Mid-Year Market Review and Outlook:

Deep Recession? We're Not Betting On It.

Q3 CHARTBOOK - August 2022

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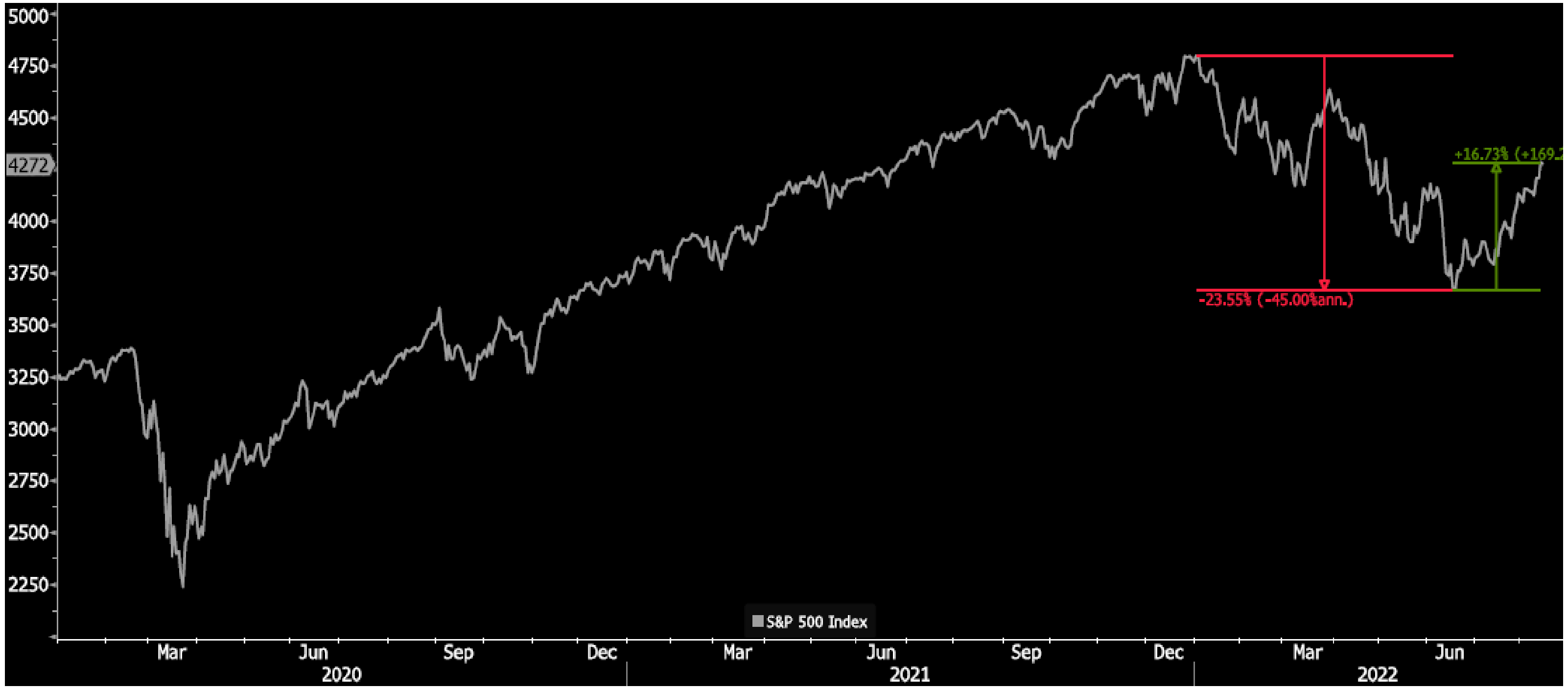
See important disclosures following the presentation.

Chartbook Preview

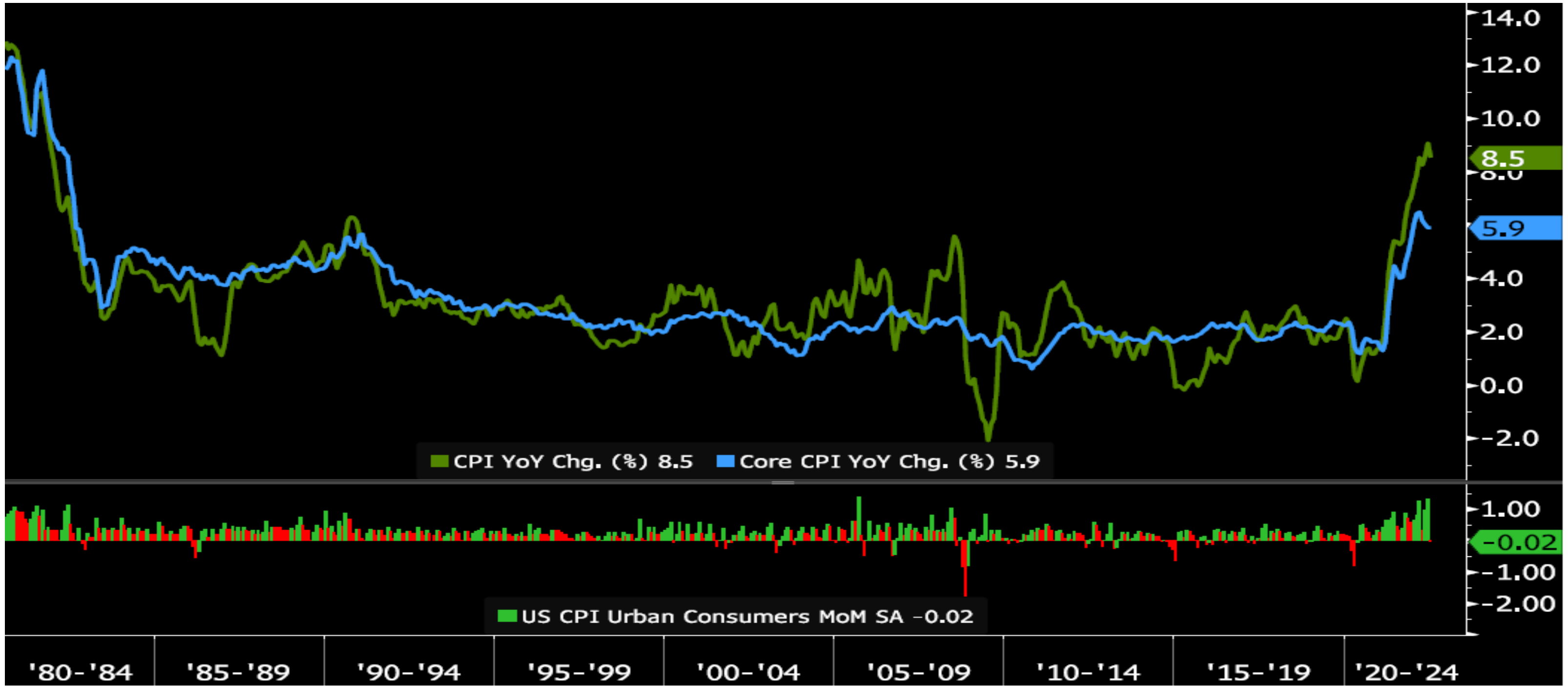
In this edition of Evergreen Chartbook, we dive into the driving force behind the recent rally in financial markets and our outlook for the rest of the year. Near-term, we remain cautious since this sharp uptick we've seen of late is happening alongside deteriorating economic data. On a longer-term basis, we think falling inflation expectations and lower commodity prices will help stabilize market sentiment. Additionally, consumer and corporate strength will likely pave the way for the US economy to emerge from this economic slowdown on solid footing. We continue to believe a near-term recession will be shallow and short-lived. That's why we think any material weakness markets experience in the back half of the year will present a strong buying opportunity.

