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The Kaufman Report

Trade what you see, not what you think.

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Monday February 22, 2010 **Closing prices of February 19, 2010**

Last Sunday we discussed the bounce in stocks from oversold levels, and said we thought the firming of prices could continue in the short-term. This was due to the change in market sentiment to pessimistic and the bullish engulfing candle printed on the weekly chart of the S&P 500. Equities did follow through during the week and in doing so broke through some resistance levels.

We also said we would become more bullish if resistance levels were broken, and we have. There are two other reasons we are more bullish. One is that sellers, who we noted last Sunday had begun to step to the sidelines, seem to have disappeared altogether. At the same time buyers, who had been reluctant, have stepped up to the plate. The second reason is the bullish engulfing candle on the weekly chart is now accompanied by a stochastic buy signal from a low level. The last two times this happened, in March 2009 and July 2009, nice rallies ensued. In addition, sentiment remains pessimistic, a condition which can help rallies.

In the very short-term caution is advised on entry points due to the percentage of stocks over their own 10-day moving averages, which is now at an overbought 92.87%, the highest since July 16th. However, during this bull market off the March lows hitting the 90% level was a sign of strength with only one time, mid-September, where it preceded a minor pullback.

Last Sunday we also discussed technical damage which had occurred during the recent selloff. While the S&P 500 did break through some resistance levels during this oversold bounce, more lie ahead. There is a resistance at 1114 – 1115, a resistance zone at the 1129 – 1131 area, and in spite of closing above the 50-day moving average for the first time since January 21st the index did not yet break through it decisively. Should the bullish signals discussed above reverse suddenly, we would become defensive.

In summary, we are more bullish due to a lack of sellers, negative sentiment, and technical signals which have preceded rallies recently. Unfortunately we are in a period where economic and political visibility is limited. For example, at the end of March the FED ends its $1.25 trillion program of purchasing mortgage backed securities backed by Fannie Mae, Freddie Mac, and Ginnie Mae. At the end of April the homebuyer's tax credit is due to expire. Less widely discussed is an IMF report due in April on an international financial transaction tax. In addition, we now have to worry about the Bipartisan National Commission on Fiscal Responsibility and Reform, which may simply be a smokescreen with the purpose of helping the government raise taxes. **Therefore, we continue to classify this as a trader's market until proven otherwise**.

Based on the S&P 500 the short-term, intermediate-term, and long-term trends are up. This is a short-term trader's market, with adept traders able to trade long or short depending on conditions. Investors need to be aware of sector rotation and should not hesitate to move out of lagging stocks and sectors and into leaders. Should recent positive technical signals be reversed, we would become defensive.

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S&P 1500 Data:

P/E: 19.34 Percent over 10-sma: 92.87%. Percent over 50-sma: 60.13%
13-Week Closing Highs: 191. 13-Week Closing Lows: 9. 52-week closing highs: 129
Kaufman Options Indicator: 0.89 Put/Call Ratio: 0.843 New High Reversals: 22. New Low Reversals: 3
Volume: +6% versus yesterday. 93% of the 10-day average. 86% of the 30-day average.
Up Stocks: 68.82%. Up Volume: 57.40%. Up Points: 71.05%. Up Dollars: 75.64%, 57% of 10-sma. Dn Dollars 67% of 10-sma.

Earnings: 425 of the S&P 500 have reported so far this earnings season. 73.4% have had positive surprises, 9.6% have been in line, and 16.9% have had negative surprises.

Federal Funds Futures project a 64.6% probability of no change to the current 0.25 % target rate and a 35.4% probability of a cut to 0.00% when the FOMC meets on 3/16. For the meeting of 4/28 the probabilities are 61.2% for no change, 31.4% for 0.00%, and 7.4% for 0.50%.

After breaking the down trend line on February 11th the S&P 500 proceeded to break through multiple resistance levels. The next major one is at 1129.25.

The stochastic is oversold, while there are negative divergences on the RSI and MACD. Some consolidation may be necessary.

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The daily chart of the S&P 500 shows it broke through resistance at the 1105 area and closed above its 50-sma for the first time since 1/21. The next resistance is 1114.81.

The stochastic is overbought and starting to show a negative crossover. The RSI and MACD still have room to move up, but some consolidation may be necessary here.

Last week we pointed out the bullish engulfing candle on the weekly chart of the S&P 500. Stocks followed through after that and the S&P 500 moved back above its 20-week moving average. The index and these moving averages are now lined up bullishly once again.

