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 second quarter of 2026. 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.

"Quarter Was Filled with Fireworks as We Approach the USA's 250th"

As I write this heading into our nation's 250th birthday weekend, we're all expecting fireworks aplenty across the entire USA, but the stock market got a jump on the festivities this past quarter as it was filled with its fair share. It was the 12th best quarter for the S&P 500 and the 8th best for small caps dating back to 1950. Better yet is that in the other 11 instances, positive returns followed in each of the next two quarters without exception. The second quarter delivered one of the sharpest reversals in recent memory, and small caps were at the center of it. Three developments defined the quarter: (1) the Iran war moved from open conflict to a negotiated, if fragile, ceasefire which unwound the oil-driven inflation scare; (2) a new Federal Reserve chair took office and immediately complicated the rate-cut narrative Wall Street had been pricing in; and (3) the "AI is going to destroy the economy" narrative gave way to an AI capex supercycle that pulled semiconductor and small cap technology stocks along for the ride.

The second quarter began where the first quarter left off — nervous. Oil was still elevated as the Strait of Hormuz remained a question mark, and as investors were still digesting whether "Magnificent 7" underperformance was a rotation or a warning sign. That concern changed quickly. The Iran war truce caused oil prices to unwind sharply, and corporate earnings came in well ahead of where analysts had modeled at the start of the quarter. S&P 500 earnings growth for the first quarter rose +25%, and revenue growth tracked toward its best pace since 2022. Second quarter earnings growth is expected to be even better. The result was a market that didn't just recover — it broadened. The equal-weight S&P 500, small caps, and micro caps all pushed to new highs by the end of the quarter, which is a very different picture than the narrow, mega-cap-only rallies of 2023-2025. The "Mag 7" became the "Lag 7" this quarter for some very good reasons that we'll highlight. Semiconductors were the top story of the quarter as the SOX Index posted double-digit gains in all three months of the quarter for its best quarterly performance since the index's inception in 1994. AI infrastructure spending and surging demand for memory chips propelled the index. The scorecard for the quarter showed that small caps continued their recent outperformance with the Russell 2000 substantially outperforming the S&P 500, +21.5% to +15.2%, respectively.

The AI theme is likely to be key to the health of the markets for the balance of 2026. It is also a mid-term election year, which is historically not a great year for the stock market. As we look ahead to the balance of 2026, we still expect an accelerating economy and waning inflation concerns, which should ultimately drive stocks higher. Please read on to see our unique views of what's on tap for the rest of 2026, themes we're investing in here at 1492, and key market drivers.

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CONTACT US
1492 CAPITAL MANAGEMENT
Chase Tower
111 E. Wisconsin Ave.
Suite 1300
Milwaukee, WI 53202
Main: 414-276-1492

www.1492CapitalManagement.com

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S&P 500

Rank	Date	Q/Q % Change	+1 Quarter	+2 Quarters
1.	3/31/1975	21.6%	14.2%	0.6%
2.	12/31/1998	20.9%	4.6%	11.7%
3.	3/31/1987	20.5%	4.2%	10.3%
4.	6/30/2020	20.0%	8.5%	21.2%
5.	6/30/1997	16.9%	7.0%	9.6%
6.	12/31/1982	16.8%	8.8%	19.5%
7.	12/31/1985	16.0%	13.1%	18.7%
8.	9/30/1970	15.8%	9.4%	19.1%
9.	6/30/2009	15.2%	15.0%	21.3%
10.	9/30/2009	15.0%	5.5%	10.6%
11.	6/30/2003	14.9%	2.2%	14.1%
12.	6/30/2026	14.9%	?	?
13.	12/31/1999	14.5%	2.0%	-1.0%
14.	6/30/1975	14.2%	-11.9%	-5.3%
15.	3/31/1976	13.9%	1.5%	2.4%
16.	3/29/1991	13.6%	-1.1%	3.4%
17.	3/31/1998	13.5%	2.9%	-7.7%
18.	3/31/1986	13.1%	5.0%	-3.2%
19.	3/29/2019	13.1%	3.8%	5.0%
20.	3/31/1967	12.3%	0.5%	7.2%
21.	6/30/1955	12.2%	6.4%	10.8%
22.	12/31/1962	12.1%	5.5%	9.9%
23.	3/30/2012	12.0%	-3.3%	2.3%
24.	3/31/1961	12.0%	-0.6%	2.6%
25.	6/30/1980	11.9%	9.8%	18.8%

2Q '26 was the 12th best quarter since 1950… for what it's worth, every observation above it produced positive forward +1 & +2 quarter performance.

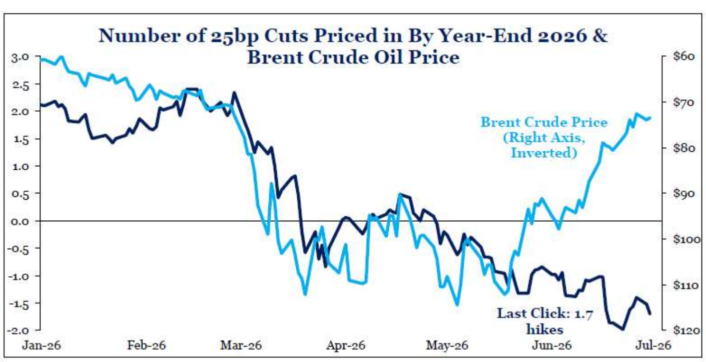
Source: Strategas Research

Russell 2000

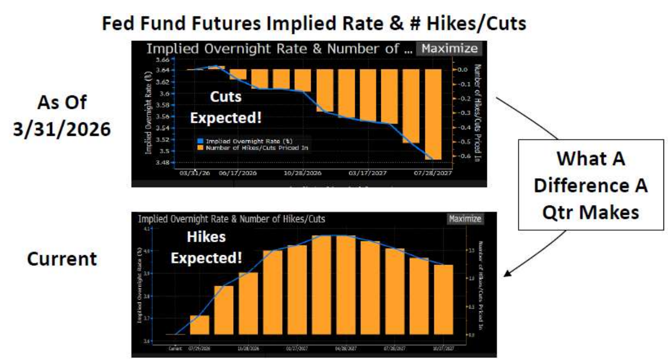
Rank	Date	Q/Q % Change	+1 Quarter	+2 Quarters
1.	12/31/2020	31.0%	12.4%	17.0%
2.	3/29/1991	29.2%	-2.0%	5.4%
3.	12/31/1982	25.5%	16.7%	39.7%
4.	6/30/2020	25.0%	4.6%	37.0%
5.	3/31/1987	23.8%	-1.1%	2.7%
6.	6/30/2003	23.0%	8.8%	24.2%
7.	9/30/1980	21.7%	6.9%	14.7%
8.	6/30/2026	21.2%	?	?
9.	12/31/2001	20.6%	3.7%	-5.3%
10.	6/30/2009	20.2%	18.9%	23.0%
11.	6/30/1983	19.7%	-5.4%	-9.6%
12.	6/30/1980	19.1%	21.7%	30.1%
13.	9/30/2009	18.9%	3.5%	12.3%
14.	3/31/1988	18.4%	6.1%	4.6%
15.	12/31/1999	18.0%	6.8%	2.4%
16.	3/31/1983	16.7%	19.7%	13.2%
17.	12/31/2010	15.9%	7.6%	5.6%
18.	12/31/1998	15.9%	-5.8%	8.5%
19.	3/30/1979	15.8%	5.7%	16.5%
20.	6/30/1997	15.8%	14.5%	10.3%
21.	12/31/1985	15.3%	13.7%	18.8%
22.	6/30/1999	15.2%	-6.6%	10.2%
23.	12/30/2011	15.0%	12.1%	7.8%

+2 quarters forward, the R2000 hit rate is 21 of 23 (91%) following +15% quarters.

