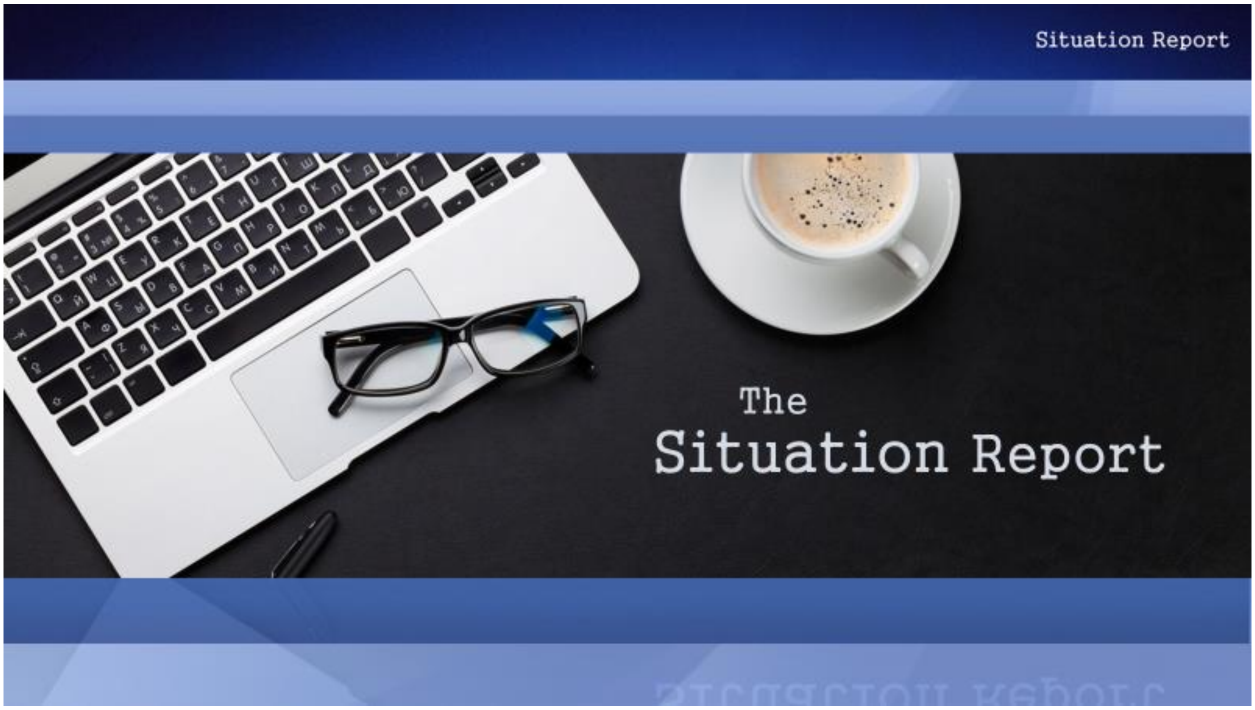


Well, here we are after an incredible year in the stock market. In fact, if Dow points were feet above sea level, the Dow would now be higher than Mount Everest!

Source: W.E. Sherman Research

And like the peak of Mount Everest, the air is thin up here!

The S&P 500 has fared even better than the Dow.

It took longer than expected, but the S&P 500 index reached 3000 in October. Since then, a sustained market run has attracted additional investors with another "leg-up" to beyond 3300 possibly in the making.

Price momentum has been in control of the markets over the last several months. Given that "an object in motion, tends to stay in motion," momentum is a hard thing to stop without a bigger event triggering a reversal in investor attitudes.

Last year, economists were worrying about the possibility of a recession. This year, they are trying to get their heads around a market that is booming too strongly. The new trendline, shown as the dark dotted line in the chart below, may be signaling "the new normal".

