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The Kaufman Report

Trade what you see, not what you think.

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Monday August 10, 2009 **Closing prices of August 7, 2009**

Stocks continued their levitation act last week as Friday's payrolls report helped the Dow Jones Industrials and the S&P 500 overcome weakness Wednesday and Thursday and move to new rally highs. The Nasdaq 100 was the laggard as it was unable to surpass its high of August 4th. We wondered last week if the Nasdaq 100 weakness was a warning sign for the market in general or if it was just sector rotation. So far the latter seems to be the case, with the dreaded Real Estate industry group being the big winner last week with a 16.02% increase, followed by Banks, up 14.97%.

For months we have identified two key elements as the primary reasons we have looked for higher prices for equities. They are the enormous global liquidity created by central banks around the world, and the total reluctance of investors to sell their stocks. We will get more color on the liquidity picture this week as the FOMC meets on Wednesday. Markets expect no tightening and in fact Fed funds futures are projecting a 45% probability of a cut to 0.0% at this meeting, along with a 32.9% likelihood of 0.0% at the meeting on 9/23.

As far as investor's desire to liquidate equities goes, there is not much change there either. While we did see some increase in selling this week versus the recent multi-year lows in many statistics of supply, until proven otherwise that seems indicative of sector rotation as prior leadership sees profit taking and money moves into previously lagging groups. This is also highlighted by the percent of stocks in the S&P 1500 that are now trading over their own 200-day moving averages, which is now a stunning 87.93%. The percent over the 50-day average is 85.53%. As we asked last week, if that's not a bull market, what is? In addition, the ability of stocks to remain at overbought levels during what is historically a seasonally weak period has to be interpreted as a sign of strength.

Still, we will remain on guard for any signs of a change in trend. In the short-term stocks are still overbought as, so caution is advised regarding entry points and the use of stop losses is recommended. We think stocks will trade higher after a brief pullback. We also think there is the potential for a deep correction later this year. However, as we have been saying for some time, we accept the possibility that huge global government intervention along with a possibly healing economy and companies that have become very lean and mean could create a scenario where profits will start to surprise to the upside and the deteriorating earnings trend will start to change. If so, we will be more than happy to delay or even cancel our expected bearishness.
Based on the S&P 500 the short-term, intermediate-term and long-term trends are up. Traders should not hesitate to rotate out of lagging sectors and stocks and into leaders. Aggressive traders can short overbought conditions, but they may need to cover quickly since those trades are counter-trend.

The following Opinion expresses the views of the editor and not those of John Thomas Financial. Fascism – a system of government marked by centralization of authority under a dictator, stringent socioeconomic controls, suppression of the opposition through terror and censorship. Fascism - A political regime, usually totalitarian, ideologically based on centralized government, government control of business, repression or criticism of opposition, a leader cult and exalting the state and/or religion above individual rights. flag@whitehouse.gov – the e-mail address where the White House would like each of us to report "disinformation" in e-mails and web videos regarding Obamacare. Why isn't it enough for Obama to just spell out the details of Obamacare and respond to criticism publicly? Obama doesn't have enough media outlets? What could possibly be the purpose of asking us to turn in our fellow citizens? This administration has become nothing less than terrifying. Let's pray that this is not the beginning of a terrible trend.

IMPORTANT DISCLOSURES

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The S&P 1500 (230.87) was up 1.495% Friday. Average price per share was up 2.28%. Volume was 117% of its 10-day average and 132% of its 30-day average. 87.48% of the S&P 1500 stocks were up, with up volume at 78.51% and up points at 94.25%. Up Dollars was 98.38% of total dollars, and was 261% of its 10-day moving average. Down Dollars was 9% of its 10-day moving average. For the week the index was up 2.509% on increasing and above average weekly volume.

The S&P 1500 is up 2.509% in July, up 10.306% quarter-to-date, up 12.658%% year-to-date, and down 35.22% from the peak of 356.38 on 10/11/07. Average price per share is $28.97, down 32.97% from the peak of $43.23 on 6/4/07.

