1492 CAPITAL MANAGEMENT
DISCOVERING OPPORTUNITY

JUNE 2020 • VOL. 13 • ISSUE 6

IDENTIFY THEMES | FUNDAMENTAL ANALYSIS | TARGET VALUATION | GROWTH STRATEGY | VALUE STRATEGY | CORE ALPHA STRATEGY | VALUE INCOME STRATEGY

1492 Vantage Point Quarterly Newsletter

Welcome to 1492 Capital Management's newsletter for the second quarter of 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.

To "V" or not to "V", That is the Question

As we stated last quarter, we're in the midst of a pandemic-induced recession. There has been a tremendous amount of banter from market observers and talking heads over the past few months about the shape of the recovery. I'm sure that most of you have heard the opinions from these folks that the recovery would come in the shape of a "V", "U", "L", "W", "square root sign", or some other nuanced combo of a letter and a shape. The fact of the matter is that the Covid-19 pandemic forced a shutdown of nearly 95% of the global economy at some point over the last few months, which unsurprisingly caused a precipitous drop in economic activity and a global recession. In opposition to this recessionary environment, central banks and governmental entities have put forth stimulus measures of epic proportions to stabilize and rejuvenate economic growth. For example, in the U.S. alone, the Federal Reserve and U.S. Government have launched a remarkably large stimulus package that includes the nearly $3 trillion CARES Act which provided support programs for individuals, businesses, hospitals and even other governmental entities. These programs now total more than $9.5 trillion, or greater than 44% of U.S. annualized GDP. This level is a staggeringly large, never-before-seen total, and we're not the only ones doing it. The global total is now in excess of $24.5 trillion or greater than 28% of global annualized GDP. As an analogy, even if you drop a heavy object like a 16 pound bowling ball from chest height onto a hard surface, the ball is going to bounce back up to some extent. If we get anything other than a "V" shaped bounce initially in this recovery given the precipitous drop, we've got serious issues. However, the trampoline (the global stimulus programs) has been put under the ball to help it bounce even higher than one would expect if it were left to just rebound off a hard surface. The stock market believes that the bounce will be powerful, but a recurrence of Covid outbreaks or a slower than expected lift could act as countervailing forces and both of these outcomes are quite possible.

We are definitely in the "V" bounce camp, but has the market already discounted a robust economic environment? Please read on to see our unique views of what's on tap for the balance of 2020, what some of the key themes are that we're investing in here at 1492, what the key stock market 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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A Review of the Quarter: To "V" or not to "V", That is the Question

As we stated last quarter, we're in the midst of a pandemic-induced recession and not a typical financially-induced recession. There has been a tremendous amount of banter from market observers and talking heads over the past few months about the shape of the recovery. I'm sure most of you have heard the opinions from these folks that the recovery would come in the shape of a "V", "U", "L", "W", "square root sign", or some other nuanced combo of a letter and a shape. The fact of the matter is that the Covid-19 pandemic forced a shutdown of nearly 95% of the global economy at some point over the last few months, which unsurprisingly caused a precipitous drop in economic activity and a global recession. However, as we shared in our last newsletter, the governments around the globe already had the recession recovery playbook from 2008. In opposition to this recessionary environment, central banks and governmental entities have put forth stimulus measures of epic proportions to stabilize and stimulate economic growth. For example, in the U.S. alone, the Federal Reserve and U.S. Government have launched a remarkably large stimulus package that includes the nearly $3 trillion CARES Act, which provided support programs for individuals, businesses, hospitals and even other governmental entities. These programs now total more than $9.5 trillion, or greater than 44% of U.S. annualized GDP. This level is a staggeringly large, never-before-seen total, and we're not the only ones doing it. The global total is now in excess of $24.5 trillion or greater than 28% of global annualized GDP. The governments and central banks around the globe have executed the playbook almost flawlessly and with unprecedented speed up to this point. The chart below shows the stimulus measures initiated around the globe in just the past four months.

Global Monetary And Fiscal Stimulus To Fight COVID-19 Impact
2020 Feb to June (CSM)

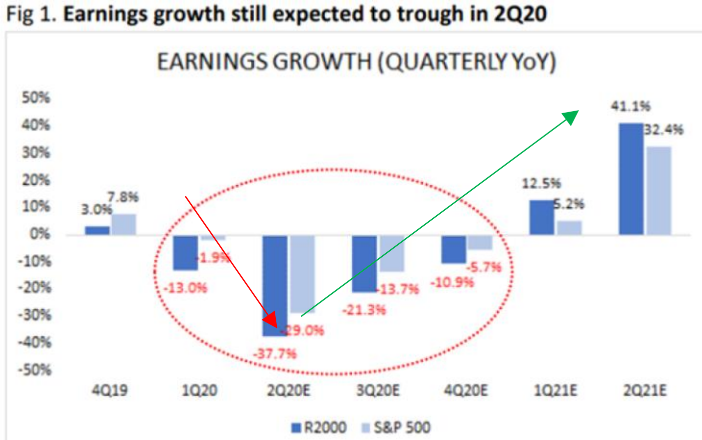
	Potential Central Bank Liquidity Injection		Potential Fiscal Stimulus		Central Bank Liquidity Injection and Fiscal Stimulus	
	$ Tln	% GDP	$ Tln	% GDP	$ Tln	% GDP
U.S.***	$6.21	29.0%	$3.30	15.4%	$9.51	44.4%
Eurozone	$1.78	13.3%	$4.02	30.2%	$5.80	43.6%
Japan**	$1.03	20.0%	$2.08	40.3%	$3.11	60.3%
U.K.	$0.37	13.6%	$0.14	5.1%	$0.51	18.7%
China****	$1.33	9.3%	$1.22	8.4%	$2.54	17.7%
Others*	$0.68		$2.38		$3.05	
Total	**$11.39**	**13.2%**	**$13.14**	**15.2%**	**$24.53**	**28.3%**

*incl RoW and ADB, IMF, WB ****China CB stimulus incl liq injections and other activities, e.g. re-lending, RRR, direct small biz lending, etc