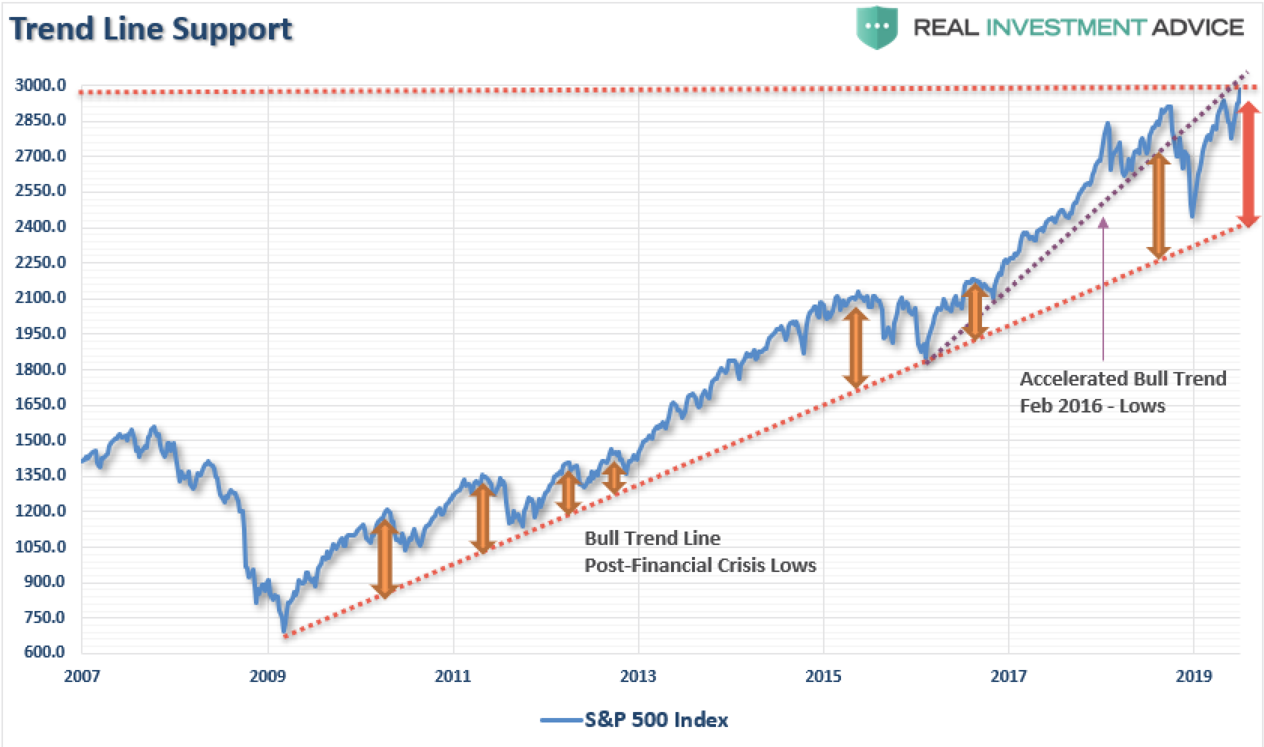
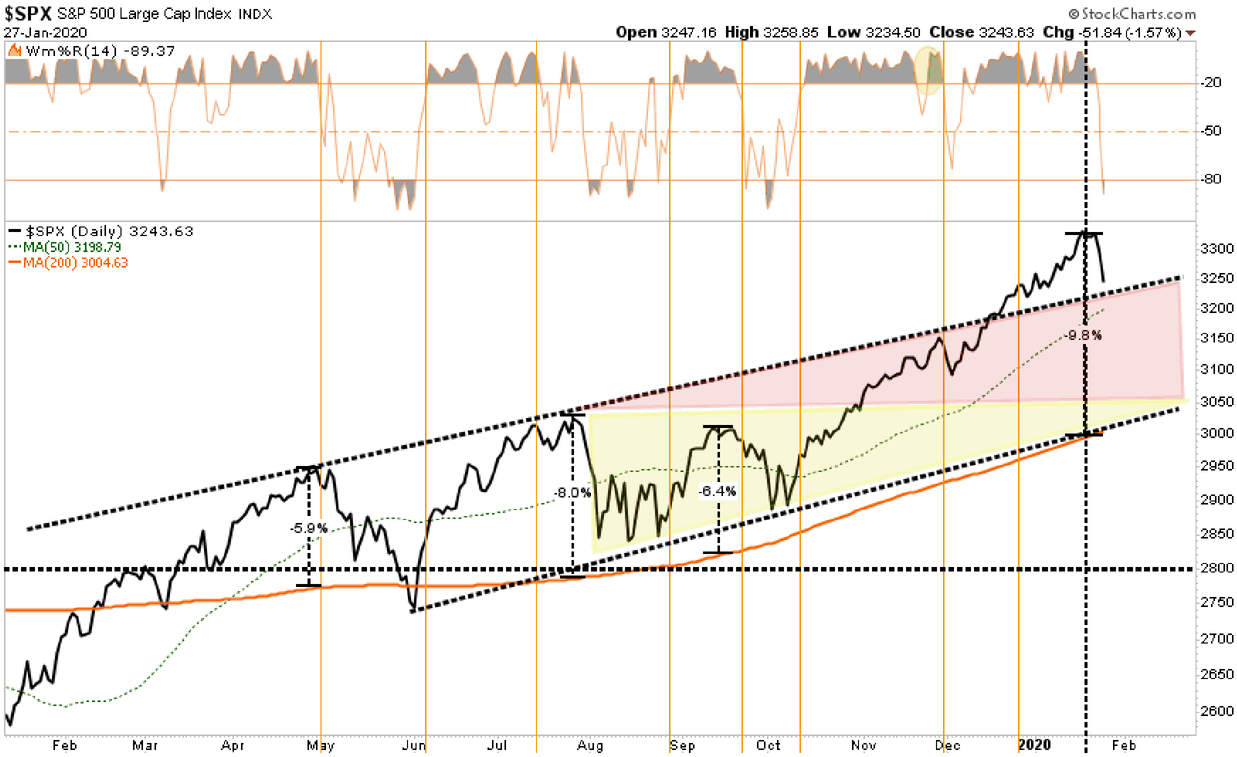


