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The Kaufman Report

Trade what you see, not what you think.

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Monday December 22, 2008 **Closing prices of December 19, 2008**

Quadruple witching options expiration week ended uneventfully from a technical point of view. So far the attempt to break through the 50-day moving average is unsuccessful, and the S&P 1500 is pinched between it and the 20-day moving average just below. The index is at an inflection point and needs to move above the 50-day soon to keep the rally intact. A move below the 20-day and the low of 12/12 will break the pattern of higher lows and make us reconsider the probabilities of testing the November lows. With our options indicator showing bullishness on the part of options buyers, a break of the 12/12 low could begin a sharp move down.

The S&P 1500 (201.18) was up 0.372% Friday. Average price per share was up 0.71%. Volume was 119% of its 10-day average and 110% of its 30-day average. 62.98% of the S&P 1500 stocks were up on the day, with up volume at 57.57% and up points at 64.10%. Up Dollars was 79.26% of total dollars, and was 102% of its 10-day moving average while Down Dollars was 34% of its 10-day moving average. The index is down 0.61% month-to-date, down 24.36% quarter-to-date, down 39.29% year-to-date, and down 43.55% from the peak of 356.38 on 10/11/07. Average price per share is $23.75, down 45.06% from the peak of $43.23 on 6/4/2007. For the week the index was up 1.197% on increasing and above average weekly volume.

The Put/Call Ratio was 0.817. The Kaufman Options Indicator is 1.09. *The spread between the reported earnings yield and 10-year bond yield is 144% and 283% 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 $10.46, a drop of 45.46%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $16.41, a drop of only 25.24%. 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 probability of 82% that the Fed will *leave rates unchanged,* and a probability of 18.0% of *cutting 25 basis points to 0.00%* when they meet on January 28th. They are pricing in a probability of 67.9 that the Fed will *leave rates unchanged* on March 17th, and a probability 18.1 of *raising 25 basis points to 0.50%.*

The short-term trend is 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 long-term downtrend must still be respected. Investors should not hesitate to move out of laggard sectors and stocks and into leaders.

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

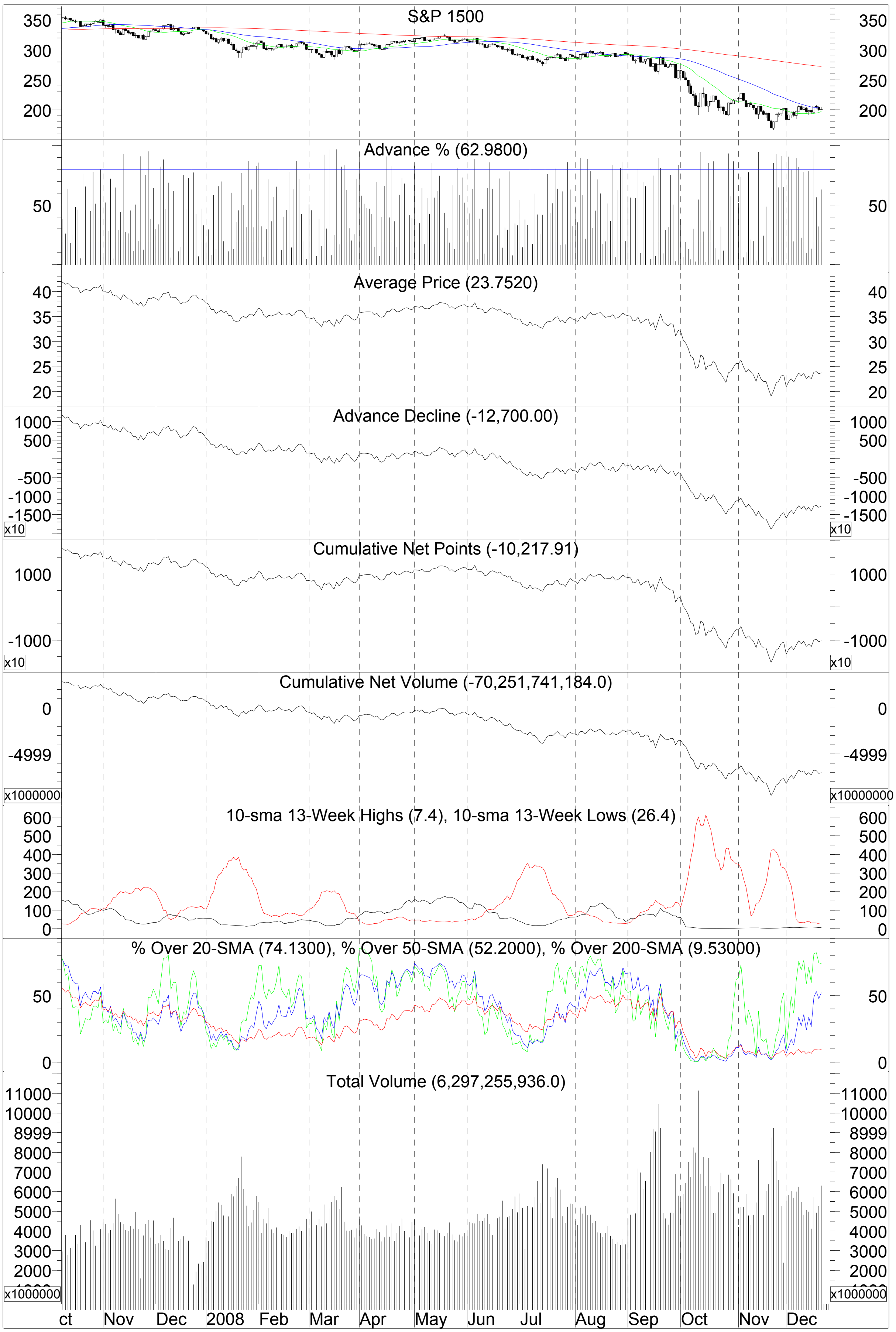
The S&P 500 is pinched between the 50-sma (blue) and the 20-sma. This won't last long. A move above the 920 level would be bullish while a break of support at the 851 area would be bearish. The 50-sma is about 898 while the 20-sma is about 873.

