1492 CAPITAL MANAGEMENT

DISCOVERING OPPORTUNITY

MARCH 2024 • VOL. 17 • ISSUE 3

INDENTIFY THEMES | FUNDAMENTAL ANALYSIS | TARGET VALUATION | GROWTH STRATEGY | VALUE STRATEGY | CORE ALPHA STRATEGY

1492 Vantage Point Quarterly Newsletter

Welcome to 1492 Capital Management's newsletter for the first quarter of 2024. 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 have tremendous 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.

The More Things Change, the More They Stay the Same

At least on the surface, the stock market had a great start in 2024 with a +10.6% gain for the S&P 500. However, despite a lot of talk about a broadening out of the stock market to include equities other than the Mag 7 in the recent five-month rally, the data says otherwise. For example, the S&P 600 Small-Cap Index advanced just +2.5% in the quarter. While the Russell 2000 Index of small caps did slightly better with a return of +5.2%, the concentration of stocks that contributed to the returns was more than the Magnificent 7's contribution to the S&P 500 returns for the quarter. As we mentioned last quarter coming into the new year, the market expected six rate cuts versus the Fed's forecasted three cuts in 2024. Given this dispersion of expectations, we anticipated someone to be disappointed. To our surprise, the markets adjusted to become more aligned with the Fed's three cuts, and the stock market pushed higher on enthusiasm around AI and some better-than-expected economic readings. Make no mistake, the market is still clearly focused on Fed policy and will become increasingly nervous if a rate cut doesn't happen by mid-summer. Some hotter-than-expected economic readings have generated higher interest rates so far this year (10- Yr. Treasury rates +40 basis points), which has continued to act like Kryptonite for small caps as has been the case for much of the last two years since the Fed started hiking rates. Meme stocks are once again the flavor of the day in a reprise of 2021. The only difference is instead of Gamestop, AMC Theaters, and Koss, this time it's Trump Media (President Trump's Twitter/X rival), Reddit, and Carvana. The names have changed but the poor fundamentals and crazy valuations remain. As you know, 2024 is a Presidential election year and with an election year typically comes a tepid start as the market tries to forecast who is going to win the Oval Office. Once there appears to be a likely winner, the uncertainty is removed, and the prospective winner's policies start to make their way into stocks. However, given the excitement over AI and Bitcoin, the stock market had a strong start to the year. Surprisingly the NASDAQ Composite (+9.3%) ceded the top spot to the S&P 500 (+10.6%) with the Russell 2000 lagging behind (+5.2%).

Unfortunately, one of our long-standing themes (infrastructure rebuild) made news when the Baltimore bridge collapsed, which demonstrated once again that our aging U.S. infrastructure is a massive problem and must be aggressively upgraded in the years to come. Please read on to see our unique views of what's on tap for the balance of 2024, themes that we're investing in here at 1492, what we believe 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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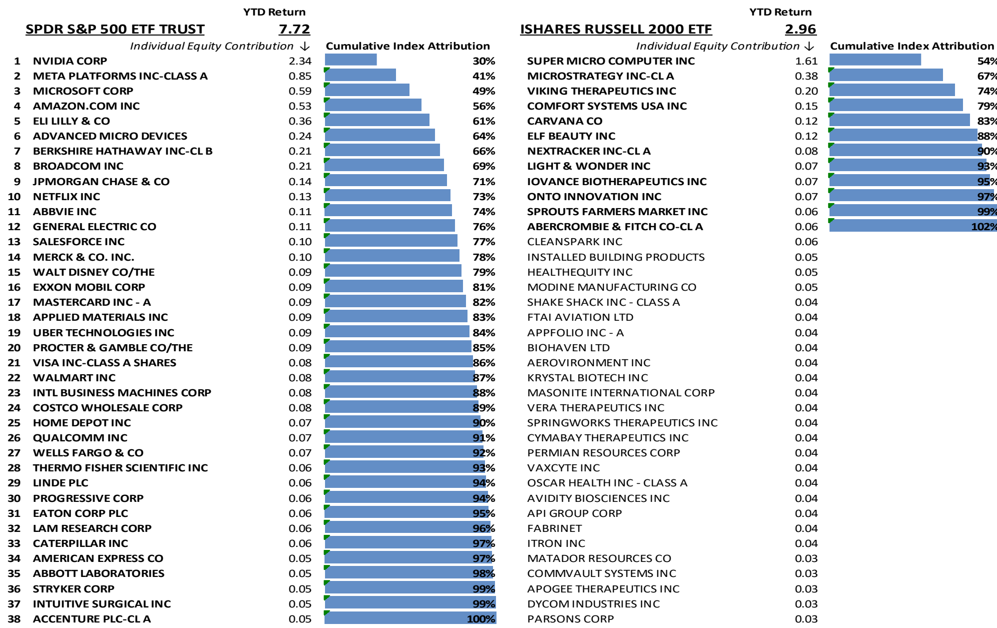
A Review of the Quarter: The More Things Change, the More They Stay the Same

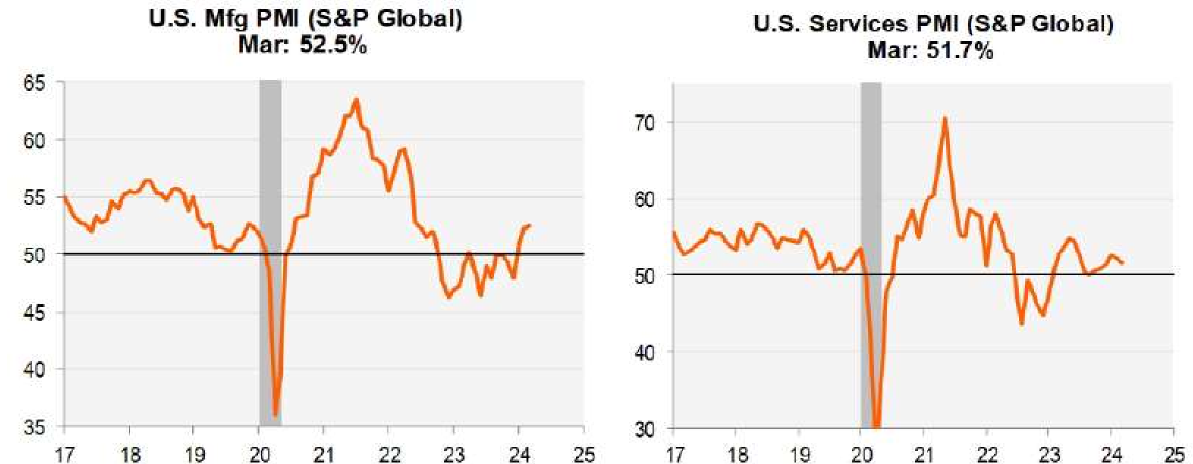
At least on the surface, the stock market had a great start in 2024 with a +10.6% gain for the S&P 500. However, despite a lot of talk about a broadening out of the stock market to include equities other than the Mag 7 in the recent five-month rally, the data says otherwise. For example, the S&P 600 small-cap index advanced just 2.5% in the quarter. While the Russell 2000 Small Cap Index did slightly better with a return of 5.2%, the concentration of stocks that contributed to the returns was more than the Magnificent 7's contribution to the S&P 500 returns for the quarter. The chart below shows that it took just the top 12 performing stocks in the Russell 2000 to equal the total return of the index for the period versus 38 stocks for the S&P 500 (through March 15). As we mentioned last quarter coming into the new year, the market expected six rate cuts versus the Fed's forecasted three cuts in 2024. Given this dispersion of expectations, we anticipated someone to be disappointed. To our surprise, the markets adjusted to become more aligned with the Fed's three cuts, and the stock market pushed higher on enthusiasm around AI and some better-than-expected economic readings.



