Eastgate Advisors

Eastgate Advisors, llc
Quarterly Review and Outlook

Index Returns	Quarter	1-Year	3-Years	5-Years
MSCI All Country World stock index	**5.2%**	**18.6%**	**7.4%**	**10.2%**
S&P 500 index	**4.5%**	**18.6%**	**10.8%**	**14.2%**
Barclays US Universal Bond index	**1.0%**	**1.0%**	**3.1%**	**2.5%**
Citi 3-month US Treasury Bill index	**0.3%**	**0.6%**	**0.3%**	**0.2%**
Bloomberg Broad Commodities Index	**2.5%**	**-0.3%**	**-10.4%**	**-10.5%**

Other Key Indicators	Qtr-End	Prev Qtr-End	Year-End 2016
10-Year US Treasury Bond Yield	**2.3%**	**2.3%**	**2.5%**
Credit Spreads Investment Grade Corporates vs US Treasuries	**107**	**115**	**130**
CBOE VIX S&P 500 index implied volatility (annualized %)	**9.5%**	**11.2%**	**14.0%**
Shiller S&P 500 Cyclical Price-to-Earnings Ratio (trailing 10-year)	**30.8**	**29.7**	**28.1**
Brent Crude Oil price/barrel	**$57**	**$47**	**$54**
Gold price/oz in USD	**$1,283**	**$1,242**	**$1,146**
US Industrial Production (y/y % change, seasonally adjusted)	**1.6%**	**2.1%**	**0.8%**
US Personal Consumption x food & energy (y/y % change, sa)	**1.3%**	**1.5%**	**1.9%**
US Consumer Price Index all items (y/y % change, sa)	**2.2%**	**1.6%**	**2.1%**
US 5-Year Inflation Expectations, 5-Years Forward	**2.0%**	**1.8%**	**2.1%**
US Real GDP (y/y % change, sa)	**2.3%**	**2.2%**	**1.8%**

Quarter in Review

Global stock indices hit record highs again during the quarter. The IMF reduced US growth expectations for 2018 while raising its global growth forecast. Political theater in Washington impeded key fiscal legislation while geopolitical risk on the Korean peninsula temporarily revived US stock market volatility in August after record lows. Major hurricanes hit the US during the quarter hurting employment growth but GDP surprised to the upside and domestic private investment in equipment grew by the most since 2015. The US Federal Reserve indicted its intention to begin unwinding its $4.5 trillion investment portfolio in October. The Fed Funds rate stood at 1.25% and the Fed indicated that it plans to raise the rate once more this year and up to three times next year implying a 2.25% target.

Eastgate Advisors' Returns	Quarter	1-Year	3-Years	5-Years	Inception
Moderate Risk Asset Allocation Net-of-Fee Composite[1]	**3.0%**	**9.7%**	**4.7%**	**6.0%**	**7.7%**
Moderate Risk Strategic Benchmark[2] (@ -10% down-side risk)	3.0%	9.5%	5.2%	6.1%	7.6%
Morningstar World Allocation Net-of-Fee Universe (762funds)	3.4%	10.5%	3.9%	5.6%	NA

Asset Class Allocations*	US Equities	Non-US Equities	Global Bonds	Commodities	Money Markets
Eastgate Moderate Risk Weight	**29.7%**	**24.5%**	**36.0%**	**2.9%**	**7.2%**
Strategic Benchmark Weight	**25.6%**	**24.4%**	**40.0%**	**0.0%**	**10.0%**
Eastgate Advisors Over/Under Weight	**+4.1%**	**+0.1%**	**-4.0%**	**+2.9%**	**-2.8%**

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

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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.

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 corporate credits 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.

