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The Kaufman Report

Trade what you see, not what you think.

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Monday April 14, 2008 **Closing prices of April 11, 2008**

Through the Looking Glass?

With all due respect to the Dow Jones Industrial Average, the S&P 500 is the most popular broad market index used to gauge equity performance. It closed Friday at 1332.83. A look at a long-term chart shows that stocks are almost exactly where they were on April 8, 1999, when the index closed at 1343.98. Simply put, *the U.S. stock market has gone nowhere in nine years!*

During this time we have seen the last stage of one bull market, a devastating bear market, and the beginning and end of another bull market. However, in spite of some dramatic moves in each direction, when all is said and done, U.S. equities have made no progress. As the Red Queen said to Alice "Now, here, you see, it takes all the running you can do, to keep in the same place. If you want to get somewhere else, you must run at least twice as fast as that!"

Some analysts point to historical valuations and other market data to make the case that the future will not be that different regarding the potential for upside in equities in the aggregate. We agree with that assessment, and we think equities will not be very rewarding for the traditional buy and hold investor. We believe in tactical asset allocation, and we think that investors must be willing to be very active in the process. To blindly sit through round trips up and down just to end up in the same place seems like a complete waste of time. Investors who want to outperform the major indexes must be willing to run twice as fast.

We are now entering the heart of earnings season. For the S&P 1500, which includes mid-cap and small-cap stocks as well as large-caps, actual earnings per share peaked in August at $19.76. Currently they are $14.90, a drop of 25.6%. Forecast earnings didn't peak until February at $21.96. Currently, they are $21.13, a drop of only 3.8%. Both numbers continue to decline. Does it make sense for actual earnings to drop by so much and forecast numbers by so little? Will the analysts get it right, in which case stocks will look undervalued, or is this going to be an example of the old saying, "hope springs eternal"? The next three weeks will give market participants the answer, and we advise everyone to stay on their toes. **(Continued)**

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The S&P 1500 was down on decreasing volume Friday, recording a panic-selling 90% down day. We said Tuesday night that stocks were locked in a tight range just under resistance, but we expected some earnings news to move stocks sharply. That news came in the form of negative reports from UPS and GE.

Along with the bad report by GE, which caused the stock to have its largest one-day drop since the crash of October 1987, investors were treated to bad news from the Import Price Index and the University of Michigan Confidence survey.

In last Monday's report we said that due to various factors we expected to see stocks pull back, and hopefully find support at the 50-day moving average. Unfortunately Friday's panic-selling pushed the index below both the 50-day moving average and the 20-day. The next short-term supports would be 298.99, the bottom of the big rally day of April 1st, and thereafter 297.02, the bottom of the end of March pull back. In the S&P 500 these numbers are 1326.41 and 1312.81, respectively.

In the short-term stocks are getting oversold, so we expect these supports to hold as investors wait for more earnings reports. A break of these levels will be bearish and probably lead to a test of the bottom of the sideways channel we have been in since January 22nd.

<u>In the long-term, the trend remains down, and this remains a bifurcated, risky, opportunistic traders market with adept traders able to enter long and short. Whipsaw risk is very high. Investors need to be alert for sector rotation and not be afraid to move out of lagging stocks and sectors and into leading ones.</u>

Federal Funds futures are pricing in an 54% probability that the Fed will cut rates *<u>another 25 basis points to 2.00%,</u>* and a 46% probability of *<u>a 50 basis point cut to 1.75%</u>* when they meet again on April 30th.

The S&P 1500 (301.56) was down 2.037% Friday. Average price per share was down 1.95%. Volume was 99% of its 10-day average and 88% of its 30-day average. 7.23% of the S&P 1500 stocks were up on the day. Up Dollars was 8/10 of 1% of its 10-day moving average and Down Dollars was 376% of its 10-day moving average. For the week the index was down 2.716% on decreasing and below average weekly volume.

Options expire April 18th (that's Friday!). The FOMC meets April 30th.

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S&P 1500 Analysis - Wayne S. Kaufman, CMT

The Kaufman Report - 4/12/2008

The S&P 1500 failed to get through the resistance zone and has created a third lower top. There is support just below current levels.

Our oscillators are no longer overbought, but only the percent over 10-sma is in the oversold zone.

