Market Update

Evergreen Investments™

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Market Performance

The equity markets continued to struggle in November, pushed lower by a combination of poor economic data, questionable earnings forecasts, and investor uncertainty about evolving plans to combat the credit crisis. Equities of all shapes and sizes were pummeled during the month, even as returns were masked by an 18% rally during the last five trading days of the month. Unfortunately, up to two-thirds of that rally was lost on the first trading day in December. U.S. Treasuries were once again the beneficiary of all the equity market tumult, as a massive flight to quality pushed yields of all government maturities lower for the month. Historically wide spreads narrowed for many investment grade corporates, mortgages, and international bonds. Further signs of a global recession pushed commodities and oil lower, though, as gold climbed and the dollar tried valiantly to hang on to October's gains. See Chart 1 for more details of Market Performance.

Massive Policy Response Continues

In yet another attempt from policy makers to help stanch the financial crisis, the Federal Reserve and the Treasury Department last week announced $800 billion in new lending programs. These latest efforts were broken down into two programs to revive the banking system and are intended to help finance consumer loans while also pushing down mortgage rates.

- In the first action, the Fed and Treasury would create a $200 billion lending facility for asset-backed securities, which constitute repackaged securities backed by various consumer and business loans. The Term Asset-Backed Securities Loan Facility (TALF) will receive $20 billion from the Treasury's Troubled Asset Relief Program (TARP) as the Fed contributes up to $180 billion in loans for this new entity. The TALF would then lend money at low rates to companies that post collateral based on securities backed by consumer debt or business loans. In what may be considered an alarming development, Secretary Paulson described his vision for this facility as a "starting point" which could be expanded to other kinds of debt.
- The second program would have the Fed purchase up to $600 billion in mortgage debt tied to loans backed by Fannie Mae and Freddie Mac. This is a direct attempt by the central bank to force down mortgage rates, which have remained stubbornly high despite the dramatic decline in the federal funds rate (from 5.25% to 1.0%) over the last fifteen months. Since monetary policy makers only have a limited amount of ammunition left in their target for the benchmark overnight lending rate, we look for the Fed to further flood the system with money by purchasing massive amounts of debt, known as "quantitative easing," until this crisis subsides.

1. Market Performance as of 11/28/08

EQUITIES	11/28/08 LEVEL	MTD TOTAL RETURN	YTD TOTAL RETURN
Dow Jones Industrials	8,829.04	-6.0	-32.5
S&P 500	896.24	-7.2	-37.7
NASDAQ	1,535.57	-10.8	-42.1
Russell 2000	473.14	-11.8	-37.4
S&P MidCap	514.56	-9.3	-39.2
Russell 1000 Growth	365.34	-8.0	-39.5
Russell 1000 Value	482.06	-7.2	-37.7
MSCI EAFE	1,168.23	-5.4	-46.6
MSCI (Emerging Markets)	526.97	-7.5	-56.7
FIXED INCOME	**11/28/08 YIELD**	**MTD TOTAL RETURN**	**YTD TOTAL RETURN**
10-Year Treasury	2.96	9.0	13.0
Lehman Aggregate	4.98	3.3	1.5
Lehman Municipal	4.70	0.3	-3.9
Lehman Corporate	8.51	4.1	-11.0
Lehman High Yield	21.84	-9.3	-31.4
Lehman Mortgage	4.84	3.9	6.6
Lehman Global ex. US	2.57	2.8	1.1
COMMODITIES & CURRENCIES	**11/28/08 LEVEL**	**MTD TOTAL RETURN**	**YTD TOTAL RETURN**
CRB Index	244.94	-8.7	-31.7
Crude Oil - WTI	54.43	-19.7	-43.3
Gold	819.00	14.0	-1.9
Trade Weighted Dollar	86.71	0.4	13.0

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.

