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The Kaufman Report

Trade what you see, not what you think.

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Monday February 23, 2009 **Closing prices of February 20, 2009**

Stocks disregarded an oversold condition and traded lower for the fifth consecutive day Friday. The DJIA and the S&P 500 made their lowest weekly closes since 1997, and both need to rally to prevent their lowest monthly closes since 1997. A rally is possible due to the oversold condition, options buyers turning short-term bearish, and earnings season being 85% over. <u>However, the lack of any type of oversold bounce causes us to reiterate our frequent warning from last October that a market that doesn't respond to oversold conditions is dangerous. The short-term, intermediate-term, and the long-term trends remain down. This continues to be an opportunistic trader's market, with adept traders able to take advantage long or short. Investors should not hesitate to sell lagging stocks and sectors and move into leaders.</u>

We recently wondered if the government is running out of ammunition. Based on the market's responses to all the recent government plans maybe we should hope that is the case. Our elected officials should have to take their own version of the Hippocratic Oath, keeping in mind that when dealing with a sick patient their first responsibility is to do no harm. The stimulus package should include money directly back to the taxpayers but doesn't because the politicians want to increase their own power. The mortgage default solution is unfair and un-American. The argument that it helps the property values of those subsidizing the "at risk" borrowers is silly. That only matters if you need to cash out of your house soon. Even those who are moving will sell for less but also buy for less. This plan will create chaos and resentment. <u>Stop manipulating free markets. That's how this mess was created. Government is not the solution, it is the problem.</u>

The S&P 1500 (174.61) was down 1.11% Friday. Average price per share was down 0.66%. Volume was 138% of its 10-day average and 144% of its 30-day average. 32.37% of the S&P 1500 stocks were up, with up volume at 27.07% and up points at 36.05%. Up Dollars was 19.83% of total dollars, and was 44% of its 10-day moving average. Down Dollars was 70% of its 10-day moving average. The index is down 6.745% in February, down 14.8% quarter-to-date and year-to-date, and down 51% from the peak of 356.38 on 10/11/07. Average price per share is $20.91, down 51.63% from the peak of $43.23 on 6/4/07.

<u>Put/Call Ratio: 1.062, 4th day in a row over 1.00. 0.668 on 2/9 was the lowest since 1/30/06. Kaufman Options Indicator: 1.05.</u> *<u>The spread between the reported earnings yield and 10-year bond yield is 70%, and 192% based on projected earnings</u>*. *<u>The dividend yield on the S&P 500 recently moved above the 10-year bond yield for the first time since 1958.</u>*

Reported aggregate earnings for the S&P 1500 peaked in August 2007 at $19.18 and <u>are now at $8.25, a drop of 56.99%</u>. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $14.14, a drop of 35.58%. <u>The spread between reported and projected earnings is near the widest the level in years. If investors believed the estimates stocks would be much higher.</u>
426 of the S&P 500 have reported 4th quarter earnings. According to Bloomberg, 59.1% had positive surprises, 9.2% were line, and 31.8 % have been negative, a high number. The year-over-year change has been -35.5% on a share-weighted basis, -18.0% market cap-weighted and -23.8% non-weighted. <u>Ex-financial stocks these numbers are -15.4%, -5.7%, and -7.8 %, respectively.</u>

Federal Funds futures are pricing in a probability of 94.0% that the Fed will *<u>leave rates unchanged</u>*, and a probability of 0.0% of *<u>raising 25 basis points to 0.50%</u>* when they meet on March 17th. They are pricing in a probability of 85.2% that the Fed will *<u>leave rates unchanged</u>* on April 29th and a probability of 9.4% of *<u>raising 25 basis points</u>*.

IMPORTANT DISCLOSURES

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Economic News

2/20/09 – The Consumer Price Index for January rose for the first time in six months by +0.3%, hitting the estimate. It was unchanged on an annual basis for the first time since 1955. Energy expense rose 1.7%, led by a 6% increase in gasoline prices.

2/19/09 – Initial Jobless Claims for the week ending 2/14 hit 627,000 versus the 620,000 estimate. The prior week was also 627,000. Continuing Claims were 4.99 million and set another record. The Producer Price Index for January was +0.8% versus a +0.3% estimate. Leading Indicators rose 0.4% versus the estimate of 0.1%. Some economists said this was a temporary jump.

