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The Kaufman Report

Trade what you see, not what you think.

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Monday December 15, 2008 **Closing prices of December 12, 2008**

Last week we outlined the reasons for our cautious optimism for stocks. For the week the S&P 1500 was up 0.556%. We think the most important current issue is that stocks are not reacting negatively to bad news, and this is most likely due to extreme valuation levels. Equities as an asset class are viewed as being cheap. We also think this will be supportive for stocks at least until the next earnings season in January. Technically the most important issue is the 50-day moving average which is now in play and could push stocks down. A move above it will of course be a major positive.

Our concerns for the first quarter will be earnings reported in January, levels of unemployment, whether or not the TARP and near zero interest rates begin to help the economy and what policy response is left after that, and the ongoing saga of the Detroit Three. We consider the current move in stocks a bear market rally, and we will remain vigilant for signs of another leg down.

The S&P 1500 (198.80) was up 0.965% Friday. Average price per share was up 2.11% as small caps jumped. Volume was 89% of its 10-day average and 87% of its 30-day average. 78.32% of the S&P 1500 stocks were up on the day, with up volume at 71.75% and up points at 82.40%. Up Dollars was 92.15% of total dollars, and was 107% of its 10-day moving average while Down Dollars was 8% of its 10-day moving average. The index is down 1.79% month-to-date, down 25.25% quarter-to-date, down 40.01% year-to-date, and down 44.22% from the peak of 356.38 on 10/11/07. Average price per share is $23.10, down 46.56% from the peak of $43.23 on 6/4/2007.

The Put/Call Ratio was 1.04. The Kaufman Options Indicator was 1.04. *The spread between the reported earnings yield and 10-year bond yield is 107% and 224% based on projected earnings. These are unheard of levels*. *The dividend yield on the S&P 500 recently moved higher than the 10-year bond yield for the first time since 1958.*

Reported aggregate earnings for the S&P 1500 peaked in August 2007 at $19.18 and are now at $10.63, a drop of 44.58%, and have been moving slightly higher since $10.57 on 10/24. Estimated aggregate earnings peaked at $21.95 in February 2008, are still moving lower, and are now $16.70, a drop of only 23.92%. Analysts have obviously been very late in lowering estimates. *If investors had any confidence in current earnings estimates stocks would be much higher than they currently are.*
498 companies in the S&P 500 have reported third quarter earnings. According to Bloomberg, 58.1% have had positive surprises, 9.7% have been in line, and 32.3% have been negative. The year-over-year change has been -18.3% on a share-weighted basis, +5.3% market cap-weighted, and -2.7% non-weighted. Ex-financial stocks these numbers are 10.1%, 23.7%, and 15.8%, respectively.

Federal Funds futures are pricing in a 28.0% probability that the Fed will *cut rates 50 basis points to 0.50%,* and a 72.0% probability of *cutting 75 basis points to 0.25%* when they meet on December 16th. They are pricing in a 28.0% probability that the Fed will *cut rates 50 basis points to 0.50%* on January 28th, and a 72.0% probability of *cutting 75 basis points to 0.25%.*

