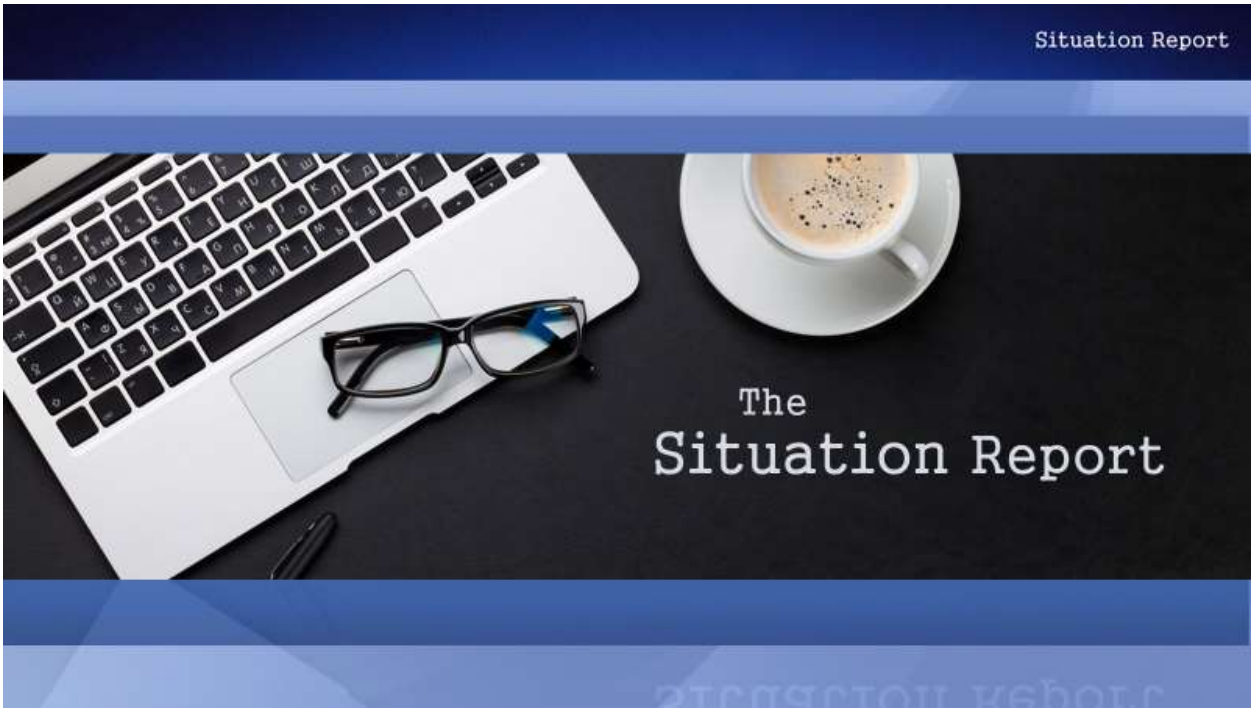
PROACTIVE CAPITAL MANAGEMENT—SPECIAL REPORT



March 2, 2020

THE CORONAVIRUS CORRECTION

Anyone thinking that the stock market would simply ignore the potential economic impact of the coronavirus pandemic is getting a wakeup call. Remember, computers run wild on days like these and they don't stop until the closing bell rings.

It's becoming clear that the economic impact of the Coronavirus is going to be substantial, especially in Asia. As far as Europe goes, it's likely that the continent also will see a slowdown in economic activity regardless if this outbreak turns into a true pandemic or not.

While the US is comparatively more isolated, a slowdown in Asia, Europe, and in other areas of the globe will impact U.S. company's corporate revenues and profits. While it’s too early to be sure this outbreak will turn into a worldwide pandemic event, this outbreak has created a notable correction in stock markets across the globe, and the U.S. is no exception.

For now, it is important to recognize that market watchers (including us) have been expecting (even hoping for) a pull-back in the markets.

Covid-19: *The Cornavirus* Source: CDC

A lot of people have been throwing the word "Pandemic" around a lot over the past few days. Interestingly, Dr. Anthony Fauci, director of the US National Institute of Allergy and Infectious Diseases, said earlier this month that there is no actual scientifically definitive definition of what constitutes a pandemic. "It really is borderline semantics, to be honest with you," Fauci said, adding that there could be arguments on either side as to whether the coronavirus outbreak could be described as a pandemic."