Source: Cornerstone Macro

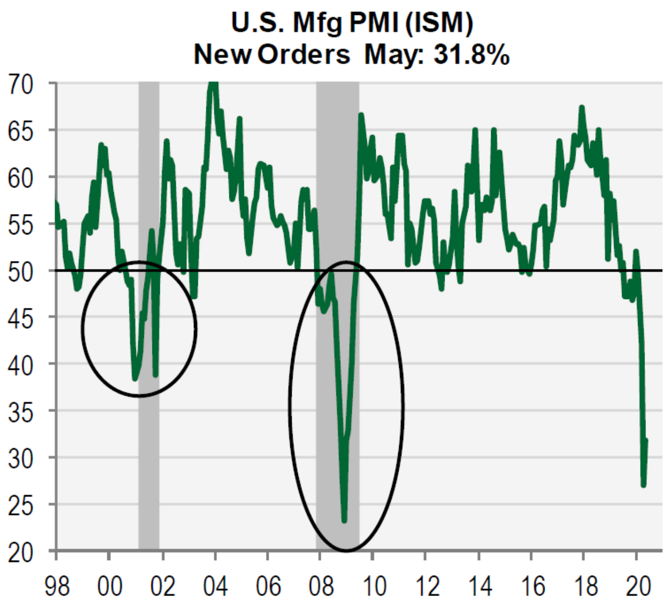
As an analogy, even if you drop a heavy object like a 16 pound bowling ball from chest height onto a hard surface, the ball is going to bounce back up to some extent. If we get anything other than a "V" shaped bounce initially in this recovery after the precipitous drop, we've got serious issues. However, the trampoline (the global stimulus programs) has been placed under the ball to help it bounce even higher than one would expect if it were left to just bounce off a hard surface. The stock market believes the bounce will be powerful, but a recurrence of Covid outbreaks or a slower than expected rebound could act as a countervailing force. Both of these outcomes are quite possible. The chart below shows the expected drop in earnings for the Russell 2000 and S&P 500 and the subsequent "V" shaped recovery as the pandemic fades and the stimulus impacts.

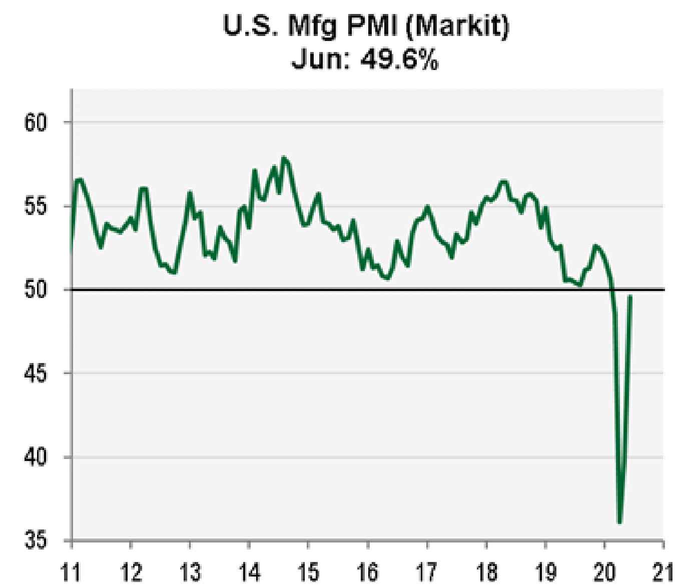
Fig 1. **Earnings growth still expected to trough in 2Q20**



Source: Furey Research Partners and FactSet. Based upon median growth figures.

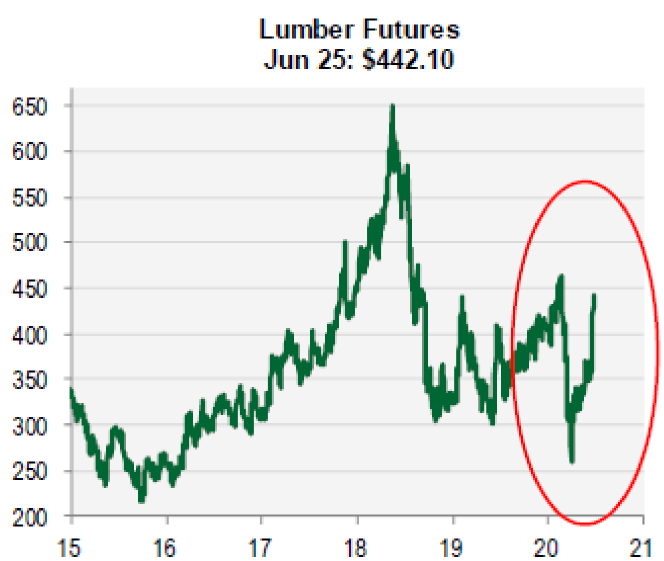
After the stock market's rapid plunge of nearly 40% from late February through March, many are questioning how the stock market can rise so much despite ugly economic statistics like more than 20 million people unemployed and slower growth as far as the eye can see. If there ever were a better time to adopt the "don't fight the Fed" mantra, I'm not sure when that would have been because the rapidity and magnitude with which the Fed has acted has put plenty of fuel on the fire to stimulate growth and encourage companies to retain or rehire their employees in short order. The Fed's willingness to go on the record that they are likely to keep interest rates at near zero all the way into 2022 has also helped spur on certain segments of the economy that are rate sensitive. Big ticket purchases of homes and autos have seen remarkable resilience despite grim economic numbers. Anecdotally, many car dealerships are reporting that the month of May was the strongest sales month in their history, despite not having enough inventory due to auto manufacturers being shut down due to Covid-19 concerns. The charts below show the precipitous drop in the U.S. Manufacturing PMI in May (left chart) and subsequent "V" rebound thus far in June (right chart).

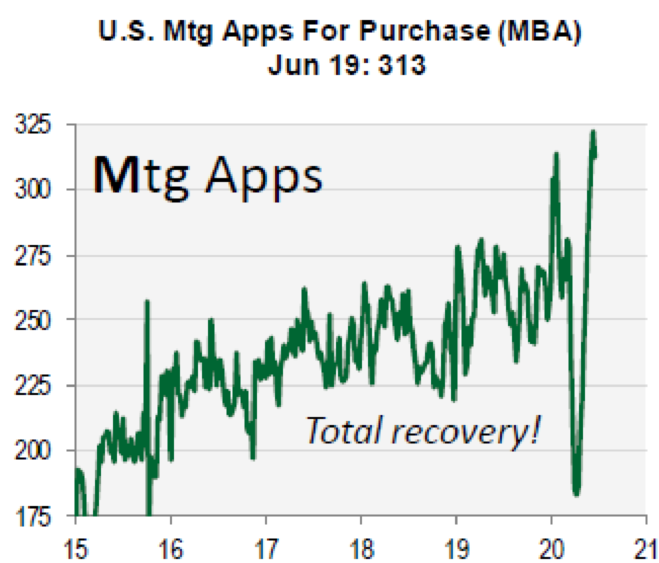




Source: Cornerstone Macro

The drop in mortgage rates has stimulated home buying as well. It's too early to know if this is a result of people conceding that they are going to be spending more time in their homes as "work from home" has become a trend or if they're fleeing the cities that have been hotbeds of Covid-19 and riots. In any event, the spike in lumber prices and mortgage applications are demonstrating amazing resilience as shown in the charts below.

