The Case for Small Caps

Source: Internet, ETFTrends.com

By: 1492 Capital Management, LLC

Second Quarter 2016

Welcome to 1492 Capital Management Management's quarterly newsletter for the second quarter of 2016. In this quarterly newsletter, we are taking a different approach and foregoing our normal commentary on the market and small caps in particular. Instead, we are providing a ***Special Report*** on small caps and why this may be the most compelling time to buy small cap stocks since 2009.

Our corporate tagline is "Discovering Opportunity" which is our daily focus for our clients with our Small Cap Growth, Small Cap Value, Small Cap Core Alpha, and Small Cap Dynamic Hedge strategies. Our investment professionals possess a tremendous amount of experience navigating the current, choppy investment waters. 1492's time-tested strategies are based on a three-step process of identifying investment themes from hundreds of meetings annually with company executives, extensive tire-kicking of the financial statements, and a rigorous valuation methodology. Our job is to know what we own so that our clients will, too.

The first half of 2016 is in the books and what a ride it's been. First, there were the fears of a global recession to start the year which proved to be unfounded. Then just as sentiment and economic indicators were beginning to show signs of life, Brexit unexpectedly was approved by the citizens of Britain. A quick two-day, seven percent selloff and a subsequent rebound of nearly the same magnitude transpired all within a week's time. As dedicated readers of our quarterly newsletters know, we've been much more constructive on the market this year than many other prognosticators have been. As a matter of fact, all the major indices ended the second quarter in the green on a year-to-date basis. An improving fundamental backdrop was just beginning to emerge with improving economic statistics outnumbering weaker readings. While Brexit clearly throws some cold water on this improving backdrop due to the uncertainty it creates as nobody currently knows what it means in economic terms to Britain or the European Union, we doubt the impact will be big enough to derail an improving global economic backdrop. However, it more than likely creates a pause as corporations and investors alike try to figure out the lasting impacts to the European economy. This will likely take some time as policy makers aren't incented to come to quick decisions on how to gracefully remove Britain from the EU. We made the decision to forego our normal quarterly newsletter commentary before the Brexit vote took place. However, Brexit only emphasizes why domestic small cap stocks should be viewed, in our opinion, much more favorably given they have much less exposure to international markets than mid or large cap stocks. Couple this view with faster growth, the best relative valuations for small caps we've seen since 2009, and a very powerful merger and acquisition wave, and we believe you've got the recipe for a strong small cap outperformance cycle. Therefore, the balance of this quarter's newsletter is focused on ***"The Case for Small Caps"*** in which we try to dispel some common misperceptions of the small cap asset class and summarize succinctly why we believe it's a great time to invest in small cap stocks. It's an easy read as there are more charts and graphs than verbiage, so please read on to see our unique view of the small cap asset class.

If you would like to discuss this report or any of our strategies with us, please contact Tim Stracka at 414-238-3398.

Thanks to our clients and all those who have continued to support us over the past seven years as we build the best small cap investment firm in the country.

This presentation highlights the most compelling reasons for owning small cap stocks right now. The data included within this document is a combination of pieces culled from previous newsletters we've written and some documents we've recently pulled from Wall Street research.

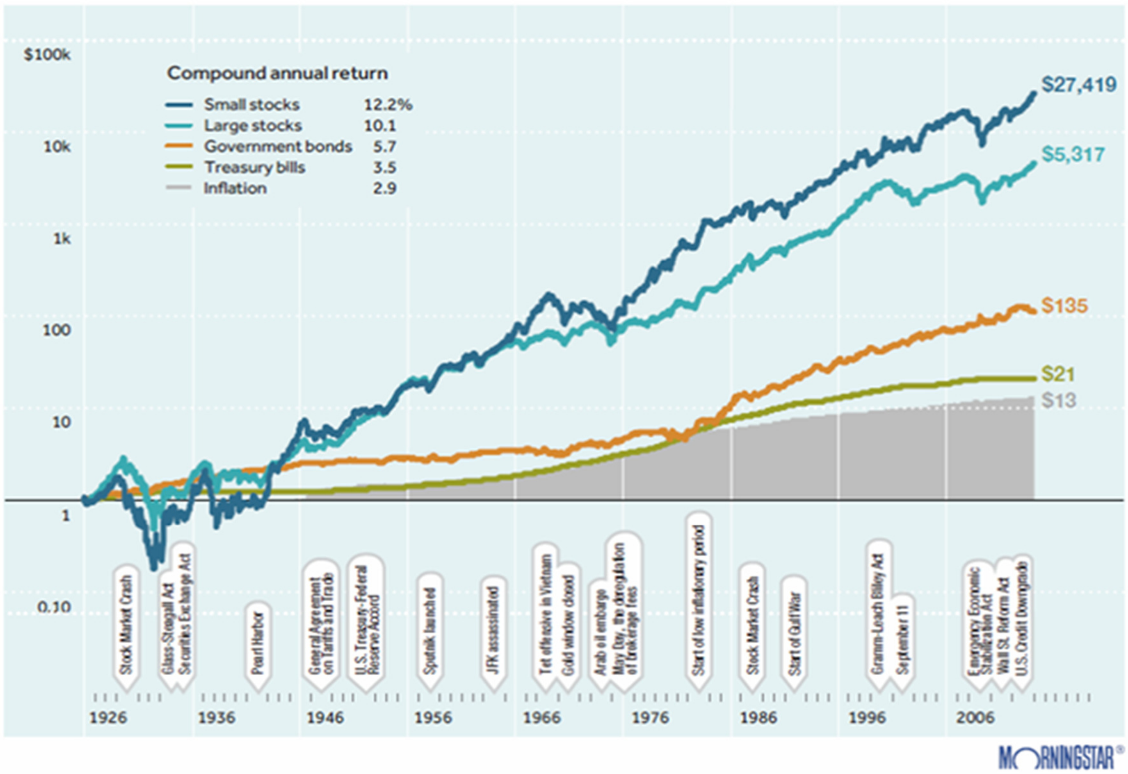
Before we get into the supporting data, we'd like to summarize what we believe are the most compelling reasons to own small caps at any point in time.

The Current Case for Small-Caps

- Expanding universe of small companies which continually refreshes through the creation of new companies, spinoffs, and IPOs, which provides an evergreen source of new investment opportunities.
- Cumulative results highlight the benefit of owning small caps over long-term periods.
- Excellent historical results following the worst market periods.
- Average small cap core fund has outperformed all but one hedge category over last twenty years.
- There are always small cap stocks with compelling valuations amongst the thousands of stocks in the small cap universe.
- Lower-return periods have favored small-caps.
- Lower exposure to weak international economies.
- M&A activity is setting up for a very robust period for small cap buyouts.
- There are exploitable inefficiencies in the small cap realm given fewer number of analysts following each stock.
- Insider ownership is at a much higher level in small caps helping to more closely align management and investor interests.

Historical Performance

The graph and table below show the performance of small caps relative to large caps, government bonds, and inflation over time. As you can see, small caps have outperformed large caps quite substantially over the long run.



While the numbers above may not look that impressive at first glance, the effect of compounding the annual differential over an extended period of time certainly makes a huge difference as the table below shows.

The Long-Term Advantage Offered by Small-Caps

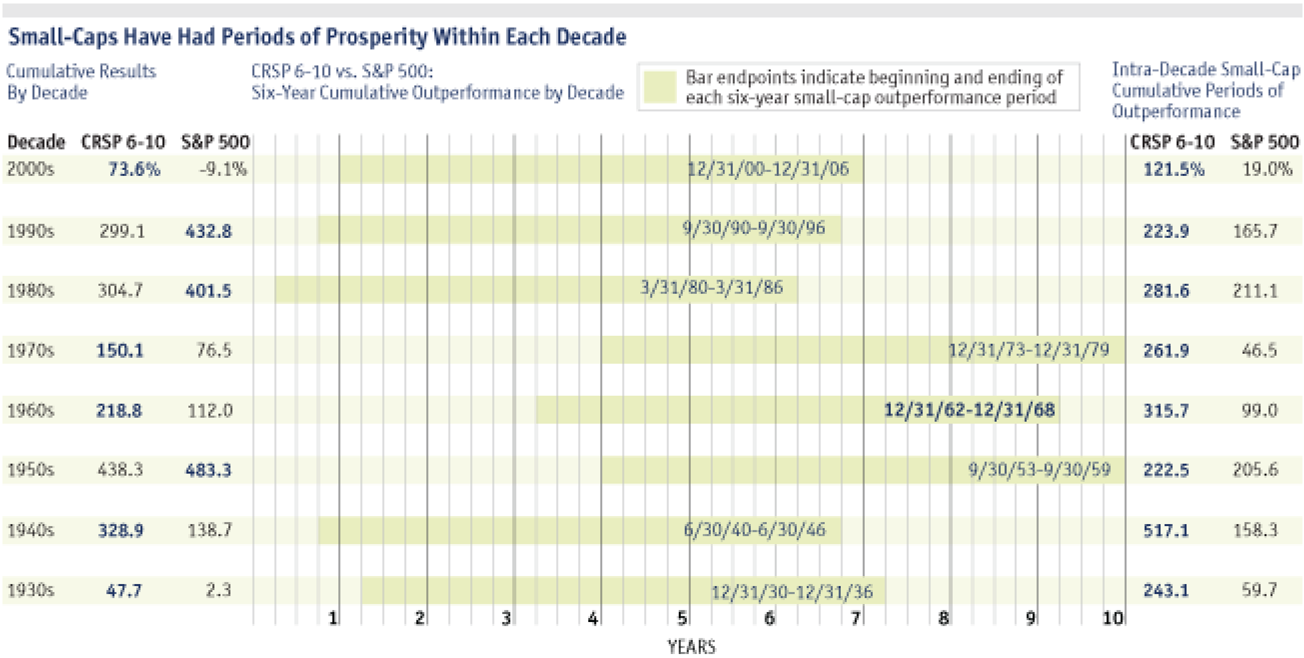
CRSP 6-10 vs. S&P 500: Total Returns December 31, 1925 - December 31, 2014

	CRSP 6-10	**S&P 500**
Cumulative Total Return	2,814,260.3%	523,686.7%
Average Annual Return	12.2%	10.1%
Growth of $10,000	$281,426,031	$52,368,651

Source: 1492 Capital Management, LLC

The table below shows small caps have had periods of significant prosperity throughout every decade going back to the 1930's. Each decade has had a 6 year period of outperformance by small caps.

