1492 CAPITAL MANAGEMENT

DISCOVERING OPPORTUNITY

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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 third 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.

Economy Enters a Tricky Period - Market is Focusing on the Wrong Data

The third quarter was strong for the U.S. stock market, but there was substantial volatility along the way that evidenced that we're entering a tricky backdrop. Last quarter we predicted that the market was ripe for change, and change is what we got. The Magnificent 7 weren't the only stocks driving the market; they lagged for a change. The Fed cut interest rates by 50 basis points and signaled more cuts were on the horizon. There were two assassination attempts on a Presidential candidate as well. For good measure, the international markets joined the volatility. Japan's stock market dropped 12.4% in a single day (worst since 1987 crash), and China finally launched stimulus into their lethargic economy late in the quarter, which unleashed the single biggest weekly rally in that country's stock market in over 15 years. The tricky part moving forward is that the market wants the often talked about but rarely achieved "Goldilocks economy" to sustain low inflation with moderate growth. However, as the stock market demonstrated in the third quarter, equities can sell off in a heartbeat if a certain economic data point goes in the wrong direction. The market's performance during the quarter had two significant short-term selloffs, which were both on the heels of weaker-than-expected payroll numbers at the beginning of August and September. We've moved from a "bad news is good news" to a "bad news is bad news" environment. Mistakenly, the monthly payroll number (jobs added to the economy) is not the right data point to emphasize. To the contrary, it's the unemployment figures. Why unemployment? Because with the economy slowing and stimulus waning, the one thing that will kill the economy is people losing their jobs and pulling back on spending. We don't need more jobs to keep the economy humming as the unemployment rate is still only 4.2% which is ***well below the trough levels in prior economic cycles***. Despite all the noise in the quarter and the elections on the horizon, the stock market posted very strong returns. The script flipped from the first half of the year with small caps outperforming large caps as the Russell 2000 Index and the S&P 500 advanced +9.3% and +5.9%, respectively. The NASDAQ for the first time in quite a while was the laggard at +2.8%.

The Presidential election is likely to take center stage in October in what is typically an already difficult month for the markets due to mutual funds' tax loss selling. However, the Fed has set the table for additional rate cuts that will likely stimulate the U.S. economy in the months ahead. 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.

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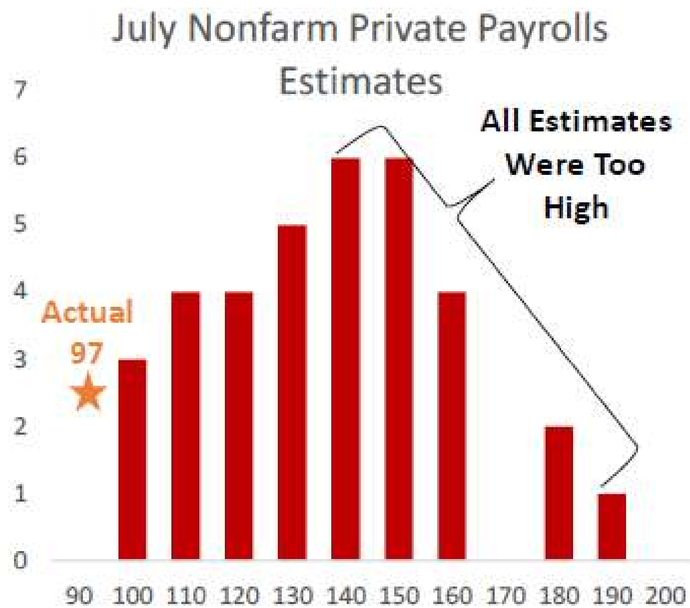
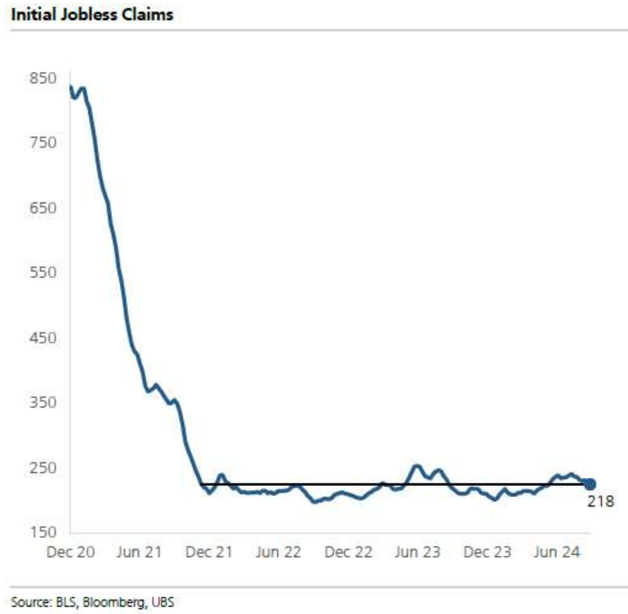
A Review of the Quarter: Economy Enters a Tricky Period - Market is Focusing on the Wrong Data

The third quarter was strong for the U.S. stock market as the S&P 500 logged its fourth positive quarter in a row, but there was substantial volatility along the way that evidenced that we're entering a tricky backdrop. Last quarter we predicted that the market was ripe for change, and change is what we got. The Magnificent 7 weren't the only stocks driving the market; they lagged for a change. The Fed cut interest rates by 50 basis points and signaled that more were on the horizon. There were two assassination attempts on a Presidential candidate, and for good measure, the international markets jointed the volatility. Japan's stock market dropped 12.4% in a single day (worst since 1987 crash), and China finally launched stimulus into their lethargic post-covid economy late in the quarter, which unleashed the single largest weekly rally in that country's stock market in over 15 years. See our Wealth Management Monitor section below where we discuss China in more depth. On the left pane below is the performance of the nine investing style boxes from January 2023 through June 2024. The right pane shows the performance of the same nine style boxes for the third quarter 2024. The Magnificent 7 stocks reside in the large-cap growth style box. Clearly, change was afoot in the third quarter. Now the question becomes is this a true changing of the guard or a temporary reversal?

Source: PSC

The tricky part moving forward is that the market wants the often talked about but rarely achieved "Goldilocks economy" to be sustained with low inflation and moderate growth. However, as the stock market demonstrated in the third quarter, equities can sell off in a heartbeat if a certain economic data point goes in the wrong direction. The market's performance during the quarter included two significant short-term selloffs, which were both on the heels of weaker-than-expected payroll numbers at the beginning of August and September. The chart below left shows July payrolls or jobs added. Note the number came in substantially lower than consensus, causing a sharp selloff in the first week of August when this number was reported. The same thing happened with the August payroll numbers reported in early September. We've moved from a "bad news is good news" to a "bad news is bad news" environment. Mistakenly investors continue to focus on the monthly payroll number (jobs added to the economy) which we believe is not the right data point to emphasize. To the contrary, it's the unemployment figures. Why unemployment? Because with the economy slowing and stimulus waning, the one thing that will kill the economy is people losing their jobs and pulling back on spending. The chart below right shows the initial jobless claims experienced for the past three years which have been incredibly stable. As we've stated in the recent past, companies are going to be far more hesitant to cut staff levels given how hard it was to fill positions during the pandemic.



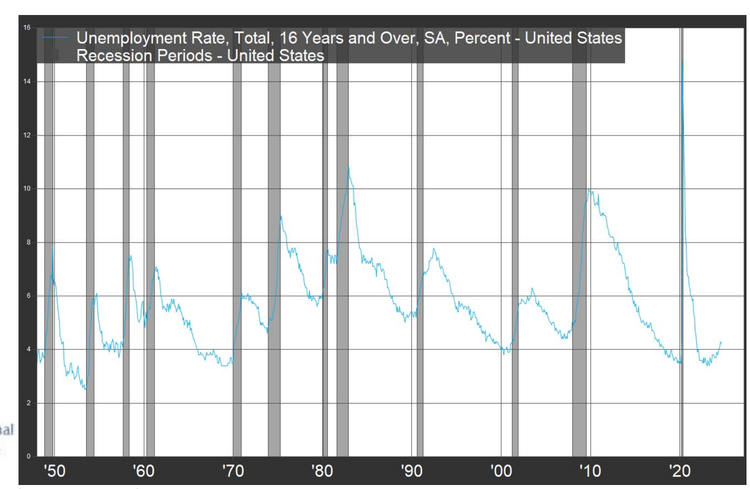


Source: PSC

For those prognosticators who point to the heretofore infallible and obscure "Sahm" rule as to why we're certainly going into a recession based on the current unemployment level, we'll provide our contrarian thoughts below. First, the Sahm rule states that the start of a recession is signaled when the three-month moving average of the unemployment rate rises by 0.5 percentage points relative to the three-month averages from the previous 12 months. While it's true that every other time this change has occurred, the economy has entered a recession as shown on the chart below left (grey bars represent recessionary periods). This cycle, the unemployment rate bottomed at an exceptionally low 3.5% and now sits at 4.2%, which triggers the Sahm rule which states that a recession is imminent. The problem with this metric is that it ignores absolute levels of unemployment and simply relies on percentage changes. Because it has had a great predictive track record in the past and there are so few metrics that have a 100% hit rate, many economists have dug this up and pointed to it as if it's a certainty that a recession is imminent. While it's true that the Sahm rule has been triggered, we maintain that this time it is different due to what happened to employment patterns during the pandemic. Unemployment dropped to extraordinarily low levels because the number of Americans in the workforce went down during this period. Jobs were plentiful but there weren't enough bodies to fill them all. Now that several years have passed and our economy has normalized, so too have the number of job openings. We don't need more jobs to keep the economy humming as the unemployment rate is still only 4.2% which is ***well below the trough levels in prior economic cycles***. Notice in the chart below right that the current unemployment level of 4.2% (blue line), which is a peak for this cycle, is still substantially below the trough of nearly every other cycle. Keep your eyes on the unemployment number because if Americans maintain their jobs and continue to get moderate increases in their pay, they will keep spending, and the economy will keep humming.

