Market Update

Evergreen Investments™

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Market Performance

Persistent economic weakness, plunging corporate profits, and uncertainty regarding the federal response to the financial crisis caused stocks to plummet last month, as the Dow Jones Industrial Average suffered its worst February since 1933. The major equity indexes finished the month at their lowest levels in more than a decade and are now down approximately -50% from their peak in October 2007. Equities of all sizes and shapes struggled, with the largest losses experienced in the small cap and value indexes. International markets were also punished as economic data from developed and emerging countries surprised to the downside. In the fixed income markets, only the municipal and mortgage indexes managed slight gains. Most commodities weakened while oil, gold and the dollar rose last month. See Chart 1 for more details of Market Performance.

Earnings Review

The rapid deterioration in fourth quarter economic activity, both domestic and global, has resulted in a massive drop in corporate profitability. Indeed, at the beginning of the fourth quarter, consensus estimates suggested an EPS gain for the S&P 500 Index in excess of +45% from the same period in 2007, which was already weak as the housing crisis began to fully impact profits in the financial services sector. As the fourth quarter 2008 progressed, and into the first quarter of 2009, corporate guidance weakened further and analysts slashed profit estimates, pushing the consensus forecast to an estimated decline of -45% for the quarter. See Chart 2.

Considering the larger than expected hits to corporate profitability (AIG, FNM, & GM) that were not included in this forecasted data, it now appears operating earnings for the S&P 500 Index declined much worse than these increasingly dire consensus projections for the fourth quarter. To be sure, the Financial Services sector was once again the largest detractor in the index's decline in profitability, followed by Materials and Consumer Cyclicals. The rapid decline in profits was astonishing, considering our call on the recession last March and our profit projections that were more than $30 below Wall Street consensus for 2008 and 2009. Indeed, what seemed to be aggressive caution has now proved too sanguine. As the final tallies are reported in the coming weeks, fourth quarter earnings may drop by as much as -65%, bringing EPS down -33% for 2008. See Chart 3.

Consequently, as we work off this dramatically lower base, and factor in continued economic weakness in the coming months, we are bringing down our S&P 500 operating earnings estimate to $50.00 in 2009. Moreover, we suspect the entire earnings model for the index will be dramatically altered in the years to come for several reasons. Perhaps most important, the financial sector has lost almost $2 trillion in market capitalization over the past 18 months. To be sure, it was this size that contributed approximately 20% of the index's weight, and

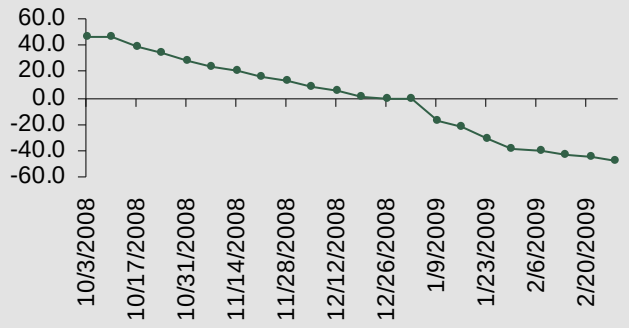
1. Market Performance as of 2/27/09

EQUITIES	2/27/09 LEVEL	FEB TOTAL RETURN	YTD TOTAL RETURN
Dow Jones Industrials	7,062.93	-11.2	-18.9
S&P 500	735.09	-10.6	-18.2
NASDAQ	1,377.84	-6.7	-12.6
Russell 2000	389.02	-12.2	-21.9
S&P MidCap	449.44	-9.7	-16.2
Russell 1000 Growth	325.77	-7.5	-12.0
Russell 1000 Value	370.74	-13.4	-23.3
MSCI EAFE	997.65	-10.3	-19.1
MSCI (Emerging Markets)	499.30	-5.6	-11.7
FIXED INCOME	**2/27/09 YIELD**	**FEB TOTAL RETURN**	**YTD TOTAL RETURN**
10-Year Treasury	3.04	-1.3	-5.8
Barclays Aggregate	4.62	-0.4	-1.3
Barclays Municipal	4.10	0.5	4.2
Barclays Corporate	7.70	-2.0	-1.5
Barclays High Yield	19.05	-3.1	2.7
Barclays Mortgage	4.60	0.6	0.8
Barclays Global ex. US	2.31	-4.0	-8.4
COMMODITIES & CURRENCIES	**2/27/09 LEVEL**	**FEB TOTAL RETURN**	**YTD TOTAL RETURN**
CRB Index	211.57	-4.0	-7.8
Crude Oil - WTI	44.76	7.4	0.4
Gold	942.50	1.5	6.6
Trade Weighted Dollar	88.15	2.0	7.3

Source: Factset, Bloomberg, Lehman Brothers, Evergreen Investments.
*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. 4Q08 Consensus EPS



Source: Thompson Reuters and Strategas Research Partners

through the use of leverage, allowed the sector to contribute up to one-third of the S&P 500's profitability through 2007. Yet as the financial sector weakened, the index has gone from what was once leveraged financial leadership to non-leveraged, non-financial leadership. Another issue is that given the global scope of the crisis, corporate profits are likely to remain under pressure in the coming year as once favorable currency translations and international demand levels turn negative. Furthermore, the extreme equity market weakness has resulted in an increase in under-funded pensions, the result of which is expected to be higher pension costs for businesses going forward. Finally, declines in share buybacks and dividend payouts may also alter total returns for investors going forward.

Unfortunately, these fundamental issues have collided with another major technical breakdown in the S&P 500, which closed trading in February (735) below the lows achieved last November (742). This major violation in technical support suggests the next floor for the market hovers in the 670 region, a level last achieved in August, 1996. Assuming a recessionary/deflationary market P/E multiple of 12x-13x our $50 estimate for 2009 could bring 600-650 into play, as the market attempts to find a bottom in this unprecedented economic and financial crisis. It should be noted, though, that trough earnings and trough multiples rarely coincide, particularly during periods of exceptionally low interest rates and low/no inflation. Furthermore, the lagged effects of innovative monetary and fiscal policy measures may result in signs of improved demand as the year progresses, especially if the mortgage foreclosure relief plan works as advertised and sufficient details emerge on the proposed public-private partnership to remove distressed assets from bank balance sheets. Considering the potential for these developments, investors may 'bid-up" prospects for recovery later this year and into 2010. Improved demand and early signs of pricing power may result in a market willing to pay as much as 16x-17x earnings, for a potential new upper end of the trading range into the 800-850 area.

3. S&P 500 Index Quarterly EPS

	2008		2009	
	$	%	$	%
Q1	$16.60	-25%	$10.25	-38%
Q2	$17.00	-29%	$11.25	-34%
Q3	$16.00	-23%	$13.75	-14%
Q4	$5.40	-65%	$14.75	173%
Full Year	$55.00	-33%	$50.00	-9%

Source: Strategas Research Partners and Evergreen Investments

It is important to remember that plenty of cash remains on the "sidelines" with a market that is willing to pay 33x to earn less than 3% on 10-year Treasuries, $4 trillion is sitting in money markets (more than 40% of equity market capitalization), and up to $500 billion in private equity is waiting to take advantage of red-tag sales with 50% discounts on Price to Sales, Price to Book Value and Price to Cash Flow. In addition, history has shown that any time the economy has contracted by four percentage points or more, the S&P 500 Index has climbed by 25%, on average, twelve months after the nadir in output, justifying the possibility for a move through the top end of our trading range later this year.

ABOUT THE AUTHOR

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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.