Eastgate Advisors

Eastgate Advisors, llc
Quarterly Review and Outlook

Index Returns	Quarter	1-Year	3-Years	5-Years
MSCI All Country World stock index	**6.9%**	**15.0%**	**5.1%**	**8.4%**
S&P 500 index	**6.1%**	**17.2%**	**10.4%**	**13.3%**
Barclays US Universal Bond index	**1.1%**	**1.9%**	**3.0%**	**2.8%**
Citi 3-month US Treasury Bill index	**0.1%**	**0.3%**	**0.2%**	**0.1%**
Bloomberg Broad Commodities Index	**-2.3%**	**8.7%**	**-13.9%**	**-9.5%**

Other Key Indicators	Qtr-End	Prev Qtr-End	Year-End 2015
10-Year US Treasury Bond Yield	**2.4%**	**2.5%**	**2.3%**
Credit Spreads (Bloomberg IG Corporates vs US Treasuries)	**118**	**123**	**165**
CBOE VIX S&P 500 index implied volatility (annualized %)	**12.4%**	**14.0%**	**18.2%**
Shiller S&P 500 Cyclical Price-to-Earnings Ratio (trailing 10-year)	**29.0**	**28.0**	**24.2**
Brent Crude Oil price/barrel	**$52**	**$54**	**$38**
Gold price/oz in USD	**$1245**	**$1146**	**$1060**
US Industrial Production (y/y % change, seasonally adjusted)	**+1.5%**	**+0.8%**	**-3.3%**
US Personal Consumption x food & energy (y/y % change, sa)	**+ %**	**+1.7%**	**+1.4%**
US Consumer Price Index all items (y/y % change, sa)	**+2.4%**	**+2.1%**	**+0.7%**
US 5-Year Inflation Expectations, 5-Years Forward	**+2.2%**	**+2.1%**	**+1.8%**
US Real GDP (y/y % change, sa)	**+1.9%**	**+2.0 %**	**+1.9%**

Quarter in Review

The "Trump Rally" continued during the first quarter as the new administration began a bumpy transition from campaigning to governing. Investors anticipated significant tax and regulatory reform, health care reform and an increase in US infrastructure spending with help from a Congress dominated by the president's party. The UK formally notified EU partners of its anticipated withdrawal from the European Union by April of 2019. Global equities posted strong returns with US equity indices hitting records and market volatility falling sharply. Trailing 12-month earnings for S&P companies grew for the first time since 2014. The Shiller S&P 500 cyclically adjusted price-to-earnings ratio (CAPE) rose to 29 times trailing 10-year earnings compared with its 20-year average of 27 times earnings. According to Mercer Investment Consulting US non-financial corporations retired about $565 billion of equity in 2016 likely putting upward pressure on stock valuations from reduced supply. Despite a Fed Funds rate increase to 1.0% in March the US bond market ended in positive territory. A weaker USD (-2%) helped returns to allocations outside of the US for US dollar denominated investors. Global oil prices fell on rising unconventional US oil (shale) production. The Economist® estimated that China now accounts for over two-thirds of world GDP growth (estimated to have been about 3% in 2016) compared with 11% from the US.

Eastgate Advisors' Returns	Quarter	1-Year	3-Years	5-Years
Moderate Risk Asset Allocation Net-of-Fee Composite[1]	**4.3%**	**8.7%**	**3.1%**	**5.2%**
Moderate Risk Strategic Benchmark[2] (@ -10% down-side risk)	3.9%	8.2%	3.9%	5.4%
Morningstar World Allocation Net-of-Fee Universe (763funds)	4.2%	9.1%	2.1%	4.7%

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Asset Class Allocations*	US Equities	Non-US Equities	Global Bonds	Commodities	Money Markets
Eastgate Moderate Risk Weight	**29.4%**	**23.2%**	**38.0%**	**2.0%**	**7.9%**
Strategic Benchmark Weight	**26.3%**	**23.7%**	**40.0%**	**0.0%**	**10.0%**
Eastgate Advisors Over/Under Weight	**+3.1%**	**-0.5%**	**-2.0%**	**+2.0%**	**-2.1%**

*Based on quarter-end manager holdings. Gross exposures may not sum to 100%.

Return Analysis

Our return objective is to out-perform the strategic benchmark after fees, over a three-to-five-year investment horizon. We seek to add value through asset allocation decisions, external manager selection, manager allocation decisions, by managing investment risk, maintaining adequate liquidity and controlling investment costs.

Active Decision	Quarterly Value Added Versus The Strategic Benchmark
Asset Allocation*	**+2.3%**
Manager Selection	**-0.6%**
Manager Allocation	**-1.3%**
Total Quarterly Net-of-Fee Value Added:	**+0.4%**

*Asset allocation is the allocation among the passive global markets portfolio, the active alpha portfolio and the money market portfolio.

What affected returns during the quarter?

Underlying holdings analysis at quarter-end showed that we had higher small and mid-cap global equity exposures, more non-US fixed income and more non-dollar bonds than the strategic benchmark. Other key factors that affected returns:

- An over-weight to global equities helped performance.
- A weaker US dollar helped non-US allocations.
- An over-weight to lower quality fixed income helped as credit spreads narrowed.
- Active managers (the alpha portfolio) under-performed the passive global markets portfolio hurting performance.