Sahm Recession Indicator signals the start of a recession when the three-month moving average of the national unemployment rate (U3) rises by 0.50 percentage points or more relative to the minimum of the three-month averages from the previous 12 months.

Source: PSC



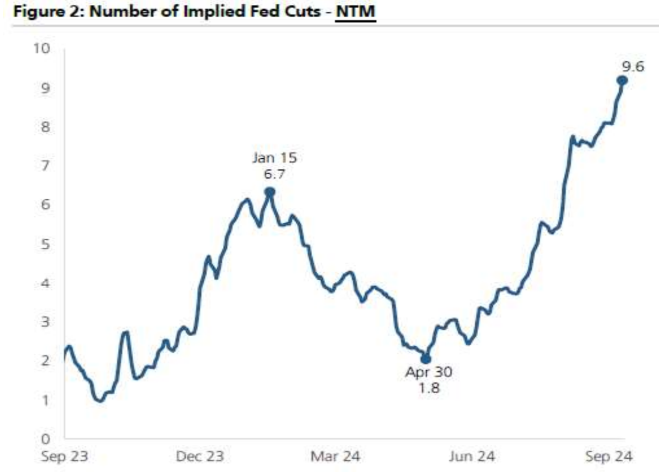
Source: 1492 Capital Management and Factset

As we know, the Fed cut interest rates by 50 basis points at their September meeting. As the chart below left shows, this was the second longest period in history between the last rate hike and the first rate cut at 415 days. The performance of the stock market during this Fed hiatus was great relative to historical averages. Now that the Fed has ripped off the band-aid on rate cuts, the market has once again jumped the gun in terms of rate cut expectations. Recall that at the start of this year, the market was pricing in six rate cuts of 25 basis points each. As inflation was stubbornly slow in retreating earlier in the year, those rate cut expectations nearly went to zero as the chart below right shows. However, now that the Fed has started the rate cut cycle, the market has once again jumped the gun in our opinion. They now expect a total of 9.6 rate cuts over the next year, which includes the two we just received in September. This number would imply that the Fed Funds rate would decline from the current 4.75-5% to approximately 3% by next September. In our opinion, for this to occur, the economy would have to slow dramatically, and we don't see that right now. Undoubtedly, certain segments of the economy are slowing, particularly the low-to-mid-income consumer. This segment of the population may have tapped out savings accumulated during the pandemic and several companies have witnessed dramatic weakness in this segment of late. Notably Dollar General, Dollar Tree, and even Walmart recognized weakness. However, the recent economic data has remained stable overall. The third chart below shows the recent past and forecasted real and nominal GDP levels. Note that the consensus forecast is still predicting 2% real GDP growth through the end of 2025. This level seems wholly inconsistent with an additional 7.6 rate cuts. In our view, we would need to see a dramatically slowing economy and a spike in unemployment for the Fed Funds futures to be correct. In fact, there are no signs of this slowing as the current Atlanta Fed's GDPNow reading is showing real GDP growth for the third quarter slightly above 3%.

Length Of Fed Pauses & S&P Performance

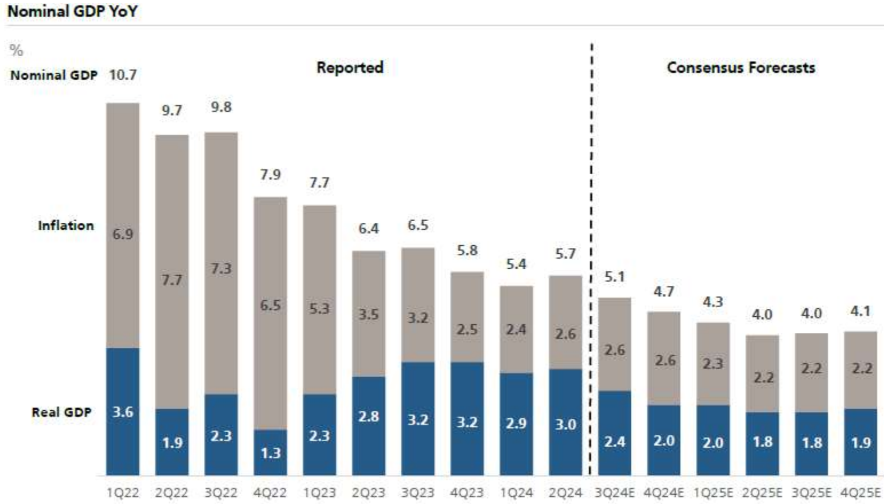
Last Hike Date	First Cut Date	Days	S&P Return During The Fed Pause
5/1/1974	7/1/1974	61	-6.1%
3/3/1980	4/1/1980	29	-8.7%
5/8/1981	6/1/1981	24	1.0%
8/21/1984	10/2/1984	42	-1.8%
2/24/1989	6/5/1989	101	13.3%
2/1/1995	7/6/1995	155	19.2%
5/16/2000	1/3/2001	232	-7.4%
6/29/2006	9/18/2007	446	22.1%
12/19/2018	7/31/2019	225	20.3%
7/26/2023	9/13/2024	415	25.3%
	Average	146	5.8%

Figure 2: Number of Implied Fed Cuts - NTM



Source: Bloomberg, UBS

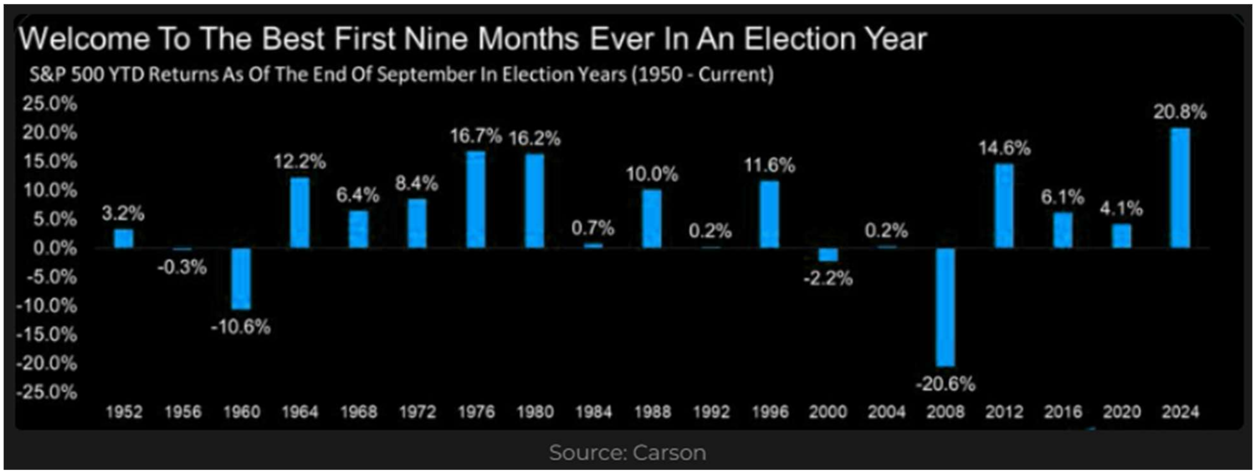
Nominal GDP YoY



Source: BEA, Bloomberg, UBS
Note: Nominal GDP forecasts based on consensus Real GDP and PCE projections

Despite all the noise in the quarter and the elections on the horizon, the stock market posted very strong returns. The script flipped from the first half of the year with small caps now outperforming large caps as the Russell 2000 Index and the S&P 500 finished the quarter up +9.3% and +5.9%, respectively. The NASDAQ, for the first time in quite a while, was the laggard at

+2.8%. This result brings the first nine month return for the S&P 500 to the best level in an election year since 1950 as shown in the chart below.

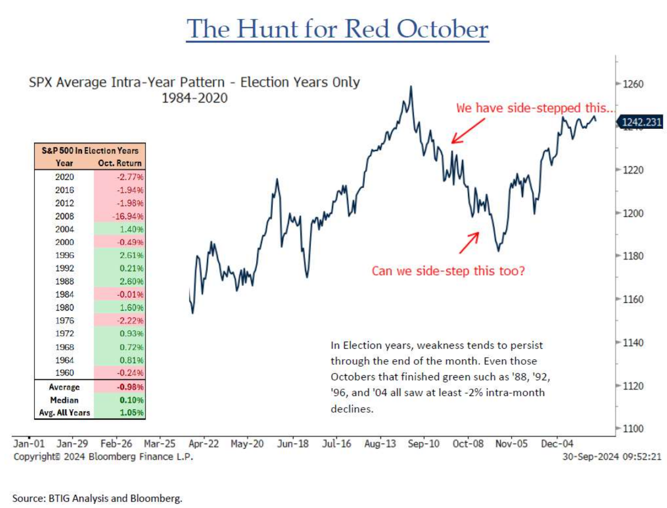


This performance begs the question as to what lies ahead for the market given the strong returns realized so far this year? While October tends to be one the worst performing months of the year, primarily attributable to mutual funds' tax loss selling (capital gain/loss for mutual funds are calculated on a fiscal year ending October 31), the offset to this pressure is how the stock market fares in periods following the strongest first nine months of a year. As shown in the chart below left, 2024's performance qualifies as the 9th best all-time for the first nine months of a year. Strong performance begets strong performance based on historical returns for both October and the fourth quarter that show decent returns to finish the year well. The stock market has bucked the historical trends for this election year with impressive performance so far, but prior election years tend to have a swoon in October as we lead up to the November Presidential election. The chart on the right shows this historical pattern in election years only. This pattern can be attributed to the point of maximum uncertainty in who will become the next President and what those policies will mean for the economy and stock market. Time will tell.

