John Thomas Financial
14 Wall Street, 5th Floor
New York, New York 10005
wskaufman@johnthomasbd.com
www.kaufmanreport.com

The Kaufman Report

Trade what you see, not what you think.

Wayne S. Kaufman, CMT
Chief Market Analyst
(800) 257-1537 Toll Free
(212) 299-7838 Direct

Monday July 7, 2008 **Closing prices of July 3, 2008**

Last week was another tough one for equities as the S&P 1500 fell 1.975%. The index has now retraced 100% of the March to May rally. It also recorded its lowest weekly close since August 2006. The media is full of stories about major indexes entering bear market territory by declining 20% off their highs, along with the obligatory statistics about the length and depth of the average bear market. There is enough of this data out there so we will refrain from piling on.

We will say that we have been calling this a bear market for a while, as noted on some of the following charts. More recently, since the June 11th 90% down day, which followed closely the June 6th 90% down day, <u>we have been warning that a market that does not respond to oversold conditions is dangerous.</u>

Extreme oversold conditions still remain as investors brace for a very important earnings season. The rising price of crude oil is like a boa constrictor slowly squeezing the life out of some sectors of the economy, while high inflation hurts everyone. The effect on corporate profits and forecasts is about to be quantified in the upcoming earnings reports.

Reported aggregate earnings for the S&P 1500 have dropped 28% since peaking last August. In sharp contrast, forecast earnings have only come down 6.76% since peaking in February. The recent plunge in equities along with the move down in bond yields has widened the spreads between earnings yields and bond yields to levels where stocks should be very attractive to investors.

The spread based on projected earnings has reached the widest level since March, which at that time had reached the widest levels seen in decades. This disconnect between current and projected earnings will be resolved soon. If numbers are brought down, the question will be how much of that is already built into stock prices. <u>However, if current quarter numbers are met, and forecasts are not ratcheted down dramatically, in hindsight stocks at current levels will appear to have been very undervalued</u>.

<u>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.</u>

Federal Funds futures are pricing in an 82.2% probability that the Fed will <u>*leave rates at 2.00%,*</u> and a 17.8% probability of <u>*raising 25 basis points to 2.25*</u> when they meet on August 5th.

The S&P 1500 (292.65) was down 0.028% Thursday. Average price per share was down 0.51%. Volume was 63% of its 10-day average and 69% of its 30-day average. 37.77% of the S&P 1500 stocks were up on the day. Up Dollars was 94% of its 10-day moving average and Down Dollars was 46% of its 10-day moving average. For the week the index was down 1.975%.

Options expire July 18th.

IMPORTANT DISCLOSURES

The media is trumpeting that we are in a bear market with major indexes down 20%. We have made that case for a while, as the S&P 1500 traded below the 400-day moving average in January, and the 200-day moving average crossed under it in April.

This indicator is derived from 13-week new highs and 13-week new lows. It is in the area where important bottoms have been made in the past.

This is the weekly chart showing the 80-week moving average (400-day) and the 20 and 40-week averages. We commented some time back that the negative crossovers were similar to those seen in 2001.

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The S&P 1500 has retraced 100% of the March to May rally. Friday's shortened session printed a doji candle on the daily chart. Doji are signs of indicision, which are frequently seen at the end of moves. However, while sellers may have become reluctant as a prior support came into play, we do not see a catalyst for buyers until earnings are reported.

All of our oscillators are in the oversold zones. The percent of stocks over their 10-day moving average is 11.07%. It has reached single digits during other extremely oversold periods.

Our price oscillator is in very oversold territory.

