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 fourth 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 and wealth management portfolios. 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 business fundamentals, and a rigorous valuation methodology.

Elections Have Consequences- Market's Interpretation Isn't Always Right

2024 was the year of the Presidential election with several twists and turns along the way. In the end, Americans chose Trump as President, and as with any election, there are consequences. In typical fashion, the markets immediately jumped to conclusions. Stocks initially rallied aggressively (particularly small caps) as optimism surged around an agenda that is supposed to favor domestic companies over international and that renews an era of mergers and acquisitions which had been stymied under Biden's DOJ. The bond market began selling off right after the Fed's first interest rate cut in September as it sniffed out a Trump victory and as his implied inflationary impact from a new wave of tariffs and tax cuts. Bond yields have risen over 100 basis points since mid-September and pushed the 10-year US Treasury note yield above 4.5%, which is a level which is considered bearish for stocks. We believe the market's initial interpretation that a second Trump administration will be inflationary, primarily due to tariffs, is incorrect. Tariffs aren't inflationary as we'll explain later in the newsletter. The market is also setting lofty expectations for the newly formed DOGE (Department of Government Efficiency) to be led by Elon Musk and Vivek Ramaswamy. The numbers being bantered about for DOGE imposed, initial government spending cuts are in excess of $2 trillion and are pure fantasy. Nobody has benefited more from his endorsement of Trump and his involvement in DOGE than Elon Musk as Tesla's stock has skyrocketed 80% since election day. Musk's stake in Tesla has risen nearly $80 billion since the election so his "investment" in the Trump campaign seems to be working out just fine for him. The recent surge in interest rates has taken a bit of the shine off a great year for the stock market, which saw the S&P 500 rise +25.0% as the "Magnificent 7" served as the primary performance driver. Despite the strong year for the S&P 500, the Russell 2000 Index rose +11.5% and the other 493 stocks in the S&P 500 actually outperformed since June 30th, which implies a broadening out of the market. However, as rates climbed in the last few weeks of the year, the market returned to a defensive posture. As part of that playbook, they bought the "Magnificent 7" stocks and sold off everything else.

The Fed has indicated that further rate cuts are a way off. This stance will likely put the stock market's upward trajectory on a temporary pause as the market wants to continue to see a strong economy with minimal inflation. The current economic combo platter of 3.2% real GDP growth, 2.5% inflation, and 4.2% unemployment is ideal, but is it sustainable? Please read on to see our unique views of what's on tap for 2025, 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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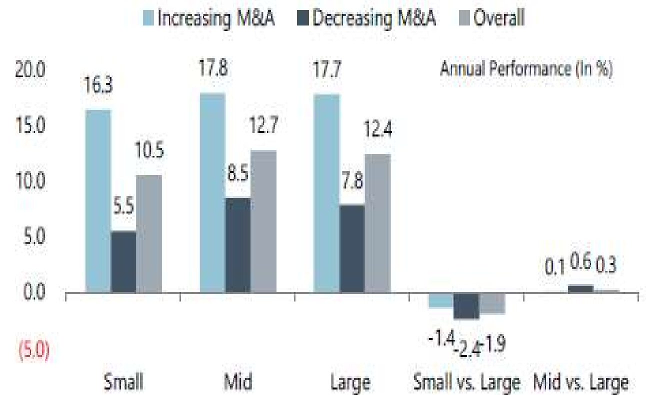
Elections Have Consequences - Market's Interpretation Isn't Always Right

2024 was the year of the Presidential election with several twists and turns along the way. In the end, Americans chose Trump as president, and as with any election, there are consequences. In typical fashion, the markets immediately jumped to conclusions. Stocks initially rallied aggressively (particularly small caps) as optimism surged around an agenda that is supposed to favor domestic companies over international and that renews an era of mergers and acquisitions which had been stymied under Biden's DOJ. Interestingly, when Trump was elected in 2016, the initial reaction to sectors allegedly destined to be the big winners ended up reversing once the market had a chance to digest policy and prospects a quarter later. The chart below left shows this phenomenon in 2016/2017 and the initial returns since the election so far in 2024. One of the sectors that is thought to be a big loser in the new administration is Health Care due to the appointment of RFK Jr. to the cabinet post as head of HHS. His positions are historically against those of the large pharma companies. The chart on the right shows that stock market returns across all size segments are substantially better when merger and acquisition activity increases. It's hard to imagine that M&A activity won't accelerate under a President whose best-selling book was "The Art of the Deal".

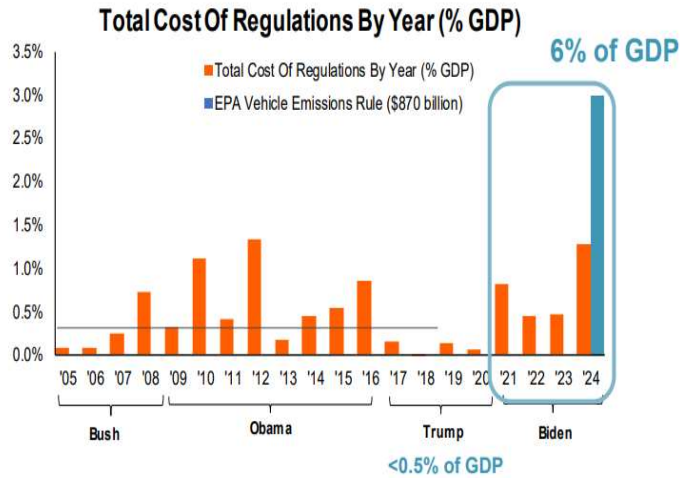
Index/Sector	Trump '16	1Q17
Small Cap Energy	25.5%	-11.1%
Large Cap Energy	21.7%	-14.2%
Small Cap Financials	18.9%	-1.6%
Mid Cap Financials	17.6%	1.7%
Small Cap Value	17.0%	-0.6%
Large Cap Financials	16.5%	2.1%
Russell 2000 EW	15.9%	-0.1%
Small Cap Materials	15.2%	4.4%
Small Cap Industrials	15.0%	0.4%
Russell 2000	13.6%	2.1%
Mid Cap Industrials	13.1%	3.1%
Large Cap Comm Services	12.8%	-5.1%
Small Cap Consumer Discretiona	12.6%	1.2%
Mid Cap Comm Services	12.2%	-15.1%
Japan/Nikkei	11.3%	-1.1%
Small Cap Consumer Staples	10.3%	-5.0%
Small Cap Growth	10.0%	5.1%
Mid Cap 400	9.7%	3.6%
Small Cap Technology	9.4%	6.8%
Large Cap Europe	8.7%	4.5%
Large Cap Energy	8.6%	-7.3%
Mid Cap Consumer Discretionary	8.3%	4.2%
Mid Cap Technology	8.0%	7.2%
Mid Cap Materials	8.0%	7.5%
Small Cap Europe	7.9%	5.5%
Large Cap Value	7.2%	2.6%
Large Cap Industrials	7.0%	4.0%
Small Cap Utilities	6.8%	2.4%
Mid Cap Health Care	6.2%	9.5%
Small Cap Health Care	6.2%	12.4%
Russell 1000 EW	5.6%	4.9%
Large Cap Materials	5.4%	5.3%
Mid Cap Real Estate	4.7%	0.4%
S&P 500	4.6%	5.5%
Mid Cap Consumer Staples	3.6%	2.1%
Large Cap Consumer Discretiona	3.5%	8.1%
Mid Cap Utilities	3.3%	4.9%
Large Cap Growth	2.5%	8.5%
Large Cap Real Estate	1.3%	2.7%
Large Cap Tech	1.0%	12.2%
Large Cap Health Care	0.9%	7.9%
Large Cap Utilities	-1.0%	5.4%
Large Cap Consumer Staples	-1.7%	5.6%
China/CSI-300	-1.8%	4.4%
India	-5.1%	17.4%
Emerging Markets	-6.0%	12.0%

Index/Sector	Trump '24
Large Cap Consumer Discretionary	16.7%
Small Cap Technology	16.0%
Large Cap Growth	10.8%
Large Cap Comm Services	9.7%
Large Cap Energy	7.8%
Large Cap Financials	7.3%
Small Cap Consumer Staples	6.7%
Large Cap Tech	6.4%
Japan/Nikkei	6.2%
Mid Cap Financials	5.7%
Small Cap Financials	5.5%
Mid Cap Consumer Staples	5.1%
Russell 2000 EW	4.6%
Small Cap Growth	4.4%
Small Cap Industrials	4.2%
Mid Cap Technology	3.9%
S&P 500	3.2%
Russell 2000	2.3%
Small Cap Consumer Discretionary	1.7%
Mid Cap Comm Services	0.9%
Mid Cap 400	0.1%
Small Cap Value	0.0%
Russell 1000 EW	-0.5%
Mid Cap Consumer Discretionary	-0.5%
China/CSI-300	-0.9%
Large Cap Value	-1.1%
Mid Cap Industrials	-1.4%
Mid Cap Utilities	-1.4%
Large Cap Industrials	-2.0%
Large Cap Europe	-2.5%
Mid Cap Health Care	-3.0%
Large Cap Consumer Staples	-3.0%
Small Cap Europe	-3.0%
Small Cap Materials	-3.6%
Small Cap Energy	-4.3%
Small Cap Utilities	-4.4%
Small Cap Health Care	-4.4%
Large Cap Energy	-4.6%
Large Cap Utilities	-5.9%
Emerging Markets	-6.2%
Mid Cap Materials	-7.0%
Mid Cap Real Estate	-8.8%
Large Cap Real Estate	-8.9%
India	-9.4%
Large Cap Health Care	-10.1%
Large Cap Materials	-12.2%