The S&P 500 Fell Into Bear Market, But Has Rallied Sharply Recently



- In early June, the S&P dipped into bear market territory declining (from peak-to-trough) by more than -23.6%
- Since then, we have seen a sharp rally with the S&P up nearly 17%, erasing over half of the decline seen during the first half of the year

Inflation Rates Have Begun to Tick Lower



- Part of the rally can be attributed to recent inflation prints coming in lower than forecasted
- Additionally, we finally saw month-over-month declines in the CPI and Core CPI (ex. food and energy)
- It appears we may have passed the peak inflation point, and inflation rates seem likely to trend lower over the next 12 months

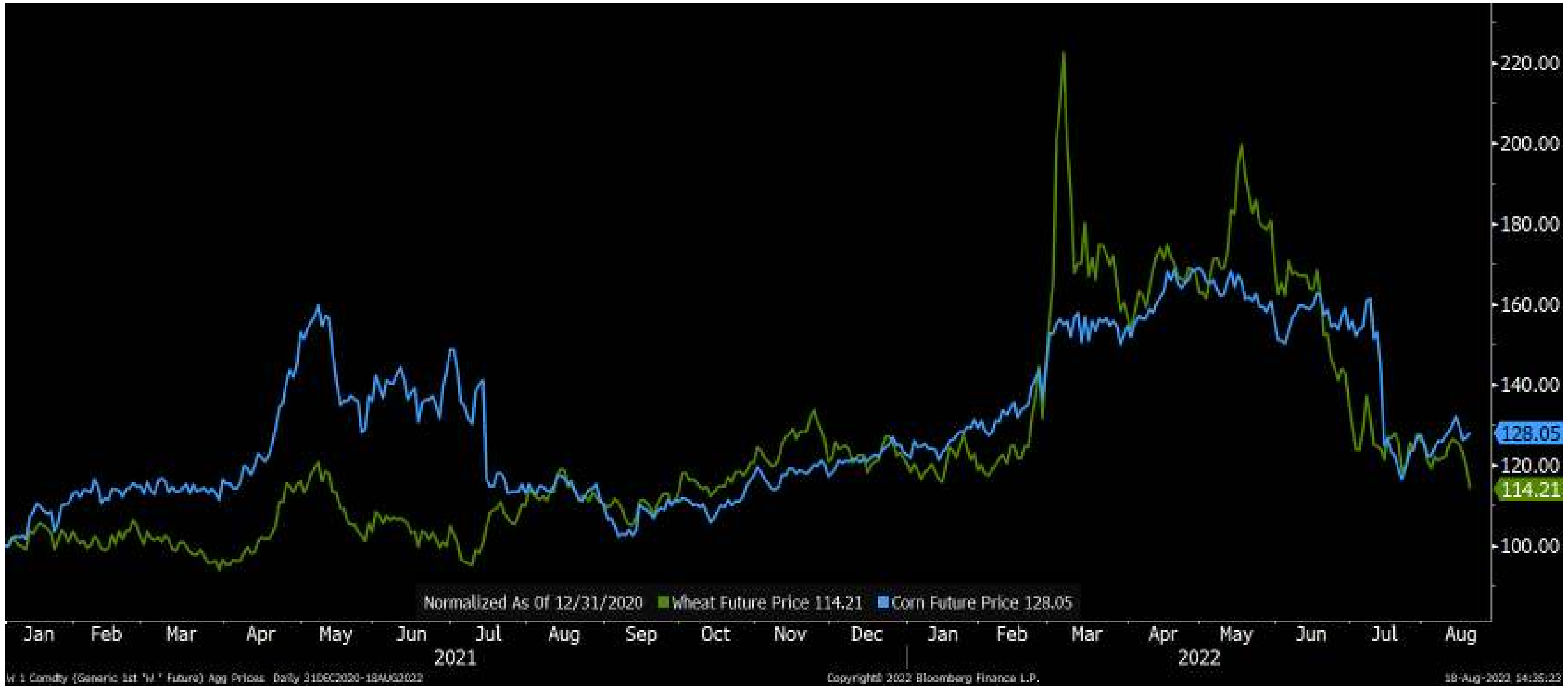
Cooling Inflation Has Been Driven by Lower Commodity Prices

- Energy prices have fallen from their recent peaks, which has helped put a damper on the inflation rate
- Oil has moved from just over $110 to $87 per barrel and natural gas has dropped down from $8.00 to $7.54 per MMBtu

Gasoline Prices Have Provided Consumer and Sentiment Relief

- Recent commodity price drops have trickled down to lower gasoline and diesel prices, with the national average gas price down from nearly $5.50 to $4.00 per gallon
- This will surely help consumer confidence and should flow through to spending in other categories, especially if the price continues to trend lower

Agriculture Prices Have Also Pulled Back Sharply From Their 2022 Highs

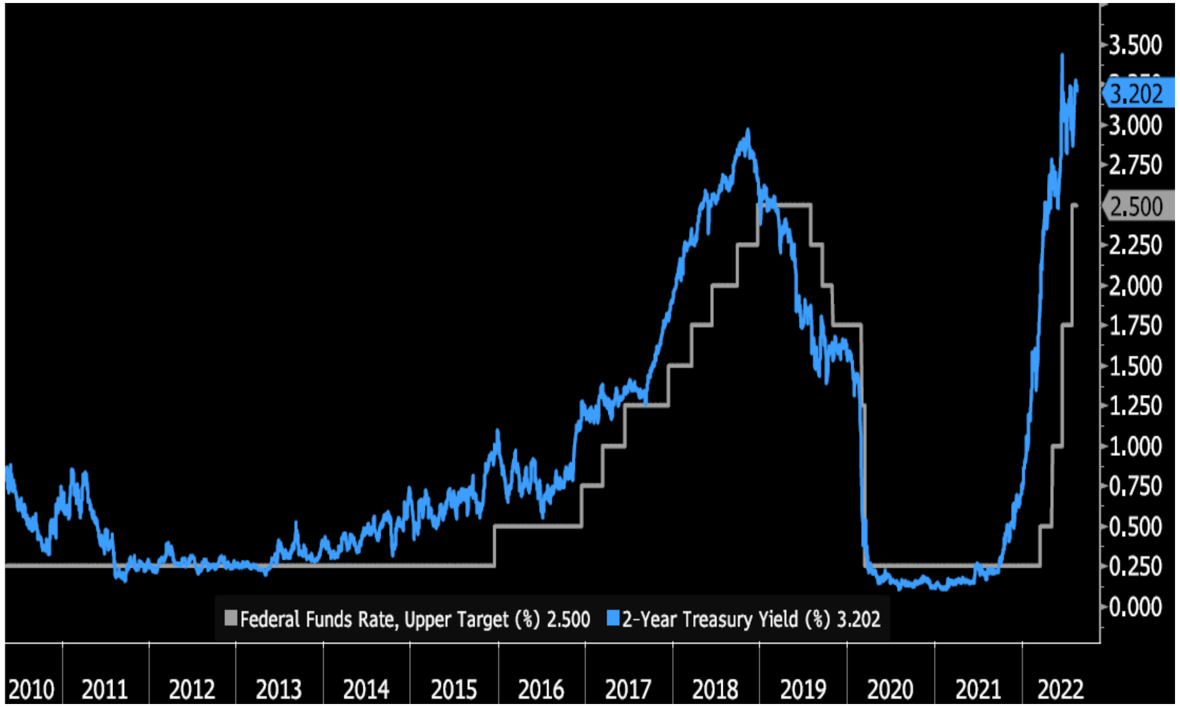


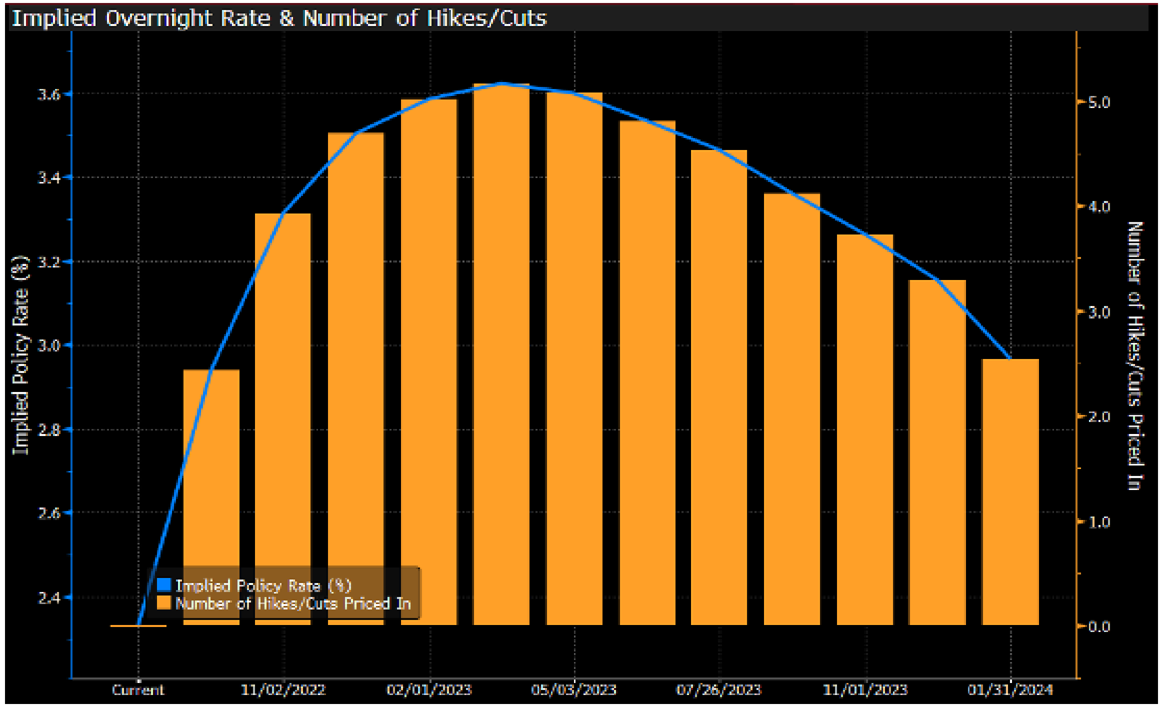
- Agriculture prices have also moved significantly lower with wheat and corn futures down considerably from the early-year highs
- We are starting to see these input costs spill over to lower prices at the grocery store
- Lower food and energy prices will offer some relief to lower-wage earners who have felt the impact from inflation the most