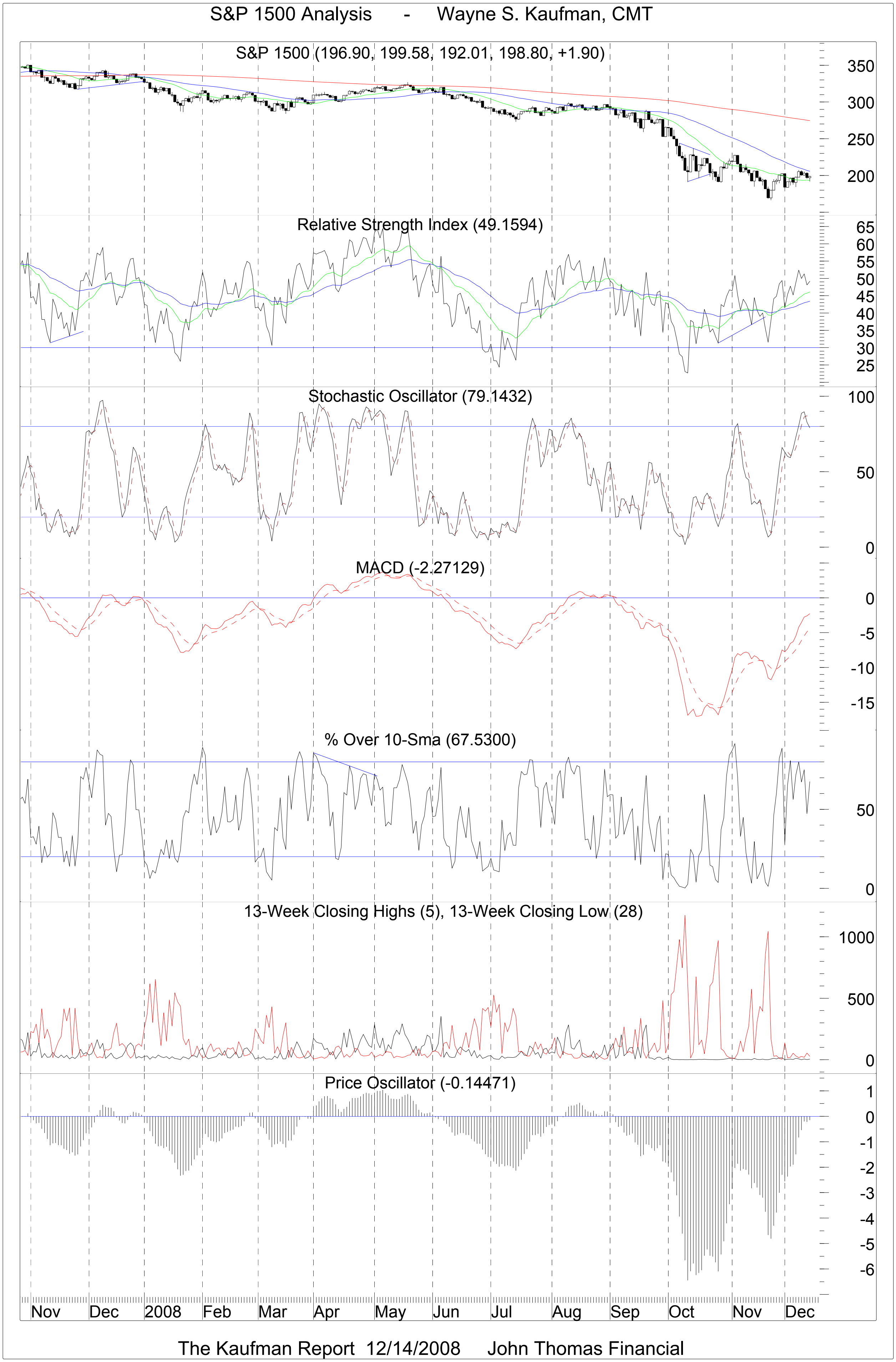
The short-term trend is now up, while the intermediate and long-term trends remain down. We reiterate that this continues to be an opportunistic trader's market, with adept traders able to take advantage long or short, but the primary downtrend must still be respected. Investors should not hesitate to move out of laggard sectors and stocks and into leaders.

IMPORTANT DISCLOSURES

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

Stocks pulled back as expected due to overbought levels, too much bullishness on the part of options buyers, and the 50-day moving average bearing down on major indexes. Still, the S&P 1500 held trend line support and the 20-sma (green).