Our price oscillator, which has a history as a good indicator of trends, is still positive. Of course, this market has had very high whipsaw risk.

S&P 1500 Analysis - Wayne S. Kaufman, CMT

The Kaufman Report - 4/12/2008

The S&P 1500 was over-bought at resistance and has pulled back, falling through the 50 (blue) and 20-sma (green). Support is at 298.99 and 297.02.

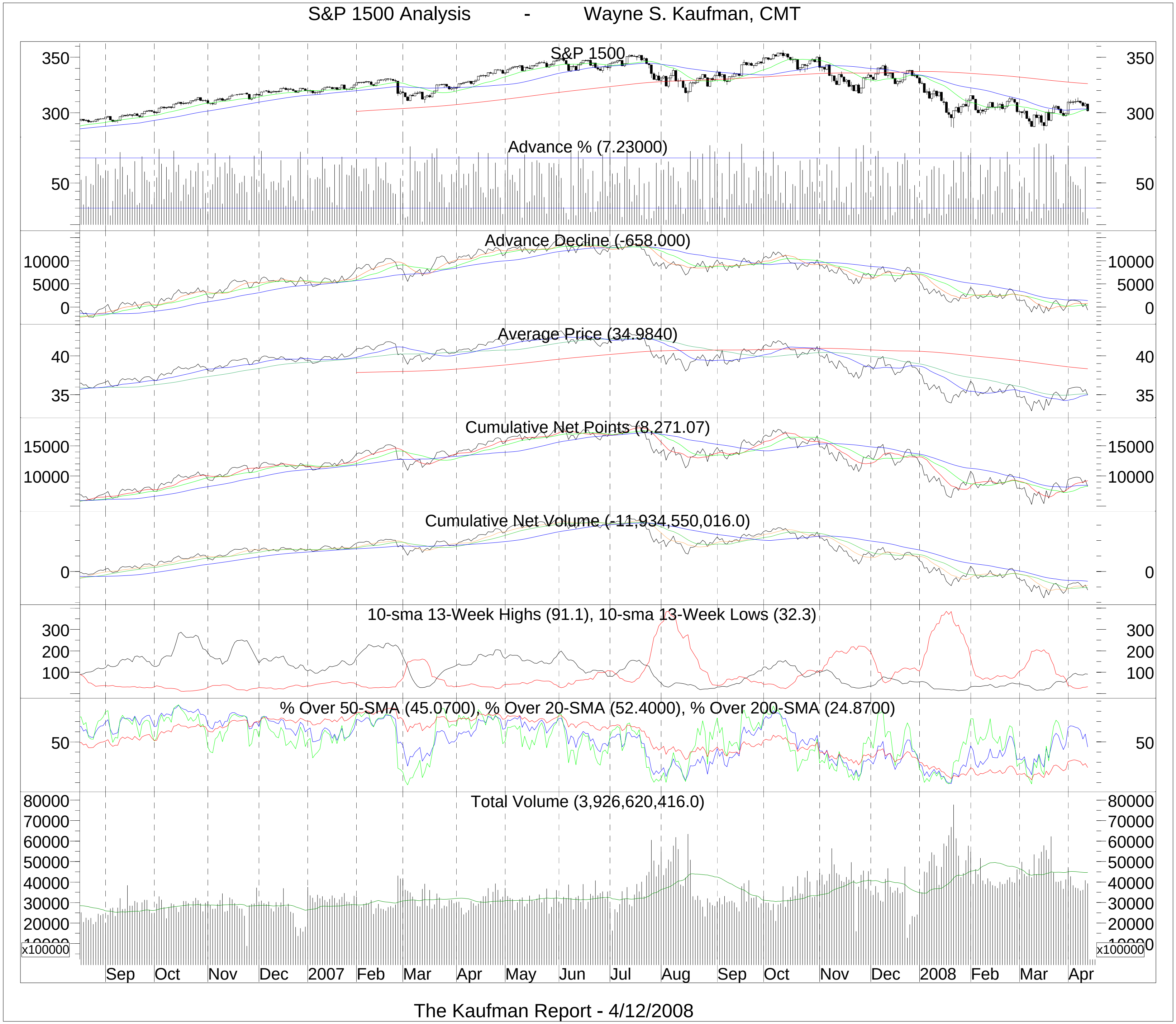
The Nasdaq 100 met resistance at the 38.2% retracement level. It is still above the 50-sma (blue).

