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 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.

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.

Liberation Day Set the Tone for the Year

2025 proved to be a year of resilience, volatility, and ultimately strong returns for global equities. Geopolitics, monetary policy shifts, and earnings strength shaped the narrative. It turned out to be a great year for the markets with the S&P 500 posting double-digit returns for the third year in a row. Three consecutive double-digit return years are quite rare in the history of the stock market. There have been only three other such occurrences in the past 76 years. The year started with concerns over tariffs, and investors feared a return of runaway inflation and a potential recession. As a result, the S&P 500 subsequently fell by 19% from its peak. At that point in early April, few believed that we would realize a positive return, let alone a nearly +20% year for the stock market. The April 2nd Liberation Day, the day on which a broad swath of tariffs was announced on nearly every country, was the turning point that set the tone for the remainder of the year. Market sentiment shifted rapidly in May as the administration began easing the most restrictive trade measures and negotiating initial trade deals. This "walk back" sparked a massive relief rally. The positive performance was largely due to earnings growth, which replaced valuation expansion as the primary engine of the market. The Fed's accommodative stance on interest rates also added fuel to the fire with three 25 basis point rate cuts in the back half of 2025.

Growth equities, particularly those tied to artificial intelligence infrastructure and adoption, drove outsized returns in 2025. The traditional Magnificent 7 names continued to be market cap leadership anchors, although sentiment cooled late in the year. Helped by currency effects and stimulus in key regions, international equities outpaced U.S. returns. Metals like gold (+66%), silver (+160%), and platinum (+146%) were the shiny objects of the year and were initially propelled higher on inflation fears that gave way to a speculative fervor. Interestingly, Bitcoin, otherwise known in the cryptocurrency world as "digital gold", was a huge underperformer with an approximate -6% loss on the year. Go figure. Despite all of the angst about higher inflation due to tariffs, it actually fell throughout the year and looks poised to approach 2% in mid-2026 as we anniversary the imposition of tariffs beginning in late spring. On the regulatory front, the "One Big Beautiful Bill" was passed, which sets the table for further fiscal stimulus in 2026. The longest government shutdown that occurred in the fall did little to upset the market as we've seen this movie before. This year was one of the worst on record for active managers due to the "meme-like" frenzy around certain industries like quantum computing and nuclear power. Both areas are likely five years away from becoming reality. Nevertheless, when all was said and done for the year, the S&P 500 once again outpaced the Russell 2000 Index with returns of +17.9% and +12.8%, respectively. However, the small cap

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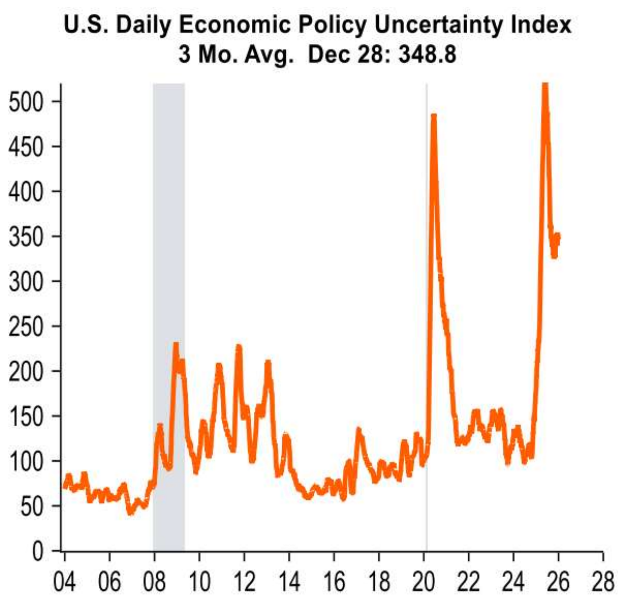
Russell 2000 outperformed the S&P 500 since the end of February and is now showing signs of leadership. The NASDAQ Composite was the gold medalist for the year with a +21.1% gain.

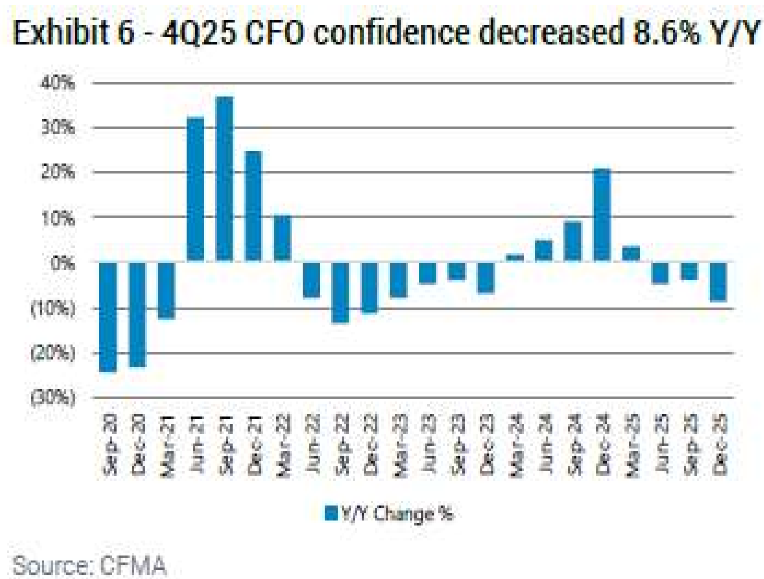
As we look ahead to 2026, the year could start with a bang as we're expecting that a SCOTUS decision on tariffs, a new Fed Chair to be named, and tax breaks, which include full expensing of new buildings and equipment, will add further fuel to an already strong economy despite the dour sentiment. The key to the stock market is how much longer the AI capex cycle can last and what will be the impact on the economy as growth in AI spending slows. Please read on to see our unique views of what's on tap for 2026, themes we're investing in here at 1492, and key market drivers.

A Look Back at 2025 - Liberation Day Set the Tone for the Year

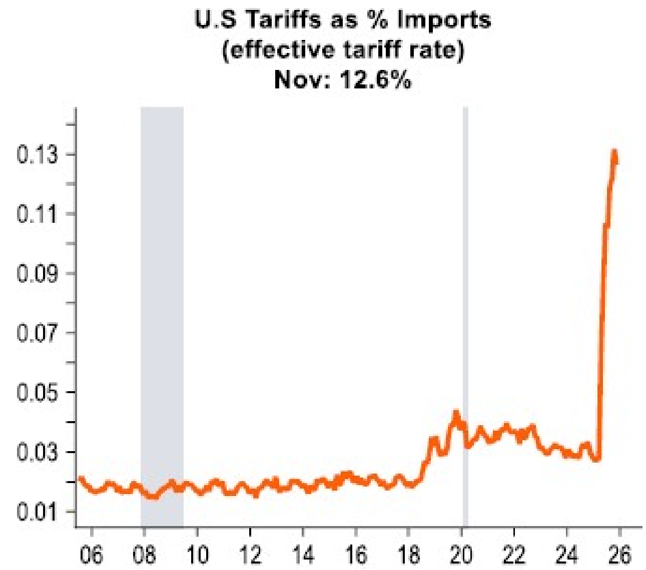
2025 proved to be a year of resilience, volatility, and ultimately strong returns for global equities. Geopolitics, monetary policy shifts, and earnings strength shaped the narrative. It turned out to be a great year for the markets with the S&P 500 posting double-digit returns for the third year in a row. Three consecutive double-digit return years are quite rare in the history of the stock market. There have been only three other such occurrences in the past 76 years. The year started with concerns over tariffs, and investors feared a return of runaway inflation and a potential recession. The policy uncertainty index spiked to levels higher than during the COVID pandemic, as shown in the chart below left, which is hard to believe. Corporate confidence was shaken as many couldn't adjust their supply chains fast enough to avoid tariffs, particularly as President Trump kept moving the tariff rates week to week. The chart below right shows the steep drop in CFO confidence throughout 2025, which is still depressed despite real GDP growth of nearly 4% in the third and fourth quarters of 2025. As a result, the S&P 500 subsequently fell by 19% from its peak into early April.



Source: PSC



At that point in early April, few believed we would realize a positive return, let alone a nearly +20% year for the stock market. The April 2nd Liberation Day, the day on which a broad swath of tariffs was announced on nearly every country, was the turning point that set the tone for the remainder of the year. As it turns out, tariffs were implemented across most countries and brought the effective tariff rate up from about 3% before the new tariffs to nearly 13% as of November as shown below left. This move added significantly to the amount of excise taxes (tariffs) collected, as shown in the chart below right, which settled at a nearly $400 billion annualized rate.