More Importantly, Inflation Projections Have Moved Much Lower

- Perhaps most significant for monetary policy, longer-term, market-based inflation expectations have also moved considerably lower
- As you can see in the chart above, five-year inflation expectations have moved down from 3.75% in March to 2.73% today

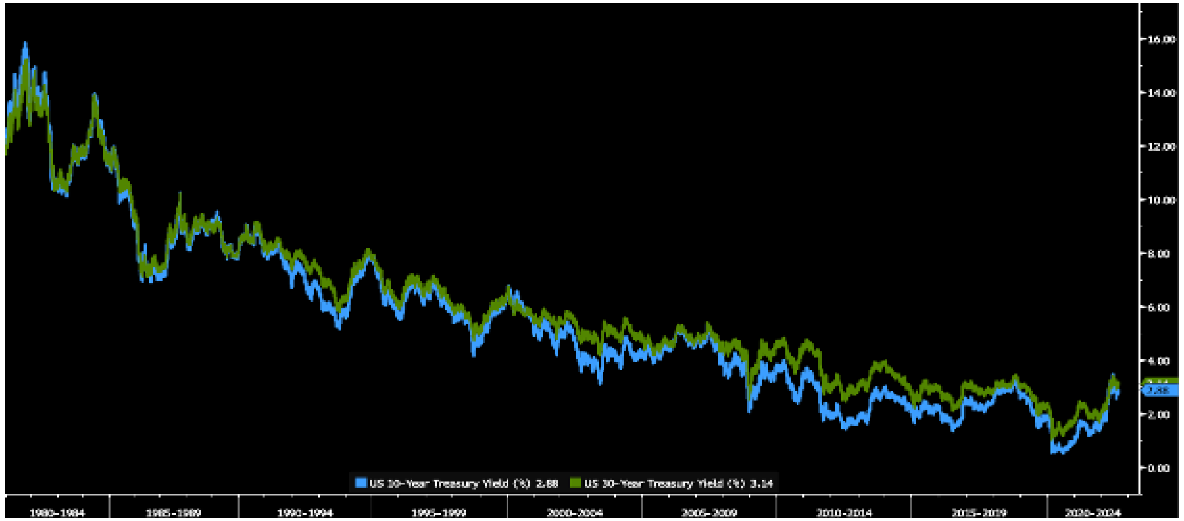
The Market Now Anticipates a “Fed Pivot” By 2023

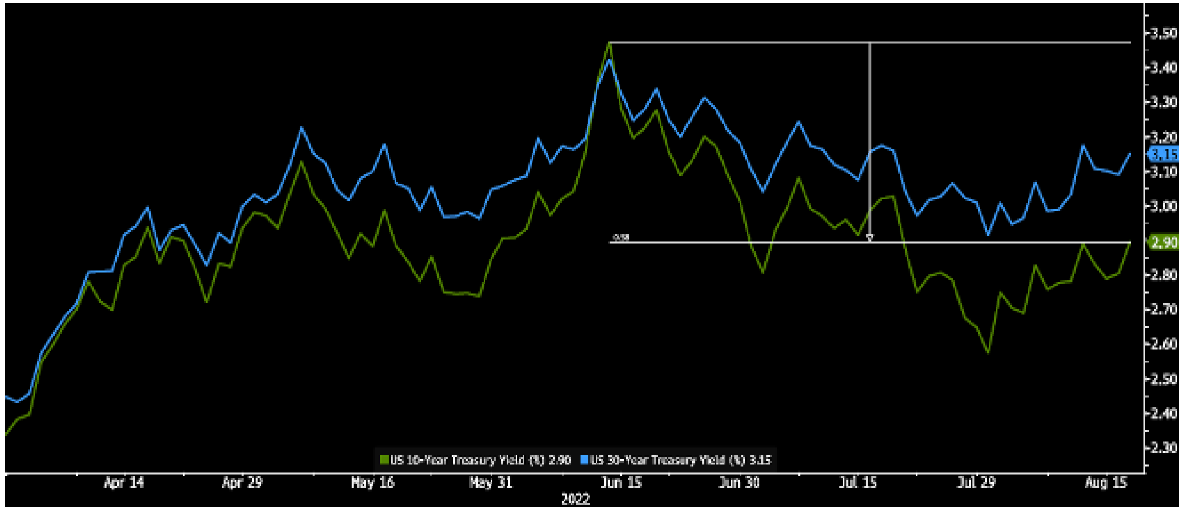




- Also aiding the markets is the idea that short-term interest rates are close to peaking out. As you can see in the chart on the left, the two-year treasury yield is at 3.2%, modestly above where it maxed-out during the last hiking cycle
- In other words, the Fed is likely close to “pivoting” from interest rate increases to pausing, or eventually cutting rates
- The chart on the right shows the market-based federal funds rate in the future, and currently there is a projected cut by mid-2023

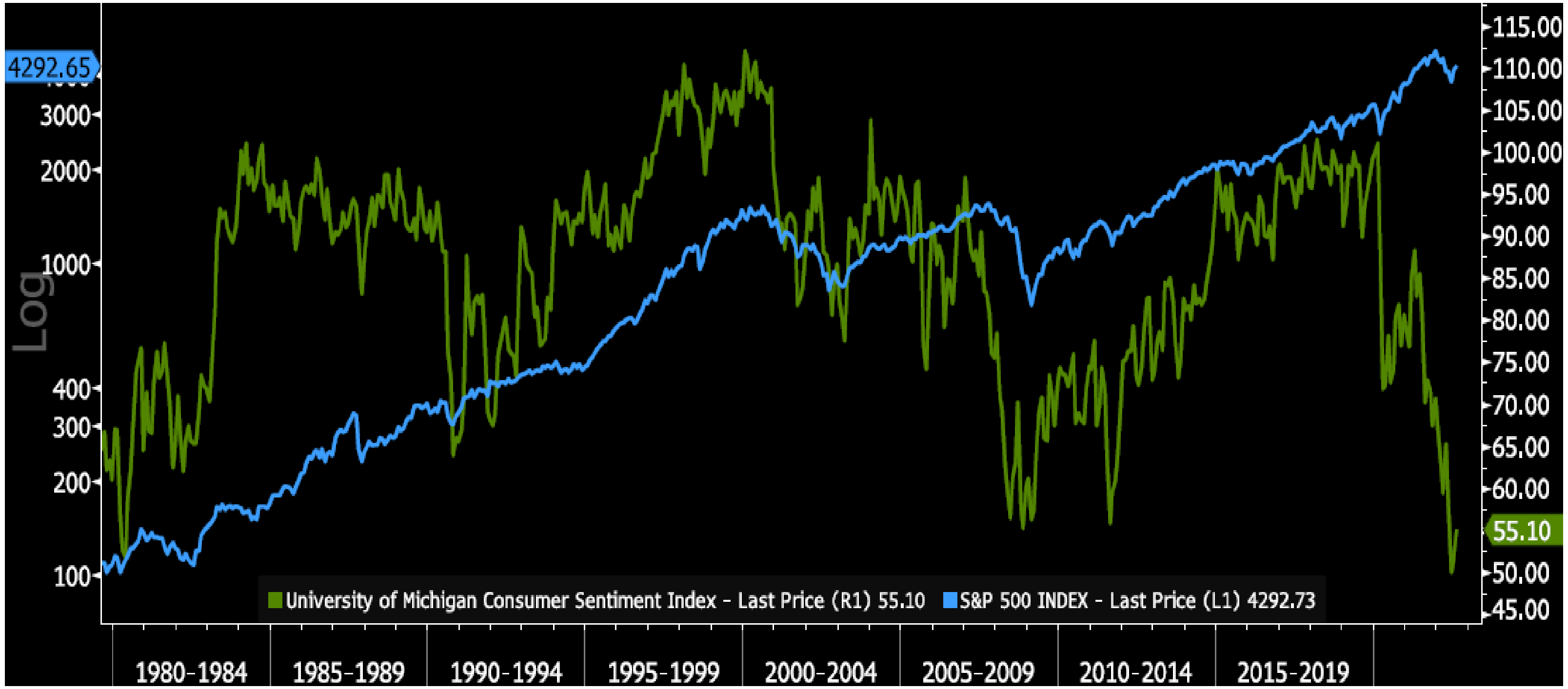
Long-Term Interest Rates Have Moved Lower Too, Providing Market Relief