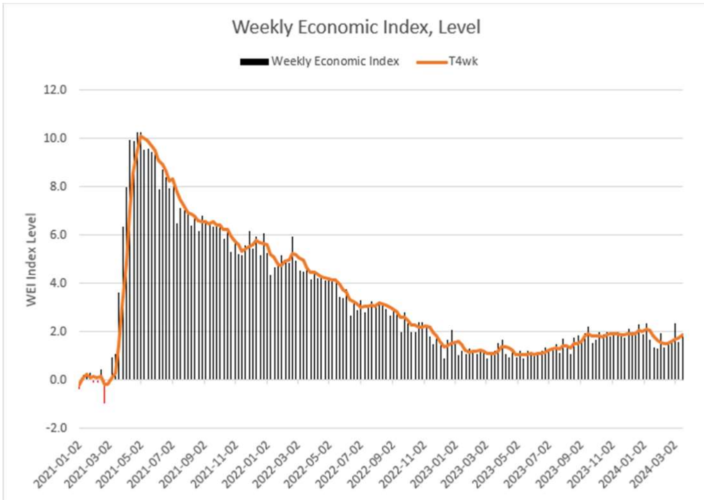
	SPDR S&P 500 ETF TRUST	YTD Return 7.72		ISHARES RUSSELL 2000 ETF	YTD Return 2.96	
		Individual Equity Contribution ↓	Cumulative Index Attribution		Individual Equity Contribution ↓	Cumulative Index Attribution
1	NVIDIA CORP	2.34	30%	SUPER MICRO COMPUTER INC	1.61	54%
2	META PLATFORMS INC-CLASS A	0.85	41%	MICROSTRATEGY INC-CL A	0.38	67%
3	MICROSOFT CORP	0.59	49%	VIKING THERAPEUTICS INC	0.20	74%
4	AMAZON.COM INC	0.53	56%	COMFORT SYSTEMS USA INC	0.15	79%
5	ELI LILLY & CO	0.36	61%	CARVANA CO	0.12	83%
6	ADVANCED MICRO DEVICES	0.24	64%	ELF BEAUTY INC	0.12	88%
7	BERKSHIRE HATHAWAY INC-CL B	0.21	66%	NEXTRACKER INC-CL A	0.08	90%
8	BROADCOM INC	0.21	69%	LIGHT & WONDER INC	0.07	93%
9	JPMORGAN CHASE & CO	0.14	71%	IOVANCE BIOTHERAPEUTICS INC	0.07	95%
10	NETFLIX INC	0.13	73%	ONTO INNOVATION INC	0.07	97%
11	ABBVIE INC	0.11	74%	SPROUTS FARMERS MARKET INC	0.06	99%
12	GENERAL ELECTRIC CO	0.11	76%	ABERCROMBIE & FITCH CO-CL A	0.06	102%
13	SALESFORCE INC	0.10	77%	CLEANSPARK INC	0.06	
14	MERCK & CO. INC.	0.10	78%	INSTALLED BUILDING PRODUCTS	0.05	
15	WALT DISNEY CO/THE	0.09	79%	HEALTHEQUITY INC	0.05	
16	EXXON MOBIL CORP	0.09	81%	MODINE MANUFACTURING CO	0.05	
17	MASTERCARD INC - A	0.09	82%	SHAKE SHACK INC - CLASS A	0.04	
18	APPLIED MATERIALS INC	0.09	83%	FTAI AVIATION LTD	0.04	
19	UBER TECHNOLOGIES INC	0.09	84%	APPFOLIO INC - A	0.04	
20	PROCTER & GAMBLE CO/THE	0.09	85%	BIOHAVEN LTD	0.04	
21	VISA INC-CLASS A SHARES	0.08	86%	AEROVIRONMENT INC	0.04	
22	WALMART INC	0.08	87%	KRYSTAL BIOTECH INC	0.04	
23	INTL BUSINESS MACHINES CORP	0.08	88%	MASONITE INTERNATIONAL CORP	0.04	
24	COSTCO WHOLESALE CORP	0.08	89%	VERA THERAPEUTICS INC	0.04	
25	HOME DEPOT INC	0.07	90%	SPRINGWORKS THERAPEUTICS INC	0.04	
26	QUALCOMM INC	0.07	91%	CYMABAY THERAPEUTICS INC	0.04	
27	WELLS FARGO & CO	0.07	92%	PERMIAN RESOURCES CORP	0.04	
28	THERMO FISHER SCIENTIFIC INC	0.06	93%	VAXCYTE INC	0.04	
29	LINDE PLC	0.06	94%	OSCAR HEALTH INC - CLASS A	0.04	
30	PROGRESSIVE CORP	0.06	94%	AVIDITY BIOSCIENCES INC	0.04	
31	EATON CORP PLC	0.06	95%	API GROUP CORP	0.04	
32	LAM RESEARCH CORP	0.06	96%	FABRINET	0.04	
33	CATERPILLAR INC	0.06	97%	ITRON INC	0.04	
34	AMERICAN EXPRESS CO	0.05	97%	MATADOR RESOURCES CO	0.03	
35	ABBOTT LABORATORIES	0.05	98%	COMMVAULT SYSTEMS INC	0.03	
36	STRYKER CORP	0.05	99%	APOGEE THERAPEUTICS INC	0.03	
37	INTUITIVE SURGICAL INC	0.05	99%	DYCOM INDUSTRIES INC	0.03	
38	ACCENTURE PLC-CL A	0.05	100%	PARSONS CORP	0.03	

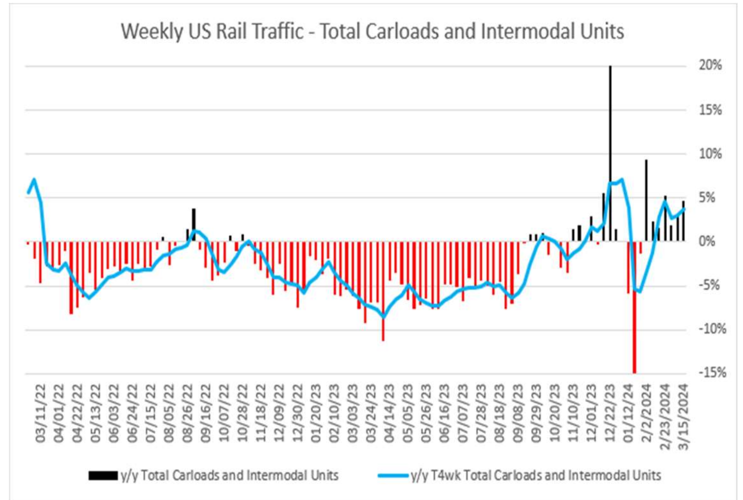
Source: PSC Research

The next four charts below surprisingly show that the economy experienced a bit of an uptick as the manufacturing PMI showed a bit more strength than the services side of the economy which continues to hang in there. Both show a reading above 50 which indicates growth. Charts 3 and 4 below show that the economy has gained a bit of a foothold following the post-COVID surge and subsequent slowdown. Railcar loadings unexpectedly surged as we entered 2024 after showing a few years of weakness. Freight loadings are the best real-time look at the strength of the economy, and despite a lot of industries with inventory overhangs, it appears orders are reaccelerating. Make no mistake, the market is still clearly focused on Fed policy and will become increasingly nervous if a rate cut doesn't happen by mid-summer.



Source: PSC Research

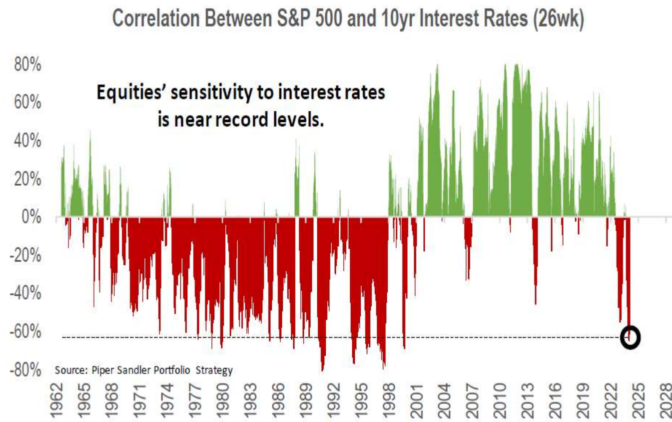




Source: Strategas

Some hotter-than-expected economic readings generated higher interest rates so far this year (10-Yr. Treasury rates +40 basis points), which have continued to act like Kryptonite for small caps as has been the case for much of the last two years since the Fed started hiking rates. The chart below left shows the correlation between the stock market and 10-year Treasury interest rates. When interest rates rise, stocks decline and vice versa. The current trend has held through the Fed's current rate tightening cycle and is one of the most dramatic on record. The good news is that the Fed has shown their hand, has pivoted, and is now indicating rate cuts are on the horizon, which should be good for the stock market and in particular, small cap stocks. The chart below right shows that other central banks around the globe have already beat the Fed to the punch and started to cut rates. So far, this cycle has seen 93 interest rate cuts globally. Hopefully by the time we write our next newsletter, the U.S. Fed will be added to the list.

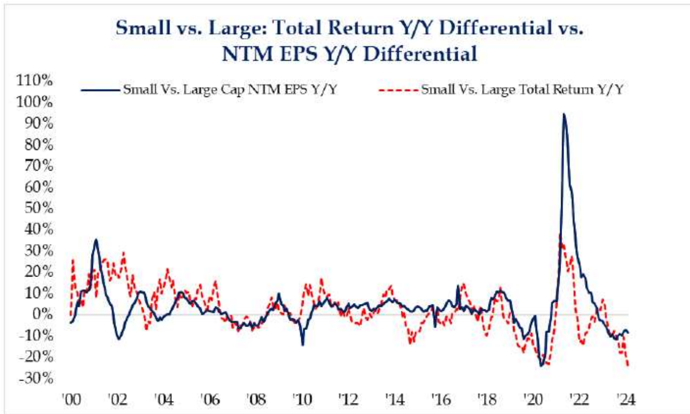
Markets Have Been At The Mercy Of Bond Yields For Over Two Years

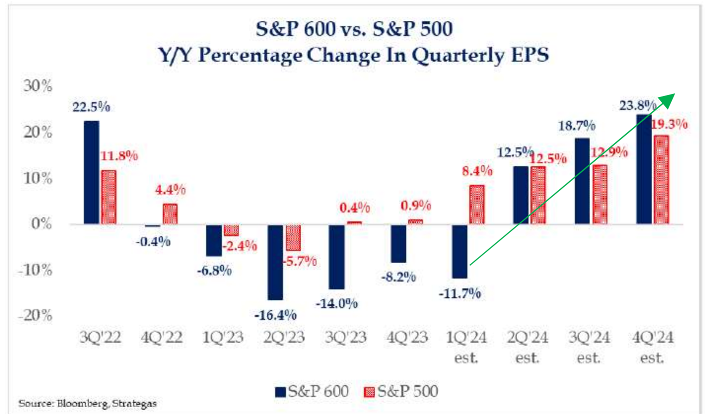


PSC's Central Bank Easings List

Count	Countries	Date	BP Ch	Current Rate
1.	China prime	6/19/2023	-10	3.55
2.	Vietnam	6/19/2023	-50	4.50
3.	Moldova	6/20/2023	-400	6.00
4.	D Republic	6/29/2023	-25	7.75
5.	Sri Lanka	7/5/2023	-200	12.00
	:			
83.	Kazakhstan	2/23/2024	-50	14.75
84.	Hungary	2/27/2024	-100	9.00
85.	Argentina	3/11/2024	-2000	80.00
86.	Georgia	3/13/2024	-75	8.25
87.	Ukraine	3/14/2024	-50	14.50
88.	Czech Rep	3/20/2024	-50	5.75
89.	Brazil	3/20/2024	-50	10.75
90.	Moldova	3/21/2024	-50	3.75
91.	Switzerland	3/21/2024	-25	1.50
92.	Paraguay	3/21/2024	-25	6.00
93.	Mexico	3/21/2024	-25	11.00

