1492 CAPITAL MANAGEMENT

DISCOVERING OPPORTUNITY

JUNE 2024 • VOL. 17 • ISSUE 6

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 second 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.

Status Quo for the Quarter, but Change is Coming on the Horizon

The June quarter was more of the same that we've experienced in the recent past with subdued and gradually falling inflation, the Fed on hold with interest rate cuts, large caps outperforming small caps, and the Magnificent 7 stocks driving the bulk of stock market returns in the quarter and year-to-date. The top 10 stocks by market cap have accounted for 77% of the S&P 500's return so far this year. Additionally, Nvidia, the AI darling, has generated 31.6% of the S&P 500's year-to-date returns and has flirted with being the largest stock in market capitalization terms over the past month. It surpassed both Microsoft and Apple for a time. All three of these stocks are now part of the exclusive $3 trillion market cap club (see our trivia section for some interesting tidbits about companies of this size). Appreciation in the stock market hasn't translated to inflation in the economy. The latest reading of the Fed's favorite inflation gauge, the Core PCE Price Index, has continued to gradually fall to 2.57% last month, which is within spitting distance of the Fed's 2% target. As a result, interest rate cuts are likely on the near-term horizon (our guess is September) as consumer weakness is starting to appear in demand trends for some of the most recognizable consumer brands in the world. Nike, Starbucks, Walgreens, and Lululemon to name just a few have reported slowing sales trends of late and have seen their stocks get slammed as a result. Economic data points are weakening as savings from the COVID era are depleted, and high interest rates are freezing the housing and automotive markets as consumers wait and hope for lower rates. The upcoming presidential election will likely throw some uncertainty into the mix as we head into the fall, and President Biden's now infamous debate performance will enhance it. Nevertheless, the returns so far this year have exceeded the typical election year returns which tend to be more back half loaded. The stock market in the quarter was mixed as tech titans continue to drive large caps. The S&P 500 rose +4.3%, and the NASDAQ Composite jumped +8.5%, which pushed it back ahead of the S&P 500 on a year-to-date basis with returns of +18.6% and +15.3%, respectively. However, small caps continue to languish with quarterly and year-to-date returns for the Russell 2000 of -3.3% and +1.7%.

Artificial intelligence (AI) has caught the imagination of the stock market and while initial returns have accrued to a select few players, we'll discuss opportunities that we see as the theme broadens out. 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.

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: Status Quo For the Quarter, but Change is Coming on the Horizon

The June quarter was more of the same that we've experienced in the recent past with subdued and gradually falling inflation, the Fed on hold with interest rate cuts, large caps outperforming small caps, and the Magnificent 7 stocks driving the bulk of stock market returns in the quarter and year to date. The top 10 constituents of the S&P 500 index, and the table below right shows the contribution of the largest ten stocks so far this year compared to other years with significant concentration of returns.

Top	Stock	Market Cap ($Tn)	Cumulative Market Cap Weight	Cumulative Net Income Weight	Profit Margin LTM	Earnings Growth LTM
1	MSFT	3.3	7%	5%	36%	25%
2	NVDA	3.1	14%	7%	53%	791%
3	AAPL	3.1	21%	13%	26%	9%
4	AMZN	1.7	25%	15%	6%	769%
5	META	1.1	27%	18%	32%	121%
6	GOOG	1.9	31%	23%	26%	45%
7	AVGO	0.7	33%	23%	24%	-27%
8	BRK.B	0.7	34%	27%	20%	877%
9	LLY	0.7	36%	28%	17%	8%
10	JPM	0.6	37%	31%	20%	22%

Source: Strategas

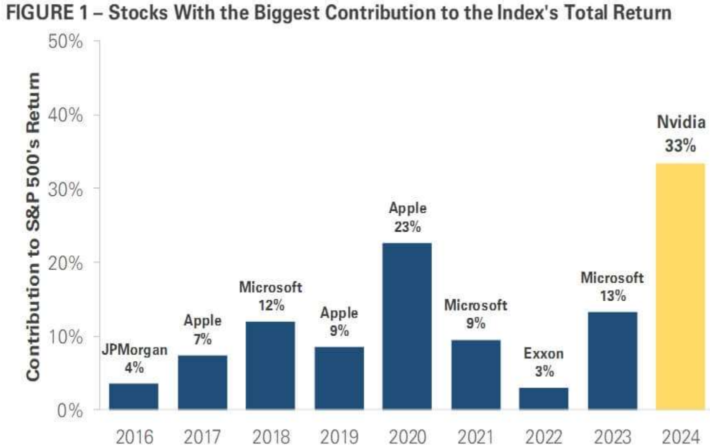
Annual S&P 500 Contribution of 10 Largest Weights During Positive Performance Years

Year	Top 10 as % of Total	S&P 500 % Perf.
2007	78.7%	3.5%
2024	77.2%	14.5%
2023	68.4%	24.2%
2020	58.9%	16.3%
1999	54.5%	19.5%
2021	45.0%	26.9%
1998	36.8%	26.7%
1996	33.9%	20.3%
2017	33.3%	19.4%
2019	32.8%	28.9%
1991	28.6%	26.3%
2006	27.6%	13.6%
2016	26.6%	9.5%
2003	23.6%	26.4%
1995	22.3%	34.1%
2014	22.2%	11.4%
2004	21.1%	9.0%
2005	20.5%	3.0%
2010	19.6%	12.8%
2012	19.2%	13.4%
1997	19.1%	31.0%
2013	17.6%	29.6%
2009	15.5%	23.5%
1992	14.9%	4.5%
1993	12.2%	7.1%

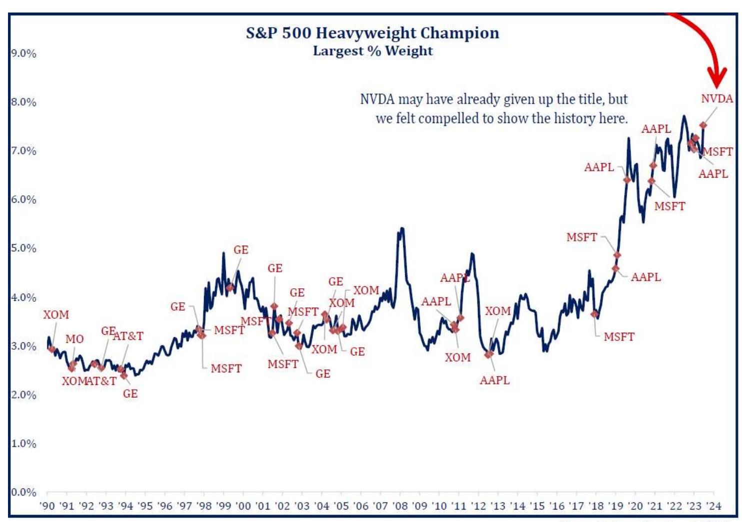
Source: Strategas, Bloomberg, 7/1/24

Additionally, Nvidia, the AI darling, has generated 31.6% of the S&P 500's returns year-to-date and has flirted with being the largest stock in market capitalization terms over the past month. It surpassed both Microsoft and Apple for a time. All three of these stocks are now part of the exclusive $3 trillion market cap club (see our trivia section for some interesting tidbits about companies of this size). The chart below left shows the largest contributors to the S&P 500's overall return for each year going back to 2016. Nvidia has been dominant in 2024 as the chart shows and this performance is only through the first six months. The chart on the right shows the largest single stock each year back to 1990. Note that stocks like Microsoft and Exxon have led in several different periods through history, which is a sign of a truly great company. Time will tell if Nvidia can hold its top spot over a longer period.

FIGURE 1 – Stocks With the Biggest Contribution to the Index's Total Return

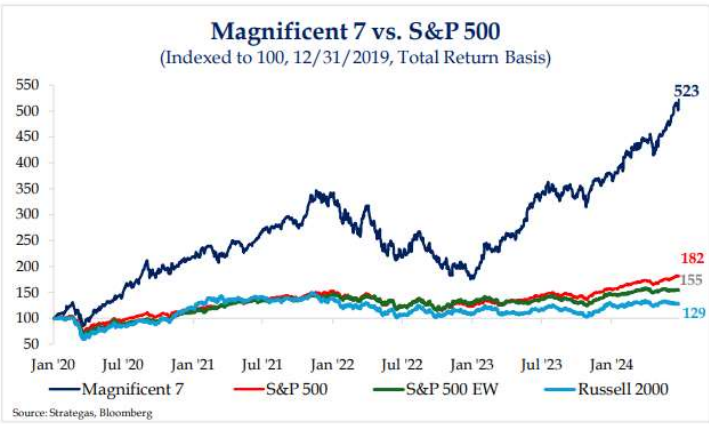


Source: Standard & Poor's. Data from January 1, 2016 to June 13, 2024.

