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The Kaufman Report

Trade what you see, not what you think.

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Monday January 5, 2009 **Closing prices of January 2, 2009**

Equities rallied strongly last week led by a rebound in energy stocks. On Friday we listed reasons for optimism such as the calendar change causing money managers to become more aggressive, the mountain of cash on the sidelines, very attractive valuation levels, and massive global stimulus by governments around the world. After last week's 6.77% rally in the S&P 1500, stocks are very overbought and we remain concerned about the extreme optimism shown by options buyers. Also, so far the rally has been more a result of a complete lack of sellers as opposed to an increase in demand for stocks. We are cautiously optimistic since the short and intermediate-term trends are up and resistance levels have been broken, but with current overbought levels and earnings season coming up investors must remain on their toes. This is still a bear market rally until proven otherwise.

The S&P 1500 (211.16) was up 3.04% Friday. Average price per share was up 2.73%. Volume was 98% of its 10-day average and 67% of its 30-day average. 79.26% of the S&P 1500 stocks were up on the day, with up volume at 92.0% and up points at 87.2%. Up Dollars was 98.9% of total dollars, and was 240% of its 10-day moving average while Down Dollars was 4.1% of its 10-day moving average. The index is up 3.04% month-to-date, up 3.04% quarter-to-date, up 3.04% year-to-date, and down 40.75% from the peak of 356.38 on 10/11/07. Average price per share is $24.90, down 42.40% from the peak of $43.23 on 6/4/2007. For the week the index was up 6.77%.

The Put/Call Ratio was 0.957. The Kaufman Options Indicator is 1.14 after hitting 1.21 Tuesday, indicating too much bullishness.

The spread between the reported earnings yield and 10-year bond yield is 103% and 218% based on projected earnings, still very wide 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 $10.36, a drop of 45.98%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $16.22, a drop of only 26.10%. 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 74% that the Fed will *leave rates unchanged*, and a probability of 26.0% of *cutting 25 basis points to 0.00%* when they meet on January 28th. They are pricing in a probability of 65.4% that the Fed will *leave rates unchanged* on March 17th, and a probability 21.3% of *cutting 25 basis points to 0.00%.*

The short-term and intermediate-term trends are now up, but the long-term trend remains 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

