



1492 CAPITAL MANAGEMENT

DISCOVERING OPPORTUNITY

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IDENTIFY 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 2025. In each quarterly newsletter, we provide our perspective on the most recent quarter, preview what lies ahead, and offer a bit of market trivia.

We Have Moved

Our corporate slogan is "Discovering Opportunity," which is our daily focus for our clients with our small-cap and wealth management portfolios. But we also discovered a new office to call our home. Our address is below, and our phone and email addresses have not changed.

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The Russell 2000 Finally Made a New High - It Only Took 966 Trading Days

After 966 trading days, or nearly four years, the Russell 2000 Index finally made a new all-time high and surpassed its last high in late 2021. As most know, the S&P 500 and NASDAQ have been powering to new all-time highs for the past 18 months. The Magnificent 7 and a very narrow market has led the ascent. This new high in the Russell 2000 is the first sign that the markets have started to broaden. However, every time that we think that there is going to be a sustained broadening of the market, the Magnificent 7 power higher, which is what happened in the past couple of months. The September quarter's results for active managers were one of the worst relative performances in history. Only 10% of small cap investment managers and 22% of all managers are beating their respective benchmark in the quarter and year-to-date, respectively, as index returns. A "meme-like" frenzy in certain industries like quantum computing and nuclear power stocks, to name a few, which are years away from bringing real products to market, are driving index returns. Gold and rare earths mineral stocks also powered higher with the latter due to the government announcing a couple of deals to invest in rare earths mines in the U.S. AI has been a key catalyst of market sentiment, and while we are long-term AI bulls, some of the things that are happening in the stock market today give us pause. For example, stocks are popping up 20% or more when they announce plans to spend more money on capital expenditures to go aggressively after the AI "opportunity." This movement reminds us of the market behavior during the tech bubble of 1999, when every company was spending money to build out their web presence without a real business plan to make money over the long term. In the short run, the stocks were rewarded until the market realized there was an absolute glut of internet capacity and dotcom companies. We shall see.

Resilient market performance amid a backdrop of policy uncertainties, easing trade tensions, and continued enthusiasm around technological advancements, particularly AI, marked the quarter. Supported by solid corporate earnings and anticipatory Federal Reserve rate cuts, global equities advanced though headwinds from tariffs and slowing economic growth tempered optimism. Curiously, despite the wave of optimism behind cryptocurrencies, gold hit an all-time high and had its best quarterly performance since 2016. When the dust settled on the quarter, the S&P 500 rose +8.12% but trailed both the NASDAQ Composite and the Russell 2000, which climbed +11.41% and +12.39%, respectively. Despite its strong performance in the quarter, the Russell 2000 still trails the S&P 500 year to date with the indices posting returns of +10.39% and +14.83%, respectively.

Trump's One Big Beautiful Bill passed this quarter and set the stage for an accelerating fiscal policy into 2026. Looking ahead, tariffs will be challenged in court, but Trump has plenty of other legal options should some be shot down in the courts. Please read on to see our unique views of what's on tap for the balance of 2025, themes that we're investing in here at 1492, and key market drivers.

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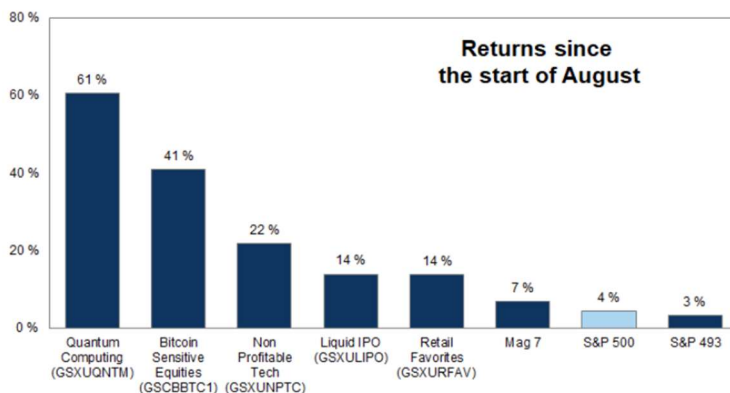
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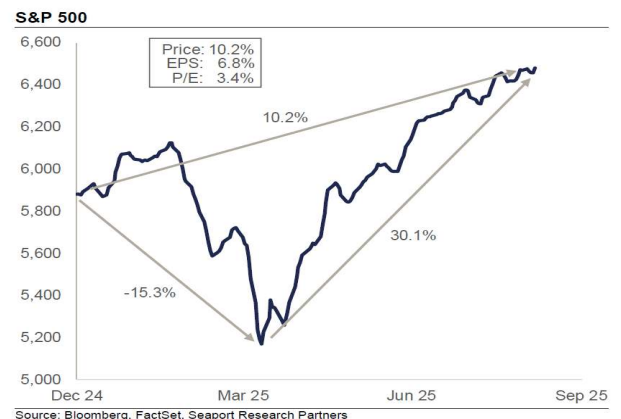
However, every time that we think that there is going to be a sustained broadening of the market, the Magnificent 7 power higher, which is what happened in the past couple of months. The September quarter's results for active managers were one of the worst relative performances in history. Only 10% of small cap investment managers and 22% of all managers are beating their respective benchmark in the quarter and year to date, respectively. A “meme-like” frenzy in certain industries like quantum computing and nuclear power stocks, to name a few, which are years away from bringing real products to market, are propelling index returns. Gold and rare earths mineral stocks also powered higher with the latter due to the government announcing a couple of deals to invest in rare earths mines in the U.S. The chart below left highlights this speculative frenzy that we’ve seen in the market since early August. Quantum Computing, Bitcoin-sensitive, and non-profitable tech stocks were the biggest winners over this period. This scenario smells of the “meme” stock rallies of 2021, in which day trading investors flock to a hot narrative and buy stocks without regard for valuation or timing of the true fundamental uptick. Note the performance of the other S&P 493 stocks as this effort doesn’t feel like a market that’s broadening. The chart on the right shows the performance of the S&P 500 year to date, which has been in a one directional rally since “liberation day” in April.

