Shenandoah Asset Management, LLC

Quarterly Review: March 31, 2005

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Market Data & Commentary:

Source: Vestek & Frank Russell

Index	Month	Q1'05	1 Yr
S&P 500	-1.8%	-2.2%	6.7%
Dow Jones Industrials	-2.3%	-2.1%	3.6%
NASDAQ	-2.6%	-8.1%	0.3%
S&P/BARRA Value	-1.8%	-2.4%	9.2%
S&P/BARRA Growth	-1.8%	-1.9%	4.1%
S&P 500 Equal-Weighted	-1.4%	-2.4%	10.3%
S&P 400 Midcap	-1.1%	-0.4%	10.4%
Russell 2000	-2.9%	-5.4%	5.4%

	Q1'05	1 Yr
Basic Materials	0.5%	26.5%
Capital Goods	-1.2%	18.2%
Communication Svc	-6.5%	2.7%
Consumer Cyclicals	-2.3%	8.1%
Consumer Staples	0.0%	10.6%
Energy	17.8%	50.9%
Financial	-6.1%	6.1%
Health Care	0.4%	8.9%
Technology	-8.3%	-4.9%
Transportation	-2.9%	32.9%
Utilities	2.4%	16.9%

Equity markets failed to build on the momentum developed in the latter part of 2004. Oil's march through $55 a barrel, concern that the FOMC may be required to raise rates at a faster than "measured pace" and the expected slowdown in corporate earnings growth all created a headwind for the markets. The net result was that the major indices all recorded negative results for the quarter: DJIA –2.1%, S&P 500 –2.2% and the NASDAQ –8.1%. More specifically, a number of underlying factors drove the market's performance during the quarter:

- ***Fed continued to raise rates.*** The Fed added a further +0.50% (two +0.25% increases) to the Fed Funds rate this quarter. The Funds rate ended the quarter at 2.75%. In the statement that accompanied the most recent increase, the FOMC noted its concern regarding higher levels of inflation creeping into the economy. This statement signaled that the Fed could be forced to raise interest rates more aggressively than the +25 bps "measured pace" of the past 7 rate increases. The result was heavy selling in the equity and bond markets. Recent economic data indicates that the US economy is beginning to slow. This raises the risk involved in a more aggressive interest rate move from the Fed. With that in mind, for now, markets have lowered the likelihood of an aggressive Fed move near-term.
- ***Growth outperforms Value?*** Growth was the clear winner across all market capitalization levels. For the quarter, the S&P/BARRA Growth index out-performed its Value counterpart, returning –1.9% vs. –2.4%, S&P/BARRA Mid-cap Growth outperformed Mid-cap Value –0.1% vs. –0.7%, and S&P/BARRA Small-cap Growth out-performed Small-cap Value –1.7% vs. –2.4%. Note: These results are in contrast to the Russell indices where Value outperformed Growth across all market capitalization levels during the period. The disparity is primarily due to sector weighting differences between the two sets of indices.
- ***Small-cap stocks under-performed Large-cap.*** The equal-weighted S&P 500 index under-performed the cap-weighted version by –20 bps in the quarter (-2.35% vs. –2.15%), however; the equal weighted index leads the cap-weighted index by +360 bps over the past 12 months (+10.3% vs. +6.7%). The equal-weighted index also dominates the cap-weighted index over the 2, 3, 4, 5 and 10-year time periods. Furthermore, the Russell 2000 (small) under-performed the S&P 500 (large) by –320 bps for the quarter.
- ***Corporate earnings outlook – where the economic rubber hits the road.*** The upcoming Q1'05 EPS reporting season should provide investors with an indication of how well "Corporate America" is dealing with the recent increases in the price of oil and interest rates. S&P 500 companies are expected to report high single digit year over year EPS growth (ex Energy this falls to mid-single digit growth). This is the first quarter since Q2'03 that the year over year growth estimate is below double digits. On that occasion the actual growth rate was closer to +10%. Clearly, we are in a different stage of the earnings cycle than we were in Q2'03. That said, the focus should be on the sustainability of EPS growth (even at this more moderate level) as we move further into 2005. This is especially important for sectors outside of the faster growing Energy and Materials sectors.

