1492 CAPITAL MANAGEMENT
DISCOVERING OPPORTUNITY
SEPTEMBER 2020 • VOL. 13 • ISSUE 9

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

1492 Vantage Point Quarterly Newsletter

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

The Rich Get Richer, but Deservedly So

As a follow up to last quarter's newsletter – "To V or not to V, that is the question", the economic data that has been released subsequently clearly confirms a "V" shaped economic rebound despite ongoing flare ups in Covid-19 cases in pockets both here in the U.S. and in Europe. Fueled by record stimulus around the globe, the "V" rebound has led to a miraculous recovery in the financial markets. However, much of the benefit has accrued to the leaders that were in place prior to the pandemic, and we're not talking about Amazon's Jeff Bezos or Tesla's Elon Musk. No, we're talking about the same stocks, sectors, and strategies that were working prior to the pandemic have continued to work, and in many cases further excelled since the inception of the pandemic. For example, in our fourth quarter 2019 newsletter we boldly predicted that Apple and Microsoft, which advanced +89% and +58%, respectively in 2019, and accounted for 20% of the S&P 500's total return for the year, were unlikely to soar again. We postulated that this tempering of performance would allow small caps to have a better relative year in 2020. Well fast forward nine months and guess what? Apple and Microsoft are up an additional +58% and +35%, respectively through September. The rest of the FAANG group have equally gaudy returns so far in 2020. Amazon leads the pack with a +70% return year to date compared to the S&P 500's paltry +5.6% return. However, the rich get richer theme doesn't end here. The best performing sectors in 2020 are the same as they were a year ago - Technology, Consumer Discretionary (thanks to Amazon), and Healthcare. Similarly, from a portfolio strategy point of view, "growth" strategies have decimated "value" strategies by a country mile so far in 2020, which is a trend that has been in existence since the Great Recession. These stocks, sectors, and strategies have earned this outperformance as the individual components have ushered in a new digital economy that has likely been pulled forward a few years due to the Covid-19 pandemic. However, these trends have market soothsayers proclaiming that the stock market is in a bubble (we'll take on this issue later) and that the deficit spending and stimulus has us on a path to financial ruin (we'll also take on this issue).

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.

IN THIS ISSUE:

CONTACT US
1492 CAPITAL MANAGEMENT
309 North Water St. Suite 210
Milwaukee, WI 53202
Main: 414-276-1492

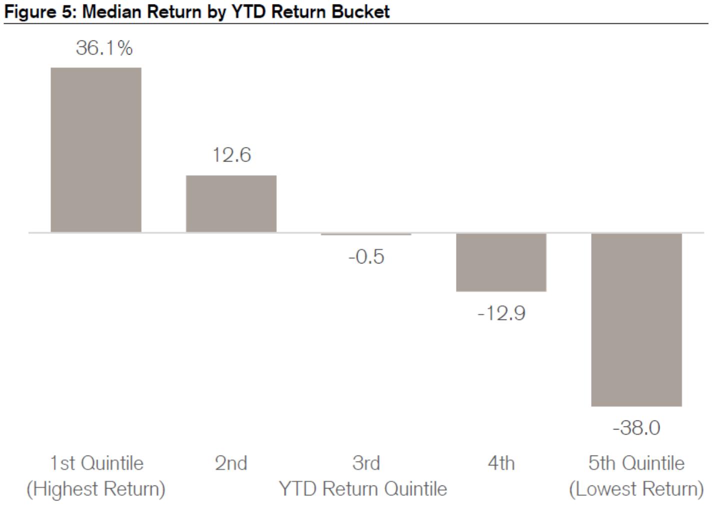
www.1492CapitalManagement.com

A Review of the Quarter: The Rich Get Richer, but Deservedly So

As a follow up to last quarter's newsletter – "To V or not to V, that is the Question", the economic data that has been released subsequently clearly confirms a "V" shaped economic rebound despite ongoing flare ups in Covid-19 cases in pockets both here in the U.S. and in Europe. Fueled by record stimulus around the globe, the "V" rebound has led to a miraculous recovery in the financial markets. However, much of the benefit has accrued to the leaders that were in place prior to the pandemic, and we're not talking about Amazon's Jeff Bezos or Tesla's Elon Musk. No, we're talking about the same stocks, sectors, and strategies that were working prior to the pandemic have continued to work, and in many cases further excelled since the inception of the pandemic. For example, in our fourth quarter 2019 newsletter we boldly predicted that Apple and Microsoft, which advanced +89% and +58%, respectively in 2019, and accounted for 20% of the S&P 500's total return for the year, were unlikely to soar again. We postulated that this tempering of performance would allow small caps to have a better relative year in 2020. Well fast forward nine months and guess what? Apple and Microsoft are up an additional +58% and +35%, respectively through September. The rest of the FAANG group have equally gaudy returns so far in 2020. Amazon leads the pack with a +70% return year to date compared to the S&P 500's paltry +5.6% return. However, the rich get richer theme doesn't end here. The best performing sectors in 2020 are the same as they were a year ago - Technology, Consumer Discretionary (thanks to Amazon), and Healthcare. Similarly, from a portfolio strategy point of view, "growth" strategies have decimated "value" strategies by a country mile so far in 2020, which is a trend that has been in existence since the Great Recession. These stocks, sectors, and strategies have earned this outperformance as the individual components have ushered in a new digital economy that has likely been pulled forward a few years due to the Covid-19 pandemic, an issue we never contemplated when we boldly predicted that Apple and Microsoft would have much more muted returns in 2020. However, these trends have market soothsayers proclaiming that the stock market is in a bubble (we'll take on this issue later) and that the deficit spending and stimulus has us on a path to financial ruin (we'll also take on this issue).

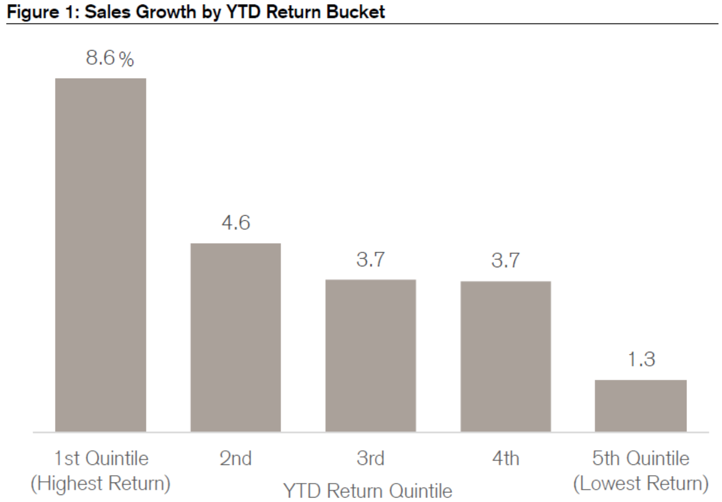
We'll drill down on the individual stocks, sectors, and strategies in that order. First, with respect to individual stocks, the first chart below left shows a clear return chasm between the haves and have nots. The rich got richer to the tune of +36% which is the median return for the top quintile of the S&P 500 based on year-to-date returns. However, the have nots are down a whopping -38% year to date. The chart below right shows that as sales growth goes, so go the returns. Sorted by year-to-date returns, the top quintile had the best sales growth of +8.6%. This analysis makes intuitive sense.

Figure 5: Median Return by YTD Return Bucket



Note: Median total return by bucket. Buckets determined by YTD total return. S&P 500 ex- Fins & REITs.
Source: Standard & Poor's, Thomson Financial, FactSet and Credit Suisse

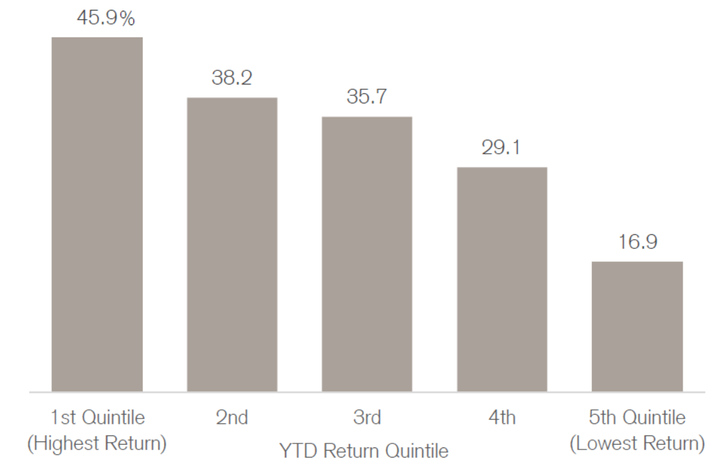
Figure 1: Sales Growth by YTD Return Bucket



Note: Median Sales Growth by bucket. Buckets determined by YTD total return. S&P 500 ex- Fins & REITs.
Source: Standard & Poor's, Thomson Financial, FactSet and Credit Suisse