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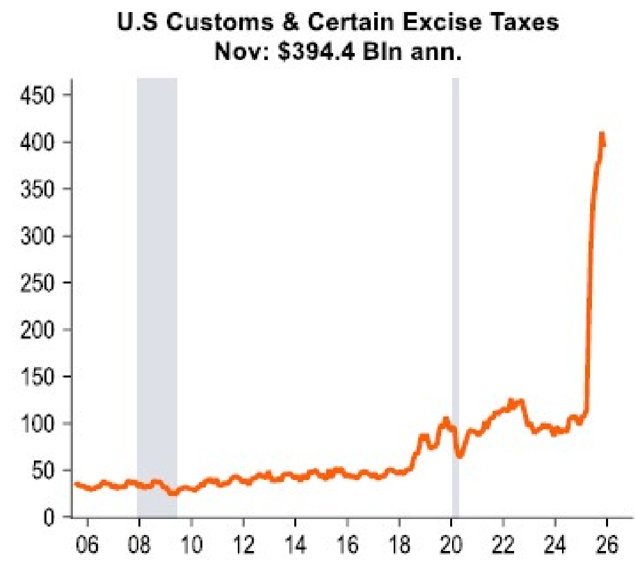
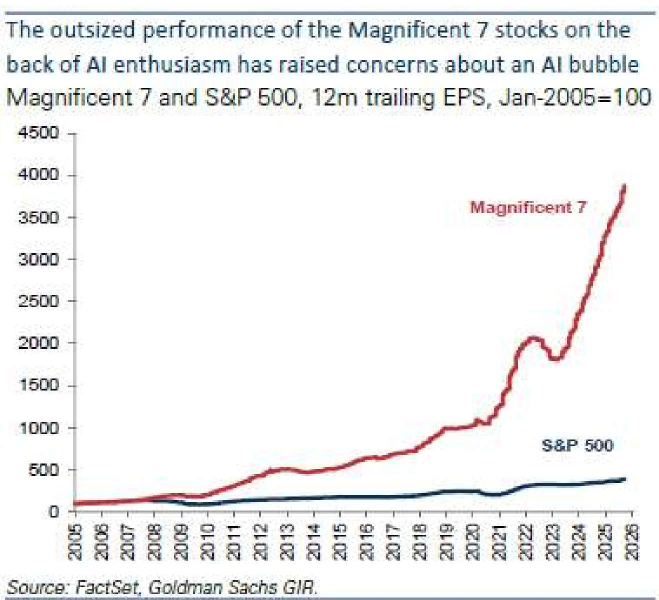


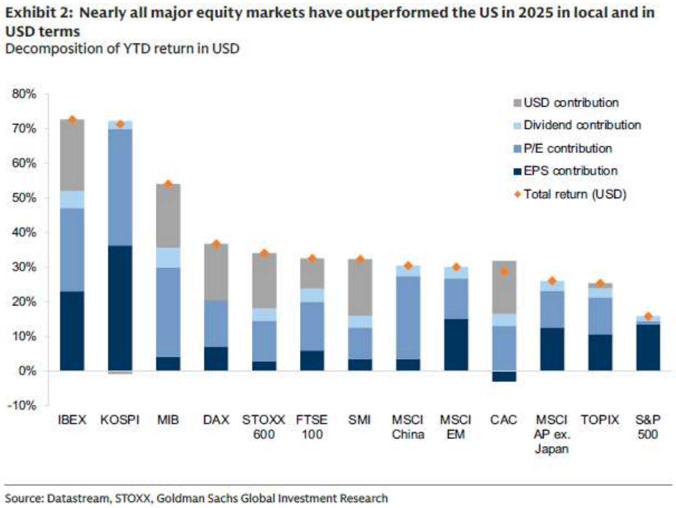
Source: PSC

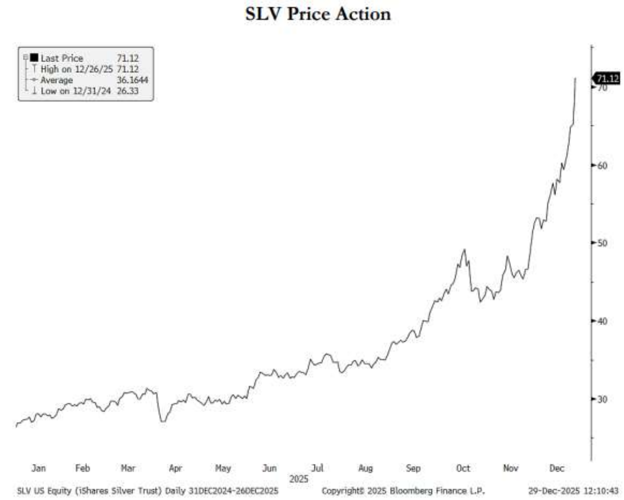
Market sentiment shifted rapidly in May as the administration began easing the most restrictive trade measures and negotiating initial trade deals. This "walk back" sparked a massive relief rally. The positive performance was largely due to earnings growth, which replaced valuation expansion as the primary engine of the market. The chart below left shows the significant earnings contribution that the "Magnificent 7" companies have made over the past few years. It's no wonder these stocks have significantly outperformed. The Fed's accommodative stance on interest rates also added fuel to the fire with three 25 basis point rate cuts in the back half of 2025. The chart below right shows the market's expectation for rate cuts as 2025 progressed. The current consensus is for another two 25 basis point cuts in 2026.



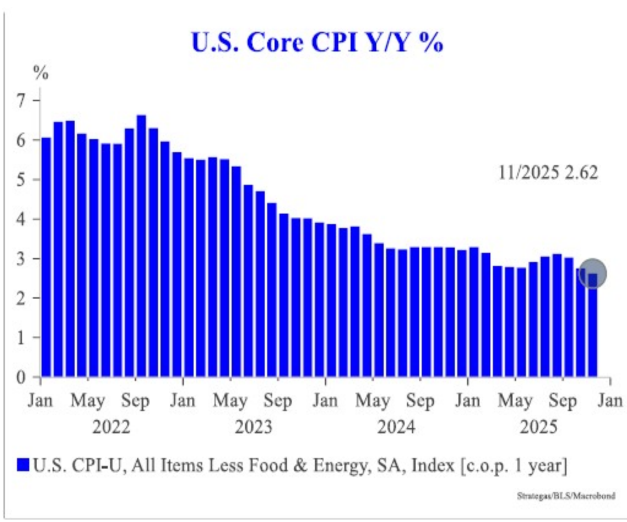
Source: Strategas

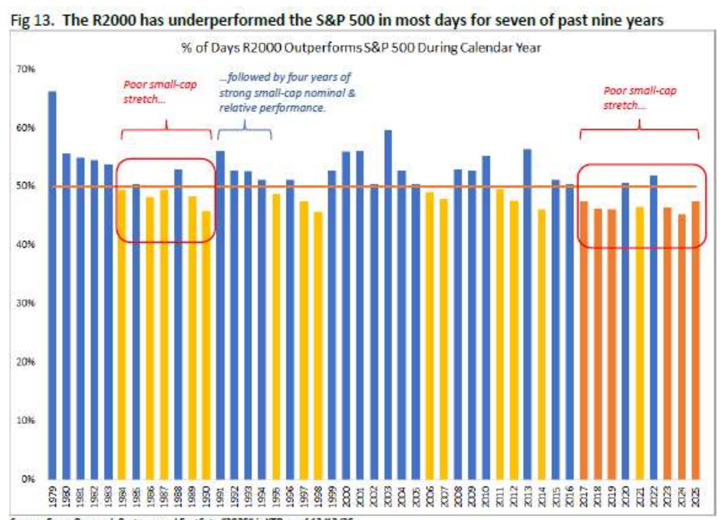
Growth equities, particularly those tied to artificial intelligence infrastructure and adoption, drove outsized returns in 2025. The traditional Magnificent 7 names continued to be market cap leadership anchors, though sentiment cooled late in the year. Helped by currency effects and stimulus in key regions, international equities outpaced U.S. returns. The U.S. dollar dropped 10% on the year, which helped emerging markets outperform. The chart below left shows the significant outperformance that many international markets experienced in 2025. Metals like gold (+64%), silver (+144%), and platinum (+127%) were the shiny objects of the year and were initially propelled higher on inflation fears that gave way to a speculative fervor. Silver, as shown in the chart below right, went parabolic as the year progressed. Interestingly Bitcoin, otherwise known in the cryptocurrency world as "digital gold", was a huge underperformer with a -7% loss on the year. Go figure.





Despite all of the angst about higher inflation due to tariffs, it actually fell throughout the year and looks poised to approach 2% in mid-2026 as we anniversary the imposition of tariffs beginning in late spring. The chart below left shows the core CPI metric retreating throughout the year, despite the narrative that tariffs were going to ignite inflation again. On the regulatory front, the "One Big Beautiful Bill" was passed, which sets the table for further fiscal stimulus in 2026. The longest government shutdown ever, which occurred in the fall, had little impact on the market as we've seen this movie before. This year was one of the worst on record for active managers due to the "meme-like" frenzy surrounding certain industries like quantum computing and nuclear power. Both areas are likely five years away from becoming a reality. Nevertheless, when all was said and done for the year, the S&P 500 once again outpaced the Russell 2000 Index with returns of +17.9% and +12.8%, respectively. However, the small cap Russell 2000 outperformed the S&P 500 since the end of February and is now showing signs of leadership. The chart below right shows the continuing underperformance of the Russell 2000 in seven of the past nine years. The NASDAQ Composite was once again the gold medalist for the year with a gain of +21.1%.