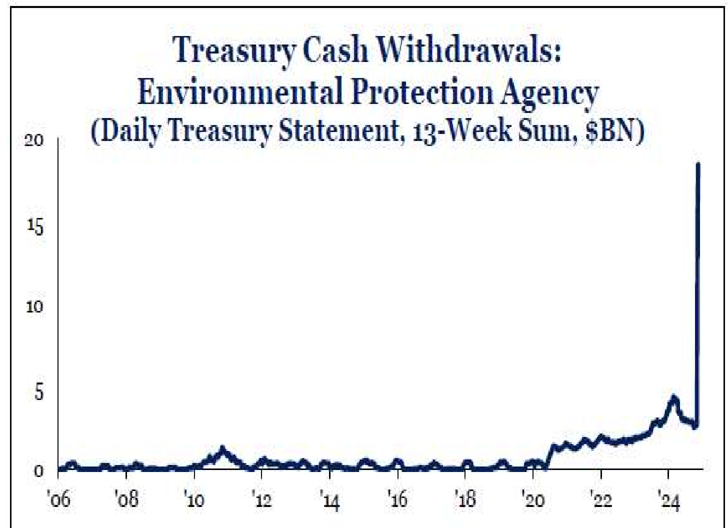
Source: Factset, Raymond James research



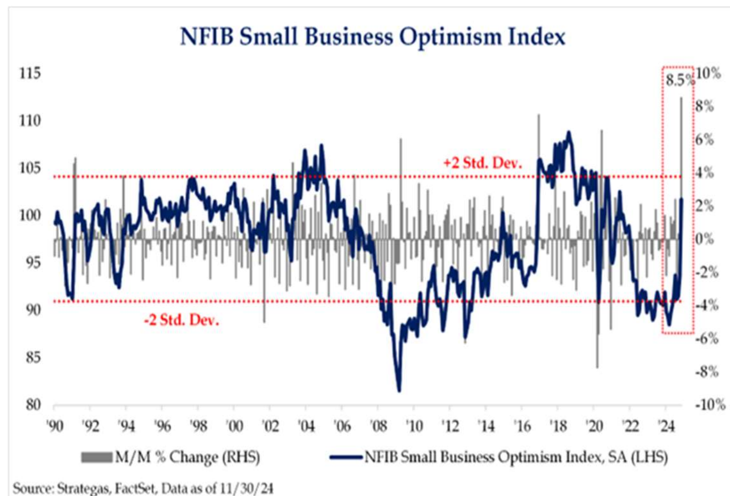
The chart below left shows the annual cost of new regulations by presidential term. On this note, there is reason for optimism as the first Trump administration rolled back many onerous regulations and added very few. Note that including the recent passage of the new EPA emissions rules, the total cost of the Biden Administration's regulations added during his term totaled 6% of GDP. Thus, there is optimism that many of these regulations will be removed under Trump. Even before leaving office, the Biden Administration is accelerating the awarding of dollars to its favored causes like the EPA as shown in the chart below right.



Source: Doug Holtz-Eakin, American Action Forum



The response to Trump's election was notable in small businesses that felt like the cumulative impact of inflation over the past four years and additional regulations suffocated them. The chart below left shows the spike in the small business optimism index following Trump's election. This move was the largest monthly jump in the history of the index. The chart on the right shows the return of various indices in the inauguration year after the Presidency switches parties. The figures in the red box show that inauguration years have historically favored small and mid cap stocks with returns in the mid-teens and 80%+ positive outcomes.



Source: Strategas, FactSet, Data as of 11/30/24

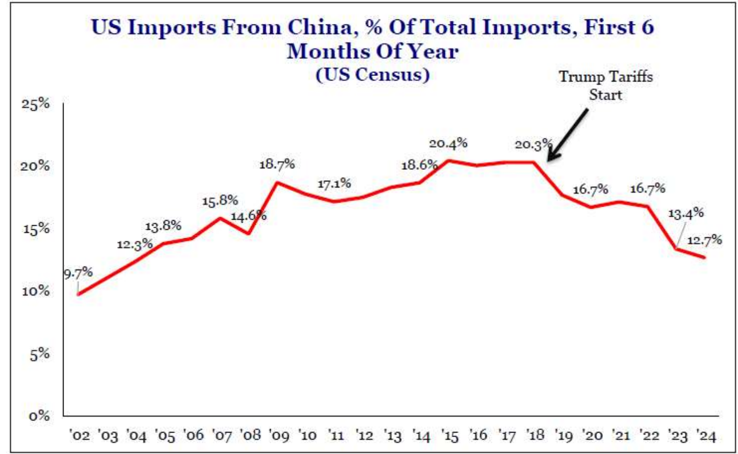
Major Averages Performance | When the U.S. Presidency Switched Parties (1900-YTD)

Year	Party	President	Annual Return			
			INDU	SPX	MID	RTY
1913	Democratic	Woodrow Wilson	-10.34%	-	-	-
1921	Republican	Warren G. Harding	12.30%	-	-	-
1933	Democratic	Franklin D. Roosevelt	63.74%	44.08%	-	-
1953	Republican	Dwight D. Eisenhower	-3.77%	-6.62%	-	-
1961	Democratic	John F. Kennedy	18.71%	23.13%	-	-
1969	Republican	Richard Nixon	-15.19%	-11.36%	-	-
1977	Democratic	Jimmy Carter	-17.27%	-11.50%	-	-
1981	Republican	Ronald Reagan	-9.23%	-9.73%	-	-1.50%
1993	Democratic	Bill Clinton	13.72%	7.06%	11.72%	17.26%
2001	Republican	George W. Bush	-7.10%	-13.04%	-1.64%	1.02%
2009	Democratic	Barack Obama	18.82%	23.45%	35.00%	25.21%
2017	Republican	Donald Trump	25.08%	19.42%	14.45%	13.14%
2021	Democratic	Joe Biden	18.73%	26.89%	23.21%	13.70%
2025	Republican	Donald Trump	?	?	?	?
		Average	8.32%	8.34%	16.55%	11.47%
		Median	12.30%	7.06%	14.45%	13.42%
		% Positive	54%	55%	80%	83%
		Maximum	63.74%	44.08%	35.00%	25.21%
		Minimum	-17.27%	-13.04%	-1.64%	-1.50%

Source: Piper Sandler Technical Research/Bloomberg # of occurrences: 14

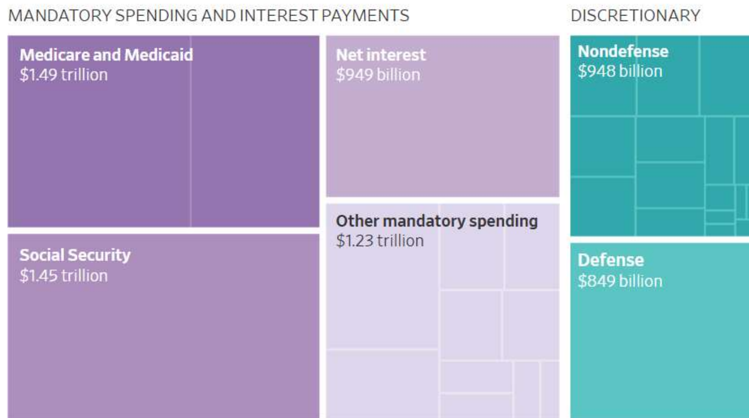
The bond market began selling off right after the Fed's first interest rate cut in September as it sniffed out a Trump victory and his implied inflationary impact from a new wave of tariffs and tax cuts. Bond yields have risen over 100 basis points since mid-September and pushed the 10-year US Treasury note yield above 4.5%, which is a level that is considered bearish for stocks. The chart below left shows this phenomenon in which the Fed is cutting rates, but the market rates are going higher. We believe the market's initial interpretation that a second Trump administration will be inflationary, primarily due to tariffs, is incorrect. Tariffs aren't inflationary because, in an environment in which consumers don't have unlimited disposable income, people are forced to shift wallet share. Therefore, some prices rise due to tariffs and others decline due to falling demand. It's been shown in prior episodes of tariffs that the country or entity that is hit with a tariff absorbs about half of the increase and tries to pass on the other half to consumers. Also, foreign currencies adjust accordingly. However, other domestic sources for the goods generally take share and offset much of the remaining tariff impact. *Net, tariffs generally redistribute fixed-budget spending and without a lift to disposable income, overall price levels generally won't increase.* The chart below right shows the significant drop in imports from China that occurred in the first Trump administration when it imposed tariffs on a number of Chinese manufactured goods. Anecdotally, many companies that we speak to regularly have shifted their supply chains to other countries in Southeast Asia and Mexico over the past six years.

Source: PSC



Source: Strategas

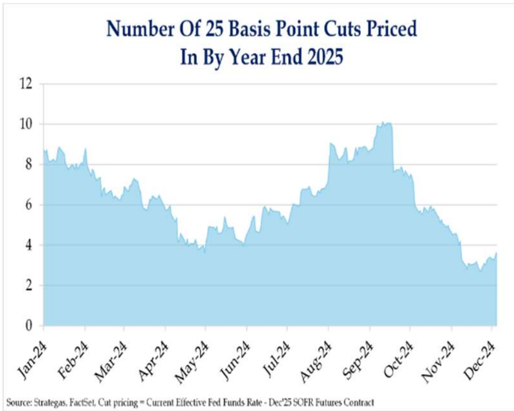
The market is also setting lofty expectations for the newly formed DOGE (Dept. of Government Efficiency) to be led by Elon Musk and Vivek Ramaswamy. The numbers being bantered about for DOGE imposed, initial government spending cuts are in excess of $2 trillion and are pure fantasy. The U.S. federal government spent $6.75 trillion in the fiscal year ending September 30, 2024. As the chart below left shows, a significant majority of this spending is on mandatory programs like Social Security, Medicare/Medicaid, and interest expense on the government debt. Approximately $550 billion is spent on salaries and wages for the 3.7 million Americans employed as civilians or defense personnel. Even cutting a substantial amount of headcount wouldn't generate anywhere near the targeted savings numbers. The non-defense discretionary bucket of spending, which is where most spending cuts traditionally are derived, only represents $948 billion. We applaud the new administration for trying to shrink government spending in a non-traditional way as most other efforts throughout history have failed. However, expectations need to be more realistic. Nobody has benefited more from his endorsement of Trump and his involvement in DOGE than Elon Musk, as Tesla's stock has skyrocketed 80% since election day. Musk's stake in Tesla has risen nearly $80 billion since the election, so his "investment" in the Trump campaign seems to be working out just fine for him. Tesla is in the "Magnificent 7," which has accounted for much of the S&P 500 Index's 2024 gain. The top 10 stocks in the S&P 500 by market cap now represent a whopping 40% of the total index as shown in the chart below right, which is a level that is double that of 10 years ago and significantly higher than the tech bubble of 2000.