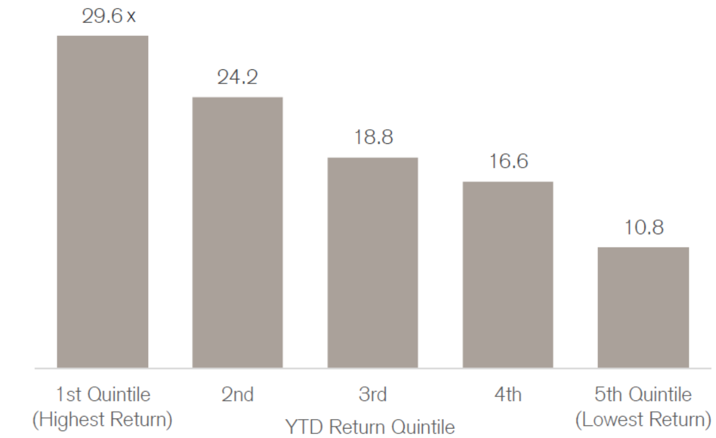
Similarly, when sorted by year-to-date returns, the chart below left shows that the best performers also had the best gross margins. Lastly, the chart below right shows that the stock market was willing to pay a significant premium in terms of the Price/Earnings multiple for the characteristics associated with the top two quintiles of higher sale growth and better gross margins.

Figure 3: Gross Margin by YTD Return Bucket



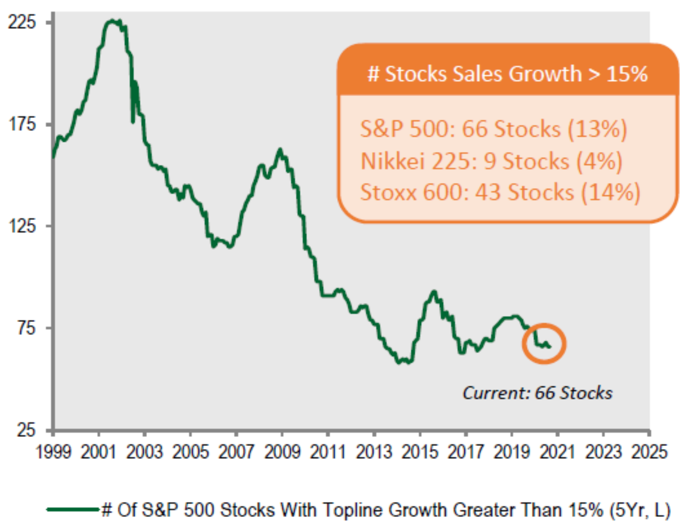
Note: Median Gross Margin by bucket. Buckets determined by YTD total return. S&P 500 ex- Fins & REITs.
Source: Standard & Poor's, Thomson Financial, FactSet and Credit Suisse

Figure 6: NTM P/E by YTD Return Bucket



Note: Median NTM P/E by bucket. Buckets determined by YTD total return. S&P 500 ex- Fins & REITs.
Source: Standard & Poor's, Thomson Financial, FactSet and Credit Suisse

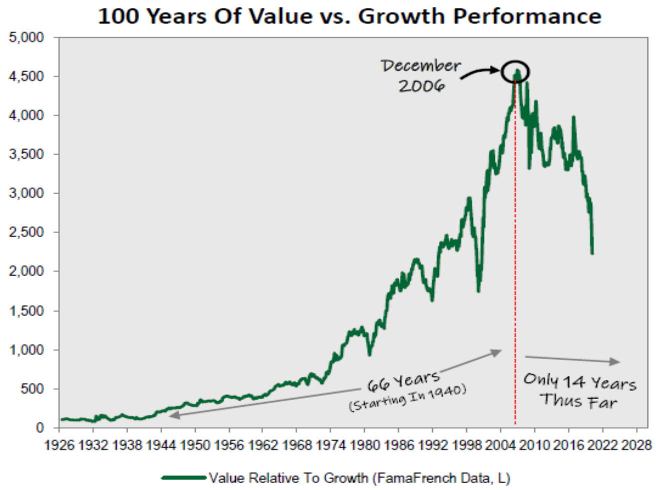
If you analyze the current composition of the S&P 500, it becomes evident why the "rich are getting richer". There is a clear lack of growth companies in the world, particularly in a year like this one when there is a global recession. As the chart below left shows, there are only 66 stocks or 13% of the S&P 500 that have sales growth rates for the trailing five years greater than 15%. As the chart shows, this number has been in secular decline, and this decline is a common theme across the global indices. Growth is scarce and investors are paying up to get it. The chart on the right shows the combined weight of the five largest stocks in the S&P 500 over the past 30 years. It's at an all-time high of 23.9%. The conclusion that most will jump to is that this analysis means that there is a stock market bubble. We refute that notion in the section below entitled "We Refute the Stock Market Bubble Thesis". .



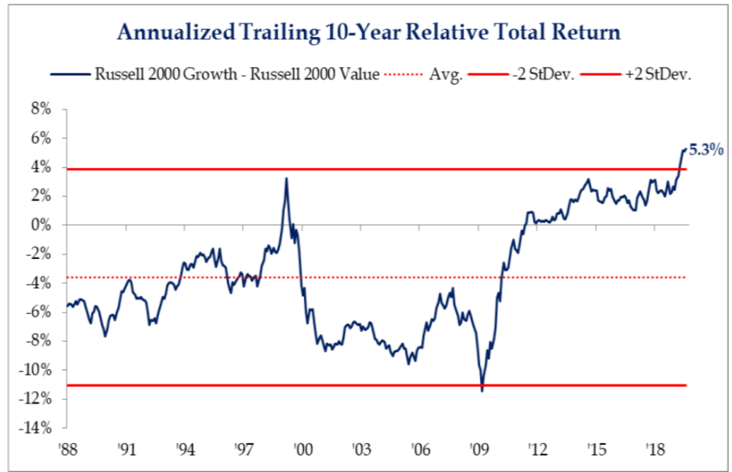
Source: Cornerstone Macro

Source: Strategas Research

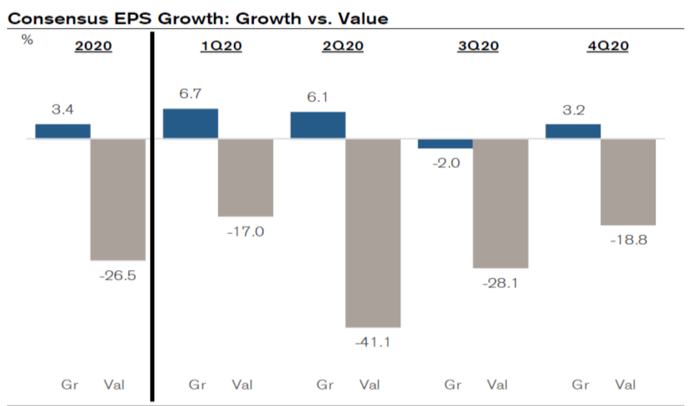
Viewing the dichotomy of returns at the most basic strategy level of growth vs. value, we find a similar theme. The rich are getting richer, which in this case means that growth continues to outpace value strategies by a wide margin. The first chart below left shows that value strategies had significantly outpaced growth for nearly 70 years leading up to the Great Recession. Then the tide turned, and growth is in the process of unwinding decades of underperformance. The rate of descent is steepening this year as, once again, growth is scarce. The chasm between the returns of the Russell 2000 Growth and Value indices is almost 25% year to date, and the gap is the worst since March 2000. The third chart below shows the consensus earnings growth by quarter for the Russell 2000 Growth index (blue) compared to the Russell 2000 Value index (grey). It becomes very apparent why growth should be outperforming value this year. What it ultimately comes down to is the construction of the indices. The value index contains a much larger weight in underperforming parts of the economy like financials, energy, real estate, and utilities.



Source: Cornerstone Macro



Source: Strategas Research



Source: Russell, Thomson Financial, FactSet and Credit Suisse

During the third quarter, the stock market continued its meteoric rebound to levels that many didn't think we'd see for years when the market collapsed back in March. The gains for the quarter were quite robust considering all of the uncertainty that surrounds us, such as: Covid; racial unrest; and, the pending election. However, the "V" rebound we predicted last quarter is in full swing thanks to stimulus measures around the globe and to the reopening of many parts of our economy following Covid shutdowns. As we stated above, the bounce off the March 23 low has been pretty spectacular but unveven as large caps have signifiantly outperformed small caps. The NASDAQ Composite has been by far the best performer both in the third quarter and year to date. Amazingly, with all that's happened this year, the IPO market has been tremendously strong, and 2020 may be the strongest year since 2000 when there were 421 IPO's. The NASDAQ Composite index remarkably broke out to an all-time high and bested both the Russell 2000 and the S&P 500 in the quarter. 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. These equities are the "rich get richer" stocks. We pointed out many of these themes in last quarter's newsletter in the section entitled "Skating to where the puck is going – Part 2". The table below highlights the returns for both the third quarter and year-to-date 2020 for the popular indices.