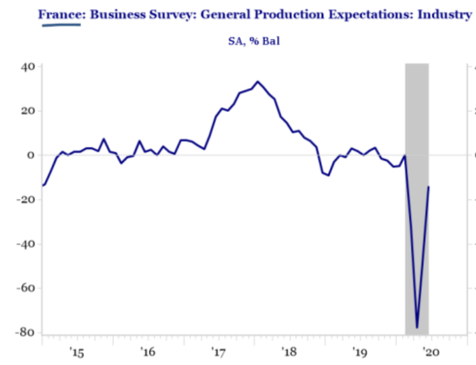




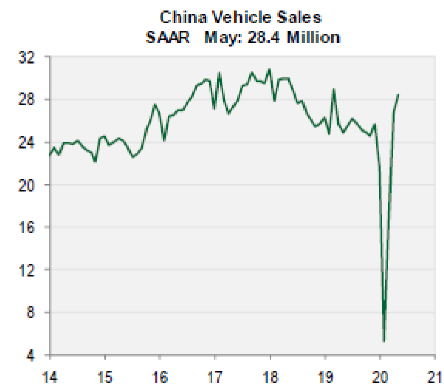
Source: Cornerstone Macro

The “V” shaped recovery isn’t just a U.S. event. Note the “V” shaped recoveries in Europe and China as shown in the charts below.

Source: Ifo-Institut fnr Wirtschaftsforschung



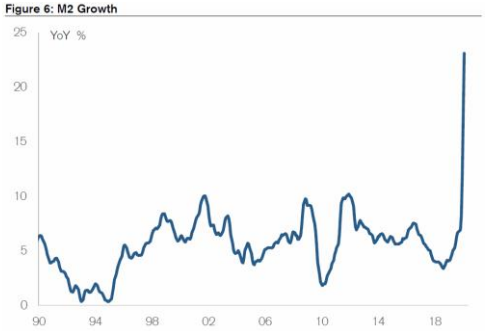
Source: Institut National de la Statistique/Economique



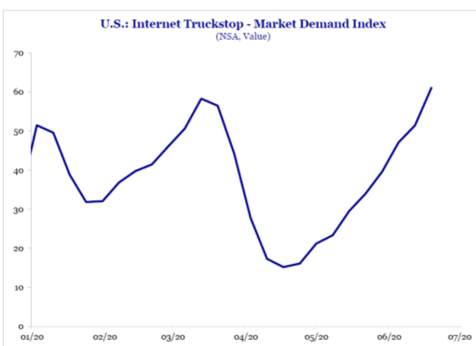
Source: Cornerstone Macro

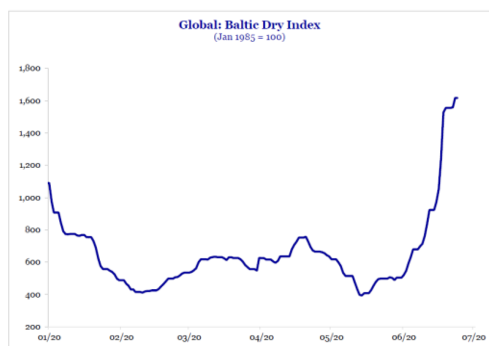
The amount of cash that’s been injected into the U.S. Economic system to act as the trampoline for the economy to bounce off of has been massive. The combination of the tax refund checks of $1,200 per person, of enhanced Federal unemployment benefits of $600 per week, and of $520 billion of Payroll Protection Program loans/grants that have been provided to small businesses have led to an historic increase in the money supply as shown in the M2 money supply chart below left. This historically large surge in money has started to provide some economic green shoots both here and abroad. The middle chart below shows the “Internet Truckstop - Market Demand Index” which is a proxy for trucking demand in the U.S. and the chart below right shows the Baltic Dry Index which is a proxy for shipping cargo internationally. Increases in these indices is an encouraging sign of economic activity picking up post the Covid shutdowns, but sustainablitiy will be key.

Figure 6: M2 Growth



Note: 3 month moving average with most recent data point being actual value
Source: Federal Reserve, the BLOOMBERG PROFESSIONAL™ service, and Credit Suisse





Source: Strategas Research

The market’s rebound off the March 23 low has been pretty spectacular. As our loyal readers will know, last quarter’s Russell 2000 Index performance was the worst on record and the fifth worst for the S&P 500. While the gains this quarter weren’t the best ever for a single quarter (this was the third best quarter ever for the Russell 2000 Index), they were very substantial and give us clues that the Fed’s playbook is working even though it might not seem like it as we sit here today with unemployment rates at record high levels. The S&P 500’s June quarter return was the best since the fourth quarter of 1998. Remember that the stock makret is a discounting mechanism and is looking ahead to what the future may hold in the coming year. Let’s hope that the recent outbreaks of Covid-19 cases don’t become widespread and force major economic shutdowns. The best news is that even with the recent outbreaks, the hospitalization rates remain manageable, and the daily death tolls are some of the lowest since the outbreak began in early March. Amazingly, another sign of market health is that capital makets activity in the month of May was a single month record in which $76.5 billion was raised through 141 equity issuances. This record was short lived as June was even larger with $83 billion raised through 142 equity issuances. After getting bludgeoned in the first quarter, small caps returned to stage an impressive comeback in the second quarter. However, the NASDAQ Composite index remarkably broke out to an all-time high and bested both the Russell 2000 and the S&P 500. The NASDAQ index is laden with stocks that will be/are major beneficiaries of the Covid-19 pandemic’s pull forward of the digitalization of our economy. We pointed out many of these themes in last quarter’s newsletter in the section entitled “Skating to where the puck is going”. See our update on this below in our section entitled “Skating to where the puck is going - Part 2”. The table below highlights the returns for the second quarter and year-to-date 2020 for the popular indices.