Chart Source: Lance Roberts—Real Investment Advice Newsletter

With the tax breaks passed in late 2017, a moratorium on Fed rate increases, and the Federal Reserve currently again pushing billions of dollars into the financial system, the market momentum has accelerated, as illustrated in the charts above.

While the possibility exists that the bull market may continue the momentum to excessive heights, history suggests that the current trajectory of the market is likely unsustainable. We would expect to see some type of a pull-back/correction in 2020. While our technical indicators are currently positive, they are at levels normally seen prior to market reversals. The chart below shows how much of a drop in the market it would take for it to hit its 200-day moving average (9.8% from its peak). Historically the 200-day moving average serves as support for markets, and this would be an important line for us to monitor if we did see a correction in the market.



From a historical perspective, a geopolitical event, a shift in expectations, or an unexpected event (epidemic?) or economic weakness in the U.S. or abroad, could send the S&P index back to a more sustainable trendline. This would be consistent with the "norm" we have seen in the markets for many years.

A reversion to the lower trendline on our Trend Line Support chart has occurred several times during the present bull market. With the market values currently so high, this would represent an extraordinary fall in market prices. It would be greater than the pull-back experienced in late 2018 and our Bull-Bear Indicator would be full bear market mode. At this point, that's something few people are expecting, but it is something we are keeping in mind.

Valuations Look Stretched

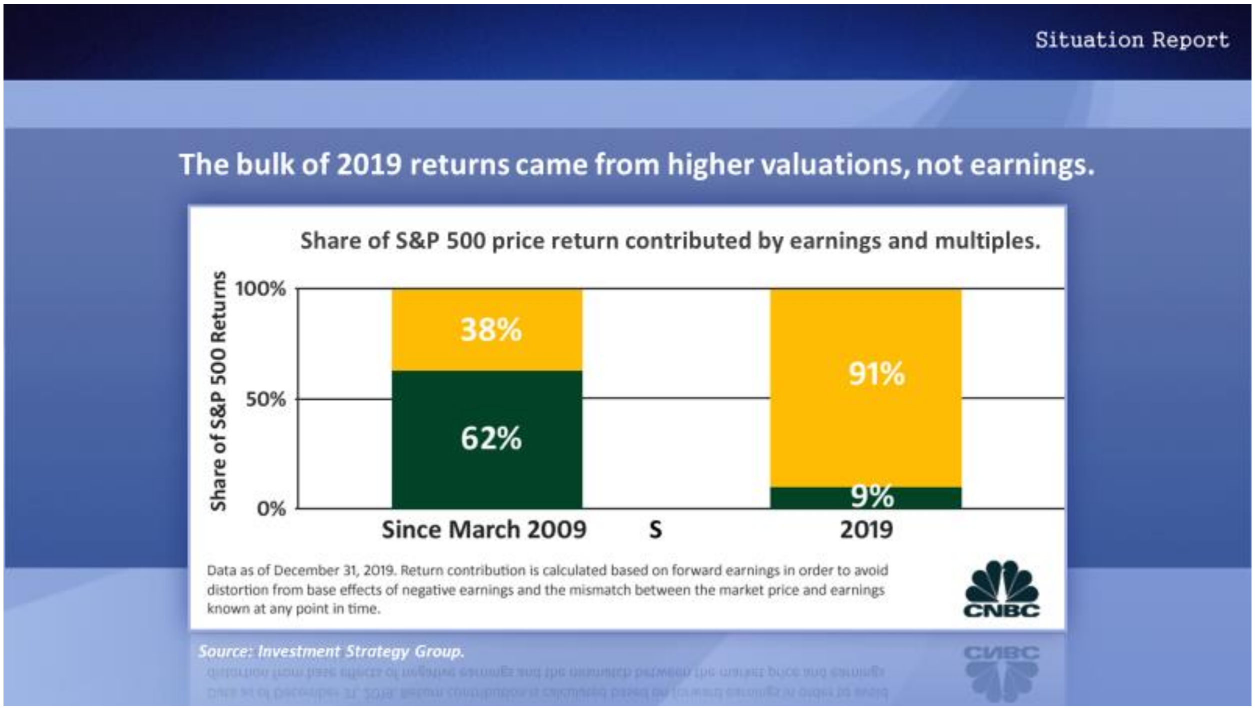
The relationships between stock valuations and market fundamentals, are dislocated**.** The charts above offer proof that markets are extended well above their normal long-term trendlines. Many fundamental economic gauges are inconsistent with current price levels and valuations. Stock market cap-to-GDP, price-to-sales, margin balances, cyclically adjusted price-to-earnings ratios, and other indicators tell us the large cap US stock market is well above historic valuations.

