Market Update

Evergreen Investments™

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Market Performance

Where are the dog days of summer? Thankfully, they failed to arrive during the first half of the third quarter as the financial markets continued to perform well. The major equity indexes have all generated healthy gains this quarter, although the pace of their climb has moderated in early August trading, where performance leadership has come from mid-caps, value, and developed markets. While the government bond market has been skittish given concerns about significant Treasury issuance, demand has remained solid at the Treasury auctions. Investor appetites also persist for corporate bonds, as investment grade and high yield issues continue to build on their year-to-date gains. Though the price of oil has dropped this summer, commodities have largely benefited from signs of global recovery as the dollar has tried to stabilize. See Chart 1 for more details of Market Performance.

U.S. Economy

The markets continue to rally on economic data that is simply "less bad" than previous experiences. The transition to "good" data, however, remains elusive.

- Non-farm Payrolls declined by 247,000 last month as the unemployment rate, in a statistical anomaly, ticked down to 9.4%. More than 6.7 million jobs have been lost since the recession began in December, 2007. Given the lagging nature of this indictor, we expect the unemployment rate to exceed 10% heading into next year.
- Retail Sales fell by -0.1% last month and when excluding for the rebound in autos, sales declined by an even more disturbing -0.6% rate. Consistent with our outlook, this report suggests the lack of consumer firepower to propel output sustainably higher by anything other than below trend growth over the next year.
- The lack of consumer demand has been evident in inflation readings. The Consumer Price Index was unchanged last month, but remains down by -2.1% from July of 2008, the weakest annual reading in almost 60 years. Falling home prices and a rising unemployment rate are the foundations of our projection for a "less than spectacular" economic recovery.

But we expect it to be a recovery, nonetheless. The combination of government spending, an inventory re-build and improved trade (due to the weaker currency) should enable output in the coming quarters (+ 2.5%) to compare favorably with the depths of the recession. Indeed, it appears the Federal Reserve shares this assessment, as monetary policymakers adjusted the wording of their most recent policy statement from economic activity that is "slowing" to merely "leveling out."

1. Market Performance as of 8/14/09

EQUITIES	8/14/09 LEVEL	MTD TOTAL RETURN	YTD TOTAL RETURN
Dow Jones Industrials	9,321.40	1.8	8.5
S&P 500	1,004.09	1.8	13.0
NASDAQ	1,985.52	0.4	25.9
Russell 2000	563.90	1.3	14.0
S&P MidCap	645.99	2.9	21.4
Russell 1000 Growth	441.27	0.7	20.2
Russell 1000 Value	518.05	3.3	8.5
MSCI EAFE	1,458.43	2.4	20.7
MSCI (Emerging Markets)	852.74	1.1	53.0
FIXED INCOME	**8/14/09 LEVEL**	**MTD TOTAL RETURN**	**YTD TOTAL RETURN**
10-Year Treasury	3.56	-0.4	-8.6
Barclays Aggregate	3.90	0.3	3.8
Barclays Municipal	3.87	0.5	8.8
Barclays Corporate	5.24	0.6	13.7
Barclays High Yield	11.31	1.6	40.5
Barclays Mortgage	4.25	0.1	3.9
Barclays Global ex. US	2.33	0.7	2.2
COMMODITIES & CURRENCIES	**8/14/09 LEVEL**	**MTD TOTAL RETURN**	**YTD TOTAL RETURN**
CRB Index	257.75	0.1	12.3
Crude Oil - WTI	67.51	-2.8	51.4
Gold	948.70	-0.7	7.3
Trade Weighted Dollar	79.01	0.7	-3.8

Source: Factset, Bloomberg, Barclays, 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.

Equity Review

The equity markets have surged throughout the summer months as second quarter earnings failed to meet dire expectations. The trend for the vast majority of companies has been to exceed projections from an earnings standpoint, while failing to achieve top-line forecasts. The lack of revenue gains suggest that businesses have been able to dramatically cut costs, particularly wages, as the recession deepened and the unemployment rate escalated. In addition, accommodative monetary policy has helped lower interest expense and the 50% drop in oil prices from this time last year has also contributed to lower input/commodity costs for many businesses.

2. Second Quarter Operating Earnings

Sector	Q208	Q209	Y/Y %
Consumer Discretionary	$1.68	$2.86	71%
Consumer Staples	$4.27	$4.55	7%
Energy	$13.54	$4.57	-66%
Financials	($1.05)	$1.13	NM*
Health Care	$6.34	$6.61	4%
Industrials	$5.97	$3.71	-38%
Info Technology	$4.56	$3.70	-19%
Materials	$4.73	$1.66	-65%
Telecom Services	$2.25	$1.88	-16%
Utilities	$2.67	$2.52	-6%
S&P 500	$17.02	$13.94	-18%

Source: Standard & Poor's, Evergreen Investments
* NM - Not meaningful due to negative Y/Y comparison

According to Standard & Poors, second quarter operating earnings for companies in the S&P 500 Index declined by -18% from the same period last year. See Chart 2. It should be noted that given the dramatic changes in the makeup of the index as a result of the financial crisis, the reported loss is not a direct comparison. For example, changes in the automobile industry have skewed results for the Consumer Discretionary sector while the carnage in the banking and brokerage businesses have altered the dynamics within the financial services industry. However, given S&P's strict adherence to the rules defining profits from operations, we believe the total dollar amount of profits remains a solid foundation from which future profit growth forecasts can be calculated.

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 are raising our profit estimates by approximately 10% for 2009 and 2010. See Chart 3. Yet businesses can't cut costs forever, and at some point revenue growth is a necessity for a sustainable expansion. Given our projections for below trend growth (a less than spectacular recovery) it should be noted that our profit estimates for 2010 are approximately 10% lower than consensus.

3. S&P 500 Quarterly Earnings

	2009		2010	
	$	%	$	%
Q1	$ 10.10	-39%	$ 14.70	45%
Q2	$ 13.90	-18%	$ 15.90	14%
Q3	$ 14.50	-9%	$ 16.80	16%
Q4	$ 15.60	NM*	$ 18.20	17%
Full Year	$ 54.10	9%	$ 65.60	21%

Source: Standard & Poor's, Evergreen Investments
* NM - Not meaningful due to negative Y/Y comparison

Considering the market's recent technical achievements (highlighted in the Market Update 8.5.09) as well as the large sums of cash on the sidelines, a move to the 1050-1100 range for the S&P 500 Index is not out of the question over the next several months. Support appears sturdiest at the 930 (50-DMA) and 880 (200-DMA) levels. Yet the market is already trading at a P/E ratio of 16-17 times forward-four quarter earnings projections, and for the S&P to climb higher on a sustainable basis, we must see an improvement in longer term fundamentals, such as sustainable revenue trends, to accompany the market's technical developments.

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.