October & 4Q Performance Following Strongest 12/31 to 9/30
Data Since 1950

Rank	Year	12/31-9/30 Perf.	October Perf.	4Q Perf.
1.	1987	32.9%	-21.8%	-23.2%
2.	1954	30.2%	-1.9%	11.4%
3.	1997	27.9%	-3.4%	2.4%
4.	1995	27.2%	-0.2%	5.4%
5.	1989	25.7%	-4.0%	1.2%
6.	1958	25.2%	2.5%	10.3%
7.	1975	22.3%	6.2%	7.5%
8.	1955	21.4%	-3.0%	4.1%
9.	1967	20.4%	-2.0%	-0.2%
10.	2019	18.7%	2.0%	8.5%
		Average:	-2.6%	2.7%
		Median:	-2.0%	4.8%
		Historical Average	0.9%	4.3%
		Historical Median	1.3%	5.3%

Source: PSC



As shown in the table below, the stock market in the quarter was strong as the market broadened out from just the Magnificent 7 driving returns. Small caps outperformed large caps with the Russell 2000 Index and the S&P 500 up +9.3% and +5.9%, respectively. The NASDAQ for the first time in quite a while was the laggard at +2.8%. However, the NASDAQ and S&P 500 maintain a sizeable lead over small caps on a year-to-date basis. 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 11% below its 2021 high. The S&P 500 has now posted positive performance in four straight quarters.

Index Returns		
Index	Third Qtr. 2024 Return	2024 YTD Return
Russell 2000	+9.27%	+11.17%
Russell 2000 Growth	+8.41%	+13.22%
Russell 2000 Value	+10.15%	+9.22%
S&P 500	+5.89%	+22.08%
Dow Jones Industrials	+8.21%	+12.31%
NASDAQ Composite	+2.76%	+29.03%

Source: 1492 Capital Management, LLC and FactSet

From a style perspective, the Russell 2000 Value Index (+10.2%) beat the Russell 2000 Growth Index (+8.4%) in the quarter. The broadening out in the market has certainly helped small-cap stocks, particularly those with a value tilt, like bond proxies such as utilities, real estate, staples, and financials. The best performing sectors in the Russell 2000 for the quarter were Real Estate (+17.9%) and Communication Services (+17.8%) with the latter benefitting from a takeover of its largest constituent during the quarter. There was only one sector that posted a negative return in the quarter as Energy (-8.3%) retreated based on concerns of an oversupply of oil as the economy slows. The table immediately below highlights the performance of the Russell 2000 style indices by sector for the third 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. However, this quarter showed a relatively stable performance between larger and smaller market caps as the market performance broadened.

Russell 2000:

Table 8 - Russell 2000 Scorecard through September 30th

	September			Quarter to Date			Year to Date			
GICS Sector	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Wgt
Com Serv	3.10	0.09	2.41	17.79	0.43	8.53	11.35	0.29	0.18	2.7
Discretionary	3.04	0.31	2.34	9.73	0.92	0.47	9.01	0.88	-2.16	10.0
Staples	2.40	0.07	1.70	10.34	0.25	1.08	17.97	0.51	6.80	2.8
Energy	-3.63	-0.23	-4.33	-8.34	-0.53	-17.61	-0.31	0.08	-11.47	5.3
Financials	-1.26	-0.26	-1.96	15.20	2.57	5.93	11.55	1.97	0.38	18.0
Health Care	-0.85	-0.13	-1.55	9.55	1.77	0.28	10.02	1.89	-1.14	17.5
Industrials	1.80	0.31	1.10	8.50	1.42	-0.77	12.99	2.21	1.83	17.0
Info Tech	0.77	0.09	0.08	4.30	0.65	-4.97	14.25	2.10	3.08	12.8
Materials	3.12	0.14	2.42	8.24	0.37	-1.03	7.29	0.31	-3.88	4.5
Real Estate	3.79	0.26	3.09	17.94	1.08	8.68	12.12	0.71	0.95	6.5
Utilities	2.09	0.06	1.39	12.76	0.33	3.49	8.85	0.21	-2.31	2.8

Size Quintile	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Wgt
1 (Largest)	1.50	0.86	0.80	9.72	5.52	0.45	13.45	7.66	2.28	57.1
2	-0.45	-0.13	-1.15	7.45	1.77	-1.82	12.17	2.92	1.00	23.5
3	0.33	0.04	-0.37	11.17	1.29	1.90	4.94	0.51	-6.23	11.7
4	-1.48	-0.08	-2.18	8.49	0.47	-0.78	2.86	0.14	-8.30	5.5
5 (Smallest)	-0.18	0.00	-0.88	8.50	0.22	-0.77	0.03	-10.54	2.31	0.0

Source: Jefferies

Returns in the international markets were generally positive with substantial stimulus programs rolled out in China late in the quarter. European markets were generally positive with ECB interest rate cuts. Japanese investors continued to worry over interest rates and the Yen's weakness. Bond market returns were quite positive as interest rates fell as the Fed signaled rate cuts were imminent. 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 now looks more in line with demand going forward. Lumber gained as homebuilding prospects improved with mortgage interest rates declining in synch with the Fed rate cuts.

Index	Third Qtr. 2024 Return	2024 YTD Return
France	+2.3%	+4.2%
Germany	+6.0%	+15.4%
Brazil	+6.4%	-1.8%
India	+7.0%	+17.6%
China- A Shares	+14.3%	+16.0%
China- Shenzhen A Shares	+19.1%	+6.0%
Japan	-5.8%	+13.3%
Long-Term Treasuries (TLO)	+6.8%	-0.6%
Investment Grade Corp Bonds	+5.9%	+5.2%
Gold	+13.7%	+27.6%
Volatility- VIX index	+34.5%	+34.2%
Oil	-16.4%	-5.0%
Natural Gas	+12.5%	+23.0%
Lumber	+15.7%	-4.8%

Source: 1492 Capital Management, LLC

Thematic Investing: Investing in the Space Industry is No Longer as Difficult as Rocket Science

“Failure is not an option.” is a quote often attributed to NASA Flight Director Gene Kranz during the Apollo 13 rescue mission in April 1970. However, for investors in the space industry, failure was all too common. After decades of implosions for rockets and companies attempting to make a business in outer space, it may finally be time to invest in the space industry. I recall investing in a satellite company 25 years ago. They invested hundreds of millions of dollars in a few satellites to beam programming around the globe. I can remember sitting and waiting for news reports that the rocket carrying the satellite made it to orbit and didn’t explode on its mission. If it reached the proper orbit, the company would make hundreds of millions of annual revenue with extraordinarily high margins. If it failed, they would get an insurance payoff for the replacement of the satellite, but it would be years before they could try again. Thankfully it succeeded but talk about sleepless nights.

The space industry, particularly satellite constellations that provide imagery and sensor data, has entered an unprecedented phase of growth and opportunity. Investing in this sector today offers a blend of technological innovation and increasing demand, which makes it more promising than ever. Here’s why.

Historically, space investments were limited to government-driven programs, with NASA and the U.S. Department of Defense at the helm. High costs, long project timelines, and minimal commercial opportunities made space a difficult sector for private investors. In the early 2000s, a few major players dominated the market for commercial satellite launches and services, and the barriers to entry were steep. Ultimately NASA turned over many of their space-based programs to the private sector which could execute much more cheaply and efficiently.

However, the sector has transformed dramatically in the last decade. Advancements in technology, miniaturization of satellite hardware, and the lowered cost of rocket launches have significantly reduced entry barriers. Companies like SpaceX and Rocket Lab have pioneered reusable rocket technology, which cut launch costs by up to 90%. The rise of "new space" companies has democratized access to space and is spurring a wave of private investment and innovation.

The cost to launch a satellite has dropped from around $18,500 per kilogram in the 1980s to just $2,720 per kilogram with SpaceX's Falcon 9 as of 2023. Additionally, the technology components of satellites have miniaturized over the years and much more power can be packed into a “wine bottle” sized satellite, which, depending on features and function, have costs as low as $300,000 per satellite,. The global satellite imagery market was valued at $5.8 billion in 2023 and is projected to grow at a CAGR of 13.3% through 2031. Demand for real-time data used in applications such as weather forecasting, agricultural monitoring, defense intelligence, and economic analytics is driving much of this growth. AI has worked its way into space applications because it can be used to link a series of images or data points together to make conclusions about what is happening over a time series.

In 2020, there were fewer than 3,000 operational satellites in orbit. Thanks to mega-constellations like SpaceX’s Starlink and OneWeb, this number has grown to over 10,000 in 2024. Starlink alone aspires to put up to 42,000 satellites in orbit. These constellations are paving the way for faster, more accurate data acquisition on a global scale. Governments, particularly the U.S., continue to be key drivers of growth. The U.S. Department of Defense and NOAA have announced multiple multi-billion-dollar contracts for satellite imagery and sensor data to support defense and climate monitoring efforts. In 2023, the U.S. Space Development Agency awarded $1.8 billion in contracts to satellite companies for national defense purposes. Demand for data across several key sectors is driving the rapid expansion of satellite constellations:

Defense & Security: Nations are increasingly reliant on satellite-based intelligence for surveillance, threat detection, and strategic planning. Geospatial imagery and sensor data are critical for real-time military operations and long-term defense planning.