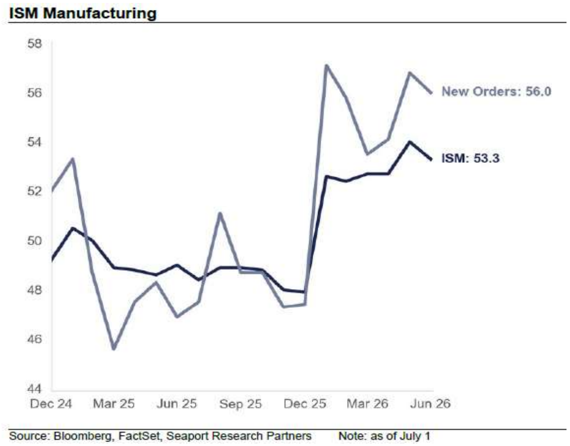
The second quarter delivered one of the sharpest reversals in recent memory, and small caps were at the center of it. Three developments defined the quarter: (1) the Iran war moved from open conflict to a negotiated, if fragile, ceasefire which unwound the oil-driven inflation scare; (2) a new Federal Reserve chair took office and immediately complicated the rate-cut narrative Wall Street had been pricing in; and (3) the "AI is going to destroy the economy" narrative gave way to an AI capex supercycle that pulled semiconductor and small-cap technology stocks along for the ride. We've often said that if you want to get a sense for which direction interest rates are going, then look at the Fed Funds Futures and go the opposite direction. Once again, the market has moved from hopeful for rate cuts to rate hikes based on the short-term direction of oil. The chart on the left shows how the interest rate expectations mirror the increase in oil prices until just recently. The chart on the right shows how quickly the market went from pricing in nearly two and a half 25 basis point rate cuts to nearly two 25 basis point rate hikes. We'll take the opposite side of that trade as inflation statistics in the coming months are likely to cool as oil prices have plummeted from $110/barrel to $67/barrel.



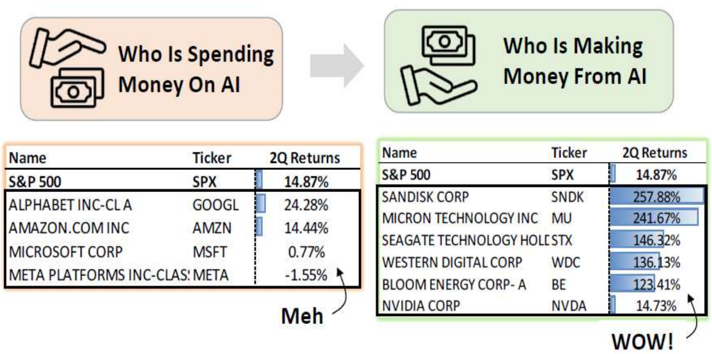
Source: Strategas Research



The second quarter began where the first quarter left off — nervous. Oil was still elevated as the Strait of Hormuz remained a question mark, and investors were still digesting whether "Magnificent 7" underperformance was a rotation or a warning sign. That concern changed quickly. The Iran war truce caused oil prices to unwind sharply, and corporate earnings came in well ahead of where analysts had modeled at the start of the quarter. S&P 500 earnings growth for the first quarter rose +25%, and revenue growth tracked toward its best pace since 2022. Second quarter earnings growth is expected to be even better as the chart below left shows. The result was a market that didn't just recover — it broadened. Foreshadowing this broadening of earnings growth, the PMI (Purchasing Managers Index) in the chart below right showed an abrupt uptick as we entered 2026. AI capital spending and the tax law changes that allow corporations to immediately deduct capital expenditures for tax purposes fueled the advance.



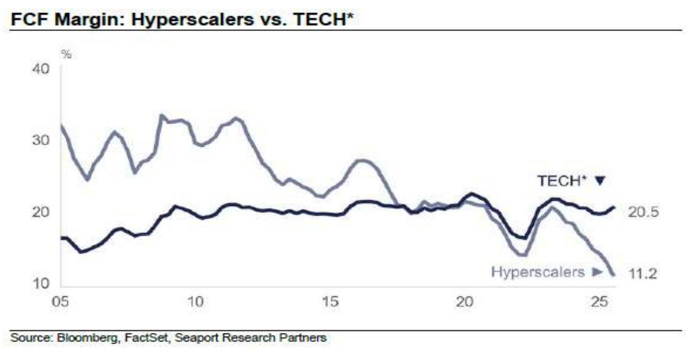
The equal-weight S&P 500, small caps, and micro caps all pushed to new highs by the end of the quarter, which was a very different picture than the narrow, mega-cap-only rallies of 2023-2025. The "Mag 7" became the "Lag 7" this quarter for some very good reasons that we highlight below. The second quarter performance of some of the "Mag 7" stocks are shown in the left box in the chart below left. The market has quickly followed the "Mag 7"'s AI spend and invested in those "picks and shovels" providers in the box on the right. The primary reason the "Mag 7" has become the "Lag 7" is precisely what is shown in the chart below right. The free cash flow margin (FCF margin) has plummeted for the hyperscalers (i.e. Mag 7) from over 30% in the past to 11% currently. This drop is due to the enormous shift in the capital intensity of their business models as they invest in AI data centers and infrastructure. This trend isn't likely to improve much in the near term based on the accelerating capex plans most of the "Mag 7" have for the coming year.



