



Shenandoah Asset Management, LLC

Quarterly Review: June 30, 2009

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Market Data & Commentary:

Source: Vestek & Frank Russell

Index	Month	Q2'09	1 Yr
Russell 3000	0.3%	16.8%	-26.6%
Russell Top 200	0.2%	14.9%	-25.1%
Russell Midcap	0.3%	20.8%	-30.4%
Russell 2000	1.5%	20.7%	-25.1%
Russell 3000 Growth	1.3%	16.8%	-24.5%
Russell 3000 Value	-0.7%	16.8%	-28.7%
Dow Jones Industrials	-0.4%	12.0%	-23.1%
NASDAQ Composite (Prc Chg)	3.4%	20.1%	-20.0%
S&P 500 Cap-Weighted	0.2%	15.9%	-26.2%

	Q2'09	1 Yr
Financials	32.0%	-37.7%
Industrials	20.2%	-35.9%
Information Technology	19.9%	-19.0%
Consumer Discretionary	19.0%	-18.5%
Materials	17.4%	-41.8%
Energy	12.0%	-44.0%
Utilities	11.8%	-29.9%
Consumer Staples	10.2%	-11.8%
Health Care	9.5%	-12.2%
Telecommunications	3.9%	-23.1%

Performance turnaround for equities! The market turnaround that began in March gained momentum in the second quarter. Helping to drive equities higher were a number of factors including: evidence that the worst of the financial and economic malaise may be over and relatively strong (albeit of a low base) Q1'09 EPS reports. Against this more optimistic outlook investors were willing to take on risk again. This change in attitude was captured in the characteristics of the stocks and sectors that showed the greatest gains in the early stages of the market turnaround, i.e. low priced (<\$5), small capitalization stocks with relatively weak current earnings expectations in cyclical and previously out of favor sectors (Financials) significantly outperformed stocks with opposite characteristics. Not surprisingly, given the considerable run-up in April and May, equities floundered in June as investors grew concerned that, while improving, near-term economic and business fundamentals may not be strong enough to propel the market higher. As a result, most indices ended June relatively flat vs. May but well above where they ended Q1. More specifically, a number of underlying factors drove the market's performance during the quarter:

- **The Fed has planted the seeds, now it must wait to see if the economy's so called "green shoots" can survive what could be a long hot summer.** Since the beginning of the financial and economic meltdowns the Federal Reserve has been considerably active regarding interest rate adjustments and the use of its balance sheet. With the consensus view now that the worst of the crisis is behind us, the Fed appears to be in a wait and see mode. Given the slack in the economy, apart from a recent spike in oil prices, the Fed believes that the risk of inflation remains low. Therefore, it's near-term focus will continue to be on promoting growth. With that in mind, it is unlikely that we will see an increase in the Fed Funds rate from its historically low level in the near future.
- **Value just beats Growth (ex small-cap) but continues to lag over the past 12 months.** For the quarter, the Russell 200 Value index out-performed Growth, +15.1% vs. +14.7%, Mid-cap Value out-performed Mid-cap Growth +20.9% vs. +20.7%, and Small-cap Growth out-performed Value +23.4% vs. 18.0%. The strong performance of the Technology and Financial sectors, more heavily weighted in the Growth and Value indices respectively, was an important driver of this quarter's style indices results. *Note:* For the S&P indices, Growth outperformed Value across all capitalization categories.
- **Everyone was a winner this quarter, however; small-cap stocks benefitted most from the considerable rally in equities.** The Russell 2000 (small) out-performed the Russell 200 (large) by +580 bps (+20.7% vs. +14.9%). However, mid-cap was the best performer +20.8%. This result is inline with our longer-term studies that show mid-cap outperforming (absolute and risk adjusted) large-cap and small-cap. *Note:* The S&P 600 (small) out-performed the S&P 500 (large) by +520 bps.
- **Financials and Cyclical out-performed the more defensive sectors of the market.** Financials, up +32.0%, were buoyed by a number of factors including, some better than expected EPS results and positive capital raising activities. As investors sought out riskier areas of the market, defensive sectors such as Telecom, up +3.9% and Healthcare, up +9.5% became less attractive on a relative basis. For the past 12 months, the more defensive Healthcare sector has held up relatively well, while the Energy and Financial sectors have been the laggards.
- **EPS outlook – will the recent increase in earnings momentum continue through the Q2'09 EPS reporting season?** While better than the disastrous results of Q4'08 it was clear that corporate profitability continued to struggle in Q1'09. However, as we suspected, investors appeared to look past the current results toward the earnings improvement expected to begin later in 2009 and continue into 2010. Even without the benefit of an economic tailwind, year/year earnings comparisons become considerably easier by Q4'09. Earnings momentum has improved recently. Although near-term index level EPS estimates continue to trickle lower, this is better than the sharp declines that we experienced in late 2008— early 2009. Heading into Q2'09, expectations are for S&P 500 earnings to decrease -17% (y/y), up from a -39% in Q1'09. Year/year improvement in the Financial and Consumer Discretionary (due to the removal of General Motors from the index) sectors will be more than offset by continued weakness in other areas of the economy such as the Energy and Materials sectors that were recording historically high profit levels a year ago. The late quarter equity market weakness is an indication that investors are concerned that, a) the late 2009 earnings recovery may not occur until 2010 and b) that the recovery is likely to be less robust than current forecasts.