2/18/09 – Housing Starts for January were the lowest on record at 466,000 annualized, missing the forecast of 529,000 and falling 17% from December. Building permits dropped 4.8% to 521,000 annualized.

2/17/2009 – Empire Manufacturing Index, which shows NY manufacturing, was -34.65 in February versus the -23.75 estimate. It dropped from -22.2 in January for the fastest drop ever. Net long-term TIC inflows, which shows international demand for U.S. financial assets, was $34.8 billion in December, up from -$21.7 billion in November and above the $20 billion estimate.

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.

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Economic News

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.

The S&P 500 printed a hammer on the daily chart. There are multiple levels of resistance up to 818, which should be very strong resistance.

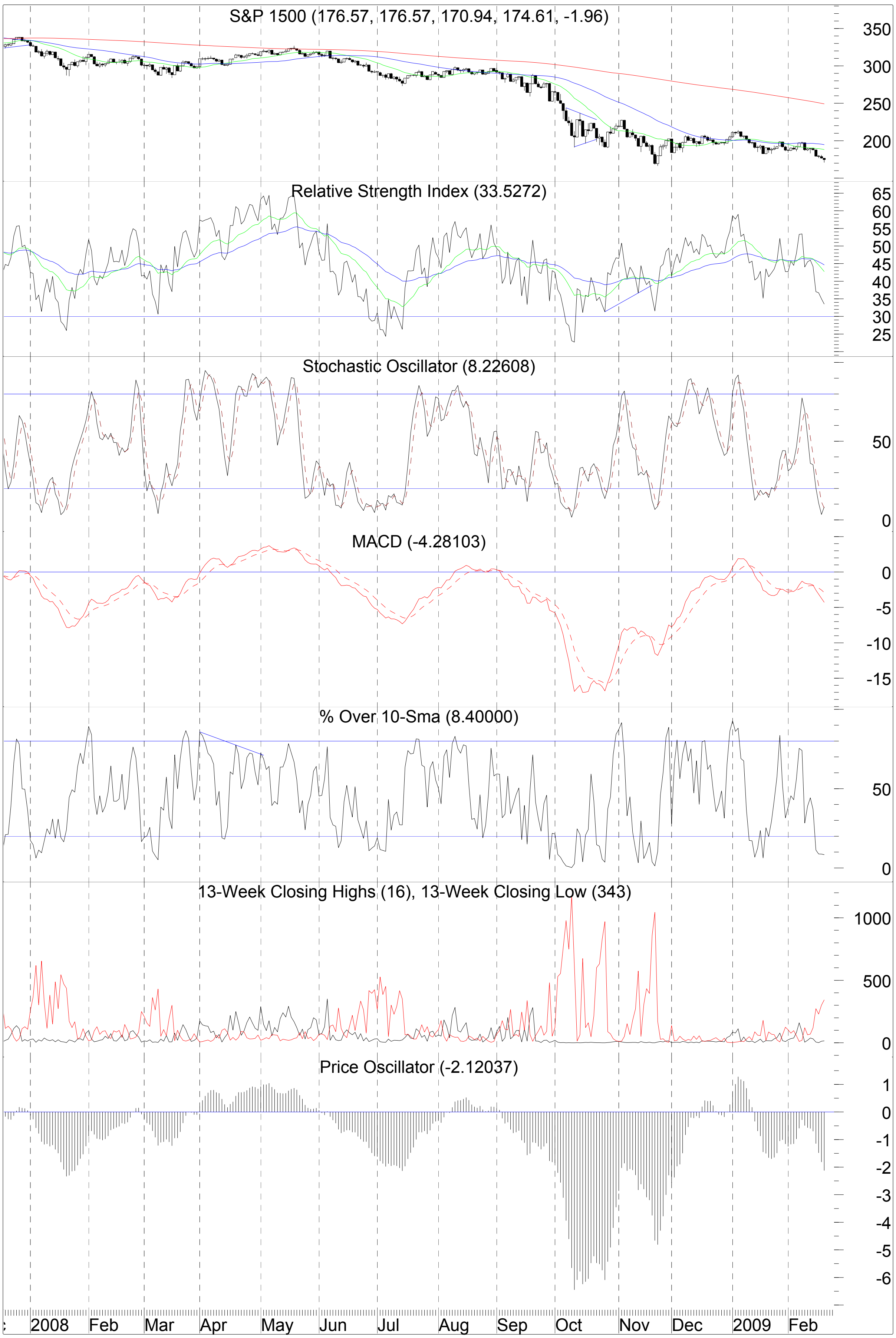
The S&P 500 printed its lowest weekly close since April 1997. With current oversold conditions we would expect to see some kind of a bounce. If the weekly stochastic crosses over negatively it will be from low levels, but still a bad sign.

