JOHN W. ROSENTHAL CAPITAL MANAGEMENT, INC.

1st Quarter 2018 General Newsletter

Save the Date for our 2018 Annual Investor Meeting: Monday June 4 at 11:45 a.m. – Morris Inn
Formal Invitation Forthcoming!

Headlines:

- **April is off to a Very Positive Start with Fund 1 up Approximately 5.2%, Fund 2 up Around 2.3% and Fund 3 up Roughly 2.3% in this month alone!**
- **Volatility was the Main Story in Q1 '18!**
- **Our Banks Performed Well in the 1st Quarter: All 3 Funds Beat the DJIA and S&P Indices While Funds 2 & 3 Bested Both Bank Indices to Which we Compare our Performance.**

Q1 2018	Our Funds	XABQ	BANK	S&P Comp.	Nasdaq Comp.	Dow Jones
Fund 1	+0.01%	+1.16%	+1.7%	-1.22%	+2.31%	-2.49%
Fund 2	+2.96%					
Fund 3	+1.94%					

- **The Yield on the 10 yr. UST is Finally at ~3 % & the FOMC Raised the Fed Funds Rate in March, Helping Community Banks Continue to Expand their Net Interest Margins.**
- **Lower Tax Rates have had the Expected Positive Impact on EPS at Banks!**
- **Still More Benefits Likely to Come for our Banks from the Tax Law Change as Overall Economic Activity (GDP) is Generally Expected to Increase.**
- **Tariffs are the New "Wildcard" for the Economy!**

As I write these letters each quarter, I ask myself: "what do they want to know", "do I provide relevant info", "do I share too much – or too little"? The answers tend to vary depending on my mood, recent conversations with you and how our investments are performing. One thing for sure: I try to be *transparent and realistic* without burying you in minutia. So, here it goes:

Volatility is Back:

This link to the VIX Volatility Index says it all. There were more 1% moves (plus or minus) during Q1 '18 than there were in ALL of 2017. Many of those moves were +/- 2%. Specific stocks and certain market sectors even touched on "correction" territory (minus 10%) during the quarter. Our portfolios did not undergo anything close to that level of downward movement. This bears out the somewhat defensive nature of the high-quality community bank stocks we own. Their dividends, earnings and growth all provide downside protection. In fact, given the rising rate environment, our Funds performed in line with our expectations. As highlighted in the table above, our portfolios did very well on a relative basis and could even be described as a bit countercyclical to broader market indices. And on the heels of these results and as noted above, April is off to a great start! While it's too early to simply annualize our YTD results and claim a successful year, the trend for 2018 is certainly indicative of a course that would meet our espoused return objectives.

Lower Tax Rates:

While it was no surprise to see the delightful increases in EPS from our banks due to the lower rates now in effect – what remains to be seen is the potential boost our banks might enjoy from improved overall economic activity. As I've often written in the past, loan growth is a very important metric for banks. If GDP pops in the coming quarters as the impact of the tax cuts start to ripple through the economy and affect consumer spending patterns, this could portend additional tailwinds for our banks and their performance as loan demand could move upward. Loans are by far the biggest contributor to net interest margin. More loan activity is a long-term positive for lenders. We are sanguine about improving GDP – but it is by no means assured. So, we will continue to watch economic activity and loan growth very closely in the quarters ahead.

Rates, Yield Curves and Margins (redux):

Thankfully, again this quarter, the yield on the 10-year UST has continued to go up. The yield on this bellwether rate is now 2.99% – effectively at my prediction of 3% – albeit 3 months behind the timeframe I guessed this would happen. The FOMC also raised the overnight Fed Funds target rate in March and are suggesting they may boost this rate 2 or 3

more times in 2018. The actual number of times the Fed raises the "managed" overnight Fed Funds rate may ultimately depend on the "market" rate of longer duration UST's. If the Fed bumps up the Fed Funds rate without a corresponding increase in *market* rates of longer term UST's it will flatten the curve further and increase the chances of a recession. That is NOT the goal of this Fed or anyone else in Washington – especially in light of the low level of inflation today.

In the meantime and notwithstanding what might happen down the road, *this* rate environment has helped most community banks expand their net interest margins. We'll expound on this in the *Bank Performance Newsletter* to be sent in the next few weeks, but generally margins of banks in our portfolios have increased during the year. This, in turn, has helped overall profitability and should drive stock prices up over time as margins continue to expand. However, (and this bears repeating from my last letter and what I'm really trying to convey) it's not *only* the absolute level of rates that matters to banks, but the shape of the yield curve. If the yield curve flattens (i.e. short and long term rates are nearly the same), banks have a harder time growing their margins. In contrast, the steeper the yield curve (meaning long term rates are much higher than short term rates), the better for banks. So, while rates have been rising in 2017 and 2018, the long-end of the curve has risen less than the short end of the curve. Yield Curve Comparison – Today vs. 1 year ago. Yet, by no means is the curve "flat". It's just a bit *less steep* than it has been. The lesson in this repeated commentary from me is that not only do the absolute level of rates matter to banks, but the shape of the yield curve also means a lot to banks and their ability to expand their margins. So, we will continue to watch both rates and the shape of the curve as 2018 unfolds.

Happily, **and this is of the utmost importance**, we have concentrated our investments in banks which have a much higher proportion of non-interest bearing deposits, i.e. checking accounts. The value of these accounts goes up a great deal as rates rise. While the reason for this is somewhat obvious, I'll underscore it to drive home the point: *non-interest bearing deposits don't **cost** more as rates rise because they are exactly as described – NON-INTEREST BEARING.* So community banks which have a larger proportion of no-cost accounts should see margins expand more rapidly as rates rise. In summary, the current rate environment is still acceptable for community banks, (much more so than big banks whose proportion of wholesale funding, and its corresponding higher cost, is far larger than smaller banks) but could become even more beneficial if both short and long-term rates continue to rise.

I can't move off the topic of rates without a few more comments. Pundits have greatly exaggerated the potential impact to the stock market when the 10 year UST eclipses 3%. Once again, I believe this is an over-reaction and is typical behavior and serves only to dramatize events. Two leading bankers, Jamie Dimon from JP Morgan Chase and Lloyd Blankfein from Goldman Sachs, have worked hard to disavow investors of the notion that higher rates are a horrible thing for the markets. While near term reactions to a 3% 10 year UST are unpredictable and may cause a temporary selloff, primarily due to AI and program trading, I think we'll find that, in the long run, the primary reasons for rising rates are "good news" – not bad. Simply put, with a higher GDP and some modest inflation, rates may move away from historically low levels toward more normal standards. This would be very good for all banks – but especially our community banks.