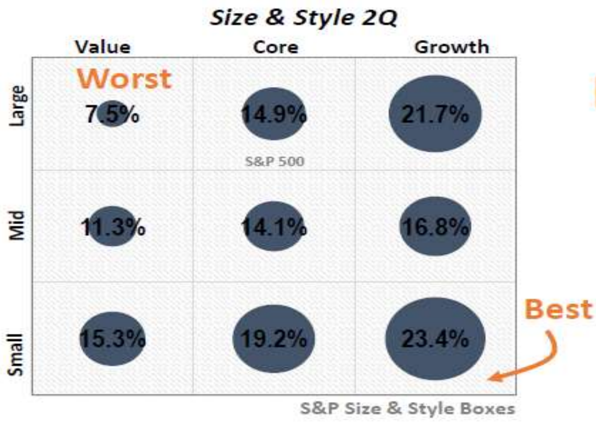
Name	Ticker	2Q Returns
S&P 500	SPX	14.87%
ALPHABET INC-CL A	GOOGL	24.28%
AMAZON.COM INC	AMZN	14.44%
MICROSOFT CORP	MSFT	0.77%
META PLATFORMS INC-CLAS!	META	-1.55%

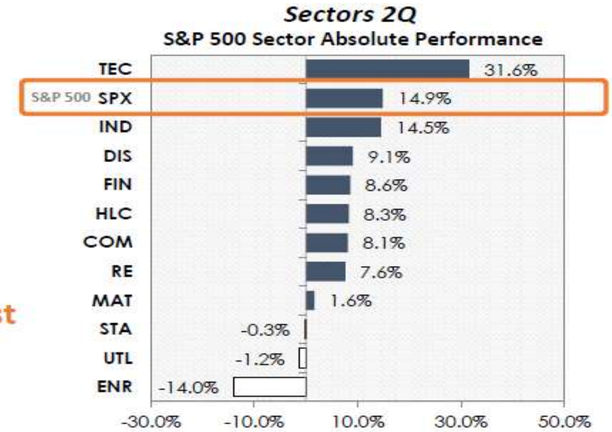
Name	Ticker	2Q Returns
S&P 500	SPX	14.87%
SANDISK CORP	SNDK	257.88%
MICRON TECHNOLOGY INC	MU	241.67%
SEAGATE TECHNOLOGY HOLI	STX	146.32%
WESTERN DIGITAL CORP	WDC	136.13%
BLOOM ENERGY CORP- A	BE	123.41%
NVIDIA CORP	NVDA	14.73%

Source: PSC Research



Readers of our first quarter letter will remember the parade of AI-disintermediation selloffs we cataloged that included front office software, gaming, legal tech, insurance brokers, and freight logistics. Each group experienced double-digit one-day hits on fears that AI would devour their business models. That narrative didn't disappear entirely in the second quarter, but the much larger and more bullish story of the sheer scale of capital being deployed to build AI infrastructure overwhelmed it. Total annual capex spending across the major hyperscalers plus Meta has gone from roughly $156 billion in CY2023 to an estimated $712 billion in CY2026, which is more than a fourfold increase in three years. That spending shows up directly in semiconductor and memory chip demand, and it's a big part of why the SOX Index had its best quarter since 1994. Regional data center construction has also been a genuine offset to the collapse in office building construction that we highlighted last quarter, and is keeping overall U.S. construction spending at a healthy level. We remain constructive on this theme in our strategies, but we're watching closely for signs of excess with more on that below. Semiconductors were the top story of the quarter as the SOX Index posted double-digit gains in all three months of the quarter for its best quarterly performance since the index's inception in 1994. AI infrastructure spending and surging demand for memory chips propelled the index higher. The scorecard for the quarter showed that small caps continued their recent outperformance with the Russell 2000 substantially outperforming the S&P 500, +21.5% to +15.2%, respectively. The charts below show the skew to growth and to the tech sector broadly. The Russell 2000 has increased its lead over the S&P 500 on a YTD basis to over 1,240 basis points and to over 2,100 basis points since Liberation Day last April.





The table below shows that the stock market posted strong returns in the second quarter of 2026. Growth clearly outperformed value during the quarter, and small caps significantly outpaced large caps.

Index Returns		
Index	Second Qtr. 2026 Return	2026 YTD Return
Russell 2000	+21.49%	+22.57%
Russell 2000 Growth	+25.71%	+22.18%
Russell 2000 Value	+17.19%	+22.99%
S&P 500	+15.20%	+10.21%
Dow Jones Industrials	+12.90%	+8.85%
NASDAQ Composite	+21.60%	+13.13%

Source: 1492 Capital Management, LLC and FactSet

From a style perspective, the Russell 2000 Growth Index (+25.7%) posted a strong win against the Russell 2000 Value Index (+17.2%) for the quarter and closed the gap to a near dead heat on a year-to-date basis. This victory for the growth side of the house was primarily technology-driven, which is a larger weight in the growth index. The best performing sector in the Russell 2000 for the quarter, unsurprisingly, was the Technology sector (+56.2%) as the AI trade moved down market cap from the large cap Mag 7. A distant second was Healthcare (+24.5%), which made an amazing push late in the quarter on the heels of biotech stocks. The worst performing sector and the only sector to finish in the red was Energy (-10.1%) as the oil price quickly collapsed from over $110/ barrel to $67/ barrel as I write this newsletter. Utilities (+0.1%) were weak due to a risk-on market. The table below highlights the performance of the Russell 2000 Index by sector for the month of June, the second quarter of 2026, and year-to-date 2026. The second table below shows the performance by size. For years, there has been a significant market cap skew in the numbers as the performance was significantly worse as you moved down the market cap spectrum. There was a reprieve of this trend late last year, but the Iran war impact sent investors scrambling for more liquidity, at least temporarily, in their portfolios. The second quarter was relatively stable across market caps, but on a year-to-date basis, the trend is still slightly worse as you move down market cap. See the red arrow below.

Table 10 - Russell 2000 Scorecard through June 30th

	June			2nd Quarter			Year to Date			
GICS Sector	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Wgt
Com Serv	-2.43	-0.07	-6.05	14.80	0.41	-6.61	14.44	0.40	-7.55	2.4
Discretionary	8.43	0.65	4.81	16.45	1.31	-4.96	10.90	0.85	-11.09	9.4
Staples	7.07	0.11	3.44	10.16	0.18	-11.26	12.76	0.22	-9.23	2.0
Energy	-6.57	-0.38	-10.20	-10.06	-0.61	-31.48	24.26	1.43	2.27	5.7
Financials	7.77	1.26	4.14	16.56	2.84	-4.85	15.18	2.68	-6.81	18.7
Health Care	14.36	2.34	10.73	24.54	3.98	3.13	19.03	3.09	-2.96	20.0
Industrials	-1.59	-0.38	-5.22	23.71	4.43	2.29	26.86	4.91	4.87	14.9
Info Tech	2.28	0.20	-1.35	56.19	7.71	34.77	48.54	6.91	26.55	14.3
Materials	-7.08	-0.34	-10.71	2.58	0.18	-18.84	8.67	0.46	-13.32	4.2
Real Estate	6.81	0.34	3.18	18.40	0.97	-3.01	18.15	0.93	-3.84	5.8
Utilities	-3.29	-0.10	-6.92	0.13	0.03	-21.29	2.36	0.11	-19.63	2.7
Size Quintile	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Absolute	Contribution	Relative	Wgt
1 (Largest)	1.50	0.90	-2.12	20.58	12.71	-0.84	20.46	12.61	-1.53	52.4
2	7.42	1.67	3.80	22.01	4.87	0.59	24.14	5.34	2.16	27.2
3	7.77	0.78	4.14	24.44	2.42	3.03	27.64	2.75	5.65	12.4
4	5.42	0.25	1.79	22.27	1.04	0.85	20.83	0.98	-1.15	5.8
5 (Smallest)	1.90	0.03	-1.73	22.07	0.38	0.65	17.26	0.30	-4.73	2.1