The table below shows that the stock market posted strong returns in the fourth quarter and rounded out a good year after a softer start. For the small cap Russell 2000, the current quarter's return was in line with the S&P 500. For the year, the S&P 500 rose +17.9% but trailed the NASDAQ Composite, which was up +21.1%. Despite its strong performance in the last three quarters of the year, the Russell 2000 still lagged the S&P 500 year to date as the index posted a return of +12.8%.

Index Returns		
Index	Fourth Qtr. 2025 Return	2025 YTD Return
Russell 2000	+2.19%	+12.81%
Russell 2000 Growth	+1.22%	+13.01%
Russell 2000 Value	+3.26%	+12.59%
S&P 500	+2.66%	+17.88%
Dow Jones Industrials	+3.59%	+12.97%
NASDAQ Composite	+2.72%	+21.14%

Source: 1492 Capital Management, LLC and FactSet

From a style perspective, the Russell 2000 Value Index (+4.6%) eked out a win against the Russell 2000 Growth Index (+2.92%) 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. For 2025, the Russell 2000 Growth Index beat the Russell 2000 Value Index by the slimmest of margins and outperformed for the third straight year. Rate cuts were a favorable driver of small cap performance since March, which is when the market started anticipating further Fed rate cuts. The best performing sector in the Russell 2000 for the quarter, surprisingly, was the Healthcare sector (+18.6%) as biotech stocks took off in sync with interest rate cuts. A distant second was Materials (+5.1%) as higher metals commodity prices drove interest in the sector. The worst performing sectors were Technology (-4.6%) and bond proxy Consumer Staples (-4.5%). Oddly, on a year-to-date basis, the best performing sector in the Russell 2000 was the Materials sector (+38.2%) due to higher metals pricing and rare earths enthusiasm. Materials had a great year as they became the bargaining chip for many of the tariff discussions currently taking place. The table immediately below highlights the performance of the Russell 2000 Index by sector for the fourth 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. The fourth quarter reversed that trend and was enough to push the smallest of the small to a victory for the first time in many years. 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 6 - Russell 2000 Scorecard through December 31st

	December			Fourth Quarter			2025			
GICS Sector	**Absolute**	**Contribution**	**Relative**	**Absolute**	**Contribution**	**Relative**	**Absolute**	**Contribution**	**Relative**	**Wgt**
Com Serv	6.18	0.16	6.76	4.35	0.10	2.16	16.53	0.36	3.72	2.8
Discretionary	-0.48	-0.04	0.10	-3.69	-0.33	-5.88	-0.09	0.17	-12.90	8.9
Staples	-1.15	-0.02	-0.57	-4.44	-0.09	-6.63	-3.81	-0.07	-16.61	1.8
Energy	-2.50	-0.11	-1.92	1.30	0.07	-0.89	1.53	-0.06	-11.28	4.8
Financials	1.87	0.31	2.45	1.51	0.29	-0.68	7.97	1.67	-4.84	17.7
Health Care	-0.62	-0.14	-0.04	18.55	2.99	16.36	27.17	3.83	14.36	18.7
Industrials	-1.23	-0.22	-0.65	-1.84	-0.38	-4.03	17.56	3.25	4.76	17.3
Info Tech	-3.14	-0.43	-2.56	-4.56	-0.74	-6.75	9.64	1.63	-3.17	14.7
Materials	3.85	0.15	4.43	5.05	0.20	2.86	38.23	1.50	25.43	4.4
Real Estate	-1.11	-0.07	-0.53	1.85	0.12	-0.34	3.50	0.09	-9.31	5.7
Utilities	-5.42	-0.17	-4.84	-1.58	-0.04	-3.77	15.07	0.47	2.26	3.0

Size Quintile	**Absolute**	**Contribution**	**Relative**	**Absolute**	**Contribution**	**Relative**	**Absolute**	**Contribution**	**Relative**	**Wgt**
1 (Largest)	-1.73	-1.03	-1.15	1.17	0.69	-1.02	13.46	8.14	0.65	59.5
2	0.86	0.18	1.44	2.91	0.64	0.72	9.00	1.87	-3.81	22.5
3	1.47	0.16	2.05	5.52	0.59	3.33	15.46	1.60	2.65	10.9
4	1.23	0.06	1.81	3.85	0.20	1.66	16.16	0.83	3.36	5.2
5 (Smallest)	2.92	0.05	3.50	3.53	0.06	1.34	16.99	0.35	4.18	2.0

Returns in the international markets were generally nicely positive and continued their strong year-to-date performance. As a whole, they outperformed the U.S. stock market on the year. European markets have, for the most part, been stronger than Asian markets in 2025, but Japan and China both had very healthy years. Tariffs once again are the determining macro factor, as European countries aren't facing as high tariffs as the Asian countries. China markets rose as their market caught the AI bug, and more government stimulus sent their equities soaring. Bond market returns were modest once again as shorter-term interest rates fell following the three Fed rate cuts in the second half of the year, but longer-term rates stayed fairly sticky. From a commodity perspective, nearly all commodities were weak in the quarter outside of metals as tariff-related demand concerns began to take hold, and the early pull forward of materials seen at the start of the year began to wane. However, precious metals and rare earths metals began to soar as the latter benefitted from the U.S. government's investments in several companies. Natural gas and oil continue to be weak despite the massive demand for energy to power data centers. Energy demand continues to be stable, and Trump favors exporting liquefied natural gas, which should be a nice tailwind for the commodity. Silver 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	Fourth Qtr. 2025 Return	2025 YTD Return
France	3.20%	10.40%
Germany	2.60%	23.00%
Brazil	10.20%	34.00%
India	6.20%	9.10%
China- A Shares	2.20%	18.40%
China- Shenzhen A Shares	0.50%	29.30%
Japan	12.00%	26.20%
Long-Term Treasuries (TLO)	-1.20%	1.70%
Investment Grade Corp Bonds	1.00%	8.20%
Gold	12.00%	64.20%
Volatility- VIX Index	-7.00%	-15.20%
Oil	-7.20%	-19.40%
Natural Gas	-4.00%	2.30%
Lumber	-12.20%	-2.30%

Source: 1492 Capital Management, LLC

Thematic Investing: The AI Cycle Broadens from the "Magnificent 7" to the Rest of the Market

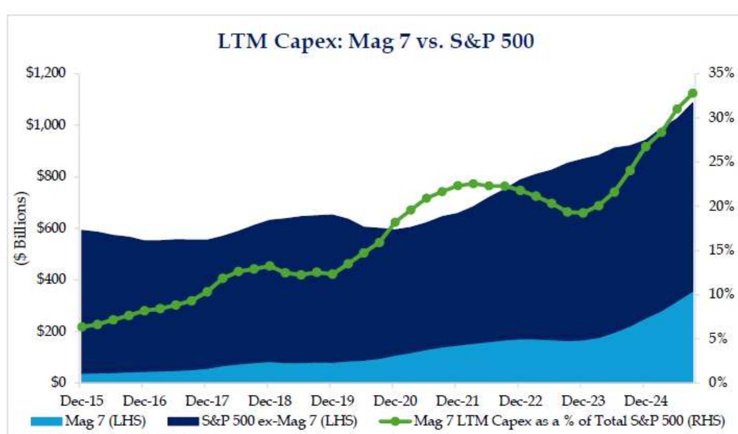
From 2023-2025, the AI narrative centered overwhelmingly on the handful of hyperscale technology leaders that have driven both innovation and capital markets performance. Anchored by Nvidia, Microsoft, Alphabet, Amazon, Meta, Apple, and Tesla, these "Magnificent 7" dominated AI capital expenditures and investor attention. They accounted for a large share of both capex and market cap gains. The chart below left shows the significant ramp in the capital expenditures that the hyperscalers are making as they ramp up their AI datacenters across the globe. It's estimated that the spending by these companies in 2025 accounted for nearly 1% of GDP growth. Cumulatively, they are expected to grow capex by another 35% in 2026 to a whopping $554 billion. The chart on the right shows the rolling trailing 12 months of capex of the "Magnificent 7". They used to be viewed as cash flow machines, which they were, but now they are outspending cash flow as they invest in their AI datacenter initiatives. As the green line shows, the "Magnificent 7" accounted for about 7% of the capital expenditures in the S&P 500 ten years ago, and this year they are approaching 35%.

Capex

Nominal Capex Spending (FactSet) $B

	2023	2024	2025	2026
GOOG	$32	$52	89	114
META	$27	$37	70	109
AMZN	$54	$83	124	145
MSFT	$28	$44	64	98
Total	*$141*	*$217*	*$347*	*$467*
AAPL	$11	$9	$13	$14
NVDA	$1	$3	$6	$5
TSLA	$9	$12	$10	$12
ORCL	$7	$21	$48	$55
Total	**$169**	**$262**	**$424**	**$554**

Source: PSC



As we transition into 2026 and beyond, a structural broadening of the AI investment cycle has begun. It is one that will expand opportunity beyond those mega caps into a host of other infrastructure enablers, consulting firms, healthcare platforms, and other key industry vertical players. We anticipate the broadening theme crystallizes across three overlapping phases:

Phase I- Hyperscale Foundation (2023-2025):
Investment and performance are concentrated on foundational AI leaders.

