

Market Data & Commentary:

Source: Vestek & Frank Russell

Index	Month	Quarter	YTD 2002
S&P 500	-5.9%	8.4%	-22.1%
Dow Jones Industrials	-6.1%	10.7%	-14.9%
NASDAQ	-9.7%	14.0%	-31.5%
S&P/BARRA Value	-5.2%	9.9%	-20.9%
S&P/BARRA Growth	-6.5%	7.1%	-23.6%
S&P 500 Equal-Weighted	-5.2%	13.0%	-17.5%
S&P 400 Midcap	-4.1%	5.8%	-14.5%
Russell 2000	-5.6%	6.2%	-20.4%

	2002Q4	YTD 2002
BASIC MATERIALS	8.3%	-7.7%
CAPITAL GOODS	10.1%	-7.7%
COMMUNICATION SVC	22.4%	-42.5%
CONSUMER CYCLICALS	4.6%	-8.3%
CONSUMER STAPLES	4.4%	-3.3%
ENERGY	7.9%	2.0%
FINANCIAL	3.0%	-7.8%
HEALTH CARE	2.1%	-17.4%
TECHNOLOGY	19.0%	-38.9%
TRANSPORTATION	9.6%	-2.9%
UTILITIES	4.9%	-16.1%

Led by what we believe was a speculative rally, the U.S. stock markets recorded their best quarterly performance of 2002. For the quarter, the major U.S. indices all recorded positive results. The NASDAQ, Dow Jones Industrial, and S&P 500 posted gains of +14.0%, +10.7% and +8.4%, respectively. However, this was not enough to avoid the markets recording their third consecutive year of negative returns. This had not occurred since during the Great Depression. More specifically, a number of underlying factors drove the markets performance during the quarter:

- Fed moves on interest rates. At their November meeting, the FOMC governors chose to lower rates a further 50bps to 1.25% in an effort to help the U.S. economy through its “soft spot.” The initial market enthusiasm was later tempered as the economic recovery continued to struggle to gain traction. In addition, increased geopolitical tension, including the beginnings of a nuclear stand-off with North Korea, overhangs the market.
- Style returns mixed. Value resumed its dominance over growth across all but the small capitalization levels. The S&P/BARRA Value index out-performed its Growth counterpart, returning +9.9% vs. +7.1%. Mid-cap Value also outperformed Mid-cap Growth +6.6% vs. +5.1%. However, the Smallcap Growth, driven in part by a rebound in the Telecom and Technology sectors, outperformed Smallcap Value +5.1% vs. +4.7%
- Small cap. stocks outperformed Large cap. stocks. The equal weighted S&P 500 index out-performed the cap weighted version by +360 bps in the quarter. For the latest 12 months, the equal weighted index has out-performed the cap-weighted index by +460 bps. The equal weighted index continues to lead the cap-weighted index over the 1, 2, 3, 4, 5 and 10-year time periods.
- October/November rally was NOT driven by fundamentals in our opinion. During this period, the performance of companies with negative earnings and trading at less than \$10 far outpaced the general market advance (many of these up 100% or more) indicating that the third quarter rally was driven by short-covering and pure speculation. However, in December, investors turned their attention back to the reality of a soft U.S. economy and increasing geopolitical tension.
- U.S. economy to improve in the second half of 2003? As was the case at the beginning of 2001 and 2002, consensus expectations appear to be for the U.S. economy to recover by H2'03. Of course, due to various factors, this expectation has yet to be realized. As we look to the Q4 reporting season, due to lowered expectations, we would not be surprised to see an increase in the number of companies reporting a positive earnings surprise, however; given the uncertain economic environment, near-term guidance is likely to disappoint.

The Q4 rally was driven by a rebound in the battered Telecom and Technology sectors, up +22.4% and +19.0%, respectively. For the year, the Energy sector, aided by increased tension in the Middle East was the best performer and only sector to deliver a positive return, +2.0%. Healthcare was the worst performing sector for the quarter, +2.1%. Not even the stellar Q4 performance of the Telecom and Technology sectors was enough to offset the carnage of Q1 through Q3. For the year, Telecom was down -42.5% and Technology was down -38.9%.

Model Attribution: *Fourth Quarter, 2002*

Quint	Opt E/I	Earnings	Insider	DDM	Cashflow	Technical	Size
5 (high)	3.2%	1.0%	5.8%	9.7%	7.4%	-3.0%	5.7%
4	4.5%	6.0%	5.9%	9.6%	7.9%	5.1%	6.4%
3	6.1%	7.6%	10.2%	5.7%	8.1%	12.1%	7.5%
2	8.6%	8.5%	6.1%	5.9%	4.6%	12.1%	4.7%
1 (low)	8.7%	10.4%	3.2%	2.4%	3.2%	6.5%	6.6%
Spread	-5.4%	-9.4%	2.6%	7.3%	4.2%	-9.5%	-1.0%

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. During this period of extreme volatility in the markets, style and capitalization leadership changed rapidly and often, i.e. for October, November and December the best performing groups were Large cap Growth, Large cap Value and Small cap Value, respectively.

We believe that sector moves continue to drive the performance of fundamentals, rather than fundamentals driving performance. The speculative rally that occurred in the October/November period drove the perverse performance of our Earnings model. Apart from the Insider model, the SAM models all exhibited somewhat random returns (no monotonic pattern) illustrating the frequent changes in investor sentiment and leadership that occurred during the quarter.

- The Earnings model, spread was -9.4%, a reversal of its strong Q3 performance. The primary driver of the negative spread was the speculative rally that occurred during October and November. During this period, investors appeared to disregard earnings as the performance of companies with negative earnings (i.e., companies that are losing money) outpaced the broader market.
- The Insider Transaction model spread was +2.6%. Investors continue to continue to focus on Insider transactions as a guide in their choice of stock purchases and sales.
- The OPT E/I model (Earnings and Insider Trading) spread was -5.4%, the positive Insider Transaction model performance was outweighed by the weak performance of the Earnings model.
- The DDM model was the best performing model +7.3% this is somewhat surprising given the speculative nature of the market during the first two months of the quarter. However, given the long-term dividend paying assumptions of the model, low priced stocks can rank highly.
- Our Cashflow model posted a +4.2% return for the quarter, however; all of the positive spread was gained in December when it appeared that investors' returned their focus to company fundamentals.
- Price momentum (our Technical model) is further evidence of the "rubbish rally" that occurred in the beaten up Technology and Telecom sectors. (Note: We do not use price momentum in our investment process.)
- The smallest stocks out-performed the largest by +1.0% for the quarter.

YTD, our models have all performed well. The Earnings model, +7.1% spread (the most heavily weighted factor in our process) has been the primary driver of portfolio performance. Insider Transactions remain a source of added value. The DDM and Cashflow models generated significant positive returns for the year.

Model Attribution: *Year to Date, 2002*

Quint	Opt E/I	Earnings	Insider	DDM	Cashflow	Technical	Size
5 (high)	-12.5%	-17.5%	-13.4%	-19.6%	-15.7%	-16.2%	-20.0%
4	-16.3%	-16.1%	-14.6%	-11.8%	-11.3%	-12.7%	-17.1%
3	-17.8%	-12.3%	-15.6%	-15.3%	-10.0%	-10.0%	-15.1%
2	-19.3%	-19.7%	-15.9%	-12.6%	-15.5%	-18.5%	-17.1%
1 (low)	-18.7%	-24.5%	-20.0%	-25.9%	-30.8%	-25.7%	-13.6%
Spread	6.2%	7.1%	6.7%	6.3%	15.1%	9.5%	-6.4%