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The Kaufman Report

Trade what you see, not what you think.

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Friday December 5, 2008 **Closing prices of December 4, 2008**

MULLIGANISM

Everyone is familiar with the classic economic systems of capitalism, socialism, and communism. Here in the United States we have morphed into a new system. We have established Mulliganism. For those who don't play golf, a mulligan is a shot that doesn't count. The player getting the mulligan is usually inept, and the other, more proficient players charitably allow him a "do-over."

Those of us who grew up playing sports in the school yards of New York are very familiar with do-overs. There were always do-overs when it couldn't be decided if a base runner was safe or out, if a ball was fair or foul, if a player was out of bounds, or if a handball hit a line or not. If there was a problem, just cry out "do-over" and start again. Although there were those who abused the do-over system (they were called cheaters), it was a pretty reasonable way to work things out.

Now the do-over is becoming popular amongst politicians and executives of failing corporations. Al Franken is crying "do-over" again and again in Minnesota. Citigroup just got a do-over. AIG got a do-over, then wanted to do-over the do-over. The enabler of do-overs, the Troubled Assetts Relief Program, got a do-over itself once Mr. Paulson realized that "facts and conditions have changed."

The automobile companies, having learned over the years that being slow and unresponsive isn't all that effective, are jumping up and down screaming "do-over." Unfortunately for the auto executives, even our legislators know that the purpose of a do-over is to have a different result than the first time around. When asked for some kind of evidence that a do-over won't result in the auto companies asking for more do-overs in the future, the best the auto execs can come up with is the threat of how bad things will be for everyone if they don't get their do-over. Sounds like the sore loser kid who threatens to takes his ball and go home if he doesn't get his way.

The auto companies also don't like any money they may get being referred to as a bailout. They are adamant it is a bridge loan. Maybe this is the bridge to nowhere everyone is always referring to. They will probably get money from the government, but let's call it what it really is: a gigantic make work program. Where are they going to put all those cars?

Whatever happened to the concept that smart operators in market places would be rewarded for their greater ability and productivity? Whatever happened to the concept that the inefficient use of assets would be punished by taking the ability to squander and mismanage those assets away from the inept?

We have entered a period where the inept are rewarded by being given more assets after losing the ones they have, and the competent are punished by having their assets taken away and given to the inept. Welcome to Mulliganism!

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We warned Wednesday night that "stocks are starting to get overbought at resistance, and options buyers are getting optimistic." Stocks plunged Thursday, erasing the gains of Wednesday. We have been cautiously optimistic about this rally, but at this time the word cautious seems more important than the word optimistic. The reason for that is our proprietary options indicator is now at the same level it hit on 10/21, which was the start of a four-day 11.63% decline in the S&P 1500. However, until Monday's low is broken, the current short-term uptrend is intact. A break above last Friday's high would be very positive.

The S&P 1500 (190.55) was down 2.964% Thursday. Average price per share was down 2.87%. Volume was 90% of its 10-day average and 96% of its 30-day average. 19.45% of the S&P 1500 stocks were up on the day, with up volume at 20.6% and up points at 13.0%. Up Dollars was 2.8% of total dollars, and was 3.4% of its 10-day moving average while Down Dollars was 141% of its 10-day moving average. The index is down 5.86% month-to-date, down 28.35% quarter-to-date, down 42.50% year-to-date, and down 46.53% from the peak of 356.38 on 10/11/07. Average price per share is $21.92, down 49.29% from the peak of $43.23 on 6/4/2007.

The Put/Call Ratio was 0.938. The Kaufman Options Indicator was 1.07.

The spread between the reported earnings yield and 10-year bond yield is 117% and 245% based on projected earnings. These are unheard of levels*. *The dividend yield on the S&P 500 is greater than the 10-year bond yield for the first time since 1958.

