

Market Data & Commentary:

Source: Vestek & Frank Russell

Index	Month	Quarter	2001YTD
S&P 500	-8.1%	-14.7%	-20.4%
Dow Jones Industrials	-11.1%	-15.5%	-17.0%
NASDAQ	-17.0%	-30.6%	-39.3%
S&P/BARRA Value	-9.5%	-16.2%	-18.2%
S&P/BARRA Growth	-6.8%	-13.3%	-22.8%
S&P 500 Equal-Weighted	-12.5%	-17.1%	-13.9%
S&P 400 Midcap	-12.4%	-16.6%	-15.7%
Russell 2000	-13.4%	-20.8%	-15.4%

	2001Q3	2001YTD
BASIC MATERIALS	-10.5%	-1.3%
CAPITAL GOODS	-16.4%	-12.7%
COMMUNICATION SVC	-20.2%	-23.1%
CONSUMER CYCLICALS	-16.5%	0.9%
CONSUMER STAPLES	-7.3%	1.4%
ENERGY	-19.5%	-27.5%
FINANCIAL	-6.5%	-3.6%
HEALTH CARE	-8.2%	-3.2%
TECHNOLOGY	-32.3%	-24.8%
TRANSPORTATION	-24.0%	-12.8%
UTILITIES	-10.5%	-13.5%

The U.S. stock markets were unable to consolidate on the positive performance of Q2. The Dow Jones Industrial, S&P 500 and NASDAQ posted losses for the quarter of -15.5%, -14.71% and -30.63%, respectively. Clearly, the terrorist attacks on September 11 had a negative impact on the markets performance, however, it is important to note that, at August 31, all of the indices were down quarter to date. Corporate earnings continued to disappoint as analysts failed to stay ahead of the deteriorating corporate environment. On the economic front, the discussion moved from if the U.S. was slipping into a recession to how deep the recession may be and the shape of the subsequent recovery - V, U or L shaped. Apart from the September terrorist attacks, a number of underlying factors drove the markets performance during the quarter, specifically:

- Monetary Policy stimulus. Although the Fed did lower rates by another 25bps at its August 26 meeting, it appeared, that after a 300bps reduction in the Funds rate since January 2001, a near-term wait and see approach would be adopted. Of course, this changed with the events of September 11. In an effort to offset the negative sentiment of the attacks and to further help prime the economic pump, the Fed lowered rates by 50 bps to 3.0% prior to the equity markets re-opening on September 17. Recent comments from Fed governors indicate that they are willing to continue to lower rates.
- Style returns for the quarter were mixed. In the large-cap. arena, the S&P/BARRA Growth index outperformed its value counterpart, returning -13.3% vs. -16.2% for the S&P/BARRA Value index. However, in the mid-cap. and small-cap. arena value indices returned -13.01% and -16.6%, respectively vs. -20.2% and -17.5% for the growth indices. The technology sector performance is a primary driver behind this performance, in our opinion.
- Large-cap. stocks outperformed during the quarter. In an about face, the cap weighted S&P 500 index outperformed the equal-weighted version by 236bps in the quarter. The Large cap stocks out-performance was driven by a 438bps positive spread in September as investors sought the security of the larger "blue chip" names. For the latest 12 months, although the equal weighted index out-performance narrowed, it remained at a very respectable +1,600 bps. The equal weighted index now leads or matches the cap-weighted index over the 1, 2, 3, 4, 5 and 10 year time periods ended 9/30/01.
- A 12 months to forget. For the 12 months ended 9/30/01, the NASDAQ and S&P 500 indices are down -59.2% and -26.7%, respectively. The Dow Jones, which had been in positive territory for the 12 months to 6/30/01, is down -15.38%.

No sector had a positive performance for the quarter. Not surprisingly, the transportation sector was one of the worst performers down, -24%. The technology sector was down -32.3% as investors moved to more defensive positions in the Financial, Consumer Staple and Healthcare sectors, which were the best performers, down -6.5%, -7.3% and -8.2%, respectively.