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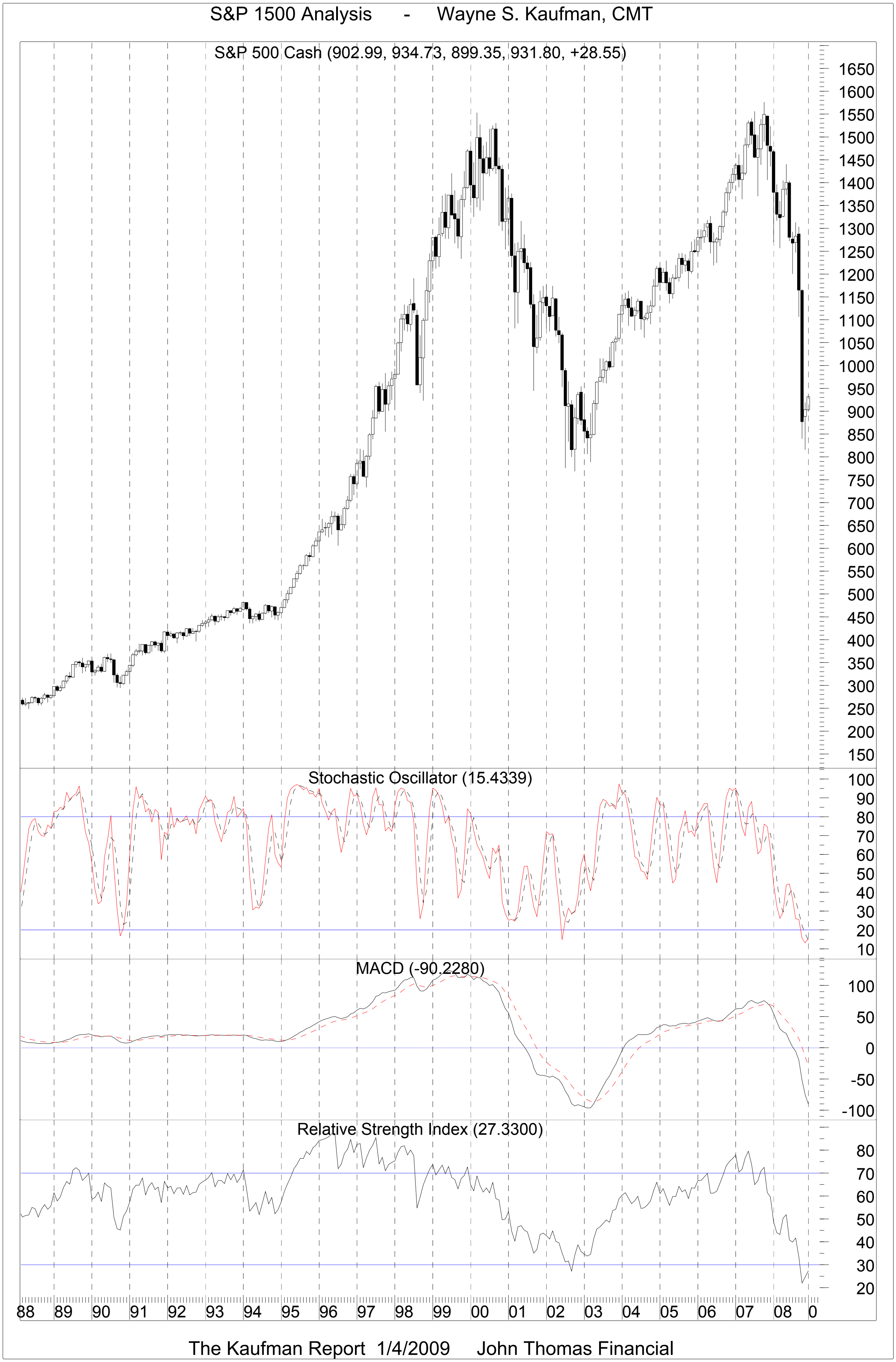
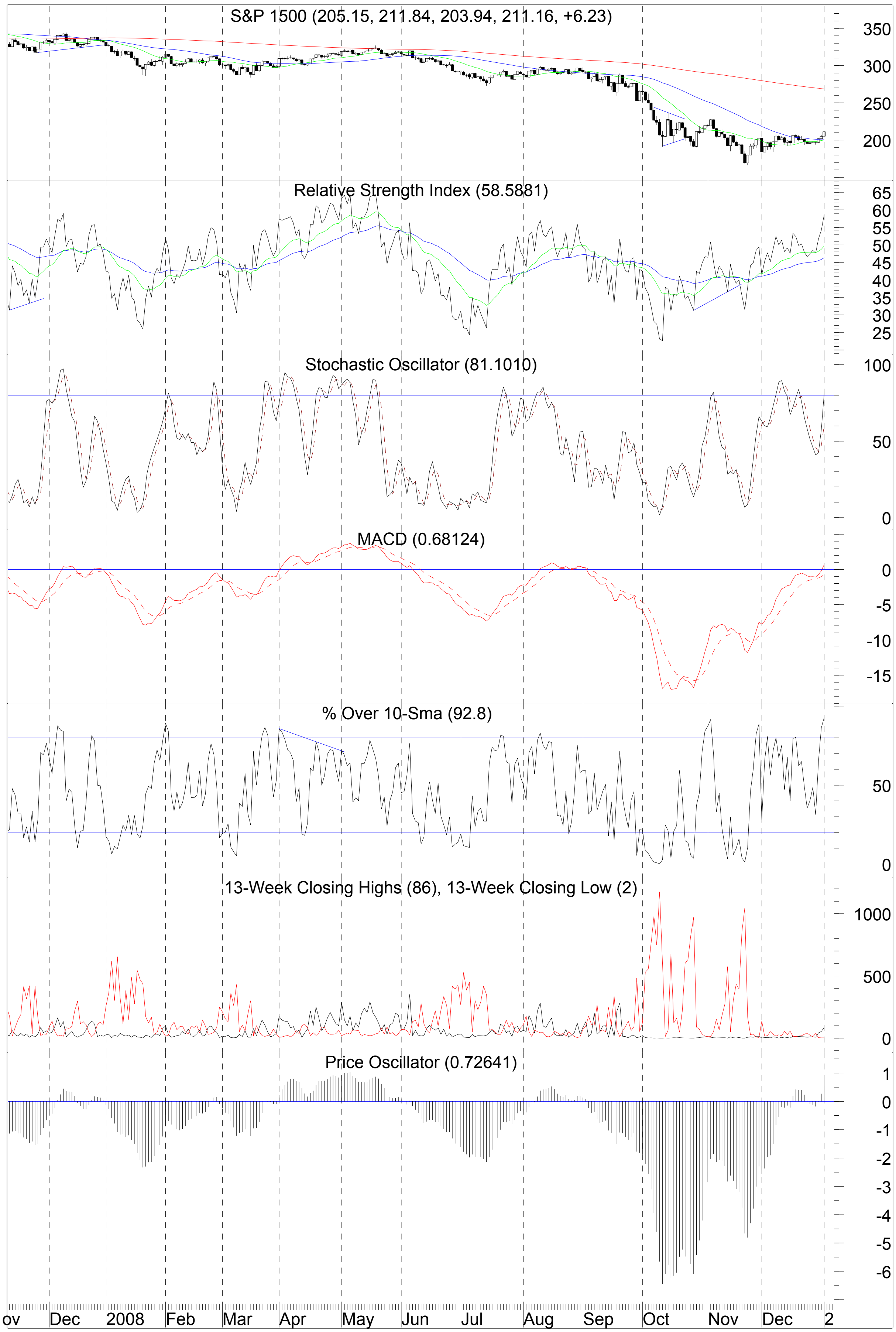
The S&P 1500 has broken above the two resistance lines we discussed Friday. We view this as very positive, although in the short-term stocks are getting very overbought. Based on this breakout we would have a target of around 1000. However, with earnings season starting shortly any type of price targets can be interfered with as new information becomes available to investors.

