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The Kaufman Report

Trade what you see, not what you think.

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Tuesday February 17, 2009 **Closing prices of February 13, 2009**

On Thursday night we wondered if Thursday's late day rally after an early plunge was short-covering, another false breakout/breakdown, or the start of a sustainable rally. We said it was the former until proven otherwise. On Friday there was no follow through as stocks sold off broadly, with the only cause for optimism a decline in daily volume. Bulls take heart in the recent lack of intense selling in the face of terrible news and weekly indicators which are at low levels where rallies can begin. The bearish case remains more compelling with indexes below important moving averages, P/E ratios at high levels, reported and forecast earnings continuing their march lower, options buyers becoming too optimistic, and the Dow Jones Industrial Average making its lowest weekly close since 3/7/03. We also start to wonder if the government is running out of ammunition. With options expiring this week we can look forward to more volatility.

The short-term, intermediate-term, and the long-term trends remain down. This continues to be an opportunistic trader's market, prone to infuriating whipsaws, with adept traders able to take advantage long or short. However, a tradable trend may begin at any time. Investors should not hesitate to sell lagging stocks and sectors and move into leaders.

The S&P 1500 (187.65) was down 0.971% Friday. Average price per share was down 0.69%. Volume was 80% of its 10-day average and 84% of its 30-day average. 34.48% of the S&P 1500 stocks were up, with up volume at 26.91% and up points at 31.95%. Up Dollars was 13.17% of total dollars, and was 17% of its 10-day moving average. Down Dollars was 120% of its 10-day moving average. The index is up 0.219% in February, down 8.43% quarter-to-date and year-to-date, and down 47.35% from the peak of 356.38 on 10/11/07. Average price per share is $22.47, down 48.02% from the peak of $43.23 on 6/4/07.

Put/Call Ratio: 0.889. 0.668 on 2/9 was the lowest since 1/30/06. Kaufman Options Indicator: 1.07, highest since 1.09 on 1/8.

The spread between the reported earnings yield and 10-year bond yield is 47%, and 164% based on projected earnings. The dividend yield on the S&P 500 recently moved above 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 $7.97, a drop of 58.45%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $14.26, a drop of 35.03%. The spread between reported and projected earnings is the widest in years. If investors believed the estimates stocks would be much higher.

393 of the S&P 500 have reported 4th quarter earnings. According to Bloomberg, 58.7% had positive surprises, 9.7% were line, and 31.6% have been negative, a high number. The year-over-year change has been -37.2% on a share-weighted basis, -18.2% market cap-weighted and -22.8% non-weighted. Ex-financial stocks these numbers are -14.9%, -4.9%, and -5.0 %, respectively.

Federal Funds futures are pricing in a probability of 94% that the Fed will *leave rates unchanged*, and a probability of 6.0% of *raising 25 basis points to 0.50%* when they meet on March 17th. They are pricing in a probability of 88.3% that the Fed will *leave rates unchanged* on April 29th and a probability of 11.3% of *raising 25 basis points*.

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Economic News

2/16/09 – Japanese GDP dropped 3.3% from the prior quarter, or 12.7% annualized, the biggest drop since 1974. Exports dropped at an 45% annualized rate as the synchronized global contraction hurts countries where global trade is extremely important.

2/12/09 – Jobless claims for w/e 2/7 were 623k versus 610k estimated. The 4-week moving average of 607,500 is the most since November 1982. Continuing claims w/e 1/30 were 4,810k versus estimated 4,800k, and rose the 4th week in a row to another record. Business Inventories for December -1.3% versus -0.09% estimate, biggest drop since 2001. Sales -3.2% after -5.7% in November. 1.4 months of inventory highest since April 2001. January Retail Sales +1% versus -0.8% estimate rose for the first time since July. Gasoline sales +2.6%, sales at auto dealers and parts stores up 1.6% for the first gain since August.

2/11/09 – China exports fell 17.5% year-over-year in January, the most in 13 years. Imports plunged by a record 43.1%. The $39.1 billion trade surplus was China's 2nd biggest ever. Numbers may be skewed by the Chinese New Year.

2/11/09 – The U.S. December trade deficit was $39.9 billion, wider than the $35.7 billion estimate. It was the lowest in almost six years. Exports and imports each declined for the 5th straight month, highlighting the effects of the synchronized global contraction. This is causing rumblings of protectionism worldwide, which would not be a good thing for the global economy.