Tariffs – The Wildcard:

Your guess is as good as mine as to what the outcome of the Administration's focus on renegotiating various trade agreements will be. Are the threatened tariffs part of a larger negotiating strategy by the President and his team? Will they actually be imposed? To what degree? Could this impact the so-called "synchronous global recovery"? Higher taxes via tariffs will likely increase the cost of goods and may take some steam out of the new-found disposable income available to consumers. This could stoke inflation too. Yet, even though the Fed has been working hard for the past several years to generate their target of 2% price escalations, inflation remains low. Nonetheless, oil and gas prices are up. Commodity prices are up. Wages are up. And Central Banks around the world are beginning to unwind their balance sheets which they used for quantitative easing. So, I believe inflation is definitely heading higher. The goal is to avoid too much inflation too fast which might cause the Fed to increase overnight rates even faster than planned. Nobody wants that outcome – not even the President. So, while I'm personally in favor of leveling the playing field for international trade, in the final analysis, I don't think the risks are huge that we'll have a full-blown, all-out, trade war. Hopefully, cooler heads will prevail, trading partners will work to achieve a more level playing field, and tariffs will NOT cause a premature end to the long bull market we've enjoyed. In my opinion, this issue is far more likely to determine the returns for the market in 2018 than interest rates. Stay tuned.

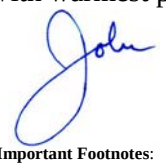
2018 Annual Investor Meeting:

Each year we look forward, with great excitement, to hosting our Annual Investor Meeting. We'll rendezvous on Monday, June 4 at the Morris Inn. Our crowds have steadily grown – which is primarily attributable to the keynote speakers we arrange for you. We warmly invite you to come at 11:45 a.m. to mingle with friends and fellow investors. Our luncheon will begin at noon followed by our presentations and Q&A from you all. We'll adjourn at 1:30 p.m.

Our guest speaker this year is Frank Sorrentino, chairman and CEO of ConnectOne Bank, headquartered in New Jersey. You all know how important "culture" is to our investment decision making process. When you hear Frank describe the extraordinary culture of "CNOB", you'll once again be reminded why "Culture is King" and a core part of our investment philosophy! Formal invitations will be forthcoming but mark your calendar and we encourage you to bring friends/guests.

I hope this Newsletter is a useful tool as we try to keep you informed about your investment(s) with us. As always, if you have any questions or comments, I warmly welcome your call or email. You may reach me at 574-243-6501 or john@rosenthalpartners.net

With warmest personal regards,



*** Important Footnotes**:

Past performance may not be indicative of future results. Therefore, no current or prospective client should assume that the future performance of any specific investment, investment strategy (including the investments and/or investment strategies recommended by the advisor), will be profitable or equal to past performance levels. Additionally, Form ADV Part II for John W. Rosenthal Capital Management, Inc., filed with the Secretary of State of Indiana, is available on line at www.rosenthalpartners.net - or if you would like to receive a paper copy of our Form ADV Part II and/or information regarding the firm's proxy voting policy you may contact us at the number provided above and we will mail them to you immediately.

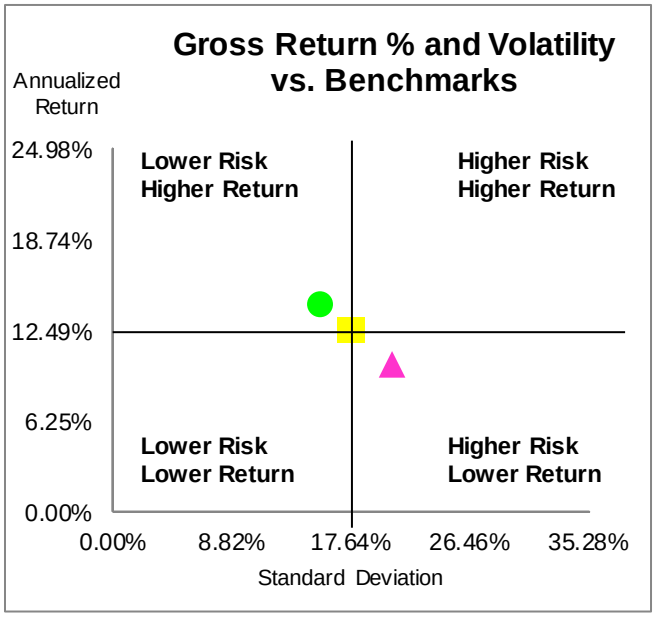
Appendix A – Fund 1 Performance Data: Q1 '18

As noted in the headlines of the 1st Quarter 2018 General Newsletter, Q2 2018 results are off to a very strong start! Specifically, as of April 23, 2018 Fund 1 has increased by ~5.2% this month alone!

Our goal as stewards of your assets is to preserve and grow them in a prudent manner. We are happy that this conservative approach has historically produced results that have beaten the benchmark. But whether we beat the benchmark isn't as important to us as whether we stay *true* to our stated philosophy of good risk-adjusted returns over time. Our Funds are not so much "wealth creation" mediums (although we have increased your net worth since inception) as they are "wealth preservation" channels. Nonetheless, and because we are not afraid to be tough on ourselves and transparent, we have added another benchmark to compare our performance. While we haven't stacked up as well against this newly introduced benchmark, we are not reluctant to share this with you knowing that you understand our approach is tempered by limiting the risk we assume in achieving our results.

We have recently upgraded and reformatted our Performance Data which we present to you. As our Funds mature, and each individual investor adds to or redeems portions of their investment(s), (i.e. each investor's results are more *customized and dependent* on the investment choices made by each limited partner) "aggregate" data may be less relevant. Nonetheless, it is still somewhat useful to see this information on a cumulative, Fund-wide basis. Said another way, the data presented below isn't necessarily identical to what is shown on your statement.