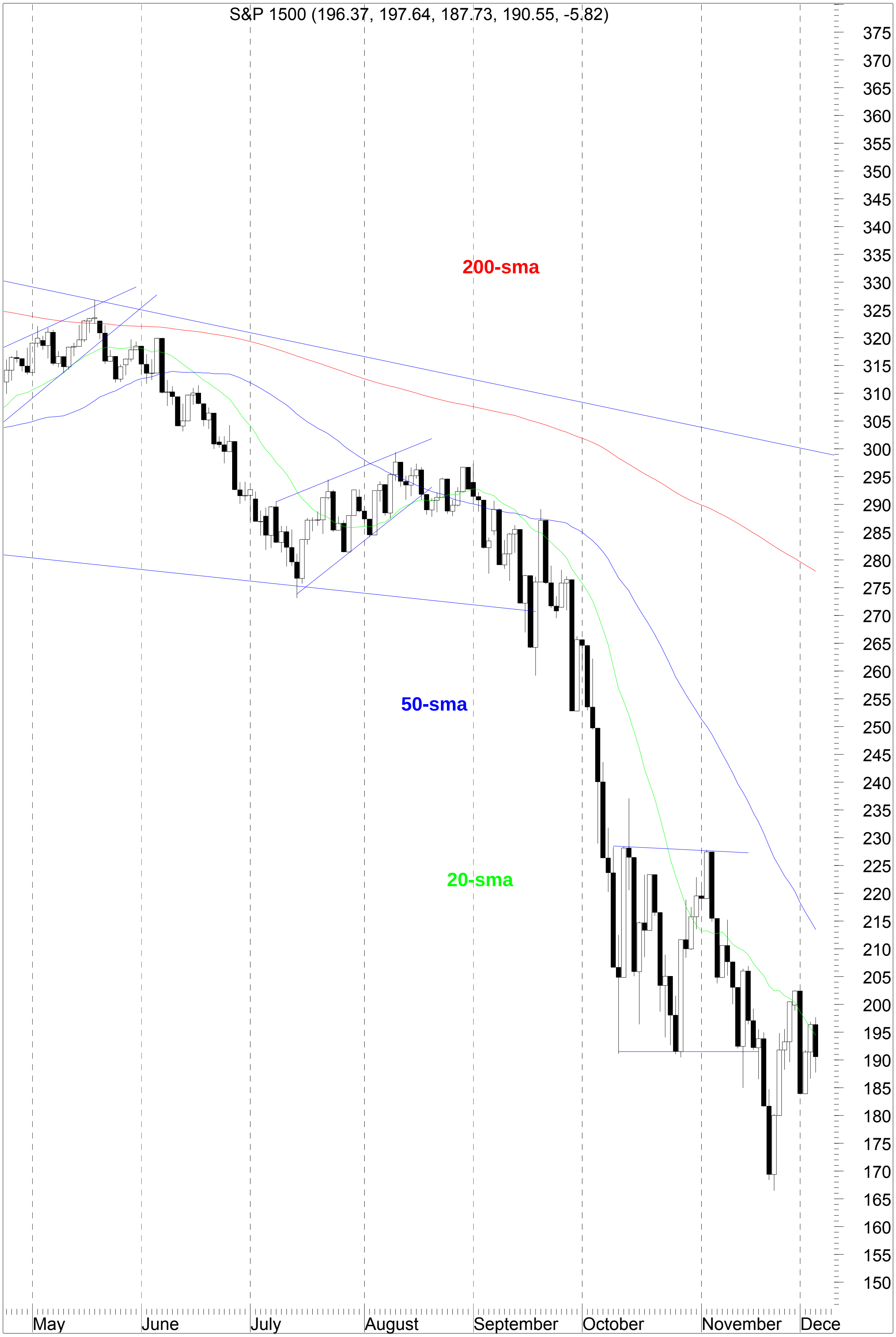
Reported aggregate earnings for the S&P 1500 peaked in August 2007 at $19.18 and are now at $10.64, a drop of 44.53%, and have been moving slightly higher since $10.57 on 10/24. Estimated aggregate earnings peaked at $21.95 in February 2008, are still moving lower, and are now $16.91, a drop of only 22.96%. 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.*

491 companies in the S&P 500 have reported third quarter earnings. According to Bloomberg, 58.3% have had positive surprises, 9.2% have been in line, and 32.5% have been negative. The year-over-year change has been -18.3% on a share-weighted basis, +5.3% market cap-weighted, and -2.6% non-weighted. Ex-financial stocks these numbers are 10.1%, 23.7%, and 16.0%, respectively.

Federal Funds futures are pricing in an 36.0% probability that the Fed will *cut rates 50 basis points to 0.50%,* and a 64.0% probability of *cutting 75 basis points to 0.25%* when they meet on December 16th. They are pricing in a 36.6% probability that the Fed will *cut rates 50 basis points to 0.50%* on January 28th, and a 62.7% probability of *cutting 75 basis points to 0.25%.*

The short-term, 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.

