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Copy of letter sent to individual clients of SeaBridge Investment Advisors for the Third Quarter of 2007.

Dear Client:

In August, I thought I would be quite happy to get through 3Q07 with flat performance – zero return for the quarter. Thanks to a 50 basis point cut in the Federal Funds rate, the markets rallied strongly in late September and we came through the quarter much better than that.

For the quarter, the S&P 500 was up 2%, the broad U.S. market Russell 3000®index returned 1.6%, the global MSCI World Index was up 3.6% and the MSCI World Index ex USA was up 4.7%.*

Performance differences among securities in SeaBridge portfolios were pronounced. Stocks which we thought were in the safe end of the real estate spectrum declined sharply, notwithstanding their good positions. Floating rate senior secured bank loans, which we held in our most conservative portfolios, dropped to a 10% discount with bank liquidity problems. Master limited partnerships, which have served us so well over the years, had a difficult quarter. Happily, our basic materials stocks, China stocks, shipping stocks, and oil stocks rallied vigorously, more than offsetting our problem children. Thank goodness for diversification!

So where does that leave us as we go into 4Q07? I am generally encouraged that the real estate lending bubble has burst, and we have made some new investments and reduced cash in many of our portfolios. Problems in housing and consumer spending remain, but it now appears the U.S. will slow but avoid a recession. Europe will also likely slow and Japan may be slipping back into another recession. But Asia, ex Japan, is growing briskly. So the overall balance of world growth will probably come in at 2-3% as we move into 2008. The dollar has been weak and is likely to remain so. This raises the stated earnings of global companies when foreign earnings are translated back into their U.S. financial statements. Therefore, the stated earnings of larger global companies should continue to grow.

The key question, of course, is the eventual depth of the housing recession, which is bad and getting worse. It took five years to get into the housing mess, and it will probably take a year to contain the problem. As adjustable rate mortgages reset to higher rates, more and more families are being pushed beyond their ability to pay. With house prices falling, this leads to foreclosures and sales of foreclosed properties, and further declines in house prices. The number of defaulted mortgages in the CDO's (Collateralized Debt Obligations: mulched-up baskets of mortgages sold as pooled loans) is rising steadily even as the financial authorities dig to find the residual owners of all these loan pools which have been sold and resold. Investigation is slow, but some holders are being identified as their funding sources refuse to lend and the holders have to go into liquidation.

The first round of losses on bad CDO loans was reported in SIV's (special investment vehicles) sponsored by smaller German banks. The CDO assets were not on German bank balance sheets, but are held in separate investment companies set up by, and owned by, the banks. These SIV's obtained cheap financing in the commercial paper market to carry leveraged portfolios of higher yielding CDO's. As rumors swirled about their bad assets, the buyers of SIV commercial paper balked. The SIV's had to call on borrowing lines from their sponsoring banks to refund their commercial paper, which resulted, in extreme cases, in the banks having to take SIV assets back onto their balance sheets. To husband liquidity for such possible events, banks generally reduced lending and investing which, in turn, resulted in a liquidity crisis in the banking market, especially in Europe.

In England, Northern Rock, a large bank specializing in mortgage origination, had a funding crisis, and in the absence of quick reassurances from financial authorities, England had the first run on a Bank in 40 years. The Bank of England eventually stepped forward and guaranteed all deposits in all banks, but not before London had taken a black eye as a leading financial center.

* 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.

Hedge funds around the world had a trying quarter because many use considerable leverage to enhance their results. As a result, the market dislocations were magnified in their portfolios. This was made worse as some leveraged funds had margin calls, forcing the sales of stocks which were widely owned by other hedge funds. These sales caused some of the leveraged "quant hedge fund" models to go astray, with more forced sales of large positions held on leverage. Our portfolios had some exposure to a few of these stocks, but we also had a number of high quality growth stocks which went up as investors were running to buy safer stocks. We were also able to use our high cash positions to nibble at some stocks which had been sold down significantly.

All in all, everyone learned a lesson about how volatile our markets can be with significant participants using large amounts of leverage. However, in general, the hedge fund community came through the 3Q07 dislocations better than many had feared. The enduring problems seem to be in the commercial banks, which are once again stuck with underwater private equity loans and loans to sub-prime mortgage originators. The Fed's reduction in the discount rate in August gives the banks more time and easy access to liquidity to work through these problems.

With this going on, in mid-September the Fed chose to cut the federal funds rate by ½% rather than the ¼% which had seemed the more likely course. This move is open to several interpretations:

1. The Fed wanted to eliminate all question about whether it will supply the liquidity needed to head off a recession.
2. More problems exist in the U.S. money market funds which hold short term mortgage paper than are publicly acknowledged, and the Fed wanted to get ahead of these problems and over-supply the market with cheap money.
3. Congress is getting passionate about the housing slump, and the Fed wanted to shut down the political pressure to make cheap money more available.
4. With housing weak, a slumping stock market at the same time could impair consumer confidence. Therefore, a bold action to buoy the stock market as we go into the Christmas season is desirable.

The answer is probably some of each of those, and the immediate reaction to the Fed move appears to have helped with each of the four possible reasons.

We are left, nonetheless, with more questions for the fourth quarter:

1. Will the relentless bad news from the housing sector erode confidence in spite of the Fed's action?
2. Will the retreat of the U.S. dollar, now encouraged by lower U.S. interest rates, turn into a rout?
3. Can Asia keep growing fast if the U.S. stalls to near-recession levels?

We have guesses for answers to these questions (yes, no, maybe), but our practical answer is to try to position our portfolios to stay out of the way of fallout if we get a resoundingly bad answer to any of those questions. As a result, we are cautious about the financial, housing and consumer sectors in the U.S. In Asia, we are trying to stay away from exporters of consumer goods to the U.S.

We are trying to find reasonably valued holdings which are benefiting from Asian domestic growth. We have reduced exposure to Japan, especially in our Global Trust portfolios where a 10% Japanese exposure has hurt performance this year. We have repurchased companies lending to the business and real estate markets in some portfolios, where their price slump appears to put them back in the "good value" column. We hope the market healing will let us deliver a good quarter to end 2007.

With best wishes,

Garnett L. 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.