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The Kaufman Report

Trade what you see, not what you think.

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Monday June 23, 2008 **Closing prices of June 20, 2008**

We have been continually highlighting our concern about the spreads between earnings and bond yields. Last Sunday we pointed out that the spread based on the current P/E was at about the same level it was at on July 13, 2007 and May 29th 2008, both of which preceeded sharp drops in equities. This level proved troublesome for the third time, as stocks plunged with the S&P 500 down 3.01% and the Dow Jones Industrials down 3.775% on the week. Year-to-date the S&P 500 is down 10.245%, and is now down 16.38% from its October 11th high. *The Dow closed below 12,000 for the first time since March, and recorded its lowest weekly closing price since September 29, 2006.*

As we entered June we said we expected to see weakness for equities due to the breakdown of the bearish rising wedge on May 21st, negative seasonality, and a lack of fundamental news flow. Month-to-date the S&P 1500 is down 5.55%. We also said it would be a good test of how aggressive sellers would become, and that we didn't expect pullbacks to be deep. While we were correct in forecasting weakness, the selling became stronger than we expected when it retraced more than 50% of the rally from the March low to the May high. That breach occurred on June 11th, and we then gave a new downside target of the 301 area on the S&P 1500. That target was reached Friday.

Friday's triple witching options expiration session had the feel of a panic-selling day, but it was not quite a 90% down day. The S&P 1500 recorded a panic-selling 90% down day June 11th, just three days after a 90% down day June 6th. The June 6th 90% down day erased the strong rally of June 5th. Since the June 5th rally there has been rapid deterioration in market breadth. The lack of any kind of a bounce after the June 6th 90% down day was worrisome, but to be followed so quickly by a second 90% down day was very disconcerting. We cautioned at the time that a market that does not respond to oversold conditions is dangerous.

In the very short-term, we are expecting a tradeable bounce soon. Our oscillators remain at low levels, and some positive divergences are starting to develop, along with a bullish falling wedge. For example, the S&P 1500 index made a new correction low Friday, but the percentage of stocks over their own 10-day moving average is 30.27% versus 12.8% on June 11th. A rally might not happen until after the FOMC meeting on Wednesday, but *aggressive short-term traders should view weakness Monday or Tuesday as an entry point long.* Federal Funds futures are pricing in a 90% probability that the Fed will leave rates at 2.00%, and a 10% probability of *raising 25 basis points to 2.25* when they meet again on June 25th.

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.

The S&P 1500 (300.83) was down 1.827% Friday. Average price per share was down 1.65%. Volume was 122% of its 10-day average and 134% of its 30-day average. 14.17% of the S&P 1500 stocks were up on the day. Up Dollars was 3% of its 10-day moving average and Down Dollars was 243% of its 10-day moving average. For the week the index was down 3.096% on rising but about average weekly volume. Options expire July 18th.

After the downward breakout of the bearish rising wedge on May 21st, we gave price targets based on the 38.2 and 50% Fibonacci retracements of the rally from the March bottom to the May top. After the 50% level was broken on June 11th we gave new targets of the 61.8% level at the 301 area, and after that a 100% retracement of the rally. On Friday the 301 target was hit. The good news is a bullish falling wedge that may currently be forming on the daily chart. While these are not terrific patterns in bear markets, a breakout to the upside would decrease the chance of testing the March lows.