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



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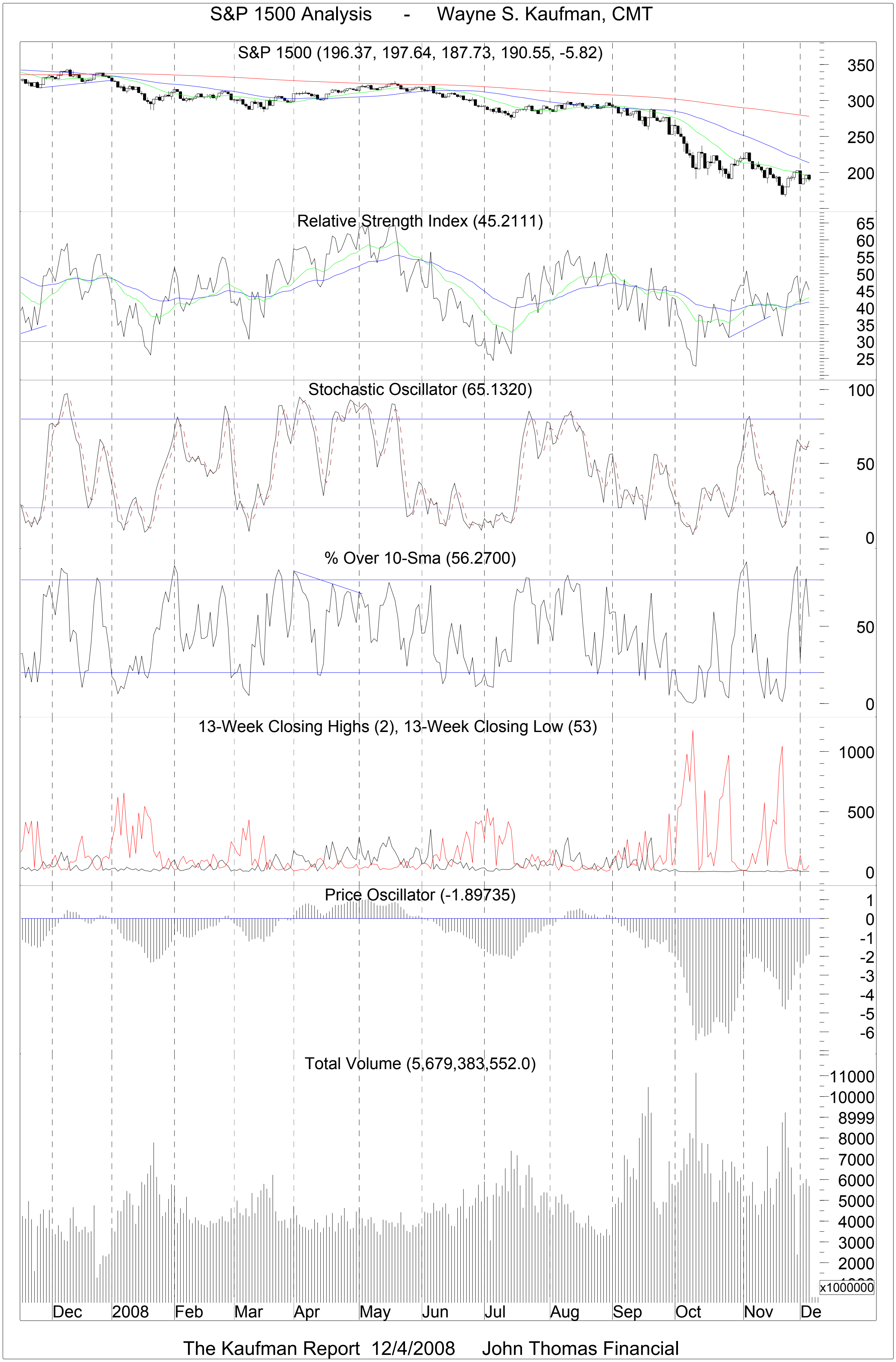
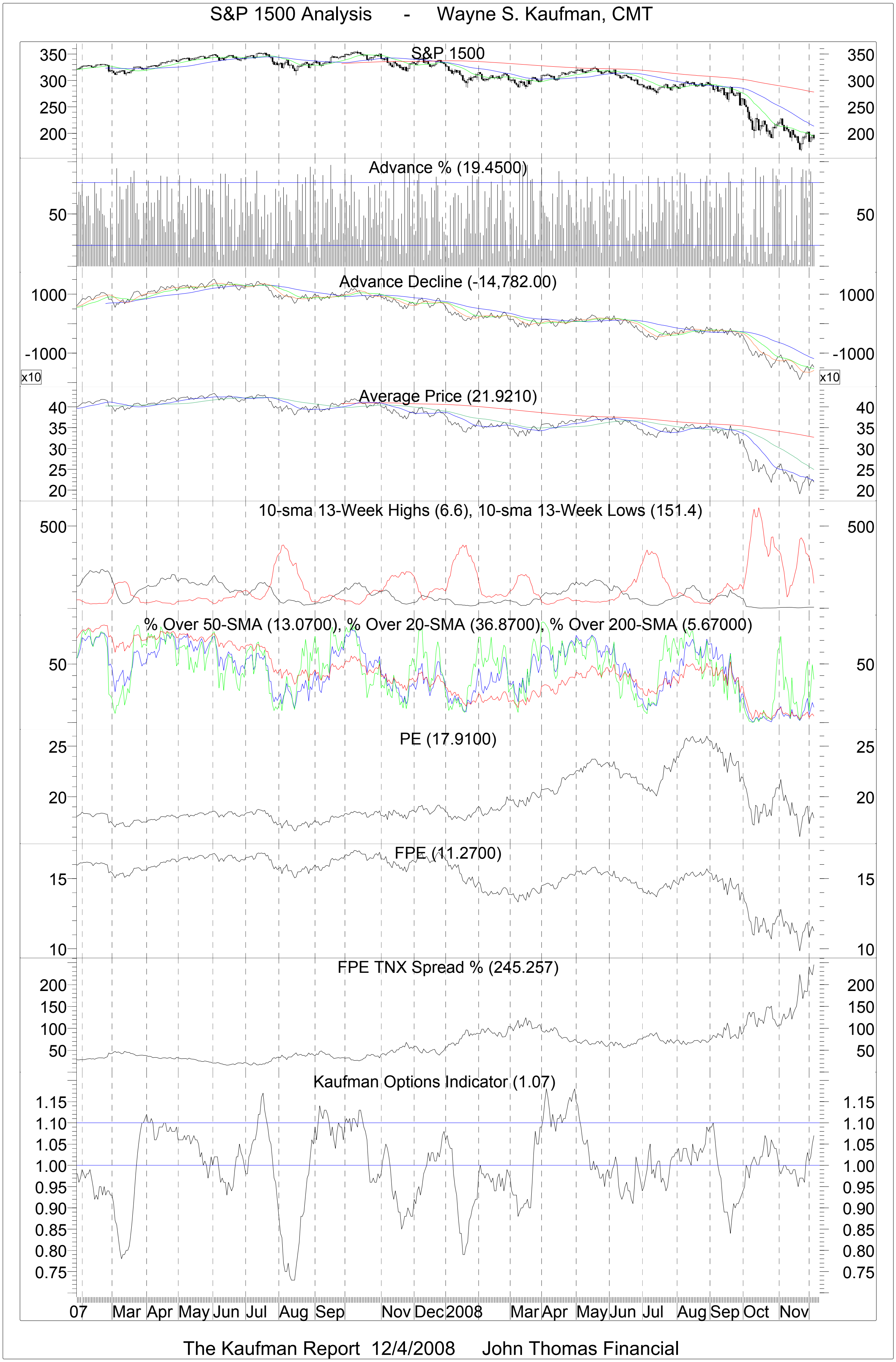
The S&P 1500 was repelled by the 20-sma Thursday. It did make a higher high and higher low versus Wednesday. A break above or below Monday's range should be significant.

The 50-sma (blue) will be coming back into play soon.



Our momentum indicators are at high enough levels stocks are vulnerable to a sharp drop.



19.45% of stocks traded higher Thursday.

P/E ratios are in a range.

Spreads between bond and equity yields continue to move to never before seen levels.

Our proprietary options indicator is showing bullishness among options buyers. It last hit 1.07 on 10/21, the start of a four day 11.63% decline.