Key Risk Metrics	Metric Value	Q/Q Change
Estimated 12-month down-side risk potential (@ 90% confidence):	**-4.4%**	**(+)**
Risk relative to the strategic benchmark (market leverage):	**1.0 x**	**(-)**
% of return explained by the strategic benchmark allocation (R^2):	**94%**	**(-)**
Estimated annual active risk (tracking error):	**1.0%**	**(-)**
Weighted average annual expense ratio:	**0.36%**	**(nc)**
Number of global stocks (idiosyncratic risk indicator):	**6,521**	**(+)**
Number of global bonds:	**8,891**	**(+)**
Estimated interest rate sensitivity relative to the strategic benchmark:	**91%**	**(+)**

Looking Ahead

I expect moderate global economic growth and low developed world inflation over the next one-to-three years. OECD leading indicators have been accelerating but the global economy has been constrained by excessive debt hurting consumption in developed economies. I believe that pent up US consumer demand for goods may be mostly exhausted after 104 months of expansion and could weigh on US growth prospects in 2018. I see evidence in declining auto sales and flat consumer credit aggregates. Rising rates would hurt consumer spending as debt service costs rise.

Monetary policy has become less accommodative in recent months (though still accommodative by historic standards) but I don't believe that the US economy needs more stimulus with low inflation and 4% unemployment. It is my opinion that comprehensive Federal tax reform (and not just tax cuts) would help raise secular GDP growth prospects but I am skeptical that this will happen prior to Congressional elections next year after wasted efforts on repeal and replace, the need to pass the fiscal 2018 budget, the slow pace of confirmations for key economic policy roles in the Trump administration and delayed start to the tax reform process.

US equity valuations, while uncomfortably high by historic measures are not, in my opinion, in bubble territory and I believe that healthy corporate earnings growth should continue into next year. Corporate share buy-backs and a declining supply of investable stocks (publicly traded stocks have fallen from over 8,000 to under 5000 US issuers) may drive part of this multiple expansion. Based on valuations and improving macro conditions, non-US equities, especially emerging markets, appear more attractive than US equities and a weaker USD has been supportive. The yield-to-maturity of the Barclays US Universal bond index (a broader index than the US Aggregate index) implies expected returns to US bonds under three percent over the next several years. US Treasury bond yields remain among the highest in the developed world. Market estimates of future short rates imply money market returns under 2% even if the Federal Reserve plans on higher rates.

Risks include debt build up in major global economies which increases deflationary pressures that weaken growth. An uncontrolled deflation of China's debt-bubble could result in a global recession. A repudiation of NAFTA by the Trump administration would cause harm to all three countries since Canada and Mexico combined are our biggest trade partners. Geopolitical risk (Korea is an example) can push investors into safe-haven investments (US treasuries, USD, gold) hurting risk asset prices. The impact of the Fed's balance sheet unwind on global capital markets is unknown but may be a drag on US economic growth if it pushes rates higher and could reverse the favorable effects of quantitative easing. The Federal Reserve may need to halt or reverse its "Quantitative Tightening" if the economy falls into recession in the next several years. In general, full valuations and abnormally low market volatility argue for caution rather than aggressive return seeking.

During the 3rd quarter we added small positions in Sequoia Fund (ticker SEQUX) to several of the accounts in the Moderate Risk composite. This fund had been closed to new investors since 2013. After a disastrous performance in 2016 and after its long time lead portfolio manager retired following a massive loss of assets, the fund reopened to new investors. We had paid attention to this fund for several years and when it announced its re-opening decided to add a 1% position in the Moderate Risk strategy. The fund has a concentrated value oriented portfolio of about 30 securities and will invest in US and non US equities, global fixed income and other assets that its managers feel are under-valued. Its biggest long-term holding is Berkshire Hathaway stock. We will add the fund to all accounts in the Moderate Risk strategy as we get a chance to rebalance them in the 4th quarter. We also plan to tactically increase emerging markets equity allocations to modestly above benchmark weights.

I note that while we lag our strategic benchmark slightly over three and five years on a net-of-fee basis, we continue to outperform the strategic allocation benchmark *before fees* across all reporting periods. This strategy is, by its nature, more conservative than many world asset allocation strategies and we have historically under-performed our peer universe in strong equity markets.

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 **9-30-2017**.

[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. Inception date of the Moderate Risk Allocation strategy is January 1, 2009.