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The Kaufman Report

Trade what you see, not what you think.

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Monday August 3, 2009 **Closing prices of July 31, 2009**

Are we there yet?

This is the time of the year many families load up the SUV or mini-van and hit the road. Parents are very familiar with the constant "are we there yet" emanating from the little ones during what seems to be an endless journey. We are at a similar point in the financial markets after a prolonged and historic bear market and recession. Is the recession over? Is the bear market over?

Our job is to help investors navigate the financial markets. We do this not by attempting to be economists, but by constantly evaluating the supply and demand equations in the markets and by following our motto at the top of the page. Therefore, we will trade what we see, not what we think. At this juncture it seems difficult to make the case this remains a bear market, while many statistics argue strongly that it is a bull. The most compelling are the percentages of stocks over important moving averages. 85% of the S&P 1500 are trading over their 50-day moving average, while 83% are above their 200-day moving average. That means if you bought a stock in the last nine months or so you had a five out of six chance of making money. If that's not a bull market, what is? Rightly or wrongly, investors are currently not interested in selling their stocks. As long as demand is greater than supply, the path of least resistance will be higher.

We do have concerns, the foremost being valuation. 70.6% of the companies in the S&P 500 have reported second quarter earnings. While the financial media is trumpeting that roughly three out of four have exceeded analyst estimates, aggregate earnings are still marching inexorably lower. Aggregate earnings forecasts are firming or even rising slightly, but let's not forget that analysts have a history of being overly optimistic. They were way behind the curve in lowering the numbers during the decline. Meanwhile, P/E ratios are rising and are at the highest level seen in many months, and spreads between equity and bond yields have narrowed dramatically.

If forced to put a positive spin on current valuations, it would be that investors no longer believe in financial Armageddon and they are able to see who the survivors are. There is some wisdom to this, because life can sometimes be a war of attrition. The companies that have made it through all of this are now very lean and mean and should benefit from operating leverage at the point the economy truly gets better. If a company can make money now, it should do very well in a decent economy, and investors seem content to wait for that.

Still, we will remain on guard for any signs of a change in trend. In the short-term stocks are still overbought as we enter a period of seasonal weakness, so caution is advised regarding entry points. 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 .

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The S&P 1500 (225.22) was up 0.071% Friday. Average price per share was up 0.10%. Volume was 108% of its 10-day average and 115% of its 30-day average. 48.48% of the S&P 1500 stocks were up, with up volume at 67.41% and up points at 53.35%. Up Dollars was 52.44% of total dollars, and was 50% of its 10-day moving average. Down Dollars was 147% of its 10-day moving average. For the week the index was up 0.882% on increasing and above average weekly volume.

The S&P 1500 was up 7.61% in July, up 7.61% quarter-to-date, up 9.9%% year-to-date, and down 36.80% from the peak of 356.38 on 10/11/07. Average price per share is $28.09, down 35.02% from the peak of $43.23 on 6/4/07.

Percent over 10-sma: 73.53%. 13-Week Closing Highs: 231. 13-Week Closing Lows: 16.

Put/Call Ratio: 0.841. Kaufman Options Indicator: 1.03.

P/E Ratios: **78.45 (before charges)**, 17.27 (continuing operations), 16.84 (analyst estimates).

P/E Yield 10-year Bond Yield Spreads: ***-64% (earnings bef. charges),*** *65% (earnings continuing ops), and 70% (projected earnings)*. Aggregate earnings before charges for the S&P 1500 peaked in August 2007 at $19.18 and are now at $2.87, a drop of 85.03%. Aggregate earnings from continuing operations peaked at $19.95 in September 2007 and are now $13.04, down 34.64%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $13.38, a drop of 39.04%.