Dow Jones Transports - Wayne S. Kaufman, CMT

The Kaufman Report - 4/12/2008

Transports broke out of a reverse head and shoulders pattern but couldn't get above the October resistance. They have fallen back to the neckline, which is very common, but a move below the 200-sma (red) will be bearish. A move below the March lows would be very negative.

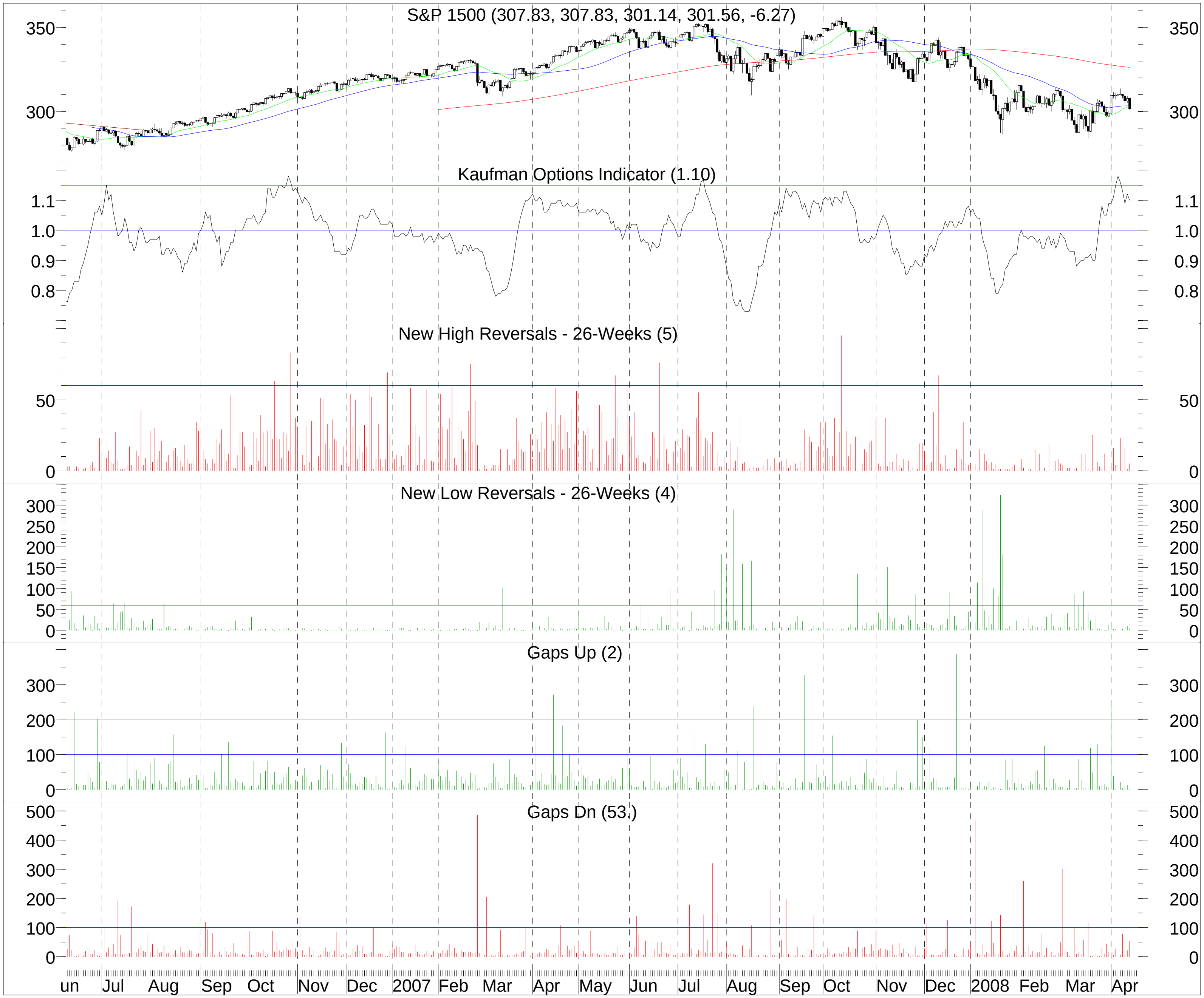
Transports have been outperforming the S&P 500.