Index Returns		
Index	Third Qtr. 2020 Return	2020 YTD Return
Russell 2000	+4.93%	-8.69%
Russell 2000 Growth	+7.16%	+3.88%
Russell 2000 Value	+2.56%	-21.54%
S&P 500	+8.47%	+5.57%
Dow Jones Industrials	+7.63%	-2.65%
NASDAQ Composite	+11.24%	+25.33%

Source: 1492 Capital Management, LLC and FactSet

From a style perspective, the Russell 2000 Growth Index (+7.2%) handily beat the languishing Russell 2000 Value Index (+2.6%) in the third quarter despite the value index substantially underperforming the growth index in the first two quarters of the year. The value index has a substantially larger weighting in financials/REITs (nearly 40%), energy, and materials 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. Under the hood of the indices there was a marked change in leadership in the quarter with some cyclical sectors bubbling up to the top. The Consumer Discretionary (+18.9%) and Industrials (+11%) sectors led the way. The worst performing sectors in the quarter were Energy (-9.8%) and Utilities (-3.2%). The two tables below highlight the performance of the Russell 2000 style indices by sector for the month of September, for the third quarter, and for year-to-date 2020.

Table 6 - Russell 2000 Growth Scorecard through September 30th

	September			3Q2020			YTD			
GICS Sector	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Wgt
Com Serv	-5.09	-0.13	-2.95	-1.32	-0.01	-8.48	-9.91	-0.27	-13.78	2.3
Discretionary	-1.20	-0.16	0.94	17.16	2.15	10.01	6.76	0.43	2.88	13.7
Staples	-3.83	-0.13	-1.69	9.82	0.31	2.66	1.10	0.09	-2.77	3.2
Energy	-14.14	-0.02	-11.99	-6.05	-0.01	-13.20	-51.92	-0.35	-55.80	0.1
Financials	-2.93	-0.13	-0.79	5.07	0.21	-2.09	-4.07	-0.80	-7.95	4.2
Health Care	-0.12	-0.03	2.02	4.38	1.45	-2.78	12.47	6.88	8.59	34.5
Industrials	-1.52	-0.21	0.62	15.30	1.97	8.14	3.37	-2.11	-0.51	13.8
Info Tech	-5.00	-1.08	-2.86	3.15	0.72	-4.01	6.21	1.98	2.33	20.1
Materials	-4.34	-0.12	-2.20	6.53	0.19	-0.63	-13.24	-0.49	-17.12	2.6
Real Estate	-2.20	-0.08	-0.05	6.71	0.24	-0.44	-10.70	-1.28	-14.57	3.7
Utilities	-2.07	-0.04	0.07	-3.67	-0.07	-10.83	-11.67	-0.21	-15.55	1.7

Table 8 - Russell 2000 Value Scorecard through September 30th

	September			3Q2020			YTD			
GICS Sector	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Wgt
Com Serv	-10.97	-0.28	-6.32	-1.19	-0.03	-3.75	-31.61	-0.87	-10.07	2.4
Discretionary	-0.09	-0.02	4.56	20.91	2.17	18.36	1.68	1.25	23.22	13.3
Staples	-1.92	-0.07	2.73	7.14	0.23	4.59	4.70	0.50	26.24	3.7
Energy	-15.81	-0.72	-11.16	-9.98	-0.41	-12.54	-56.76	-2.96	-35.22	3.9
Financials	-6.24	-1.68	-1.59	-3.95	-1.10	-6.51	-33.77	-13.14	-12.23	26.6
Health Care	-2.02	-0.12	2.63	7.61	0.54	5.05	7.31	1.31	28.85	6.9
Industrials	-3.69	-0.62	0.96	7.29	1.12	4.73	-16.11	-1.24	5.43	16.8
Info Tech	-4.64	-0.27	0.01	0.11	0.04	-2.45	-11.08	-0.18	10.46	6.0
Materials	-5.27	-0.30	-0.62	6.49	0.38	3.93	-18.62	-0.35	2.92	5.6
Real Estate	-4.45	-0.44	0.20	-2.58	-0.29	-5.13	-27.11	-4.26	-5.57	9.9
Utilities	-2.73	-0.12	1.92	-3.05	-0.10	-5.61	-20.49	-1.59	1.05	5.0

Source: Jefferies

The rebound that we saw in the U.S. markets held form in the international markets as well with a couple of exceptions like Brazil and France where Covid cases have escalated recently. Interestingly, Sweden's stock market was the best performer by far in Europe (+11.1%). Recall that Sweden was the one country that didn't lock down its economy for Covid. Maybe there is something to be said for that strategy. 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 for the recently signed Phase 1 deal between the U.S. and China. Volatility in the market continued to ease from its near-record highs in the first quarter but still remains elevated from a historical perspective. On the commodity front, lumber was the most interesting as it shot up over 125% mid-quarter on strong housing demand, but later retreated and ended up "only" +40%.

Index	Third Qtr. 2020 Return	2020 YTD Return
France	-2.0%	-18.0%
Germany	+4.2%	-3.2%
Brazil	-1.6%	-19.1%
India	+9.6%	-7.5%
China- A Shares	+7.8%	+5.9%
China- Shenzhen A Shares	+8.8%	+25.5%
Japan	+6.3%	+1.3%
Long-Term Treasuries (TLO)	+0.5%	+21.3%
Investment Grade Corp Bonds	+1.0%	+6.4%
Gold	+5.0%	+24.1%
Volatility- VIX index	-13.3%	+91.4%
Oil	+1.5%	-34.7%
Natural Gas	+45.9%	+16.5%
Lumber	+40.0%	+50.5%

Source: 1492 Capital Management, LLC

Thematic Investing: ESG is All the Rage but Nothing New to 1492

ESG investing has become all the rage over the past few years and a year like 2020 has thrust it into the mainstream. ESG stands for Environmental, Social, and Governance. ESG investing is a term that is often used synonymously with socially responsible investing, sustainable investing or mission-based investing. We would define it as embedding the consideration of ESG factors alongside financial factors in the investment decision making process. The three components of ESG can be defined in short by the following: Environmental "E" factors assess how a company impacts the natural world, Social "S" factors assess how a company manages relationships with employees, suppliers, customers and communities, and Governance "G" factors assess how the actions and policies of executive management and board of directors are aligned with broader stakeholder groups. One common misnomer about the ESG process is that it bans investing in certain industries that have an observable taint to them like a fossil fuel company. This assumption is incorrect. In fact, the ESG process generally will score companies relative to their respective industry participants as identified by SIC codes at the sub industry level. Thereby it identifies companies with more/less observable risk when compared to their peers. In this manner, a company like Exxon Mobil may actually have a better ESG score than a Facebook or General Electric. The skeptic in us is that many entities are using the ESG movement as a way to allay outsider's emotional ties to these ESG factors by slapping the ESG moniker on their product. They then pay lip service to the issues, attempt to differentiate themselves in a crowded investment landscape, and charge a premium fee.

The hunt for ESG issues has always been a key consideration of our research here at 1492 Capital Management; however, we just haven't postered them with the catchy ESG label. As fundamental investors, shouldn't we always be looking out for those issues that may impact or elevate the risk to the well-being of its stakeholders, potentially undermine a company's ability to profitably grow, or hurt the environment? We do. We believe that a good "G" is the most important part of the ESG acronym. It represents the base that drives changes to the "E" and the "S". Without a good "G", it's unlikely that a company will have a good "E" and "S" score. Every day as we research the companies that are already in our portfolios or candidates to be added, we are constantly on alert to issues that could lead to larger, longer term problems. Potential issues vary wildly from company to company. For example, a fin-tech company that processes financial transactions isn't going to have the same issues as an energy exploration company. The fin-tech company's key risk may be cybersecurity as they process millions of transactions with sensitive information like social security numbers or account numbers embedded in them. Whereas, the key issues for an energy exploration company may be environmental as it is drilling for oil and is injecting precious water resources into the ground all while emitting carbons into the atmosphere to some degree. Where possible we actively participate in the ESG process. For example, we are active in voting proxies on behalf of our clients. We don't simply rubber stamp an approval on each issue up for vote just because the company recommends that we vote with them. If we don't agree or believe it's not in the best interests of shareholders/ stakeholders, we'll vote against them. If we view the issue to be too large of a risk, then we'll vote with our feet and exit the stock.