2/10/09 – Wholesale inventories in December fell 1.4% versus a projected drop of 0.7%. Inventories have dropped four straight months, the longest streak in almost seven years. At current demand levels there is a 1.27 month supply of inventory, the highest since 2002. This points to further reductions in production. Factory inventories fell 1.4% in January. Retail inventories will be reported 2/12.

2/6/09 – The Unemployment Rate in January hit 7.6%, slightly above the 7.5% estimate. This was up from 7.2% in December and the highest since 1992. Payrolls fell by 598,000 (estimate 540,000), the biggest decline since December 1974. This is the first time since the beginning of payroll records in 1939 that job losses exceeded 500,000 for three consecutive months. Average Hourly Earnings increased 3.9% year-over-year.

2/5/09 – Initial Jobless Claims increased by 35,000 for the week ending 1/31 to 626,000, the highest number since October 1982. Continuing Claims hit a record 4.788 million for the week ending 1/24. Silver lining: Productivity rose 3.2% in the fourth quarter versus a 1.6% forecast. U.S. December Factory Orders dropped 3.9% versus a -3.1% estimate. Excluding transportation equipment (cars and aircraft) orders fell 4.4%.

2/4/09 – ADP Employer Services report showed a loss of 522,000 jobs in January, less than the 535,000 forecast and much lower than the December loss of 659,000. The Institute of Supply Management index of non-manufacturing businesses rose to 42.9 in January from 40.6 in December, and was above the estimate of 39.0.

2/3/09 – U.S Pending Home Sales rose for the first time in four months. The December increase of 6.3% beat the estimate of 0.0%. November showed a drop of 4%. According to the U.S. Census Bureau, a record 19 million U.S. houses were vacant at the end of 2008 for a 2.9% vacancy rate (vacant for sale), the highest ever. Purchases of New Homes in December, reported last week, dropped 14.7% versus November.

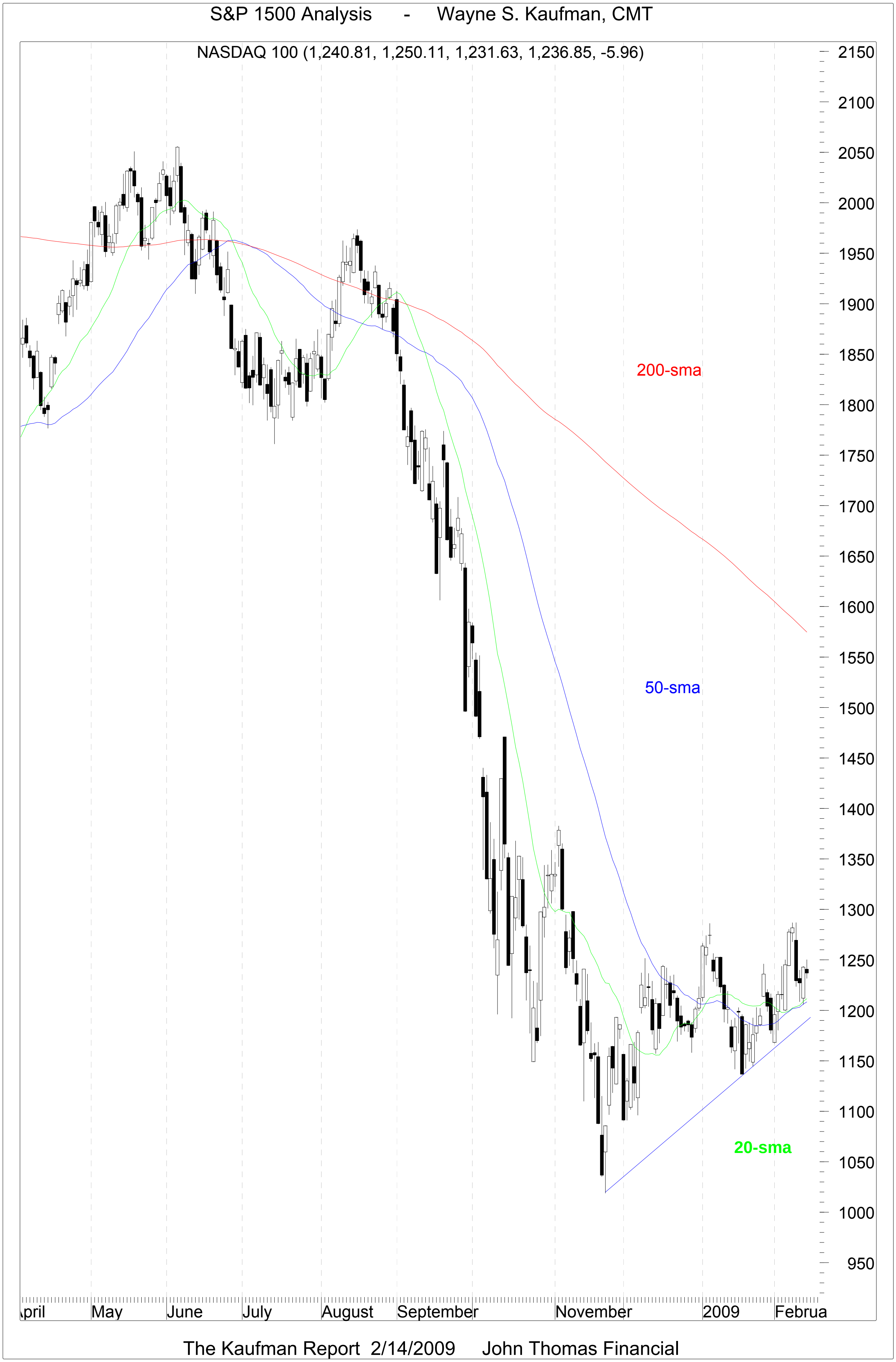
2/2/09 – Personal Income fell 0.2% in December, better than the -4% estimate, the third straight decline. The last three-month decline was January 1954. Personal spending in December fell 1% versus the .9% estimate, for a record sixth consecutive month. Consumer spending rose 3.6% for 2008, the smallest gain since 1961. Consumer Spending dropped at a 3.5% annual pace in Q4 versus 3.8% in Q3, the first ever declines above 3% in consecutive quarters. Silver lining: the decrease in spending pushed the savings rate up to 3.6% in December from 2.8% in November.