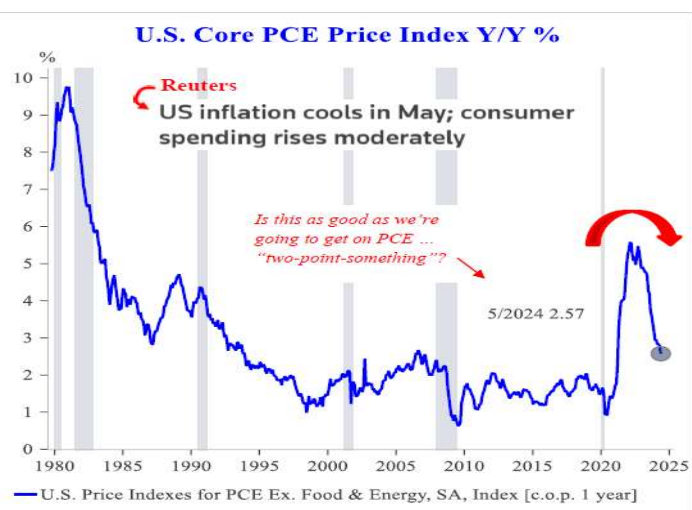


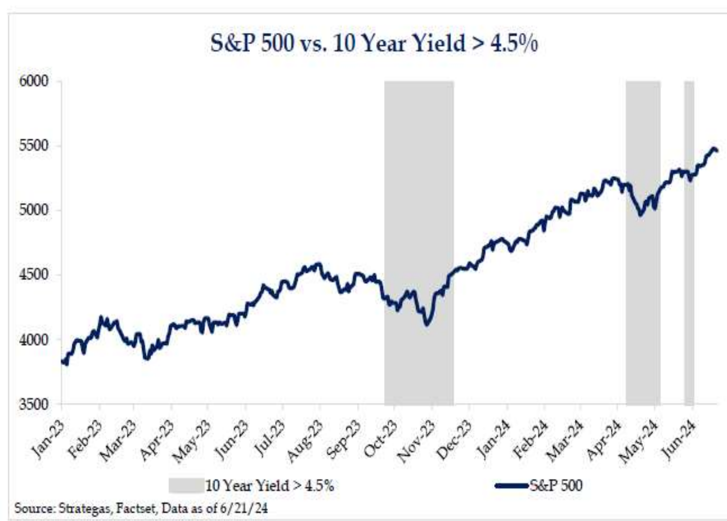
Source: Strategas, Bloomberg, 6/20/24

The performance of the largest stocks in the world has been a true phenomenon to watch over the past decade as the single largest stock has rotated between Apple and Microsoft. However, the speed of innovation and a new era of computing have catapulted Nvidia to the top of the ranks rather quickly and has resulted in $1 trillion of market cap gains in a month. The performance of the Magnificent 7 stocks over the past five years has been extraordinary as size hasn't stifled innovation and growth. The chart below left highlights how top-heavy the stock market has been since 2020 with the Magnificent 7 easily outperforming the broader S&P 500 and Russell 2000 over this timeframe. However, as the chart shows, 2022 wasn't great with many of the Magnificent 7 down 30%+ on the year. It should come as no surprise as to why they have reasserted themselves as the stock market leaders. It's fundamental earnings growth that is lacking elsewhere in the stock market as shown in the chart on the right. This chart shows that the Mag 7 earnings grew 52% year over year in the first quarter of 2024, whereas the remaining 493 constituents of the S&P 500 saw a decline of nearly -9%. We expect this to change as we move through the balance of the year and into 2025. Please see our outlook section entitled "Change is on the Horizon - Small Caps Should be the Beneficiary" where we present a possible changing of the guard for the stock market.

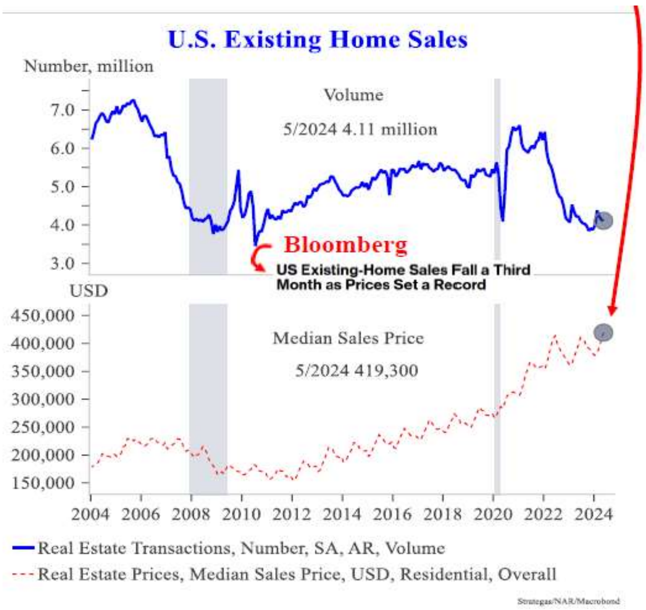


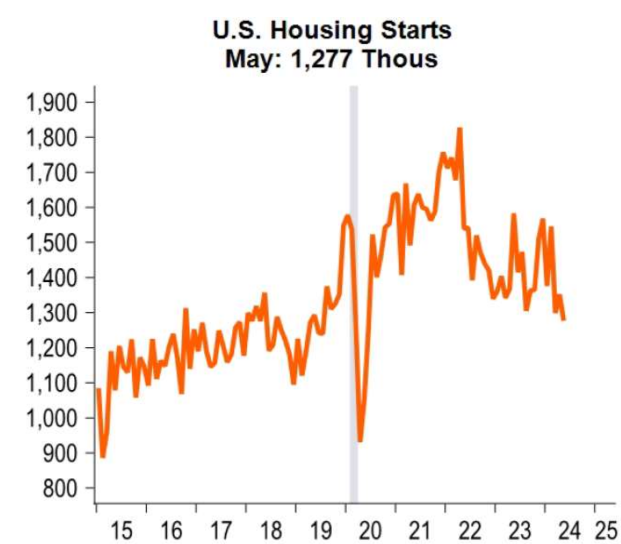
Appreciation in the stock market hasn't translated to inflation in the economy as the latest reading of the Fed's favorite inflation gauge, the Core PCE Price Index, has continued to gradually fall to 2.57% last month, which is within spitting distance of the Fed's 2% target and near levels seen for much of the past 20 years as shown in the chart below left. As a result, we believe interest rate cuts are likely on the near-term horizon (our guess is September) as consumer weakness is starting to show up in demand trends for some of the most recognizable consumer brands in the world including Nike, Starbucks, Walgreens, and Lululemon, to name just a few that have reported slowing sales trends of late and have seen their stocks get slammed as a result. Economic data points are weakening as savings from the COVID era are depleted and high interest rates are freezing the housing and automotive markets as consumers wait and hope for lower rates. The level of interest rates has been a key determinant for the stock market direction over the past 18 months. As you can see on the chart below right, when the yield on the 10-Year Treasury note has exceeded 4.5% (at 4.4% as I write this), the stock market has retreated as shown in the periods with gray shading. There is a clear Jekyll and Hyde phenomenon going on here, and 4.5% seems to be the operative threshold for the stock market.





