

SeaBridge Investment Advisors LLC

450 Springfield Avenue, Suite 301 • Summit, NJ 07901-2610
Garnett Keith, John Conti, David Descalzi, Susan Boyd
Tel: (908) 273-5085 • Fax: (908) 273-6297

April 6, 2009

(Abbreviated) copy of letter sent to individual clients of SeaBridge Investment Advisors for the First Quarter 2009.

We hope we are at a point of inflection beyond which the economic news turns from uniformly bad, to mixed, and eventually to good. January and February were full of worse-than-expected reports from almost every economic quarter. Economic news improved in March as the Fed announced massive bond purchases and Treasury Secretary Geithner detailed a plan to remove toxic assets from the banks. Markets turned up on March 9th and the subsequent rally through the first three days in April erased much of the losses from earlier in the year.

In the quarter, the S&P 500 was down 11.0%, the broad U.S. market Russell 3000® index was off by 10.8%, the global MSCI World Index returned a negative 10.6% and the MSCI World Index ex USA was also down 10.6%.¹

As I write, the questions before every investor are:

1. Have we seen the bottom?
2. Should I shift to a less conservative investment posture?
3. Will economic recovery begin, and what will be its nature?

Have we seen the bottom?

We are hopeful that we have seen the bottom, but that assumes two things. First, that the powerful monetary and fiscal actions of governments around the world will take effect to buoy the economic down-spiral. Clearly, it is helping securities prices as the massive build-up of money in Treasury securities begins to seek higher returns. Second, that production which is now falling faster than consumption will recover as inventories are depleted. Because of the fall in inflation, with 91.5% of the labor force employed, real disposable incomes are rising. Savings have soared as confidence has collapsed. As production is restored to equal demand, the news should get better, somewhat restoring consumer and investor confidence and spending. This should set off a virtuous circle which will stabilize housing and securities markets, and economic recovery will begin. This is the hope. In the near term, we expect that the recession will continue but diminish in force as we move into the fall. Negative real growth is expected to be 4 percent for 2009 with unemployment averaging 9%, and topping out at 11-12% in early 2010.

What is happening in the rest of the world is important, too. Garnett was recently in Hong Kong, and the tone there is concerned but hopeful. It appears that China hit bottom in 4Q08, and export shipments are improving gradually. China has announced a \$585 billion economic stimulus package and eased money so

¹ Results for these indices (S&P 500, Russell 3000®, Morgan Stanley Capital International All Country (MSCI) World Index and MSCI World Index ex USA) are quoted as being somewhat representative of the broader equity markets for comparison to SeaBridge U.S., global, and foreign 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.

that M2 is growing at around 20%. Best guess on China's growth for 2009 is about 6%. (Growth estimates are from the most recent IMF forecast.)

South Korea and Taiwan are weak as their U.S. oriented exports sectors have been hit hard. Real growth estimates for 2009 run negative 3 to 4 percent. Indonesia, supported by commodity exports to China, looks to grow 3 or 4%.

Australia is having a housing recession but, if raw material exports to China are picking up again, it will avoid problems of the magnitude hitting the U.S. and Europe. Forecasts for 2009 are negative real growth of a fraction of one per cent and unemployment topping out between 6 and 7 percent.

India is benefiting from being relatively more closed to world trade and should grow about 4%. The monsoon, vitally important to India's large agrarian sector, looks good.

Japan, on the other hand, is still spiraling down as shipments of autos, machine tools and other capital goods are likely to remain weak for some time. Japan's real growth for 2009 could hit -7%, the worst decline in the developed world.

Put it all together, and China's and India's growth should let Asia record modestly positive numbers in 2009. If the U.S. and Europe can stabilize our economies in 2009, Asia's exports should recover in 2010 and growth will be strong.

Europe has problems more acute than the U.S. The big problems come from the emerging countries in Eastern Europe and Russia. These economies were running hot in 2005-07 based on entry into the EU which fueled exports to Western Europe. Finances were stretched and borrowing was often in Euros or Swiss Francs. Exports have collapsed and currencies are very weak, threatening to balloon foreign currency debts and cause widespread bankruptcies. Europe's banks, particularly those in Austria, Sweden and some in Italy, have very large exposures. Hence another round of banking crises in Europe cannot be ruled out. Negative real growth in Europe will run 3 to 5 percent in 2009, with Russia leading the downdraft at close to negative 6%.

Unemployment in the EU will approach 9 percent in 2009, which will put heavy burdens on government transfer payment programs. With an aging population, the fiscal outlook for Europe is troubling, which is one reason they are resisting more fiscal stimulus to fight the recession.

The UK is a special case with an economy heavily over-weighted in the financial and housing sectors. Both of these are currently in trouble and, in spite of massive government stimulation, real growth is estimated to be a negative 3.5 to 4.0 percent for 2009 with unemployment approaching 8%.

Mexico and Canada follow the U.S. and will have negative growth of about 3 percent. South America is doing better with fractionally negative growth forecast for 2009.

So, 2009 will likely show negative real growth for the world for the first time in decades. Asia is positive, and there are early signs that U.S. growth will turn positive late in the year or early in 2010. Europe and Japan need positive growth in the U.S. and Asia to allow their export driven/aging consumer economies to turn positive.