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

On February 12th the S&P 500 broke decisively through the lower trend line of the triangle. It found support at 808.06 and printed a hammer candle. The next support after that remains the January 21st low of 804.30. The index sits just below resistance in the form of the 20-sma which is at 839. There is a resistance zone from the 50-sma at 867 to the 2/9 high of 875.

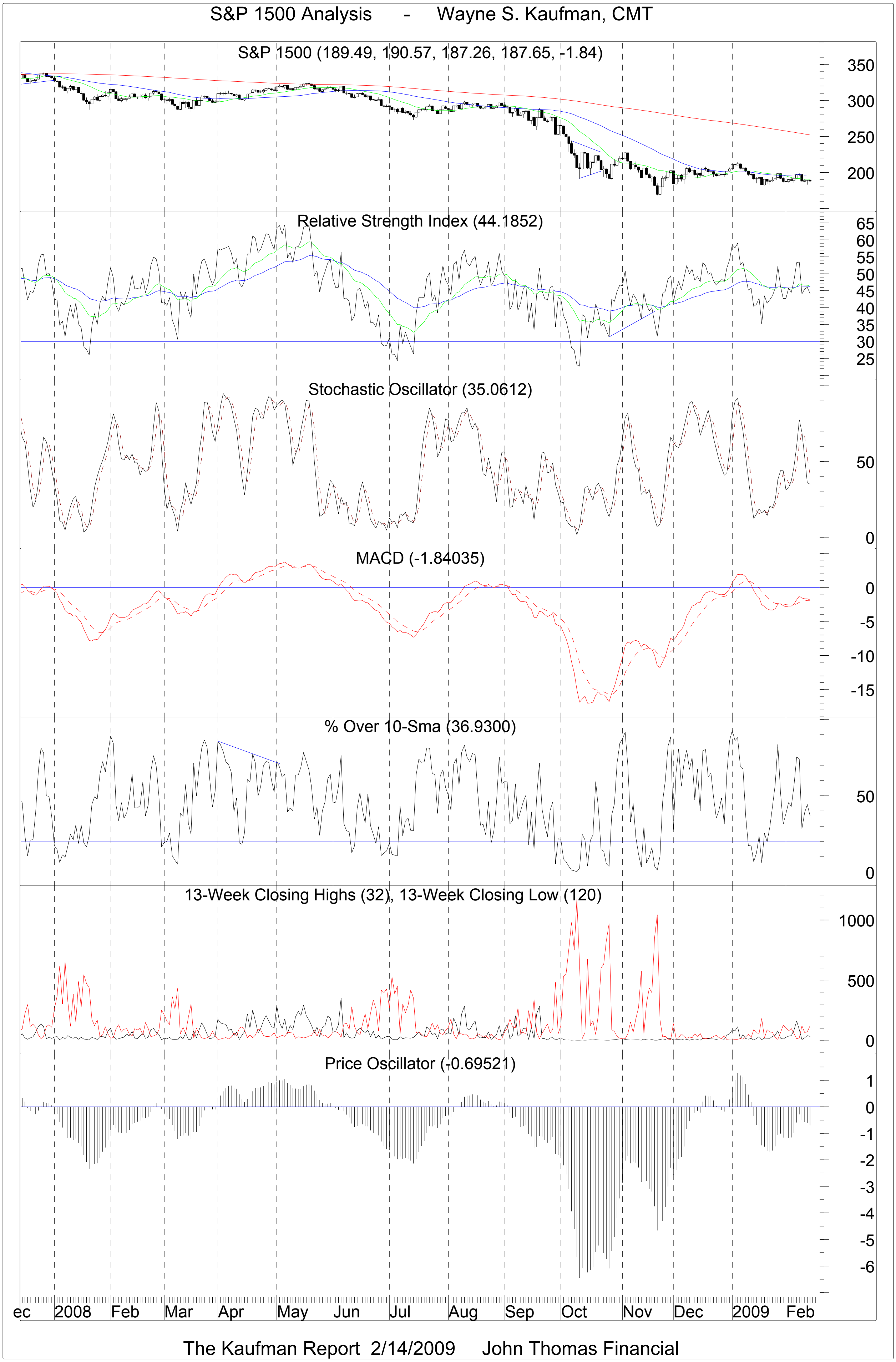
On the weekly chart of the S&P 500 the momentum indicators are at low levels where rallies can start.