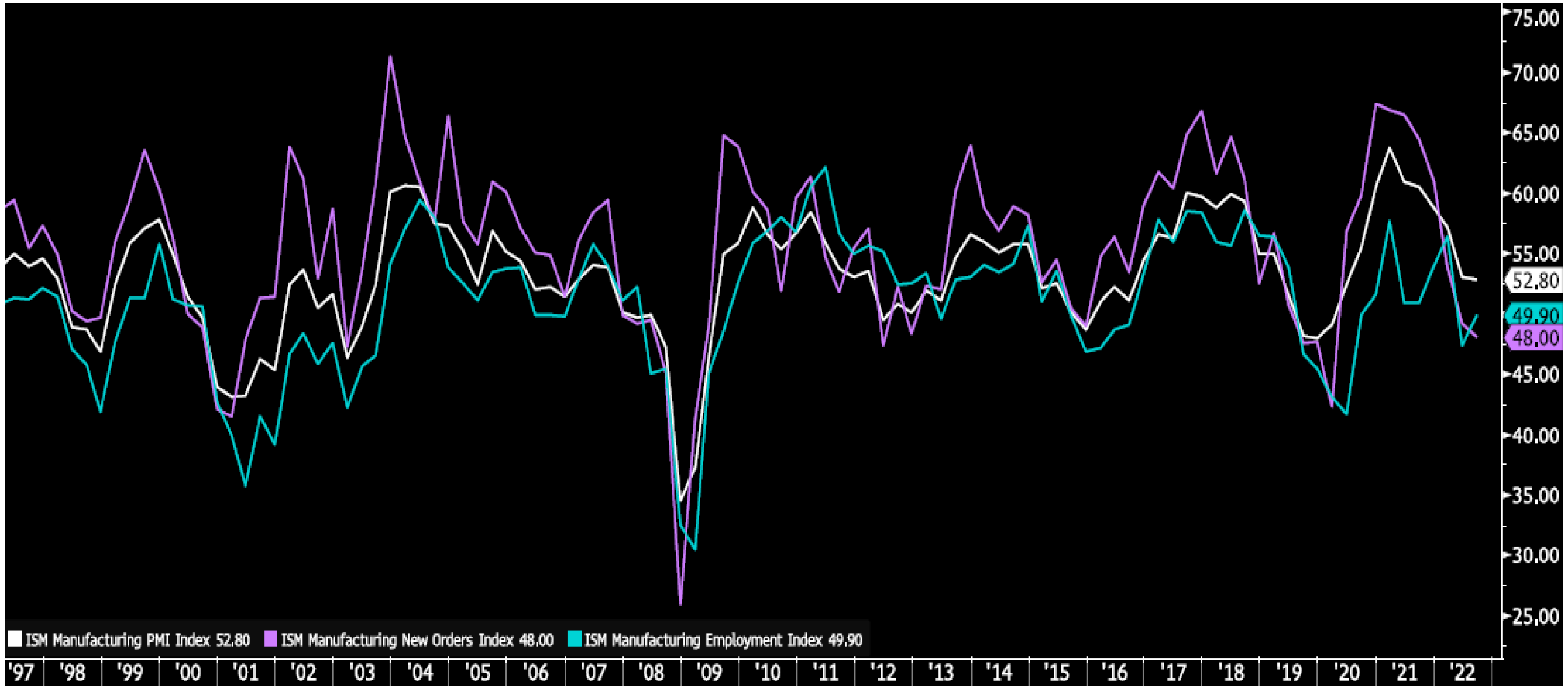
- Long-term interest rates have risen significantly from their 2020 lows, but over the last few months they've come down sharply
- The 10-year treasury yield peaked at 3.5% in June and has since moved down to 2.88%
- This is the rate used globally to value risk assets, so the move lower has no doubt provided relief to valuations for equity and income markets

Low Consumer Confidence can be a Contrarian Signal For Stocks



- Another positive for markets, at least from a contrarian indicator standpoint, is that consumer sentiment sits at the most bearish level since 1980
- As you can see, low points for consumer sentiment have generally been good entry points to buy equities
- Warren Buffett has famously said, it's wise for investors to be, "fearful when others are greedy, and greedy when others are fearful"

The Manufacturing Sector is Now Firmly in Contraction



- Moving on from what has aided markets lately, manufacturing indices have been heading decidedly lower
- The ISM manufacturing index continues to slide, and likely will keep falling with both new orders and the employment index now in contraction territory (under 50)

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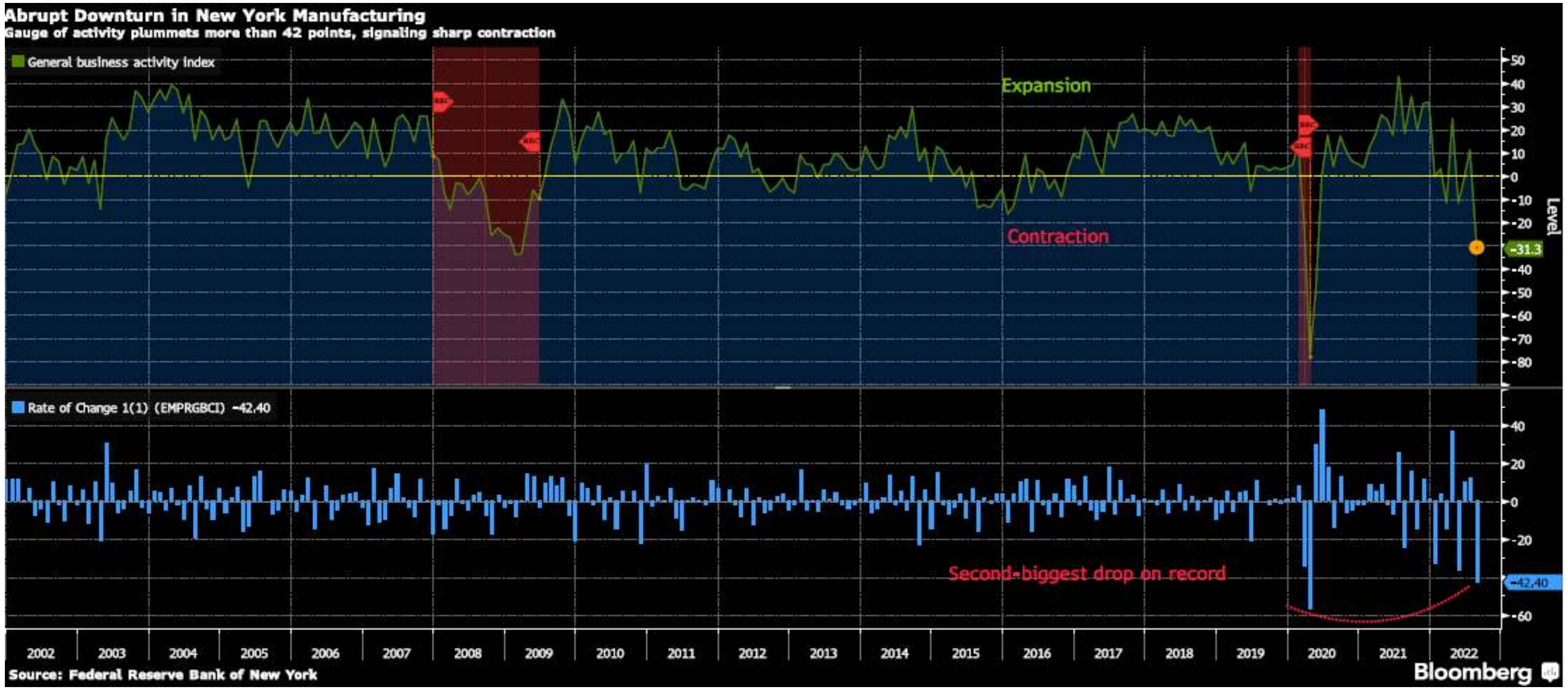
New York Manufacturing Index Looking Downright Recessionary