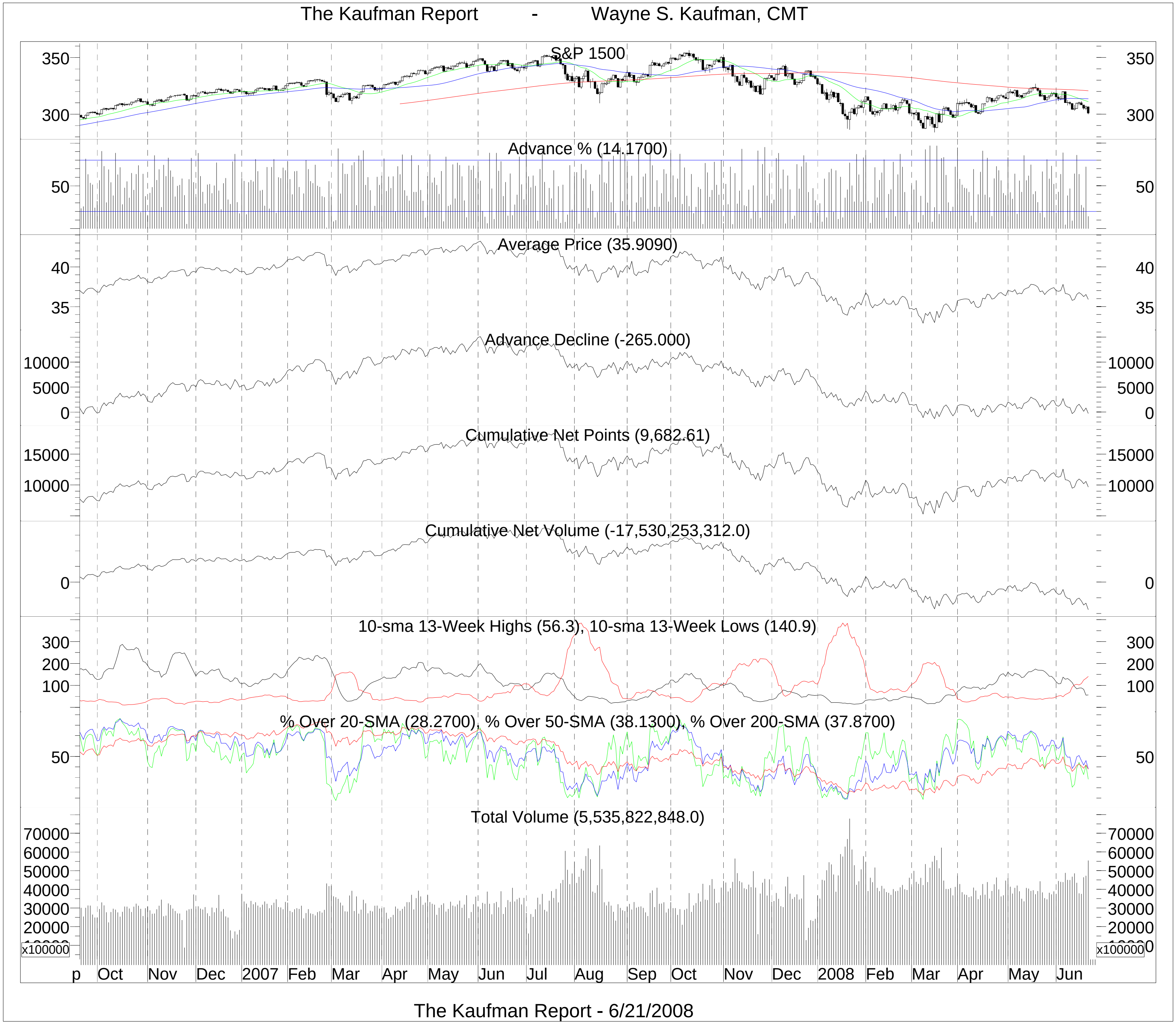
The RSI is at a low level but not in the oversold zone.

The stochastic is in the oversold zone.

A positive divergence has formed on the percent over 10-sma.

New lows have been overwhelming new highs, but on Friday there was a positive divergence.

Our price oscillator, a good indicator of trends, remains in negative territory.



