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*Edited copy of letter sent to individual clients of SeaBridge Investment Advisors for the Fourth Quarter 2015.*

"2015 was a difficult year, will 2016 be better?"

2015 was a difficult year in the world and in the markets. Markets survived a possible Greek Eurozone exit, the August China market meltdown, and the crash of shale oil and oil pipeline stocks. Terrorist attacks in Paris and California reminded us that we are facing new threats. The drama of when will the Fed raise interest rates played over and over again on the financial news channels. Having promised a move this year, the Fed finally produced a .25% increase on December 17th.

The outlook for markets in 2016 remains challenging. The U.S continues to grow slowly but the strong dollar weighs on the economic acceleration everyone has been hoping for. China is growing but at a slower rate. Excess capacity built to provide for faster growth continues to put pressure on growth, particularly on commodity, materials and industrial sectors. The European Central Bank is printing money at a faster rate, but huge inflows of migrants are straining economies and splintering Europe's center-right and center-left political parties.

Rather than providing a long single letter with attachments for each SeaBridge style, we have made this a shorter letter covering the essentials for each style, and attached a more detailed commentary from portfolio managers on the investment style of your portfolio.

The 2015 moves of market averages obscure a salient fact: even though most stocks were down significantly for the year, the averages were held up by soaring performance from a dozen very expensive technology companies. Ned Davis of market analysis fame has labeled these the *"Nifty Nine."* They include Amazon, Netflix, Facebook, Salesforce, Starbucks, Google, eBay, Priceline, and Microsoft. Other than Alphabet (Google) in several styles and Priceline in Inflation Fighter, we did not own these stocks due to their very high valuations.

For the fourth quarter in the U.S., the S&P 500 was up 7% and the Russell 3000® Index was up 6.3%. On the world markets, the MSCI AC World Index increased 5.15%, the MSCI AC World Index ex the USA was up 3.3%, and the MSCI AC Far East ex Japan Index had a positive return of 4.4%. For the full year, the S&P 500 increased 1.4%, the Russell 3000® Index was up 0.5%, the MSCI AC World Index returned -1.8%, the MSCI AC World Index ex the USA was down 5.25%, and the MSCI AC Far East ex Japan Index declined 9.2%.[1]

[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.

Following are brief highlights of the year for each of our styles:

- Value styles
  - **<u>Core Global</u>** had a difficult year. We held quality companies with over-weights in industrials and shale oil producers. We sold two of our three shale oil exploration companies, WPX Corp and Laredo Petroleum, because the price of their shares are being influenced by distress in the high-yield bond market. We continue to hold Pioneer Natural Resources. We have held the industrial companies on the belief that U.S. growth would be strong enough to allow their exceptional values to be reflected in market prices. Happily, the value inherent in the portfolio was recognized by take-over bids for two of our companies – Airgas and Plum Creek at substantial premiums to market prices.
  - **<u>Asia Strategy</u>** had a difficult year absolutely, but performed a bit better than the region which suffered from growing apprehension that China is heading for a "hard landing". The portfolios were oriented to growing consumption in "Greater China" – Hong Kong, Singapore, Taiwan and the suppliers of that region. However, growing doubts about the smokestack companies in PRC proper, made worse by a clumsy attempt to goose the Shanghai and Shenzhen markets in order to facilitate debt refinancing, caused money to flee the area in July and August. This drove prices to levels reminiscent of the 2009 crisis lows. We believe Greater China stocks are cheap and the region can continue to grow twice as fast as the U.S. and Europe. Growth is led by retail consumption, which features heavily in our holdings. There is a risk of a China melt-down, but we believe the odds are against it.