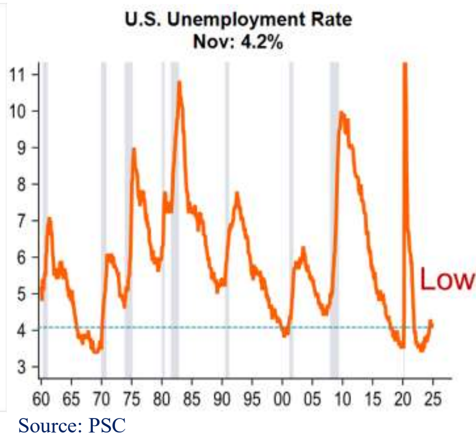


Note: Numbers don't add up to $6.75 trillion, because some categories are from the CBO's November report; others are from data released in June and may change.
Source: Congressional Budget Office

Source: Charles Schwab, Bloomberg, as of 12/20/2024. Indexes are unmanaged, do not incur management fees, costs and expenses and cannot be invested in directly. Past performance is no guarantee of future results.

The Fed, at its recent December meeting, indicated that further rate cuts are likely a way off. This stance will likely put the stock market's upward trajectory on a temporary pause. The chart below left shows the current expectations of the Fed Funds Futures, which implies the market is now expecting three additional rate cuts by the end of 2025. However, notice from the chart, the market's predictions have been quite poor and volatile this year. The market wants to continue to see a strong economy with minimal inflation. The current economic combo platter of 3.2% real GDP growth, 2.4% inflation (Core PCE), and 4.2% unemployment is ideal, but is it sustainable? The chart below in the middle shows that the current unemployment level is historically quite low, and the Core PCE Deflator chart on the right, which is the Fed's favorite measure of inflation, is currently at 2.4% and moving closer to its 2% target.

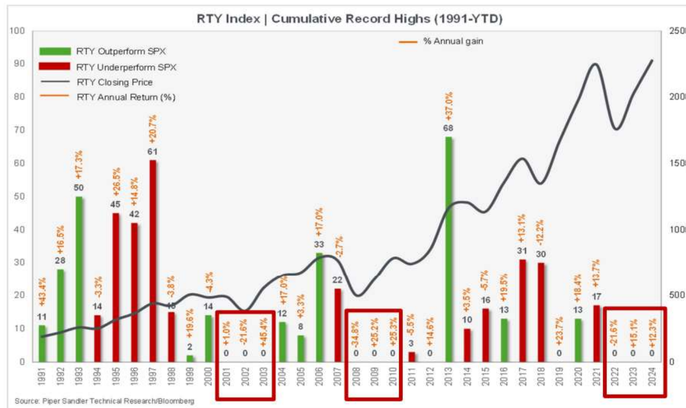


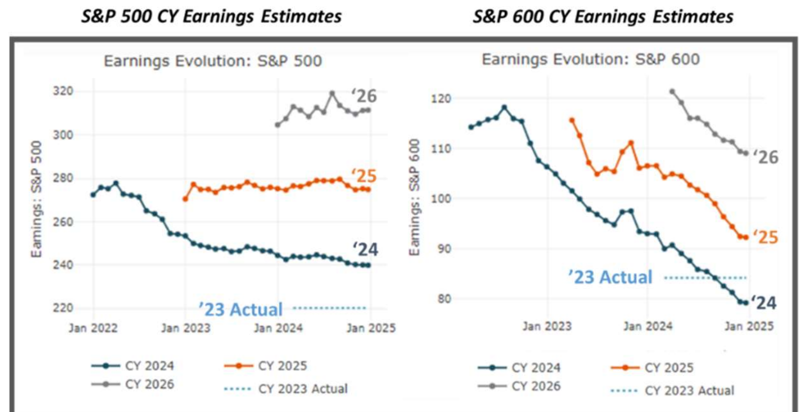


Source: PSC

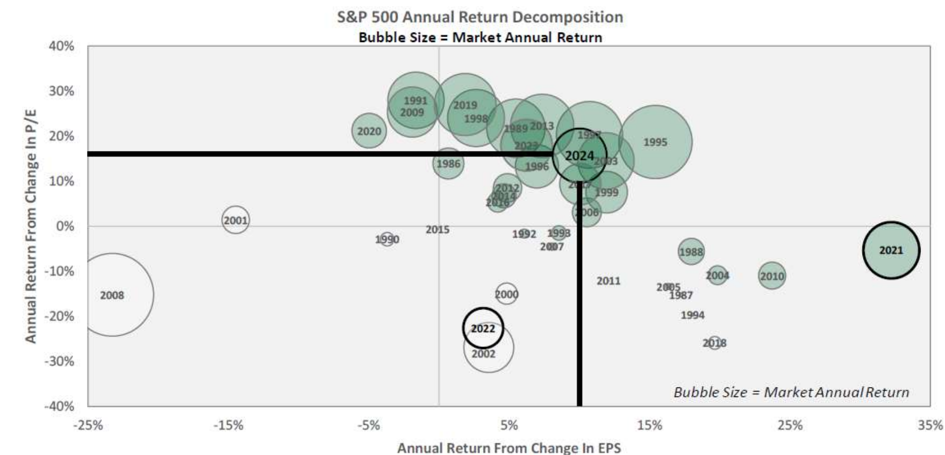
Source: PSC

The recent surge in interest rates has taken a bit of the shine off a great year for the stock market which saw the S&P 500 rise +25% as "Magnificent 7" served as the primary performance driver. Despite the strong year for the S&P 500, the Russell 2000 Index (+11.5%) and the other 493 stocks in the S&P 500 outperformed since June 30th, which implies a broadening out of the market. However, in the last month of the year, as rates climbed, the market returned to a defensive posture. As part of that playbook, they bought the "Magnificent 7" stocks and sold off everything else. The Russell 2000 Index dropped -8.3% in December alone and remains the only major index that hasn't reached a new all-time high in 2024. In fact, it hasn't hit a new high in three years as shown in the chart below left. This failure has only happened two other times in the last 35 years. The main culprit is that earnings expectations for small caps have fallen more dramatically in 2024 than for the S&P 500 as shown in the chart below left. Earnings expectations are always a little frothy entering a year, but the S&P 500's held steadier than the S&P 600 Small-cap Index on the right. The third chart below shows the annual return decomposition between earnings growth (about 10%) and P/E expansion (about 15%) for the S&P 500. This recipe yields a good year in the stock market.



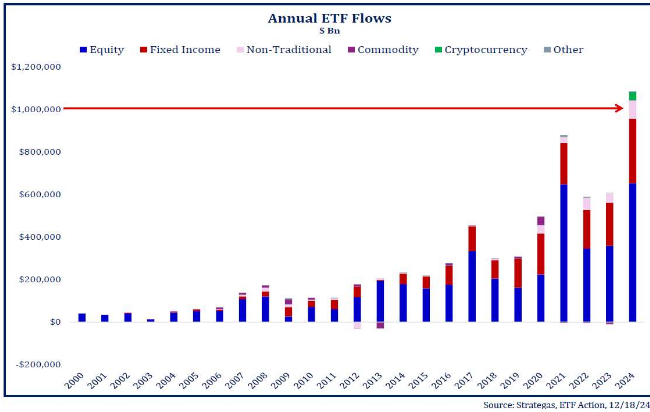


Source: PSC



Source: PSC

As shown on the chart below left, fund flows throughout 2024 have been strong across all asset classes and helped to fuel returns across most asset classes. ETF flows pierced the $1 trillion level for the first time in 2024. Notably, cryptocurrency flows showed up meaningfully as more vehicles were approved for trading as Bitcoin ETF's and as Trump endorsed cryptocurrencies more broadly. The chart on the right shows what happened in prior periods where the S&P 500 was up more than 20% per year for two years. The prospects are pretty strong for the small and mid cap asset classes, in particular, as shown in the red box. However, there haven't been many instances like this scenario going back to 1928.



Source: Strategas, ETF Action, 12/18/24

SPX Performance After Two Consecutive Year Return > 20% (1928-YTD)

Year 1	% Return	Year 2	% Return	Following Year Return SPX	MID	RTY
1935	41.37%	1936	27.92%	-38.59%	-	-
1954	45.02%	1955	26.40%	2.62%	-	-
1995	34.11%	1996	20.26%	31.01%	30.44%	20.69%
1996	20.26%	1997	31.01%	26.67%	17.68%	-3.83%
1997	31.01%	1998	26.67%	19.53%	13.35%	19.59%
2023	24.23%	2024	26.47%	?	?	?
Source: Piper Sandler Technical Research/Bloomberg			Average	8.25%	20.49%	12.15%
# occurrences: 6			Median	19.53%	17.68%	19.59%
			% Positive	80%	100%	67%
			Maximum	31.01%	30.44%	20.69%
			Minimum	-38.59%	13.35%	-3.83%

As shown in the table below, the stock market in the quarter was mixed but positive and closed out a generally strong year. In the second half of the year, the market broadened out from just the Magnificent 7 driving returns. Small caps underperformed large caps for the year with the Russell 2000 Index and the S&P 500 up 11.5% and +25.0%, respectively. The NASDAQ recorded another strong year as the gold medalist with a +29.6% advance. The NASDAQ and S&P 500 maintained a sizeable lead over small caps on a year-to-date basis due to the outperformance of the "Magnificent 7" in the first half of the year and the month of December. This market strength lifted the S&P 500 and NASDAQ Composite to numerous all-time highs, whereas the Russell 2000 still hasn't surpassed its all-time high from late 2021. The S&P 500 has now posted positive performance in five straight quarters.

Index Returns

Index	Fourth Qtr. 2024 Return	2024 YTD Return
Russell 2000	+0.33%	+11.54%
Russell 2000 Growth	+1.70%	+15.15%
Russell 2000 Value	-1.06%	+8.05%
S&P 500	+2.41%	+25.02%
Dow Jones Industrials	+0.51%	+12.88%
NASDAQ Composite	+6.35%	+29.57%

Source: 1492 Capital Management, LLC and FactSet

From a style perspective, the Russell 2000 Growth Index (+15.2%) beat the Russell 2000 Value Index (+8.1%) for the year. This marks a two-year winning streak for the growth index. The broadening out in the market certainly helped small cap stocks in the second half of the year, but the small cap indices pulled back sharply in the month of December as interest rates climbed substantially as the quarter progressed. The best-performing sector in the Russell 2000 for the quarter was Technology (+9.7%) by a long shot as many tech stocks were targets of retail meme stock buying on themes around quantum computing and cryptocurrencies. Otherwise, it was a mixed bag for sector performance in the fourth quarter with the Healthcare sector (-7.6%) bringing up the rear as the market expressed concern over the sector's prospects with RFK Jr. as head of HHS. For the year, every sector except for Energy (-3.0%) was up on the year with the Technology sector (+25.3%) taking the crown for 2024. The table immediately below highlights the performance of the Russell 2000 style indices by sector for the fourth quarter and full year 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 in 2024. However, this quarter showed a relatively stable performance between larger and smaller market caps as the market performance broadened.