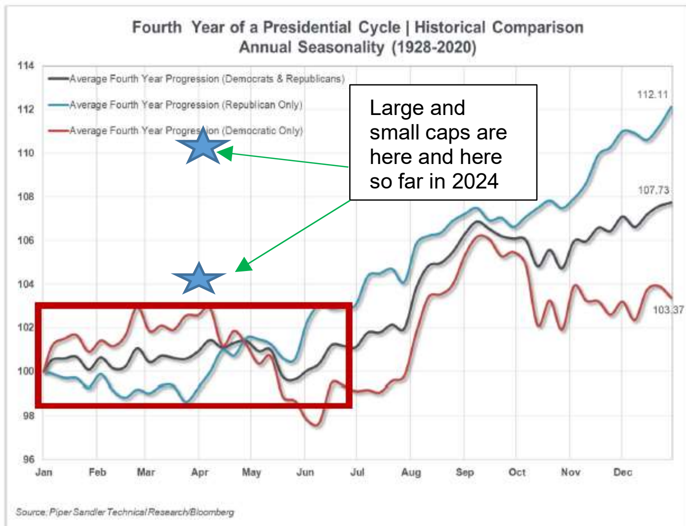
The chart below left shows the year-over-year total return differential between large and small cap stocks over the past 25 years (red dashed line). For much of the past ten years large caps have outperformed small caps. This event is due to the fact that earnings expectations for large caps have outperformed small caps (blue line) and to the ascent of large cap tech stocks. The chart on the right shows that the earnings trend is forecasted to favor small caps in the back half of 2024. We'll see if small cap stocks close the performance gap if this pattern holds. Meme stocks are once again the flavor of the day so far in 2024 in a reprise to 2021. The only difference is instead of Gamestop, AMC Theaters, and Koss, this time it's Trump Media (President Trump's Twitter/X rival), Reddit, and Carvana. The names have changed but the poor fundamentals and crazy valuations remain.

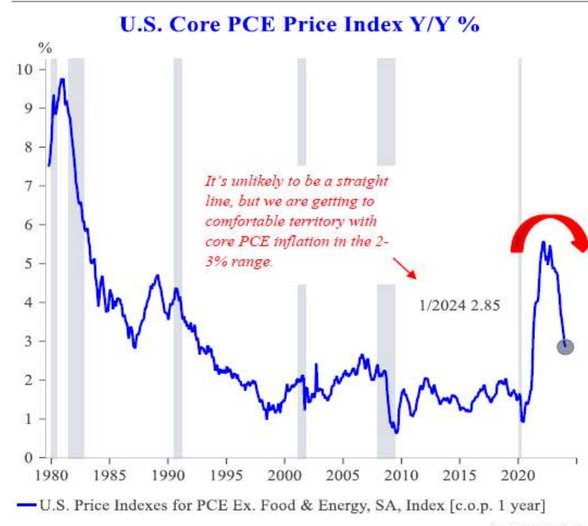




Source: Strategas

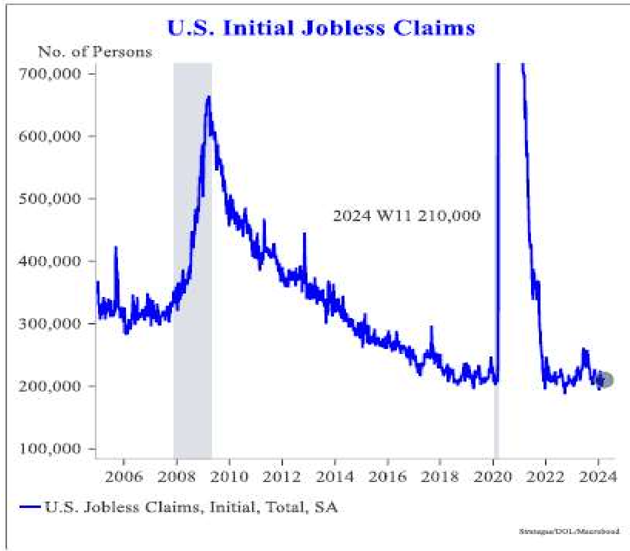
As you know, 2024 is a Presidential election year and with an election year typically comes a tepid start as the market tries to forecast who is going to win the Oval Office and once there appears to be a likely winner, the uncertainty is removed, and the prospective winner's policies start to make their way into stocks. The chart below left shows the average stock market performance during the fourth year of a Presidential cycle. This year's strong start is quite an anomaly. The excitement over AI and Bitcoin has propelled the stock market a strong first quarter, but surprisingly, the NASDAQ Composite (+9.3%) ceded the top spot to the S&P 500 (+10.6%) with the Russell 2000 (+5.2%) and the S&P Small Cap 600 (+2.5%) lagging behind. This year the market has significantly outperformed the typical election year performance as shown in the chart below left. The stock market has advanced for five straight months on the Fed pivot, and only time will tell if we see the back half of the year market rally that is typical in election years. We will likely need the Fed to cut rates in the near term to continue the market's upward trajectory. The Fed's dot plot for interest rate expectations currently shows that three 25 basis point rate cuts are expected in 2024, and Fed Chair Powell continues to emphasize that they want to see more progress towards their 2% inflation target. The favorite data point for the Fed's inflation measure is the Core PCE reading which is shown in the chart below right. The index currently stands at 2.8% and shows no signs of turning back at this point. Our expectation is that the Fed will begin rate cuts in the June/July timeframe for a couple of reasons. First, the Federal deficit is enormous and needs to be financed with treasury note issuances. The Fed missed the opportunity early on in the tightening cycle to effectively refinance the country's debt at significantly lower rates. Given where interest expense as a percentage of the U.S. budget is forecast, lower rates is the only answer. Secondly, the Fed is supposed to be apolitical, and if they waited to cut rates right before the election, they would be viewed as doing so for the purpose of getting the current administration reelected.





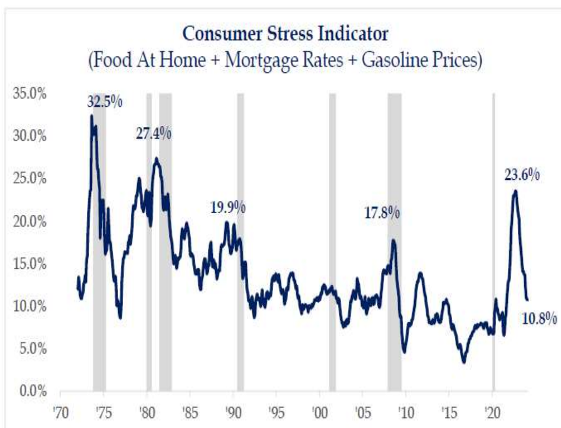
The U.S. consumer is the life blood of the U.S. economy as 70% of our economy is based off of consumption. Therefore, the health of the U.S. consumer remains front and center. As we stated last quarter, we don't believe that the U.S. economy will go into recession this year barring an unforeseen global event. This view is predicated on jobs and on consumer strength. Our thesis has been that employers will be more hesitant to lay off workers even if the economy softens a bit based on how difficult it was to get and retain workers during the pandemic. The current employment statistics remain pretty firm as shown below. The

chart on the left shows that initial jobless claims remain muted and at low levels, and the chart on the right shows continuing unemployment claims that have recently peaked and flattened out.

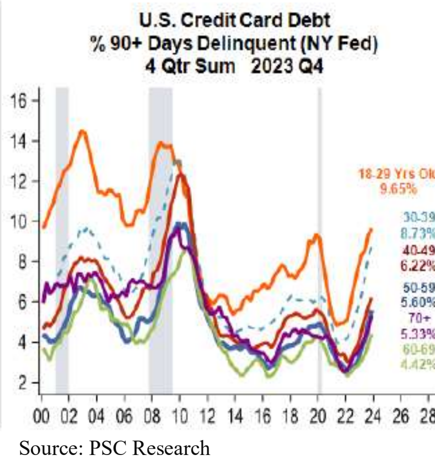


Source: PSC Research

However, we are carefully watching the health of the consumer, and we're picking up some mixed signals which may be indicating a consumer that may be tapped out from a spending perspective, particularly in the low to middle-income consumer. Several consumer driven companies who have reported earnings of late have noted particular weakness in these income cohorts that wasn't there over the past few years. Companies like Lululemon, Nike, and Foot Locker to name a few cut their sales and earnings expectations recently. The chart below left is basically a consumer misery index that measures the stress that a typical consumer may be under as it measures the combined year-over-year increases in food costs, mortgage rates, and gas prices. As you can see, the current measure is receding from its COVID highs when supply chain issues pushed the prices of everything higher. The trends in the middle and right chart are a little more concerning. The middle chart shows that credit card debt delinquencies are rising. Each line is a different age cohort, and the younger age groups are defaulting at a higher rate. This occurrence may be due to the fact that student loan payments have kicked back in after years of deferrals, and this event would disproportionately impact the younger cohorts that are newly out of school. The chart on the right shows that credit card balances are up nearly +22% from pre-COVID levels. We are becoming a cashless society, and everything gets put on a credit card, which may explain this balance increase. This data only emphasizes why we need to pay attention to the delinquency chart in the middle and the personal savings level which has been coming down rapidly as pent up savings during COVID are quickly returning to normal levels.