353 of the S&P 500 have reported 2nd quarter earnings. According to Bloomberg, 74.5% had positive surprises, 8.5% were in line, and 17.0% have been negative. The year-over-year change has been -31.7% on a share-weighted basis, -24.3% market cap-weighted and -28.8% non-weighted. Ex-financial stocks these numbers are -29.7%, -23.9%, and -26.8 %, respectively.

Federal Funds futures are pricing in a probability of 80.1% that the Fed will leave rates unchanged and a probability of 19.9% of cutting rates 25 basis points to 0.00% when they meet on August 12th. They are pricing in a probability of 77.7% of no change, 19.2% of cutting 25 basis points to 0.00%, and 3.1% of raising 25 basis points to 0.50% when they meet on September 23rd.

The Kaufman Report - Wayne S. Kaufman, CMT

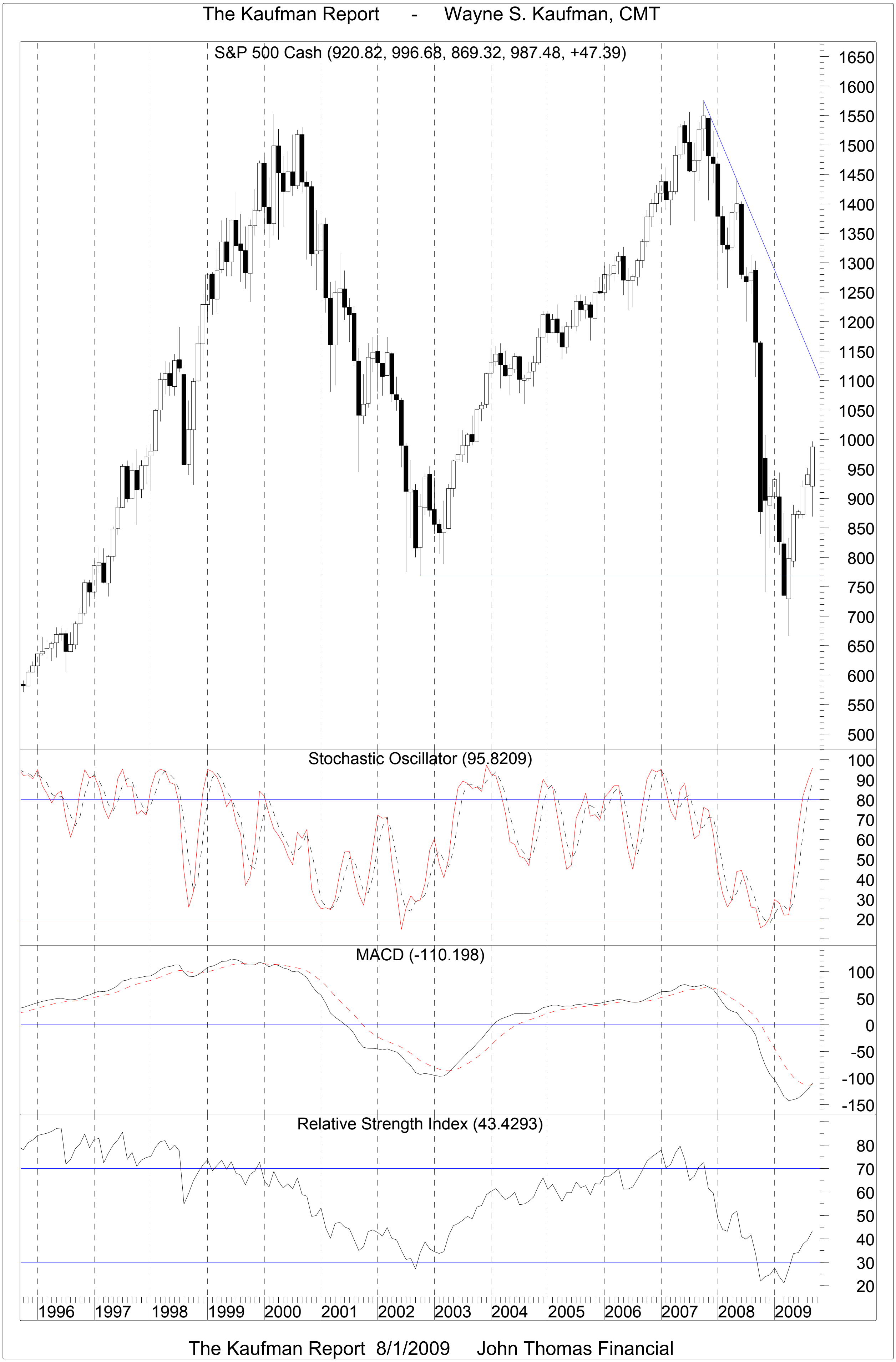
The S&P 500 made a new rally high Thursday, although selling came in towards the end of the session. On Friday the index printed a doji candle. Doji are signs of indecision which frequently mark the end of moves.

