1492 CAPITAL MANAGEMENT
DISCOVERING OPPORTUNITY
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IDENTIFY THEMES | FUNDAMENTAL ANALYSIS | TARGET VALUATION | GROWTH STRATEGY | VALUE STRATEGY | CORE ALPHA STRATEGY | VALUE INCOME STRATEGY

1492 Vantage Point Quarterly Newsletter

Welcome to 1492 Capital Management's newsletter for the second quarter of 2019. In each quarterly newsletter, we provide our perspective on the most recent quarter, preview what lies ahead, and offer a bit of market trivia.

Our corporate slogan is "Discovering Opportunity" which is our daily focus for our clients. Our investment professionals possess a tremendous amount of experience navigating through multiple market cycles. This experience was again demonstrated as we are pleased to report that the 1492 Small Cap Growth and 1492 Small Cap Core Alpha strategies were recognized by Broadridge MarketPlace's Best Money Managers[(1)] for their performance generated over the 12 quarters ended March 31, 2019 as shown in the table below.

Broadridge Marketplace Best Money Managers- Period Ended 3/31/2019			
Product Name	**Asset Class**	**Ranking**	**Quarters**
1492 Small Cap Growth	U.S. Equity All Styles	Ranked 18 out of 1525	12 Quarters
1492 Small Cap Growth	U.S. Small Cap Equity	Ranked 9 out of 409	12 Quarters
1492 Small Cap Growth	U.S. Small Cap Growth Equity	Ranked 8 out of 126	12 Quarters
1492 Small Cap Core Alpha	U.S. Growth & Value Equity	Ranked 6 out of 450	12 Quarters
1492 Small Cap Core Alpha	U.S. Small Cap G & V Equity	Ranked 2 out of 156	12 Quarters

Trump Tariff Tweets Take Their Toll

Posting quite rosy headlines, the S&P 500 (+18.5%) and Russell 2000 (+17.0%) had their best first half of a year since 1997 and 2003, respectively. However, President Trump's tariff tweets have created uncertainty and have taken their toll on the global economic outlook due to a 180 degree reversal on the prospects for a trade deal with China in early May. To add fuel to the fire, the president banned U.S. companies from selling any components into China's largest technology company, Huawei. To top it off, he threatened a series of escalating tariffs on imports from Mexico if the Mexican government didn't stop the flood of immigrants into the U.S. and then recanted the threat a week later. Trump's stance softened on Chinese trade talks and the Huawei ban following meetings at the G-20 summit, but the damage was done. Saving the day for the stock market, the U.S. Federal Reserve signaled the start of an interest rate easing cycle after the bond market forced their hand and the inverted yield curve. However, if you peak under the hood of the stock market and global economy, some ugly divergences are happening. For example, the Russell 2000 trails the S&P 500 over the prior year by 13.3%, and nearly 65% of countries around the globe are reporting ISM Manufacturing Survey readings below 50 (indicative of shrinking economies when <50). The rules of the road, particularly for U.S. based companies doing business abroad, have become increasingly pothole ridden and brakes are being tapped all around the globe as a result. Please read on to see our unique views of what's on tap for the balance of 2019, what the key drivers will be, and indulge in some stock market trivia.

For detailed performance information on 1492's strategies, please click on these fact sheet links (Small Cap Growth / Small Cap Value / Small Cap Core Alpha) to find gross and net of fee

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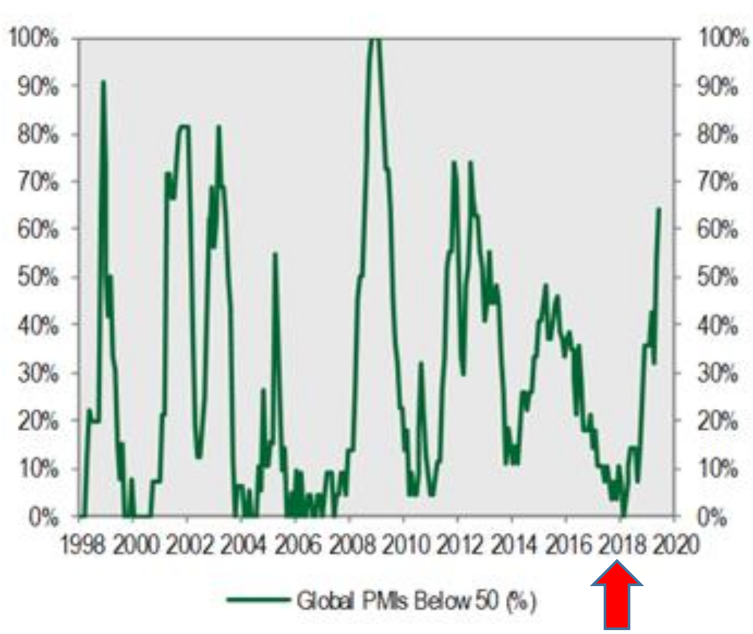
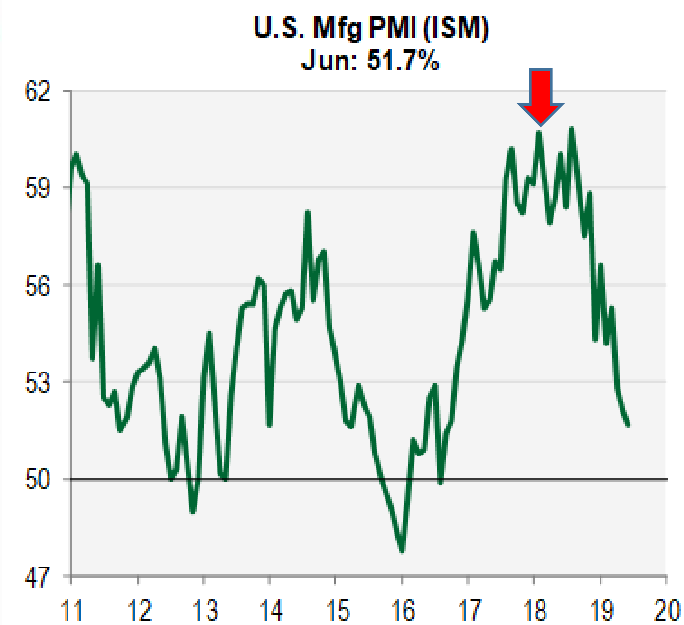
performance information and disclosures. If you would like to discuss any of these strategies with us, please contact Tim Stracka at 414-238-3398.

A Review of the Quarter: Trump Tariff Tweets Take Their Toll

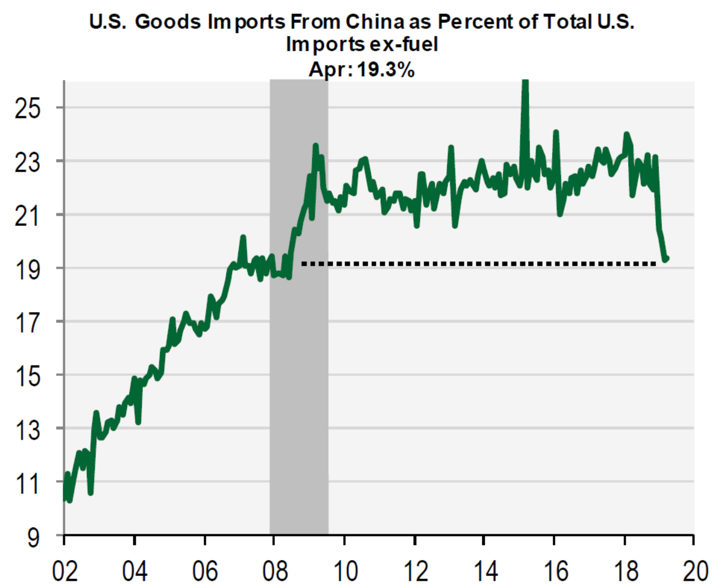
Posting quite rosy headlines, the S&P 500 (+18.5%) and Russell 2000 (+17.0%) had their best first half of a year since 1997 and 2003, respectively. However, President Trump's tariff tweets have created uncertainty and have taken their toll on the global economic outlook due to a 180 degree reversal on the prospects for a trade deal with China in early May. To add fuel to the fire, the president banned U.S. companies from selling any components into China's largest technology company, Huawei. To top it off, he threatened a series of escalating tariffs on imports from Mexico if the Mexican government didn't stop the flood of immigrants into the U.S. and then recanted the threat a week later. Trump's stance softened on Chinese trade talks and the Huawei ban following meetings at the G-20 summit, but the damage was done. Saving the day for the stock market, the U.S. Federal Reserve signaled the start of an interest rate easing cycle after the bond market forced their hand and the inverted yield curve. However, if you peak under the hood of the stock market and global economy, some ugly divergences are happening. For example, the Russell 2000 trails the S&P 500 over the prior year by 13.3%, and nearly 65% of countries around the globe are reporting ISM Manufacturing Survey readings below 50 (indicative of shrinking economies when <50). The red arrows on the charts below signify when Trump announced that he was going to imposed tariffs on China. The U.S. economy was posting readings in the high 50's earlier this year as shown in the chart below right, but they dropped precipitously of late as threats of additional tariffs surfaced. The rules of the road, particularly for U.S. based companies doing business abroad, have become increasingly pothole ridden and brakes are being tapped all around the globe as a result.