So, have we seen the bottom? The signs for a turn seem to be coming into view, but we are not yet to the point where we can be certain. Markets tend to turn at the first signs of a recovery, and their strength since mid-March is one of the hopeful indicators.

Should I shift to a less conservative investment posture?

As you know SeaBridge has a range of investment styles of decreasing aggressiveness:

1. Asia
2. International
3. Core Global Equity
4. Global Trusts
5. Yield Growth
6. Cautious Core

Consistent with the above facts, we are taking steps in a slightly more aggressive direction in each of the styles.

In **Asia**, which is up over 5 percent year to date, we are continuing to reduce cash reserves. We think the outlook for China is particularly good and valuations are cheap.

In **International**, we have kept very high cash reserves while the deflationary forces seemed so strong. We are reducing cash now, with emphasis on Asian and perhaps a few Latin American companies. We continue to generally avoid Europe based on concerns that their cycle will lag in an upturn, and fear of an Eastern European bank blow-up. There are, however, some excellent European companies which operate all over the globe, and we are considering them.

In **Core**, we moved into the markets fairly fully in the first quarter, which was painful in February, but rewarding in March. Our portfolio is well positioned for a cyclical recovery.

Our **Global Trust** portfolios, like Core, are already positioned for a rise in equity markets and a narrowing of spreads in the credit markets. Therefore, we are making no big changes in the portfolios at this time.

In **Yield Growth**, we are making a few changes in stocks to reintroduce some cyclicity, which we have tried to avoid for the last year. We have large holdings in “income vehicles.” These include investment grade bond mutual funds, REITs holding government guaranteed mortgages, master limited partnerships holding pipelines, and a number of closed end investment funds (CEFs). CEFs trade on the New York Stock Exchange and hold bonds, preferred stocks, and equities. Following the public panic in October 2008, CEFs have been trading at substantial discounts to their net asset values. (i.e. the CEF shares trade at a substantial discount to the value of the securities held in the CEF.) Their yields have been high and we believe the discounts will diminish as investor confidence is restored. In spite of high portfolio yields, we believe the Yield Growth portfolios have significant recovery potential if markets stabilize and investor confidence returns.

In **Cautious Core**, we are reducing cash somewhat, although money market funds and cash substitute funds will still be, by far, the largest element on the portfolios.

Getting back to the question, “*Should I shift to a less conservative investment posture?*,” the answer is that we are taking some steps away from conservative portfolio postures. Those steps are larger in Asia, International, Core and Global Trusts. The steps are smaller in Global Trusts, the more conservative Yield Growth style, and very small in Cautious Core.

If you feel you would like to reconsider your portfolio category, please let us know.

Will economic recovery begin, and what will be its nature?

As indicated above, the deflationary forces will remain very powerful as we go through the summer and into the fall. The world has lost two trillion dollars of demand as the U.S. consumer has swung from borrowing to saving, and unemployment around the world has soared. In addition, in excess of one trillion dollars of capital spending programs have been cancelled by corporations as the recession has spiraled down. The fiscal programs of governments around the world have attempted to offset part of this lost demand, maybe half for 2009. Those spending programs are funded with borrowed money and will be withdrawn in 2010 and 2011. As the national economies find their footing, much of the fiscal and monetary stimuli, which is now being massively applied, must be withdrawn. Otherwise we will have big inflation problems.

So best guess is that the recovery has begun in China, will begin in the U.S. and smaller Asian countries in 2010, and will begin in Europe and Japan in 2011. However the recovery will be slow in the U.S. as consumer spending will not return to its 2007 level for several years. Housing and the auto industry will not come roaring back as they have following post-war II recessions. The Fed will be withdrawing money from the system as rapidly as it can to avoid inflation. In sum, we think the U.S. economy will feel more like 1955- 64 than like 1997-2007.

Conditions in Europe will likely be much like the U.S. with payments for the national welfare systems weighing on the economies in the same way that paying off war debts will weigh on the U.S. Government while the U.S. consumer pays our way out of credit card hock.

The outlook for Asia, ex-Japan, is brighter. Savings at all levels are high, populations are young, and ambitions to lift living standards are strong.

We certainly hope the worst of capital destruction is behind us. We cannot be sure yet, but the signs are more hopeful than they have been for two years.

Note: this is a copy of a quarterly letter sent to clients of SeaBridge Investment Advisors. It is presented in order to illustrate the current thinking of the investment manager. This does not represent an offer to buy or sell securities.

This letter discusses, in general, client portfolios. SeaBridge manages portfolios for clients in several different styles. Results for individual clients may differ. Results in the future are likely to be different. Please contact Susan Boyd if you wish to see more details on the after-fee returns for any of our investment styles. Please refer to the Form ADV Part II for SeaBridge Advisors LLC (or our website www.SeaBridge.com) for a complete fee schedule. The views presented here represent the opinion of Garnett Keith, Dave Descalzi, John Conti and Susan Boyd of SeaBridge Investment Advisors based on their analysis of publicly available information. The opinions of other analysts based on these data may differ. There are no guarantees that the expectations expressed here will be realized in the future.