Exhibit 2: Performance across select slices of the US equity market



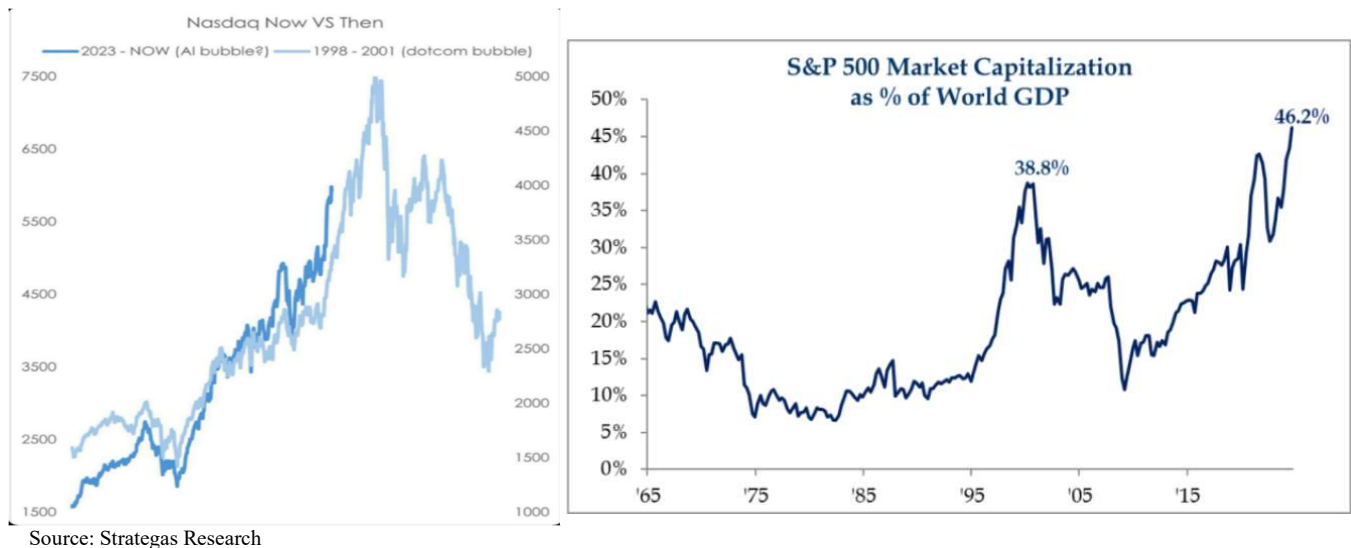
Source: PSC

Returns: YTD

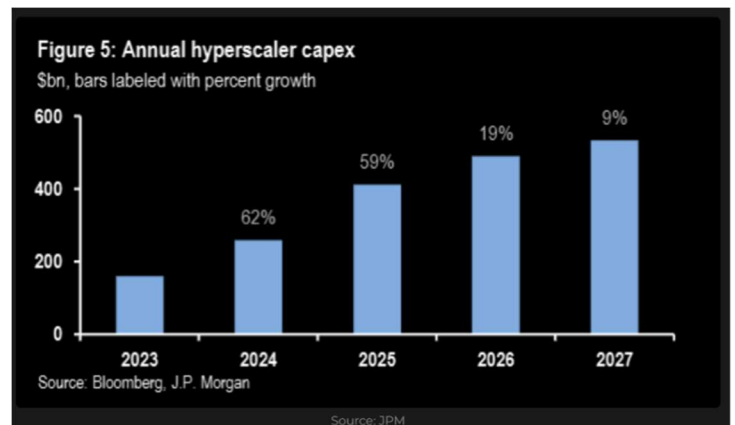
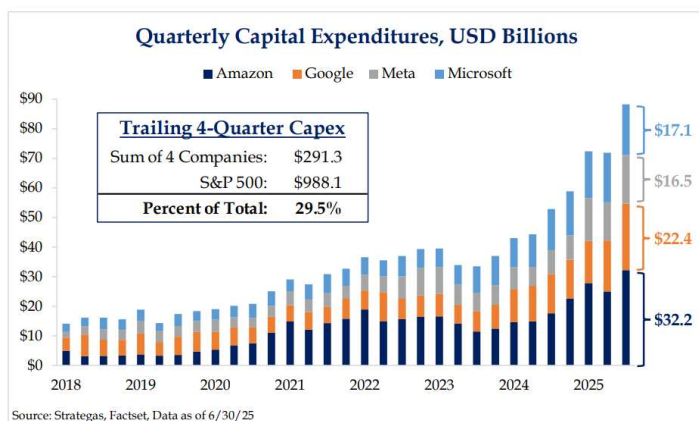


AI has been a key catalyst of market sentiment, and while we are long-term AI bulls, some of the things that are happening in the stock market today give us pause, like driving stocks up 20% or more when they announce plans to spend more money on capital expenditures to go aggressively after the AI “opportunity”. This reminds us of the market behavior during the tech bubble of 1999,

when every company was spending money to build out their web presence without a real business plan to make money over the long term, but in the short run, the stocks were rewarded, until the market realized there was an absolute glut of internet capacity and dotcom companies. We shall see. Every great run in the stock market always seems to get called out as a “bubble”. While the chart below left tries to make a comparison of the current NASDAQ run to the dotcom bubble of the late 1990’s, I don’t think that they are even close. I was a portfolio manager during both periods, and the major difference was the froth that spread across hundreds and hundreds of stocks in that period, and any company that attached a “.com” to their company name was rewarded with an immediate doubling of their stock price. That pattern is certainly not the case with most stocks today. On the contrary, the current move in the NASDAQ Composite index, as we’ve talked about for quite some time, is really a function of the Magnificent 7 stocks having incredible growth and profitability, which is something the dotcom era generally lacked. The chart below right shows how U.S. centric the recent move has been as the total market capitalization of the S&P 500, now represents 46% of the world’s GDP, which easily surpasses the level reached in the tech bubble of the late 1990’s. Thanks, Magnificent 7.

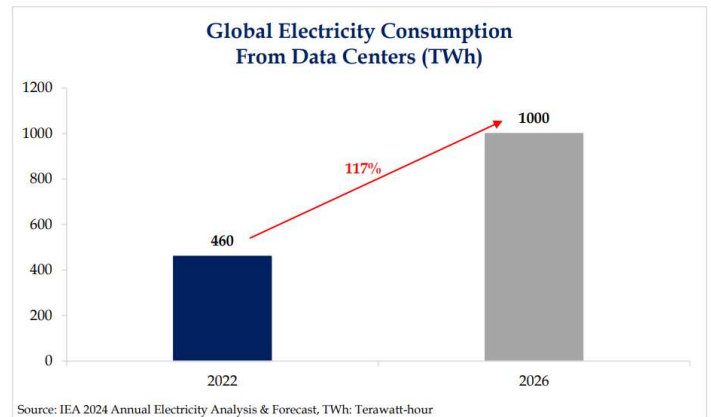
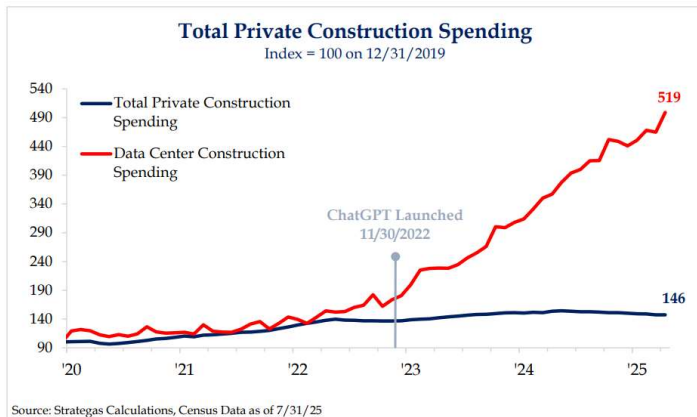


The optimism around AI and its massive capital spending are undeniable. The thing that worries me is that the spending to address the “AI Opportunity” has been so enormous over the past few years and has been extremely concentrated amongst a few big players. The chart below left shows the quarterly capital expenditures of Amazon, Google, Meta, and Microsoft. Combined, they account for over 29% of the entire S&P 500 capex over the last four quarters. What happens when they pause? The chart on the right shows the current consensus capex growth rates for the major hyperscalers (same players listed above). The growth rate must slow due to the law of large numbers, but they are still forecasted to spend nearly \$.5 trillion in 2026.

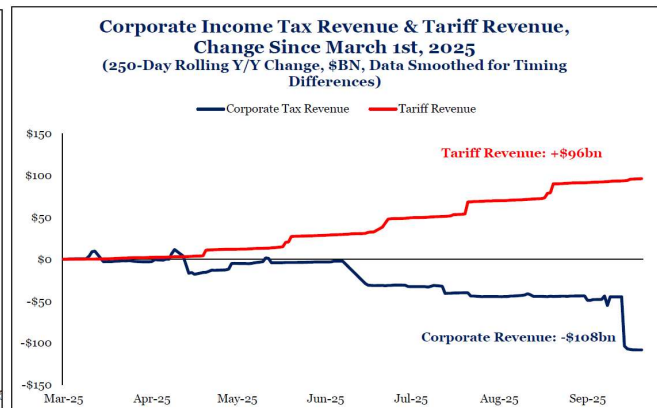


Much of the spending has gone into building data centers across the country. In nearby Kenosha, WI, Microsoft has announced that they are building a datacenter campus which will house four data centers across a 240-acre campus. The cost of the first two data centers is projected to be greater than \$7 billion. The data center boom is happening across the U.S. as shown in the chart below left. Note that data center spending has grown four times faster than total private construction in the U.S. over the past several years. Along with the buildout of these data centers comes enormous power requirements. This need has been a major investment theme of ours for the past few years, as electricity demand from all sources will more than double from 2022 to 2026. This surge is why nuclear power stocks have been on a tear of late even though nuclear plants are likely not coming

online for another three to five years. This development begs the question as to why aren't energy stocks working if we don't have enough power regardless of its source?