Source: Strategas



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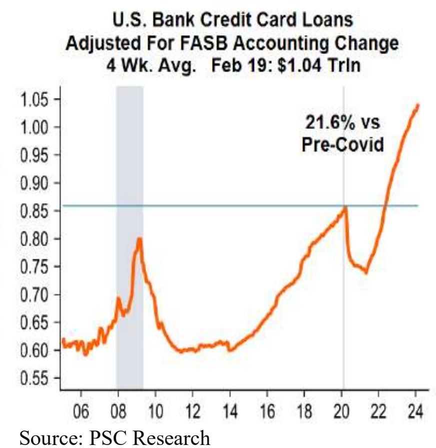
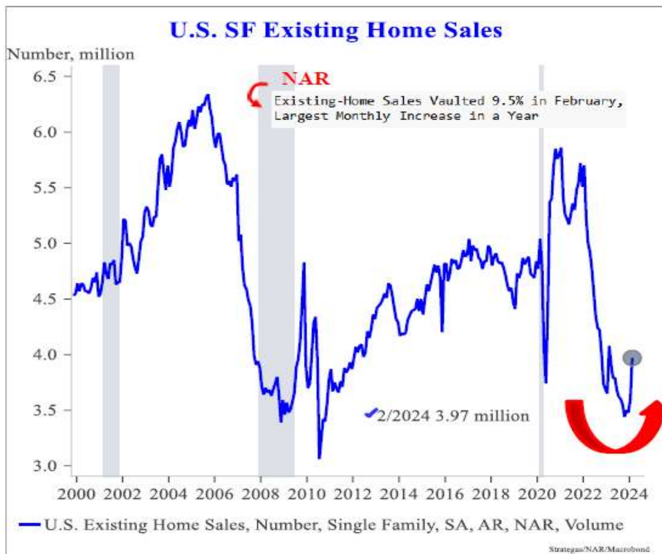


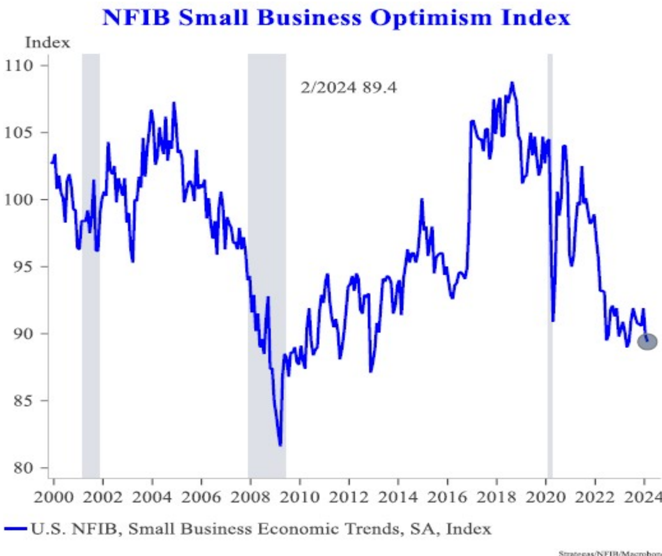
Source: PSC Research

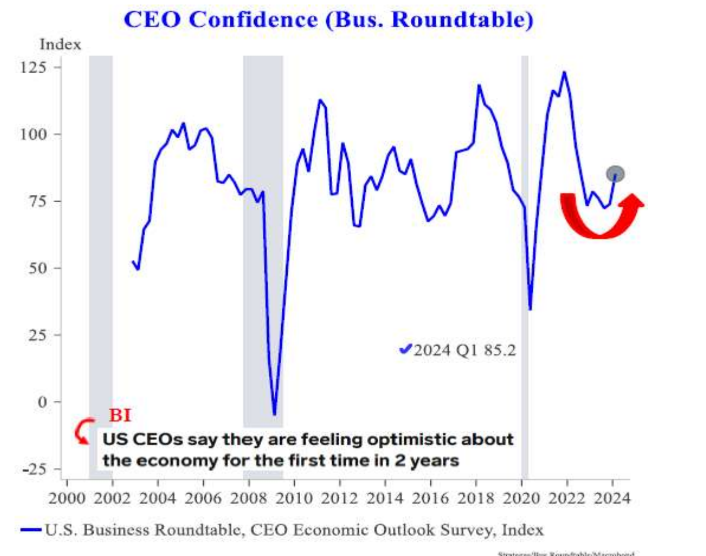
Despite rising rates so far in 2024, the housing sector has remained strong. Housing related stocks have been one of the best performing industries in the stock market year to date. When 30-year mortgage rates hit 8% in the second half of 2023 there was a definite pause in both existing home sales and new housing starts. Nobody wanted to give up their 3%, 30-year mortgage

to step into an 8% mortgage. The combo platter of higher house prices and spiking mortgage rates have increased the average monthly mortgage payment from $1,200 in 2021 to over $2,500 today. However, there are always new homeowners that come into the mix. With the lack of inventory that we've discussed numerous times in this newsletter, these buyers may be waiting in the wings for a pullback in rates. You can see this idea in the two charts below. The chart below left shows existing home sales which saw a dramatic decline as the Fed started to raise rates over the past few years and recently saw an uptick as mortgage rates began to recede from the 8% level. The new housing starts chart on the right shows a much more muted reaction both on the way down and on the rebound. We are in a new housing inventory deficit position which means that new housing starts are lagging new household formations dramatically. It will take years of increasing housing starts to fill the gap. It appears that new housing starts have put in a low and will continue to increase assuming that the Fed cuts rates from here. Housing is a key cog in the U.S. economy.



At the corporate level we're seeing a bit of a dichotomy in terms of how optimistic small business owners are compared to CEOs of large corporations. Small businesses have been under pressure over the past several years as inflation has taken a toll on their cost structures particularly as it relates to labor, healthcare, and insurance costs. This effect can be seen in the chart on the left as small business operators have become less optimistic about their prospects. Whereas the chart on the right shows that CEOs of larger companies have become more confident recently. The latest headlines in the news tends to drive both of these indices. However it also may reflect the Fed's pivot which means we've likely seen the peak in interest rates. The inventory levels that have accumulated in many industries are starting to normalize, and order patterns are beginning to pick up.





China has been in the economic news quite a bit over the recently. There is the ongoing trade battle between the U.S. and China that is primarily related to the tech sector and the unwillingness of the U.S. government to allow Chinese companies and

government entities to use our leading-edge semiconductors, semiconductor capital equipment, and artificial intelligence technology. This battle appears to be intensifying and began in 2016 with the imposition of tariffs on Chinese manufactured goods into the U.S. Case in point is Apple's iPhone which is no longer allowed to be used within any Chinese governmental entity or government-controlled corporation. Prior to this ban, the iPhone was the number one selling cellphone in China. China's real estate market has also been suffering recently as several large real estate companies have effectively gone bankrupt, and real estate prices in certain geographies within China are in freefall. For much of the past 25 years, China's GDP growth led the world as many global corporations set up operations there. However, over the past few years, many corporations have moved production facilities to other Southeast Asian countries to avoid tariffs and the escalating rhetoric between the U.S. and China, particularly as it relates to China's ambitions with respect to Taiwan. The Chinese government policies have become more insular, and their economy has suffered as a result. Their economy never saw the expected post-COVID rebound that many economists expected. In fact, Chinese GDP growth is running at the lowest level, excluding the COVID era, since the 1990's as shown in the chart below left. Note the blue line on that chart is real estate investment which is down 55% year over year. Chinese consumer confidence has similarly slumped to levels not seen in decades as shown on the right. As China's economy is the second largest in the world, this downturn is a real drag to global growth. We expect that China will likely institute more pro-growth policies and cut rates further to stimulate their sagging economy.

Source: PSC Research

Source: PSC Research

As shown in the table below, the stock market finished the quarter with a strong but bifurcated performance with most of the strength up market cap. While the Magnificent 7 didn't perform uniformly, as Apple and Tesla fell off the pace, the remaining five were still the largest drivers of performance with Nvidia's +90% move leading the way. The recent strength in economic indicators in the quarter as we referenced above, led to some broadening out in the markets as the energy and materials sectors had above par performance in the quarter on strengthening oil and copper prices, respectively. This market strength lifted the S&P 500 and NASDAQ Composite to all-time highs. However, the small cap Russell 2000 is still more than 15% below its 2021 high. The S&P 500 has now posted five straight months of positive performance which began in November on the heels of the Fed pivot. The S&P 500 was the gold medalist this quarter and bested the NASDAQ Composite which has led for much of the past 18 months.

Index Returns		
Index	First Qtr. 2024 Return	2024 YTD Return
Russell 2000	+5.18%	+5.18%
Russell 2000 Growth	+7.58%	+7.58%
Russell 2000 Value	+2.90%	+2.90%
S&P 500	+10.56%	+10.56%
Dow Jones Industrials	+5.62%	+5.62%
NASDAQ Composite	+9.31%	+9.31%

Source: 1492 Capital Management, LLC and FactSet

From a style perspective, the Russell 2000 Growth Index (+7.6%) beat the Russell 2000 Value Index (+2.9%) for the quarter. Much of the disparity can be traced to the makeup of the respective indices. Specifically, the value index has a significantly larger weighting in interest sensitive sectors (bond proxies) like Financials, REIT's, and Utilities all of which are down so far this year.

