1492 CAPITAL MANAGEMENT
DISCOVERING OPPORTUNITY
MARCH 2020 • VOL. 13 • ISSUE 3
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 first quarter of 2020. 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 with our small cap strategies and our wealth management portfolios. Our investment professionals possess a tremendous amount of experience navigating through multiple market cycles. 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.

March Madness of a Different Kind - Good News is the U.S. Government has the Playbooks
Yes, we are in a recession and no, we won't pretend that we are experts with respect to the Coronavirus. We are definitely in a recession, but it's not comparable to any one that we've experienced in the last 100 years. This event is a "flash recession". We know how we got here and the best part about it is that we've already received the playbooks (yes plural) on how to get out of this mess. Excesses in the financial system tend to cause most recessions and can be excruciatingly long in the making as in 2008. As we know, this recession was primarily caused by the Coronavirus, but the secondary cause that's been lost in the shuffle is the collapse in the price of oil. The first playbook that we're referring to is the one that arose from the 2008/2009 recession from the Fed and U.S. Treasury. The second one is the Coronavirus playbook that South Korea and Singapore have used (notice we didn't say China) to squash the spread of the virus. The U.S. government playbook has already been implemented to a great degree within weeks versus a process that took in excess of 12 months to roll out in 2008. For example, the Fed immediately implemented two emergency interest rate cuts to effectively bring the Fed Funds rate to 0%. Second, they immediately rolled out the alphabet soup of programs to support the dislocations that were occurring in the bond market, which effectively provides a backstop to an economic and financial meltdown. Amazingly, the Fed has already purchased in excess of $1 trillion of bonds in two weeks compared to a total that took over eight months to achieve in 2008. They are forecasting another $3 trillion to be bought in the next few weeks. Lastly, the $2.2 trillion CARES plan, which is equivalent to 10% of our entire U.S. GDP, was approved by Congress and is in the process of being implemented to get cash in the hands of consumers and businesses alike to avoid a catastrophic meltdown of our economy. The secondary problem that is likely to cause a longer lasting problem for our economic recovery than the Coronavirus is the collapse in the price of oil. See the section below "The U.S. Energy Renaissance is Dead - Long Live the Renaissance".

The largest issues that the world is struggling with are how quickly can our activities "normalize" and will future pandemics be treated in a similar fashion. We don't claim to know the answers with certainty but please read on to see our unique views of what's on tap for the balance of 2020, what the key drivers will be, and indulge in some stock market trivia. We will be providing our strategy webinars and detailed performance information on 1492's strategies in a separate email in the coming week. If you would like to discuss any of our strategies with us, please contact Tim Stracka at 414-238-3398.

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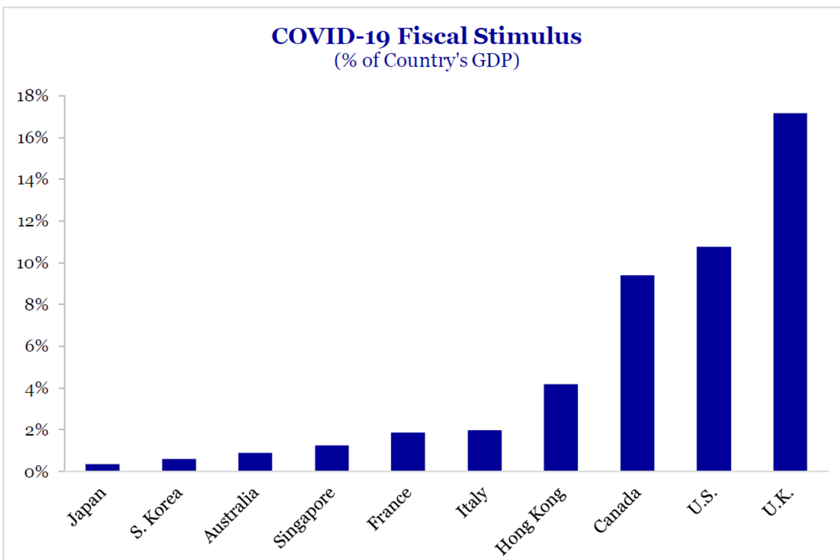
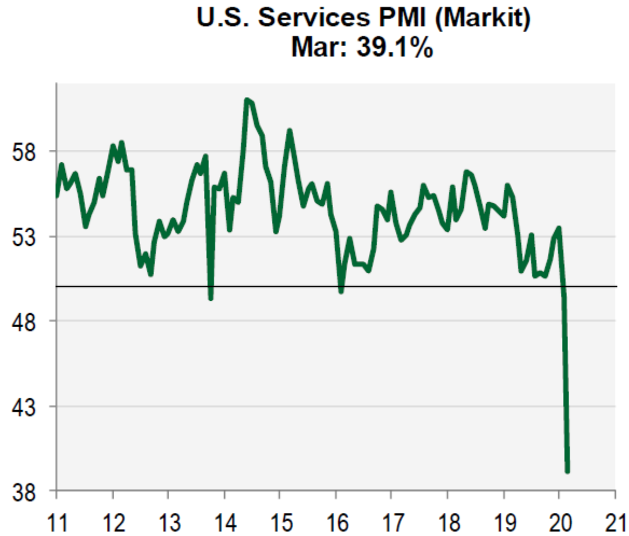
March Madness of a Different Kind: The Good News is the U.S. Government has the Playbooks

The term “unprecedented” has been used more times than we can count in the past three weeks. However, what this country faces isn’t insurmountable. We are definitely in a recession but it’s not comparable to any one that we’ve experienced in the last 100 years. This is a “flash recession”. We know how we got here and the best part about it is that we’ve already received the playbooks (yes plural) on how to get out of this mess. Excesses in the financial system tend to cause most recessions and can be excruciatingly long in the making like in 2008. As we know, this recession was primarily caused by the Coronavirus, but the secondary cause that’s been lost in the shuffle is the collapse in the price of oil. The first playbook that we’re referring to is the one that arose from the 2008/2009 recession from the Fed and U.S. Treasury. The second one is the Coronavirus playbook that South Korea and Singapore have used (notice we didn’t say China) to quash the spread of the virus. The U.S. government playbook has already been implemented to a great degree within a matter of weeks versus a process that took in excess of 12 months to roll out in 2008. For example, the Fed immediately implemented two emergency interest rate cuts to effectively bring the Fed Funds rate to 0%. Second, they immediately rolled out the alphabet soup of programs to support the dislocations taking place in the bond market, which effectively provides a backstop to an economic and financial meltdown. Amazingly, the Fed has already purchased in excess of $1 trillion of bonds in two weeks compared to a total that took over eight months to achieve in 2008. They are forecasting another $3 trillion to be bought in the next few weeks bringing the total to $4 trillion. This plan isn’t a bazooka as it’s been referred to in the media, it’s an atomic bomb. Lastly, the $2.2 trillion CARES plan, which is equivalent to 10% of our entire U.S. GDP, was approved by Congress and is in the process of being implemented to get cash in the hands of consumers and businesses alike to avoid a catastrophic meltdown of our economy. The U.S. isn’t alone in implementing stimulus packages. The chart below highlights each country’s stimulus programs that have been announced to date. This chart doesn’t include China’s which is equal to 8.8% of their GDP nor Germany’s recently announced $1.2 trillion package.

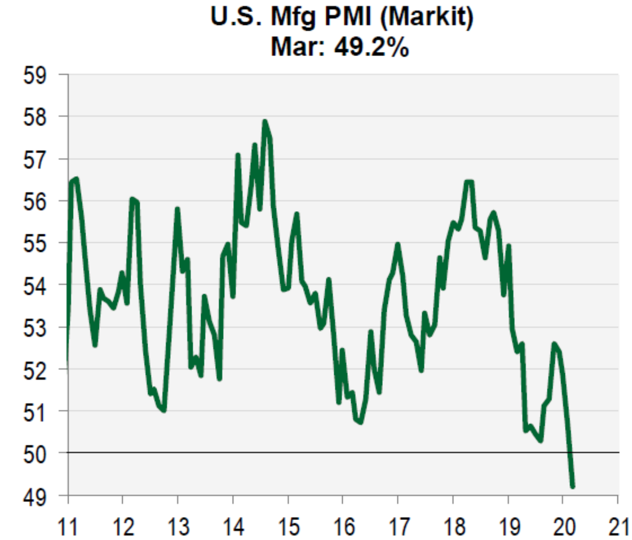


Source: Strategas Research

The timing of something like this crisis is never good, but it appeared that the economy was just starting to reaccelerate following a slowdown in 2019 caused by the Chinese tariffs. Last quarter in our 2020 outlook newsletter we predicted that the U.S. economy would begin to accelerate, and as the charts below show, the economic data that was released in the first two months of 2020 was quite strong. However, the data in March fell precipitously as this data included the effective shutdown of the U.S. economy for a portion of the month.