Phase II- Infrastructure Buildout (2025-2027):
AI computer, networking, memory, and data center ecosystems scale; small to mid cap infrastructure beneficiaries outperform.

Phase III- Application and Commercialization (2026-2028):
AI embeds across industries- cybersecurity, enterprise SAAS, automation, health tech, and vertical platforms drive durable revenue growth outside core tech. We expect continued dispersion of performance away from narrow, cap-weighted leadership into specialized growth segments as the AI investment cycle matures.

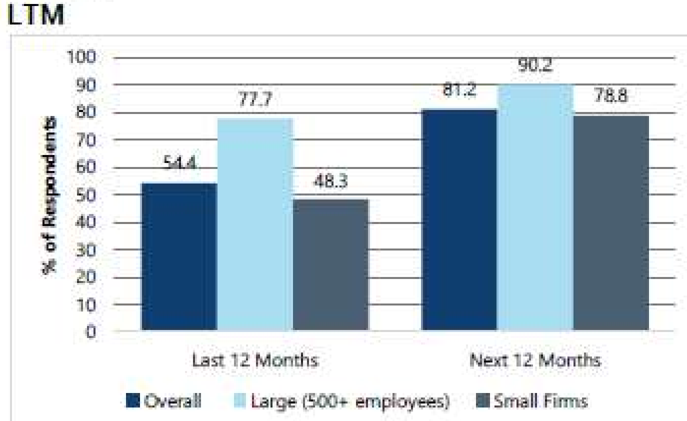
We view AI not as a single sector bet but as a multi-layered economic transformation - one that starts with hyperscale compute and ultimately diffuses throughout the global economy. Its path is similar to how the internet boomed in the late 1990s / early 2000s. As the cycle evolves, small and mid cap players with specialized technology, strong revenue traction, and strategic partnerships stand to capture disproportionate returns compared to the narrow leadership of the last several years.

While the "Magnificent 7" dominated the headlines and the lion's share of market returns in 2023 and 2024, **2025 served as the critical bridge to a more democratic AI investment landscape.** As we look toward 2026, the market is no longer just betting on who builds the chips; it is betting on who *uses* them and who *powers* them. The investment cycle is moving from the **Infrastructure Phase** (building the brain) to the **Inference and Application Phase** (putting the brain to work). This shift is creating a massive "Alpha" opportunity in small and mid cap stocks that were previously overlooked. The number of companies adopting and actually using AI is still relatively small at 17.3%, as the chart below left shows, but is accelerating rapidly. The spending intentions of companies have moved from 54% that have spent on AI over the past 12 months to 81% that plan to spend on AI initiatives in the next 12 months. Boards of directors across the globe are insisting that management teams roll out AI initiatives to avoid being left behind.

...with 17.3% of companies across all industries having adopted AI, up significantly from around 10% in Q3
Share of US firms using AI by sector, %

Source: Census Bureau, Goldman Sachs GIR.

Exhibit 14 - 81% of firms plan to invest in AI over the NTM, up from 54% that have invested in AI in the LTM



Source: Federal Reserve

Several catalysts are converging to drive this "broadening out" in 2026:

- **The "Inference" Inflection:** By mid-2025, the cost of "running" AI models (inference) dropped by over **70%** compared to a year prior. This reduction makes it financially viable for smaller, nimble companies to integrate enterprise-grade AI into niche products without the massive overhead seen in 2024.
- **Agentic AI:** 2026 will be the year of the **AI Agent**. Unlike simple chatbots, these agents can execute complex workflows (e.g., handling an entire insurance claim from start to finish). Small cap software firms with "deep vertical" data are the primary beneficiaries here.
- **Fiscal Tailwinds (The OBBBA Impact):** The passage of the **"One Big Beautiful Bill Act" (OBBBA)** in mid-2025 has begun funneling billions into domestic high-tech manufacturing and grid modernization. This act is a direct shot in the arm for small cap industrial and energy firms.

2026 Beneficiaries: The New "Picks and Shovels"
We are shifting our focus toward three specific sub-sectors where we expect small cap outperformance to accelerate:

1. The "Grid Tech" Small caps
The AI boom has a physical limit: **Power.** As hyperscale data centers expand, the localized grid infrastructure is under immense strain.

- **Beneficiary:** Companies providing components to the electrical grid leading to the datacenter and fiber optics players whose components and lines can harness and direct the computing power amongst the servers inside the datacenter. **Why:** They provide the "glue" that holds the modern grid together, which is a necessity as we overhaul the U.S. electrical system for the AI age.

2. Specialized AI Data Engineering
The "Mag 7" may have the models, but they don't have specialized data for every industry.

- **Beneficiary:** Providers of the high-quality, human-curated data training sets required for specialized medical, legal, and financial AI. Specialized consulting firms can assist the typical company that doesn't have a team of AI engineers on staff to accurately create these vertical datasets and the corresponding cybersecurity required in such cases.
- **Why:** As models become more "vertical," the value of clean, specialized data increases exponentially.

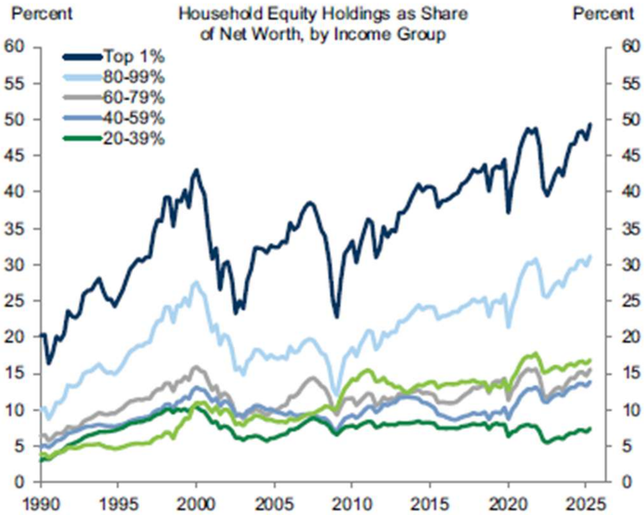
3. Enterprise "Agent" Platforms
The software "SaaS" model is evolving into the "Agent" model, where you pay for results rather than seats.

- **Beneficiaries:** Companies leading the charge in "Robotic Process Automation" (RPA) infused with AI agents and contact centers as a solution that is fused into an AI-led interaction hub.
- **Why:** These companies are moving from being "tools" to being the "brains" of the enterprise.

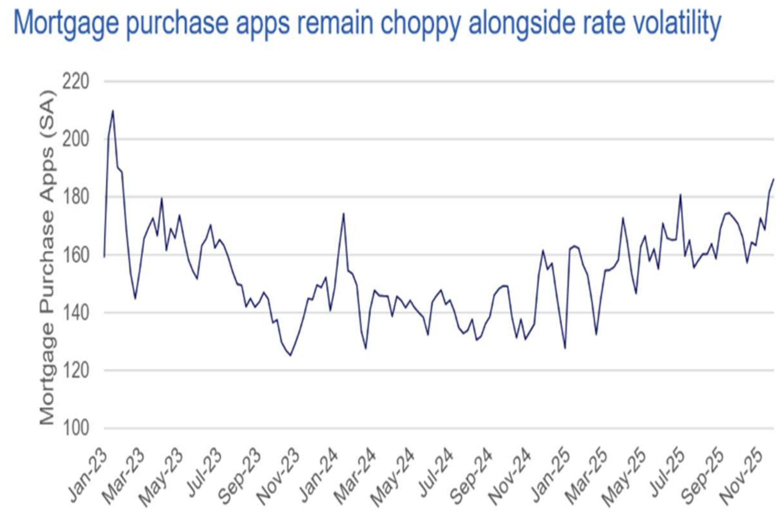
Thematic Investing Update: Hitting Two Investment Themes with One Stone in 2026

With the expectation of additional Fed rate cuts in 2026, we expect an improved housing market in the new year. While the current job market is sluggish, we remind our readers that unemployment is a lagging economic indicator. Current mortgage rates from Bankrate.com show a national average of 5.6% on a 5/1 adjustable rate mortgage (ARM) and 6.25% on 30 year fixed. With a complete guess of two rate cuts in '26, the 5/1 ARM has the potential to be in low 5's shortly, which may make the first home and move up from the starter home purchase possible. Americans may just have to stomach a greater risk of the unknown after the first five years of a fixed interest rate with an ARM to make home ownership possible in the currently stubbornly sticky 10-yr U.S. Treasury yield / 30 year mortgage rate environment. An additional catalyst for our housing theme holdings is the expectation of a record breaking 2025 tax refund season of $100-150 billion largely from the One Big Beautiful Bill Act (OBBBA), which should arrive shortly before or during the key spring home selling season. Goldman Sachs also forecasts an acceleration in real income growth from 1.7% in 2025 to 2.7% in 2026 with particular strength in the middle income group.