The Dow Jones Industrials also printed a hammer on the daily chart after taking out the November lows last week. It was the lowest weekly close since May 1997.

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

The Nasdaq 100 remains above its January lows. It has resistance at the 1205 - 1212 zone.

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



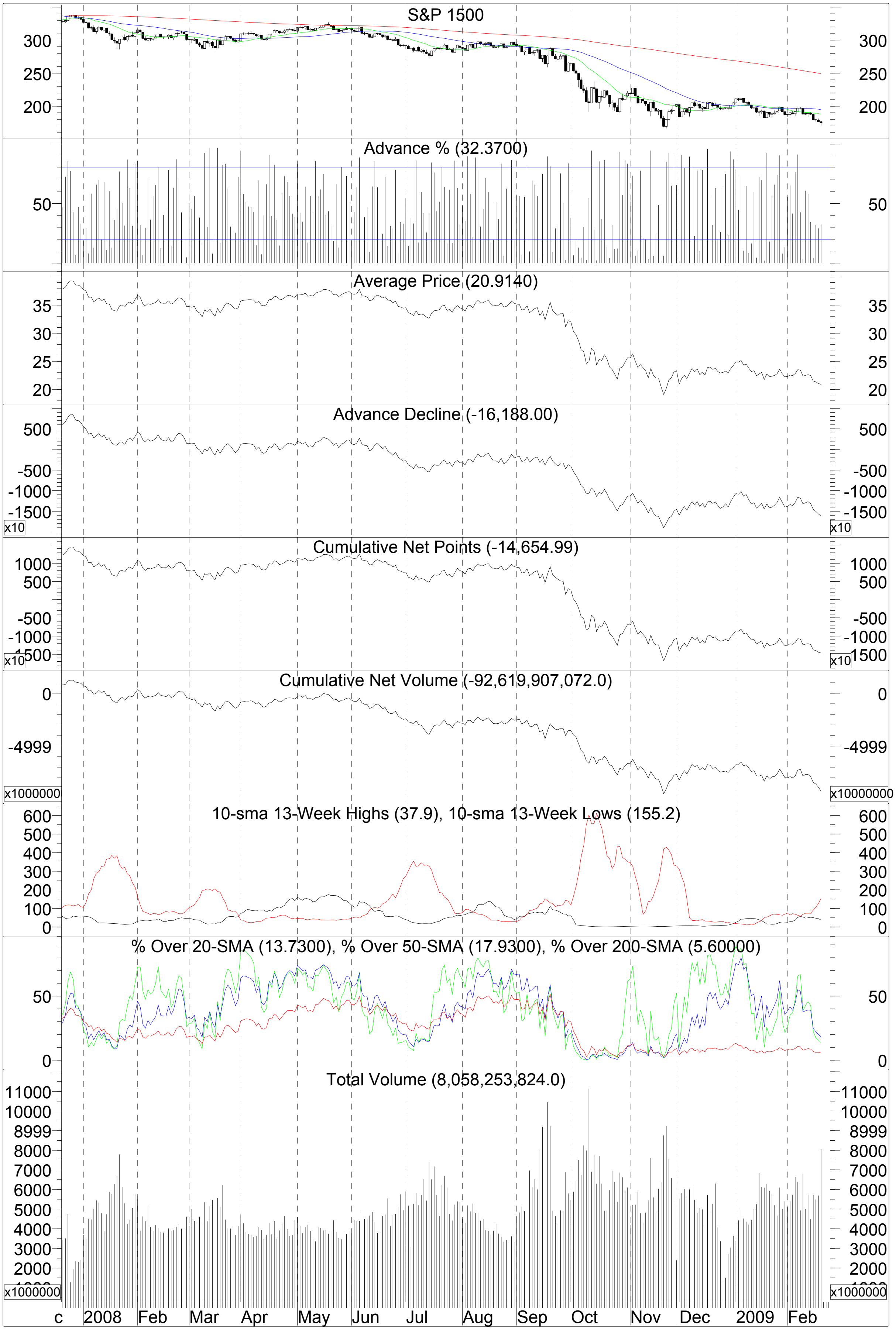
Our short-term momentum indicators are near or at oversold levels.