Table 8 - Russell 2000 Scorecard through December 31st

GICS Sector	December Absolute	December Contribution	December Relative	4Q2024 Absolute	4Q2024 Contribution	4Q2024 Relative	2024 Absolute	2024 Contribution	2024 Relative	Wgt
Com Serv	-8.03	-0.21	0.22	0.69	0.02	0.35	12.11	0.32	0.57	2.7
Discretionary	-7.97	-0.78	0.29	-1.66	-0.19	-2.00	7.20	0.70	-4.34	9.7
Staples	-6.29	-0.18	1.97	5.62	0.14	5.28	24.59	0.66	13.05	2.8
Energy	-7.74	-0.37	0.51	-2.68	-0.09	-3.02	-2.98	-0.01	-14.52	5.1
Financials	-9.11	-1.72	-0.85	3.47	0.60	3.13	15.42	2.58	3.88	18.7
Health Care	-10.13	-1.65	-1.87	-7.57	-1.20	-7.91	1.69	0.69	-9.85	16.3
Industrials	-9.31	-1.65	-1.06	4.05	0.68	3.71	17.57	2.90	6.03	17.8
Info Tech	-2.94	-0.46	5.32	9.71	1.04	9.37	25.34	3.15	13.80	13.8
Materials	-11.87	-0.53	-3.61	-4.69	-0.18	-5.03	2.25	0.13	-9.29	4.3
Real Estate	-7.84	-0.47	0.42	-5.97	-0.37	-6.31	5.43	0.34	-6.11	6.1
Utilities	-8.44	-0.22	-0.19	-4.64	-0.12	-4.98	3.81	0.09	-7.73	2.7

Size Quintile	December Absolute	December Contribution	December Relative	4Q2024 Absolute	4Q2024 Contribution	4Q2024 Relative	2024 Absolute	2024 Contribution	2024 Relative	Wgt
1 (Largest)	-9.04	-5.22	-0.78	-0.85	-0.46	-1.19	13.49	7.78	1.95	57.4
2	-7.73	-1.81	0.53	1.45	0.30	1.11	11.38	2.65	-0.16	23.4
3	-6.93	-0.79	1.32	1.34	0.15	1.00	6.48	0.69	-5.06	11.5
4	-5.40	-0.29	2.86	5.01	0.25	4.67	8.03	0.39	-3.51	5.6
5 (Smallest)	-7.23	-0.15	1.02	2.80	0.06	2.46	0.09	-8.15	2.16	0.0

Source: Jefferies

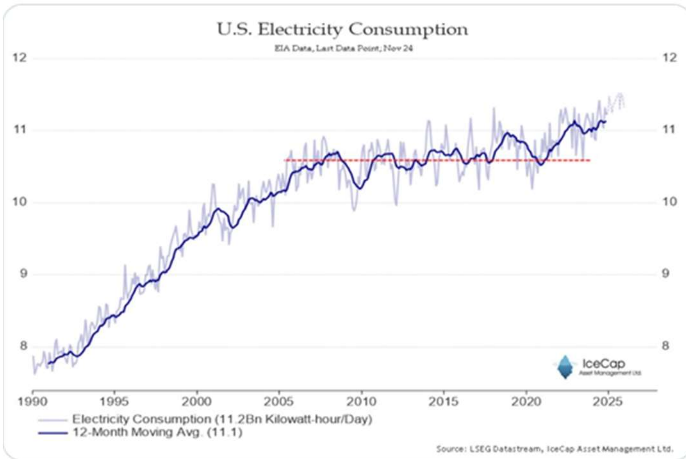
Returns in the international markets were quite mixed with positive returns in most of Asia and mixed returns in Europe and Latin America. China's substantial stimulus programs rolled out over the past few months have broadly helped their markets and emerging markets. European markets were mixed with Germany leading the way as they have significant exposure to China. Japanese investors continued to worry over interest rates and the Yen's weakness but had a strong year overall. Bond market returns were flat to negative again as the spike in interest rates late in the year caused a selloff across the entire bond spectrum. From a commodity perspective, natural gas was a clear standout after being pummeled late 2023 and into the first part of 2024 as supply now looks more in line with future demand. Gold also appreciated nicely as it rode the theme of inflation reaccelerating under President Trump. Oil was flat as demand concerns crept into the market as supplies built.

Index	Fourth Qtr. 2024 Return	2024 YTD Return
France	-3.2%	+0.9%
Germany	+3.0%	+18.9%
Brazil	-8.7%	-10.4%
India	-7.2%	+9.5%
China- A Shares	+0.5%	+12.6%
China- Shenzhen A Shares	+1.6%	+6.5%
Japan	+5.4%	+21.3%
Long-Term Treasuries (TLO)	-9.9%	-9.8%
Investment Grade Corp Bonds	-2.9%	+2.5%
Gold	-0.7%	+27.5%
Volatility- VIX index	+3.7%	+39.4%
Oil	+5.2%	+0.1%
Natural Gas	+6.0%	+33.1%
Lumber	+5.6%	+1.3%

Source: 1492 Capital Management, LLC

Thematic Investing: Power Demand Surge for AI/HPC Datacenters

To paraphrase from the classic baseball film "Field of Dreams", if you power it, they will come. We thought this movie reference aptly describes the insatiable thirst for reliable power that AI/HPC (high-performance computing) datacenters require to set up operations. As you can see in the chart below left, U.S. daily electricity consumption is breaking out from a two decade long sideways pattern of minimal growth, and the AI/HPC datacenter and bitcoin mining boom are the driving forces. According to the Electric Power Research Institute, datacenters could use up to 9% of total electricity generated in the U.S. by the end of the decade, which is a doubling from current levels. The chart below right shows the complexity of datacenters by tiers with the higher tiers dominating the landscape and requiring extremely high levels of uptime, processing redundancy, and power outage protection. These higher tier datacenters are the ones that the likes of Amazon, Microsoft, and Meta require.



Data Centers	Tier 1	Tier 2	Tier 3	Tier 4
Uptime	~99.67%	~99.74%	~99.98%	~100.00%
Implied Downtime	~28.8 Hours	~22.7 Hours	~1.6 Hours	~0.4 Hours
Redundancy	None	Limited	N+1	2N
Power Outage Protection	NA	NA	72 Hours	96 Hours
Est. US Share of Capacity (MW) in 2024	~10%*		~50%	~40%

Source: Uptime, Mordor Intelligence, BTIG Research
*Note: ~6% of US data center capacity in 2029 is split between Tiers 1 and 2

AI/HPC providers across the four tiers need a consistent power supply and the sooner the better. While utilities are adding power generation to be available in the medium term, the near-term demand has created a shift in the bitcoin mining business plan as they are holding significant power supply used in their operations. Simplistically, the miners like mining, but they love money. Many of the miners are offering portions of their power supply to sign AI/HPC clients to use repurposed existing mining facilities or create new facilities for their processing needs. According to Reuters, roughly 20% of power capacity from bitcoin mining is shifting to AI over the next two years. Morgan Stanley research estimates that using the existing power from bitcoin mining to drive the AI/HPC datacenter buildout can save 3.5 years of time versus waiting for utility grid expansion, which translates to huge monetary savings as well. Recently bitcoin miner Core Scientific struck a deal to lease its facilities for $6.7 billion over 12 years to Nvidia-backed CoreWeave. In general, the bitcoin industry is offering two business models to the AI/HPC datacenter community. On the chart below left, the bitcoin provider will provide the power, the facility, and the GPUs (graphic processing units) as a cloud service provider to the client in a high capex/high revenue model. On the chart below right, the bitcoin company will provide the power and the facility for a lower capex/lower revenue strategy.

Cloud Service Provider

Datacenter & DGX SuperPOD Deployment
Typical Size: 0.5 – 15 MW
Contract Duration: 0.5 – 3 Years
CapEx / MW [1]: $29M - $33M
Potential Revenue / MW [2]: $10-$21M

Co-Location Services

Rack-Ready Datacenter
Typical Size: Scaled Deployments 75+ MW
Contract Duration: 10 – 20 Years
CapEx / MW [3]: $8M - $12M
Potential Revenue / MW [4]: $1.2M-$1.8M

Source: Bitdeer Technologies Group

According to an analysis from BTIG Research, the bitcoin miner pays roughly $.04-.05/kWh for its power and has a gross profit of roughly $.06/kWh at a $100,000 bitcoin price. With a colocation deal for a datacenter customer with power passthrough costs, the miner can earn roughly $.15-17/kWh or over twice the gross margin with the stability of a long-term contract as the landlord. Hence, the improved margin profile drives the attractiveness of redeploying power and facilities to the datacenter business from the traditional bitcoin mining. Better profitability to the miner and faster data processing capacity from using the bitcoin power supply versus the longer wait for new utility power generation creates a win-win scenario for both parties if it's well executed. In preparation for this business shift, four bitcoin miners have collectively raised $1.9 billion in capital recently to have the proverbial dry powder for the capital spending needed for their new strategy.

Along with this shorter-term strategy of sourcing power from bitcoin miners, the buildout of new datacenters will also focus on reliable power supply, which favors natural gas generation. As an example, Meta plans to develop a $10 billion datacenter in northern Louisiana. While there is a plan to supply it with 100% renewable energy long term, it is highly likely that there will be delays in power supplied from nuclear and that natural gas is the reliable fuel option for the extra power needed for the sizable incremental electricity required for this facility. Meta management therefore chose to locate this project next to Haynesville shale natural gas production, which is a prolific basin with ample production growth possibilities and generally unconstrained infrastructure. Here in Wisconsin, Microsoft is spending $3.3 billion for the first phase of its datacenter project, and WE Energies, the Wisconsin utility in that area, is requesting two natural gas-fired power plants to satisfy the region's AI/HPC electricity demand growth. Serving as the best near-term fuel source for reliable and expandable power generation, natural gas is now benefitting from both this datacenter surge and the liquified natural gas demand that is ramping in the U.S. We believe that natural gas reserves will be a catalyst for mergers and acquisitions activity in the energy industry in the near term.