Index Returns		
Index	Second Qtr. 2020 Return	2020 YTD Return
Russell 2000	+25.42%	-12.98%
Russell 2000 Growth	+30.58%	-3.06%
Russell 2000 Value	+18.91%	-23.50%
S&P 500	+20.54%	-3.08%
Dow Jones Industrials	+17.77%	-9.55%
NASDAQ Composite	+30.95%	+12.67%

Source: 1492 Capital Management, LLC and FactSet

From a style perspective, the Russell 2000 Growth Index (+30.6%) crushed the languishing Russell 2000 Value Index (+18.9%) in the second quarter despite the value index substantially underperforming the growth index in the first quarter. The value index has a substantially larger weighting in financials and industrials which have lagged considerably. Growth indices outperforming value indices has become a common refrain since the Great Recession of 2008, and this quarter continued that trend. All of the sectors within the Russell 2000 Index finished with positive returns for the quarter except for Utilities (-0.1%), which is the prototypical "risk off" sector and was the relative outperformer in the first quarter. The best performing sectors within the Russell 2000 were the Consumer Discretionary (+58.1%) and the Healthcare sector (+32.4%). The Energy sector was a surprisingly strong performer as well despite the price of oil on futures contracts entering into negative territory for the first time in history, if only just for a few hours. Amazingly, the price of a barrel of oil has since recovered to nearly $40 per barrel at month's end. However, this rebound offers little consolation as the Energy sector is still down -51.7% year to date. The two tables below highlight the performance of the Russell 2000 style indices by sector for the month of June, for the second quarter, and for year-to-date 2020.

Table 11 - Russell 2000 Growth Scorecard through June 30th

	June			2Q2020			YTD			
GICS Sector	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Wgt
Com Serv	0.38	0.03	-3.46	23.87	0.61	-6.71	-8.70	-0.24	-5.64	2.6
Discretionary	5.60	0.69	1.75	54.27	5.18	23.68	-8.88	-1.60	-5.82	12.6
Staples	2.51	0.08	-1.34	21.31	0.71	-9.27	-7.94	-0.21	-4.88	3.2
Energy	3.89	0.00	0.05	48.78	0.14	18.19	-48.83	-0.31	-45.77	0.2
Financials	2.76	0.09	-1.08	17.89	0.86	-12.69	-8.70	-0.94	-5.64	4.3
Health Care	4.07	1.36	0.23	32.18	11.46	1.59	7.75	5.07	10.81	34.4
Industrials	6.30	0.81	2.46	29.27	4.49	-1.31	-10.35	-3.81	-7.28	13.0
Info Tech	1.92	0.44	-1.93	30.14	5.65	-0.45	2.97	1.18	6.03	21.2
Materials	3.93	0.11	0.09	28.36	0.75	-2.23	-18.56	-0.63	-15.49	2.7
Real Estate	6.67	0.26	2.82	18.93	0.70	-11.66	-16.32	-1.43	-13.26	3.8
Utilities	-3.77	-0.03	-7.61	0.09	0.04	-30.50	-8.31	-0.14	-5.25	1.9

Table 13 - Russell 2000 Value Scorecard through June 30th

	June			2Q2020			YTD			
GICS Sector	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Wgt
Com Serv	-0.17	0.01	-3.06	9.49	0.23	-9.42	-30.79	-0.82	-7.29	2.4
Discretionary	7.05	0.77	4.16	63.58	5.10	44.67	-15.91	-0.90	7.59	10.9
Staples	2.68	0.11	-0.22	19.41	0.69	0.51	-2.28	0.26	21.22	3.5
Energy	-4.31	-0.20	-7.21	26.35	0.99	7.44	-51.96	-2.49	-28.47	4.4
Financials	3.36	0.96	0.46	9.62	2.46	-9.29	-31.05	-11.73	-7.55	29.0
Health Care	3.15	0.19	0.25	34.00	2.17	15.10	-0.28	0.75	23.22	6.2
Industrials	4.31	0.74	1.42	21.34	2.86	2.44	-21.81	-2.30	1.69	16.1
Info Tech	1.63	-0.01	-1.26	17.27	1.91	-1.64	-11.17	-0.21	12.32	6.2
Materials	4.55	0.27	1.66	30.00	1.36	11.09	-23.58	-0.71	-0.08	5.5
Real Estate	5.43	0.55	2.53	14.14	1.39	-4.76	-25.18	-3.87	-1.68	10.4
Utilities	-7.17	-0.50	-10.07	-4.84	-0.26	-23.75	-17.99	-1.46	5.51	5.4

The rebound that we saw in the U.S. markets held form in the international markets as well. However, there was still a great deal of angst globally surrounding the Covid-19 pandemic and what the repercussions were going to be between the U.S. and China as a result of China's lack of disclosure to the world on the severity of the Covid-19 outbreak in their country. Tariffs on Chinese goods were offered as a possible penalty as well which wasn't helpful given the recently signed Phase 1 deal between the U.S. and China. Volatility in the market subsided from its near-record highs in the first quarter but still remains elevated from a historical perspective.

Index	Second Qtr. 2020 Return	2020 YTD Return
France	+12.7%	-17.4%
Germany	+25.4%	-7.1%
Brazil	+28.5%	-17.1%
India	+22.8%	-15.4%
China- A Shares	+8.7%	-2.1%
China- Shenzhen A Shares	+19.2%	+14.7%
Japan	+16.8%	-5.8%
Long-Term Treasuries (TLO)	-.2%	+21.3%
Investment Grade Corp Bonds	+10.7%	+5.4%
Gold	+5.1%	+5.1%
Volatility- VIX index	-42.4%	+123.4%
Oil	+93.4%	-35.2%
Natural Gas	+5.1%	-21.6%
Lumber	+56.2%	+7.6%

Source: 1492 Capital Management, LLC

Updated 2020 Outlook: A Quick Look Ahead at the Presidential Election

There are roughly 125 days until the Presidential election in early November. The recent national events from the pandemic to civil unrest has brought the election into focus. Most weekly polls show a high single digit lead for Biden over Trump. However, this level is exactly where Hilary Clinton stood at the same time in 2016, and we all know how that worked out. Our purpose here isn't to opine on who we think is going to win the election but to point out what a Biden win may mean for the stock market. Biden's camp hasn't really put all of his stakes in the ground yet, but he has provided some guidance about tax reform. If you recall, Trump's tax reform brought corporate taxes down to a level that made the U.S. competitive with the rest of the world and forced companies with foreign operations to repatriate much of those profits from overseas. Biden has vowed to undo much of the corporate tax cuts that the Trump administration initiated in 2016. The first chart below compares the existing tax structure to the proposed Biden plan. The areas shaded in green represent cuts from the prior law, and red represents hikes from current law. Yellow is neutral or undecided.