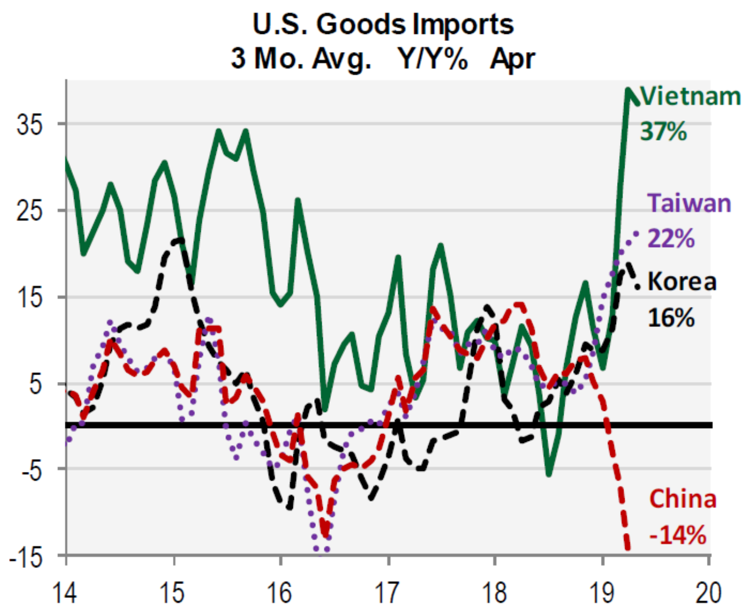




Source: Cornestone Macro

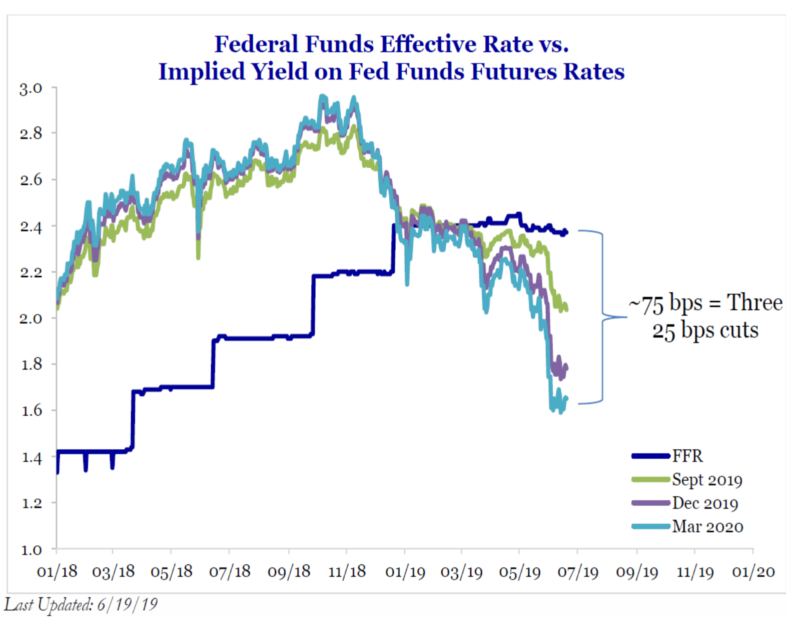
Trump's tariff tweets have created a massive amount of uncertainty as tariffs raise costs for U.S. businesses and consumers, disrupt supply chains, invite retaliation, and slow business investment because companies are trying to avoid geographies which are high cost. This thirst for low-cost manufacturing is what caused the mass exodus out of the U.S. and into China over the past 25 years. However, the labor arbitrage that attracted manufacturers to move their facilities there to begin with is nearly gone when factoring in transportation costs to ship the finished goods to their ultimate destination. After adding the potential for up to 25% tariffs on nearly every good exported from China to the U.S., you have the makings of a mass exodus from that country. We're witnessing the beginning of this move as you can see from the charts below. The chart on the left shows that goods imported from China have taken a precipitous decline this year, and the chart on the right shows the countries that are beneficiaries of this exodus. Several of our portfolio companies have announced plans to dramatically scale back production in China and move manufacturing facilities to countries where the U.S. has strong relationships and won't be subject to tariffs like in Vietnam, Thailand, India, and Jordan. However, these moves don't come without cost or risk, and the stock market has pummeled these stocks mightily through no fault of their own. One portfolio holding had its two manufacturing facilities located in China and Mexico. When the Chinese tariff situation began to escalate, they decided they would shift more production to Mexico, only to run head on into Trump's threat of Mexican tariffs to stem the tide of immigrants coming through Mexico into the U.S.

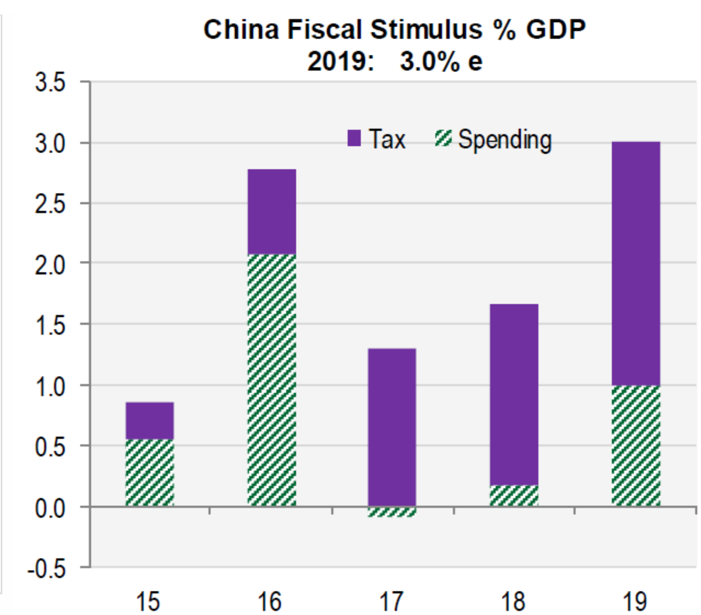




Source: Cornerstone Macro

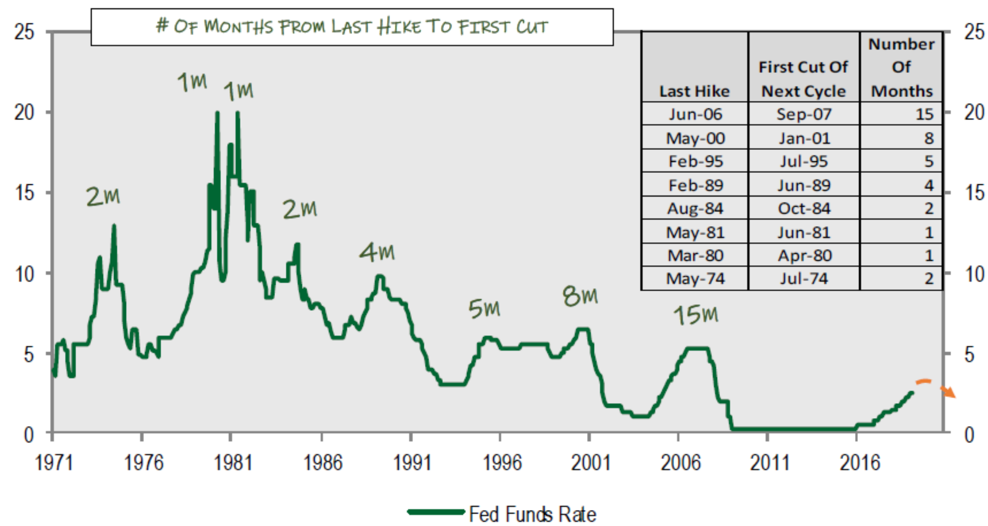
The U.S. Federal Reserve and the Chinese government have come to the rescue of the stock market. The Fed has indicated that they will be accommodative and lower interest rates as early as their next meeting in July, and the Chinese government has been stimulating China's economy for over a year. What a difference a year makes. Last year at this time the Fed was on schedule to hike three more times in 2018 and up to another four times in 2019. Earlier this year, they changed their tune and told the markets that they were done tightening and now, a few short months later, the bond market is forecasting three rate cuts by March 2020. The chart below left shows the implied yield on Fed funds futures or the expected fed funds rate over the next nine months. The chart on the right shows the aggressive change the Chinese government has made in stimulating their economy through a combination of tax cuts and spending initiatives that total a whopping 3% of their GDP.





