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 third 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 demonstrated as we are again pleased to announce that 1492 Capital Management has been named a Top Gun(1) by Informa Investment Solutions' PSN manager database, North America's longest running database of investment managers. With our long-term, thematic investing focus, we are excited that the 1492 Small Cap Core Alpha strategy achieved a 3 Star rating as the eighth best performing strategy in their Small-Mid Core Universe for the three year period ended June 30, 2019.

Geopolitical Hotspots Flare Up

It's been pretty quiet for the past few years on the geopolitical front until just recently. This quarter we saw an escalation in the never-ending United Kingdom Brexit saga, Hong Kong protests over extradition laws with mainland China, Saudi Arabian oil facilities under attack from Iran, ongoing trade dispute between the U.S. and China, and impeachment proceedings against President Trump. Surprisingly, despite this noise and sinking economic statistics globally, the stock market was able to survive with the S&P 500 posting a gain of +1.70% in the quarter and finished the first three quarters with a return of +20.55%. This return marked the best first three quarters of any year dating back to 1997. In typical risk-off fashion, the Russell 2000 posted weaker results with a -2.40% decline as there was a flight to liquidity and quality on the heels of these issues. We believe that the markets were able to hang in there due to optimism surrounding the pending trade discussions between China and the U.S. which are set for October 10th. However, as we've seen time and again over the past 18 months, all that we need is a poorly toned tweet from President Trump and sentiment can change on a dime. The Federal Reserve's lowering of interest rates and other central banks' rate cuts around the globe have helped the tone considerably as well. However, we believe that if a trade deal isn't struck within the next six months, recession may be the final outcome for the U.S. economy. As we said last quarter, 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. Perversely, Iran's attacks on Saudi Arabia's oil infrastructure may actually be a positive for the U.S. economy. 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 performance information and disclosures. If you would like to discuss any of these strategies with us, please contact Tim Stracka at 414-238-3398.

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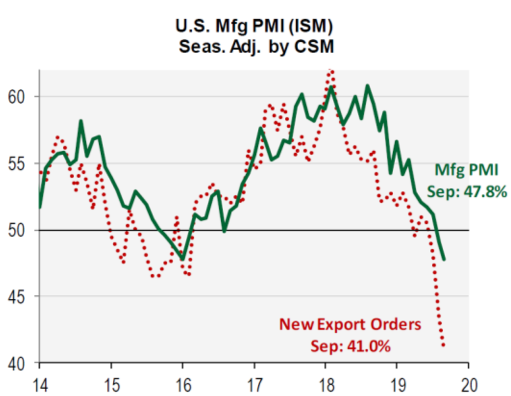
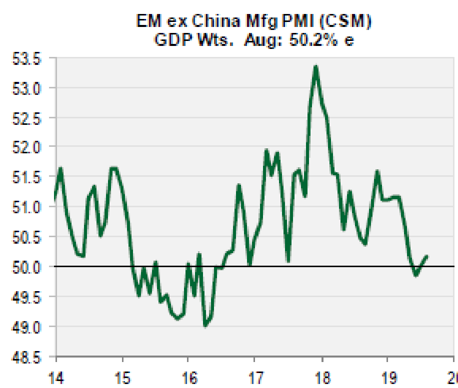
A Review of the Quarter: Geopolitical Hotspots Flare Up

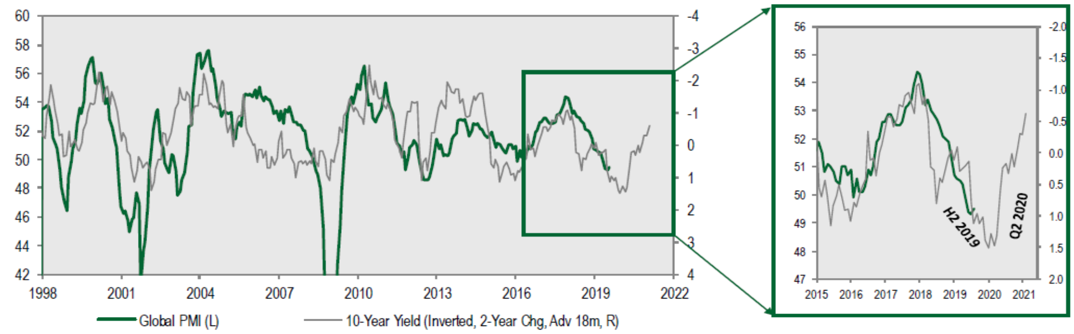
While there is always some geopolitical uncertainty around the globe, the past few years have been relatively calm- until this quarter. We've now recently witnessed an escalation in the never-ending United Kingdom Brexit saga, Hong Kong protests over extradition laws with mainland China, Saudi Arabian oil facilities under attack from Iran, ongoing trade dispute between the U.S. and China, and impeachment proceedings against President Trump. Add to the mix an inverted yield curve, which has been a pretty good harbinger of an impending recession, and you've got the necessary ingredients for a significant decline in the stock market. Surprisingly, despite this noise and sinking economic statistics globally, the stock market as measured by the S&P 500 was able to drudge through the toughest part of the calendar relatively unscathed. The index posted a return of +1.70% for the quarter ended September 30, 2019 and finished the first three quarters with a return of +20.55% which is the best first three quarters of any year dating back to 1997. In typical risk-off fashion, the Russell 2000 posted weaker results falling -2.40% as there was a flight to liquidity and quality on the heels of these geopolitical issues. We believe that the markets were able to persevere due to optimism surrounding the pending trade discussions between China and the U.S. which are set for October 10th. However, as we've seen time and again over the past 18 months, all that we need is a poorly toned tweet from President Trump and sentiment can change on a dime. The Federal Reserve's lowering of interest rates and other central banks' rate cuts around the globe has helped the tone considerably as well. Additionally, China has added nearly 100 stimulative measures to their economy over the past eighteen months to offset the slowdown from the ongoing tariff war with the U.S., according to Cornerstone Macro Research. The three charts below show that a significant majority of the world economy is precariously feeling a marked slowdown in manufacturing. On the left is the U.S. Manufacturing PMI (Purchasing Manager Index) statistic which breached 50 (the line of demarcation between a growing and shrinking industrial economy) for the first time since 2015 when we had an industrial recession following an oil price collapse to $26 per barrel. The middle chart shows the emerging markets-ex China Manufacturing PMI which is also hovering just above 50 after slipping just below recently. And lastly, on the right, is Germany's Manufacturing PMI, which has been plummeting for much of the past 18 months and shows little sign of stabilization. Germany's economy is quite tied to the health of China's economy as they produce a tremendous amount of manufacturing equipment used in China's plants.





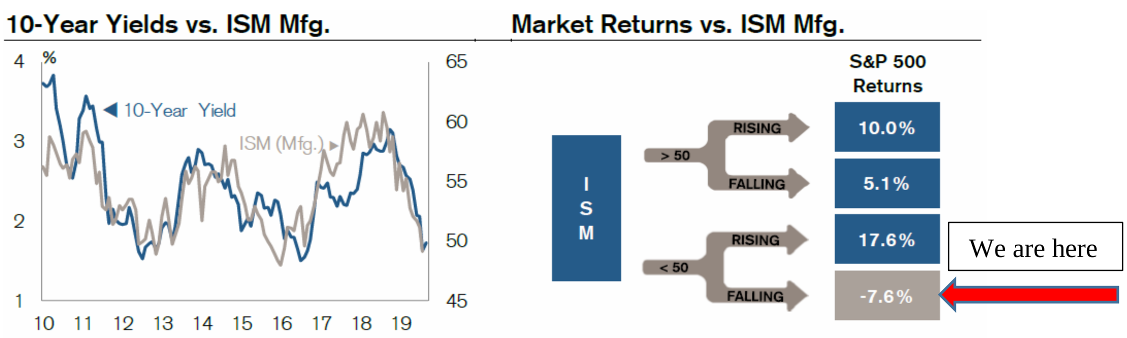
Source: Cornerstone Macro and Strategas Research

This softness begs the question, "Why is the stock market hanging in near all-time highs?" While there is no one single factoid to point to, we believe that the chart below tells much of the story. The grey line represents the inverted change in the 10 Year Treasury interest rate advanced eighteen months, and the green line represents the Global PMI which has a high degree of correlation to the change in interest rates over time. Recall that the U.S. Federal Reserve began to aggressively tighten interest rates over three years ago. These increases and tariffs had the effect of putting on the brakes of the global economy. The Fed just began to unwind some of this tightening with two rate cuts this year. There is a lagged effect to these tightenings and easings, and the chart below depicts an approximately 18 month lag. Therefore, the market may be in the early stages of sniffing out a reacceleration of the Global PMI sometime early in 2020. The stock market is a discounting mechanism, and the market is acting in anticipation of the future. The stock market may also be counting on a truce in the U.S./China tariff war.