Here are a few of the issues that exist in today's ESG investing world. First, there is no common definition of how to measure the ESG factors by the more than 150 ESG data providers that exist today globally. In fact, the factors used by the various rating services to score a company's effectiveness in dealing with the ESG factors vary tremendously. They don't even agree on which factors are the most important to any given industry, or how they should be weighted in determining a score on a given factor. The largest of the 150+ ESG data providers are trying to influence the industry that their methodology is best. However, coming to an agreement is likely light years away as there is too much money at stake in selling their rating services and their ESG mutual funds and ETF's. Some of the largest providers include MSCI, Sustainalytics and FTSE Russell. Many of these data providers use AI (artificial intelligence) and algorithms to scan all public documents created both by the company (10-K's, 10-Q's, other public filings) and outsiders (sustainability reports that a company paid a third party to do on their behalf) and are searching for key words that may identify a pivotal issue. We have a somewhat skeptical view of the organizations that are pushing the ESG movement, not because it's not the right thing to do, but because there are massive profit motives involved with the organizations that have elevated the process to the forefront. Let's face it, most people around the globe would love the world to be a cleaner, equitable, and overall better place.

One major issue is the Microsoft versus microcap issue. It's become a necessity for companies to publish their own reports or statements on how they are addressing the E, S, and G. Thus, they can control how outside rating agencies and investors view its ESG narrative. Microsoft has infinitely more resources than does a typical small or microcap company. It wouldn't surprise us if Microsoft has a dedicated team to oversee the entire ESG/sustainability arena, complete with a team of lawyers and writers who craft very strong narratives on how they're addressing the litany of issues that get thrown into the ESG bucket. Unfortunately, a small or microcap company generally doesn't have the resources to artfully craft many of these documents. In some cases, not having something written for public digestion will count as a strike against them, despite the fact that they may be effectively managing the issue internally. Additionally, we haven't heard of any firm that is actually auditing all the ESG claims that these companies are espousing. As with anything, buyer beware.

Thematic Investing: Biotechnology Meets Silicon Valley

A few years back I had the opportunity to attend a Business Intelligence conference hosted by the Gartner Group out in Las Vegas. The presenting companies were mainly software oriented and focused on topics such as data analytics, big data, database mining, artificial intelligence (A.I.), and machine learning. A.I. and machine learning were still relatively new buzzwords in the investment community at the time, but it was abundantly apparent to me after attending this conference that these new technology tools were rapidly colliding with business as we knew it. After sharing my findings with our research team here at 1492 Capital Management, we surmised there would be a window of opportunity over the next few years where companies and management teams who integrated these business tools in to their operations would be able to gain a significant competitive advantage. We believed that the use of data analytics and machine learning would be so disruptive that there would potentially be new winners and losers in virtually every industry in our economy.

As we position our investment strategies for the final push of 2020 and beyond, we'd like to highlight a new investment theme in the area of life sciences, particularly Biotechnology A.I. The use of A.I. in the biotech industry includes drug target identification, drug screening, image screening, and predictive modeling. A.I. is also being used to crunch through scientific journals and reports to glean information that can optimize clinical trial design. The ever increasing speed and computing power of microchips has made this trend possible. Data analysis on terabytes of information which heretofore would have been virtually impossible can now be done in a matter of hours or days.

One of the first companies to make use of A.I. in drug discovery and design is a privately held enterprise called Atomwise. The company, founded in 2012, created the first convolutional neural network (CNN) for drug discovery. Without getting too deep in the science, CNN's are a method of analyzing visual imagery for pattern recognition. Atomwise's AtomNet technology platform has virtually screened over 16 billion molecules and has partnered with several of the leading biotech companies globally. The company recently completed a $123 million Series B round of financing in hopes of furthering its ability to tackle the global biotech market that is expected to top $729 billion in value by 2025 according to Global Market Insights.

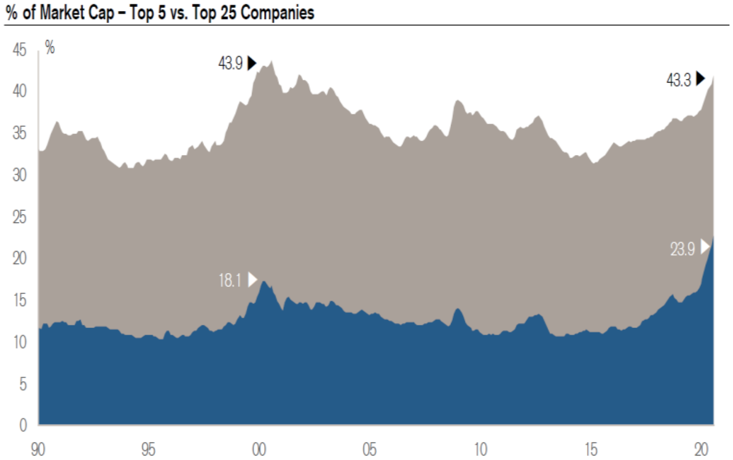
A.I. can also be used as an enabling technology that will optimize existing techniques for drug discovery and development such as CRISPR gene editing and RNA interference. The knowledge curve for gene editing, more recently referred to as CRISPR technology, has been a steep parabola in recent years as gene-therapies have taken the biotech industry by storm. While gene editing capabilities have been around for decades, the CRISPR technology allows researchers to much more quickly and cheaply design and edit genetic strands of DNA. CRISPR, shorthand for CRISPR-Cas9, is a special part of the DNA sequence. It is a protein that acts like a pair of scissors that can cut out certain segments of the DNA strand. In its natural setting, CRISPR acts as a self-defense mechanism which goes about cutting out foreign DNA from say a virus that binds to one's own cells. While there is significant controversy around the field of gene-editing, especially as it pertains to genetically engineering a human, we believe it will be an important tool in the hands of scientists as they develop vaccines and therapies for both rare and common diseases over the next several decades.

The field of clinical diagnostics is also benefitting from the application of A.I. A prime example is a private company called Eyenuk, Inc. The company's founder faced a personal health issue where he had a several month wait for a retinal scan. This delay along with the experiences of his diabetic father led to his acute awareness for a need to improve the screening process for diseases such as diabetic retinopathy, glaucoma, age-related macular degeneration, stroke risk, cardiovascular risk and Alzheimer's. Developed using machine learning, Eyenuk's EyeArt technology can detect diabetic retinopathy more accurately and much more quickly than the human eye with 99.6% sensitivity based on the U.K. National Health Service's assessment.

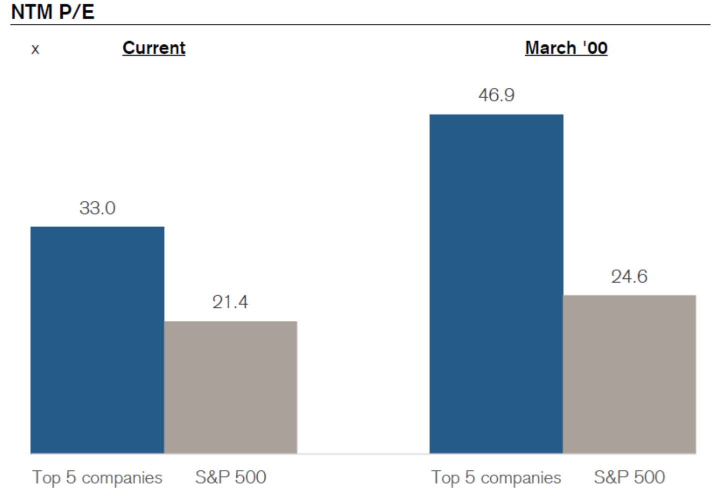
Over the past few months our research team has had the opportunity to interview and see presentations from dozens of biotech companies. A handful are focused on implementing A.I. into the drug discovery and development process. We believe that this implementation will be a burgeoning field of opportunity for the next several years as the companies that can effectively integrate this new approach will have significant advantages. The entire process for the biotech industry from molecule discovery, to clinical trial design, and ultimately to FDA approval will be made more efficient and less costly. Importantly we expect new drugs and biologics will be able to come to market faster with a higher probability of success and with less binary risk to the investor. We've already begun to seed new biotech positions in our investment strategies that exemplify these traits discussed in this section. Stay tuned for more details in the coming quarters!

2020 Updated Outlook: We Refute the Stock Market Bubble Thesis

As we mentioned in our section above entitled "The Rich get Richer, but Deservedly So", the likely conclusion that many are likely to come to is that the stock market is in a bubble due to the record highs for both the NASDAQ and the S&P 500, to particularly strong returns for parts of the market, and to valuations pushing near historically high levels. Actually, many market prognosticators have already filled the airwaves with this assertion. We strongly refute this notion and here is why. Yes, the top five stocks in the S&P 500 make up nearly 24% of the index by weighting, which is a new record. Yes, the top five stocks make up 43% of the total market cap of the S&P 500 as shown in the chart below left -- almost a new high. However, the top five are very dissimilar to the five stocks that marked the bubble in 2000 which were Exxon, General Electric, Microsoft, Citigroup, and Cisco. The key difference being that three of these five from 2000 are highly cyclical industries that didn't deserve the premium valuation that was awarded them back in 2000. The largest five stocks in the S&P 500 today are Apple, Microsoft, Amazon, Facebook, and Alphabet. All of these companies could be argued as secular growers as opposed to cyclical in our world today. *The five-year earnings per share growth rates of these five companies has averaged 31%.* Considering growth rates, interest rate differentials between 2000 and today, and investment alternatives, the valuations for these five are still at "reasonable" levels. The chart below right highlights the difference in valuation between both periods for the top five companies and for the overall S&P 500 index.