Percent over 10-sma: 71.20%. 13-Week Closing Highs: 448. 13-Week Closing Lows: 6.

Put/Call Ratio: 0.729. Kaufman Options Indicator: 1.07.

P/E Ratios: **103.63 (before charges)**, 18.68 (continuing operations), 17.33 (analyst estimates).

P/E Yield 10-year Bond Yield Spreads: ***-75% (earnings bef. charges),*** *39% (earnings continuing ops), and 50% (projected earnings).* Aggregate earnings before charges for the S&P 1500 peaked in August 2007 at $19.18 and are now at $2.23, a drop of 88.37%. Aggregate earnings from continuing operations peaked at $19.95 in September 2007 and are now $12.36, down 38.05%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $13.33, a drop of 39.27%.

446 of the S&P 500 have reported 2nd quarter earnings. According to Bloomberg, 72.2% had positive surprises, 8.3% were in line, and 19.5% have been negative. The year-over-year change has been -29.9% on a share-weighted basis, -22.3% market cap-weighted and -25.1% non-weighted. Ex-financial stocks these numbers are -29.4%, -24.2%, and -27.6 %, respectively.

Federal Funds futures are pricing in a probability of 55.0% that the Fed will leave rates unchanged and a probability of 45.0% of cutting rates 25 basis points to 0.00% when they meet on August 12th. They are pricing in a probability of 52.3% of no change, 32.9% of cutting 25 basis points to 0.00%, and 14.8% of raising 25 basis points to 0.50% when they meet on September 23rd.

IMPORTANT DISCLOSURES

	Daily	WTD	MTD	QTD	YTD
Dow Jones Industrials	1.23%	2.16%	2.16%	10.93%	6.76%
S&P 500	1.34%	2.33%	2.33%	9.92%	11.87%
Nasdaq 100	1.20%	1.01%	1.01%	9.63%	33.66%
Nasdaq Composite	1.37%	1.10%	1.10%	9.00%	26.84%
S&P 1500	1.49%	2.51%	2.51%	10.31%	12.66%
S&P Midcap 400	2.60%	4.31%	4.31%	13.31%	21.70%
S&P Smallcap 600	2.73%	2.88%	2.88%	13.39%	13.22%
Bank of New York Mellon ADR	0.45%	2.06%	2.06%	12.56%	21.22%

	Daily	WTD	MTD	QTD	YTD
Consumer Discretionary	3.31%	4.85%	4.85%	14.68%	23.30%
Financials	2.70%	10.44%	10.44%	20.14%	14.43%
Industrials	2.53%	5.07%	5.07%	14.78%	5.96%
Information Technology	0.95%	0.70%	0.70%	9.91%	36.37%
Health Care	0.83%	-0.91%	-0.91%	4.80%	3.79%
Utilities	0.83%	-0.37%	-0.37%	3.30%	-0.91%
Materials	0.47%	4.02%	4.02%	17.86%	32.33%
Consumer Staples	0.45%	-1.04%	-1.04%	5.06%	1.45%
Telecom Services	0.10%	-2.74%	-2.74%	0.76%	-6.03%
Energy	-0.07%	0.15%	0.15%	4.46%	1.08%