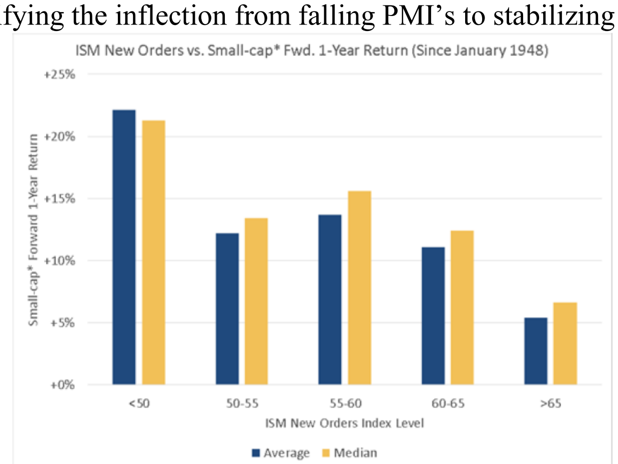
Source: Cornerstone Macro

The rules of the road for international business, 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. The chart below uses the same metrics of the 10 Year U.S. Treasury yield and the ISM Manufacturing index as the chart above. This relationship is shown on the chart below left. On the right there is a schematic that shows the S&P 500 index returns based on how the ISM Manufacturing index is performing. As the red arrow shows, we're in the part of the cycle where the ISM index is falling below 50 which historically leads to stock market losses averaging -7.6%. The question then becomes how quickly can we move from falling below the 50 line to rising below the 50 line? Note that rising below the 50 line of demarcation provides the best historical returns of +17.6% on average. This performance makes sense because it implies that conditions for economic growth have become more accommodative through rate cuts and other stimulus measures, and the stock market is anticipating accelerating future growth rates. Given that we've just entered the "falling below 50" part of this trip, the stock market action will likely depend heavily on how quickly the U.S. China trade war comes to a conclusion (assuming it does) and on how much more stimulus central banks around the globe will inject into the global economy. Currently, they are injecting stimulus at a measured not panicked pace.



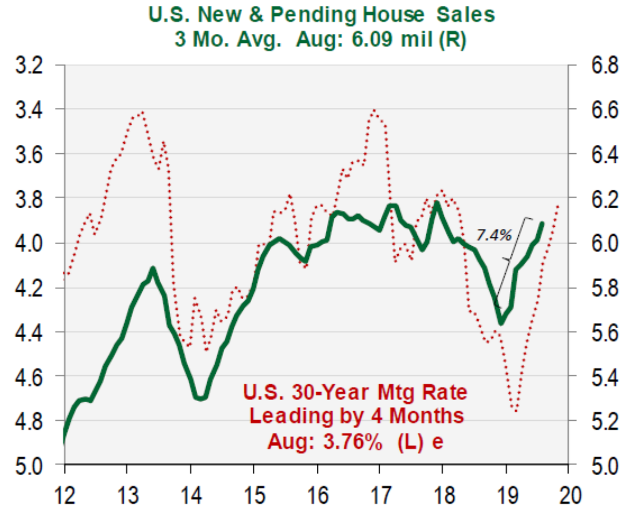
Note: (Left) 3-mo moving average, (Right) Since 1970
Source: Federal Reserve, ISM, The BLOOMBERG PROFESSIONAL™ service, Standard & Poor's, Credit Suisse

Despite the gloom and doom that's associated with PMI's below 50, it's actually the time when small caps shine as shown on the chart below. The key is identifying the inflection from falling PMI's to stabilizing or improving.

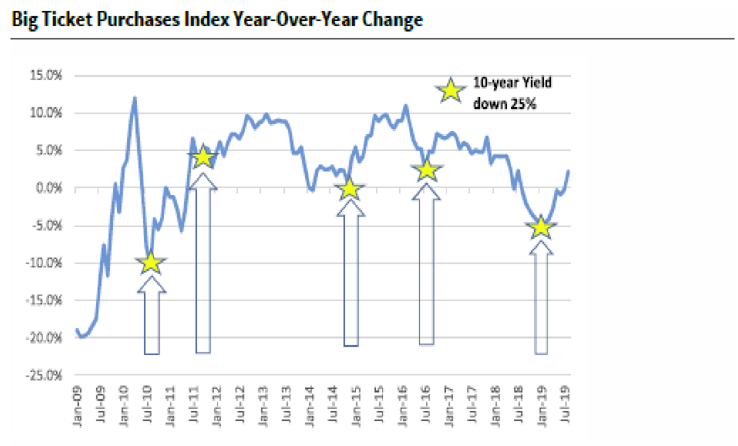


Source: Strategas Research

One area of the economy that seems to be holding up relatively well is consumer spending. Last year when interest rates spiked higher due to aggressive Federal Reserve tightening, auto and home sales tailed off rather dramatically. The sensitivity at the consumer level to these rate hikes was quite surprising and sent both auto and home sales rates plummeting. Now that the 10-year Treasury note is yielding around 1.7% and the 30 year mortgage rate is hovering close to 3.5%, which is down from nearly 5% late last year, big ticket purchases have made a come back and are buoying the domestic economy. The chart below left shows house sales in green compared with the 30 year mortgage rate in red (rates shown inverse). Notice how quickly home sales fell off in 2018 as mortgage rates increased. Subsequently, as rates have come down, home sales have accelerated. Similarly, the chart below right shows that the "Big Ticket Purchases Index" accelerated in 2019 after a 25% decline in the 10-year Treasury yield.



Source: Cornerstone Macro



Source: Bloomberg, SSI Statistical Surveys, U.S. Census Bureau, RVIA website, and Raymond James research

Despite all of the noise during the quarter, the major indices held in relatively well as the S&P 500 posted the best returns for the first three quarters of a year since 1997. Small caps weren't as fortunate during the quarter as investors flocked to liquidity and size. Value stocks outperformed growth stocks in the third quarter but still trail on a year-to-date basis. I contend that the growth index was the beneficiary of the annual Russell 2000 rebalance that happens every June 30th. This rebalance kicked many of the high flying software and internet stocks with nosebleed valuations out of the Russell 2000 Index into the Russell 1000 Index due to their appreciation over the past 12 months. Their swoon then began late in August and into September, and this fluke in timing dramatically helped the Russell 2000 Growth Index performance during the quarter when many of these names corrected in excess of 25%. The table below highlights the returns for the third quarter and year-to-date 2019 for the popular indices.

Index Returns

Index	Third Qtr. 2019 Return	2019 YTD Return
Russell 2000	-2.40%	+14.18%
Russell 2000 Growth	-4.17%	+15.34%
Russell 2000 Value	-0.57%	+12.82%
S&P 500	+1.70%	+20.55%
Dow Jones Industrials	+1.19%	+15.39%
NASDAQ Composite	+0.18%	+21.54%

Source: 1492 Capital Management, LLC and Factset

From a style perspective, the Russell 2000 Value Index (-0.57%) trumped the Russell 2000 Growth Index (-4.17%) in the third quarter, but growth maintained its year-to-date 2019 lead. Growth indices outperforming value indices has become a common refrain over the past 10 years since the Great Recession, but value stocks' late-in-the-quarter rally has some wondering if the tide is going to change. We contend that this shift will only be sustained if we see an acceleration in economic statistics which likely only comes on the heels of a China trade deal. The only sectors within the Russell 2000 Growth Index that finished with positive returns for the quarter were the typical "risk off" sectors of Real Estate (+2.98%), Staples (+2.76%), and

Utilities (+0.74%). Surprisingly, the best performing sector in the Russell 2000 Value Index was Technology (+5.99%) presumably as investors dumped high-flying tech for those that have recently been left behind. The worst performing sectors in both the Growth and Value indices were Energy and Health Care. We attribute this weakness to concerns that these two sectors will be most affected should the Democrats win the White House in 2020. The first two tables below highlight the performance of the Russell 2000 style indices by sector for the month of September, the third quarter, and year-to-date 2019. Note that the month of September was significantly stronger than the first two months of the quarter for the Value Index as the Fed cut rates further and as the Trump administration hinted at a temporary truce with China on the trade war front. Lastly, the third table below shows that the performance within the Russell 2000 was worse moving down the market cap spectrum. 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. The year-to-date differential between the largest quintile and smallest quintile by market cap is one of the largest that I've ever seen in my career.