Note: 3-month moving average
Source: Standard & Poor's, Thomson Financial, FactSet and Credit Suisse

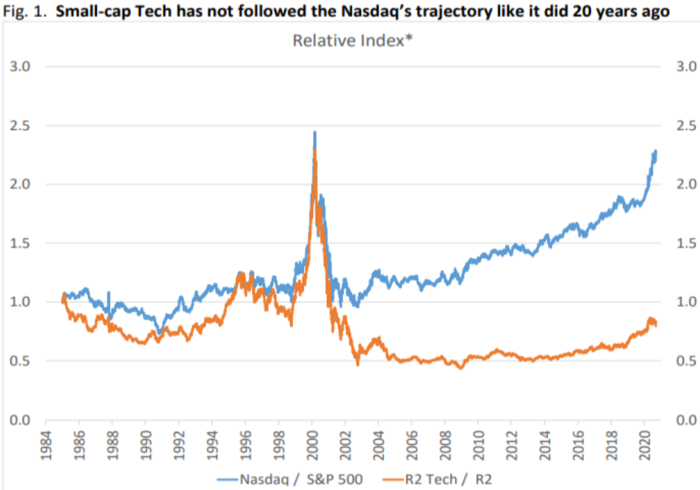


Source: Standard & Poor's, Thomson Financial, FactSet and Credit Suisse

A second point that we'd make is that small caps haven't kept pace even within the technology sector of the Russell 2000 Index. The chart below left shows that in 2000, both the NASDAQ and Russell 2000 Technology sector hit extreme levels. Whereas, today the NASDAQ is pushing those historical relative highs (we argue for good reason), but the Russell 2000

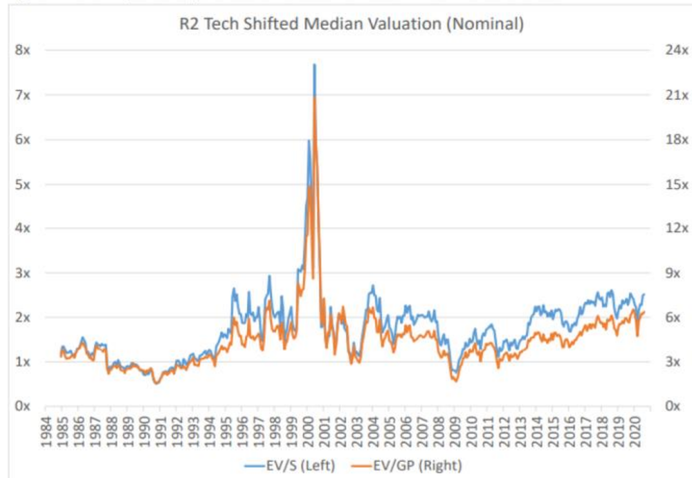
Technology names haven't participated anywhere close to the historical levels. The chart on the right shows the Enterprise Value to Sales ratio in blue and Enterprise Value to Gross profit ratio in orange for the Russell 2000 Technology sector as different measures of valuation. On both of these metrics, the Russell 2000 Technology sector isn't anywhere near the epic valuations of the tech bubble in 2000.

Fig. 1. Small-cap Tech has not followed the Nasdaq's trajectory like it did 20 years ago



*Source: Furey Research, FactSet; as of 9/8/20; *Nasdaq / S&P 500 employs price indices, R2 Tech / R2 employs total return indices*

Fig. 3. More importantly, valuation is also well-below Tech Bubble levels

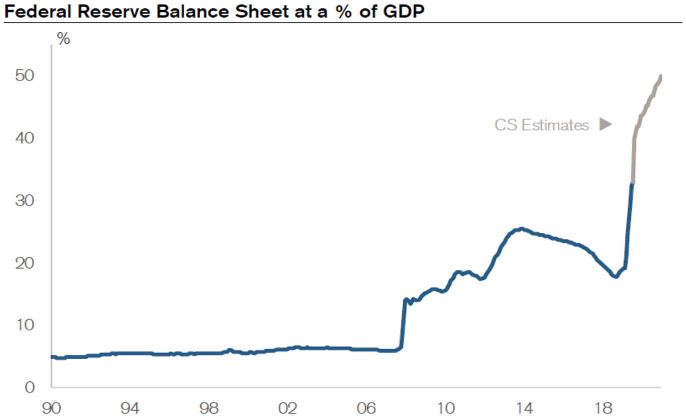


Source: Furey Research, FactSet; as of 8/31/20

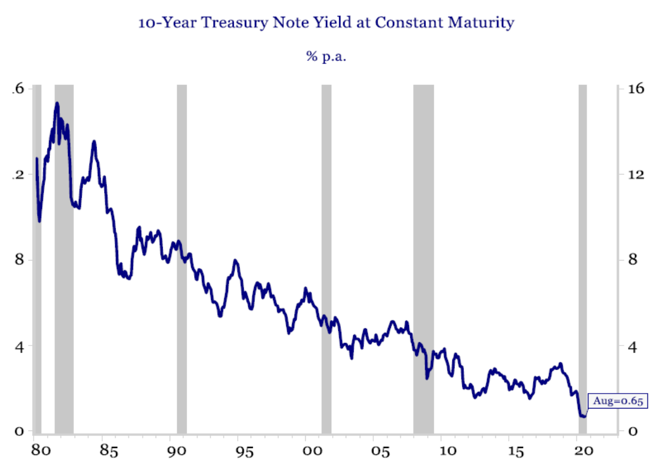
2020 Outlook: If There Were Ever a Time for Deficit Spending, It's Now

Government debt and deficit spending in the U.S. are much like death and taxes. We know that they're going to happen, and they only attract attention on when times are tough. However, if there was ever a time for ratcheting up government debt and deficit spending, now is the time. The fact is that we're in the midst of a pandemic. Millions of Americans have lost their jobs, and hundreds of thousands of companies have shuttered their doors and are in need of assistance. A quick and meaningful response is key to limiting the long term damage. For the most part, we believe that the government has taken the lessons learned from the Great Recession of 2008 and delivered on a massive stimulus effort this year. The chart below left shows the Federal Reserve's balance sheet as a % of GDP. The Fed's move to buy all different asset classes was large and swift and is projected to grow. However, now is not the time to pullback as the economy is still on shaky ground primarily due to the uncertainty over the pandemic's longevity. Modern Monetary Theory, a macroeconomic theory which we subscribe to in part, states that a government can and should print as much money as they need to spend because they can't go broke unless a political decision is made to do so. The government has a choice to make – let the economy drop and pay for unemployment benefits and take in lower tax revenues as businesses fail, or print money and provide stimulus to the economy to keep it from falling. While the first instinct is to look at the absolute level of debt as it balloons when stimulus is enacted, we think that this idea is missing the point. Interest rates are extraordinarily low and the cost to finance the stimulus programs are near zero with the 10 Year Treasury note yielding 0.68%. The chart below right shows that while interest rates have been in secular decline since the 1980's, they fell precipitously earlier this year when the pandemic hit.

Federal Reserve Balance Sheet at a % of GDP

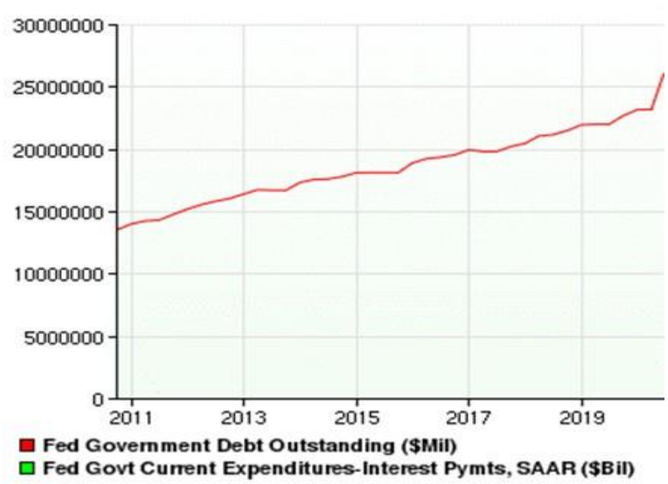


Note: 3 month moving average with most recent data point being actual value. CS Economics team estimates
Source: Federal Reserve, BEA, The BLOOMBERG PROFESSIONAL™ service, Credit Suisse



Source: Federal Reserve Board

The weighted average cost of financing the governments $26.7 trillion of outstanding debt is currently around 2% and falling as older maturity instruments are refinanced at the current lower rates. Contrast this level to the rates in the year 2000 when the yield on the 10 Year Treasury note was 6%, which is nearly 10 times the current yield. The key is to focus on the cost to carry the debt and not on the absolute level of the debt. The chart below left shows the growth in the Federal government's debt outstanding, which is a continuous upward sloping line until this year when they borrowed more money to fuel the economy. The chart on the right shows the government's annual interest expense incurred on this debt. Two things to note. First, the total debt outstanding in the chart on the left went up 93% from 2011 until today. Second, the absolute amount spent on interest expense has increased about 45% as interest rates have dropped over the last decade. Note the interest expense line is actually beginning to rollover despite the spike in outstanding debt as interest rates are falling more than the outstanding debt is rising. This effect is why we think the focus needs to be on the carrying cost of the debt and not the absolute debt level.

