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Edited copy of letter sent to individual clients of SeaBridge Investment Advisors for the Fourth Quarter 2014.

"*So far, so good, but global turbulence is not over*"

Seldom has the world seemed so bifurcated. The U.S. is recovering gradually but consistently. However, in other major domains the situation appears to be deteriorating.

For the quarter in the U.S., the S&P 500 gained 4.9% and the Russell 3000® Index was up 5.2%. On the world markets, the MSCI AC World Index was up only 0.5%, the MSCI AC World Index ex the USA lost 3.8%, and the MSCI AC Far East ex Japan Index had a barely positive return of 0.2%. For the full year, the S&P 500 rose 13.7%, the Russell 3000® Index was up 12.6%, the MSCI AC World Index gained 4.7%, the MSCI AC World Index ex the USA was down 3.4%, and the MSCI AC Far East ex Japan Index was up 3.5%.[1]

In the U.S.:

- Employment gains were stronger in the past quarter, and the long awaited wage improvements are beginning to appear. Voluntary resignations are increasing, and part time work is slowly giving way to recovering full time employment.
- The dramatic collapse in energy prices should leave budget room for more consumer spending on other items. We hope that the recent economic acceleration will continue in 2015.
- Real estate is positive, on balance. Commercial real estate spending is picking up and, with sharp increases in residential rents, the trends for home building are positive. If one applies Auguste Comte's observation that *demography is destiny* to housing, a further recovery in single-family housing should be coming to America in the next few years - our family formations have lagged enormously during the recession. This does not mean that every mis-located spec home from 2005 will fully recover in price, but as wages improve, we think housing starts will almost certainly accelerate from 800,000 to more than 1+ million per year.
- Christmas sales were better this year - roughly 4% growth versus 3% last year. However, the shift to on-line shopping continues, leaving malls and main street merchants with "Year-end Sales" signs in the window for the new year.
- Technological innovation and discovery continue apace, with biotech-formulated drugs beginning to provide relief and even cures for diseases like hepatitis, which have been a scourge for decades.
- In late September, our stock market took fright at the specter of multiple foreign goblins, only to be reassured in mid-October by the re-launch of Japan's huge, surprise money-printing. Likewise, in late November our

[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.

market was spooked by fears of Fed tightening and a global slowdown, only to find reassurance in Fed Chair Janet Yellen's statement that the FOMC will "be patient" before tightening credit. (These causality links are a bit simplistic, but generally in sync with the timing sequence of turbulence in a market made volatile by excess liquidity from all over the world, followed by a strong reassurance rally.)

Elsewhere:

- Europe continues to struggle with unrevised German *ordo-liberalism:* meaning, "we set the rules and if you follow them you will be as efficient as we are." Unfortunately, southern EU neighbors are not so efficient and "the rules" are requiring 30+% youth unemployment. This is political suicide for indebted country governments. Greece is the recalcitrant at the moment, with a left center government having fallen and the radical left Syriza Party leading in the election polls. The main plank in the Syriza Party's platform is to demand forgiveness of half the Greek-to-EU debt. Failing that concession, Greece would withdraw from the EU.

  Any withdrawal precedent frightens the pro-EU political elite, and efforts to placate Greece will almost certainly be attempted. Portugal, Spain, Ireland and Italy are watching with obvious self- interest. To help the weak southern economies, the European Central Bank hopes to kick off their version of money printing, but so far the Germans declare it unconstitutional. So, 2015 looks like another year with EU growth of about 1% and further increases in unemployment and government indebtedness. Some political shock to the status quo would seem to be in the offing.

- China continues its reforms, and growth is reported around 7%. However, the rapid rise in debt makes it clear that many loans from the 2009-11 building boom cannot be repaid and are being rolled over on a "pay what you can" basis. The reported 1% non-performing loan number from the banks is viewed with skepticism, and debt problems in the shadow banking system are unknown but undoubtedly much higher. Observations by outside skeptics guess that growth is headed significantly lower, and in fact may already be much lower, but misreported. Nonetheless, Beijing has enormous financial strength growing out of reserve accumulation over the past 20 years, and few predict a "blow-up." But indigestion headlines are likely as China struggles to keep growing and shift to a consumer economy. On a positive note, the Chinese internet marketing sector is booming, with Alibaba Group Holding Limited, the Amazon of China, listing on the NYSE at a record breaking amount in September.

- Japan can certainly be credited with an heroic effort to overcome deflation. However, the declining and aging population, falling domestic savings rate, and terrible fiscal numbers (deficit of 14% of GDP) leave the outcome very much in doubt. Bank of Japan head Haruhiko Kuroda stunned the markets at the end of October by announcing that its money printing program would be increased by another 10 trillion Yen to 80 trillion which translated to $726 billion per year at the time. The BOJ simultaneously directed the Japanese pension system (the world's largest) to buy stocks to drive up prices, and to buy foreign securities to drive down the exchange rate. (Essentially, Kuroda-san said we will print the money and buy the debt, you sell the debt and buy the equities.)

  Since Japan's GDP is a little less than $5 trillion, it is roughly 30% of the U.S. in size. To adjust Japan's current QE program to a U.S. equivalent would be roughly $2.4 trillion, or 2.5 times the size of the U.S. QE at its peak.

  One is not sure where Japan's reflation efforts end, but in mid-execution it appears the Japanese Yen will be weak, and Japanese stocks will trend higher in local currency. The size of Japan's Central Bank programs is unprecedented in modern history. The risk of some unforeseen outcome in the Japanese securities markets is a risk with more than a negligible probability.

- Finally, and unusually, a few words on Latin America. It has been a long 56 years since Fidel Castro came out of the mountains of Oriente Province to take Cuba from Fulgencio Batista. The fact that our relationship with Cuba is about to reopen could be a major turning point in US-LATAM relations. An opening not only changes Cuba, but also deprives the crippled regime in Venezuela of their principal supporter and reduces Russia's ability to stir up trouble in our hemisphere. Some post-Christina Fernandez change is coming to Argentina, and Dilma Rousseff is beginning to take actions which she must hope will stop Brazil's slide toward "corrupt failed state status." All this may lead to a new LATAM situation in spite of generally weak institutions, huge wealth disparities, and a hangover from their "commodities for China" boom. We currently own very few LATAM stocks but a favorable turn of events could add a brighter picture on our southern doorstep.

Our outlook for 2015 is generally positive with the hope that earnings of American companies can grow enough to support stock prices even as the Fed begins to withdraw money from our financial system. We remain less sanguine about our bond markets, although our outlook for interest rates has been wrong for the past 18 months. There will, no doubt, be shocks at home as we go back to a world where the markets are less supported by Fed money printing. And, the possibilities for some unfavorable shock coming out of Europe, China or Japan are obvious given their challenges. However, our guess is that world markets will end 2015 higher than 2014, and we hope to select securities which will enhance portfolio values in the New Year.

Personal best wishes for 2015 from the SeaBridge team,

Garnett L. Keith

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.

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General Disclosures:

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