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

The weekly chart of the S&P 500 has been improving and has four weeks of higher bottoms.

Our momentum indicators are still at high levels, leaving stocks vulnerable to a pull back.

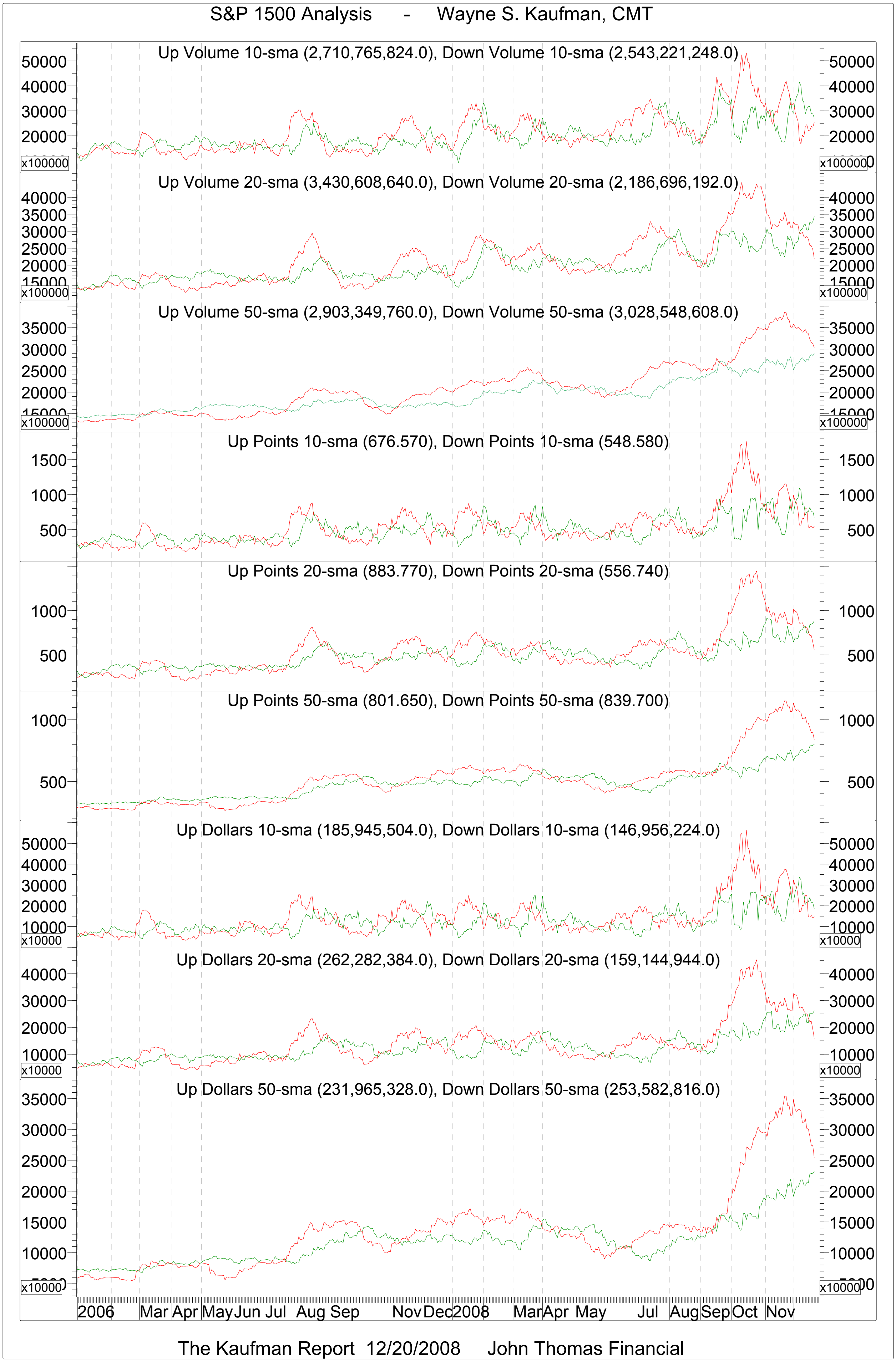
S&P 1500 Analysis - Wayne S. Kaufman, CMT