Chart 1

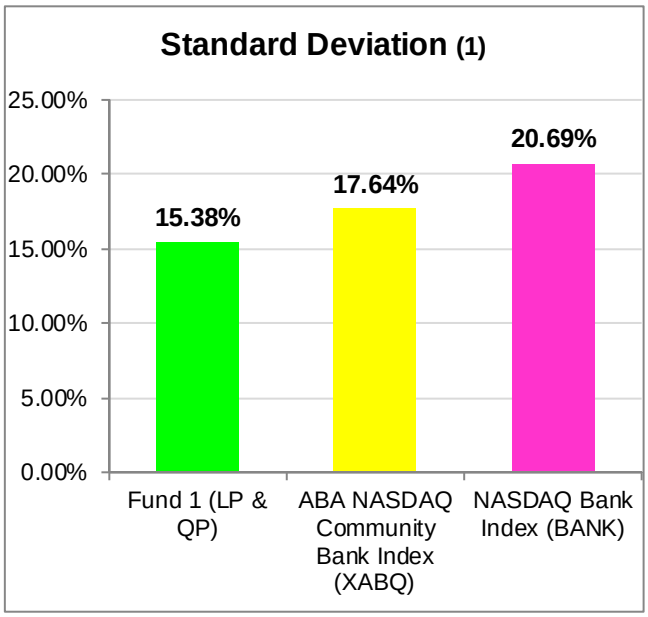


*From 03/31/10 - 03/31/18

	Gross Return %	Standard Deviation
Fund 1 (LP & QP)	14.33%	15.38%
ABA NASDAQ CB Index (XABQ)	12.49%	17.64%
NASDAQ Bank Index (BANK)	10.17%	20.69%

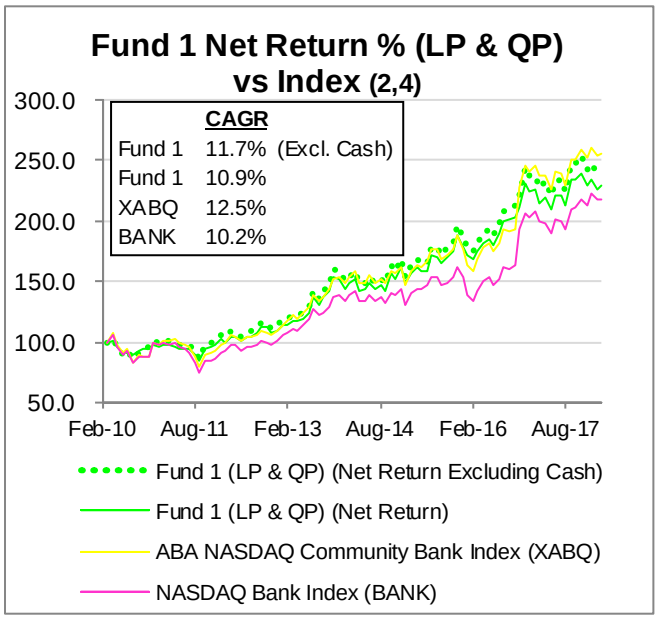
Commentary for Chart 1:
We believe Chart 1 is the most relevant and useful information we can share with you. This chart shows the Gross Return of our Portfolio vs. the Gross Returns of two important benchmarks (making it an apples-to-apples comparison) and then compares those results to the Standard Deviation (a common and frequently used measurement of risk) of each. In simplest terms, it plots the risk-reward relationship between these key data points. As you can see, on a Gross Return basis, our portfolio has produced the greatest return with the lowest risk. This, of course, is precisely what we set out to do.

Chart 2



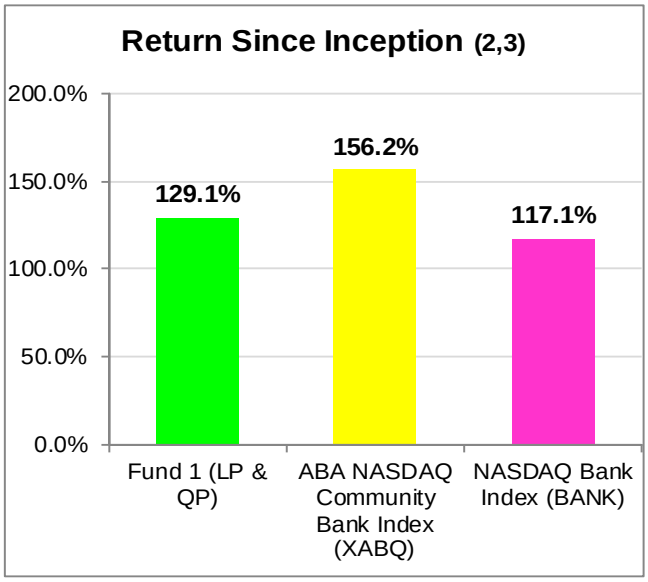
Commentary for Chart 2:
As highlighted in Chart 1, the overall risk – (as measured by Standard Deviation) – in our portfolio is far less than the two important industry benchmarks. When measuring Standard Deviation, lower implies less risk and is therefore better! Thus, we claim the risk-adjusted returns we are generating for you are in line with our stated goals.

Chart 3



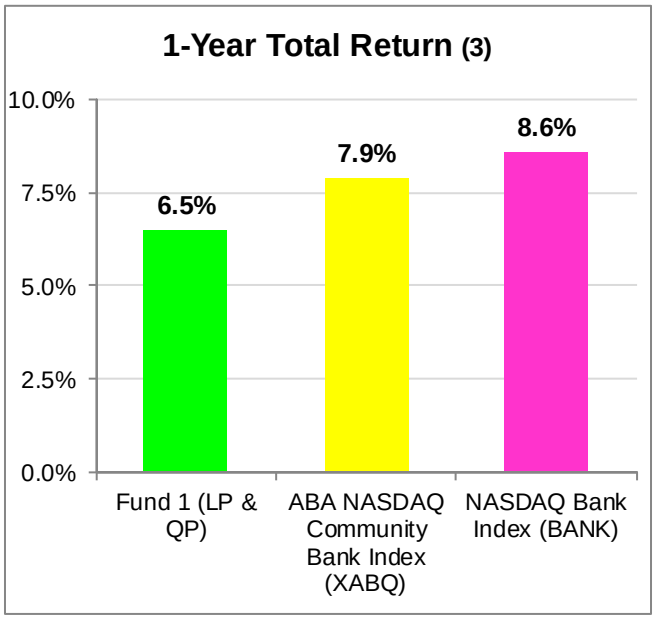
Commentary for Chart 3:
The CAGR's presented in this chart facilitate an evaluation in comparable terms of the portfolio of stocks in Fund 1 <u>excluding</u> cash with the CAGR's of two important benchmarks (which don't include cash either); as well as a "net return" <u>including</u> cash. This data is net of our management fees and expenses – but, again, the dotted green line *excludes* cash held in the Fund. Our long-standing target has been to achieve a return in the very low double-digit range. We are delighted to have accomplished our stated goal over time.