The weekly chart of the S&P 500 shows the stochastic starting to enter the overbought zone. It can still go higher and stay high for a while. The MACD is showing a positive crossover from a low level, and the RSI is moving up out of the oversold zone. Overall this is a positive picture.



The monthly chart of the S&P 500 shows stochastic and RSI in oversold territory, while the MACD is still moving down. So far this looks similar to the bottom made in 2002.

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



Our momentum indicators are all at high levels.

The percent over 10-sma is 92.8, a very high level and an area from which stocks can pull back sharply.

13-week new highs are breaking out and on Friday they were the most since September 19th.

Our price oscillator is back in positive territory. It has a history of being a good indicator of trends.

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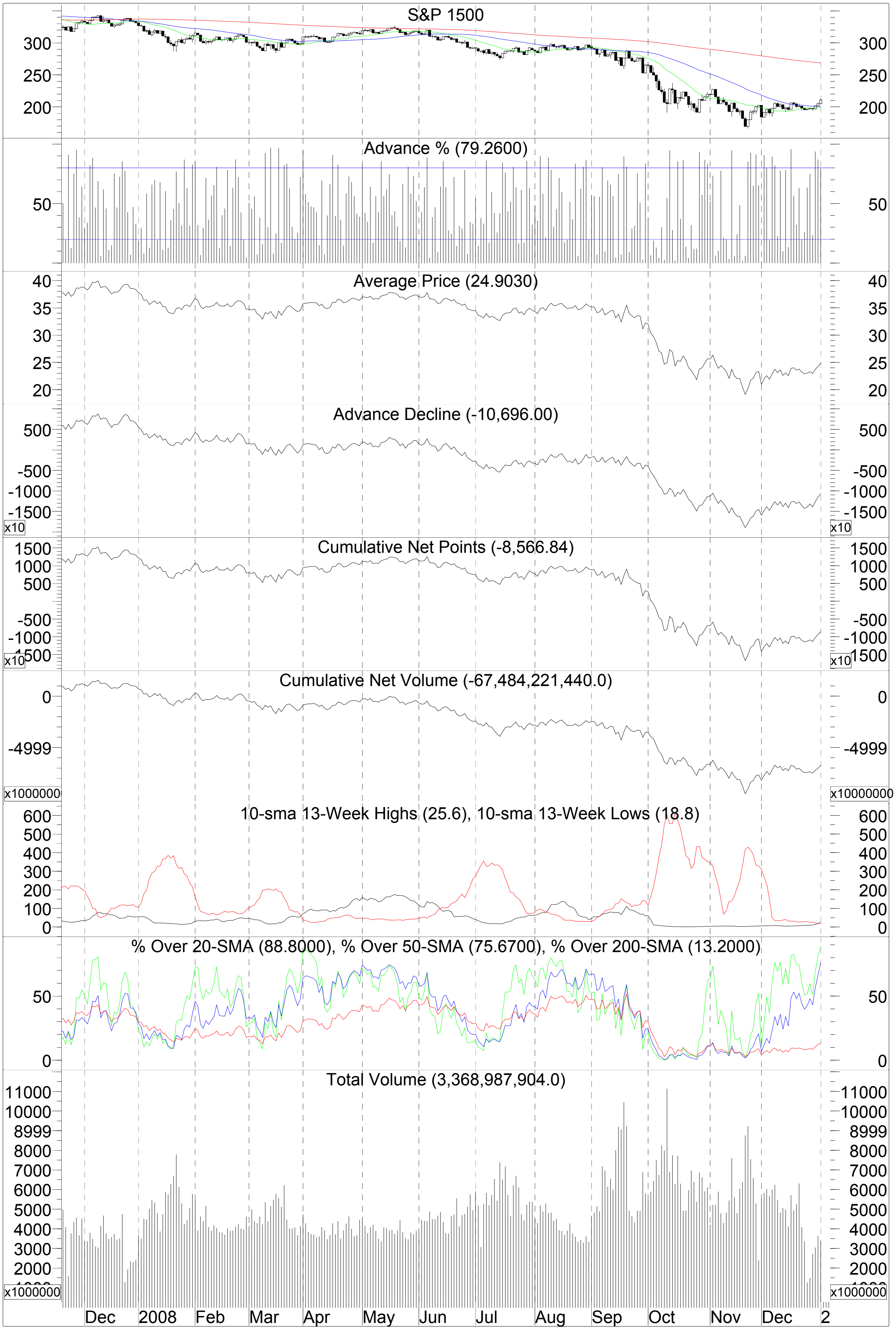