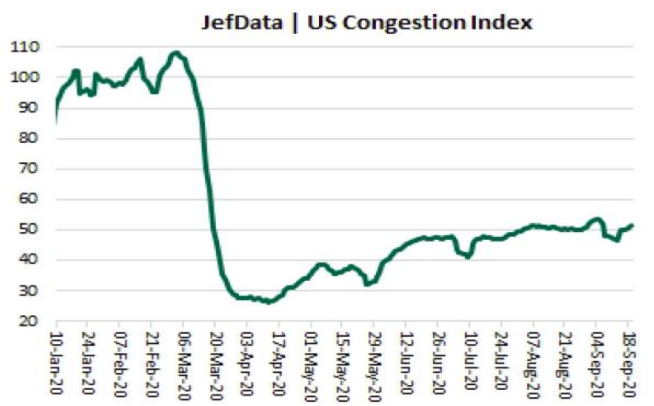


2020 Outlook: The Impact of Covid is Likely to Last Longer than the Disease Itself

As we all know, Covid-19 has had a terrible impact on the health of citizens and economies around the globe. However, there are likely going to be much longer lasting trends and implications that far outlast the disease itself. We highlighted a number of themes and trends that were likely to benefit from the pandemic in a piece we penned back in March in our first quarter newsletter called "Skating to Where the Puck is Going". In that piece we highlighted the following trends;

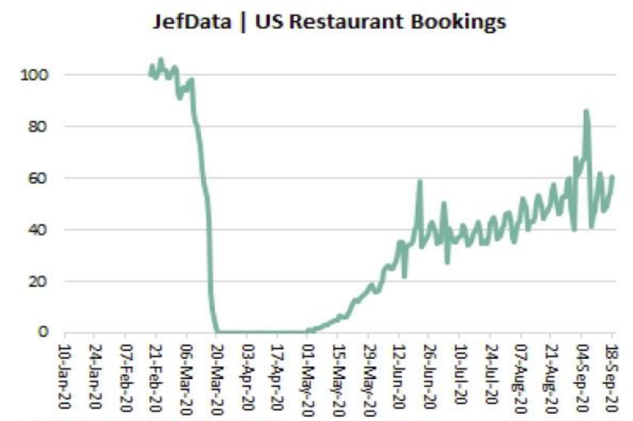
1. **Supply chain management**
2. **Robotics**
3. **Robust telecom networks**
4. **Online education**
5. **Telemedicine**
6. **Cloud based communications platforms**
7. **Smartphones**
8. **Computer sales**
9. **Netflix and other streaming services**
10. **Online gaming platforms and Esports**
11. **Home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

However, in the six months since we wrote that piece, we've observed a number of interesting trends, habits, and decrees that will impact how we operate as a society going forward. Like many, "Zoom" calls that now replace personal interaction have overtaken our work and personal lives. By the way, Zoom has parlayed this phenomenon into a company that now has a market value approaching $150 billion, despite the fact that there are numerous competitors that do what they do and that offer a free service to boot. Interestingly, I think many people are becoming too comfortable with the "work from home environment" as they realize that they are far more productive without spending hours in their car commuting or flying around the world for meetings that can be effectively held over a collaborative software like Microsoft Teams. At some point companies will have to figure out how their corporate cultures will be defined or held together. Despite this dilemma, certain companies have stated that many of their employees can work from home indefinitely, while others have extended the timeframe to at least the middle of next year. This change will have implications on many fronts. The two charts shown below are two that we see being impacted possibly forever. We understand forever is a long time, but think about how many people have historically commuted to and from their jobs each day. We're actually thankful for this trend as our commute to the office has been cut by more than half, and we're rarely, if ever, sitting in traffic. The chart below left shows that congestion is at half the level of what it was pre-pandemic and doesn't look to be increasing at a rate that is consistent with the "V" recoveries that we're seeing in the economy. Interestingly, auto sales have been through the roof. Used cars have been in shortage in some areas, and pricing is up +6% over last year. People who normally would have taken public transportation are now bypassing this mode and driving themselves. The secondary impact of fewer people working in offices is that restaurants that were normally packed with corporate lunches/dinners will likely see a dramatic drop in business. This industry is already struggling but it's tough to make it when half of your business goes away. The optimistic view is that the strongest will survive, and the overstored condition that has existed in the U.S. for years will be removed.



Source: Municipal Open Data Portals, TomTom, Jefferies

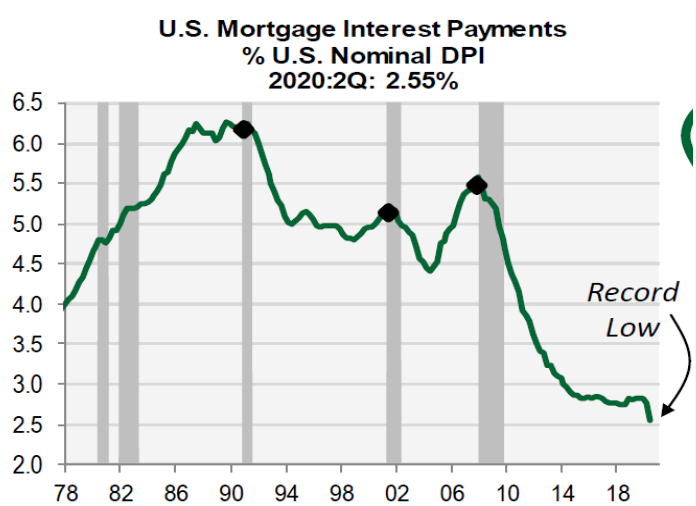
Daily congestion proxy for the US, leveraging multiple municipality auto activity datasets and TomTom congestion data on ~70 municipalities. Output is based on the most recent available data per source. 100 represents 'normal' level based on observations from 2019. Aggregated and normalized by Jefferies and sourced from multiple Municipal Open Data portals and TomTom.



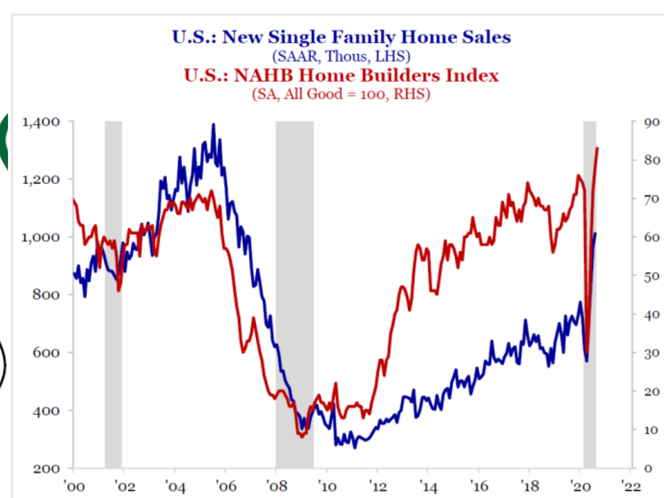
Source: OpenTable, Jefferies

Daily US restaurant booking volumes, sourced from ~20k restaurants in cities representing 57% of the US population. 100 represents 'normal' level based on pre-COVID observations. Aggregated and normalized by Jefferies and sourced from OpenTable.

Another surprise is how robust the housing market is despite millions of people being furloughed or layed off. It's likely a function of three things- low interest rates, unrest in major urban centers, and the "work from home" movement. Below left is a chart that shows how mortgage interest payments as a percent of disposable income has dropped tremendously. Mortgage interest rates have pushed toward 3%, which makes a home purchase more affordable. Home builders are having record years despite the pandemic as the inventory in most markets is at all-time lows, and demand is surging making for a sellers market. The chart below right shows the home builders index is soaring to a 25 year high, and the sale of new single family homes has finally eclipsed the 1,000,000 unit mark, which is a level that we haven't seen since before the Great Recession.