The 200-sma is no longer sloping down.

The RSI is showing a negative divergence, but more important is the negative crossover on the stochastic, which is dropping out of the overbought zone.

The S&P 500 has retraced 35.27% of the bear market. It is nearing a resistance zone which will also coincide with a Fibonacci 38.2% retracement, which would be at 1,014. The 80-week (about 400-day) moving average is finally coming into the picture. The 20-week moving average remains above the 40-week moving average, where it had been until it crossed under in November 2007.

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



The monthly stochastic is at a high level, but the RSI is not. The monthly MACD is showing a positive crossover.

Wednesday night we said the pattern of 12 consecutive higher bottoms on the Nasdaq 100 meant another move higher could be coming. We also said we would be skeptical unless it occurred on strong volume. The move higher to new rally highs did occur Thursday, but was reversed as the index closed lower on the day than where it opened and printed a bearish shooting star candle. A similar reversal occurred Friday.

The slope of the 200-sma is now moving steadily higher.

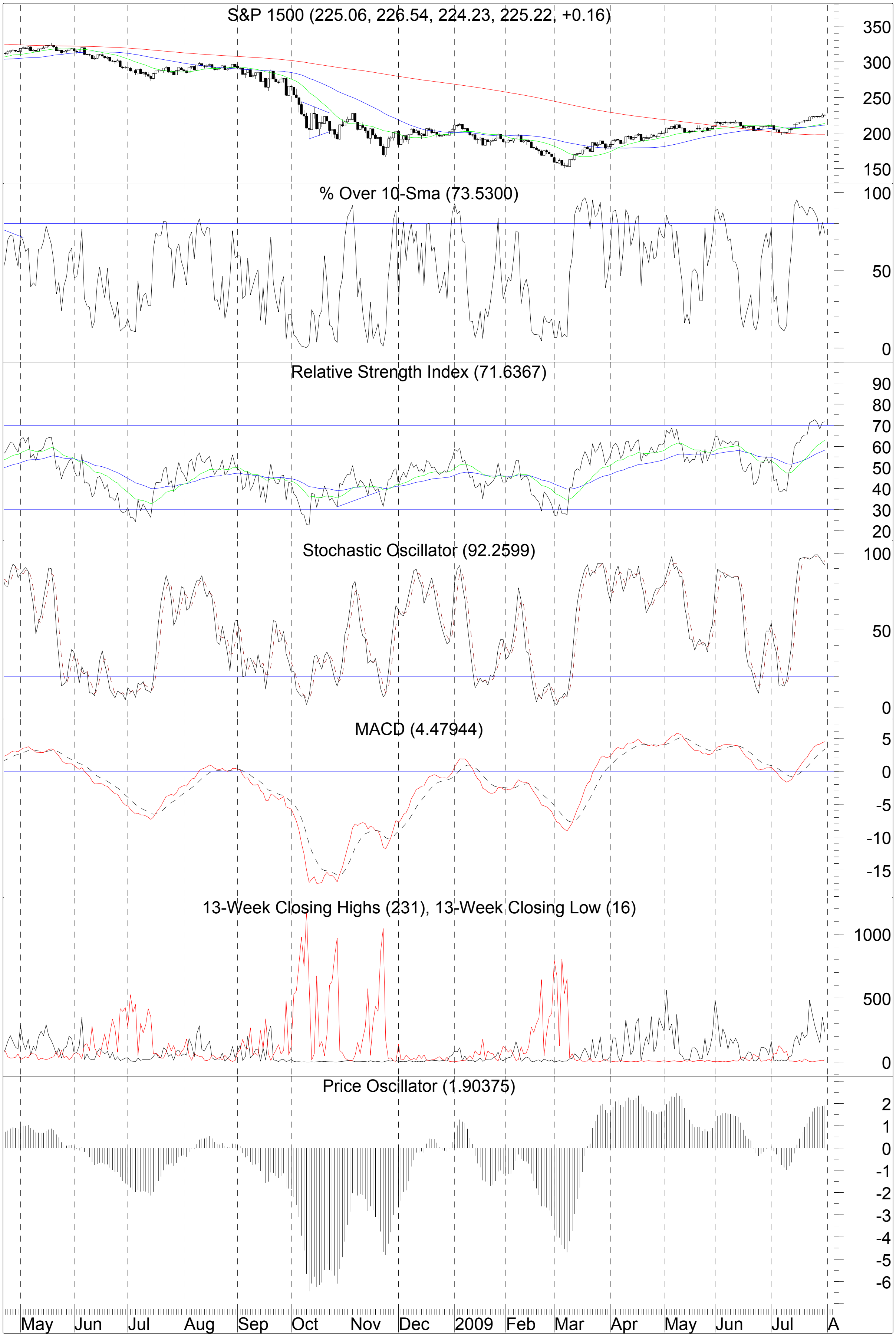
Momentum indicators remain at high levels but seem to be turning down. The stochastic is showing a negative crossover from the overbought zone.

