Shenandoah Asset Management, LLC

Quarterly Review: June 30, 2005

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Market Data & Commentary:

Source: Vestek & Frank Russell

Index	Month	Q2'05	1 Yr
S&P 500	0.1%	1.4%	6.3%
Dow Jones Industrials	-1.7%	-1.6%	0.7%
NASDAQ	-0.5%	2.9%	0.5%
S&P/BARRA Value	1.5%	2.6%	11.2%
S&P/BARRA Growth	-1.2%	0.1%	1.5%
S&P 500 Equal-Weighted	1.5%	3.1%	11.0%
S&P 400 Midcap	2.3%	4.3%	14.0%
Russell 2000	3.9%	4.3%	9.4%

Sector	Q2'05	YTD '05
Energy	6.4%	21.4%
Materials	-7.0%	-7.0%
Industrials	1.1%	-1.4%
Consumer Discretionary	3.3%	1.6%
Consumer Staples	1.6%	3.8%
Health Care	6.9%	6.1%
Financials	4.8%	-2.0%
Information Technology	1.6%	-7.3%
Telecommunications Servi	2.6%	-4.1%
Utilities	9.1%	11.9%

Equity markets struggled to gain any momentum during the quarter. The price of oil and interest rate expectations were the primary drivers of intra-quarter volatility. The price of oil remained stubbornly high, briefly breaking through $60 barrel in June and the FOMC continued to raise short-term interest rates at a “measured pace.” So far, the US economy has been able to shrug off the dampening effect of these two variables and record respectable growth. However, investors continue to be concerned that corporate earnings growth will come under pressure as we move into 2H’05 and 2006. The net result was that the major indices recorded mixed results for the quarter: DJIA –1.6%, S&P 500 +1.4% and the NASDAQ +2.9%. More specifically, a number of underlying factors drove the market’s performance during the quarter÷

- ***Fed stays on course.*** 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 3.25%. In June, a Fed Governor commented that he thought the Fed was in the eighth inning of its interest rate increases. This led the market to believe that the Fed was close to ending or at least taking a pause in its current round of increases. However, the official statement that accompanied the latest +0.25% bps increase on 6/30/05 included no signal that this was the case. The current consensus thinking has the Fed making two and possibly three more rate increases, which would leave the Funds rate at 3.75% to 4.0%, before taking a pause.
- ***Value back in style.*** Value was the clear winner across all market capitalization levels. That said, monthly spreads were volatile. The out-performance of growth stocks during the market rally in May was more than offset by their underperformance during the negative to flat market performance of April and June, respectively. For the quarter, the S&P/BARRA Value index out-performed its Growth counterpart, returning +2.6% vs. +0.1%, S&P/BARRA Mid-cap Value outperformed Mid-cap Growth +4.9% vs. +3.7%, and S&P/BARRA Small-cap Value out-performed Small-cap Growth +4.1% vs. +3.8%.
- ***Small-cap stocks out-performed Large-cap.*** The equal-weighted S&P 500 index out-performed the cap-weighted version by +170 bps in the quarter (+3.1% vs. +1.4%). Furthermore, the equal weighted index leads the cap-weighted index by +470 bps over the past 12 months (+11.0% vs. +6.3%). The equal-weighted index also dominates the cap-weighted index over the 2, 3, 4, 5 and 10-year time periods. In addition, the Russell 2000 (small) out-performed the S&P 500 (large) by +290 bps for the quarter.
- ***Corporate earnings outlook – is there any spark outside of the Energy sector?*** Q2’05 S&P 500 EPS growth is expected to be in the high single digits, down from the double digit growth that has been the norm since mid-2002. Also concerning investors is that ex Energy companies the expected growth rate falls even further. The lack of earnings growth in sectors outside of Energy has been a headwind for the equity market. With this in mind, absent a stellar reporting season for non-Energy companies, it appears unlikely that equity markets will move substantially higher without a sustainable easing in the price of oil and/or a signal that the FOMC is near the end of the current round of short term interest rate increases

For the quarter, the Utility sector, up +9.1% was the best performer, due in part to this sector managing to avoid the market downdraft that occurred in April. The Materials sector, down –7.0% was unable to overcome April’s weakness (-8.0%). Slowing economic growth around the world and a higher $US dampened enthusiasm for the sector. Year to date, Energy, up +21.4% is the best performing sector while Technology, down –7.3% is the laggard.