The stochastic has made a positive crossover from the oversold zone. The last two times it did this in combination with a bullish engulfing candle on the weekly chart of the index very nice rallies ensued.

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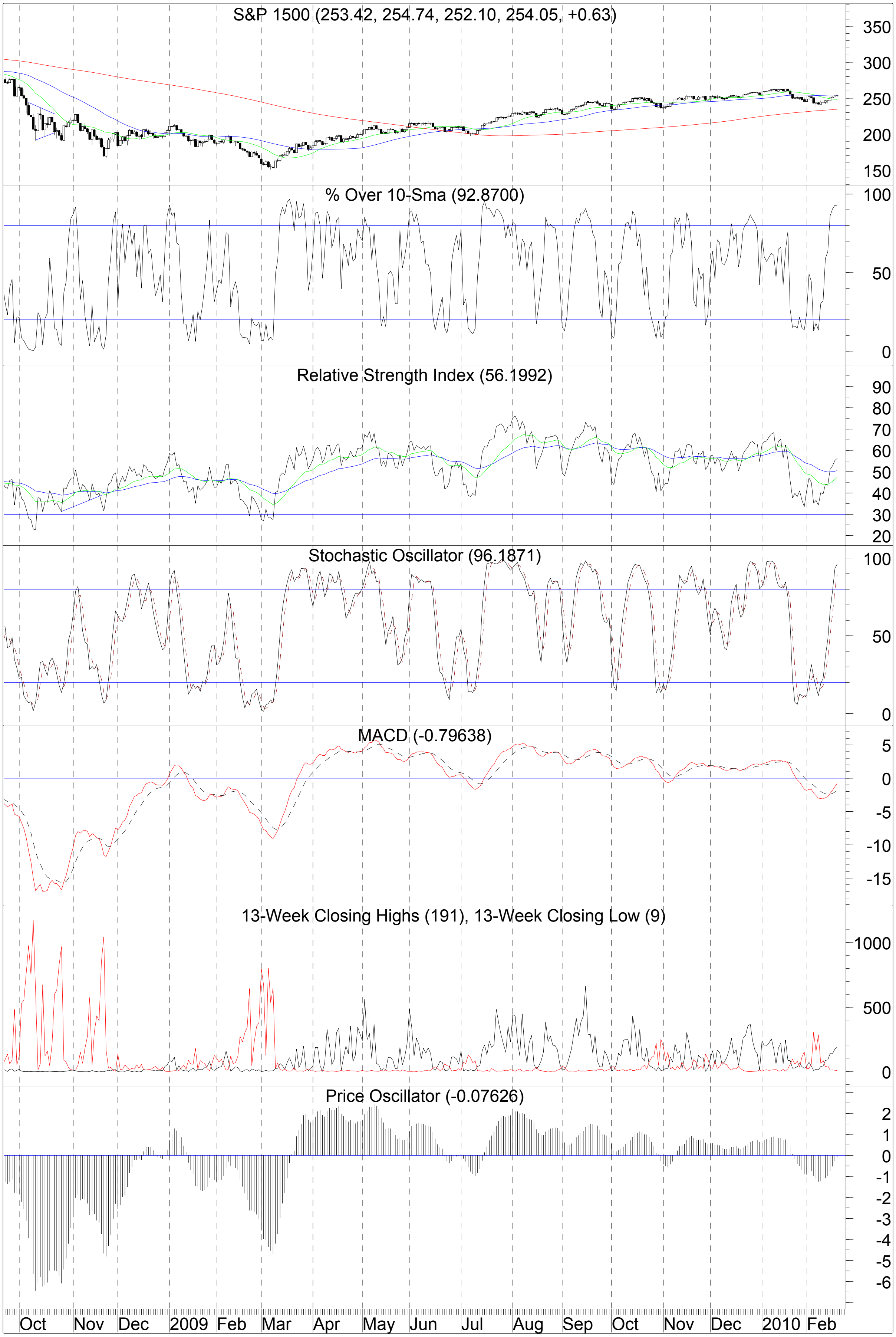