Weather & Climate: Accurate and timely weather forecasting is becoming more critical in the face of fears of climate change. Satellite constellations provide real-time atmospheric and oceanic data that improve predictive models and inform disaster response strategies.

Economic Monitoring: Satellite imagery is used to track global supply chains, monitor infrastructure projects, and assess crop yields. Hedge funds and institutional investors are also leveraging satellite data to gain insights into economic activity in key sectors.

The convergence of lowered costs, increased demand for data, and rising geopolitical tensions have positioned satellite constellations as an attractive investment opportunity. Satellite companies, both startups and established players, are benefiting from large contracts, recurring revenue models that mirror software companies, and technological advancements that provide long-term scalability. As space becomes a critical infrastructure for a data-driven world, investing in satellite constellations offers not just growth potential, but also diversification into sectors like defense, agriculture, and finance. Investors who recognize the vast, untapped potential of this market today are likely to reap significant rewards as satellite-driven data becomes indispensable to global decision-making. Two real-life examples of use cases are shown below. On the left is a view of Lahaina, HI after the devastating fire there a year ago. Agencies are looking for further risks, development problems and opportunities, and civil government issues. The picture on the right below shows real-time target engagement for both commercial and defense uses. The new generation of satellites can take images down to as fine as 30 centimeters with great resolution. Maybe "big brother" is watching.

Source: Blacksky and Planet Labs investor relations

With a history of technological advances that are lowering costs and creating more investment opportunities, the current space sector environment is a far cry from its government-heavy past. The demand for satellite imagery and sensor data is soaring across defense, economic, and environmental sectors. The combination of reduced launch costs, expanding satellite networks, and high demand for real-time data makes investing in satellite constellations a potentially attractive option in today's market.

Thematic Investing Update: Regional Banks: Tax Haven States Theme in a Rate Cut Environment

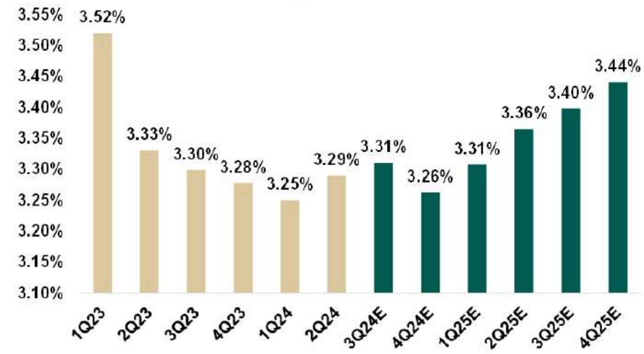
As we have discussed previously, we have our Regional Banks: Tax Haven States theme deployed across our small-cap strategies. The theme leverages the migration of people from high-income tax states to states without personal income tax like Florida, Texas, and Tennessee. Simplistically population growth has translated into loan growth, and with the Federal Reserve cut of 50 basis points recently, we thought it prudent to update our thoughts on this theme. In early September, we met with several of our bank theme holdings at an investment conference. As deposit cost pressures have been a multi-year issue while the Fed funds rate moved quickly higher, it was nice to hear now that even before the recent Fed rate cut deposit pricing was beginning to decline. As you can see in the table below, there has been an average decline of 35 basis points in time deposit (CDs) pricing over the last six weeks through the end of September across Stephens Inc.'s 86 bank survey.

6-Week Change in Promotional Time Deposit Offering By Region

Region	APY	Duration (Months)	Change (Bps)
Super Regional	4.50%	5	-50
Midwest	4.43%	6	-48
Southwest	4.58%	5	-41
Southeast	4.50%	7	-35
West Coast	4.35%	7	-25
Northeast	4.60%	7	-25
All 86 Banks	**4.50%**	**6**	**-35**

Note: Change is week ending 9/27/24 vs. week ending 8/15/2024. Source: Company Reports

Figure 5: Net Interest Margin



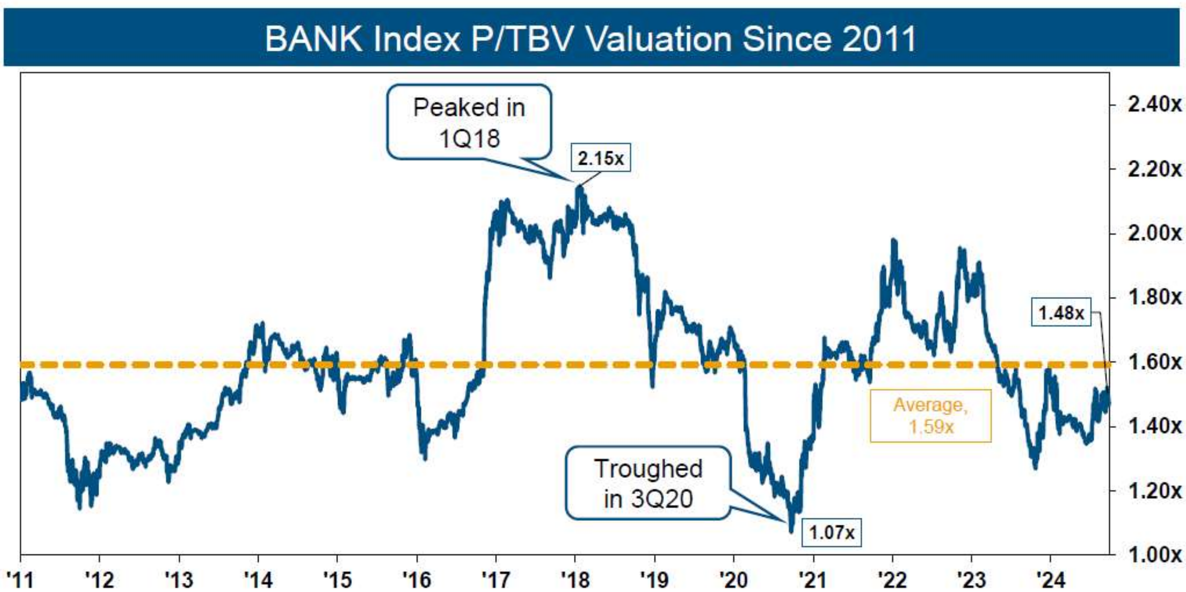
Source: D.A. Davidson & Co.

For several years banks have suffered from declining net interest margin due primarily to deposit pressure on one end and secondarily to loan competition on the other. As you can see in the chart above right, the second quarter of 2024 marked a small inflection from the first quarter low among the D.A. Davidson bank universe. With a 50bp rate cut to absorb in the fourth quarter, it will be difficult for banks, in general, to adjust deposit pricing down quickly enough to offset their floating rate loans that will see a faster decline. The key to net interest margin preservation will be how much of each bank's loan portfolio is at a fixed rate that is set to reprice higher from interest rates set several years and are easily 2 to 3 interest rate points lower than current rates. As that repricing is often a commercial real estate loan scenario, our theme holdings have opportunities to move loan yields higher on this fixed-rate part of the portfolio as they are in growth areas with strong real estate demand. As the net interest margin chart depicts after incorporating two 25 basis point cuts in 2024 and 100 basis points of first half 2025 cuts, the industry should see higher net interest margin in 2025 as the lag of lower deposit costs catches up with the loan portfolio adjustments. We believe that the net interest margin will also benefit from second-half 2025 loan growth from the rate cut impact on the economy and the attractiveness of lower loan yields. A steeper yield curve that will result from these additional rate Fed cuts has historically been beneficial as banks lend at the long end of the curve and borrow at the cheapening short end. A steepening yield curve widens that gap. In addition, the revenue line of banks should benefit from more fee income as lower rates should help bolster the mortgage business versus the 2024 period.

With the prospects of improving net interest margin and loan demand in 2025, the elephant remaining in the room as we look out for 12 months is credit deterioration. As seen in the chart below, the high yield spread, which is, in its simplest form, the difference between the high yield index yield and the U.S. Treasury yield, is bouncing along multi-year lows. This low level is indicative of an economy experiencing minimal credit deterioration. While we would be naïve to think that there will not be any further credit bedbugs, our theme holdings are well reserved, and the much-discussed issues in commercial real estate, particularly in office space, do not arrive all at the same time. Management teams that we have met with recently have been tightening their credit standards in this area for some time and generally have less painful options to correct problem loans due to the robust economic growth in their markets. In addition, according to Stephens research, the yield on the five-year constant maturity U.S. Treasury has dipped roughly 120 basis points since April which offers some relief on repricing loans linked to that benchmark. A significantly lower Fed funds rate in 2025 should also help to ease the flow of problem credits.

Source: Furey Research Partners, FactSet Research. Data available as of September 21st, 2024

There are other positives for our bank theme as well as we enter 2025. While the historic rise in interest rates lowered the prices of fixed income securities in the investment portfolio of banks over the last few years, the tide is turning with lower rates and that lost tangible book value (TBV) from years of unrealized securities losses should begin to return in the second half of 2024 and into 2025 and accelerate TBV growth. Price-to-TBV is a top, if not the top, valuation metric for banks.