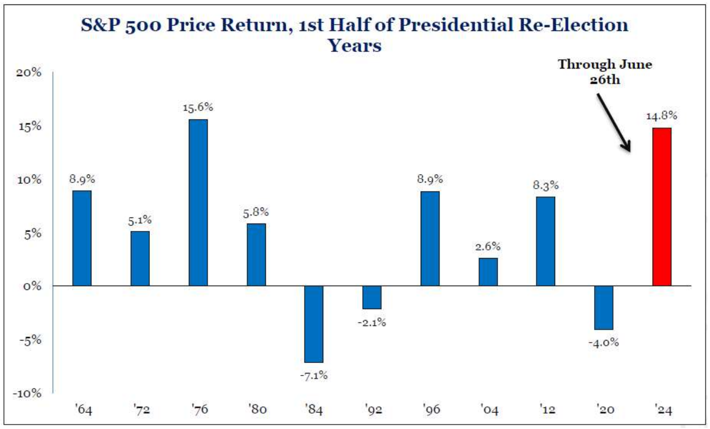
Signs are mounting that high interest rates continue to impact rate-sensitive parts of the economy, and housing is the most rate-sensitive area for the U.S. consumer. The spring selling season is traditionally the strongest period for new and existing home sales, and this year's volumes were very subdued. The chart below left shows both the volumes of existing home sales (top panel) and median home prices (bottom panel). The lower volume of sales is due to the fact that consumers haven't quite adjusted to higher rates. Mortgage rates for much of the past 15 years have been significantly lower following the Great Financial Crisis in 2009 and COVID in 2020, and most homeowners refinanced or bought a new home with a 3% + / - mortgage rate. However, despite lower demand for houses, sales prices continue to escalate as the cost of new builds is up nearly 40% over the past four years and has dragged the cost of existing homes up as well. Recall that the Fed started hiking interest rates in March 2022 and it was as if someone flipped off the home buying switch as shown in the U.S. housing starts chart below right. The third and fourth charts below show what happened to the monthly payment as prices escalated 40% in four years and as Fed Funds interest rates went from 0% to 5.5% in two years. *The monthly payment nearly tripled for the median house between 2020 and 2024*. The current 30-year mortgage rate is hovering just above 7% and it appears that there is a psychological level that starts with a "6% handle" in which buyers are willing to engage in home buying. As we said in last quarter's newsletter, as long as there aren't mass layoffs (we don't think this is the case as employers learned how hard it was to get employees following COVID), the economy should continue to move ahead at a slower pace until rates start to drop.

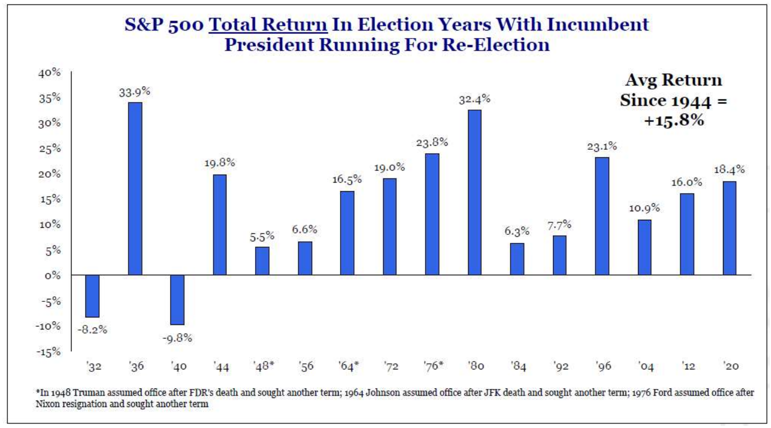




Source: PSC

The upcoming Presidential election will likely throw some uncertainty into the mix as we head into the fall, and President Biden's now-infamous debate performance will enhance it. Nevertheless, the returns so far this year have exceeded the typical election year returns, which tend to be more back half loaded as shown in the chart below left. However, as shown in the chart on the right, the average return for an election year since 1944 is +15.8%, which is just about where the S&P 500 sits as of June 30th.





Source: Strategas

As shown in the table below, the stock market in the quarter was mixed as tech titans continue to drive large caps. The S&P 500 rose +4.3%, and the NASDAQ Composite jumped +8.5%, which pushed it back ahead of the S&P 500 on a year-to-date basis with returns of +18.6% and +15.3%, respectively. However, small caps continue to languish with quarterly and year-to-date returns for the Russell 2000 of -3.3% and +1.7%, respectively. The first six-month return of the Russell 2000 relative to the S&P 500 was the fourth worst on record. 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 17% below its 2021 high. The S&P 500 has now posted positive performance in seven of the last eight months which began in November on the heels of the Fed pivot.

Index Returns

Index	Second Qtr. 2024 Return	2024 YTD Return
Russell 2000	-3.28%	+1.73%
Russell 2000 Growth	-2.92%	+4.44%
Russell 2000 Value	-3.64%	-0.85%
S&P 500	+4.28%	+15.29%
Dow Jones Industrials	-1.73%	+3.79%
NASDAQ Composite	+8.47%	+18.57%

Source: 1492 Capital Management, LLC and FactSet

From a style perspective, the Russell 2000 Growth Index (-2.9%) beat the Russell 2000 Value Index (-3.6%) for the quarter. The significant drop in April was too much to overcome for the small-cap indices where a few large constituents, namely Super Micro Computer and MicroStrategy, very much influenced results. These stocks held on to much of their gains before being pushed out of the Russell 2000 indices as of June 30th due to their oversized market caps. Much of the disparity between the year-to-date growth and value indices returns can be traced to these two stocks being in the Rusell 2000 Growth Index and not in the Russell 2000 Value Index. The best performing sectors in the Russell 2000 for the quarter were two risk-off sectors, namely Consumer Staples (+2.3%) and Utilities (+0.1%), and they were the only two sectors that posted positive results for the quarter as well. This result is much different than in the S&P 500 where Technology was the leader. On the negative side of the ledger were Consumer Discretionary (-6.0%) and Industrials (-4.4%), which are both highly sensitive to interest rates and show there is fear of a slowing economy. The table immediately below highlights the performance of the Russell 2000 style indices by sector for the second quarter and year-to-date 2024. The second table below shows that there continues to be a significant market cap skew in the quarter and year-to-date numbers as the performance was significantly worse moving down the market cap spectrum.

Russell 2000:

Table 9 - Russell 2000 Scorecard through June 28th

	June			2nd Quarter			Year to Date			
GICS Sector	**Absolute**	**Contribution**	**Relative**	**Absolute**	**Contribution**	**Relative**	**Absolute**	**Contribution**	**Relative**	**Wgt**
Com Serv	-0.18	0.00	0.78	-0.65	-0.01	2.66	-5.47	-0.13	-7.18	2.2
Discretionary	-1.94	-0.21	-0.99	-6.02	-0.64	-2.71	-0.66	-0.03	-2.37	10.4
Staples	0.61	0.02	1.56	2.28	0.09	5.58	6.91	0.24	5.21	3.5
Energy	-4.04	-0.30	-3.08	-2.77	-0.23	0.54	8.76	0.56	7.06	7.5
Financials	0.50	0.09	1.45	-1.78	-0.19	1.53	-3.17	-0.55	-4.87	16.0
Health Care	1.23	0.18	2.19	-4.28	-0.66	-0.98	0.48	0.12	-1.23	15.2
Industrials	-3.07	-0.54	-2.12	-4.42	-0.81	-1.11	3.92	0.69	2.22	17.2
Info Tech	1.25	0.19	2.21	-2.92	-0.49	0.39	9.54	1.33	7.84	15.3
Materials	-7.64	-0.38	-6.68	-4.23	-0.20	-0.92	-0.88	-0.06	-2.59	4.5
Real Estate	1.27	0.07	2.22	-3.29	-0.18	0.02	-4.94	-0.34	-6.64	5.6
Utilities	-2.83	-0.08	-1.87	0.13	0.02	3.43	-3.46	-0.11	-5.17	2.6
Size Quintile	**Absolute**	**Contribution**	**Relative**	**Absolute**	**Contribution**	**Relative**	**Absolute**	**Contribution**	**Relative**	**Wgt**
1 (Largest)	-0.71	-0.40	0.25	-2.94	-1.73	0.36	4.32	2.45	2.62	58.8
2	-0.34	-0.08	0.62	-2.09	-0.44	1.22	2.26	0.55	0.56	23.0
3	-2.27	-0.26	-1.32	-5.45	-0.64	-2.14	-5.61	-0.71	-7.32	11.2
4	-3.15	-0.17	-2.20	-6.84	-0.37	-3.54	-5.86	-0.35	-7.56	5.0
5 (Smallest)	-2.00	-0.04	-1.05	-5.99	-0.12	-2.68	-0.16	-8.57	1.98	0.0

Source: Jefferies

Returns in the international markets were generally negative with European markets concerned about the impending elections in France, and Japanese indices worried over interest rates and the Yen's weakness. India was the strongest performer by far and continues its multiyear winning streak as companies move to that market for growth and as an alternative to China. China's markets continue to languish on slowing GDP and real estate woes. Bond market returns were generally mixed on a relative basis as interest rates were volatile during the quarter. From a commodity perspective, natural gas was a clear standout after being pummeled late last year and into the first part of 2024 as supply looks to be more in line with demand going forward. Lumber remains weak as homebuilding continues to soften as mentioned above.