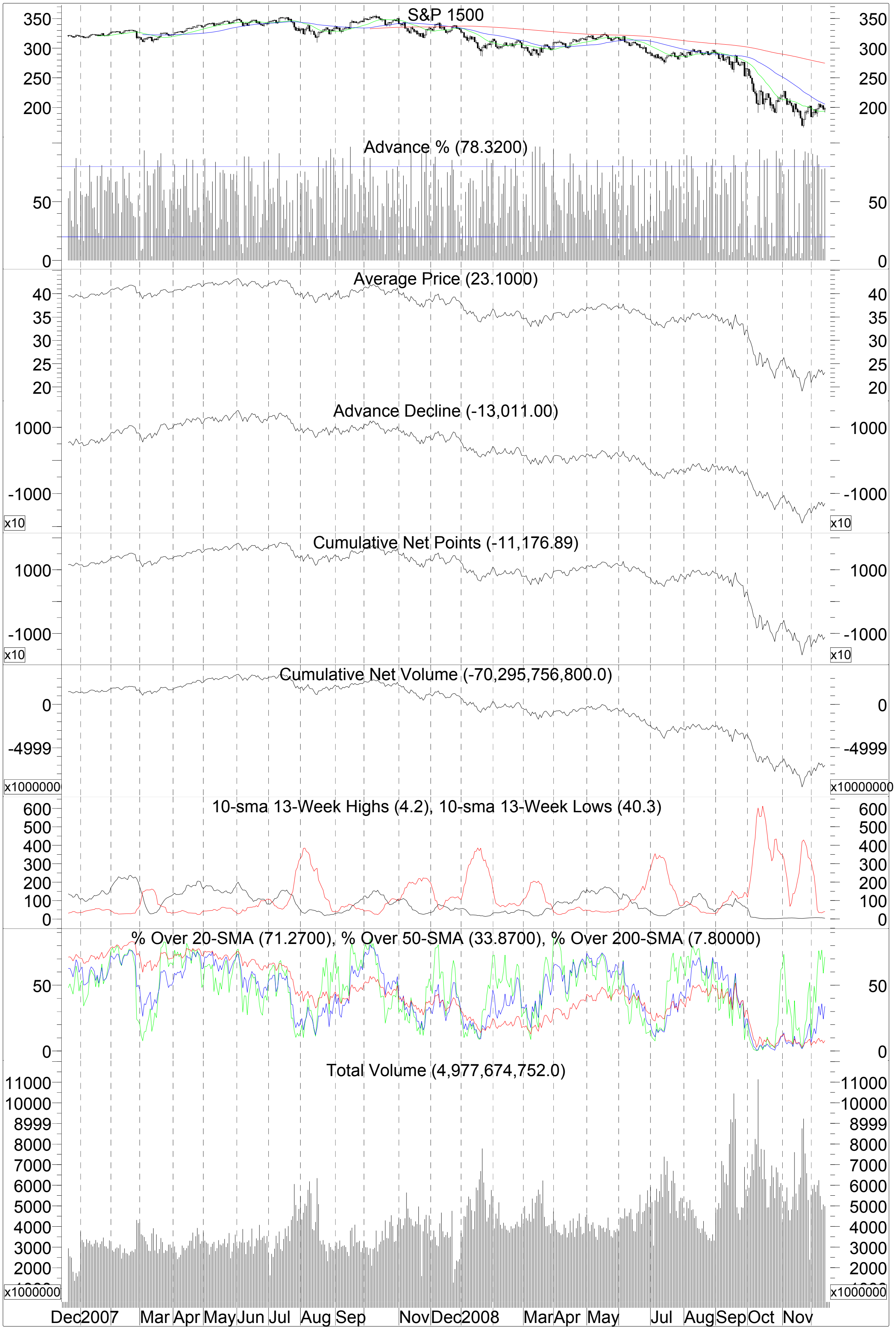
Weekly charts are showing improvement, which was one of our reasons for optimism stated last week.



Our oscillators are at levels where stocks are vulnerable to a further pull back.

Our price oscillator is just under the neutral level after an extended stay in negative territory.

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



78.32% of stocks traded higher Friday.

Volume decreased on Friday.