- It's been a truly historic decline in this space, as the NY manufacturing index this week had its second largest drop on record
- As you can see above, this type of weakness tends to happen during rather significant slowdowns in the economy

The Housing Market Also Showing Cracks in its Foundation

- The housing market is another area slowing considerably with home sales, housing starts, and building permits all rolling over sharply
- Home prices have remained relatively resilient, but between April and June the median sale price for a new home fell 11.9%. On a year-over year basis, that figure is now 7.4%, compared with 21.3% in April
- Higher mortgage rates and prices have pushed out potential buyers, and today's housing market has flipped quickly from a seller's market to a buyer's market
- We are now regularly observing prices cuts, and the bidding wars we had long been accustomed to seeing, at least for now, appear to be in the rear-view mirror

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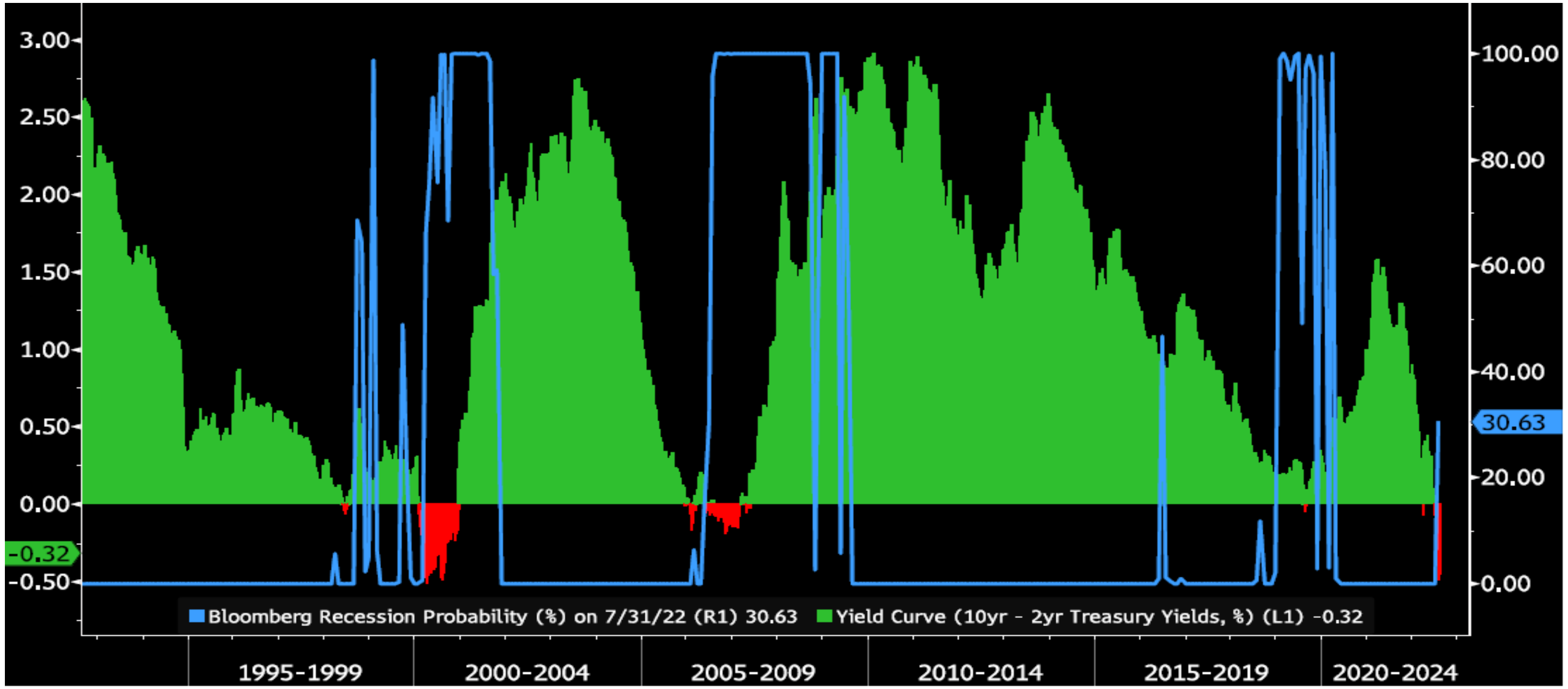
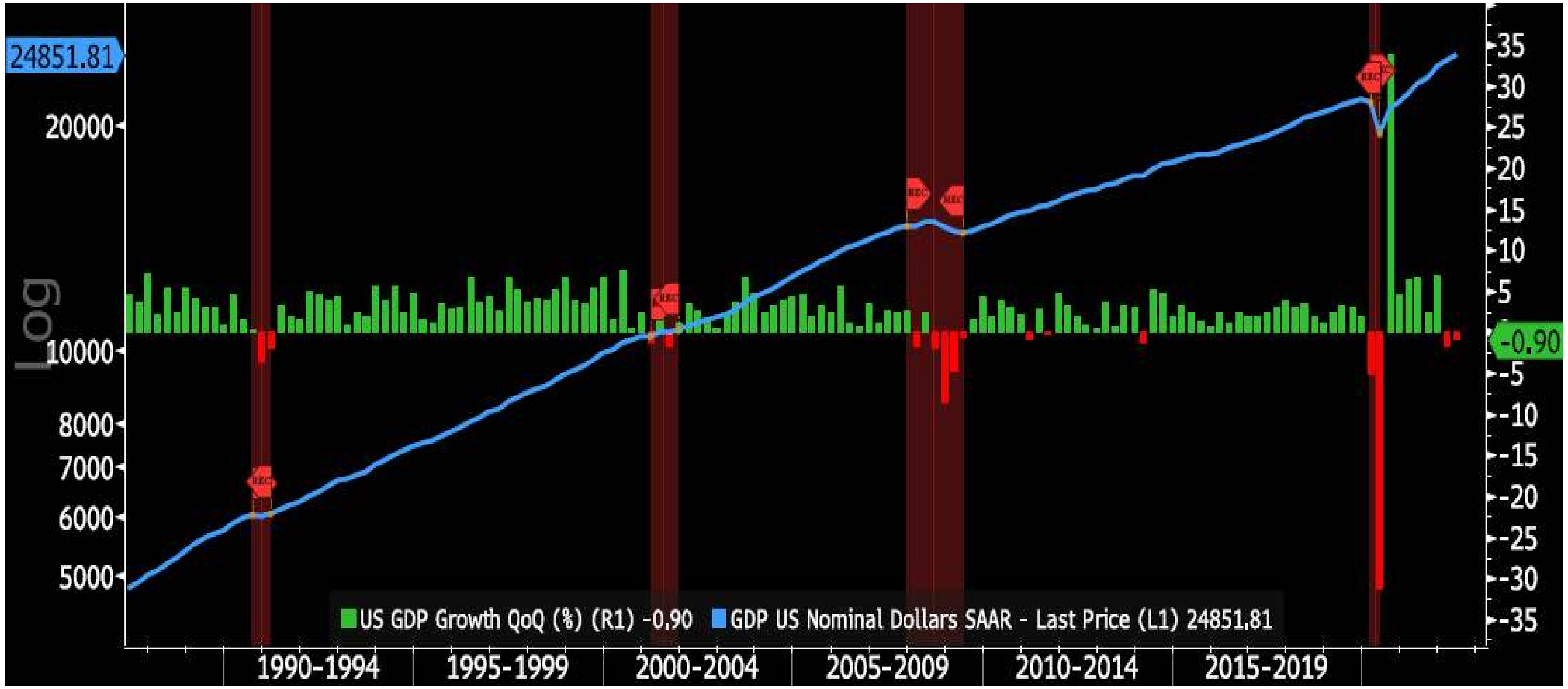
Recession Odds are on the Rise



- The yield curve inversion (short-term rates moving above long-term rates) remains in the zone that has previously forecasted past recessions
- To illustrate the likelihood of such an event, the Bloomberg recession indicator has climbed up to 37%
- It's true, there have been soft landings in the past when this measure was reading hot, so it's tough to make a definitive call. But there are clearly parts of the economy that are slowing down, and others that are in downright contraction mode