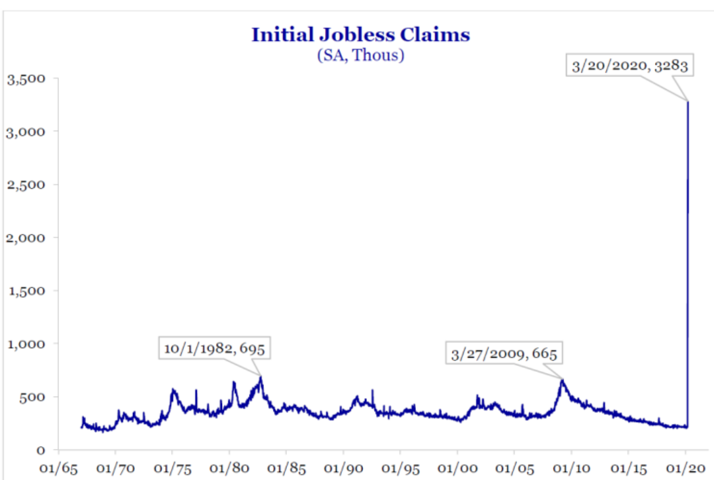


Source: Cornerstone Macro Research

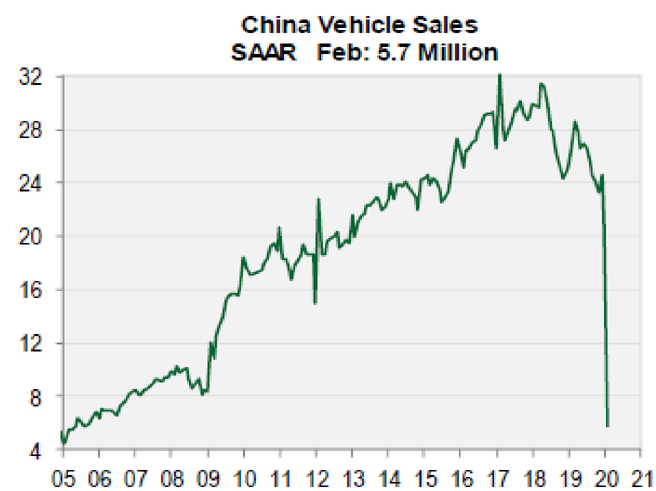


Source: Cornerstone Macro Research

There is no doubt that conditions will continue to deteriorate rapidly as we get data for a full month or more from the U.S. economy's closure. Digesting the unemployment reading that came out late in March, it wasn't a surprise, but it's expected to get much worse the longer the shutdown extends. The chart below left shows how anomalous this reading is compared with readings over the past 55 years. This precipitous drop will be seen in economic statistics across the board and hence our term 'flash recession". The second chart below right shows what happened to China's car sales when they effectively shut down their economy back in January. We expect the same sort of drop when we receive the U.S. numbers.

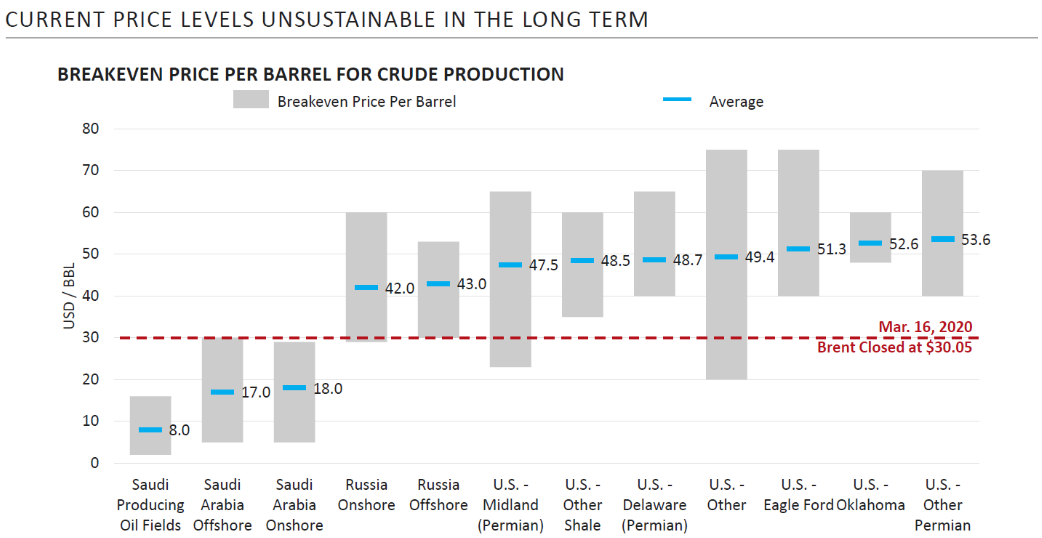


Source: Strategas Research



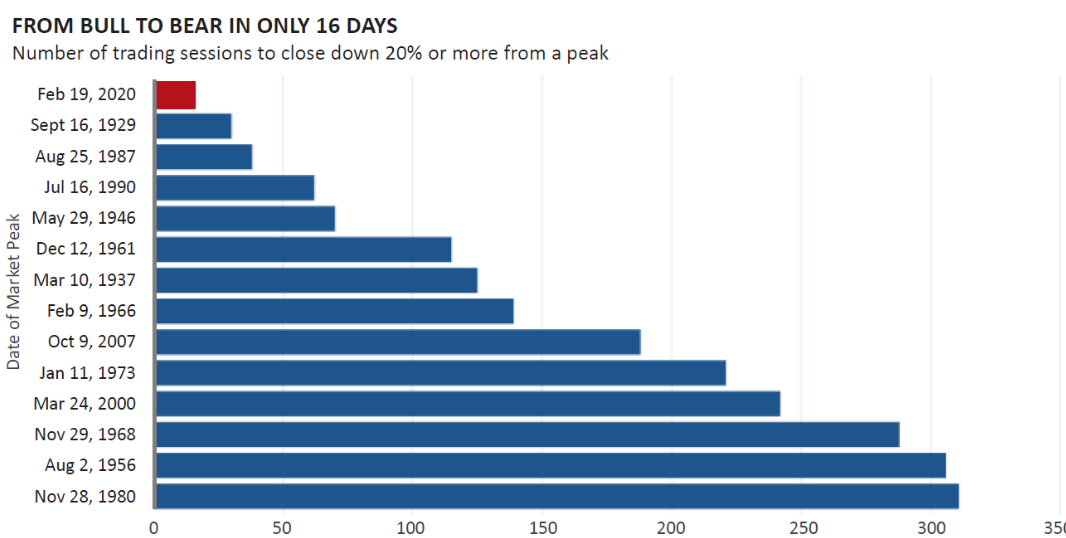
Source: Cornerstone Macro Research

The second shoe to drop in this market debacle was the collapse of oil prices. This event is very reminiscent to what happened in November 2014 when the Saudis/OPEC decided that they didn't want to cut their own supply to support the price of oil. In that fiasco, the price of oil plummeted from around $75 per barrel to $26 per barrel at the bottom in early 2016. This time around we have a battle between the Saudis/OPEC and Russia. OPEC had cut back on its production back in 2018 to help support the price of oil and had even taken further actions to extend and increase those cuts in 2019 to avoid a glut of oil on the market. Russia agreed to cut production, too so that the Saudis didn't have to shoulder the entire burden. However, Russia continued to increase production all the while until their recent meeting in early March 2020. At this meeting it was hoped that OPEC and Russia could come to an agreement to implement further cuts to their production. Unfortunately, no agreement could be reached, and instead of cutting production, OPEC decided that they were going to increase production which caused the price of oil to come cascading down. The timing couldn't have been worse as this timing is exactly when demand was falling precipitously due to the travel bans and shutdowns around the globe. On the heels of this discourse, oil has plummeted from the mid-$60's per barrel in January to $20 per barrel as we write this newsletter. The Coronavirus has overshadowed this debacle, but if we rewind the clock to the fallout post the 2014 saga, it was ugly for the U.S as we went into an industrial recession that lasted until early 2016. This time around it could be even worse for our industrial economy as shale oil production has continued to grow dramatically since that time to the point that the U.S. is technically self-sufficient in our oil needs. The production ramp over the past few years was only achieved through massive capital expenditures in the oil patch and in pipeline capacity. This spending has already taken a major hit as most energy producers have announced capital expenditure cuts in excess of 35% just in the past few weeks. This adjustment will have a negative impact to our economy. As they say, the only thing that corrects $20 oil is $20 oil as spending collapses and as the decline curves on newly producing wells hit production by about 40% annually. The chart below shows that the Saudis can withstand lower oil prices longer than almost anyone from a pure production cost per barrel, but they use oil as the primary funding mechanism for their social programs. Some estimate that they need oil prices greater than $75 per barrel to fund these programs. The coming months will be telling to see who blinks first.