Source: Jefferies

Returns in the international stock markets were generally positive and highly negatively correlated with their relative energy independence. Additionally, international markets were generally positive in the quarter except those whose economy is heavily basic materials/metals focused like Brazil. European markets rebounded as oil prices declined. Bond market returns remained range-bound around +0% as rates gyrated with the day-to-day movement in oil. Commodities were mostly negative in the quarter as oil prices collapsed following the truce in the Iran war. Natural gas, which is primarily a U.S. market, rebounded from the first quarter. Lastly, volatility eased (-33%) as concerns over the Iran war and hyperinflation eased.

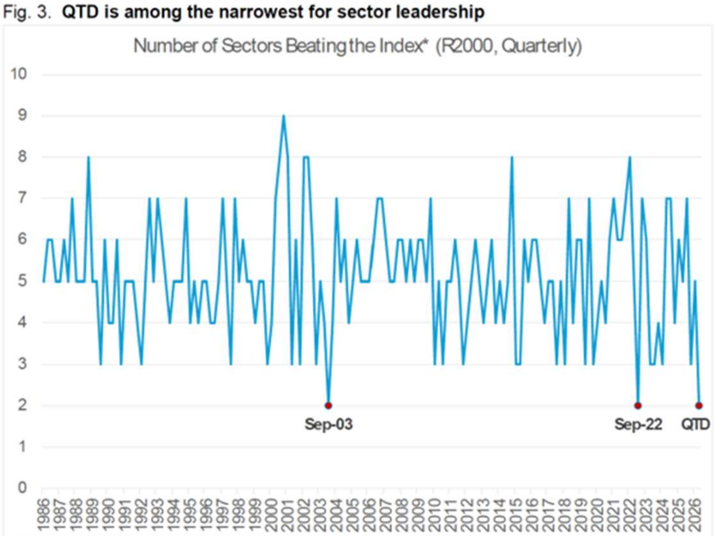
Index	Second Qtr. 2026 Return	2026 YTD Return
France	+10.1%	+5.7%
Germany	+10.2%	+2.1%
Brazil	-8.2%	+6.8%
India	+5.1%	-9.1%
China- A Shares	+13.0%	+10.9%
China- Shenzhen A Shares	+10.2%	+11.9%
Japan	+30.5%	+40.4%
Long-Term Treasuries (TLO)	+0.2%	-1.5%
Investment Grade Corp Bonds	+1.2%	0.7%
Gold	-16.1%	-7.9%
Volatility- VIX Index	-33.0%	+14.8%
Oil	-30.6%	+19.9%
Natural Gas	+16.2%	-2.1%
Lumber	+1.4%	+14.3%

Source: 1492 Capital Management, LLC

Small Cap Market Update: Counting Winners on Fingers and Toes then Thankfully Some Broadening Out in June

There are times in the stock market when it feels like all of the outperforming small cap stocks can be counted on your fingers and toes. The first two months of the second quarter was one of those periods as Technology and Industrials were the only two Russell 2000 sectors that bested the index. As seen in the chart below left, the narrow sector leadership during this two-month period has only been seen two other times since 1986. During the fourth quarter of 1999 in the dot-com bubble, there were even three leadership groups. As seen in the table on the right, only nine subsectors of the Russell 2000 Index outperformed in quarter-to-date through May 2026. On the tailwinds of the AI/datacenter boom, semiconductors and semiconductor equipment soared +89.1%, which simplistically is about four years of strong returns in two months. According to BTIG research, the large cap semiconductor index (SOX) soared 71% in the nine weeks ended May 29th. The only time that it had climbed faster was the nine weeks ended March 10, 2000, during the dot-com bubble. High beta stocks were up 55.5% in the first two months of the quarter, according to Jefferies research, which destroyed the Russell 2000 Index return of 17.1%. It was very much a one trick pony of investment factors that worked through two-thirds of the second quarter.

Fig. 3. **QTD is among the narrowest for sector leadership**



*Source: FRP, FactSet; as of 5/29/26; *Sector must outperform by more than 20 bps to qualify as "beating the index"*

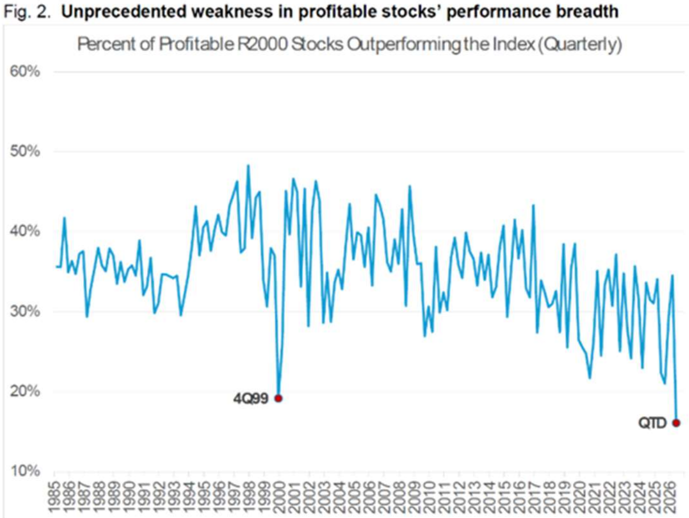
Fig. 14. Clear winners and clear losers and nothing in-between

	Absolute Return (%)					
R2000	**Past Year**	**YTD**	**1Q26**	**Apr-26**	**May-26**	**QTD**
Semiconductors & Semiconductor Equipment	207.0	88.5	(0.3)	51.7	24.7	89.1
Electrical Equipment	273.6	105.5	22.4	53.6	9.3	67.9
Technology Hardware & Equipment	98.1	52.7	7.2	30.5	9.2	42.4
Software & Services	18.8	16.0	(17.4)	14.9	22.1	40.3
Construction & Engineering	110.5	56.9	17.2	24.4	7.6	33.9
Aerospace & Defense	73.8	29.3	1.4	5.8	20.5	27.5
Telecommunication Services	98.5	30.2	2.8	18.1	7.3	26.6
Transportation	38.2	19.5	(3.3)	11.2	11.1	23.5
Commercial & Professional Services	9.4	5.2	(12.0)	11.5	7.2	19.5
Index	**43.1**	**18.2**	**0.9**	**12.2**	**4.4**	**17.1**

Source: Furey Research Partners

As seen in the chart below left, the percentage of profitable stocks that outperformed the Russell 2000 Index in the second quarter through May was the lowest since 1985 and was worse than the fourth quarter of 1999 during dot-com mania. With a two-month relative performance gap that you could drive an 18-wheeler through, unprofitable companies' stocks were up +25.7% vs +17.1% for profitable entities. Due to the strength in June of biotech stocks, this gap widened further to +29.9% vs +17.7% for the full second quarter of 2026.

