

Shenandoah Asset Management, LLC

Quarterly Review: September 30, 2008

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Market Data & Commentary:

Source: Vestek & Frank Russell

Index	Month	Q3'08	1 Yr
Russell 3000	-9.4%	-8.7%	-21.5%
Russell Top 200	-8.4%	-7.9%	-22.0%
Russell Midcap	-12.3%	-12.9%	-22.4%
Russell 2000	-7.9%	-1.1%	-14.5%
Russell 3000 Growth	-11.6%	-11.9%	-20.6%
Russell 3000 Value	-7.1%	-5.3%	-22.7%
Dow Jones Industrials	-5.8%	-3.7%	-19.9%
NASDAQ Composite (Prc Chg)	-12.1%	-9.2%	-22.9%
S&P 500 Cap-Weighted	-8.9%	-8.4%	-22.0%

	Q3'08	1 Yr
Consumer Staples	3.5%	-3.0%
Financials	1.2%	-38.3%
Health Care	0.3%	-13.1%
Consumer Discretionary	-2.8%	-27.0%
Industrials	-11.1%	-26.6%
Information Technology	-12.5%	-23.8%
Telecommunications	-16.2%	-36.2%
Utilities	-19.8%	-18.4%
Materials	-25.4%	-23.5%
Energy	-27.0%	-15.5%

▪ **Equities struggled to gain any positive traction.** It was a volatile quarter, again! Stock prices vacillated as the equity market struggled to incorporate upbeat sentiment about falling oil prices against concerns regarding weak credit markets and the economy. That said by quarter's end the "Bears" were firmly in control. The markets muddled through July and August. Significant daily +/- volatility during this period essentially netted to flat overall performance. A number of events negatively impacted equity market performance in September. Not even drastic action taken on the part of the Federal Reserve, Treasury Department and Congress, some of which have not been used since the Great Depression, was enough to stabilize markets. More specifically, a number of underlying factors drove the market's performance during the quarter:

▪ **The Fed was kept busy trying to put out credit related fires.** The Fed chose to keep interest rates on hold at its two meetings this quarter. Lower oil and other commodity prices along with the negative impact of the credit crisis on non-financial company growth, combined to reduce the near-term risk of inflation. However, the escalation in credit related issues kept the Fed busy, primarily in September. In addition to its efforts to add liquidity to the frozen credit market, the Fed was involved in number of other market supporting activities including support of the Treasury's \$700 billion credit relief package. While it may prefer to stay on hold, continued sluggish economic activity would likely force the Fed to lower interest rates at some time prior to year-end, more likely sooner rather than later, in our opinion.

▪ **The relative out-performance of the Financial sector helped Value outperform Growth across all cap ranges.** For the quarter, the Russell 200 Value index out-performed Growth, -5.5% vs. -10.0%, Mid-cap Value out-performed Mid-cap Growth -7.5% vs. -17.5%, and Small-cap Value out-performed Growth +5.0% vs. -6.9%. The relative weighting of the out-performing Financial sector, which is heavily over-weighted in the Value indices vs. its weight in the Growth indices, was a primary driver of style index performance differences. **Note:** Value was also the dominant style for the S&P indices.

▪ **Small-cap equities outperformed Large-cap, again.** The Russell 2000 (small) out-performed the Russell 200 (Large) by +680 bps (-1.1% vs. -7.9%). This somewhat unusual result was likely due, in part, to the forced selling of larger more liquid stocks to fund investor redemptions. In addition, the small cap index benefited from its relative underweighting/overweighting vs. the Russell 200 index in the relative underperforming/outperforming Energy and Financial sectors. **Note:** The S&P 600 (small) out-performed the S&P 500 (large) by +710 bps for the quarter.

▪ **Not surprisingly "defensive" sectors outperformed during this period of market weakness.** The Consumer Staple sector, +3.5%, due in part to its classification as a "defensive" sector was the best performing sector this quarter. The Energy sector, down -27.0%, was the focus of a sharp sell-off as slowing economic growth sent the price of oil toward \$100 per barrel, down from \$150. For the past 12 months, Consumer Staples, down -3.0%, has held up relatively well. Financials showed some signs of improvement in Q3, however; the sector remains the laggard over the past 12 months, down -38.3%.