Source: Strategas Research and Cornerstone Macro

Last quarter we highlighted the following chart which shows the number of months between the last Fed rate hike and the first rate cut of the next cycle. If the Fed does what's expected and cuts rates in July, then the time from last hike to first cut will be seven months which is par for the course.

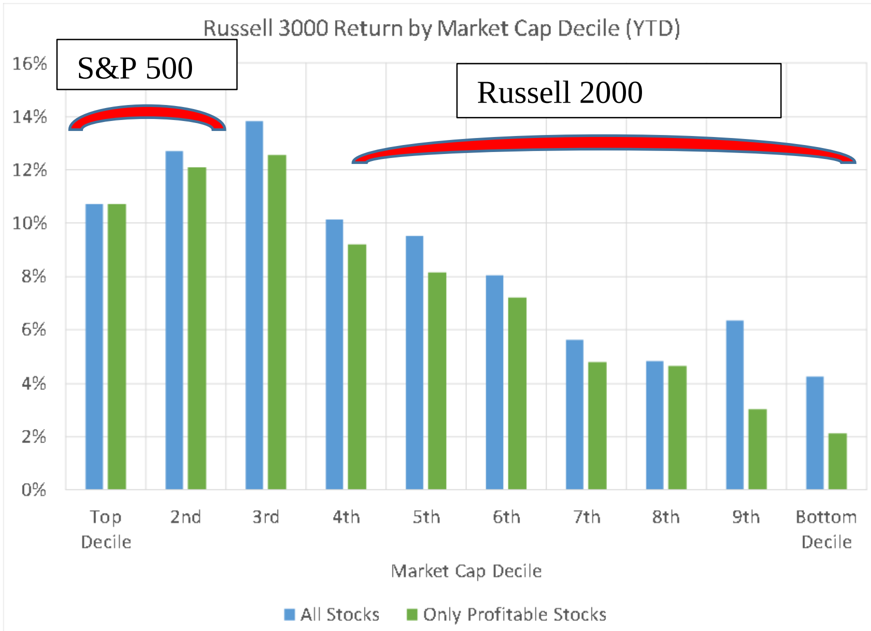


Last Hike	First Cut Of Next Cycle	Number Of Months
Jun-06	Sep-07	15
May-00	Jan-01	8
Feb-95	Jul-95	5
Feb-89	Jun-89	4
Aug-84	Oct-84	2
May-81	Jun-81	1
Mar-80	Apr-80	1
May-74	Jul-74	2

Source: Cornerstone Macro

Despite the negative economic data of late, the S&P 500 is within a whisker of its all-time high. However, as we alluded to above, there are some major divergences between the S&P 500 is doing and the rest of the stock market. Even within the S&P 500, the breadth is weak. The first chart below shows this concern in living color as the red line represents the 50 most extended stocks among the 100 stocks comprising the S&P 500 Low Volatility ETF (SPLV). This group is primarily Utilities, REIT's and Consumer Staples. This extended list of stocks is compared to the S&P Low Volatility ETF (purple line) and the S&P 500 (black line), respectively. It isn't a great endorsement for the economic prospects ahead when the stock market leaders are bond proxies! The second chart below shows the year-to-date returns for the Russell 3000 Index which is comprised of the largest 3,000 publicly traded stocks by market capitalization. The S&P 500 is basically comprised of the largest 500 companies in the U.S. and are captured in the top two deciles of the chart below. However, notice the near linearly worsening of performance as you move down market cap. Moreover, the green bars on the chart represent profitable companies in each decile. Note that in every decile profitable companies underperformed all stocks in the decile, which implies that unprofitable companies performed substantially better across the board.

Source: Strategas Research



Source: Furey Research and 1492 Capital Management

Despite these divergences, all of the major indices posted positive returns for the quarter, and the first half of the year was the best since 1997 and 2003 for the S&P 500 and Russell 2000, respectively. Growth stocks outperformed value stocks in both the second quarter and year-to-date and continued the long winning streak for growth indices. The table below highlights the returns for the second quarter and year-to-date 2019 for the popular indices.

Index Returns		
Index	Second Qtr. 2019 Return	2019 YTD Return
Russell 2000	+2.10%	+17.01%
Russell 2000 Growth	+2.75%	+20.36%
Russell 2000 Value	+1.35%	+13.51%
S&P 500	+4.30%	+18.54%
Dow Jones Industrials	+2.59%	+14.03%
NASDAQ Composite	+3.87%	+21.33%

Source: 1492 Capital Management, LLC and Factset

From a style perspective, the Russell 2000 Growth Index (+2.75%) continued its winning ways and outpaced the Russell 2000 Value Index (+1.35%) in both the second quarter and year-to-date 2019. Growth indices outperforming value indices has become a common refrain over the past ten years since the Great Recession. All sectors within the Russell 2000 Growth index finished with positive returns for the quarter except for energy (-8.97%). The best performing sectors in the Russell 2000 were Financials (+5.3%) and Producer Durables (+7.9%) as investors propelled these sectors higher in anticipation of Fed rate cuts which should help reaccelerate the economy. The Energy sector was the worst performer (-7.8%) despite oil being up nearly 30% year to date. The first two tables below highlight the performance of the Russell 2000 style indices by sector for the month of June, the second quarter, and year-to-date 2019. Note that the month of June was significantly stronger than the first two months of the quarter as the Fed indicated their willingness to cut rates and as the Trump administration hinted at a temporary truce with China on the trade war front in the days leading up to the G-20 summit late in the quarter. Lastly, the third table below shows that the performance within the Russell 2000 was worse as you moved down market cap. This effect is a continuation of a trend which has existed since early 2014 with only a brief respite in the second half of 2016 and in early 2018.

Table 5 - Russell 2000 Growth Performance Attribution through June 30

	June			Second Quarter			Year To Date		
Russell Sector	**Absolute**	**Contribution**	**Relative**	**Absolute**	**Contribution**	**Relative**	**Absolute**	**Contribution**	**Relative**
Discretionary	5.34	1.01	-2.36	1.81	0.35	-0.94	18.79	3.50	-1.57
Staples	5.08	0.13	-2.63	1.54	0.03	-1.22	8.08	0.22	-12.28
Energy	10.42	0.16	2.72	-8.97	-0.17	-11.72	10.89	0.22	-9.47
Financials	5.78	0.46	-1.92	4.67	0.35	1.92	16.80	1.33	-3.56
Health Care	9.91	2.50	2.21	0.54	0.17	-2.21	19.20	5.04	-1.16
Mat. & Process	13.85	0.95	6.15	6.41	0.46	3.66	23.34	1.63	2.98
Prod. Durables	8.88	1.43	1.18	8.82	1.36	6.06	23.89	3.61	3.53
Real Estate	3.07	0.10	-4.63	0.08	0.00	-2.67	18.35	0.55	-2.02
Technology	6.00	0.96	-1.70	1.28	0.16	-1.47	24.99	3.98	4.63
Utilities	0.85	0.02	-6.85	3.86	0.07	1.11	17.31	0.31	-3.05

Table 7 - Russell 2000 Value Performance Attribution through June 30

	June			Second Quarter			Year To Date		
Russell Sector	**Absolute**	**Contribution**	**Relative**	**Absolute**	**Contribution**	**Relative**	**Absolute**	**Contribution**	**Relative**
Discretionary	3.36	0.39	-3.01	-5.26	-0.64	-6.61	4.14	0.65	-9.37
Staples	3.18	0.07	-3.19	-7.77	-0.17	-9.12	0.24	0.04	-13.27
Energy	9.05	0.45	2.69	-7.32	-0.40	-8.67	11.23	0.68	-2.28
Financials	6.18	1.67	-0.19	5.54	1.40	4.19	13.78	3.63	0.28
Health Care	9.54	0.37	3.18	-4.52	-0.18	-5.87	5.28	0.29	-8.23
Mat. & Process	14.09	0.69	7.73	0.75	0.06	-0.60	17.77	0.91	4.27
Prod. Durables	9.68	1.11	3.31	6.56	0.75	5.21	17.25	1.97	3.74
Real Estate	2.82	0.43	-3.55	1.63	0.23	0.28	17.63	2.45	4.12
Technology	7.55	0.80	1.18	-0.07	0.00	-1.42	18.81	1.83	5.30
Utilities	4.68	0.38	-1.68	3.94	0.31	2.59	14.17	1.02	0.66
Size Quintile	**Absolute**	**Contribution**	**Relative**	**Absolute**	**Contribution**	**Relative**	**Absolute**	**Contribution**	**Relative**
1 (Largest)	6.94	3.84	-0.13	3.54	1.96	1.44	18.68	9.69	1.70
2	7.61	1.83	0.54	1.19	0.27	-0.91	17.20	4.35	0.22
3	7.42	0.92	0.36	0.33	0.03	-1.77	13.67	1.85	-3.31
4	6.03	0.36	-1.04	-0.35	-0.05	-2.44	12.00	0.81	-4.98
5 (Smallest)	5.45	0.13	-1.62	-4.21	-0.12	-6.31	8.70	0.27	-8.27