The percent over 10-sma is very low at 8.4%. On November 20th it hit 1.27%.

13-week closing lows are moving higher again.

Our price oscillator is negative but starting to get to extreme levels.

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



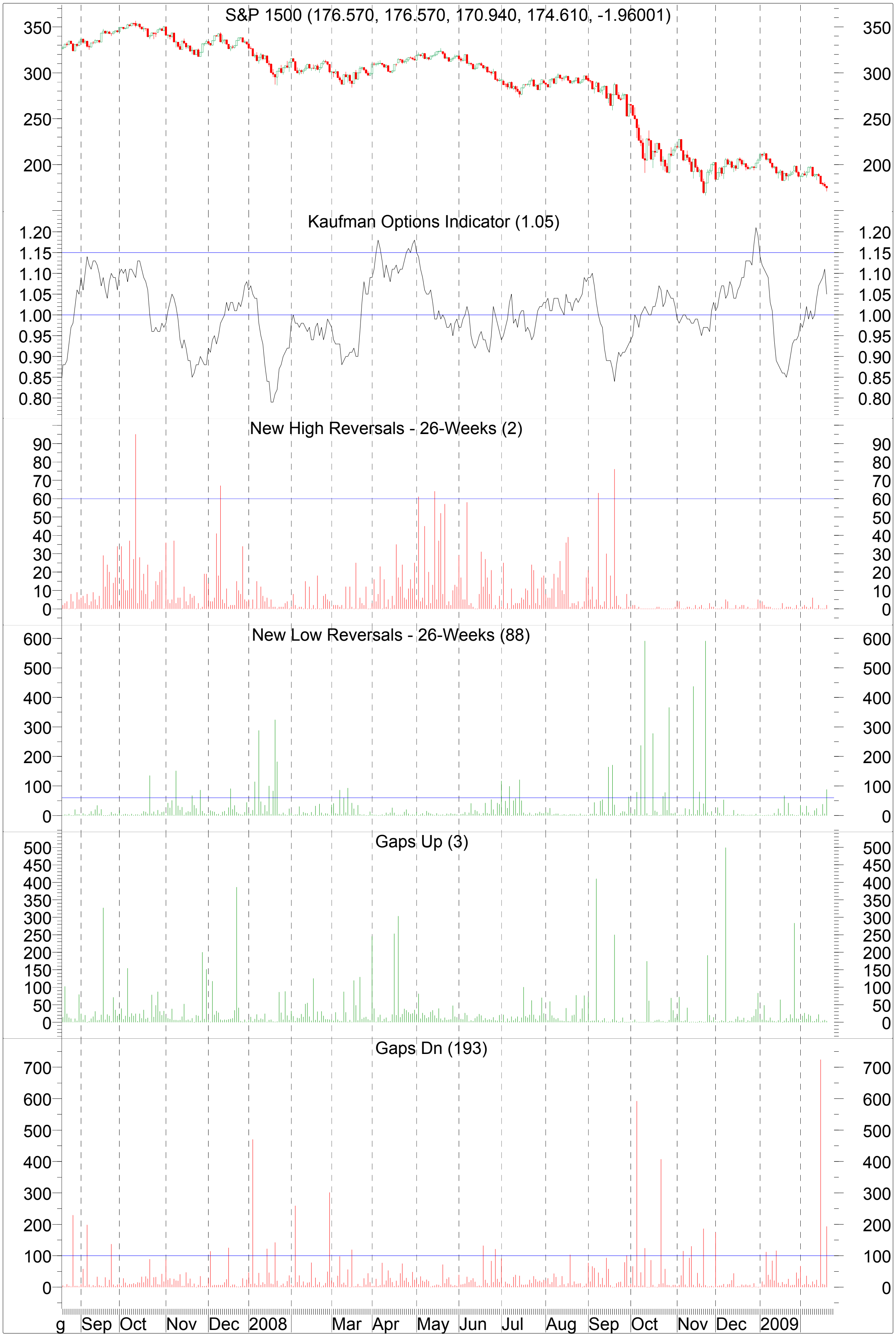
32.37% of stocks traded higher Friday.

Average new lows continue to overpower new highs.

All of these percents are at oversold levels.