Strong Intra-Decade Performance

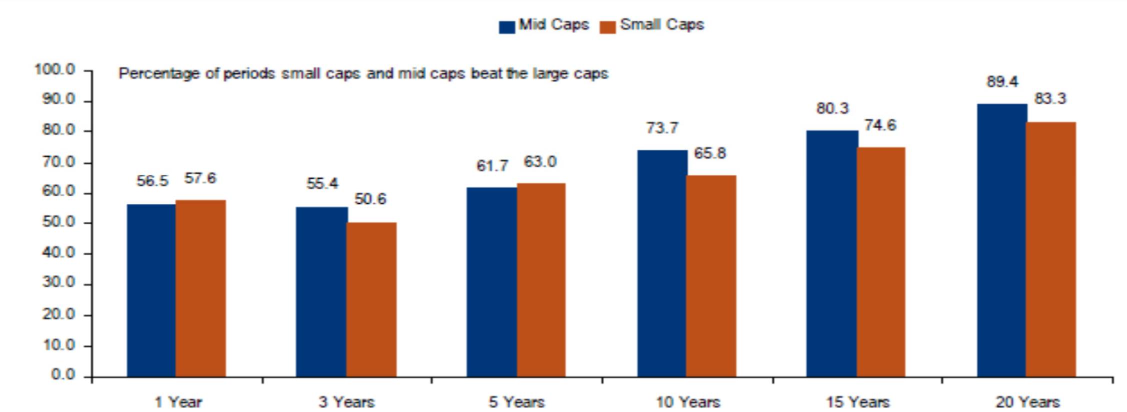


Source: Royce Funds

- High-return decades ('90s, '80s, '50s) favored large-caps
- Lower- and normal-return decades ('00s, '70s, '60s, '40s, '30s) favored small-caps
- Within each decade, small-caps enjoyed a six-year period of outperformance relative to large-caps

Looking at returns another way, the longer the holding period is, the higher the chances are that small caps outperform large caps. Think of this as the batting average of small caps beating large caps. In any single year, there is a 57.6% chance of small beating large. In any 20 year rolling period that percentage increases to 83.3%. Those are pretty good odds.

Chart 3: Percentage of periods small and mid outperforms large rises as holding periods extend



Source: BofA Merrill Lynch

If you believe that we are in a low to normal return environment, small caps should outperform based on historical precedent. The table below shows that in low to normal return environments, the propensity for small caps to outperform large caps approaches 100% of the observations.

Normal- and Lower-Return Periods Favored Small-Caps

Small-Cap and Large-Cap Outperformance by Quintile (Based on Quarterly S&P 500 Returns)
10-Year Average Annual Total Returns: December 1935 - December 31, 2011

10-Year Returns by Quintile	Range of Returns	CRSP 6-10 Outperformance Percentage	S&P 500 Outperformance Percentage
1st Quintile	>16.3%	18%	82%
2nd Quintile	>13.2% and ≤16.3%	36	64
3rd Quintile	>8.7% and ≤13.2%	90	10
4th Quintile	>4.9% and ≤8.7%	98	2
5th Quintile	≤4.9%	97	3

Source: Royce Funds

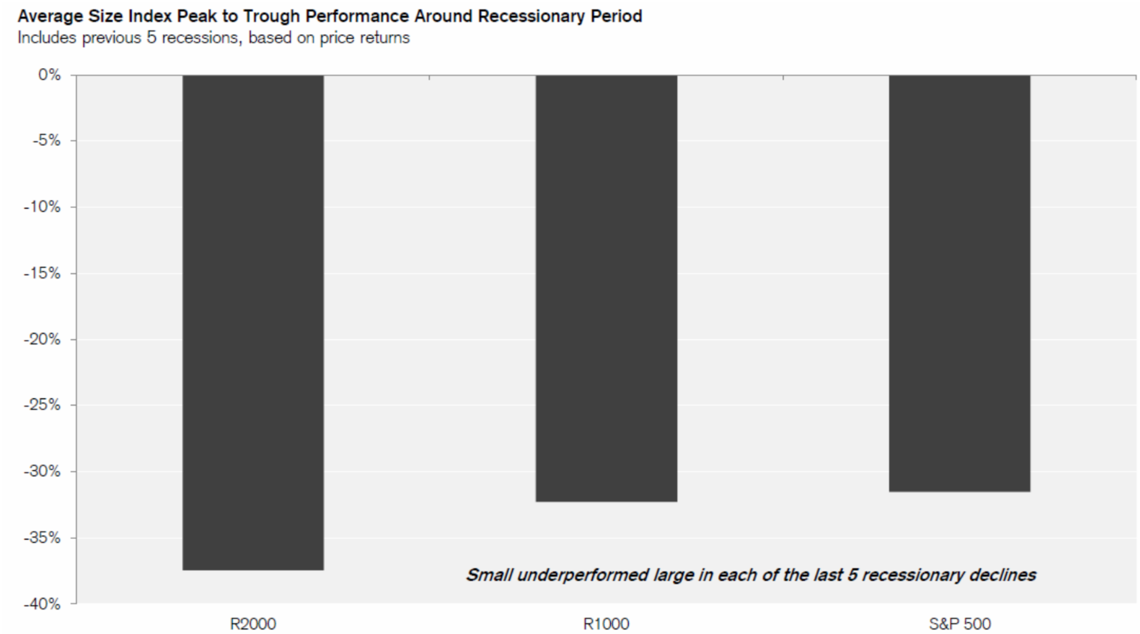
The tables below show how small caps perform in different ranges of real GDP growth. The table on the left highlights how small caps do on an *absolute* basis in different real GDP ranges and the table on the right shows how small caps perform *relative* to large caps in different real GDP ranges. Note that small caps have shown some of their best annual returns during periods of relatively slow GDP growth. The line highlighted in brown shows the historical performance of small caps during a period of real GDP growth of 2-3% which is currently the consensus forecast for 2016 and 2017. During the prior 11 annual periods in which GDP growth was 2-3%, small caps were up on average 22% and outperformed large caps by an average of 9% annually.

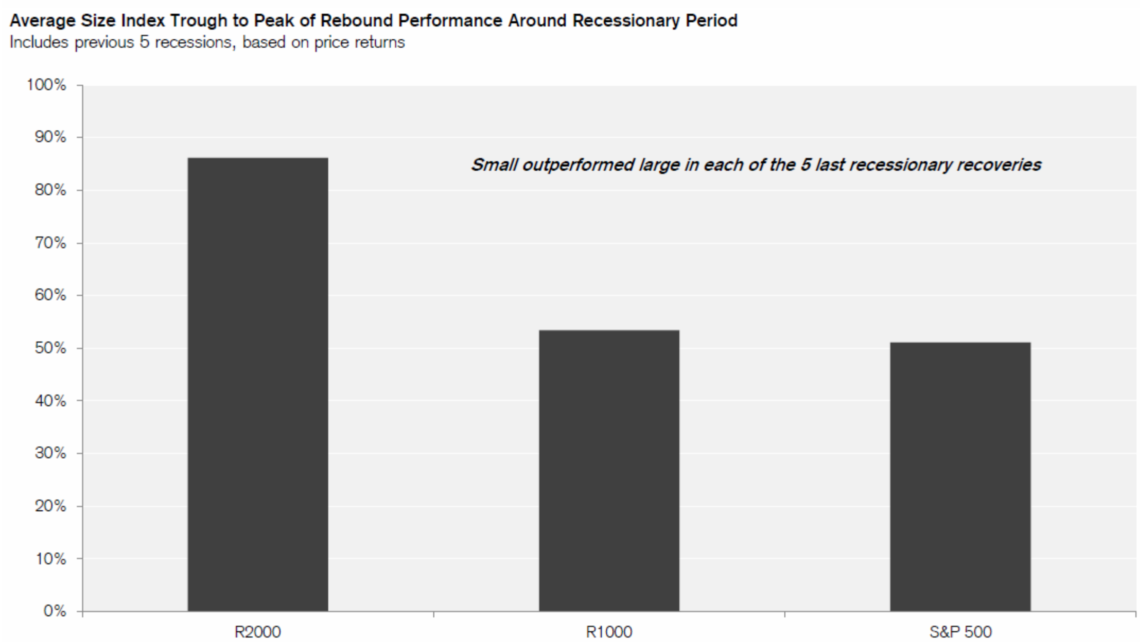
Real GDP Range	# Times	Small Cap Absolute Performance Avg	Max	Min	% Times Up
Above +10%	5	43%	88%	-9%	80%
8% to 9%	5	26%	54%	-5%	80%
7% to 8%	4	9%	20%	-7%	75%
6% to 7%	3	8%	42%	-12%	33%
5% to 6%	6	3%	57%	-58%	67%
4% to 5%	13	15%	36%	-6%	62%
3% to 4%	11	10%	43%	-25%	82%
2% to 3%	11	22%	84%	-15%	82%
1% to 2%	4	-10%	2%	-20%	25%
0% to 1%	2	-26%	-17%	-34%	0%
-1% to 0%	8	33%	65%	-20%	88%
-2% to -1%	3	80%	143%	25%	100%
-3% to -2%	1	27%	27%	27%	100%
Below -3%	5	-14%	33%	-50%	20%

Real GDP Range	# Times	Relative Performance: Small Less Large Avg	Max	Min	% Times Up
8% to 9%	1	7%	7%	7%	100%
7% to 8%	4	-9%	4%	-16%	25%
6% to 7%	3	10%	29%	-3%	67%
5% to 6%	5	5%	33%	-16%	60%
4% to 5%	13	2%	33%	-31%	54%
3% to 4%	11	-3%	24%	-17%	36%
2% to 3%	11	9%	60%	-9%	64%
1% to 2%	4	-2%	14%	-16%	50%
0% to 1%	2	-9%	3%	-21%	50%
-1% to 0%	8	9%	22%	-5%	88%
-2% to -1%	1	3%	3%	3%	100%
-3% to -2%	1	1%	1%	1%	100%

Source: Credit Suisse

There is likely a perception that small caps dramatically underperform large caps in recessionary periods. While the declines shown below aren't pretty, they aren't dramatically worse than mid or large caps. However, in coming out of recessionary periods, small caps have dramatically outperformed both mid and small caps (see second chart below).

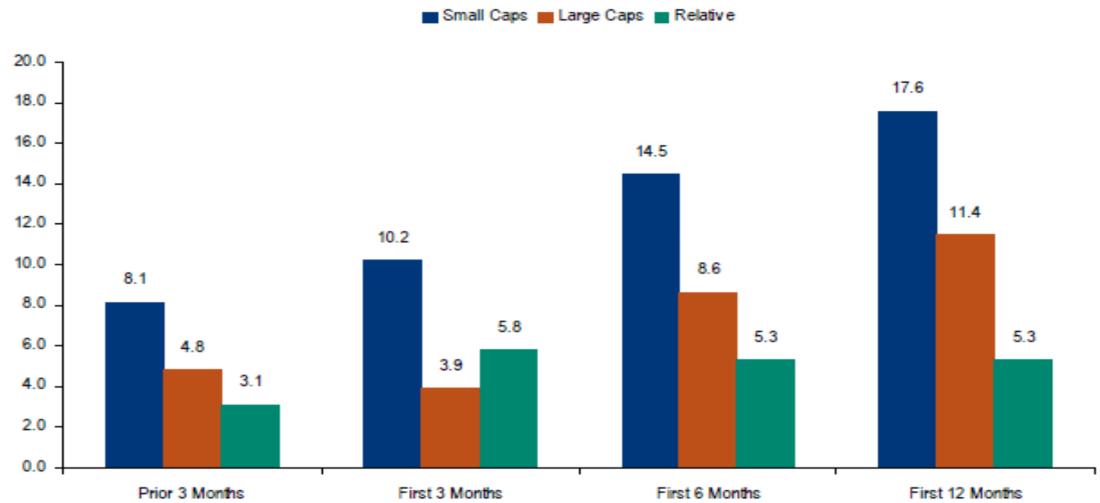




Source: Jefferies LLC

Surprisingly, small caps have outperformed large caps during the periods immediately following Fed rate hikes. If you believe that the Fed will continue to raise rates, small caps have a strong track record in this type of environment.

