SeaBridge Investment Advisors, LLC

Global Diversified Q1 2023

Investment Style: Global Equities & Fixed Income

SeaBridge Global Diversified Strategy seeks to achieve risk-adjusted investment returns over the medium to long-term by investing in high-quality companies and fixed-income investments at attractive prices, while exercising a deep understanding of the macroeconomic environment to manage investment risk. Companies are selected based on our fundamental research, utilizing a long-term horizon, and seeking to invest in quality and value. Depending on the client's objective and risk tolerance, the strategy seeks to provide capital growth, current income, and preservation of capital through a portfolio of stocks and fixed income investments.

Outlook and Positioning:

The Fed's fight to bring down inflation spilled over to the banking sector, resulting in several bank failures and concerns over the financial health of the regional banks. The Fed's liquidity and funding programs should mitigate further fall-out from this mini-financial crisis, but the recent episode highlights the lagged impact of aggressive monetary tightening. We have concerns about slower bank credit creation and the likelihood that this will hinder economic growth by straining the willingness of businesses and households to borrow and spend. Inflation remains well above the Fed's 2% target, particularly in the services sector. The pace of disinflation has not been as fast as the Fed had expected, and the path ahead is also unlikely to be linear. So far, the U.S. consumer spending and job growth economy has been resilient. Europe is benefiting from a warmer winter and improved energy supplies. China's growth is reemerging after three years of Covid lockdowns.

As interest rate policy normalizes, a higher cost of capital environment may influence the market backdrop in the years ahead. Higher interest expenses could inevitably be a strain on cash flows. Companies with more debt and weaker cash flows could experience downgrades by rating agencies. However, companies with pristine balance sheets and the ability to self-fund their businesses should have an edge. In the near term, we remain cautious in the portfolio's equity portion as lower earnings expectations may not be reflected in the stock prices. After years of underperformance, valuations abroad look attractive compared to U.S. stocks. The valuation backdrop and an improved earnings outlook in Europe and Asia led us to increase the exposure to international equities over the last two quarters. With bonds offering more attractive yields, the fixed-income allocation should dampen portfolio volatility. We will look to add to duration and credit exposure as opportunities arise.

Contributors and Detractors:

Spotify and Taiwan Semiconductor were the most significant contributors to performance during the first quarter. Spotify's recovery was aided by the CEO's open letter published in January. It marked a turning point for the streaming media platform by prioritizing profitability instead of growth. This was a welcome change for investors concerned about the company's high investment spending. The message's tone was modesty and accountability and helped restore credibility with investors. However, the company has been facing declining profitability despite investing heavily in podcast content, which led to solid revenue growth. As a result, Spotify was penalized in 2022 for this misguided investment spending program. In 2023, the company appears to have made a turning point by adopting a more disciplined approach to financial management. Taiwan Semiconductor is the world's largest and most dominant semiconductor fabrication company. The stock also struggled in 2022, but inflows were returning to the semiconductor industry as the downward earnings revisions cycle may end, reflecting better prospects ahead for a secular growth industry.

CVS and Chevron were the largest detractors in the quarter. CVS recently made two significant acquisitions in a push to become a health services giant. The stock price has struggled as investors are skeptical about the company's ability to digest these purchases. The stock trades very cheaply, compensating holders for this heavy dose of pessimism. We are confident in management's ability to deliver value in the long term, but it will likely take some time to transform the business model. Chevron's stock underperformed in the quarter as energy stocks slowed after a stellar performance in 2022. We like Chevron for its oil exposure, solid balance sheet, and dividend growth attributes.

Portfolio Activity:

The end of 2022 was an active period as we worked to increase international exposure. Changes have been more gradual to begin the 2023 campaign. We sold Crown Castle due to the high valuation relative to the current interest rate environment and reduced growth expectations from the cell tower business. We bought Insight Select Income Fund, a no-leverage closed-end fund. It holds investment grades debt, yields about 5%, and trades at an attractive discount compared to its net asset value.