62.98% of stocks traded higher Friday.

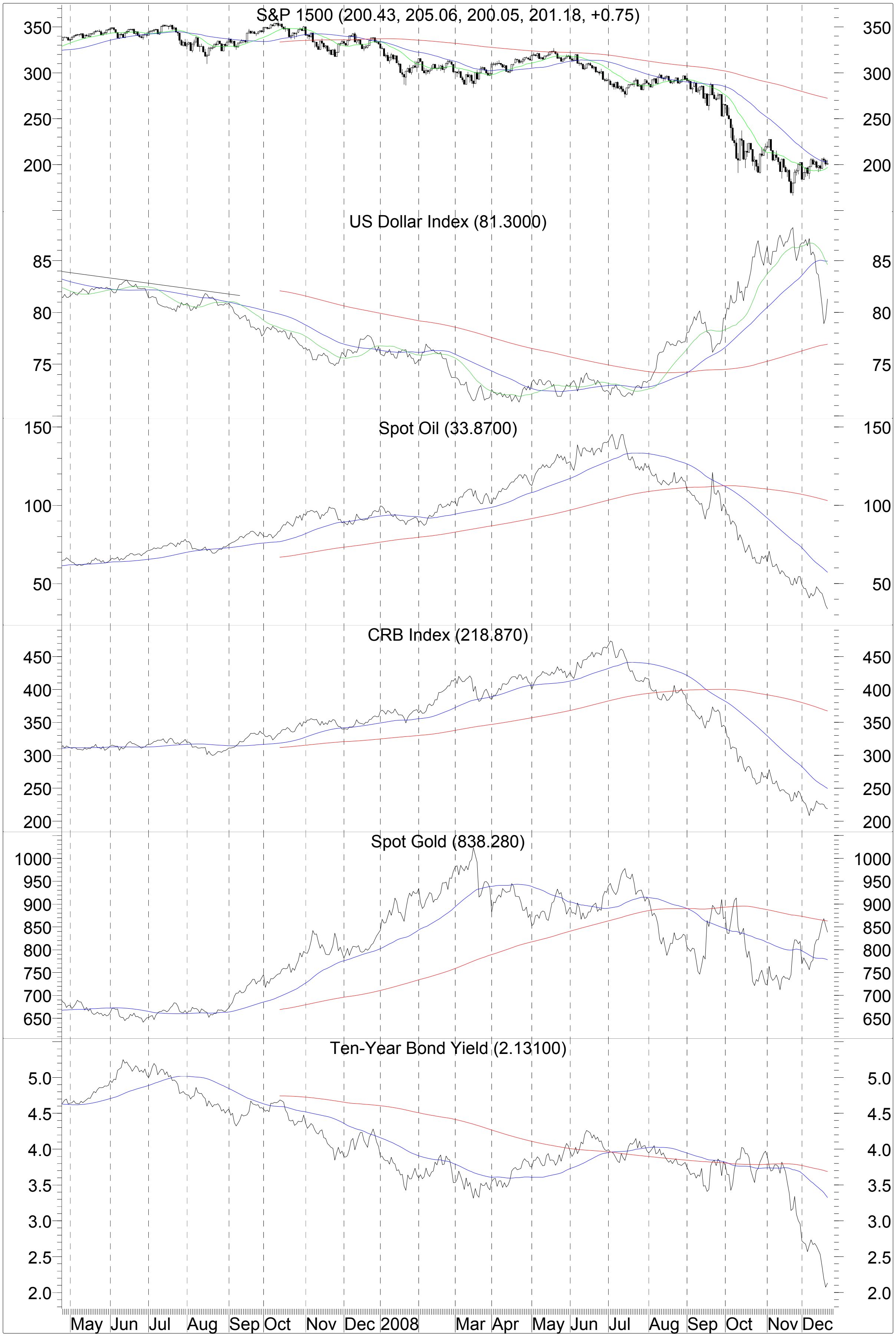
52.2% of the S&P 1500 are above their own 50-sma, the first time more than half have done this since September.