	Daily	WTD	MTD	QTD	YTD
Real Estate	5.66%	16.02%	16.02%	28.21%	7.02%
Media	4.01%	5.39%	5.39%	12.77%	14.90%
Banks	3.68%	14.97%	14.97%	21.09%	-5.80%
Retailing	3.61%	5.10%	5.10%	15.55%	33.46%
Transportation	3.45%	4.15%	4.15%	15.39%	7.92%
Consumer Durables & Apparel	3.39%	5.72%	5.72%	22.06%	20.66%
Insurance	3.33%	8.95%	8.95%	21.35%	6.53%
Commercial & Professional Services	3.25%	3.10%	3.10%	5.27%	-0.32%
Consumer Services	2.53%	3.93%	3.93%	7.02%	8.12%
Capital Goods	2.21%	5.52%	5.52%	15.55%	6.04%
Diversified Financials	1.75%	8.52%	8.52%	18.34%	30.30%
Technology Hardware & Equipment	1.14%	0.80%	0.80%	12.59%	43.12%
Software & Services	1.12%	1.44%	1.44%	5.23%	28.21%
Health Care Equip & Services	0.96%	-0.59%	-0.59%	5.05%	12.34%
Utilities	0.83%	-0.37%	-0.37%	3.30%	-0.91%
Pharmaceuticals, Biotech & Life Sciences	0.78%	-1.05%	-1.05%	4.69%	0.29%
Food & Staples Retailing	0.75%	0.36%	0.36%	4.32%	-1.45%