Consumer balance sheets are also strong, and their investment portfolios may help offset that fear of unknown future interest rates associated with ARMs. After three strong years in the stock market, the top 60% of the U.S. income bracket are at or near multi-decade highs for equity holdings as a share of net worth as seen in chart below left. There is always a chance that a new Fed chairman also ponders buying mortgage backed securities, but that idea would have to be balanced against augmenting an affordability crisis if too much demand is unleashed. According to Strategas, the Fed could expand its balance sheet with $300 billion of bond purchases through this April, and they estimate that every $250 billion of buying equates to a roughly 25 basis point rate cut. In addition, affordability should also show improvement as houses are staying on the market longer, which leads to price reductions. According to Realtor.com, inventory is surging as the number of actively listed homes jumped 12.6% year over year in November. Throughout the course of economic history, more supply of anything has led to lower prices, which should provide a much needed boost to housing affordability. As seen in the chart on the right below, if mortgage purchase applications were a stock, we would say that we are generally making higher highs and higher lows in an upward trend which is a good sign of a gradually improving market with various 2026 tailwinds that argue for faster improvement.

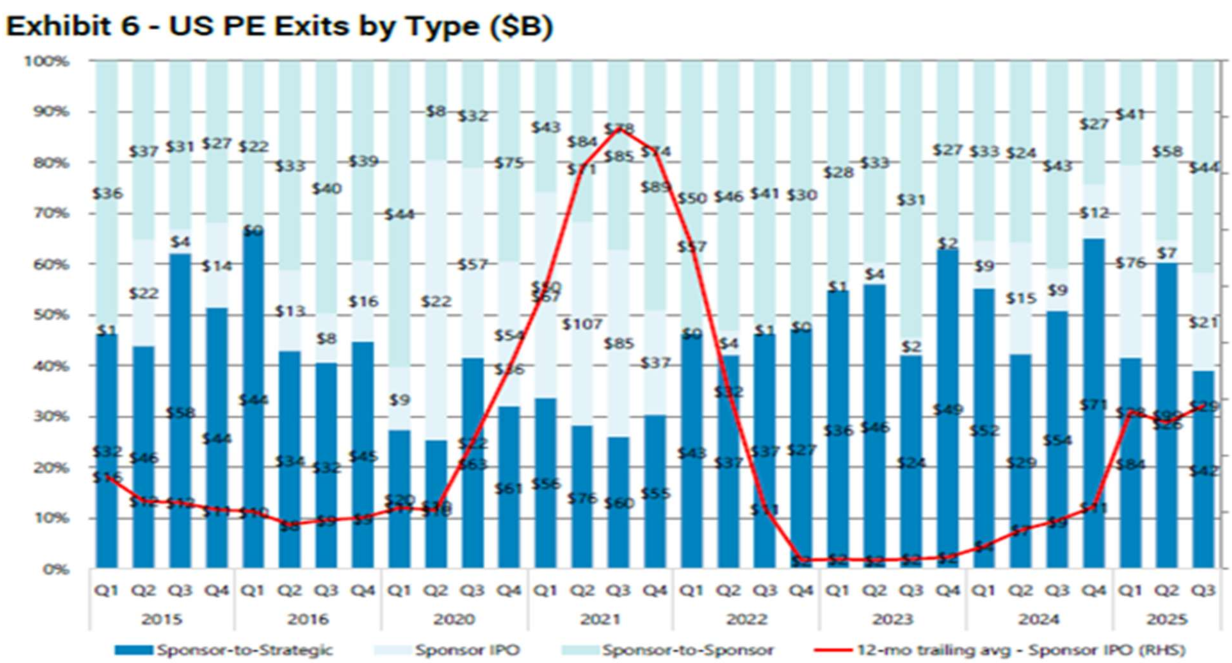


Source: Goldman Sachs



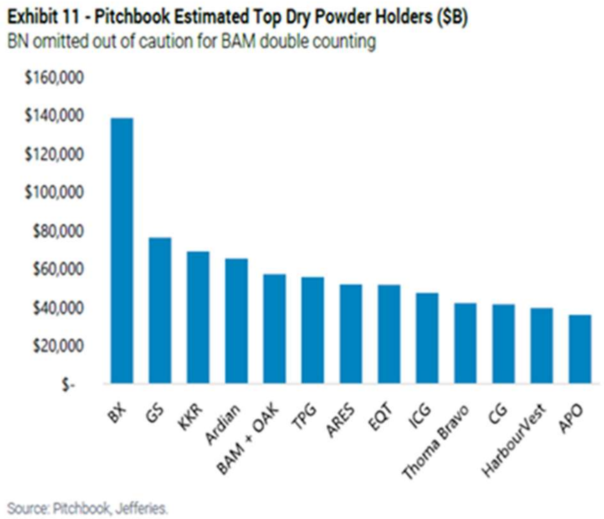
Source: RBC

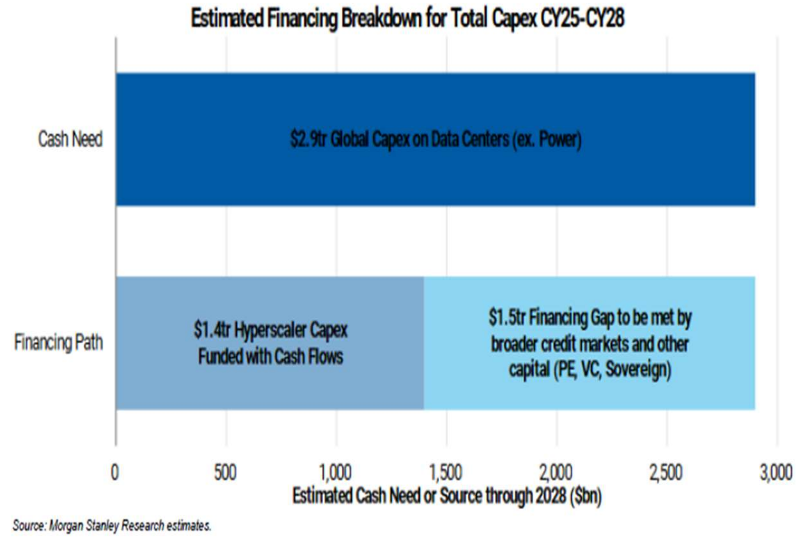
With respect to our capital markets theme, lower interest rates should make for improved M&A activity and equity and debt offerings in 2026 to follow a strong 2025. Despite all of the uncertainty in 2025, the number of U.S. IPOs jumped over 20% with 222 offerings versus 183 in 2024 according to Roth Capital. Per Dealogic, mergers and acquisitions/advisory volume totaled $4.43 trillion this year through November and tracked to $4.92 trillion for the full year which is the second best year in the last ten. Stability in U.S trade policy in 2026 should also get more buyers and sellers off of the proverbial sidelines across all economic sectors for M&A. Importantly, private equity needs to show their investors' realized returns, and the IPO market is a very likely path to do so. According to Jefferies research, roughly 22% of U.S. private equity exits were via initial public offerings in 2025 which is down from 35% in 2021 as shown in the light blue bars in the chart below. Additionally, the private equity sponsor to strategic buyer exit route should be a smoother road in 2026 with lower interest rates and a firmer trade policy to bolster buyer confidence. All of these catalysts should generate improved fee revenue for our capital markets theme holdings in the 1492 Capital Management strategies.



Source: Pitchbook, Jefferies

Considering now the dollars that private equity needs to invest, the chart below left shows the billions that the top ten proverbial dry powder holders possess to acquire companies. With greater retail access to private equity in 2026, these war chests are likely to continue to be replenished for M&A activity. In addition, AI is impacting all corners of the U.S. economy at once which has and should continue to create a frenzy of transactions. Companies will buy what they need to compete in AI if the cost in both dollars and time is too high to build to be competitive. According to Goldman Sachs, U.S. hyperscalers capital expenditures averaged an astounding $760 million per day between the first quarter of 2024 and the third quarter of 2025, and healthy spending is expected to continue. This investment pace requires financing, and Morgan Stanley estimates that the funding gap for capex from 2025-2028 after cash flow usage could be as much as $1.5 trillion globally as seen in the chart below right. This massive capital need should benefit our capital markets theme holdings as well as they aid their clients in finding suitable funding sources.