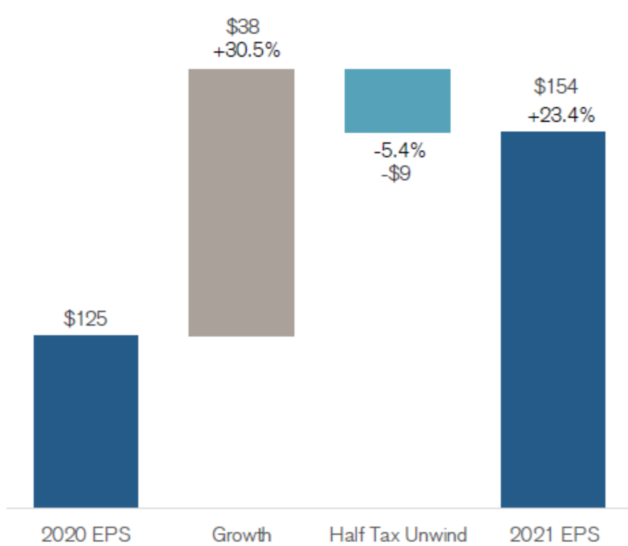
Corporate Tax Reform: Trump vs. Biden

	Trump Tax Cut & Jobs Act	Biden Tax Proposals[1]
Corporate Tax Rate	Reduced from 35% to 21%	Increase to 28%
Multinational Reforms	Repatriation and Territorial tax relief Minimum tax on foreign earnings (GILTI, BEAT)	Increase minimum tax on foreign earnings (GILTI)
Minimum Tax on "Book" Profit	No	Yes
Immediate Expensing (Capex)	Yes	Not clear; but could introduce new limits
Limits on Interest Deduction	Yes, but some relief under CARES Act	Not clear
Limits on NOL Carrybacks	Yes, but temporary relief under CARES Act	Yes, reverse CARES Act provisions
Investor Taxes	No	Increase Capital Gains and Dividend Tax

Source: Credit Suisse Accounting & Tax analysis; Tax Cut and Jobs Act of 2017; 1: Note key details of the Biden Tax proposals are not available at this point; this is preliminary analysis based on Joe Biden commentary and analysis of his campaign's tax proposals via The Tax Foundation and Tax Policy Center.

The chart below shows the impact to current S&P 500 consensus earnings estimates for 2021 if Biden's plan was implemented and half of the Trump tax cuts were unwound. If Biden wins, it's estimated that his plan would lower earnings estimates for 2021 from $163 to $154, which again assumes half of Trump's tax reforms were unwound.

Impact on 2021 Consensus EPS from Higher Taxes (Assuming Half Unwind)

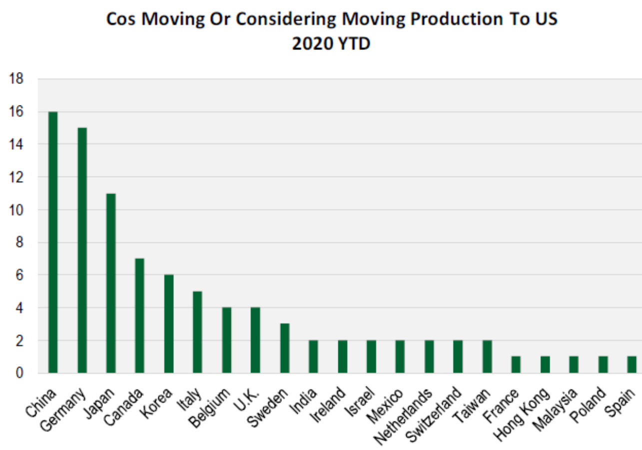


Note: Half tax unwind assumes median effective tax rate of 23.3%
Source: Standard & Poor's, FactSet, Credit Suisse

2020 Outlook: A Picture is Worth a Thousand Words

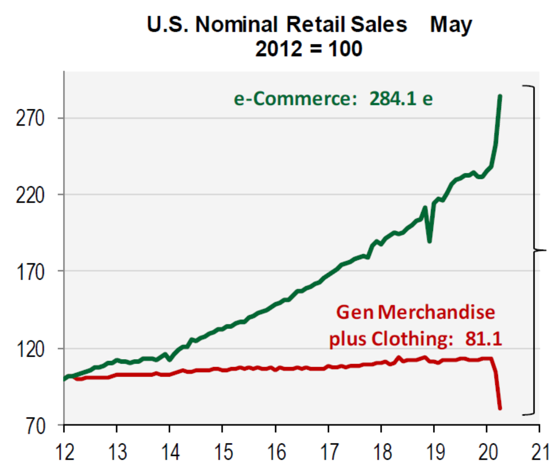
Above we articulated our revised 2020 outlook and the key issues and drivers for the stock market. Yet, we believe that there are other topics that we haven't spent a great deal of time on that deserve some mention. In order to provide you with a shorter read, as everyone's time is valuable, we decided 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 pandemic has forced many companies with global operations to consider moving their production back to the U.S. to avoid any black swan events that may disrupt their supply chains.



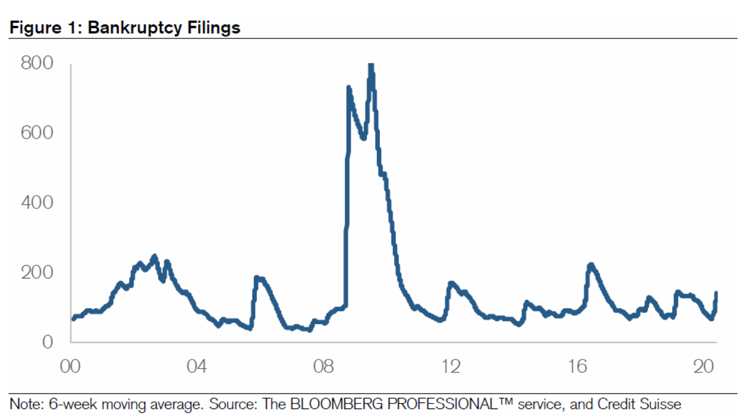
Source: Cornerstone Macro

The pandemic has rapidly changed a lot of things but maybe none more than the propensity for consumers to buy online. As the chart shows, the preference for online shopping has been trending higher for years, but when it's made one of only a few options, it accelerates rapidly.