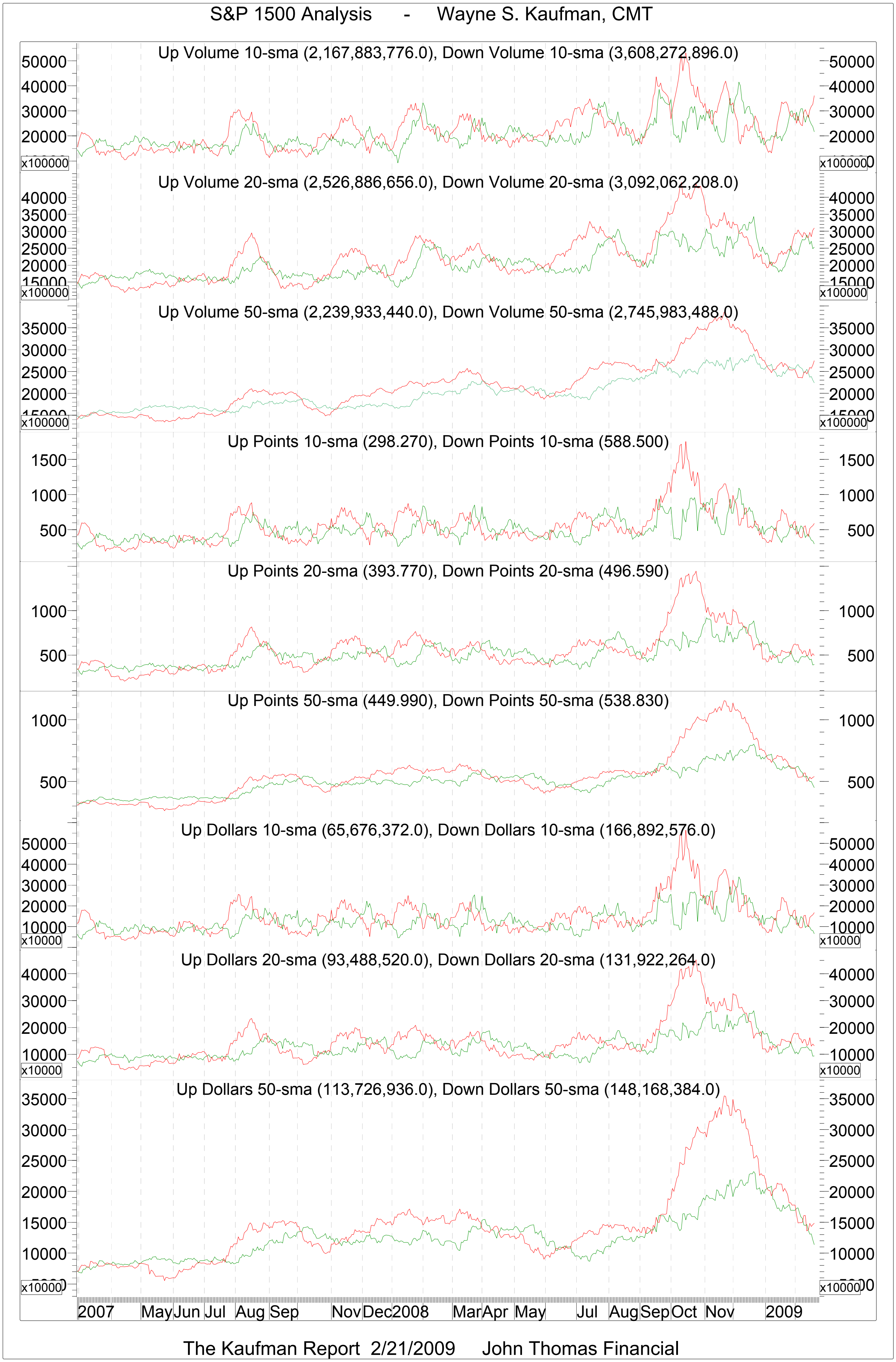
Volume expanded during Friday's option expiration.