Most investors do not seem at all concerned as money continues to move into risky asset classes. In the past, this is a classic sign of a bubble. While a defensive posture seems prudent, the market momentum does not rule out further gains.

We remain respectful of the momentum behind the moves that have given us substantial gains in 2019. However, the momentum is propelled by continuing to flood the economy with liquidity and tamping down interest rates (heretofore only reserved for emergencies). This concerns us because it leaves the government with less ability to deal with the natural cyclical realities of expanding and contracting markets and the eventual reality of a bear market.

Without a sharp improvement in the underlying fundamental and economic backdrop, the risk of something going 'wrong' in 2020 is rising.

A Looming Earnings Recession?



It is always important to see how the market gains are achieved.

According to W.E. Sherman Research, in 2019, more than 90% of 2019's market index gains came from what analyst's term "multiple expansion." This means that the price of stocks is expanding (going up) much faster than the earnings.

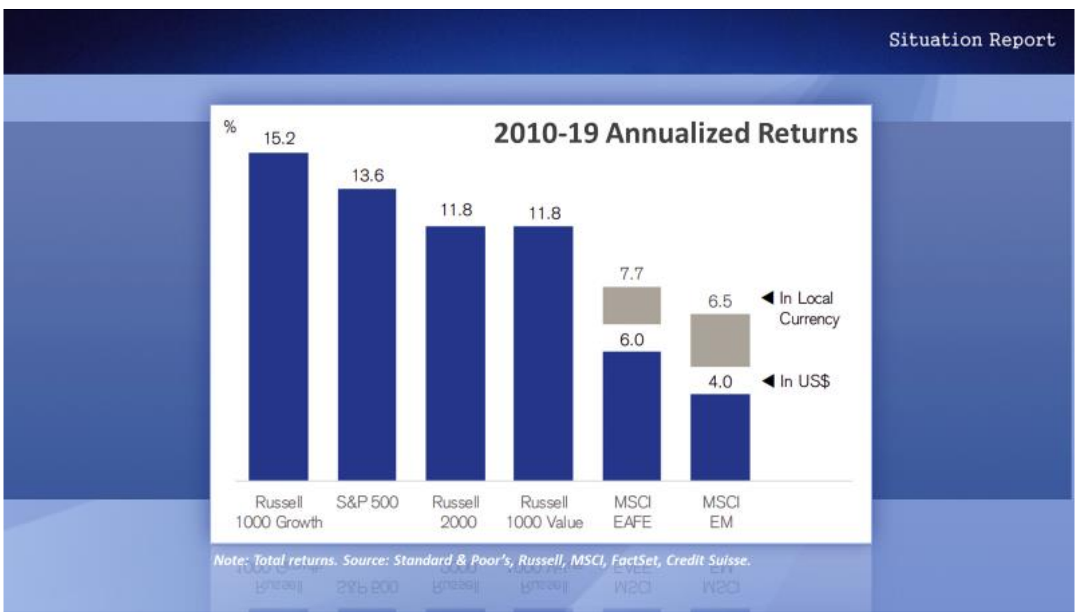
Earnings only contributed 9% to last year's gain in price. That's FAR less than normal. In fact, in a normal year since the beginning of this bull market almost 11 years ago, earnings could be expected to make up 62% of a stock's price.

That obviously can't continue, and – most concerning – gains built on multiple expansions in the underlying stock price can be quickly reversed and given back, since they are based on hope for the future and government intervention in the present, and not on real earnings which can provide a substantive floor to the inevitable market pull-back.

The question now is, what happens if earnings growth continues to retract, and valuations finally become a concern for market investors?