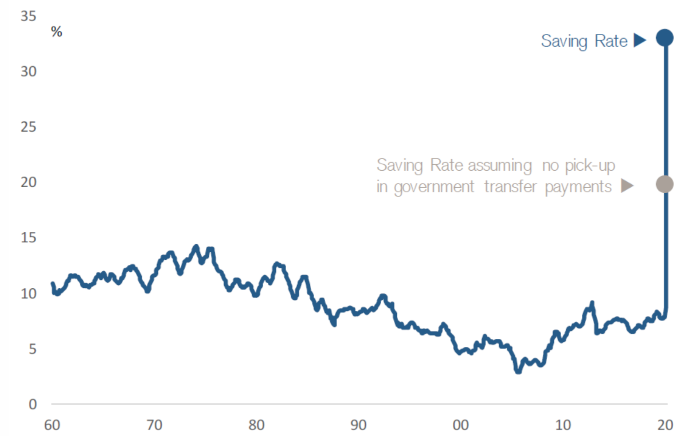
Source: Cornerstone Macro

The government has done a good job so far of keeping companies afloat during the pandemic with programs like the Paycheck Protection Program (PPP), but bankruptcy trends are something to keep an eye on as the Covid-19 outbreaks persist.



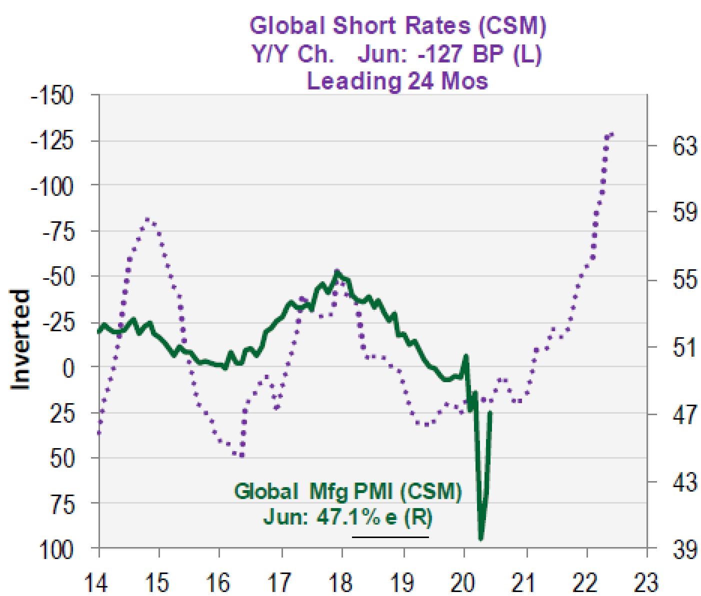
The saving rate has skyrocketed recently with all of the programs aimed at keeping consumers and businesses engaged like the increased Federal unemployment benefits, $1,200 tax refunds, and the PPP program. This effort should provide a little cushion for those Americans who have been displaced, to get back on their feet.

Figure 12: Saving Rate



Note: Assumes no pick-up in government transfer payment of $9,301 from February 2020 to April 2020
Source: BEA, the BLOOMBERG PROFESSIONAL™ service, and Credit Suisse

The chart below is still one of my all-time favorites. It shows the change in global short term interest rates (dotted line inverted) with the global manufacturing PMI overlaid. There is a high degree of correlation through time between cheap money (low interest rates) and manufacturing activity.



Source: Cornerstone Macro

<u>Updated 2020 Outlook: Skating to Where the Puck is Going – Part Two</u>

Last quarter we wrote a section of the newsletter entitled "Skating to Where the Puck is Going". 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 puck on its future path. We wrote this piece in late March when we knew much less than we know now about Covid-19 and how the government and companies were going to react to it. As a reminder, last quarter we wrote the following excerpt, but we believe much of this still holds true today:

"The mistake that Wall Street economists, analysts, and talking heads are already making is focusing on the here and now. We heard 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."

The purpose of rehashing this piece is to provide you with a bit of insight into our firm's hallmark investment approach called "Thematic investing". The list of themes that we highlighted last quarter were themes that we believed would be in play as the world adapted to the pandemic. They included the following:

1. **Supply chain management**
2. **Robotics**
3. **Robust telecom networks**
4. **Online education**
5. **Telemedicine**
6. **Cloud based communications platforms**
7. **Smartphones**
8. **Computer sales**
9. **Netflix and other streaming services**
10. **Online gaming platforms and Esports**
11. **Home furniture and home office furniture**
12. **Onshoring**
13. **Digital media and social media platforms**
14. **Data centers**

These were 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 in the future if they aren't already being exploited currently. Read on for more about our "thematic investing" approach and how we do it day to day. We also explain some of our current themes and how they're deployed in our client portfolios.

Thematic Investing: A Review of 1492's Thematic Approach to Investing

Our firm's hallmark investment approach is called "Thematic Investing". Thematic investing involves deploying investments in a number of companies that benefit from the same trends or economic forces. We meet with hundreds of companies annually which helps us to uncover these investment themes. Unlike some investors who talk about themes from a "top down" perspective, identifying improving or accelerating fundamentals from a "bottom up" perspective drives all of our themes. Once a theme is identified we investigate the competitive landscape horizontally for competitors and vertically, up and down the supply chain to identify companies that are best positioned to benefit. Our thematic approach enables us to;

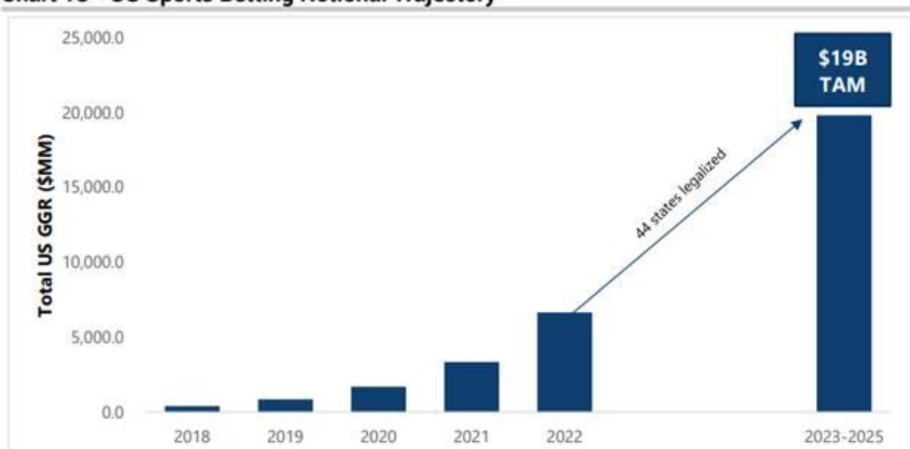
- Focus our research efforts on industries we believe hold great promise
- Maximize the higher growth segments of the economy in our client's portfolios
- Allows us to nimbly enter and exit our investments due to the diversification that the thematic approach provides

In the following sections, we'll provide some examples of "real life" themes, why we think they're compelling, and how we discovered them.