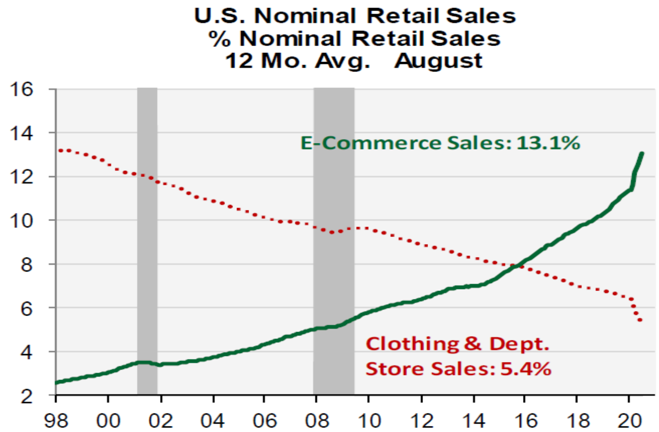


Source: Cornerstone Macro

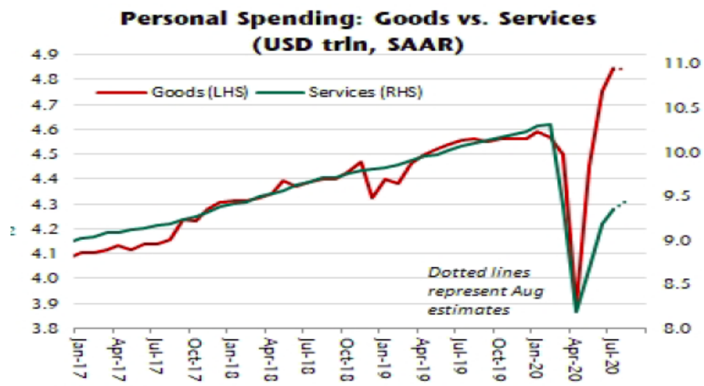


Source: Strategas

Anyone that hadn't figure out how to use Amazon or other online services to deliver goods prior to the pandemic, likely has now. On the chart below left notice the inflection in ecommerce sales and the corresponding drop in brick and mortar store sales have had since the pandemic. It likely pulled forward this trend change by several years. The chart below right shows how personal spending has changed dramatically from a service economy (restaurants, hotels, travel) to a goods based economy (apparel, home furnishings, autos, etc.). Given the work from home environment, many consumers are electing to spruce up their home with new furnishings and decorations if they're going to be spending significantly more time there.



Source: Cornerstone Macro

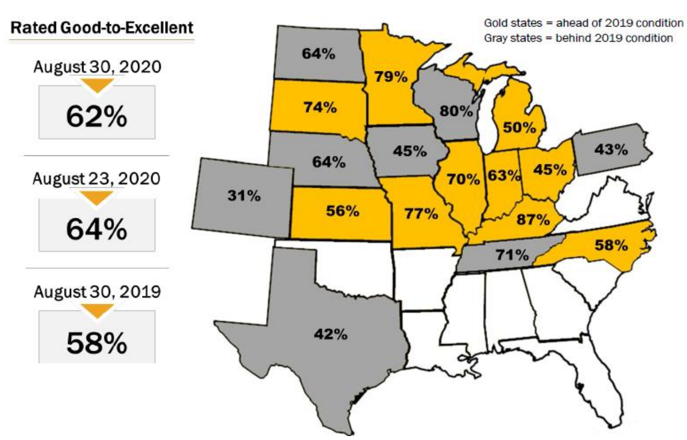


Source: Haver, JEF

Updated 2020 Outlook: An Ugly 2020 Except for the Weather

With the Coronavirus dominating the macroeconomic sandbox in 2020, it has unquestionably been a difficult business environment in most areas of the economy. However, the weather has substantially improved for a variety of "outdoor sport" businesses. As we discussed in our third quarter 2019 newsletter, the July 2018 to June 2019 period was the wettest 12 months on record in the U.S. and delivered roughly eight more inches of rain than the historical average. This deluge dampened, no pun intended, the prospects for building houses, planting crops and completing public construction projects, but we commented that it would obviously create better year-over-year conditions for weather dependent industries in 2020. What a difference a year can make! According to the NOAA, the July 2019 to June 2020 period delivered precipitation that was only roughly 2% above average, and the June to August 2020 time was particularly hot and dry.

With these weather conditions in tow, we've seen a strong rebound in the outdoor sport industries this year. For example, in agriculture, much improved planting conditions across the eastern corn belt of the United States this spring has given rise to near record corn and soybean yields per bushel for this fall's harvest. According to the September WASDE report, expected year-over-year increases in corn production for the U.S. are estimated at roughly 9.4% and at a whopping 22.5% increase in soybeans. With improved corn conditions as seen on the map below, estimates call for 15-25% year-over-year production increases in the eastern Corn Belt areas of Illinois through Michigan where last year's weather significantly impacted operations.



Source: The Andersons

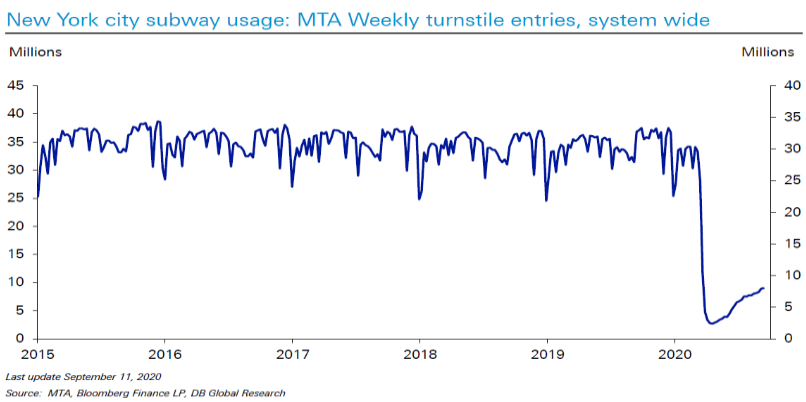
Along with more robust Chinese buying of U.S. agricultural goods in the last few months, this improved harvest provides attractive investment opportunities in companies that benefit from ample grain availability for storage operations and for processing into animal feed, ethanol and feedstock (soybean oil and inedible corn oil) for the rapidly expanding demand for renewable diesel that we commented on in last quarter's newsletter.

Having deployed a housing theme across multiple 1492 Capital strategies, homebuilding stocks have also had the wind at their backs this year as better building conditions and very low mortgage rates have propelled the sector despite COVID-19. According to Raymond James research, the national months' of supply of home inventory in August tied the record-low from February of this year and was down 25% year over year. In our opinion, the drier weather, low mortgage rates, and barebones housing inventory should continue to provide tailwinds for this sector in an otherwise ugly economic year. While 2020 is unquestionably a year most of us cannot wait to forget, vastly improved weather has created a few sunny spots in pivotal U.S. industries like agriculture and homebuilding.

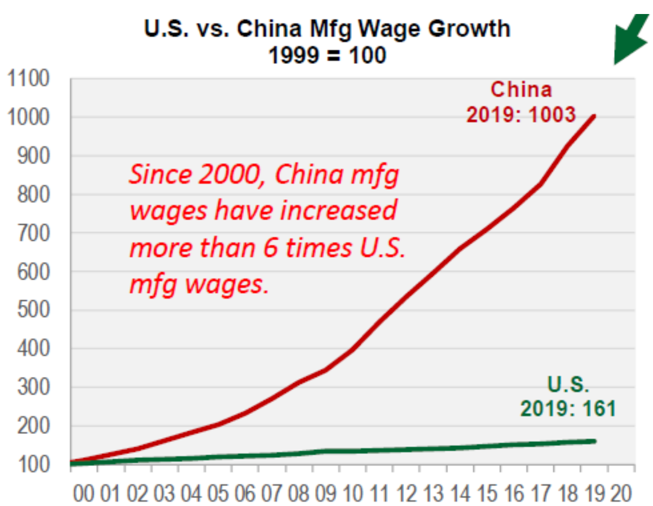
2020 Outlook: A Picture is Worth a Thousand Words

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.

Below is chart of New York City subway usage through time until the Covid pandemic hit. It's rebounded but not much.

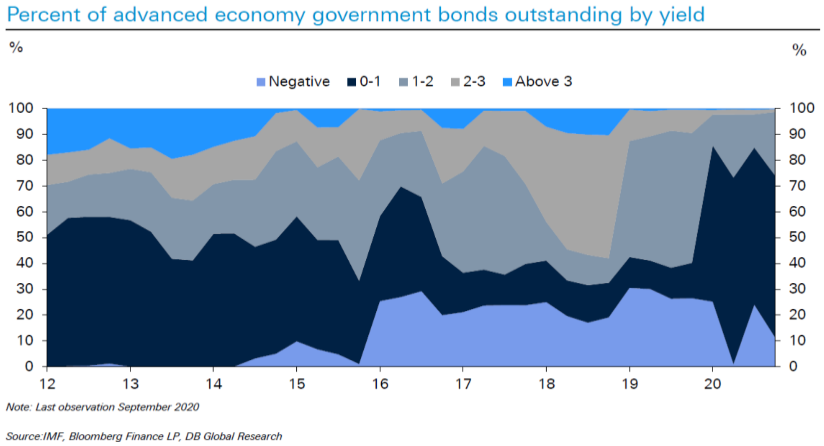


Wage growth in China has grown six-fold since 2000. This, combined with newly imposed tariffs, make manufacturing there less attractive.