Chart 13: Small caps have outperformed even when the Fed has hiked interest rates

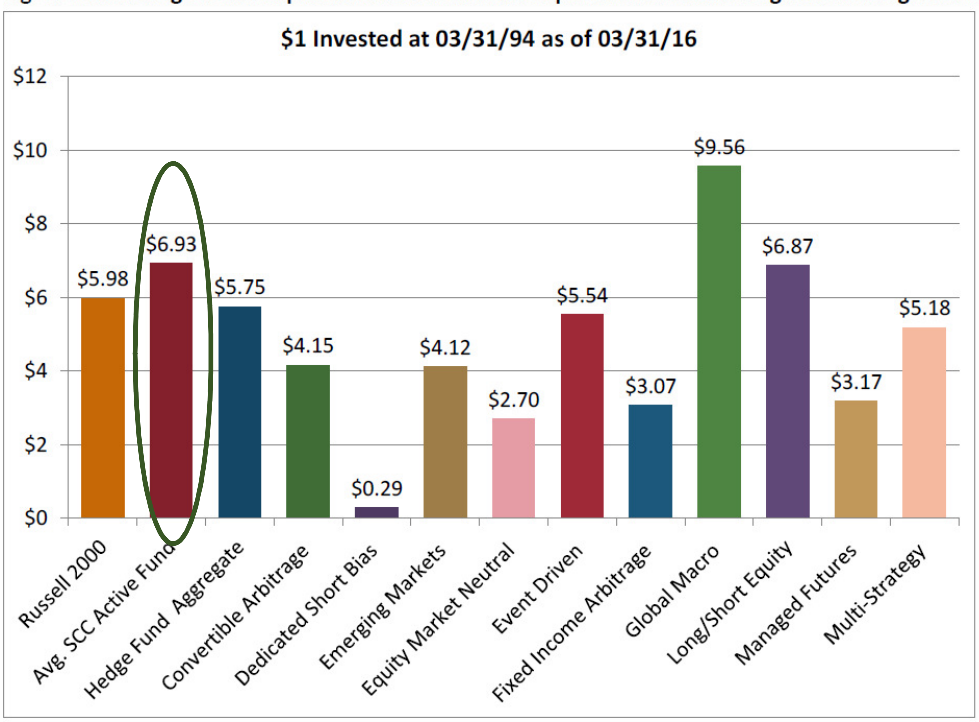


Source: BofA Merrill Lynch

Performance Vs. Hedge Funds

There has been a long running debate over the benefit of hedge funds and whether their performance was worth the price. After twenty years, we finally have data that shows that the average small cap core mutual fund has outperformed all but one category of hedge funds over this period.

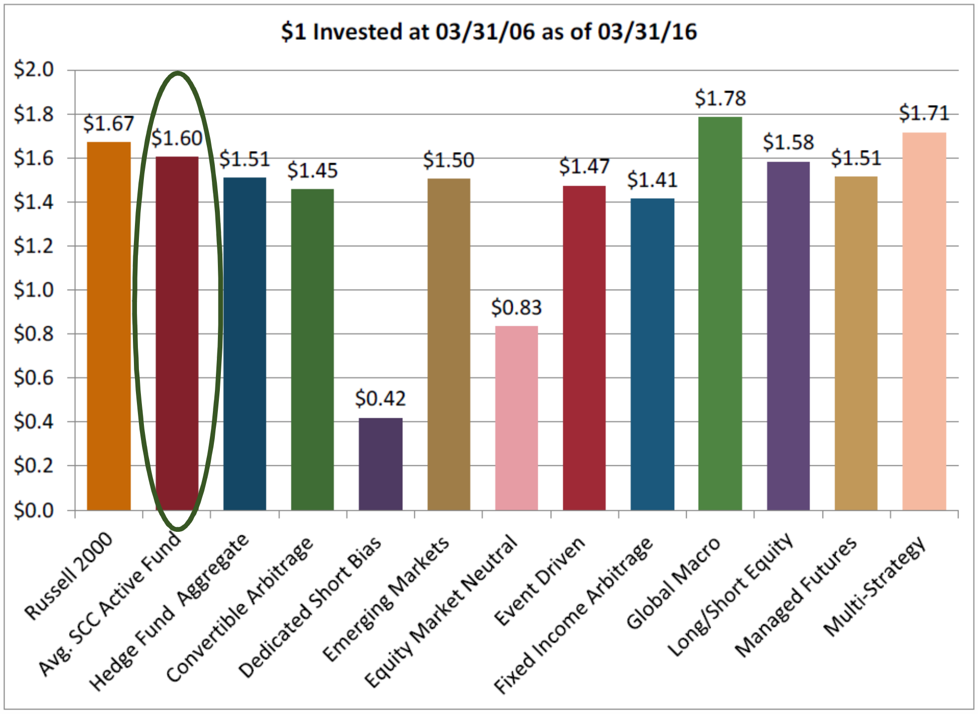
Fig. 2. **The average small-cap core active fund has outperformed most hedge fund categories since 1994...**



Source: FRP, FactSet, and Morningstar

The past ten year results show similar results as shown below.

Fig. 3. **…and in the past 10 years too**



Source: FRP, FactSet, and Morningstar

Risk vs. Reward

One of the common held fallacies amongst equity strategists is that small caps are riskier than large caps. We wrote on this topic in a newsletter several years ago and we have copied the excerpt below.

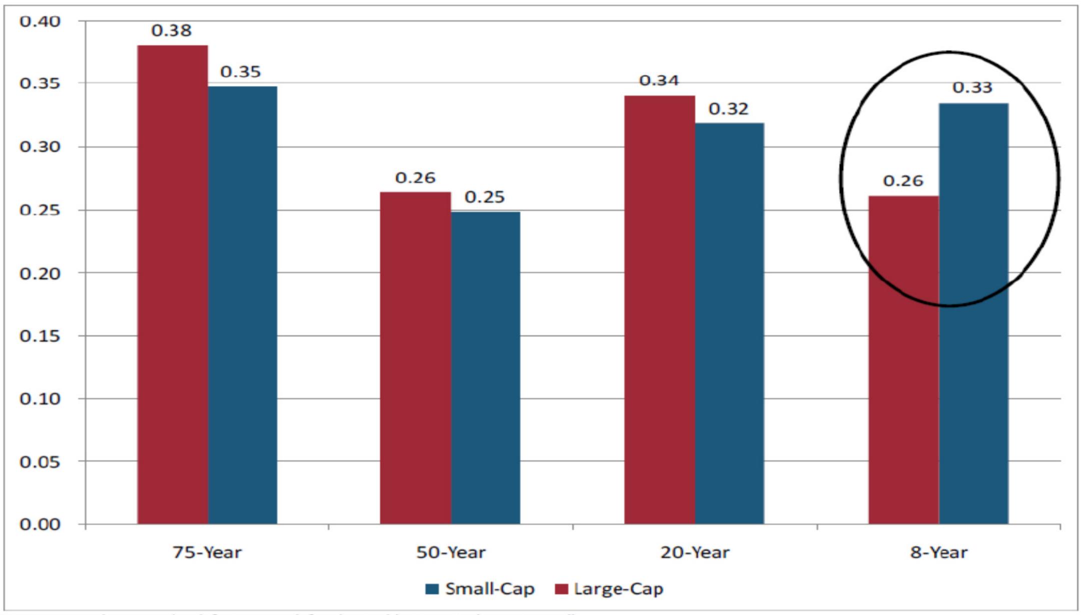
Debunking Long Held Market Notion - Small Caps Aren't Riskier

One of the longest held beliefs in the world of stocks is that small caps are riskier or more volatile than large caps and, therefore, one should own less of this asset class to counteract its volatility. While it is true that small caps have a higher standard deviation or volatility when compared to large caps, they also provide higher returns. Therefore, one must look at stocks similarly to how consultants look at money managers- taking into account the unit of excess return per unit of risk, otherwise known as the Sharpe Ratio. Without getting too technical, the Sharpe ratio was developed by Nobel laureate William F. Sharpe to measure risk-adjusted performance. The Sharpe ratio is calculated by subtracting the risk-free rate - such as that of the 10-year U.S. Treasury note - from the rate of return for a portfolio and dividing the result by the standard deviation of the portfolio returns. The Sharpe ratio is used to characterize how well the return of an asset compensates the investor for the risk taken. The higher the Sharpe ratio number, the better its risk-adjusted performance has been. The Sharpe ratio tells us whether returns are due to smart investment decisions or a result of excess risk.

Thanks to our friends at Furey Research for the tables and chart below which show that over the past 75 years small caps have been scarcely more risky than large caps and for the past 8 years they have actually delivered quite superior risk adjusted returns. This brings up an asset allocation issue that we always ponder as small cap managers. If consultants are going to index the large cap portion of the market (and by definition not generate any alpha) because few large cap managers have been able to provide significant sustained alpha over time, then why not shift more of these assets to active small cap managers who have shown the ability to provide alpha over time on a risk-adjusted basis? While we admit this issue is self serving as small cap managers, it also makes a lot of sense. One answer could be that small caps only account for 9% of total stock market capitalization versus 16% for mid caps and 75% for large caps, but therein lies the opportunity as well- to make an outside of consensus allocation.

Fig 16. **Small-Cap and Large-Cap Sharpe Ratios**

	Annualized Return		Annualized Risk		Avg. Risk	Sharpe Ratio		Coefficient of Variation	
Period	Sml-cap	Lrg-cap	Sml-cap	Lrg-cap	Free Rate*	Sml-cap	Lrg-cap	Sml-cap	Lrg-cap
8-Year	9.1%	6.2%	21.0%	15.8%	2.1%	0.33	0.26	2.31	2.55
20-Year	9.8%	8.7%	19.8%	15.2%	3.5%	0.32	0.34	2.02	1.75
50-Year	10.4%	9.3%	20.7%	15.2%	5.3%	0.25	0.26	1.98	1.63
75-Year	11.4%	10.0%	21.6%	16.0%	3.9%	0.35	0.38	1.89	1.60



Small-caps' Sharpe ratio in the past 8 years has been superior to large-caps.