Fig. 2. **Unprecedented weakness in profitable stocks' performance breadth**



Source: FRP, FactSet; as of 6/2/26

Table 5 - ...And even though it may take some time, High Beta will lag by wide margin over next 12-months

Rolling 12-Month Spread Quintile	Subsequent Performance 1 Month	3 Month	6 Month	12 Month
Q1 (Biggest U/P)	-0.3	-0.8	-0.9	0.6
Q2	0.1	0.9	1.2	2.4
Q3	-0.5	-0.8	-0.5	0.7
Q4	-0.1	-0.9	-0.8	0.1
Q5 (Largest O/P)	**0.8**	**1.4**	**0.7**	**-5.0**
Overall Average	**0.0**	**0.0**	**-0.1**	**-0.1**

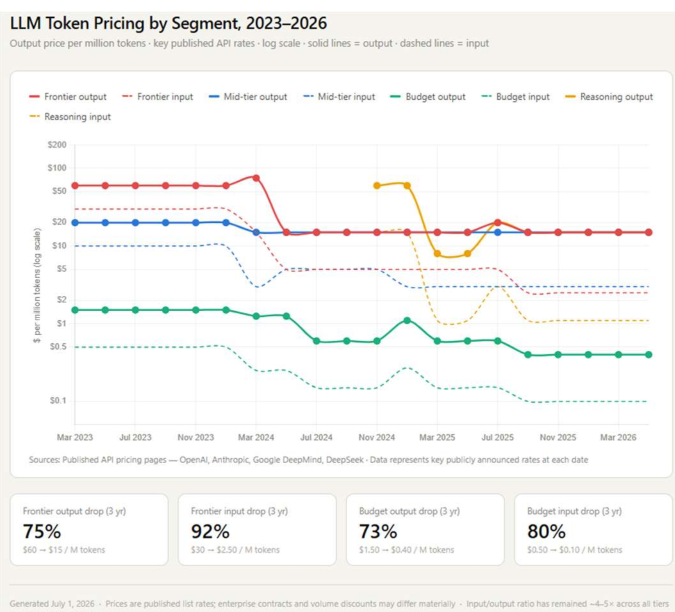
Source: FactSet; FTSE Russell; Jefferies
Based on rolling 12 month spread between Highest Beta names and the universe

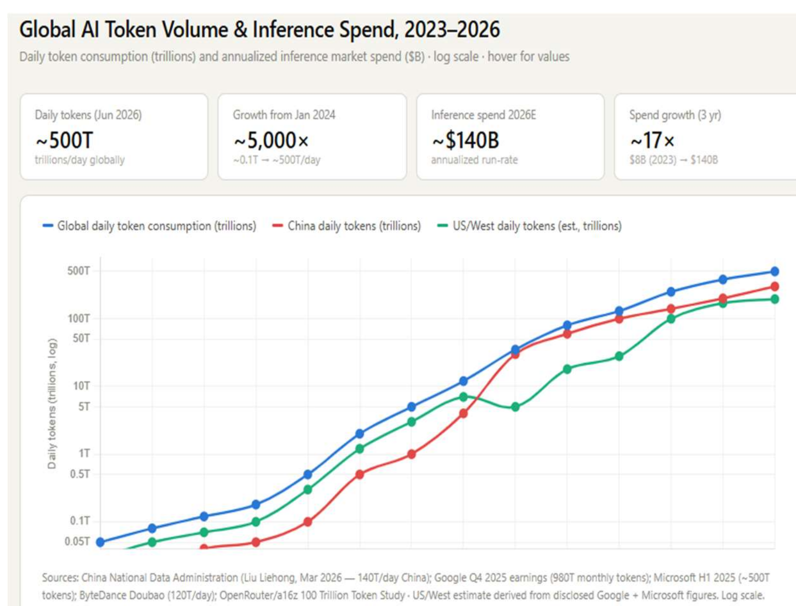
Nevertheless, small cap performance in June brought some much needed broadening of market breadth. Healthcare came roaring back in the last month to finish as the second best sector for the second quarter after being in seventh out of ten during the first two months. This acceleration added a third sector to outperform the Russell 2000 during the second quarter. While it was on the back of the largely unprofitable biotech sector, Healthcare went from up +8.9% QTD through May to finish the quarter at +24.5%. Real Estate (10.9% through May to 18.4% for the quarter), Consumer Discretionary (7.4% to 16.5%), Consumer Staples (2.9% to 10.2%) and Financials (8.2% to 16.6%) also had very healthy gains in June but couldn't match the index for the quarter. Technology and Industrials advanced +2.3% and declined -1.6%, respectively, in June, which further supports the sector rotation thesis. Historically when high-beta stocks have a 12 month performance spread over the Russell 2000 that is in the top quintile as we had through the period ended May at 92%, Jefferies research shows that during the following 12 months, high beta lags the universe by 500 basis points on average as seen in the table above right from the previous page. With the start of the quarter possessing too many performance similarities to the dot-com quarters of 4Q'99 and 1Q'20, it would be healthy for the market to continue its June trend and diversify its money-making opportunities in the second half of 2026.

Thematic Investing Update: Jevons Paradox is Playing Out in AI Tokens, but Will it Continue?

The stock market is hyper-focused on AI spending, and the direction and level of that spend will drive the market in the coming months. Any sign of a slowdown in spending on AI infrastructure or in token usage by AI LLM users will likely lead to a swift drawdown in equity markets around the globe. AI usage and pricing are measured by tokens. A token is the fundamental unit of AI work. It's a small chunk of data: characters of text, pieces of an image, or a slice of audio that an AI model processes. One token is approximately equal to four characters. Input tokens are those tokens used to query LLM's like ChatGPT, whereas output tokens are the results of the query sent back to the user in the form of an answer. The pricing disparity in the AI market is stark as output tokens typically cost between 3X and 10X more than input tokens. This pricing disparity is a reflection of the physical constraints of the intelligence provided primarily by the GPU hardware and of the LLM model that is being used to produce the output. The more advanced or cutting-edge LLM models cost more. Whether it is training, inference, or reasoning, every interaction is measured in tokens. Our view is that as long as token pricing and usage remain balanced, investment dollars will continue to flow into building data centers and needed energy infrastructure. Jevons Paradox is said to occur when technological improvements that increase the efficiency of a resource's use lead to a rise, rather than a fall, in total consumption of that resource. We've done some proprietary research on AI token pricing and usage, which shows that Jevons Paradox is indeed alive and well. Token prices have dropped by approximately two orders of magnitude compared to 2023, yet this efficiency improvement has not reduced overall resource consumption. It has instead stimulated unprecedented demand.