The weekly stochastic just had a positive crossover from a low level.



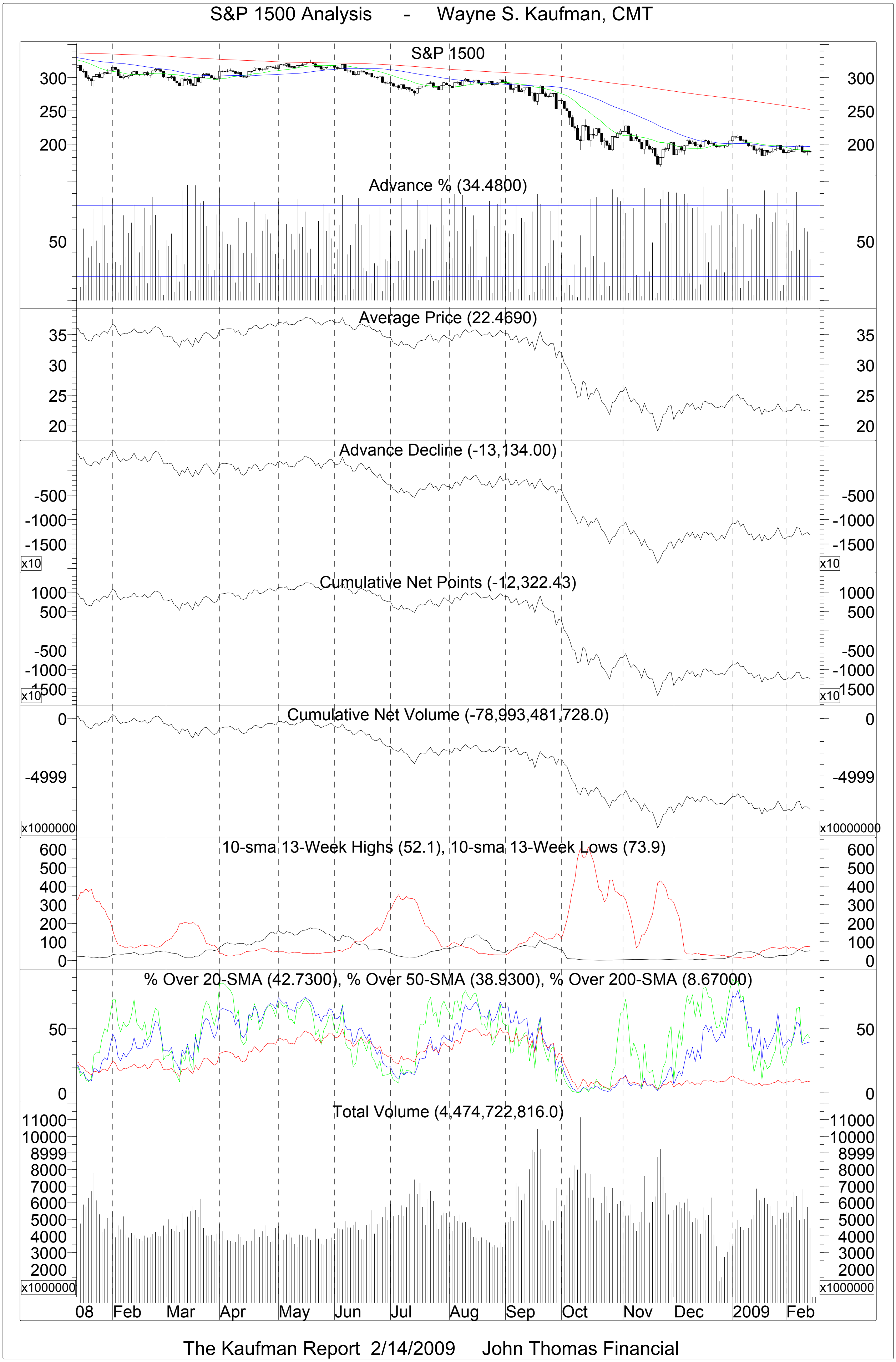
The Nasdaq 100 remains above its 20 and 50-sma and its up trend line. They are at 1211 and 1208, respectively. After that there is a support zone from 1205 - 1200. Since this has been a leading index, a move below the trend line could be very damaging to the market in general.