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

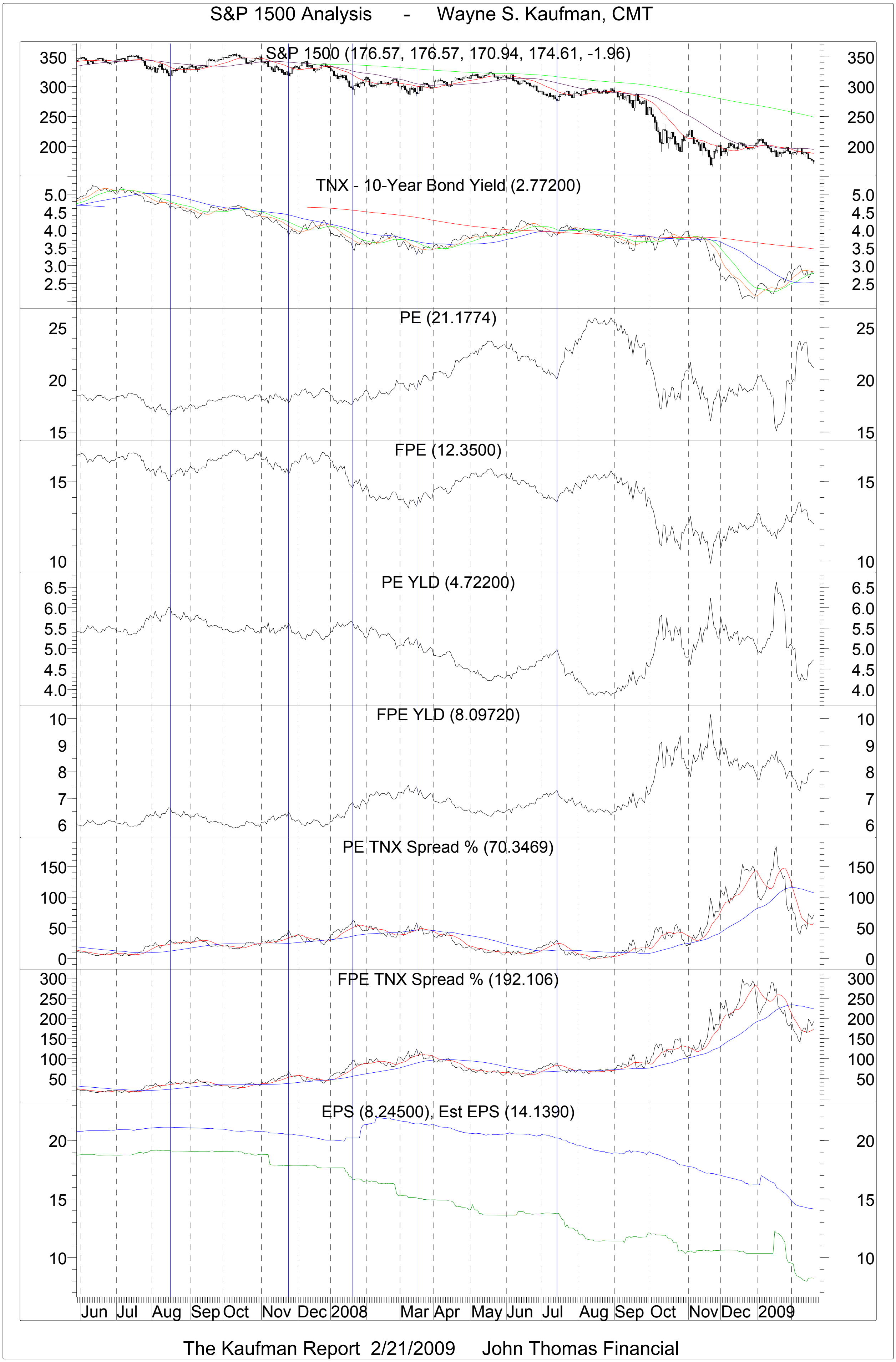


Our options indicator has started to drop from optimistic levels but still needs to be much lower to be in the area where important bottoms are made. The 5-day average of the put/call ratio is 1.062, a level where short-term bottoms can be made.

88 new low reversals shows bottom fishers becoming more interested. Or is it just short covering? Either way it is buying at these levels.



Our statistics of supply (red lines) versus demand (green) show negative crossovers for all statistics at all time frames. Simply put, supply continues to be greater than demand. Still, it can be seen that the sellers are not nearly as aggressive as they have been in the past. The share volume numbers are probably skewed by the low priced financials like C and BAC.