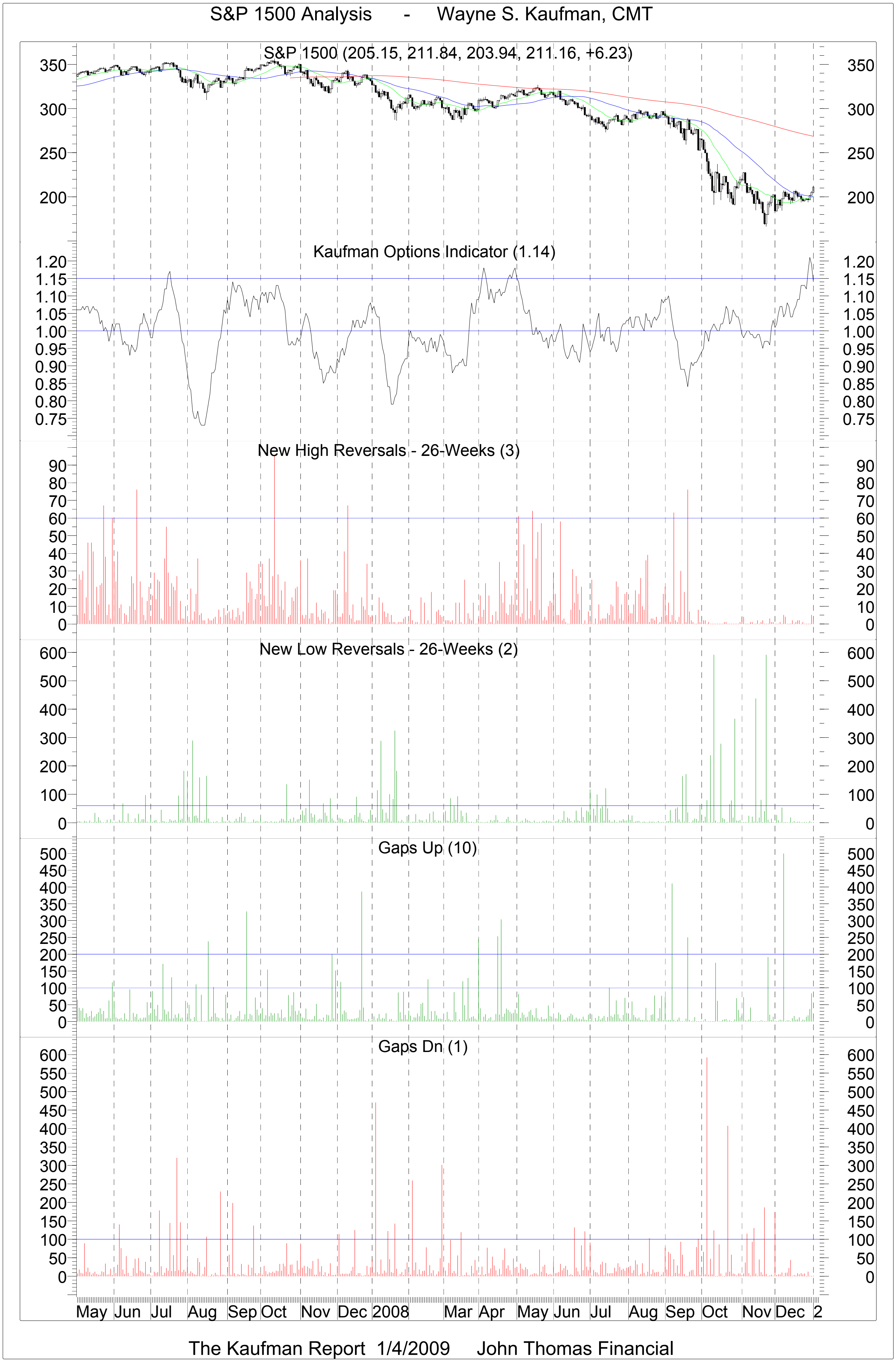
79.26% of stocks traded higher Friday, the third strong day in a row.

The AD line continues to lead higher.

The 10-sma of new highs is above new lows for the first time since 9/8/2008.

At 88.8% the percent over 20-sma is in overbought territory.

Volume remains at low levels, the one negative in the recent market action.



Our proprietary options indicator hit extremely high levels last week, showing too much optimism on the part of options buyers. This may need to get washed out before stocks can continue higher. It can leave stocks vulnerable to a sharp drop.

