



Shenandoah Asset Management, LLC

Quarterly Review: December 31, 2008

121 Shockoe Slip
Richmond, VA 23219
(804) 343-1400
cmclennan@samllc.com

Market Data & Commentary:

Index	Month	Q4'08	1 Yr
Russell 3000	1.9%	-22.8%	-37.3%
Russell Top 200	0.7%	-20.6%	-36.1%
Russell Midcap	4.3%	-27.3%	-41.5%
Russell 2000	5.8%	-26.1%	-33.8%
Russell 3000 Growth	2.1%	-23.2%	-38.5%
Russell 3000 Value	1.8%	-22.4%	-36.3%
Dow Jones Industrials	-0.4%	-18.5%	-32.0%
NASDAQ Composite (Prc Chg)	2.7%	-24.3%	-40.5%
S&P 500 Cap-Weighted	1.1%	-21.9%	-37.0%

	Q4'08	1 Yr
Telecommunications	-5.9%	-35.5%
Utilities	-11.8%	-32.0%
Consumer Staples	-13.7%	-18.7%
Health Care	-13.8%	-24.5%
Energy	-23.1%	-38.0%
Industrials	-24.6%	-42.1%
Consumer Discretionary	-25.0%	-38.6%
Information Technology	-25.7%	-43.2%
Materials	-32.3%	-48.6%
Financials	-35.7%	-53.8%

It was a disastrous quarter for equities! Any hope that September's weakness would provide a buying opportunity was quickly dashed as equity markets moved sharply lower in October and into November. A record setting late November rally and generally positive results in December helped to offset some of the early quarter damage. Daily performance volatility continued. Intra-day performance swings greater than +/- 5% were not uncommon with some reaching +/- 10%. Factors driving equity markets lower included but were not limited to, the continuing credit crisis, the economic malaise impacting the global economy and forced selling by investment funds as investors rushed to cash. More specifically, a number of underlying factors drove the market's performance during the quarter:

- **The Fed continued in its efforts to stabilize the ailing financial system and return the economy to growth.** Likely hoping that its previous monetary policy activities would begin to bear fruit and concerned about the risk of inflation, the Fed had kept the Funds rate steady at 2% since late April. However, the Fed's hand was forced in early October, as equity markets around the world spiraled out of control. By quarter – end the Funds rate target had been lowered to a range of 0% to 0.25% , a –1.75% to –2.0% decrease. In addition to its monetary policy activities the Fed continued to work in concert with the U.S. Treasury and central bankers around the world in an effort to calm investors and increase corporate and individuals access to credit. With the Funds rate essentially at 0% the next move will be up, although it is unlikely that will occur any time soon.
- **No real winners, however; on a relative basis Value held up slightly better than Growth.** For the quarter, the Russell 200 Value index out-performed Growth, -20.2% vs. –21.0%, Mid-cap Value out-performed Mid-cap Growth -27.2% vs. –27.4%, and Small-cap Value out-performed Growth -24.9% vs. –27.5%. The lack of any significant performance disparity between the Value and Growth indices this quarter is indicative of the breadth of the market weakness, i.e. the relative sector weighting differences between the indices was less. **Note:** For the S&P indices Value outperformed Growth in all but Large-cap.
- **Not too surprisingly, given the negative market performance, Large-cap outperformed mid and small-cap equities.** The Russell 200 (large) out-performed the Russell 2000 (small) by +550 bps (-20.6% vs. –26.1%). During this period of significant turmoil, investors appear to have sought the relative safety (and dividends) of larger cap stocks. **Note:** The S&P 500 (large) out-performed the S&P 600 (large) by +330 bps for the quarter.
- **Defensive and “dividend rich” sectors significantly outperformed on a relative basis.** The four horsemen of defensive investing Telecom, Utilities, Consumer Staples and Healthcare were by far the best performing sectors this quarter. The Financial sector, down -35.7%, remains in a state of flux as once industry titans such as Citigroup and Merrill Lynch have been forced into the arms of the government or more stable competitors. For the year, Consumer Staples, down –18.7%, held up relatively well. Financials, down –53.8%, apart from some sign/hope of improvement in Q3, was unable to gain any traction this year.
- **EPS outlook – have we reached the bottom yet!** As the financial and economic crisis has deepened we have seen a sharp decrease in corporate earnings growth expectations. As recently as early December, the consensus Q4'08 growth estimate for S&P 500 index earnings was close to +15%. By year-end the estimate had fallen to the low to mid single digits. In addition to continued weakness in the Financial and Consumer Discretionary sectors, demand and price destruction has resulted in the ratcheting down of expectations for the once high flying Energy and Materials sectors. Given the negative tone of recent company pre-announcements, we expect that Q4'08 growth has further to fall. The outlook for 2009 earnings growth, while down from earlier in the year, is forecast at 20%+. While noting that this forecast is off a relatively weak 2008 base, if achieved 2009 S&P 500 earnings (dollar basis) would be inline with 2007 and less than 10% below 2006's record level. With that in mind, at least 1H'09 estimates will likely need to be lowered further, in our opinion. That said, it is important to note that the consensus estimate often misses the tipping point in earnings growth, up or down. Therefore, it is likely that early signs of an improvement in corporate earnings growth, when it does occur, will likely be lost in the negativity of the consensus.

