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The Kaufman Report

Trade what you see, not what you think.

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Wednesday December 17, 2008 **Closing prices of December 16, 2008**

Stocks rallied broadly on the FOMC rate cut and announcement that it "will employ all available tools to promote the resumption of sustainable economic growth and to preserve price stability." It was a 90% up day with all ten S&P sectors rising, led by Financials +11.25%, Materials +6.06%, and Consumer Discretionary +5.62%. We reiterated Monday that equities as an asset class are viewed as being cheap, and the plunge in bond yields after the FOMC announcement helps maintain very extreme valuation levels even as reported and projected earnings move lower.

In the short-term stocks are nearing overbought levels as they near resistance, and the 50-day moving average is still in play on major indexes, so some hesitation or pull back is possible. However, we expect the rally to continue, but investors still need to be selective and careful about entry points.

The S&P 1500 (206.24) was up 5.25%% Tuesday. Average price per share was up 5.97%. Volume was 106% of its 10-day average and 100% of its 30-day average. 95.78% of the S&P 1500 stocks were up on the day, with up volume at 95.51% and up points at 99.06%. Up Dollars was 99.96% of total dollars, and was 294% of its 10-day moving average while Down Dollars was 1/5 of 1% of its 10-day moving average. The index is up 1.89% month-to-date, down 22.46% quarter-to-date, down 37.76% year-to-date, and down 42.14% from the peak of 356.38 on 10/11/07. Average price per share is $23.90, down 44.71% from the peak of $43.23 on 6/4/2007.

The Put/Call Ratio was 0.907. The Kaufman Options Indicator was 1.06. *The spread between the reported earnings yield and 10-year bond yield is 116% and 241% 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 $10.51, a drop of 45.20%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $16.61, a drop of only 24.33%. 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.*

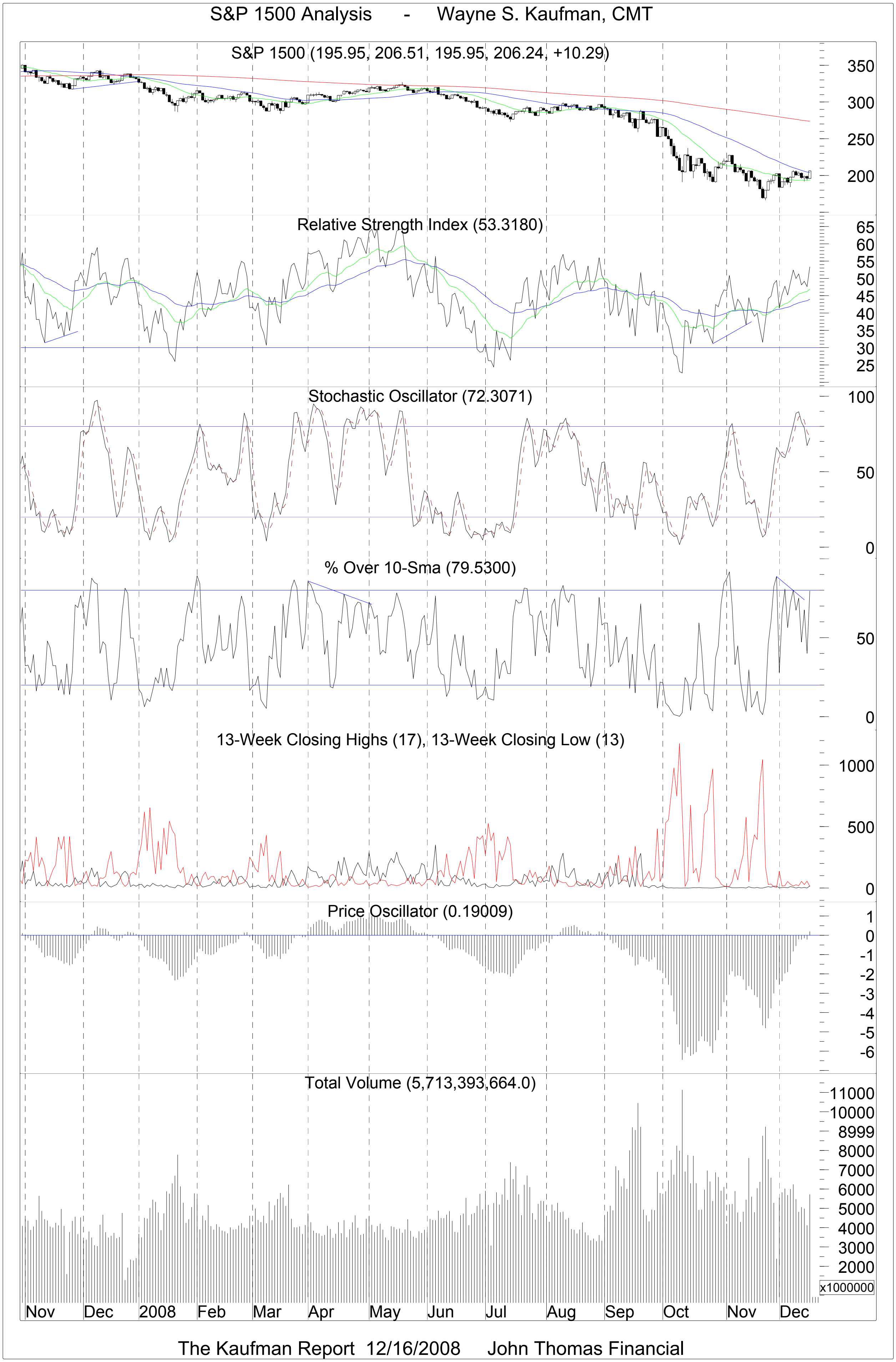
498 companies in the S&P 500 have reported third quarter earnings. According to Bloomberg, 58.1% have had positive surprises, 9.7% have been in line, and 32.3% have been negative. The year-over-year change has been -18.3% on a share-weighted basis, +5.3% market cap-weighted and -2.7% non-weighted. Ex-financial stocks these numbers are 10.1%, 23.7%, and 15.8%, respectively.

