in 2018 and beyond.

On the **economic front** in the U.S., data for the first quarter shows that inflation has hit the Fed's target of 2%, and future growth forecasts were raised slightly (from 2.0% to 2.1% for 2018). The Fed continues to keep a watchful eye on the struggle between inflationary and deflationary forces. The very high level of debt in the system puts downward pressure on consumption, and the failure of consumer spending to accelerate leads to business uncertainty regarding productivity increasing capital spending. The debt overhang, an aging/retiring population in developed countries, and productivity increases far below past decades lead some observers to feel we are trapped in an era of "secular stagnation." However, consumer and business sentiment has soared to record levels, and optimists believe that with deregulation and tax reform, the U.S. economy can surge forward to 3+ percent real growth.

Another question is whether full employment will cause wage growth to accelerate and whether productivity will grow fast enough to allow corporate profits to grow. With equity markets at current levels, the answer to this needs to be positive. We are optimistic about the earnings potential of the companies in our portfolios, but are very much aware that wage inflation and rising interest rates may lead to a period of more market volatility.

In terms of **trade**, the world has been on a 25-year ride of accelerating globalization and multinational trade treaties. In the U.S., President Trump intends to reverse that trend and replace major treaties with a series of bi-lateral agreements. The U.K. needs to negotiate new trade terms with the EU and the rest of the world in its Brexit process. Meanwhile, President Xi of China carried the banner of globalization as a global statesman at the World Economic Forum in Davos, Switzerland.

Despite the challenges noted above, the global markets have done quite well in the quarter. So what could go wrong as the year unfolds? Some possibilities are:

- President Trump has legislative disappointments on taxes.
- Protectionism across developed countries further limits broad global growth.
- The elections in Europe empower protectionist leaders, which could lead to a further unravelling of the EU.
- The recapitalization of EU banks (Italy) fails to get backing from Berlin leading to a banking crisis.

- The Greek crisis arises anew and the IMF, under threats from Washington, fails to participate.
- China experiences financial instability exacerbated by very high debt level and inflated housing prices.
- A very strong Dollar (following a border adjustment tax) sets off emerging market debt problems.
- Further Russian interventions lead to a major confrontation.
- Kim Jong-Un in North Korea launches a missile toward Japan, which forces U.S. military intervention.

So while we climb the wall of worry that is customary for bull markets, we would note that, for the first time in a long time, there seems to be synchronous, improving economic growth occurring in all developed regions of the world and China. The IMF is revising growth forecasts higher in these regions, in stark contrast to their pattern of lowering expectations over the past few years. Despite all the apparent political turmoil, most of which is the result of a rising nationalism and increasing skepticism over globalization, we would emphasize that gathering powerful economic forces may be sufficient to overwhelm the threats posed by the uncertain politics. It has taken nine years since the Great Recession to turn the Queen Mary of global growth in our favor. We would not underestimate the benefit of this turn on our equity portfolios.

The first quarter worked out well in most of our portfolios which cover a range of investment styles across the risk spectrum. These offer diversification for clients who wish to invest in multiple strategies or specialization for those clients who have a very specific objective. Some of our strategies do well in certain environments while others may fall behind in those periods. SeaBridge strategies that lagged last year are leading this year and vice versa. We continue to maintain the discipline behind each investment style through different market cycles. If you wish to discuss whether your current portfolio mix adequately meets your current risk level and objectives, please get in touch. We would be happy to talk with you about the issues and help you decide whether you want to make any changes.

You will get commentaries with more details on the specific SeaBridge strategies in which you are invested in your email. Please let us know if you do not receive them or if you would like to see the commentaries on other SeaBridge strategies.

Looking forward, we are holding extra cash in many of our strategies, in part reflecting the fact that we think many stocks are fully priced and partly to have cash available to invest if and when we discern positive resolution to some of the issues we discussed above. We have confidence in the companies we have in the portfolios (we can always be wrong of course).

Thank you for your continuing faith in our team. We have been working on increasing the depth in our organization for the past several years. While Garnett Keith continues to oversee the portfolio management process in the investment strategies he developed, Howard Chin has direct responsibility for the Yield Growth and Cautious Core strategies, David Descalzi has assumed responsibility for the International strategy in addition to his Asia strategy, and Adrian Morffi has taken on Inflation Fighter, Global Trust and Longview. These individuals have all been working in these areas for years and are very qualified to continue these portfolio strategies going forward. If you are interested in speaking with any of these managers or with John Conti, who continues to manage the SeaBridge Core Global strategy, please let us know.

Best Wishes,
Your SeaBridge Team