

## Market Data & Commentary:

Source: Vestek & Frank Russell

Index	Month	Quarter	2001YTD
S&P 500	0.9%	10.7%	-11.9%
Dow Jones Industrials	1.8%	13.9%	-5.5%
NASDAQ	1.0%	30.1%	-21.1%
S&P/BARRA Value	1.5%	8.0%	-11.7%
S&P/BARRA Growth	0.2%	13.1%	-12.7%
S&P 500 Equal-Weighted	3.1%	18.0%	1.5%
S&P 400 Midcap	5.2%	18.0%	-0.6%
Russell 2000	6.2%	21.1%	2.5%

	2001Q4	2001YTD
BASIC MATERIALS	4.2%	2.9%
CAPITAL GOODS	5.3%	-8.0%
COMMUNICATION SVC	-0.9%	-23.7%
CONSUMER CYCLICALS	7.1%	8.1%
CONSUMER STAPLES	1.9%	3.4%
ENERGY	14.5%	-16.9%
FINANCIAL	-3.9%	-7.3%
HEALTH CARE	5.3%	1.9%
TECHNOLOGY	17.0%	-12.0%
TRANSPORTATION	5.7%	-7.8%
UTILITIES	0.0%	-13.5%

The U.S. stock markets rebounded strongly in the wake of the September 11 terrorist attacks. For the quarter, The Dow Jones Industrial, S&P 500 and NASDAQ all posted better than double digit gains, up 13.9%, 10.7% and 30.1%, respectively. The lack of further terrorist attacks, military success in the war in Afghanistan, additional interest rate cuts and some signs of economic recovery all provided a positive backdrop for the equity markets. More specifically, a number of underlying factors drove the markets performance during the quarter:

- **Monetary Policy stimulus.** The Federal Reserve continued to use lower interest rates as a means to prime the US economic pump. During the quarter, the Fed lowered interest rates a further 125bps to 1.75%. Clearly, the Fed is running out of room for further cuts, however; another 25bps cut in January can't be ruled out, in our opinion.
- **In general, growth was the dominant style during the quarter.** In the large-cap. and mid-cap arena, the S&P/BARRA Growth index out-performed its value counterpart, returning 13.1% and 22.2%, respectively vs. 8.0% and 14.3% for the S&P/BARRA Value index. However, the S&P/BARRA small cap value index, up 21.4% outperformed the equivalent growth index, up 19.9%. The dominance of growth is not surprising given the strong performance of the technology sector, up 17.0%.
- **Small-cap. stocks outperformed during the quarter.** In a return to the trend that we saw in the first six months of 2001, the equal weighted S&P 500 index out-performed the cap-weighted version by 730bps in the quarter. For the latest 12 months, the equal weighted index has out-performed the cap-weighted index by +1,341 bps. The equal weighted index now leads the cap-weighted index over the 1, 2, 3, 4, 5 and 10-year time periods ended 12/31/01.
- **A positive end to a negative year.** Even the strong market performance of the last quarter was not enough to erase the negative returns from earlier in the year. For the 12 months ended 12/31/01, the NASDAQ, S&P 500 and Dow Jones indices were down -21.1%, -11.9% and -5.5%, respectively. This marks the second consecutive year of stock market losses (the first time since '73 - '74).

In a dramatic turnaround from Q3, only two sectors registered negative performance for the quarter. The technology sector was the best performer, up 17.0% as investors become increasingly confident that the US economy is poised for recovery in the second half of 2002. Energy, up 14.5% for the quarter, was the beneficiary of higher oil prices. The Financial sector was the worst performer, down -3.9%, negatively impacted by a shift to more aggressive growth companies, the view that the interest rate reduction are coming to an end, the "Enron" effect and concerns that increased loan losses will reduce earnings growth.

## Model Attribution: *Fourth Quarter, 2001*

Quint	Opt E/I	Earnings	Insider	DDM	Cashflow	Technical	Size
5 (high)	14.4%	13.2%	17.8%	27.1%	23.7%	8.2%	8.3%
4	13.5%	14.8%	19.8%	21.5%	20.2%	9.9%	13.0%
3	18.6%	13.2%	18.5%	22.4%	16.2%	19.4%	17.7%
2	23.1%	22.0%	19.4%	14.5%	17.7%	30.3%	25.9%
1 (low)	24.4%	26.7%	19.2%	10.2%	27.4%	25.7%	30.3%
<b>Spread</b>	<b>-10.1%</b>	<b>-13.5%</b>	<b>-1.4%</b>	<b>17.0%</b>	<b>-3.7%</b>	<b>-17.5%</b>	<b>-22.0%</b>

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

The Shenandoah models posted mixed results during the quarter. The DDM had a strong period (again), but this was offset by the poor performance of our earnings model. Returns for the period clearly had nothing to do with current or near-term earnings forecasts; instead, investors focused speculatively on the possibility of a V-shaped economic recovery and poured money into the technology sector, hoping for a sharp, cyclical recovery of earnings in that area. Valuation levels in the technology sector remain extreme by any measure, but investors and traders were undaunted, betting that significant future earnings growth would justify current prices.

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 (no monotonic pattern) but quintile 1 ("worst") clearly out-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 added value during the quarter, as exhibited by the 17% spread between the best and worst quintiles. This value bias was not confirmed by the performance of our Cashflow model.
- The Earnings and Insider Trading models, the primary drivers of our process, contributed negatively as exhibited by their -13.5% and -1.4% spreads, respectively.
- Not surprisingly, the OPT E/I model (Earnings and Insider Trading) also suffered.
- Price momentum (our Technical model) was a significant a factor during the period, illustrating the dramatic performance reversal between the third and fourth quarters.
- Size continued to be a factor in determining performance this quarter. The smallest stocks out-performed the largest by 22% for the quarter.

Year to date model performance is bizarre. Our value models, Cash Flow and DDM have been the best performers, each delivering a +46% inter-quintile spread. Earnings has been the worst performing model, -18.8%; 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)	3.9%	-5.7%	8.8%	32.2%	31.3%	-8.5%	-12.9%
4	-1.2%	2.8%	11.0%	17.8%	21.0%	-3.0%	-2.0%
3	9.5%	-4.5%	11.1%	10.9%	6.8%	-3.1%	2.0%
2	8.9%	9.3%	3.5%	0.5%	-1.1%	6.3%	16.5%
1 (low)	4.3%	13.0%	-7.7%	-13.8%	-14.6%	8.4%	25.9%
<b>Spread</b>	<b>-0.4%</b>	<b>-18.8%</b>	<b>16.5%</b>	<b>46.0%</b>	<b>46.0%</b>	<b>-16.9%</b>	<b>-38.8%</b>