Federal Funds futures are pricing in a 66.0% probability that the Fed will *leave rates unchanged,* and a 34.0% probability of *cutting 25 basis points to 0.00%* when they meet on January 28th. They are pricing in a 64.1% probability that the Fed will *leave rates unchanged* on March 17th, and a 31.9% probability of *cutting 25 basis points to 0.00%.*

The short-term and intermediate-term trends are now up, while the long-term trend remains 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 long-term

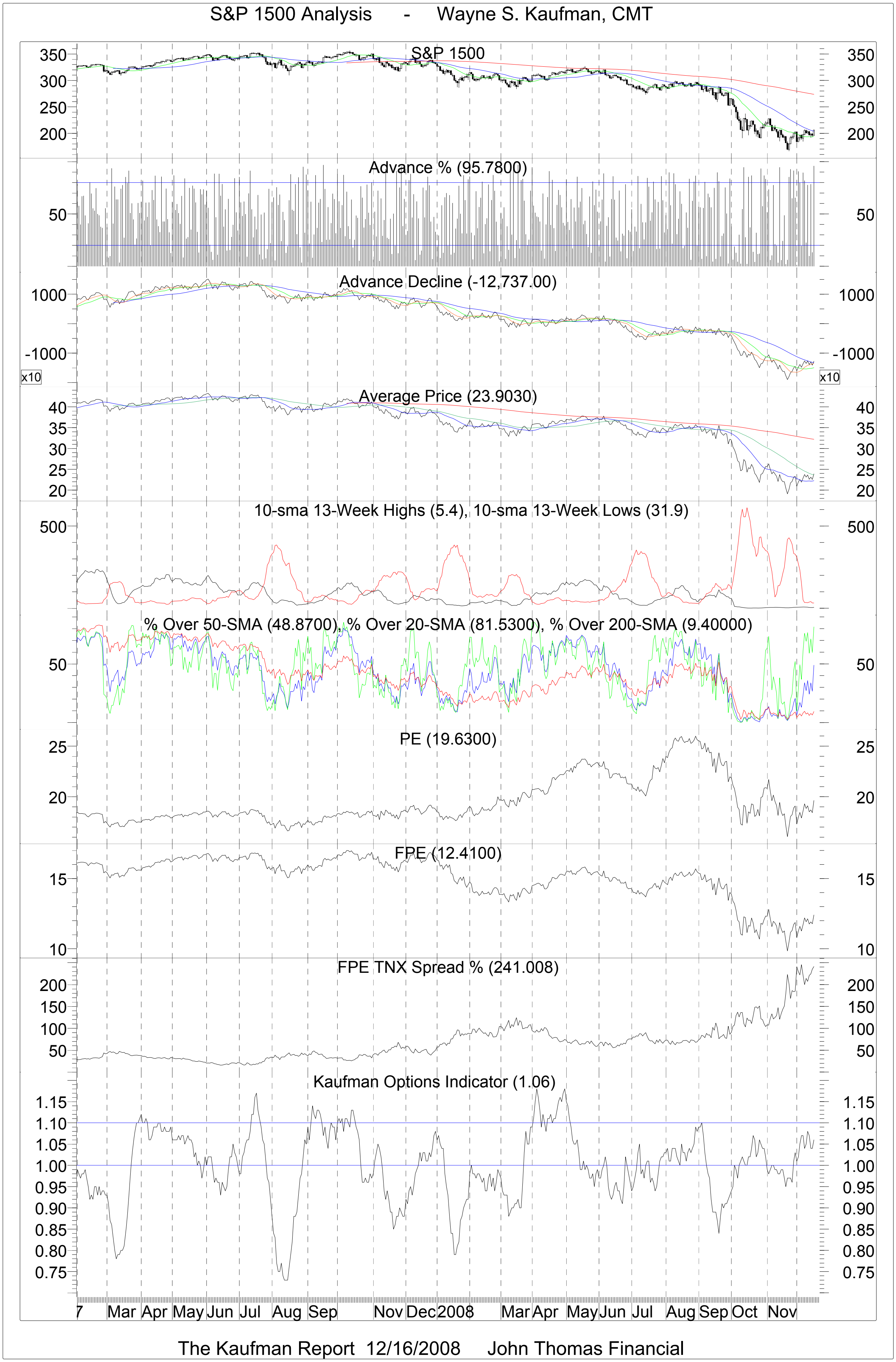
IMPORTANT DISCLOSURES

The S&P 1500 held support at the 20-sma (green) and rallied Tuesday to close above the 50-sma and at the highest level since 11/13.



The RSI is breaking above resistance levels and is at the highest levels since August.

Finally! Our price oscillator has moved above the neutral level for the first time since early September.



95.78% of stocks traded higher Tuesday.

The percent over 20-sma is at its best levels since August.

P/E ratios are moving higher.

Spreads between bond and equity yields are near their recent highs due to the plunge in bonds.

Our options indicator is not yet at the extreme bullish levels it used to reach during stronger rallies.