Notes: Saudi Arabian and Russian breakeven rates were calculated by IHS Markit for Brent production in 2018. The results of this analysis was included in the Saudi Aramco prospectus. The calculation considers post-tax price per barrel required to achieve a 10% rate of return through 2030. U.S. breakeven rates consider WTI production and were collected by the Federal Reserve Bank of Dallas through a 2019 survey of 82 exploration and production company executives, responding to the question "In the top two areas in which your firm is active: What WTI oil price does your firm need to profitably drill a new well?"
Data sources: IHS Markit; Federal Reserve of Dallas

The "flash recession" was met by an equally violent sell off in the stock market that created the fastest path to a bear market (down 20%) in history. Record swings both up and down were the norm in the month but in the end, the downward swings won out. The first chart below shows that it only took 16 days for the stock market to drop 20% from the prior peak. The second chart below shows how these wild downward swings rank in the top 10 worst days on Wall Street. Lastly, the third chart below shows how swift the decline was in small caps. This period included the worst two and four week declines in the history of the Russell 2000 Index. The prevalence of ETF's and algorithmic trading has exacerbated the dramatic selloff and wild swings in the market. When this period is all said and done, widespread use of ETF's may be reconsidered as ETF holders repeatedly pushed the sell button in mass at the market open and created terrible executions as many institutional managers withheld bids on stocks until well after the opening bell.



Sources: Financial Times, @_PeterWells, S&P Global, Refinitiv. FT Calculations using bear markets as classified by S&P Global.

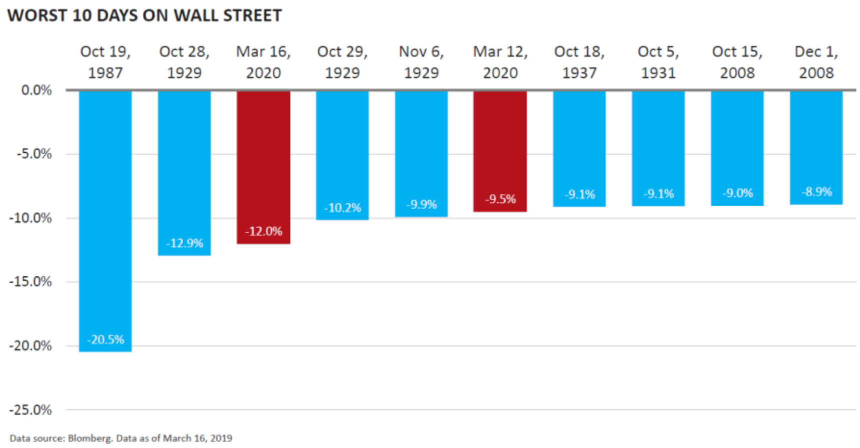


Fig 10. **R2000 Worst 2 & 4 Week Declines**

	Period Ending	2 Wk Decline	Fwd Year		Period Ending	4 Wk Decline	Fwd Year
1	3/20/20	-30.0%	--	1	3/20/20	-39.6%	--
2	10/23/87	-26.8%	25.3%	2	10/24/08	-33.2%	29.7%
3	10/10/08	-25.9%	19.7%	3	10/30/87	-31.2%	27.1%
4	11/21/08	-19.6%	46.2%	4	3/6/09	-25.4%	92.4%
5	4/14/00	-15.8%	1.6%	5	8/19/11	-22.6%	27.7%
6	8/5/11	-15.1%	12.0%	6	9/21/01	-21.2%	-1.8%
7	9/21/01	-14.9%	-1.8%	7	4/14/00	-21.0%	1.6%
8	3/6/09	-14.6%	92.4%	8	3/28/80	-19.7%	73.1%
9	10/9/98	-13.7%	36.1%	9	8/24/90	-17.6%	34.2%
10	3/6/20	-13.7%	--	10	7/26/02	-17.4%	24.5%
		Average	**28.9%**			**Average**	**34.3%**
		% Pos	*88%*			*% Pos*	*89%*

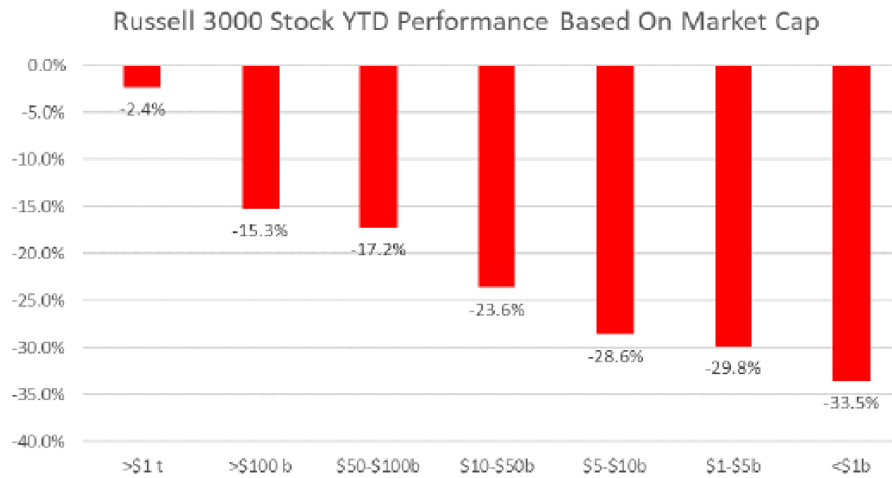
Source: Furey Research Partners and FactSet. Excludes overlapping periods.

The S&P 500 had its fifth worst quarter in the past 70 years and it was the worst quarterly performance for the Russell 2000 in its history. The first table below shows where this ugly March quarter ranks among the worst quarters for the S&P 500. As the table shows, the outlook from these lows is generally favorable. As is typical in stock market drops, small caps have fared far worse than large caps. The second chart below shows that performance was significantly worse moving down the market cap spectrum. If you want to see what typically happens on the other side of these drops, see the section "Skating to Where the Puck is Going" below. The performance figures quoted in the second chart below are through March 26th.

S&P 500 Worst 10 Quarters Since 1950

	Date	Performance	+1 Quarter	+2 Quarters
1.	3Q 1974	-26.1%	7.9%	31.2%
2.	4Q 1987	-23.2%	4.8%	10.7%
3.	4Q 2008	-22.6%	-11.7%	1.8%
4.	2Q 1962	-21.3%	2.8%	15.3%
5.	**1Q 2020**	**-20.0%**	**?**	**?**
6.	2Q 1970	-18.9%	15.8%	26.7%
7.	3Q 2002	-17.6%	7.9%	4.0%
8.	3Q 2001	-15.0%	10.3%	10.2%
9.	3Q 1990	-14.5%	7.9%	22.6%
10.	3Q 2011	-14.3%	11.2%	24.5%

Source: Strategas Research



Source: Raymond James

The combo platter of the Coronavirus and the oil price collapse caused precipitous declines that were downright ugly. However, despite the massive declines, the relative performance of growth versus value didn't change. This factor was attributable to financials significantly underperforming as bankruptcy risk skyrocketed around the globe due to the economic shutdown. Financials/REITs have a dramatically heavier weighting in the value indices compared to the growth indices. As we mentioned above, large caps significantly outperformed small caps and the NASDAQ was the best performing index by far due to its heavier weight in technology, internet, and biotech sectors which are viewed as more resilient in a recession. The table below highlights the returns for the first quarter and year-to-date 2020 for the popular indices.

Index Returns		
Index	First Qtr. 2020 Return	2020 YTD Return
Russell 2000	-30.61%	-30.61%
Russell 2000 Growth	-25.76%	-25.76%
Russell 2000 Value	-35.66%	-35.66%
S&P 500	-19.60%	-19.60%
Dow Jones Industrials	-23.20%	-23.20%
NASDAQ Composite	-13.95%	-13.95%

Source: 1492 Capital Management, LLC and FactSet

From a style perspective, the Russell 2000 Growth Index (-25.8%) unceremoniously outperformed the Russell 2000 Value Index (-35.7%) in the first quarter. As mentioned above, growth indices outperforming value indices has become a common refrain since the Great Recession of 2008, and this quarter was no different. All of the sectors within the Russell 2000 Index finished with negative returns for the quarter, and the prototypical "risk off" sector, Utilities (-12.0%), was the relative outperformer despite wild swings that occurred on a daily basis where the market was anticipating municipalities to default on their debt. The worst performing sector within the Russell 2000 was the Energy sector (-58.7%) which wasn't too surprising as oil prices plunged from the mid $60's to around $20 per barrel at quarter end. The Healthcare sector, although down substantially (-19.6%), was the second best performer in the quarter. Earlier in the year investors were concerned that the Presidential election would cause the sector to underperform as both Democrats and Republicans alike targeted the Healthcare sector. However, the sector quickly went from part of the problem to part of the solution to defeat the Coronavirus. See our section below entitled "Thematic Investing: Target May Be Off the Back of Pharma/Biotech Post Covid-19". The first two tables below highlight the performance of the Russell 2000 style indices by sector for the month of March, the first quarter, and year-to-date 2020.