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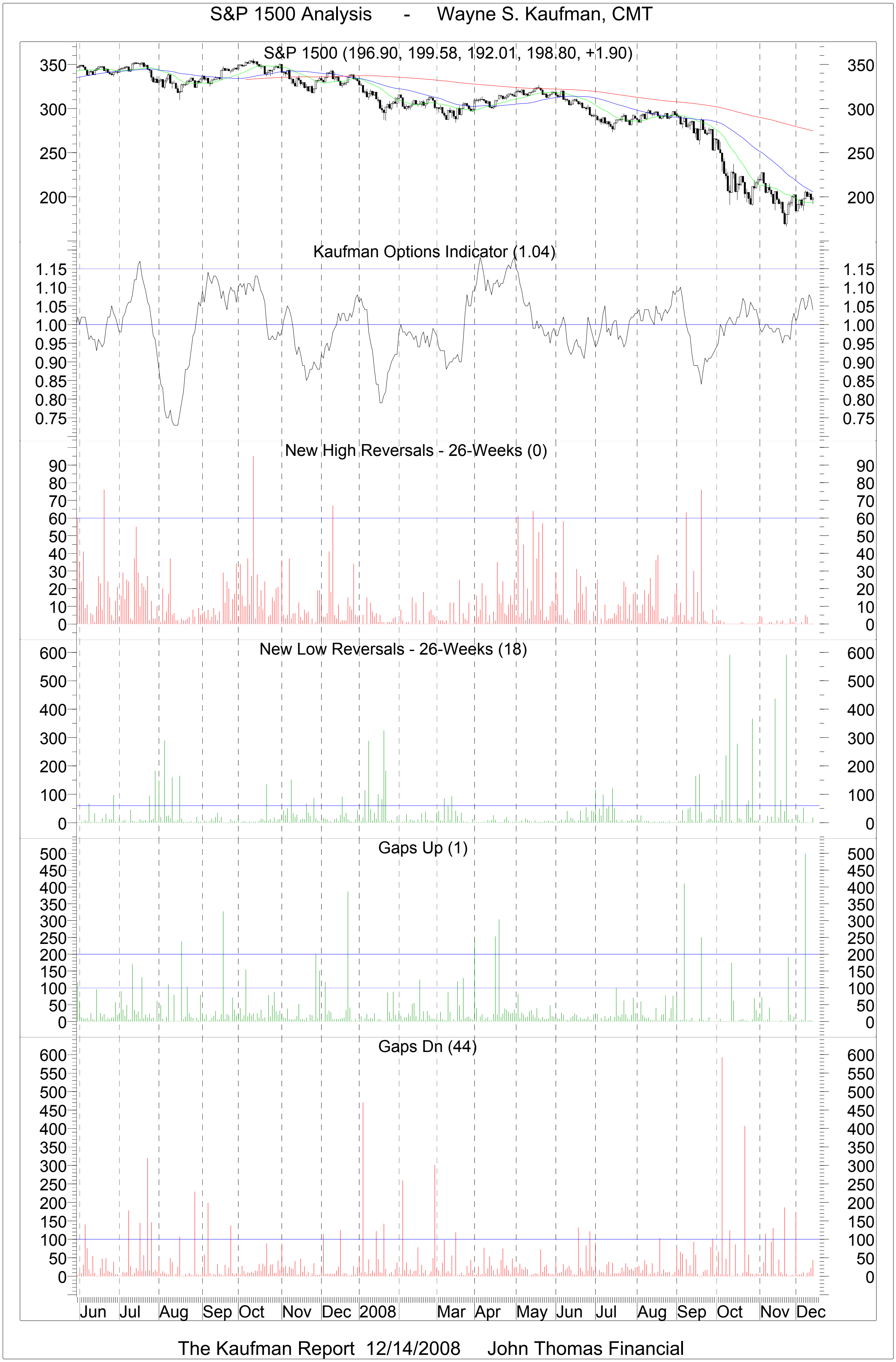
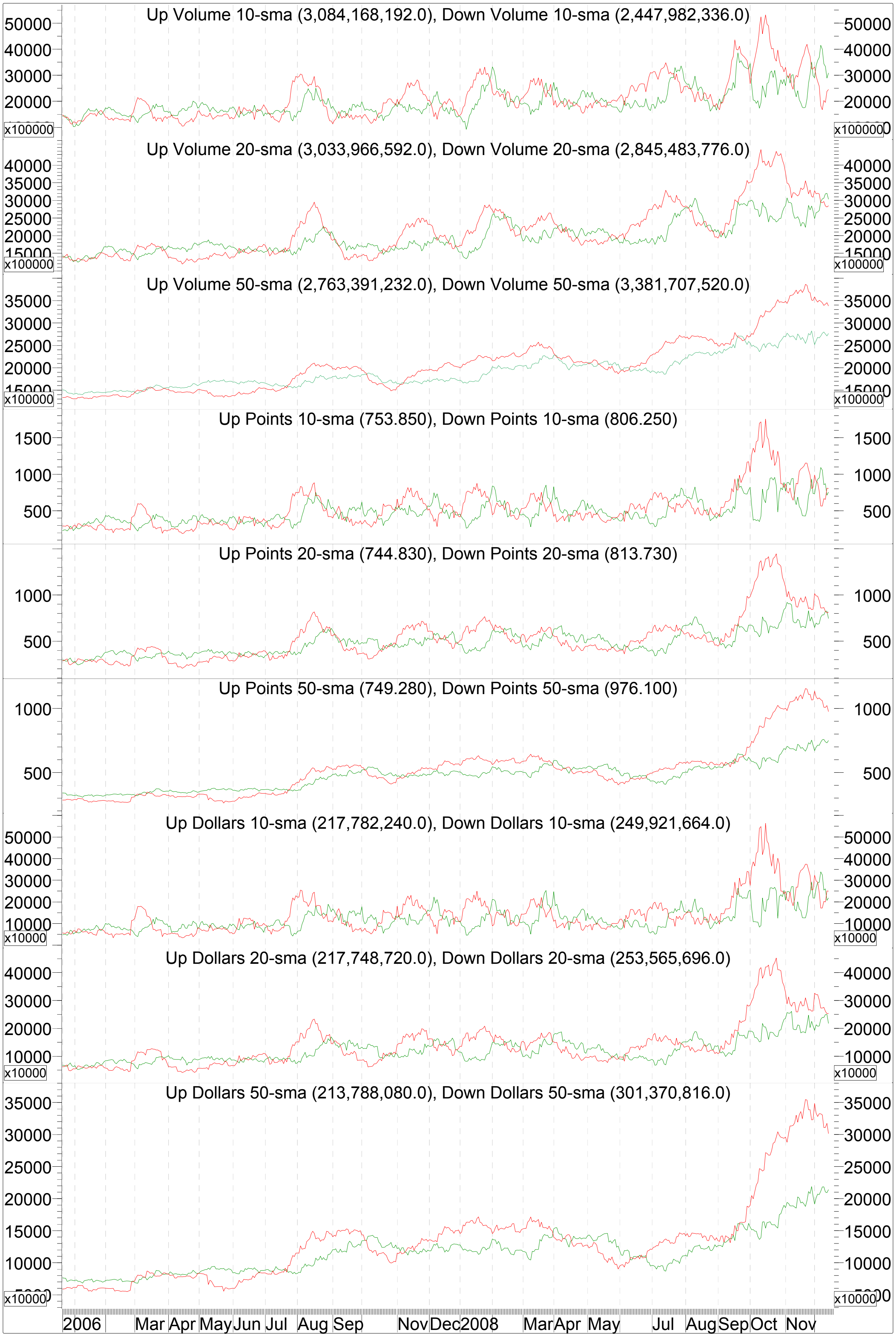