Index	Second Qtr. 2024 Return	2024 YTD Return
France	-6.6%	+1.9%
Germany	-1.4%	+8.9%
Brazil	-3.3%	-7.7%
India	+10.3%	+17.4%
China- A Shares	-1.4%	-0.1%
China- Shenzhen A Shares	-6.6%	-11.0%
Japan	-1.3%	+19.1%
Long-Term Treasuries (TLO)	-2.6%	-6.9%
Investment Grade Corp Bonds	+0.2%	-0.6%
Gold	+4.5%	+12.3%
Volatility- VIX index	-4.4%	-0.2%
Oil	-2.0%	+13.6%
Natural Gas	+47.4%	+9.3%
Lumber	-23.0%	-17.6%

Source: 1492 Capital Management, LLC

Thematic Investing: The Next Step in the Evolution of AI

A few select companies have seen tremendous success as the first inning of the AI tech revolution has begun with Nvidia as the poster child for AI. Nvidia sells GPU's (Graphic Processing Units) which are the core processing power of AI installations. Their revenues have exploded from $26 billion in their fiscal year ended January 2023 and are expected to reach more than $120 billion in their fiscal year ended January 2025, which is nearly a fivefold increase in two years. This growth is amazing, particularly considering the size of their revenue base. They are clearly in the pole position for targeted AI spending over the near term, and few other companies have seen even a fraction of this growth. The spending pattern that is taking place now, primarily by the hyperscalers like Microsoft, Meta, Amazon, and Google, is unsustainable as there is a race to be the first company to figure out a business model based on the power of AI and advanced computing power. Their capex plans won't continue to triple and quadruple each year as they have this year, and their focus will turn to how to make money off their AI data centers and large language models that they've developed. Therefore, beneficiaries downstream will begin to emerge as AI business models and applications are refined. While we're not calling for an Nvidia downturn imminently, we expect that sometime in the next year, the cyclicality that is inherent in the semiconductor industry will return. A stock like Nvidia which is currently trading at a Price/Earnings ratio of 48, will likely start to see compression of that multiple as sales begin to slow as spending moves elsewhere in the AI chain. The key then is what will be the next set of opportunities in the AI evolution?

The Next Steps in the AI Evolution: Industries Poised for Transformation

As the deployment of GPUs catalyzes the current wave of advancements in artificial intelligence, attention is turning towards the next frontiers of innovation. Industries across the spectrum are gearing up to harness the power of AI in increasingly profound ways with significant implications for their operations and growth strategies.

Emerging Industries Poised for AI-Driven Transformation

1. Healthcare: AI's potential to revolutionize healthcare is immense with applications ranging from diagnostics and personalized medicine to operational efficiencies in hospitals and clinics. Investment in AI-powered medical imaging, drug discovery, and patient care management systems is expected to surge as healthcare providers seek to enhance outcomes and reduce costs.

2. Financial Services: In finance, AI is already being leveraged for fraud detection, algorithmic trading, and customer service automation. The next wave will likely see deeper integration of AI into risk management, credit scoring, and regulatory compliance processes and drive efficiency and improve decision-making in a highly data-driven industry.

3. Manufacturing and Logistics: Industries involved in manufacturing and logistics are increasingly adopting AI to optimize supply chain operations, predict maintenance needs, and enhance product quality through predictive analytics and autonomous systems. The use of AI in robotics and IoT (Internet of Things) devices is set to redefine how factories and warehouses operate and drive productivity gains and cost savings.

4. Retail and E-commerce: In retail, AI is poised to transform customer experience through personalized recommendations, virtual shopping assistants, and inventory management systems that predict demand patterns. Retailers are also exploring AI-driven solutions for dynamic pricing, fraud prevention, and supply chain optimization to stay competitive in a rapidly evolving market.

5. Agriculture: Agriculture is another sector where AI holds great promise in precision farming techniques that optimize crop yields and reduce environmental impact and in autonomous agricultural machinery that improves efficiency and labor productivity. AI-powered systems for crop disease detection and soil analysis are expected to become integral to modern farming practices.

The Role of GPUs and Beyond

While GPUs have been instrumental in accelerating AI research and applications, the future evolution of AI will likely see advancements in specialized hardware such as TPUs (Tensor Processing Units) and in custom AI chips tailored to specific tasks. Moreover, the integration of AI with emerging technologies like quantum computing and edge computing will open up new frontiers for innovation across industries.

As we look ahead, the AI revolution promises to reshape industries in profound ways, drive efficiencies, unlock new insights from data, and create entirely new business models. Organizations that strategically invest in AI technologies and talent stand to gain a significant competitive advantage in the digital economy of the future.

Consulting Firms and Software Companies: A Beneficiary of Increased AI Spending

Before any of the above industries can maximize the power in AI computing, many companies operating within those industries will hire consultants and software companies that focus on implementing AI solutions and specialized software vertical platforms that are industry specific. Consulting firms and software companies are well-positioned to capitalize on the burgeoning demand for AI solutions across various industries. Here's how they stand to benefit:

1. Strategic Consulting: Consulting firms specializing in technology and digital transformation will play a crucial role in advising organizations on how to effectively integrate AI into their business processes. They will provide strategic guidance on AI adoption, implementation roadmaps, and organizational change management and help companies navigate the complexities of AI deployment.

2. AI Software Development: Software companies focused on AI development will experience heightened demand for advanced AI algorithms, platforms, and applications tailored to specific industry needs. These companies will innovate in areas such as natural language processing, computer vision, and machine learning frameworks and offer scalable and customizable solutions to enterprises.

3. Data Analytics and Insights: Consulting firms and software providers that offer sophisticated data analytics capabilities will see increased demand for AI-driven insights. They will help organizations derive actionable intelligence from vast datasets, enabling better decision making and drive operational efficiencies across sectors like marketing, customer service, and supply chain management.

4. Training and Talent Development: As AI adoption accelerates, there will be a growing need for skilled AI professionals. Consulting firms and training providers specializing in AI education and talent development will play a pivotal role in upskilling existing workforce and preparing future AI experts to meet industry demands.

Conclusion

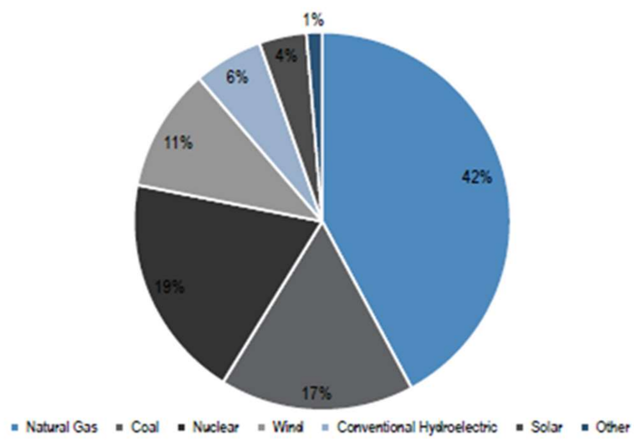
As we anticipate the next phase of the AI revolution beyond GPU deployment, consulting firms and software companies are poised to thrive by facilitating AI adoption, developing cutting-edge solutions, and empowering businesses to leverage AI for competitive advantage. Their expertise will be instrumental in shaping the transformative impact of AI across industries and pave the way for a future of intelligent automation and data-driven decision making. At 1492 Capital Management, we are increasingly seeing opportunities to take positions in companies that will likely benefit from the next stage of AI spending.

In full disclosure, to demonstrate the power of AI, we used ChatGPT to craft much of the above section on the evolution of AI after giving it a few simple prompts. We made a few simple edits to the ChatGPT output, but much of what you just read in this section was produced using AI, and we agreed with most of what it produced in a matter of seconds. This exercise is just a small example of how AI will create efficiencies for those willing to push the boundaries.