Model Attribution: *Fourth Quarter 2008*

Quint	Opt E/I	Earnings	Insider	QV	Cashflow
5 (high)	-24.7%	-25.2%	-27.7%	-28.5%	-31.6%
4	-25.4%	-23.3%	-29.5%	-27.2%	-25.5%
3	-26.6%	-26.7%	-27.3%	-26.7%	-28.3%
2	-31.9%	-30.4%	-25.2%	-24.4%	-20.6%
1 (low)	-28.7%	-31.5%	-27.6%	-31.8%	-28.6%
Spread	4.0%	6.3%	-0.1%	3.3%	-3.0%

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

The Shenandoah models recorded mixed results. The relatively narrow absolute model spreads and -27% average quintile performance are indicative of the breadth of the equity market weakness.

- **The Earnings model spread was +6.3%.** As it became evident that corporate earnings estimates remained too high, companies and analysts were forced to dramatically lower their earnings outlooks. The result was a significant increase in the number of stocks ranked worst (quintile 1) by the earnings model and the relative underperformance of these stocks as their prices were also adjusted downward.
- **The Insider Transactions model spread was -0.1%.** The insider model reported modestly negative spread results during the October/November sell-off. However, insiders were rewarded in December when stocks with the most attractive insider transaction characteristics (quintile 5) outperformed. **Note:** For now insiders appear to have moved to the sidelines. Insider selling picked up into the year-end rally moving our Insider **model into neutral territory.** That said the recent move was not large enough to shift the model to a bearish reading. Therefore, for now, the longer-term bullish trend remains in place.
- **The OPT E/I model (Earnings and Insider Transactions) spread was +4.0%.** When combined the positive performance of the Earnings model, which is the most heavily weighted model in our process, was partly offset by slightly negative Insider model performance.
- **Our Valuation models recorded disparate results: QV +3.3% and Cashflow -3.0%.** Somewhat surprisingly, given the equity market weakness, our valuation model inter-quintile spread performance was mostly upside down (ex Q1 the QV model spread was negative). This result is likely due, in part, to a rotation out of Financials and economically sensitive sectors, i.e. Energy and Materials and into "defensive" sectors, i.e. Utilities, Consumer Staples and Healthcare with little regard to current valuation.

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)	6.8%	-26.1%	-39.0%	-39.0%	-5.2%	\$ 188.1	07/01/05
Midcap Composite (Net)	6.7%	-26.2%	-39.2%	-39.2%	-5.5%		
<i>Russell Midcap</i>	4.3%	-27.3%	-41.5%	-41.5%	-7.1%		
Large Value (Gross)	3.0%	-19.9%	-33.5%	-33.5%	-7.3%	\$ 11.9	02/01/06
Large Value (Net)	3.0%	-20.0%	-33.8%	-33.8%	-7.6%		
<i>Russell 1000 Value</i>	1.4%	-22.2%	-36.9%	-36.9%	-9.7%		
130/30 (Gross)	4.0%	-24.2%	-39.8%	-39.8%	-31.0%	\$ 7.1	06/01/07
130/30 (Net)	3.9%	-24.4%	-40.4%	-40.4%	-31.7%		
Russell 1000	1.6%	-22.5%	-37.6%	-37.6%	-27.3%		
					Total Firm	\$ 210.0	

Performance Highlights:

- The Shenandoah Long-only strategies reported strong relative performance this quarter.
- Midcap strategy (gross) is +250 bps ahead of the Russell Midcap benchmark for the one year and +190 bps ahead since inception (annualized) periods.
- Large Value strategy (gross) is +340 bps ahead of the Russell 1000 Value benchmark for the one year and +240 bps since inception (annualized) periods.
- After a period of strong performance through mid-year, the 130/30 Alpha Extension strategy has under-performed recently.