Our proprietary options indicator has been showing optimism on the part of options buyers. Too much optimism leaves stocks vulnerable to pull backs.

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



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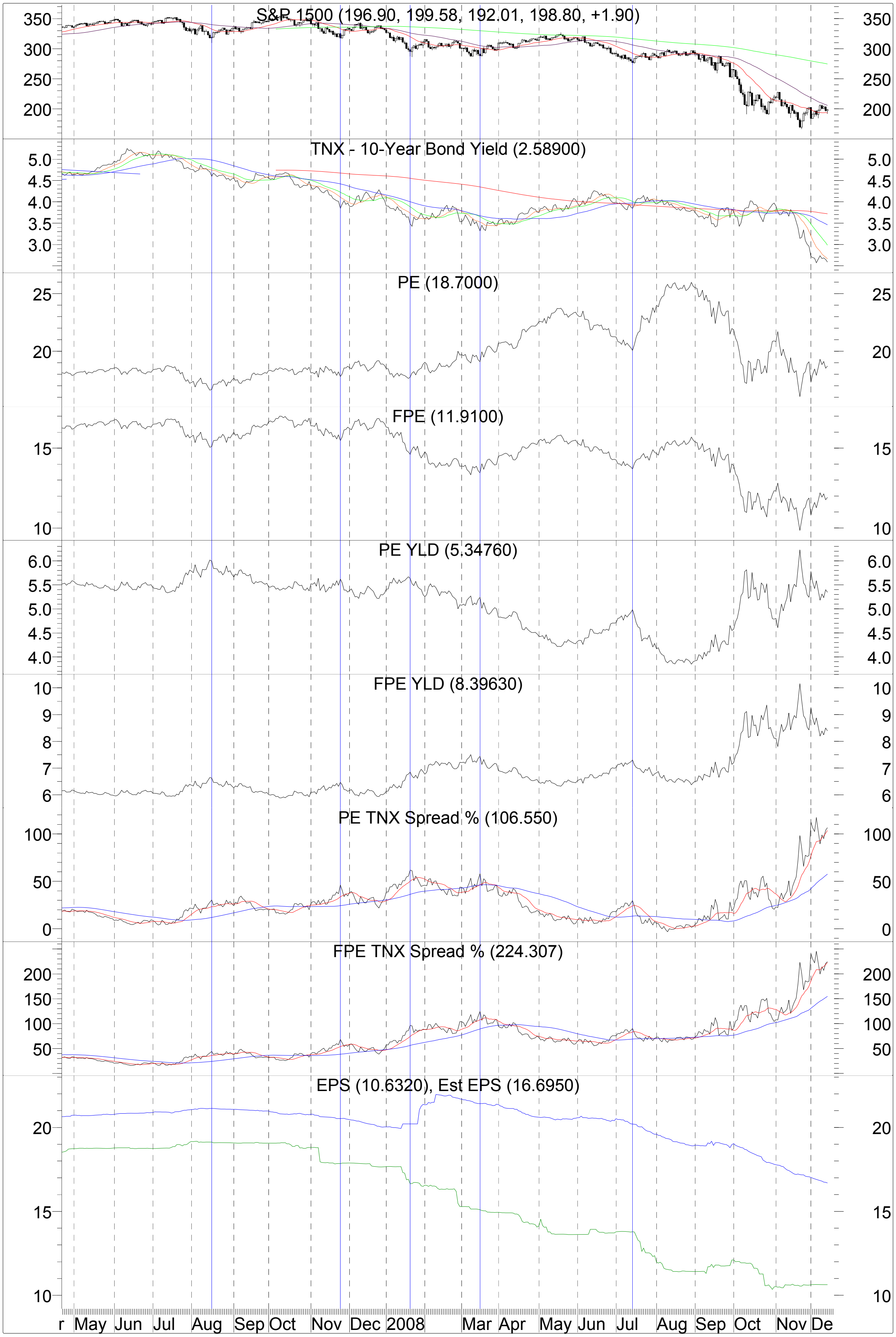
Our 10-day statistics of demand (green lines) versus supply (red) are mixed.