Thematic Investing: Natural Gas Boom for Electricity Supply to Burgeoning Datacenter Growth

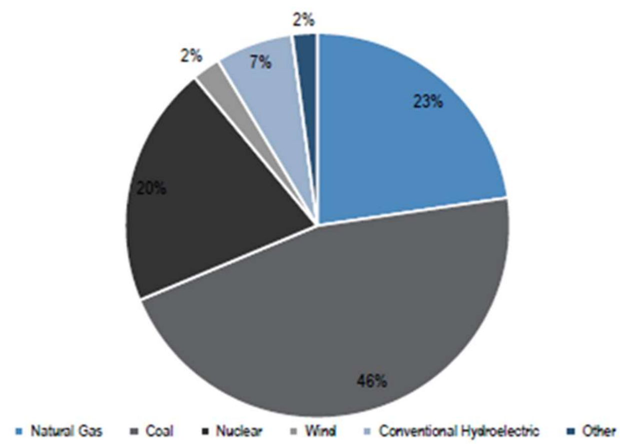
As we discussed in our first quarter newsletter, electricity demand in the U.S. is emerging from its decade long slumber of flattish growth to a more robust pace due to the proliferation of datacenters needed for the increase in processing power associated with the rapid expansion of artificial intelligence (AI) applications. With coal in decline and new hydro and nuclear facilities very unlikely in the near-term, the power source for this incremental demand is largely left to natural gas and renewables. As the proverbial Saudi Arabia of natural gas, we believe that our abundant domestic reserves will serve as the key raw material to generate the incremental U.S. power load. A datacenter operation demands five 9's (99.999%) uptime in its operation, and U.S natural gas offers that consistency of supply. In fact, natural gas as a percentage of U.S. electric power generation has increased from 18 Bcf (billion cubic feet) per day in 2010 to 35 Bcf per day in 2023 according to J.P. Morgan research. As seen in the charts below, natural gas was counted on over this time period to pick up the drop off in coal fired power generation due to the closing of many of those facilities.

Figure 7: U.S. Power Generation Mix - 2023



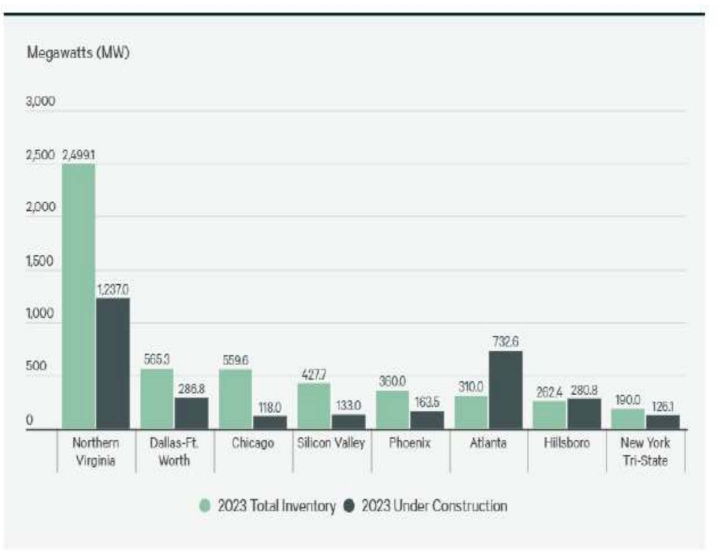
Source: EIA.

Figure 8: U.S. Power Generation Mix - 2010



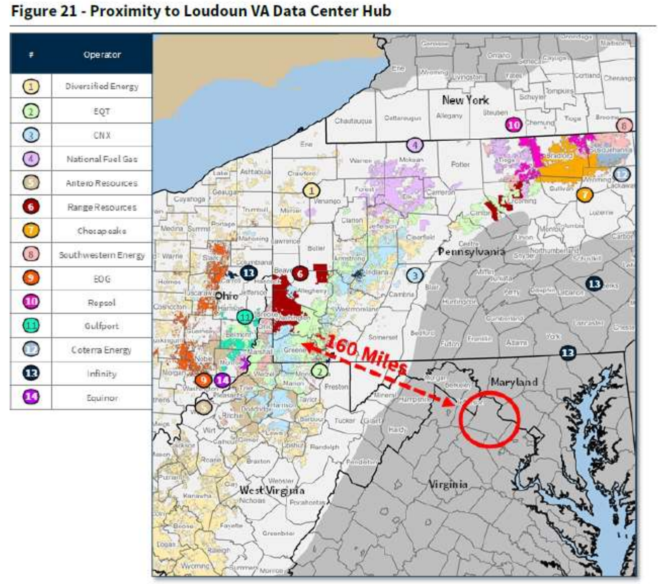
Source: EIA.

While we have no doubt that a large portion of the power generated for new datacenters will come from solar and wind, natural gas power will also serve as a backup supply to provide the consistent source of electricity that these facilities demand.
These datacenters are being constructed in areas of the U.S. where there is ample natural gas for electricity generation. One of the more robust areas of growth for datacenters is in northern Virginia, which has been dubbed "datacenter alley." As seen in the chart below left, this area has the greatest inventory of future megawatts needed in the U.S. for the datacenters under construction.



Source: CBRE Research, CBRE Data Center Solutions, 2H23

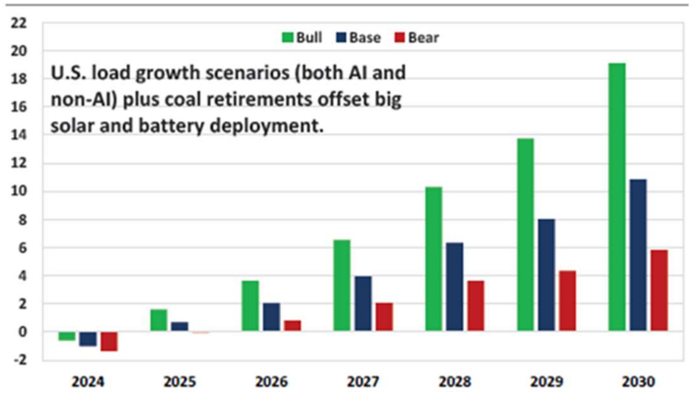
Figure 21 - Proximity to Loudoun VA Data Center Hub



Source: Enverus, Raymond James research

The good news is that natural gas production from the prolific Marcellus shale, which is pipeline constrained to move its natural gas down to the southern U.S., is available a short distance away in southwest Pennsylvania as seen in the chart above right. There are similar robust datacenter plans in Ohio to take advantage of the exact same natural gas dynamic. While there will be inevitable construction delays or cancellations, TD Cowen estimates that if these datacenters come to fruition in northern Virginia and New Albany, OH, each area's total electricity demand will outstrip supply in the winter of 2027 and summer 2028, respectively. They also estimate that third-party data centers will see their share of U.S. electricity consumption as a percentage of total consumption grow to 6.6% in 2028 from 1.5% in 2018. This datacenter and electricity demand growth help to contribute to a robust natural gas demand opportunity as seen in the chart below.

Figure 35 - U.S. Natural Gas Demand Opportunity (Bcf/d)



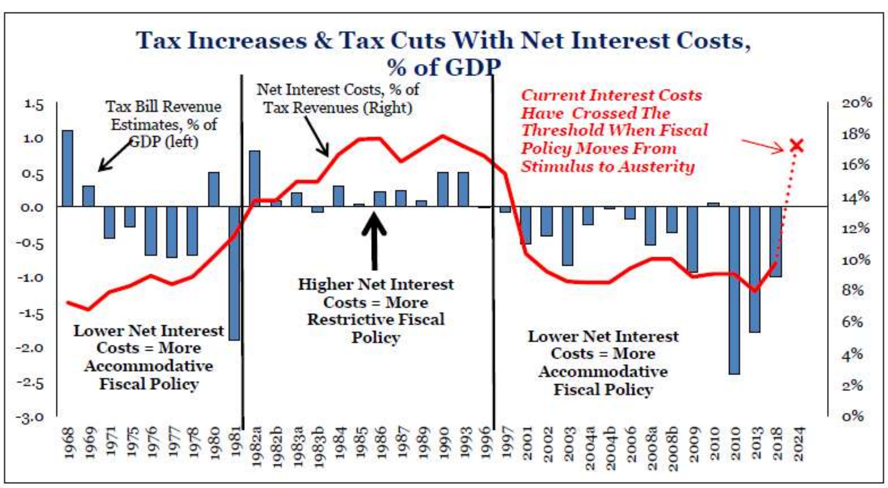
Source: EIA, Raymond James research

Raymond James research predicts that natural gas demand for U.S. electricity load growth (AI and non-AI) could expand to an incremental six Bcf per day in 2028 from a base of roughly 35.4 Bcf/d of U.S. natural gas deliveries to electric power customers in 2023 according to the U.S. Energy Information Administration (EIA) or roughly a 16% increase. When this power load demand is layered on to the rapid expansion of demand for natural gas for liquified natural gas (LNG) for export from the U.S., we see a robust multi-year investment theme in the growth of U.S. natural gas.