While the World Health Organization (WHO) recognizes that the virus is a serious problem, it's not acknowledging this as a pandemic event *yet*. Nevertheless, the US Centers for Disease Control and Prevention (CDC) with 86 confirmed cases is taking measures now to prepare for a possible US pandemic according to Dr. Nancy Meissonier, director during a press briefing last Friday. Source: CNN Health on-line.

How deep will the global slowdown be due to the virus?

It's difficult to estimate how deep the global slowdown will be because the situation concerning the Coronavirus is still developing.

Will the economic impact of the virus lead to recessions in key economies, including in the U.S.?

No one trusts the figures coming out of China about individuals that have the disease or the "*lethality*" of the virus. As the outbreak now has spread to countries with free presses and more advanced healthcare systems, we should get a better idea on how deadly this outbreak is and how fast it potentially can spread. If the situation continues to worsen in upcoming weeks some key economies in Asia and in Europe will likely fall into mild or possibly even severe recessions.

Could a bear market in U.S. equities develop as a result?

The expected correction in the US markets has arrived along with virus. It's possible we are on the precipice of a bear market in U.S. equities. Remember that historically the bear market is always well ahead of the recession. We're closely watching the economic numbers and factoring in the financial collateral damage likely to be the result of the Coronavirus.

In the early days of the *Great Financial Crisis* of 2008, traders learned the hard way that John Q. Public and his family will pull in the reins quickly if they get scared. And when the consumer stops spending, the U.S. economy slows down - fast.

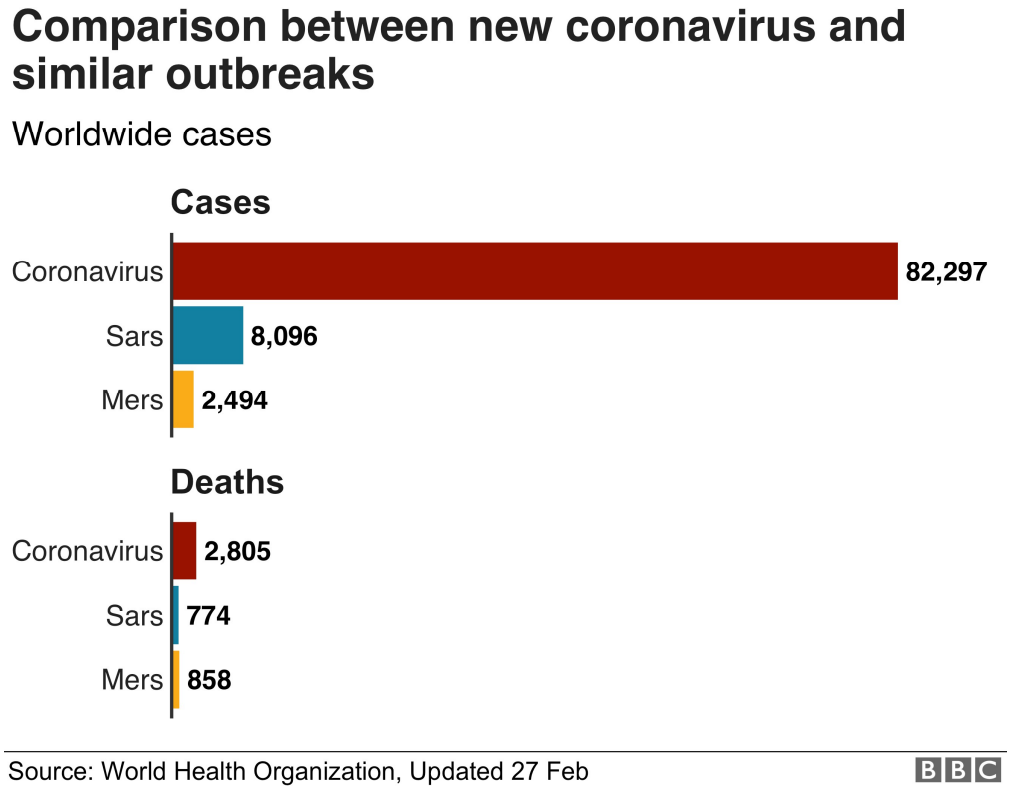
The bottom line is that until we have enough cases of the coronavirus across the US; folks are not likely to change their spending habits to any great degree. If the consumer doesn't change their spending habits, then the U.S. economy seems likely to survive. But the consumer can't do it alone.