Table 8 - Russell 2000 Growth Performance Attribution through March 31st

	March			1Q2020			
GICS Sector	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Wgt
Com Serv	-21.03	-0.52	-1.94	-26.29	-0.65	-0.53	2.3
Discretionary	-33.36	-4.07	-14.27	-40.93	-5.19	-15.17	9.6
Staples	-11.49	-0.32	7.60	-24.08	-0.70	1.69	3.4
Energy	-49.53	-0.20	-30.43	-65.60	-0.35	-39.84	0.3
Financials	-15.97	-1.00	3.13	-22.56	-1.38	3.20	5.9
Health Care	-13.15	-3.44	5.94	-18.48	-4.90	7.28	33.9
Industrials	-23.97	-4.97	-4.88	-30.65	-6.35	-4.88	17.5
Info Tech	-15.81	-2.60	3.29	-20.88	-3.43	4.89	18.2
Materials	-19.23	-0.55	-0.13	-36.55	-1.06	-10.78	2.7
Real Estate	-25.91	-1.40	-6.81	-29.63	-1.63	-3.87	4.4
Utilities	-1.16	-0.03	17.94	-8.39	-0.14	17.38	1.9

Table 10 - Russell 2000 Value Performance Attribution through March 31st

	March			1Q2020			
GICS Sector	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Wgt
Com Serv	-27.34	-0.67	-2.67	-36.78	-0.89	-1.12	2.2
Discretionary	-39.77	-3.95	-15.10	-48.59	-5.04	-12.93	7.8
Staples	-4.17	-0.09	20.51	-18.17	-0.37	17.49	3.4
Energy	-40.33	-1.48	-15.66	-61.98	-2.92	-26.32	3.5
Financials	-26.12	-8.50	-1.44	-37.10	-11.94	-1.44	29.9
Health Care	-21.04	-0.97	3.63	-25.58	-1.19	10.08	6.0
Industrials	-24.20	-2.92	0.47	-35.56	-4.34	0.10	12.5
Info Tech	-14.22	-0.95	10.45	-24.26	-1.79	11.40	11.4
Materials	-25.52	-1.03	-0.85	-41.21	-1.75	-5.55	4.3
Real Estate	-27.42	-3.52	-2.75	-34.45	-4.42	1.21	11.5
Utilities	-6.66	-0.59	18.01	-13.81	-1.00	21.85	7.6

Source: Jefferies

The carnage was severe across most international and commodity markets. You only have to look to one of the benchmarks below, the Volatility Index or VIX (+261.3%), to know that it was an ugly period for almost any asset class. The only other asset classes that were spared were long term treasuries (+20.2%) and gold (+5.1%), which are both viewed as safe havens. Treasuries were the big winner following the Federal Reserve's two emergency cuts which pushed rates to new all-time lows. Oil was the biggest loser year-to-date down a whopping -66.9% following the collapse of talks between OPEC and Russia to curtail production. The Chinese stock markets were a relative winner as they were only down in the mid-single digits which may provide hope to the U.S. stock market that we can emerge from this virus episode relatively unscathed. In fact, the Chinese stock market made a new 52 week high prior to the spread of the virus to Europe and the U.S. The Chinese government has implemented well in excess of 100 stimulative measures in hopes of generating an economic rebound. Almost all other commodities fell during the quarter as demand plummeted following the global shutdown and relinquished their gains from last year following the signing of the first leg of the Chinese trade deal.

Index	First Qtr. 2020 Return	2020 YTD Return
France	-26.5%	-26.5%
Germany	-25.0%	-25.0%
Brazil	-36.9%	-36.9%
India	-28.6%	-28.6%
China- A Shares	-9.5%	-9.5%
China- Shenzhen A Shares	-2.8%	-2.8%
Japan	-20.0%	-20.0%
Long-Term Treasuries (TLO)	+20.2%	+20.2%
Investment Grade Corp Bonds	-3.2%	-3.2%
Gold	+5.1%	+5.1%
Volatility- VIX index	+261.3%	+261.3%
Oil	-66.9%	-66.9%
Natural Gas	-24.9%	-24.9%
Lumber	-31.1%	-31.1%

Source: 1492 Capital Management, LLC

Updated 2020 Outlook: Skating to Where the Puck is Going

Skating to where the puck is going has become an often used phrase and is often incorrectly attributed to hockey great Wayne Gretzky. It should be correctly attributed to his father Walter Gretzky just for the record. The phrase is probably overused, but it's the best analogy that I could think of in this world that was turned upside down in very short order. The imagery that this phrase should depict is moving ahead of the puck or the status quo and anticipating how fast and far you need to skate to meet the moving puck on its future path. From the number of virus cases and government response, to the new realities that the virus has put on Americans and companies alike, there is no doubt that things are moving fast. The mistake that Wall Street economists, analysts, and talking heads are already making is focusing on the here and now. We hear predictions for recession, depression, and even Armageddon. Wall Street is focusing on the here and now or where the puck is currently. Many analysts and economists are trying to gauge or estimate what the next quarter or two of earnings numbers are going to look like for the S&P 500. This effort is a fools game and pure folly. The truth is nobody knows what the next quarter or two are going to look like so why spend time trying to predict it. The fact is that even if somebody nails it, it's irrelevant because what we'll likely see in the next several months won't be a static condition. Humans are social beings and staying cooped up in their homes isn't a normal condition. When the green light is flashed to go about our business, there is going to be a tremendous pent up demand to get out and catch up with family and friends, to go out to dinner, to attend a sporting event, to get businesses back up and running, and to get back to some level of normalcy. People are again using the term the "new normal" for whatever the future holds implying some enormous changes in the way we behave as humans going forward as a result of this. The truth is that the virus won't impact that many of us directly from a health perspective, but the shutdown of our economy affects almost everyone. We'll be raring to get back up and running as fast as possible, and we'll ultimately fall back into our normal patterns except for maybe washing our hands more than we used to do. However, from a stock or business standpoint, this entire situation has shed light on a number of things (i.e. where the puck is going). Here is where we think the puck is going and how we're thinking about the balance of 2020 and beyond.

This event has made it clear that many businesses, schools, and healthcare systems weren't prepared for something like this. However, it's highlighted what areas are important and are likely to garner disproportionate focus and spend on a go forward basis. Many of these topics will be front and center in board meetings across the globe in the coming weeks and months. These include:

1. **Supply chain management –** even Amazon wasn't able to keep up with certain items. More software and reexamination of how the supply chain is structured will be a focus. Amazon likely takes strides to become more vertically integrated.

2. **Robotics** become even more useful – as harsh as this may sound, robots don't get sick.

3. **Robust telecom networks** have become overloaded globally due to the number of homes that are simultaneously logged on for online education, work, or Netflix. 5G networks will be put on an accelerated track as a result of current networks becoming bogged down with massive traffic demands. Telecom equipment providers, fiber optic component manufacturers, and semiconductor components will see even greater demand as 5G network deployments are accelerated and existing networks are upgraded.

4. **Online education** becomes even more popular but it clearly isn't a solution in all cases. This situation has made it clear that schools from elementary through college will be examining their existing solutions and will be making future investments to avoid outright failures or underwhelming alternatives to face-to-face teaching that became evident in this crisis.

5. **Telemedicine** is here to stay and will be a much more popular option, particularly in cases like this one where health care professionals are kept out of harm's way but are still able to assess healthcare emergencies and make diagnoses.

6. **Cloud based communications platforms** become an absolute necessity. Premise based systems will go the way of the dinosaur. If users can't get into the office to access them, then what good are they? The ability to communicate via phone, conference call, text messaging, and video conferences via cloud based systems has proven its worth tenfold.

7. **Smartphones** and the inherent computing power within them have shown to be invaluable. We expect that there will be a massive upgrade cycle in the coming months due to features/functionality/compute power that users felt helped them to stay connected or if their phones lacked such features, how inadequate they were. There may not be so much pushback on price points in the future due to the realization of how critical they are as a productivity tool and are effectively acting as computers.

8. **Computer sales** which have been relatively flat over the past few years are likely to have a renaissance as companies put upgraded solutions into their employee's hands if working from home is going to become more commonplace.

9. **Netflix and other streaming services** are in high demand and are likely building brand loyalty during the quarantine that is taking place across much of the globe.

10. **Online gaming platforms** like PS4 and Xbox are receiving a major boost as kids and adults engage or re-engage to pass the time. These systems also allow for socialization from a distance. Esports platforms are seeing record participants, many for the first time, and record usage due to the lack of traditional sports to watch.

11. **Home furniture and home office furniture** manufacturers likely see a boost over time as consumers realize they need more comfort oriented solutions if they are to spend more time in the home or home office.

12. **Onshoring** becomes much more popular as it's become very evident that the U.S. doesn't want to be held hostage by any country for critical goods like pharmaceuticals. The pendulum likely swings back from outsourcing to onshoring.

13. **Digital media and social media platforms** proved their worth on a number of fronts from pure socialization and staying connected with friends and families to giving advertisers a way to stay in front of consumers despite many eschewing traditional TV and radio mediums for new wave media like Netflix, Amazon Prime and Disney+.

14. **Data centers** are seeing record traffic through their facilities for all the reasons we stated above. This surge likely leads to a new wave of spending on these facilities around the globe.

These items are just a few of our immediate thoughts on where the puck is likely going in the near future, and our portfolios will reflect more of these themes if they aren't already being exploited currently.

Where Do We Go From Here?

So this begs the question, where do we go from here? From a market perspective, no two recessions are alike but this one is undoubtedly different. This one in particular is quite obvious in what put us here and in what will get us out of it. The one thing that is consistent across recessionary timeframes is that the market discounts the end of the recession well in advance of its conclusion. On average, the market low is established four months in advance of the technical recession bottom. As the table below shows, the market return for the period leading up to the end of a recession is significantly positive in almost all cases and is on average a very meaningful +24.9%. Therefore, investors can't wait for the smoke to clear or they'll miss a significant part of any rally off the bottom.