Our proprietary options indicator is showing bullishness on the part of options buyers. It is at the highest level since 1.10 on September 4th, just ahead a a big move lower for equities.



A look at our 10 and 20-day statistics of supply (red lines) versus demand (green lines) shows that the recent rally has been caused more by a decrease in supply than in a big increase in demand.

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

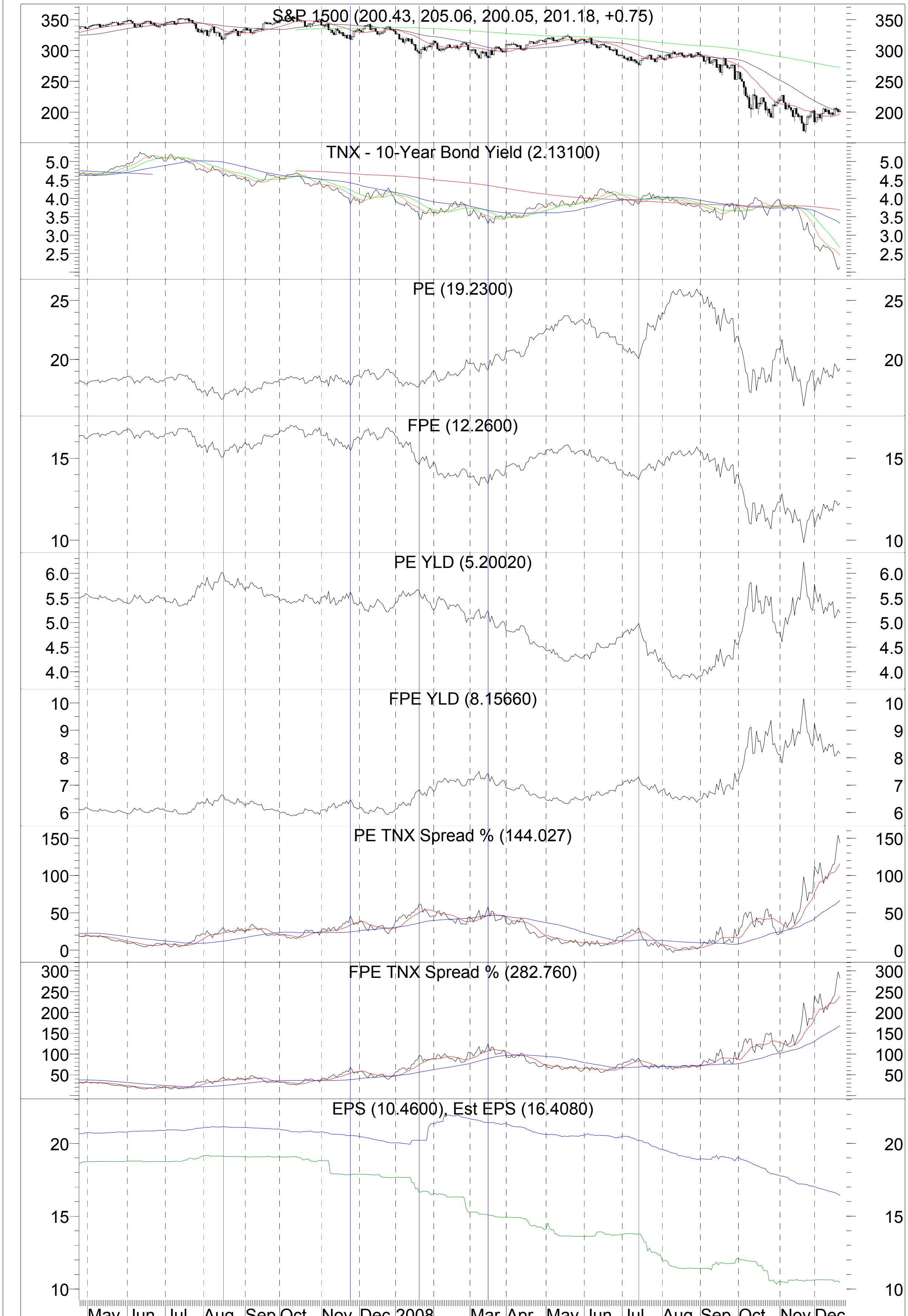


The U.S. Dollar is bouncing from oversold levels after an amazing crash caused by the Fed.

Oil can't seem to find a bottom, but we think this will not last much longer.

Gold hit resistance at the 200-sma (red) and may have more short-term downside. We think it will rally longer-term.

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



10-year bond yields have crashed and are very oversold.

P/E ratios continue to be range-bound.

Spreads between equity and bond yields continue to move in a parabolic pattern and don't seem to matter anymore.

Forecast earnings (blue) continue their inexorable move lower while reported earnings are flat-lining, at least until January's earnings season.