Market Update

Evergreen Investments™

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Market Performance

The combination of a slowing economy and a frozen credit market has pummeled equities in the first several trading days of the fourth quarter. The Dow Jones Industrial Average has fallen for seven consecutive days for a stunning 21% decline. Over the past year, the world's leading market measure has fallen by almost 40% from its record high. Moreover, the total U.S. equity market capitalization has plunged by $2.5 trillion over the past seven days and by more than $8 trillion over the past year. Investors are obviously skeptical about the steps taken by the Federal Reserve, the U.S. Treasury, foreign governments and foreign central banks to address the financial crisis. Consequently, money has poured into the perceived safe haven of U.S. Treasuries. See Chart 1 for more details of Market Performance as of 10/09/08.

Policy Response

The U.S. Treasury and the Federal Reserve Bank have led an unprecedented global response to what could prove to be the worst financial crisis in history. Fannie Mae, Freddie Mac, Lehman Brothers, Merrill Lynch, AIG, Washington Mutual, and Wachovia have all been seemingly placed as footnotes to history as the Federal Reserve has virtually doubled its balance sheet in recent weeks. Indeed, the Fed has been extraordinarily innovative in expanding is balance sheet, opening its discount window to both depository and non-depository institutions and accepting a variety of collateral over a variety of time periods for these loans. In addition, the central bank will now enter the commercial paper market, essentially lending directly to U.S. corporations. These steps were strengthened with this week's coordinated, 50-basis point reduction in global, overnight lending rates. The U.S. Treasury will lead the way for the $700 billion Troubled Asset Relief Program (TARP) in an attempt to establish a market for illiquid, mortgage-related securities. Treasury is also considering purchasing preferred shares in financial institutions in order to inject capital directly onto bank balance sheets.

One paragraph does not do justice to the enormity of the aforementioned actions taken to shore up confidence and to combat this financial crisis. We apologize if we've forgotten to address any other major changes! The past month has been historic and indicates a complete transformation going forward for both Wall Street and the U.S. economy. The "financial crisis in slow motion" persists, moving in stages from housing, to bank earnings, to the current credit crisis. Indeed, it looks like the consumer is next on the hit parade, particularly since the seizure in the credit markets may have profound economic consequences through the next year. Perhaps this is best illustrated by

1. Market Performance as of 10/09/08

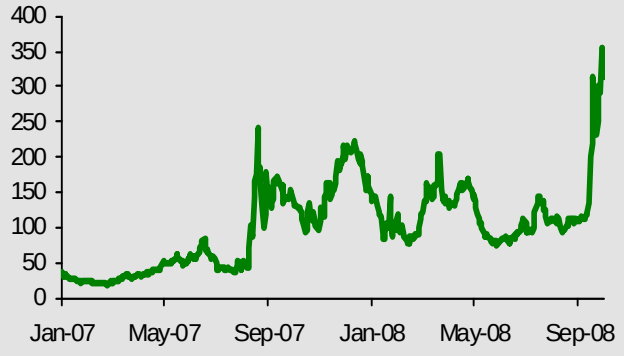
EQUITIES	10/09/08 LEVEL	MTD TOTAL RETURN	YTD TOTAL RETURN
Dow Jones Industrials	8,579.19	-20.8	-34.0
S&P 500	909.92	-21.9	-37.0
NASDAQ	1,645.12	-21.4	-38.0
Russell 2000	499.20	-26.5	-34.1
S&P MidCap	548.70	-24.5	-35.4
Russell 1000 Growth	381.56	-21.0	-37.0
Russell 1000 Value	482.08	-23.6	-38.0
MSCI EAFE	1,321.18	-14.9	-39.8
MSCI (Emerging Markets)	618.90	-21.3	-49.3
FIXED INCOME	**10/09/08 YIELD**	**MTD TOTAL RETURN**	**YTD TOTAL RETURN**
10-Year Treasury	3.84	0.0	4.5
Lehman Aggregate	5.43	-0.9	-0.3
Lehman Municipal	4.87	-1.2	-4.4
Lehman Corporate	8.38	-3.0	-11.4
Lehman High Yield	16.63	-9.8	-18.9
Lehman Mortgage	5.57	-0.3	3.5
Lehman Global ex. US	2.97	0.8	1.6
COMMODITIES & CURRENCIES	**10/09/08 LEVEL**	**MTD TOTAL RETURN**	**YTD TOTAL RETURN**
CRB Index	310.53	-9.5	-13.4
Crude Oil - WTI	86.59	-14.0	-9.8
Gold	886.50	0.6	6.2
Trade Weighted Dollar	81.37	2.5	6.1

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.

Libor, which continues to suggest an unwillingness of banks to lend to one another. If they're not going to lend to each other, they're certainty not going to lend to the rest of us. See Chart 2.

2. Three Month LIBOR less 90-day Treasury



Source: Strategas Research Partners

Cyclical Bull in a Secular Bear?

At what price is all this doom and gloom factored into the markets? Indeed, at 900, the S&P 500 is trading at a P/E ratio of just 9x next year's consensus earnings estimate. As a reminder, given our early call on the recession last March, we remain more than $25 below the average estimate on Wall Street for 2009. If earnings fall to our projection of just $75 next year, the market is currently valued at just 12x operating EPS for 2009, a level that has previously fully discounted recessions. In addition to the P/E ratio, the market is also cheap relative to the historical averages for Price to Book Value (currently 2.0 vs. LT average of 2.5) and Price to Sales (currently 1.0 vs. LT avg. of 1.5). From a technical standpoint, sentiment indicators show extremely weak levels as the market, as measured by the S&P 500 Index, is approximately 20% below its 200-day moving average. See Chart 3.

Moreover, plenty of cash remains on the sidelines with $500 billion in private equity, $3 trillion in sovereign wealth funds, and $3.5 trillion in money market funds. Indeed, the total of money market funds as a percentage of total equity market capitalization is approaching 30%, an all-time high. As a result, we suspect the market is setting up for a powerful, "Cyclical Bull Rally" off these extreme lows. The enticing combination of government intervention, sentiment, valuation and technical extremes may prove too much of an opportunity for investors, who collectively may tap into the huge cash positions to force stocks higher, potentially in excess of 20% from current levels.

3. S&P 500 Index vs. 200 DMA

Source: Baseline

We refer to this as a "Cyclical Bull Rally" because it appears the longer-term, or secular, bear market, unfortunately, remains intact. The economy has likely slipped into contraction this quarter and weakness may persist through 2009 as the absence of credit, weak housing and rising unemployment do battle with unprecedented government support. Yet we remind investors that the stock market typically bottoms six months before the economy and that the average bear market lasts approximately 15 months and falls by one-third. Given these parameters, we may already be there relative to duration and magnitude. It is also important to remember that it is always darkest before dawn. While October gets a bad rap with some of the worst trading days in history, the month has also been the launching pad for some of the greatest bull markets in history. The typical bull market lasts four years and climbs by approximately 125% with a gain of +15% in the first three months and +30% in the first twelve months. If investors choose to wait it out and miss the critical early stages of the bull, though, the power of compounding will prove insufficient to match market gains during the four-year period. Yet another argument for "time-in," rather than "timing," the market!

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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.