Shenandoah Asset Management, LLC

Quarterly Review: September 30, 2005

121 Shockoe Slip
Richmond, VA 23219
(804) 343-1400
e-mail: bhill@samllc.com

Market Data & Commentary:

Source: Vestek & Frank Russell

Index	Month	Q3'05	1 Yr
S&P 500	0.8%	3.6%	12.3%
Dow Jones Industrials	0.9%	3.4%	7.2%
NASDAQ	0.0%	4.6%	13.4%
S&P/BARRA Value	1.0%	3.4%	13.8%
S&P/BARRA Growth	0.6%	3.8%	10.7%
S&P 500 Equal-Weighted	0.8%	4.8%	18.7%
S&P 400 Midcap	0.8%	4.9%	22.2%
Russell 2000	0.3%	4.7%	17.9%

	Q3'05	YTD '05
Energy	24.2%	50.8%
Materials	7.2%	-0.4%
Industrials	8.3%	6.8%
Consumer Discretionary	-4.3%	-2.7%
Consumer Staples	-0.3%	3.5%
Health Care	5.2%	11.6%
Financials	1.1%	-1.0%
Information Technology	6.0%	-1.7%
Telecommunications	5.5%	1.2%
Utilities	4.7%	17.1%

Equity markets began the quarter on a positive note. The stabilization of the price of oil, albeit at a relatively high level, and generally better than expected news on the economic and corporate earnings fronts were the key drivers. However, this early enthusiasm was dampened by a spike in the price of oil, peaking at $70+ a barrel, as hurricanes (Katrina and Rita) battered oil production and refining facilities in and around the Gulf of Mexico. The destruction and economic dislocation caused by the hurricanes increased the level of uncertainty regarding the outlook for the US economy and corporate earnings. That said, the equity market reaction was muted, which allowed the major indices to hold onto most of their early gains: DJIA +3.4%, S&P 500 +3.6% and the NASDAQ +4.6%. More specifically, a number of underlying factors drove the market's performance during the quarter:

•***The Fed remained on song.*** The Fed added a further +0.50% (two +0.25% increases) to the Fed Funds rate, which ended the quarter at 3.75%. The latest +25 bps increase occurred post Hurricane Katrina but prior to Hurricane Rita. The FOMC noted in its decision statement that that the economic impact of Katrina did "not pose a more persistent threat." With that in mind, the Fed signaled that it will continue to maintain its current "measured" pace of interest rate increases. This announcement was viewed negatively by the market, which had been expecting an indication that the latest round of monetary policy tightening was nearing an end.

▪***Value vs. Growth results mixed.*** In general, growth out-performed during the market rally in July, while value fared better in the negative to flat performance months of August and September. That said, there was no clear winner across all market capitalizations. Sector weighting, especially Energy and Consumer Discretionary, was likely a key driver of index performance. For the quarter, the S&P/BARRA Growth index out-performed its Value counterpart, returning +3.8% vs. +3.4%, S&P/BARRA Mid-cap Value outperformed Mid-cap Growth +5.4% vs. +4.4%, and S&P/BARRA Small-cap Growth out-performed Small-cap Value +6.6% vs. +4.2%.

▪***Small-cap stocks out-performed Large-cap.*** The equal-weighted S&P 500 index out-performed the cap-weighted version by +120 bps in the quarter (+4.8% vs. +3.6%). Furthermore, the equal weighted index leads the cap-weighted index by +640 bps over the past 12 months (+18.7% vs. +12.3%). 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 +110 bps for the quarter.

▪***Corporate earnings outlook – watch out for the kitchen sink.*** Q3'05 operating earnings for the S&P 500 are forecast to grow at a respectable 15% (y/y) clip. The Energy sector remains a key driver (EPS growth forecast in the 50%+ range). The negative impact of higher energy prices, the hurricanes and the slowing economy are expected to feature prominently throughout this quarter's reporting season. In fact, we have already seen a number of negative EPS pre-announcements related to the hurricanes and/or higher energy prices. With this in mind, investors should be on the lookout for companies that attempt to use the hurricanes as a scapegoat for poor corporate performance or as an opportunity to clean up their balance sheets. As always, close attention will be paid to company guidance for Q4'05 and FY 2006. Given the significant head winds that the market has faced year to date, positive news on oil prices and/or the economy could provide the catalyst for a year-end rally, in our opinion.