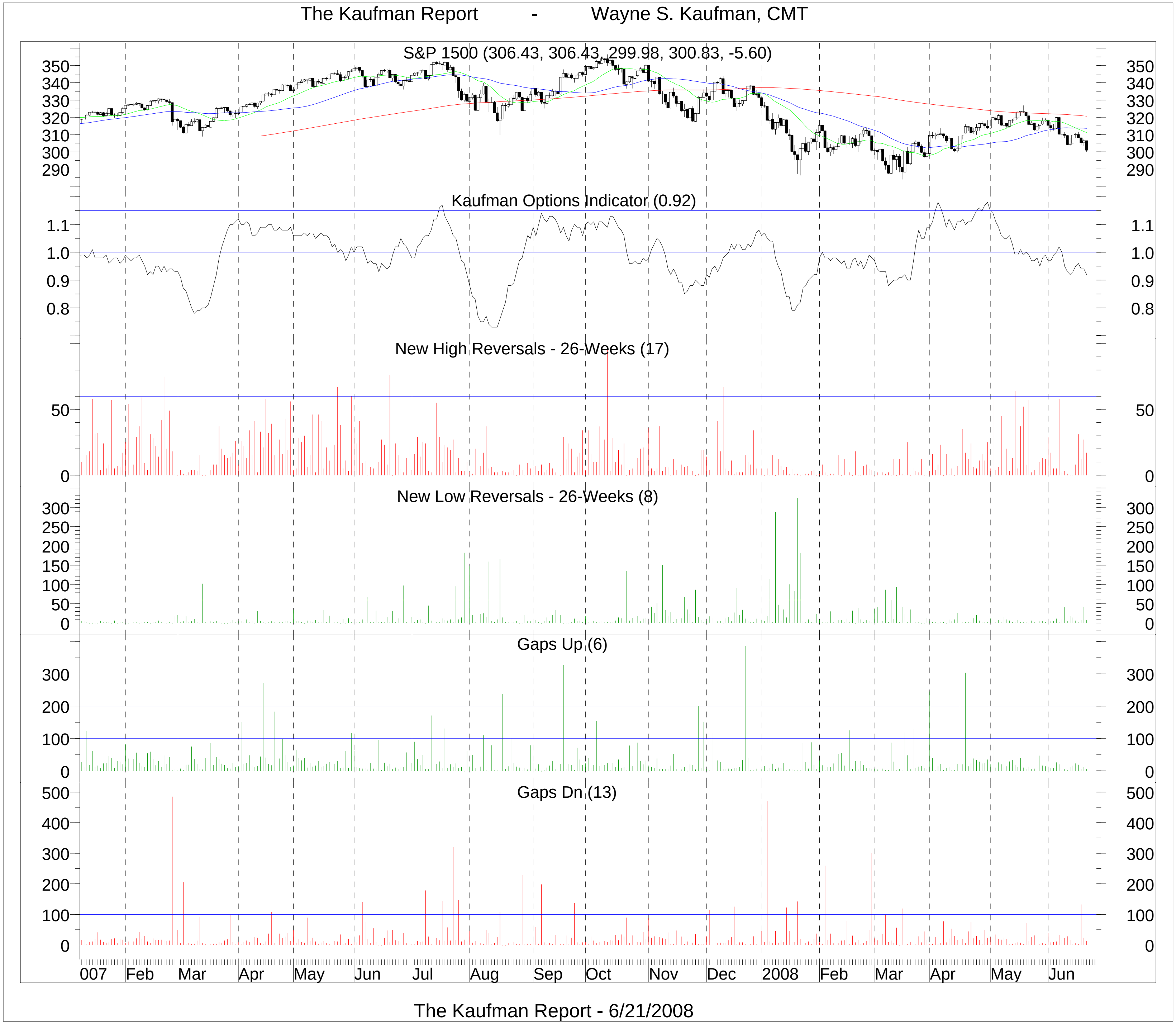
Only 14.17% of stocks traded higher Friday.

Cumulative Net Volume has fallen below the March lows.

The 10-day moving average of 13-week lows is above the 10-dma of 13-week highs and the spread is widening.

Only 28.27% of stocks are above their 20-sma, and 38.13% are above their 50-sma.