Thematic Investing: Legalization of Sports Wagering

Sports wagering is in the first inning of what could be a decade long growth cycle as it morphs from an illegal activity in most states to a highly profitable and tax revenue generating enterprise. The U.S. Supreme Court's ruling in May 2018 made sports wagering in the U.S. legal. This ruling granted states the right to legalize sports betting. It's estimated that the sports betting and online gaming market in the U.S. is less than $2 billion today but expected to grow to more than $40 billion over the next decade. This legalization comes at a critical time in which nearly every state in the union is looking for a way to boost their tax revenue to fill the hole that the Covid-19 pandemic has left. Ironically, sports betting is taking off just when nearly every major sporting league is shut down. This shutdown didn't stop the recent golf match between Tiger Woods/Peyton Manning and Phil Michelson/Tom Brady from being the largest bet on golf match in history by a factor of four. However, online betting's promise is much more than just sports betting. It also includes iGaming which allows casinos and other regulated entities to offer casino floor games like slots, blackjack and roulette to be played on licensed online platforms. These offerings are highly regulated endeavors, as you can imagine, to make sure that players are given a fair shake and not manipulated in any way. Sports betting has long been the domain of Las Vegas and Atlantic City sports books within licensed casinos. No more. Currently there are 22 states that have legalized sports betting and 6 states that have approved iGaming. By 2025 we expect that 75% of the country will have legalized sports betting. The revenue attraction is just too enticing for states to ignore. Each of the states has granted a limited number of licenses to brick and mortar casinos, in most cases, to manage these online platforms with partners who bring customers and who are generally savvy online marketers. Daily fantasy sports operators have been some of the first to jump into the fray. Many of them haven't even turned on their platforms yet for live betting but the buzz around this change has been enormous. There are a limited number of publicly traded ways to invest in this industry currently, but we expect that we'll see more as time progresses. The chart below shows the projected ramp in gross gaming revenue (GGR) over the next five years.

Chart 13 - US Sports Betting Notional Trajectory



Source: Jefferies Estimates

Thematic Investing: Cloud-Based Communications

The global pandemic has forced a quick and dramatic change in the corporate work environment from one that was centered on a corporate headquarters or super-regional offices to one that is now a decentralized work-from-home structure. This swift change in structure has forced many companies to reevaluate their communications infrastructure and to literally change it in a matter of days in many cases. The only way to execute this change is through cloud based communications. This portfolio theme at 1492 Capital Management has been deployed since 2014 when unified communications in the cloud was ready for prime time. However, many large corporations have been dragging their feet and trying to get the last bit out of their prehistoric premise-based PBX (private branch exchange) systems. In very short order, thanks to the pandemic, these dated systems were proven to be outdated. No other company was able to capitalize on this rapidly accelerating trend more than Zoom which primarily provides an easy to use video conferencing service. Zoom became a verb almost overnight. Interestingly, there have been a number of competitors in that space for years like WebEx and GoToMeeting, yet Zoom won mindshare with a skyrocketing stock price. Videoconferencing was just one application that needed to be addressed. The others were cloud based calling, contact centers, collaboration tools, and messaging. These UCAAS (unified communications as a service) players have been providing these cloud-based services for years and doing it successfully as corporations have slowly become comfortable putting their computer and software systems into the cloud. The high growth trend that was in place prior to the pandemic just received a major boost as numerous cases have been documented where these UCAAS providers have moved thousands of workers to a cloud based platform literally within days without a hiccup. Its major inflections like this pandemic that cause companies around the globe to reevaluate their dated systems and accelerate their upgrade path. This trend is clearly taking place currently and will continue for years to come. We plan on continuing to participate in this long running theme in our portfolios.

Thematic Investing: Renewable Diesel – Secular Fuel Demand Growth for an ESG World

Renewable diesel is a fuel that is chemically equivalent to traditional diesel but is produced using environmentally friendly inputs like used cooking oil, rendered animal fats, inedible corn oil or soybean oil. Unlike traditional biodiesel fuel, renewable diesel doesn't have any blending limits with petroleum diesel and has lower emissions than both traditional diesel and biofuels. In California, the carbon intensity (CI) index that uses ultra-low sulfur diesel as its base at 100% provides more environmentally friendly options for our ESG world. Renewable diesel made from soy oil or used cooking oil offers CI scores of 55% and 21%, respectively, as seen in the chart below.

Source: Bunge

Carbon intensity is a measure of grams of carbon dioxide equivalent per mega joule of energy generated from the fuel. In our ESG-focused world, this chemically equivalent transportation fuel that is easier to mix with traditional diesel and easier to transport than traditional biodiesel is becoming increasingly more available with a vastly lower carbon footprint than classic diesel fuel. Finnish renewable diesel producer Neste estimates that global renewable diesel demand will quadruple over the next ten years to 20 million metric tons annually from five million per year in 2019 and roughly double in demand from 2019 to 2022.

In the U.S, federal and certain state governments are working hard to make sure this alternative fuel is available for an expanding market. The EPA has reinstated the $1 per gallon blending tax credit for all biodiesel fuels through 2022, and California is at the forefront of lowering its greenhouse gas emissions with its Low Carbon Fuel Standard (LCFS) program. California's program calls for a 20% reduction in its CI by 2030 while using 2010 as its benchmark year. Depending on the feedstock used in making the renewable diesel that is sold in California, the producer could receive a credit of roughly $0.92 per gallon from using soybean oil to $1.82 per gallon from used cooking oil from the state. Consequently, your ability to source the low CI feedstock is key to maximizing profitability per gallon. An LCFS program also exists in Oregon and in British Columbia and is under consideration in the state of Washington and the rest of Canada with rumblings of interest in New York, which is the third largest diesel market in the U.S. While early days, additional market expansion opportunities for renewable diesel also include ocean shipping and air travel.