Economic Recessions vs. Market Lows

Recession Start	Recession End	Duration	Market Low	Conculsion	S&P % Perf. from Low to Recession End
Jul. '53	May '54	10 Months	Sep. '53	8 Months Prior	28.5%
Aug. '57	Apr. '58	7 Months	Oct. '57	6 Months Prior	11.4%
Apr. '60	Feb. '61	9 Months	Oct. '60	4 Months Prior	21.3%
Dec. '69	Nov. '70	10 Months	May '70	6 Months Prior	25.8%
Nov. '73	Mar. '75	16 Months	Oct. '74	5 Months Prior	33.8%
Jan. '80	Jul. '80	6 Months	Mar. '80	4 Months Prior	23.9%
Jul. '81	Nov. '82	15 Months	Aug. '82	3 Months Pror	35.3%
Jul. '90	Mar. '91	8 Months	Oct. '90	5 Months Prior	27.0%
Mar. '01	Nov. '01	7 Months	Oct. '02	11 Months After	-
Dec. '07	Jun. '09	17 Months	Mar. '09	3 Months Prior	35.9%
			Average	4 Months Prior	24.9%

Source: Strategas

No matter the cause of the recession, the path of recovery points to a similar outcome where small caps outperform large caps in most instances. This outperformance is obviously due in part to the fact that they underperformed on the way down. They are also more economically sensitive as a general rule and will be more sensitive to any uptick in the economy which is bound to happen very quickly in this case in our opinion. The table below shows all prior bear markets going back to 1980. The bottom line is that once the market bottoms the forward annualized returns are quite strong, particularly for the forward one year as seen in the first green circle on the left. On the right side of the chart is a second green circle which shows that the relative outperformance of small over large caps is quite dramatic, particularly in the first year following the market bottom.

Russell 2000 Forward Performance from Bear Market Bottoms

Bear Market		Price Chg.	R2 Ann. Absolute Price Chg.			R2 Ann. Relative* Price Chg.		
Start	Bottom	From Peak	Fwd. 1Y	Fwd. 3Y	Fwd. 5Y	Fwd. 1Y	Fwd. 3Y	Fwd. 5Y
02/08/80	03/27/80	-26.7	75.2	31.7	20.4	38.1	15.7	7.6
06/15/81	08/12/82	-29.2	92.4	25.6	23.3	34.7	3.3	-2.5
06/24/83	07/25/84	-26.0	30.5	21.3	13.2	1.8	-6.2	-4.4
08/25/87	10/28/87	-39.1	39.7	5.0	13.1	19.1	-5.3	0.8
10/09/89	10/31/90	-34.0	54.0	29.2	20.2	24.7	14.0	6.3
04/21/98	10/08/98	-36.9	37.7	11.3	11.3	-1.5	6.9	9.5
03/09/00	10/09/02	-46.1	59.4	24.9	20.6	25.7	9.8	5.7
10/09/07	03/09/09	-59.4	95.1	32.4	28.2	26.5	6.4	5.6
04/23/10	07/06/10	-20.5	42.6	19.6	15.8	12.5	2.7	1.0
04/29/11	10/03/11	-29.6	37.9	21.6	15.4	6.4	0.2	1.0
06/23/15	02/11/16	-26.4	45.6	17.4		19.0	2.8	
08/31/18	12/24/18	-27.2	32.4			-4.7		
02/20/20	?	?						
		Average	**53.6**	**21.8**	**18.1**	**16.9**	**4.6**	**3.1**
		Median	**44.1**	**21.6**	**18.0**	**19.1**	**3.3**	**3.3**

Source: Jefferies

The following chart shows which type of domestic strategies outperform in the ensuing 12 months that follow the end of a bear market. What you'll notice as you peruse the chart is that small caps strategies (Growth, Value, Microcap, etc.) generally rise to the top of the chart on a consistent basis. The reason that this outperformance may not occur this time around is that some of the largest companies on the planet, like Microsoft, Apple, Amazon, and Netflix, are well positioned to exploit those opportunities we identified above in the section above entitled "skating to where the puck is going" and are likely going to continue to outperform. However, given the massive underperformance of small/microcap stocks over the past year, we believe that what's past is prologue.

Russell Absolute Forward Return (One Year After Month-end Bear Market Troughs)

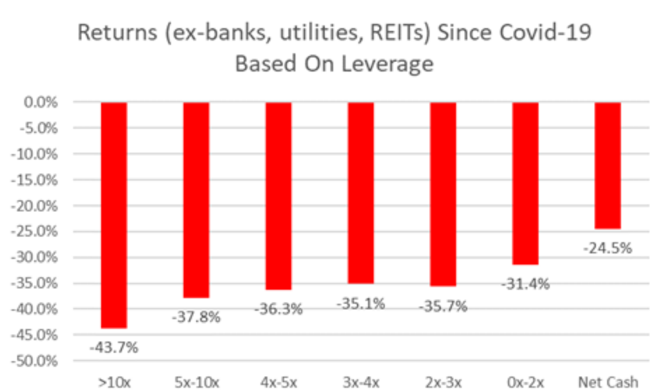
Dec-18	Feb-16	Sep-11	Feb-09	Feb-03	Aug-98	Oct-90	Nov-87	Jul-84	Jul-82	Mar-80
LgCp Grw +36.4%	SmCp Val +41.3%	McrCp +36.3%	MdCp Val +74.7%	McrCp +84.4%	MdCp Grw +48.8%	SmCp Grw +66.5%	SmCp Val +33.1%	MdCp +38.8%	SmCp Grw +99.3%	SmCp Grw +81.5%
MdCp Grw +35.5%	SmCp +36.1%	SmCp Val +32.6%	MdCp +71.0%	SmCp Grw +64.9%	LgCp Grw +48.3%	SmCp +58.6%	SmCp +30.0%	LgCp Val +38.1%	SmCp +94.7%	SmCp +72.1%
LgCp +31.4%	McrCp +35.7%	SmCp +31.9%	SmidCp +68.0%	SmCp +64.4%	SmCp Grw +43.3%	SmidCp +57.8%	MdCp Val +29.9%	SmidCp +34.7%	SmCp Val +89.6%	SmidCp +66.0%
MdCp +30.5%	MdCp Val +31.8%	SmCp Grw +31.2%	MdCp Grw +67.1%	SmCp Val +64.0%	LgCp +39.3%	MdCp Grw +55.1%	SmidCp +28.7%	LgCp +33.8%	SmidCp +87.5%	SmCp Val +62.2%
SmCp Grw +28.5%	SmidCp +31.7%	SmidCp +30.9%	McrCp +66.6%	SmidCp +61.2%	SmidCp +32.4%	MdCp +51.8%	LgCp Val +28.5%	SmCp Val +33.7%	MdCp +73.2%	MdCp +58.5%
SmidCp +27.8%	SmCp Grw +30.9%	LgCp Val +30.9%	SmCp Val +65.9%	MdCp Grw +52.7%	MdCp +31.8%	SmCp Val +51.6%	MdCp +27.0%	SmCp +30.6%	LgCp Grw +62.2%	LgCp Grw +43.4%
MdCp Val +27.1%	LgCp Val +29.1%	LgCp +30.1%	SmCp +64.0%	MdCp +52.3%	LgCp Val +30.1%	MdCp Val +49.5%	SmCp Grw +26.7%	LgCp Grw +29.3%	LgCp +61.8%	LgCp +41.4%
LgCp Val +26.5%	MdCp +26.8%	MdCp Val +29.3%	SmCp Grw +61.9%	MdCp Val +51.9%	SmCp +28.4%	LgCp Grw +40.4%	LgCp +23.4%	SmCp Grw +27.6%	LgCp Val +61.1%	LgCp Val +39.0%
SmCp +25.5%	LgCp +25.5%	LgCp Grw +29.2%	LgCp Val +56.5%	LgCp Val +42.3%	MdCp Val +21.9%	LgCp +36.6%	MdCp Grw +23.0%			
McrCp +22.4%	LgCp Grw +22.2%	MdCp +28.0%	LgCp +55.3%	LgCp +39.7%	SmCp Val +14.1%	LgCp Val +32.8%	LgCp Grw +18.1%			
SmCp Val +22.4%	MdCp Grw +21.5%	MdCp Grw +26.7%	LgCp Grw +54.2%	LgCp Grw +37.2%						

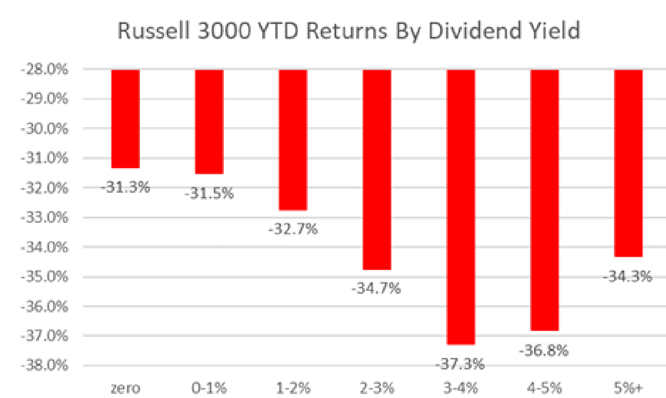
Source: Furey Research

2020 Outlook: A Picture is Worth a Thousand Words

Above we articulated our revised 2020 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.