Investors who were not in US Large Cap (Blue Chip) stocks have been left far behind.

DFA's small-cap value fund, above, is little higher than it was a year ago, while the S&P 500 is up more than 25% over the same period. Even adding dividends, (1.2%) doesn't change the story.



The gains of the last 10 years have not been evenly spread out across asset classes. Diversification has been a money losing proposition. Gains have been dominated by Large Cap US Growth stocks. Small Caps, Value, and international stocks lagged. Emerging Markets returned barely more than one quarter of the gains of Large Cap US Growth.

If the markets are healthy as the Dow and S&P would seem to indicate, why aren't ALL markets enjoying the prosperity?

The S&P 500's top 5 stocks contributed more than 17% of the index's market capitalization in 2019.

This concentration of gains in Large Cap US Growth stocks has resulted in the market capitalization of the top 5 companies[1] (that's the top 1% - of the S&P 500 stocks) accounting for more than 17% of the total market cap of the entire S&P 500.

Some observers claim this has resulted in a vicious cycle in which index funds and ETFs (exchange traded funds) must keep buying these stocks to keep up with their ever-increasing share of total market cap, and the very act of their buying them drives the prices of these stocks even higher.

Obviously, today's rising tide in the stock market is not floating all boats.

Bullish Sentiment Is Slipping

The "Fear of Missing Out," was the overriding investor logic in 2019. One Month ago, investors were nearly as "bullish" as they can get at 92 on the CNN Fear & Greed Indicator. From a historical perspective, such a high Greed score is an obvious warning to at least temporarily reduce risk in the market.

[1] Amazon, Microsoft, Apple, Alphabet (Google Class A, & C shares) Facebook.

One Week ago, the CNN Fear & Greed Index was still in the "Extreme Greed" range at 77 which is much more likely to be the case nearer to the end of a bull run than its beginning.

Summary

Statistically speaking, the odds are suggesting that the market could indeed be higher in 2020. Our long-term Bull-Bear Indicator remains decidedly positive and our equity allocations in our more aggressive accounts remain substantial.

However, we have outlined a few of the several growing risks which could derail the markets. This discussion is an honest assessment of trends, statistics, and probabilities given the current monetary, financial and socio-economic backdrop.

While our more aggressive portfolios remain well stocked with equities currently, we do so with a strict investment discipline that has allowed us to mitigate the rising market risk by systematic profit-taking and by keeping our investment selections to those with lower risk ratings than our benchmark indexes.

If stocks do post gains in 2020, we will continue to prudently harvest some of the gains. As we have stated previously, participating in the bull market over the last decade is only one-half of the job. The other half is keeping those gains during the inevitable bear market cycle.

Our portfolio composition is determined by market opportunities or the lack thereof, rather than any predetermined commitment to a rigid allocation strategy. We continue to develop new and carefully considered investment portfolios for our clients. Our study of the natural market cycles combined with the consistency of our approach to risk management, has been integral to the success of our clients since 2003.

Preserving Capital and Making It Grow means delivering consistent positive risk-adjusted returns throughout entire market cycles, with a strong focus on risk management and capital preservation.

PROACTIVE HAPPENINGS

ProActive President and CEO, Nick Neukirch, was recently elected investment committee chairman of the Topeka Public Schools Foundation for a three-year term. The TPSF oversees the management of funds used to provide a variety of scholarships and financial assistance to TPS students. The investment committee also oversees the investments of the Hummer Sports Park Endowment.

The Topeka Public Schools Foundation administers scholarships to encourage continued study in college, university or technical school. Each scholarship has its own qualifying requirements and awards committee. If your family would like scholarship information, or if you are interested in offering a scholarship or donating, please contact the TPS Foundation office at (785) 295-3018.

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ProActive Sr. Vice President, and CIO, Jim Reardon J.D., CFP was re-appointed to the Board and Executive Committee of The Villages for a two-year term. He was also re-appointed as chairman of The Villages Investment Committee. Currently, the investment committee oversees the management of over $10,000,000 in endowed funds.

The Villages was founded in 1964 by Dr. Karl Menninger with the help of Chicago Philanthropist and noted self-help author, W. Clement Stone. The first group home opened its doors in 1969 surrounded by a 372-acre nature preserve located along the Kansas River. The Villages has provided stable, emotionally supportive homes in Topeka and Lawrence for children and youth who are at risk and in need of care and shelter. The Villages Homes offer a family-style setting rather than an institutional or orphanage presence.

See the Villages website at www.thevillagesinc.org

Regards,

Your ProActive Capital Management Team

ProActive Capital Management, Inc.

www.pcmks.com

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