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Copy of the first quarter 2022 letter mailed to clients.

April 11, 2022

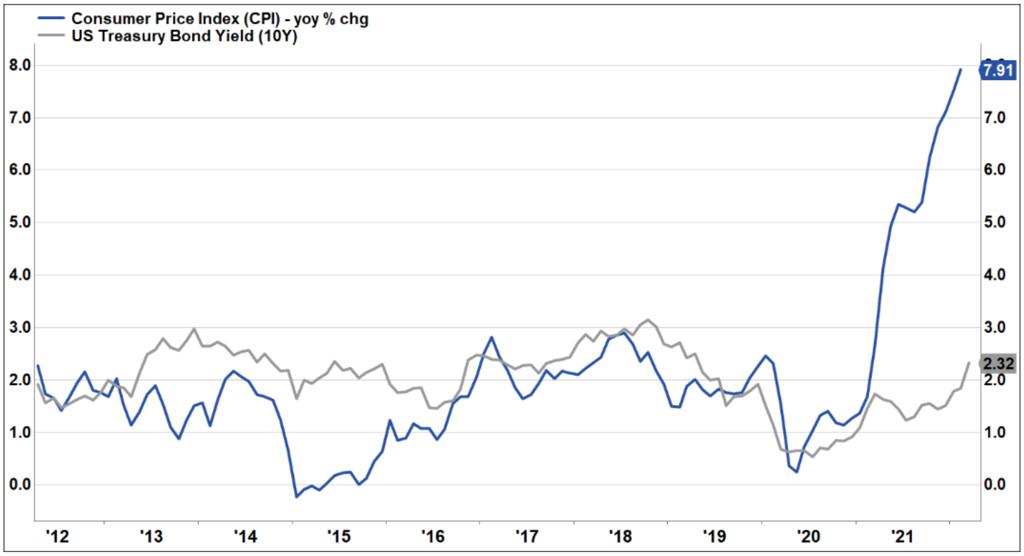
We entered the new year on a hopeful note that we had finally seen the worst of Covid. The virus was still with us but in a clearly less lethal form. Folks who had been mitigated out of full participation in their lives would get back to work, eat out, and go to the movies. Yes, there was inflation, but with Covid marginalized, the supply chain would heal as factory shutdowns would be a thing of the past and logistics workers would return to do their jobs. Consumer demand fueled by unprecedented government transfer payments, would remain strong. The Federal Reserve under the calm leadership of Jerome Powell, would carefully begin to withdraw the massive amounts of money deployed during the pandemic and set interest rates toward a level that would reflect both a strong economy and rising inflation expectations.

This was the hope. After a positive start to the year, however, it soon became clear that there would be no smooth path toward post Covid "normalcy". A new Covid variant appeared and stood in the way of realizing this objective. More significantly, inflation, once thought transitory, has now become a more intractable problem, with the Federal Reserve looking increasingly "behind the curve" in enacting policy designed to achieve its main objective of promoting stable prices. The quarter closed on a depressing note with the unthinkable Russia invasion of Ukraine.

The humanitarian crisis born of Russia's reckless adventurism affronts our sensibilities. In the context of the human suffering so evident in Ukraine, our professional concerns over the war's effect on the global economy seem trivial. Still, we are obliged to assess how this latest tragic development in human affairs exacerbates the challenges around growth, markets, supply chains, interest rates and inflation and complicates the navigation of the investment landscape.

It is curious to us that risk assets have been relatively resilient in the face of the significant issues noted above. The strength of the consumer characterized by high savings, rising wages, and plentiful jobs has certainly been a tailwind for markets. Furthermore, despite the hawkish rhetoric of the Federal Reserve, Fed actions taken to date to confront the undeniable inflation challenge the central bank faces have been meager with only one modest interest rate hike so far in the new year and with no reversal of quantitative easing. There remains an enormous amount of liquidity in the system.

Markets may have remained relatively buoyant in the quarter for these reasons. But we worry that they do not reflect the high likelihood of a slowdown which may result from Fed tightening or the natural demand destruction that comes with high inflation and its effect on the affordability of goods and services. Despite a slightly inverted curve, historically a harbinger of recession, the markets are not yet auguring a hard landing of an overstimulated economy.



Source: FactSet

Clearly, inflation has been running hot. Now, because of disruptions to certain commodities markets resulting from the Ukraine tragedy, the broad supply and demand imbalances that are the residue of the pandemic period have further widened. Interest rates may have to rise beyond current expectations. All of this may signal for us a paradigm shift in market sentiment. Here are our thoughts on how we think this shift will impact our portfolios.