Source: Jefferies

Alleged progress being made in the China trade negotiations plus the Fed's apparent desire to begin an easing cycle on the interest rate front created a positive environment for stock markets around the globe in the second quarter. The only exception to this joy was in China where investors were apparently betting that China is ending up on the wrong end of this trade dispute. However, the Chinese stock markets are still up nearly +20% year to date. The tariff wars have taken their toll on China's economy recently, but the Chinese government has initiated over 80 stimulative measures over the past nine months to reaccelerate their economy. These measures have included interest rate cuts, reserve requirement ratio cuts, tax cuts and spending plans. Emerging markets are still a bit soft as they are highly dependent upon the outcome of the tariff negotiations between the U.S. and China. As stock markets around the world have moved higher, volatility has declined quite a bit after a major spike in the fourth quarter of 2018. Germany and much of Europe continued to rebound despite their economies shrinking in the latest ISM surveys due to their high correlation with China's economy which appears to be on the mend. Bond investments did well as there was a clear flight to safety as the yield curve inverted and recession fears infiltrated the market. Amongst commodities, precious metals like gold were the winners in the quarter as money moved in as part of the safety trade. Oil rebounded significantly from a dip earlier in the quarter as OPEC has indicated that they will follow through on their plans to cut production and ease the supply/demand imbalance.

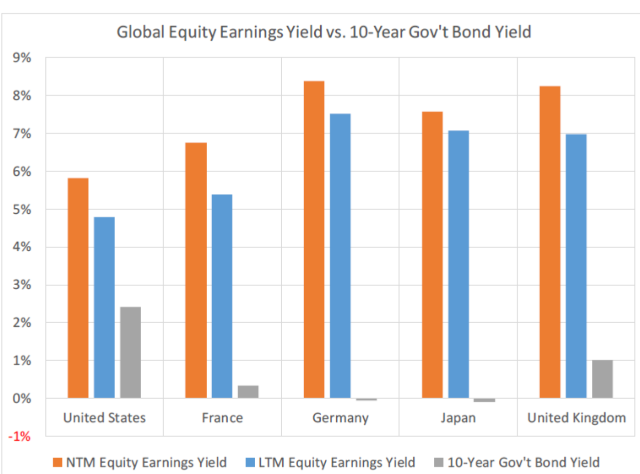
Index	Second Qtr. 2019 Return	2019 YTD Return
France	+6.2%	+20.4%
Germany	+7.6%	+17.2%
Brazil	+5.8%	+10.9%
India	+2.3%	+9.8%
China- A Shares	-3.6%	+19.5%
China- Shenzhen A Shares	-7.8%	+23.3%
Japan	+.6%	+4.3%
Long-Term Treasuries (TLO)	+4.9%	+8.9%
Investment Grade Corp. Bonds	+4.5%	+10.1%
Gold	+8.9%	+10.3%
Volatility- VIX index	+2.0%	-35.8%
Oil	-2.8%	+28.8%
Natural Gas	-13.3%	-19.1%
Lumber	+5.2%	+14.0%

Source: 1492 Capital Management, LLC

Updated 2019 Outlook: Skimpy Global Yields Make Stocks the Only Game in Town - Especially Small Caps

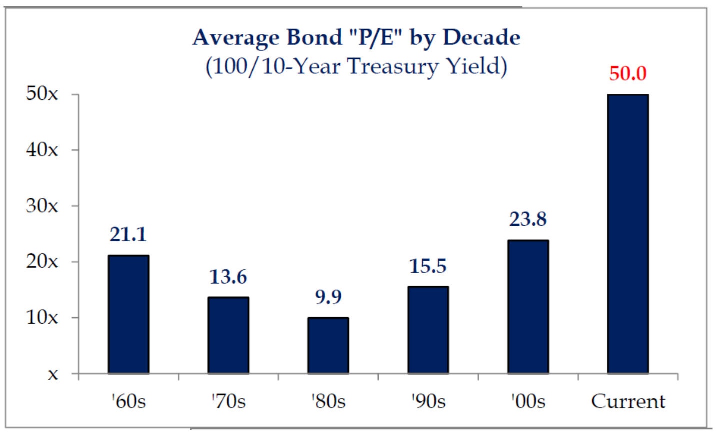
Yield Opportunities Have Collapsed Around the Globe

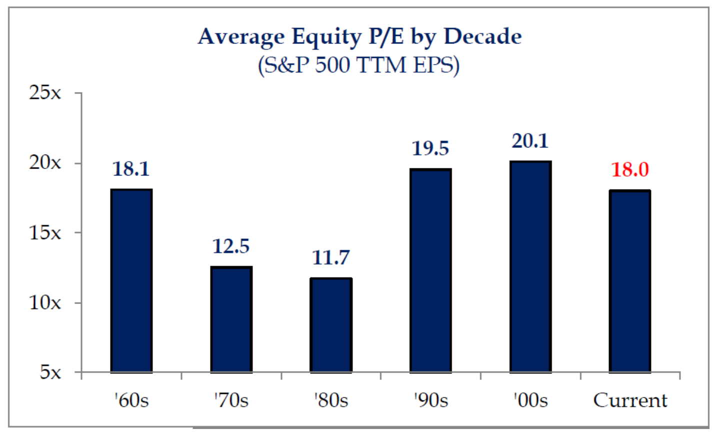
As I write this newsletter, the yield on the 10 Year U.S. Treasury Note is 1.95%. If that sounds low to you, look around the globe, and see what other countries yield profiles look like. Foreign yields make our 10-Year Treasury rates look downright gaudy. The chart below left highlights this phenomenon. The orange bars represent the earnings yields (inverse of the P/E ratio- a 20 P/E =5% earnings yield) for each country's stock market over the next twelve months. The grey bars represent each country's current yield on their respective 10-year government securities. Note that yields in Germany and Japan are currently negative. The chart below right emphasizes the magnitude of the amount of negative yielding securities around the globe. *Currently there is $13 trillion invested globally willing to accept a negative yield on their investment. Put another way, these investors are paying someone to use their money, and that is crazy.* Despite these low yields, money continues to flow into bonds and other fixed income instruments and bond proxies like utilities, REIT's and consumer staple stocks with large dividends in the search for ever-elusive yields. This search has pushed the valuation on these bond proxies to record highs. Insatiable demand is coming from the aging population around the globe who's entering the retirement years with greater rapidity and with a reduced appetite for risk. Thanks to an overly aggressive Fed that raised rates quite rapidly over the past two years, the best yields for the money remain on the short end of the U.S. yield curve. However, this opportunity will likely be short-lived as the Fed is expected to cut interest rates beginning in July.



Source: Furey Research Partners, FactSet Research. Data as of March 29th, 2019

Pension funds and foundations which have historically been very dependent on yields to meet their stated return objectives are going to be forced to make some tough choices. Either they'll have to reduce their return goals (which in the case of pensions means that the corporation will have to fund the shortfall) or they'll have to increase their risk profile to move to investments that can offer a higher return. For example, a foundation that has a 7.5% annual return goal will be hard pressed to hit this target if they invest in low yielding fixed income instruments. For every dollar that they invest in a 10 year U.S. Treasury Note yielding 2%, they'll have to invest another dollar in something that can return 13% to make the average return equal their 7.5% targeted return. They are faced with two pivotal choices. Pension funds and foundations can reduce the targeted return which lowers the amount of money that can be given away as part of their mandate or they will have to move a larger share of their assets up the risk spectrum into equities for example. This dilemma is highlighted in the two charts below. The chart on the left shows the valuation on the 10-year U.S. Treasury note through time. Again, the P/E on a bond is simply the inverse of its yield (2% yield = 50 P/E). Despite constant cries from market pundits that the stock market is expensive today, the truth is that it's very reasonable when compared to valuations across the past six decades, especially considering where interest rates are currently. This discussion is a nice lead into our next section that stocks may be the only game in town.