For the quarter, the Energy sector, up +24.2% was the best performer, due to higher prices of energy commodities. The Consumer Discretionary sector, down –4.3% bore the brunt of the expected economic slowdown caused by the three headed monster - higher oil prices, the negative impact of the hurricanes, and higher interest rates. Year to date, Energy, up +50.8% is the best performing sector while Consumer Discretionary, down -2.7% is the laggard.

Model Attribution: *Third Quarter, 2005*

Quint	Opt E/I	Earnings	Insider	DDM	Cashflow
5 (high)	8.5%	10.1%	4.1%	1.4%	6.8%
4	6.8%	5.9%	6.4%	2.6%	4.7%
3	4.4%	3.6%	4.9%	3.7%	4.5%
2	3.5%	2.9%	5.2%	5.9%	3.6%
1 (low)	0.6%	1.5%	3.3%	9.5%	4.2%
Spread	***7.8%***	***8.6%***	***0.9%***	***-8.2%***	***2.7%***

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

The majority of the Shenandoah models posted positive spreads for the quarter. The Earnings model, +8.6% and the OPT E/I model, +7.8% were the best performing models. The Cashflow and Insider models recorded solid positive spreads. The DDM model, -8.2% was the only model to record a negative spread for the quarter. The Earnings, OPT E/I and Cash flow models all exhibited a clear monotonic pattern. Although monotonic, the performance of the DDM model inter-quartile spreads were upside down, i.e. higher ranked stocks (quintiles 5 and 4) underperformed their weaker counterparts (quintiles 3,2 and 1).

The Energy sector was up +24.2% for the quarter vs. an average of +3.7% for the remaining sectors. With that in mind, it is not surprising that the ranking of Energy stocks vs. stocks in average or underperforming sectors such as Consumer Discretionary, down -4.7% and Consumer Staples, down -0.3% was a significant influence on the absolute and relative quintile and spread performance 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 +8.6%. Monthly spreads were driven by the out-performance of Energy stocks ranked strongest (quintile 5) by this model, especially during August and September vs. the under-performance of economically sensitive companies ranked weakest (quintile 1).

▪The Insider Transactions model spread was +0.9%. The majority of the positive spread came from the under-performance of Financial and Healthcare stocks ranked weakest (quintile 1) during the market rally in July. The Insider spread was essentially flat for the remainder of the quarter. Note: **Insider selling** moved back to a **decidedly bearish level** as insiders continued to be sellers of their company's stock (even during the period of market strength). **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 +7.8%. The significant positive performance of the Earnings model, which is the most heavily weighted model in our process, was dampened slightly when combined with the Insider model performance.

▪Our Value models recorded mixed results: Cashflow +2.7% and DDM -8.2%. The performance disparity was largely due to the out-performance of Energy stocks ranked strongest (quintile 5) vs. weakest (quintile 1) by the Cashflow and DDM models, respectively. In addition, the DDM model spread was negatively impacted by the general underperformance of stocks ranked strongest (quintile 5) by this model.

The Shenandoah models have produced mixed results YTD (note: the OPT E/I, Earnings and DMM model performance is largely influenced by the most recent quarter). The Earnings model, +11.9% (the most heavily weighted factor in our process), and the Insider Transaction model, +2.5% combined to provide an OPT E/I model spread of +11.1%. The valuation model spreads are significantly different; Cashflow +13.8% vs. DDM -9.2%. As we have noted earlier this is due, in part, to the ranking of Energy stocks by the valuation models. The OPT E/I, and Cashflow models have exhibited the clearest inter-quintile spread pattern (monotonic) YTD. The DDM model YTD inter-quintile spread pattern is "upside down."

Model Attribution: *Year to Date 2005*

Quint	Opt E/I	Earnings	Insider	DDM	Cashflow
5 (high)	12.9%	12.8%	6.8%	3.0%	15.0%
4	9.2%	9.9%	8.0%	2.9%	10.2%
3	8.1%	5.6%	8.7%	5.6%	6.7%
2	3.8%	6.5%	7.7%	11.2%	2.7%
1 (low)	1.7%	0.9%	4.2%	12.3%	1.2%
Spread	***11.1%***	***11.9%***	***2.5%***	***-9.2%***	***13.8%***