Will the Fed Provide Support if Needed?

The Fed is watching. Probabilities of a rate cut at next month's meeting have increased to nearly 25% from just 4% one month ago. Furthermore, other key world banks like the Peoples Bank of China, Bank of Japan, European Central Bank, and others already are taking presumptive measures to combat the upcoming economic slowdown. While a bear market may not be imminent, it leaves one to ponder how long governments can continue to prop up their economies. And at what price?

So How is ProActive Playing this Market?

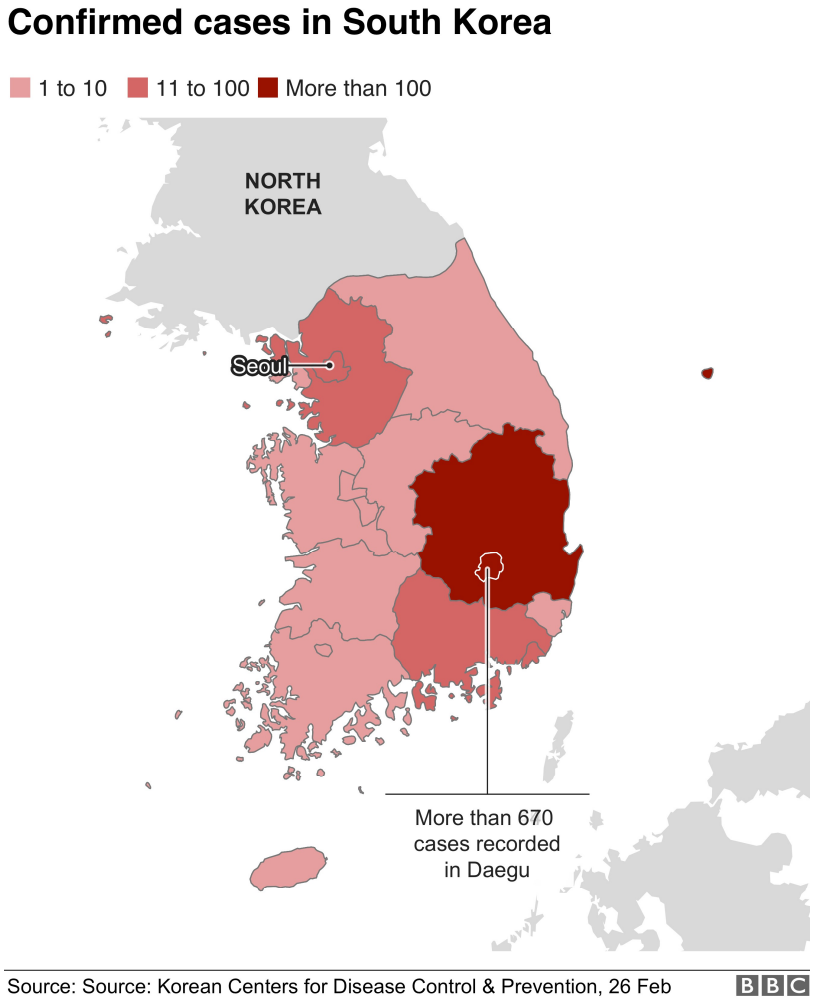
We are taking the Coronavirus very seriously. **We are tracking the Coronavirus through an amazing real time tracker website by Johns Hopkins University. Check it out here.**



It has been widely suggested that perhaps the Coronavirus will prove to be no worse than some of the other serious viral threats that were sensationalized in the past. Clearly this is not the case. It's already 10 times worse than the SARS outbreak with 10,000 more since this chart came out.

With no known cure; its long incubation period; and highly contagious nature; this is nasty stuff. There are now over 89,000 people **infected** to date, and the term *Pandemic* is not an exaggeration. Chinese authorities say daily **new cases** are falling, but investors don't have much faith in these censorship prone announcements. The "official" death toll in China from this virus is now 2,800 with global fatalities totaling 3,000 and growing daily.

More concerning is that virus has started to spread to other countries. South Korea, Italy and Iran have all seen outbreaks of cases in recent days with South Korea the worst-affected country after China.