Resilient market performance amid a backdrop of policy uncertainties, easing trade tensions, and continued enthusiasm around technological advancements, particularly AI, marked this quarter. Supported by solid corporate earnings and anticipatory Federal Reserve rate cuts, global equities advanced. After jawboning Fed Chair Powell for months on end about cutting interest rates, President Trump got his wish. The Fed sliced rates a quarter point in September and indicated that more cuts were likely in the offing before year-end and into 2026, data-dependent, of course. The market is pricing in a total of about five rate cuts by the end of 2026 as shown in the chart below left. Tariffs have been a hot topic all year, but as the chart below shows, a total of \$96 billion has been collected since March 1st. However, the government's coffers haven't been overrun with cash yet. Corporate income tax revenue has been an offset as tax provisions put into the "One Big Beautiful Bill" are already having an impact on tax receipts, as shown below right.



Curiously, despite the wave of optimism behind cryptocurrencies, gold hit an all-time high and had its best quarterly performance since 2016. The table below shows that the stock market posted strong returns in the third quarter after a softer start to the year. For the small-cap Russell 2000, the current quarter's return accounts for more than 100% of the year-to-date performance. When the dust settled on the quarter, the S&P 500 rose +8.12% but trailed both the NASDAQ Composite and the Russell 2000, which were up +11.41% and +12.39%, respectively. Despite its strong performance in the quarter, the Russell 2000 still lags the S&P 500 year to date as the indices posted returns of +10.39% and +14.83%, respectively.

Index Returns		
Index	Third Qtr. 2025 Return	2025 YTD Return
Russell 2000	12.39%	10.39%
Russell 2000 Growth	12.19%	11.65%
Russell 2000 Value	12.60%	9.04%
S&P 500	8.12%	14.83%
Dow Jones Industrials	5.22%	9.06%
NASDAQ Composite	11.41%	17.93%

Source: 1492 Capital Management, LLC and FactSet

From a style perspective, the Russell 2000 Value Index (+12.6%) eked out a win against the Russell 2000 Growth Index (+12.2%) for the quarter. This victory for the value side of the house shows that many “left for dead” stocks were key drivers of performance in the quarter, which resulted in many active managers trailing significantly in the quarter. Small-cap indices beat the large-cap benchmarks as the anticipation of and ultimate start of the rate-cutting cycle in September, powered a recovery in small caps after a tough first half of the year. Rate cuts are a favorable driver of small-cap performance, and we address that further in the outlook section below. The best performing sector in the Russell 2000 for the quarter surprisingly was the Materials sector (+25.3%) due to a speculative run on rare earths metal stocks. The government struck some sweetheart deals with several companies like MP Materials where the feds made a direct investment. They also set a floor for metal pricing which will make it very lucrative for domestic producers to compete against the Chinese who reportedly have over 90% of the world’s rare earth metals. A distant second was in sector performance was Industrials as the tariff reprieve was viewed as a potentially positive impact for these companies that might end up escaping the tariff impact altogether. The worst performing sectors were once again the bond proxies like Consumer Staples (+1.8%) and Financials (+4.4%). The Staples sector was weak on reports of weak consumer spending, especially in the low-income consumer segment. Financials were plagued with weakness in insurance companies as the market is beginning to soften after several years of very strong pricing. Oddly, on a year-to-date basis, the best performing sector is Materials (+31.6%) as they have become the bargaining chip for many of the tariff discussions currently taking place. The table immediately below highlights the performance of the Russell 2000 Index sector for the third quarter and year-to-date 2025. The second table below shows that there was a reversal in the performance by size. For years, there has been a significant market cap skew in the numbers, as the performance was significantly worse moving down the market cap spectrum. This quarter reversed that trend but not enough to offset the year-to-date numbers. See the green arrows below. This change could be indicative of a broadening out of the market’s performance and a move away from just the Magnificent 7.

RUSSELL 2000:

Table 7 - Russell 2000 Scorecard through September 30th
September

GICS Sector	September			Third Quarter			Year to Date			Wgt
	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Absolute	Contribution	Relative	
Com Serv	5.70	0.16	2.59	15.79	0.40	3.39	11.67	0.25	1.28	2.8
Discretionary	-0.63	-0.05	-3.75	11.13	1.22	-1.27	3.73	0.49	-6.66	9.9
Staples	-5.08	-0.11	-8.19	1.75	0.06	-10.64	0.66	0.02	-9.73	2.0
Energy	4.34	0.20	1.23	15.77	0.72	3.37	0.22	-0.13	-10.17	4.8
Financials	-2.81	-0.52	-5.92	4.35	0.95	-8.04	6.37	1.35	-4.02	17.9
Health Care	5.74	0.88	2.63	13.92	2.13	1.53	7.28	0.82	-3.11	16.0
Industrials	5.31	0.91	2.20	16.56	2.84	4.17	19.77	3.55	9.38	17.7
Info Tech	9.02	1.30	5.91	16.09	2.27	3.70	14.88	2.31	4.49	15.5
Materials	5.75	0.23	2.64	25.26	0.97	12.86	31.59	1.27	21.20	4.2
Real Estate	-1.49	-0.08	-4.60	7.03	0.45	-5.36	1.62	-0.03	-8.77	5.8
Utilities	6.32	0.19	3.21	12.64	0.40	0.24	16.92	0.50	6.53	3.3
Size Quintile	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Wgt
1 (Largest)	4.21	2.45	1.10	11.66	6.74	-0.74	12.15	7.30	1.76	58.8
2	0.86	0.20	-2.25	12.82	2.99	0.43	5.91	1.19	-4.48	22.5
3	1.78	0.20	-1.33	12.67	1.44	0.27	9.38	0.99	-1.01	11.0
4	3.36	0.18	0.24	15.51	0.82	3.12	11.93	0.62	1.54	5.4
5 (Smallest)	3.69	0.08	0.57	17.83	0.39	5.44	13.46	3.07	2.23	0.0

Source: Jefferies Inc.

Returns in the international markets were generally positive and continued their strong year-to-date performance. They have generally outperformed the U.S. markets so far this year. European markets have, for the most part, been stronger than Asian markets in 2025. Tariffs once again are the determining macro factor as European countries aren’t facing as high tariffs as the Asian countries. China markets caught fire as their market caught the AI bug, and more government stimulus sent their markets soaring. Bond market returns were modest as shorter-term interest rates fell following the Fed rate cut, but longer-term rates stayed fairly sticky. From a commodity perspective, nearly all commodities were weak in the quarter as tariff-related demand concerns began to take hold, and the early pull forward seen at the start of the year began to wane. However, precious metals and rare earth metals began to soar following the U.S. investments that we mentioned above. Natural gas and oil continue to be weak despite the massive demand for energy to power data centers. Demand continues to be stable, and Trump favors exporting liquefied natural gas, which should be a nice tailwind for the commodity. Gold was the top medalist, no pun intended, as it hit all-

time highs predicated on the theory that the U.S. dollar will continue to weaken due to the massive U.S. government debt load and burgeoning deficit.

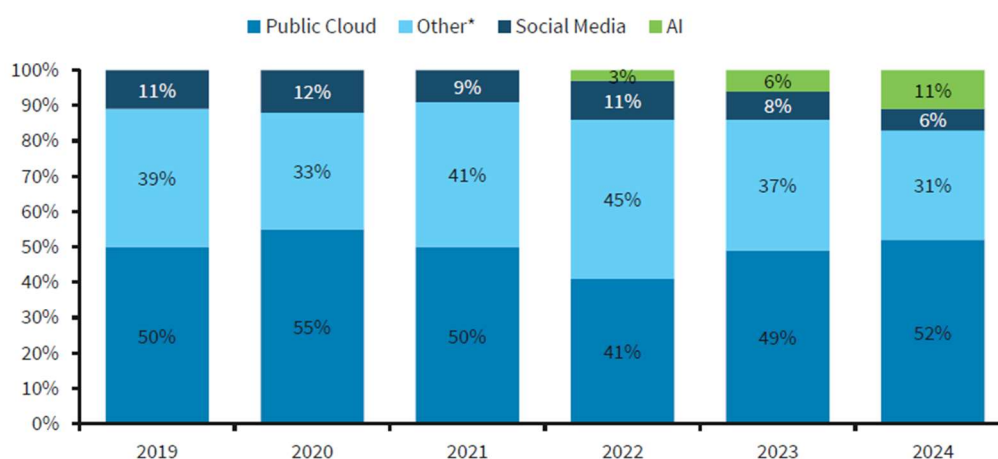
Index	Third Qtr. 2025 Return	2025 YTD Return
France	+3.3%	+11.3%
Germany	-0.1%	+20.0%
Brazil	+5.3%	+21.6%
India	-3.3%	+3.6%
China- A Shares	+13.9%	+16.6%
China- Shenzhen A Shares	+21.4%	+25.5%
Japan	+8.8%	+11.8%
Long-Term Treasuries (TLO)	+1.4%	+2.9%
Investment Grade Corp Bonds	+2.6%	+7.1%
Gold	+17.1%	+46.7%
Volatility- VIX Index	-6.0%	+0.4%
Oil	-4.2%	-13.0%
Natural Gas	-5.4%	+6.6%
Lumber	-2.5%	+11.4%