Household & Personal Products	0.75%	-4.65%	-4.65%	3.76%	-8.08%
Automobiles & Components	0.75%	2.32%	2.32%	32.71%	93.10%
Materials	0.47%	4.02%	4.02%	17.86%	32.33%
Food, Beverage & Tobacco	0.16%	0.01%	0.01%	6.04%	8.24%
Telecom Services	0.10%	-2.74%	-2.74%	0.76%	-6.03%
Energy	-0.07%	0.15%	0.15%	4.46%	1.08%
Semiconductors & Equipment	-0.17%	-1.54%	-1.54%	13.93%	36.96%

The S&P 500 responded to Friday's employment report by leaping to new rally highs. In doing so it reached the 1014 area, which is the 38.2% Fibonacci retracement of the entire bear market.

The slope of the 200-sma is actually rising!

Momentum indicators remain at high levels with the stochastic showing a negative crossover.

The S&P 500 is up four weeks in a row.

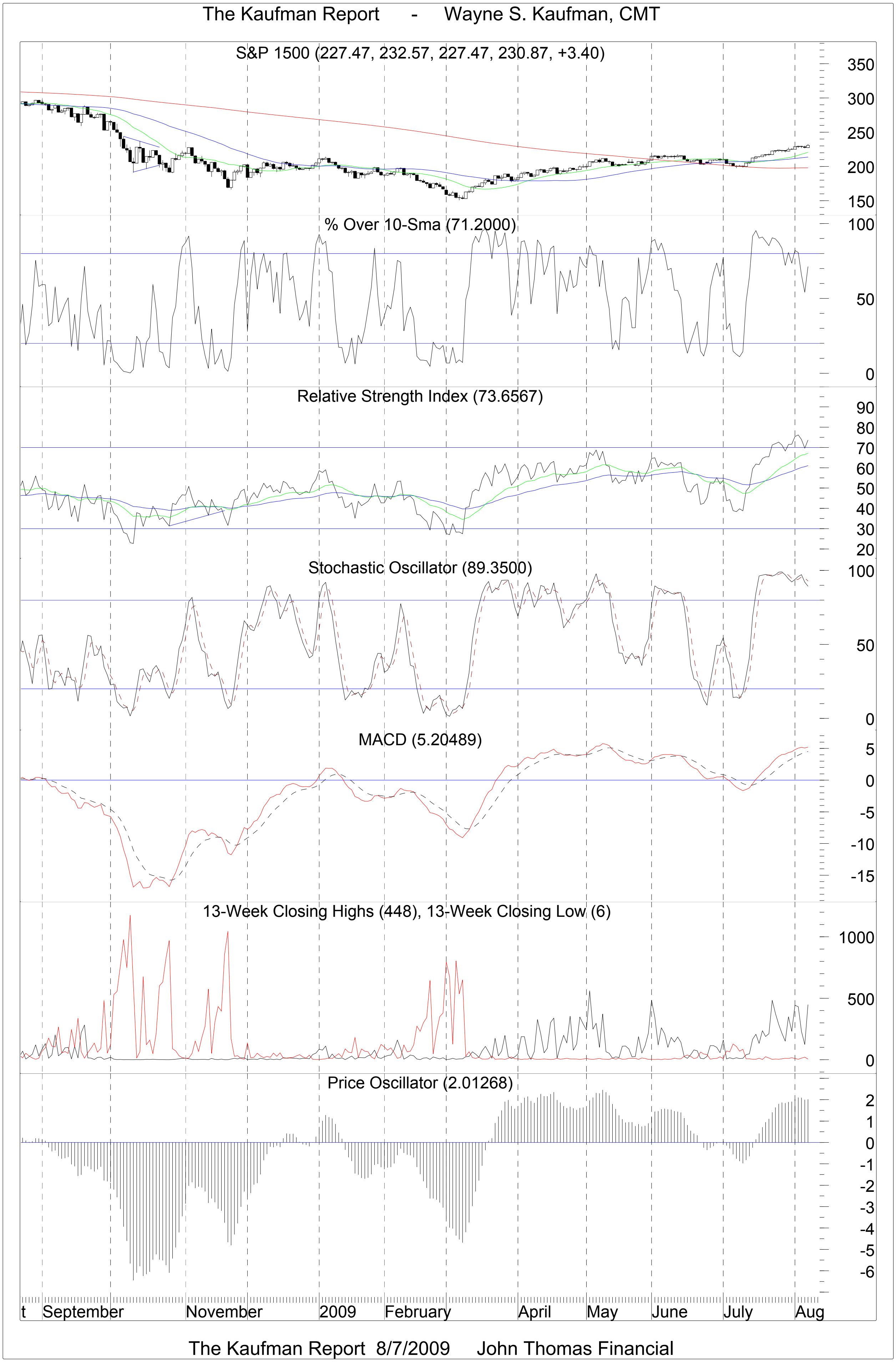
Weekly momentum indicators are at high levels but have not yet turned down.