According to research from Cowen, U.S renewable diesel capacity is expected to expand from roughly 500 million gallons currently to 2.5 billion gallons in 2023. While all of these announced projects will likely not be completed, the renewable diesel industry is in growth mode as macro trends of reducing greenhouse gas emissions and government support drive demand and supply expansion for this ESG friendly fuel. Having attended many virtual conferences over the last two months, 1492 Capital Management has had the opportunity to visit with producers of renewable diesel as well as with key players in the vitally important feedstock supply chain, and we have recently deployed this renewable diesel theme across many of our strategies.

Thematic Investing: National Defense Strategy's New Emphasis on Near-Peer Threats

President Trump released his National Security Strategy in 2017, and a year later the National Defense Strategy (NDS) and National Military Strategy (NMS) followed which are both produced every other year on even-numbered years. While the NMS is mostly top secret, the NDS is open for public review and generally both strategic reports corroborate each other. The Chairman of the Joint Chiefs of Staff issues the NMS while the Secretary of Defense writes the NDS.

The Department of Defense's (DoD) primary purpose is to provide combat-ready military forces to deter war and protect the security of the United States of America. The NDS from 2018 outlines a number of pressing issues that require immediate attention. Namely we as a nation have been focused on asymmetric warfare for the past 30 years since the first Gulf War, which requires devising and developing strategies and weaponry to combat terrorist organizations. As we launch into the next decade, inter-state strategic competition, not terrorism, is now the chief concern for U.S. national security.

The following is a synopsis of former Secretary of Defense Jim Mattis's summary of the 2018 NDS. China, Russia, North Korea, Iran have all clearly demonstrated both economic and military aggression towards neighboring countries and the U.S. This increasingly complex security environment along with rapidly developing technology from China is eroding our influence and ability to maintain global peace through strength. The threat from new technology comes in many forms such as big data analytics, artificial intelligence, autonomy, robotics, directed energy, hypersonics, and biotechnology.

As the DoD looks to modernize its strategy and weapons, focus will be on the following:

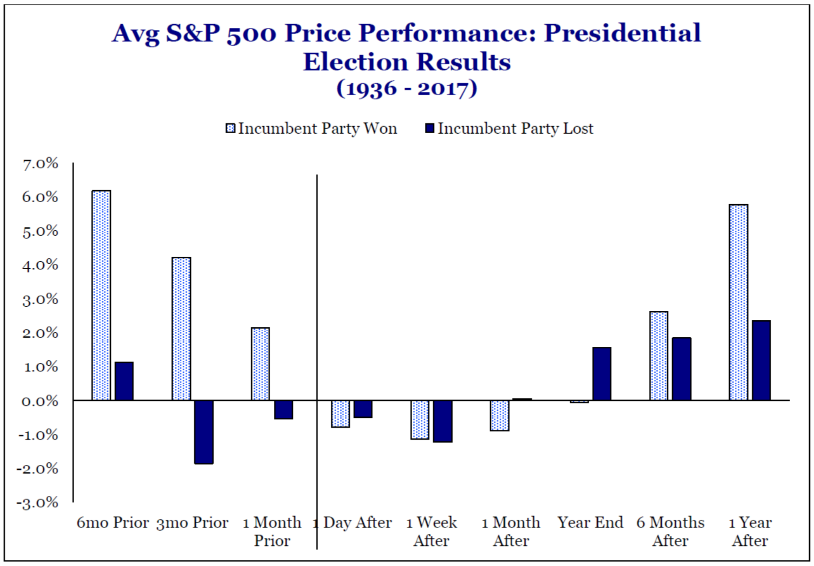
1. Nuclear forces
2. Space and cyberspace
3. Command, control, communications, computers, intelligence, surveillance, reconnaissance, otherwise known as C4ISR
4. Missile defense
5. Joint lethality in contested environments
6. Forward force maneuver and posture resilience
7. Advanced autonomous systems
8. Resilient and agile logistics.

Over the past two years, we have studied and identified certain investment themes that address the future direction of our national defense strategy. The shift of our DoD to these "near-peer" threats, namely China and Russia, will be an urgent process that will consume time and budget resources for the next several years. We believe this change will provide a secular tailwind for a number of companies operating to produce the weapons and technology that our security forces will demand to combat these foreign and domestic threats.

One area in particular that we've invested and deployed in the portfolios pertains to autonomous drone technology. As the Air Force seeks to maintain air superiority, it will look to more technologically advanced as well as cost-effective drones. The F-35 JSF program for instance costs $1.5 trillion to develop, and each unit runs at $90 million. This number doesn't include the cost of training the pilot. Going forward these types of programs will be cost prohibitive, not to mention they continue to put the human life of the pilot in direct danger. The Air Force is currently in the middle of flight testing a jet drone that can effectively be a force multiplier for a squadron of manned jet aircraft. These drones will cost approximately $4 million a unit, can perform both air-to-air and air-to-ground attacks, and can be controlled in flight by an F-35 JSF weapons specialist or from a ground station or fly autonomously. While these drones won't be replacing manned fighter jets anytime soon, they will be used in conjunction with a squadron of jets to establish air superiority at a fraction of the cost of an F-35 JSF while also removing a human life at risk.

Stock Market Trivia

Each quarter we offer a piece of market trivia that we believe is interesting or timely, or both. As we mentioned earlier, the Presidential election isn't too far off. However, the stock market has consistently been a good predictor of who is going to win in the months leading up to the election. When the market sells off in the three months prior to the election, there is a high likelihood that the incumbent party will lose. The reason that this selloff happens is that the market doesn't like change, and if they sense a new administration is coming in with a new agenda, the market dips. The chart below shows the summarized results through time, and the table below shows the detail by election.



Source: Strategas Research

S&P 500 Performance 3 Months Prior To Presidential Election

Year	S&P 500 Price Return	Incumbent Party	
'28	14.91%	Won	√
'32	-2.56%	Lost	√
'36	7.92%	Won	√
'40	8.56%	Won	√
'44	2.29%	Won	√
'48	5.36%	Won	√
'52	-3.26%	Lost	√
'56	-2.58%	Won	X
'60	-0.74%	Lost	√
'64	2.63%	Won	√
'68	6.45%	Lost	X
'72	6.91%	Won	√
'76	-0.09%	Lost	√
'80	6.73%	Lost	X
'84	4.80%	Won	√
'88	1.91%	Won	√
'92	-1.22%	Lost	√
'96	8.17%	Won	√
'00	-3.21%	Lost	√
'04	2.16%	Won	√
'08	-19.48%	Lost	√
'12	2.45%	Won	√
'16	-1.90%	Lost	√

Source: Strategas Research

We hope that you found our second 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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