Source: 1492 Capital Management, LLC

Thematic Investing: AI Gold Rush - Deploying the Picks & Shovels Approach

With tech behemoths dominating the large language AI models business, our AI theme at 1492 Capital Management continues to deploy the proverbial picks and shovels providers to this revolutionary technology trend. As a refresher, the picks and shovels approach harkens back to the U.S. gold rush where many a mining speculator would need the equipment of picks and shovels to dig for gold. The providers of the equipment made money while the miners often went home empty-handed in their pursuit of the yellow metal. Similarly, according to Jefferies research, they estimate that 30-50% of AI projects fail at proof of concept, so we undoubtedly find ourselves in a history repeats itself risk environment where individual stock selection within the broader AI theme is key.

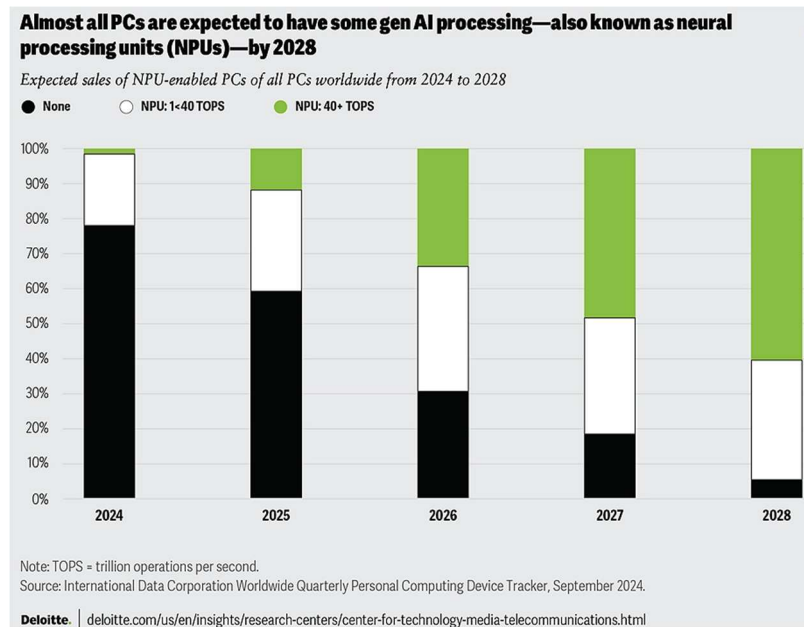
FIGURE 3. Mix of global data center IT demand



*Other includes financial institutions, public sectors, MSP/SaaS, etc.
Source: DC Byte, Barclays Research

As seen in the chart above, AI as a percentage of global data center IT demand is accelerating. For example, Oracle, a major tier 1 hyperscaler, recently surprised the market with a fiscal 2026 capex guide of \$35 billion, which dwarfs Wall Street consensus estimates of \$25.5 billion. As AI and its wingman datacenter infrastructure expand, there is an unsatiable thirst for memory semiconductors. Whether it be in a rack in a datacenter or in the AI PC that is starting to permeate the consumer market, memory

demand is accelerating. With respect to the latter, the forecast for AI-enabled PCs with neural processing units (NPUs) of various TOPS (trillion operations per second) should dominate growth in this technology segment over the next three years.



For memory to operate efficiently, it requires a memory controller, and we have deployed the leading outsourced memory controller in our AI theme. It is well positioned in the high-end PC market and is rapidly expanding into the enterprise market with design wins that include Nvidia's BlueField product. In fact, there is so much demand for the company's enterprise controllers that they cannot service additional customers in the near future.

As high-performance computing (HPC) ramps with the AI trend, the semiconductor chips required need advanced packaging/2.5D for their assembly and testing before going to market. With the domestic chip insourcing trend underway in the U.S., this advanced packaging holding in our theme sits comfortably in the fairway for both tailwinds. The nice thing about technology is its every increasing manufacturing complexity that provides moats to companies like this one that have invested in the leading edge. The movement of all this AI generated data also necessitates high speed transport, and we have positioned ourselves in a semiconductor holding as well as an optical and photonic products company that are capitalizing on this tailwind.

IT consulting firms with strong AI practices should see strong demand for their services as smaller firms seek help in effectively deploying this technology and just as importantly monitoring its output in their businesses, and we've deployed a holding that capitalizes on this trend. While Gen-AI usage will undoubtedly take share from lower end consulting work, AI, like all technology, will only rise in complexity and require more sophisticated IT services for implementation. AI also extends into Advance Driver Assistance Systems (ADAS) for greater safety in autos and trucks as well as completely autonomous vehicles. In healthcare, AI embedded software can aid in simulation to speed up future drug development. The FDA has endorsed modernizing drug development with its New Approach Methodologies (NAMs) plan that was launched this past April. Within both the auto and healthcare sectors, we have added positions that are well positioned to benefit from these growth vectors. Like all investment trends, AI will have product hiccups and inevitably suffer excessive Wall Street speculation along the way. However, this multi-year investment theme should continue to create a plethora of picks and shovels type opportunities for the 1492 Capital Management strategies.

Thematic Investing: AI Gold Rush Part 2: Agentic AI - What is it and Where Are the Opportunities

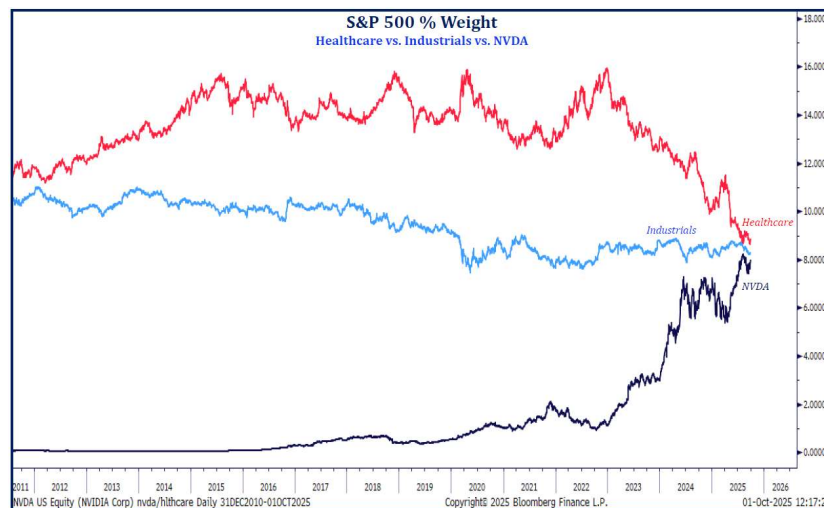
Putting the shovels down for a moment and switching gears to the consumer / retail segment of our economy, agentic AI is on the cusp of becoming a mainstream tool. What is agentic AI? It is an intelligent agent that autonomously analyzes something, optimizes the outcome, and executes on the deliverable. Agentic AI has the potential to drive increased retail sales as consumers and businesses increasingly adopt the technology. On the consumer side, one major advantage of this technology is its ability to act as a personalized shopping assistant, learn from a user's behavior and preferences, and budget in real time. Instead of simply suggesting items based on past purchases or search history, Agentic AI can create full outfits, anticipate needs (e.g., seasonal or event-specific clothing), and even place orders and make payments on behalf of the user. These actions reduce many of the frictions that exist in standard e-commerce or brick-and-mortar retailing such as the time spent searching many different websites or driving to the mall and the stress of finding what is needed on the spot. Once it's time to check out, Visa, Mastercard and some

other companies have incorporated agentic AI functionality through secure, tokenized credentials that can complete the purchase. This level of intelligent personalization could increase purchase frequency and value while reducing friction in the customer journey and offering a more relevant and seamless shopping experience.