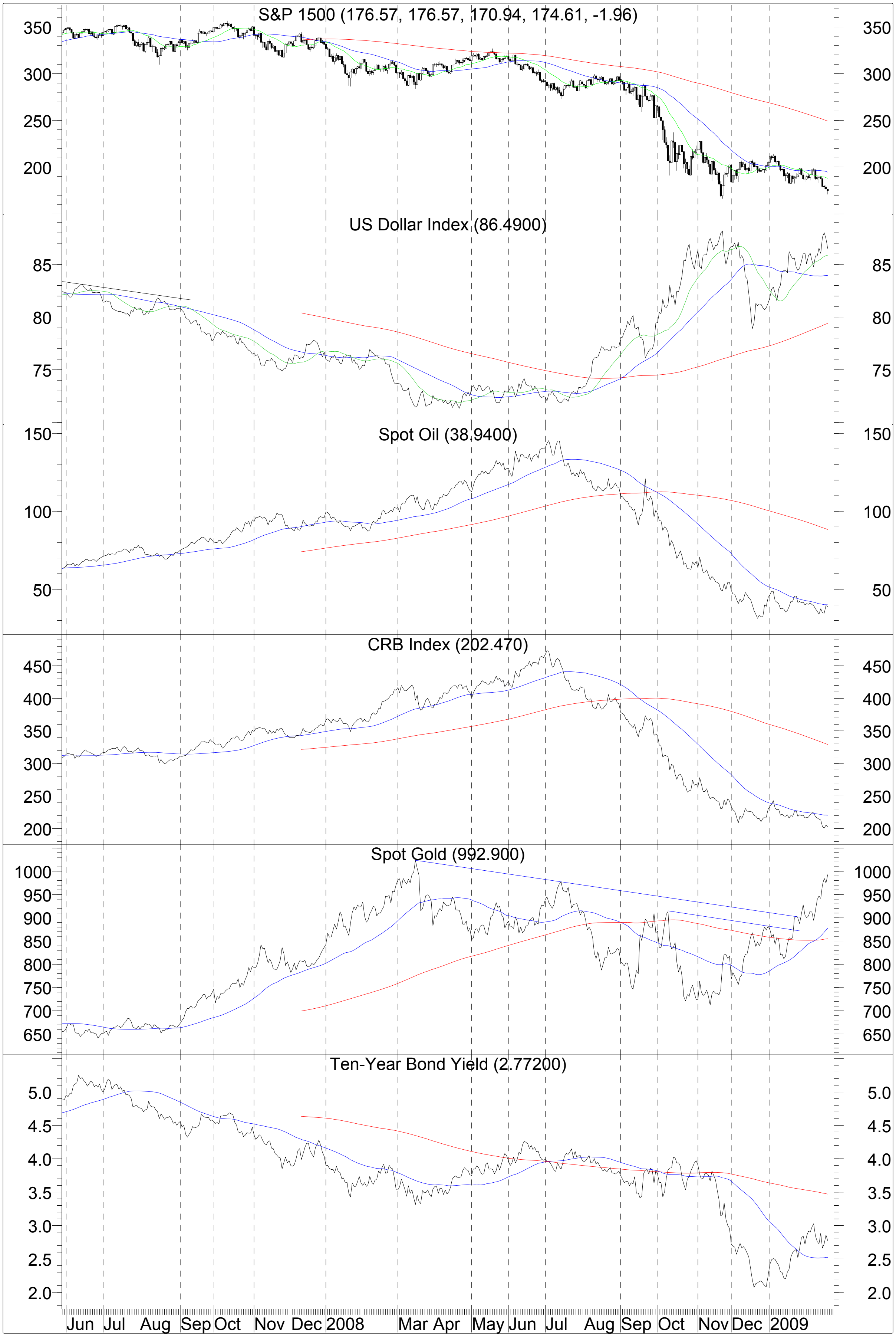
The 10-year bond yield is rising but has resistance at the 3.25% area.

P/E ratios, which had reached high levels, are dropping as equities move lower.

Spreads between earnings yields and bond yields had reached low levels based on their recent ranges. They are rising as stocks drop.

Reported and forecast earnings may level off now that earnings season is 85% over. That could last a few weeks, but as we get into mid-March quarterly updates and pre-announcements will become important.

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



The U.S. Dollar Index ran into resistance last week.

Crude is still fighting the 50-sma as it tries to put in a bottom.

Gold has followed through on its break above two resistance levels. It is getting overbought as it nears the March 2008 resistance.