Last week the Nasdaq 100 printed a high wave spinning top candle, which is a sign of indecision. It is not far under a resistance zone of prior supports, and it is just shy of a 50% retracement of its entire bear market move down. The 50% number is 1629, or 1.6% away. For the curious, that bear market low was a drop of 54.5% from the top.

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

The weekly chart of the Nasdaq 100 shows it is just under resistance.

Monthly momentum indicators are rising with room to move higher. The MACD is starting to make a positive crossover.

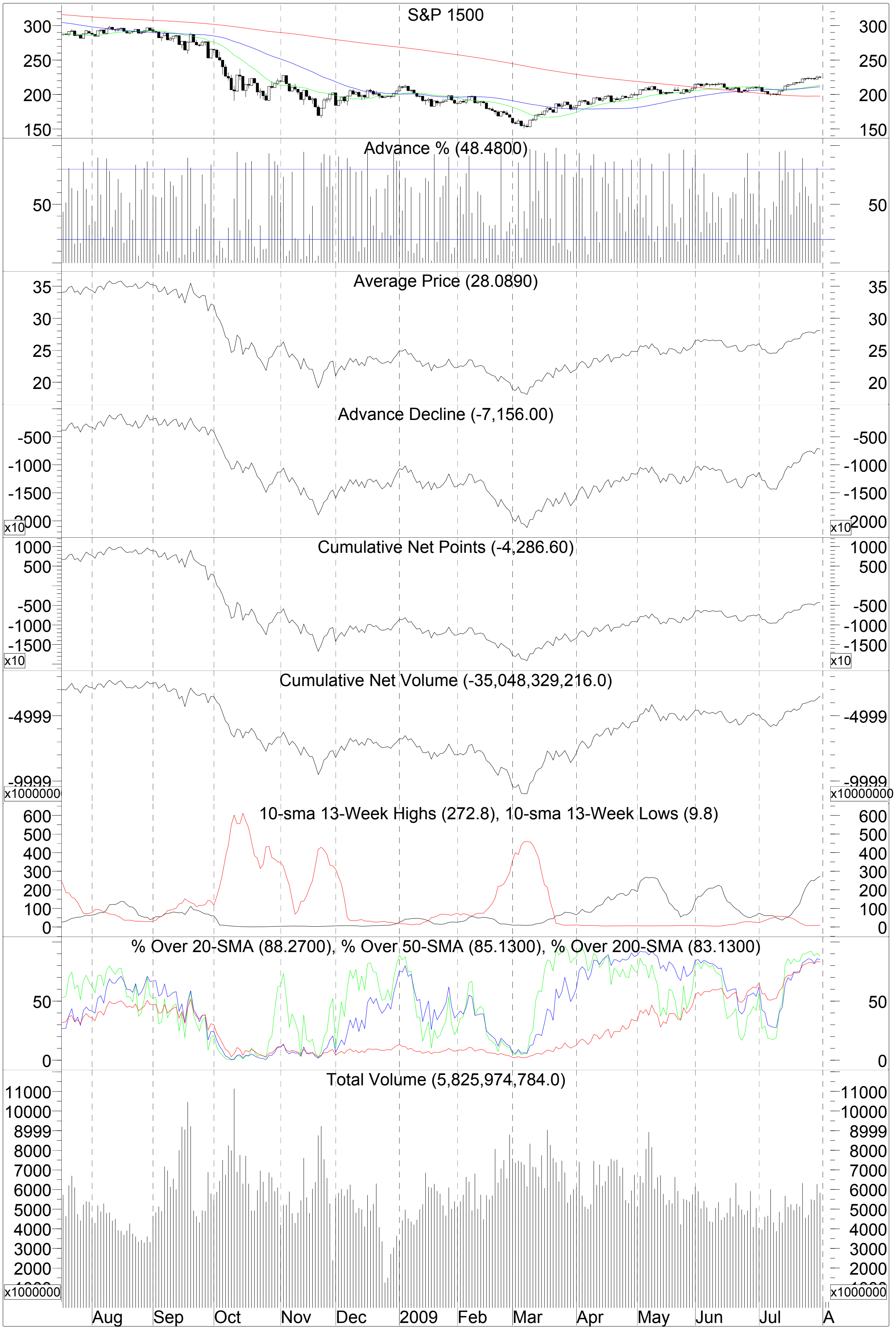


A negative divergence has developed in the percent over 10-sma.

The RSI is in the overbought zone for the first time since 2007. This is a sign of strength.

The stochastic has a negative crossover.