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

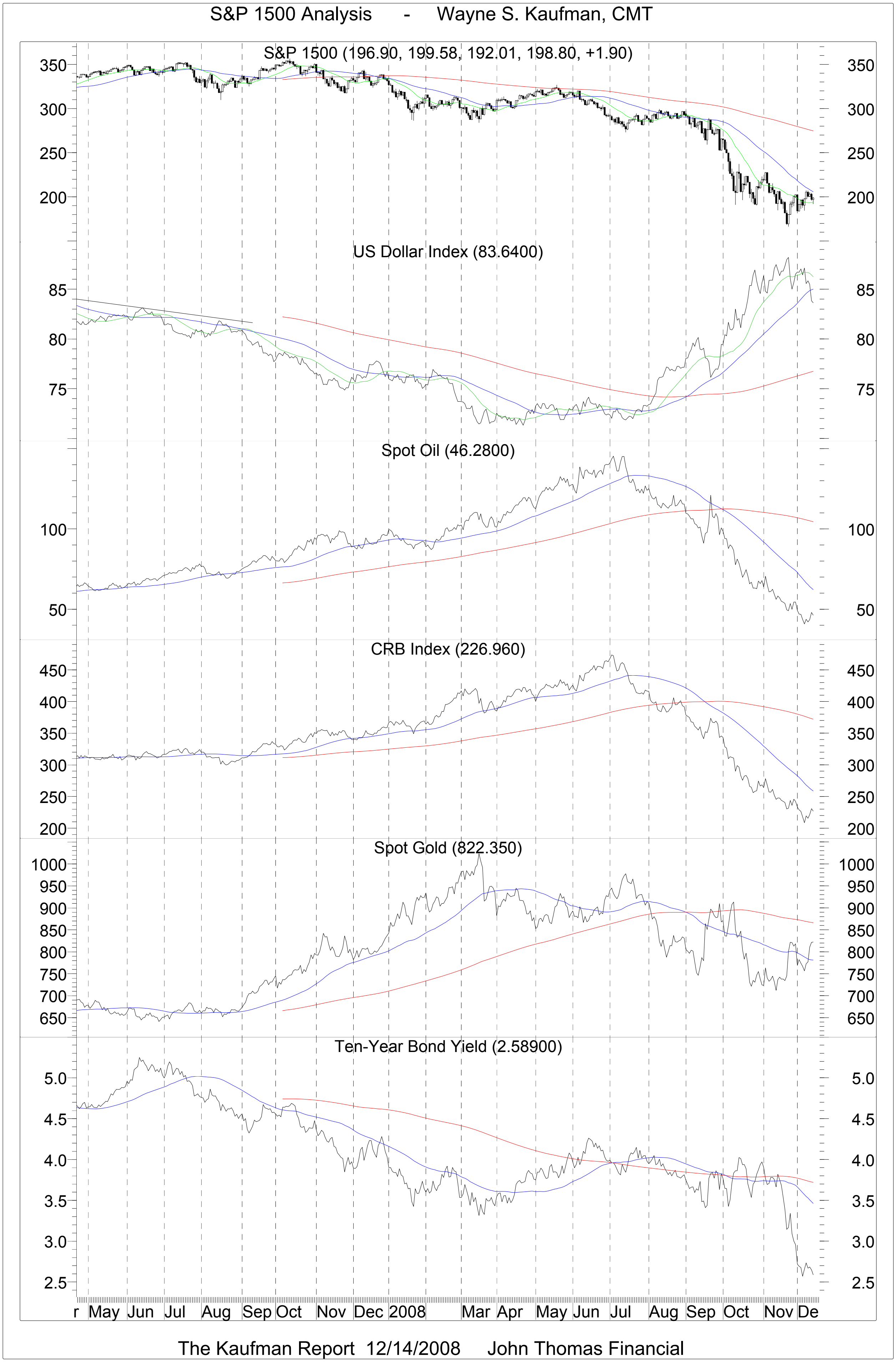


Bond yields remain at extremely low levels as investors continue their flight to safety.

P/E ratios remain in a range.

Spreads between bond and equity yields remain at amazing levels.

Reported earnings bottomed on 10/24, while projected numbers continue dive-bombing lower.



We have been looking for a short-term top in the U.S. Dollar Index, and last week's move down from a small head and shoulders top probably caps the Index for a while.

We've also been looking for a bottom in oil, and the drop in the Dollar helps in that regard.

Gold is above its 20 and 50-sma, with the 200-sma (red) at 863. It should test that level, and if it breaks it will probably be on its way to the mid-900s.