Table 9 - Russell 2000 Growth's Performance Attribution through September 30

	September			3Q2019			Year to Date			
Russell Sector	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Wgt
Discretionary	0.15	0.04	0.97	-2.70	-0.35	1.47	15.58	3.00	0.25	13.5
Staples	-1.61	-0.05	-0.79	2.76	0.09	6.94	11.07	0.30	-4.26	3.3
Energy	-1.37	-0.02	-0.55	-8.87	-0.11	-4.69	1.06	0.10	-14.27	1.1
Financials	0.33	0.02	1.15	-2.73	-0.18	1.44	13.60	1.10	-1.73	6.2
Health Care	-4.93	-1.36	-4.11	-9.63	-2.71	-5.45	7.71	2.11	-7.63	26.4
Mat. & Process	7.47	0.47	8.29	-0.21	0.01	3.96	23.08	1.57	7.75	6.8
Prod. Durables	3.39	0.54	4.21	-0.59	-0.07	3.58	23.16	3.39	7.83	16.7
Real Estate	2.78	0.13	3.60	2.98	0.14	7.15	21.88	0.66	6.54	4.9
Technology	-2.14	-0.34	-1.32	-4.58	-0.76	-0.41	19.25	3.05	3.92	15.8
Utilities	-1.65	-0.05	-0.82	0.74	0.02	4.91	18.17	0.32	2.84	3.0

Table 11 - Russell 2000 Value Performance Attribution through September 30

	September			3Q2019			Year to Date			
Russell Sector	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Wgt
Discretionary	8.99	1.09	3.85	3.50	0.45	4.09	7.42	1.05	-5.47	12.4
Staples	6.17	0.11	1.02	3.63	0.06	4.22	3.88	0.10	-9.01	1.8
Energy	2.77	0.20	-2.37	-22.56	-1.72	-21.97	-12.82	-0.98	-25.72	5.8
Financials	4.87	1.32	-0.28	0.13	-0.01	0.72	13.95	3.63	1.05	27.8
Health Care	1.95	0.10	-3.19	-7.84	-0.41	-7.26	-2.79	-0.12	-15.69	4.8
Mat. & Process	6.79	0.41	1.65	-2.55	-0.16	-1.96	15.00	0.77	2.11	6.2
Prod. Durables	5.33	0.65	0.19	-1.57	-0.20	-0.98	15.12	1.73	2.23	12.2
Real Estate	5.29	0.74	0.15	4.93	0.70	5.52	23.34	3.10	10.44	14.3
Technology	5.33	0.42	0.19	5.99	0.45	6.57	26.31	2.27	13.41	7.7
Utilities	1.51	0.10	-3.63	3.59	0.26	4.18	18.72	1.31	5.83	7.0

Size Quintile	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Wgt
1 (Largest)	0.48	0.26	-1.60	-1.67	-0.90	0.73	16.69	8.56	2.53	53.6
2	3.66	0.91	1.58	-2.45	-0.58	-0.05	14.36	3.67	0.20	25.0
3	4.29	0.52	2.21	-4.14	-0.55	-1.74	8.88	1.25	-5.28	12.4
4	4.22	0.26	2.14	-3.45	-0.21	-1.04	8.14	0.59	-6.02	6.2
5 (Smallest)	5.21	0.14	3.13	-4.92	-0.16	-2.52	3.38	0.11	-10.79	2.9

Source: Jefferies

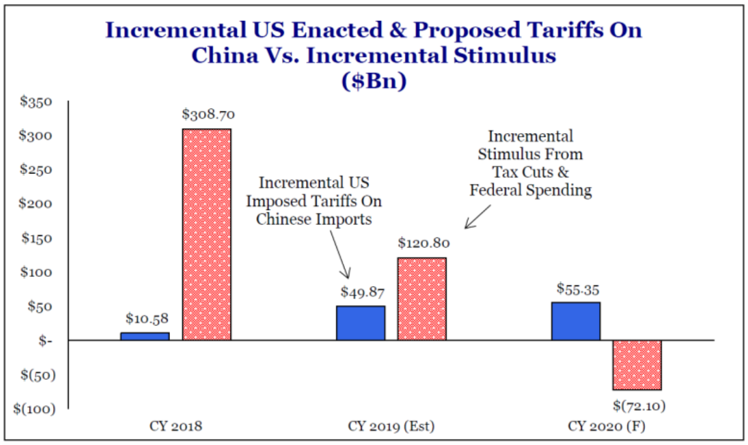
Alleged progress with the China trade negotiations plus the Fed's start of an easing cycle on the interest rate front created a positive environment for stock markets around the globe in the third quarter. The only exception to this joy was in China where investors were apparently betting that China 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 100 stimulative measures over the past 12 months to reaccelerate their economy. These measures have included cuts in: interest rates; the reserve requirement ratio; and, taxes along with increased 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 as 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. Astonishingly, oil fell during the quarter despite having its single largest daily advance ever of roughly 15% when Iranian drone strikes halted half of Saudi Arabia's oil production.

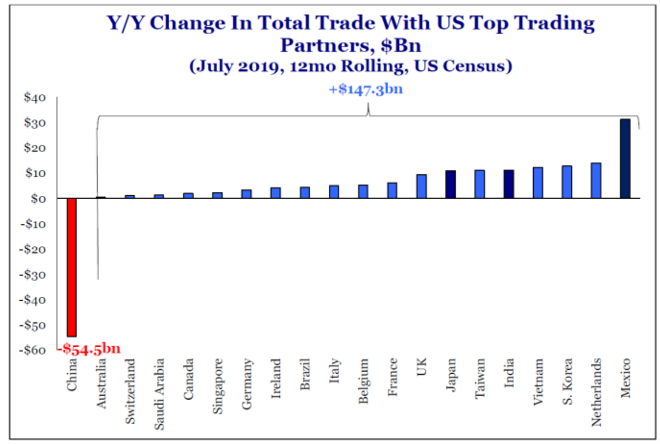
Index	Third Qtr. 2019 Return	2019 YTD Return
France	+2.7%	+23.7%
Germany	+0.2%	+17.5%
Brazil	+3.7%	+15.1%
India	-1.4%	+8.8%
China- A Shares	-2.5%	+17.8%
China- Shenzhen A Shares	+2.1%	+27.0%
Japan	+3.1%	+10.8%
Long-Term Treasuries (TLO)	+7.5%	+17.1%
Investment Grade Corp. Bonds	+3.0%	+13.3%
Gold	+4.2%	+15.0%
Volatility- VIX index	+7.7%	-36.1%
Oil	-7.5%	+19.1%
Natural Gas	+1.0%	-18.3%
Lumber	-3.1%	+10.4%

Source: 1492 Capital Management, LLC

Updated 2019 Outlook: Contrary to Trump's Claims - Tariffs Have Consequences - 6 Months to Pull Up

President Trump has made numerous claims that the tariffs that he's implemented over the past 15 months don't have consequences to the U.S. consumer, are easy to win, and are paid for by foreign countries. Dare we say that we believe these claims are all "fake news" to some degree, and if a deal isn't struck with China within the next six months, the U.S. economy will likely fall into a recession. The math behind implementing tariffs clearly points to China having more to lose, which is what Trump believes. For example, US GDP is roughly $20.5 trillion and China's GDP is $13.6 trillion. China exported $563 billion of goods to the U.S. in 2018 according to the Trading Economics website. This amount is equal to 4.1% of China's GDP. Conversely, the U.S. exported about $120 billion of goods to China in 2018, which is equal to 0.6% of U.S. GDP and thus has a significantly smaller impact on the U.S. The broad math says that China has more to lose in this tariff war. However, this analysis is just the broader framework. Now let's examine who pays the tariffs. Tariffs are not paid by the country where they're imposed. The exporter of those goods pays. Many of the goods that are being shipped from China to the U.S. are being manufactured in China at U.S. companies and are then shipped back to the U.S. for consumption in order to take advantage of cheap labor in China. U.S companies, in many cases, are paying the tariff to the U.S. government. Given the massive trade deficit between the U.S. and China, U.S. companies are contributing much of the billions of dollars that Trump claims are going into U.S. coffers. The chart below shows that the cost of the tariff war offsets the stimulus programs like the tax reform act and others, particularly as we move into 2020 when the tariffs will act as a significant headwind. The chart below right shows the significant drop off in trade with China over the past 12 months relative to other trading partners.

