SEABRIDGE
INVESTMENT ADVISORS, LLC

SeaBridge Core Strategy

Third Quarter 2015
Commentary

In our August commentary, we noted that we raised cash reserve levels in anticipation of increased volatility in the stock market. Our expectation of unusually high volatility was the result of two specific issues:

1) Slowing economic activity in China
2) The potential for the Federal Open Market Committee (FOMC) to take the first step towards normalizing monetary policy before the end of 2015

We further stated that our strategy was to take advantage of increased market volatility to invest our cash reserves in equities at more attractive valuations. In fact, stock market volatility increased in August and September as expected, and we deployed a portion of our cash reserves back into equities. We expect to continue to invest our cash reserves into stock market volatility through the end of 2015.

We believe the U.S. economy is growing at a slowly accelerating rate. Modest economic growth within the context of low interest rates and low inflation is a constructive backdrop for equity price appreciation, and is likely to reward patient, long-term investors, in our opinion. In the short-term, however, equity prices have become volatile in response to uncertainty. The continued slowing in economic activity in China has created uncertainty regarding the health of emerging economies and the potential implications for the U.S. economy. In addition, the stated intention of the FOMC to begin the process of normalizing monetary policy before the end of 2015 has also unnerved investors because we have had extraordinarily easy monetary policy and abnormally low interest rates for seven years. In fact, if the FOMC were to raise its target Fed Funds rate, it would be the first increase in nine years.

Most equity investors do not like change. From our perspective, change represents opportunity and we are poised to take advantage of opportunity. Our view has been that the extended period of low interest rates has led to low volatility in the stock market (i.e. prior to August and September 2015) and encouraged pockets of speculation and extreme valuation. It has also been our belief that as interest rates rise at a modest pace to reflect the growing strength of the U.S. economy, high valuation stocks would yield to the more value oriented equities that we hold in our portfolios. After all, equity valuations are merely the present value of future streams of cash flow. As interest rates rise, discount factors similarly rise, thus reducing the present value of companies that are valued using cash flows far into the future.

Clearly, we don't have a crystal ball. Nonetheless, we have a road map, or game plan, if you will. Earlier this year, we presented our equity strategy based on the assumption that the U.S economy would continue to grow at a slowly increasing rate based on three primary drivers of incremental growth: 1) residential construction, 2) non-residential construction, and 3) state and local spending. In the final revision to second quarter 2015 GDP, the U.S. economy reportedly grew at a rate of 3.9%. This is above the 3.4% rate of growth that the U.S. has experienced since WWII, and likely much higher than we may see in the next few quarters as it incorporates some economic activity that was deferred from the weather-affected first quarter. Nonetheless, the second quarter data clearly support our base case view of the current economic environment. Residential construction contributed 0.3% to GDP growth, non-residential construction contributed 0.18% and, very importantly, state and local spending contributed a resounding 0.46% to growth in the quarter. We believe these incremental drivers of growth are, in aggregate, sustainable. The exact contribution of each of the three economic drivers may change. For example, the contribution from state and local spending is likely to be lower, and the contribution from non-residential construction should be higher, in our judgment.

In an economic environment in which the U.S. economy is growing at a pace of nearly 3%, the job market should continue to tighten and the Federal Reserve's FOMC should begin the process of reversing the extraordinary measures implemented during the financial crisis. The FOMC, however, constantly seems to be in a state of paralysis owing to economic events outside of the United States. In 2014, the FOMC should have begun the process of fostering higher interest rates, but they were thwarted by the looming threat of a European recession. Earlier in 2015, the potential Greek default kept the FOMC from acting. More recently, in the September meeting of the FOMC, instability in emerging market currencies and concerns about growth in China gave the FOMC pause. In their own words, the FOMC balked at raising interest rates in September because "Recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term." The FOMC was likely surprised by the decline in U.S equity prices following their statement of inaction as they may have thought the market would have been assuaged by their interest rate largesse. In a speech given by chairperson Yellen one week after the FOMC meeting, her words suggested that the FOMC may have been too cautious in its last decision to forestall a rate increase. Yellen's speech implied that the FOMC is still likely to take at least one step towards allowing interest rates to seek a more normal level by the end of 2015. They are more likely to raise rates following the December meeting rather than the October meeting, however, given the soft non-farm payroll data reported for September. This data series has a very large standard error and is subject to substantial revision, so we would not infer too much from one month's data.