Over the long-term, both small- and large-cap have similar Sharpe ratios with large-caps holding a slight advantage.

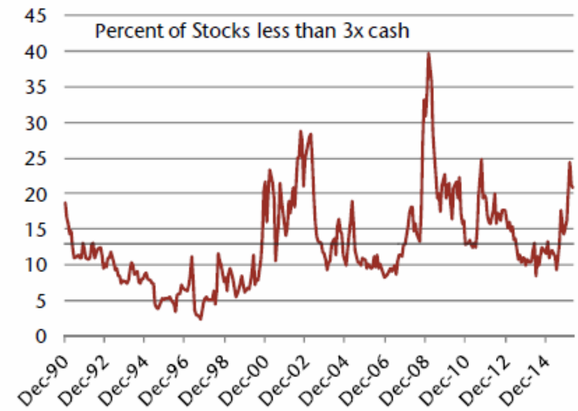
*Source: FRP and FactSet; *Risk-free rate is defined as yield on 3-month Treasury Bill*

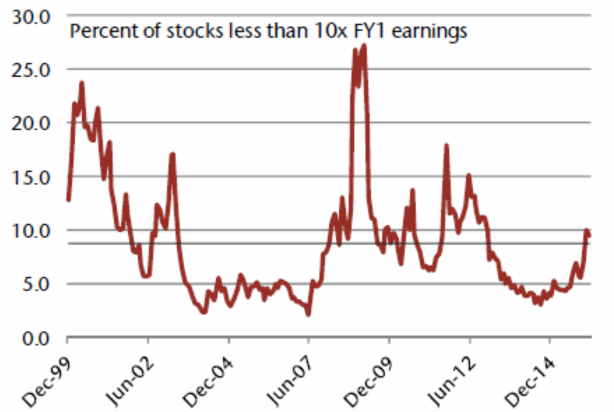
Valuation

We constantly here the arguments put forth by market strategists that you should own more large caps now because they are cheaper on a valuation basis. Below we highlight several excerpts from prior 1492 Capital Management newsletters highlighting various aspects of the valuation argument comparing small vs. large cap valuations. We believe we've identified some compelling arguments that poke holes in these strategists' claims.

As we have said numerous times in the past in this publication, valuation in small cap stocks looks quite compelling. Still, there are several equity strategists on Wall Street who claim small caps appear expensive relative to large caps. What they are missing is that they are comparing a subset of 2,000 stocks (Russell 2000) that have many non-earning companies that skew the price-to-earnings ratio of the index higher against the S&P 500 which only has 500 stocks in it, most of which earn profits. Therefore, we argue the point that it is a market of stocks and not a stock market, and if you remove those companies from the Russell 2000 that are non-earners, the valuation between small and large caps actually looks quite similar. The other point these strategists are missing is the balance sheet impact. Many of them only examine the price-to-earnings ratio of the stocks and in so doing they miss the part of the valuation puzzle that is extremely important and that is the balance sheet. Today, the average small cap stock has 19% of its market cap in cash on the balance sheet, which is ignored by using a price-to-earnings ratio.

The charts below highlight how compelling valuations are within the Russell 2000 Index currently when compared with the past 27 years. Over 20% of stocks in the Russell 2000 Index trade at less than three times cash on the balance sheet, and nearly 10% of those equities trade at less than 10 times earnings!





Source: Jefferies LLC

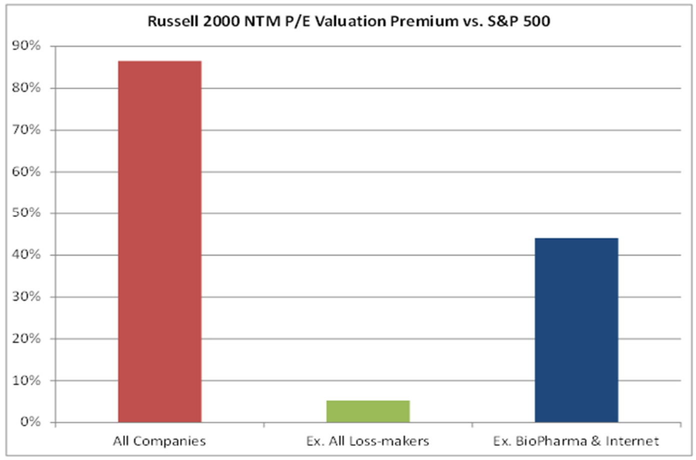
The excerpt below from a 2010 newsletter is still valid in explaining why talking heads who claim that large caps are cheaper than small caps are missing the boat. We've updated the numbers for 2016 but the argument is unchanged.

Small Caps are expensive vs. large caps and we already missed the run in small caps*- This is an ongoing debate that has been going on longer than the Hatfield and McCoy feuds. First, let's look at where the "market" is trading at versus the long-term average. The S&P 500, our proxy for the market, currently trades at 17.2 times trailing earnings. Whereas the long-term average over the past 42 years for the S&P 500 has been 16.7 times trailing earnings according to Ned Davis Research. On a forward looking basis the S&P 500 trades at 16.3 times earnings. Therefore, we conclude that the market is fairly valued relative to historical levels.*

Small caps currently trade at 17.5X forward earnings, which admittedly is higher than the forward P/E on the S&P 500 on the surface and we would argue that the valuation differential between small caps and large caps is only relevant if you are buying the index. But if you start looking under the hood, the thing many people miss when they make this comparison is that small caps have 19% of their market cap in cash on the balance sheet, which if accounted for properly, brings the valuation for small caps to a discount to large caps. Let's also remember that the Russell 2000 is an index of 2000 stocks as the name implies and the S&P 500 similarly has 500 stocks in it. Of the 2000 stocks in the Russell 2000, nearly 30% are non-earning companies which skew the P/E ratio up substantially. If you were to remove them from the calculation, the Russell 2000 P/E is quite similar to the S&P 500. Furthermore, drilling down one more layer, if you look at the number of stocks within the Russell 2000 and the S&P 500 that trade at less than 15 times 2016 earnings you would see 645 stocks in the Russell 2000 versus only 285 in the S&P 500, or 2.25 times as many. Therefore, the opportunity set for someone who is investing in a market of stocks and not the stock market is quite a bit more attractive from a valuation standpoint as you move down market cap.

The chart directly below highlights the valuation misunderstanding discussed above.

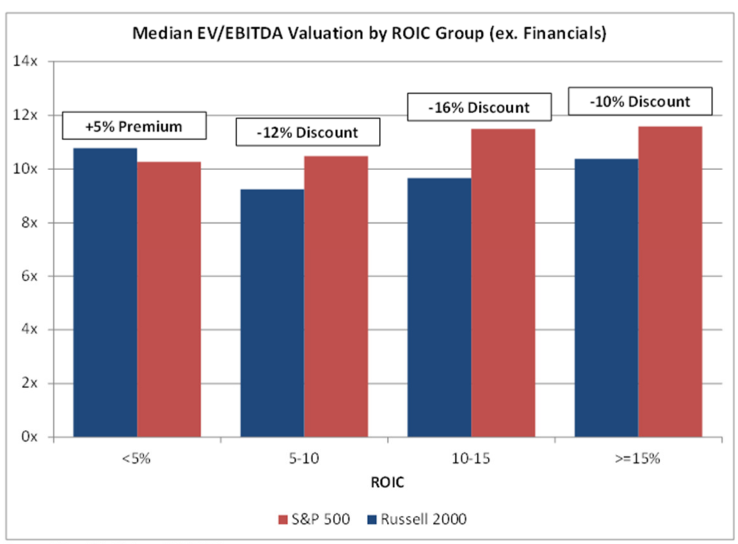
Small Cap Valuation is Often Misunderstood



Source: Furey Research Partners and FactSet; As of 8/31/15

Further, when you apply a valuation metric that accounts for the balance sheet, small caps look quite compelling compared to large caps, especially for the highest returning stocks within the Russell 2000 Index. As shown below, the top three quartiles of the Russell 2000 Index, in terms of ROIC, (return on invested capital) are currently valued at a 10% to 16% discount when compared to the S&P 500.

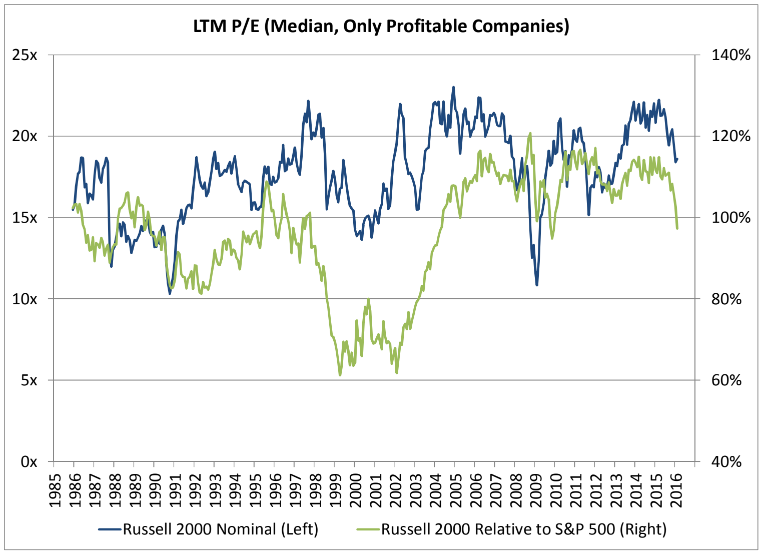
Inexpensive Stocks Can Be Found in the Highest Return Small Caps



Source: FRP and FactSet; as of 12/31/15

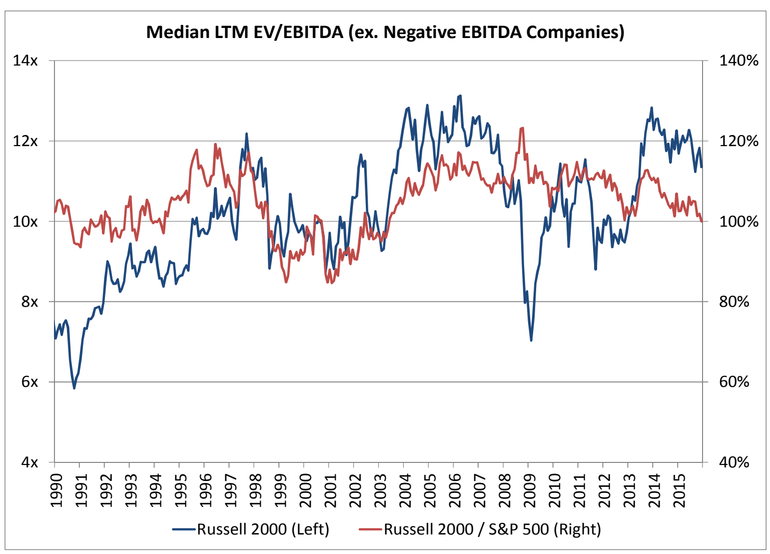
The next two charts below show that whether you use P/E ratios or EV/EBITDA multiples, small caps are the cheapest they've been relative to large caps since the early 2000's.