The first chart below left shows that pricing for frontier model (cutting-edge) tokens is the highest and is lower for mid-tier and budget models. Output token pricing is higher than input token pricing for each tier. This chart shows the pricing declines experienced in each of these tiers over the prior three years. Prices fell 75–92% while volume grew 5,000X, which is producing the net spend growth that you see in the bottom right chart. The number of tokens processed is shown in the chart below right as well. The volumes and growth rate of token usage are staggering, and over 500 trillion tokens are being consumed on a daily basis. The third chart below shows the dollars that are being spent on token consumption with the LLM's. The current run rate of annualized token consumption spend is approximately $140 billion (yellow line). This chart is a log-based chart, so the curve doesn't seem as steep, but spending has increased 17X in just three years. This ramp in spending is going to be the key driver for whether the hyperscalers continue to invest in data centers at the levels projected for the coming year. This spending is also the driver of the return on investment that LLM's, like Anthropic and OpenAI, are likely to garner. If either token pricing or consumption begins to falter, we would expect the enormous AI expenditures to begin to wane as will the chances for successful IPOs from the likes of Anthropic and OpenAI. These two companies are currently valued in the private markets at nearly $1 trillion each as the market has never seen faster revenue ramps at this scale in history.





Source: 1492 Capital Management, LLC and Claude

The scale of spending is genuinely extraordinary. Total hyperscaler-plus-Meta capex is on pace to more than quadruple from 2023 to this year. Historically, capex of that magnitude has been funded primarily out of the wildly profitable core businesses' free cash flow. Increasingly, though, a meaningful and growing share of AI infrastructure spending is being financed through a web of vendor financing, take-or-pay contracts, joint ventures, and debt issuances from chip makers, cloud providers, and their customers. These arrangements can include a chip supplier that effectively helps finance the purchase of its own product, or where one company's revenue guidance is substantially dependent on the capital spending plans of a small handful of counterparties who, in some cases, are also its investors or customers in overlapping deals.

This financing isn't unprecedented. Capital-intensive buildouts in telecom, fiber, and railroads all went through periods where vendor financing and circular capital flows accelerated growth well beyond what internally generated cash flow alone would have supported. In several of those cycles, the infrastructure that was constructed ultimately proved valuable even after the financing structures that built it did not survive intact. The bull case here is straightforward. Enterprise AI adoption and inference demand are real and growing, and the companies underwriting this spending have genuinely strong balance sheets relative to prior capex cycles. The semiconductor demand backing it up (evidenced by the SOX Index's best quarter since 1994) reflects actual, not merely promised, revenue. The more cautious case is that when a handful of counterparties are simultaneously customer, supplier, and investor to one another, it becomes very difficult for outside analysts or even insiders to cleanly separate organic demand growth from deal structures designed to pull revenue and capex forward. We don't think that this murkiness is a reason to avoid the theme, which remains one of the more powerful secular growth stories that we've seen in our careers. We do think it's a reason for disciplined, balance-sheet-aware stock selection within it, and we'll be watching debt issuance, counterparty concentration, and free cash flow coverage of capex commitments closely as we move into the second half of the year. Other issues to watch are China-based and open-source LLMs' usage and competitive pricing, which has been very aggressive and could eventually cause pricing pressure for the U.S. based LLMs.

Thematic Investing Update: GLP-1 Use on the Rise – Where's the Beef?

In September 2023, we examined how the rise of GLP-1 weight loss drugs could squeeze restaurant profitability. At the time, our analysis focused on how reduced appetite and shifting food choices would shrink order sizes, alter menu mix, and ultimately erode margins.

Fast forward nearly three years. Today, despite an estimated 12.4% to 18% of Americans (roughly 30 to 45 million people) using GLP-1 medications, the outlook for the food service sector is far less grim than initially feared.

Why the resilience? The consumer focus has pivoted toward premium, center-of-plate proteins, which has allowed agile restaurant concepts to successfully adapt and defend their margins. According to RW Baird research, per capita meat consumption has hit a 20-year high. This growth is predominantly due to chicken demand, which is unsurprising given that persistent supply constraints have kept beef prices elevated for quite some time.

Consequently, investor opportunities are changing. Concepts featuring clean, protein-centric menus are naturally appealing to GLP-1 users and are better positioned for margin expansion than fast food or snack-heavy brands built on deep fried offerings. Mediterranean and Mexican fast-casual concepts, for instance, naturally align with this "better-for-you" protein trend and contrast sharply with traditional fast-food chains that are heavily reliant on side orders like French fries.

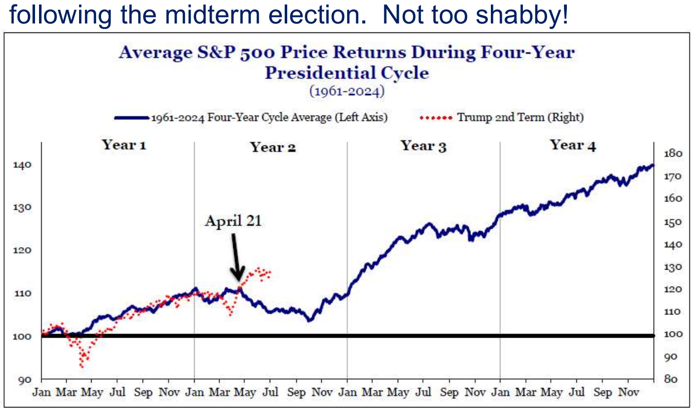
Going a step further, full service restaurants may capture the most significant margin upside as consumer share-of-wallet shifts toward premium dining experiences centered on quality proteins. As we noted three years ago, navigating this evolving landscape requires forward-thinking management teams who can pivot menu development and execute marketing strategies that resonate with today's changing consumer.

2026 Updated Outlook: Navigating the Balance of 2026 - Risks and Opportunities

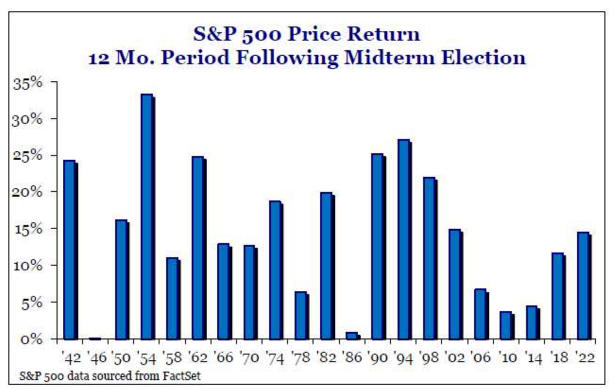
Our base case coming into the second half is that the domestic economy remains on solid footing, the Iran ceasefire holds even if imperfectly, and small caps continue to close the valuation gap with large caps that has persisted for the better part of a decade. As we look ahead to the balance of 2026, we find ourselves firmly in the historical volatility window of a midterm election year. Historically, the period from May through October tends to bring a "wait-and-see" approach from institutional investors, which is creating choppy, range-bound trading conditions before a typical post-election relief rally. However, the fundamental backdrop of this economy remains incredibly resilient. The consumer continues to show remarkable durability against a framework of strong wage growth, and the generational capex cycle around AI acts as a persistent economic buffer. While the broad markets may look extended trading at roughly 21 times forward earnings, this valuation is actually healthier than it appears because corporate earnings expectations are running incredibly fast and are effectively digesting the stock price gains. Our view is that any near-term election headline pullbacks should be viewed as excellent buying opportunities, particularly in high-quality small cap names that possess true fundamental support and low structural obsolescence.