Only 7.23% of stocks traded higher Friday.

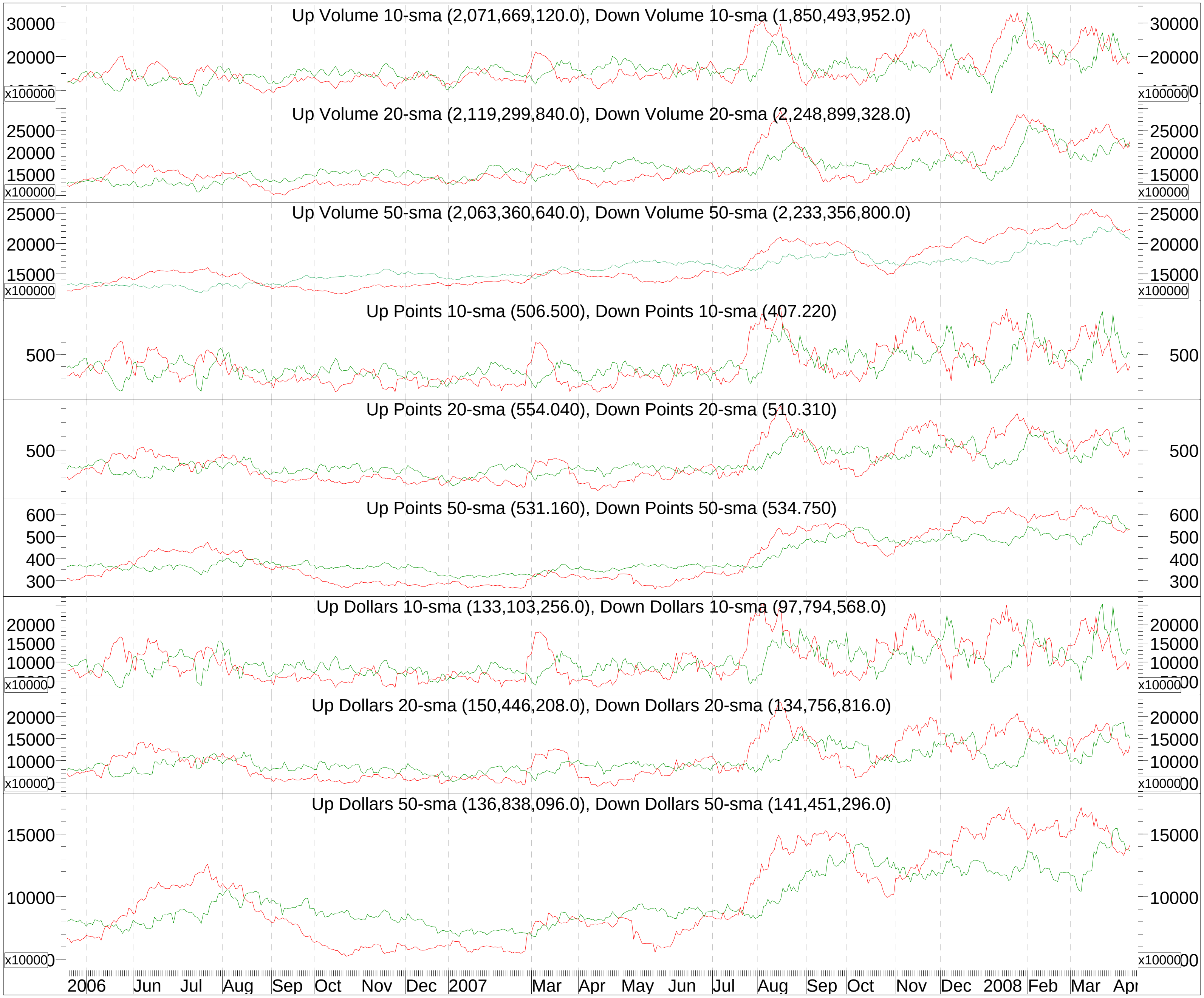
Only 24.87% of stocks are above their 200-sma. This is typical of bear markets.

Interestingly, volume decreased on Friday's panic selling down day.