Parts of South Korea are on lock down with 4,335 confirmed cases and 26 deaths and according to the Wall Street Journal, the Coronavirus it is spreading faster than it did in China. South Korea's biggest virus clusters have been linked to a religions group near the south eastern city of Daegu, which has a population of around 2.5 million people.

Italy has 1,694 confirmed cases with 34 deaths so far. Eleven towns in northern Italy are at the center of the outbreak—a total of 55,000 people have been quarantined. Schools, universities, and cinemas have been closed and several public events cancelled.

Elsewhere, in Iran, there have been 978 cases reported and 54 confirmed deaths from the disease Iran. The Deputy Health Minister of Iran has been **confirmed** to have the infection. Iran has been the source of dozens of cases in neighboring countries, including Afghanistan, Bahrain, Iraq, Kuwait, Oman and Pakistan. Lebanon and other countries also have reported their first afflicted individuals.

Economic Impact. We're even more focused on the financial impact of measures being taken to contain the virus. Global supply chains have been shut down, travel halted, and investors are spooked.

Apple (AAPL), **Starbucks (SBUX)** and other American multinationals have shut down a large part of their operations in China and this obviously will impact near-term revenue and earnings projections. The longer China remains mostly closed for business, the impact to the global supply chain will expand.

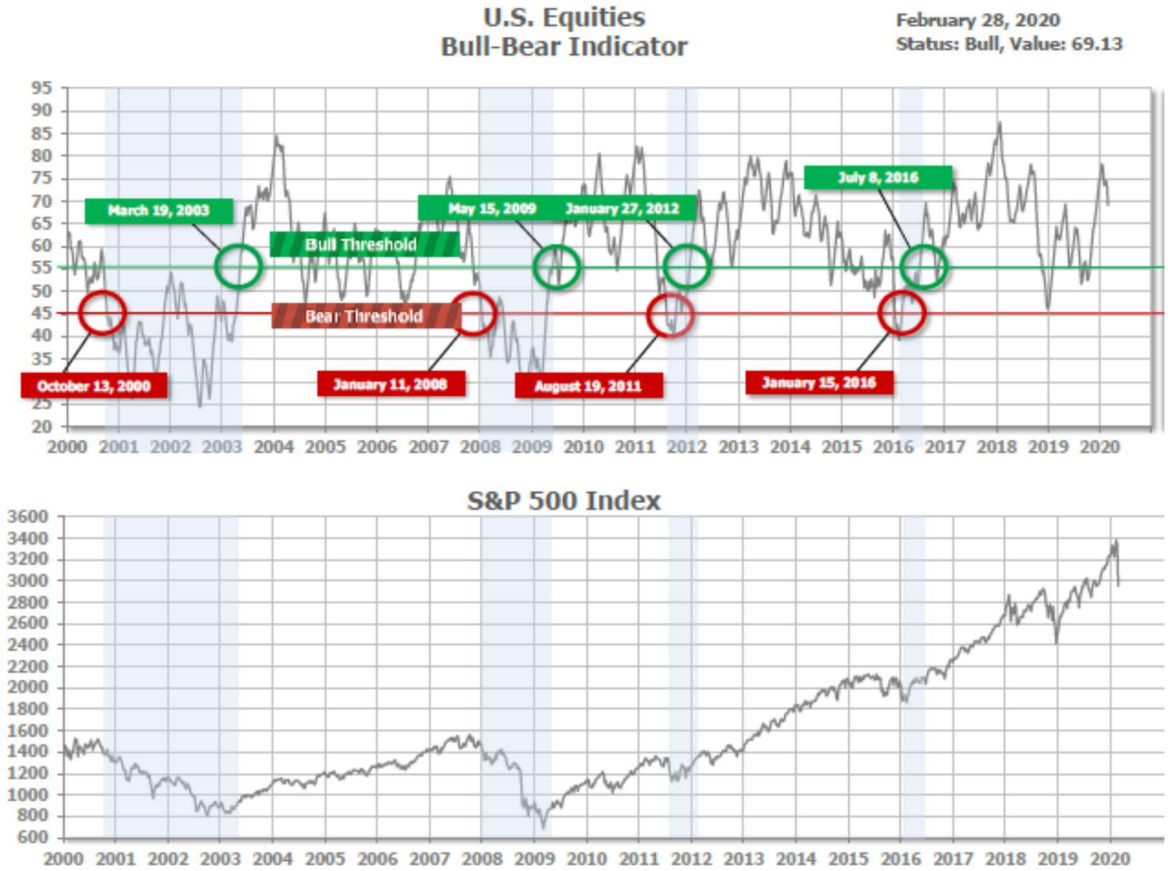
Automobile-related stocks are getting crushed and travel-related companies including cruise lines like **Royal Caribbean Cruises (RCL)** and airline stocks will be hit hard as they cancel cruises and flights. Commodity-based stocks, especially those related to oil, also are taking big hits on reduced global demand. None of these factors are good for the market's short-range outlook.