Chart 4



Commentary for Chart 4:
We continue to beat the original benchmark (BANK) to which we have historically compared our performance. We have underperformed against the new benchmark we've added. XABQ consists of 367 Community Banks – which is why it is also a relevant benchmark. These banks tend to be slightly smaller than the banks in the NASDAQ Bank Index – which are publicly traded on the NASDAQ exchange.

Chart 5



Commentary for Charts 5, 6 and 7:
The final 3 charts present the 1, 3 and 5 year returns for Fund 1 vs. our benchmarks. It is customary for Investment Advisors to present this data to investors. The charts are self-explanatory. There is no other way to say it other than our 1-year return has fallen short of the benchmarks. This chart will now be presented on a rolling-twelve month basis. Please remember however that 2016 was a record year with returns net of fees in excess of 30%. Our five year results are better than our one-year return.

Chart 6

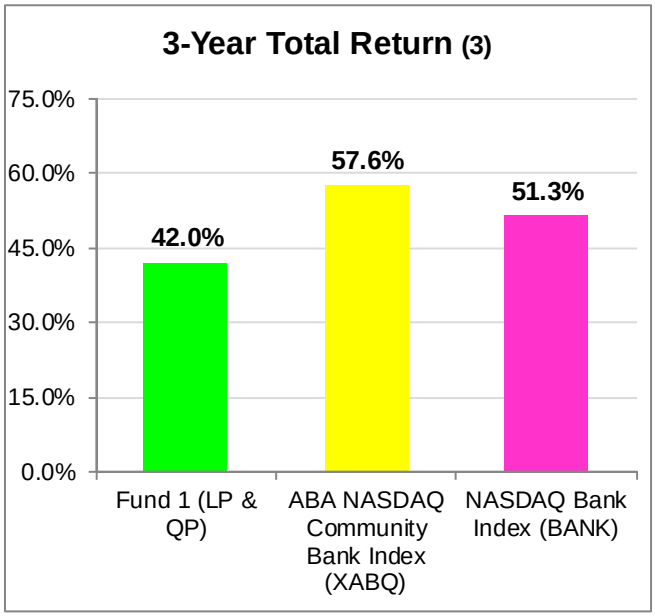
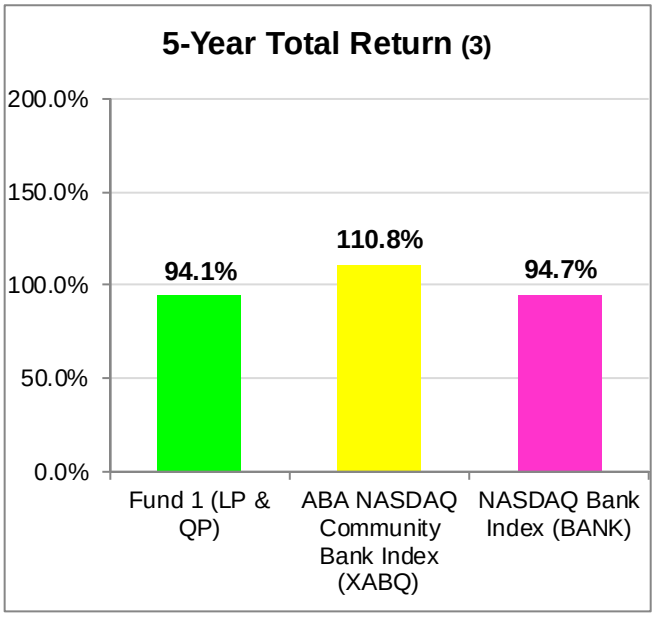


Chart 7



(1) Standard deviation based on information provided by broker (net of fees) from 03/31/2010 – 03/31/2018.
(2) For comparison purposes, inception date for Fund 1 uses March 2010 monthly statement from LICCAR.
CAGR = Compound Annual Growth Rate
(3) Total return for Fund 1 (LP & QP) based on monthly statements compiled by LICCAR net of all management fees and expenses;
ABA Nasdaq Community Bank Total Return based on data provided by MarketWatch.
NASDAQ Bank Index based on data provided by S&P Global Market Intelligence (based on ending index value, not total return).
(4) Net return (excluding cash) for Fund 1 = Fund 1 Total Return divided by prior month end market value of bank stock investments.

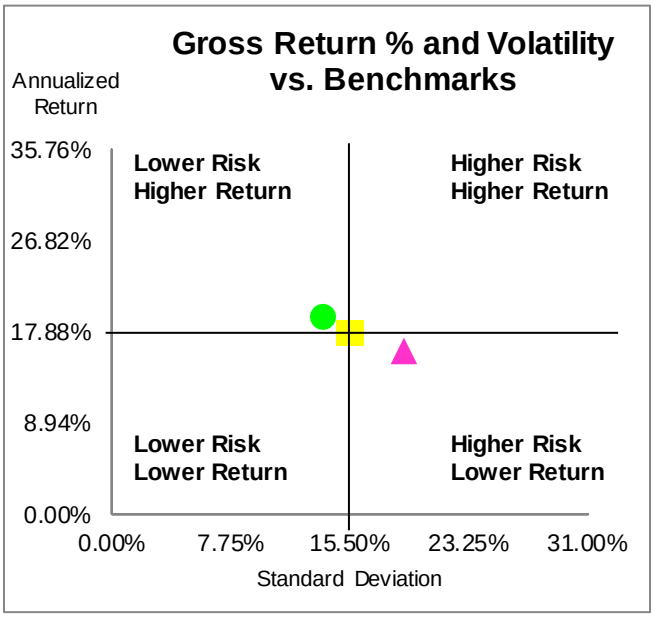
Appendix B – Fund 2 Performance Data: Q1 '18

As noted in the headlines of the 1st Quarter 2018 General Newsletter, Q2 2018 results are off to a very strong start! Specifically, as of April 23, 2018 Fund 2 has increased by ~2.3% this month alone!

