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Edited copy of letter sent to individual clients of SeaBridge Investment Advisors for the First Quarter 2013

"Thank you, Ben!"

When one looks for the reasons for the better-than-expected U.S. equity markets in the last quarter, the Fed does not get all the credit, but they certainly stand high on the "credit due" list. Give some credit to the Texas entrepreneurs who developed horizontal drilling; give some to the Wall Street bankers who started buying up houses in Las Vegas, Phoenix and Atlanta; and save some credit for the American savers who got tired of earning nothing on their cash.

But there is little doubt that the Fed's easy and plentiful – some would say excessive – monetary policy lifted the economy and caused a flow from money funds, bank accounts, and corporate coffers into equities. (Contrary to rumors, money did not flow from bond funds to equities, on balance, in 1Q13. Bond fund balances actually increased during the quarter.) The lift from Election Day 2012 through March 31st – roughly 1350 to 1570 on the S&P 500 - was more than we thought we deserved. It was "too much too soon" in the words of The Bank Credit Analyst, a seasoned and respected watcher of the financial scene.

This does not necessarily mean the market rise is over. The U.S. economic news continues to provide positive surprises, on balance. The Fed promises to keep buying 90% of all the bonds the Treasury issues to fund our deficits. And the strength in the housing, auto, and energy markets seems to be in the early stages. So, happy days could continue into the summer and far beyond.

However, as always, there are clouds in the sky.

- Europe is sinking ever lower into a serious recession.
- The EU leadership botched the Cyprus bailout in new and inventive ways.
- Japan is trying a bold reflation strategy, which looks like competitive devaluation to its neighbors. To make things more unsettling, Premier Minister Abe-san's foreign policy looks like taking back apologies to its neighbors for WWII and prior periods of occupying nearby countries.
- The Dollar is strengthening, which will not be good for the translation into reported earnings of the overseas profits of U.S. companies.
- The tax increase, called "fiscal cliff compromise", is biting into consumer take-home pay and the impact of the "sequester non-compromise" will hit government spending in the second and third quarters.
- And then there are Iran and North Korea…

So why are markets so ebullient? The answer, as noted at the outset, is, in part, that the Fed is printing $80 billion a month to keep interest rates low, absorb government debt, and lift the price of assets – homes and financial assets. If the economic news were poor, savers would keep their money in bonds, money funds and bank accounts. But, importantly, economic growth is broader and somewhat stronger than we expected. The equity market is rising, and money is migrating in pursuit of higher returns on savings.

For total returns on the world market indices we report to you each quarter, this year-to-date: the S&P 500 rose 10.6%, the Russell 3000® Index was up 11.1%, the MSCI World Index gained 6.6% and the MSCI World Index ex the USA was up 3.3%.[1]

Slower growth, predicted for the second and third quarters could cause the stock market to correct. But the real challenge will come when unemployment is falling and the Fed thinks it is time to slow or halt the money presses. At that point interest rates will likely rise, and no one can predict how fast. When the Fed last tightened sharply in 1994, rates rose 3.00% when the market was expecting a 0.6% rate rise. Not only did bond prices fall sharply, but equities took a tumble too. We are thinking about what to do to try to protect values in our more conservative styles as this gets closer.

In the meantime, enjoy the Spring, and enjoy portfolio values which are a lot better than a few years ago.

Best wishes,

Garnett L. Keith, Jr.

Note: this is a copy of a quarterly commentary 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 or interests in any fund.

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[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.