The second reason for the growth index outperformance is the exceptional performance of a single stock - Super Micro Computer (SMCI). This stock added 400 basis points to the performance of the index and is now the largest single position in the Russell 2000 Index ever. It has appreciated eight-fold over the past year and is now a $65 billion market cap company. For reference, the top end of the Russell 2000 Index when it was rebalanced last June from a market cap standpoint was about $7.5 billion. I've been investing a long time, and I've never seen a single stock have such a disproportionate impact on the index. The impact on both the Russell 2000 and Russell 2000 Growth Index is shown in a table below. Another stock that had a similar influence on the small cap indices was MicroStrategy (MSTR) which is basically a software company acting as a holding company for bitcoins. This stock has appreciated along with the bitcoin cryptocurrency, but many day traders play it as a way to trade bitcoin without having to hold the actual coin. These two stocks explain much of the disparity in performance between the Russell 2000 and S&P 600 small cap indices year to date. The best performing sectors for the quarter were Technology (+12.8%) and Energy (+11.9%). Interestingly, the tech sector would have only risen +3.2% if it weren't for the contribution of SMCI. Energy improved as oil prices rose during the quarter and appeared pretty firm. On the negative side of the ledger were Communication Services (-4.9%) and Utilities (-3.6%) which are both highly sensitive to interest rates which have risen this year. The table immediately below highlights the performance of the Russell 2000 style indices by sector for the first quarter and year-to-date 2024. The second table below shows that there continues to be a significant market cap skew in the year-to-date numbers as the performance was significantly worse moving down the market cap spectrum.

Table 6 - Russell 2000 Scorecard through March 28th

	March			Year to Date			
GICS Sector	**Absolute**	**Contribution**	**Relative**	**Absolute**	**Contribution**	**Relative**	**Wgt**
Com Serv	-0.46	-0.01	-4.04	-4.85	-0.13	-10.04	2.1
Discretionary	2.97	0.33	-0.61	5.70	0.63	0.51	10.9
Staples	0.21	0.00	-3.37	4.53	0.15	-0.65	3.3
Energy	11.12	0.78	7.54	11.86	0.81	6.68	7.3
Financials	3.98	0.63	0.40	-1.42	-0.37	-6.60	15.9
Health Care	-1.01	-0.16	-4.59	4.98	0.81	-0.21	15.3
Industrials	5.09	0.89	1.51	8.73	1.55	3.54	17.5
Info Tech	4.07	0.58	0.49	12.83	1.88	7.65	14.9
Materials	4.95	0.22	1.37	3.49	0.15	-1.69	4.5
Real Estate	3.87	0.21	0.29	-1.71	-0.16	-6.89	5.6
Utilities	4.49	0.11	0.91	-3.59	-0.13	-8.77	2.5
Size Quintile	**Absolute**	**Contribution**	**Relative**	**Absolute**	**Contribution**	**Relative**	**Wgt**
1 (Largest)	4.38	2.50	0.80	7.57	4.37	2.39	57.4
2	3.15	0.74	-0.43	4.43	1.02	-0.76	23.3
3	1.55	0.18	-2.03	-0.52	-0.11	-5.70	11.7
4	2.47	0.13	-1.11	1.41	0.05	-3.77	5.5
5 (Smallest)	1.15	0.02	-2.43	-1.62	-0.06	-6.80	0.0

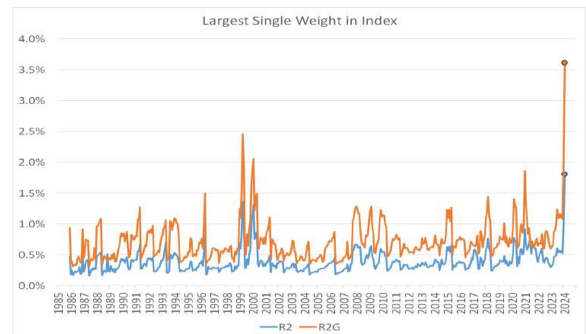
Source: Jefferies

Table 1 - Big difference in performance with and without SMCI (NC-$1010.03)

	March			Year to Date		
Index/Sector	**Overall**	**X-SMCI**	**Difference**	**Overall**	**X-SMCI**	**Difference**
Russell 2000	3.6	3.2	0.4	5.2	3.7	1.5
Info Tech	4.1	2.6	1.5	12.8	3.2	9.6
R2000 Growth	2.8	2.4	0.4	7.6	3.6	4.0
Info Tech	4.6	2.3	2.3	16.4	4.9	11.5

Note: SMCI (Not Covered-Closed on 3/28 at $1010.03)

Source: FactSet; FTSE Russell; Jefferies



Source: Furey Research

Returns in the international markets were generally positive with European and Japanese indices leading the way on recovering economies. Interestingly, Japan is starting to hike rates as their economy has been one of the best performers globally. China's markets continue to languish on slowing GDP and real estate woes as we referenced above. Bond market returns were generally

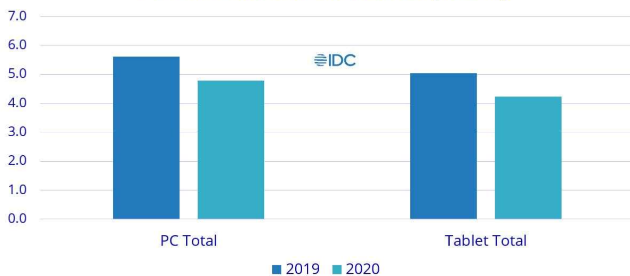
poor on a relative basis as interest rates climbed during the quarter. From a commodity perspective, there are conflicting signals between oil which is a global commodity and is reasonably strong due to restraint of OPEC production and natural gas, which is much weaker and is generally a regional commodity. The winter in the U.S. has been quite mild and is leading to oversupply. The recent Biden policy to restrain international liquefied natural gas (LNG) shipments has some concerned that this policy will be enacted for the long run, which would leave much of the export opportunity for natural gas to go untapped.

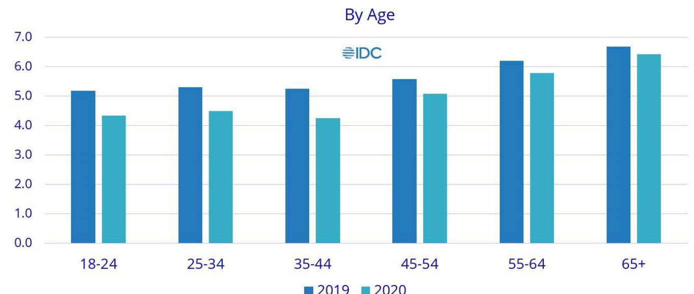
Index	First Qtr. 2024 Return	2024 YTD Return
France	+8.8%	+8.8%
Germany	+10.4%	+10.4%
Brazil	-4.5%	-4.5%
India	+2.0%	+2.0%
China- A Shares	+2.2%	+2.2%
China- Shenzhen A Shares	-4.9%	-4.9%
Japan	+20.6%	+20.6%
Long-Term Treasuries (TLO)	-3.75%	-3.75%
Investment Grade Corp Bonds	+0.3%	+0.3%
Gold	+8.0%	+8.0%
Volatility- VIX index	+4.5%	+4.5%
Oil	+16.1%	+16.1%
Natural Gas	-24.2%	-24.2%
Lumber	+7.6%	+7.6%

Source: 1492 Capital Management, LLC

Thematic Investing: Tech Refresh Cycle is on the Horizon and It's Not Just Because of AI

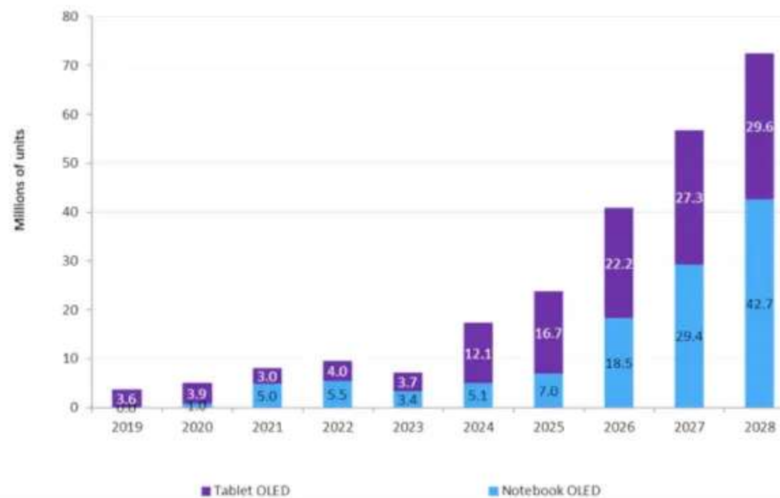
Technology spending historically has been very cyclical, but since the internet craze of the 1990's, it has generally been on an upward trend with a few pockets of cyclical downturns. While AI may drive this cycle, there is a lot more to it than in prior periods. First let's rewind to the last major tech upgrade cycle in 2020 when PC's, notebooks, and laptops were last upgraded. Recall that COVID had everyone around the globe working from home, and nearly every company purchased new computers so that all of their employees could work efficiently remotely. This cycle lasted from mid-2020 to mid-2021 when you literally couldn't find a decent new computer as supplies were tapped out. The supply chains at semiconductor companies which are the heart of any computer, were unable to keep pace with demand. Corporate replacement cycles generally run three to four years according to Intel, and individuals typically refresh on a slightly longer cycle with age playing a role in how quickly you're willing to refresh your PC (Charts below left and right). Given that math, the second half of 2024 is likely going to be the start of a technology upgrade cycle. While it may be tempting to elongate the replacement period, for most companies, PCs are the lifeblood of employee productivity. With technology moving at light speed and cybersecurity threats outpacing the ability to stop them, extending the life of a computer fleet may compromise an organization's security. Large companies like Dell and HP, two of the largest PC manufacturers in the world, have recently predicted that a PC upgrade cycle is likely on the near-term horizon due to the refresh that is due.





