



Shenandoah Asset Management, LLC

Quarterly Review: June 30, 2010

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Market Data & Commentary:

Source: Vestek & Frank Russell

Index	Month	Q2'10	1 Yr
Russell 3000	-5.8%	-11.3%	15.7%
Russell Top 200	-5.3%	-12.1%	11.6%
Russell Midcap	-6.3%	-9.9%	25.1%
Russell 2000	-7.8%	-9.9%	21.5%
Russell 3000 Growth	-5.6%	-11.6%	14.0%
Russell 3000 Value	-5.9%	-11.1%	17.6%
Dow Jones Industrials	-3.4%	-9.4%	18.9%
NASDAQ Composite (Prc Chg)	-6.6%	-12.0%	14.9%
S&P 500 Cap-Weighted	-5.2%	-11.4%	14.4%

	Q2'10	1 Yr
Utilities	-4.8%	1.8%
Telecommunications	-6.2%	1.5%
Consumer Staples	-9.2%	10.0%
Consumer Discretionary	-11.2%	27.4%
Health Care	-11.8%	8.1%
Information Technology	-12.4%	15.3%
Industrials	-12.6%	24.1%
Energy	-12.9%	1.5%
Financials	-13.8%	15.4%
Materials	-15.6%	14.5%

After a strong start, equities struggled! Strong Q1'10 EPS reports combined with generally better than expected (BTE) economic results to drive the equity market higher in April. However, economic data released in May and June failed to meet expectations. The optimistic interpretation of the recent data is that, while growth appears to have slowed, it remains well off its worst level and is unlikely to turn negative. The pessimistic view is that the economy will struggle to gain any positive traction near-term without continued (unsustainable) monetary and fiscal stimulus. Neither view provided a strong foundation for equity prices, which aside from a few relatively short periods of strength trended lower during this period. More specifically, a number of underlying factors drove the market's performance during the quarter:

- **The Fed remained on hold, continues to indicate that interest rates will remain low for an extended period.** The FOMC remains in a holding pattern and continues to state that it is likely to remain there for some time. Uncertainty surrounding the impact of the European debt crisis on U.S. economic and job growth, caused the FOMC to offer a more subdued assessment of the economy in its June statement. The lone dissenter in the vote to keep rates unchanged continues to be Kansas City President Thomas Hoenig. Mr. Hoenig believes that the Fed's language regarding the need to keep the funds rate at an exceptionally low level for an extended period of time could "increase risks to longer-run macroeconomic and financial stability." That said, for now based on its recent actions (or inaction) and statements, the FOMC (at least the majority of its members) appear more likely to err on the side of allowing the economy to overheat than risk it dipping back into negative growth.
- **Style results (Value vs. Growth) mixed.** For the quarter, the Russell 200 Value index out-performed Growth, -11.8% vs. -12.3%, Mid-cap Value out-performed Mid-cap Growth -9.6% vs. -10.2%, however; Small-cap Growth out-performed Value -9.2% vs. -10.6%. Concentration of relative outperforming and underperforming sectors within the style indices, i.e. Value indices overweight in Financials, Utilities and Telecom vs. Growth indices overweight in Technology, Consumer Discretionary and Healthcare largely offset one another this quarter. **Note:** For the S&P indices, Growth outperformed Value across the board. This result highlights the sector weighting differences between the Russell and S&P indices.
- **Small and Mid-cap indices outperformed Large-cap.** The relative strength of the smaller cap indices during April's rally more than offset their relative weakness during the May/June sell-off. The Russell 2000 (small) out-performed the Russell 200 (large) by +220 bps (-9.9% vs. -12.1%). The mid-cap index performance (-9.9%) was inline with the small-cap index. Our longer-term studies 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 +270 bps.
- **Defensive sectors held up better than their more economically sensitive counterparts!** While lagging the broad market since the equity market rally began in March '09, defensive sectors such as Utilities (-4.8%), Telecom (-6.2%) and Consumer Staples (-9.2%) were relative outperformers during this period of equity market weakness. Sectors heavily reliant on economic growth to fuel their earnings and stock prices, i.e., Materials (-15.6%) and Energy (-12.9%), struggled. For the past 12 months, the Consumer Discretionary sector (+27.4%) has been the best performer. The Telecommunications (+1.5%) and Energy (+1.5%) sectors have been the laggards.

Equity Market Outlook— Shenandoah does not attempt to time the market in any way. We do, however, maintain a forward looking view of the stock market in the context of our models. The outlook of our Discounted Cash Flow (DCF) and Earnings models remains bullish but less so than earlier in the year. Only a slight improvement in valuation attractiveness during the equity market sell-off is indicative of a deterioration in corporate economic profitability and/or the earnings growth outlook. It appears that investors are beginning to question, at least for now, the aggressive 2010 year/year growth expectations. Once again, Insiders proved prescient having shifted to a more bearish position by the end of April, just ahead of the equity market sell-off. However, as the market continued to fall, the view of Insiders became more constructive on the outlook for equities. By quarter end, the Insider transaction model had moved to a Neutral reading. **In summary**, while our models remain positively biased, the near-term direction of equities will rely heavily on the strength of Q2 EPS results/guidance.