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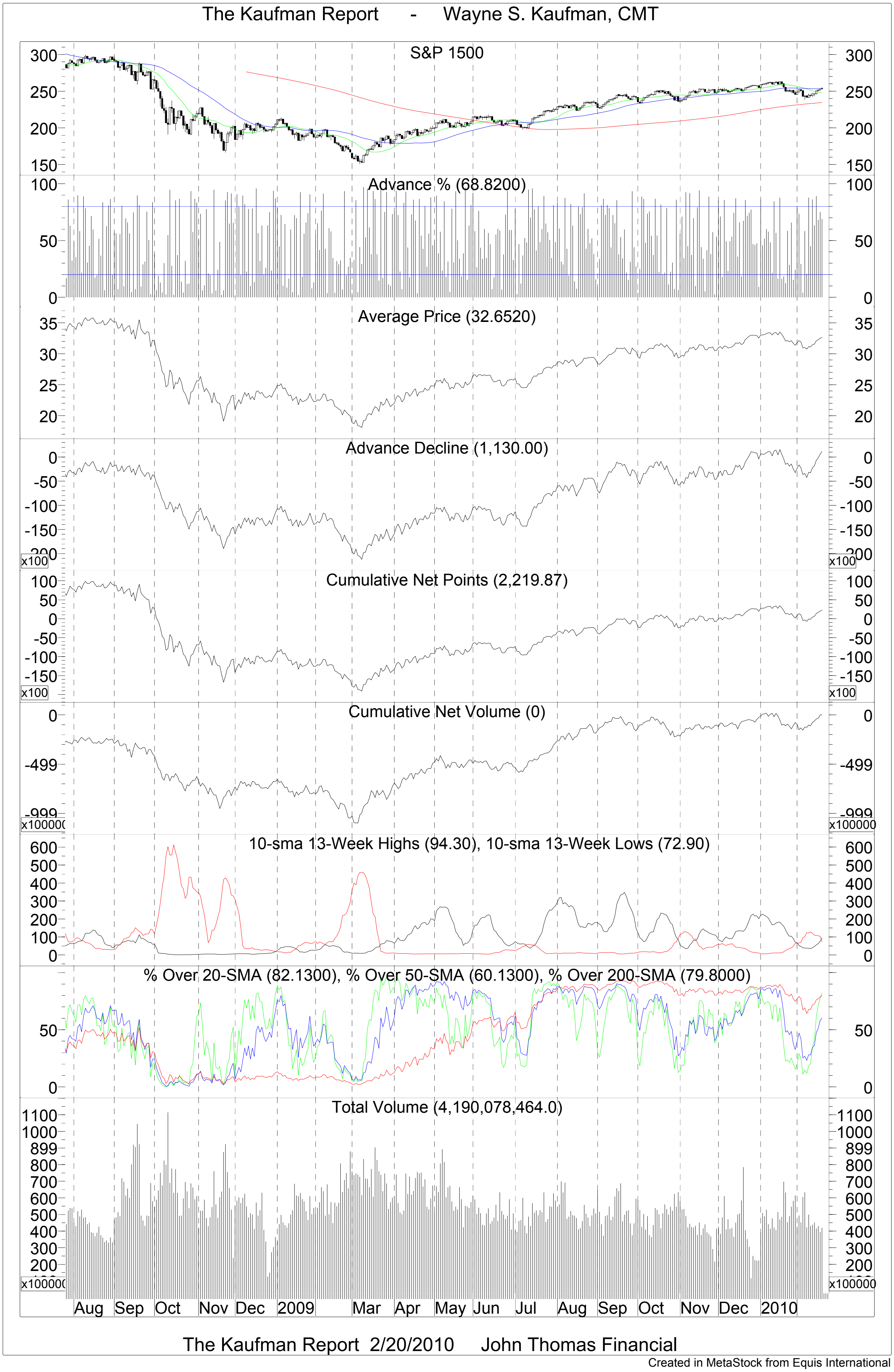
92.87% of the S&P 1500 are over their own 10-sma, the most since July 16th.

The stochastic is in the overbought zone. The RSI has room to move higher. The MACD is showing a positive crossover from a low level.

13-week closing highs are increasing again after a lull.