Source: Stephens

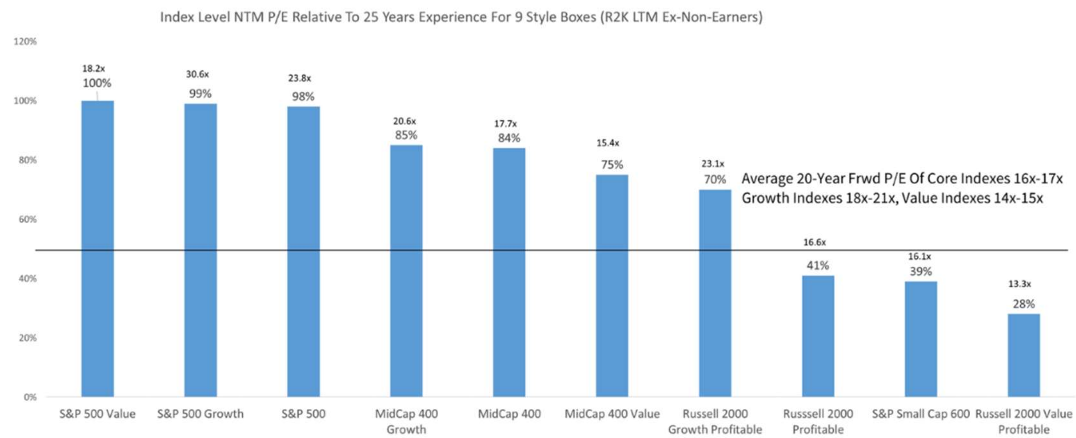
With respect to valuation, the chart above depicts the BANK index price-to-tangible book value ratio since 2011. We currently sit below the 1.59X average with an acceleration in industry tangible book value growth in 2025 that is likely, in our opinion, to aid valuation of our bank theme holdings. Lastly, if this presidential election resembles 2016, a Republican win is generally perceived to be favorable for the group as less regulation is likely to accelerate the mergers and acquisition activity in the sector. We remain excited about the prospects for our Regional Banks: Tax Haven States theme as our holdings are well positioned for rebounding net interest margins, higher mortgage business fees, a stabilization of credit, and better tangible book value growth as they preside over economic growth in some of the most robust lending markets in the United States.

2024 Updated Outlook: Case for Small-Cap Stocks: A compelling Opportunity in 2024 and Beyond

As we head into 2025, small-cap stocks are emerging as a particularly attractive asset class for investors seeking long-term growth and value. While large-cap stocks have been favored in recent years, small caps offer several advantages as we look ahead, including favorable valuations, growth potential, and a shifting interest rate environment. Here's why small caps could outperform large caps and other asset classes in the coming year.

Valuation Advantage of Small Caps

One primary reason small-cap stocks look increasingly appealing is their valuation. Currently, small-caps are trading at a significant discount compared to their large-cap counterparts. The Russell 2000, which tracks small-cap stocks, has a price-to-earnings (P/E) ratio that is notably lower than that of the S&P 500, which is dominated by the Magnificent 7 companies. Historically, small caps tend to trade at a discount during periods of economic uncertainty or market volatility, but this gap often narrows as economic conditions improve. As we move past the election and the Fed cuts rates further, uncertainty should wane. The chart below shows how cheap small cap valuations are relative to their historical average.



Source: UBS

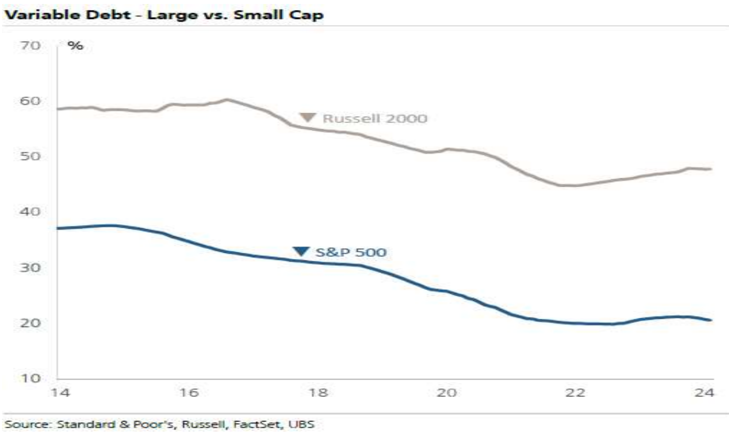
As the economic recovery stabilizes and earnings for small-cap companies start to rise, their valuations could become more attractive, offering a higher upside for investors. This relative undervaluation gives small caps a built-in advantage over large caps, where growth expectations and multiples are already priced in. The Magnificent 7 companies face far more difficult comparisons as we move to 2025 just as small-caps should see an acceleration in earnings due to lower interest costs, leading to a significant acceleration in earnings just as large caps earnings growth slows. The chart below shows earnings and sales growth for the Russell 2000 compared to the S&P 500 for 2024 and 2025. Current forecasts show a significant acceleration for the Russell 2000 constituents.

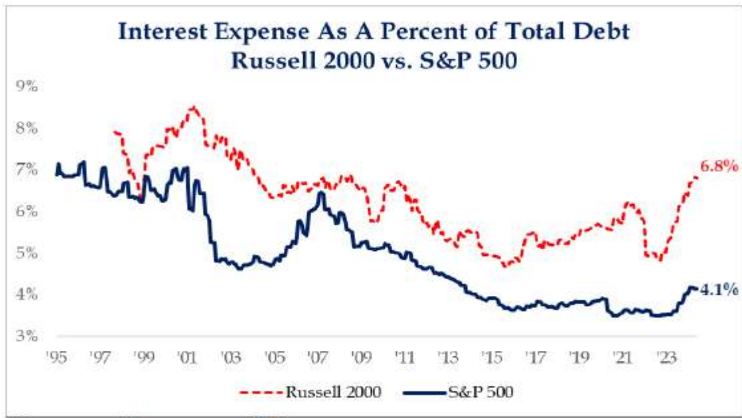
Source: Furey Research Partners and FactSet. Based upon our capitalized loss earnings model. '24E and '25E uses current constituents. Growth rates based upon comparisons to earnings printed by historical constituents. Data as of 8/13/24.

Small-cap stocks are typically more domestically focused, making them more sensitive to local economic conditions. With the U.S. economy expected to rebound to reaccelerate into 2025 as interest rate cuts kick in, small-cap companies stand to benefit more from this recovery than large, multinational firms. Large-cap stocks often have significant international exposure, making them vulnerable to global risks like geopolitical tensions, currency fluctuations, and slower growth in foreign markets. Small caps also tend to be more agile and better positioned to capitalize on economic expansions. Historically, small-cap stocks outperform large caps during the early stages of economic recovery, as they can pivot quickly to capture new opportunities. This is particularly true in sectors like technology, healthcare, and consumer discretionary, where innovation and changing consumer preferences can drive rapid growth.

Interest Rate Environment: A Tailwind for Small Caps

Higher interest rates have been a headwind for small-cap companies since the Fed started their interest rate hiking cycle in 2022. These smaller businesses typically have higher debt levels and greater exposure to variable-rate financing. The Federal Reserve's rate hikes have increased borrowing costs, which has weighed more heavily on small-cap earnings and cash flows compared to their large-cap peers that often have stronger balance sheets and more fixed-rate debt. However, the interest rate outlook is changing as we near 2025. As inflationary pressures have eased and the economy slows, the Federal Reserve rate cuts should provide significant relief to small-cap companies. Lower interest rates will reduce borrowing costs, improve profitability, and free up capital for investment and expansion. This shift would create a more favorable environment for small caps to thrive as the burden of variable-rate debt diminishes. The chart below left shows the percentage of the debt held by Russell 2000 and S&P 500 constituents which is variable rate debt. The Russell 2000 has a significantly higher percentage. The chart on the right shows the effective cost of debt for the Russell 2000 and S&P 500, respectively. Note that the rate is significantly higher for the Russell 2000 and, therefore, it should be a bigger beneficiary as rates decline over the next year.





Source: Strategas

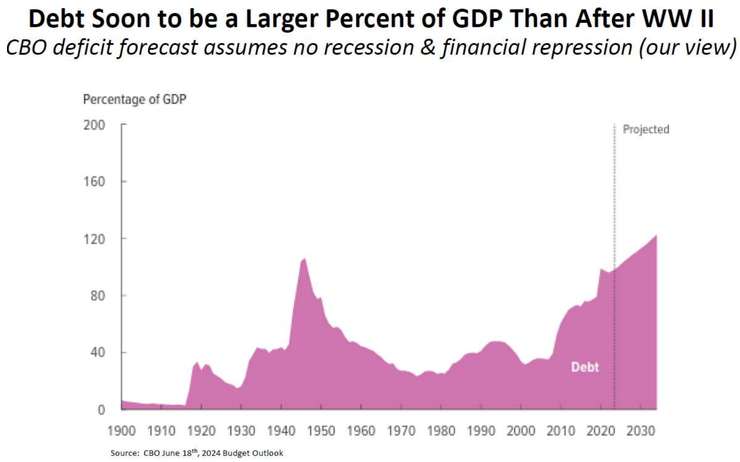
When compared to other asset classes, such as bonds, real estate, or large caps, small-cap stocks currently offer a compelling valuation. Bonds, while offering a safer yield, are unlikely to provide the same capital appreciation potential as small caps in a lower-rate environment. Similarly, real estate has faced headwinds from rising mortgage rates and tighter credit conditions, which have dampened demand and put downward pressure on prices. Large caps, particularly in sectors like technology, are still trading at premium valuations despite the market correction in 2022–2023. Many large-cap stocks are priced for perfection and leave little room for multiple expansion. Small caps, however, have more upside potential due to their lower starting point and sensitivity to economic recovery.