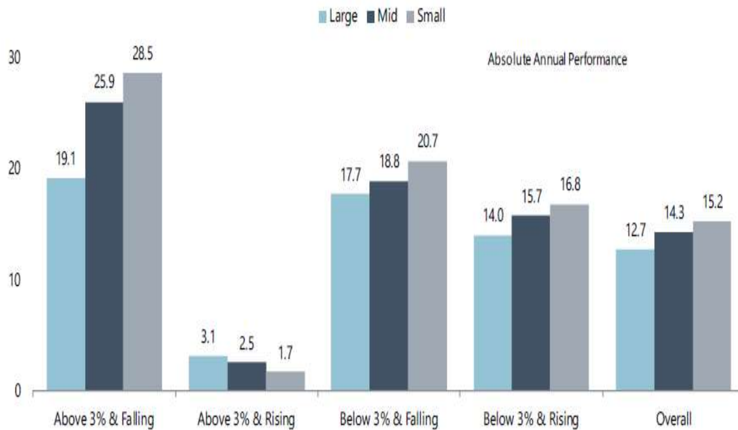
From a thematic investment perspective, this power demand surge for datacenters theme can be deployed with bitcoin mining companies with flexible power supply, with power generation and electrical infrastructure providers with mission critical equipment, and with strategically well-positioned natural gas companies that supply the critical fuel for near term power generation. We have begun deploying this investment theme and continue to research additional opportunities as we enter 2025.

2025 Outlook: Our Fearless Forecast – It's All About Interest Rates in the Right Places in 2025

In any market environment, interest rates are a key cog in the wheel that determines the stock market's direction. A very recent case in point is the performance of the Russell 2000 Index late in 2024. In late November 2024, the index was up 22% for the year but finished at only +11.5% as interest rates climbed above 4.5%. In last year's outlook piece, we used one of our favorite lines regarding small caps- "Rising 10-year yields are like Kryptonite for small caps". This thought still holds as small caps *are perceived* to be more sensitive to rates because they are viewed as having to finance their growth through higher-cost financing mechanisms, like high-yield debt and their earnings streams are generally longer duration in nature. We disagree with this point but that's an argument for another day. Sometimes it's the absolute level, and sometimes it's the direction of interest rates that drives the stock market. Interest rates play a part in the discount rate of future cash flows to determine the theoretical "present value" of those cash flows and thus the current value of a stock or the entire market. For 2024, it was the direction that mattered most as the Fed began its interest rate cutting cycle in September and made a total of four- 25 basis point cuts through year end. However, as we showed above, despite the Fed *cutting* the Fed Funds rate by 100 basis points in 2024, the real interest rate that drives valuations, mortgages, and corporate borrowing is the 10-year U.S. Treasury rate which *rose* about 70 basis points throughout 2024. Much of that increase occurred in the fourth quarter of the year and acted as a headwind for the stock market, particularly for small cap stocks, after the euphoric broadening advance leading up to and immediately post-election. We believe that the success of the stock market in 2025 will be heavily dependent on the level of rates, based on what we've seen in 2024. Every time that interest rates pushed near or above 4.5% on the 10-year Treasury note, the stock market stalled or declined. A 10-year rate at 4.5% when inflation is hovering around 2.5% is fairly restrictive as it implies a real rate of 2%. Historically, real rates hover between 50 basis points to 1%, which would imply a reasonable 10-year rate of 3-3.5%. Given the concerns over the country's debt load and deficit, we wouldn't expect rates to move significantly lower unless Trump's policies are shown not to be inflationary.

The current economic backdrop is +3.2% real GDP growth, 2.5% core inflation, and unemployment of just 4.2%. This scenario is about as perfect a backdrop as you could ask for because these statistics would imply a nominal growth rate of 6% for the economy, which would likely produce low double-digit earnings growth for U.S. corporations. With unemployment fairly stable at around 4.2%, the risk of recession is quite low. The chart below left shows that stocks generally do very well with inflation sub-3% and falling. The falling part is what currently concerns the market. Inflation has hit a level that appears to be sticky, but if you peel back the components of inflation, the three biggest influences are housing, oil, and wages. Housing has been the stickiest component of all as housing prices haven't fallen as quickly as other inflation components. However they could begin to retreat as rents drop and as home prices begin to weaken as mortgage interest rates have remained stubbornly high. Oil doesn't appear to be a big issue, but it's always something to watch because it affects nearly everything we touch on a daily

basis. Lastly, unemployment remains historically low as the chart below right shows. Still, companies aren't awarding large raises to employees after significant increases during COVID. The number of Americans that remain on unemployment is around 1.9 million which provides some flexibility to companies to add employees without higher wages.



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

Source: PSC

As Promised, Here is Our Forecast.

1. The consensus view is much different from a year ago when everyone predicted an imminent recession. We believe today's view is quite the opposite with strategists trying to one-up each other on upside targets and robust growth which is always a bit dangerous. The truth, we believe, is somewhere in the middle with decent but not spectacular growth. The key statistic to watch is unemployment. With unemployment steady, there is no cause for a recession.
2. The animal spirits that came with Trump's reelection are likely tamped down for a time as it will prove tougher to execute his agenda as simply and cleanly as people expect. The year's first half becomes a show-me period for Trump, the economy, and the stock market.
3. Barring an unpredictable geopolitical event, inflation is a dead issue and fades away as a key market concern.
4. M&A will be robust as company balance sheets are strong, interest rates are stable, private equity funds deploy a massive amount of capital, and as Trump's DOJ ushers in a new era of regulatory friendliness that will allow most mergers to pass.
5. Artificial intelligence (AI) moves into the next phase and is no longer just the domain of hyperscalers building out datacenters. Software and service companies take center stage as more companies deploy "real" AI solutions.
6. International economies which have been lethargic, begin to pick up as stimulus measures in China and lower interest rates globally begin to accelerate global growth. See the chart below left which shows lower global interest rates lead a pickup in the economy by 13 months.
7. Earnings growth expectations of 13% for the S&P 500 in 2025 prove reasonably accurate as a steepening yield curve and markedly better M&A help the financial sector lead the way.
8. The government balance sheet becomes a larger focus as Trump tries to push extending the Trump 1.0 tax cuts and as refinancing the government debt takes center stage.
9. The Fed will cut rates but not until later in the year as they'll want to watch from the sidelines for a time to see what the new administration does and any impact from their 100 basis point cut in 2024.
10. Small caps finally get their day in the sun due to the combo platter of historically low relative valuations, significantly accelerating M&A, and the "Magnificent 7" earnings growth being less magnificent in 2025. Again, small caps don't need the "Magnificent 7" to do poorly to outperform. See the third chart below which shows the valuation disparity between the Magnificent 7 and all others.

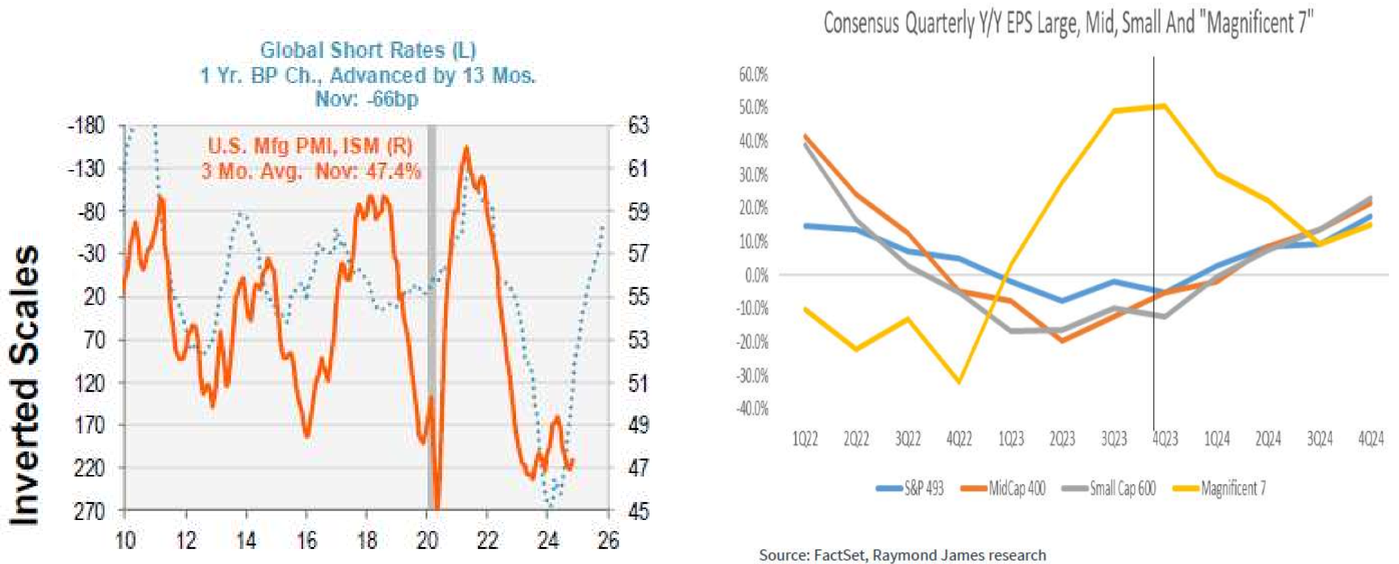
Potential Headwinds to Our Forecast

1. Dollar strength continues and acts as a drag on earnings growth as U.S. products are too expensive overseas.
2. Momentum continues, and money continues to pour into the same stocks (aka "Magnificent 7"). We think this event is unlikely as earnings growth for these seven stocks begins to look like the average company. See the chart below right, which shows that Magnificent 7's earnings growth is forecast to slow in line with the rest of the market.
3. The economy stalls as we wait to see what Trump 2.0 looks like and what may or may not be impacted. Pre-buying of goods in front of potential tariffs accelerated growth in late 2024 and robbed growth from 2025.

