

# *SeaBridge Investment Advisors LLC*

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*Copy of letter sent to individual clients of SeaBridge Investment Advisors for the Second Quarter 2009.*

The second quarter of 2009 was a good one for the equity markets, generally reversing the losses in the first quarter and leaving a positive return for the six months.

While they still ended up, equity markets' trajectories did slow all quarter as the strength of the market rebound off the March panic lows dissipated. Many markets topped out in May and June saw a modest retracement of year-to-date gains.

For the full quarter, the S&P 500 was up 15.9%, the broad U.S. market Russell 3000® Index was 16.8%, the global MSCI World Index returned 22.5% and the MSCI World Index ex USA was up 27.9%. For the six month period, the S&P 500 index had a positive 3.2% return, the Russell 3000® Index was up 4.2%, the MSCI World Index returned 9.6% and the MSCI World Index ex the USA was up 14.4%<sup>1</sup>

In the U.S. fixed income markets, risk premia (yields in excess of Treasury yields for various asset qualities) continued to narrow as fears of financial collapse dissipated. Rising confidence allowed discounts on closed end bond and preferred funds to close toward par, adding to the gains on underlying bond and preferred stock holdings.

**Each of the SeaBridge investment strategies shows a year-to-date gain**, generally with stronger gains in the second quarter more than offsetting losses in the first quarter in most portfolios.

This leaves us with the obvious question, where do the economy and markets go from here? Television commentators are tripping over one another to report "the recession is ending." The recovering stock market and low interest rates have allowed the leading indicators to turn up. But what commentators spend less time on is the transient nature of the drivers of the rebound:

- A sharp swing from inventory liquidation to inventory rebuilding
- Government stimulus programs starting to take effect
- Transfer payments to unemployed workers

There are signs that house prices are in a bottoming process in all but the most overbuilt cities, but the inventory overhang of unsold homes is daunting for sellers. Durable goods orders appear to have turned up modestly. With short term interest rates much lower than longer term rates, banks are making money on most loans as they add to reserves for growing credit card defaults. Banks are raising fresh capital, and possible bank failures are no longer making headlines. All these give a sense that the "worst is over."

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<sup>1</sup> 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.

However, the grim June jobs report delivered a powerful reminder that things may not get much better for some time. Job losses jumped back up to 467,000, with 7.2 million jobs lost since the recession began in December 2007. Average hours worked fell to 33 hours which means that, even for those working, wages are falling.

In most recessions, very low interest rates lead to home buying and auto purchase increases. In this recession consumer spending is unlikely to recover strongly until the employment outlook improves. Data from merchants indicates that, even in late June, the consumer is still economizing and favoring the low end of price choices on necessities. Hotels and house-goods retailers are tottering on the edge of bankruptcy. So, while we can hope for increasing strength in the second half economy, just how much strength there will be remains to be seen.

Things are better in non-Japan Asia, where China's mandate to banks to lend has restored real estate investing. Infrastructure projects are accelerating, particularly in the rail system. Chinese consumer spending is picking up, but in magnitude this alone is not able to offset the continuing export weakness. China has used the deep recession to rebuild strategic commodity stockpiles. This has given commodity markets a sense of strength, which is likely to be ephemeral unless world growth picks up beyond the stockpile building.

With uncertainties about growth, but the capital markets healing, we are reviewing our holdings trying to make sure businesses owned are suited to the atypical nature of this recovery. In Yield-Growth and Cautious Core portfolios we continue to like our commitment to credit fixed income. In Asia we like companies focused on domestic consumption and, in China, those benefitting from the massive infrastructure building. Similarly, our Core Global portfolios are positioned to benefit from a hoped-for economic recovery in emerging markets.

Our hope is that portfolios can expand their gains modestly during the second half of the year. Of course, we cannot guarantee that that will come to pass.

Best wishes,

*Garnett L. Keith, Jr*

*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](http://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.*