Shenandoah Asset Management, LLC

Quarterly Review: March 31, 2007

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

Market Data & Commentary:

Source: Vestek & Frank Russell

Index	Month	Q1'07	1 Yr
S&P 500	1.1%	0.6%	11.8%
Dow Jones Industrials	0.8%	-0.3%	13.8%
NASDAQ	0.2%	0.3%	3.5%
S&P/Citigroup Growth	0.9%	-0.1%	8.1%
S&P/Citigroup Value	1.3%	1.3%	15.6%
S&P 500 Equal-Weighted	0.7%	2.8%	12.5%
S&P 400 Midcap	1.4%	5.8%	8.5%
Russell 2000	1.1%	2.0%	5.9%

	Q1'07	1 Yr
Energy	7.4%	9.4%
Materials	10.1%	17.0%
Industrials	5.3%	5.9%
Consumer Discretionary	3.5%	9.0%
Consumer Staples	4.8%	14.8%
Health Care	5.2%	6.9%
Financials	-3.0%	3.4%
Information Technology	2.4%	1.4%
Telecommunications	-0.9%	15.5%
Utilities	5.6%	23.7%

Equity markets were unable to gain traction in either direction this quarter. The New Year got off to a slow start as investors locked in '06 profits, betting against a continued advance. As it turned out, the skepticism was warranted. There was little in the way of positive news to attract investors back into the market for more than brief periods. However, there were a number of factors that provided reasons for caution, i.e. a sharp slowdown in earnings growth, spotty economic reports and trouble overseas (a sell-off in the Chinese equity market and rising tension with Iran). These factors all worked to keep a lid on near-term enthusiasm for equities. Major equity index returns: DJIA -0.3%, NASDAQ +0.3% and the S&P 500 +0.6%. More specifically, a number of underlying factors drove the market's performance during the quarter:

▪***The Fed remained on hold, the direction of the next move remains uncertain.*** As expected, the FOMC chose to leave the Funds rate unchanged (5.25%) when it met in January and March. In the absence of a change in interest rates, in an effort to infer the direction of the Fed's inevitable next move, much attention was given to the language used in the FOMC's post meeting policy statements. Changes made to the March statement were interpreted by investors to mean that the Fed's next interest rate move was likely to be down, a sharp equity rally ensued. However, in the week following the FOMC meeting, during his testimony to Congress, Chairman Bernanke appeared to chide investors who had looked past comments made in the statement regarding the committee's continued concern with the level of inflation. Equities sold-off on this news.
▪***Style performance varied by cap range.*** For the quarter, the S&P/Citigroup Value index out-performed Growth, +1.3% vs. -0.1%, S&P/Citigroup Mid-cap Growth just out-performed Mid-cap Value +5.9% vs. +5.7, and S&P/Citigroup Small-cap Growth out-performed Value +4.3% vs. +2.2%. ***Note:*** Style performance was also inconsistent for the Russell indices that we monitor, Large cap flat, Mid-cap -Value out-performed Growth and Small-cap – Growth outperformed Value.
▪***Small-cap beats Large-cap, Mid-cap beats everyone.*** Small-cap equities outperformed Large cap. The equal-weighted S&P 500 index out-performed the cap-weighted version by +220 bps in the quarter (+2.8% vs. +0.6%). The equal weighted index also leads the cap-weighted index over the past 1, 2, 3, 4, 5 and 10-year time periods. The relative strength of small-cap stocks was also apparent in the Russell indices, i.e. the Russell 200 (large-cap) under-performed the Russell 2000 (small-cap index) by -200 bps. Small-cap Technology, Healthcare Industrials and Energy stocks significantly outperformed their large-cap counterparts. ***Note:*** The sweet spot of the equity market this quarter was the Mid-cap area. The S&P 400 Index outperformed the S&P 500 and S&P 600 by +520 bps and +260 bps, respectively. The relative out-performance of Mid-cap Financial, Consumer Discretionary and Industrial stocks accounted for the majority of the performance disparity.
▪***Sector performance was mixed.*** The Materials sector, up +10.1%, benefited from continued strong demand for commodities, especially in countries investing heavily in infrastructure such as China and India. The Financial sector, down -3.0%, was the laggard. The rising level of loan delinquencies, especially in the sub-prime segment, added to other issues affecting the sector, i.e. slowing loan growth and a narrowing net interest rate margin. The Thrift and Consumer Finance industries, due to their actual or perceived exposure to the sub-prime market, bore the brunt of the weakness. For the past 12 months, Utilities, up +23.7% helped by a mix of increasing demand, M&A activity and improved operating performance was the best performing sector. Technology, up +1.4% on slower growth expectations, was the worst performing sector.