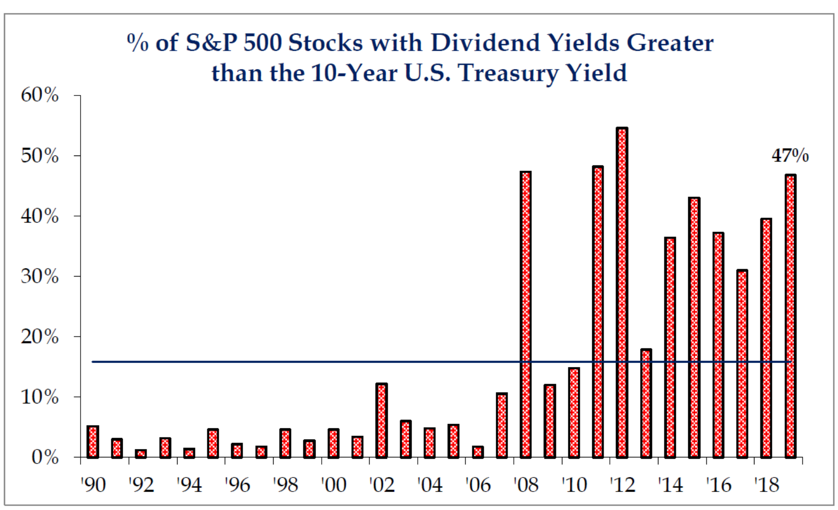




Source: Strategas Research

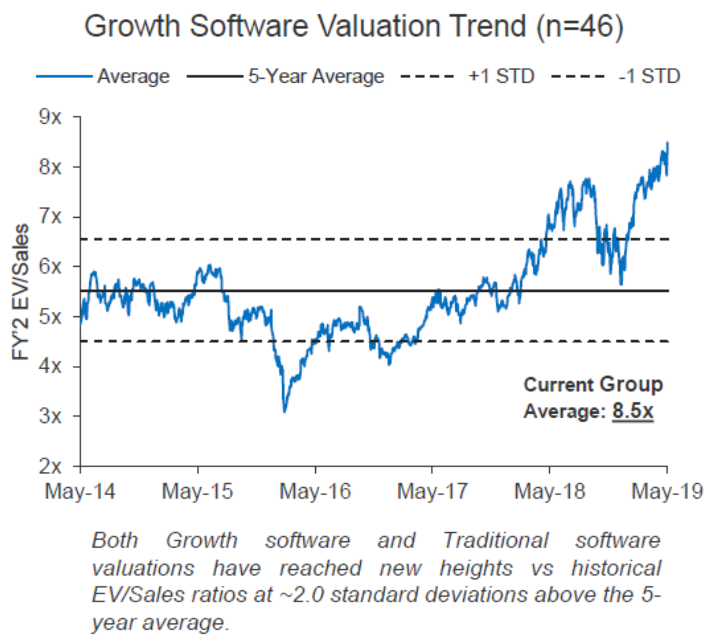
Stocks May Be the Only Game in Town, Especially Small Caps

As we stated above, low yields globally are forcing investors to make tough choices. The choice is to accept low fixed income yields or find something that can provide a higher return with an acceptable amount of risk. As we showed in the valuation charts above, the alternative is to consider equities. Not only can stocks provide significantly higher potential returns, but the dividend yield on the S&P 500 is also currently quite attractive from a historic standpoint as shown in the chart below. Nearly half of the S&P 500 stocks have dividend yields greater than the current yield on the 10-year U.S. Treasury note, which allows you to get paid as you wait for the potential stock market appreciation.



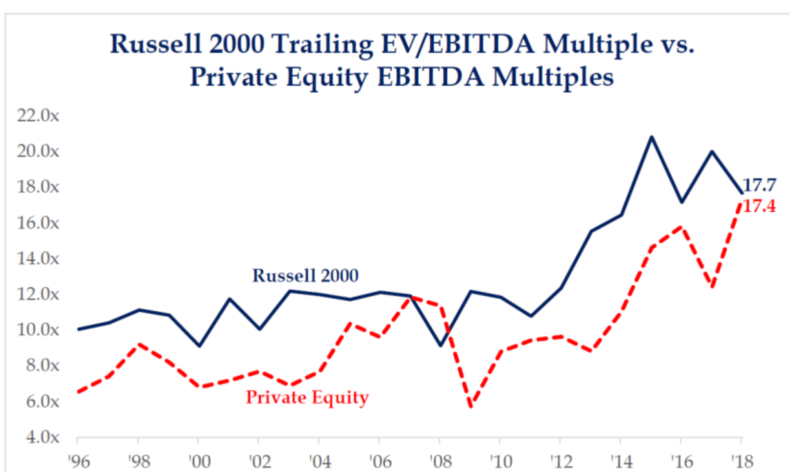
Source: Strategas Research

However, as everyone knows, there is more risk in equities, and the current environment is no exception. While the stock market appears reasonably valued on the surface as shown above, there are some anomalies occurring which give us pause. For example, as we highlighted earlier, unprofitable stocks have been the clear performance winners year-to-date. Investors' willingness to pay up for gig economy stocks like cloud-based software stocks is, in large part, driving this anomaly. The valuations in this space have become breathtakingly high in our opinion. Many stocks in this sector are trading for more than 15 times revenue, which means that if a company had 100% margins (which they don't), it would take you 15 years to get your money back. The market is paying for growth at any price. The chart below shows the escalation in valuation multiples through time in this software sector.



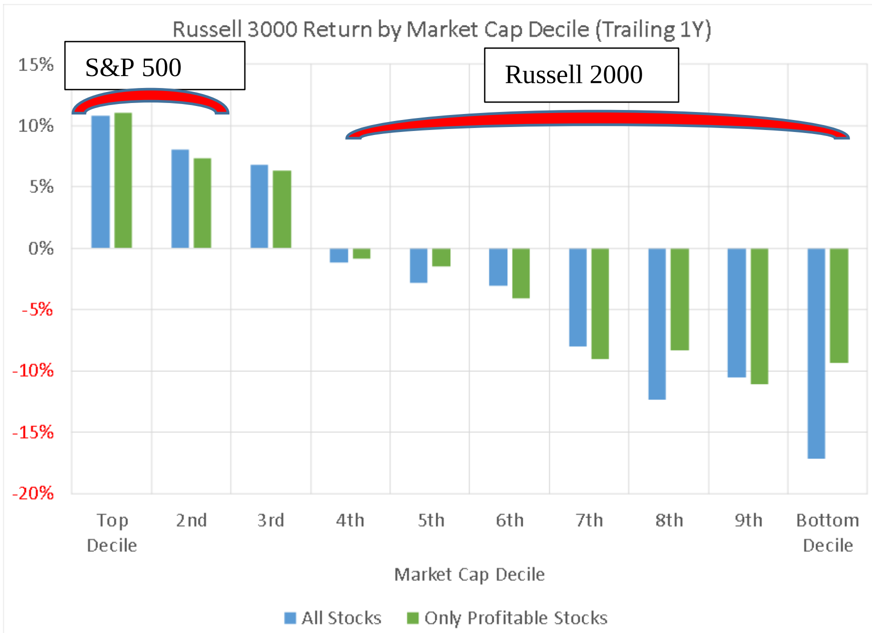
Source: Jeffries

Private equity firms have also been paying up for their investments of late. Historically, private equity investors would attempt to buy stocks that were trading at a discount to the stock market or the industry in which the company operated. Then they would fix the company, strip out costs, and sell it back into the stock market years later for a hoped-for premium to their cost. There appears to be too much money sloshing around in the private equity coffers these days as they are no longer paying a discount to public market valuations for companies in their portfolios as the chart below shows. Historically, these astute investors would pay several multiple points lower on an Enterprise Value to EBITDA basis. However, that gap has narrowed considerably of late and leads us to another anomaly.



Source: Strategas Research

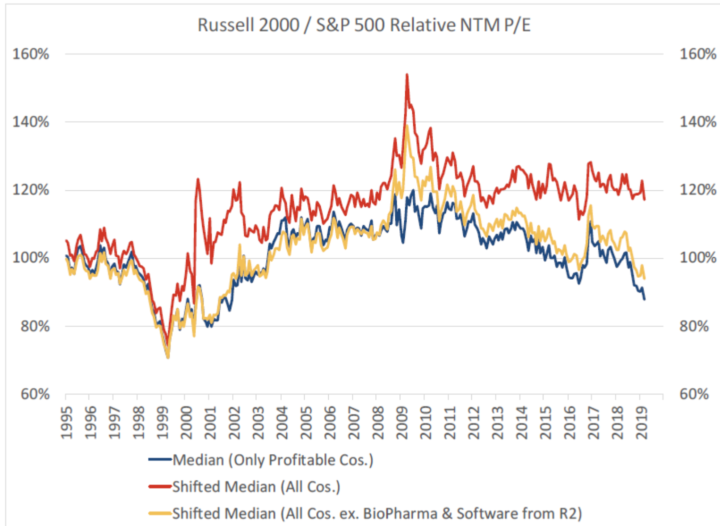
In our section entitled "Review of the Quarter" we noted that small caps were noticeably underperforming large caps of late. This underperformance can be seen in the chart below which shows the returns of the Russell 3000 Index by decile over the last year. Performance has been linearly worse as you move down the market cap spectrum. The S&P 500 has outperformed the Russell 2000 by +13.3% since June 30, 2018, which is a very wide margin by any historical standard. The performance differential between the top and bottom deciles for profitable companies only is in excess of 20%!!