Similar to previous programs in dealing with the financial crisis, and the resulting recession, new ground continues to be broken from a policy standpoint. Indeed, with the $200 billion TALF, the Fed and Treasury will for the first time directly finance consumer debt. Additionally, the efforts from policy makers to simultaneously shore up confidence in the banking system while also propping up the economy can be seen in the huge financial commitment from government to prevent both a 1930's style depression and a 1990's style Japanese deflationary spiral. Indeed, the government has offered to guarantee more than $3 trillion to investors and depositors in bank debt, money market funds and non-interest bearing deposit accounts. The U.S. is also poised to invest up to another $3 trillion, to be distributed between the commercial paper market, Citigroup, AIG, TARP and the Federal Home Loan Bank system. Finally, the Federal Reserve has more than doubled the size of its balance sheet these past few months, committing up to $1.7 trillion in low-interest loans through a variety of innovative lending facilities to support financial institutions.

As a result, Uncle Sugar is positioning to commit more than $7 trillion in guarantees, investments, and loans (more than one-half the size of annual U.S. GDP) to help combat this economic and financial crisis. While all this money is bound to worry inflation hawks, we suspect policy makers are betting that the combination of: 1) moderating global growth, 2) the absence of wage pressures, and 3) falling home/energy prices, will prove to be sufficient disinflationary trends over the next year or so, allowing officials time to pick their fight with possible deflation/depression now over the potential threat for longer-term inflationary pressures later. Perhaps this is why Paul Volker has remained so visible with President-Elect Barrack Obama economic advisory teams.

Periods of Weak GDP and Market Performance

As great an inflation fighter as Mr. Volker was in the 1980's, though, he cannot (nor can anyone) prevent the economy from slipping into recession. Indeed, after fifteen months of market uncertainty, the National Bureau of Economic Research (NBER) finally dated the current recession, timing its beginning to the fourth quarter of 2007, when the economy contracted by -0.2%. Though GDP numbers were positive in the first half of 2008, these gains were largely attributable to export growth, driven higher by the weaker currency. While popular opinion often refers to the definition of recession as consecutive declines in quarterly output, the folks at NBER believe a recession results from a simultaneous decline in production, employment, income and sales.

Given the severity of the credit crisis, in conjunction with the cyclical correction in output, we believe the economy will contract by up to four percentage points in the current quarter. For perspective, a quarterly decline of this magnitude has only occurred eleven times since World War II. See Chart 2. As such, we thought it would be interesting to review how the market performs during the period of weakness (GDP declines of at least -4.0%) and perhaps more important, how the market performs after the period of extreme economic weakness. History has shown that the market (S&P 500 Index) typically climbs more than +5.0% during the weak periods, suggesting that investors had already figured out the recession was coming. In the current example, however, the stunning drop in lending activity caught the markets by surprise, resulting in a drop of more than -25.0% for the S&P 500 during the first two months of this quarter. On a more encouraging note, though, stocks have typically rallied in the periods (3 months, 6 months & 1 year) following extreme weakness in economic activity.

2. S&P 500 Performance During & Following Weakest Real GDP Quarters

	Real GDP Q/Q % AR	During	+3 Mos	+6 Mos	+12 Mos
1958 - Q1	-10.4%	5.3%	7.5%	18.9%	31.7%
1980 - Q2	-7.8%	11.9%	9.8%	18.8%	14.9%
1982 - Q1	-6.4%	-8.6%	-2.1%	7.6%	36.6%
1953 - Q4	-6.2%	6.3%	8.6%	17.7%	45.0%
1949 - Q1	-5.9%	-0.9%	-6.0%	3.5%	14.8%
1960 - Q4	-5.1%	8.6%	12.4%	11.2%	23.1%
1981 - Q4	-4.9%	5.5%	-8.6%	-10.6%	14.8%
1975 - Q1	-4.7%	21.6%	14.2%	0.6%	23.3%
1970 - Q4	-4.2%	9.4%	8.9%	8.2%	10.8%
1957 - Q4	-4.2%	-5.7%	5.3%	13.1%	38.1%
1949 - Q4	-4.0%	7.8%	3.0%	5.4%	21.7%
Average		**5.5%**	**4.8%**	**8.6%**	**25.0%**

Source: S&P, Strategas RP, and Evergreen Investments

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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.