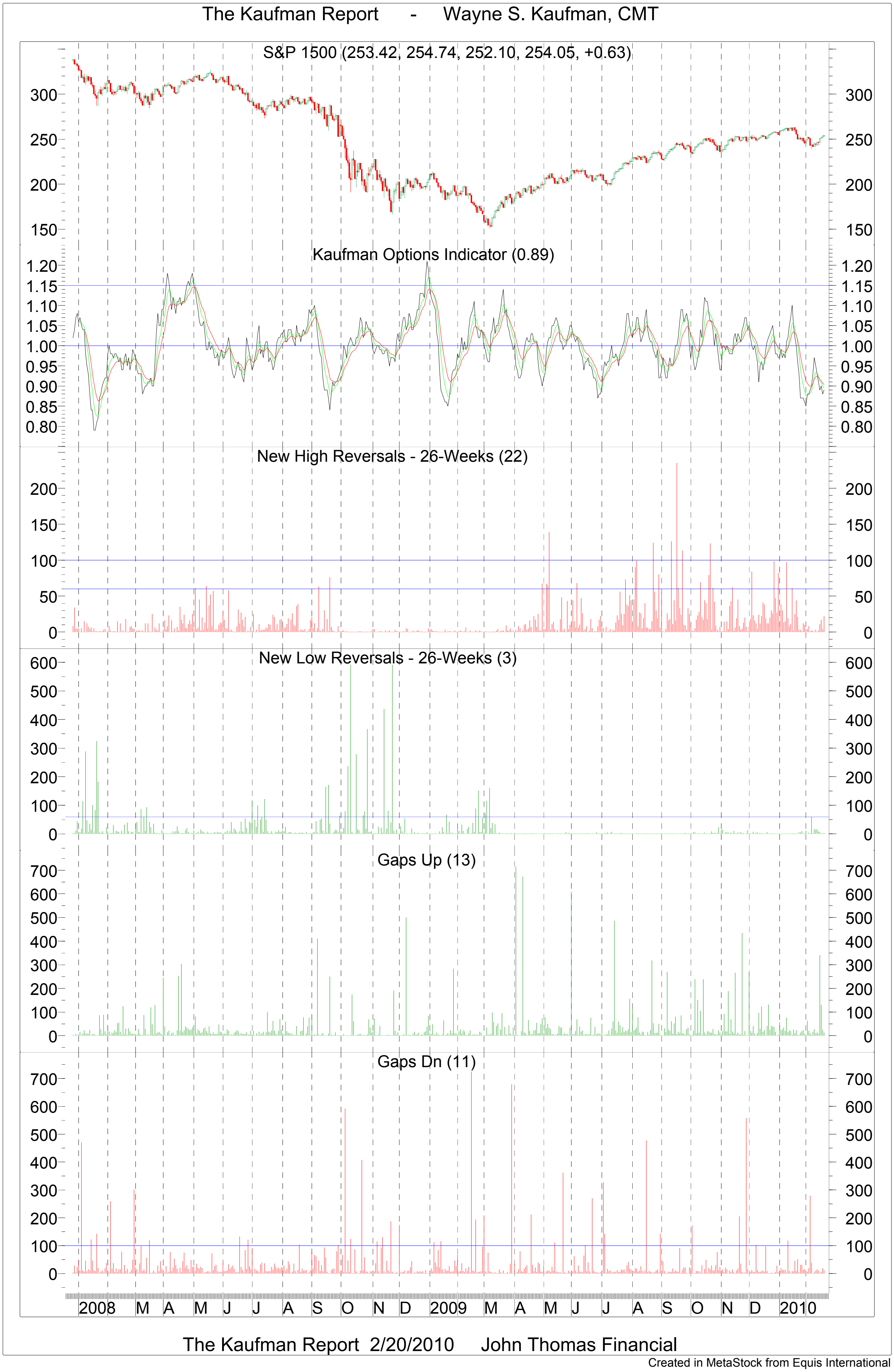
Our price oscillator is just under the neutral level.



68.82% of stocks traded higher Friday.