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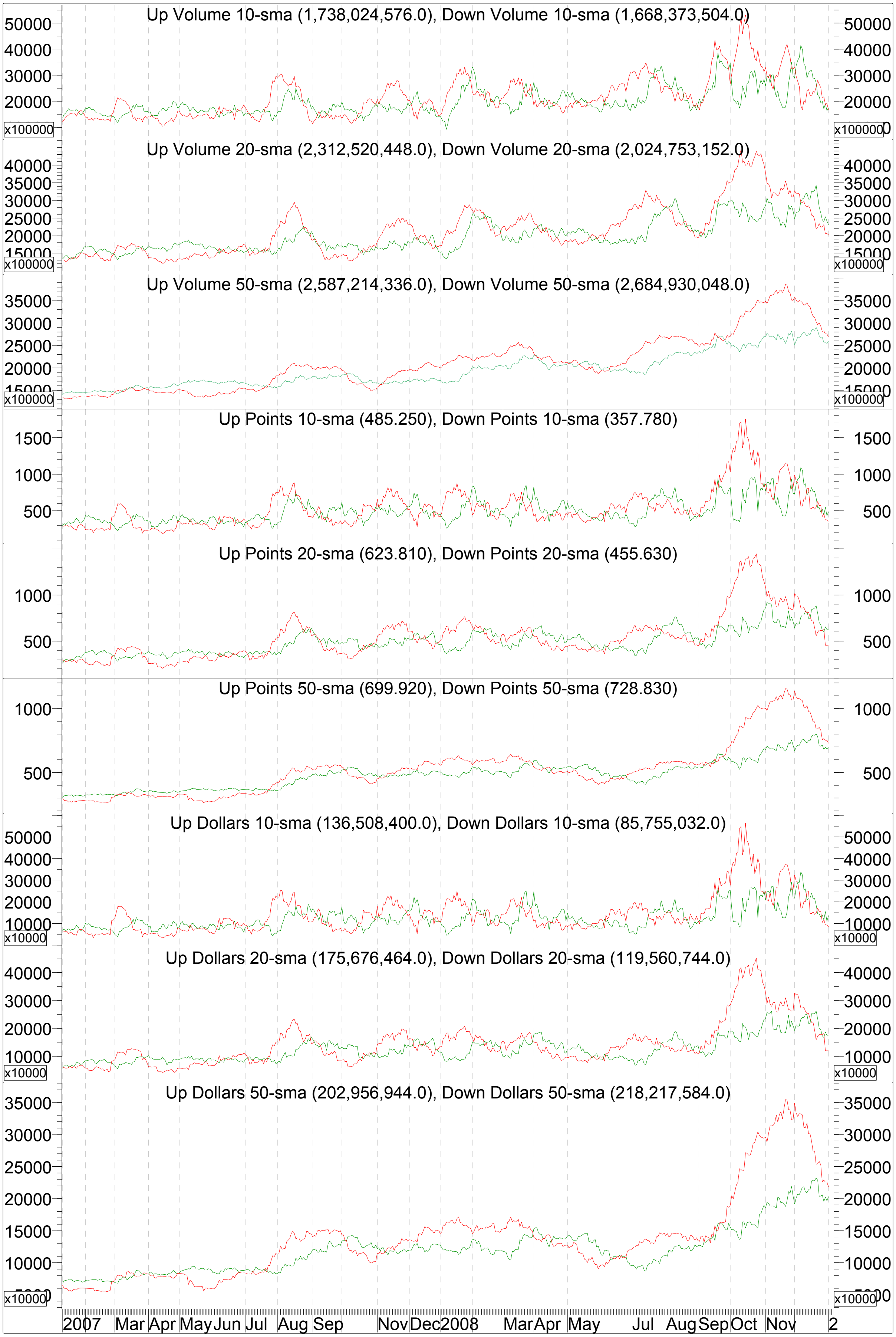