Q1'07 EPS reporting season – how bad will it be? The reported S&P 500 index EPS growth for Q4'06 came in at +8.9%, slightly below expectations and below 10% for the first time in 19 quarters. The earnings slowdown is expected to continue for the first three quarters of 2007 (low to mid-single digits), before a sharp move upward in Q4'07 (+14.6%). A key driver of the Q1 and full year 2007 slowdown is a significant reduction in year/year EPS growth expectations for the Financial, Industrial, and Energy sectors, the later is expected to record negative year/year growth. With companies possibly stretching to meet EPS goals, investors should continue to be on the look out for signs of deteriorating earnings quality, in our opinion.

Model Attribution: *First Quarter 2007*

Quint	Opt E/I	Earnings	Insider	DDM	Cashflow
5 (high)	3.6%	3.9%	3.4%	4.9%	5.1%
4	3.9%	4.1%	5.0%	5.0%	4.8%
3	4.8%	3.9%	3.2%	3.2%	3.9%
2	3.0%	2.6%	3.5%	4.6%	1.3%
1 (low)	2.9%	3.6%	3.2%	3.5%	3.0%
Spread	***0.7%***	***0.3%***	***0.2%***	***1.4%***	***2.1%***

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, albeit slight in the case of the Earnings and Insider Transaction models, results for the quarter. Our valuation models, DDM and Cashflow recorded the highest spreads. It appears that, during this relatively volatile period, investors were focused on buying stocks with the most favorable valuation characteristics.

None of the Shenandoah models exhibited a clear positive monotonic pattern. This is indicative of sector and industry rotation muddying the performance of the model quintiles. The following is an overview of factors that influenced the performance of our models during the quarter.

▪***The Earnings model spread was +0.3%.*** The lack of a significant model spread for the quarter was due, in part, to the mixed intra-quarter performance of the model. Flat performance in January was followed by a negative spread in February. The February spread was negatively impacted by the confusion that followed the sharp equity market sell-off, in the last week of the month. However, as we moved into March investors began to focus on the upcoming Q1'07 EPS reporting season, rewarding companies with the strongest current earnings characteristics (quintile 5) over their weaker counterparts (quintile 1), resulting in positive model performance.

▪***The Insider Transactions model spread was +0.2%.*** Due to the high level of aggregate selling there are a relatively small number of companies ranked strongest (quintile 5) by this model. Therefore, the average performance of this quintile was more susceptible to significant moves by a relatively small number of stocks. With this in mind, the spread between the next strongest (quintile 4) vs. stocks ranked weakest (quintile 1), (+1.8%) may be a better indicator of the Insider model performance during Q1. **Note:** We saw a pickup in insider buying during the period surrounding the late February market sell-off. As a result the overall level of **Insider selling nudged into Neutral territory,** down for the record level reached at the end of Q4'06. That said, the current level of insider buying was not enough to reverse the **longer-term Bearish trend.**

▪***The OPT E/I model (Earnings and Insider Transactions) spread was +0.7%.*** When combined the positive performance of the Earnings model, which is the most heavily weighted model in our process, and the Insider transaction model improved modestly.

▪***Our Valuation models both recorded positive spreads: DDM (+1.4%) and Cashflow (+2.1%).*** Although our valuation models reported similar positive spreads for the quarter, monthly spread performance diverged. A primary driver of the intra-quarter performance differences was the ranking of outperforming Energy and Utility companies by the two models. On a relative basis, the Cashflow model ranked more Energy companies strongest (quintile 5) vs. the DDM model and the DDM model ranked more Utility companies weakest (quintile 1) vs. the Cashflow model.

During the past 12 months, the Shenandoah model results were mixed. The Earnings model, -4.2% (the most heavily weighted factor in our process), and the Insider Transaction model, +10.9% combined to provide an OPT E/I model spread of -0.1%. The DDM model was the best performing model, +12.1% primarily due to the out-performance of the stocks ranked strongest (quintile 5) by this model. The Cashflow model spread, +6.3% was dampened by the relative under-performance vs. the DDM model of stocks ranked strongest (quintile 5). The DDM model was the only model to exhibit a clear inter-quintile spread pattern (monotonic). The Insider and Cashflow model spreads were close to monotonic while the lumpy performance of the Earnings model quintiles is indicative of other factors, such as sector and industry rotation, overwhelming the model signal.

Model Attribution: *One Year*

Quint	Opt E/I	Earnings	Insider	DDM	Cashflow
5 (high)	8.1%	7.6%	12.6%	15.9%	11.2%
4	8.7%	6.3%	12.5%	13.2%	12.7%
3	12.3%	11.1%	9.2%	10.9%	11.4%
2	7.8%	8.2%	9.3%	7.8%	5.0%
1 (low)	8.1%	11.8%	1.8%	3.8%	4.9%
Spread	***-0.1%***	***-4.2%***	***10.9%***	***12.1%***	***6.3%***