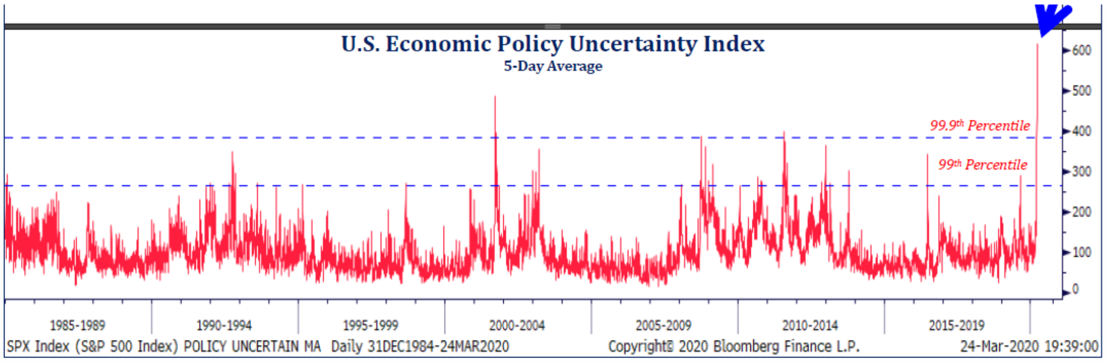
The two charts below show the year-to-date returns of the Russell 3000 based on the amount of leverage (i.e. debt to ebitda) that the company had (left) and the dividend yield (right). The market punished any company with leverage of any kind but particularly punished those with excessively high debt levels. Not even high yielding securities (below right) could stem the downward slide of the market. In fact, the higher the yield was on a stock, the lower was the return. The market was likely punishing REITs and other stocks where a high dividend was likely going to be reduced or slashed altogether.





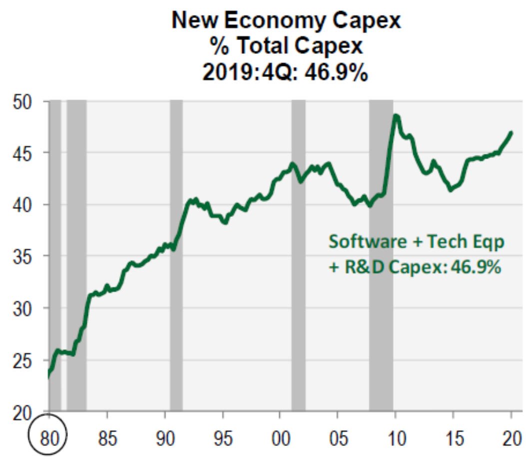
Source: Raymond James

The chart below shows the level of economic policy uncertainty going back to 1985. It was by far a record, but with the Fed's and U.S. government's very quick actions with respect to stimulus, this uncertainty likely subsided dramatically.



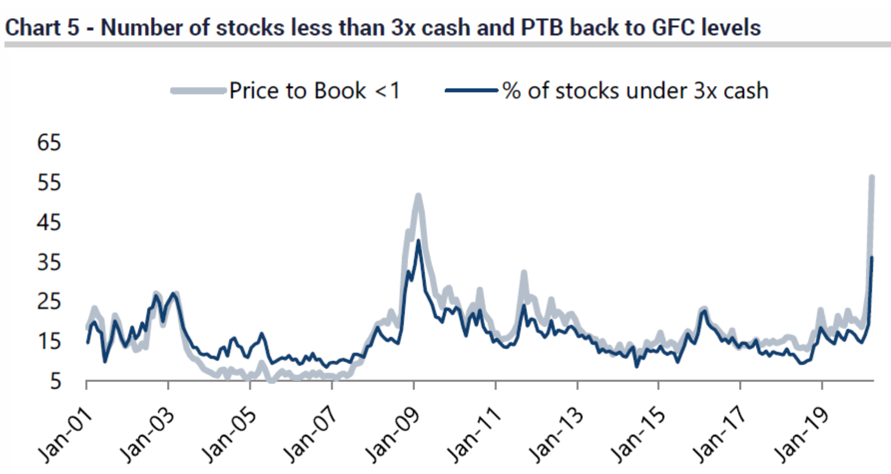
Source: Strategas Research

The chart below shows the percentage of capital expenditures that are spent on such items as computers and software, etc. The percentage has consistently grown in the computer age, and we expect that to continue going forward.



Source: Cornerstone Macro

We haven't spent much time talking about valuation in this newsletter but the chart below highlights the percentage of stocks within the Russell 2000 that currently trade at less than one times price to book ratio or less than three times cash on their balance sheet. We haven't seen such bargains since the great recession of 2009, which was a fabulous buying opportunity.



Source: FactSet; FTSE Russell; Jefferies

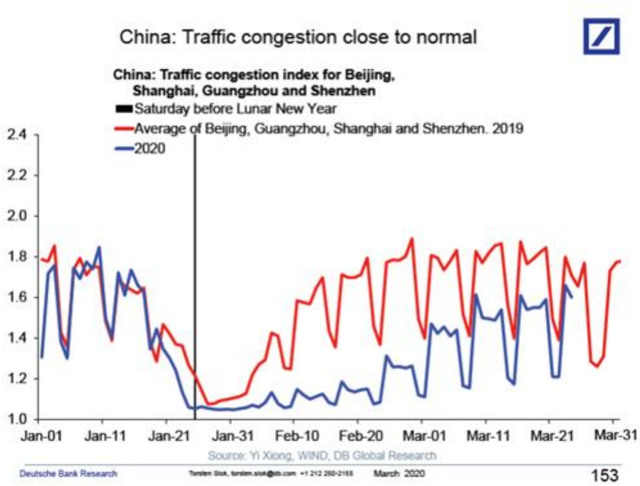
This table is simply the breakdown of how the $2.2 trillion economic stimulus package (CARES Act) will be spent.

Estimate Of Major Provisions In The CARES Act, In Billions Of Dollars

Provision	Cost ($ bn)
Rebates to Individuals	$290
Small Businesses	376
Loan Forgiveness	349
Loan Subsidies	17
Emergency EIDL Grants	10
Corporate Tax Relief	232
Payroll Grants to Airlines/Cargo/Contractors	32
ESF Loans/Loan Guarantees/Investments	500
Airlines/Cargo	29
Businesses Important to National Security	17
Fed 13(3) Lending Facilities	454
Unemployment Insurance	250+
Coronavirus Relief Fund	150
Appropriations	340
Hospitals/Veterans Care	117
FEMA Disaster Fund	45
Department of Education	31
SNAP & Child Nutrition	25
Strategic National Stockpile	16
Vaccines / Therapeutics & Other Medical	11
DoD	11
Other	85
TOTAL	$2,170

Sources: Ways and Means Republicans, Senate Republicans, and Cornerstone Macro.

The two charts below show that there is hope for the U.S. to recover relatively quickly, which assumes that you can use China as the model. These charts are of the Chinese property sales (left) and of the traffic congestion (right) pre and post their bout with the Coronavirus. They show that their activities started approaching normal within two months of their country's shutdown. There is hope.



Thematic Investing: Target May Be Off the Back of Pharma/Biotech Post COVID-19

Drug pricing and supply are hot topics of discussion today. Entering 2020 we believed that the pharmaceutical and biotech industries would face headwinds as Washington amped up talks of competitive bidding and price controls. This rhetoric is nothing new. Back in 2015, then Democratic Presidential candidate Hillary Clinton tweeted about price gouging that caused drug stocks to retreat. The tweet was in response to Turing Pharmaceutical's 5000% price increase on its drug Daraprim from $13.50 a tablet to $750. Investor sentiment for the drug industry has ebbed and flowed since 2015, but it appeared that the current environment was conducive for legislative action with seemingly bipartisan support until COVID-19 happened.

You might say that the industry has brought scrutiny upon itself with unjustified price increases over recent years as Turing Pharmaceutical is just one example. Valeant Pharmaceuticals made headlines in the wrong way back in 2015 when it raised the price on its diabetes drug Glumetza from $572 to $5,148. At the same time, Mylan Labs came under fire after the company was publicized for raising the price on the EpiPen from $50 to $500 over the course of the previous ten years. Annual pharmaceutical price increases are quite common, in fact, as manufacturers raise list prices every January on average 8-10%. However, with consumers pressuring their legislatures to take action on escalating drug prices, the industry is taking more muted increases. In 2018, 580 of the top drugs in the U.S. saw higher prices on average of 8% and up another 5.2% in 2019 according to GoodRx. By slowing the rate of price increases at this time of increased scrutiny, drug companies are clearly trying to fly under the radar and not call attention to themselves.

