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The Kaufman Report

Trade what you see, not what you think.

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Monday July 21, 2008 **Closing prices of July 18, 2008**

Last Sunday we quoted the Guns N' Roses lyric that "nothin' lasts forever, even cold November rain." That proved true as a six week decline ended with the S&P 1500 rising 1.736% for the week. Stocks bounced from an extreme oversold condition which was aided by short-covering in financials.

We believe that the bottom is in for the near-term. Whether or not this becomes a longer-term bottom remains to be seen. We are concerned that our proprietary options indicator never hit the bearish levels seen at prior important bottoms. We are also concerned with the loss of leadership provided by the energy and materials sectors. We have been pointing out since mid-June that markets that do not respond to oversold conditions are dangerous. Last week's bounce was not as strong as we would have liked to see if it was an important long-term bottom. Therefore, until proven otherwise, we believe that any rally that occurs at this time will be a bear market rally.

We are now entering the heart of second quarter earnings season. So far 95 companies of the S&P 500 have reported. According to Bloomberg, 73.7% have had positive surprises, 3.2% have been in line, and 23.2% have been negative. The year-over-year change has been -32.6% on a share-weighted basis, -36.6% market cap-weighted, and -25.2% non-weighted.

The current short, intermediate, and long-term trends are down, and we reiterate that this continues to be a bifurcated, opportunistic trader's market, with adept traders able to take advantage long or short. Investors need to be alert to sector rotation and should not hesitate to move out of lagging sectors and stocks and into leaders.

Federal Funds futures are pricing in a 92.8% probability that the Fed will *leave rates at 2.00%,* and a 7.2% probability of *raising 25 basis points to 2.25* when they meet on August 5th.

The S&P 1500 (287.14) was down 0.007% Friday. Average price per share was up 0.22%. Volume was 94% of its 10-day average and 111% of its 30-day average. 43.47% of the S&P 1500 stocks were up on the day. Up Dollars was 44% of its 10-day moving average and Down Dollars was 63% of its 10-day moving average. For the week the index was up 1.736% on increasing and above average weekly volume. The S&P 1500 printed a hammer on the weekly chart. Hammers are bottoming candles.

Options expire August 15th.

IMPORTANT DISCLOSURES

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The S&P 1500 remains in an obvious downtrend. It bounced last week after reaching an extremely oversold condition and the lowest level since November 2005. It is just below the 20-sma (green) which is at 289.16. The retracement levels of the plunge from the May top to the July low would be the 294 area for a 38.2% retracement and the 300 area for a 50% retracement.