The Dow has been very weak and on Friday recorded its lowest close since 11/20. Support is 7693.98 which is the intra-day low of 2/12. It was the lowest weekly close since 3/7/03.



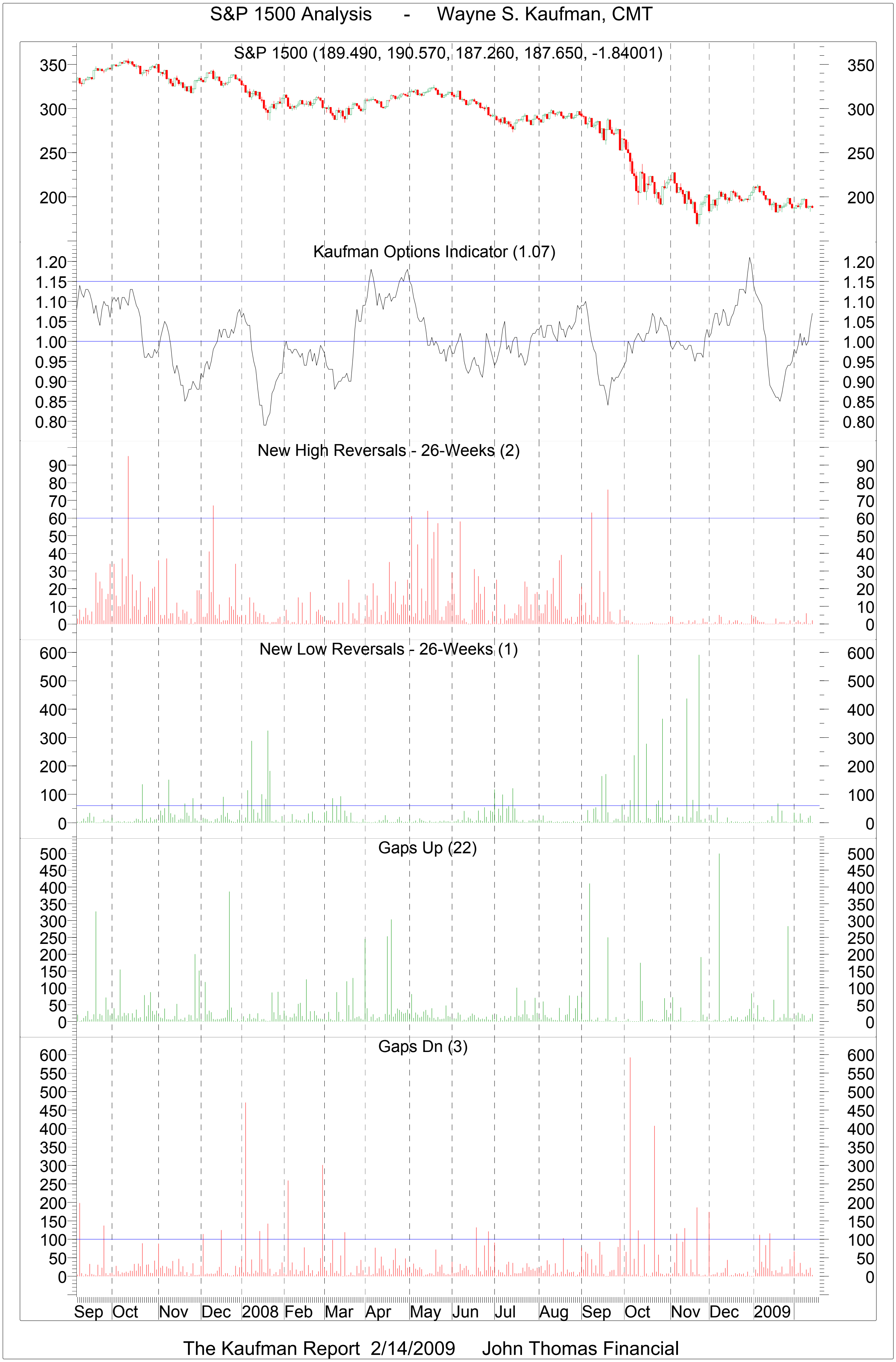
Our short-term momentum indicators have been dropping from high levels, but are not yet oversold.