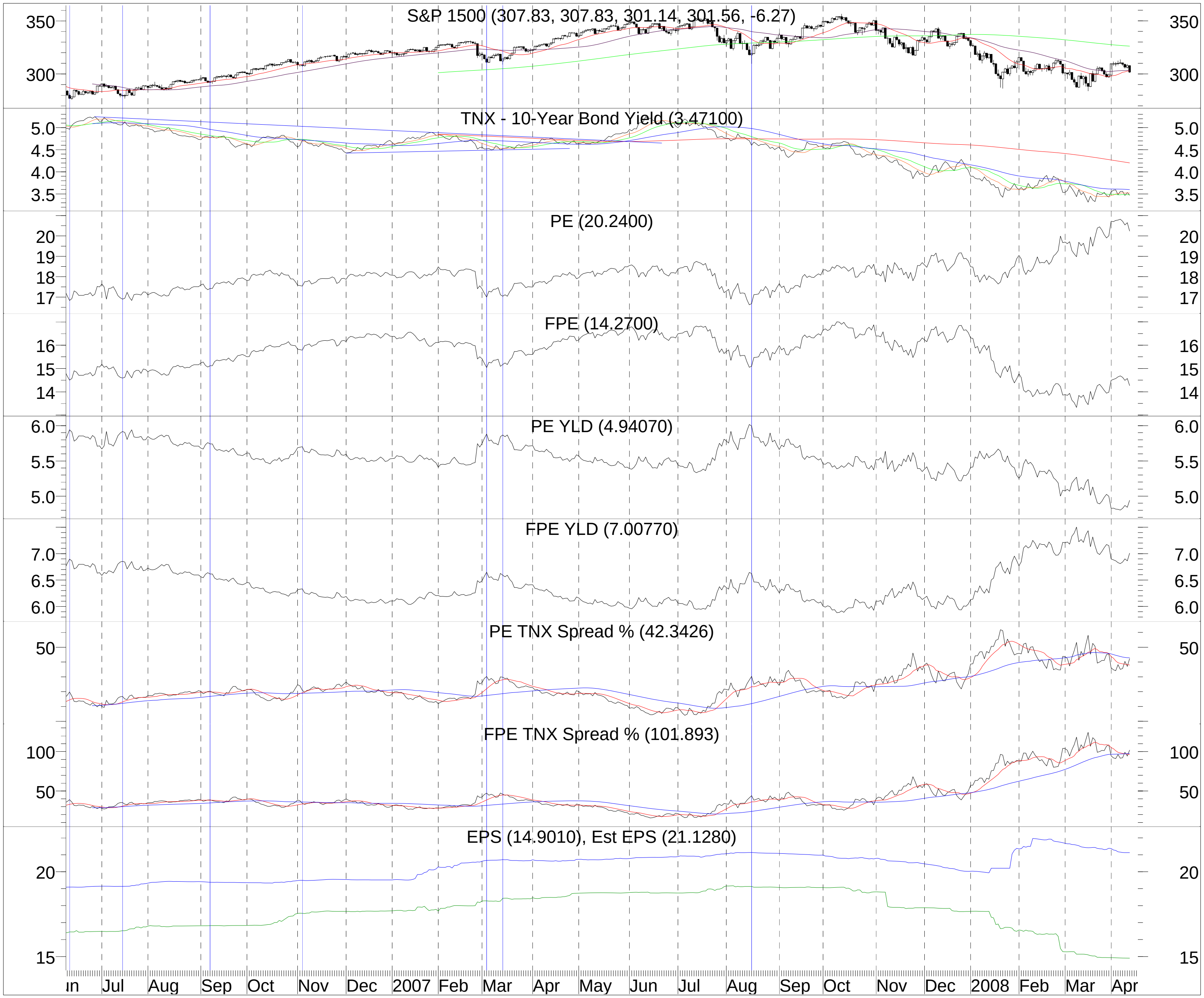
Our options indicator has dropped sharply after hitting overly bullish levels. Friday the put/call ratio hit 1.29, the highest since 1.483 on March 17th. Readings above 1.00 indicate fear.