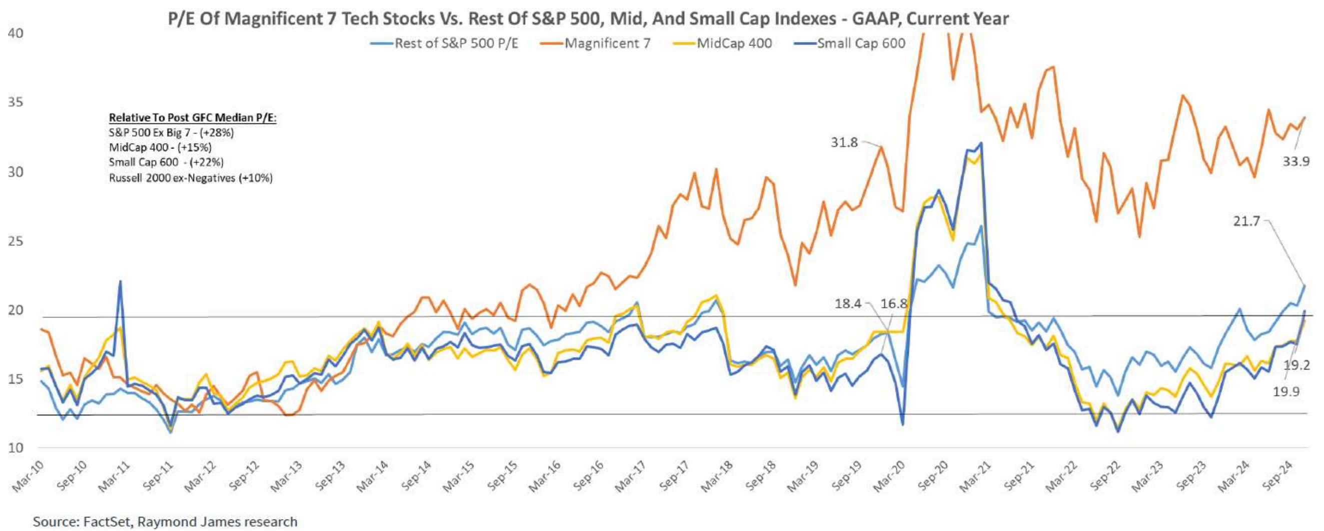
4. Funds from passed legislation like the Infrastructure Investment and Jobs Act and Inflation Reduction Act that are to provide a significant tailwind in 2025 and 2026 are pulled back by the Trump Administration.
5. Housing remains sluggish due to low affordability.

Potential Tailwinds to Our Forecast

1. Valuation disparity between large and small caps is still at a generational discount that favors small caps.
2. Inflation continues to cool, and the Fed sees fit to cut rates sooner and more aggressively in 2025.
3. China stimulates its economy more than expected as the initial salvo isn't enough and as the unemployed create angst.
4. Fund flows to small caps pick up in a continuation of what we saw in the second half of 2024.
5. Private equity funds with cash go shopping in the public markets which have been marked down compared to private markets.
6. Real uses of Artificial Intelligence provide productivity boosts and enhance corporate margins.



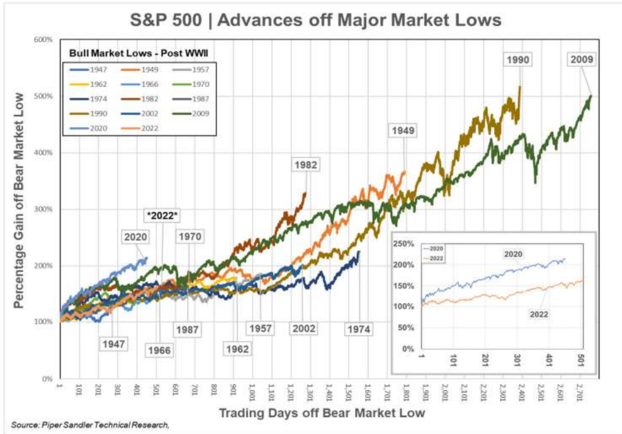
2024 Was The Story Of Rising P/Es Everywhere, Even Small/Mid Trading Near Post GFC Highs

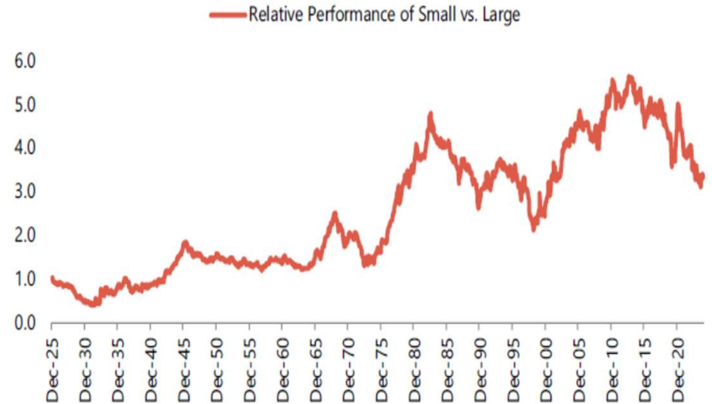


Now we present the case for small caps. As we stated at the outset, this environment should be favorable for small caps as they generally outperform as inflation wanes, interest rates fall, and longer-duration asset classes (like small caps) outperform. This setting would be a continuation of the trends we saw in most of 2024 (absent December). With the yield curve steepening and M&A and IPO activity accelerating, banks and brokerage stocks should do better. If banks do better, small caps should have a relative advantage over large caps as there is a larger exposure to banks in the Russell 2000 compared to the S&P 500. Additionally, if Trump gets his way and more tariffs are implemented and more reshoring occurs, small caps should be significant beneficiaries of the "made in the USA" movement. To level set where we are in the current bull market cycle, the chart below

left shows that we are only 540 days into the current bull market cycle. These cycles have a median duration of 979 days, and many of them go much longer as the chart shows. However, as the chart below right shows, this bull market has left the station without the small caps in tow. There have been nearly eight years of underperformance by small caps, and it is the longest losing streak ever.

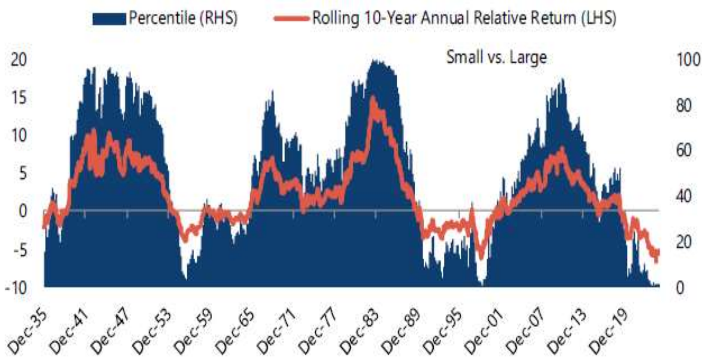
Historically, advances off bull market lows have a median duration of 979 trading days. The current bull market started on October 12, 2022, and is just 540 trading days old, about half as old as the average bull market post WWII (see chart below).

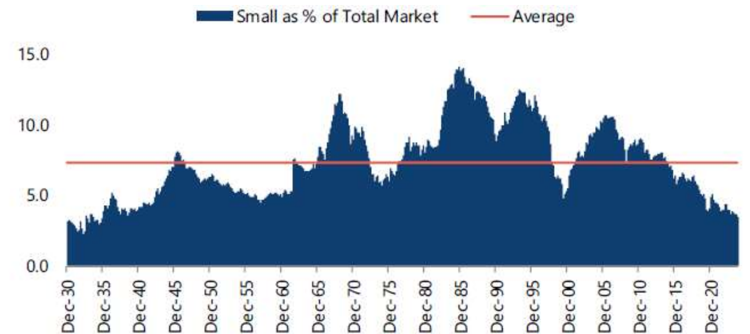




Note: The performance was calculated (or Derived) based on data from CRSP cap-weighted database.
Source: Center for Research in Security Prices (CRSP®), The University of Chicago Booth School of Business; Jefferies

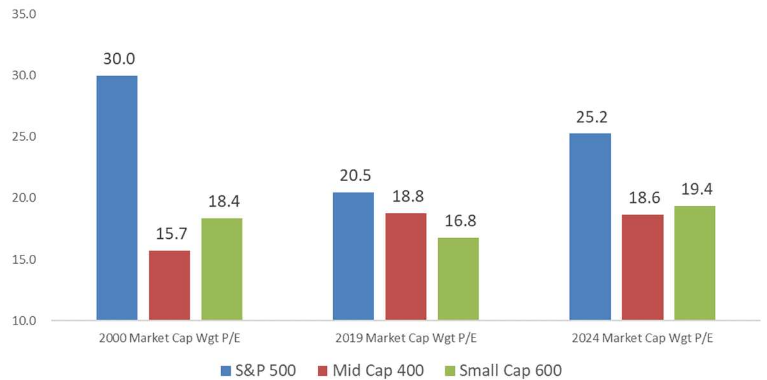
This losing streak has created some extremes in the small cap asset class. First, the rolling 10-year return of small vs. large caps is in the first percentile going back to 1926, as shown in the chart below left (orange line). Second, small caps now represent less than 4% of the US equity market. These levels were last seen back in the 1930s as the chart below right shows. Part of the reason for these extreme readings is because of what the largest of the large caps have done over the past eight years. Three stocks in the S&P 500 are above $3 trillion in market capitalization, and the two largest dwarf the entire Russell 2000 combined market capitalization. Therefore, it would take just a small amount of capital to rotate out of large caps and into small to have a significant impact on the Russell 2000 performance. However, this rotation won't happen unless the largest of the large don't look so attractive, and that will only happen if their earnings growth doesn't look as attractive as the small caps. As valuations are already dramatically in favor of small caps, you simply need a catalyst to draw more attention to their attractiveness, and that's simply better earnings.





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

Regarding earnings, small cap earnings growth is forecast to increase on both an absolute and relative basis in 2025. The chart below left shows the absolute earnings growth in the light blue bars and the relative earnings growth (relative to large caps) in the blue line. As we stated earlier, M&A activity is expected to accelerate in 2025 as Trump's DOJ is expected to be more lenient in letting deals take place. Further, 58% of M&A deals involve companies with market caps below $1 billion, which is the sweet spot of the Russell 2000. While valuation alone won't start a new small cap cycle, the current valuations of small caps vs. large caps favor small by a wide margin as shown in the chart below right. While the disparity between large and small cap valuations isn't as wide as it was in 2000 at the end of the tech bubble, the current relative valuations clearly would be compelling if small caps post earnings growth in line with or better than large caps.