Small Cap Relative PEs Near Decade Lows



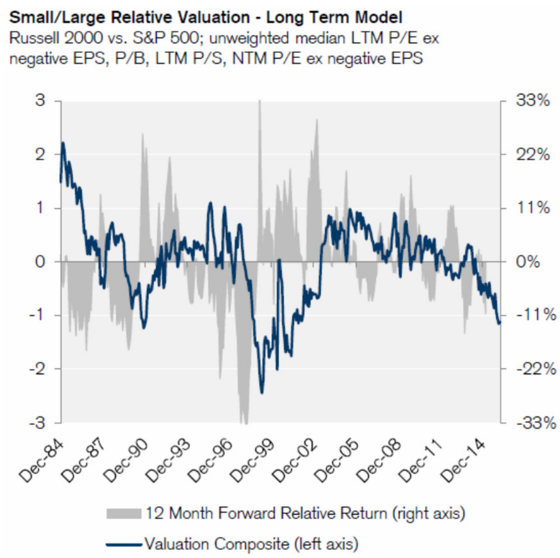
Small Cap Relative EV/EBITDA Also At Decade Lows

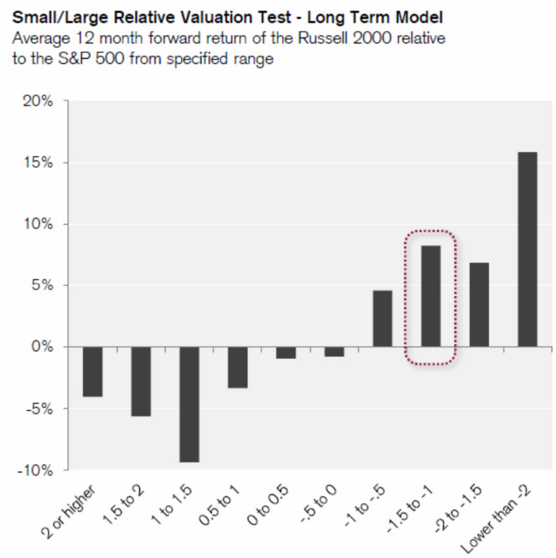
YE 2015 Relative Valuations are Compelling



Source: Furey Research Partners

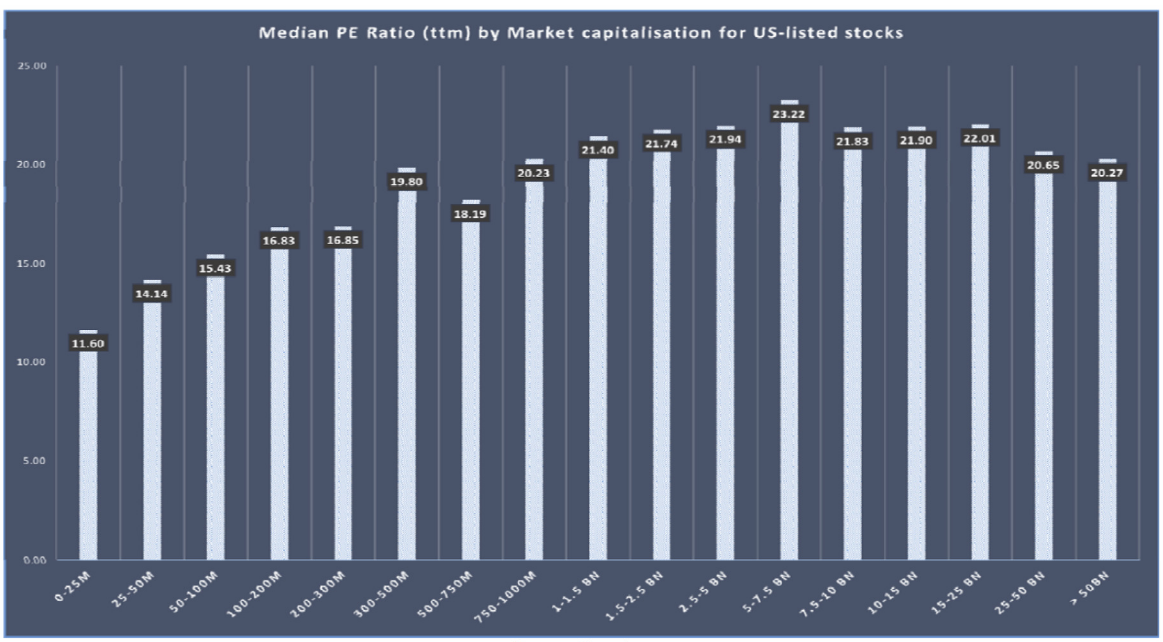
The chart below left looks at the relative valuation between the Russell 2000 and S&P 500 using a composite valuation methodology. Once again, the same conclusion is reached that small caps are trading at a double digit discount to large caps and normally this provides small caps with significant relative outperformance in the next 12 months. The chart on the right shows that on average, when trading at the current relative discounted valuation, small caps should outperform large caps by nearly 800 basis points over the next 12 months.





Source: Credit Suisse

Further, the smaller the market cap, the cheaper the valuation. The smaller the market cap, the worse the performance trend has been in place since March 2014. This performance combined with better earnings down market cap has created an anomaly you don't see too often: valuations are cheaper the more you move down market cap.



Source: Quantr.co

Active Management vs. ETF's

One of the many arguments against active managers is that investors can get the same exposure to small caps via ETF's and pay a lower fee. While the fee argument may be correct, there is definitely a case to be made for alpha generation by a skilled manager. The argument for active management in its simplest form is shown in the table below by Wisdom Tree. They argue that their ETF's which are actively managed based on different weighting of the stocks in a given index driven by valuation adds value. Think about the alpha that can be generated by managers who don't own the entire index and can cherry pick the very best ideas from a universe of thousands of stocks.

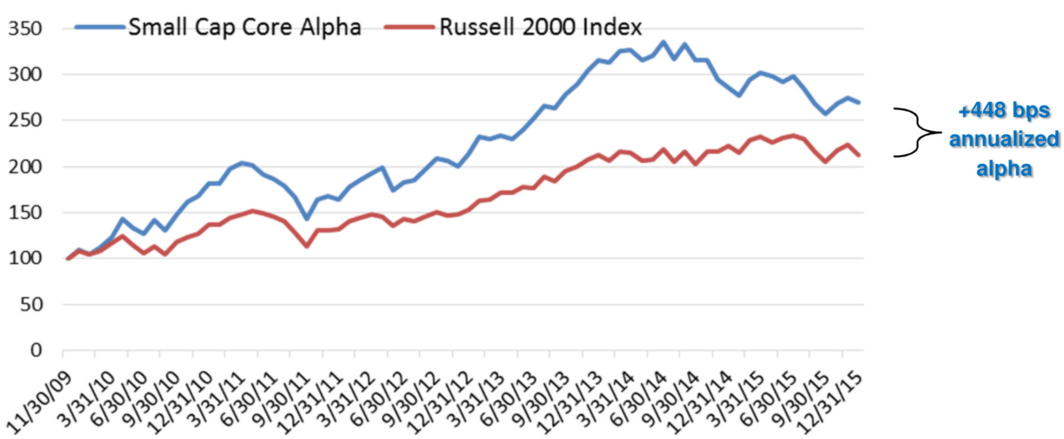
HYPOTHETICAL EXAMPLE

Company	Market Cap (millions)	Earnings Stream[19](millions)	P/E Ratio	Market Cap Weight	Investment	Weighted P/E Ratio	Earnings Weight	Investment	Weighted P/E Ratio
A	150	25	6	13.64%	$13,636		33.33%	$33,333	
B	250	25	10	22.73%	$22,727		33.33%	$33,333	
C	700	25	28	63.64%	$63,636		33.33%	$33,333	
Totals	1,100	75			$100,000	14.67		$100,000	9.92

Source: WisdomTree

WisdomTree's methodology essentially says that the companies generating the greatest core earnings receive the highest index weights and therefore those stocks will have the greatest potential impact on subsequent returns. It is important to note that for its U.S. core size-based Indexes, WisdomTree looks at S&P's measure of "core earnings" as opposed to net income[20]. The idea in doing so is to capture as closely as possible what are believed to be repeatable earnings due to ongoing business operations, and not one-time gains, divestitures or asset dispositions. Using WisdomTree's approach on this hypothetical portfolio of three stocks, all with the same level of hypothetical earnings, the portfolio P/E ratio was reduced from 14.67x (market cap-weighted result) to 9.92x (earnings-weighted result), or by about 30%.

The charts shown below represent the performance of 1492 Capital Management's Small Cap Core Alpha and Small Cap Value strategies. As you can see we have added a significant amount of alpha in each strategy since inception, after fees. You can see the power of compounding this alpha over a number of years in the tables below each chart. *Alpha in the two performance tables below is calculated using the gross returns provided. See the appendix for a GIPS compliant table and disclosures.*

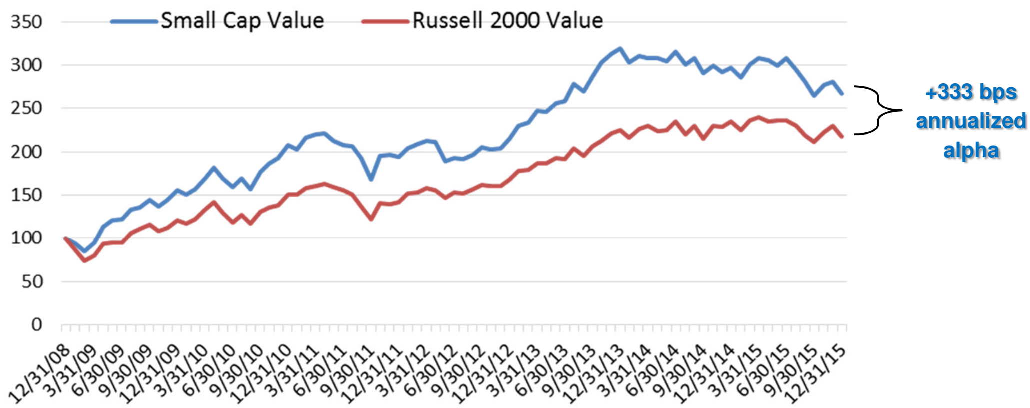


Supplemental Information as of 12/31/2015

Inception date: 12/1/2009	QTD	YTD	1-year	3-year*	5-year*	Annualized Since Inception	Cumulative Since Inception
Gross Return	4.64%	-5.75%	-5.75%	7.97%	8.21%	17.69%	169.38%
Net Return	4.45%	-6.50%	-6.50%	7.03%	7.24%	16.60%	154.62%
Russell 2000 Index	3.59%	-4.41%	-4.41%	11.65%	9.19%	13.21%	112.70%
Alpha	1.05%	-1.34%	-1.34%	-3.68%	-0.98%	4.48%	56.68%

* = Annualized return

A $100,000 investment in our Small Cap Core Alpha strategy at inception (12/1/2009) would have grown to $254,620 net of fees compared to $212,700 for the Russell 2000 Index.