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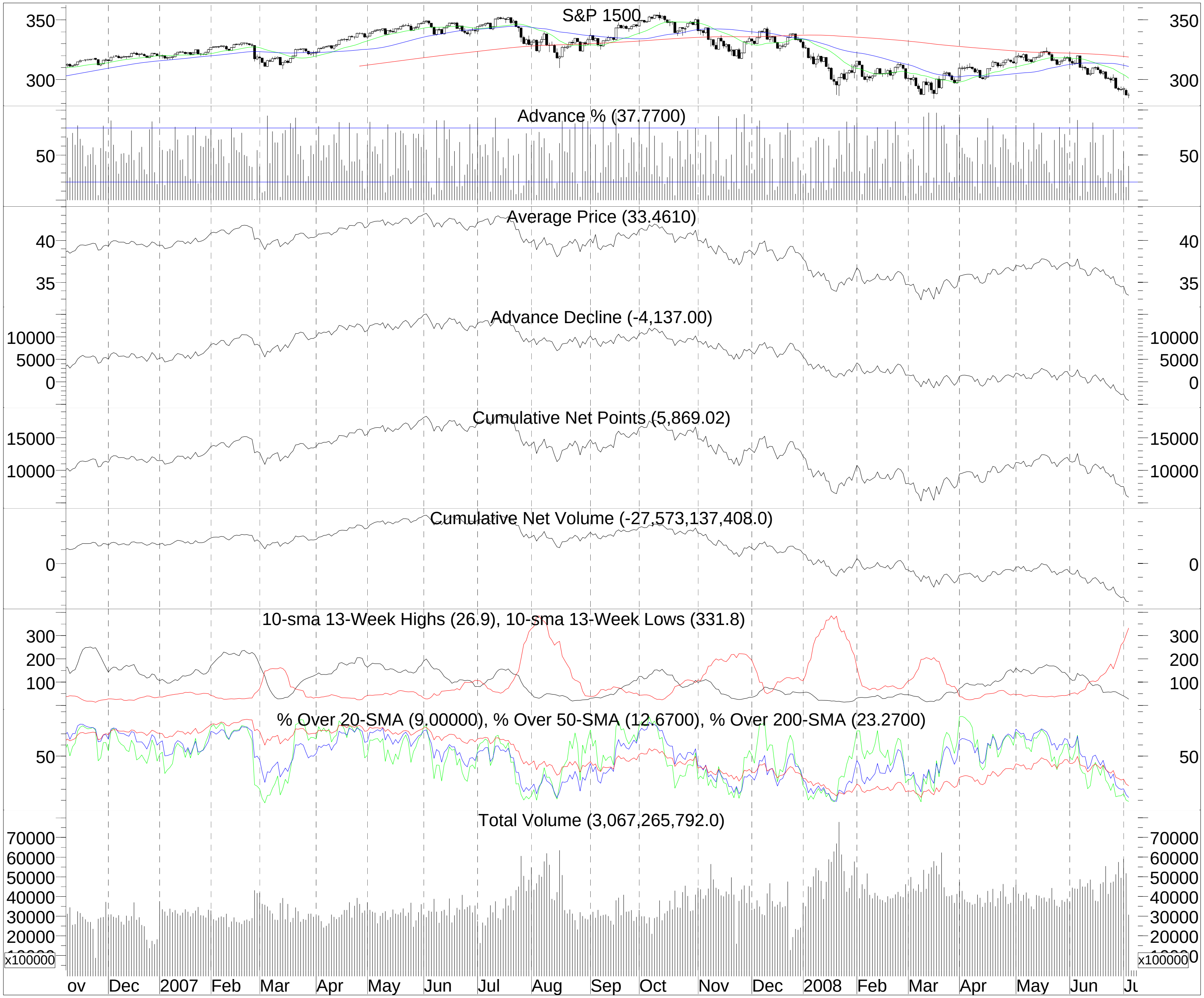
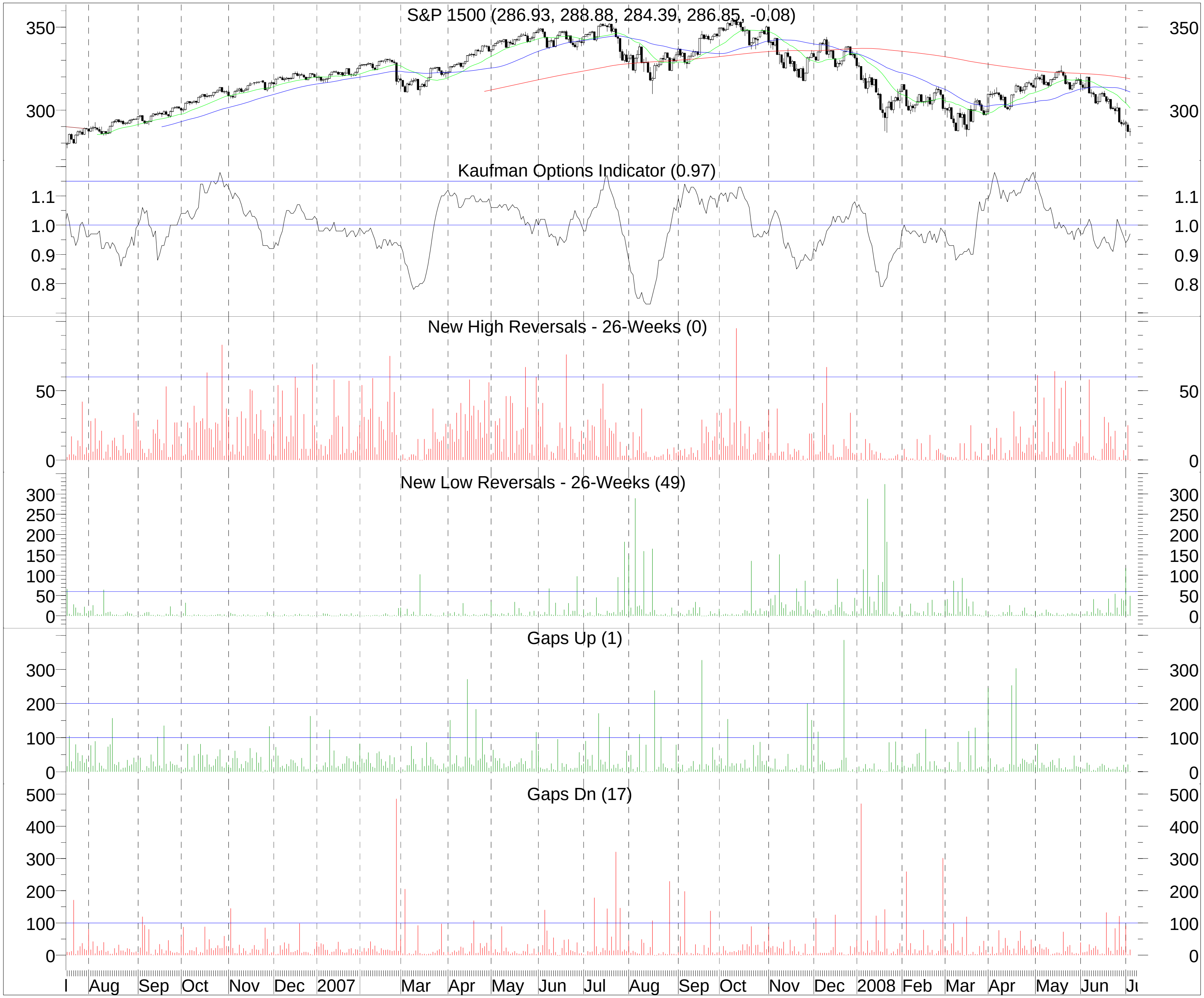