As of this writing, most major averages are now also below their 200-day moving averages. Historically when stocks are below their 200-day moving averages it means volatility on average is likely to rise and market conditions become more challenging. It's important to remember that a drop below the 200-day moving averages has happened several times in the past 10 years without causing an end to the bull market.

Stability Factors

Fortunately, over the last 1-2 years we have reduced risk in the models that we manage as we are clearly in the late stages of a bull market. In most of our TIAA accounts we have been out of equities (stocks). Across our models where we have equities, we'll continue to re-balance and reduce risk during rallies in the market. We are risk managers, and we will error on the side of caution.

Finally, as you know, we have great faith in our **Bull-Bear Indicator** to warn us when the bull market is over and it's time to act accordingly.



Our Cyclical Bull-Bear Indictor (upper chart) is like a barometer. It uses 90 different market data points to measure market "pressure." A high number of positive data points (above 55) are indicative of a strong market. When less than 45 data points are favorable the bear threshold has been crossed and market exposure reduction has usually been the prudent course.

The S&P 500 is now back to where it was in mid-October of last year. In the big picture, being set back by four months in the market doesn't typically raise an eyebrow. That's because such corrections have happened dozens of times in history. What makes this time seem different, however, is the *speed* of the decline.

The most memorable similar episode in recent times ended December 24th, 2018 after the S&P had fallen nearly 20%. Remember that the Bull-Bear Indicator stayed Bullish in response to that three-week sustained slide - even though it flirted with that Bear threshold, twice.

At 69, Our Bull-Bear Indicator, remains well within its Bull range.

DISCLOSURE

ProActive Capital Management provides asset management, financial planning, and investment advisory services on *a fee-only* basis, free from commissions and other sales incentives that can often drive advisory relationships.

ProActive Capital Management, Inc. (PCM") is a registered investment adviser as defined by the Securities Exchange Commission. PCM is registered with the Kansas Securities Commission. Such registration does not imply a certain level of skill or training.

Certain technology, research, charts and commentary are licensed from the W.E. Sherman Company for unrestricted use in our publications. PCM commentary also draws on research by Robert Shiller: Yale School of Management; Lance Roberts: Real Investment Advice Newsletter; InvesTech Research; Dow Theory Forecasts; J.P. Morgan Asset Management; Doug Short and Jill Minsky: Advisor Perspective charts, and other sources which ProActive Capital Management believes to be reliable. PCM cannot and does not guarantee the accuracy, adequacy or completeness of any such information.

The information herein has been provided for illustrative and informational purposes only and is not intended to serve as investment advice or as a recommendation for the purchase or sale of any security. The information herein is not specific to any individual's personal circumstances. The information or position applies to the date of release and will change over time. Since PCM meets with clients systematically, there is no obligation for us to continually update this periodical.

Past performance does not guarantee future performance. This commentary is prepared for clients whose accounts are managed by our tactical management team at PCM. No strategy can guarantee a profit. No investment strategy can protect clients from the effects of unforeseen *cataclysmic events* such as the 9-11 attack. All investment strategies involve risk, including the risk of principal loss.

PCM does not provide tax or legal advice. To the extent that any material herein concerns tax or legal matters, such information is not intended to be solely relied upon nor used for the purpose of making tax and/or legal decisions without first seeking independent advice from a tax and/or legal professional.

This commentary is designed to enhance our lines of communication, share our point of view, and to provide you with timely, interesting, and thought-provoking information. You are invited and encouraged to respond with any questions or concerns you may have about your investments or just to keep us informed if your investment goals and objectives change.