▪ **EPS outlook – expectations continue to fall.** As we expected, analysts have continued to ratchet down their EPS growth forecasts for 2008 (negative mid-single digits now expected for SP500 vs. positive mid-teens earlier in the year). Q3'08 year/year (y/y) growth is forecast register its fifth consecutive quarter of negative growth. Significant weakness in the Financial sector, and to a lesser extent Consumer Discretionary sector earnings, continue to be the primary drivers of negative revisions. However, due to the sharp decrease in oil and non oil commodities and expectations of a slowdown in economic growth are likely to place downward pressure on non-financial company earnings growth as we head into Q4'08. Earnings forecasts for the next few quarters continue assume that sectors, like Energy and Technology, while cooling somewhat, will continue to provide a solid base upon which the expected improvement in the Financial and Consumer Discretionary sectors will build. Assuming that analysts' prefer to be guided by the companies they follow, it is unlikely that we will see any significant adjustments to Q4'08 and FY'09 estimates until companies begin to report Q3 results. Therefore, given that conditions have only worsened recently, the risk continues to be that current expectations will prove far too optimistic. The \$64,000 question - has the expected slowdown in earnings already been factored into stock prices?

Model Attribution: Third Quarter 2008

Quint	Opt E/I	Earnings	Insider	QV	Cashflow
5 (high)	-18.0%	-22.3%	-5.9%	-5.8%	-19.0%
4	-10.0%	-10.0%	-10.5%	-5.8%	-12.7%
3	-9.2%	-8.7%	-10.1%	-7.5%	-7.1%
2	-5.9%	-4.8%	-11.0%	-10.9%	-4.6%
1 (low)	-5.4%	-2.2%	-11.4%	-21.5%	-7.6%
Spread	-12.7%	-20.1%	5.4%	15.7%	-11.4%

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. In a dramatic reversal from Q2'08 spread performance, the QV and Insider models both posted positive spreads while the spreads for the Earnings and Cashflow models were negative. We believe that the large disparity in sector performance, along with sector concentrations within model quintiles, impacted this quarter's raw model spread results, especially in the model tails

▪**The Earnings model spread was -20.1%.** The raw Earnings model logged the worst model spread performance this quarter. The monotonic inter-quintile spread pattern indicates that investors appeared to be differentiating between companies with the best/worst current earnings characteristics. Unfortunately, stocks with the best characteristics (quintile 5) underperformed stocks with the weakest characteristics (quintile 1).

▪**The Insider Transactions model spread was +5.4%.** Insiders remain positive regarding the outlook for the Financial and Consumer Discretionary sectors, which were relative out-performers this quarter. **Note:** Insiders have been aggressive buyers during periods of market weakness. However; they maintained their Neutral position during the late September sell-off. The lack of enthusiasm on the part of insiders is considered Bearish for the general direction of equity markets, in our opinion

▪**The OPT E/I model (Earnings and Insider Transactions) spread was -12.7%.** The negative performance of the Earnings model, which is the most heavily weighted model in our process, was partly offset by the positive Insider model performance.

▪**Our Valuation models recorded disparate results: QV +15.7% and Cashflow -11.4%.** The models' differing opinion on the relative attractiveness of sectors such as Energy, Healthcare, Financials and Consumer Discretionary was an important factor in the significant performance difference in the raw model spreads of our valuation 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.

Product Performance

Strategy	1 Month	3 Months	YTD	1Year	Since incep	AUM (\$ mill)	Inception
Midcap Composite (Gross)	-12.1%	-12.8%	-17.5%	-19.9%	3.6%	\$ 255.1	07/01/05
Midcap Composite (Net)	-12.2%	-12.8%	-17.7%	-20.2%	3.3%		
<i>Russell Midcap</i>	<i>-12.3%</i>	<i>-12.9%</i>	<i>-19.5%</i>	<i>-22.4%</i>	<i>1.9%</i>		
Large Value (Gross)	-8.5%	-7.5%	-17.0%	-21.6%	0.1%	\$ 14.9	02/01/06
Large Value (Net)	-8.5%	-7.6%	-17.2%	-21.9%	-0.3%		
<i>Russell 1000 Value</i>	<i>-7.4%</i>	<i>-6.1%</i>	<i>-18.9%</i>	<i>-23.6%</i>	<i>-1.8%</i>		
130/30 (Gross)	-13.1%	-14.2%	-20.6%	-24.8%	-20.9%	\$ 9.3	06/01/07
130/30 (Net)	-13.2%	-14.4%	-21.2%	-25.5%	-21.7%		
Russell 1000	-9.5%	-9.3%	-19.5%	-22.1%	-17.1%		
					Total Firm	\$ 283.2	

Performance Highlights:

- Against a volatile backdrop, the Shenandoah strategies reported mixed relative performance this quarter.
- Midcap strategy (gross) is +250 bps ahead of the Russell Midcap benchmark for the one year and +170 bps ahead since inception (annualized) periods.
- Large Value strategy (gross) is +200 bps ahead of the Russell 1000 Value benchmark for the one year and +190 bps since inception (annualized) periods.
- After a period of strong performance through 06/30/08, the 130/30 Alpha Extension strategy under-performed this quarter.