2024 Updated Outlook: Change is on the Horizon - Small Caps Should be the Beneficiary

As we stated at the outset of this newsletter, we believe that change is on the horizon related to several key stock market drivers. While it's hard to predict a specific period for each item for which we see change coming, we'll provide our thesis and our best guess as to timing.

1. Government / President: While we can't predict at this point who will be in the White House come January 2025, things will likely be very different politically, particularly if Trump takes the White House. Betting odds currently have him as the odds-on favorite. Regardless, whoever is in the Oval Office must address the burgeoning deficit and debt load ($34.6 trillion currently). If interest rates just stay flat from here, the interest cost as a percent of the U.S. Government's budget will exceed 20% by 2026. This percentage is unsustainable and will need to be addressed regardless of whoever occupies the White House. There are only two ways to solve the problem: 1. interest rates must come down; or 2. spending will need to drop. The chart below shows that fiscal policy becomes more restrictive when interest costs exceeded 14% of the budget historically. It's unlikely that interest rates will decline enough to solve the issue. It's likely to be a two-pronged approach with lower rates starting in September as the Fed starts to cut, and then fiscal policy will need to be dialed back starting in 2025. The good news for the stock market is that lower rates are generally helpful, and many of the spending initiatives that were put in place during COVID, like the Inflation Reduction Act, will continue on for a few more years before winding down.



Source: Strategas

2. Small caps historically rebound after a poor relative start to the year. As we noted earlier, small caps had one of their worst first half relative performance to the S&P 500. History shows that in the majority of the prior instances, small caps have posted strong relative performance averaging 4.7% in the back half of the year.

Table 2 - 6th worst relative start to new year, bodes well for 2H

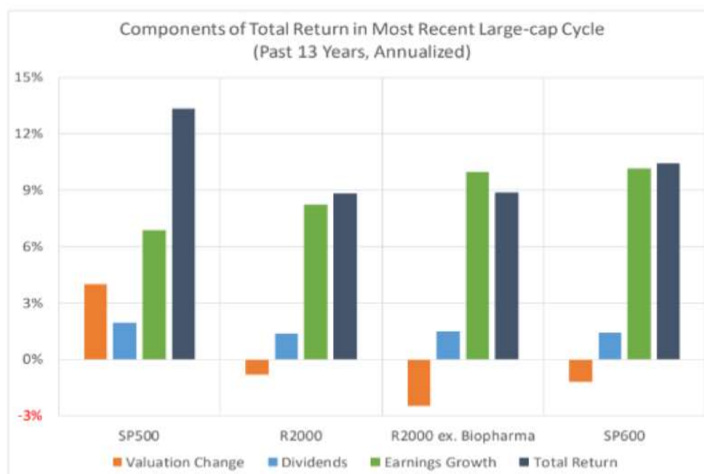
	1st Half			2nd Half		
Year	**Small**	**Large**	**Difference**	**Small**	**Large**	**Difference**
1973	-32.0	-10.0	-22.0	-3.5	-4.9	1.5
1929	-4.4	13.2	-17.6	-35.7	-20.5	-15.2
1935	-3.3	10.6	-14.0	66.5	30.5	36.0
1970	-33.7	-20.0	-13.8	36.0	27.7	8.3
1969	-17.5	-4.1	-13.4	-5.6	-3.3	-2.3
2024	**1.7**	**14.2**	**-12.5**	**?**	**?**	**?**
1998	7.3	18.7	-11.4	-6.3	10.7	-17.0
1939	-21.8	-12.3	-9.5	33.8	17.7	16.1
2020	-9.5	-0.9	-8.6	41.7	24.4	17.3
1947	-9.0	-0.5	-8.5	6.7	5.1	1.6
2023	9.7	18.1	-8.4	9.4	8.4	1.0
Average	**-10.2**	**2.5**	**-12.7**	**14.3**	**9.6**	**4.7**
Overall	**8.8**	**5.3**	**3.5**	**6.2**	**6.1**	**0.1**

Note: '24 is based on Russell 2000 and Russell 1000; all other years are CRSP data.

Source: Center for Research in Security Prices (CRSP®), The University of Chicago Booth School of Business; Jefferies

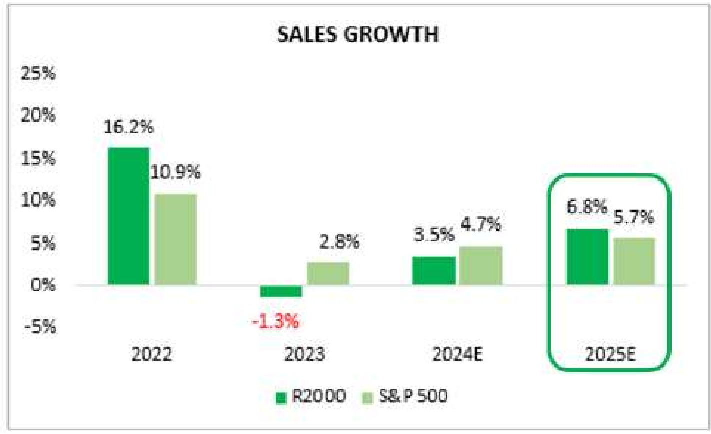
3. Earnings growth for all but the Magnificent 7 will likely accelerate as we enter the second half of the year as comparisons get easier, and interest rates are stable to falling. Regular readers of our newsletters will know that small caps have underperformed massively since the Great Recession of 2009 by an annual average of nearly -5% and are now approaching a two standard deviation event (see chart below left). However, I would bet that most wouldn't have guessed that earnings growth over the past 13 years was better for small caps than large caps (see chart below right). Everyone is so conditioned to think that earnings drive stocks (which is generally true), but they don't account for the concentration of that earnings growth, which has been mostly in some very large stocks that have had enormous valuation expansion (think Apple or Nvidia). While earnings growth may have been better for small caps over the past 13 years, valuations expanded tremendously for large caps compared with shrinking valuations for small caps.

Source: Strategas, FactSet, Russell 1000 Relative to Russell 2000, Data as of 5/31/2024



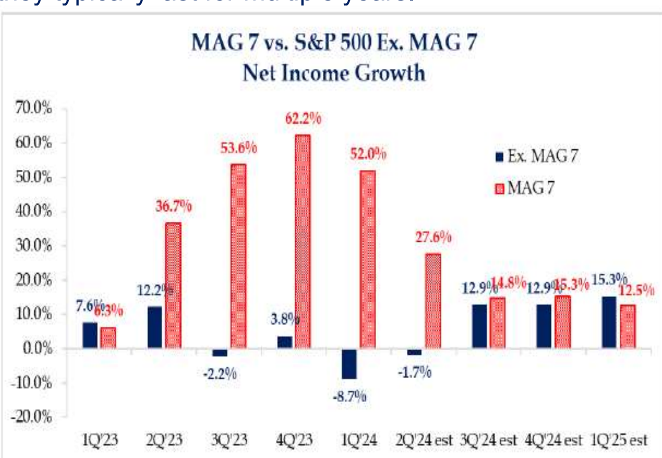
Source: FRP, FactSet; as of 3/28/24; Earnings and Valuation use Non-GAAP EPS

4. What is the catalyst for change? It's the rate of change of earnings growth in favor of small caps versus large caps which has been favoring the largest of the large caps for quite some time as we noted earlier. The sales and earnings growth projected by Wall Street analysts for small and large caps is expected to swing in favor of small caps over large caps. The chart below shows current consensus expectations for small and large-cap earnings and sales growth for 2024 and 2025. While these are less than perfect and are generally optimistic, it's the direction or rate of change that favors small caps ahead.

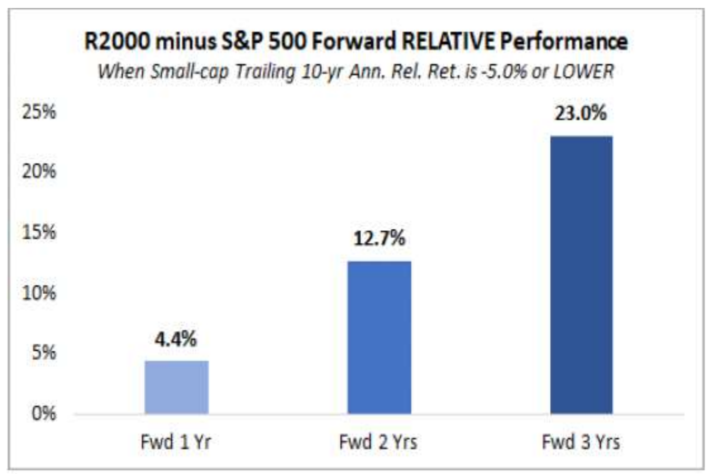


Source: Furey Research Partners and FactSet. Based upon our capitalized loss earnings model. '24E and '25E based upon current constituents. Data as of 5/6/24.

