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Copy of letter sent to individual clients of SeaBridge Investment Advisors for the First Quarter of 2006.

Dear Client:

Equity returns were strong in the first quarter with large cap U.S. stocks, as represented by the S&P500, up 4.2%. Small cap stocks had impressive returns again, with the Russell 2000 Index returning 13.9%. Foreign markets also did well, with the Morgan Stanley Cap International ("MSCI") Index ex the U.S. up 9.8%. Emerging Markets were up even more, as indicated by the MSCI Emerging Markets Index's return of 12.1%. The BRIC markets (Brazil, Russia, India, China) were up a staggering 22.7% in the quarter. With rising interest rates, bonds underperformed, with the Merrill Lynch ("ML") U.S. Corporate & Government 1-10 year index down 0.34% and the ML Global Broad Market Corporate Index (BBB rated) returning -0.38% for the quarter.

On a sector basis in the U.S., Telecom stocks led the pack (the S&P500 Telecom sector was up 13.4% on a price-change basis). Energy was up 8.6%, Technology 4%, Consumer Discretionary 2.7%, and Health Care 0.9% (all on a price-change basis).

As you know, we don't manage our portfolios to match any of the indices, so our portfolio results differ from these index results. Returns for our portfolios varied, depending on client objectives and strategy, influenced by the percentage of foreign holdings, emerging market concentration, energy exposure, fixed income component, etc. However, they all had good positive returns.

Currently we appear to be at an inflection point. There are a lot of forces at work. It is not clear how they will turn out.

I will summarize some of the issues impacting the world economy:

- With the U.S. continuing to do well and Japan and Europe recovering, we are in a period of synchronous global expansion. This may continue or the U.S may diverge and start to fall, based largely on the severity of the housing decline in the U.S. and related consumer confidence and spending.

- Globally, growth is absorbing excess resources. Where resources are ample, as with Asian labor with its rapidly rising productivity and declining unit labor costs, prices are stable to declining. On the other hand, where resources are in short supply, as with iron ore, prices are rising.

- Oil is a special case, with ample inventories in the U.S. and "below needs" inventories in Asia. A significant amount of the claim on world oil inventories is in the hands of financial speculators. These holdings are as a bet on future prices, or held as a hedge against some untoward event which reduces currently available supply. It is interesting to speculate what the price path for oil will be as ownership comes out of the hands of speculators and into the ownership of the Asian nations which need it for growth.

- So far, increases in commodity prices have been absorbed in the producer price index and not passed onto the consumer price index in a major way. Overall the Goldman Sachs Commodity Index ("GSCI") has been in a sideways channel for three months, which is remarkable in light of how much some commodity and hydrocarbon prices have risen in the past year.

- So long as inflation remains tame, I think that Central Banks will likely keep money easy. The average G-7 weighted interest rate is about 3.5% and global growth is about 3.7% and inflation perhaps 2.7%. These average numbers are benign, but there are hot spots within the numbers, as one might imagine.

- Summer 2006 should be a testing period for the U.S. The removal of the volatile additive MTBE has caused gasoline prices to move higher. Rates on adjustable rate mortgages will begin resetting upwards. Prime rate – from which retail lending and credit card rates are set - has moved to 7.75%. Home equity loan balances have peaked and are turning to a payoff mode. Home prices are declining slightly in the "coastal hot spots"; inventories of unsold homes are building; home buying intentions, as signaled by the Michigan confidence index, are in a vertical descent. Yet consumer confidence remains high, supported by job growth and buoyant stock prices.

- The more we learn of Fed Chairman Bernanke, the better qualified he looks for the role. He has said future rates will be "data driven," which means if things turn soft he will pause and if growth continues to absorb resources he will lift rates beyond 5%.

- The odds on protectionist legislation are not high, but somewhat concerning. Given that the Administration is very weak and Democrats are looking for an issue on which to skewer them, the potential for mischief is real.

These factors lead to some conclusions about assets:

- All asset classes are floating high on the liquidity created
    - i. to pull Japan out of a deflationary spiral;
    - ii. to keep the Asia Currencies from appreciating versus the dollar;
    - iii. to pull the U.S. out of the recession which followed excess capital investment of the 1990's and the hit to confidence of September 11.

- As a result there is no "cheap asset class" in the world. The Asian currencies come closest to relative cheapness given their countries' high productivity and low labor costs. Asian Central Banks are "rigging" the exchange rates to keep it that way.

- Hence, assuming a world regime of generally free trade, Asian investments will probably be advantaged in delivering good relative returns for many years. There are, of course, specific political and other risks which need to be taken into account. In particular, India looks overextended relative to its fundamentals at the moment.

- The U.S. stock market is reasonably priced relative to bond yields. However, the risk for the market as a reservoir of future real spending is that either Americans need to slow spending and increase saving, or the dollar needs to be devalued relative to things – real assets, gold, and other currencies. So the U.S. market could go up in price and yet leave stockholders feeling poorer relative to the prices of things they need to buy. This is not what the CPI is telling us, but the CPI, with its rental equivalent valuation for housing costs, understates the cost of living changes for most Americans.

- Stocks related to housing in the U.S., and to consumer spending (which has been powered by mortgage equity withdrawals or MEW) appear to be in the path of adjusting to a new reality. A serious decline in housing prices may or may not happen, but the upside/downside on housing and consumer spending stocks do not seem attractive.

- Assets are generally priced for continuing low volatility. Investors are relatively anesthetized regarding risk – there have been three years of rewards for risk taking since the last painful price declines.

- However, there is also a little man in me who observes that our financial markets have a recently inflated structure of derivatives which as yet is untested; there is enormous cross currency borrowing/investing (the carry trade) which is subject to unwinding; and the "who saves and who spends" imbalance will eventually require major adjustments. So, volatility may not stay at these low levels and risks may be increased.

- Hence, my view, in the words of my late, wise French friend, Pierre Philippe, is "Qui vivra verra." (He who lives will see.)

With some of the concerns I listed above weighing on our minds toward the end of this past quarter, we began to trim some of our emerging markets exposure and some of our energy sector overweight. We also trimmed some issues exposed to consumer spending and to housing and rising mortgage rates and added some more non-cyclical growth stocks to the portfolios. For portfolios with significant bond holdings, we sold some positions, fearing that interest rates might continue to rise longer than currently expected by the market.

We continue to be cautious about the outlook and are reviewing carefully the portfolio holdings, with a view toward trimming those that we think might be most at risk, and adding companies that we think should do well in an environment with rising interest rates, slowing consumer spending and slowing growth. As an example, companies that sell to cash rich corporations might fit the bill.

With best wishes for the spring,

Garnett Keith