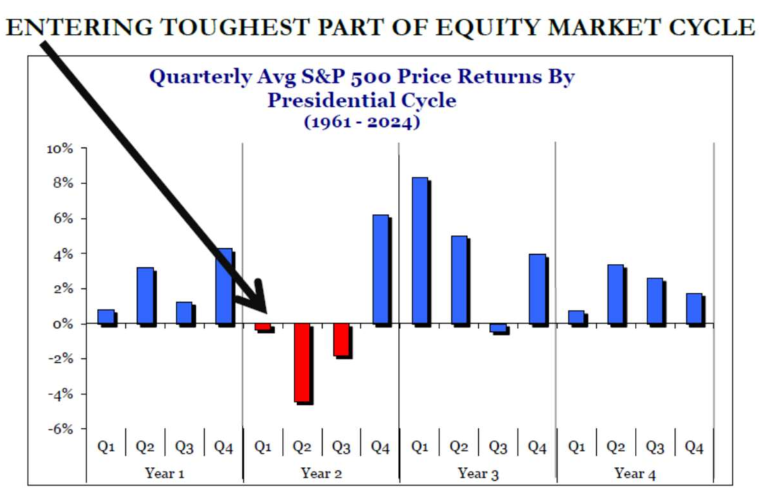


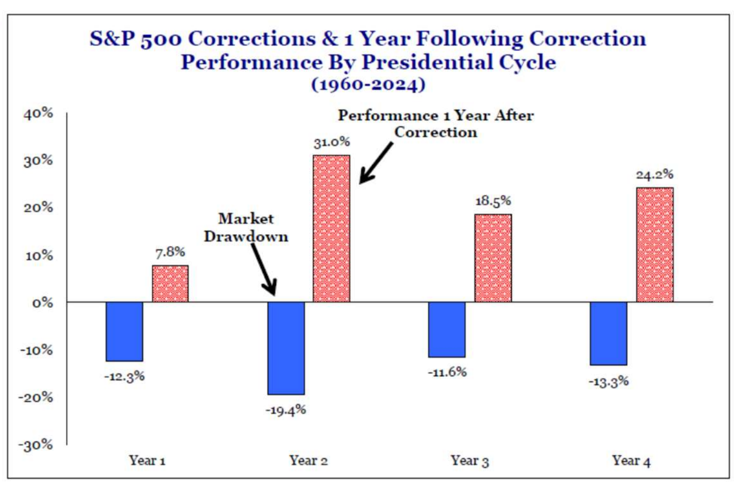


As we enter 2026, we believe that the housing and capital markets themes deployed in the 1492 Capital Management strategies should both benefit nicely from further Fed rate cuts. With lower inflation expected in the new year, the path to move interest rates lower is clear. In housing, we should witness more appetizing mortgage rates, improved affordability, and additional cash for down payments courtesy of the OBBBA. On the capital markets side, lower rates will help both capital raising and M&A activity in a hopefully stabilized global trade environment.

2026 Outlook: The Year of the Phase Shift

As we look ahead to 2026, the year could start with a bang as we're expecting that a SCOTUS decision on tariffs, a new Fed Chair to be named, and tax breaks, which includes full expensing of new buildings and equipment, will add further fuel to an already strong economy despite the dour sentiment. The key for the stock market is how much longer the AI capex cycle can last and what the impact will be on the economy as growth in AI spending slows. The second year of the presidential cycle is historically the worst year out of the four, as shown in the chart below left. If the SCOTUS decision on tariffs comes down against the Trump administration, the market won't likely take it well. However, tariffs won't be dead as there are plenty of other statutes like Sections 301, 232, 122, and 338, all of which give the President power to impose tariffs. In our minds, tariffs are going to be imposed, and it's just a matter of which statute is used. We think it's highly unlikely that the $400 billion of tariffs collected to date will be refunded. This thought brings us to the risk of an early year selloff if some of these near-term risks break the wrong way. Unfortunately, as shown in the chart below right, the second year of a presidential cycle also brings with it the largest average market correction by far. Let's hope that we don't have to go through a selloff again like last year.





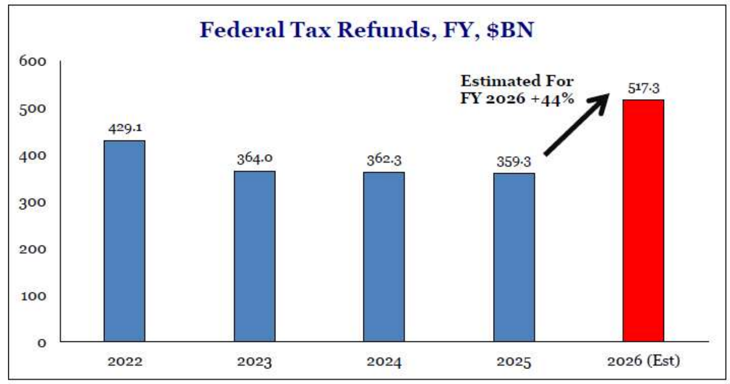
Source: Strategas Research

The appointment of a new Fed chair will be an important milestone in January as well. At this point, the market seems to be vacillating between the two Kevin's- Warsh and Hassett, and Hassett has the nod at this time. Both would be good choices for anyone who wants to see the Fed cut rates. Speaking of cuts, tax rates will be coming down for many in 2026 as a result of the "One Big Beautiful Bill Act" that was passed in 2025. This act will put larger refunds in the hands of individuals and allow 100% deductions for corporations on any new building and equipment expenditures made. This deduction could be a major boon for capital expenditures and the beneficiaries like capital equipment manufacturers and commercial builders. The chart below left, shows the large impact on disposable personal income that the new tax law provides. It will add six percentage points to disposable income growth in the first quarter alone. The chart below right shows the Federal tax refund dollars by year, and they are projected to go up by a whopping 44% in 2026.

TAX REFUNDS SET TO BOOST DPI BY 6 PPTS.

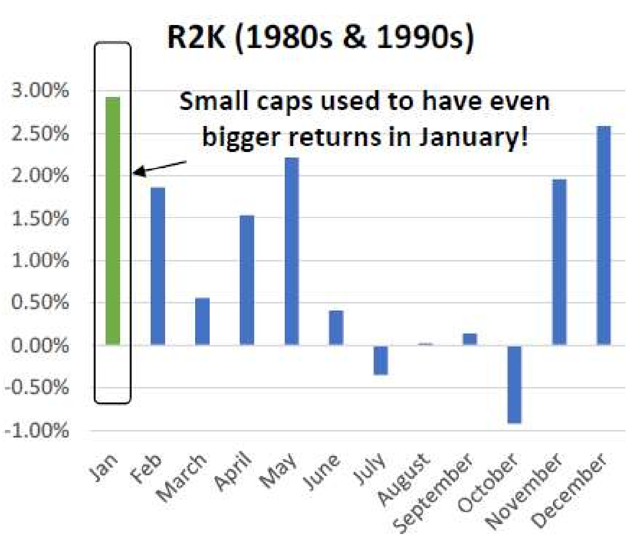
	2026			
	1Q	2Q	3Q	4Q
Individual Tax Relief From OBBBA Provisions, A.R	$344 Bn	$220 Bn	$100 Bn	$100 Bn
Nominal DPI, Q/Q A.R.				
Without Tax Relief	4.0% e	4.0% e	4.0% e	4.0% e
With Tax Relief +6ppts	10.3% e	1.8% e	1.9% e	4.0% e
Real DPI Q/Q A.R.				
With Tax Relief	8.3% e	-0.2% e	-0.1% e	2.0% e

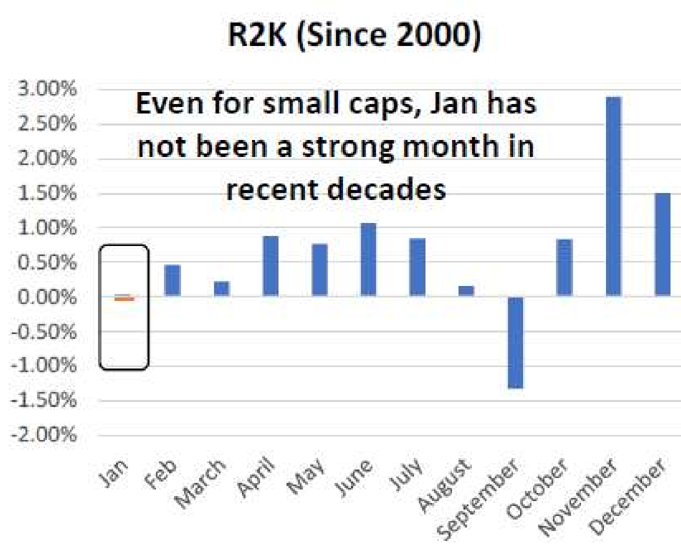
Source: PSC



Source: Strategas Research

Continuing with our January theme, the Russell 2000 historically experienced a "January Effect" in which the index would rally more during January than any other month of the year, which was attributed to investors selling losing stocks in December for tax loss purposes. Investors then reinvest those funds plus new capital from year-end bonuses and portfolio rebalancing during January. This phenomenon was quite prevalent during the 1980s and 1990s, as shown in the chart below left, but this anomaly seems to have been arbitraged away since the year 2000 as investors tried to take advantage of the phenomenon. It just goes to show that there is no such thing as a free lunch in today's stock market.





Source: Furey Research

As we close the door on 2025, "Liberation Day" tariff shocks and the initial easing of restrictive monetary policy defined the year. We enter 2026 facing a fundamentally different market setup. We believe that a **"Phase Shift"** will characterize 2026. This shift is a transition from speculative AI excitement to tangible productivity gains and from a "higher-for-longer" interest rate regime to a stabilized neutral rate environment. Both monetary and fiscal policy will come into focus with the new Fed chair and with any fiscal initiatives that the Trump administration wants to push through in advance of the mid-term elections.