Two Quarters of Negative Real GDP Growth, but Nominal GDP Trending Higher

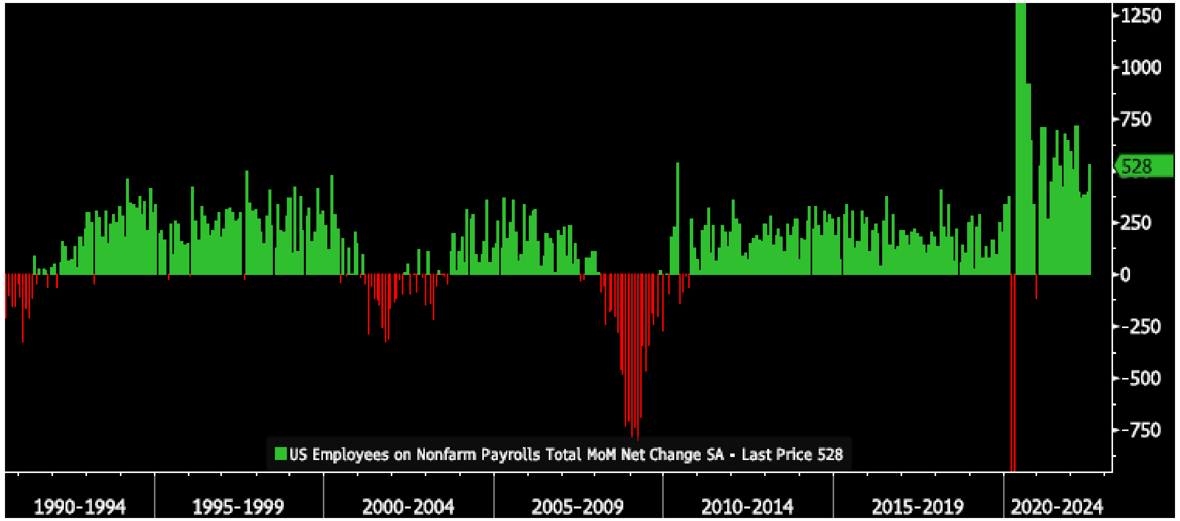


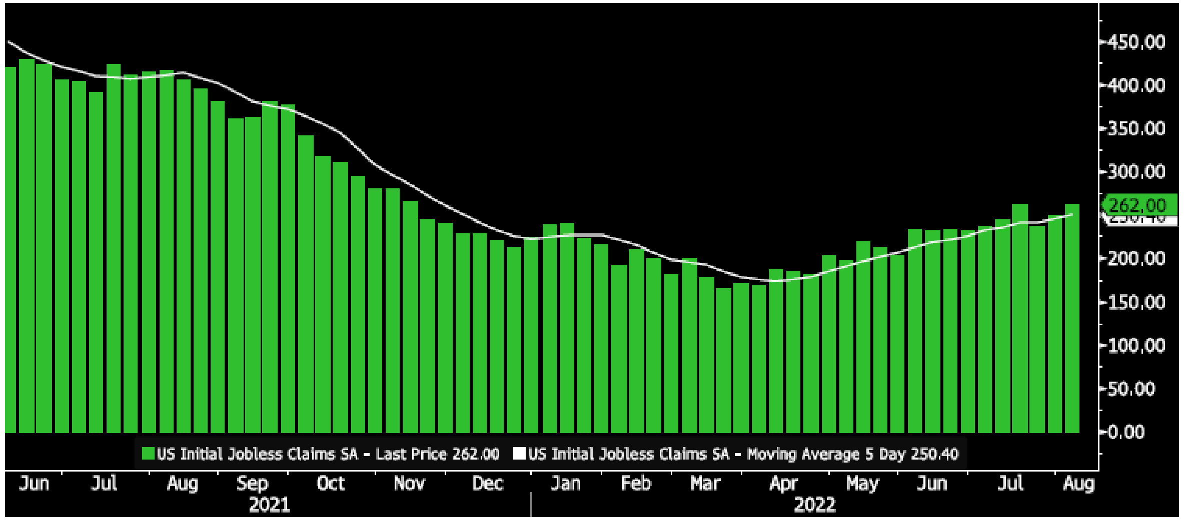
- Two quarters of negative GDP growth has been often considered a recession bellwether, which did take place in Q1 and Q2 of this year
- However, nominal GDP has been strong and remains in a solid up-trend so the case could be made that the negative GDP prints for Q1 and Q2 was caused by a large spike in inflation
- This type of “recession” is preferred to the traditional version of falling nominal growth, falling prices, and significantly weaker demand

The Service Sector is Still Expanding

- On the service side of our economy, the ISM Service Index remains firmly in expansion mode. New orders are also expanding and, at least for now, showing no sign of recession
- It's worth noting that over 75% of jobs in the US are in services, so this is obviously a crucial factor in determining whether we have a full-blown recession, or more of a mild slowdown
- So far, this indicator would point to the latter, but as you can see above the recent trajectory is starting to change course

The Labor Market Still Looks Quite Strong





- The labor market overall remains quite healthy with 3.1 million jobs created year-to-date, or a strong monthly average of 450,000 per month
- However, jobless claims have moved up sharply (chart on the right), which can be a warning sign for the labor market, but 262,000 per month remains low based on a long-term trend
- The economy can change quickly, but with the service sector and labor market currently quite healthy, it remains unlikely we have a severe downturn

The NASDAQ Off to One of the Worst Starts on Record

- Moving to equity markets, the NASDAQ was on track for its worst year on record but has recovered considerably since June
- Typically, when equities start down through the first few quarters of a given year, they finish flat or lower as you head into the back half of the year
- We do think volatility will be elevated for the rest of 2022, so taking some profits after this immense rally makes sense

With Equity Market Technicals Extended, A Pullback Seems Likely

- Technicals suggest that the stock market is overly extended in the near-term
- As you can see in the lower pane of the chart above, the 14-day relative strength indicator has moved north of 70, commonly referred to as an overbought level
- These types of sharp up-moves are often followed by at least a minor pullback