Conclusion: Small Caps Offer Attractive Value and Growth Potential

As we move into 2025, the investment landscape is shifting, and small-cap stocks are well-positioned to benefit. Their relative undervaluation, sensitivity to domestic economic recovery, and improved outlook in a lower interest rate environment all point to significant upside potential. For investors looking for growth opportunities, small caps represent a strong alternative to large-cap stocks and other asset classes. The current valuation discount provides a favorable entry point, while the anticipated easing of interest rates will alleviate some of the financial pressures that have weighed on small-cap companies and their valuations. While small caps possess higher volatility, their long-term return potential makes them a compelling choice for investors with a high-risk tolerance and a long-term horizon.

Other Considerations- The National Debt and the Presidential Election

The national debt has exploded since the start of the pandemic. The chart below left shows that the government debt is now on pace to be a larger percentage of GDP since right after World War II. The pace of debt accumulation has accelerated of late to an alarming rate as shown in the chart on the right.



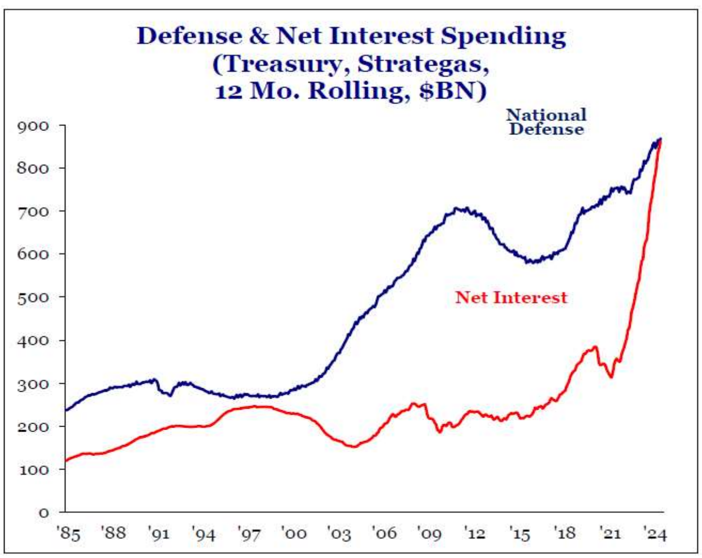
Time Required to Reach Total U.S. Debt Levels

Of:	
$10 Trillion	232 Years
$20 Trillion	9 Years
$30 Trillion	4.5 Years
$31 Trillion	8 Months
$32 Trillion	8 Months
$33 Trillion	3 Months
$34 Trillion	3 Months
$35 Trillion	7 Months
Latest Level	*$35.27 Trillion*

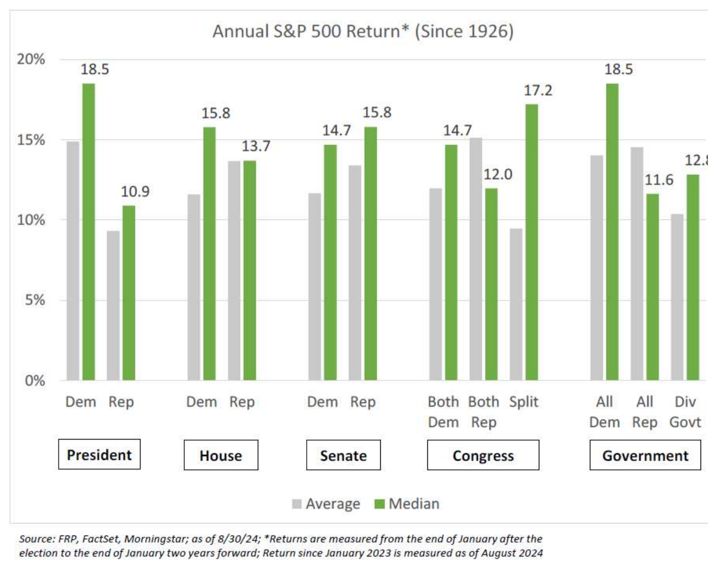
Six months on average to reach each additional trillion in debt from $31 - $35.

Source: Strategas

Whoever becomes the next President of the United States will have to deal with the burgeoning cost of the national debt as interest expense is now equivalent to U.S. defense spending as shown in the chart on the left. This imbalance isn't sustainable and puts a spotlight on the Fed and interest rate cuts because of the accelerating pace of interest expense. Speaking of Presidents, the chart on the right shows how the stock market has performed since 1926 depending on which party controls the White House and Congress. The good news is that regardless of which party is in control, the stock market has seen double-digit returns over time.

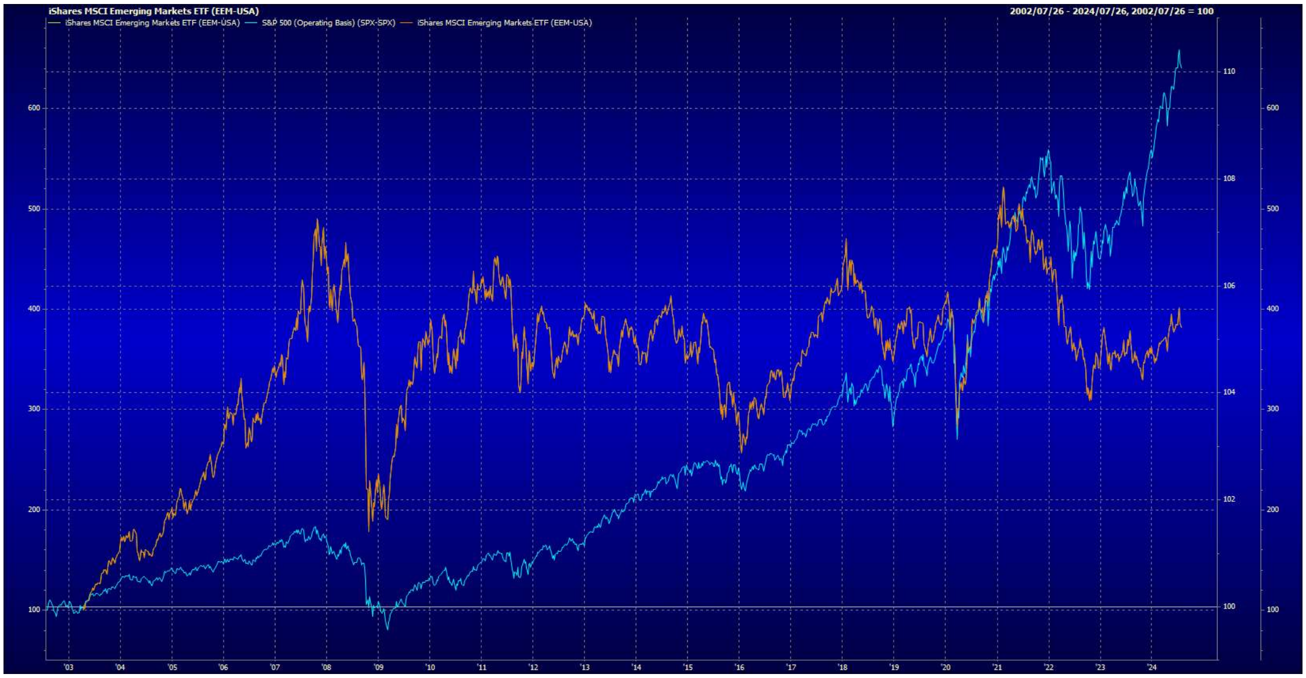


Source: Strategas



Wealth Management Monitor

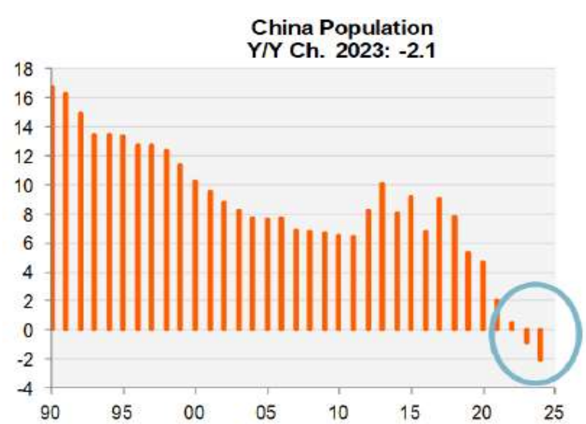
As many of you know, 1492 Capital Management also offers a series of wealth management portfolios that are managed consistently with our small-cap strategies through the use of thematic research and stock picking. These portfolios range in risk from very conservative to ultra-aggressive and everything in between. Many of these portfolios include an allocation to international equities. With a few exceptions like India, International markets have generally not kept up with U.S. stock market returns over the past 15 years primarily because the explosive growth in China peaked in 2010 and their economy has stalled relative to its hypergrowth rates of the 2000s. The chart below shows the EEM-Emerging market index (red line) compared to the S&P 500 since 2003. While there have been some periods of EEM outperformance post-2009, it's still below the levels seen in 2009.