Model Attribution: *Second Quarter 2010*

Quint	Opt E/I	Earnings	Insider	QE	Cashflow
5 (high)	-11.4%	-11.4%	-9.1%	-12.4%	-9.6%
4	-10.6%	-11.1%	-10.8%	-10.6%	-10.6%
3	-9.6%	-9.3%	-10.3%	-8.0%	-11.5%
2	-10.0%	-10.0%	-9.7%	-10.0%	-9.9%
1 (low)	-10.4%	-10.2%	-11.9%	-12.7%	-11.5%
Spread	-1.0%	-1.3%	2.8%	0.4%	1.9%

Note: "Spread" is the difference between the returns of the high (5) and low (1) quintiles by each model/measure. QE is a combination quantitative model that adds growth, profitability and capital use factors to the quantitative value (QV) model

The Shenandoah models recorded mixed results. Earnings (-) and Insider (+) combined for a negative OPT E/I model spread. The performance of the QE (-) and Cash flow (+) models reflected the relative underperformance of companies more reliant on growth to justify their stock prices. The lack of monotonic inter-quintile model spread patterns and the lack of significant Best (quintile 5) vs. Worst (quintile 1) performance spreads are indicative of macro level factors, more than company fundamentals, driving performance during the periods of speculation and despair that occurred during the quarter.

- **The Earnings model spread was -1.3%.** Our Earnings model continues to do an outstanding job of identifying companies most likely to report a quarterly earnings surprise. For the Q1'10 EPS reporting season, approximately 80% of companies ranked Best (quintile 5) reported a positive EPS surprise vs. 65% of companies ranked Worst (quintile 1). However, sector and/or industry concentrations muddied the effect of reported EPS results on average quintile performance.
- **The Insider Transactions model spread was +2.8%.** Once again, Insiders proved prescient having shifted to a more bearish position by the end of April, just ahead of the market meltdown. However, as the market continued to fall, the view of Insiders became more constructive on the outlook for equities. By quarter end, the Insider model had moved to a Neutral reading.
- **The OPT E/I model (Earnings and Insider Transactions) spread was -1.0%.** When combined, the negative performance of the Earnings model more than offset the positive Insider model performance.
- **QE model spread—(+0.4%).** The "lumpy" inter-quintile spread pattern was due, in part, to the concentration of companies in relatively outperforming/underperforming sectors and industries within the universe along with a number of "style" (Growth vs. Value) shifts that impacted performance during the quarter.
- **Valuation model spread - Cash flow (+1.9%).** companies considered to have a larger "margin of safety", i.e. percentage of undervaluation vs. the model's estimate of intrinsic value (ranked Best—quintile 5) outperformed companies considered to be trading above their estimated intrinsic value (ranked Worst—quintile 1).

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	3Year	Since incep	AUM (\$ mill)	Inception
Midcap Composite (Gross)	-6.9%	-11.3%	-3.8%	21.6%	-8.4%	1.7%	\$ 243.5	07/01/05
Midcap Composite (Net)	-6.9%	-11.4%	-3.9%	21.2%	-8.7%	1.4%		
<i>Russell Midcap</i>	<i>-6.3%</i>	<i>-9.9%</i>	<i>-2.1%</i>	<i>25.1%</i>	<i>-8.2%</i>	<i>1.2%</i>		
Large Value (Gross)	-6.4%	-11.7%	-4.5%	17.3%	-10.3%	-1.8%	\$ 10.4	02/01/06
Large Value (Net)	-6.5%	-11.7%	-4.7%	16.9%	-10.6%	-2.2%		
<i>Russell 1000 Value</i>	<i>-5.6%</i>	<i>-11.1%</i>	<i>-5.1%</i>	<i>16.9%</i>	<i>-12.3%</i>	<i>-3.8%</i>		
							Total Firm	\$ 257.9

Performance Highlights:

- The Shenandoah Midcap and Large Value strategies reported results that were below their respective benchmarks for the quarter. Both strategies were unable to keep up with benchmark returns during April's equity market rally. Relative performance improved in May and June.
- Midcap strategy (gross) performance is -350 bps behind and +50 bps ahead of the Russell Midcap benchmark for the one year and since inception (annualized) periods, respectively.
- Large Value strategy (gross) is +40 bps and +200 bps ahead of the Russell 1000 Value benchmark for the one year and since inception (annualized) periods, respectively.