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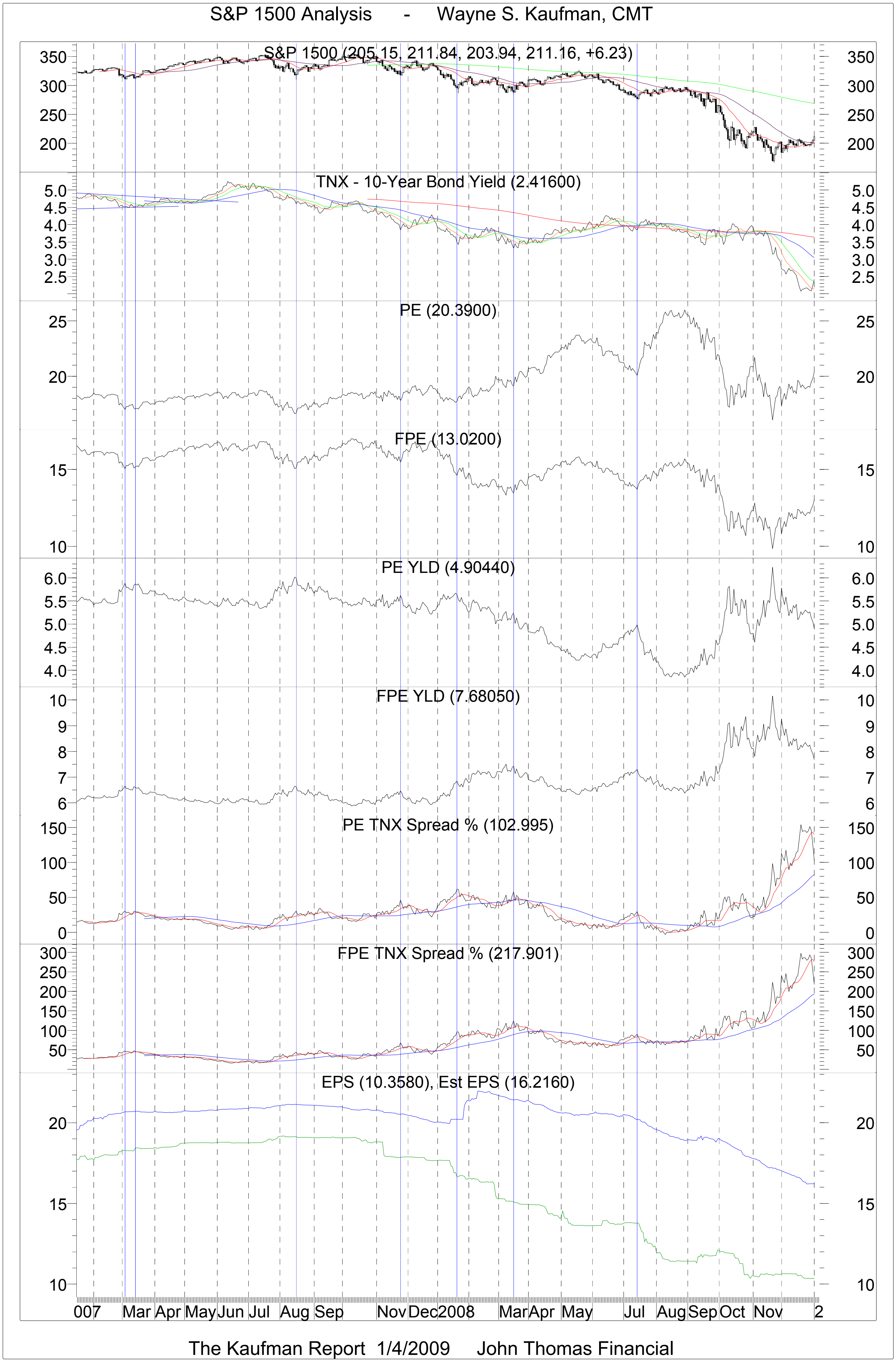
It is easily seen that the recent rally is more due to a decrease in supply (red lines) than from an increase in demand (green lines). However, we will not argue with a rally, but we will keep in mind how quickly things will change if sellers aggressively re-enter the market.