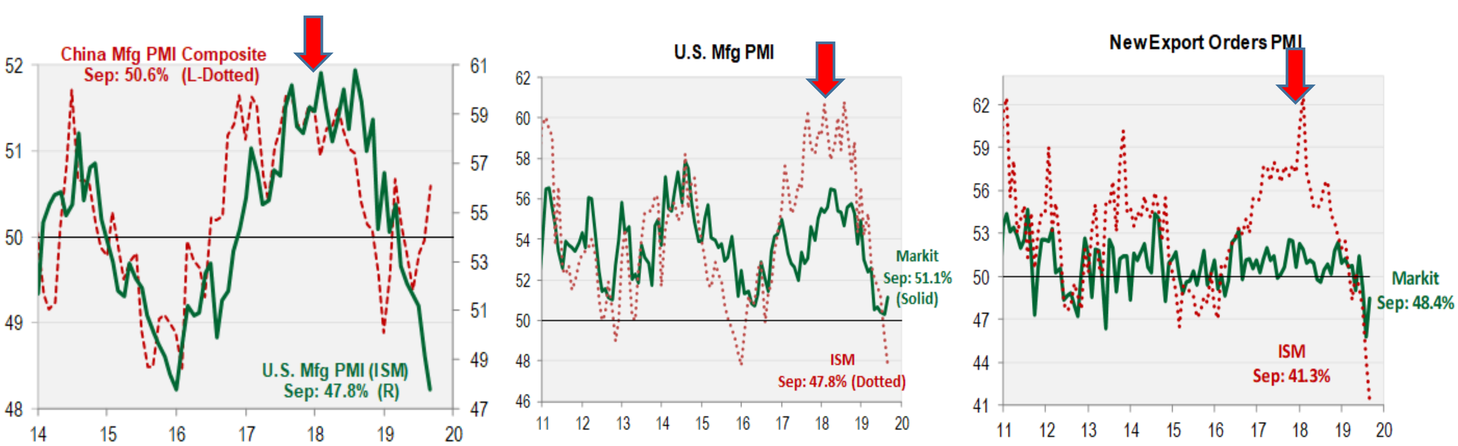




Source: Strategas Research

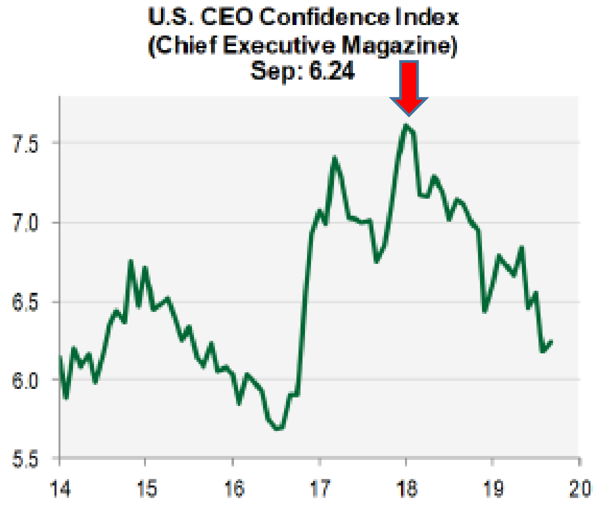
Recall that washing machines being exported from China to the U.S. were one of the very first items to have a tariff slapped on it, which clearly impacted the U.S. consumer with more expensive washing machines. Additionally, agriculture exports, particularly soybeans, is one of the commodities that China hit with 25% tariffs in retaliation (an estimated $14 billion worth of soybeans are to be exported to China annually), which makes U.S. produced soybeans more expensive. This has caused much of the farming economy in the U.S. to fall into recession after many years of tough commodity prices generally. In order to support U.S. farmers, President Trump has allocated $26 billion in aid to them. This subsidy offsets much of what the U.S. is currently collecting in tariffs. Other examples are numerous, and our portfolio companies haven't been immune to the tariff war's impact. For example, G-III is a clothing manufacturer for some of the most famous brands sold in American department stores like Tommy Hilfiger and Calvin Klein. Historically, they manufactured much of these goods in China and shipped them back to the U.S. for sale to customers like Macy's and Nordstrom's. Unfortunately, these goods were assigned tariffs, and G-III has had to absorb part of the tariff and has tried to get concessions from their manufacturing partners in China. The balance of the increase is passed on to consumers through higher prices. At the end of the day, they are shifting manufacturing to other parts of the globe like Vietnam, Malaysia, and India to name a few, which is costly and disruptive.

On each of the following charts we've placed a red arrow on them which denotes the start of the tariff war. We don't think it's a coincidence that each of the charts below shows significant slowing since implementation, not only because of the tariffs, but from the uncertainty a long drawn out tariff war has created. The chart below left shows both the China Manufacturing PMI (Purchasing Managers Index) versus the U.S. Manufacturing PMI. Note that both of them began rolling over in early 2018 and both sit well below their pre-tariff peak. China has deployed over 100 stimulus measures in order to accelerate their economy. The two charts below middle and right show the ISM and Markit PMI indices for the U.S. The middle is the broad manufacturing index and the right is the new export orders index. Note that both have been plummeting, and the September measures are the worst since the recession in 2009.

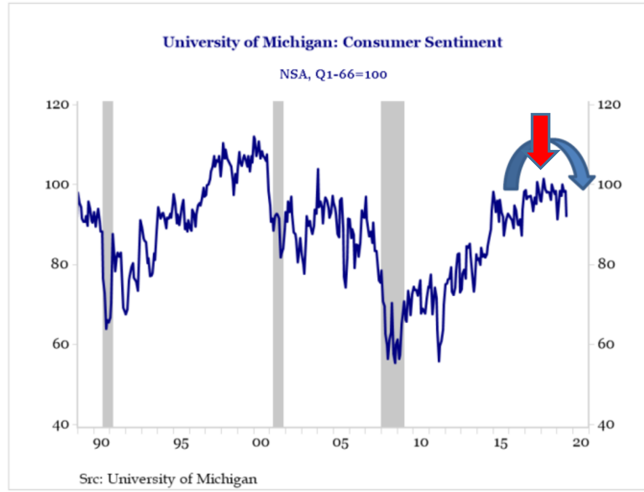


Source: Cornerstone Macro

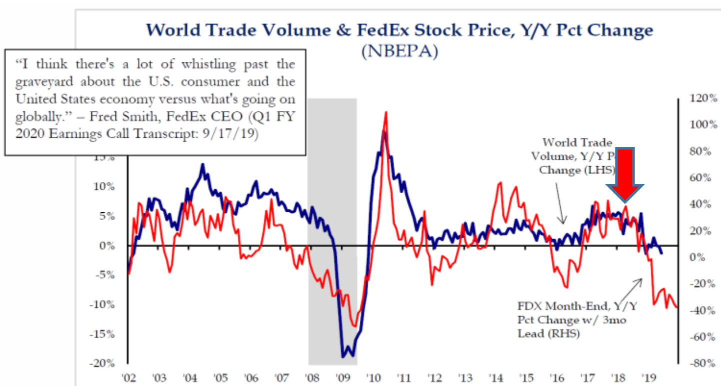
Confidence at both the CEO and Consumer level is waning. The longer the tariff wars goes on, the lower the numbers are likely to go.



Source: Cornerstone Macro



The lack of confidence is starting to infiltrate its way into corporate results. The chart on the left shows world trade volume compared wth Fed Ex stock price. While there may be other issues that Fed Ex is facing, like competition from Amazon, UPS and others, its stock price has had a high correlation with global trade. The chart on the right shows how it is becoming more common for companies within the S&P 500 to state publicly that growth is slowing. This trend is clearly worrisome.

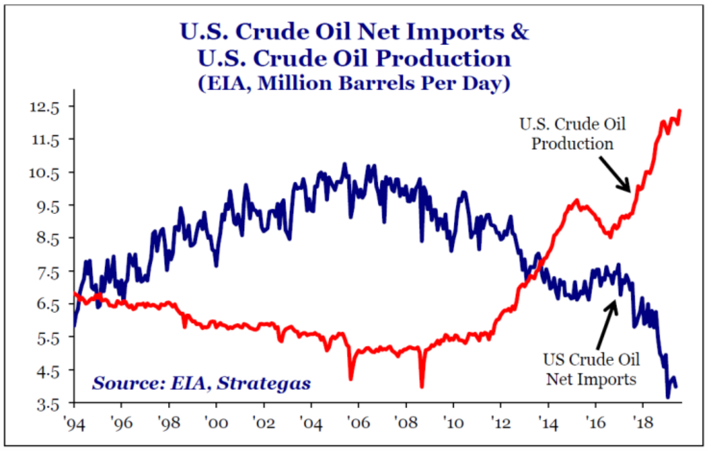


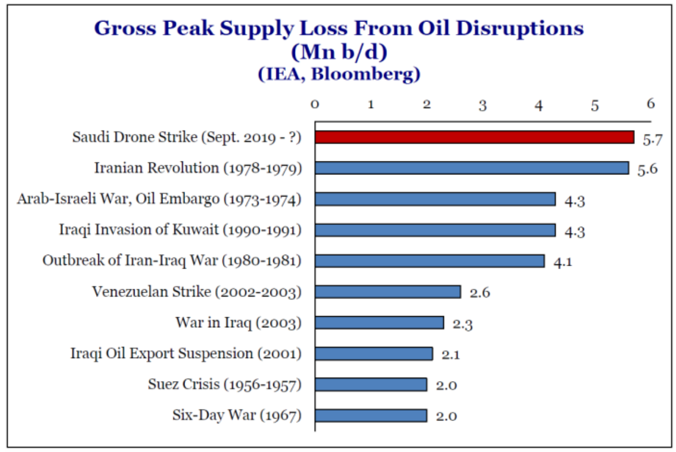
Source: Strategas Research

The above charts all show troubling trends that aren't likely to improve unless a tariff deal is struck. The strength of the U.S. consumer has bailed the economy out so far, but that too will weaken in time if corporate America continues to weaken. We estimate that if a deal isn't reached within six months, a recession is likely in the cards. Assuming President Trump wants to be reelected, he better act sooner rather than later or he may end up like his predecessors. See our Trivia section below.

<u>Updated 2019 Outlook: Perversely, the Attack on Saudi Arabia's Oil Infrastructure Could be Good for U.S.</u>

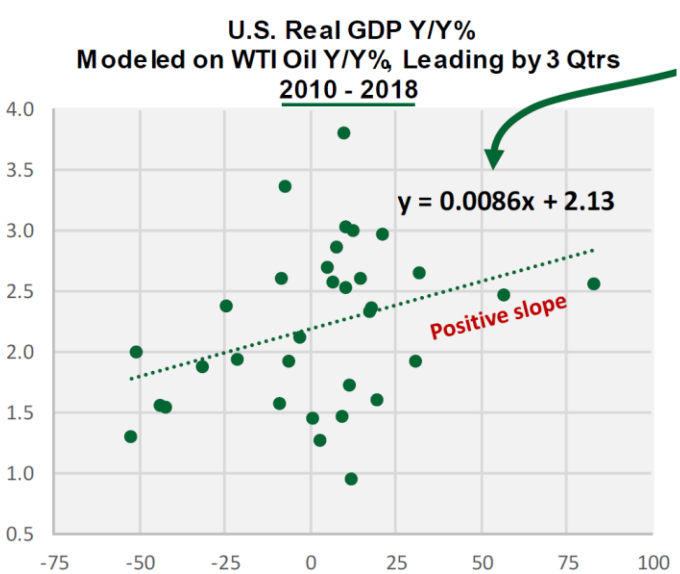
Through the past several years, we've written extensively about the increasingly significant impact that the oil industry has on the broader U.S. economy as U.S. oil production has become much more meaningful over the last 10 years due to the shale revolution. The chart below left shows the significant increase in U.S. oil production over the past decade (red line). Perversely, the attack on Saudi Arabia's oil infrastructure, which was the single largest oil production disruption in history as shown in the chart below right, may actually provide a boost to the U.S. economy.