Supplemental Information as of 12/31/2015

Inception date: 1/1/2009	QTD	YTD	1-year	3-year*	5-year*	Annualized Since Inception	Cumulative Since Inception
Gross Return	0.60%	-10.13%	-10.13%	7.48%	5.20%	15.05%	166.78%
Net Return	0.38%	-10.92%	-10.92%	6.54%	4.28%	14.10%	151.74%
Russell 2000 Value	2.88%	-7.47%	-7.47%	9.06%	7.67%	11.72%	117.25%
Alpha	-2.28%	-2.66%	-2.66%	-1.58%	-2.47%	3.33%	49.53%

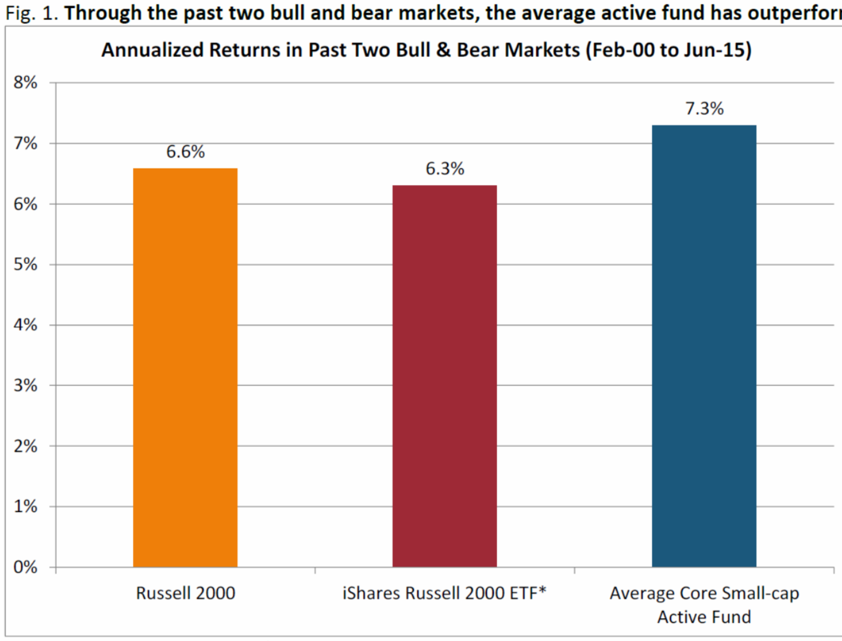
* = Annualized return

Source: 1492 Capital Management, LLC

A $100,000 investment in our Small Cap Value strategy at inception (1/1/2009) would have grown to $251,740 net of fees compared to $217,250 for the Russell 2000 Value Index.

While the active vs. passive debate rages on, the proof is in the pudding. The chart below shows that over the past two bull and bear market cycles, the *average* small cap core mutual fund has outperformed the Russell 2000 Index and Russell 2000 ETF. Given you can't buy the Russell 2000 Index, the real comparison is in the Russell 2000 ETF vs. the average small cap fund. In the past 15 years, active management has added 100 basis points of alpha after fees, using the average small cap manager – not to mention an outperformer.

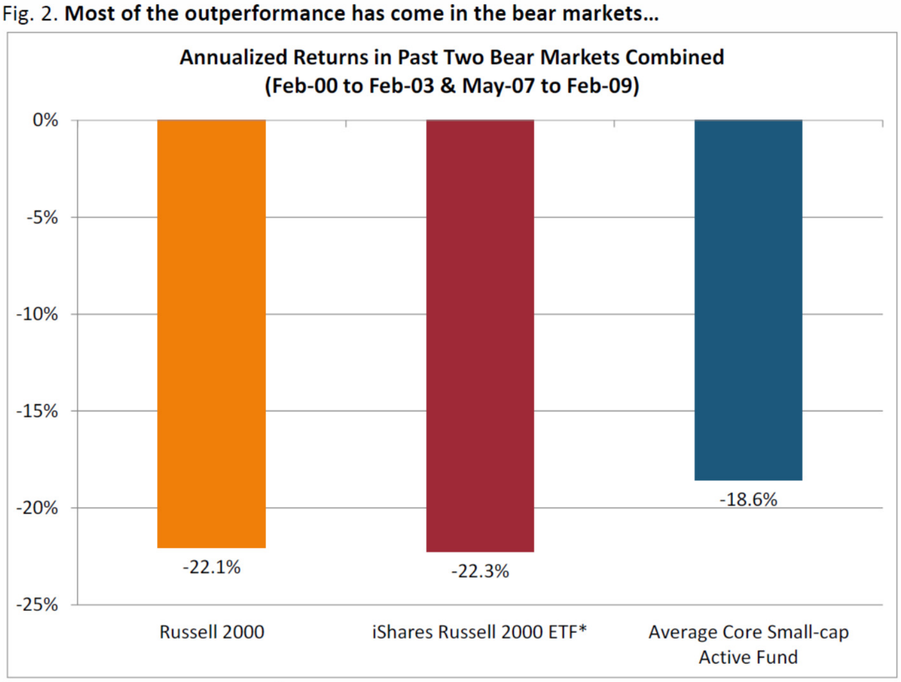
Fig. 1. **Through the past two bull and bear markets, the average active fund has outperform**



*Source: FRP, Morningstar and FactSet; *Returns for Mar-00 to May-00 are assumed to be the same as the Russell 2000.*

As the chart below shows, most of this outperformance has come in down markets.

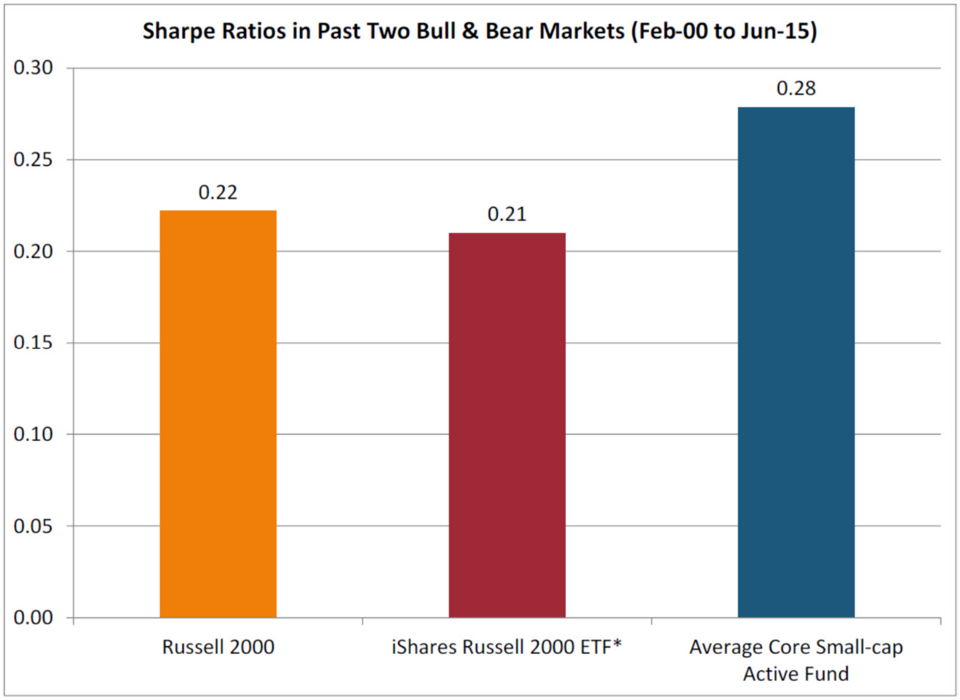
Fig. 2. **Most of the outperformance has come in the bear markets…**



*Source: FRP, Morningstar and FactSet; *Returns for Mar-00 to May-00 are assumed to be the same as the Russell 2000*

Further, adjusting for risk, the average small cap core fund has posted a better risk adjusted performance as shown below when comparing Sharpe ratios.

Fig. 6. **…resulting in superior risk adjusted returns over all periods**

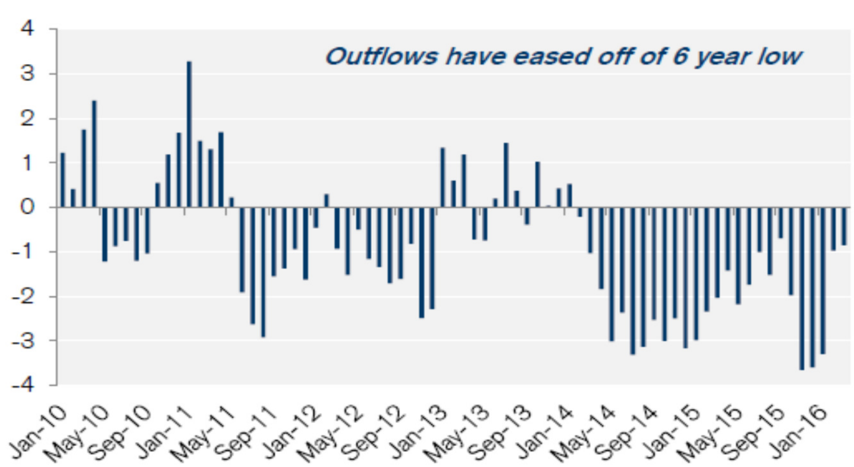


*Source: FRP, Morningstar and FactSet; *Returns for Mar-00 to May-00 are assumed to be the same as the Russell 2000*