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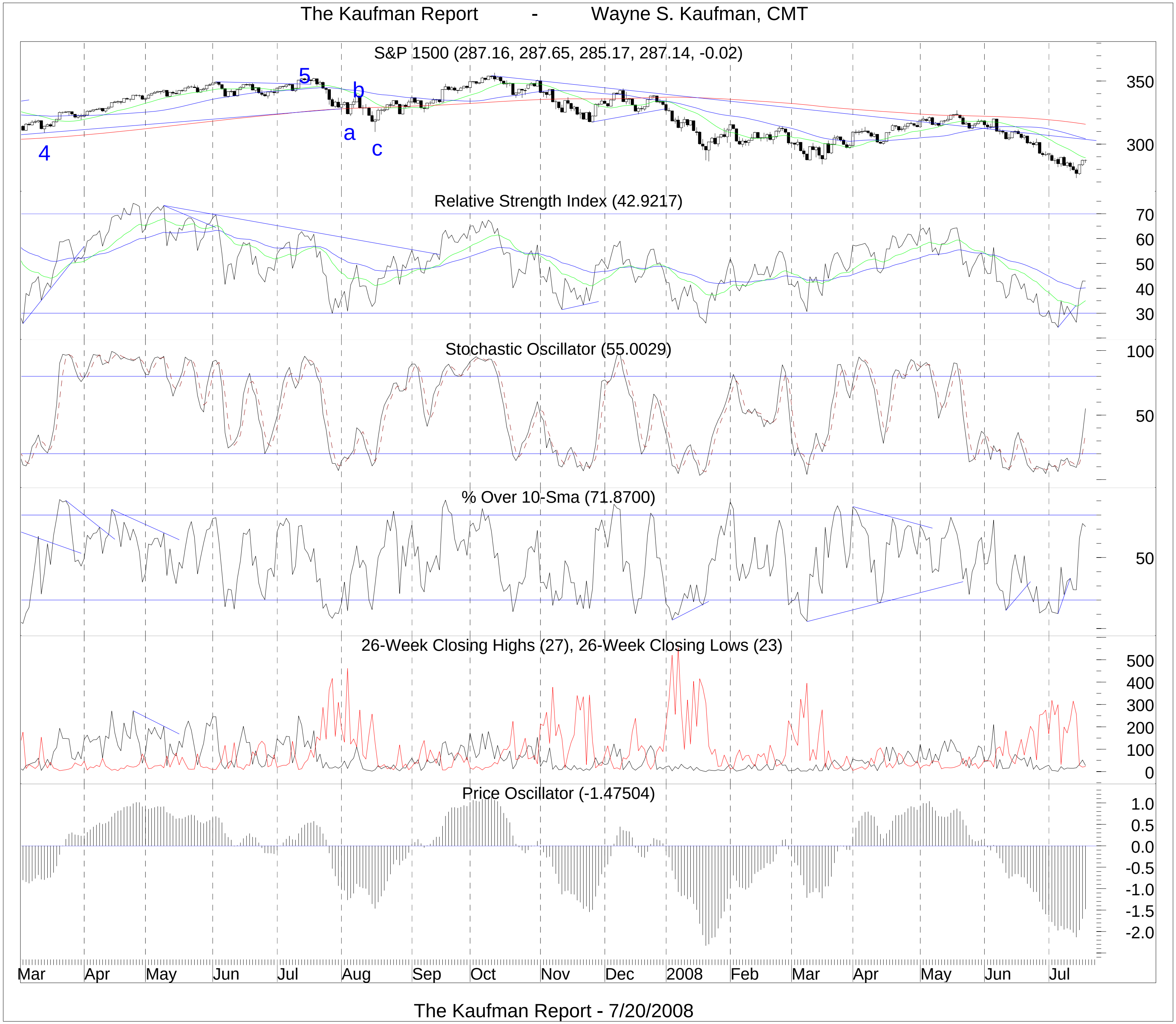
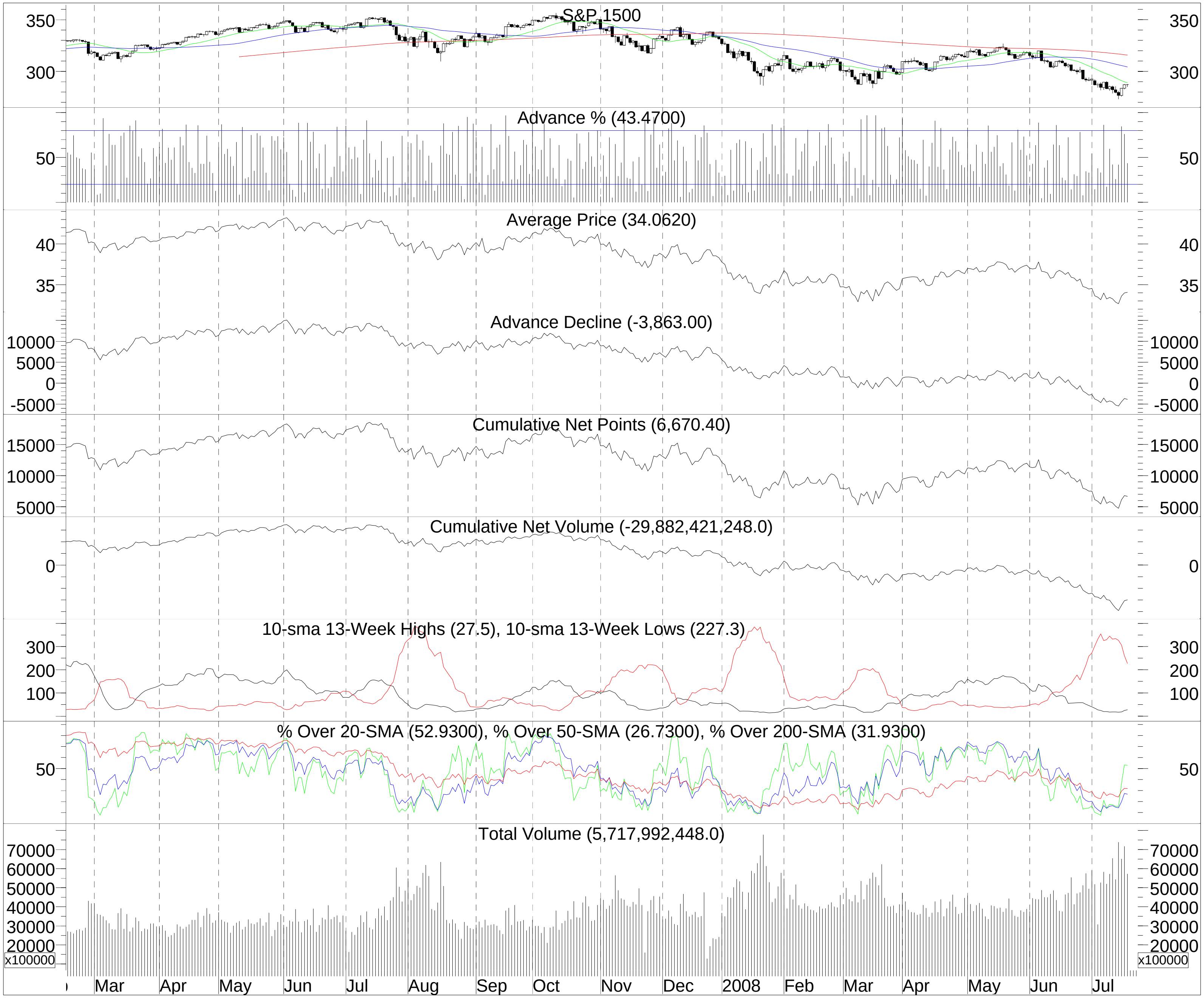
This indicator is derived from 13-week highs and lows. It recently reached the oversold level seen at tradable rallies and important bottoms.