On the retailer's side, benefits could be realized on the top line (as described above) as well as the bottom line of the income statement. Agentic AI can automate and optimize inventory management, dynamic pricing, and targeted marketing at a granular level. By analyzing market trends, competitor pricing, and individual customer data, it can autonomously adjust pricing or recommend promotions to boost conversions, which are all drivers of higher margins and better use of capital. Whether the consumer is shopping in the store or online, agentic AI can power virtual stylists or customer service agents capable of real-time problem solving while reducing staff overhead and improving customer satisfaction. We tried this exercise on ChatGPT by asking for fall-inspired outfit that included a sweater, leather boots and leather pants. After three or four clarifying details were provided, pictures popped up and good, better, best quality / price options easily appeared. As these systems become more trusted and embedded in everyday life, their proactive nature of initiating purchase suggestions or following up on the transaction without prompting could lead to higher customer engagement and ultimately increased revenue for retailers. For retail brands, we believe there's a first mover advantage. Whoever offers these agents first will capture the carts that they fill on behalf of their human customers.

2025 Updated Outlook: Small Caps - Key Drivers Falling into Place for Sustained Outperformance

At the risk of sounding like a broken record, there are several key drivers that are beginning to fall into place that we believe could finally lead to sustained small cap outperformance. The key one is that the Magnificent 7 earnings growth has to begin to stall. The law of large numbers is beginning to take hold, even for the most beloved stock Nvidia. For much of the past three years, there hasn't been any reason to exit the Magnificent 7. They mostly posted strong earnings growth (e.g. TSLA and AAPL) and, more importantly, they were at the epicenter of the AI explosion. Weak earnings growth and deteriorating fundamentals at Tesla haven't been able to topple the stock for more than a few months at a time because the market continues to buy the hype of the autonomous robots in every house and driverless cars taking over America. Such belief is what happens in a bull market. I will go on record that these will take longer than the year or two that many are throwing around before they contribute meaningfully to the financials of Tesla. The chart below is remarkable. It shows that Nvidia's weight in the S&P 500 is approaching the same size as two of the more meaningful sectors in the S&P 500 - Healthcare and Industrials. Wow!!



Source: Strategas Research

Market Outlook for the Balance of 2025

Looking ahead to the fourth quarter of 2025 and into 2026, several key themes and drivers are likely to shape market performance:

Key Concerns Weighing on Markets

Policy Uncertainty Resolution: The trajectory of trade policy will remain a critical factor. The legal cases against tariffs that are coming to fruition shortly may cause some ripples in the markets, but we believe that tariffs will mostly stay in place as they are today. Additionally, based on our conversations with companies across multiple industries, most have figured out how to minimize the impacts and have taken action to circumvent them.

Valuations Stretched by Historical Standards

Equity valuations remain elevated with the S&P 500 trading at premium multiples relative to long-term averages. This level leaves little room for disappointment and heightens sensitivity to any negative surprises in earnings or economic data. Technology and growth sectors, which have stoked much of the recent rally, appear particularly vulnerable to multiple compression if growth expectations moderate. From a pure valuation standpoint, small caps are still quite attractive.

Monetary Policy Uncertainty

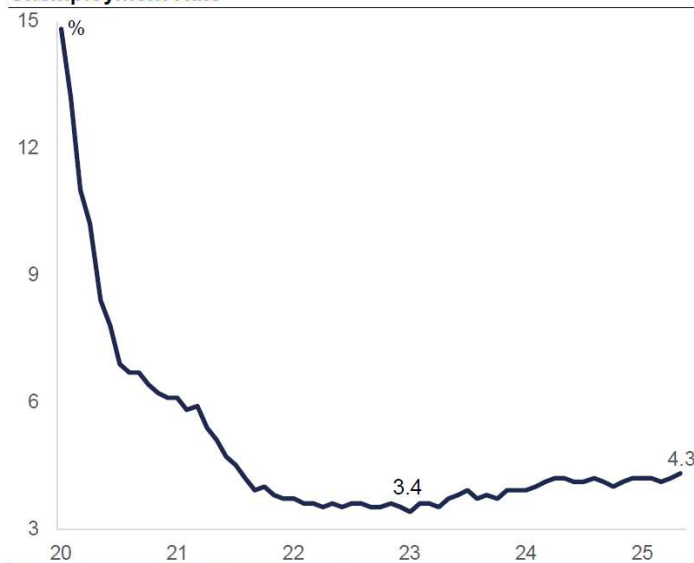
While the Federal Reserve has signaled a more accommodative stance, the path forward remains data dependent. Any resurgence in inflationary pressures could force a hawkish pivot, which might derail the soft-landing narrative that has underpinned market confidence. We still believe that core inflation is under control, and labor market slack is showing up, which leads us to believe that the Fed should be able to stay on their easing path. We expect further rate cuts in the coming months with potentially one more before year end. The two charts below emphasize these points.

Core and Headline CPI



Source: Bloomberg, Seaport Research Partners

Unemployment Rate



Source: Bloomberg, Seaport Research Partners

Geopolitical Flashpoints

Ongoing tensions across multiple theaters continue to pose tail risks. Supply chain disruptions, energy market volatility, and the potential for escalation in regional conflicts could quickly undermine investor sentiment and introduce significant market volatility.

Debt and Deficits

The U.S. national debt, now hovering around \$37 trillion, has contributed to a Moody's downgrade in sovereign credit rating, which raises alarms about future government spending and economic flexibility. Higher debt and interest costs are weighing on bond yields, which in turn may pressure equity markets.

Potential Upside Drivers

Easing Financial Conditions

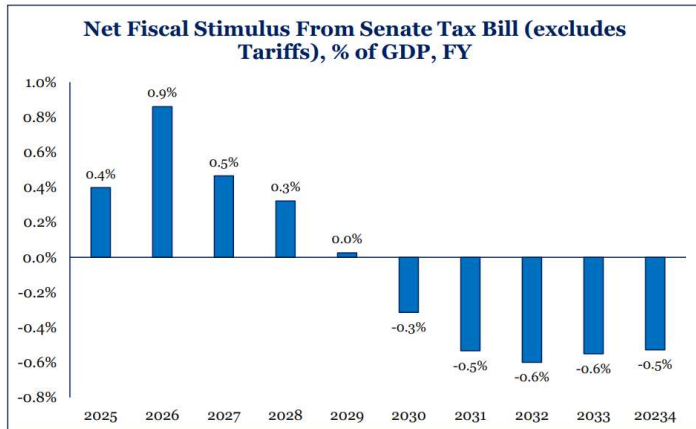
A dovish Fed trajectory could provide meaningful support for risk assets, particularly interest rate sensitive sectors like real estate. Lower financing costs should also benefit corporate investment and merger activity and potentially unlock value across mid-cap and small-cap segments that have lagged large-cap performance.

AI and Technology Innovation

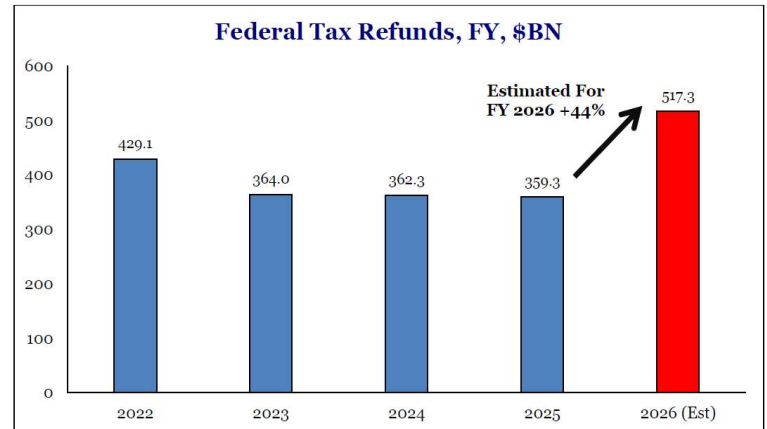
The ongoing artificial intelligence revolution continues to create genuine productivity gains and new revenue streams across sectors. The continued evolution of AI technology and its commercial applications will be crucial for the technology sector's performance. The sustainability of current AI investment levels and the emergence of profitable AI business models will be key factors to monitor. Undoubtedly the pace of spending has to slow as the law of large numbers materialize. However, the spread of the technology to other use cases needs to pick up the baton, run with it, and show just how additive this technology can be.