Our goal as stewards of your assets is to preserve and grow them in a prudent manner. We are happy that this conservative approach has historically produced results that have beaten the benchmark. But whether we beat the benchmark isn't as important to us as whether we stay *true* to our stated philosophy of good risk-adjusted returns over time. Our Funds are not so much "wealth creation" mediums (although we have increased your net worth since inception) as they are "wealth preservation" channels. Nonetheless, and because we are not afraid to be tough on ourselves and transparent, we have added another benchmark to compare our performance. While we haven't stacked up as well against this newly introduced benchmark, we are not reluctant to share this with you knowing that you understand our approach is tempered by limiting the risk we assume in achieving our results.

We have recently upgraded and reformatted our Performance Data we present to you. As our Funds mature, and each individual investor adds to or redeems portions of their investment(s), (i.e. each investor's results are more *customized and dependent* on the investment choices made by each limited partner) "aggregate" data may be less relevant. Nonetheless, it is still somewhat useful to see this information on a cumulative, Fund-wide basis. Said another way, the data presented below isn't necessarily identical to what is shown on your statement.

Chart 1

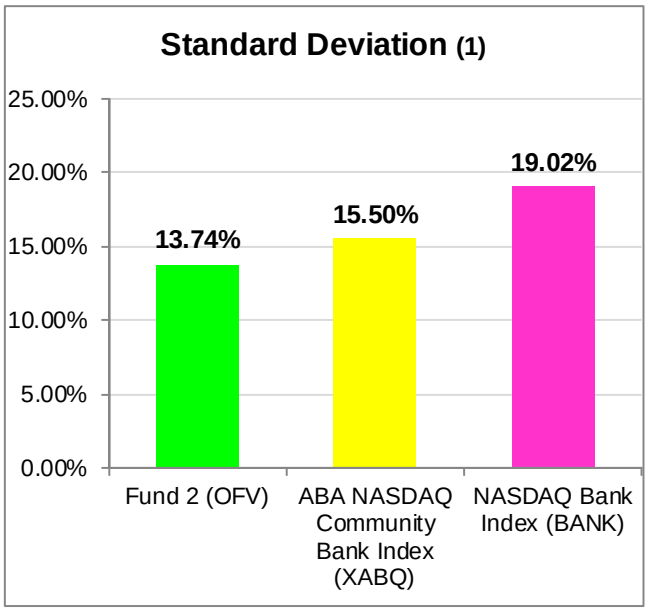


*From 11/30/11 - 03/31/18

	Gross Return %	Standard Deviation
Fund 2 (OFV)	19.42%	13.74%
ABA NASDAQ CB Index (XABQ)	17.88%	15.50%
NASDAQ Bank Index (BANK)	16.06%	19.02%

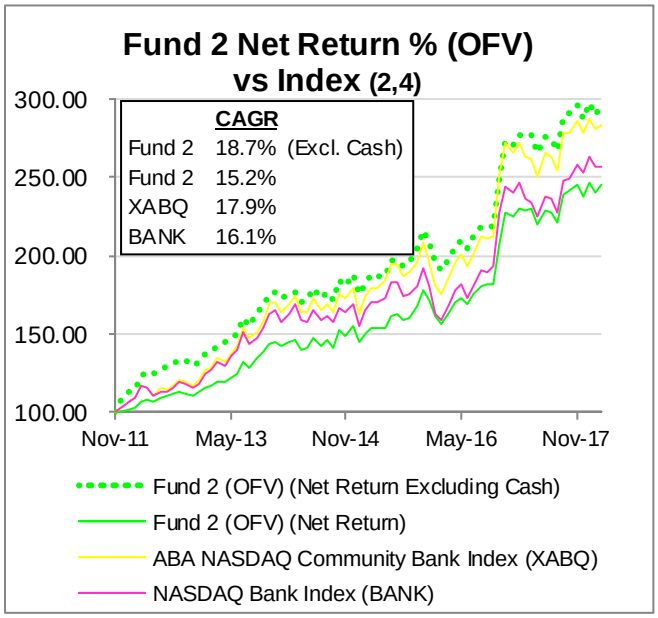
Commentary for Chart 1:
We believe Chart 1 is the most relevant and useful information we can share with you. This chart shows the Gross Return of our Portfolio vs. the Gross Returns of two important benchmarks (making it an apples-to-apples comparison) and then compares those results to the Standard Deviation (a common and frequently used measurement of risk) of each. In simplest terms, it plots the risk-reward relationship between these key data points. As you can see, on a Gross Return basis, our portfolio has produced the greatest return with the lowest risk. This, of course, is precisely what we set out to do.

Chart 2



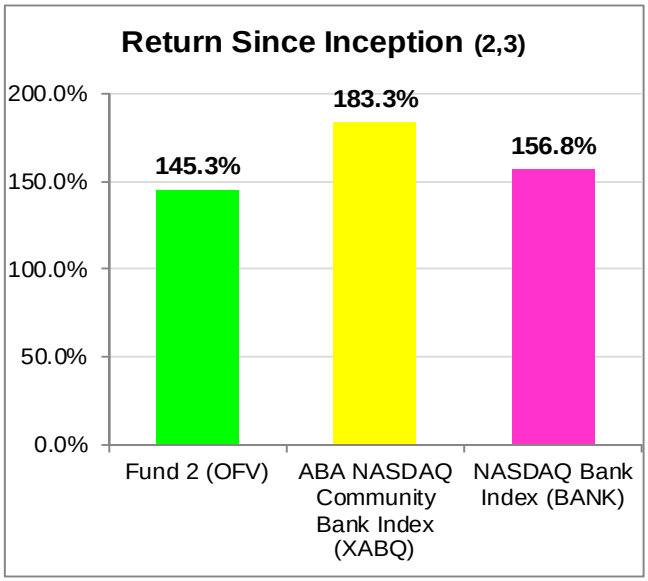
Commentary for Chart 2:
As highlighted in Chart 1, the overall risk – as measured by Standard Deviation – in our portfolio is far less than the two important industry benchmarks. When measuring Standard Deviation, lower implies less risk and is therefore better! Thus, we claim the risk-adjusted returns we are generating for you are in line with our stated goals.