Source: Furey Research and 1492 Capital Management

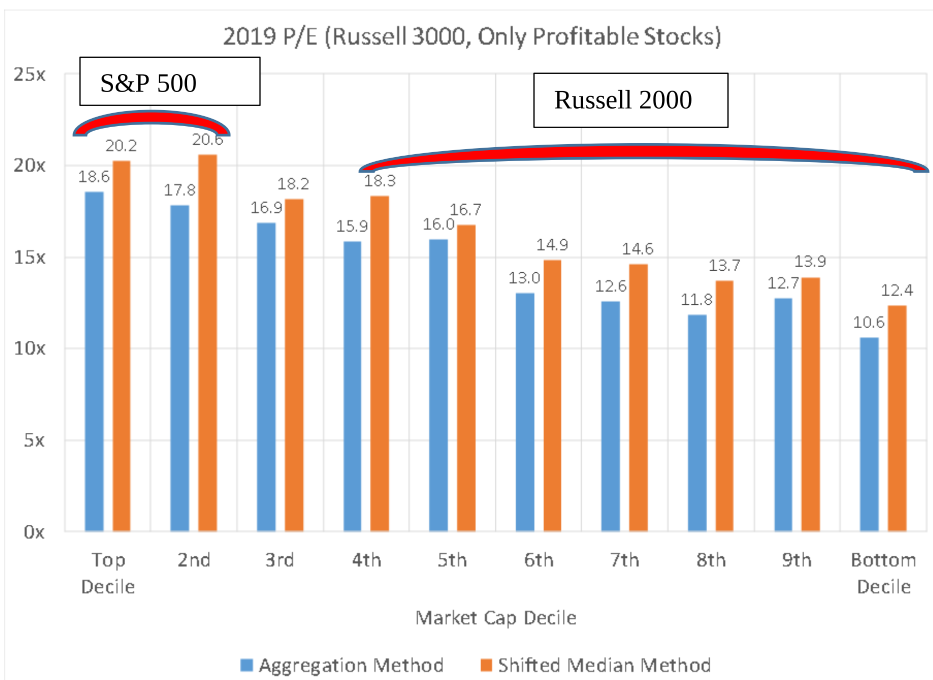
The magnitude of this small cap underperformance is a fairly rare occurrence. As shown in the chart below, only four times in the past twenty years has the Russell 2000 underperformed the S&P 500 by more than 10% over a trailing one year time frame. This anomaly doesn't last very long as the Russell 2000 usually closes this performance gap in short order as you can see in each of the four instances shown below left.

The performance anomaly of the last year has left small caps stocks attractively valued relative to large caps. The chart below shows that profitable small caps stocks (blue line) are the cheapest they've been relative to the S&P 500 since 2002

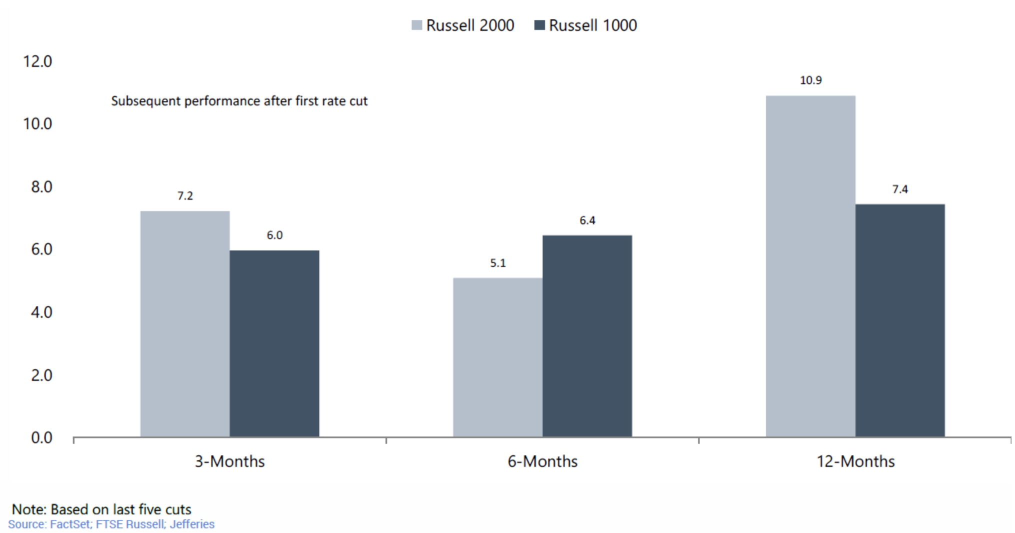


Source: Furey Research Partners, StockCharts.com as of April 18th, 2019

The underperformance for small caps that we referenced above has left most of the profitable companies within the Russell 2000 Index extremely attractively valued. We don't expect this anomaly to last very long as the massive amounts of private equity assets sitting in cash will seek out these values in short order. If we haven't convinced you yet, small cap stocks outperform large caps following the Federal Reserve's first rate cut of a cycle. The first reduction is expected at their next meeting in late July. Therefore, we conclude that investors seeking outsized returns should examine the currently ignored asset class of small cap stocks.



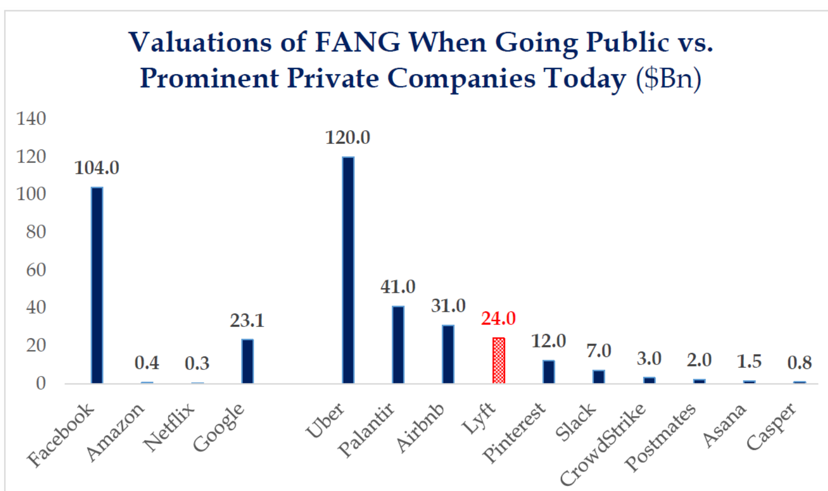
Source: Furey Research and 1492 Capital Management



Updated 2019 Outlook: A Picture is Worth a Thousand Words

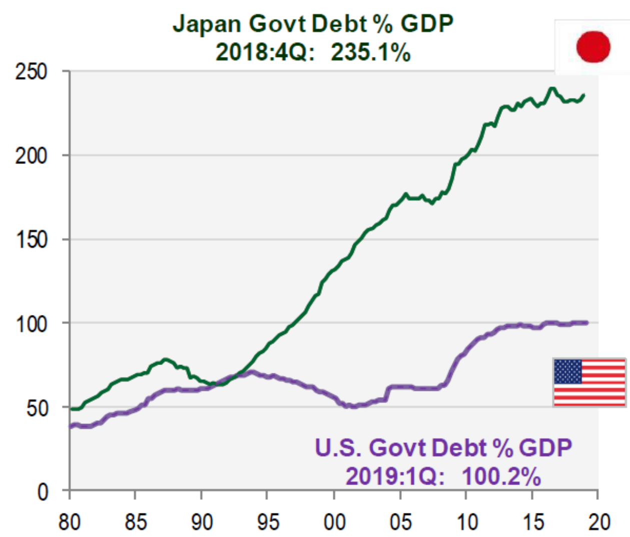
Above we articulated our updated 2019 outlook and the key issues and drivers for the stock market. Yet, we believe that there are other topics that we haven't spent a great deal of time on that deserve some mention. In order to provide you with a shorter read, as everyone's time is valuable, we decided to express it in pictures. As they say, a picture is worth a thousand words, and we'll let you interpret what we view as some compelling charts. We'll provide a bullet point or two of explanation as to why we think the chart or graphic is important.

So far 2019 has been a big year for IPO's, particularly for some of the so-called "unicorns" like Uber and Lyft. Unfortunately many of these IPO's haven't fared well in their coming out party. Valuation may have something to do with it.