A few specific points:

- **Midterm election year seasonality still applies.** As we noted last quarter, the period between the end of March and October in midterm years tends to be muted to negative, and a strong rebound into year-end and the 12 months following the election (average +14.8% over that window since 1950) then follows. The rally that we've seen in Q2 has pulled forward some of that seasonal strength, and we wouldn't be surprised to see more chop in Q3 before a stronger finish to the year. The chart below left shows this pattern in year two of the four year presidential cycle. The chart below right shows the 12-month returns following the midterm election. Not too shabby!



Source: Strategas Research

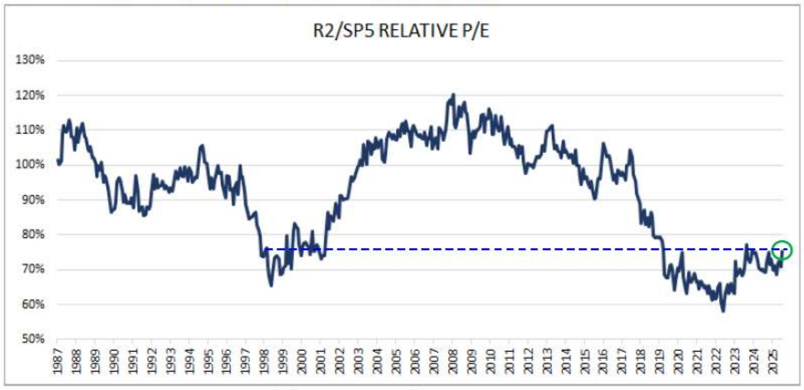


Source: Strategas Research

- **The Fed is now the wildcard, not oil.** With the inflation scare from the energy shock fading, the market's attention shifts back to core inflation and to how much patience Chair Warsh's committee has. We think the bar for a cut has gotten modestly higher than it was entering the year, but a Fed on hold is a very different environment than a Fed that's actively hiking. Equities have historically tolerated "on hold" reasonably well.
- **Small cap valuations remain historically attractive.** Even after the second quarter rally, the Russell 2000 trades at a meaningful discount to the S&P 500 on a forward P/E basis, and consensus estimates call for small cap earnings growth to outpace large caps in 2026. The valuation gap between large and small caps remains near its widest level in decades as

shown in the chart below, which is the same setup that preceded the late-1990s period of sustained small cap outperformance that we referenced last quarter.

Fig 99. **Relative to large-caps, small-caps remain attractive**



Source: Furey Research Partners and FactSet. Data as of 6/30/26. Represents median P/E using latest available trailing 12-month earnings. Profitable companies only.

- **Corporate capex tailwinds remain intact.** The ability to write off 100% of capital expenditures upfront continues to be a powerful incentive for corporate investment, and AI-related infrastructure spending shows no signs of slowing in the near term.

Key Risks and Opportunities for the Balance of 2026
Risks:

- The Iran ceasefire framework is only 60 days old and unenforced in key respects, and a breakdown would reintroduce the oil-and-inflation scare that dominated the first quarter.
- A Fed chair who proves more hawkish than markets expect could delay rate cuts further and pressure valuations, particularly in longer-duration growth names.
- Core inflation has now risen for three consecutive months, and a further acceleration would narrow the Fed's room to maneuver considerably.
- AI capital spending is increasingly reliant on vendor financing and circular deal structures (see AI token section above). A pullback in that spending, whether due to financing strain or a demand disappointment, would hit the sectors that have led the 2026 rally the hardest.
- Midterm election volatility historically peaks in October; positioning for a bumpier back half of the year makes sense even within a constructive full-year view.

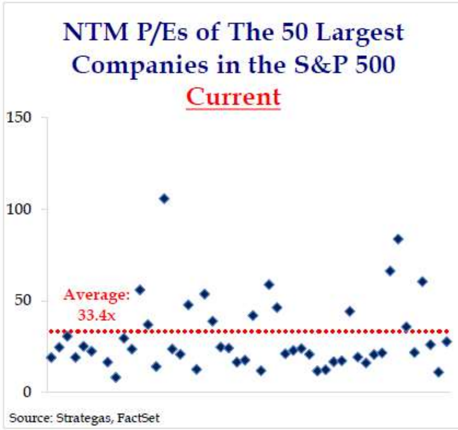
Opportunities:

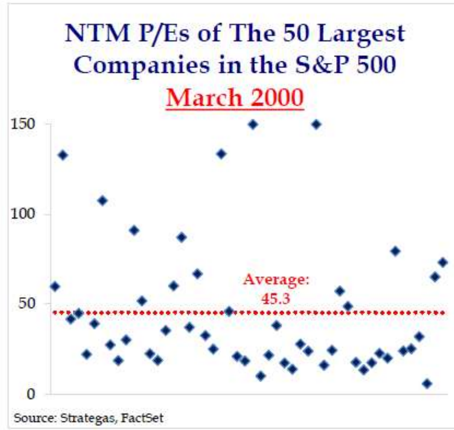
- Continued broadening of market leadership beyond mega cap technology favors active stock selection over passive mega cap exposure.
- A durable resolution to the Iran conflict would remove one of the two major overhangs (along with Fed policy) that have driven volatility all year.
- Small cap valuations remain compelling on a multi-year view even after the recent rally.
- Reshoring and domestic capacity investment tied to the supply chain lessons of the Iran war continue, which is a theme that we highlighted extensively last quarter and one that we continue to hold across our energy, LNG infrastructure, and specialty metals strategies.

2026 Outlook: A Picture is Worth a Thousand Words

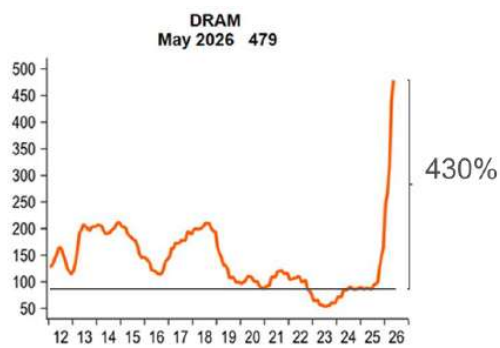
We articulated our updated 2026 outlook above and the key issues and drivers for the stock market. Yet, we believe there are other topics that we haven't spent much time on that deserve some mention. We decided to express it in pictures to provide you with a shorter read, as everyone's time is valuable.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

Many market commentators want to equate today's stock market with the tech bubble of 1999/2000. The charts below show the current P/E ratios for the largest 50 stocks in the market during both periods. Today's valuations are still a far cry from those of 1999/2000.