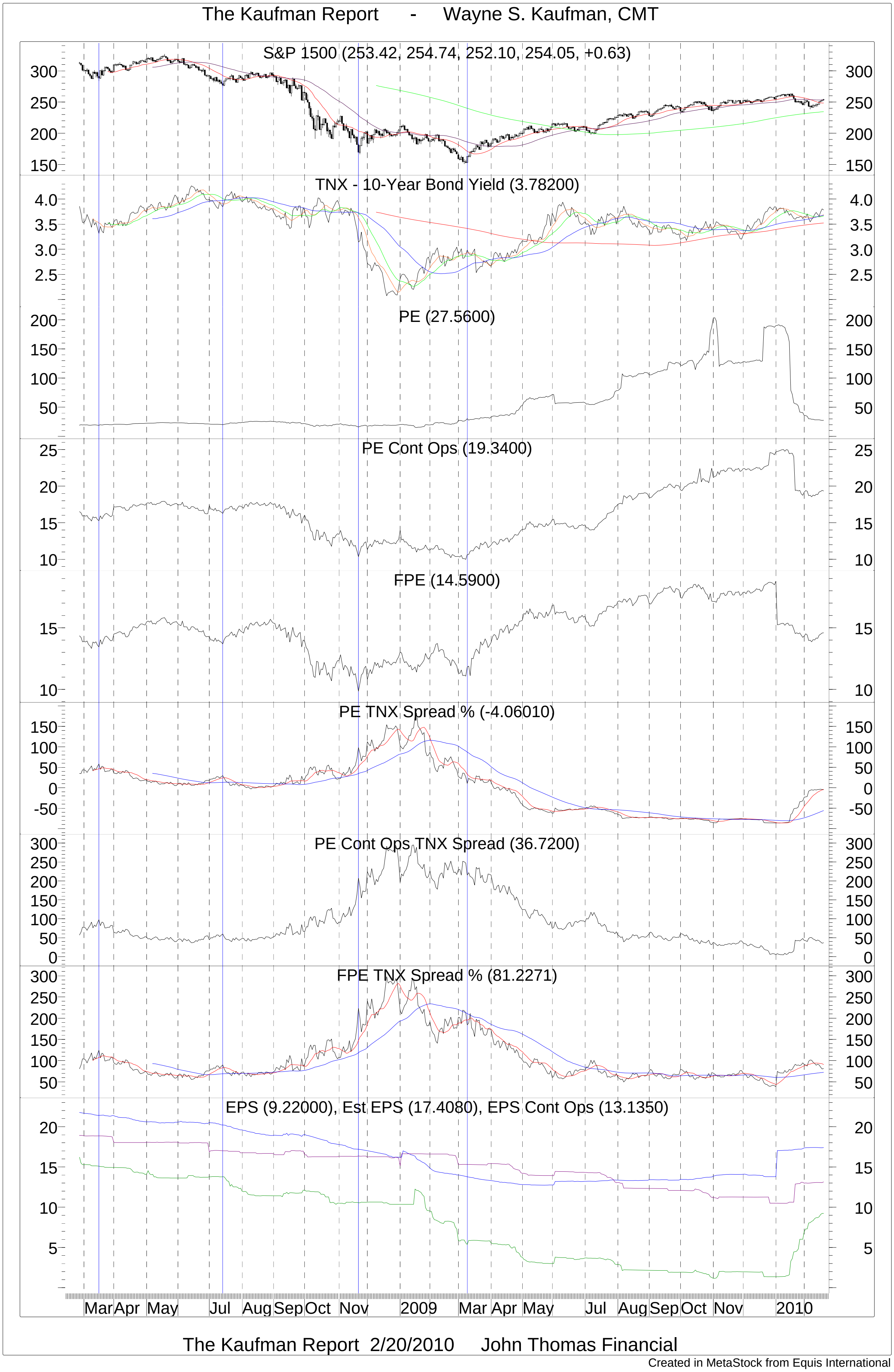
The AD line, which is a leading indicator, is only 418 net advances away from posting a new high.

We said recently that we need to see the percent of stocks over these moving averages get back to bull market levels quickly, and that has happened. Only the percent over 50-sma, now at 60.13%, is under the 75% level.



Our proprietary options indicator remains at a very low 0.89. This shows pessimism. We said last week this would make it difficult for stocks to drop sharply in the short-term. We feel the same way this week, and a good degree of skepticism is usually helpful for rallies.

Last week we said our statistics of supply (red) versus demand (green) showed some improvements in the 10-sma numbers, but that more of the improvement was from sellers backing away than from any big increase in buying enthusiasm. That picture continued with sellers completely heading for the hills last week while there was a change in demand as emboldened buyers stepped up to the plate. With earnings season 85% over, it seems that it will take some sour economic news to bring sellers back in force. Obviously, with a lack of sellers it will be difficult for stocks to move significantly lower. Pullbacks or consolidations that take place due to buyers becoming reluctant with little pickup in selling statistics tend to be short-term affairs characteristic of bull markets.