S&P 500 Earnings Growth Strong, but Slowing

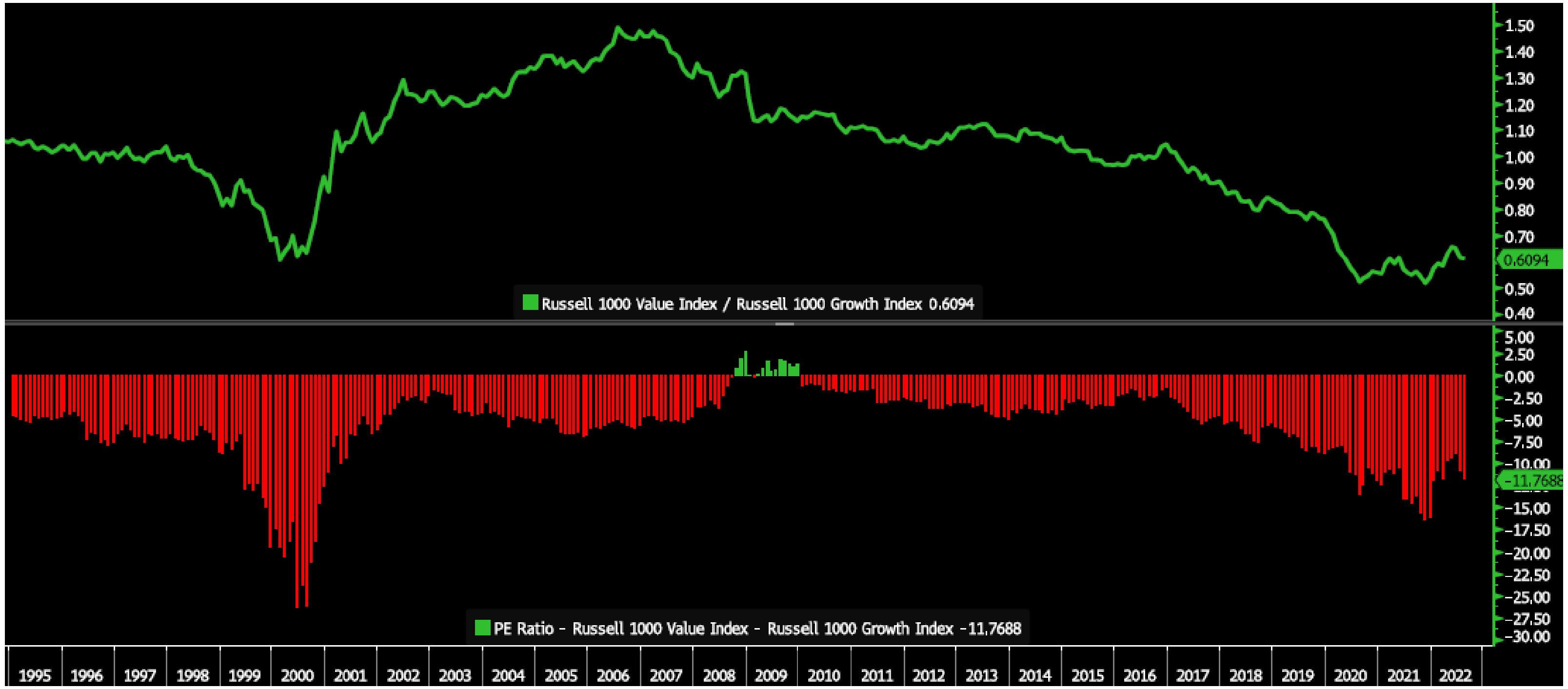
Surprise | Growth

Sector (GICS)	Reported	Sales Growth	Earnings Growth
11) All Securities	457 / 498	14.44%	8.69%
12) > Energy	21 / 21	77.13%	304.63%
13) > Materials	27 / 28	16.94%	13.02%
14) > Industrials	68 / 71	12.45%	33.57%
15) > Consumer Discretionary	45 / 57	14.99%	-3.22%
16) > Consumer Staples	26 / 32	7.33%	0.27%
17) > Health Care	59 / 64	10.07%	7.17%
18) > Financials	66 / 66	2.95%	-22.17%
19) > Information Technology	62 / 76	7.28%	0.71%
20) > Communication Services	23 / 23	4.21%	-15.13%
21) > Utilities	29 / 29	12.81%	4.92%
22) > Real Estate	31 / 31	17.19%	11.15%

Sector (GICS)	Reported	Sales Surprise	Earnings Surprise
11) All Securities	457 / 498	2.82%	4.13%
12) > Energy	21 / 21	9.53%	10.07%
13) > Materials	27 / 28	1.28%	3.08%
14) > Industrials	68 / 71	0.26%	4.50%
15) > Consumer Discretionary	45 / 57	2.26%	4.32%
16) > Consumer Staples	26 / 32	2.66%	5.11%
17) > Health Care	59 / 64	2.76%	7.17%
18) > Financials	66 / 66	1.80%	6.63%
19) > Information Technology	62 / 76	0.12%	1.47%
20) > Communication Services	23 / 23	-0.30%	-7.21%
21) > Utilities	29 / 29	16.10%	7.94%
22) > Real Estate	31 / 31	3.46%	1.14%

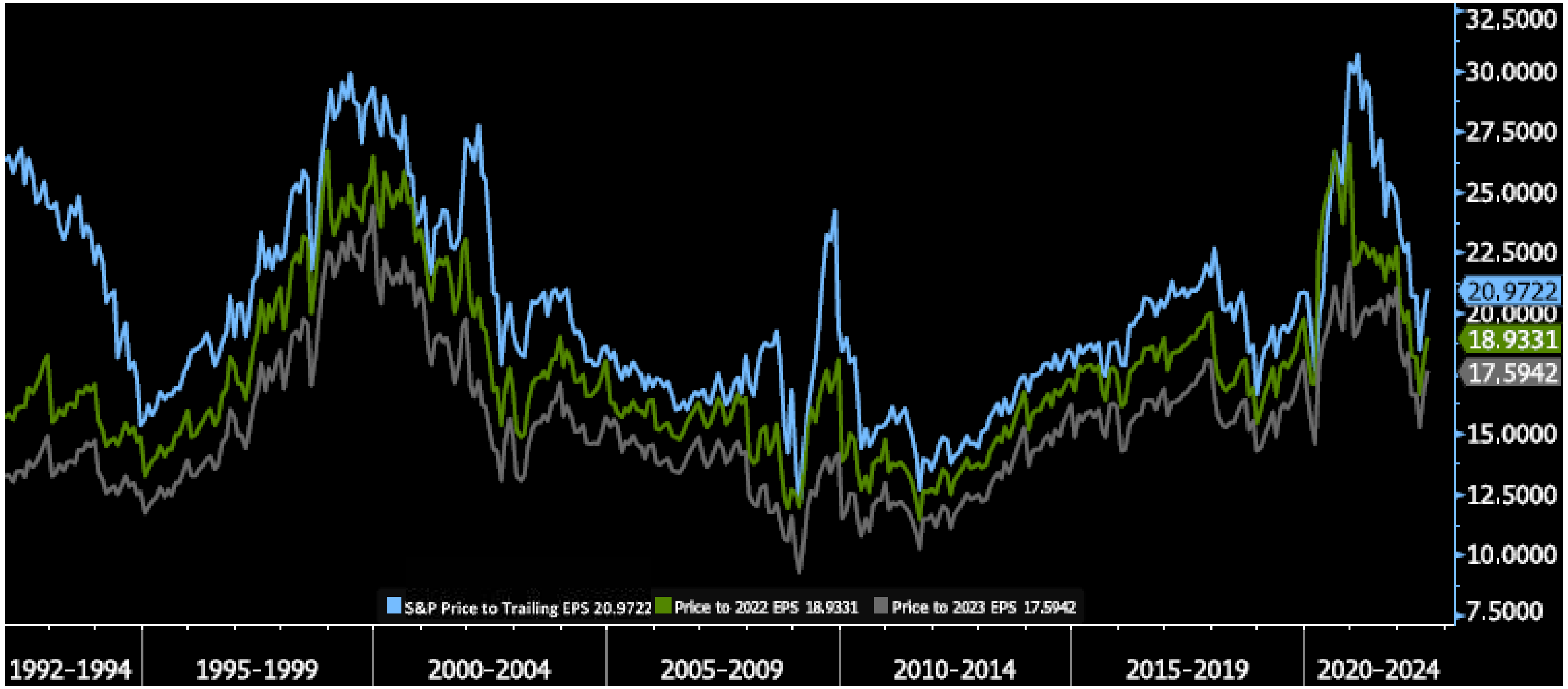
- With earnings season just concluded, the quarter overall was much better than expected, but also showed some signs of exhaustion
- On the positive side, earnings came in better than expected with 9% YoY growth compared with the expectation for 6.1%, along with healthy upside to surprises for both sales and earnings
- On the softer side, earnings ex-energy came in about flat for the quarter (year-over-year). We would point out that financials had a significant amount of non-reoccurring reserves set aside, so there are some offsets you could point to. Also, at Evergreen we own a fair amount of energy so it certainly wouldn't be representative to strip out for own portfolios
- Overall, the earnings season helped equity sentiment but keeping an eye out for commentary regarding both guidance and hints of a slowdown will be important

Value Stocks Still Appear Cheap, But Look to Add Growth Stocks During Selloffs



- Value stocks still scream cheap to us, but at the worst of the decline, growth/technology also started to look quite attractive - especially compared to the underlying growth rates for several high-quality stocks in this segment
- Our preference is to hold a value tilt, but to accumulate growth stocks at a reasonable price during equity market selloffs

S&P Valuation Looking Much More Attractive



- Overall, valuation began to look attractive for the S&P with the forward P/E on 2023 earnings hitting 15x during the worst of the selloff
- It's worth noting, that was near the low during the initial Covid selloff, so on absolute basis, stocks were briefly at the same valuation as March of 2020
- On a long-term basis, stocks are fairly valued, but on the slightly more expensive end compared to the last 15 years