Now let's talk about AI. We've all heard about the number of Nvidia GPU's that are going into AI datacenters to process data at unfathomable speeds to generate the output that large language models use. Server demand has been off the charts as a result, but we haven't even seen the tip of the iceberg on what an enormous opportunity in AI PCs could be. According to Wall Street firm UBS, most PCs are likely to become AI PCs over time which will require more processing power and accelerators to perform AI tasks at the edge of a network. Dell is already planning a line of AI notebook computers that are aimed at this market and that are scheduled to ship in the second half of 2024. Given the higher processing power required in these computers, the price point will likely be elevated and will need to come down as volumes ramp to spur mass market demand. Whether or not the average computer user will require the higher horsepower of these AI PCs, many will adopt them to feel like they are equipped to take advantage of the many AI use cases that are likely to surface in the coming months. This trend will also affect the smartphone market which has been rather sluggish over the past few years as there hasn't been any true breakthrough technologies embedded in these devices. With the advent of AI, we're already seeing companies like Samsung launch AI-embedded smartphones with their Galaxy AI line which is supposed to hit the market imminently with the hope that they regain the market share they've lost to Apple over the past few years. Surely, Apple will be right behind them with their version of the yet-to-be-released iPhone 18.

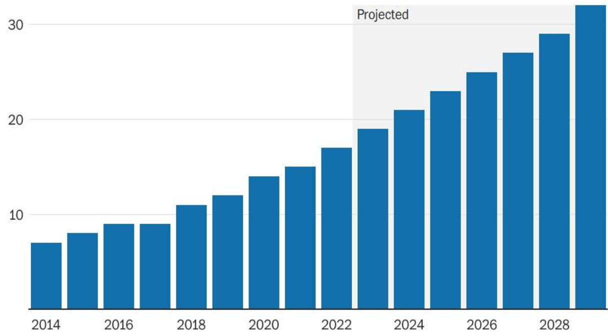
AI will be a key driver to the display screen market as well. Many mid to upper-range smartphones have already adopted OLED (organic light emitting diodes) screens which offer much better viewing and significantly lower power consumption. Well over 50% of smartphones ship with OLED screens today. Whereas in the TV market, just under 3% of the total TV market is shipping with OLED screens in a 197-million-unit annual global market. The cost of OLED screens has kept them out of the mass market price range for TVs with most big screen OLED TVs starting at $1,500 and going up dramatically from there. Nevertheless, we may be reaching the tipping point as OLED for IT (PCs, tablets, monitors, etc.) is expected to reach 49 million units by 2027 with an annual growth rate of 39% from the 9.5 million units shipped in 2022 according to UBI Research. However, that number may be low as Apple is set to release a new line of tablets and Macs with OLED screens this year which may accelerate adoption. Competitors are certain to follow, which should drive growth north of 100% in 2024. The chart below highlights the coming unit inflection. The total market for tablets and PCs shipping annually is approximately 385 million units, and we're in the first inning of OLED adoption in this IT market. The bottom line is that this tech cycle could rival that of the mid-to-late 1990's with winners up and down the tech supply chain.

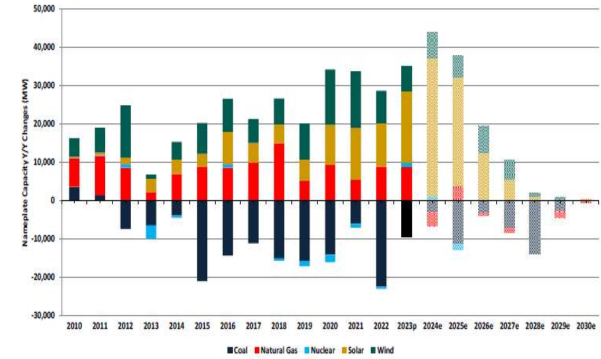


Source: Omdia Market Research

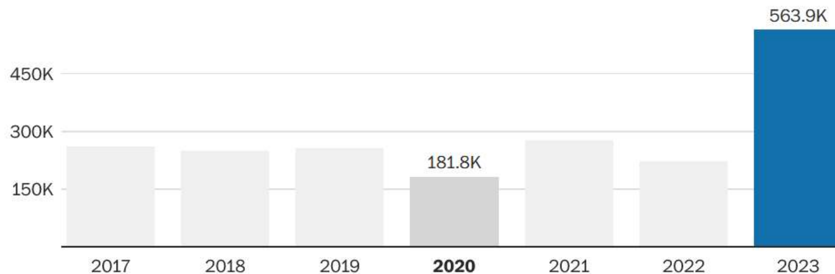
Thematic Investing: Datacenters and Reshoring Drive Electricity Demand and Grid Growth

With the proliferation of new datacenters in the U.S. over the next few years to support AI and bitcoin processing, the demands on the country's utility grid to provide new and just as importantly reliable power will be well tested. As seen in the chart below left, data center energy demand is forecasted to grow by over 50% from 2023 to 2029. If each gigawatt is roughly equivalent to the output from a large nuclear plant, we would need the equivalent of roughly a dozen new nuclear plants in the U.S. However, as you can see from the chart on the lower right, the planned new power additions after 2023 are almost entirely wind and solar, which are intermittent sources.



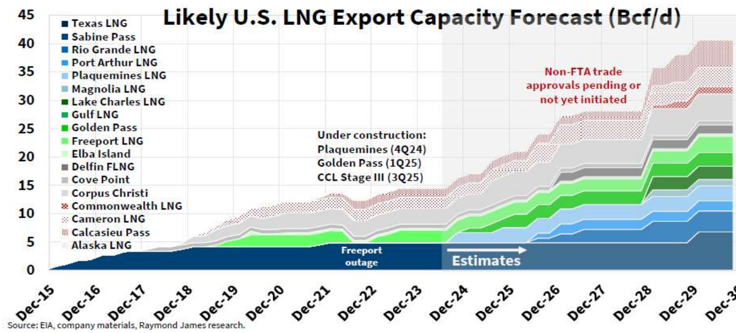


We will need backup power solutions to fill in during the wind/solar downtime. With coal, hydro, and nuclear essentially off the table for new electricity supply, natural gas-powered electricity generation will likely be needed in the near to medium term to plug the proverbial power hole both for the U.S. and globally. The U.S. Federal Energy Regulatory Commission (FERC) has been rapidly revising its five year cumulative power load growth forecasts higher as its 2.6% growth number that they offered in 2022 has now been revised to 4.7% in 2023. As seen in the chart below, we are witnessing a massive increase in new electricity demand from the previous nine-year forecast periods due to both datacenters and the power needs of new domestic manufacturing facilities from the reshoring trend.



With these multi-year demand factors in place, significant investment in the utility grid to create more power and transport it to the regions that require it is a key driver in our U.S. infrastructure upgrade theme that we have commented on in the past and continue to deploy across our small-cap and wealth management investment strategies. We believe that there will be tailwinds for both electrical and natural gas transmission infrastructure for many years. According to GridStrategies, the U.S. built roughly 1,700 miles of electrical transmission lines from 2010 to 2015, but in the second half of the last decade, that figure plummeted to roughly 645 miles per year. One of the keys in supplying reliable power is to be able to transfer it across regions of the U.S., and we think that to satiate the sizable electricity demand growth that is forecasted, there will be strong construction demand in this transmission area. We also believe that the construction of natural gas transmission will also see tailwinds in the years ahead as this power source needs to be moved to the gas-fired generation facilities throughout the U.S that will be called on when solar or wind power is unavailable.

As we think about rising electricity demand that results from datacenter growth internationally and other countries' manufacturing reshoring efforts, natural gas will be a primary input for power generation globally for the same reasons that we cited for the U.S. For many nations, the sourcing of natural gas will require the importation of LNG and then its subsequent regasification for transport through pipelines to power plants. During 2023, we launched our LNG infrastructure theme as we believe that the buildout of LNG facilities has a multi-year tailwind behind it. As in the chart below, the growth in U.S. LNG capacity begins a significant ramp starting in late 2024 through 2030. The 1492 Capital investment theme includes equipment suppliers to the engineering and construction firms that are building these plants both in the U.S and abroad.



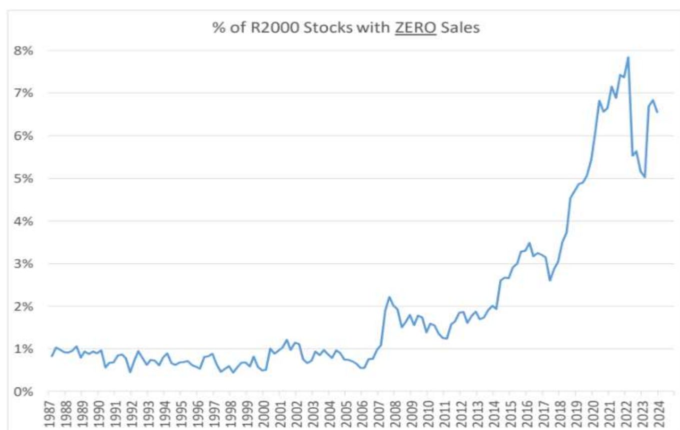
The theme also capitalizes on the massive amounts of stranded natural gas in offshore Africa that are being liquefied into LNG through floating LNG processing units (FLNG) and then transported to countries that have the import facilities to regasify the LNG for pipeline transportation to utilities. While the Biden administration is delaying approving new permits for U.S. plants for the time being, the rest of the world is moving ahead as they see similar drivers for power demand as those that we are witnessing here in the U.S. Our 1492 Capital Management themes of U.S infrastructure upgrade and LNG infrastructure are deployed to capitalize on the surge in electricity demand on utility grids.