Going forward, given the uncertain economic and political environment, we continue to expect short-term volatility in the markets, driven, in part, by the latest news headlines.

Model Attribution: *Third Quarter, 2001*

Quint	Opt E/I	Earnings	Insider	DDM	Cashflow	Technical	Size
5 (high)	-12.2%	-13.1%	-14.0%	-17.0%	-17.2%	-16.3%	-11.4%
4	-11.6%	-15.6%	-14.5%	-14.7%	-13.9%	-11.7%	-15.0%
3	-14.8%	-19.6%	-13.6%	-16.4%	-11.9%	-20.2%	-14.5%
2	-15.9%	-18.3%	-14.9%	-11.4%	-14.5%	-20.4%	-16.2%
1 (low)	-21.5%	-22.7%	-18.5%	-14.8%	-25.5%	-16.9%	-18.0%
Spread	9.3%	9.6%	4.5%	-2.2%	8.3%	0.6%	6.7%

Note: "Spread" is the difference between the returns of the high (5) and low (1) quintiles by each model/measure.

The Shenandoah models appear to have added significant value during the quarter. Unlike the first quarter in which the spreads in most models exhibited a positive monotonic pattern, the return patterns for the second and third quarters have been more random. Interestingly, no model reported a positive quintile performance for the quarter; this is in stark contrast to the second quarter in which no model reported a negative return in any quintile.

We believe that sector moves (technology) are driving the performance of fundamentals, rather than fundamentals driving performance. A closer examination of the returns above illustrates this point: Returns in quintiles 2-5 (5 = "best") are a random for almost all of the models, but quintile 1 ("worst") clearly under-performs all others. This is the tech-effect: Most tech stocks fall in the worst quintile by all of our measures except DDM, i.e. poor earnings profile, significant insider selling, and worst cashflow. For the moment, speculation in the technology sector is clearly driving the returns of the market, not the underlying fundamentals.

- The DDM was the only one of our primary models which did not add value during the quarter, as exhibited by the -2.2% spread between the best and worst returns.
- Excluding the DDM Model, all of the models exhibited positive performance. We believe that this was driven purely by the performance reversal that occurred in the technology sector during the quarter.
- The Earnings and Insider Trading models, the primary drivers of our process, contributed positively as exhibited by their 9.6% and 4.5% spreads, respectively.
- Not surprisingly, the OPT E/I model (Earnings and Insider Trading) also did well.
- Price momentum (our Technical model) did not appear to be a factor during the period
- Size continued to be a factor in determining performance this quarter. The smallest stocks under-performed the largest by 6.7% for the quarter.

Year to date model performance is mixed. Our value models, Cash Flow and DDM have been the best performers, +39.1% and +25.8%, respectively. Earnings has been the worst performing model, -5.9%; unfortunately, this is the key driver of our process. Economic uncertainty has led investors (apparently) to lose faith in earnings estimates; in fact, they seem to be ignoring earnings altogether. We continue to believe that fundamentals have nothing to do with performance at this time; instead, investors continue to jump in and out of the same old technology stocks, alternately running them up then down. We hope that fundamentals will soon return to the driver's seat.

Model Attribution: *Year-to-date, 2001*

Quint	Opt E/I	Earnings	Insider	DDM	Cashflow	Technical	Size
5 (high)	-9.2%	-16.7%	-7.6%	4.0%	6.1%	-15.4%	-19.6%
4	-13.0%	-10.4%	-7.4%	-3.1%	0.6%	-11.7%	-13.3%
3	-7.7%	-15.6%	-6.3%	-9.5%	-8.1%	-18.9%	-13.3%
2	-11.6%	-10.4%	-13.3%	-12.2%	-16.0%	-18.4%	-7.5%
1 (low)	-16.2%	-10.8%	-22.5%	-21.8%	-33.0%	-13.7%	-3.4%
Spread	7.0%	-5.9%	14.9%	25.8%	39.1%	-1.7%	-16.2%