Fiscal Stimulus and Infrastructure Spending

Continued deployment of infrastructure investment and potential fiscal measures could provide economic support through 2026. This spending should particularly benefit industrials, materials, and construction-related sectors while supporting employment and consumer spending power. The passage of the “One Big Beautiful Bill” provides tailwinds to the economy in the form of tax subsidies and R&D and capital expenditure immediate write-off provisions. These items are estimated to be equal to 0.9% of GDP growth in 2026 as shown in the chart below left. The tax refund impact is shown in the chart on the right as these new provisions materialize.



Source: Strategas Research



Source: Strategas Research

Emerging Market Recovery

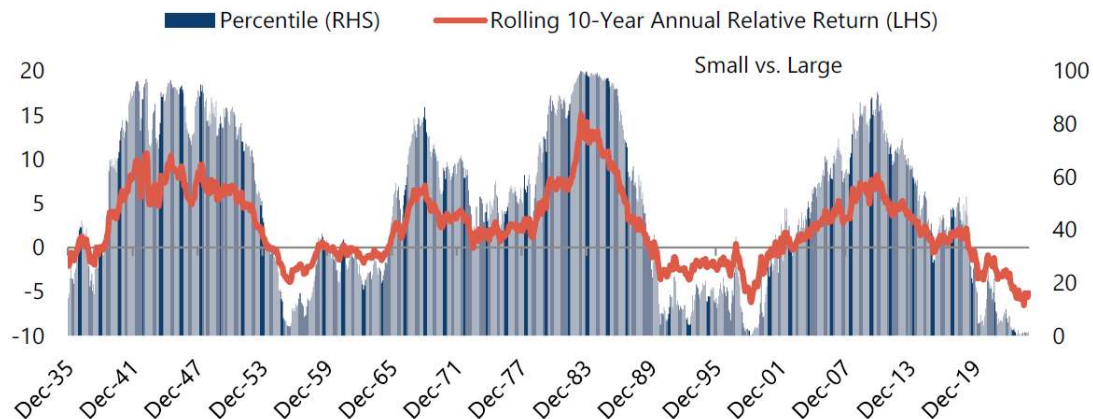
A stabilizing dollar and improving growth prospects in key emerging markets could broaden the rally beyond U.S. mega-caps. International diversification may offer attractive entry points for investors who willing to look beyond domestic equities.

Corporate Buybacks and Cash Deployment

Strong corporate balance sheets and robust free cash flow generation position many companies to return significant capital to shareholders through buybacks and dividends. This technical support could provide a floor for equity prices even amid broader market uncertainty.

Current State of Small Caps Gives Us Optimism the Market is Coming Their Way

The chart below shows the long-term history of the performance of small caps relative to large caps. The current situation is one which we've never witnessed before with the relative performance in percentile terms (bars on the chart) nearly at zero, or a place we've never seen before over the past 90 years. The orange line represents the rolling 10-year annual relative return that is hovering around a -7% figure, which means that small caps have underperformed large caps by 7% annually over the last 10 years. This trend has been worsening over the past few years as the Magnificent 7 has been the only game in town. That said, there is hope, but as we all know, hope isn't a great investment strategy.



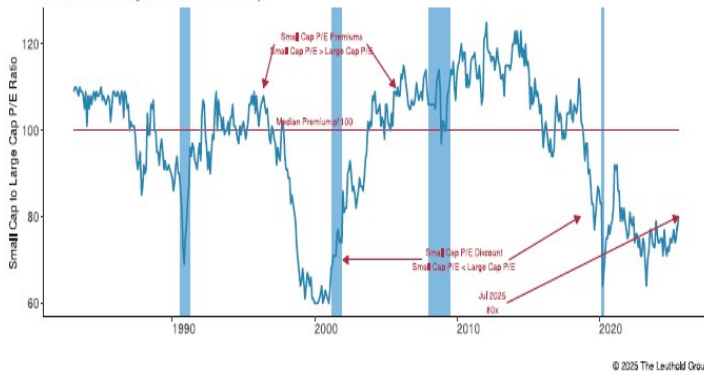
Source: Jefferies Inc.

Small-Cap Recovery Potential: While small-cap stocks outperformed in 3Q, their attractive valuation and potential for policy benefits (such as reduced international competition) could lead to continued outperformance in the fourth quarter and into 2026

if economic conditions stabilize. We feel a bit like a broken record here as small caps have underperformed for quite a while albeit with some temporary reprieves along the way, like the third quarter. Valuation by itself is never the best catalyst as valuations can stay cheap for extended periods. However as a starting point, there is no question that valuation is on the side of small caps. The two charts below highlight this notion. The blue line on the chart on the left shows the relative valuation of small caps to large caps over time. Note that the current level has only been undercut one other time, and that episode was during the tech bubble of the late 1990's. The chart on the right shows absolute valuation levels. Note the column highlighted in the red box is the P/E ratio for 2026. As you go down the chart by market capitalization, the valuations are significantly cheaper the smaller the market capitalization.

Small Cap to Large Cap Historical P/E Ratio (x100)

Based on Non-normalized trailing operating earnings
Small Cap: Leuthold 3000 Small Cap: 20.31x
Large Cap: Leuthold 3000 Large Cap: 25.44x
Vertical bars represent recessions.
Firms with no earnings are excluded in this study.



Source: Furey Research

Median Valuations: Largest 3000 Companies

	Mkt. Cap. Decile	Current Mkt. Cap Range	Current Mkt. Cap (Bill.)	Percent of Total Mkt. Cap.	2025E	2026E	Dec 99	Jun 83
Large Caps	1	>\$47.7B	\$58,745	78.0%	22.3x	20.2x	30.0x	12.9x
Mid Caps	2	\$47.7B-17.8B	\$ 7,963	10.6%	20.6x	17.9x	24.0x	13.0x
	3	\$17.8B-9.2B	\$ 3,516	4.7%	20.4x	18.6x	20.2x	13.3x
	4	\$9.2B-5.5B	\$ 1,961	2.6%	18.3x	16.0x	19.4x	12.9x
Small Caps	5	\$5.5B-3.4B	\$ 1,197	1.6%	18.1x	15.8x	16.3x	13.4x
	6	\$3.4B-2.2B	\$ 765	1.0%	16.0x	14.5x	17.8x	13.9x
	7	\$2.2B-1.4B	\$ 491	0.7%	16.2x	14.3x	16.1x	14.5x
	8	\$1.4B-922M	\$ 323	0.4%	15.9x	13.2x	15.3x	15.0x
Micro Caps	9	\$922M-\$63M	\$ 203	0.3%	14.9x	12.8x	15.4x	16.5x
	10	\$583M-212M	\$ 126	0.2%	13.1x	10.6x	13.3x	17.0x
Totals		B=Bill, M=Mill	\$75,289	100%				

Source: Furey Research

However, until small-cap earnings estimates stop being cut and at least stabilize, they will likely continue to underperform large caps. It's not unusual to see forecasted earnings come down at the start of a year as there always seems to be a lot of optimism in the earnings expectations for the current and next year. However, small caps have certainly improved their ability to predict their earnings streams and have given conservative guidance. The chart below left shows that small cap stocks are beating consensus expectations by a wider margin than both large and mid-cap stocks, which is a good starting point. The fact is that large cap earnings growth has trounced that of small caps due mainly to the Magnificent 7 over the past year or two, but it looks like there could be a trend change ahead. The blue bars in the chart on the right represent the earnings growth for the S&P 500 and the pink bars represent the earnings growth for the S&P 600 small cap index. In the trailing quarters, large cap earnings growth easily outpaced small caps. However, based on consensus expectations, this trend will change in the fourth quarter and continue into 2026. The only way that this switch will happen is if the Magnificent 7 starts to show how difficult it is to grow at the scale they possess. Additionally, as AI begins to permeate into the businesses of more companies, this event should be additive to earnings growth for small cap companies. Based on our research, we see the AI trend beginning to spread to other companies whether it is data center cooling, consulting firms providing guidance to companies on how to execute AI, or energy plays that are helping to power the plethora of data centers being built. The tentacles of AI are starting to spread.