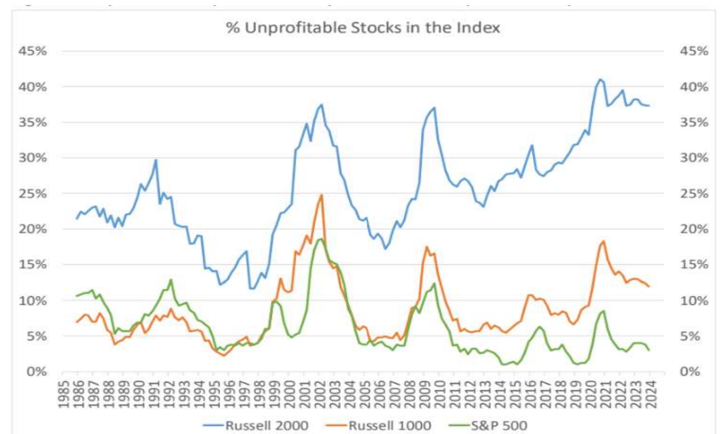
2024 Updated Outlook: Active Management in Small Cap Stocks: Case in Point

We begin every newsletter with an introduction of our corporate tagline, “Discovering Opportunity,” and we want to take this opportunity to refresh our readers on what that means. In short, we meet with hundreds of companies every year to find those that we believe could generate positive returns for our clients. How do we do this? We take a thematic approach to find a pervasive tailwind; we pore through the company financial statements; and then we apply a rigorous valuation methodology for entry and exit points. In other words, we utilize a very active approach to our investment management process.

First, small cap stocks have many fewer analysts covering them than large cap stocks, and this point is where our work becomes important. According to Furey Research Partners, the average large cap company has three to four times the number of analysts as the average small cap company. This imbalance implies that the small cap market is less efficient as the information about the company isn’t as widely known. Our fundamental research work comes into focus here, and we believe our meetings with management teams are crucial. Additionally, we often “discover” or learn about small cap companies that are not included in a benchmark index – the Russell 2000 Index – for example, which is an additional point of differentiation from a passively managed index product. This discovery process is important because studies have shown that concentration in stocks (think passive index products or the mob mentality of the Magnificent 7 in the large-cap space) is inversely correlated to active manager relative performance generated.

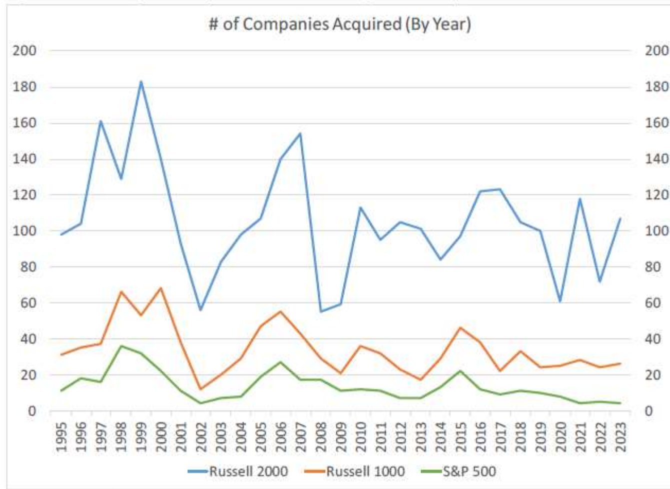
These two graphs show some pretty interesting trends in small-cap stocks. Almost six percent of the companies in the Russell 2000 Index do not have any reported sales (left), and the number of unprofitable companies in the index generally has been increasing over the past decade (right). These companies are what are often included in passive index products.



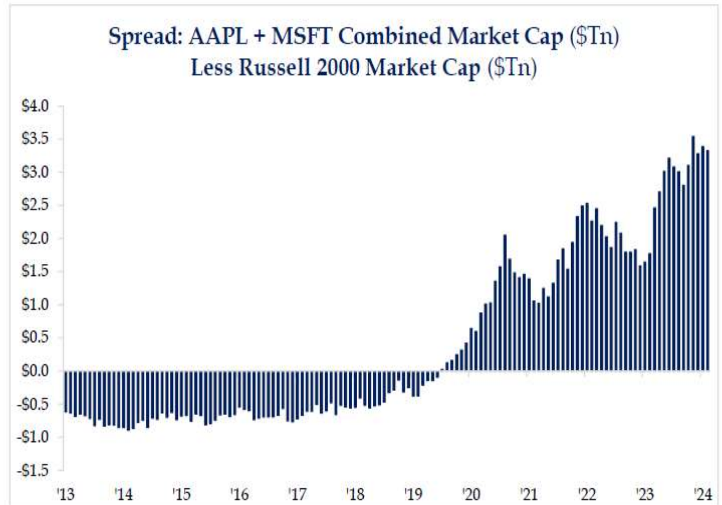


Perhaps a little easier to understand is the potential for M&A activity and the valuation–return benefit that typically coincides in the small cap space. In an average year, there are three times as many takeovers in the Russell 2000 Index of companies than there are in the largest capitalization companies of the Russell 1000 Index (chart below left). This situation increases the potential return that an active manager could generate. The years since the pandemic lows have led to corporate balance sheets being flush with cash, which is a key tool to ignite mergers and acquisitions to generate growth. While we typically do not buy a company's stock solely for this reason, when we discover a company with a great product or service in a desirable market position, we'd accept the acquisition upside all day long. To add another perspective, *the total market capitalization of the two largest companies in the U.S. stock market dwarfs the size of the entire market cap of the Russell 2000 by several trillion dollars* (chart below right). It wouldn't take much firepower from the likes of these larger companies to buy many potential small cap targets. Additionally, with the prospect of lower interest rates on the horizon, M&A activity could accelerate as could the earnings potential of small cap companies with debt on their balance sheet.

Fig. 15. **There's significantly more M&A occurring in small-caps**



Source: FRP, FactSet; as of 12/29/23



Source: Strategas Research

From a purely fundamental standpoint, small caps have historically had better earnings growth when compared to large caps. Other than the most recent five year period when the Magnificent 7 had stellar earnings growth, small caps have outearned large caps over all other horizons. The chart below compares the earnings growth of the Russell 2000 to the S&P 500 over several periods in the green box. This difference is important because, at the end of the day, a company is valued based on the discounted value of its long-term stream of earnings. Small cap stocks are attractive and are larger companies' acquisition targets to add another leg of growth to the acquirer's stool.

Compounded Annual EPS Growth	5 Years	10 Years	15 Years	20 Years	25 Years	Avg. Div. Yield	Std. Dev. Of Y/Y Returns
Small Cap 600	8.5%	9.9%	8.3%	10.2%	9.7%	1.6%	20.0%
MidCap 400	10.7%	10.6%	9.4%	10.2%	9.1%	1.5%	18.3%
S&P 500	9.0%	7.5%	7.4%	7.6%	7.1%	1.8%	17.0%
Russell 2000	8.7%	9.5%	14.1%	12.2%	8.1%	1.3%	21.2%
Russell 1000 Growth	12.2%	9.8%	8.5%	9.4%	8.3%	1.1%	20.1%
Russell 1000 Value	5.5%	5.3%	8.5%	6.2%	5.9%	2.3%	16.7%
Europe	6.4%	5.6%	0.4%	7.4%	3.8%	2.9%	
Japan	-1.6%	1.9%	0.8%	6.5%	9.9%	1.9%	
Emerging Markets	-3.0%	-2.1%	-1.0%	4.5%	4.8%	2.1%	
China	-4.6%	-1.5%	2.3%	4.7%		1.4%	

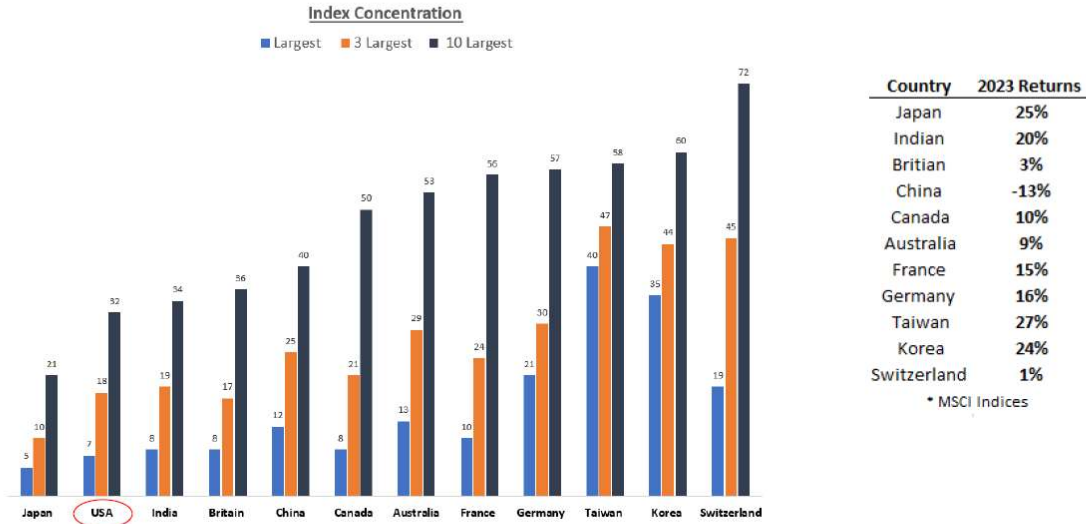
Source: FactSet, Raymond James research; Note: data for international indices at the bottom of the table is missing serveral years depending on the market from 2000-2007 due to data availablility

2024 Updated Outlook: A Picture is Worth a Thousand Words

We articulated our updated 2024 outlook above 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. 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.

If you think the U.S. stock market is concentrated with our Magnificent 7- check out these other countries where a single company or industry can literally drive the market.