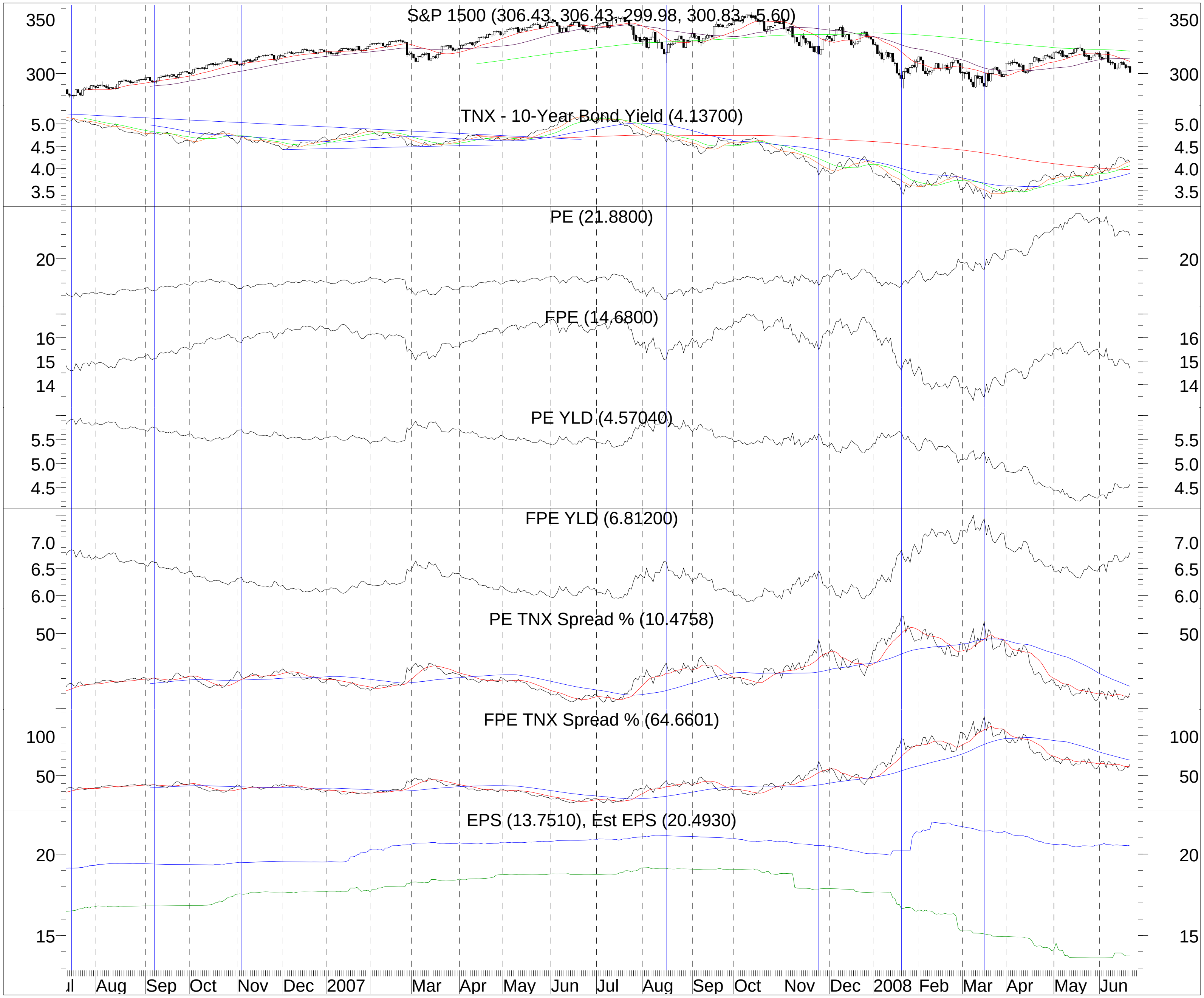
Volume expanded Friday.



Our proprietary options indicator is in negative territory, showing options buyers are bearish. It is not as bearish as we have seen at important market bottoms. However, on Friday the put/call ratio hit 1.329, the highest since 1.484 on March 10th. Readings over 1.00 indicate fear.

New low reversals, when a stock makes a new intra-day low but closes higher on the day, are nowhere near the amount we usually see at bottoms. However, this can change on any single day.

All of our statistics of supply (red lines) are greater than our statistics of demand (green lines) for all time frames.