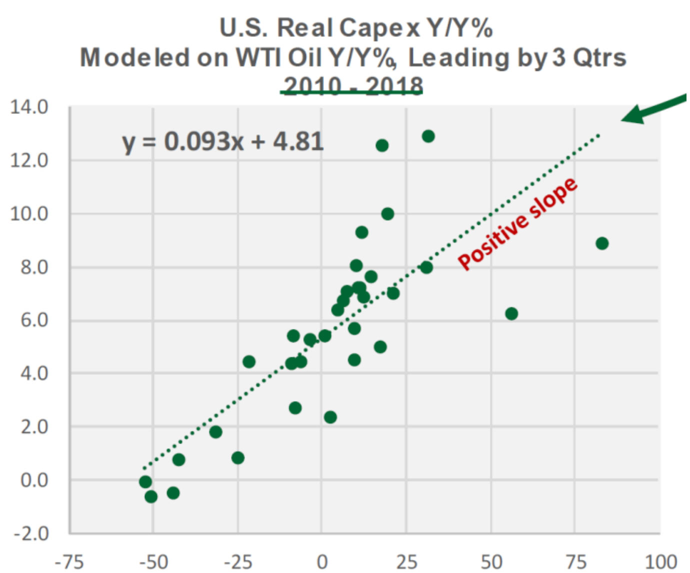




Source: Strategas Research

This attack led to the largest single day increase in the price of crude oil of nearly 15%. However, the market has rolled over and incredibly the price of oil is now lower than the day before this attack happened. This occurrence seems absurd to us as the market should be pricing in more geopolitical risk going forward and not less. However, we expect that the recent swoon is tied to recession concerns more than anything else. In any event, if oil begins to price in further production risk, it should have a positive impact on price. The two charts below show that the U.S. GDP and capital expenditures have a significant positive correlation to a rise in the price of oil, which wasn't always the case. Prior to the oil shale revolution of the past decade, there was a negative correlation as higher oil prices impacted consumer spending as we were importing most of our oil from overseas in those days. Now, as the price of oil rises, oil producers will spend more on drilling and infrastructure which has become very meaningful to the U.S. economy. Investing in the energy sector over the past few years has provided miserable stock returns, but this sort of disruption could prove quite valuable to the sector and the U.S. economy overall.

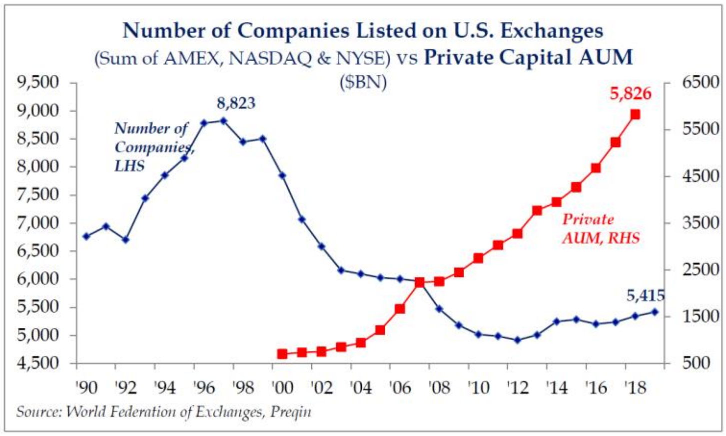


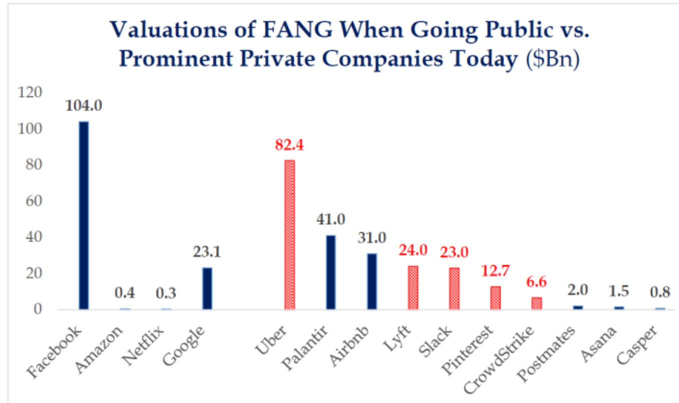


Source: Cornerstone Macro

<u>Updated 2019 Outlook: Unicorns Losing Their Horns - Private Equity May Be the Latest Bubble</u>

Much ado has been made about the "unicorns", which are revolutionary companies that were going to change the world and were valued in the private markets at greater than $1 billion. If one were looking for a financial bubble, one might have found it here. The list of unicorn companies that private equity and venture capital funds have bid up to extraordinary valuations in the private market (pre-IPO) has increased to over 400 recently and has a combined valuation in excess of $1.3 trillion. Many of these companies are staying private longer as funding which used to be provided in the public markets is no longer required, as private markets are awash in capital that is waiting to find a home. The chart below left shows the meteoric rise in private equity fund assets (red line). Note as more companies have searched for funding in private markets, the number of publicly traded companies has shrunk. The chart below right shows the IPO valuation when the "FANG" stocks debuted as well as some prominent "unicorns" that came public this year.

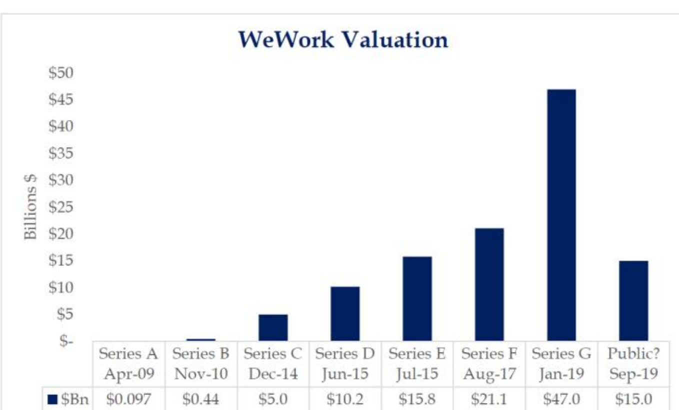


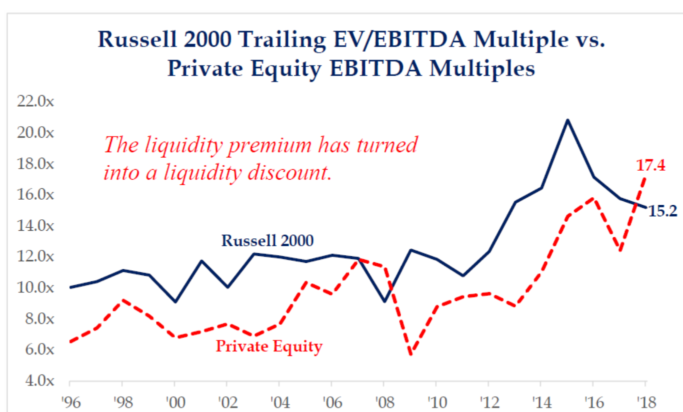


Those highlighted in red have since gone public and reflect their IPO valuation.

Source: Strategas Research

Ultimately private equity and venture capital funds have limited lives, and they typically need to liquidate their holdings in less than 10 years. Thus, a typical path for a company in one of these funds is to be sold into the public markets where the private equity or venture capital sponsors are able to find liquidity. Many of the unicorns that have tested the IPO market this year have received a rude awakening. They include Uber (-35%), Lyft (-46%), Slack (-11%), and Spotify (-33%) to name a few. All of them are significantly lower in their public market debut. WeWork's recent attempt to go public at a mind-numbing valuation that the public market rejected, demonstrates the bubble-like mentality going on in the private markets. The chart below left shows the increasing valuation accorded to one of the most heralded "unicorns", WeWork, in the private market. A down valuation round is never desired in the private markets as it indicates a potential problem. Note that WeWork's private market valuation reached a meteoric $47 billion. After this valuation was deemed to be nonsensical when they were testing the public market for an IPO, they were rebuffed. What followed has been a complete meltdown in the company's valuation, and its CEO and management team were ousted following this failed IPO attempt. More broadly, the chart below right shows a 23 year history comparing Russell 2000 valuation multiples to private equity multiples. Private equity firms historically would search out undervalued companies in both the private and public markets, strip out costs, and attempt to bring in better management with the end goal to sell the company back into the public market at a premium. However, as the chart shows, the private equity valuation multiples are now in excess of those for the Russell 2000 Index, which may be indicative of a bubble.