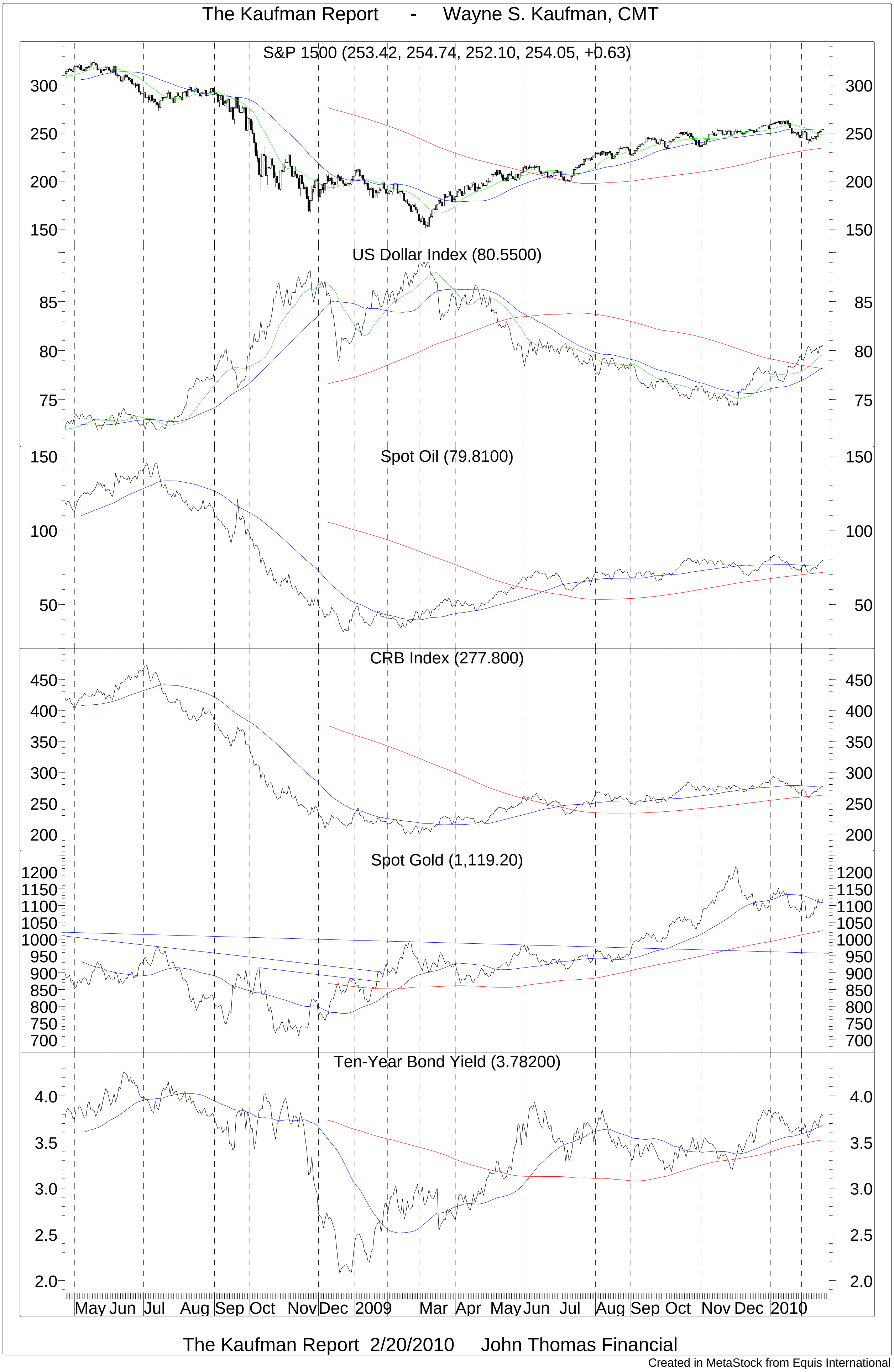


10-year bond yields remain in an up trend and are not overbought in any time frame.

P/E ratios plunged from very high levels, but seem to be bottoming.

Spreads between bond and equity yields are still at levels where stocks can rally.

All of our metrics of earnings have been moving higher. The question now is if forecasts will continue to increase. They bottomed first, back in May.



The U.S. Dollar Index remains in an up trend with price and moving averages lined up bullishly. It is in the 80 - 82 resistance zone we previously identified. The RSI is showing a negative divergence on the daily chart.

After testing its 200-sma (red) crude oil bounced back through its 50-sma. This was in spite of strength in the U.S. Dollar Index and shows strong demand for oil. There is a resistance zone at 83.5 - 86.5. A break above that will target high $90s or $100 oil.

Gold has moved back above its 50-sma and is not overbought although it is at a resistance zone. While the chart points to higher prices we are concerned about too much bullishness for gold.