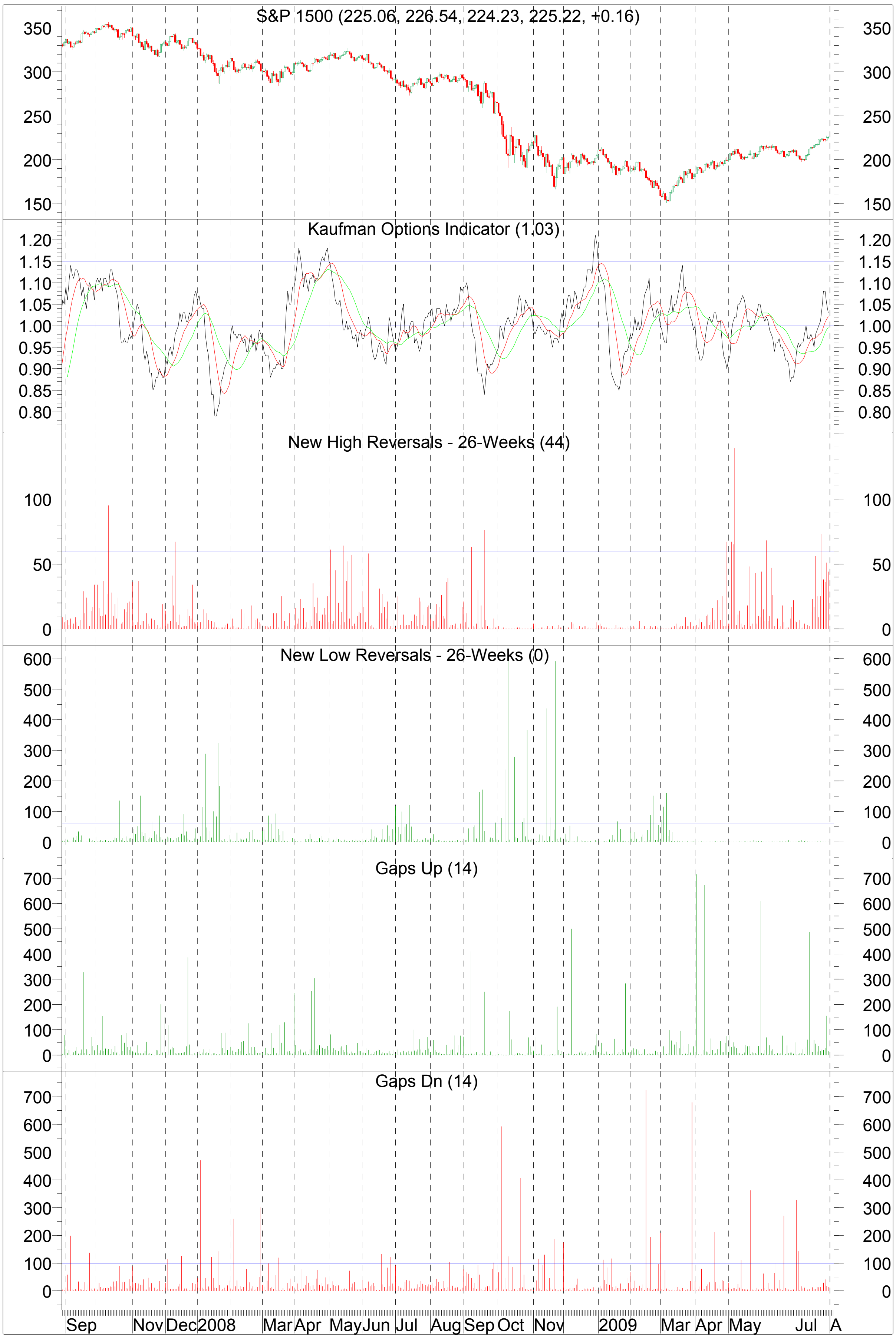
Our price oscillator, a good indicator of trends, remains in positive territory.



Our statistics of market internals have all made new rally highs, confirming the high on the S&P 1500.