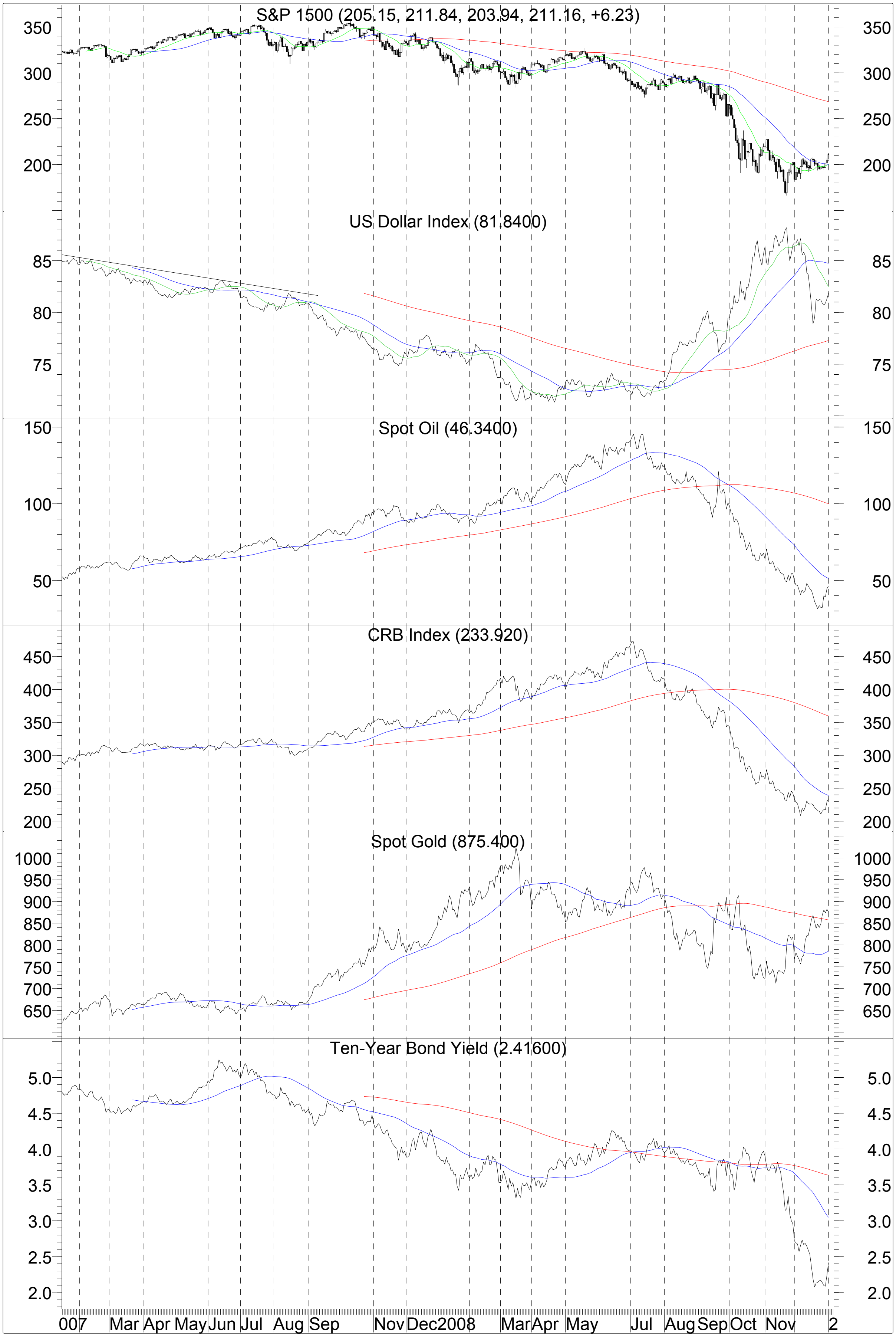


P/E ratios are moving up out of their recent range. The forward P/E is at the highest level since October 3rd, just as stocks were beginning their breathtaking plunge.

Spreads between equity and bond yields are plunging, but are still at very wide levels where stocks are attractive versus bonds.

This promises to be an exciting earnings season, especially with so many companies no longer giving guidance.

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



The U.S. Dollar Index has been strong since bottoming on 12/18. It is hard to see how printing so many Dollars won't hurt the currency over time, but it may take a while for the down turn to resume.

We have been waiting for crude to bottom after saying it overshot on the downside, and it has exploded to the upside. There is some resistance at 48, and the 50-sma is at 52.

Gold is above the 200-sma (red) and has made consecutive higher bottoms and tops. Their is resistance in the low 900s, but we expect to see gold hit 1000 again in the future.