Model Attribution: *Second Quarter, 2005*

Quint	Opt E/I	Earnings	Insider	DDM	Cashflow
5 (high)	3.7%	2.6%	4.0%	3.7%	5.3%
4	2.8%	4.9%	3.4%	1.3%	4.5%
3	4.5%	3.0%	3.2%	2.2%	3.7%
2	3.0%	4.5%	3.4%	4.6%	1.7%
1 (low)	4.2%	3.2%	4.2%	4.6%	3.0%
Spread	***-0.5%***	***-0.5%***	***-0.2%***	***-0.9%***	***2.3%***

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 spreads for the quarter. Once again monthly market performance was volatile. The Cashflow model was the only model to record a positive spread, +3.9%. The OPT E/I, Earnings, Insider and DDM models reported negative spreads, although marginally so, and all models lacked a clear monotonic pattern. The performance of these models appears to have been muddied by the sector and industry rotation that occurred during the quarter.

There was a large disparity between the extremes of sector performance this quarter, i.e. Utilities (+9.1%), Healthcare (+6.9%) and Energy (+6.4%) vs. Materials (-7.0%). 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 -0.5%. This model failed to gain any traction during the quarter. Monthly spreads were only slightly positive or negative and there was a lack of differentiation in the performance of stocks with the strongest vs. the weakest current earnings prospects. Investors were clearly focused on other factors.
- The Insider Transactions model spread was -0.2%. Weakness in May, due primarily to the out-performance of stocks ranked weakest by this model (quintile 1) especially in the Industrial, Consumer Discretionary and Information Technology sectors offset the positive model spreads in April and June. Note: **Insider selling** moved back to a **decidedly bearish level** in June as insiders used May's market advance as a selling opportunity. **We believe that this is a negative signal for the near-term performance of equities**.
- The OPT E/I model (Earnings and Insider Transactions) spread was -0.5%. The negative performance of the Earnings model, which is the most heavily weighted model in our process, combined with the slightly negative Insider model performance.
- Our Value models recorded mixed results: Cashflow +2.3% was the best performing model. This model benefited from the out-performance of Energy stocks ranked strongest (quintile 5) vs. the underperformance of Materials and Information Technology stocks ranked weakest (quintile 1). The DDM model spread was -0.9%. Positive spreads in May and June were unable to overcome the large negative spread in April as Utility and Consumer Staples stocks ranked weakest by this model (quintile 1) outperformed during the market selloff.

The Shenandoah models have produced solid results YTD. The Earnings model, +3.0% (the most heavily weighted factor in our process), and the Insider Transaction model, +1.6% combined to provide an OPT E/I model spread of +3.0%. The valuation model spreads are mixed; Cashflow +10.6% and the DDM model spread -0.8%. The Cashflow model has exhibited the clearest inter-quintile spread pattern (monotonic) YTD.

Model Attribution: *Year to Date 2005*

Quint	Opt E/I	Earnings	Insider	DDM	Cashflow
5 (high)	4.0%	2.5%	2.5%	1.7%	7.7%
4	2.2%	3.8%	1.5%	0.3%	5.3%
3	3.5%	2.0%	3.6%	1.7%	2.1%
2	0.3%	3.4%	2.4%	5.1%	-0.9%
1 (low)	1.1%	-0.6%	1.0%	2.5%	-2.8%
Spread	***3.0%***	***3.0%***	***1.6%***	***-0.8%***	***10.6%***