A hammer candle was printed on the weekly chart of the S&P 500. Hammers are bottoming candles. The Jan. 22nd low was a 38.2% retracement of the bull market of October 2002 to October 2007. That number has now been surpassed, making the 50% retracement level at the 1172 area the next target.



After reaching the oversold zone our oscillators have bounced, with the percent over 10-sma now just approaching the overbought zone.

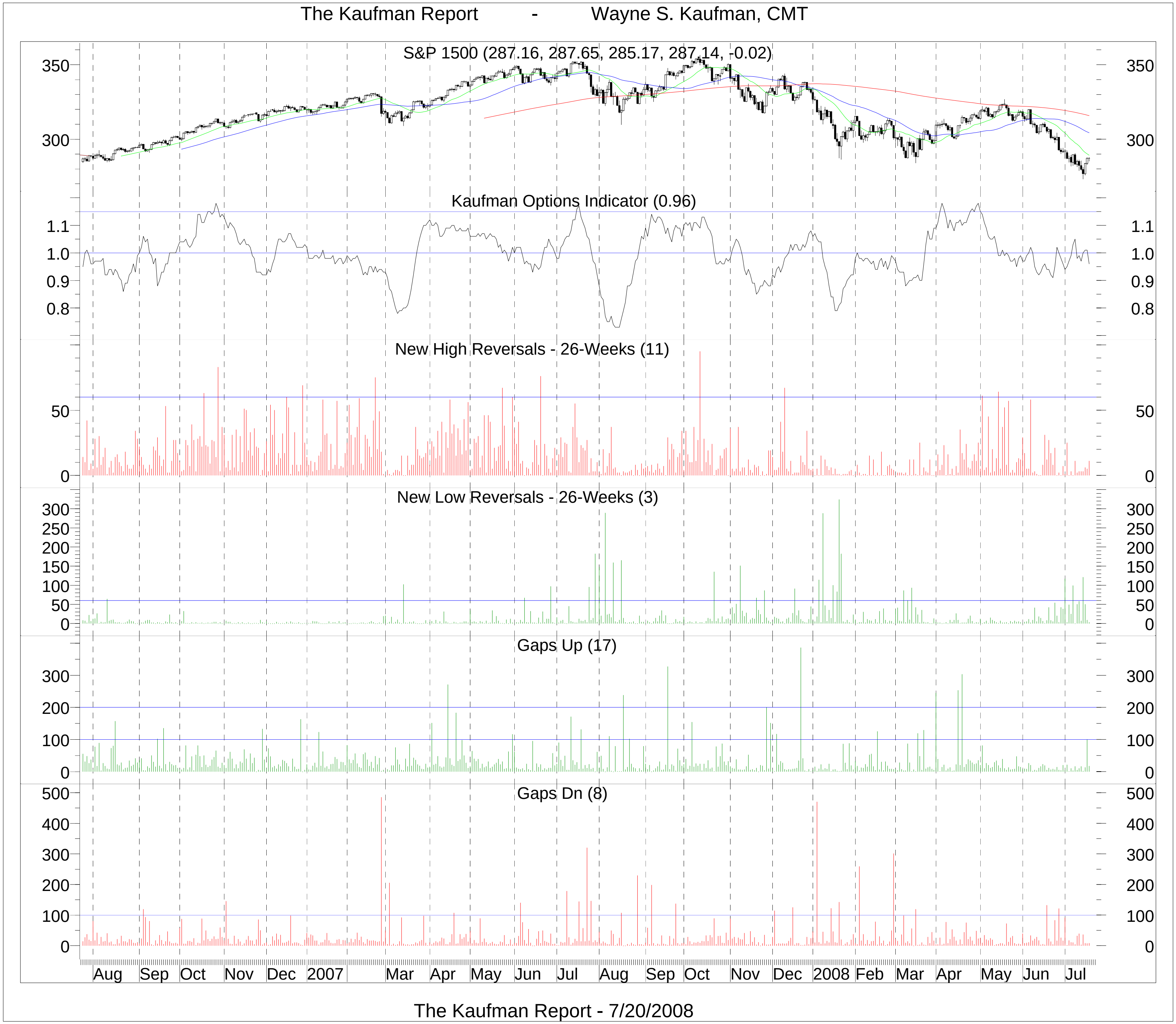
Our price oscillator, a good indicator of trends, is rebounding after reaching extreme oversold levels.



43.47% of stocks traded higher Friday.

The Advance Decline line made another multi-year low on Tuesday.

During the week volume hit levels seen at prior bottoms.



Our proprietary options indicator is slightly negative, but never hit the levels of bearishness seen at important bottoms.

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Our 10-day statistics of demand (green) have shown improvement. Unfortunately the 10-day average of supply (red) is not pulling back that much. All other time frames still show negative crossovers.