Model Attribution: *Second Quarter 2009*

Quint	Opt E/I	Earnings	Insider	QV	Cashflow
5 (high)	40.3%	16.9%	45.7%	46.4%	45.9%
4	24.7%	24.4%	33.9%	34.2%	28.0%
3	25.8%	32.4%	35.6%	28.5%	23.0%
2	37.7%	41.1%	25.0%	20.3%	21.7%
1 (low)	27.8%	41.5%	16.7%	22.7%	34.3%
Spread	12.5%	-24.5%	29.1%	23.8%	11.6%

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

The Shenandoah models recorded significant but mixed results. All of the standalone models exhibited monotonic spread patterns, unfortunately the Earnings model was upside down, i.e. stocks with the weakest characteristics (quintile 1) outperformed stocks with the strongest characteristics, (quintile 5).

- **The Earnings model spread was -24.5%.** It is not too surprising, during a period when the economy is forecast to transition from recession to growth, to see companies with the weakest earnings characteristics (quintile 1) outperform companies with the strongest earnings characteristics (quintile 5). Companies with the weakest current earnings characteristics are often more leveraged to a turnaround in the operating environment than their stronger counterparts.
- **The Insider Transactions model spread was +29.1%.** After being unusually Bullish at March quarter-end, we saw a pick-up in insider selling as the market moved higher in April. It is considered normal to see the relative level of insider selling pick-up during a period of equity market strength. **Note:** By May insiders had moved to a more Neutral/Bearish position (indicating a pause in equity market increases) and remained there through the end of the quarter.
- **The OPT E/I model (Earnings and Insider Transactions) spread was +12.5%.** When combined the negative performance of the Earnings model, which is the most heavily weighted model in our process, was more than offset by the strong Insider model performance.
- **Our Valuation models both recorded significantly positive results: Cash flow +11.6% and QV +23.8%.** After a tough period (pre the March rally) for our valuation models, both models recorded positive spreads this quarter. The rotation out of, often overvalued, defensive sectors into the beaten down Cyclical and Financial sectors was a primary driver underlying the strong performance of the models.

Note: The Shenandoah investment process involves a proprietary quantitative algorithm. A company's raw model scores, along with a number of other variables, are combined to create a company specific "alpha score." The "alpha score" is used, along with other strategy specific factors, in the development of Shenandoah's portfolios. With this in mind, relative portfolio performance, positive or negative, may differ from the raw model Best vs. Worst spread performance discussed in this report.

Strategy	1 Month	3 Months	YTD	1Year	Since incep	AUM (\$ mill)	Inception
Midcap Composite (Gross)	1.1%	22.7%	8.0%	-30.4%	-2.7%	\$ 201.8	07/01/05
Midcap Composite (Net)	1.0%	22.6%	7.8%	-30.6%	-3.0%		
<i>Russell Midcap</i>	<i>0.3%</i>	<i>20.8%</i>	<i>9.9%</i>	<i>-30.4%</i>	<i>-4.0%</i>		
Large Value (Gross)	-0.1%	18.5%	-2.1%	-27.5%	-6.8%	\$ 11.7	02/01/06
Large Value (Net)	-0.1%	18.4%	-2.2%	-27.7%	-7.1%		
<i>Russell 1000 Value</i>	<i>-0.7%</i>	<i>16.7%</i>	<i>-2.9%</i>	<i>-29.0%</i>	<i>-9.1%</i>		
					Total Firm	\$ 216.6	

Performance Highlights:

- The Shenandoah strategies outperformed during a considerably strong quarter for equities. After a difficult April when benchmark performance was driven by the outperformance of low price, low quality stocks, we were able to add significant value as the rally broadened later in the quarter.
- Midcap strategy (gross) performance is inline with the Russell Midcap benchmark for the one year and +130 bps ahead since inception (annualized) periods.
- Large Value strategy (gross) is +150 bps ahead of the Russell 1000 Value benchmark for the one year and +230 bps since inception (annualized) periods.