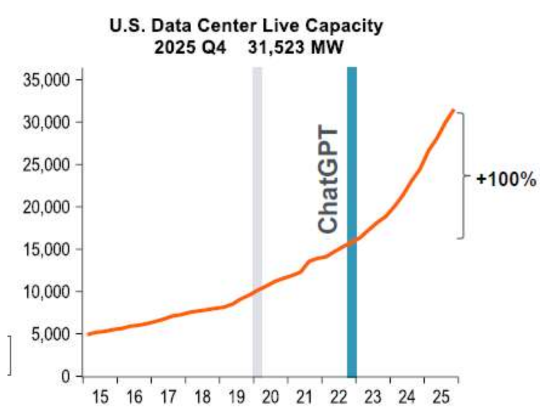


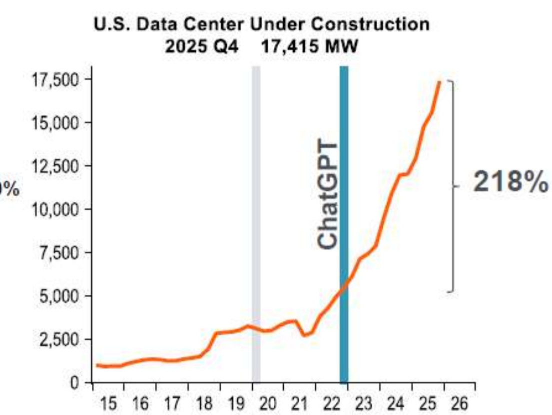
As a result of the tremendous memory chip demand from AI datacenters, DRAM pricing has gone parabolic. You will start to see the price increases show up in PC's and iPhones for example in the coming months.



Source: PSC Research

Since the launch of ChatGPT in 2023, the amount of data center capacity put in place in the U.S. has increased 100% with the equivalent of about 60% of the entire base under construction currently.

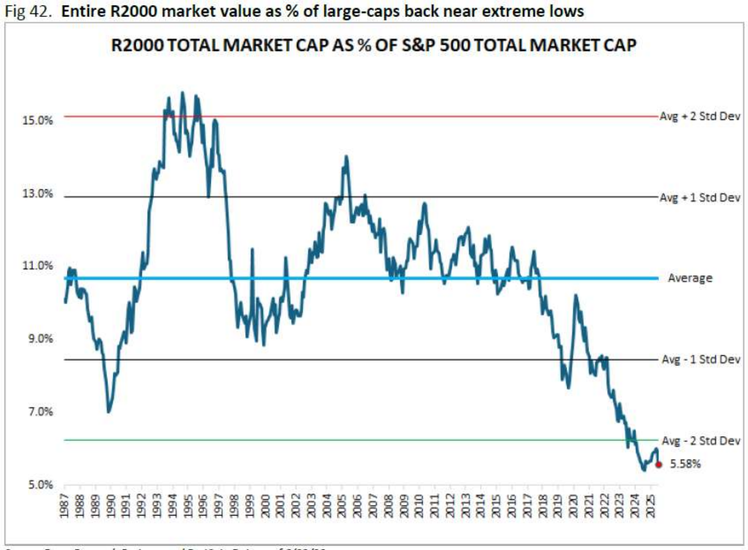




Source: Strategas Research

Despite the Russell 2000 Index outperforming the S&P 500 significantly over the past year, the total market cap of the Russell 2000 Index is still near the all-time lows as a percentage of the S&P 500's market capitalization. Further, there are still several individual companies whose individual market capitalization exceeds the entire market capitalization of the Russell 2000.

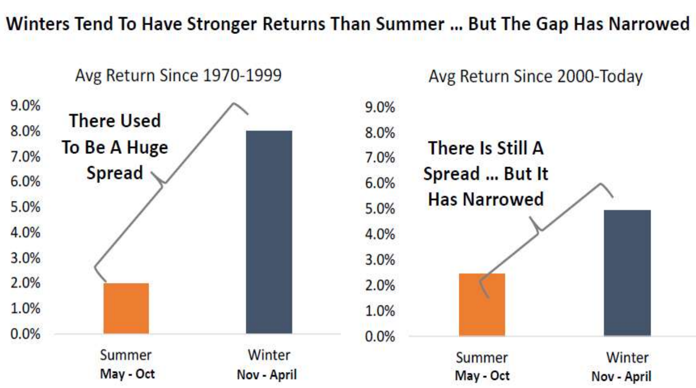
Fig 42. **Entire R2000 market value as % of large-caps back near extreme lows**

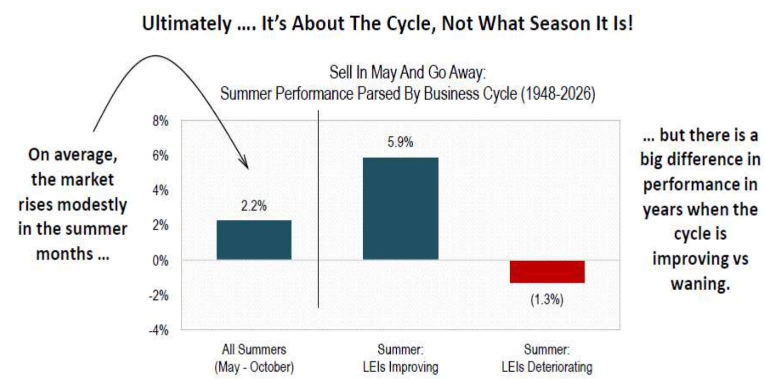


Source: Furey Research Partners and FactSet. Data as of 6/30/26.

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 stock market returns during the summer months. There is the old stock market adage, "sell in May and go away". The latest data shows that while that statement may have been true decades ago, the more recent 20 years show that the gap between winter and summer months returns has narrowed, as shown in the charts on the left. However, much of the performance during summer months can be more accurately attributed to the stage of the economic cycle that we are in as measured by the LEIs (Leading Economic Indicators). As shown in the chart on the right, when LEIs are improving, the performance is much better than when the LEIs are deteriorating, which makes logical sense. Lastly, the third chart below shows that the best performing month for the stock market, on average, is, surprisingly, July with over 85% of July's landing in positive territory. Let's hope that this trend holds true in 2026.





Source: Furey Research

Source: Bloomberg, Jefferies

We hope you found our second quarter 2026 review and updated 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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1492 Capital Management, LLC
111 E. Wisconsin Ave.
Suite 1300
Milwaukee, WI 53202
Main: 414-276-1492
Fax: 414-224-9158
www.1492CapitalManagement.com