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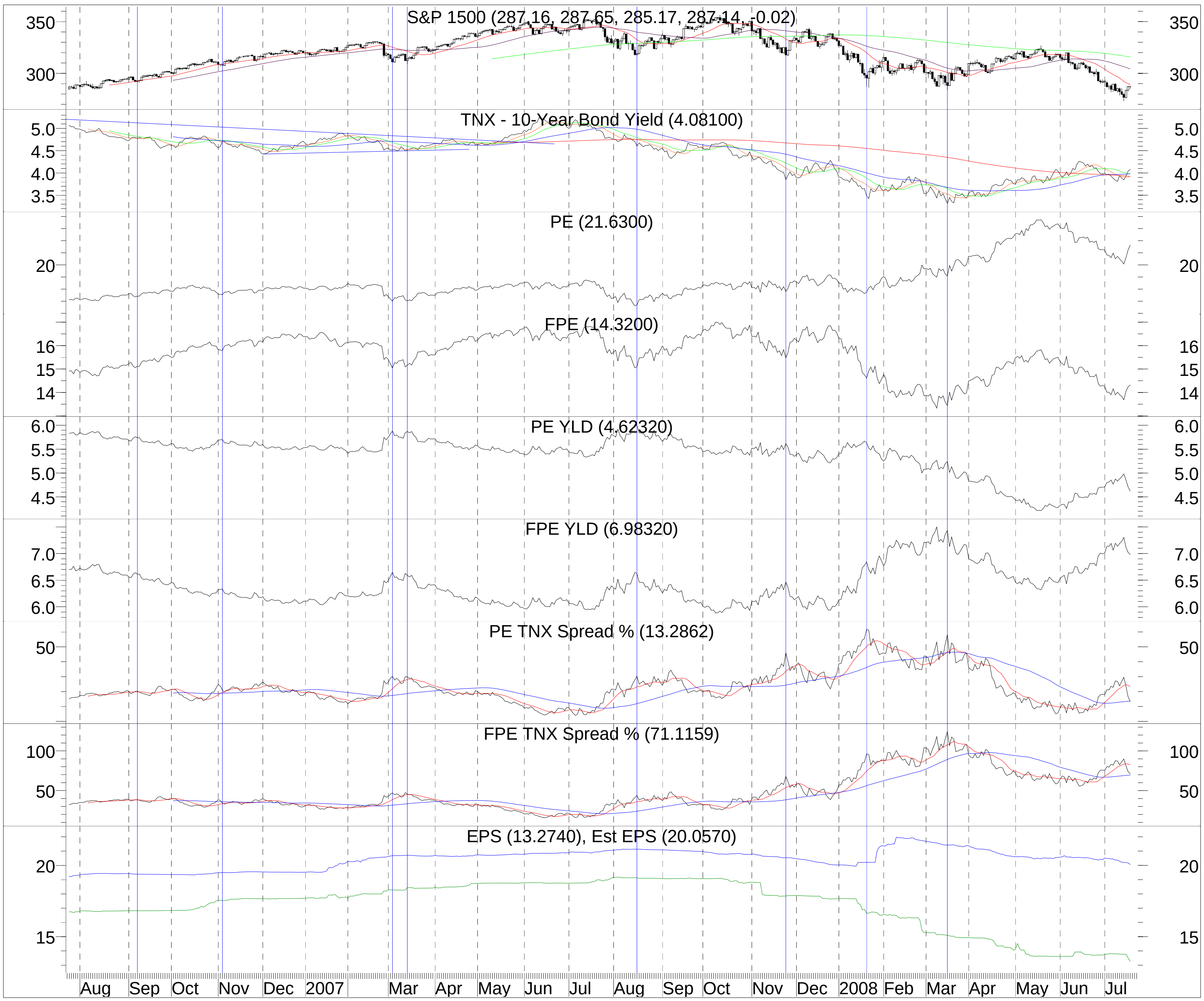