I. Monetary Policy: Finding the "Neutral" Anchor

- Following the Federal Reserve's 25 basis point cut in December 2025, the federal funds rate enters the new year in the 3.50%–3.75% range. The central question for 2026 is no longer *if* the Fed will cut, but where the "terminal rate" lies. The current Fed funds rate is still about 1% above the "neutral" rate. This provides the Fed and the new Fed chair some cushion to bring rates down a bit more aggressively than most currently expect. The market is still calling for two additional rate cuts in 2026, which are likely more back-end loaded. These rate cuts could come sooner than that, but the caveat is that the new Fed chair doesn't take the seat until May.
- **The Powell Transition:** Markets will be hyper-focused on the May 2026 expiration of Chair Jerome Powell's term. The appointment of a successor will likely inject volatility into the Treasury market as investors gauge the new leadership's stance on "running the economy hot" to manage the federal debt.
- **Yield Curve Normalization:** We anticipate a further steepening of the yield curve. With short-term rates falling and the 10-year Treasury likely hovering around **4.0%–4.35%** due to deficit concerns and the shift of the Feds balance sheet to longer term holdings over time. The "re-steepening" trade will favor financials and regional banks that have struggled with compressed net interest margins.

II. Fiscal Policy: The OBBBA Tailwind

The enactment of the **One Big Beautiful Bill Act (OBBBA)** in July 2025 remains the primary fiscal engine for 2026. The implications for corporate cash flows are significant:

- Full expensing of R&D costs will provide a direct boost to cash flow margins for a host of industries, namely biotech/pharma and technology companies who tend to spend the most on R&D.
- 100% bonus depreciation is reinstated through 2026, which incentivizes a massive pull-forward of domestic industrial capex.
- Tariff rebates are always a possibility with Trump, but we would much rather have them use these funds to pay down the national debt. The market would likely reward such a move more than a one-time rebate.

III. AI 2.0: From "Build-Out" to "Execution"

In 2024 and 2025, the market rewarded the "picks and shovels" (semiconductors and hyperscalers). In 2026, we expect the narrative to shift to **AI ROI** and expanding opportunities down market as we articulated earlier.

- **Capex Fatigue vs. Reality:** Hyperscaler capex is projected to exceed **$550 billion** in 2026. However, institutional flows are moving toward companies that can demonstrate actual margin expansion through AI integration—the "Productivity Beneficiaries."
- **The Infrastructure Multiplier:** The 2026 focus will broaden beyond chips into a host of industries that harness AI for deployment in their own companies or for others.

Key Risks and Opportunities for 2026

Risks:

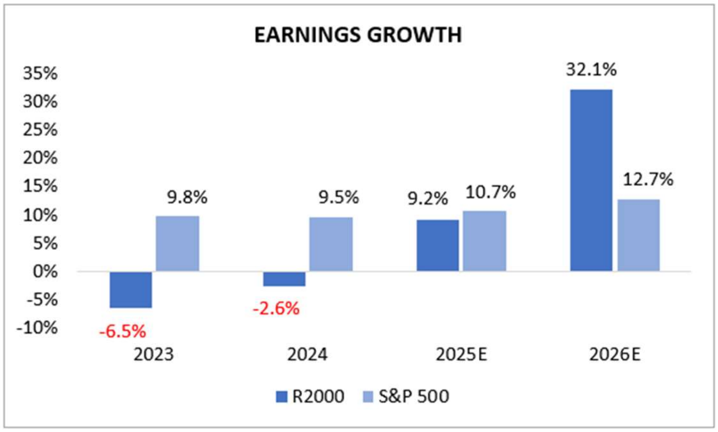
- Escalation of trade tensions leads to broader economic disruption.
- Unintended consequences of tariff policies on domestic industries and consumers.
- Midterm election volatility: Historically, midterm years see a "wait and see" approach in the first half followed by a relief rally in the second half, with uncertainty likely peaking in October.
- Slower-than-expected economic growth due to trade policy impacts.
- Labor market cools more than expected as AI job shifting impacts near-term hiring.
- AI capex spending slows more rapidly than expected as AI hyperscalers pause to digest escalating spend.

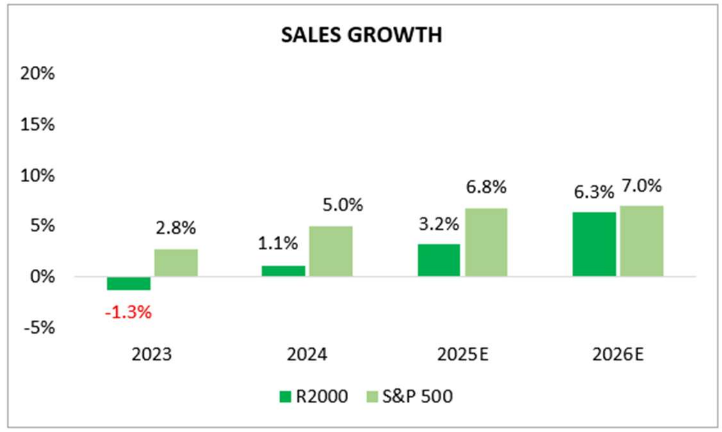
Opportunities:

- Continued technology sector innovation and AI commercialization.
- Potential for trade policy modifications that remove market uncertainty.
- Stimulus measures like tax incentives spur much stronger growth than anticipated.
- Attractive valuations in certain market segments, particularly small cap stocks.
- Benefits to domestic industries from reduced international competition.

The Outlook for Small Caps continues to improve.

The market for small cap stocks appears to be improving on several fronts. First, the projected earnings growth for the Russell 2000 into 2026 appears very robust relative to the expectations for the S&P 500. While these estimates at this time of year tend to be very optimistic (especially 32% earnings growth for small caps), there are many things under the surface that should drive a persistently better earnings outlook. One key for small caps is financials with its bank stocks. The weight of banks and financials in the Russell 2000 tends to be much greater than that in the S&P 500. With the yield curve continuing to steepen due to rate cuts, earnings should be quite robust for banks as they benefit more as the yield curve steepens. As we mentioned in our look back section earlier in the newsletter, small caps have actually outperformed the S&P 500 since the end of February 2025.



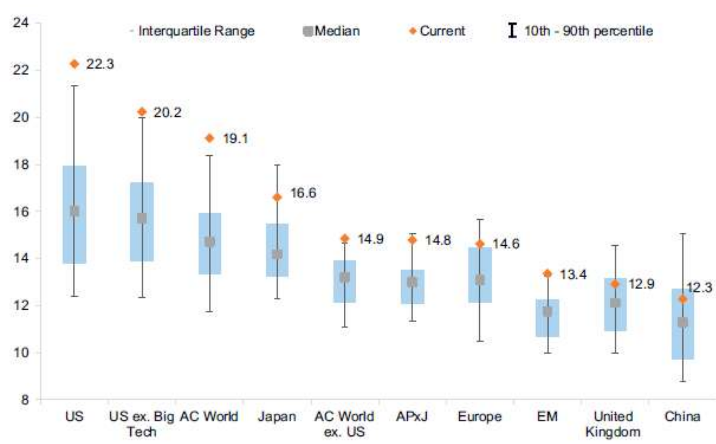


Source: Furey Research Partners and FactSet. Based upon our capitalized losses earning model. Data as of 12/15/25

The chart below left shows a technical chart. The top half of which shows the Russell 2000 breaking out to a new all-time high, and the bottom half of which depicts the relative performance of the Russell 2000 vs. the S&P 500. The chart appears to be bouncing off the bottom and overtaking the downward-sloping relative performance line. Note that small caps have been unloved for quite a few years, as the relative performance chart shows. The good news is that currently even large caps have accelerating earnings growth in 2026. This growth is important because the valuations on the S&P 500 sit at nearly the loftiest level in history. The chart below right shows the forward P/E ratio for the S&P 500 compared to other indices around the globe. It's unlikely that we'll get much more P/E ratio inflation, and we'll likely be dependent on earnings growth only for market appreciation in 2026.

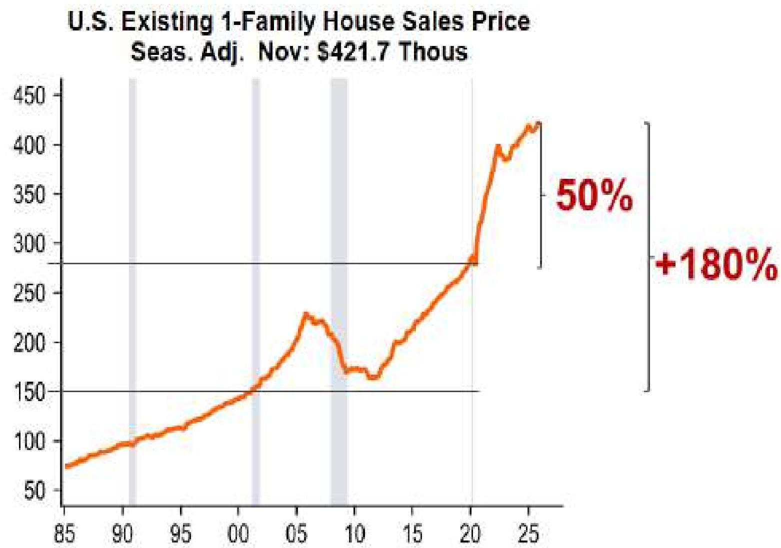
Source: BTIG

Exhibit 6: Equity valuations across regions are now at historical highs
12m fwd P/E multiple. MSCI Regions, STOXX 600 for Europe and S&P 500 for US. Data for the last 20 years.



