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September was an "up month" on our up and down market see-saw, bringing us roughly two-thirds of the way back on the S&P 500 from the July low toward the end of the April high for the year. That may not seem like huge progress, but during the summer the market has had to absorb four troubling perceptions:

1. Real growth in the U.S. economy is likely to be closer to 2% than 4% for the next several years.
2. In a slow growth environment, corporate profits are likely to grow significantly more slowly than during the 4Q09 through 3Q10 period.
3. At 2.5% growth, unemployment would fall slowly, if at all.
4. House prices are falling again as foreclosures continue to pressure home values in many markets.

With that list of burdens, why was September the strongest September for stocks in 70 years? The reasons for short term market moves are anyone's guess, but the suspects on the list include:

1. While the economic news was not good, it was less bad than the data coming in earlier in the summer. Hence the odds of a double dip recession seem to be declining.
2. The earnings yields – earnings relative to the stock price – are quite attractive relative to the yields on bonds, especially Treasury bonds, and interest on savings accounts and money market funds.
3. If the economy does get weaker, investors feel that the Fed will once again start buying bonds. In the past, this has been followed by rising equity markets.
4. The prospects for a swing toward more "business friendly" government policies seem to be rising as public dissatisfaction points to a removal of many liberal voices in Congress in November.
5. Data from China indicate that the slowing of the Chinese economy reversed in late summer. The West can probably count on strength in Asian economies as we move into 2011.

Markets may head back down in October. The employment report on October 8th will be dissected to find any signals for future weakness or strength. But, at least for now, rising equity values are lifting consumer attitudes on the margin, and that is good.

For the past quarter, the S&P 500 was up 11.3%, the broad U.S. market Russell 3000® Index gained 11.5%, the global MSCI World Index returned 14.5% and the MSCI World Index ex USA was up 16.7%. For the nine month period, the S&P 500 index returned 3.9% , the Russell 3000® Index was up 4.8%, the MSCI World Index returned 4% and the MSCI World Index ex the USA was also up 4%.[1]

So where does the autumn season find us on our portfolio strategies? For us it comes back to stock selection. The quest is to find well managed companies, with solid growth prospects, trading at reasonable

[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.

prices. Those may be found in niches in the U.S. market which can prosper even though overall growth in the economy is less strong than in the past. It means adding companies which have some or most of their business in Asia, Brazil or other places growing two or three times as fast as the U.S. Or, it may mean finding some stocks which seem so cheap relative to what we think their long term value is that we are willing to buy them and wait. This last approach is more appealing if they have a good yield to pay us while we wait.

Corporations have record cash on their balance sheets. We believe many will begin to give more cash back to the shareholders. An example, held in a number of portfolios, is **Microsoft** (MSFT). MSFT has been a poor performer this year; it trades at about $24 per share, down from $31 at the beginning of the year. MSFT generates over $2 per share in free cash flow. It has $37 billion of cash on its balance sheet, roughly half of which is trapped overseas and cannot be returned to the U.S. without paying taxes of 30+%. But offshore money can be reinvested overseas – which is where growth is fastest. Microsoft has debt of only $6 billion and is rated AAA, which few banks in the world can match. MSFT recently borrowed $4.75 billion in three through five year bonds. The interest rate on the short three year bond was 7/8%, a spread of only 25 basis points over Treasury rates. Among the stated purposes for the offering was stock repurchases, which makes powerful economic sense. MSFT earns 44% on its equity and, since it trades at 4.5 times book value, the purchaser of Microsoft stock is getting an 9.8% earnings yield on his purchase. The company just raised its dividend by 3 cents or a 23% increase, to yield 2.6%.

There are many knocks on the company: Bill Gates has abandoned ship for philanthropy and CEO Steve Ballmer is less able; the company has become bureaucratic and lost its way in the internet world; MSFT's Windows and Office products are becoming obsolete; the stock is over-owned by institutions, and the market capitalization is too big. With individuals shifting savings flows to bonds, a stock like MSFT, which lacks growth and excitement, will likely continue to suffer stock price erosion. There is a bit of truth in each charge, but a AAA company trading around 10 times earnings, growing at about 10% a year, in the middle of a replenishment cycle for its major cash cow products, yielding 2.6%, raising money probably to buy back stock, seems to us to be a sort of "high quality growth bond" which is vastly preferable to the government bonds or money funds into which the public is pouring money.

In our Core and Inflation Fighter portfolios we have been buying **Alexander& Baldwin** (ALEX). The company has three businesses: transportation, real estate and agribusiness. The primary component of the *transportation* business is container shipping between the continental U.S. and Hawaii. The Hawaiian shipping route provides stability to ALEX's transportation business. The growth, however, is coming from China. ALEX's container shipping service commands a premium over other shippers because of its frequency of service and small ship size, which stop first in Hawaii on their way to China. The *agricultural* business, which was the original focus of Alexander & Baldwin, is no longer the value driver for the company. ALEX's *real estate* business grew out of its agribusiness on Hawaii and has two components, development and leasing. Over the years, ALEX has developed its Hawaiian real estate into commercial and residential properties. As projects are sold, ALEX has re-invested the proceeds into leasable commercial properties on the mainland U.S. The portfolio is diversified, but the largest component is industrial real estate. While the leasing portfolio is solidly profitable at present, it has the potential to improve as the U.S. economy continues to recover. In addition, the company holds prime oceanfront property in Maui which is likely to be of material value when the real estate recovery eventually gets traction. ALEX yields 3.6% while the shipping business grows and we wait for real estate to recover.

In a number of our portfolios (Asia, International, Core Global) we own **Bucyrus International** (BUCY). The company has been the leader in mining draglines and, during the recession, bought the mining assets of Terex, a lower quality mining equipment supplier. Bucyrus is now upgrading the Terex equipment line. Wall Street has had some concerns about whether China's growth would remain strong enough to keep new mining equipment orders coming in. The strengthening of growth in China and the leadership's plans to accelerate building in second and third tier Chinese cities appears to be good news for the natural resource demand and new mine openings. From the orders in hand, we expect Bucyrus earnings to increase 60% over the next two years, dropping the multiple from 17 times to 12 times earnings. Of course, there are no guarantees that that will happen.

We may be wrong on any stock or bond, but this market seems to be in a "mistrustful funk," lacking confidence in either business or government and fearing a U.S. depression or currency debacle. Our country has problems, major fiscal problems. But we will probably muddle through. And Asia is booming. The markets are offering longer term opportunities which make us decidedly positive about owning carefully selected stocks and bonds rather than Treasury securities.

We hope we are right.

Garnett L. Keith, Jr

Note: Some examples of stocks were shown here to illustrate the types of securities held in the portfolio. These are not intended to be recommendations to buy or sell these securities. Our expectations about these stocks may not be realized. These specific securities may or may not be held in client or personal accounts. They may be bought or sold from portfolios at any time in the future. There is no representation about the future performance of the stocks. Not all stocks held in the portfolio perform similarly. Some stocks held in the portfolio historically performed much worse than the examples presented.