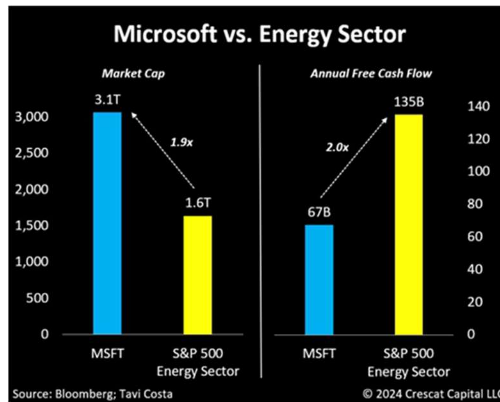


Country	2023 Returns
Japan	25%
Indian	20%
Britian	3%
China	-13%
Canada	10%
Australia	9%
France	15%
Germany	16%
Taiwan	27%
Korea	24%
Switzerland	1%

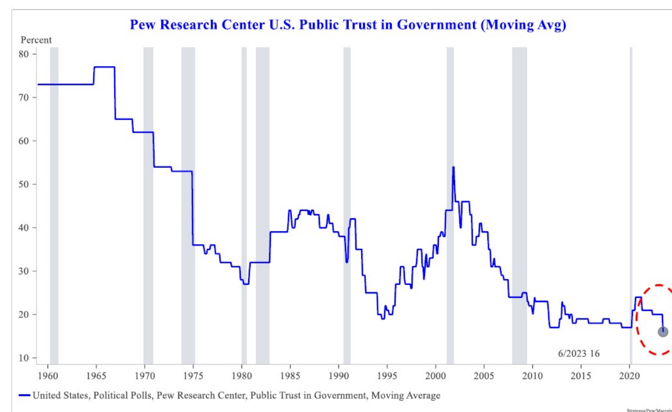
* MSCI Indices

Source: Roth MKM

Microsoft is the single largest stock in the U.S market which is almost double the size of the entire S&P 500 Energy sector. However, the free cash flow contribution by the Energy sector is more than double that of Microsoft. You know what the flavor of the day is.

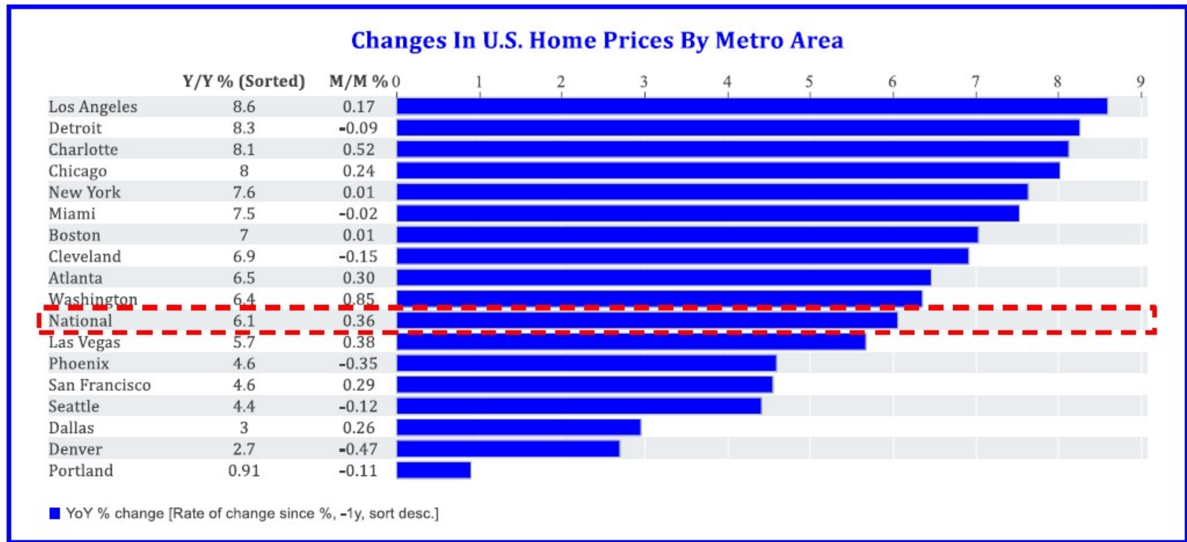


Although the chart below really doesn't have any impact on the economy, we thought that it was interesting in an election year. The public trust of the government has waned consistently since after World War II to an all-time low.



Source: Strategas

Despite mortgage rates more than doubling over the past two years, home prices nationally have continued to rise due to tight supply dynamics. It's surprising to see some of the cities at the top of this list.



Source: Strategas Research

The table below shows the performance of the S&P 500 following strong starts to the year like in 2024 (+10.5%). The average performance for the balance of the year is +7.4%, and there has only been one negative year in 1987, which significant tax law changes impacted.

Forward S&P Performance Following Strong 1Q

Rank	Year	1Q	2Q	3/31 to 12/31
1.	1975	21.6%	14.2%	8.2%
2.	1987	20.5%	4.2%	-15.3%
3.	1976	13.9%	1.5%	4.6%
4.	1991	13.6%	-1.1%	11.2%
5.	1998	13.5%	2.9%	11.6%
6.	1986	13.1%	5.0%	1.4%
7.	2019	13.1%	3.8%	14.0%
8.	1967	12.3%	0.5%	7.0%
9.	2012	12.0%	-3.3%	1.3%
10.	1961	12.0%	-0.6%	10.0%
11.	2024	10.2%	--	--
12.	2013	10.0%	2.4%	17.8%
13.	1971	9.0%	-0.6%	1.6%
14.	1995	9.0%	8.8%	23.0%
15.	1983	8.8%	9.9%	7.8%
		Average	3.4%	7.4%

Source: Strategas Research

Stock Market Trivia

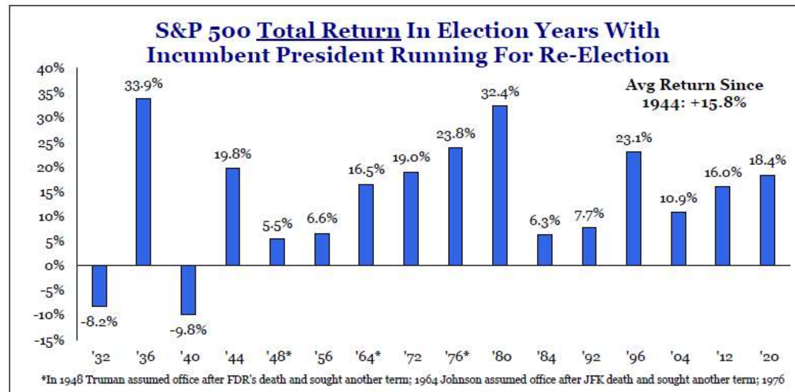
Each quarter we offer a piece of market trivia that we believe is interesting or timely, or both. This quarter we are focusing on the years when small caps outperformed large caps. If the market is going to broaden out, it will likely require a rotation down cap with investors trimming large cap positions in favor of small caps. The table below shows all the years in which the Russell 2000 Small Cap Index outperformed the S&P 500 Large Cap Index since 1979 (Russell 2000 Index inception). Interestingly small caps have outperformed large caps 25 times in the last 44 years or 57% of the time. They outperformed in these 25 years by an average of 8% per year. You would never know that small caps have had such a successful track record when we look at the last decade or so. The years outlined in red in the chart below are election years. Interestingly, small caps have outperformed large caps in nine of the last 11 election years by an average of +6.6% during those election years. This fact is particularly relevant given that 2024 is an election year. If this trend is going to hold, small cap stocks have their work cut out for them as they currently trail large caps by 5.4% after the first quarter. The stage is set for small caps as they're valued significantly lower than large caps, and their earnings growth is expected to outpace large caps as we enter the second half of the year. Small caps can move rapidly but it may take a catalyst, like the Fed to start cutting interest rates, to spur them on to victory for the year.

Years When Small-caps Outperformed Large-caps

Years When RTY Outperformed SPX (1979-YTD)				
Year	Annual Return			Fed Fund Rate Changes (bps)
	SPX	RTY	RTY Outperform SPX	
1979	12.31%	37.97%	25.66%	400
1980	25.77%	33.78%	8.01%	400
1981	-9.73%	-1.50%	8.23%	-600
1982	14.76%	20.66%	5.90%	-350
1983	17.27%	26.29%	9.02%	100
1985	26.33%	27.96%	1.62%	-50
1988	12.40%	22.42%	10.02%	187
1991	26.31%	43.35%	17.05%	-300
1992	4.46%	16.52%	12.06%	-100
1993	7.06%	17.26%	10.21%	0
1999	19.53%	19.59%	0.07%	75
2000	-10.14%	-4.32%	5.82%	100
2001	-13.04%	1.02%	14.06%	-475
2002	-23.37%	-21.58%	1.79%	-50
2003	26.38%	45.37%	18.99%	-25
2004	8.99%	17.00%	8.00%	125
2005	3.00%	3.32%	0.32%	200
2006	13.62%	17.00%	3.38%	100
2008	-38.49%	-34.80%	3.69%	-400
2009	23.45%	25.21%	1.76%	0
2010	12.78%	25.31%	12.52%	0
2012	13.40%	14.64%	1.23%	0
2013	29.60%	37.00%	7.40%	0
2016	9.54%	19.48%	9.94%	25
2020	16.26%	18.36%	2.10%	-150
Average	9.14%	17.09%	7.95%	-31.52
Median	12.78%	19.48%	8.00%	0
% Positive	80.0%	84.0%	100.0%	40.0%
Maximum	29.60%	45.37%	25.66%	400
Minimum	-38.49%	-34.80%	0.07%	-600

Source: Piper Sandler Technical Research/Bloomberg   # of occurrences: 25

The chart below shows the S&P 500's total return in election years when an incumbent President is running for election as in 2024. Note that the average return has been +15.8% in these years, and we haven't seen a negative performance in these election years since 1940.



Source: Strategas Research

We hope that you found our first quarter 2024 review and updated 2024 outlook newsletter to be insightful and interesting. Should you have any questions about anything discussed herein or would like more information about 1492 Capital Management, please call us at 414-276-1492.

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