The Magnificent 7 has outperformed due to mega trends that generated powerful earnings growth. As we mentioned earlier in the case of Nvidia, comparisons are going to get much tougher as we get into the back half of 2024 and 2025. We're not calling for an outright shrinkage, but relative growth will become much more difficult as the law of large numbers comes into play. The chart below left shows this exact phenomenon. Earnings growth has been spectacular for the Magnificent 7 for all of 2023 and so far in 2024, but the comparisons are going to become much more difficult just as the comparisons ease for nearly all other stocks. This reversion to the mean theme and the prolonged drought for small cap stocks could be the catalyst for a new small-cap cycle. The chart below right shows the relative performance for small caps after trailing large caps by -5% per year on a trailing ten year basis. The prospects for starting a new small cap outperformance cycle are strong, and they typically last for multiple years.



Source: Strategas, FactSet. As of 6/25/24



Source: Furey Research Partners and FactSet. Data through 5/24/24.

Lastly, for those who don't want to look at what might change and are happy with the status quo, the chart below should give you comfort. The chart shows that after a strong first-half performance by the S&P 500, there is more in the tank over the next six months with an average return of +7.5% and a 79% chance of the period being positive. That's pretty encouraging.

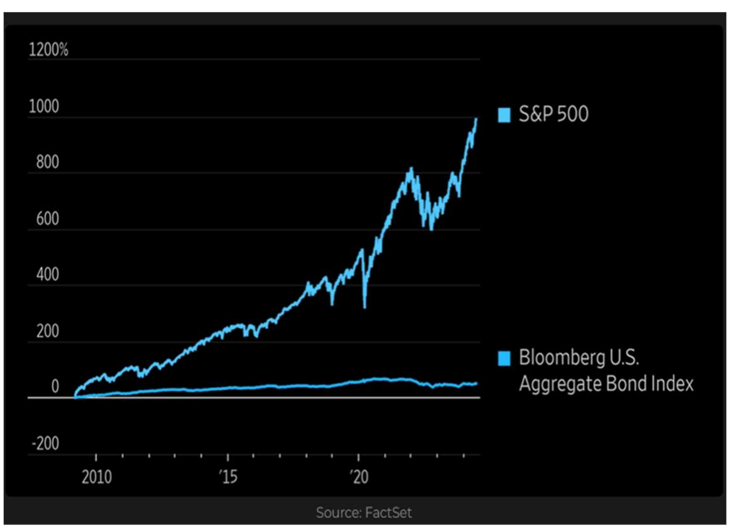
Forward S&P 500 Performance Following Strong 1st Half

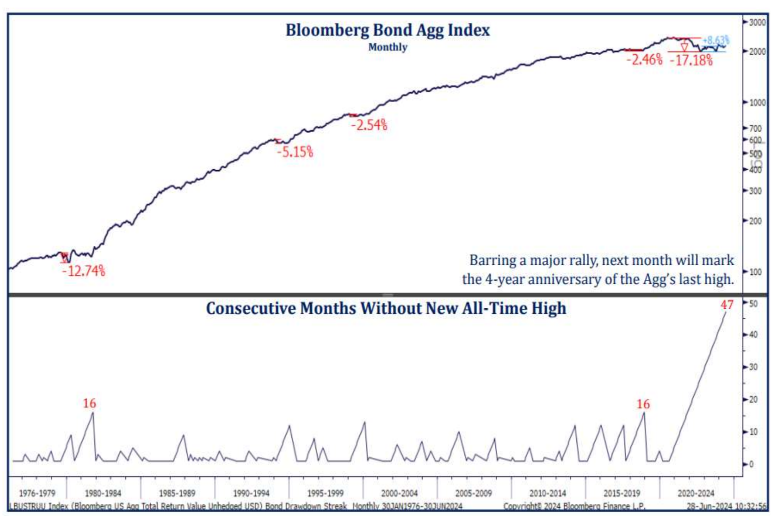
Rank	Year	1H Perf. %	+1 Month	+3 Months	+ 6 Months
1.	1975	38.8%	-6.7%	-11.9%	-5.7%
2.	1987	25.5%	4.6%	5.9%	-18.5%
3.	1983	19.5%	-3.6%	-1.2%	-1.9%
4.	1997	19.5%	7.6%	7.0%	9.7%
5.	1986	18.7%	-5.7%	-7.8%	-3.0%
6.	1995	18.6%	3.2%	6.8%	13.9%
7.	1954	17.7%	5.7%	10.6%	22.4%
8.	2019	17.3%	2.7%	1.2%	9.5%
9.	1998	16.8%	0.8%	-10.3%	8.7%
10.	2023	15.9%	3.1%	-3.6%	6.6%
11.	1976	15.6%	-0.8%	0.9%	2.5%
12.	1985	14.7%	-1.2%	-5.1%	10.1%
13.	2024	14.6%	?	?	?
14.	1989	14.5%	8.8%	10.3%	13.1%
15.	2021	14.4%	2.3%	0.2%	11.2%
16.	1955	14.0%	4.6%	6.4%	10.8%
17.	1958	13.1%	4.1%	10.7%	21.4%
18.	1967	12.8%	4.5%	6.3%	6.0%
19.	2013	12.6%	4.9%	4.7%	14.6%
20.	1991	12.4%	3.2%	4.5%	11.8%
		Average:	2.2%	1.9%	7.5%
		% Positive:	73.7%	68.4%	78.9%

Source: Strategas

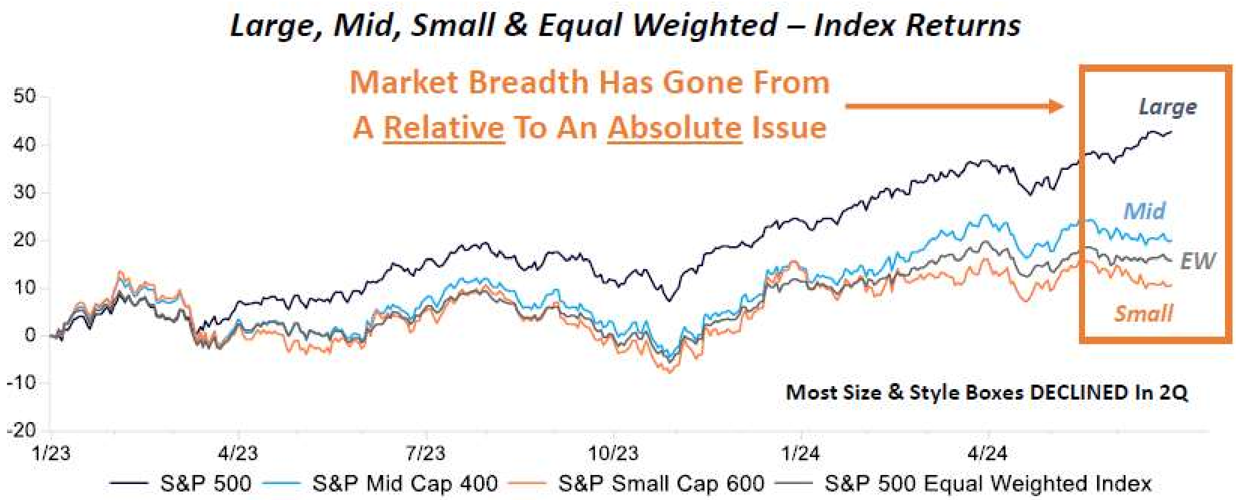
Wealth Management Monitor

As many of you know, 1492 Capital Management also offers a series of wealth management portfolios that are managed consistently with our small cap strategies through the use of thematic research and stock picking. However, we've never written specifically about issues impacting wealth management clients. Many of you will be familiar with the 60/40 equity/fixed income mix that many wealth management strategies revolve around for an investor who has a moderate appetite for risk. This 60/40 portfolio mix has not been working as planned for much of the past 15 years since the Great Recession of 2008/2009. The reason is that fixed income returns have been so poor because for much of this period, we were in a zero-interest rate environment as we recovered from the 2009 recession or the more recent Covid period. Traditional fixed income yields were so low that you basically earned nothing on any capital that was allocated to the fixed income side of the portfolio. Additionally, much of the fixed income gains in portfolios were historically generated from the appreciation of the principal of the fixed income instruments as interest rates have been in a bull market (lower rates) since the 1980's. Once you get to zero percent interest rates, there is no more juice left to squeeze. The chart below left demonstrates this phenomenon where the equity or stock part of the portfolio (S&P 500) was up over nine-fold since 2009, whereas fixed income only appreciated 40% over the same period. The chart on the right shows the bull market that fixed income markets realized for much of the period going back to the early 1980's when interest rates peaked. The more recent period has been terrible for fixed income as we've now gone 47 months and counting without making a new high in the Bloomberg Bond Aggregate Index, which is like the S&P 500 for bond investors. Now that the Federal Reserve has reset rates higher over the past two years, investors can realize a return on their fixed income investments.