For the quarter, the increase in the price of oil was a key driver in the strength of the Energy sector, up +17.8%. This was the only sector to add significant value during the period. Technology, down –8.3% struggled to gain any traction under the weight of lower growth expectations. This quarter is indicative of the past 12 months - Energy, up +50.9% was the best performing sector while Technology, down –4.9% was the laggard.

Model Attribution: *First Quarter, 2005*

Quint	Opt E/I	Earnings	Insider	DDM	Cashflow
5 (high)	0.4%	-0.2%	-1.4%	-2.0%	2.3%
4	-0.6%	-1.0%	-1.9%	-1.0%	0.7%
3	-1.0%	-1.0%	0.5%	-0.4%	-1.6%
2	-2.7%	-1.0%	-0.9%	0.5%	-2.6%
1 (low)	-3.0%	-3.6%	-3.1%	-2.1%	-5.7%
Spread	***3.3%***	***3.5%***	***1.7%***	***0.1%***	***8.0%***

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

The Shenandoah models all posted positive spreads for the quarter. During this relatively volatile period, investors clearly rewarded companies with a strong current earnings outlook, supported by Insider buying and attractive valuations vs. companies with the opposite characteristics. The DDM model exhibited no clear inter-quintile pattern and appears to have been impacted by the sector and industry rotation that occurred during the quarter.

There was a large disparity between the performance of the Energy sector (+17.8%) vs. the Technology (-8.3%) and Financial sectors (-6.1%) during this period. This appears to have influenced, at least in part, the quintile performance and the strongest vs. weakest spreads of our models. The following is an overview of factors that influenced the performance of our models during the quarter.

- The Earnings model spread was +3.5%. Positive model performance in January and February was partly offset by weakness in March. During this period of negative market returns, companies with the strongest current earnings prospects (quintile 5) held up better than those ranked weakest (quintile 1).
- The Insider Transactions model spread was +1.7%. The Insider model benefited from the general underperformance of companies ranked weakest by this model (quintile 1). Interestingly, we noticed that, in general, Insiders failed to buy into the recent price weakness. In fact, **we saw a pickup in Insider selling during this period,** which is abnormal given that Insiders tend to buy price weakness. **We believe that this is a decidedly bearish signal for the near-term performance of equities**.
- The OPT E/I model (Earnings and Insider Transactions) spread was +3.3%. The positive performance of the Earnings model, which is the most heavily weighted model in our process, was dampened slightly when combined with the lower, although solid, Insider model performance.
- Our Value models both recorded positive results: Cashflow +8.0% and DDM +0.1%. Cashflow was the best performing model this quarter. The relative out-performance of Energy and Healthcare stocks ranked strongest by this model (quintile 5) vs. the general underperformance of stocks ranked weakest (quintile 1) drove the positive spread. The DDM model spread was essentially flat. The underperformance of Financial and Homebuilding companies ranked strongest (quintile 5) offset the underperformance of Technology companies ranked weakest (quintile 1).

All of the Shenandoah models have added value during the past 12 months. The Earnings model, +7.0% (the most heavily weighted factor in our process), and the Insider Transaction model, +6.5% combined to provide an OPT E/I model spread of +9.1%. The valuation models have been the best performers; Cashflow spread of +10.6% and DDM model spread +9.2%. The DDM and Cashflow models have exhibited the clearest inter-quintile spread pattern (monotonic).

Model Attribution: *One Year*

Quint	Opt E/I	Earnings	Insider	DDM	Cashflow
5 (high)	16.9%	17.1%	13.7%	15.8%	18.5%
4	16.1%	13.8%	14.1%	14.1%	12.7%
3	11.9%	10.2%	15.2%	12.6%	12.0%
2	9.0%	10.4%	11.4%	12.5%	11.1%
1 (low)	7.8%	10.1%	7.2%	6.6%	7.9%
Spread	***9.1%***	***7.0%***	***6.5%***	***9.2%***	***10.6%***