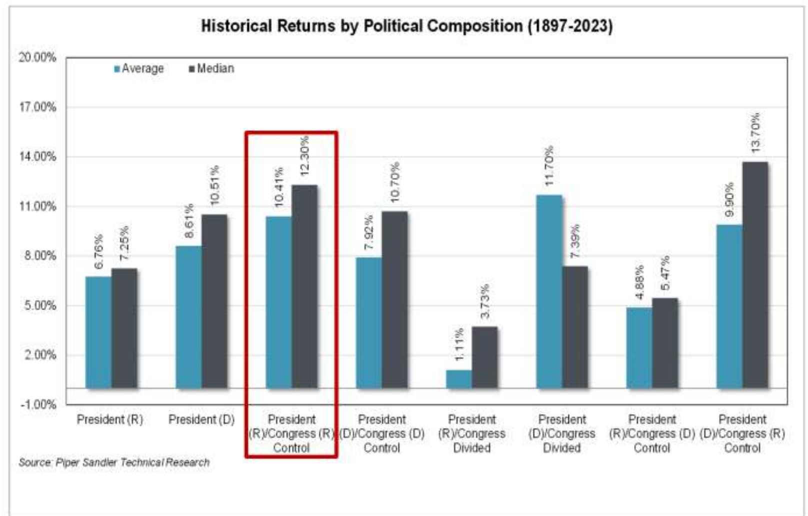


Regardless which asset class outperforms, history shows that the third year of a bull market cycle is generally an up year that favors small cap stocks as shown in the red box in the chart below left. Lastly, the chart below right shows the historical average returns by political composition in Washington D.C. As shown in the chart below right, the average and median returns when Republicans control both the White House and Congress are low double digits.

Major Averages Performance | 3rd Year of a Bull Market (1950-YTD)

Bull Market Low	3rd Year	3rd Year of a Bull Market Performance			
		SPX	MID	RTY	SML
1947	1950	21.68%	-	-	-
1949	1952	11.78%	-	-	-
1957	1960	-2.97%	-	-	-
1962	1965	9.06%	-	-	-
1966	1969	-11.36%	-	-	-
1970	1973	-17.37%	-	-	-
1974	1977	-11.50%	-	-	-
1982	1985	26.33%	-	27.96%	-
1987	1990	-6.56%	-	-21.30%	-
1990	1993	7.06%	11.72%	17.26%	-
2002	2005	3.00%	11.27%	3.32%	6.65%
2009	2012	13.40%	16.07%	14.64%	14.82%
2020	2023	24.23%	14.45%	15.09%	13.89%
2022	2025	?	?	?	?
	Average	5.14%	13.38%	9.50%	11.78%
	Median	7.06%	13.09%	14.86%	13.89%
	% Positive	62%	100%	83%	100%
	Maximum	26.33%	16.07%	27.96%	14.82%
	Minimum	-17.37%	11.27%	-21.30%	6.65%

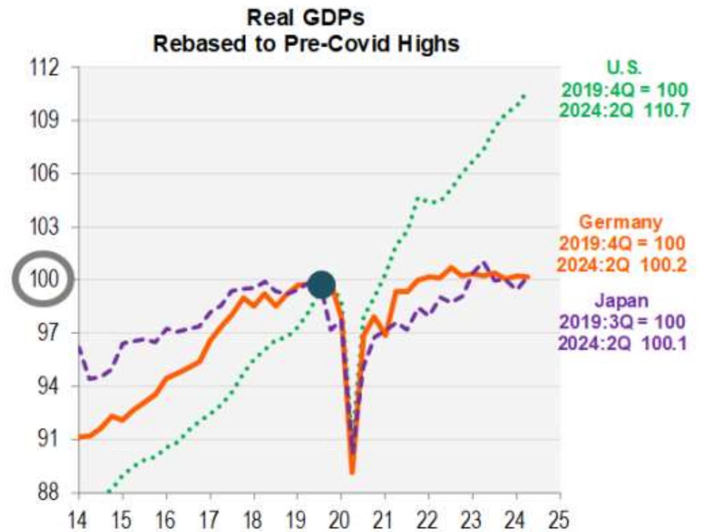
Source: Piper Sandler Technical Research/Bloomberg



Wealth Management Monitor - Focus on International Equities

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 several in between. Many of these portfolios include an allocation to international and small cap equities. Both of these asset classes underperformed the S&P 500 in 2024. However, as you can see by our "fearless forecast" above, we believe small cap stocks are set to outperform in 2025. We believe that any diversified portfolio should have some allocation to international equities commensurate with their risk appetite. The international equity allocation can be expressed in a number of ways with allocations to a broad-based diversified international stock ETF, an emerging market ETF, or a single-country focused ETF. Picking a single winner out of all of the countries that have active stock markets is more of a roll of the dice, which we're generally not comfortable doing. With a few exceptions like India, International markets have generally not kept up with U.S. stock market returns over the past 15 years as the explosive growth in China peaked in 2010, and their economy has stalled relative to its hypergrowth rates of the 2000s. China's economy is heavily linked to other countries like Germany (due to auto and industrial expertise), Brazil (due to basic materials), and most of Southeast Asia as these countries have become manufacturing outposts of China. Interestingly, India's stock market (+8.2% in 2024) didn't keep up with the S&P 500 in 2024 either. This underperformance happened despite posting one of the strongest GDP growth rates in 2024 in the entire world as shown in the chart below left. Much of the rest of the world has not seen their GDP grow from the pre-COVID levels of 2019. The chart below right shows this phenomenon in which the U.S. actually grew GDP by approximately 10% from pre-COVID levels thanks to the massive stimulus programs deployed in 2020 and 2021 during COVID. However, many other countries are languishing in the wake of China's weak growth rates which haven't yet recovered since COVID. Germany is a classic example

of a country tied at the hip to China due to their heavily manufacturing-based economy focused on autos and industrial components. However, China began a stimulus program starting in September 2024 which is expected to be expanded in 2025. This program should provide a tailwind to the Chinese economy and to those other countries who are highly dependent upon them for growth.



Source: PSC

U.S. GDP growth has been plodding along at a compound annual growth rate of 2.5% per year over the last 10 years, but the total GDP is still 50% larger than the next largest economy which is China. The chart below left shows how the U.S. GDP as a percent of global GDP has generally been in decline since 1960 as many more countries emerged from economic infancy. Since exiting the Great Financial Crisis of 2008/2009, U.S. GDP as a share of global GDP has actually grown as we've been in a very low interest rate environment in the U.S. for the past 15 years. The U.S. stock market has generally outperformed compared to international markets for much of this period and now owns a disproportionate piece of the world's market capitalization as a percent of the world GDP as shown in the chart on the right. This level implies that our companies in the U.S. (S&P 500) are being valued at a much higher level than those around the rest of the world. Granted, we have companies like Apple, Nvidia, Amazon, etc. that have led to much of this relative appreciation. However, it's not like the rest of the world is sitting still either. The last time we saw a spike/peak was right after the tech bubble of 2000. We believe that the rest of the world was ahead of the U.S. in cutting interest rates by almost a full year on average and that this stimulus should begin to show up in improved economies globally. From a valuation standpoint, the S&P 500 is currently trading at a P/E ratio of 21.5 times on 2025 earnings compared to the VEU (all world index ex- U.S.) which trades at only 13 times. Historically, the U.S. stock market has commanded a premium valuation multiple of about 29%, but the current premium is 65%, which argues for a reversion to the mean over time. That time may be 2025 as foreign economies reaccelerate their growth following stimulative action.

Source: Strategas Research

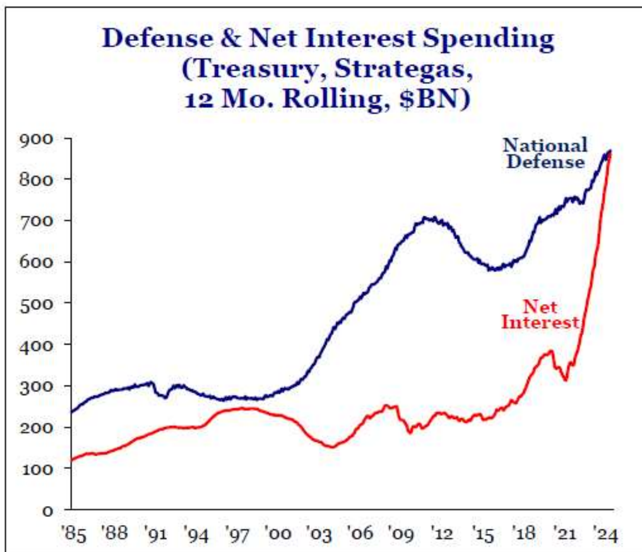
2025 Outlook: A Picture is Worth a Thousand Words

We articulated our 2025 outlook above and the key issues and drivers for the stock market. Yet, we believe there are other topics that we haven't spent much time on that deserve some mention. We decided to express it in pictures to provide you with a shorter read, as everyone's time is valuable. As they say, a picture is worth a thousand words, and we'll let you interpret what we view as some compelling charts. We've provided a bullet point or two of explanation as to why we think the chart or graphic is important.

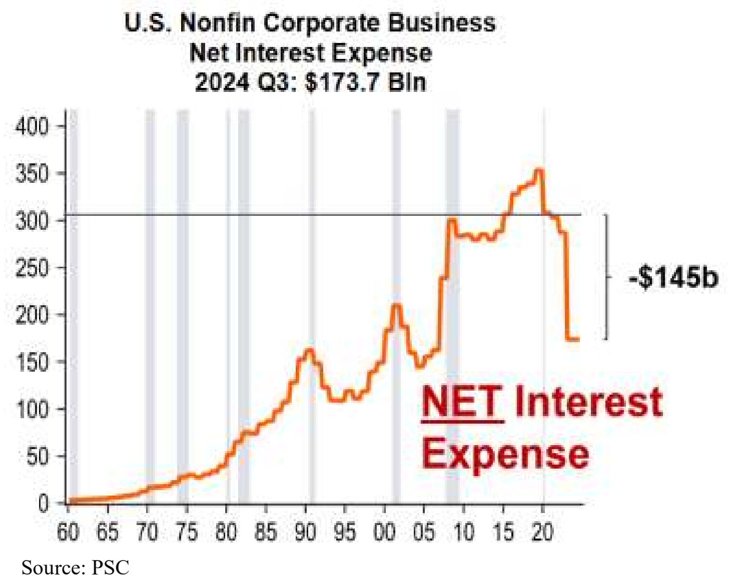
U.S. productivity, which is a key to keeping inflation in check, has been on the rise over the past two years after falling during COVID as many work environments were disrupted. Is AI and its derivatives like robotics driving this productivity, or is it something else? If it is attributable to AI, we may see a more rapid adoption than is already expected.

Source: PSC

The Fed better get interest rates down quickly as the interest on the U.S. government debt is soaring and is expected to surpass spending on national defense in 2025 as shown on the left chart. How is it that U.S. corporation's net interest expense is declining? The answer is better balance sheets and refinancings when rates were near 0%, whereas the government did not.