Risk Management

In managing investment risks, we seek to eliminate idiosyncratic risks, to manage market and active risks and control leverage in order to keep annual down-side risk at no more than -10% in nine-of-ten years while maintaining adequate liquidity and earning a return which we believe fairly compensates investors for risk. We have explicit allocation limits in place for each active manager. We also have a 3% maximum annual active risk budget. This means that we should expect to earn the return of the strategic benchmark plus or minus 3% in seven-of-ten years. That is why the strategic benchmark is a key part of our investment process.

Moderate Risk Key Risk Metrics	Metric Value	Q/Q Change
Estimated 12-month down-side risk potential (@ 90% confidence):	**-4%**	**(-)**
Risk relative to the strategic benchmark (leverage):	**1.1 x**	**(-)**
% of return explained by the strategic benchmark allocation (R^2):	**94%**	**(-)**
Estimated annual active risk (tracking error):	**1.0%**	**(-)**
Active allocations % of total fund (active managers + tactical allocations):	**34%**	**(+)**
Weighted average annual expense ratio:	**0.36%**	**(+)**
Number of global stocks (idiosyncratic risk indicator):	**5407**	**(+)**
Number of global bonds:	**7521**	**(+)**
Estimated interest rate sensitivity relative to the strategic benchmark index:	**88%**	**(-)**

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Looking Ahead

We are not focused on a quarter-to-quarter or a year-to-year investment horizon. Strategically, we maintain exposure to global markets with historic risk premia in excess of the return of a risk-free asset, like a treasury bill. We seek to control costs, manage risks and maintain adequate liquidity. Over a one-to-three year investment horizon, we determine tactical allocations to global equities, global bonds, commodities, and money markets based on valuations and our expectations for inflation and economic growth. In attempting to add additional value, we use active external investment managers with whom we have had years of favorable experiences.

Our three-to-five year strategic outlook is for modestly better global economic growth. The IMF and World Bank forecast US real GDP growth in the 2% range and about 3% globally with developed world inflation near 2% over the next several years. The OECD predicts a bit higher GDP growth in the US and world (2.8%/3.6%). In December, 2016 the US Federal Reserve forecast real GDP growth under 2% with PCE inflation of 2% from 2019. The global economy has been constrained by excessive debt and restrictive national fiscal policies which have hurt consumption in developed economies and growth in emerging economies. Unfavorable demographic trends and weak productivity growth in developed economies will continue to be drags on growth. Our one-to-three year tactical outlook suggests continued weak economic growth, modest inflation, US interest rates at a lower "neutral" policy rate than in past cycles and higher market volatility. We believe that the probability of a US recession sometime in the next three years increases sharply if the new administration does not get its fiscal policies mostly correct and in place by early 2018 which is a US Congressional election year. Congress' attention will turn from legislating to campaigning by mid-2018.

Based on our bottom-up fundamental input models, we expect public global equity market returns in the mid-single digits over our one-to-three year tactical investment horizon. US equities are fully valued from a historic perspective. A Shiller CAPE of 29 times trailing 10-year earnings implies a forward nominal return of about 5.5% over our investment horizon (barring a recession). Non-US equities (especially emerging markets) appear relatively more attractive based on valuations than US equities but a strong US dollar hurts returns to US investors in markets outside the US and we don't believe in hedging FX exposures in a long-term investment portfolio. The yield-to-maturity of the Barclays US Universal bond index, a broader market index than the US Aggregate, implies expected annual returns to US bonds under three percent. According to our scenario analysis, rising rates could reduce realized bond market total returns to under one percent over our tactical horizon but we view bonds as a key risk reducer and bond yields may not rise as much as had been expected. Market estimates of future short rates imply money market returns near 2% over our tactical horizon.

Risks over our investment horizon include excessive debt in major global economies which increases deflationary pressures that weaken growth. Using more debt to lever economic growth risks hitting a wall at some point and no one is sure where that point is. We are not convinced that the economic growth potential of the new administration's proposed policies would offset the negative impact of any increase in federal debt which is already over 105% of GDP. Rising interest rates would drive this ratio higher. Other risks include unanticipated inflation/deflation, a significant geopolitical shock or an emerging markets crisis like China's debt bubble bursting. The investment impact of the UK's exit from the European Union on both the UK and EU is likely to only be understood over the next several years. We believe that a break-up of the EU (the world's third largest economy) is an increasing risk.

Thank you for taking time to read our thoughts. Contact Greg Johnsen, CFA with questions or comments at: *gjohnsen@eastgateadv.com*. Greg's Linked In profile: gregjohnsencfa.

Important Disclosures

[1]The Eastgate Advisors' Moderate Risk global allocation composite return is the realized **net-of-fees and expenses**, asset weighted, geometric average total return of several public markets accounts of a private family investment office. Returns in excess of one-year are annualized. Returns are through **3-31-2017**.

[2] The Moderate Risk Allocation strategic benchmark is an unmanaged combination of broad market indices. It consists of 50% of the return of the MSCI All Country World ™ stock index (net), 40% of the Barclays US Universal Bond ™ index and 10% US treasury bills.