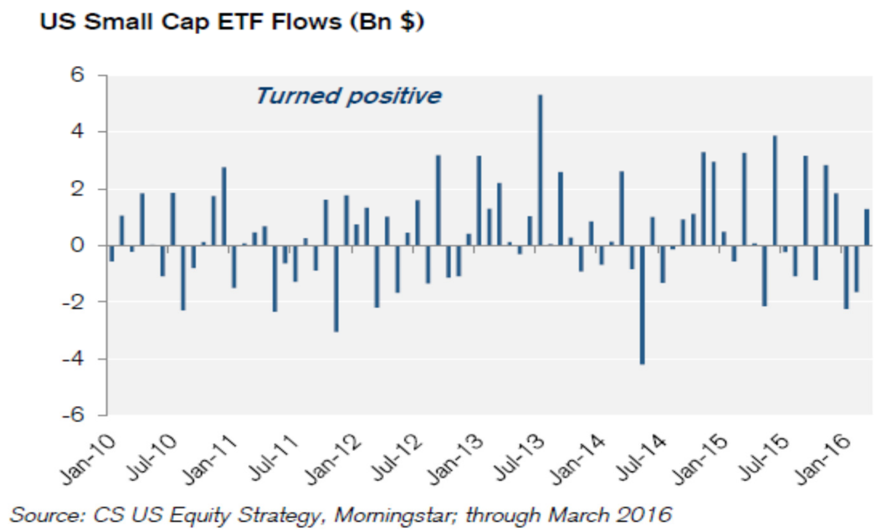
Fund Flows

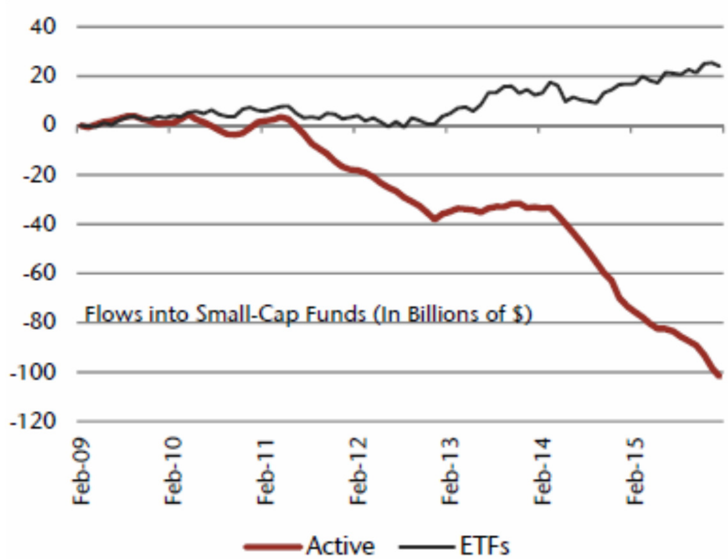
The charts below compare fund flows for actively managed small cap funds versus passive small cap ETF's. Actively managed small cap funds have seen very persistent outflows for much of the past 6 years. Whereas, small cap ETF's flows have been generally positive. The net result is a whopping $80 billion of net outflows from the small cap asset class over the past 6 years (see third chart below), despite posting fairly strong cumulative returns over this timeframe.

US Small Cap Active Flows (Bn $)



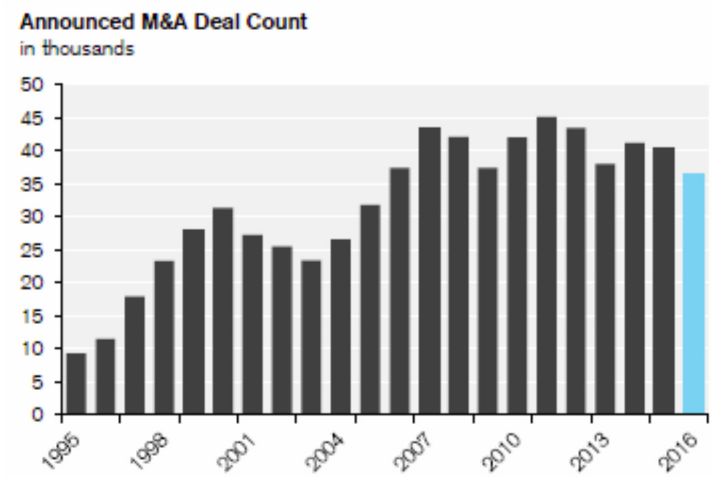
Source: CS US Equity Strategy, Morningstar; through March 2016



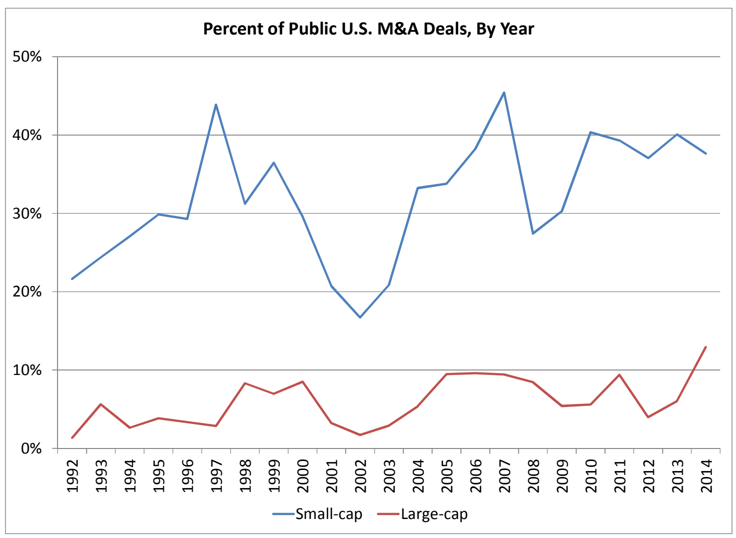


M&A Activity

The charts below highlight M&A trends over time. While the number of transactions have slowed over the past several years due presumably to economic uncertainty, the dollar volume of transactions are accelerating off the 2009 bottom. We believe the M&A environment is heating up given the strong cash balances on corporate balance sheets and the low cost of debt. The second chart below shows that small caps are involved in deals at a rate significantly higher than large caps.

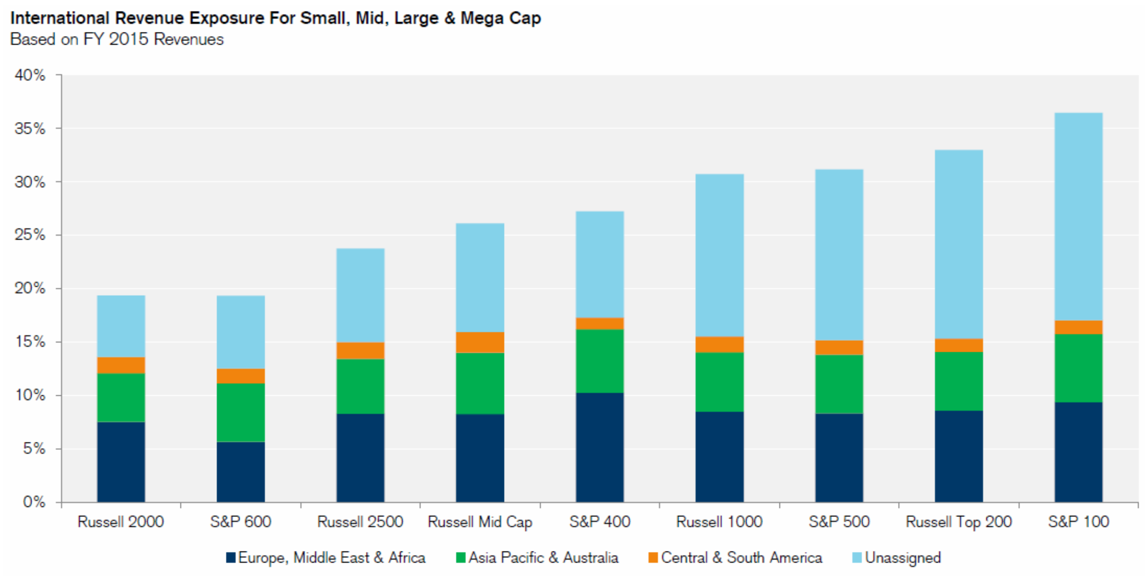


Small Caps Enjoy Far More M&A Activity Than Large



International Exposure

The following chart shows the difference in sales exposure to international markets by market cap. The chart highlights that small caps have significantly less exposure to international markets in terms of sales which we believe is a positive due to the weak European, Chinese and emerging country economies broadly. We don't expect this to change any time soon, so less exposure to international markets will be better in our view.



Source: Credit Suisse

Current View

Below are a couple of charts that show how small caps are performing from a fundamental perspective. The first table below shows that small caps have outperformed large caps for the past several quarters in terms of sales growth. Note also that they are forecasted to continue the trend for the balance of 2016 and 2017. Similarly the second chart below shows that small caps are outgrowing large caps in terms of earnings growth, too.

Weighted Median Yr/Yr Sales Growth as of 5/6/2016

	Small Cap	Mid Cap	Large Cap
Quarterly			
1Q15	7.4%	3.7%	2.2%
2Q15	6.6%	2.1%	0.9%
3Q15	5.9%	2.1%	1.4%
4Q15	5.2%	1.4%	0.7%
1Q16E	6.2%	2.5%	1.6%
2Q16E	5.7%	3.7%	1.7%
3Q16E	6.6%	4.7%	3.2%
4Q16E	7.0%	5.3%	4.5%
1Q17E	6.8%	5.6%	5.5%
2Q17E	6.3%	5.2%	5.1%
3Q17E	6.1%	5.2%	4.6%
4Q17E	6.1%	5.2%	4.3%
Trailing 12 Months			
2015	7.0%	2.6%	1.0%
2016E	6.4%	4.2%	2.4%
2017E	6.2%	5.4%	4.8%

Russell 2000, Russell Mid Cap, S&P 500

Weighted Median Yr/Yr EPS Growth as of 5/6/2016

	Small Cap	Mid Cap	Large Cap
Quarterly			
1Q15	10.6%	7.2%	7.4%
2Q15	7.9%	6.7%	7.3%
3Q15	8.6%	6.7%	5.3%
4Q15	8.9%	5.2%	5.2%
1Q16E	6.2%	7.0%	3.8%
2Q16E	6.8%	5.9%	2.5%
3Q16E	9.6%	8.8%	5.9%
4Q16E	9.6%	8.9%	9.2%
1Q17E	13.4%	11.3%	11.6%
2Q17E	14.9%	11.6%	12.5%
3Q17E	13.1%	10.9%	11.1%
4Q17E	12.2%	10.6%	10.5%
Trailing 12 Months			
2015	10.9%	6.5%	6.2%
2016E	8.5%	7.5%	6.1%
2017E	13.2%	11.2%	11.4%

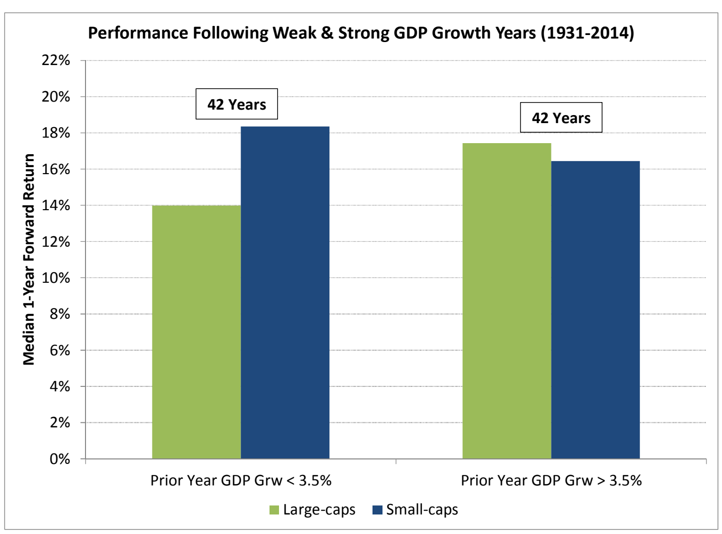
Russell 2000, Russell Mid Cap, S&P 500

Source: Credit Suisse

The chart below shows that small caps outperform large caps in slower growth environments. If the prior year's GDP growth was below 3.5%, in the subsequent year small caps outperform by over 400 basis points on average.