Chart 3



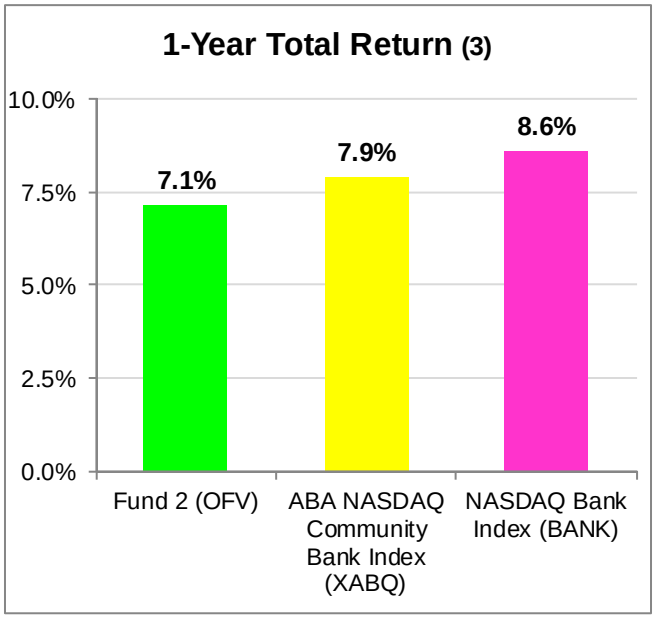
Commentary for Chart 3:
The CAGR's presented in this chart facilitate an evaluation in comparable terms of the portfolio of stocks in Fund 2 excluding cash with the CAGR's of two important benchmarks (which don't include cash either); as well as a "net return" including cash. This data is net of our management fees and expenses – but, again, the dotted green line excludes cash held in the Fund. Our long-standing target has been to achieve a return in the very low double-digit range. We are delighted to have significantly exceeded our stated goal over time.

Chart 4



Commentary for Chart 4:
We continue to be below the original benchmark (BANK) to which we have historically compared our performance due to the large cash balances that were pending investment in the early years of the Fund. We have underperformed against the new benchmark we've added to our performance measurements for the same reason. XABQ consists of 367 Community Banks – which is why it is also a relevant benchmark. These banks tend to be slightly smaller than the bank in the NASDAQ Bank Index – which are publicly traded on the NASDAQ exchange. The CAGR's in Chart 3 above demonstrate our core performance adjusting for excess cash awaiting investment.

Chart 5



Commentary for Charts 5, 6 and 7:
The final 3 charts present the 1, 3 and 5 year returns for Fund 2 vs. our benchmarks. It is customary for Investment Advisors to present this data to investors. The charts are self-explanatory. There is no other way to say it other than our 1-year return has fallen short of the benchmarks. This chart will now be presented on a rolling-twelve month basis. Please remember however that 2016 was a record year with returns net of fees in excess of 30%. Our three and five year results are better than our one-year return. In short, Fund 2 continues to perform well. We are tracking nicely vs. the original benchmark (BANK) to which we have historically compared our performance for the 3 and 5 year time-frames even though we had substantial cash balances that were pending investment into stocks.

Chart 6

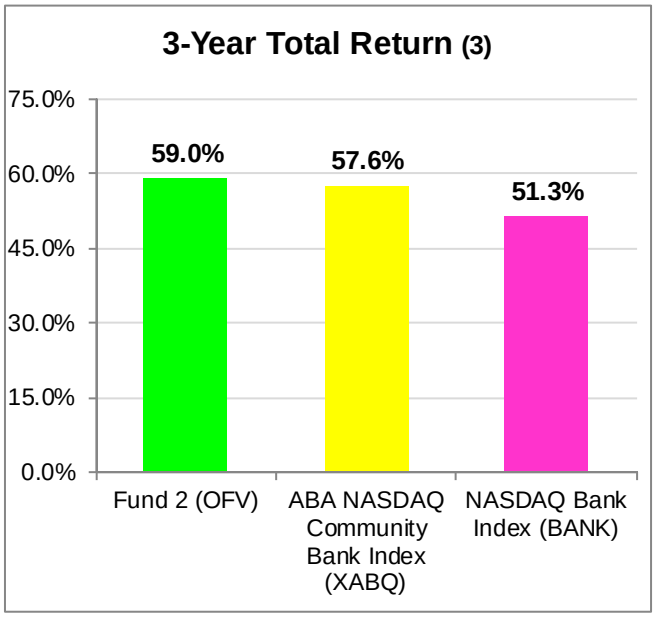
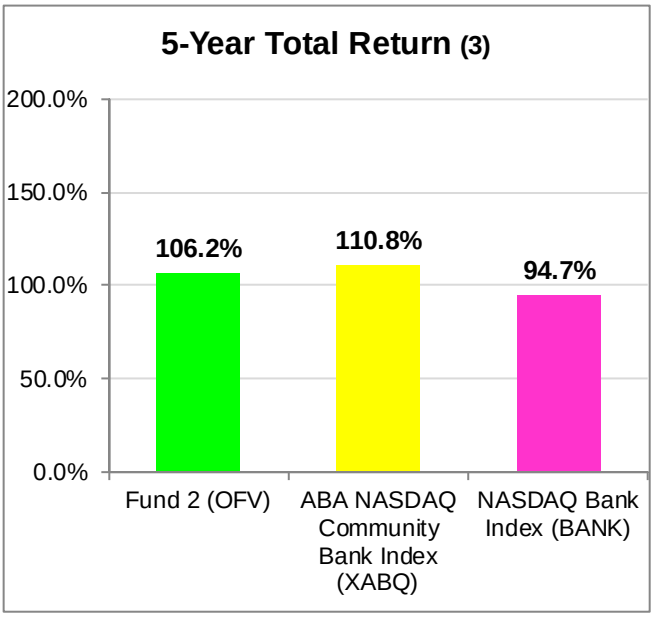


Chart 7



(1) Standard deviation based on information provided by broker (net of fees) from 11/30/2011 - 03/31/2018.
(2) For comparison purposes, inception date for Fund 2 uses November 2011 monthly statement from LICCAR.
CAGR = Compound Annual Growth Rate.
(3) Total return for Fund 2 (OFV) based on monthly statements compiled by LICCAR net of all management fees and expenses;
ABA Nasdaq Community Bank Total Return based on data provided by MarketWatch.
NASDAQ Bank Index based on data provided by S&P Global Market Intelligence (based on ending index value, not total return).
(4) Net return (excluding cash) for Fund 2 = Fund 2 Total Return divided by prior month end market value of bank stock investments.