The Nasdaq 100 printed a bearish shooting star candle on 7/30 and in spite of a marginal new high on 8/4 it has lost momentum since. It printed a bearish engulfing candle on 8/5, and on Friday it was unable to join in with the S&P 500 and the Dow Jones Industrials as they moved to new rally highs. This could just be due to sector rotation, or this non-confirmation could be a warning of a more severe pullback for equities.

Momentum indicators remain at high levels, but the stochastic and the MACD are both showing negative crossovers.

The Nasdaq 100 printed a doji candle on the weekly chart. Doji are signs of indecision frequently seen at tops and bottoms.

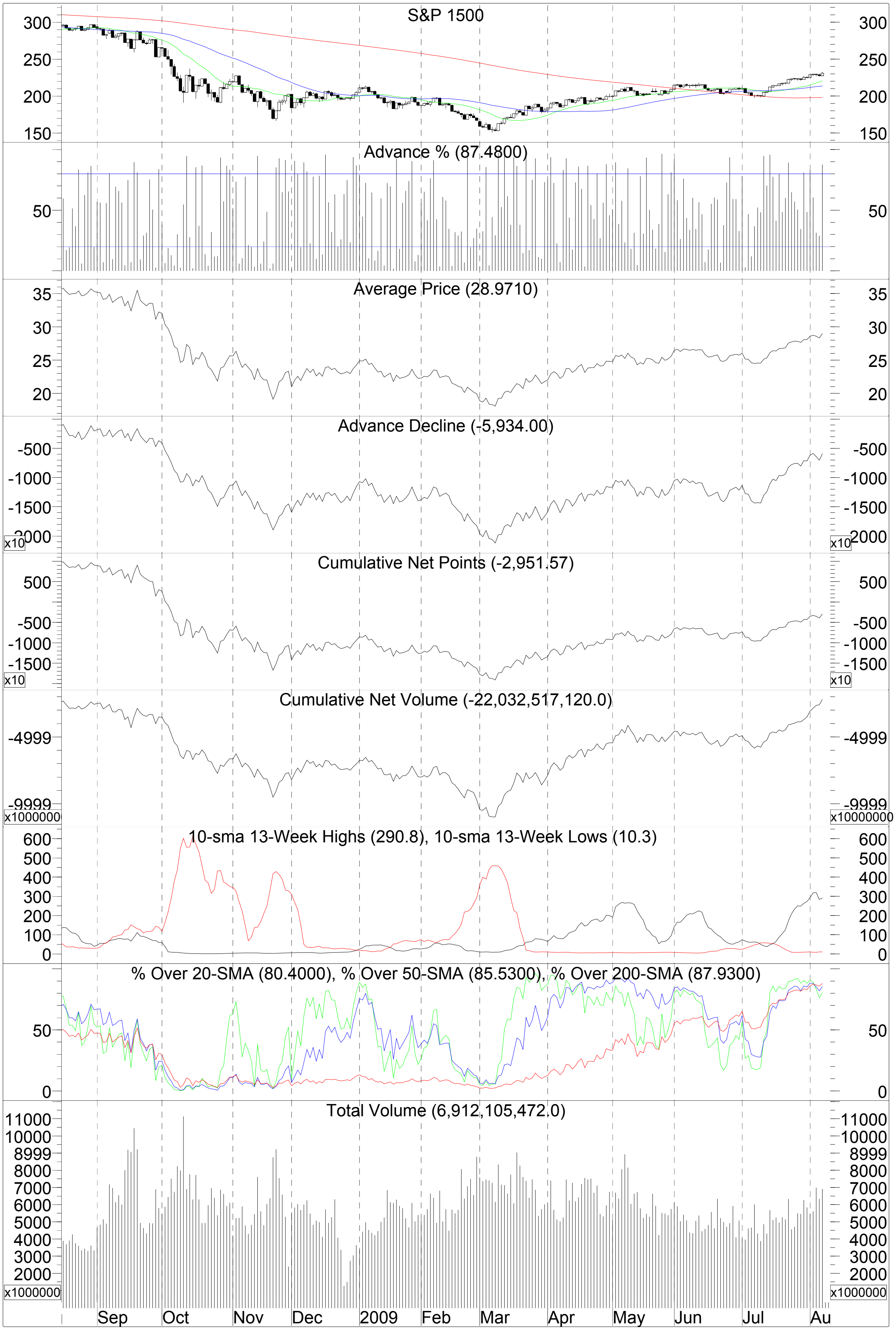
Weekly momentum indicators remain at high levels but have not turned down yet.



There is a negative divergence in the percent over 10-sma. This could just be sector rotation as recent leaders take a breather. Still, with equities at overbought levels it is a reason to stay on our toes.

Friday's 448 13-week closing highs was less than the 483 on 7/23.

Our price oscillator, a good indicator of trends, remains in positive territory.