S&P 1500 Analysis - Wayne S. Kaufman, CMT



The Kaufman Report - 4/12/2008

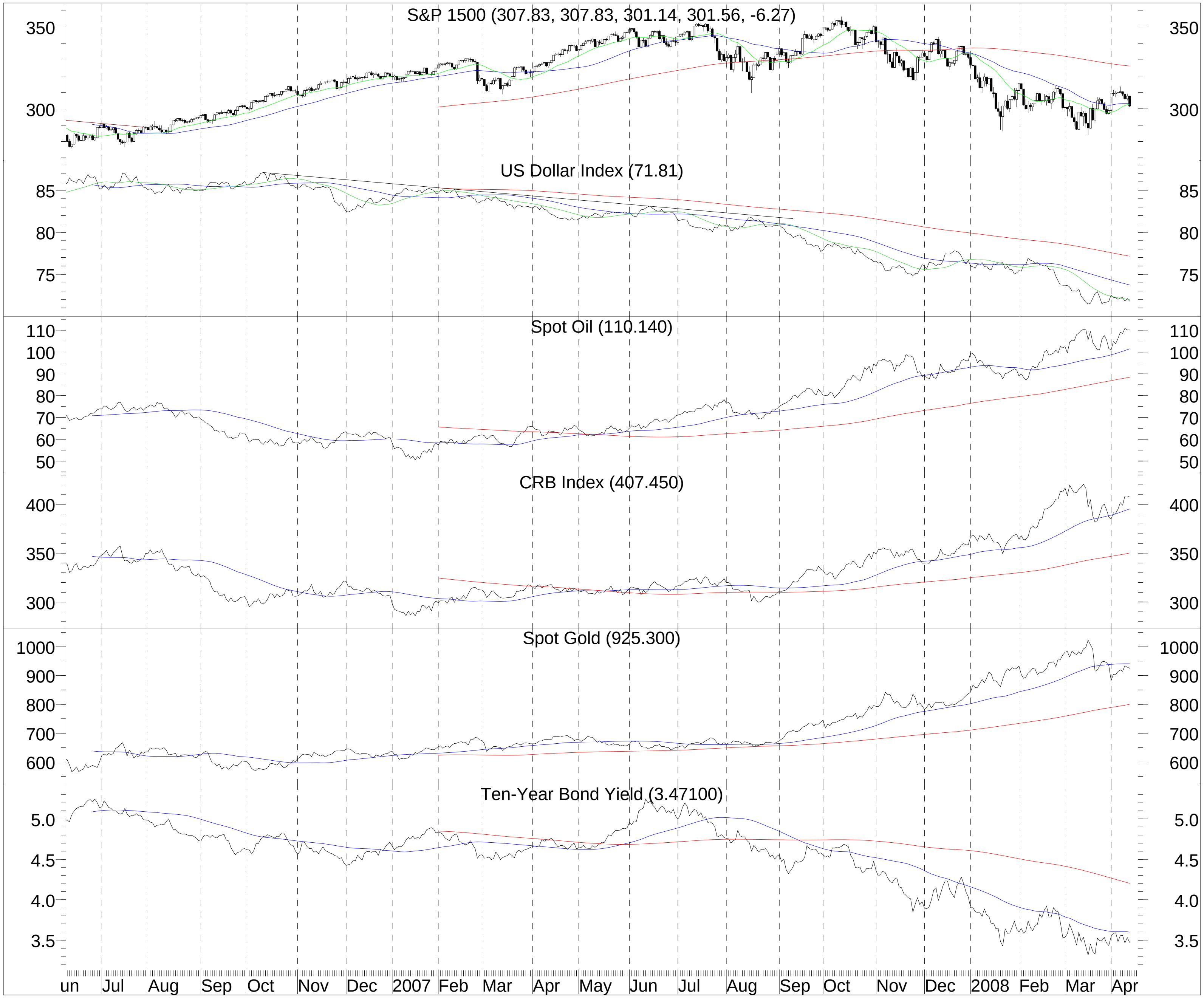
Volume has been light as both bull and bears wait for earnings news.



Spreads between equity and bond yields remain at wide levels where stocks are attractive. Of course projections need to be met, or at least not drop sharply.

Current and projected earnings continue to drop. The huge spread between the two can't remain for much longer.

S&P 1500 Analysis - Wayne S. Kaufman, CMT



The U.S. Dollar Index is trying to hold on to recent levels. There is a positive divergence on the weekly RSI.

Crude oil gave another buy signal when it broke 110 last week and made a new high.

Commodities and gold are still consolidating from an overbought condition. Any strength in the U.S. Dollar will cause further weakness in commodities.