Our price oscillator, a good indicator of trends, is still negative.

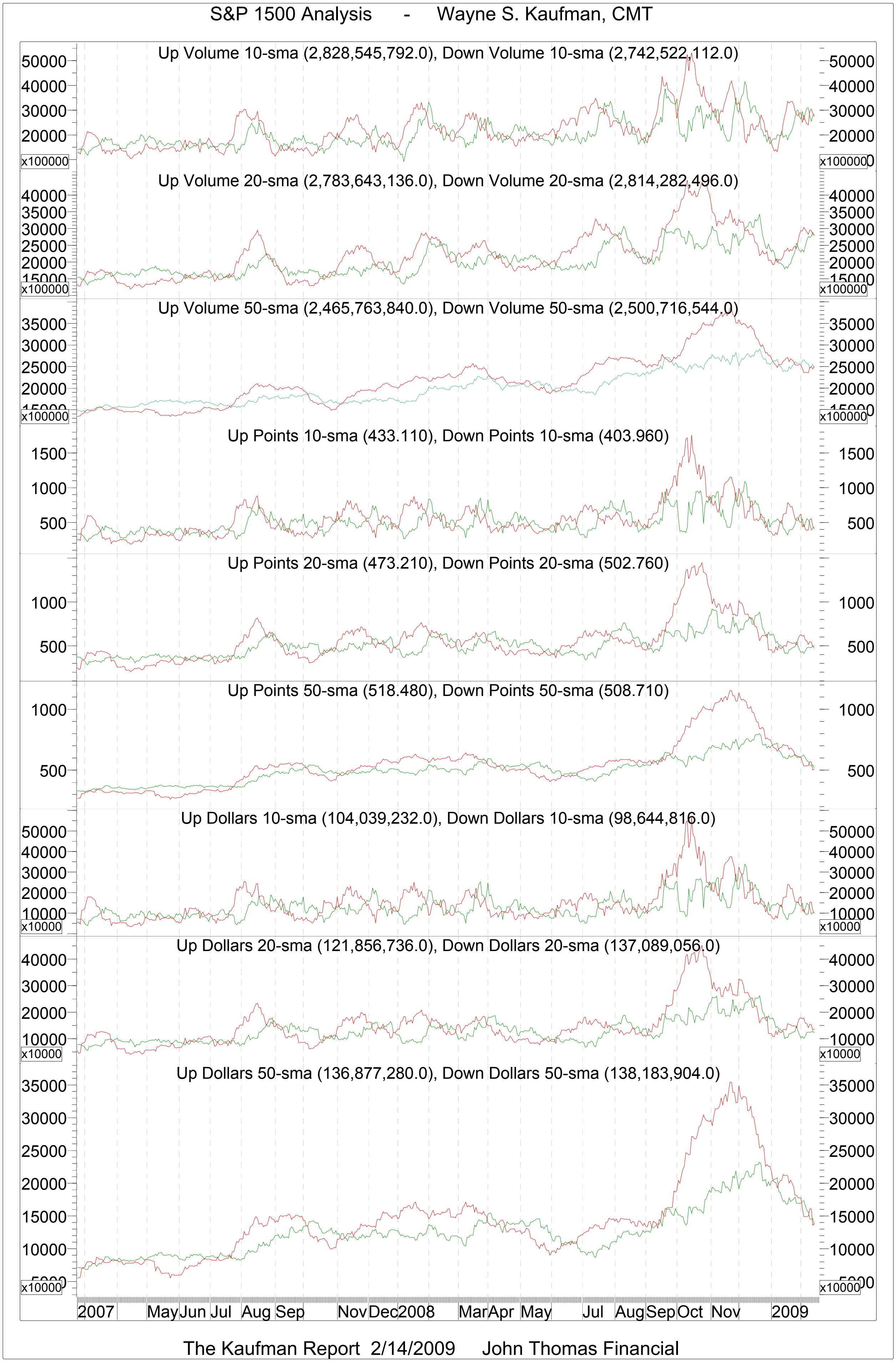


34.48% of stocks traded higher Friday.