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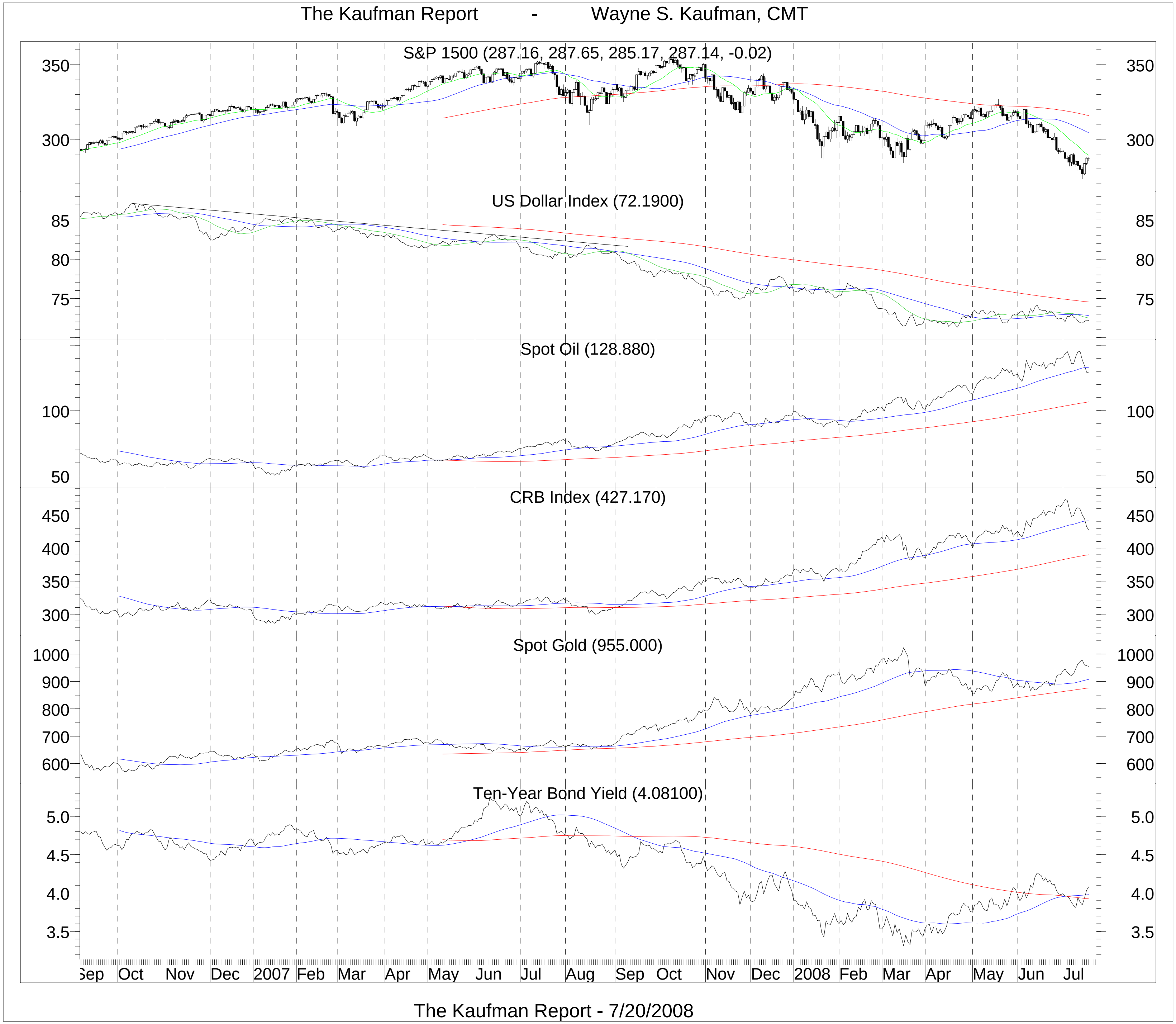
Spreads between bond yields and earnings yields have plunged as equities and bond yields rose in tandem. Unfortunately bond yields may keep rising, and current and forecast earnings continue moving inexorably lower.