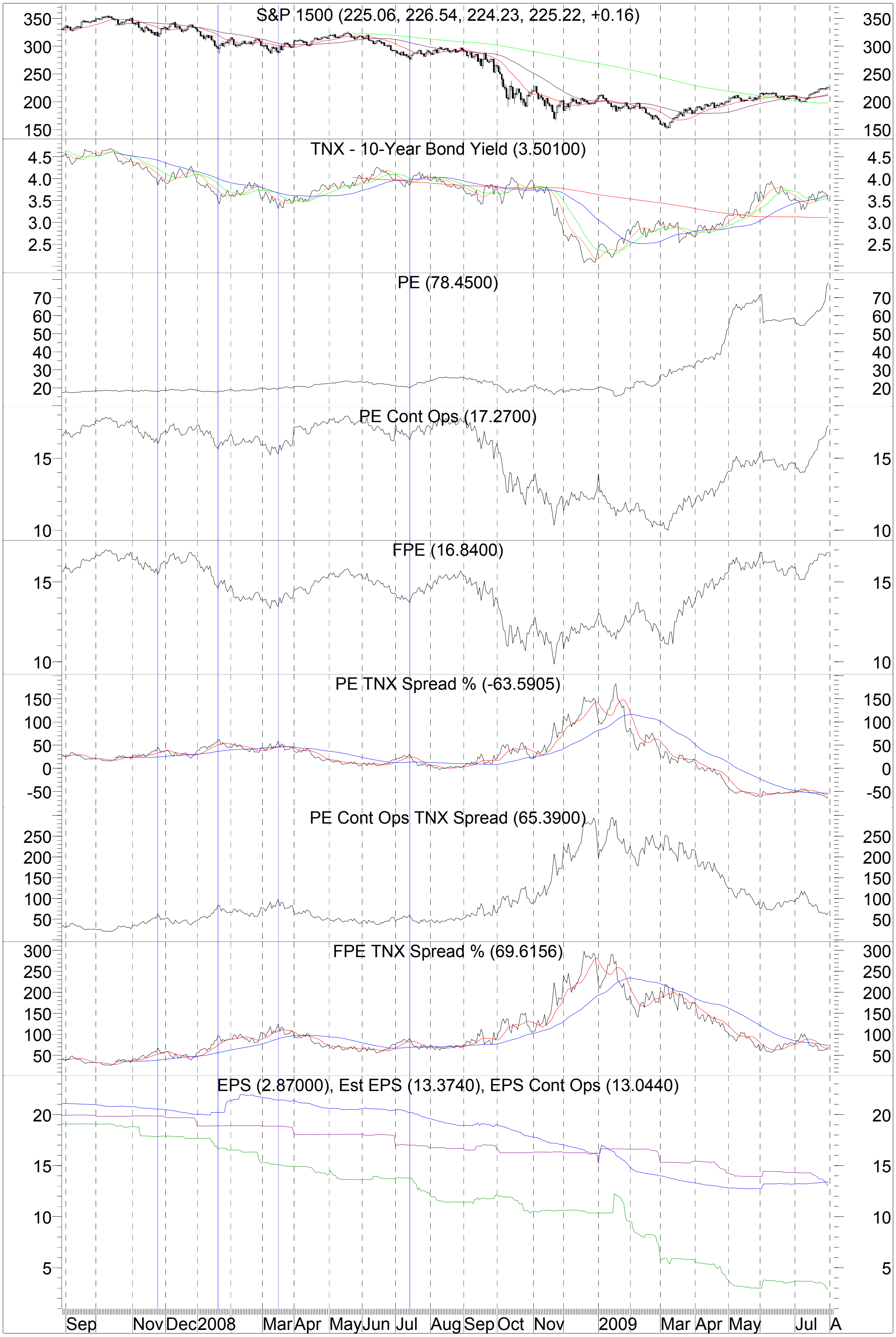
The 10-sma of 13-week closing highs made a new rally high and is the best since 10/18/2006.

These percentages over important moving averages are impressive and are bull market numbers.



Our proprietary options indicator hit 1.08 on Tuesday, the highest since 1.09 on March 24th. High numbers showing too much bullishness usually foreshadow a short-term period of weakness.

Our statistics of supply (red) versus demand (green) show positive crossovers for all time frames. Buyers are not wildly enthusiastic, but sellers are still not around. As we said last week, some statistics of supply are at their lowest levels in years, and unless sellers become motivated pullbacks will not be deep and the path of least resistance will be up.



We have been expressing caution regarding P/E ratios, but now they are getting scary.

Analyst projections (purple) are increasing while earnings before charges (green) and earnings from continuing operations (red) continue to march inexorably lower.

The U.S. Dollar Index remains in a down trend just below resistance.

Crude oil broke through resistance last week and is back above its 50-sma. There is a resistance zone up to 73, and if it breaks through that watch out! How will the current recovery react to $80 oil?

After some mid-week weakness gold vaulted higher Friday. It has entered a seasonally strong period which lasts through the end of August.