

SEABRIDGE

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

“2016 was a year of surprises, so what might 2017 hold?”

Our 2015 letter had the headline, “2015 was a difficult year, will 2016 be better?” If you look at major market returns, then answer was “yes,” but it did not feel that way. This coming year could be another positive period for markets, but there are many, largely political, uncertainties looming.

2016 was a rollercoaster ride for the markets coming out the gate with an oil price collapse to the mid-\$20s, China slowing, and continued uncertainty around the timing of interest rate tightening. But as rapidly as they fell, markets rebounded abruptly late in the first quarter as the European Central Bank announced a massive monetary easing plan, China followed suit with their own fiscal support plan, and the U.S. recovery persisted on the back of strong housing numbers. But the real surprises came later this year as the world moved decidedly toward more populist regimes, first with Britain’s “Brexit” vote to leave the European Union and then Donald Trump winning enough electoral college votes to become America’s 45th President. What remains to be seen is how much of this momentum might take hold in other countries in mainland Europe and whether a world that resists foreign trade can accelerate, let alone maintain, growth.

Attached is a table showing performance through the end of 2016 for various benchmarks. Looking at SeaBridge strategies, the best performers were our value styles led by Core Global, then Asia Strategy, and Longview, which were rewarded after a challenging 2015. Our global macro growth and income portfolios (Yield Growth) had a difficult year. The income side has been most challenging as the threat of rate increases has persisted, and the Federal Reserve did raise rates for the second time in the past year in mid-December after announcing a 0.25% hike. Our growth-at-a-reasonable-price (GARP) strategies like International and Inflation Fighter have not participated as strongly in the cyclical upturn since they were positioned more defensively. Our more conservative styles (Cautious Core and Yield Special) protected account values for the year, as is their objective. For those of you who may have more questions about “*what happened and where do we go from here?*” please let us know. You will be receiving commentaries via email on your portfolios’ specific investment strategies. We would also be happy to schedule a call to discuss your situation with you.

Looking ahead, there are macro tradeoffs to consider:

The challenges

- Global growth has remained mediocre, while price-earnings multiples have continued to expand. U.S. multiples suggest a “modestly overvalued” market, but if growth rates could accelerate past 3% then these prices appear to be justified. But that is no guarantee.
- Protectionism is the new norm:
 - The laissez-faire approach to globalization of the past is less acceptable. The specter of tariffs with Mexico and a trade fight with China may feel good to many in the manufacturing economy but the real impact could be less than desirable.

- Tighter immigration policies are also likely to change the makeup of workforces around the world. In the U.S., half of our labor growth has come from net *migration*. Limiting that positive force only serves to reduce the U.S. economy's potential growth rate going forward.
- Four of the Euro Area's five largest economies have elections in 2017, and further protectionist wins are a threat to the future of the European Union. That is a real wildcard.
- The crisis in Syria continues, and the recent assassination of Ambassador Andrey Karlov, Russia's representative to Turkey, raises some concerns about how provocative the attack could be longer-term.
- Rising interest rates are generally adverse for both bond and equity prices, yet the pace of changes by Central Banks remains to be seen.
- Given concerns early in 2016, China has had a good year. They have had policy flexibility to avoid a hard landing, and the country still has \$3T of foreign exchange reserves, although those are eroding each quarter. But many challenges remain.

The opportunities

- We are in middle of a cyclical uptrend that has been driving markets higher, and these "animal spirits" may (or may not) persist.
- President-elect Trump has proposed a number of pro-growth policies:
 - Fiscal stimulus through massive infrastructure updates in the U.S., although it may take more than a year to get clarity on "the plan"
 - Tax cuts for individuals and businesses, although at the risk of increased federal deficits
 - Possible repatriation of over \$2T of overseas corporate earnings
 - Reductions in Federal regulations which might free up businesses to grow
- Stabilization of commodity prices has taken pressure off many emerging economies, although the rising Dollar weighs heavily on their foreign debt burdens.
- The shining star in Emerging Markets has been India growing GDP at over 7% under the leadership of Prime Minister Modi who continues to combat a historically bureaucratic system.

This letter opened with the question, "*2016 was a year of surprises, so what might 2017 hold?*" If 2016 was any kind of prologue to 2017, then it is a reminder to keep a long view with investments while making sure we all have a good understanding of our individual financial situations. Translation: let us know if there are any significant changes in your situation or if you want to change your risk-return profile, and we can make adjustments that best fit your situation. We all hope for a fruitful 2017, but there are no guarantees on where the markets are headed for the coming year.

In response to the significant changes that we have seen in 2016, we have sent some interim reports by email. We also will be sending year-end commentaries for the strategies you have in your portfolios. If you do not receive those e-mails, then please let us know and we will update your email address. You can reach Susan Boyd at SBoyd@seabridge.com. John Conti, Dave Descalzi, Garnett Keith, Howard Chin, Matt Falkowski, and Adrian Morffi are accessible if you have portfolio questions, and Bobby Henebry (BHenebry@seabridge.com) is happy to speak with you if you have questions about allocation among our strategies or how we might work in concert with your non-SeaBridge holdings.

As we have said in the past, our job is to find the companies that can prosper in the world as it is. The strategy emails you will receive separately outline thoughts from each individual portfolio management team to let you know where we see value in the world. Investing is a long, patient process with inevitable setbacks and surprises, and we thank you for your continuing confidence in our team.

We look forward to serving you in 2017, and may you and your families experience a happy and healthy New Year!

Best Wishes,
Your SeaBridge Team

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