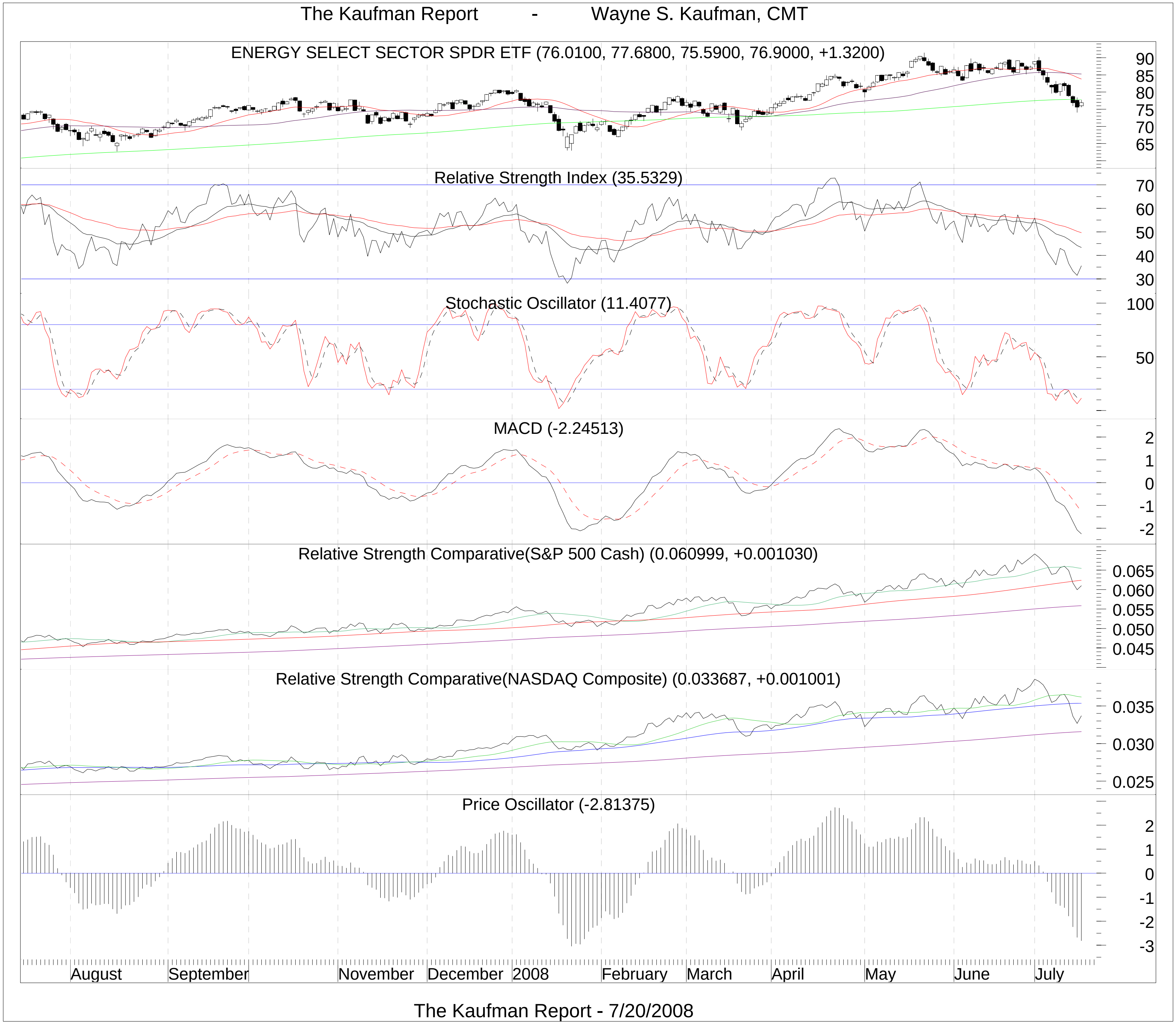


The U.S. Dollar Index is trying to hang on to its recent range but seems destined to make new lows shortly.

Oil put in a double top and we think this confirms a top for the near-term at least.

Gold reached our target of the high 900s. It is retracing back to the breakout point at the 946 to 955 zone before a possible challenge of the old high.

10-year bond yields broke above 50 and 200-sma last week and appear to be headed higher. They are not yet overbought.



The energy sector is underperforming the S&P 500 and the Nasdaq Composite on a 20 and 50 day basis. It is still showing greater relative strength on a 200-day basis.