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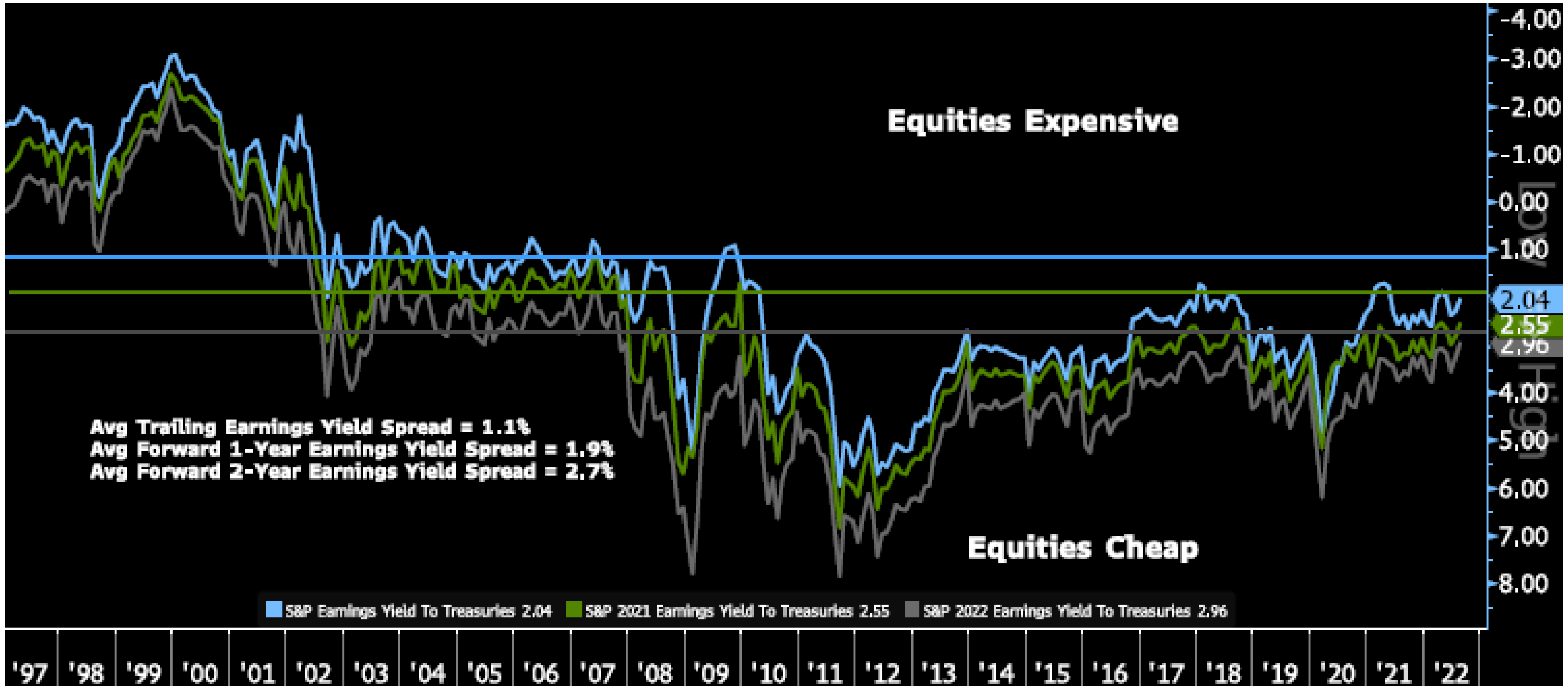
Stock Market Valuation Relative to Interest Rates is Reasonable



- Stock market valuation relative to interest rates (the risk premium) is less attractive due to the upward move in interest rates
- From a historical perspective, equities still look relatively cheap vs. the long-term average. Additionally, when you add in that the risk premium is firmly positive, it's not an egregious overall price environment for stocks

Corporate Bonds Look Attractive for Income-Seeking Investors

- We do think bond market valuations are worth pointing out since both investment grade and high-yield corporate bonds are in the upper quartile of where they've traded over the last 12 years. In other words, investors are being well compensated for buying corporate bonds
- Throughout Evergreen's income portfolios, we have been aggressively buying corporate debt to take advantage of the cashflow opportunity from the rise in interest rates and credit spreads so far this year

Corporate Credit Spreads Point to a Low Corporate Default Rate

- Credit spreads are up this year, but not at a point we would consider "recessionary"
- In other words, the high yields seem especially reasonable given our outlook that default rates stay subdued
- Spreads are also a critical element to watch for the overall economy and equity markets, and the recent retracement is a positive sign

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Quantitative Tightening is a Reason to be Cautious Near-Term

- The final chart we'll look at is the relationship between the Fed's balance sheet and the S&P 500, which has had a strong correlation over the last couple of decades
- The Fed may slow rate hikes in the near-future, but the balance sheet will begin to shrink quickly over the next year
- Historically, this has created both volatility and opportunity for investors. This environment will drain liquidity and likely keep a lid on markets for the time being
- If this situation plays out, alongside slowing growth, it will be wise to trim into strong rallies like we have seen here recently
- With that said, this scenario will also create some great bargains in the market, and investors should be ready to take advantage of selloffs. We continue to believe there will be another good buying opportunity later this year like we saw in June

Index Definitions

- *CPI represents changes in prices of all goods and services purchased for consumption by urban households. User fees (such as water and sewer service) and sales and excise taxes paid by the consumer are also included.*
- *US Personal Consumption Expenditure Core Price Index tracks overall price changes for goods and services purchased by consumers. Deflators are calculated by dividing the appropriate nominal series by the corresponding real series and multiplying by 100.*
- *Generic 1st 'CL' Future is a contract that provides for delivery of several grades of domestic and internationally traded foreign crude oils. Natural gas, wheat, corn, etc. and serves the diverse needs of the physical market.*
- *Federal Funds Target Rate Lower Bound is the short-term interest rate targeted by the Federal Reserve's Federal Open Market Committee (FOMC) as part of its monetary policy.*
- *US Condition of All Federal Reserve Banks Total Assets tracks the aggregate assets and liabilities of banks within an economy (including private or commercial banks, central banks or both).*
- *Gross domestic product (GDP) measures the final market value of all goods and services produced within a country. It is the most frequently used indicator of economic activity. The GDP by expenditure approach measures total final expenditures (at purchasers' prices), including exports less imports. This concept is not adjusted for inflation.*
- *Adjusted Retail & Food Services Sales (also referred to as retail trade) tracks the resale of new and used goods to the general public, for personal or household consumption.*
- *Bloomberg Economics Probability of US Recession within 24 Months probability model shows the chance of a downturn within the next N-months. The model uses a range of financial market, real economy, and economic imbalance indicators to gauge the N-month risk of recession.*
- *S&P CoreLogic Case-Shiller 20-City Composite City Home Price NSA Index tracks the value of single-family housing within the United States. The index is a composite of single-family home price indices for the nine U.S. Census divisions.*
- *Bankrate.com US Home Mortgage 30 Year Fixed National Avg. includes only 30-Year Fixed Mortgage products, with and without points. This index is the Overnight National Average. You will see daily rate averages on Bankrate.com in boxes labeled overnight averages (these calculations are run after the close of the business day). Included there are rates we have collected on the previous day for a specific banking product.*
- *US Empire State Manufacturing Survey General Business Conditions SA is a survey conducted on a monthly basis by the Federal Reserve Bank of New York and tracks sentiment among manufacturers in the state of New York.*
- *Philadelphia Fed Business Outlook Survey Diffusion Index General Conditions is a survey, conducted on a monthly basis by the Federal Reserve Bank of Philadelphia, and tracks sentiment among manufacturers in the Philadelphia Fed's district which includes Eastern Pennsylvania, Southern New Jersey and Delaware.*
- *Kansas City Federal Reserve SA Composite Index is a survey, conducted on a monthly basis by the Federal Reserve Bank of Kansas City, that tracks sentiment among manufacturers in the Kansas City Fed's district which includes Kansas, Colorado, Nebraska, Oklahoma, Wyoming, the northern half of New Mexico and the western third of Missouri.*
- *Dallas Fed Manufacturing Outlook Level of General Business Activity is a survey, conducted on a monthly basis by the Federal Reserve Bank of Dallas, that tracks sentiment among manufacturers in Texas.*
- *US Initial Jobless Claims SA track the number of people who have filed jobless claims for the first time during the specified period with the appropriate government labor office. This number represents an inflow of people receiving unemployment benefits.*
- *US Unemployment Rate tracks the number of unemployed persons as a percentage of the labor force (the total number of employed plus unemployed). These figures generally come from a household labor force survey.*
- *US Job Openings By Industry Total SA tracks the number of specific job openings in an economy. Job vacancies generally include either newly created or unoccupied positions (or those that are about to become vacant) where an employer is taking specific actions to fill these positions.*
- *LBUSTRUU Index is the Bloomberg US Aggregate Bond Index, a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency). (Future Ticker: I00001US)*
- *AAA US Daily National Average Gasoline and Diesel prices are the daily average prices for retail gasoline provided by AAA using data from up to 120,000 retail stations*
- *Inflation expectations both 3-year and 10-year are obtained from surveying 1,200 consumers on a wide range of economic factors that directly flow into inflation in one way or another*
- *University of Michigan surveys consumers about their attitudes and expectations to summarize and determine the changes in a consumer's willingness to buy and predict their subsequent discretionary expenditures*
- *Institute for Supply Management (ISM) tracks the general state of the economy through several surveys depicting the state and expectations of the economy including both manufacturing and services sectors*
- *US exiting and new home sales is collected by the National Association of Realtors that track sales of homes throughout the United States, collected monthly*
- *Building permits and starts is tracked by the US Census Bureau, collected monthly*
- *Bloomberg Economics uses a recession probability model that uses a range of financial market, real economy, and economic imbalance indicators that gauge the risk of a recession looking out a number of predefined months*
- *The Russell 1000 Growth/Value indices tracks companies with higher/lower price-to-book ratios and higher/lower growth forecasts using the 1,000 largest companies in the Russell 3000 Index which is the largest 3,000 companies in the US by market capitalization*

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