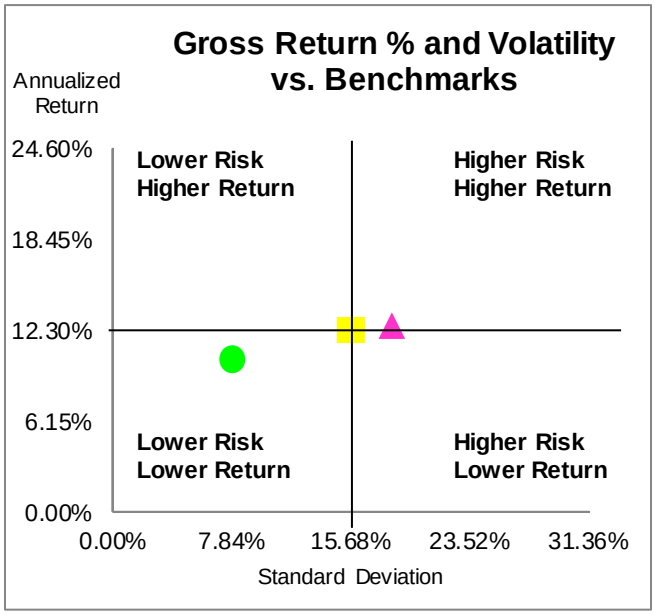
Appendix C – Fund 3 Performance Data: Q1 '18

As noted in the headlines of the 1st Quarter 2018 General Newsletter, Q2 2018 results are off to a very strong start! Specifically, as of April 23, 2018 Fund 3 has increased by ~2.3% this month alone!

Our goal as stewards of your assets is to preserve and grow them in a prudent manner. We are happy that this conservative approach has historically produced results that have beaten the benchmark. But whether we beat the benchmark isn't as important to us as whether we stay *true* to our stated philosophy of good risk-adjusted returns over time. Our Funds are not so much "wealth creation" mediums (although we have increased your net worth since inception) as they are "wealth preservation" channels. Nonetheless, and because we are not afraid to be tough on ourselves and transparent, we have added another benchmark to compare our performance. While we haven't stacked up as well against this newly introduced benchmark, we are not reluctant to share this with you knowing that you understand our approach is tempered by limiting the risk we assume in achieving our results.

We have recently upgraded and reformatted our Performance Data we present to you. Since we've now passed the 1-year anniversary of Fund 3, we are able to present the same charts that are included in Fund 1 & 2. Specifically, we have the all-important Standard Deviation numbers to show you the low level of risk within this portfolio.

Chart 1

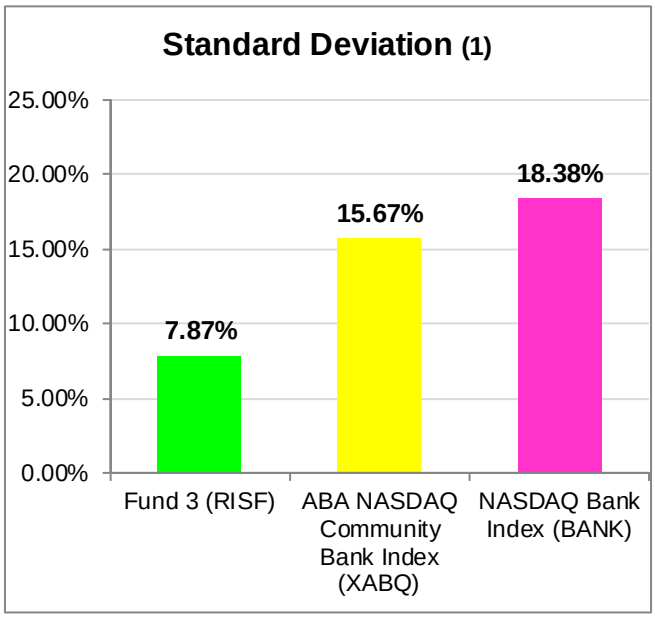


*From 04/04/17 - 04/23/18

	Gross Return %	Standard Deviation
Fund 3 (RISF)	10.39%	7.87%
ABA NASDAQ CB Index (XABQ)	12.30%	15.67%
NASDAQ Bank Index (BANK)	12.65%	18.38%

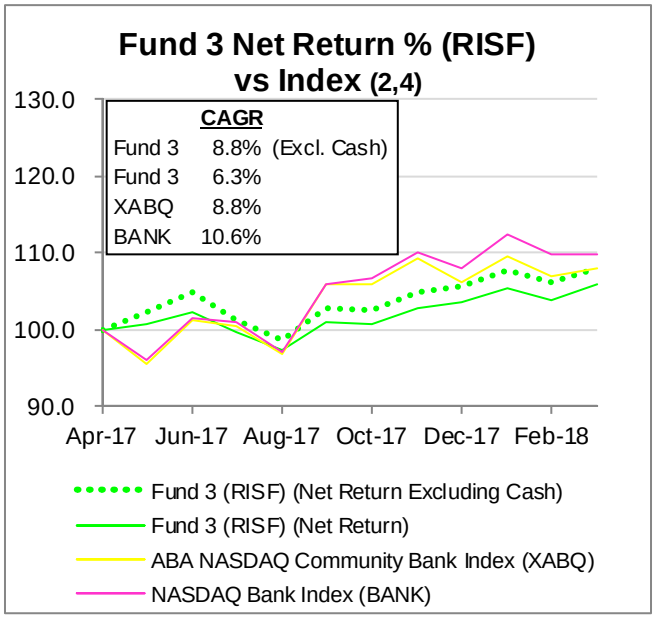
Commentary for Chart 1:
We believe Chart 1 is the most relevant and useful information we can share with you. This chart shows the Gross Return of our Portfolio vs. the Gross Returns of two important benchmarks (making it an apples-to-apples comparison) and then compares those results to the Standard Deviation (a common and frequently used measurement of risk) of each. In simplest terms, it plots the risk-reward relationship between these key data points. As you can see, on a Gross Return basis, our portfolio has produced a slightly lower return but with significantly lower risk as well. This, of course, is precisely what we set out to do.