Equities Peak Earnings

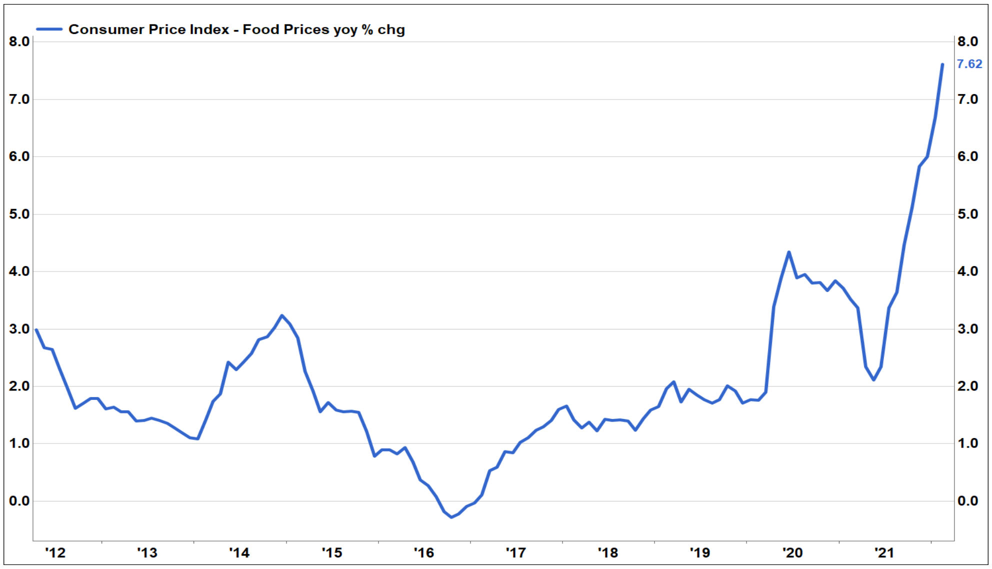
We may be nearing a cyclical peak in corporate earnings. Companies, including most in the SeaBridge universe, have largely been able to navigate the shoals of inflation and maintain profit margins pressured by rising cost of inputs. So long as a wage price spiral persists and the Ukraine war wears on, this will be increasingly harder to accomplish. The rising cost of capital will further weigh on profitability. Furthermore, revenue growth may begin to disappoint as a result of demand destruction noted above.

This outlook encourages us to lighten up on our exposure in those areas most exposed to a cyclical slowdown. In this category are housing, financials, consumer durable, and certain industrials, all potential victims of rising interest rates, the flattening yield curve, deteriorating credit conditions, and a consumer, despite significant wage advances, poorer because of inflation.

On the other hand, we may be at the beginning of a long upcycle in food, energy, defense, and cyber security.

Commodities

The Ukraine is a major agricultural product exporter of Europe with the country supplying 9% of world demand for wheat, 14% of its corn and 37% of sunflower oil. Much of this production will be lost for the year, and perhaps longer, depending on the outcome of the conflict. Food security will be at the forefront of national interests and there may be a strong, long-lasting bid under agricultural commodities. We are most interested in those companies closest to farm and field such as equipment companies and producers of crop yield enhancement technologies.



Source: FactSet

Oil and gas may be spared the fallout of an economic downturn because of the Russian invasion of the Ukraine. There is simply no easy way for Russia's contribution to global output to be taken up by alternative producers. Prices for these commodities should remain elevated for the foreseeable future and be supported by an OPEC, that has shown little willingness to increase output. We also note that the idea of petitioning oil rich rogue regimes like Venezuela and Iran to make up shortfalls may not be politically feasible. Furthermore, prices will be supported by a general reluctance by governments, including the U.S., to facilitate an increase in supply of these commodities because of a widely accepted green climate agenda. Along with renewables which can flourish in an energy starved environment, fossil fuels, which had almost been given up on as a wasting asset just a few years ago, can now potentially be revived to a point where these companies may be investible on a longer-term basis. We recognize that the shares of companies of interest in the oil and gas sector have advanced of late, and so we will need to be convinced of the remaining value proposition in these investments before we commit.

Defense and Cybersecurity

We believe there is no question that defense budgets across the globe will increase because of Russia's invasion of the Ukraine. In Europe those increases may be substantial as the NATO countries are now committed to annual defense spending of 2% of GDP, translating into additional spending in the aggregate of more than $100 billion Euros per year. In the Biden administration's proposed 2022 budget, defense spending in the U.S. is set to increase by 9%. This number will almost assuredly be higher once Republican inputs are incorporated into the final bill.

Cybersecurity also comes into focus as an investible theme as cyberattacks may be as dangerous and longer lasting than conventional military interventions. Our challenge here is to find companies attractively priced in a highly fragmented industry.

Technology

Certain technology may prove to be downturn resistant. Investment in data centers, 5G, the metaverse, artificial intelligence, the internet of things, factory automation, e-commerce, and streaming video, may hold up.

Health Care

If just for aging demographics alone, health care remains a focus for us as a sector that can weather any downturn.

Large vs. Medium and Small Sized Companies

In our search for more safety in the portfolios, we are biased toward large companies vs. their medium and small sized counterparts primarily because of their economies of scale and lower customer concentration risk.

On the other hand, even the largest companies must now deal with pay and benefit demands of labor that were less evident before the pandemic. There has been a societal shift in the management/labor equation, with the new construct now favoring the employee. Stable employer/employee relationships are critical for investment in companies of any size.