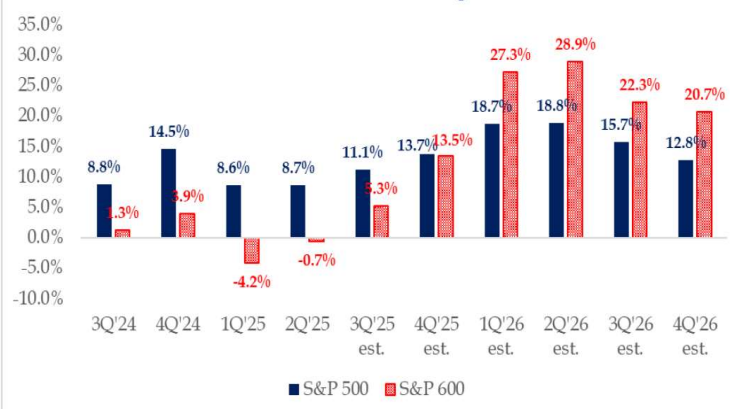
Small caps are beating by widest margin since Q1 22



Source: FactSet; Standard & Poor's; Jefferies

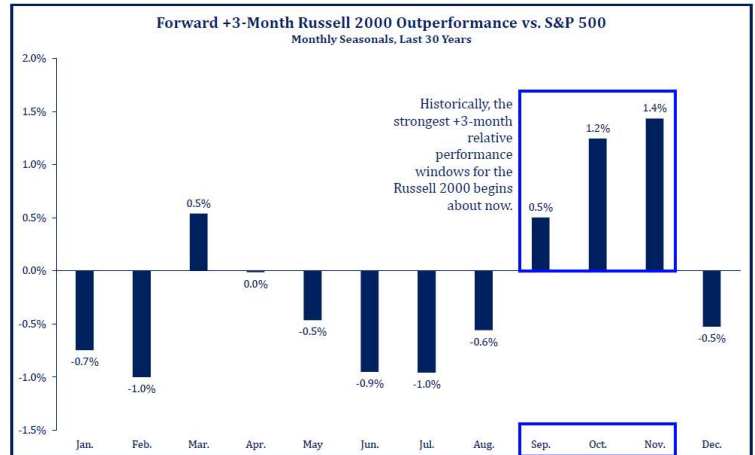
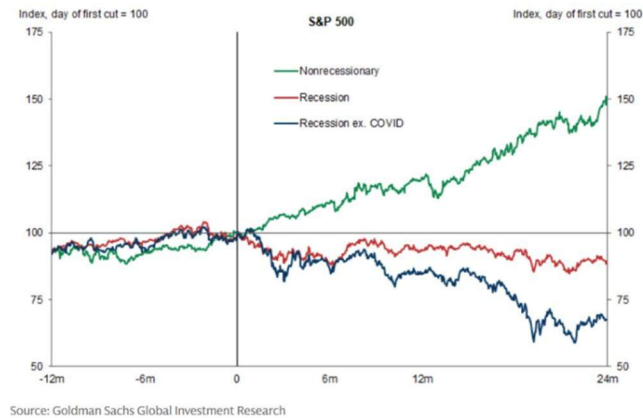
Source: Strategas Research

S&P 500 vs. S&P 600 Quarterly Y/Y EPS Growth (Source: Bloomberg)



We just got the first taste of interest rate cuts from the Fed in September. Usually the Fed is cutting to stimulate an already weak economy. The current economy, by all objective measures, is performing quite nicely with current GDP growth of around 3.5%. The chart below left shows that when the Fed cuts rates in a non-recessionary period, the performance of the S&P 500 for the next 24 months usually does quite well. Additionally, on a seasonal note, the Russell 2000 usually has its best 3-month outperformance relative to the S&P 500 beginning in September. If this holds, small caps' recent outperformance may begin to have some durability, and more people will begin to believe.

Exhibit 11: The simple story is that non-recessionary rate cuts are usually positive for equities



Key Risks and Opportunities

Risks:

- Escalation of trade tensions lead to broader economic disruption.
- Unintended consequences of tariff policies on domestic industries and consumers.
- Potential for retaliatory measures from trading partners.
- Slower-than-expected economic growth due to trade policy impacts.

Opportunities:

- Continued technology sector innovation and AI commercialization.
- Potential for trade policy modifications that remove market uncertainty.
- Attractive valuations in certain market segments, particularly small-cap stocks.
- Benefits to domestic industries from reduced international competition.

Wealth Management Monitor – Thematic Investing: Capitalizing on Mega-trends

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 that use thematic research and stock picking. These portfolios range in risk from very conservative to ultra-aggressive with several in between. Welcome to the Wealth Management Monitor! This quarter, we're continuing our focus on **identifying where opportunities currently lie in the market for the balance of 2025 and beyond**. The investment landscape is dynamic, and while prudence remains key, several compelling themes are emerging that warrant your attention. Beyond traditional sectors, **thematic investing** allows one to directly invest in powerful, long-term trends that are shaping the future. Several strong themes that we're currently invested in or researching include:

- **Artificial Intelligence (AI) Beyond the Hype to Infrastructure and Power:** The AI revolution continues to redefine productivity, but its true scale hinges on supporting infrastructure like data centers and energy supply. With global AI market growth projected to accelerate through 2030, we'll target the full value chain of semiconductors, software, and power solutions while monitoring supply bottlenecks. The widespread adoption and advancement of AI continue to reshape industries globally. Investing in companies at the forefront of AI development or those heavily leveraging AI to enhance their operations, presents significant growth potential. This opportunity includes everything from core AI technology providers to sectors that AI is revolutionizing, which include healthcare and manufacturing.

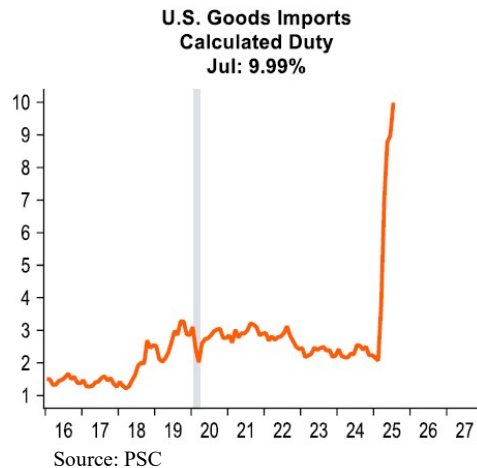
- **Global Infrastructure:** As economies look to "reshore" manufacturing and upgrade aging systems, there's a significant push for infrastructure development. This push includes not only traditional infrastructure like transportation and utilities, but also the new infrastructure required to support emerging technologies such as data centers and advanced energy solutions. Governments worldwide are investing in infrastructure renewal—transportation, digital connectivity, and clean water systems to support long-term growth. At the same time, supply chain realignment and "reshoring" of critical manufacturing, particularly in semiconductors and advanced industrials, are creating new investment opportunities across logistics, construction, and materials sectors.
- **Healthcare Innovation - Biotech and Genomic Revolution:** Personalized Medicine Takes Center Stage- Large pharma's pivot to innovative small- and mid-cap biotechs signals a renaissance in drug development, particularly in gene therapies, obesity treatments, and precision medicine. Amid patent cliffs, this trend promises 10-15% annual EPS growth for leaders. This theme goes beyond traditional pharmaceuticals. It includes cutting-edge areas like biotechnology (think gene therapy and personalized medicine), medical technology (new diagnostic tools and robotic surgery), and digital health (telehealth, wearable health tech, and AI-driven diagnostics). Companies at the forefront of preventing, treating, and managing age-related conditions are poised for significant growth.
- **Supply Chain Reshoring & Localization - A More Resilient World:** The past few years have highlighted the vulnerabilities of highly globalized, "just-in-time" supply chains. Geopolitical tensions, natural disasters, and global pandemics have spurred a significant shift towards reshoring, nearshoring, and localization of manufacturing and critical supply chains.
- **Advanced Manufacturing & Automation:** To bring production closer to home, companies are investing heavily in advanced manufacturing technologies, robotics, and automation. This trend includes everything from 3D printing to AI-driven factory optimization.
- **Logistics & Domestic Infrastructure:** Strengthening domestic supply chains requires robust logistics and infrastructure. This theme encompasses investments in warehousing, transportation networks, and specialized industrial real estate that supports localized production and distribution.
- **Strategic Materials & Resource Security:** Ensuring access to critical raw materials is paramount. This theme can involve investments in companies focused on domestic mining, recycling, and innovative materials science that reduce reliance on distant or volatile sources. Last quarter we wrote about the critical need for rare earths metals in the U.S. The Trump administration has announced several large-scale investments in companies that have access to these minerals but may have lacked the financial wherewithal or permits to move rapidly. These agreements are accelerating the push on both accounts.
- **U.S. Housing Shortage: Real Estate's Supply-Demand Rebound:** A chronic deficit of 2-3 million homes is catalyzing multifamily, senior, and workforce developments. With the recent cut in interest rates, it's clear that there is a true sensitivity to 30-year mortgage rates. Should those rates fall below 6%, we believe that we'll see a tidal wave of new home buying and refinancing activity.