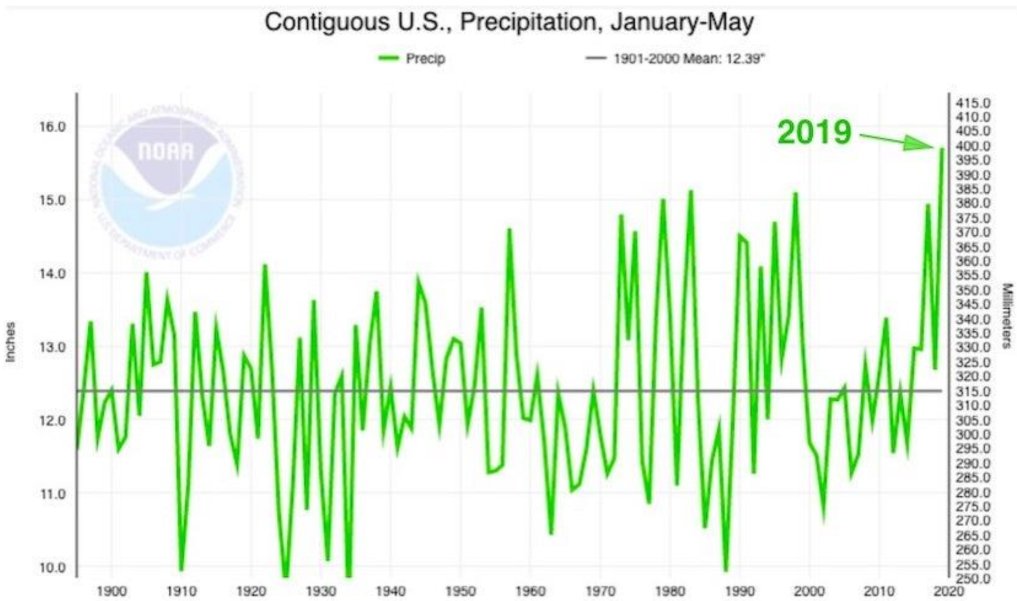




Source: Strategas Research

Updated 2019 Outlook: And Let's Throw Weather into the Investment Mix as Well

As if China trade negotiations, impeachment, and geopolitical events weren't enough to ponder for investors, we've also had the weather this year to add to this game of investment Jenga. According to NOAA's National Centers for Environmental Information, the weather from July 2018 to June 2019 was the wettest 12 months on record in the U.S. and brought us roughly eight more inches of rain than the historical average. As seen in the chart below, it was also the wettest January through May period in the contiguous United States.



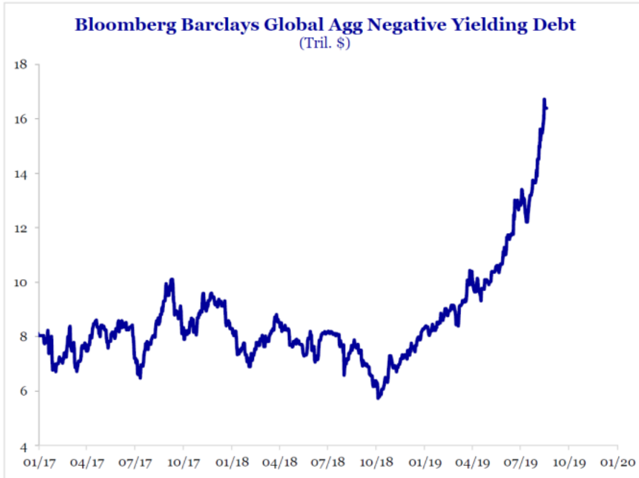
Source: NOAA

As you can infer, it's darn difficult to build a house, plant a crop, or work on a public construction project when you are instead spending your time building an ark. During late August and throughout September, the 1492 Capital Management research team attended many investment conferences to meet with management teams from publicly traded companies. Whether it be engineering and construction, grain storage, oil and gas production or building materials executives, they reluctantly yielded that weather had significantly impacted business in the first half of 2019. In many cases, the business is just pushed out to future quarters and that is, of course, the nature of "outdoor sport" businesses like those previously mentioned. As we move into 2020, it is highly unlikely that we will set another historic rainfall record in the first half of next year as well. Thus we will have a runway of six months of better climatic conditions to foster better economic conditions. Connecting oil and gas infrastructure, building homes, laying fiber optic cable for 5G, and constructing bridges and roads should be easier to execute and benefit many of our currently deployed investment themes at 1492 Capital Management. If we can layer on some China trade resolution, in our opinion, we should have a double barrel shot of economic growth in the front half of 2020.

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.

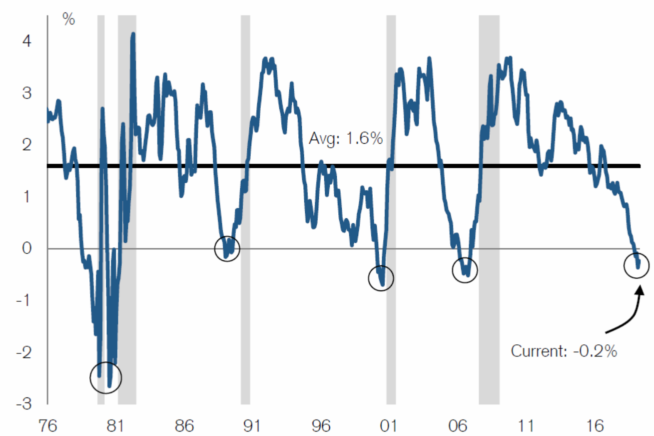
This chart shows the substantial increase in negative yielding debt globally. Why anyone would pay someone to hold their money is beyond me.



Source: Strategas Research

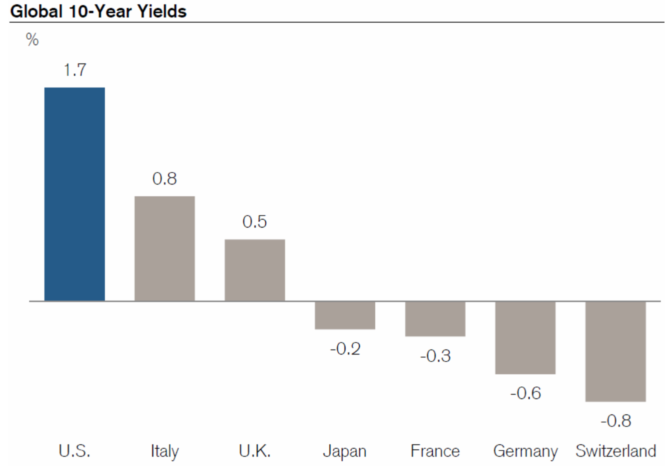
The chart below left shows the historical trend where recession follows interest rate inversions. However, given that interest rates around the globe are negative in many cases, there could be another explanation for low U.S. yields besides recession – demand for positive yielding assets. We are simply offering substantially more relative yield than other governments' bonds.

U.S. Yield Curve (3 Month – 10 Year Spread)



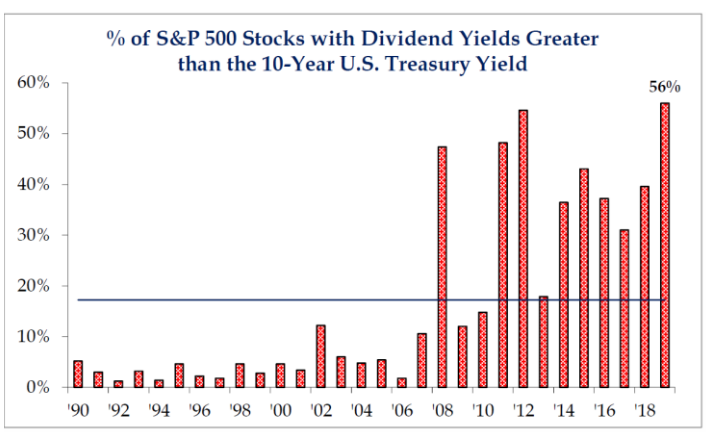
Note: Shaded area denotes recession
Source: Federal Reserve, NBER, Haver Analytics®, Credit Suisse

Global 10-Year Yields

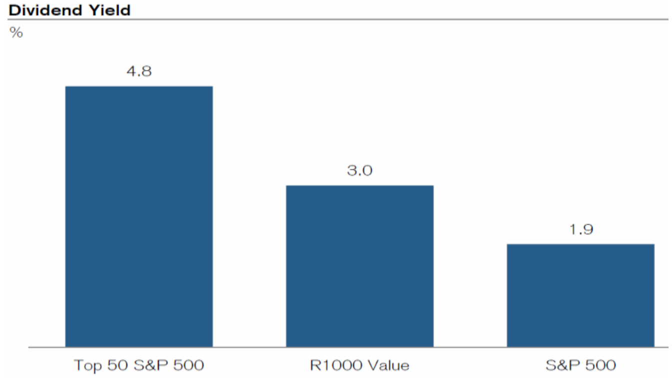


Source: The BLOOMBERG PROFESSIONAL™ service, Credit Suisse

Presently, 56% of the S&P 500 stocks have a dividend yield greater than the yield on the 10-year U.S. Treasury note (below left – source: Strategas Research). This may be one of the reasons why the stock market has been so resilient. TINA…"There Is No Alternative". Below right shows the yield on several different categories of stocks.