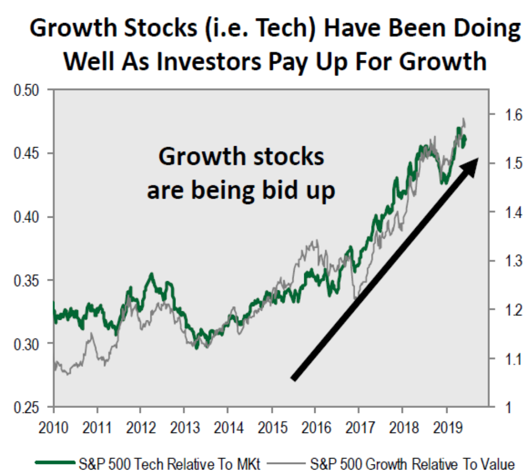
Source: Strategas Research

In an effort to stimulate their economy, the Japanese government debt has exploded over the past 25 years.



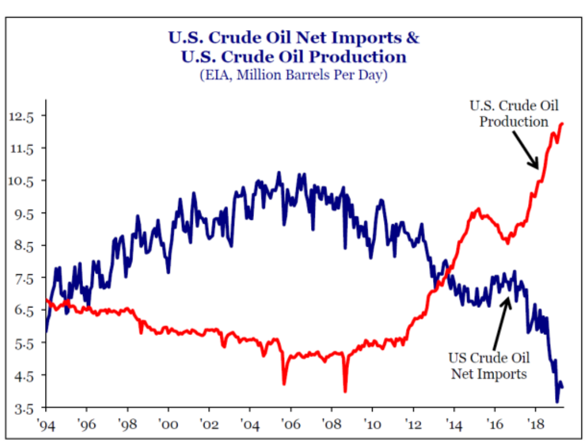
Source: Cornerstone Macro

The number of companies growing sales greater than 15% has shrunk meaningfully over the past 20 years causing investors to pay up for growth due to the scarcity factor.



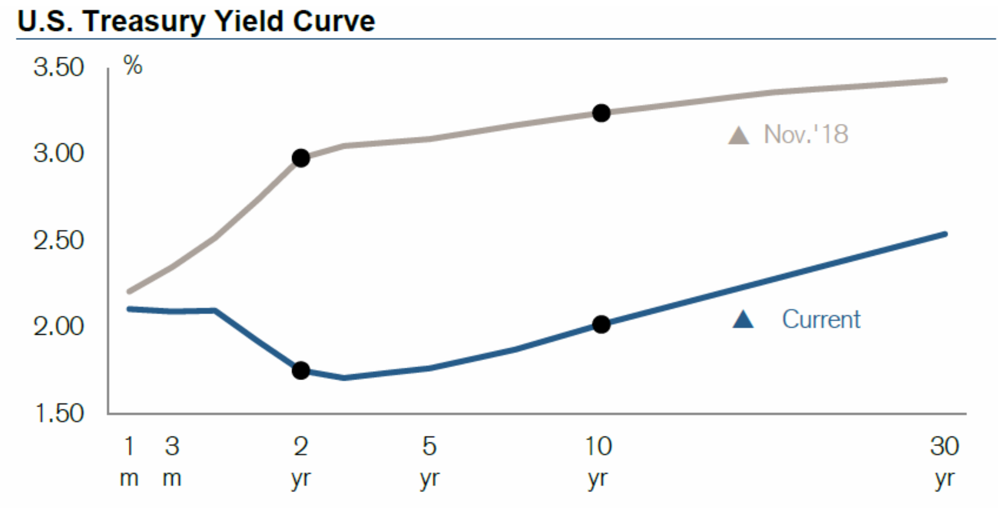
Source: Cornerstone Macro

Crude oil production in the U.S. has grown by an extraordinary eight million barrels per day in the last decade. This growth is a key cog in the U.S. economy, and politicians better be careful for what they wish for because low oil prices will have a far greater negative impact on the U.S. economy than ever before.



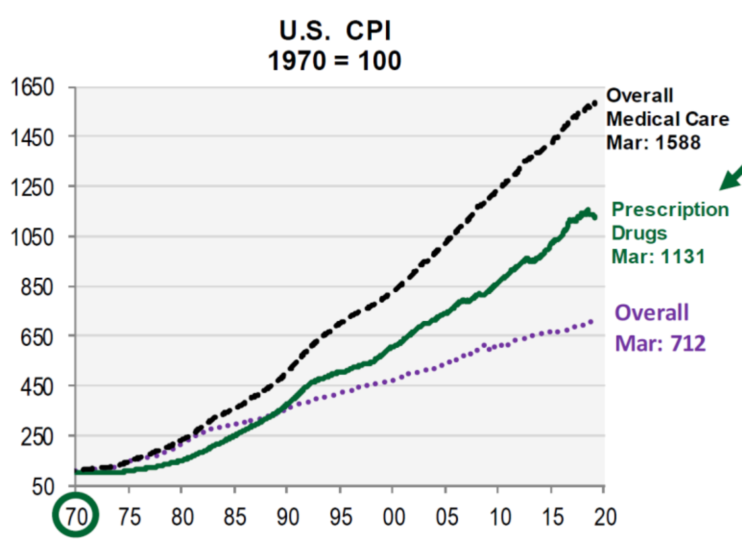
Source: Strategas Research

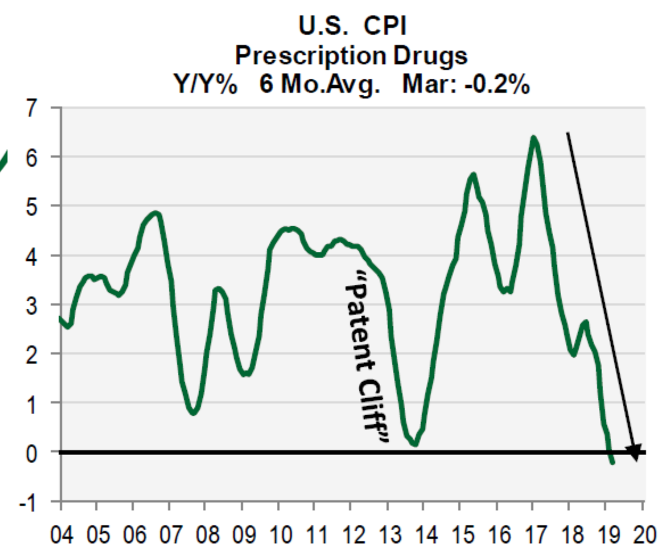
The yield curve has changed dramatically in just over seven months, and reflects the damage done from an overly aggressive Fed and from tariffs. The short end of the curve is likely to drop substantially over the next year as the Fed eases.



Source: Federal Reserve, the BLOOMBERG PROFESSIONAL™ service, Credit Suisse

There is always a lot of chatter in Washington about the escalating costs of health care. Below left, you'll see this continues unabated. However, interestingly, prescription drug costs are falling for the first time ever now as the industry is in the sights of both Trump and the Democrats. Lowering drug costs may be the only matter upon which they can actually agree.





Source: Cornerstone Macro

<u>Thematic Investing: Infrastructure Recovery Underway despite Congressional Follies</u>

While waiting and waiting for Congress to work together and pass a comprehensive infrastructure bill, it always feels as if we can watch grass grow and paint dry, wax the inside of our mailboxes, and still have plenty of free time to dedicate to other mundane pursuits. Nevertheless, despite the usual congressional follies, infrastructure spending is alive and well in the United States in 2019 and, importantly, is not subject to the whims of trade negotiations in China. A reacceleration in spending is definitely overdue in this country. According to data from Brookings Institute, total public spending on infrastructure declined by $9.9 billion from 2007 to 2017 in real terms. State gas tax is a key funding source for road construction. In 2019, four additional states have raised their gas tax, according to Jefferies research, to bring the total to 31 states with increases since 2013. This additional funding helps to accelerate contract lettings for public infrastructure projects. As seen in the State

Departments of Transportation (DOT) table below, annual DOT spending growth in the 15 states with the largest budgets is estimated to have its second strong year of growth in 2019 with a 5.5% increase year-over-year.