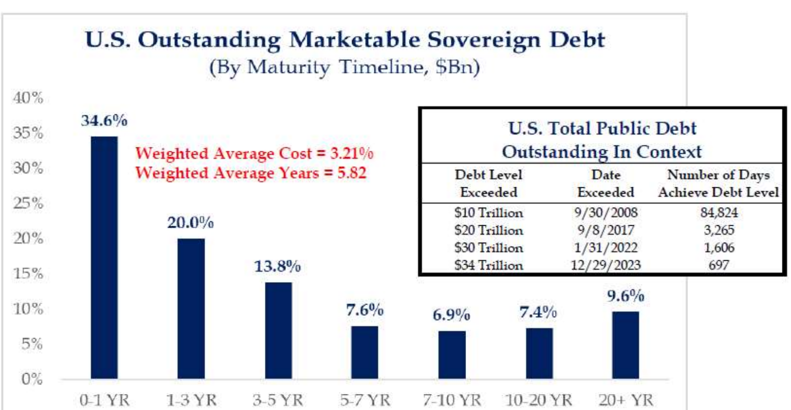
Another similar issue relates to the returns in the equity markets. Most wealth management portfolios have a portion of them dedicated to the small cap asset class, particularly for more aggressive portfolios, as small caps historically have provided better returns with a bit more risk. However, over the past few years when the Magnificent 7 generated most of the stock market's returns, any allocation to small or mid cap stocks was trailing the S&P 500 returns. If you read the prior section, you'll know that we could be at a turning point for small caps in the coming year. The chart below shows the disparity of returns between small and large caps over the past 18 months, and many are wondering why they aren't keeping up with the S&P 500. This Magnificent 7 impact is why, and it's extremely difficult to time the market shift between large and small. You have to be there early because a significant amount of relative return can be realized in a matter of months. As an example of this speed, large caps have outperformed small caps by nearly 1,400 basis points in just the first six months of this year.

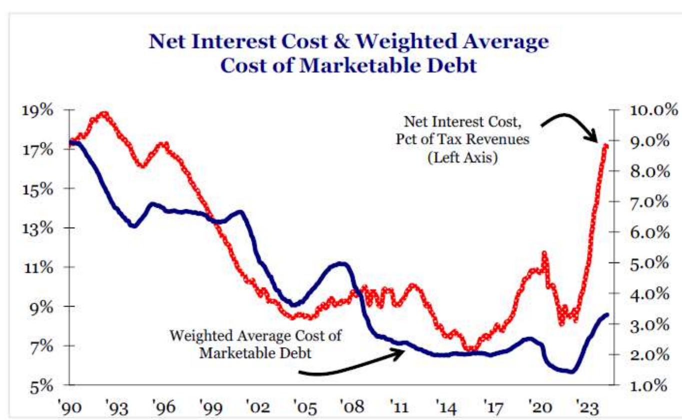


2024 Updated Outlook: A Picture is Worth a Thousand Words

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.

The U.S. Government debt will likely get more attention going forward as nearly 55% of it will need to be refinanced at higher rates, and the interest cost burden is already equal to 9% of U.S. tax revenues.





Source: Strategas

Could Biden be the first President who didn't win re-election with no recession in the prior two years? Betting odds currently favor Trump, but we're a long way away from November.

No Recession Two Years Before Re-Election

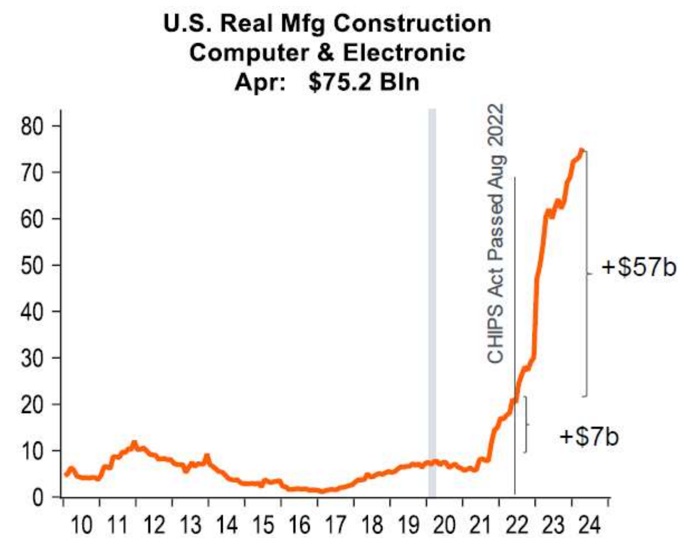
President	Recession?	Re-Elected?
Obama	No	Yes
Bush II	No	Yes
Clinton	No	Yes
Reagan	No	Yes
Nixon	No	Yes
LBJ	No	Yes
Eisenhower	No	Yes
Truman	No	Yes
FDR	No	Yes
FDR	No	Yes
FDR	No	Yes

Source: Strategas

Recession Two Years Before Re-Election

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

The chart below shows the construction spending binge that is likely a function of the Chips Act, exploding AI data center buildouts, and reshoring.

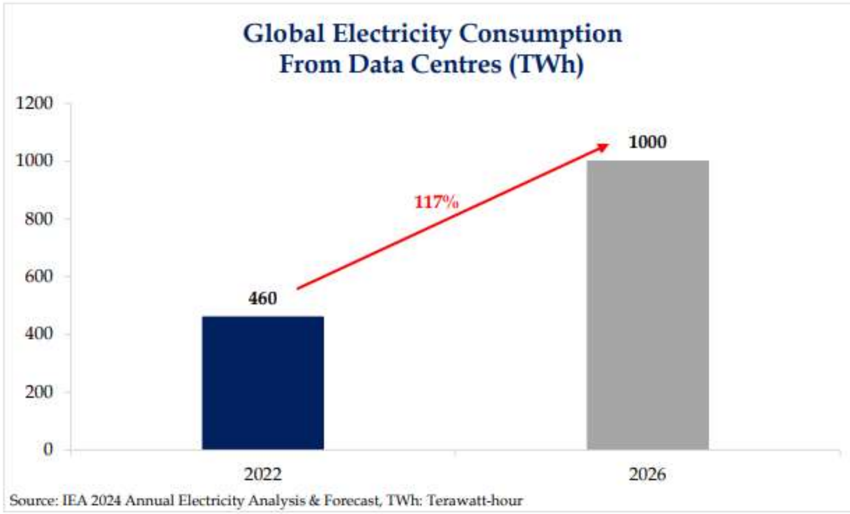


Source: PSC

The chart below shows the explosion in private equity assets under management since 2020. There are trillions of dollars of dry powder that need to be deployed, which should continue to be a support to the stock market and M&A activity broadly.

Source: Strategas

Datacenter buildouts are exploding on the heels of the AI revolution and are causing massive demand increases on our electric grid.   Fun Fact: an AI search uses ten times the amount of electricity than a Google search.



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 interesting stock market facts that you can use at your next cocktail party to prove how smart you are.

Interesting stock market facts

1. Three stocks, Apple, Microsoft, and Nvidia are each individually worth more in market capitalization terms than the entire Russell 2000 Index.
2. Microsoft is worth more than Brazil's stock market.
3. Microsoft, Apple and Google are worth more than the Chinese stock market.
4. Apple is worth more than India's entire GDP.
5. The U.S. stock market is worth more than the next seven stock exchanges combined.
6. Robotic algorithms account for 90% of all stock trades on U.S exchanges.

We hope that you found our second 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.

Kathleen Daley   Adam France   Joe Frohna   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