Company Fundamentals

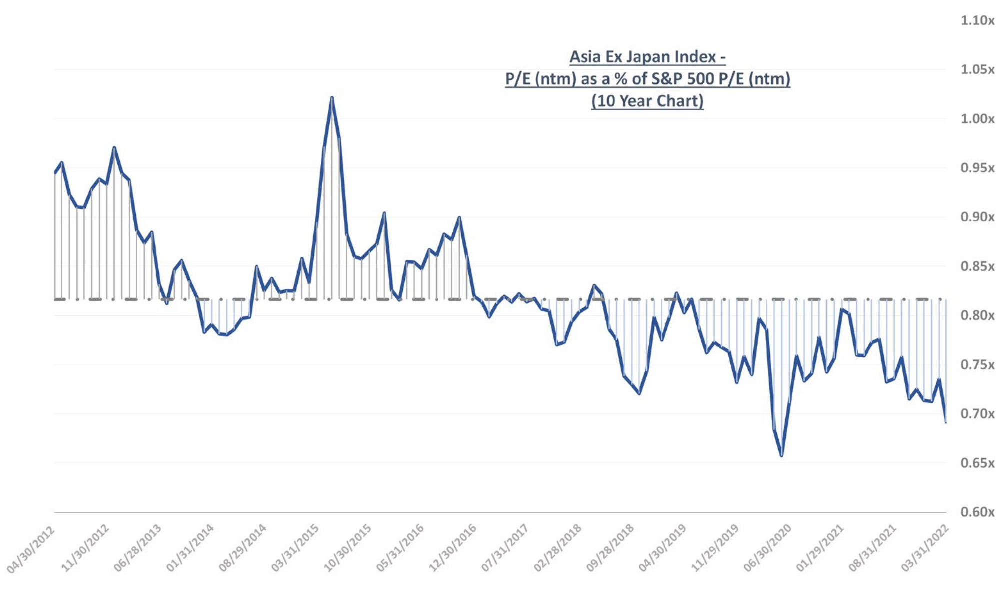
It should be noted that cash flow and clean balance sheets matter more to us in the investment decision making process than the macro considerations noted above. Dividend payers and prudent stewards of capital loom large among our investment preferences.

Fixed Income

Fixed income options for the cash or near cash SeaBridge holds in clients' accounts are expanding along with the rise in interest rates. We have long used pure cash or low duration assets in the non-equity portion of our portfolios. With the 2-year Treasury at 2.5% and with the credit spreads widening in both the investment grade and high yield areas, our intent is to produce more yield without taking appreciable additional duration or credit risk. This maneuvering primarily applies to our more conservative strategies Yield Growth and Cautious Core. All our portfolios will be affected, however, as they all contain some level of cash.

International Investing

Covid related disruptions to global supply chains are but the latest negative development that forces a reassessment of global commercial relationships. Prior to Covid, the Trump administration's trade policy regarding China highlighted the imperfections of international trade protocols. Covid then disrupted the global supply chain, accentuating a growing dissatisfaction with global sourcing and fulfillment. Russia's invasion of the Ukraine will exacerbate this unease. We can't help but feel that the profound developments of the past few years will continue to negatively affect companies' plans regarding foreign sourcing and overseas expansion. We think there will be a "closer to home bias" in corporate strategic thinking. This suggests that we may have reached the height of globalism, the objective of which is a seamless, tariff free integration of the markets for goods and services. Because of this possible retrenchment, the best things to say about international financial markets is that they still provide a way, if done correctly, to diversify away from the U.S. and that they are typically cheaper than their U.S. counterpart. For these reasons, we will continue to invest in them, particularly Asia.



Source: FactSet

The New World Order

We see the Ukraine war in terms of an emphatic beginning of a new world order that may be characterized more by conflict than cooperation, pitting liberal democracies of the free world against an axis of autocracies led by China and including Russia. Obviously, there are huge economic and political implications as to how all this evolves. China may take a very hard line in dealing with the West, or because of Russia's lack of success in Ukraine, rethink this position and adopt a more responsible attitude in its international dealings. Only time will tell. The outlook is complicated by Taiwan, the retaking of which remains a non-negotiable goal for China.

Since we may be wrong about our views, the changes to the portfolios above will be incremental. And it if we are wrong about high inflation and slowing growth, we must be prepared to admit it and reverse course on the more defensive positioning of the portfolios.

As always, we would be happy to hear from you on your thoughts and concerns about the future. Please feel free to reach out to any member of SeaBridge for further discussion.

We wish you all the best in 2022,

The SeaBridge Team

If you'd like to discuss any of the strategy commentaries, or your individual portfolio, please let us know. Also, as always, we encourage you to contact us if there are any changes in your circumstances or goals that might suggest a change in the level of risk in your portfolio or in the investment strategy we are managing for you. You can call 908-273-5085 or email SeaBridgeTeam@SeaBridge.com.

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