Top 15 states based on size of annual DOT budget

DOT 50 Model	Annual Growth, % change yoy				
State	**2015**	**2016**	**2017**	**2018E**	**2019E**
California	-13%	-5%	-7%	40%	18%
Texas	-9%	19%	-8%	12%	14%
Florida	7%	-1%	7%	1%	0%
Pennsylvania	14%	11%	-1%	8%	3%
North Carolina	0%	16%	-3%	0%	0%
Virginia	17%	15%	7%	-9%	18%
Maryland	3%	5%	12%	1%	3%
Michigan	2%	6%	6%	6%	8%
Minnesota	16%	-11%	24%	13%	5%
Iowa	1%	-1%	6%	-2%	3%
Georgia	23%	30%	5%	2%	0%
Ohio	8%	3%	-1%	-2%	-4%
Wisconsin	2%	-10%	3%	9%	1%
Illinois	1%	23%	4%	3%	-3%
Washington	0%	-10%	0%	2%	0%
Total US	**1.8%**	**3.4%**	**3.2%**	**6.0%**	**5.5%**

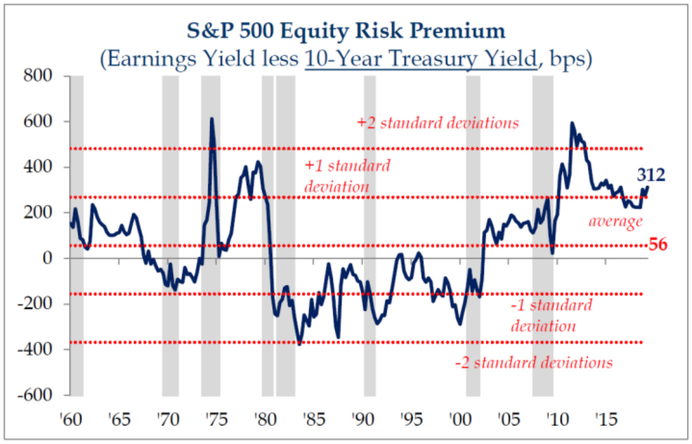
Source: State Departments of Transportation

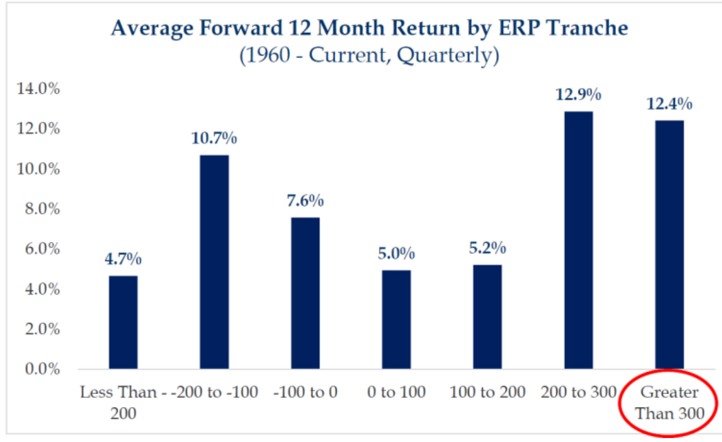
In the key market of California, infrastructure spending is accelerating as the funds from Senate Bill 1, a 10 year $54 billion public infrastructure program, begin to flow this year after a failed November 2018 attempt to repeal the bill. According to Goldman Sachs research, California's Department of Transportation budget as a percent of state GDP had been running at less than 0.5%, which is more than 50% below the national average. Additional spending in this large market is long overdue and a key driver to the overall strength of public infrastructure spending in the United States. In Texas, the state DOT budget is benefitting from the severance taxes from a healthy oil and gas industry and from the Prop 7 constitutional amendment which dedicates up to $2.5 billion in sales tax revenue if the state's total sales tax revenue exceeds $30.5 billion. With strong funding programs in place, Texas is forecasted to have its second consecutive year of double digit percentage increases in its DOT budget.

According to DA Davidson's proprietary research, the value of U.S. public project bids over the trailing twelve months is up 23% year-over-year through May, and year to date through May total value of projects bid is at its highest level in over 10 years. Adding more wind to the sails of public infrastructure spending, President Trump signed a $19 billion natural disaster relief and recovery bill last month that has billions for infrastructure repair and replacement from natural disaster damage. At 1492 Capital Management, we are deploying this public infrastructure theme across several strategies with holdings that include engineering and construction firms with sizable public infrastructure businesses and aggregate producers that are seeing both improved demand for its materials and better pricing discipline in 2019 versus a difficult 2018. While the never ending wait for a $1.5-2.0 trillion infrastructure bill from Congress may come to an end after the trade situation with China clears, it would be the proverbial icing on the cake with several positive catalysts already strengthening the public infrastructure spending outlook for 2019 and 2020.

Market Trivia

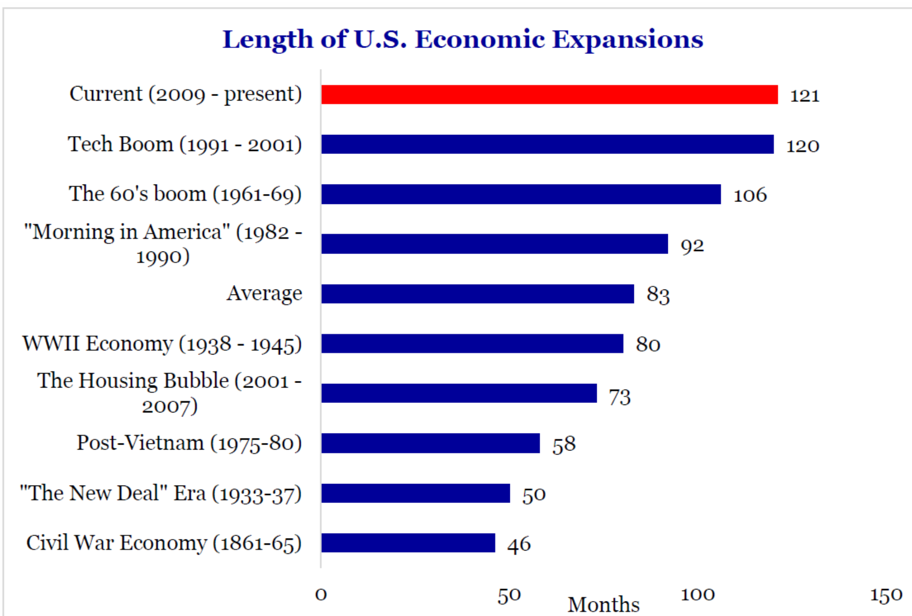
Each quarter we offer a piece of market trivia that we believe is interesting or timely, or both. With the collapse in interest rates over the past few months, the equity risk premium (defined as the earnings yield of stocks minus the 10-year treasury yield) has expanded recently as can be seen below left. When the equity risk premium has reached these levels, the following 12 month returns have averaged +12.4%, as seen below right.





Source: Strategas Research

The current economic recovery since the Great Recession now has the honor of being the longest and slowest recovery on record.



Source: Strategas Research

We hope that you found our second quarter 2019 review and updated 2019 outlook newsletter to be insightful and interesting. Should you have any questions about anything discussed herein or would like more information about 1492 Capital Management, please call us at 414-276-1492.

Joe Frohna Rodney Hathaway Adam France Nancy Frohna Tim Stracka

Important Disclosures:

(1) The minimum criteria for inclusion in ***Best Money Managers***: Performance must be calculated "net" of all fees and brokerage commissions. This means after all fees have been deducted. This standard is somewhat controversial, as the SEC requires that only "net" of fees numbers be presented publicly, while GIPS (Global Investment Performance Standards) prefers that "gross" numbers be presented along with a fee schedule. Since the SEC is a regulatory authority, and since complete fee schedule presentation would be impractical in this "ranking" format, we require "net" numbers. Performance must be calculated inclusive of all cash reserves. To explain, any given investment portfolio will hold some level of cash over a

particular reporting period. Even equity portfolios which specifically seek to be fully invested in the market at all times will temporarily have dividend payments and other ordinary cash flows which cannot instantaneously be invested in the market. These cash holdings obviously will have an effect on the performance of the overall portfolio – negative when cash returns are low relative to returns of the asset class, and positive if the opposite is true. While presentation of "equity-only" (for example) returns may provide a valuable insight into the security selection skills of the manager, we require for comparability's sake that performance results be inclusive of cash reserves for consideration in the rankings. Performance results must be calculated in U.S. dollars, that is, from the perspective of a U.S.-based investor. Currency holdings can have a very significant impact on the performance of a portfolio with international holdings. While this will always be the case (as we do not make distinctions between hedged and unhedged portfolios), we require that performance must be translated into U.S. dollars to ensure comparability to the point where these are all returns that would be seen by a U.S.-based investor. Performance results must be calculated on an asset base which is at least $10 million in size for "traditional" U.S. asset classes (equity, fixed income, and balanced accounts) or at least $1 million in the case of international and "alternative" U.S. asset classes. This minimum ensures that the firm and product are somewhat established. The goal is to not taint the rankings with "flashes in the pan" while also not excluding promising emerging managers. The minimum asset base requirement, therefore, is set at a level which balances these objectives. The classification of the product must fall into one of the categories which we rank. We only publish rankings for categories/time period combinations for which we have at least 20 contenders.

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