- Growth at a Reasonable Price
  - **<u>International</u>** had a good year in spite of troubled countries and difficulty in finding offshore companies with dependable growth. Early in the year we took advantage of exchange traded funds (ETFs) which provide exposure to the European and Japanese indices with their currencies hedged out. These provide a means to get the benefit of the money printing by the ECB and BOJ. Because their money printing inflates local markets while weakening their currencies, these ETFs are attractive on an interim basis. We also used ETFs hedging emerging market indices in the belief that if a major panic hits, the commodity exporting emerging markets would be at the center of it. We continue to look for growing companies world-wide to replace the ETFs. For all portfolios, but particularly for our ESG portfolios, we are increasing our exposure to solar power companies which were boosted at year-end by an extension of their U.S. tax credits for new investment.
  - **<u>Inflation Fighter</u>** is advantaged by a "go anywhere" mandate in its search for reliable growth at a reasonable price. Portfolios select what we believe to be the most attractive of the Yield Growth and International companies. The style took hits on small positions in MLPs and some growth disappointments in Europe. But IF portfolios benefitted from owning some of the cheaper, fast growing companies – TenCent in Hong Kong, and Google and Priceline in the U.S. As a result, IF portfolios performed slightly better than global markets in 2015.
  - **<u>Longview</u>** is a concentrated "buy and hold" style with only 15 portfolio positions. Longview got the benefit from concentration with big gains from Post, Liberty Ventures and Cimpress, but suffered substantial losses in Calpine, Colfax, Now and Ascent Capital. We expect the rapid growth of portfolio companies to bail out valuations in 2016.
  - **<u>Global Trusts</u>** is also a "go anywhere" style which benefits from all clients using this style being IRAs or other "tax-wrappered' accounts. This makes the style a good place to receive income, and hence GT portfolios own stocks from Inflation Fighter, but also a number of "bond-like" positions from Yield Growth. Holdings include both individual companies with strong yields and also funds owning income investments. The portfolios ran more or less with the markets – with growth stocks helping, but also a couple of hits from MLP general partner holdings.

- Growth and Income with reduced volatility
    - **<u>Yield Growth</u>** tries to deliver solid long term returns with a volatility less than either the stock or bond markets, individually. The portfolios' GARP (growth at a reasonable price) equities generally did well in 2016. But this style took a direct hit from the oil pipeline price collapse. During the past decade, Yield Growth portfolios have benefitted enormously from holdings in the MLP oil pipeline sector–with market gains for individual MLPs frequently running 100% or more over the holding period. These shares provided a reliable 5-7% yield plus 3-6% growth. With the growth in domestic oil production, the MLP sector grew from $10 billion to $1 Trillion in assets. Part of the yield is treated as a "return of capital" which provides current income, but with taxes deferred until the shares are sold. (Older clients may want to hold these to get a stepped up tax basis in their estates.) 2015 was the "perfect storm" for MLPs – the collapse of the oil sector raised concerns about pipeline overcapacity and hopes for the growth component of return disappeared. However, the reduced cost basis of long term holdings meant that sales would create a large tax liability. In short, we sold some (not enough) but held most. We are hopeful for an MLP recovery with oil prices in 2016-17.
    - **<u>Yield Special</u>** accounts carry a greater emphasis on income/yield with holdings geared toward the MLPs, fixed-income, and bond-like securities (think REITS, Telecom, and utilities). Until this year, MLPs have been an ideal holding for income portfolios wanting some protection from inflation via growth in distributable earnings over time. Yield Special was challenged this year as forecasts of falling production and excess pipeline capacity killed the growth dimension of MLP returns. Income-based assets also struggled as credit spreads widened, reflecting anxiety in the energy markets and the overall economy.
    - **<u>Cautious Core</u>** is like Yield Growth, but with an even stronger mandate to dampen volatility and protect portfolio principal. CC did its job in that losses were less than half those in Yield Growth, but 2015 was not a good year for "income accounts" anywhere. Rising interest rates in 2016 continue to present a "principal protection" challenge.

We hope this summary of what was going on behind the return numbers is helpful. A more detailed report on your individual portfolio style is attached.

Happy New Year to all,

*Garnett L Keith*