Source: 1492 Capital Management and Factset

China has long been a focus of global investors and presents both significant opportunities and challenges. As the world's second-largest economy, it boasts tremendous potential across various sectors such as technology, consumer goods, and green energy. However, investing in China post-pandemic requires a nuanced understanding of its shifting economic dynamics, political leadership, and structural challenges. Since the COVID-19 pandemic, China's economy has experienced relatively weak growth compared to its previous decades of rapid expansion. Several key factors have contributed to this slowdown:

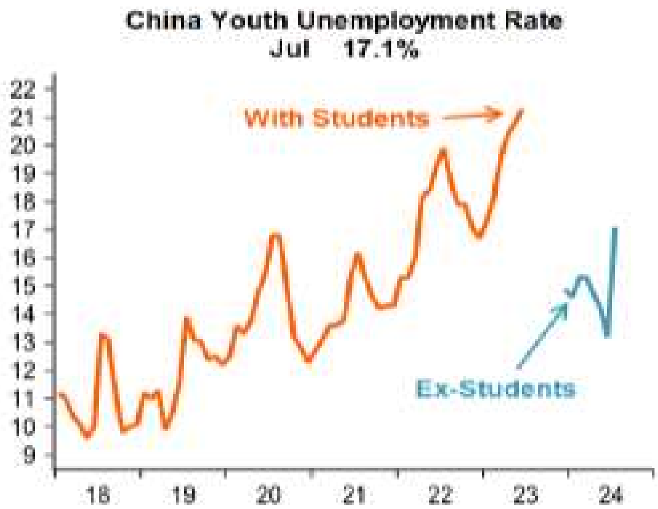
1. **Demographic Challenges:** China's population is aging rapidly with a declining birth rate and a shrinking workforce. The one-child policy, in place for decades, has left a lasting demographic impact, and is leading to fewer workers to support an aging population. This dynamic threatens long-term growth as fewer workers can reduce productivity and increase pressure on public welfare systems. The chart below shows how this phenomenon has played out over time.



Source: PSC

2. Political Leadership and Policy Shifts: Under President Xi Jinping, China has adopted a more centralized, state-driven approach to its economy. The government's increasing involvement in private sectors—especially through crackdowns on tech companies, educational firms, and property markets—has added uncertainty for investors. While these policies aim to address issues like inequality and monopolistic behavior, they have simultaneously dampened market confidence and caused a decline in entrepreneurial activity.

3. Sluggish Consumer Spending: Despite stimulus efforts, China's domestic demand has remained tepid. Lockdowns and uncertainty around potential future restrictions have dampened consumer confidence. Unlike Western economies, China's stimulus efforts have focused more on infrastructure and supply-side measures rather than on direct cash infusions into households. As a result, consumer sentiment and spending have been slow to rebound. High youth unemployment and low consumer confidence have weighed on China's economic rebound post-pandemic as seen in the two charts below.



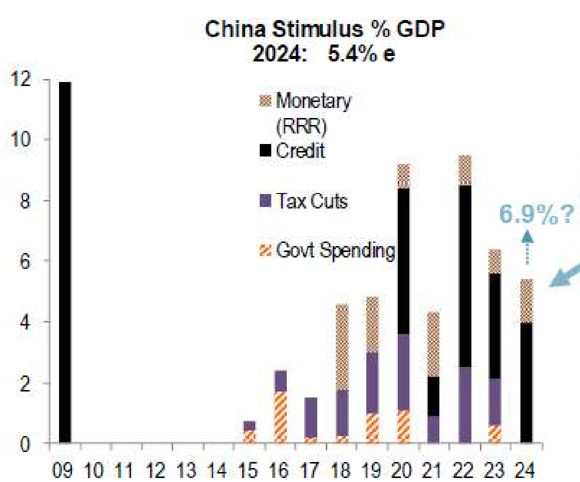
Source: PSC

Source: PSC

4. Real Estate Crisis: China's property sector, which has long been a pillar of its economic growth, faces significant challenges. Real estate developers like Evergrande have defaulted on debts and caused ripple effects throughout the economy. Given that housing investment contributes around 25-30% of China's GDP, a slowdown in this sector has had a substantial impact on broader economic performance.

5. Geopolitical Tensions: China's relationship with the U.S. and other Western nations has grown increasingly strained. Issues such as trade wars, Taiwan, and human rights concerns have led to heightened scrutiny of Chinese investments abroad with some countries tightening restrictions on Chinese firms. This geopolitical risk is a significant concern for global investors who may be wary of volatile bilateral relations.

While the Chinese government has introduced various stimulus measures to reignite growth, their effectiveness has been limited. Beijing has focused on infrastructure spending and easing monetary policy, but tight controls on local government borrowing and conservative fiscal policies have prevented a major stimulus boost. Additionally, the government has been hesitant to introduce large-scale consumption stimulus and opts instead for a supply-side approach that does not immediately translate into stronger domestic demand. Their stimulus package that was announced in late September, which triggered a 25% move in the Chinese stock market, is sizeable. It also sounds like there could be more to come. The chart below shows this package versus prior periods.



Source: PSC

China's September stimulus alone was about 2.8% of GDP, taking the ytd total to 5.4%. Last month's 13 stimulus moves focused on the property sector.

Pros of Investing in China

1. Large Domestic Market: With over 1.4 billion people, China still presents a massive market, especially in consumer goods, e-commerce, and technology. Rising incomes and urbanization are long-term trends that continue to make China attractive for multinational companies.

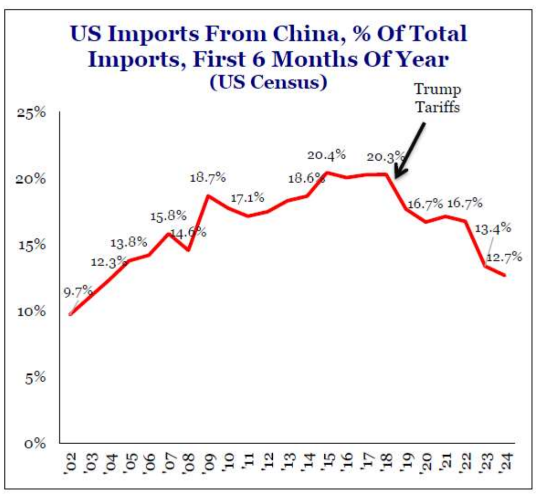
2. Advances in Technology and Innovation: China is a leader in cutting-edge sectors like artificial intelligence, fintech, and green energy. Its push towards becoming a global leader in electric vehicles, 5G, and renewable energy offers exciting growth opportunities for investors in these industries.

3. Global Supply Chain Hub: Despite some diversification of supply chains post-pandemic, China remains a critical part of global manufacturing and trade networks. Its manufacturing capabilities and infrastructure are world-class and make it a key player in global markets.

Cons of Investing in China

1. Regulatory Risks: The Chinese government's heavy hand in key industries can lead to sudden policy shifts that negatively impact entire sectors. The crackdown on technology firms in 2021 is a prime example of how regulatory uncertainty can dampen investor sentiment.

2. Political Risk: As China becomes more assertive globally, geopolitical tensions—especially with Western countries—create risks. Trade disputes, sanctions, or capital restrictions could further impact foreign investment. The impact of tariffs on Chinese imports is quite substantial according to the chart below.



Source: Strategas

3. Weak Economic Momentum: Sluggish post-pandemic recovery combined with demographic challenges limit China's growth potential. The slowdown in consumer spending and the real estate crisis are structural problems that could take years to resolve.

4. Capital Control and Market Access: China's financial system remains tightly controlled, with capital outflow restrictions and limited market access for foreign investors. Government policy heavily influences the country's stock markets, which makes it difficult to assess the true value of investments.

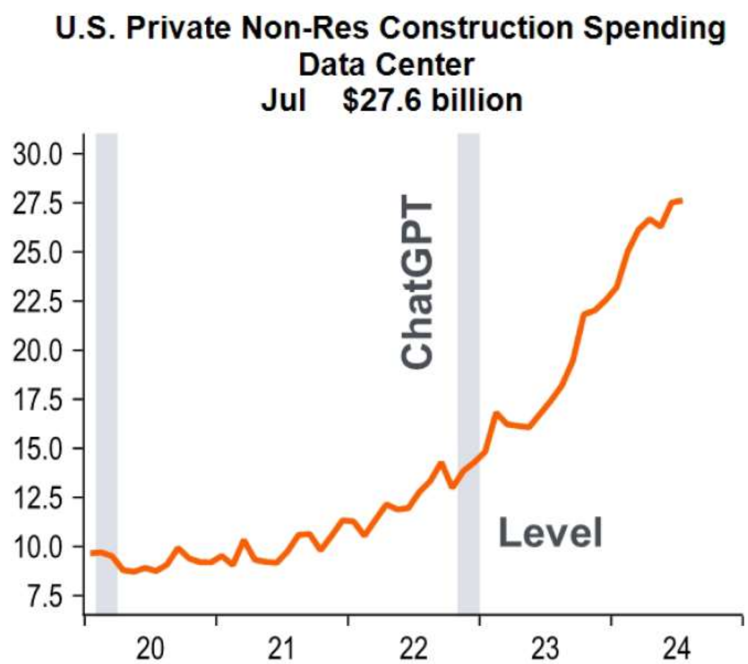
Investing in China offers a unique blend of high-growth potential and substantial risks. In the short term, the country is grappling with various challenges—from demographic shifts to regulatory overhauls and geopolitical pressures—that have tempered its economic momentum. However, sectors like technology, healthcare, and green energy continue to offer significant opportunities for investors who are willing to navigate this complex environment. The chart below shows how China's stock market has lagged significantly relative to the S&P 500 over the past two years. Note the spike in the Chinese index at the very end of the chart due to its latest stimulus measure. The real question is will it be sustained?

