Market Update

Evergreen Investments™

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September 21, 2009 | *An Investment Strategy Newsletter*

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Market Performance

Where is the much anticipated September Swoon? Thankfully, it has thus far failed to materialize as the equity markets have continued to climb higher this month, led by emerging markets and small cap stocks. The gains have been broad based, with all the major equity market indexes climbing for the month and adding to their year-to-date (YTD) gains. From a style perspective, while growth has outperformed value YTD, value has the edge over growth for the month, quarter, and since the market bottomed last March. Given concerns about federal spending and Treasury debt issuance, the yield on the 10-year Treasury has backed up a bit for the month. Yet demand for municipal and corporate debt has remained solid. The prices for gold and oil have continued to climb as the dollar remained weak. See Chart 1 for more details of Market Performance.

Equities – Technicals vs. Fundamentals

The "technicals" for the equity market (as defined by the S&P 500 Index) continue to strengthen. Indeed, earlier this summer the S&P 500 crossed above its 200-day moving average (DMA), a development which was soon followed by the 50-day moving average exceeding the 200-DMA, providing the market with further upside momentum. In addition, the market managed to hold its 200-DMA (880) in July, potentially establishing an all-important "higher-low" after the depths achieved last March. These technical gains were further enhanced in recent weeks as trends for both volume and breadth (# of advancing issues vs. # of declining issues) also improved. Earlier this month, the index managed to close above 1015, resulting in a technically significant 38% retracement of the losses from the market's high (1565) in October 2007 to the lows (666) of March, 2009. See Chart 2.

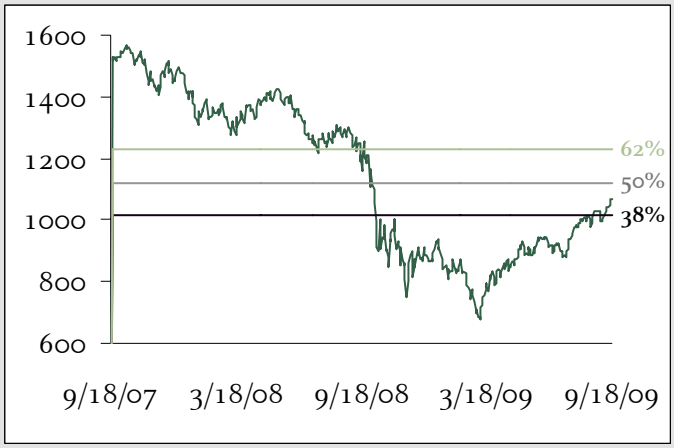
Given these developments, historical chart patterns suggest the possibility of a 50% retracement, which would bring the index up to the 1120 range. Other technical factors (Moving Average Convergence Divergence, Relative Strength) also indicate positive momentum, which may be enhanced by the more than $3.5 trillion sitting in money market funds, earning next-to-nothing for investors. If just 10% of these funds came back into equities, that could provide the market with several more percentage points in upside potential. Moreover, as the Federal Reserve plans to end its Treasury purchase program at the end of October, investors who have "parked" money in lower yielding government securities may also choose to enter the equity market before year-end.

1. Market Performance as of 9/18/09

EQUITIES	9/18/09 LEVEL	MTD TOTAL RETURN	YTD TOTAL RETURN
Dow Jones Industrials	9,820.20	3.5	14.9
S&P 500	1,068.30	4.8	20.6
NASDAQ	2,132.86	6.2	36.5
Russell 2000	617.88	8.1	25.1
S&P MidCap	701.53	7.3	32.4
Russell 1000 Growth	467.90	4.8	28.0
Russell 1000 Value	555.59	5.5	16.8
MSCI EAFE	1,571.51	4.9	31.3
MSCI (Emerging Markets)	918.90	9.6	65.2
FIXED INCOME	**9/18/09 LEVEL**	**MTD TOTAL RETURN**	**YTD TOTAL RETURN**
10-Year Treasury	3.47	-0.4	-7.8
Barclays Aggregate	3.71	0.4	5.0
Barclays Municipal	3.48	2.5	12.8
Barclays Corporate	4.94	1.0	16.2
Barclays High Yield	10.56	4.6	47.5
Barclays Mortgage	4.05	0.4	4.8
Barclays Global ex. US	2.29	1.9	5.6
COMMODITIES & CURRENCIES	**9/18/09 LEVEL**	**MTD TOTAL RETURN**	**YTD TOTAL RETURN**
CRB Index	380.9	-0.1	20.9
Crude Oil - WTI	72.04	3.0	73.0
Gold	1,010.30	6.0	13.3
Trade Weighted Dollar	76.67	-2.0	-5.9

Source: Factset, Bloomberg.
*Total Return includes price appreciation & dividend income for equities. Past performance is not indicative of future results. It is not possible to invest directly in an index.

2. S&P 500 & Retracement Levels



Source: Bloomberg & Strategas RP

Considering the potential for just a small percentage of these money market and Treasury investors to re-enter the stock market, a move above 1120 (50% retracement) would bring the NEXT traditional technical trend, a 62% retracement, into play. A move of this magnitude could potentially take the index slightly above the 1200 level – an area we would have considered highly improbable just a few short months ago. Yet monetary and fiscal authorities have created unprecedented conditions for improvements in liquidity, a very successful endeavor, and all these dollars have to find a home. Since it only took one month for the S&P 500 Index to decline from 1200 to 900 in the autumn of 2008, little-to-no technical resistance exists on the path to 1200.

Of course, this is the technical case for a rise in equities. While most investors concern themselves with fears of market "meltdowns," we are beginning to be consumed by the potential for a market "melt-up." From our perspective, the market's technicals are significantly stronger than the fundamentals supporting the economy and corporate profits. In just the past week investors were reminded that we remain in a deflationary environment and that consumer credit contracted last month at a rate that was five times greater than projections. Economic growth is likely to jump by more than +3.0% this quarter, yet a bulk of the gains are likely to come from a resumption of auto production and additions to already depleted business inventories. Any consumption gains are likely to be the result of incentives (Cash for Clunkers) and export growth continues to be buoyed by the weak dollar. Though government spending and trade can add to output, we continue to view them as "cushions" for growth. Data on housing and employment have registered readings that are "less bad" but remain a far cry, in our opinion, from "good." Until we see a floor in housing and a ceiling on the unemployment rate, we suspect the "catalysts for growth," personal consumption and business investment, will remain lackluster, resulting in a "less-spectacular" economic recovery in 2010.

Consequently, we continue to believe that consensus projections for corporate profit growth of up to +35% in 2010 are too high. Given the improved cost structure relative to wages, interest, and commodities (as well as the improved mark-to-market accounting rules for the financial services sector) we raised our profit estimates last month by approximately 10% for 2009 ($55.00) and 2010 ($65.00) . Yet businesses can't cut costs forever, and at some point revenue growth is a necessity to justify valuations for a market that is already trading at a P/E ratio of 16-17 times our 2010 forecast. For the S&P to climb higher on a *sustainable* basis, we must see an improvement in longer term fundamentals (sales, housing, credit, employment and corporate profits) to accompany the market's many technical developments. As we progress through the next year, we believe these fundamental strengths will prove critical to the market's success as investors will likely be forced to contend with the potential for higher inflation, taxes, and market interest rates.

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John is a Managing Director and Chief Market Analyst for Evergreen Investments. A member of the firm's Investment Strategy Committee, John uses a top-down, macro-economic approach in his analysis of the financial markets. He has been featured in various media outlets, including CNBC, BusinessWeek, CNN-Money, Bloomberg News and The Wall Street Journal.