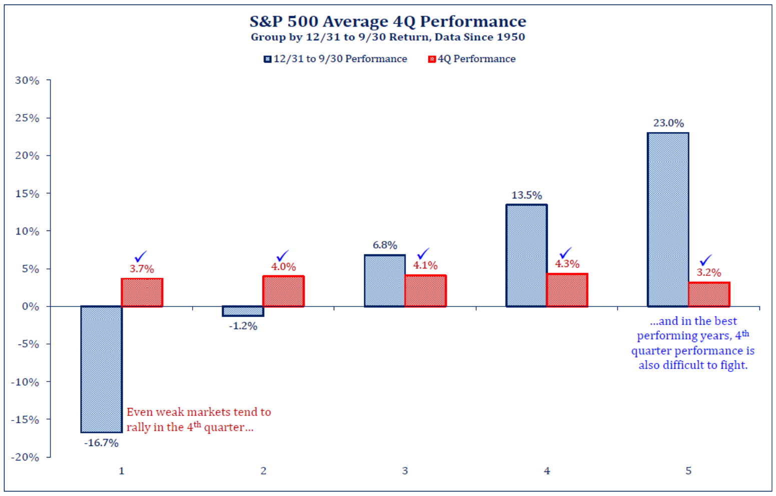


Dividend Yield



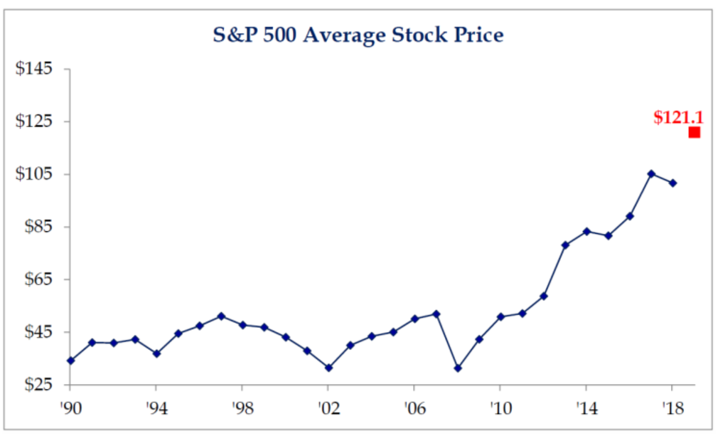
Source: Standard & Poor's, Russell, FactSet, Credit Suisse

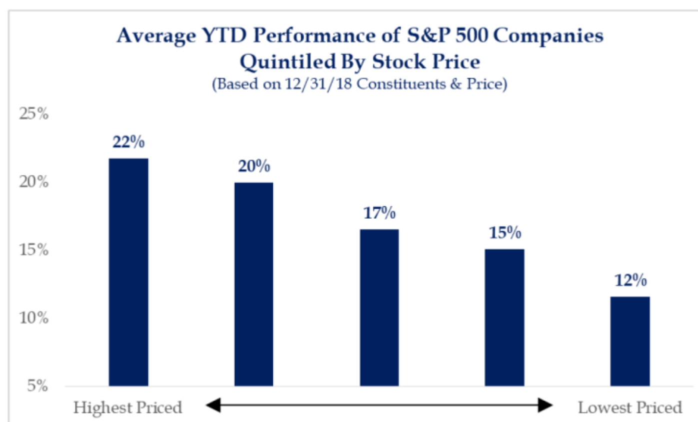
Interestingly, regardless of how strong the stock market returns are for the first three quarters of the year, the fourth quarter returns gravitate to +4%.



Source: Strategas Research

Companies used to split their stock to keep the stock price in a range that seemed affordable to the average person. No more. ETF's have seen outsized inflows for years. Many ETFs use a price-weighted methodology to determine individual stock weights within the ETF. No wonder stock splits have gone the way of the dinosaur (below left). Note the peculiar returns within the S&P 500 this year (below right) – could investing be this easy???





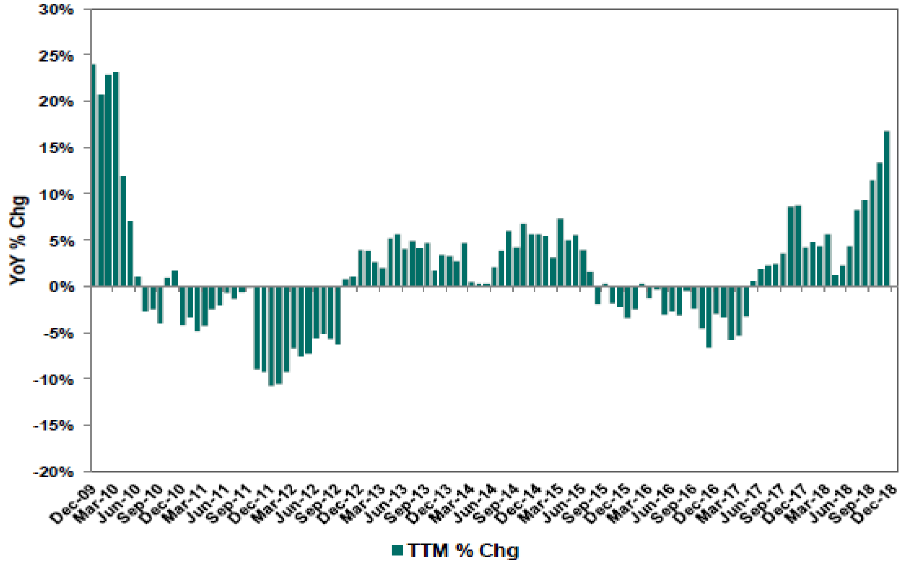
Source: Strategas Research

<u>Thematic Investing: U.S. Infrastructure at an Inflection</u>

In an environment where there is a cloud of uncertainty hanging over the global economic outlook, we are finding it prudent to find investment themes that will be more resilient to any potential recessionary period. One broad sector that we have identified is infrastructure spending. This sector encompasses everything from transportation infrastructure such as roads and bridges, to the electric power grid to oil and gas pipelines and transfer facilities as well as drinking and wastewater pipelines. Over the course of several meetings held with management teams in the last couple of months, we believe that business fundamentals are very strong for companies that will be providing both the engineering and construction services as well as hardware and technology for this infrastructure upgrade. While the backdrop for each of these industries has separate and unique growth drivers, we see a tailwind of opportunity for many of the companies operating in this space.

Starting with civil construction spending, there has been a marked increase in overall project values that have been bid on the last couple of years. Much of the funding for major civil infrastructure is coming from higher state gas taxes that have been levied while crude oil and gasoline have been relatively low since the 2014 energy recession.

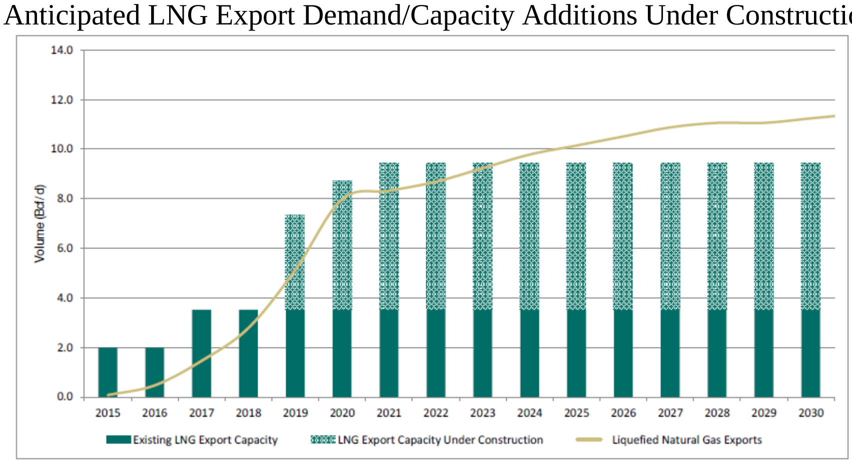
Trailing 12-Mo Change in Overall Value of Project Bid



Capital spending for 52 of the largest electric and gas utilities in the U.S. last year was roughly $131.1 billion, a nearly 19% increase over the prior year. Over $50 billion of that total will be spent on aging electric grid transmission and distribution infrastructure. A report from the U.S. Department of Energy found that 70% of power transformers and transmission lines are over 30 years old. There are a myriad of reasons why utility companies are rushing to upgrade the infrastructure, not the least of which is safety. Many of the deadly wildfires in the western part of the U.S. the last couple of years have been blamed on arcing power lines. PG&E, the nation's largest utility, filed for bankruptcy earlier this year on the heels of mounting lawsuits for liability stemming from the devastating wildfires. Once the company emerges from bankruptcy we expect it will launch an aggressive plan for infrastructure upgrades. Federal tax code changes in 2018 also paved the way for increased investment spending by utilities allowing them to deduct interest expense on debt used to finance projects. Emergence of alternative energy generation such as wind and solar, which are often long distances from metropolitan areas, are also driving the need for additional transmission lines. Suffice it to say there are multiple drivers behind the capital spending that we expect will remain strong for the industry over the next few years.