One of the difficulties that consumers have is the lack of transparency in drug pricing. From drug manufacturer to the consumer, the product can sometimes pass through as many as six different middle-men, and each take a cut of the revenue pie. Like most industries in health care, the drug industry is due for more streamlining and efficiency. This event will be one of the most significant challenges of the Trump administration in its attempt to wring costs out of the system. You might ask how big is the industry? Total revenue at retail pharmacy, mail order, long-term care and specialty pharmacies was $446 billion in 2019. Specialty drugs accounted for about a third of that total. Due to the multiple levels of transactions and rebates a drug goes through before reaching the consumer, it is very difficult to zero in on the actual cost of the drug. In the past when there was little to no copay or coinsurance for pharmacy benefits, consumers didn't care much about the tangled web of drug pricing. However, with the advent of high-deductible insurance plans and higher out of pocket expense for pharmacy benefits, consumers and lawmakers are demanding more transparency.

This schematic below illustrates the typical path a drug migrates from the manufacturer to the consumer as well as the financial trail. This structure is ever changing as health care payers are vertically integrating in to the pharmacy benefit and distribution segments of the supply chain. This move will put more pressure on hospitals and other health care providers as payers gain more negotiating leverage.

The U.S. Pharmacy Distribution and Reimbursement System for Patient-Administered, Outpatient Prescription Drugs

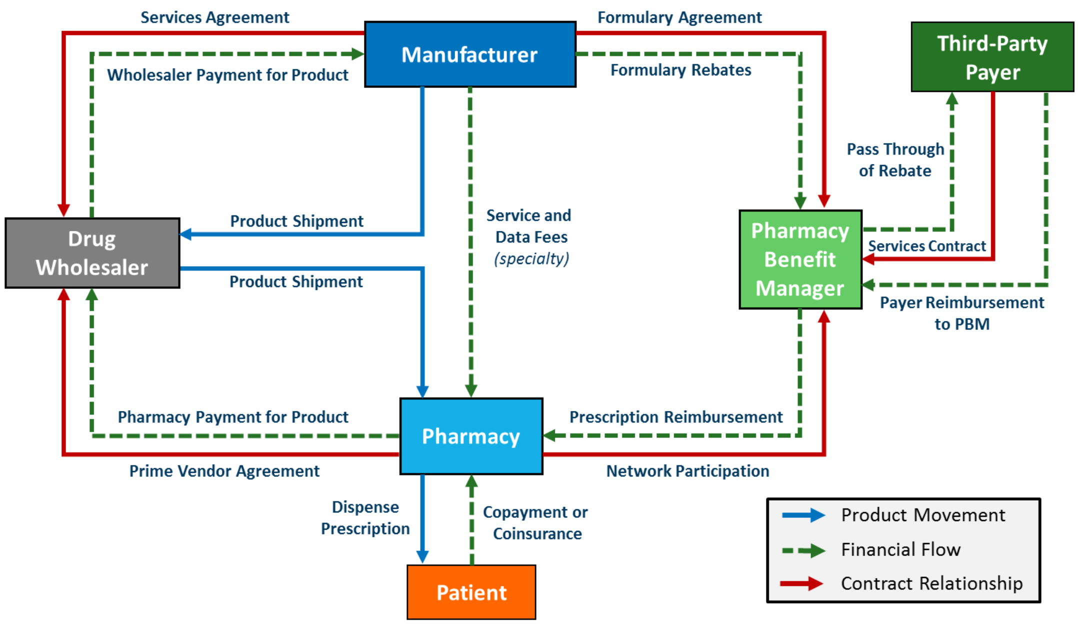
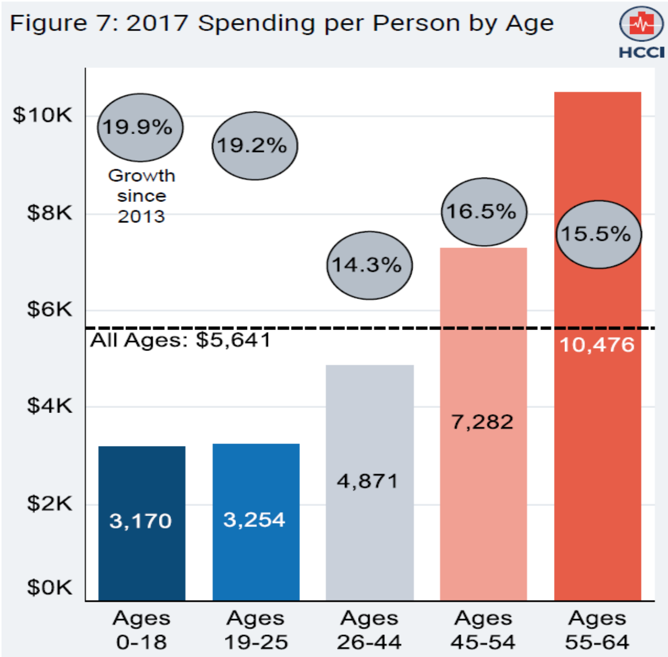


Chart illustrates flows for patient-administered, outpatient drugs. Please note that this chart is illustrative. It is not intended to be a complete representation of every type of financial, product flow, or contractual relationship in the marketplace.
Source: Fein, Adam. J., *The 2016 Economic Report on Retail, Mail and Specialty Pharmacies*, Drug Channels Institute, January 2016.
(Available at http://drugchannelsinstitute.com/products/industry_report/pharmacy/)

Despite the complexities and controversies surrounding pharmaceutical pricing and distribution, drug therapy is still arguably the most cost efficient modality for treating the majority of health conditions and diseases that face our society. Pharmaceutical benefit utilization as well as overall health care consumption will continue to grow over the next decade as the demographics of America continues to age. With over 10,000 Baby Boomers turning 70 everyday, the growth curve for pharmaceutical demand will not be linear, but will ramp at an accelerating rate. A person over the age of 55 will spend more than twice as much on health care annually than a person under 44. The following chart shows the average annual health care expenditure for Americans broken down by age cohort. As you would expect, spending ramps up considerably as a person ages. In 2017, the prescription drug component was $1065 of the overall average spend of $5,641.



Source: Health Care Cost Institute, 2019 Report

Having a prescient understanding of what will unfold over the next decade will help us formulate our investment themes around the health care and pharmaceutical industries. With the knowledge that demand will continue to grow and costs will increase, we will have to implement better strategies to contain those rising costs. Cost cutting initiatives will include data analytics, tele-medicine, technology to improve patient compliance, generic and biosimilar substitution, direct from manufacturer to consumer distribution, and reducing toxic drug-to-drug interactions just to name a few.

While we started 2020 with the mindset that the pharmaceutical industry would be under fire from citizens and lawmakers, we believe sentiment may have shifted due to the COVID-19 pandemic. Of all the jobs deemed "essential" by governors around the country, workers in the pharmaceutical industry might now be some of the most essential of all as we cope with the deadly virus. To be sure, there will continue to be headwinds in terms of pricing as well as structural issues that need to be addressed such as a secure supply chain. However, with focus directly on developing a fast diagnostics test and cure for COVID-19, we believe the pharmaceutical/biotech and health care industries in general will have a fundamental tailwind for the foreseeable future.

Details from President Trump's Stimulus Bill show that health care funding will get a sizeable piece of the pie.

- Department of Health & Human Services $140 billion
- Public Health and Social Services Emergency Fund $127 billion
- Hospital Health Care Facilities $250 million
- Strategic National Stockpile $34 billion
- Vaccines, therapeutics, diagnostics, other medical preparedness $11 billion

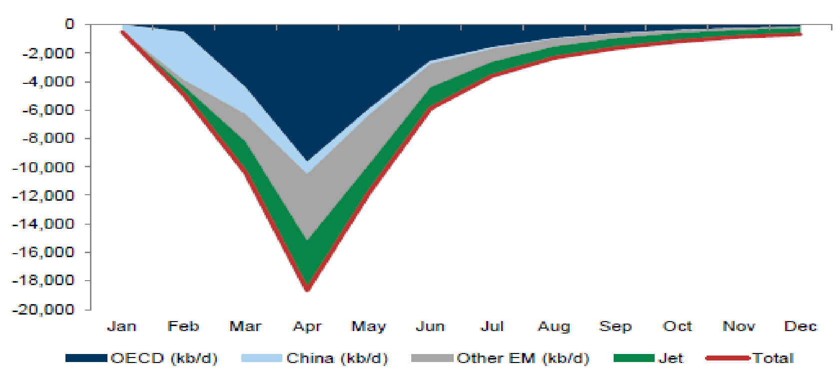
Of the $11 billion earmarked for the last category listed, $3.5 billion will go towards advanced construction, manufacturing, and purchase of vaccines and therapeutic delivery to the American people. As a nation we have been scrambling to procure necessary drugs and medical supplies to treat the increasing number of COVID-19 cases, only to find out that a very large percentage of these products are currently sourced out of China and India. In light of the recent publicity, there is grave concern amongst Americans that we are at a strategic disadvantage with such a heavy reliance on China for critical pharmaceuticals and vaccines. The Center for Infectious Disease Research and Policy (CIDRAP) out of the University of Minnesota just concluded an 18 month long study titled, Resilient Drug Supply Project. It identified 156 critical drugs that are used in the acute care setting where timeliness of delivery (hours to days) is required to prevent a rise in mortality rates. Many of these same drugs are either made, formulated, packaged or have API (active pharmaceutical ingredient) coming from China, India or Italy. Some of the more well-known drugs that could be potentially at risk for supply chain disruption from one of these countries are albuterol, epinephrine, heparin, ketamine, prednisone, vasopressin, verapamil, warfarin and several antibiotics. Over the years the manufacturing of these drugs has shifted overseas due to cost pressures here in the U.S. However, we believe that the $3 to $5 billion of stimulus money earmarked for manufacturing construction will be just the beginning of a multi-year renaissance in the rebuilding of the pharmaceutical/biotech industry in the U.S. Americans will demand that the key drugs that we rely on be made here in the U.S. We would never outsource key strategic defense systems to be manufactured in Russia or China nor should we rely on these foreign countries to manufacture important pharmaceuticals for us. This change will present a plethora of investment themes for us to develop over the coming weeks and months.

