SEABRIDGE
INVESTMENT ADVISORS, LLC

Cautious Core Strategy Q2 2022

Portfolio Manager: Howard Chin, CFA
Investment Style: Conservative Hybrid Allocation

The Cautious Core strategy seeks to generate returns by balancing the need for income, capital appreciation, and capital preservation by using a diverse set of asset classes such as Equities, REITs, Fixed Income, Closed-End Bond Funds, and Cash Alternatives.

Outlook and Positioning:

The pandemic has fueled inflationary pressures not seen in decades, and the war in Ukraine and China's zero Covid policy have further aggravated these pressures in 2022. Meanwhile, central banks have been more aggressive in raising interest rates. All asset classes, except commodities, are undergoing downward pricing adjustments to reflect tighter financial conditions and higher rates. These growing headwinds are feeding into recession worries. Inflation remains a critical issue, and investors should be prepared for higher rates over the next few months. However, we think the markets have meaningfully priced the Federal Reserve's rate hikes into the yield curve for this cycle.

We remain cautious as lower earnings expectations may not be priced in and could put additional downward pressure on equities. Companies have been cutting profit projections and signaling a slowdown in hiring recently. We remained defensive with our equities positioning and have cash in the portfolios for opportunistic buys as we look to increase the portfolio's yield. Bonds have been a poor diversifier to equity risk in the last year, but we believe the fixed income market now has more credit spread and yield opportunities. Our current portfolio is weighted toward shorter duration bond investments and away from riskier credits investments such as high yield and leveraged loans. As we gain more clarity on the path of inflation and the earnings impact of tighter financial conditions, we may look to add more exposure to longer-duration fixed income.

Contributors and Detractors:

Intercontinental Exchange (ICE), Stryker, and Bank of America detracted from performance. ICE's exchange and fixed income data businesses have remained resilient, but the slowdown in the mortgage market has hurt its mortgage real estate cloud platform. An increased debt profile stemming from a recently announced Black Knight acquisition has also impacted the stock. In our opinion, Stryker is one of the best long-term positioned companies in MedTech, but supply challenges and inflation are weighing on the company's ability to drive margins through 2022 and into 2023. We believe Bank of America is well prepared to weather any upcoming economic slowdown, but recession fears potentially dragging down credit and the mortgage market hurt the financial sector in the quarter.

Amgen, Pfizer, and WP Carey were the stocks that contributed to performance. Healthcare was a strong relative outperformer in the quarter. Covid vaccine drugs have been a huge cash generator for Pfizer to use for acquisitions, but the company also has a robust pipeline of drugs coming into the market to support its growth profile. Amgen is a reliable biotechnology company with an improving pipeline offering dividend growth prospects in an environment starving for increasing income streams. WP Carey is a diversified net lease REIT that has assets in the U.S. and Europe with around 60% of its leases supported by CPI rent escalators.

Portfolio Activity:

We reduced exposure to risk assets by selling out of Masco and Ares Capital. We eliminated Masco to lower our exposure to home improvement as it seems the consumer is beginning to cut back on discretionary spending. We continue to own Home Depot and Lowe's because the housing industry still has solid, long-term secular tailwinds. Housing has strong fundamental support due to favorable demographics with millennials moving into their prime years for single-family housing purchases. Since the global financial crisis of 2009, the housing market has been severely undersupplied, fueling the significant home price and rent inflation in the last two years. We exited our position in Ares Capital, a Business Development Company specializing in making loans to middle market companies. Ares is a well-managed BDC in the space, but we were concerned by the potential of greater-than-expected weakness in credit quality driven by softness in the macroeconomic environment.

We are in the process of initiating a position in a closed-end bond fund, Western Asset Investment Grade Bond Fund (PAI). PAI is an investment grade, no leverage, closed-end fund yielding 4.7%. Closed-end bond funds have historically been a good source of yield and diversifier for our strategy. We think opportunities are beginning to open as the underlying assets have been revalued, and the discounts to NAV are beginning to widen meaningfully from historical averages.