Volume receded Friday.

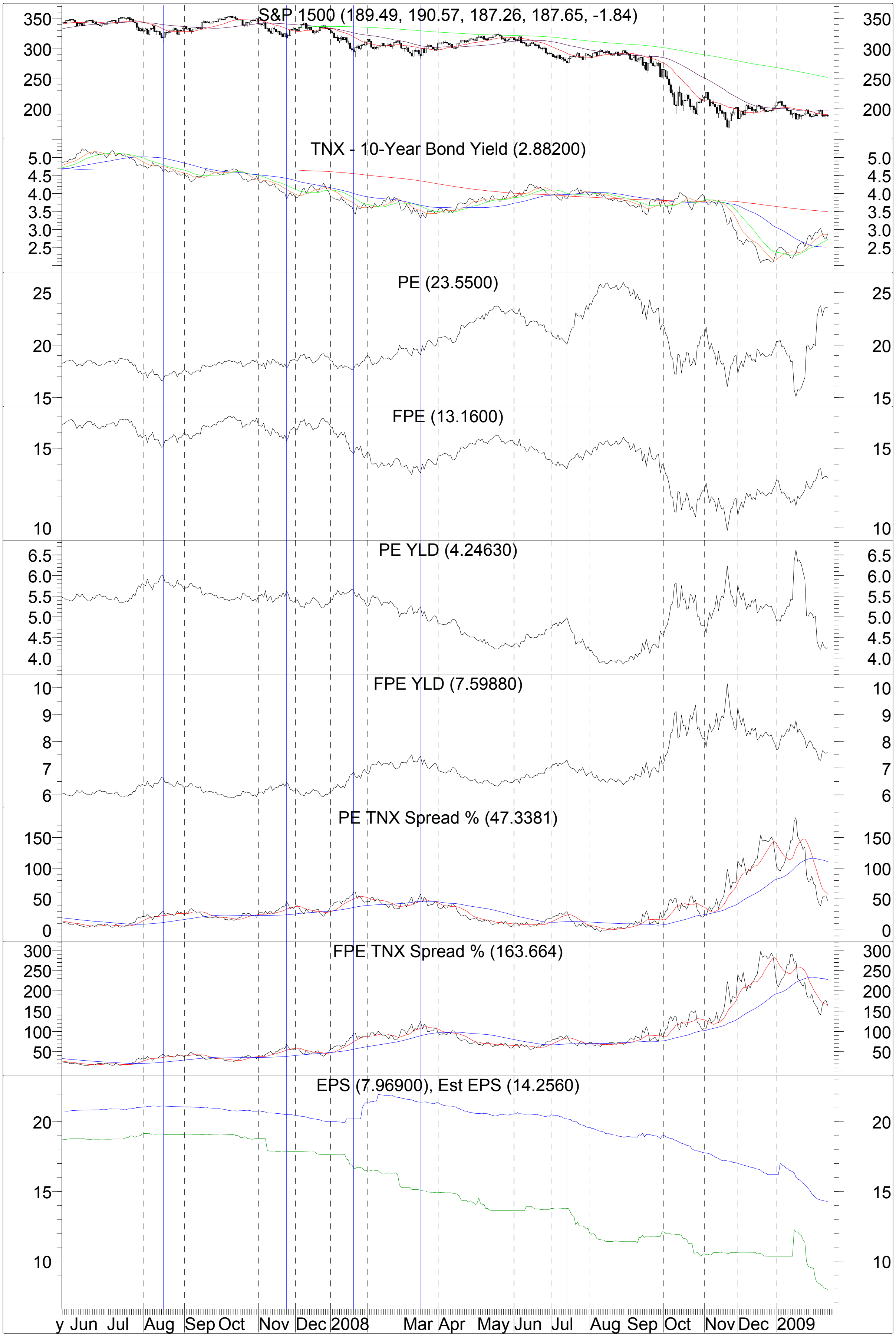


Our proprietary options indicator is showing the most optimism by options buyers since it hit 1.09 on January 8th.



Our statistics of supply (red lines) versus demand (green) show that bulls and bears have both become reluctant. As we said weeks ago, investors seem to think it is too late to sell but too soon to buy.