Thematic Investing: The U.S. Energy Renaissance is Dead – Long Live the Renaissance

As we have discussed in early 2015 and late 2016 newsletters, one of the most important driving factors in the U.S. economy has been the growth in U.S. oil and natural gas production and its multiplier effect in the capital expenditures arena. We entitled our 2015 piece "Be Careful What You Wish For" to outline the idea that with collapsing oil prices comes reduced oilfield drilling and the reversal of the positive industrial effect in the U.S. This multiplier from the domestic oil industry impacts the demand in other sectors like chemicals, steel (pipes and valves), construction (new pipeline and processing facilities projects) and transportation (truck and rail).

During 2015 and through the end February of 2016, WTI (West Texas Intermediate) oil prices tumbled from the low $60 per barrel to the mid $20 per barrel in roughly eight months. That decline is a ride on a kiddie roller coaster action compared to 2020's plummet from roughly $61 per barrel to $20 per barrel in the last three months. The double barrel blast of a biblical amount of oil demand destruction from COVID-19 along with the demise of OPEC production discipline has pulverized oil prices. The demand loss is unprecedented as Goldman Sachs predicts that March and April worldwide demand will decline 10.5 mmb/d (million barrels per day) and 18.7 mmb/d, respectively, year over year, and that full year demand will decline 4.25 mmb/d. The chart below represents the stunning COVID-19 effect on the global oil markets.

Exhibit 2: Rapidly expanding global quarantines and a halt to air travel are leading to an unprecedented collapse in global oil demand
Demand impact from Covid-19 (kb/d)



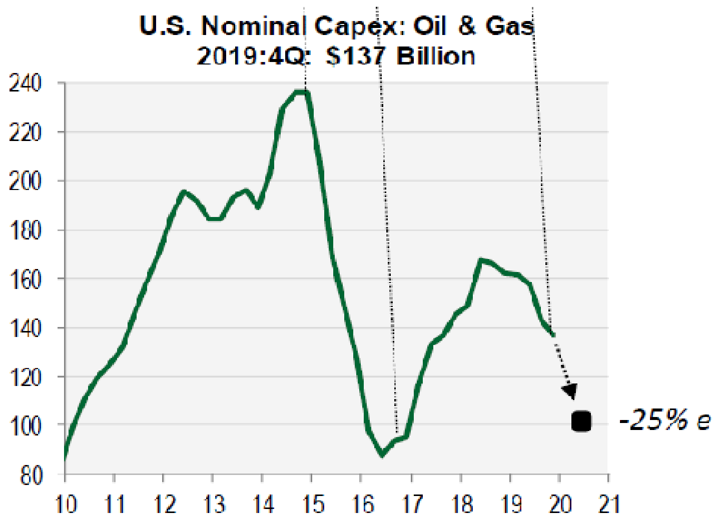
Source: Goldman Sachs

At least for the time being, the Russian unwillingness to honor production cuts along with the lost market share from multiple 1.0 mmb/d or more production annual increases from the U.S. has exhausted the Saudis patience. On paper, the Saudis allegedly will increase production from 9.7 mmb/d to 12 mmb/d in an already oversupplied market. We will see.

The U.S. oil industry is often referred to as short cycle in nature. This term means that the U.S. volume growth is largely land based, and the drill to production time is comfortably less than a year versus the typical five to seven year long, deepwater offshore projects around the globe. Short cycle also means that oilfield activity will respond quickly to a collapse in oil prices. "Take a look around you, Ellen. We are at the threshold of hell," ranted Clark W. Griswold in the comedy classic Christmas Vacation, and the U.S. oil industry likely feels the same. Because of the short cycle nature of the domestic oil industry, drilling rigs and hydraulic fracturing (frack) fleets are being released as fast as possible as capex budgets in the oil patch drop. We have already witnessed 35% budget reductions among non-integrated oil producers, and this number is climbing according to Raymond James research. At recent oil price levels, they see the U.S. rig count collapsing from an average of 943 rigs in 2019 to 425 rigs in 2020, which will obviously also remove good paying jobs in key economic centers like Texas. As we commented at the start on the "be careful what you wish for" warning from lower energy prices, the multiplier effect on industrial

America from these oil capex curtailments is just beginning across a variety of sectors in the U.S as we need less chemicals, steel, construction, and transportation to name but a few. From a cash cost perspective, it is unlikely that any currently producing U.S. oil wells are shut-in unless oil prices reach the low-mid teens. Perhaps there will be a supply side deal between the U.S., Russia, and the Saudis. However, if the Russians and Saudis want to regain oil market share, they have to exploit our short cycle and keep U.S. oilfield activity down for at least six months in order for the production decline curves of our oil wells to impact our volumes and create room for their growth.

According to Cornerstone Macro research, there has been a positive correlation between oil prices and U.S. capex since 2010 when the domestic energy renaissance began. As seen in the chart below, the growth in capex coming off the 2016 oil price lows was impressive and beneficial to industrial America. Now with the energy sector being an important gear in the U.S. industrial machine, the loss of both energy capex and jobs can offset gains in consumer spending from lower gasoline prices.



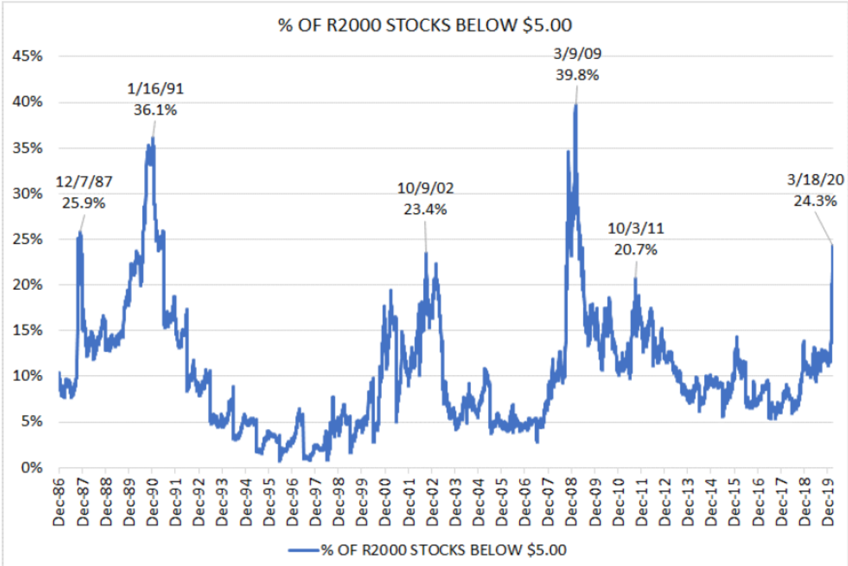
Source: Cornerstone Macro

With the unprecedented oil demand collapse and pall of extra production from OPEC, U.S. energy capex is being eviscerated in 2020 and is creating a headwind for U.S. economic growth through its industrial multiplier effect when we do inevitably emerge from the COVID-19 crisis.

Stock Market Trivia

Each quarter we offer a piece of market trivia that we believe is interesting or timely, or both. The dramatic selloff that we've seen in the markets in March has left some bargains to be sure. The first chart below shows that when the percentage of stocks within the Russell 2000 Index that are under $5.00 per share approaches 25% of all stocks, the average forward returns approach 43% on average and are positive 100% of the time as seen on the table below. We like these odds.

Fig 1. **The % of R2000 Stocks Below $5.00 Stock Price is Near Past Peaks**



Source: Furey Research Partners and FactSet. Data as of 3/20/20.

Fig 2. **Rare for so many R2000 Stocks to be below $5.00 share price**

% OF R2000 STOCKS BELOW $5.00	AVERAGE FWD YR PERFORM	% Pos	% of DAYS
10%	15.9%	80%	42%
15%	23.4%	91%	20%
20%	30.9%	98%	8%
25%	43.1%	100%	4%

Source: Furey Research Partners and FactSet. Data as of 3/20/20.

It's rare for the percentage of R2000 stocks with below $5.00 share prices to exceed 25% and has only occurred 4% of the time with those observations all clustered around three events – the Great Financial Crisis, the First Gulf War and '91 recession and following the '87 Crash.

In **every instance** when the **percentage** of R2000 stocks **below $5.00** share price **exceeded 25%,** the R2000 was **up 100% of the time with an average 43% gain.**

Source: Strategas Research

We hope that you found our first quarter 2020 review and updated 2020 outlook newsletter to be insightful and interesting. Stay safe and healthy!! 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.

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