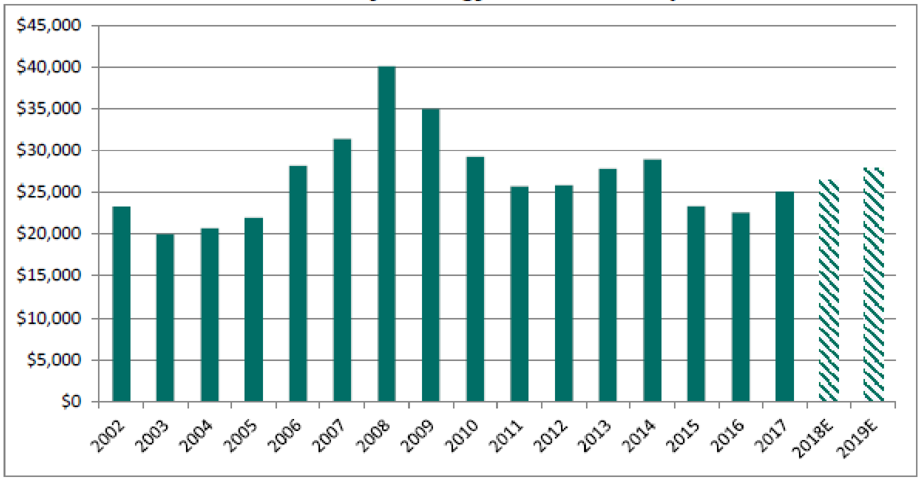
Buildout of the liquefied natural gas infrastructure in North America has been growing and is expected to ramp significantly over the coming years. Here again, there are multiple drivers behind this demand. One of which is a new regulation that is scheduled to be implemented on January 1st, 2020 by the International Maritime Organization (IMO). Essentially the new standard will require ships to use marine fuels that are low-sulfur content, such as LNG. This could positively affect refiners as well as drive additional demand for LNG.

Anticipated LNG Export Demand/Capacity Additions Under Construction



Source: EIA

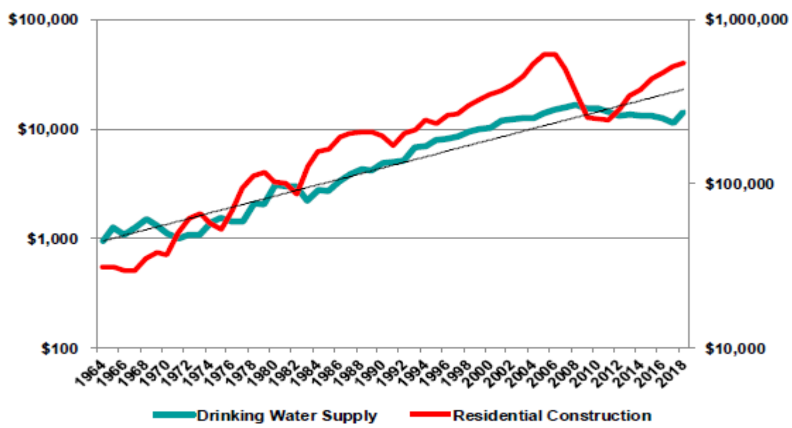
Historical Combined Major Energy Downstream Capital Investment



Source: Company filings & D.A. Davidson estimates.

Last but arguably the most important facet of infrastructure is our water system. After the Great Recession there was a dramatic downturn in new construction projects in both commercial and residential buildout. However, as interest rates have remained low and as the economy has improved, construction projects are once again booming and, therefore, causing an uptick in the need for additional water infrastructure.

Drinking Water Infrastructure-Historical Construction Spend

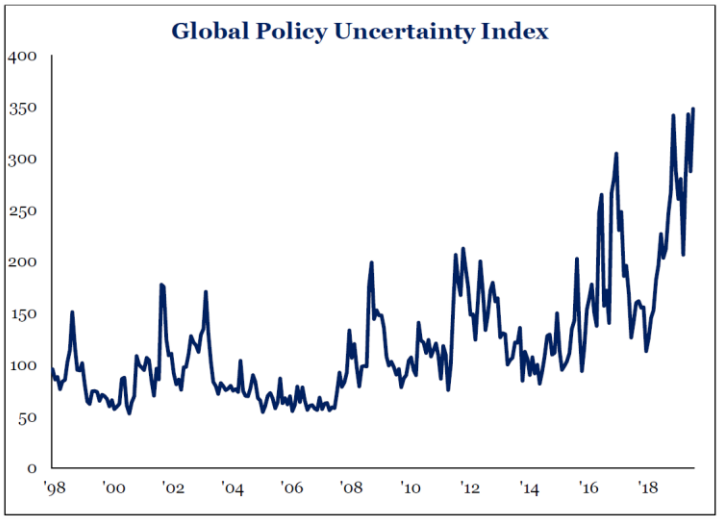


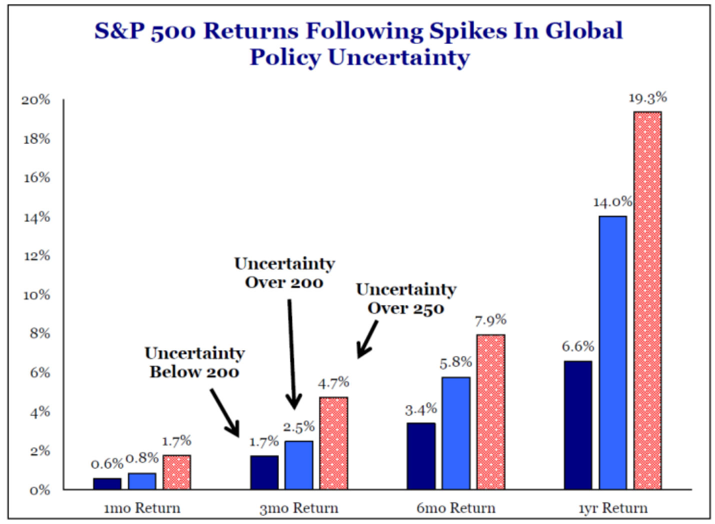
Source: Census Bureau & D.A. Davidson research

In conclusion, as we anticipate where the strongest fundamentals will be for companies in the upcoming years, we believe infrastructure upgrades across all these industries we've discussed could provide a very strong backdrop for above-market growth trends. Coupled with attractive valuations, as many of the companies operating in this sector have sold off in the most recent market downdraft, we see significant investment opportunities ahead.

Market Trivia

Each quarter we offer a piece of market trivia that we believe is interesting or timely, or both. As we've noted several times in this newsletter, global policy uncertainty has risen with the tariff war and other geopolitical happenings. The chart below left shows the "global policy uncertainty index" through time. It's clearly hit a crescendo of late and resides around the 350 level. Interestingly, as shown below right, when the index exceeds 250 the forward stock market returns over the next 12 months average 19.3%. It's possible that on the way to reaching these high anxiety levels in the past, the stock market dropped precipitously so there was nowhere to go but up. That movement has yet to occur this year.





Source: Strategas Research

As we noted earlier in the newsletter, President Trump better get the economy humming before the 2020 election if he wants to be reelected. The fate of those incumbent Presidents that enter the election year in a recessionary environment is pretty bleak as shown below. Quoting James Carville who was President Clinton's campaign strategist, "It's about the economy stupid".

No Recession Two Years Before Re-Election

President	Recession?	Re-Elected?
Obama	No	Yes
Bush II	No	Yes
Clinton	No	Yes
Reagan	No	Yes
Nixon	No	Yes
LBJ	No	Yes
Eisenhower	No	Yes
Truman	No	Yes
FDR	No	Yes
FDR	No	Yes
FDR	No	Yes
Wilson	No	Yes

Recession Two Years Before Re-Election

President	Recession?	Re-Elected?
Bush I	Yes	No
Carter	Yes	No
Ford	Yes	No
Hoover	Yes	No
Coolidge	Yes	Yes
Taft	Yes	No

Source: Strategas Research

We hope that you found our third 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) Utilizing a proprietary blend of Informa Investment Solutions' top priority performance screens, PSN Top Guns ranks products in six proprietary star categories in over 50 universes. This is a highly anticipated quarterly ranking and is widely used by institutional asset managers and investors. Top Guns receive a star rating in the range from one to six. The stars indicate the continued performance over a length of time. 1492 Capital Management was named a Top Gun, earning a 3 Star rating for the Small Cap Core Alpha as the eighth best performing strategy in their Small-Mid Core Universe for the three year period ended June 30, 2019.

The complete list of PSN Top Guns and an overview of the methodology can be located on http://www.informais.com/resources/psn-top-guns. For more details on the methodology behind the PSN Top Guns Rankings or to purchase PSN Top Guns Reports, contact Ruth Calderon at ruth.calderon@informais.com. **About Informa Investment Solutions:** A market leader in intelligence and software solutions for investment professionals and financial institutions of all sizes, Informa Investment Solutions offers a robust set of analytics and tools to help you grow and retain your business. With a nearly 40-year history, Informa Investment Solutions is part of Informa PLC, a leading business-to-business knowledge provider serving International markets. Informa Investment Solutions has set the standard for providing turnkey and customizable applications for performing manager searches, building wealth plans, and producing client reports and investment marketing materials for companies worldwide. For more information, please visit http://www.informais.com/ and follow https://twitter.com/InformaInvest

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