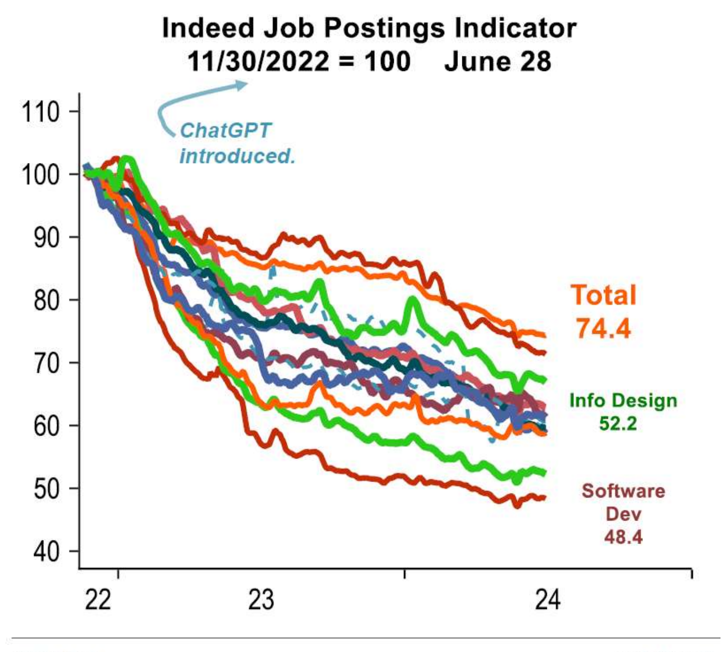
Source: Strategas

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.

Generative AI player ChatGPT was first made available in November 2022. Since then, capital spending on AI data centers has soared as shown on the left. However, you may not want to be a software developer as AI appears to be taking over some of that profession's functions based on the demand for developers shown on the right.





Whenever the stock market has strong periods of performance, the naysayers always claim that the market is in a bubble. As someone that has managed portfolios through the internet bubble of 1999-2000, the current period isn't even close, and the data below backs this up.

Mag 7 vs 2000s Tech Bubble

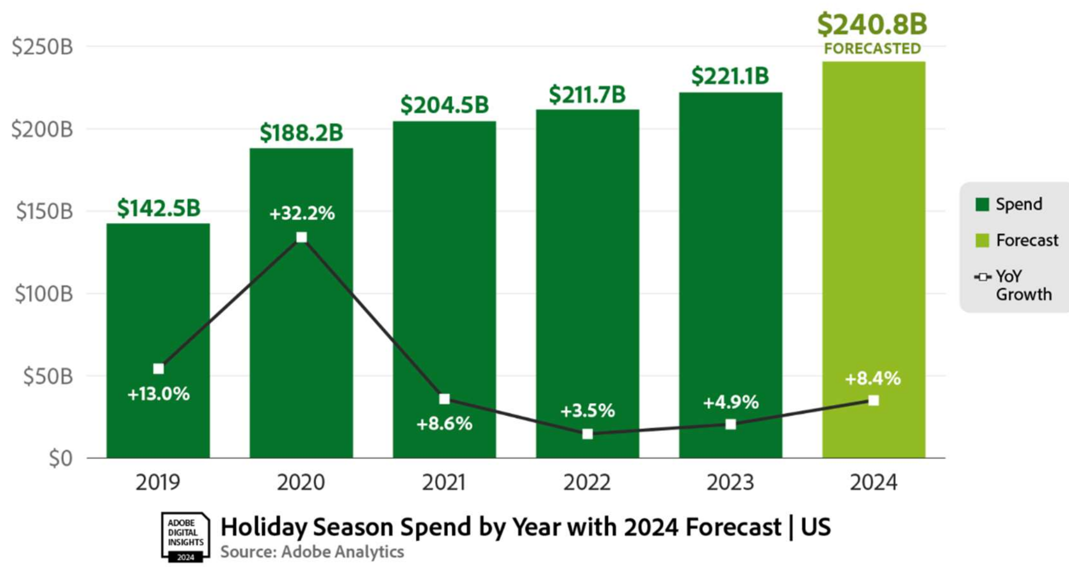
Magnificent 7	% OF U.S. MARKET CAP	CASH AS % OF MARKET CAP	24-MONTH FWD P/E	NET PROFIT MARGIN
Microsoft	6.6%	3.0%	25.7	35%
	7.3%	1.8%	26.5	27%
NVIDIA	5.7%	3.7%	24.1	53%
amazon	4.0%	8.6%	25.4	9%
Alphabet	3.9%	4.0%	16.6	28%
Meta	2.4%	4.2%	19.2	34%
TESLA	1.4%	4.3%	55.4	9%
Aggregate	31.3%	4.2%	23.9	28%
2000 Tech Bubble Leaders				
Microsoft	4.5%	3.0%	53.2	39%
cisco	4.2%	0.4%	101.7	17%
intel	3.6%	2.5%	42.1	25%
ORACLE	1.9%	1.0%	84.6	15%
IBM	1.7%	2.7%	23.5	9%
Lucent Technologies	1.6%	0.9%	37.9	9%
NORTEL	1.5%	1.1%	86.4	-1%
Aggregate	19.0%	1.7%	52.0	16%

Data for Tech Bubble stocks as of March 24, 2000. Mag 7 data as of Sept 2024.

The United States stock market now comprises nearly 50% of the world's total market capitalization. China's poor performance explains part of this level, but it can also be attributed to a strong legacy of U.S. technology development that creates new companies like Nvidia.

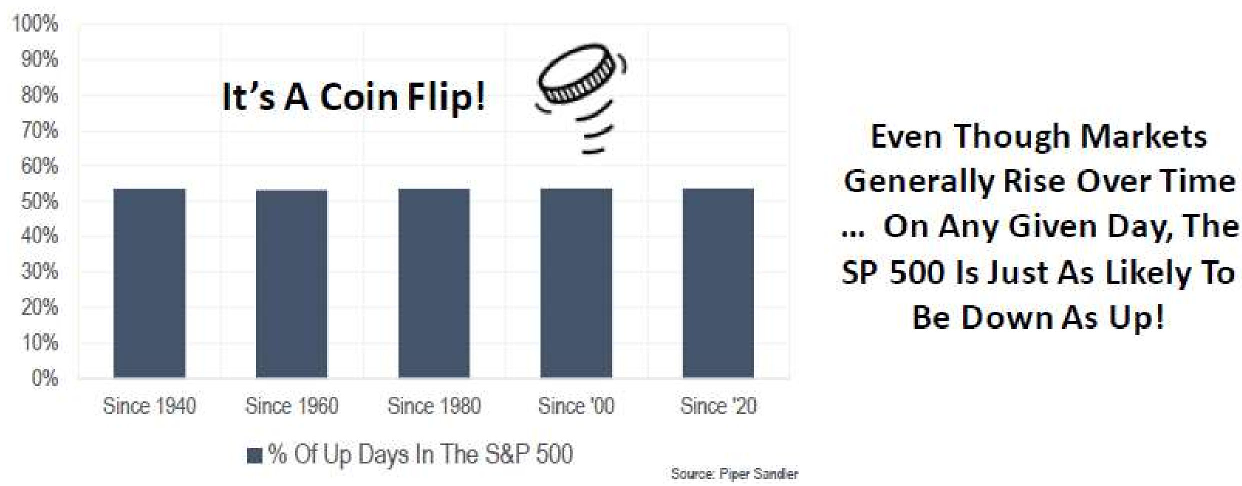
Source: Bloomberg, Apollo Chief Economist

Despite a lot of concern about the ability of the low-end consumer to keep spending (Dollar Tree, Dollar General), the forecast for Christmas 2024 spending is quite robust at+8.4% according to Adobe.

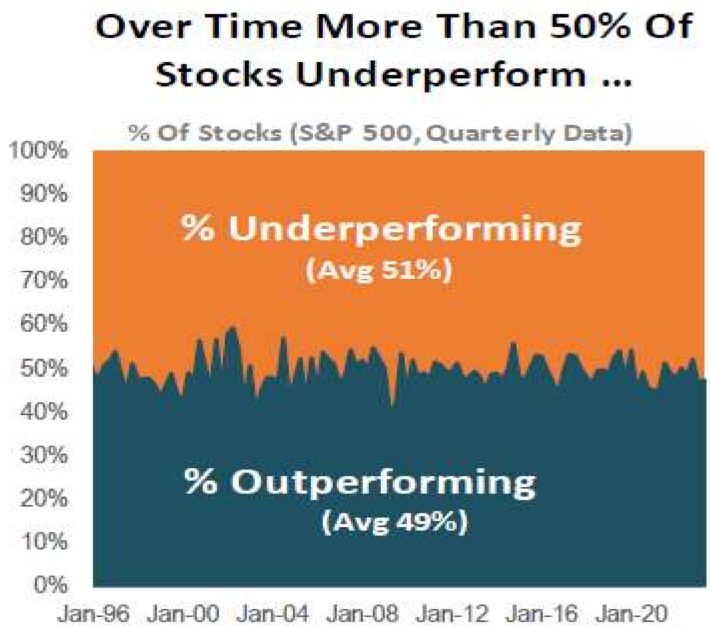


Stock Market Trivia

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 related to performance of the market and individual stocks over the long term. Interestingly, the first chart below shows that on any given day, the performance of the S&P 500 is literally a coin flip. Despite this probability, nearly 70% of the months since 1928 have been positive, and 96% of 10-year periods have been positive for the S&P 500.



Given the above facts, the statistics in the chart below may be even harder to believe. Over the long term, more stocks underperform than outperform by a slight margin. Also remember that stocks can "only" go down 100% but can appreciate multiple times over the long run. That skew is how the stock market can post strong returns collectively over the long run. The moral of the story is don't sell your winners.



Source: PSC

We hope that you found our third 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.

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