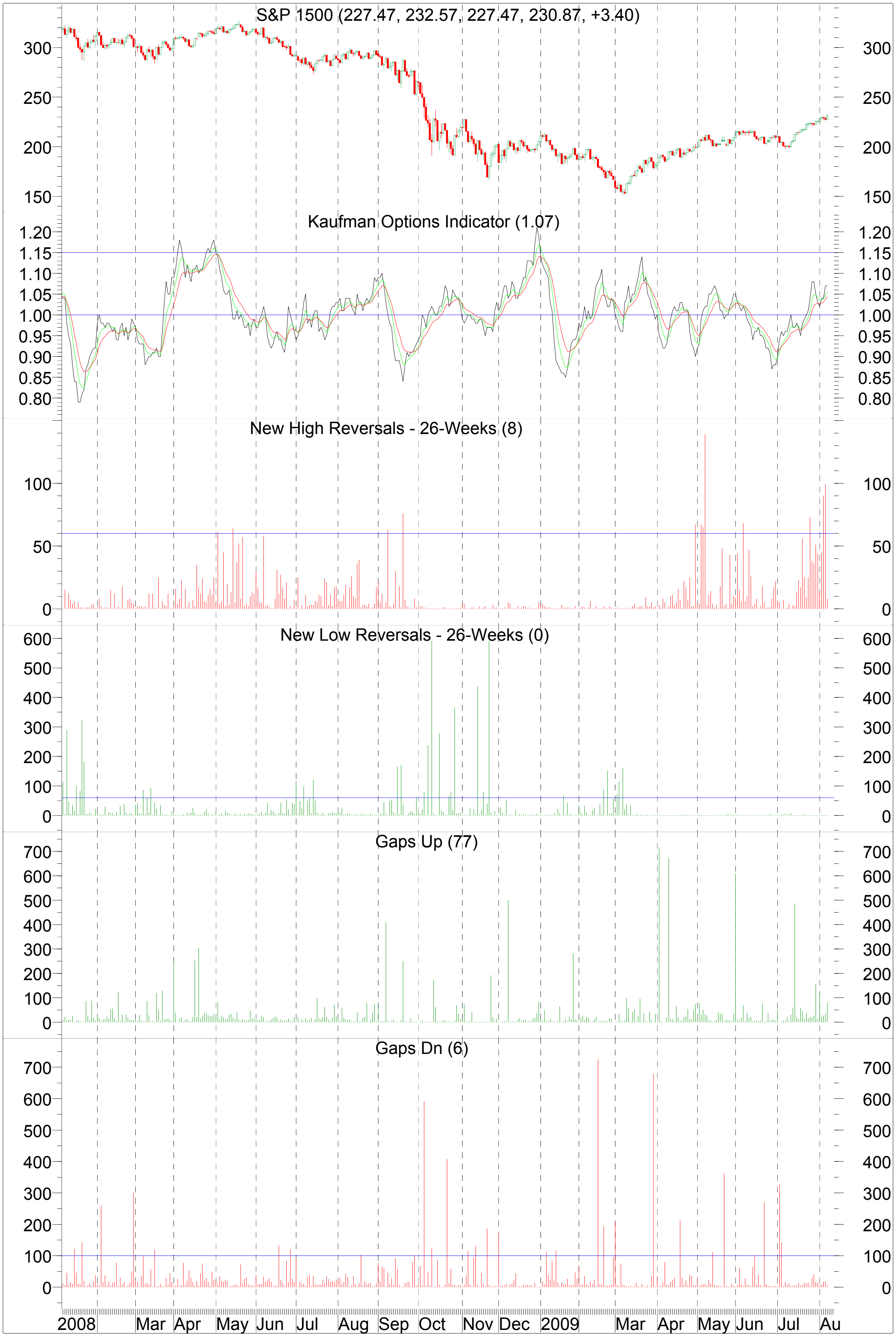


87.48% of stocks traded higher Friday.

Last week all of our statistics of market internals made new rally highs confirming the high on the S&P 1500. There is a tiny negative divergence on the AD line, but it could go away in one session. Still, with equities overbought, we remain watchful.

Last week the 10-sma of 13-week closing highs made a new rally high.