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

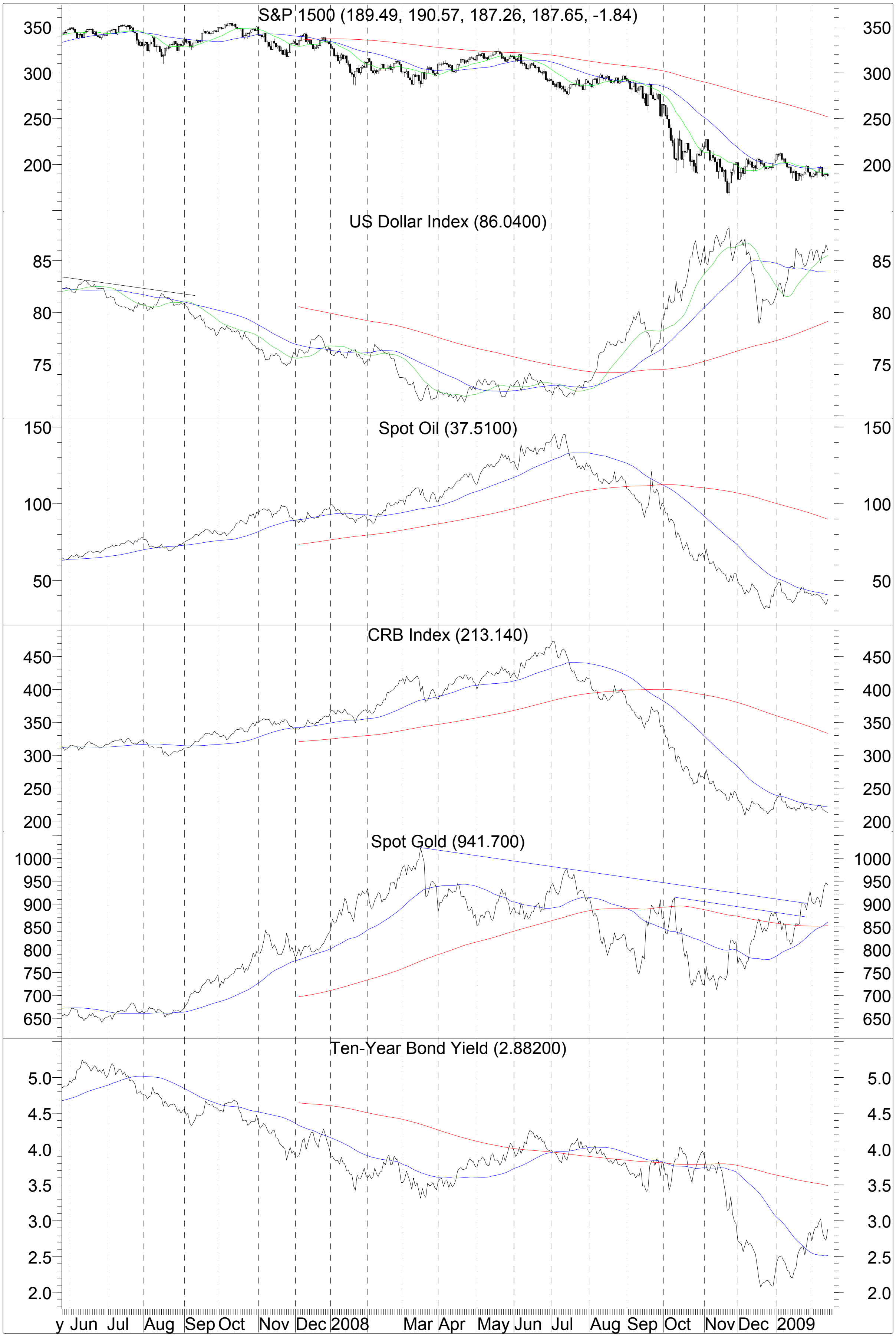


On 2/6 the P/E ratio hit the highest level since September. It remains in that range.

The forward P/E is coming down from a high level relative to its recent range.

Reported (green) and forecast earnings (blue) continue their inexorable march lower. The spread between the two is the highest in years.

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



The U.S. Dollar Index is in an up trend and consolidating under resistance.

Crude oil is trying to make a bottom and the 50-sma (blue) and 20-sma (not shown) are just above at 40. They will push prices lower or crude will start trading above them, confirming a bottom. Just poking above the MAs intra-day will not be a confirmation.

Gold remains in an orderly up trend after breaking resistance levels and is not yet overbought.