The Kaufman Report - 7/4/2008

Only 37.77% of stocks traded higher Thursday, not exactly an indication of bargain hunting.

The Advance Decline line, which has been an accurate leading indicator, continues to head lower. It is the lowest since April 2005. Cumulative Net Volume is also making new lows. Average Price Per Share is still above March lows, highlighting the market's selectivity.

Only 9% of stocks are trading over their 20-sma, and only 12.67% are above the 50-sma. Since 2004 there have been three other times the percent over 20-sma hit single digits. 8.73% on 3/10/08, 8.73% (again) on 1/18/08, and 7.73% on 3/5/07. Those were all within days of the bottom.



So many indicators are oversold that a bottom would appear to be imminent. Unfortunately, everyone expects the bottom to be near, and our proprietary options indicator is still well above levels that have marked important bottoms.

On July 1st there were 117 new low reversals, a number usually seen around bottoms.

All of our statistics of supply (red lines) are greater than our statistics of demand (green lines).

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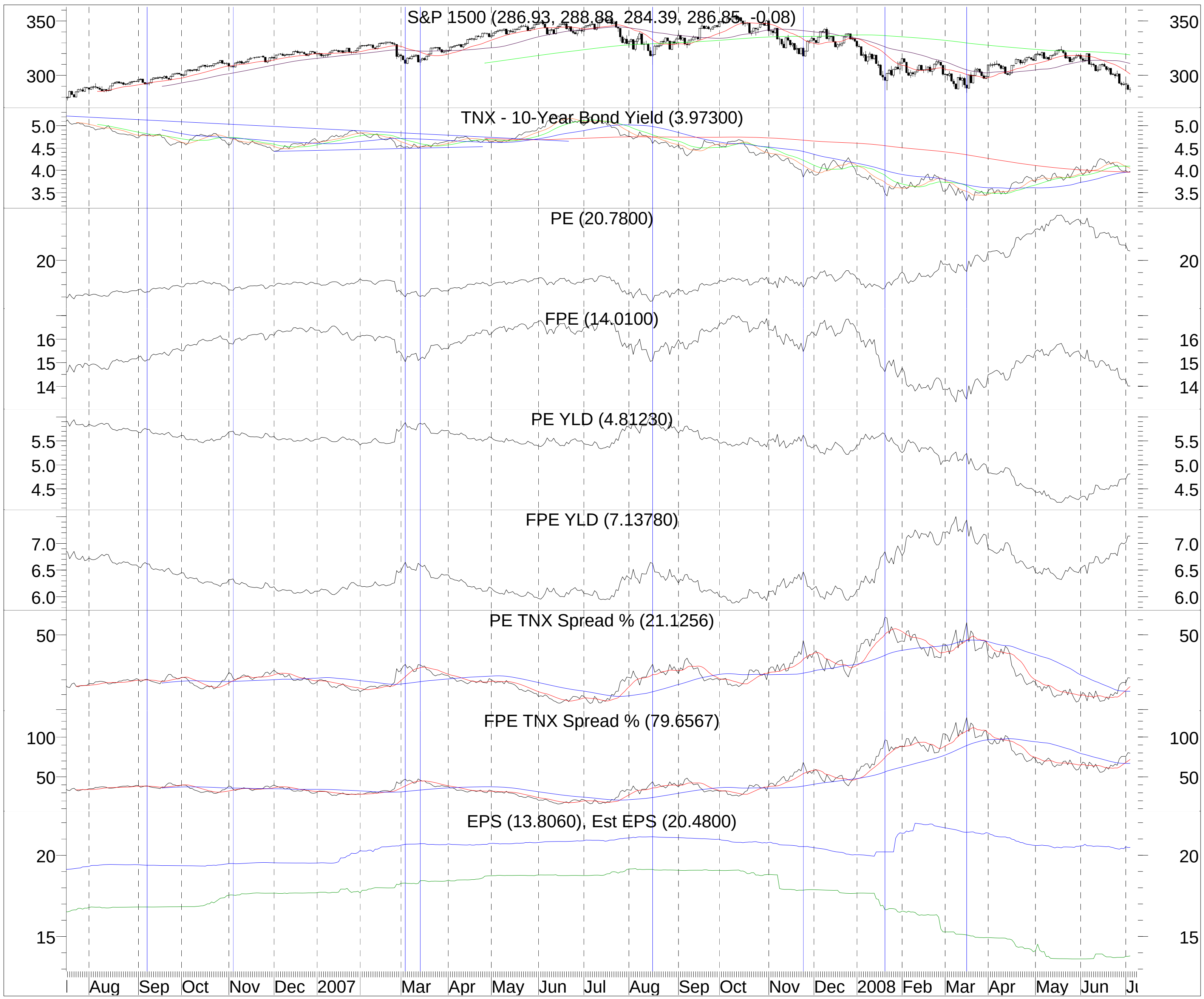
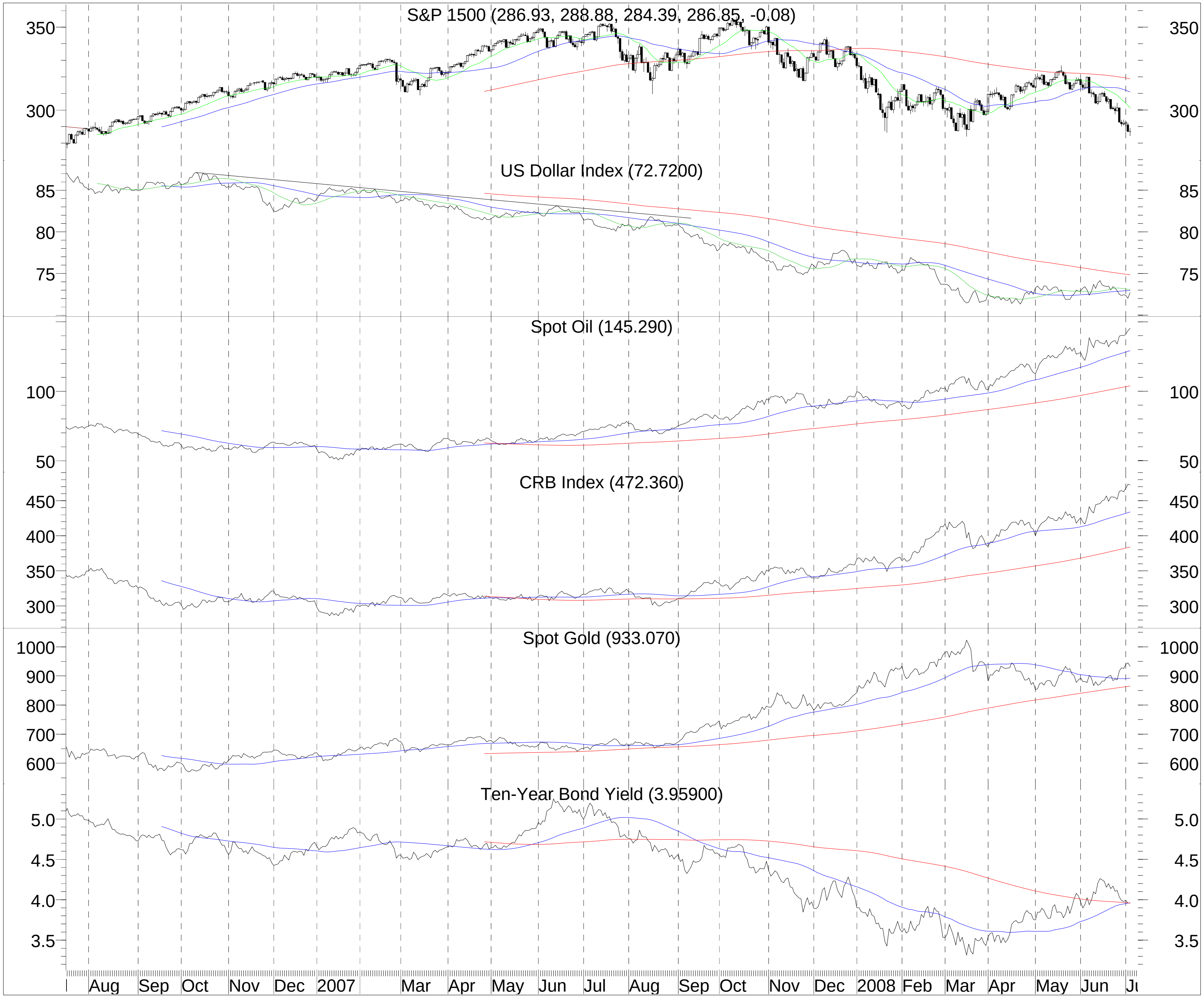