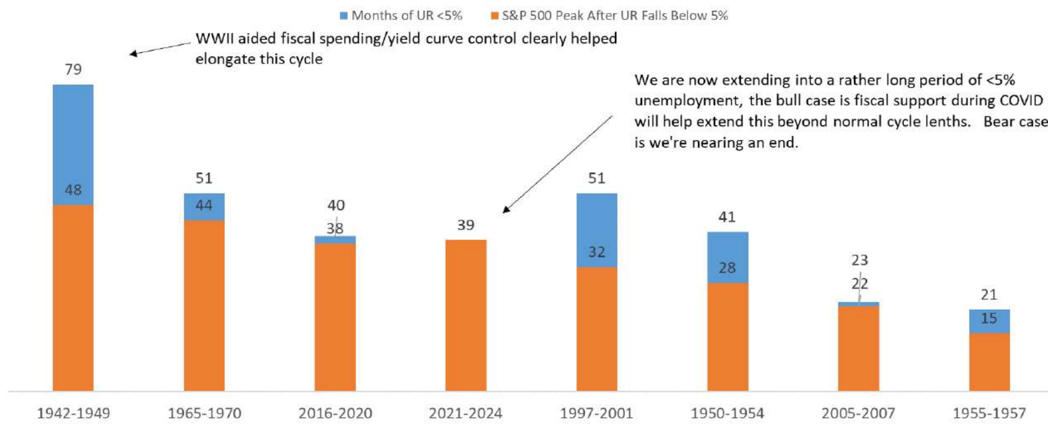


Source: Strategas



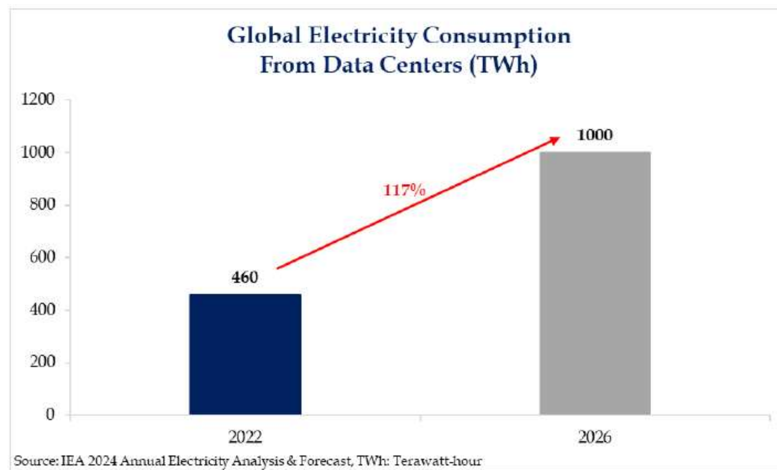
Source: PSC

We are currently in one of the longest stretches since the Great Depression in which unemployment remains below 5%. The S&P 500 has historically peaked well before the streak ends.



Source: St. Louis Federal Reserve, Raymond James research

The electric grid is taxed by the insatiable demand for power that new AI datacenters require. As the chart below shows, datacenters will more than double the amount of power demanded between 2022 and 2026. A single terawatt hour is enough to power 100 million homes for an hour.

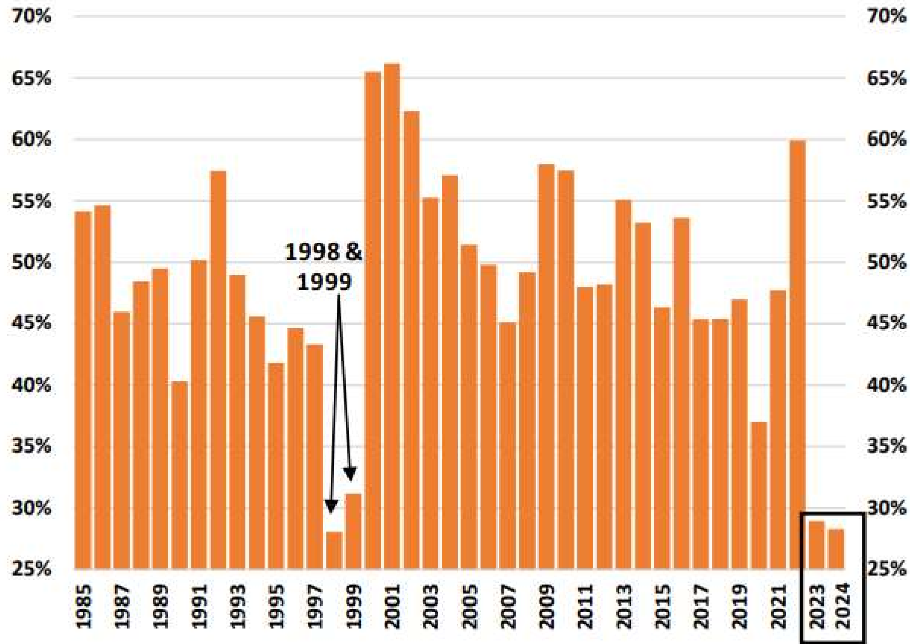


Source: IEA 2024 Annual Electricity Analysis & Forecast, TWh: Terawatt-hour

Stock Market Trivia

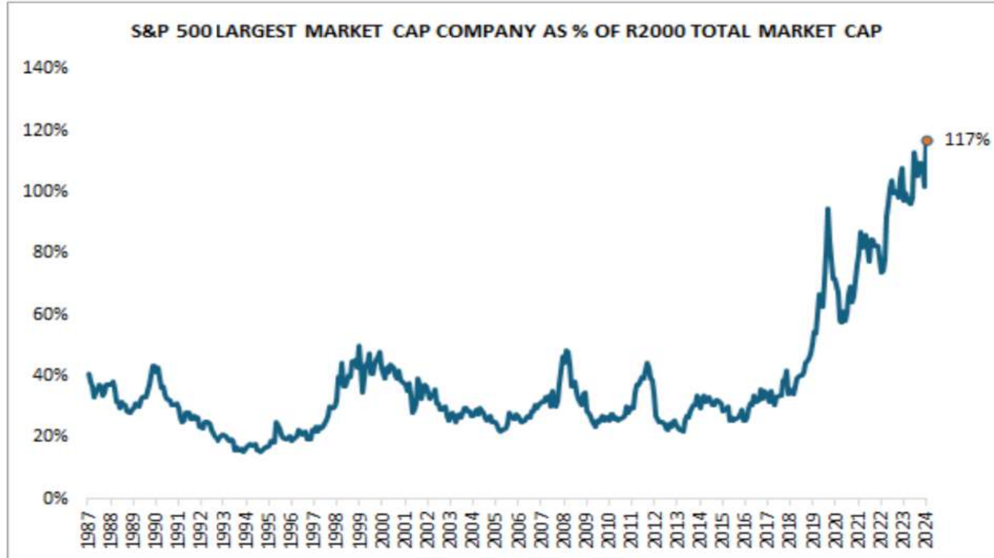
Each quarter we offer a piece of market trivia that we believe is interesting or timely, or both. This quarter we are focusing on interesting stock market facts related to the performance of the market and individual stocks over the long term. The first chart below shows the concentration of returns in the stock market for the past few years. In each of the last two years, less than 30% of all stocks outperformed the S&P 500. This level is a very low percentage for any year, let alone two years in a row. Sticking with the concentration theme, the second chart below shows that Apple Inc.'s market capitalization is now 117% of the entire market cap of the Russell 2000, which is pretty crazy. Lastly, we'll try to leave you on a good note. The third chart below shows that in the year following an election, small caps have been positive every time since 1979 and average a +17.6% gain. This historical performance is not too shabby as the average for all years is +12.6%.

% Of S&P 500 Stocks That Outperformed The Index Annually



It's Been Two Years In A Row Where <30% Of Stocks Beat The S&P 500!

Fig 22. **The S&P 500's largest market cap company is almost 20% more than the entire R2000 market cap**

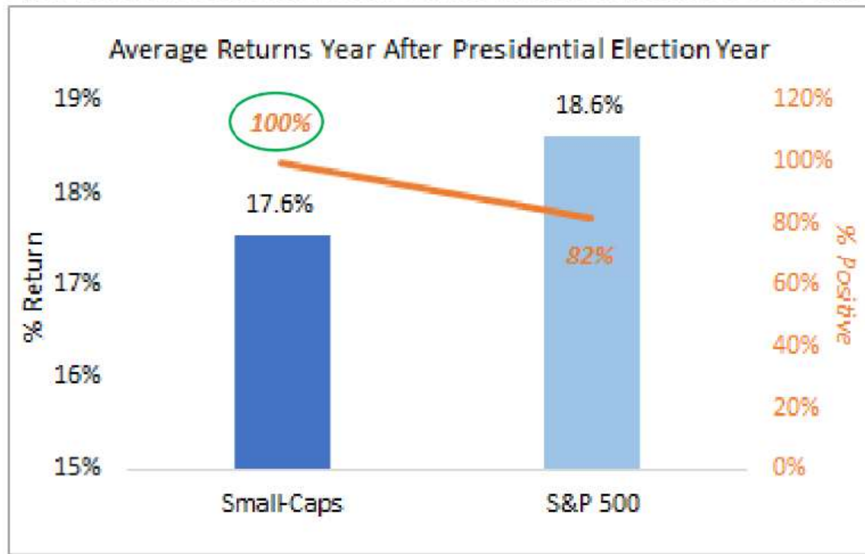


Source: Furey Research Partners and FactSet. Data as of 12/31/24.

At almost $3.8T, AAPL is the S&P 500's largest market cap company which is equal to 117% of the entire R2000's aggregate market cap, a new all-time high.

Pre-COVID, this metric's average and median value was 30%.

Fig 9. **Year after Presidential Election Year has always been positive for small-caps**



The R2000 averages 17.6% (vs. 12.6% for all years) in the year after a Presidential Election but has been up in every one of them (11 years since 1979). And while small-caps underperform on average, they outperform on a crude probability-weighted adjustment *(i.e. multiplying the average return by the frequency of positive returns).*

Source: Furey Research Partners and FactSet. Based upon R2000 total returns back to 1979.

We hope you found our fourth-quarter 2024 review and 2025 outlook newsletter insightful and interesting. If you have any questions about anything discussed herein or would like more information about 1492 Capital Management, please call us at 414-276-1492.

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