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

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

Dear Client:

The “top down” view of the world economy is full of dread and uncertainty; we think that the “bottom up” view of the affairs of the companies in your portfolio is generally hopeful and, in some cases, exciting. Seldom has the disparity been greater.

Let me start with the “bottom up” view. U.S. companies are generally in good financial condition. Borrowing is well controlled. Profit forecasts for 2010 are significantly better than 2009; valuations appear to be reasonable and even cheap when one considers the low level of interest rates. This is not true for all companies in all regions and sectors of the world economy, but we think it is true, based on the information we have, for most of the companies we have in your portfolio.

If we could be confident that the world outlook would heal as it has in all post WWII recoveries, we would be highly confident of rising portfolio values.

But we are not in a typical recession recovery. The 2008-09 recession was a collapse caused by a build-up in private debt – mostly consumer debt – for 30 years. During this period, economic fluctuations were moderate, interest rates were low, and asset values were going up. The American public convinced themselves that borrowing money to buy more assets and enjoy life beyond their immediate incomes was a sound strategy. In the spirit of good times, governments at all levels made commitments which they cannot meet in the sobered outlook before us today. So, the U.S. economy is carrying more debt and government commitments than we can pay off, and a period – certainly a few years and possibly even a decade – of slower growth is in front of us as we try to restore our financial balance.

To avoid a depression caused by collapsing consumer debt held by banks, in 2009 the U.S. Government expanded its spending even as its revenues were falling sharply. As a result the U.S. now owes roughly $4 trillion to foreign creditors, and that amount continues to rise at the rate of some $700 billion a year. Because the Dollar is the world’s reserve currency, we can borrow in dollars, which somewhat reduces the risk of the foreign held debt – in a worst case we can print the Dollars to pay the interest and principal. However, as doubt grows that we can or will put the Nation’s financial affairs in order, the cost of borrowing more money abroad will rise. This will make the carrying cost of existing debt rise significantly. This is the situation now faced by Greece and several countries in southern Europe.

If the economy were recovering strongly, we could foreswear more stimulus borrowing and raise taxes. Over time, we could work our way out of the problem. However, employment, housing, and corporate capital spending are not recovering as we had hoped. It looks like growth for 1H2010 will be at a rate of slightly less than three per cent. With 2009 stimulus programs having diminishing effect as we go forward, the outlook for the second half of 2010 looks no better.

So, in short, unless we apply more government borrowing stimulus to the economy we will have a very slow recovery, and if we keep borrowing to stimulate the economy we face a rising risk of loss of international credibility and debt funding and currency crises in the future. There is growing talk of a "double dip" recession. We are still hopeful that that can be avoided, but it is no longer an unthinkable outcome.

Europe is having a crisis over the funding the deficits of the southern European countries, especially Greece and Spain. The EU rescue proposals buy time, but it is doubtful that Greece and Spain can service their debts without some sort of debt relief. That means losses for French and German banks, which those countries want desperately to avoid. The result of this standoff is a slowdown in growth in Europe as the Mediterranean countries are put on severe austerity budgets and spending in northern Europe does not increase commensurately.

Growth continues in Asia – in fact China is growing too fast and trying to "rein in" real estate investment. China's exports are expanding nicely, again, and the main question is whether Chinese consumer spending can expand fast enough to make up for a slowing real estate sector. Growth for China now looks like 10% for 2010, down from a growth rate of almost 15% as they entered the year.

As news came in May and June that the U.S. economy was slowing and Europe was having a confidence crisis, the markets retreated. For the quarter, the S&P 500 was down 11.41%, the broad U.S. market Russell 3000® Index was down 11.32%, the global MSCI World Index returned -11.96% and the MSCI World Index ex USA was down 12.26%. For the six month period, the S&P 500 index had a negative 6.64% return, the Russell 3000® Index was down 6.05%, the MSCI World Index returned -9.11% and the MSCI World Index ex the USA was down 10.80%[1].

So, what are we doing in our portfolios? First, let me remind you we give our clients a range of portfolio styles from which to choose. These have different geographic and other characteristics, but all have at least some equity market risk. Listed in descending order of our perception of overall riskiness of the portfolios, the major SeaBridge styles are:

- Our Asia strategy takes advantage of growth opportunities in Asia in general and the growth of the Chinese economy in particular.
- Our International strategy invests in fast growing companies doing most, or a rapidly increasing proportion of their business, outside the U.S. Many of these companies are in Emerging Markets.
- Our Global Trust strategy invests globally, mainly through funds, which provides more security diversification, but is still exposed to market and international risks.
- Our Global Core strategy invests mostly in U.S. companies with growth and what we perceive to be good value to price characteristics.
- Our Yield Growth Strategy invests in stocks, globally, but also in bond and other income streams with relatively good assurance that the income will continue to come even in a

[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.

recession. We hope that the income stream will result in volatility that is lower than that of a portfolio of 100% equities.

- Our Cautious Core strategy looks to protect principal first, and then get income and growth as we can without taking too much risk. This approach still has some equity risk and is less safe than Treasury bills or money market funds, but it will provide, we hope, an income several times the .25% available on "safe for sure" holdings.

We recite these again to encourage you to make sure your SeaBridge portfolio style is appropriate given your risk tolerance and overall portfolio composition. Why do we belabor this? The answer is that the forces in the world are highly deflationary at this time. A double dip recession cannot be completely discounted, even though we are hopeful we can avoid it. Likewise, a currency crisis cannot be ruled out if we keep increasing our foreign held debt. Finally, if we face either of these crises, the Fed will undoubtedly start printing money even faster than at present to support the economy, and fears of soaring inflation will escalate. None of these will be good for the markets. Our portfolios are exposed to market risk, in greater or lesser degrees, and you need to be willing to take such risk if you are invested in equity portfolios.

So "Rule One" in the current uncertain world is to make sure you have your canoe in the right pond in terms of the risk you can take.

"Rule Two" is for us to choose well among investments of the type we are seeking. In that sphere, we feel better, although we cannot guarantee that we will be right about our assessment of any individual company. In fact, it is the prospects of the companies we own and the diversification of holdings in our portfolios that give us comfort. Our basic philosophy is to find companies with:

1. Capable managements doing things which are good for the shareholders
2. A solid, growing business franchise generating free cash flow to be reinvested in the business
3. Debt limited to amounts which give the company room to maneuver in a difficult economy
4. Prices which provide an attractive return on our investment.

We look all over the world for these. Not every investment in our portfolios fits this mold. But we feel good about the balance of risks and rewards we find in the portfolios as we go into the second half of 2010.

With best wishes to you and your family for a good summer,

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 or interests in any fund.

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.