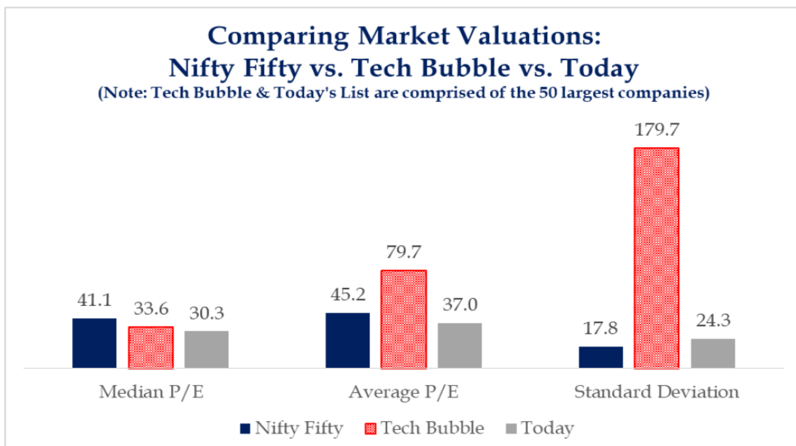


Source: Cornerstone Macro

The chart below shows that more than 10% of the world's government bonds outstanding have a negative yield.   This is more than there are bonds that have a yield greater than 2%.

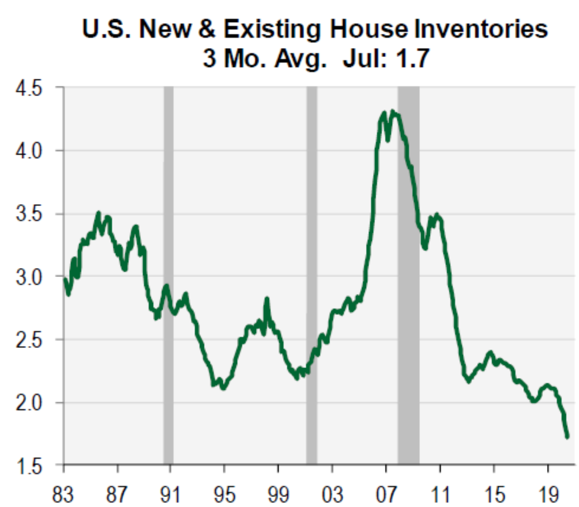


The chart below compares the market valuations across the "Nifty Fifty", Tech Bubble, and current timeframes. For all the talk about market bubbles currently, that claim doesn't hold up.



Source: Strategas

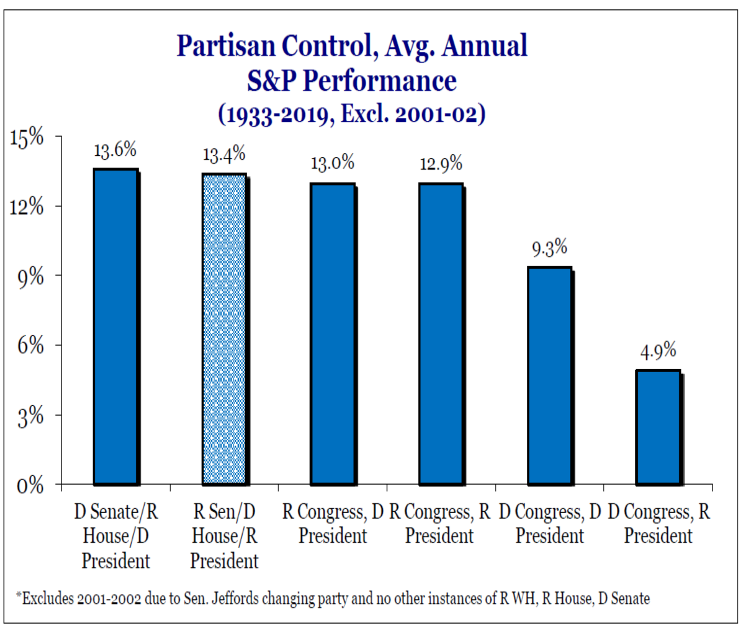
House inventories haven't been this low in more than 40 years. Demand is insatiable as people are exiting urban locations for the suburbs.



Source: Cornerstone Macro

Stock Market Trivia

Each quarter we offer a piece of market trivia that we believe is interesting or timely, or both. There are roughly 30 days until the Presidential election in early November. The recent national events from the pandemic to civil unrest has brought the election into focus. Oh, and debate season - we almost forgot. Most weekly polls show a mid- single digit lead for Biden over Trump in key swing states. 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 remind our readers how strong the stock market's predictive capabilities have been historically, what the average annual returns for the stock market look like under each combination of congress's makeup, and lastly, the impact that mail-in ballots may have on the election and why the stock market is concerned about not having a declared winner on November 3rd . The first chart below left shows the average annual performance for the S&P 500 under each possible political party makeup of Congress and Presidential party combination. It clearly shows that a divided Congress has the best outcomes for the stock market. The table below right shows that the stock market has been a much better predictor of the election outcome than polling. 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 the market senses a new administration is coming in with a new agenda, the market dips. The table below right shows the summarized results since 1928. As of October 1, the performance of the S&P 500 since August 3 (the start of the 3 month clock leading up to the election) is up +2.5%, which, if history holds, would imply a Trump victory if the election were held today. Lastly, the third chart below shows how many votes that are predicted to be cast by mail this year due to the Covid pandemic. This issue has given the stock market heartburn because if this many ballots are cast by mail, it's unlikely we'll have a winner declared on election night. The VIX index (volatility index) is showing this concern as there is a spike up in the volatility futures curve in November. Investors are betting on confusion come election eve. Interestingly, our home state of Wisconsin is giving voters a six day grace period and will count all ballots received through November 9. This is currently being challenged in court.

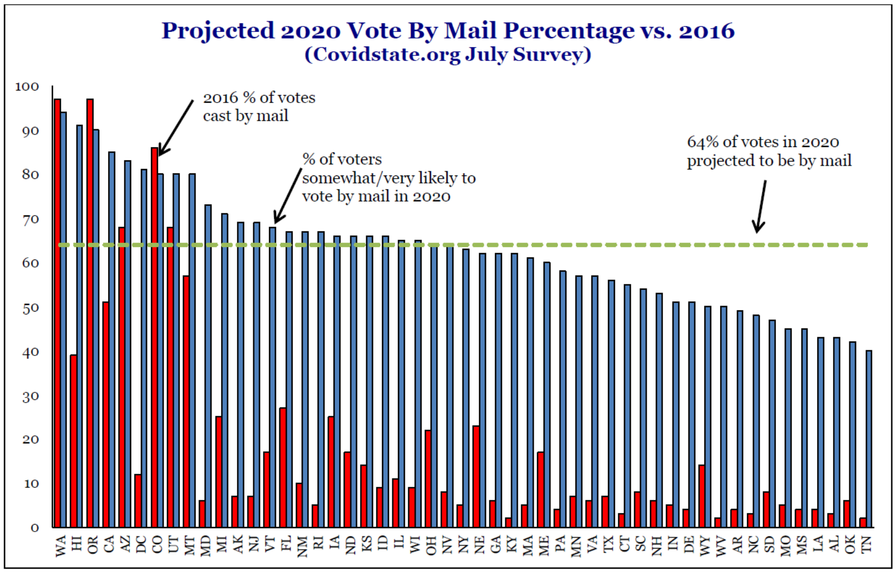


Source: Strategas Research

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



Source: Strategas Research

We hope that you found our third 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.

Joe Frohna Rodney Hathaway Adam France Nancy Frohna Tim Stracka

Comments and opinions expressed in this document regarding individual securities, markets, strategies and case studies are not recommendations or predictions, and thus should not be acted upon. They are based only upon the judgments and opinions of 1492's professional staff. The use of any investment strategy does not guarantee that an investment return will be achieved, or that a loss will not occur from the advice provided. Past performance does not guarantee future results. No investment firm, including 1492 Capital Management, guarantees gains or that losses will not occur from the strategies applied to managed portfolios. You are encouraged to contact us with your questions.

1492 Capital Management, LLC
309 North Water Street
Suite 210
Milwaukee, WI 53202
Main: 414-276-1492
Fax: 414-224-9158
www.1492CapitalManagement.com