While these opportunities are compelling, the key to success lies in a thoughtful, diversified approach tailored to your individual risk tolerance and financial goals. The current market rewards selectivity and a deep understanding of underlying trends. Our team is actively monitoring these evolving opportunities and is prepared to help you explore how they might fit within your broader investment strategy. We encourage you to reach out to discuss how we can help you strategically position your portfolio for growth in 2025 and beyond.

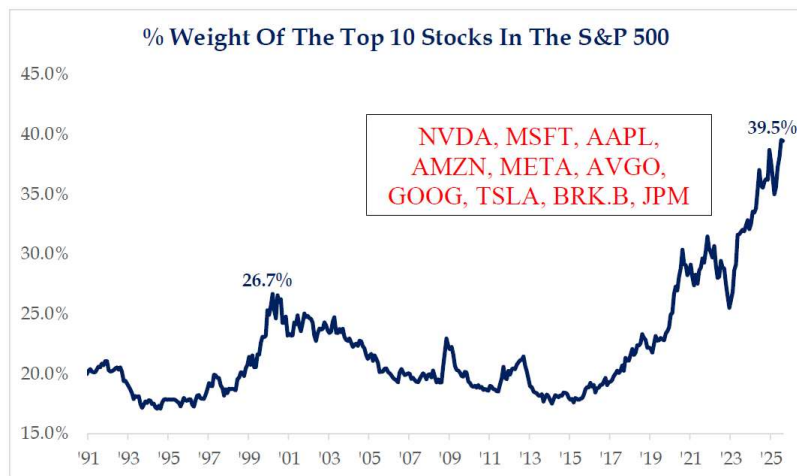
2025 Updated Outlook: A Picture is Worth a Thousand Words

We articulated our updated 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 graphics are important.

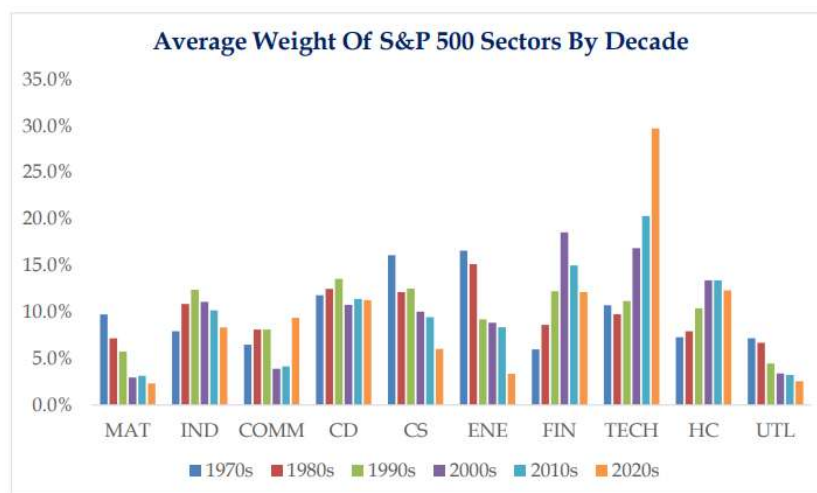
Tariffs have officially arrived. They are five times higher than the average of the previous decade.



The weight of the top ten stocks in the S&P 500 continues to build. When will it stop?

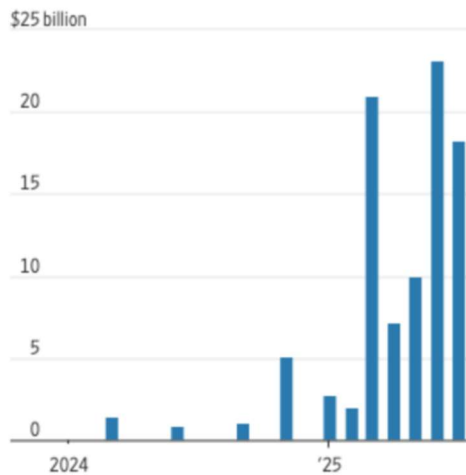


It's interesting to see the sector's trends through the decades. Clearly, technology has become the flavor of the day of late, or should I say flavor of the decade.



The crypto buying craze within companies like “Strategy”, formerly “MicroStrategy” is gaining steam. Why should we pay a premium for a company to buy Bitcoin on our behalf when many vehicles can be used to purchase it directly?

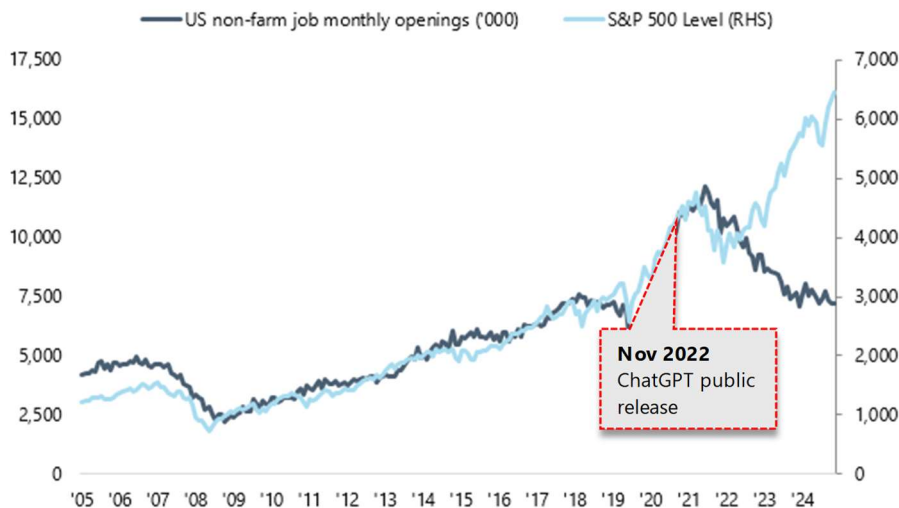
Funds raised by companies to buy crypto



Figures based on company announcements of capital plans to buy cryptocurrencies.

Source: Architect Partners

Maybe it's just a coincidence but job openings have decelerated dramatically since the launch of AI tools like ChatGPT. Maybe companies are starting to see the promised productivity enhancements of AI.



Source: Jefferies Inc.

Stock Market Trivia

Each quarter, we offer a piece of stock market trivia that we believe is interesting or timely, or both. We are focusing this quarter on how merger and acquisitions activity affects stock market performance or vice versa. The chart on the left shows a clear correlation between the pace of M&A activity and small-cap performance. Or is it strong small-cap performance that brings out the animal spirit and acts as an accelerant for M&A activity? The chart on the right shows that in periods of time when M&A activity is increasing, stocks in general perform much better. We have seen a noted acceleration in M&A activity in our portfolios at 1492 Capital Management this year as we have had four companies acquired from our portfolios thus far in 2025.



We hope you found our third quarter 2025 review and 2025 updated 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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