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April 6, 2010

Copy of letter sent to individual clients of SeaBridge Investment Advisors for the First Quarter 2010

Dear Client:

After a weak January, markets worked higher in February and March, so that we had positive returns for the quarter. Economic data at the end of March showed a powerful cyclical recovery accelerating all over the world. Corporate earnings generally exceeded the modest expectations that their managements had predicted. However, given the lingering concerns about housing, a jobless recovery, and a massive Federal deficit, a positive return for the quarter was pleasing.

In the quarter, the S&P 500 was up 5.39%, the broad U.S. market Russell 3000®index had a positive 5.94% return, the global MSCI World Index returned 3.24% and the MSCI World Index ex USA was up 1.66%.[1]

The outlook for the major areas of the world could not be more diverse. Europe is finally coming to terms with the flaws in the EMU design. At the outset in 1989, everyone acknowledged that locking together the currencies of countries with vastly different fiscal disciplines and trade prospects was risky – a locked exchange rate shuts down the major adjustment mechanism by which different nations compensate for different senses of self-discipline. But European politicians' desires for unity and clout in world affairs swept aside economists' counsel. Now "the Mediterranean countries," Portugal, Italy, Greece and Spain – profligate borrowers all, are facing major recessions and an inability to roll over their debts as they mature without help from Germany.

Greece is at the head of the crisis line and bailing out Greece is politically very unpopular in Germany, which has a near term election. So, with some embarrassment, the EMU has handed to the IMF of the job of enforcing an austerity program on Greece. This is a near term cosmetic solution, but it does not solve either of the long term problems: first, how countries with different philosophies stay locked into a common currency, nor second, who will pay the bills for much larger problems to come in Spain and Italy. There are two likely short term results:

1. We will probably have negative real growth in Europe for the next year where curtailed spending in the Med Countries is not offset by greater spending in Germany and France.
2. The flaws in the EMU concept are yet to be faced by politicians but are clear to the securities markets, which will make people less enthusiastic about investing in Europe and perhaps trigger a debt crisis.

[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.

Meanwhile, back in the U.S.A., we are having a strong cyclical rebound in manufacturing, and retail spending is recovering somewhat. But housing starts, which usually lead a recession rebound, have fallen to a rate of 575,000 per year or about one-quarter the start rate at the peak of the bubble. Construction employment has followed, and spending on appliances and home furnishings is similarly depressed. So even if all else were well, the recovery would be muted by the dismal state of what has been historically a sector that creates jobs and demand for all sorts of related purchases.

The large financial center banks have been stabilized, but regional bank balance sheets are loaded with troubled real estate – commercial as well as residential. Lending is hence subdued and bank loans outstanding are shrinking as consumers pay down credit card balances as rapidly as possible. A sustained and strong recovery without credit expansion seems unlikely.

Finally, we have the Federal deficit. Will foreigners keep funding our spending without a significant rise in interest rates? Will a partisan and "election fixated" Congress cut expenses and raise taxes enough to bring the Federal fiscal deficit under control? Short term, China and Japan keep buying our debt to keep their currencies from rising. But if our excess spending problems remain unaddressed over time, it is hard to imagine we can avoid another crisis.

So, the U.S. economy is no longer teetering on the edge of an economic abyss, as we were a year ago. But the balance of forces which stabilized us is not likely to permit sustained rapid growth and a return to robust economic health.

In Asia, almost everything is reversed: they produce and save too much and consume too little. Consumers are minimally indebted – how could they be when the average Chinese worker with a $3,200 per year income saves 30 per cent of it? With the upturn in Western spending, China's exports are again growing. That falls on top of too many infrastructure projects and an overheated and speculative real estate sector. To head off inflation, The People's Bank of China is taking reserves out of the banking system at an accelerating rate. The question is whether Beijing can slow things enough to get "only 10% growth" in 2010? The trajectory in Q110 was headed for 15% growth and rising inflation. The resulting sharp monetary tightening frightened the Chinese market[2], which was off 5% for the quarter.

Our investment philosophy is to find companies with reliable, growing cash flow, trading at reasonable prices, and where management is using the cash flow for shareholders rather than empire building. (It is a bit more complicated than that, but that is as good a one sentence description as we can give.) Given our philosophy and given the pattern of world events, we currently have certain biases:

- We want to avoid securities which would likely fall in price if U.S. interest rates rise. (Example, we have recently cut our large position in Annaly Capital Management in Yield Growth portfolios. Conversely, we added ADP to our Core Global Equity portfolios because we think it can do well in a rising interest rate environment.)
- We are concerned about a company's ability to grow cash flow in a slower than usual U.S. recovery.
- Our outlook is for rising taxes and that means we invest more for growth and gains than we have in the past few years.

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[2] As represented by the Shanghai Stock Exchange Composite.

- In Asia and Latin America, we want companies which will benefit from rapidly rising domestic incomes and spending. We prefer companies which are not reliant on exports to the U.S.
- We are looking for themes and economic sub-sectors, which have rapid growth. We want to own securities in those if we can find them at reasonable prices. (Example: industrial gas companies whose oxygen and hydrogen production are needed for energy and pollution control)
- We are not enthusiastic about companies with major exposure to the Euro.

We think the environment for investing will be generally supportive for the rest of the year. There is still a lot of cash in money market funds waiting to shift to higher return investments. Given all the problems, the Fed is unlikely to be quick to raise short term interest rates. We will continue to try to create portfolios which balance the risks and are consistent with the risk guidelines you have provided us.

With all good wishes for the Spring and Summer,

Garnett Keith

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.