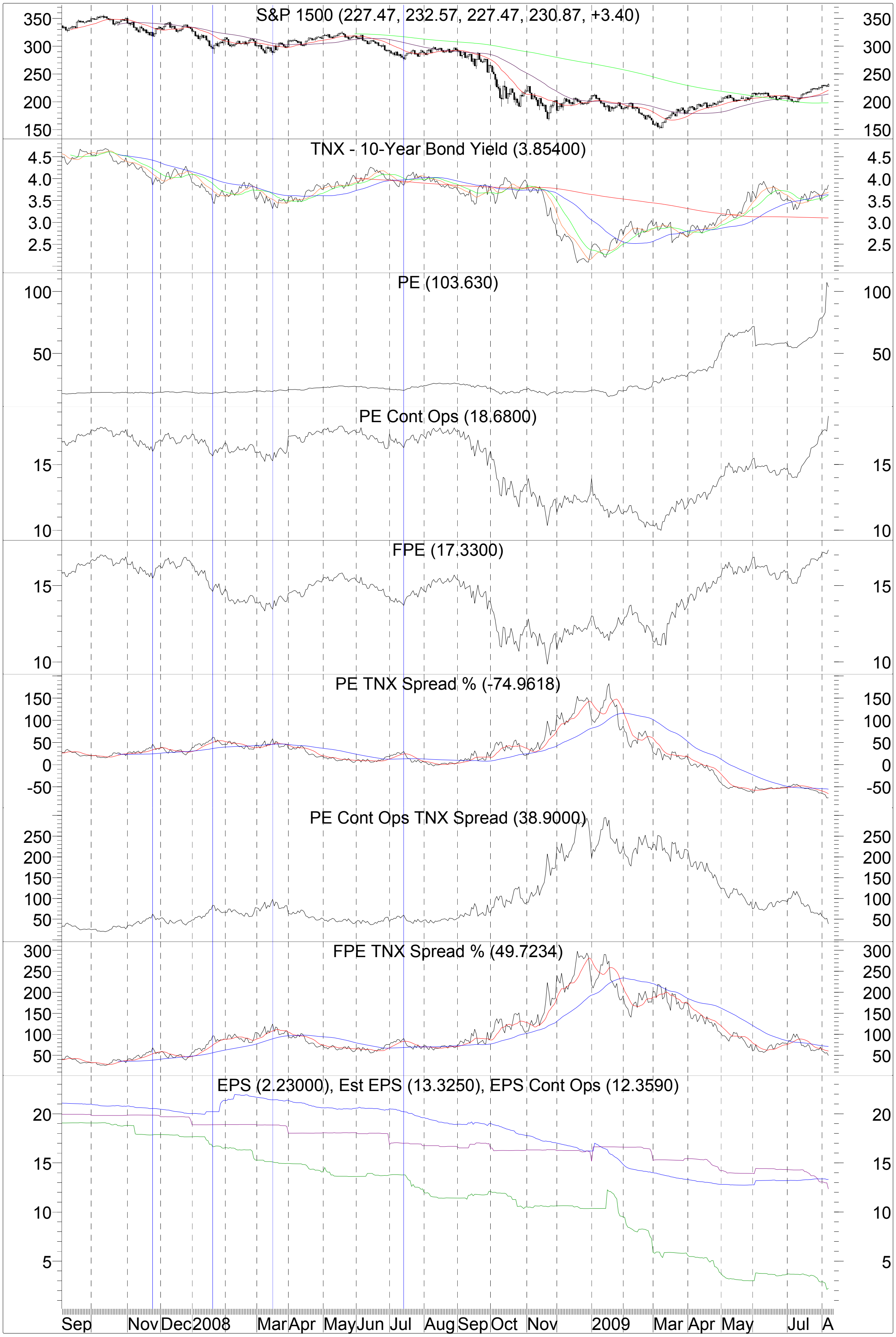
These numbers are spectacular, with the percent over 200-sma now at 87.93%, the highest number in years.



Our proprietary options indicator is at 1.07, a number that shows optimism among options buyers. It is also in the range where equities can become weak, although it is not at the extreme levels we have seen in the past.

The recent pickup in new high reversals shows an increased willingness on the part of investors to take profits.

Our statistics of supply (red) versus demand (green) show positive crossovers for all time frames. Sellers are still on the sidelines, and until they become motivated pullbacks will probably be caused by buyers taking a pause, and the path of least resistance will be higher.



P/E ratios continue to rocket higher.

Spreads between bond and equity yields continue to move lower. The spreads based on continuing operations and forecasts are actually at levels where in normal markets stocks would be attractive.

Aggregate earnings and earnings from continuing operations continue their inexorable move lower.

The U.S. Dollar Index bounced last week and printed a hammer candle on the weekly chart (not shown). With near unanimity on the bearish side it seems unlikely the Dollar will plunge in the near-term. More of a bounce seems likely.

Crude oil remains at a resistance zone which goes up to 73. If it breaks out, how will $80 oil affect any economic recovery? Of course, a bounce in the Dollar will create weakness for oil.

Gold seems destined to go to $1000, but here too we have expressed skepticism due to the near unanimous bullishness about gold. If the Dollar bounces gold will weaken, which would give a better entry long for gold.

The 10-year bond yield remains in an up trend and seems poised to move higher. There is a resistance zone from 4.014 to about 4.3%. A break above that would project much higher yields.