

Market Data & Commentary:

Source: Vestek & Frank Russell

Index	Month	Q2'04	1 Yr
S&P 500	1.9%	1.7%	19.1%
Dow Jones Industrials	2.6%	1.3%	18.7%
NASDAQ	3.1%	2.7%	26.2%
S&P/BARRA Value	2.2%	0.8%	22.3%
S&P/BARRA Growth	1.7%	2.7%	16.0%
S&P 500 Equal-Weighted	3.0%	2.4%	29.4%
S&P 400 Midcap	2.3%	1.0%	28.0%
Russell 2000	4.2%	0.5%	33.4%

	Q2'04	YTD '04
Basic Materials	7.9%	9.5%
Capital Goods	7.8%	10.7%
Communication Svc	0.9%	3.8%
Consumer Cyclical	0.1%	5.6%
Consumer Staples	1.2%	5.4%
Energy	8.4%	16.4%
Financial	-0.9%	4.7%
Health Care	3.4%	11.7%
Technology	-1.4%	0.3%
Transportation	13.2%	8.4%
Utilities	-1.0%	2.4%

As we expected, the generally better than expected Q1 earnings results were not enough to spur the market higher in April. For the remainder of the quarter the three I's (Interest rates, IRAQ and Inflation/oil) were the key drivers of daily market performance/volatility. During May and June the markets meandered higher. The net result was that the major indices recorded positive results during the quarter: NASDAQ +2.7%, S&P 500 +1.7% and DJIA +1.3%. More specifically, a number of underlying factors drove the market's performance during the quarter-

- *Fed raises rates, at last.* As it became clear that the much-anticipated job growth had begun, focus shifted to the likely timing and size of the first Fed interest rate increase in four years. The answer was provided on the last day of the quarter when the Fed Funds rate was raised by +0.25% to 1.25%. Further increases are expected as the Fed moves rates to a more neutral position. In the release to announce the increase, the FOMC indicated that they continue to expect interest rates to move higher at a measured pace. The statement calmed investor fears of the need for a more rapid move higher.
- *Mixed style results.* Growth handily outperformed Value in the large and small cap areas, however; Value was the style winner in midcap. For the quarter, the S&P/BARRA Growth index out-performed its Value counterpart, returning +2.7% vs. +0.8%. Mid-cap Value outperformed Mid-cap Growth +1.2% vs. +0.8% and Small-cap Growth out-performed Small-cap Value +4.4% vs. +2.9%
- *Small-cap stocks outperform large-cap stocks, again.* Small-cap stocks had the edge on their large-cap counterparts. The equal-weighted S&P 500 index out-performed the cap-weighted version by +70 bps in the quarter (+2.4% vs. +1.7%) and now leads the cap-weighted index by a whopping +1,030 bps over the past 12 months (+29.4% vs. +19.1%). The equal-weighted index also dominates the cap-weighted index over the 2, 3, 4, 5 and 10-year time periods.
- *Corporate earnings expectations remain high.* We enter the Q2'04 EPS season with expectations for a +20% year over year increase in S&P 500 operating earnings. However, after another positive start to the quarterly EPS pre-announcement period, a number of recent negative pre-announcements have highlighted the difficulty that companies may have in meeting analysts' aggressive forecasts. This is especially the case in the Technology sector. With that in mind, it is likely that there will be a decrease in the percentage of companies reporting better than expected EPS from the above average level reached in Q1. For companies that are able to meet or beat quarterly expectations, the strength of their guidance will be a key driver of near term equity market performance. That said, with a high level of EPS growth already priced into the market it would take a significant earnings out performance to move equity markets higher, in our opinion. In addition, indications of EPS weakness should result in aggressive selling

For the quarter, Transportation, up +13.2% was the best performing sector. A large part of the strong performance was generated in June (+9.3%). The sector benefited from a reversal in oil prices, which began to move down from the record highs reached earlier in the quarter. Higher oil prices are viewed as an obstacle to the earnings leverage normally associated with a pickup in economic growth. Technology, down -1.2% was the worst performing sector. Investors continue to grapple with the outlook for growth, which is expected to slow as we move further in 2004 and into 2005 versus valuation levels.

Model Attribution: *Second Quarter, 2004*

Quint	Opt E/I	Earnings	Insider	DDM	Cashflow
5 (high)	2.1%	3.0%	2.2%	2.0%	2.0%
4	4.5%	3.6%	1.6%	3.2%	1.6%
3	2.0%	1.7%	3.2%	3.0%	2.3%
2	0.6%	0.1%	1.2%	0.9%	2.2%
1 (low)	1.6%	2.4%	2.6%	2.0%	2.9%
Spread	0.4%	0.6%	-0.5%	0.0%	-0.8%

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 for the quarter. All of the models exhibited a relatively non-monotonic pattern, which is indicative of sector and industry moves driving the model performance. In addition, monthly model spreads were volatile and lacked a clear pattern. Average quintile performance was 2.2%, inline with the performance of the market

Once again, the muted quarterly US equity index returns masked the underlying volatility that occurred at the sector and industry level. Throughout the quarter, the economy, the Federal Reserve, oil prices and IRAQ were all candidates for the daily headline that impacted the market. The result was a lack of conviction on the part of investors regarding the level and sustainability of the economic expansion and the related impact on inflation, corporate profits and the need for an interest rate increase by the Fed. This led to rotation in and out of economic and interest rate sensitive areas of the market throughout the quarter.

- The Earnings model spread was +0.6%. Although positive, the model performance was skewed downward by the substantial underperformance in April (driven by the outsized gains by Energy and Healthcare stocks with the weakest earnings score, quintile 1 as investors shifted out of interest rate and economically sensitive areas). Positive results in May and June overcame the April's drag.
- The Insider Transaction model spread was -0.5%. This model failed to gain any traction as investors appeared to be focused on other factors during the quarter. **We did see some let-up in the level of Insider selling during the quarter to a more Neutral position. However, the most recent data indicates a pickup in insider selling moving to a moderately bearish reading, which we believe to be a negative signal for the near-term performance of equities.**
- The OPT E/I model (Earnings and Insider Trading) spread was +0.4%. The positive performance of the Earnings model, which is the most heavily weighted model in our process, overcame the negative Insider model performance.
- In a reversal from recent quarters, our value models both recorded flat to negative performance: DDM 0.0% and Cashflow -0.8%. DDM monthly returns were volatile. After a relatively flat performance in April and May, the Cashflow model performance was negatively impacted in June by strong performance of Basic Materials and Capital Goods stocks with the weakest Cashflow score, quintile 1.

Year to date all of the Shenandoah models are adding value. However, apart from the Cashflow model, intra-quartile spreads lack a clear pattern (non-monotonic). The Earnings model, +1.4% (the most heavily weighted factor in our process) and the Insider Transaction model, +2.3% combined to provide an OPT E/I model spread of +2.6%. The valuation models have been the best performers; DDM spread of +3.1% and Cashflow model spread +5.7%.

Model Attribution: *YTD 2004*

Quint	Opt E/I	Earnings	Insider	DDM	Cashflow
5 (high)	7.6%	8.1%	8.0%	8.1%	8.6%
4	10.2%	8.8%	7.2%	8.8%	8.6%
3	7.8%	6.2%	8.2%	9.2%	7.0%
2	4.5%	5.2%	5.7%	4.3%	6.4%
1 (low)	5.0%	6.7%	5.7%	4.9%	2.9%
Spread	2.6%	1.4%	2.3%	3.1%	5.7%