Source: FactSet, Goldman Sachs Global Investment Research

One last topic that we wanted to touch on revolves around housing. As most know, housing affordability is near an all-time low due to high prices and high interest rates. The chart below left, highlights this phenomenon. With continuing rate cuts by the Fed, it's possible that the 30-year mortgage breaks through the psychological 6% level (current 30-year rate is around 6.25%). We believe this would unleash a torrent of buying activity as the new homebuilding and existing home sales have been quite anemic. The cost to build new homes has escalated nearly 50% since 2019 as shown on the chart below right. The combination of higher rates and higher input costs is causing the monthly mortgage payments to be out of reach for many Americans. The existing home sales activity is also very slow because many homeowners currently have mortgage rates around 3.25% that they put in place during COVID. Nobody wants to flip out of that mortgage rate into a 6%+ rate and have their payments for a like-kind house go up 50%. The reason that we're discussing this in this section is that homebuilding and all the ancillary industries around real estate tend to be small cap centric, and this could be the fuse needed to ignite small cap stocks. Additionally, the entire real estate / homebuilding market accounts for a high single-digit percentage part of GDP, and if this market takes off, GDP growth could accelerate nicely as we move through the year.



Source: PSC

2026 Outlook: A Picture is Worth a Thousand Words

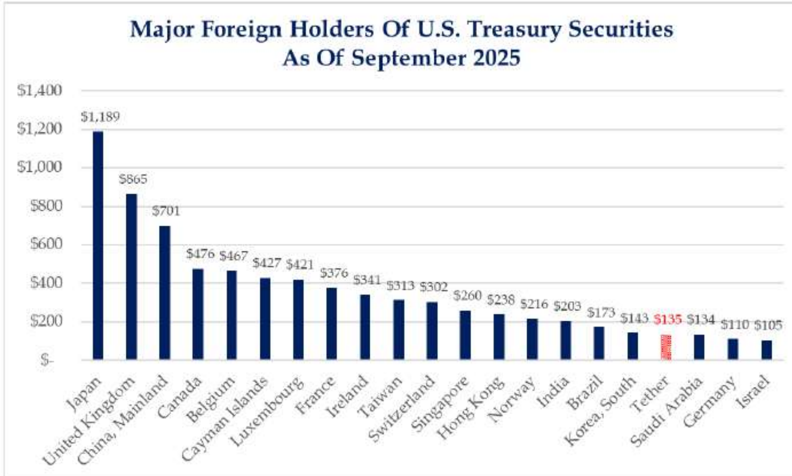
We articulated our 2026 outlook above and the key issues and drivers for the stock market. Yet, we believe there are other topics that we haven't spent much time on that deserve some mention. We decided to express it in pictures to provide you with a shorter read, as everyone's time is valuable. As they 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.

The U.S tech industry leadership shows through in the index weightings of U.S. benchmarks vs. Global (ex-U.S.) benchmarks. The last five years have been particularly noteworthy as the "Mag 7" stocks have soared.

Exhibit 17: Technology represents a higher share of the US market than it does in other regions
Weight of the technology sector

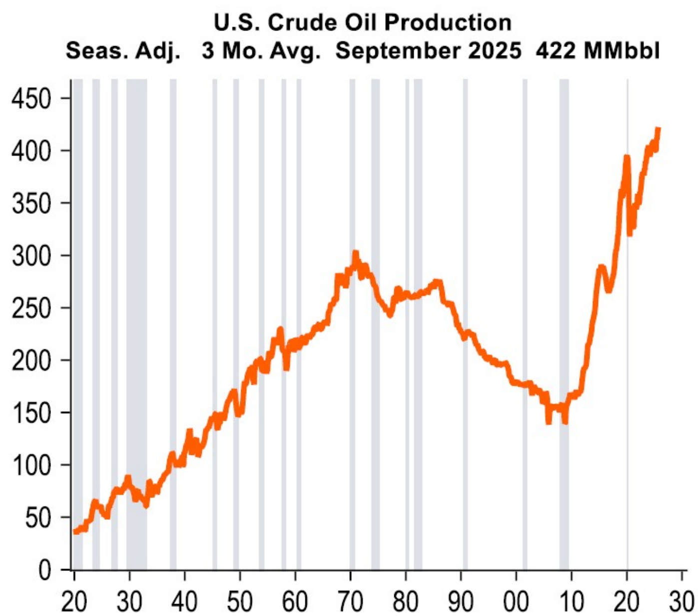
Source: Datastream, Goldman Sachs Global Investment Research

The chart below shows the major holders of U.S. Treasury securities. Amazingly, one of the "stablecoin" issuers, Tether, is one of the largest holders of treasury securities in the world. Cryptocurrency is making its mark.



Source: Strategas Research

This chart below may explain the reason for $57/barrel oil. Despite the drilling rig count falling, production keeps increasing.



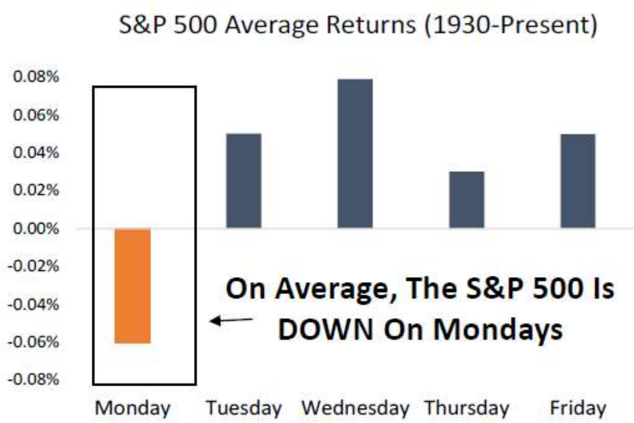
Source: PSC

The top ten stocks in the S&P 500 continue to grow as a percentage of the index. This growth doesn't look sustainable. There are now three stocks that individually have greater market cap than the entire Russell 2000 Index.

Source: Strategas, Bloomberg, Data as of 11/30/25

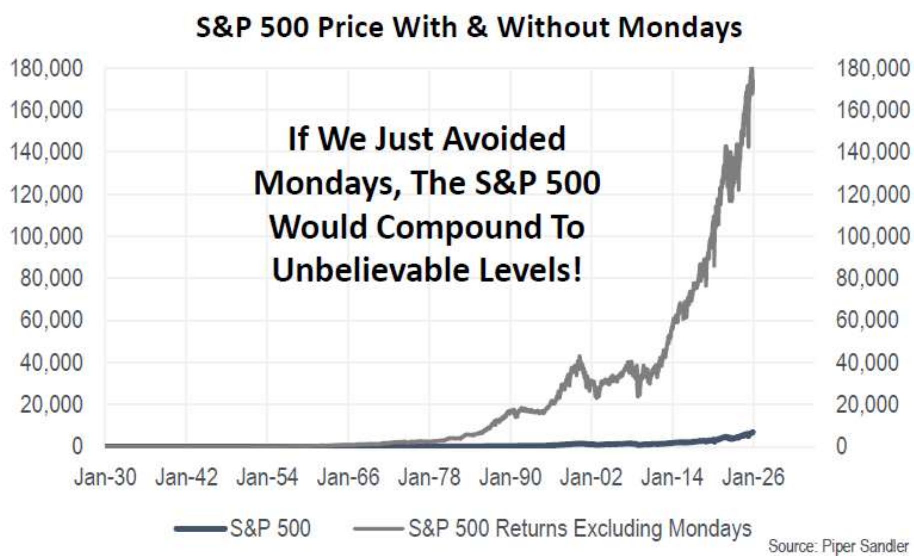
Stock Market Trivia

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 everyone must get up on the wrong side of the bed on Mondays as it's the only day of the week that has a negative return on average since 1930. The first chart below shows the average return for each day of the week. Monday is the only day of the week that posts an average loss and rises less than 50% of the time. What's amazing is what the compounding effect could be on the overall S&P 500 returns if you eliminate Monday's return. The second chart below shows this impact, and the amazing compounding effect Mondays have. The question becomes why don't we only invest Tuesday through Friday? The answer is that the transaction costs would remove some of the positive benefits. We guess that regardless of what day of the week you start investing, the first day after a period of rest and reflection (weekend) would probably still show a negative bias as traders wake up on the wrong side of the bed and make changes to their portfolio after their weekend reflection.



Day Of The Week	% Of The Time S&P 500 Rises
Monday	49.2%
Tuesday	51.4%
Wednesday	54.5%
Thursday	52.2%
Friday	54.4%

More Than Half The Time, The S&P 500 Is Down On Mondays



We hope you found our fourth quarter 2025 review and 2026 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.

Kathleen Daley Adam France Joe Frohna Nancy Frohna Tim Stracka

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