After some initial volatility resulting from modestly higher interest rates expected before year end 2015, we believe the stock market will realize that the FOMC is going to take a very gradual path towards raising interest rates. This will, hopefully, provide the stock market with the comfort needed to settle some of the current price volatility and look forward to the earnings growth that should come from continued growth in U.S. economic activity. In our judgment, the slow rate of growth in the years following the Great Recession has paved the way for a very long business cycle. Consequently, corporate earnings growth has likely not seen its peak.

As previously noted, we raised cash reserves in anticipation of a period of stock market angst as the FOMC defines its direction in this time of transition six years post the 2008/2009 financial crisis. Our plan is to continue to look for opportunities to put our cash reserves back to work in equities. We are especially eager to invest in companies that are taking steps to enhance shareholder value during this period of volatility. Many of the companies in our portfolios are buying back shares aggressively as valuations become more attractive. Two of our portfolio companies, in particular, have taken steps in recent months to greatly enhance investment returns for patient, long-term investors.

CF Industries (CF) is one of the larger U.S. manufacturers of nitrogen fertilizer. On August 12th, CF announced a brilliant transaction with CHS, the largest farm cooperative in the United States. CHS is both a customer and competitor to CF Industries. They source all essential products for their cooperative members. This, of course, includes nitrogen fertilizer produced by CF and others. CHS had plans to build a green field nitrogen fertilizer plant to help supply some of the product needed by their members rather than buy it on the open market. Instead of building the plant, CHS invested $2.8 billion to acquire 11% of CF's largest nitrogen producing subsidiary. CHS also agreed to purchase 8.9% of CFs nitrogen production at market prices. At the time of the announcement of this transaction, CF was trading at a price of approximately $56 per share. Per our calculations, the CHS investment strikes a value for CF of more than $90 per share. Importantly, this transaction replenishes CF's cash reserves, which are primarily used for share repurchase. The proceeds from the transaction combined with expected free cash flow through 2019 amount to more than $10 billion. If past is prologue, we can expect most of their cash reserves to go towards share repurchase. The current equity market capitalization is $12 billion. Overall, the transaction with CHS and the ensuing share repurchase are extremely accretive to shareholder value.

In a very similar transaction, Plum Creek Timber (PCL) formed a joint venture called Twin Creeks Timber with several institutional investors. The joint venture is, essentially, a timber private equity vehicle that will be managed and partially owned by Plum Creek. Plum Creek owns 6.6 million acres of land in the U.S., which is mostly used to harvest timber. The price of timber has been languishing in recent years and, as a result, Plum Creek Timber's share price has fallen substantially below the fair market value of its assets. In an effort to close the gap between the public and private market value of the assets, the management of PCL formed the Twin Creeks joint venture. The joint venture was capitalized by cash from several institutional investors and timber bearing land from Plum Creek's Southern properties. Plum Creek receives cash in the amount of $420 million plus a 25% interest in the joint venture for their contribution of 260,000 acres of timber land thus capitalizing the joint venture at $560 million. Using the implied $2,150 per acre for their 3.5 million acres of Southern timber, plus reasonable values for the remaining 3.1 million acres in other regions of the United States, mineral rights and development potential for some of the real estate, we believe PCL should be trading at a price more than 30% greater than the current share price. Moreover, as residential housing starts regress to the 1.5 million unit level implied by demographic trends, the value of Plum Creek's timber should grow in value. As in the CF transaction, the management of Plum Creek intends to use the majority of the cash proceeds from their transaction to buy shares in an effort to close the gap between the public and private market value of their assets.

In summary, we are taking advantage of current stock market volatility to invest our ample cash reserves into companies that are trading at discounts to our perception of their intrinsic value. An important characteristic of the companies in which we are invested is a strong shareholder orientation. When the FOMC takes the first step to allow interest rates to seek their appropriate level, markets should be calmed by the increasing clarity around monetary policy. From our perspective, market volatility represents opportunity. Of course, all good plans should change when the fact pattern changes. We expect the pace at which we invest our cash reserves to be tempered by the degree of stability in global currency markets, as well as anecdotes of current business trends gleaned from third quarter earnings conference calls.

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9/28/15