"New Normal" Economic Conditions Favor Small

Small Caps Tend to Outperform In Slow Growth Environments



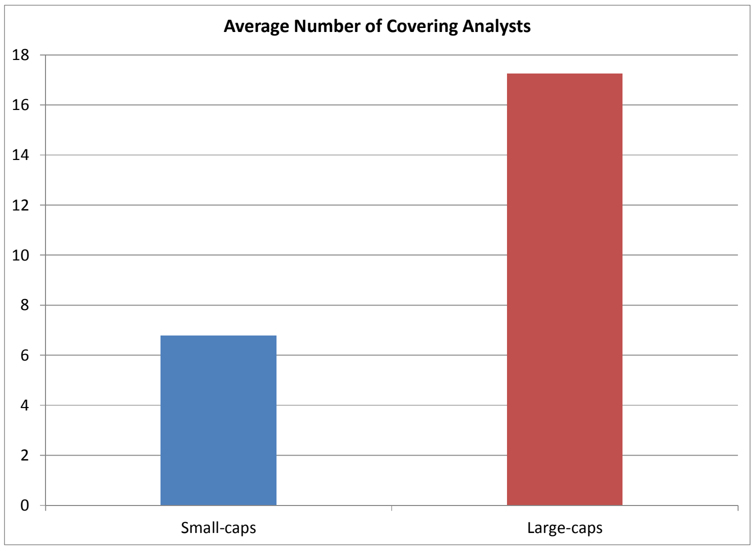
Source: Furey Research Partners

Other Considerations

Small cap stocks generally have significantly less analyst coverage than large caps. This gives an information advantage to small cap managers who do their own research work and they can exploit their findings before the rest of the market.

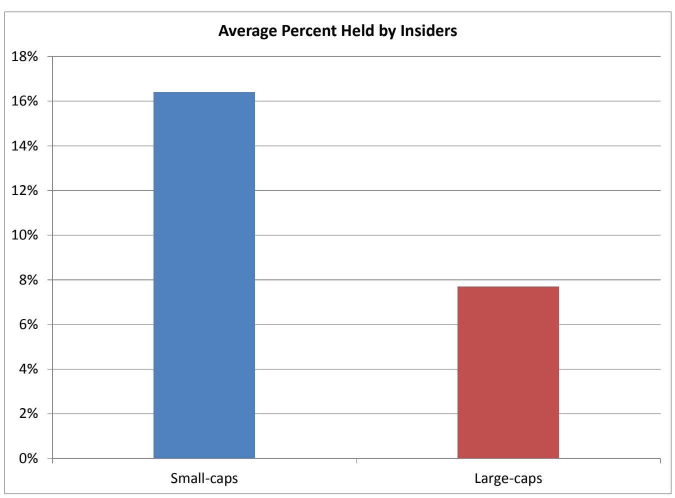
Exploitable Inefficiencies Still Exist in Small Caps

Sell Side Coverage of Small Cap Stocks is Limited Compared with Large Caps



Additionally, the inside ownership within small cap stocks is at a much higher level than large caps which better aligns the interests of management with investors.

High Level Of Insider Ownership Aligns Management and Investor Interests



Source: Furey Research Partners

In summary, we believe the current environment points strongly to the potential outperformance of small caps over large caps from a number of different perspectives highlighted above. We'd be happy to share our further perspective on any of the topics discussed in this presentation.

Joe Frohna Tim Stracka Rodney Hathaway Adam France

Past performance does not guarantee future results. No investment firm, including 1492 Capital Management, LLC, guarantees gains or that losses will not occur from the strategies applied to managed portfolios. However, we are committed to minimizing downside risk by applying strategies that we believe will minimize that risk through diversification of investments determined to be consistent with each client's investment objective.

Comments and opinions expressed in this document regarding individual securities, markets, strategies and case studies are not recommendations or predictions, and thus should not be acted upon. They are based only upon the judgments and opinions of 1492's professional staff. The use of any investment strategy does not guarantee that an investment return will be achieved, or that a loss will not occur from the advice provided. You are encouraged to contact us with your questions.

Appendix

1492 Capital Management, LLC - Strategy Performance

		Composite Gross (%) Yr End	Composite Net (%) Yr End	Benchmark Return (%) Yr End	Composite 3-Yr Std Dev %	Benchmark 3-Yr Std Dev %	Composite Accts at Yr End	Composite Assets (Millions)	Composite Internal Dispersion	Percent of Firm Assets	Firm Assets (Millions)	% Non-Fee Paying Assets
Small Cap Growth	2015	-6.47	-7.30	-1.38	15.04	14.95	28	$52.3	0.08%	35%	$149.8	0.00%
	2014	-8.32	-9.15	5.60	15.75	13.82	29	$61.9	0.03%	38%	$163.7	0.00%
	2013	52.34	50.96	43.30	19.58	17.27	31	$73.1	0.20%	39%	$188.4	0.46%
	2012	12.82	11.80	14.59	24.13	20.72	30	$48.6	0.05%	47%	$103.4	0.53%
	2011	-9.70	-10.51	-2.91	28.99	24.31	42	$53.5	0.18%	66%	$81.4	0.74%
	2010	34.06	32.52	29.09			31	$56.3	0.11%	74%	$75.8	0.95%
	2009	54.76	53.36	34.47			20	$28.2	0.09%	78%	$36.4	1.42%
Small Cap Value	2015	-10.13	-10.92	-7.47	13.63	13.46	12	$8.5	0.00%	6%	$149.8	2.13%
	2014	-6.99	-7.81	4.22	13.62	12.79	13	$9.8	0.04%	6%	$163.7	2.03%
	2013	48.57	47.24	34.52	18.08	15.82	13	$11.0	0.14%	6%	$188.4	1.95%
	2012	10.92	9.95	18.05	20.81	19.89	15	$8.4	0.08%	8%	$103.4	1.73%
	2011	-6.45	-7.26	-5.50	25.15	26.04	21	$10.5	0.20%	13%	$81.4	1.61%
	2010	33.66	32.50	24.50			16	$10.8	N/M	14%	$75.8	3.52%
	2009	54.89	54.10	20.58			11	$6.1	0.16%	17%	$36.4	3.67%
Small Cap Core Alpha	2015	-5.75	-6.50	-4.41	13.81	13.96	17	$57.0	0.00%	38%	$149.8	0.32%
	2014	-9.21	-9.95	4.89	15.89	13.12	17	$56.9	0.00%	35%	$163.7	0.34%
	2013	47.09	45.63	38.82	19.87	16.45	9	$24.6	0.00%	13%	$188.4	0.73%
	2012	30.90	29.61	16.35	24.96	20.2	4	$13.3	N/M	13%	$103.4	0.92%
	2011	-9.96	-10.73	-4.18			5	$10.4	N/M	13%	$81.4	2.16%
	2010	65.22	63.57	26.85			1	$0.7	N/M	1%	$75.8	0.00%

1492 Capital Management, LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with GIPS standards. 1492 Capital Management, LLC has been independently verified for the years ended 2009 through 2012. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation. The Small Cap Growth, Small Cap Value and Small Cap Core Alpha composites have been examined for 2009 through 2012. The 2013 and 2014 verifications are ongoing. The verification and performance examination reports are available upon request.

1492 Capital Management, LLC ("1492 Capital Management") is an independent investment management firm established in September 2008. The firm began managing portfolios in December 2008. 1492 Capital Management, LLC, manages primarily small cap equity assets in the Small Cap Growth, Small Cap Value and Small Cap Core Alpha strategies.

The Small Cap Growth and Small Cap Value composites creation dates were 1/1/09. The composite creation date for the Small Cap Core Alpha, was 12/1/09.

The results shown are from fully discretionary accounts having 1492 Capital Management's Small Cap Growth or Small Cap Value or Small Cap Core Alpha strategies applied to them. The Small Cap Growth strategy acquires primarily domestic and foreign equities listed in the U.S. that will generally have a market capitalization in line with the Russell 2000® Index and have prospects for 15% to 20% top and bottom line growth over the next 12 to 18 months. The Small Cap Value strategy acquires primarily dividend paying domestic equity and foreign equities listed in the U.S. that will generally have a market capitalization in line with the Russell 2000® Index. The Small Cap Core Alpha strategy is a portfolio focused on combining 20 to 30 stocks which have already been selected for either the Small Cap Growth or Small Cap Value strategies described above.

For comparison purposes, the composites are measured against the Russell 2000® Growth, Russell 2000® Value, and the Russell 2000® indexes, respectively. Due to the differences in the number of securities in the indexes compared with each strategy, volatility may be different between the indexes and the respective strategy. The minimum asset level to be included in a composite is $100,000.

Benchmark descriptions: The Russell 2000® Growth Index measures the performance of the small-cap growth segment of the U.S. equity universe. It includes those Russell 2000® Index companies with higher price-to-value ratios and higher forecasted growth values; The Russell 2000® Value Index measures the performance of those Russell 2000® Index companies with lower price-to-book ratios and lower forecasted growth values. The Russell 2000 ® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000® Index is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership.

Returns are calculated on a total return, time-weighted basis and include all dividends and interest, realized and unrealized gains or losses and are net of all brokerage commissions, execution costs, but without application of any taxes. Valuations are computed and performance is reported in U.S. dollars. Returns for periods of less than one year are not annualized. Clients having portfolios containing securities other than used in the calculations, and portfolios subject to different objectives, or to tax, client-imposed or other restrictions, would have had higher or lower returns than the actual performance shown.

The data used for this report was obtained from sources deemed reliable and then organized by the staff at 1492 Capital Management, LLC. Performance calculations were prepared using standard industry software or formulas.

Returns are presented before management and custodial fees and include dividends and interest, realized and unrealized gains or losses, and transaction costs. A client's returns will be reduced by the management fees and other expenses it may incur. Non-fee paying accounts are represented in the composite and their respective weights are shown in the table above.

Beginning in 2012, the composites for the Small Cap Growth, Small Cap Value and Value Income strategies exclude wrap accounts. Beginning in 2011, the composite for the Small Cap Core Alpha strategy excluded wrap accounts. By excluding the wrap accounts from that composite, certain returns during the year and for the entire year for the Small Cap Core Alpha strategy have been adjusted. The returns prior to the change in the composite were: 11.99%, -7.79%, -22.24%, 14.77%, and, -8.12% for the first quarter, second quarter, third quarter, fourth quarter, and year-to-date 2011, respectively.

A list of composite descriptions as well as policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.