Chart 2



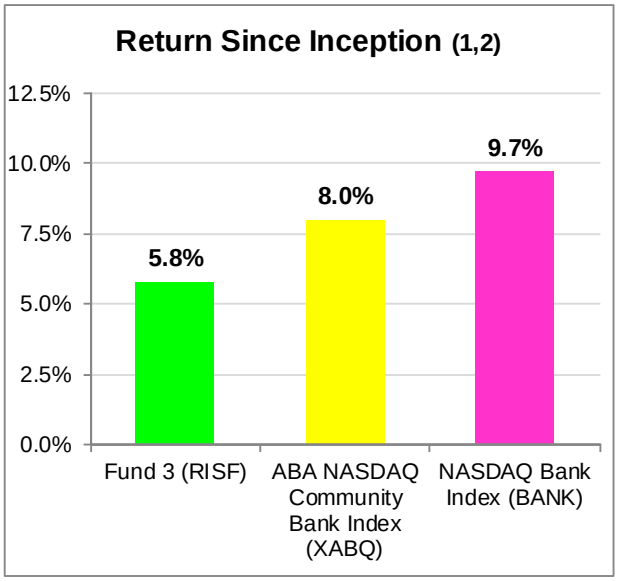
Commentary for Chart 2:
As highlighted in Chart 1, the overall risk – as measured by Standard Deviation – in our portfolio is far less than the two important industry benchmarks. When measuring Standard Deviation, lower implies less risk and is therefore better!

Chart 3



Commentary for Chart 3:
The CAGR's presented in this chart facilitate an evaluation in comparable terms of the portfolio of stocks in Fund 3 excluding cash with the CAGR's of two important benchmarks (which don't include cash either); as well as a "net return" including cash. This data is net of our management fees and expenses – but, again, the dotted green line excludes cash held in the Fund. Our long-standing target has been to achieve a return in the very high single-digit range. We are satisfied that the 8.8% return net of cash is right at our stated goal over time.

Chart 4



Commentary for Chart 4:
We have underperformed against the benchmarks to which we compare our performance due to the cash balances that were pending investment in the early days of the Fund. Nasdaq Bank Index consists of small cap banks traded on the Nasdaq Exchange and XABQ consists of 367 Community Banks – which is why it is a relevant benchmark. These banks tend to be slightly smaller than the bank in the NASDAQ Bank Index. The CAGR's in Chart 3 above demonstrate our core performance adjusting for excess cash awaiting investment.

Chart 5

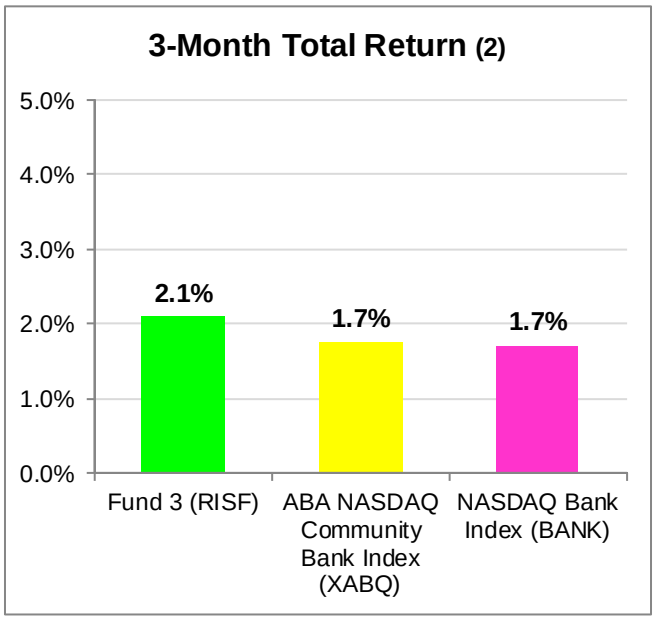
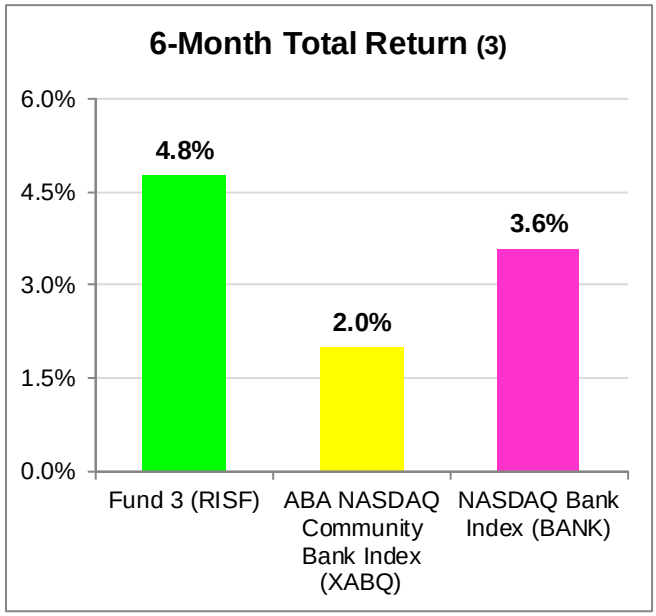


Chart 6



Commentary for Charts 5 and 6:
The final 2 charts present the 3 and 6 month returns for Fund 3 vs. our benchmarks. It is customary for Investment Advisors to present this data to investors. The charts are self-explanatory. We are pleased that our relative performance during these two periods outstrips the benchmarks to which we compare our performance.

(1) Standard deviation based on information provided by broker (net of fees) from 04/04/2017 – 04/23/2018.
(2) For comparison purposes, inception date for Fund 3 uses April 2017 monthly statement from LICCAR.
CAGR = Compound Annual Growth Rate.
(3) Total return for Fund 3 (RISF) based on monthly statements compiled by LICCAR net of all management fees and expenses;
ABA Nasdaq Community Bank Total Return based on data provided by MarketWatch.
NASDAQ Bank Index based on data provided by S&P Global Market Intelligence (based on ending index value, not total return).
(4) Net return (excluding cash) for Fund 3 = Fund 3 Total Return divided by prior month end market value of bank stock investments.

Additional Investment Form

I wish to *increase* my investment by:_____
(Fill in any dollar amount ≥ $25,000)

Name:_____

Email:_____

Best Phone #:_____

I understand you will forward additional paperwork for me to execute which will indicate that I continue to accept *all* the terms and conditions of the Limited Partnership Agreement.

Please return this form using any of the following options:

Scan and email to: john@rosenthalpartners.net
or

Fax to: 574-243-4377
or

Mail to:
John W. Rosenthal Capital Management, Inc.
4220 Edison Lakes Parkway
Ste. 310
Mishawaka, Indiana 46545

THERE IS NO NEED TO SEND CASH NOW

We will Invoice You at the Proper Time

Questions Please Call 574-243-6501