P/E ratios have been falling since peaking in May. The P/E based on current earnings was at multi-year highs then.

Spreads between bond and earnings yields have widened dramatically as bond yields and equities moved lower in tandem. The spread based on projected earnings is at levels where stocks have been very attractive, not far under multi-decade widest levels reached in March. Projected and current earnings have levelled off and if projections are met and forecasts not ratcheted down, in hindsight stocks at curren levels will look undervalued.

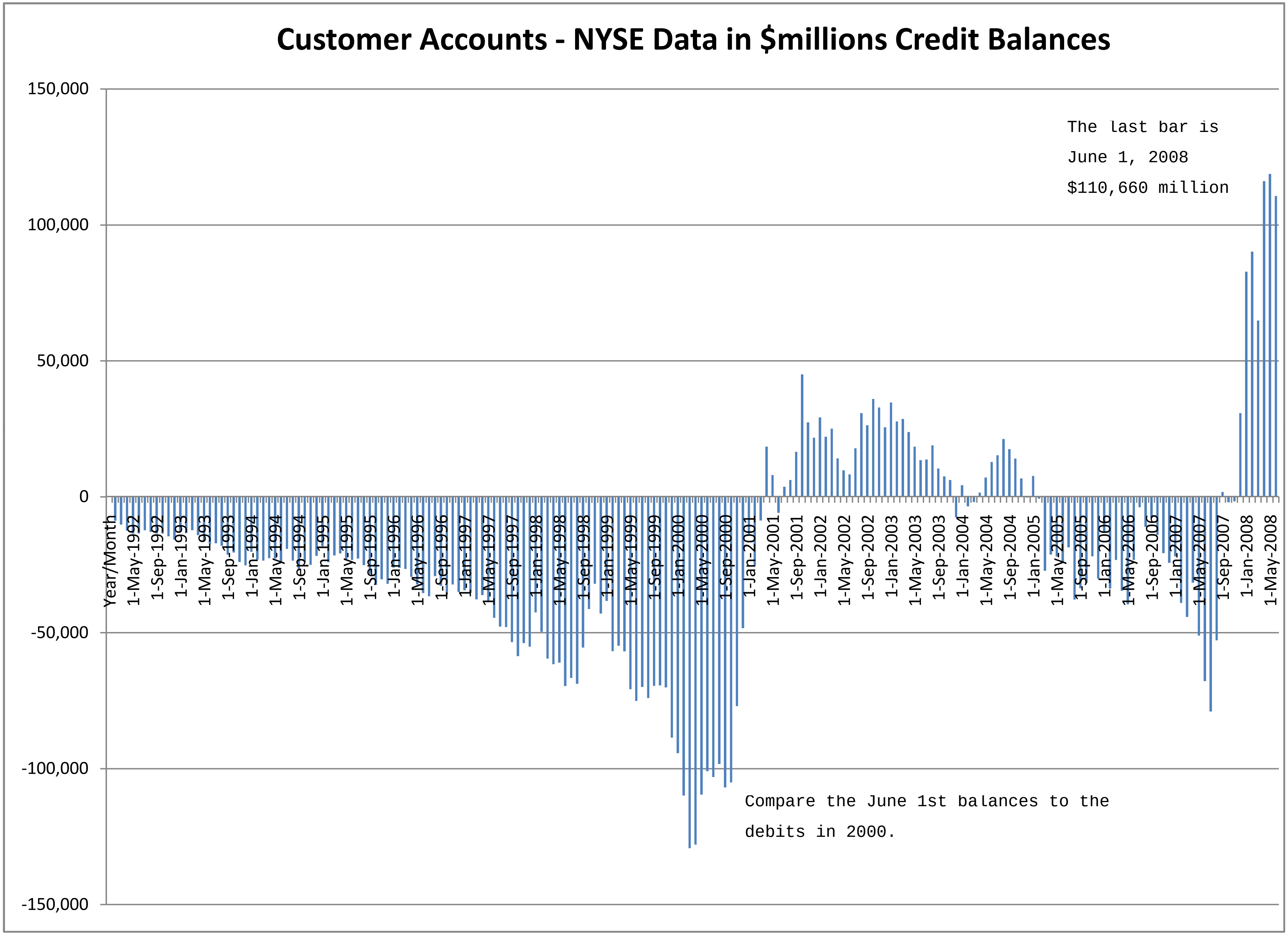


The U.S. Dollar Index now has support at the 72 level.

Crude oil continues its climb higher and is not yet overbought.

The Commodities Index is trending with crude oil.

Gold pulled back a little, but appears on its way to the high 900s.



Customer Accounts - NYSE Data in $millions Credit Balances
150,000
100,000
50,000
0
-50,000
-100,000
-150,000
Year/Month
1-May-1992
1-Sep-1992
1-Jan-1993
1-May-1993
1-Sep-1993
1-Jan-1994
1-May-1994
1-Sep-1994
1-Jan-1995
1-May-1995
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1-Jan-2006
1-May-2006
1-Sep-2006
1-Jan-2007
1-May-2007
1-Sep-2007
1-Jan-2008
1-May-2008
The last bar is
June 1, 2008
$110,660 million
Compare the June 1st balances to the
debits in 2000.