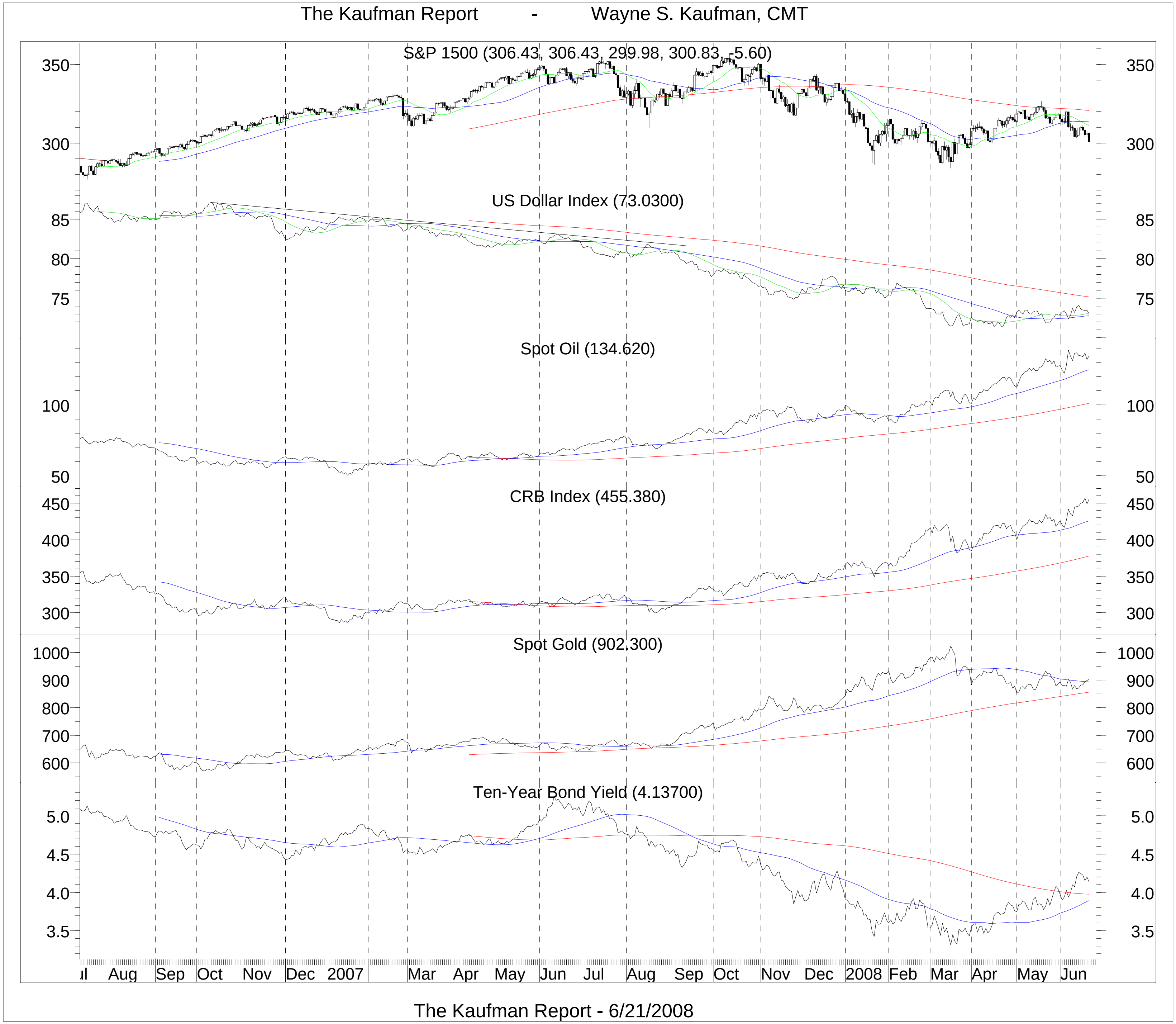
10-year bond yields are in an up trend but are just under resistance.

Since hitting the highest level in years the P/E ratio has dropped.

The forward P/E ratio remains at a reasonable level.

After a precipitous drop spreads between bond and earnings yields are levelling off.

Current and forecast earnings have been moving sideways. If forecasts are met and begin to rise, stocks will appear in hindsight to have been cheap. That could cause a rally in stocks until Q3 worries begin.



The U.S. Dollar Index has been strong recently, which may be hurting some large-cap stocks which have benefitted from a weak U.S. Dollar. It is still in a long-term down trend with a scary head and shoulders pattern on the monthly chart.

In spite of strength in the U.S. Dollar, crude oil and commodities have been very strong, which does not follow their classic inverse relationship to the Dollar and reflects strong demand.

Gold has been trying to create a base, but has has resistance overhead and unlike oil and commodities, gold has been hurt by the strong Dollar.

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The Kaufman Report - 6/21/2008

The Dow Jones Industrials made their lowest daily close since March 10th. It also printed a new correction closing low on the weekly chart (not shown), which was the lowest weekly close since 9/29/2006. It is retesting the January and March lows.

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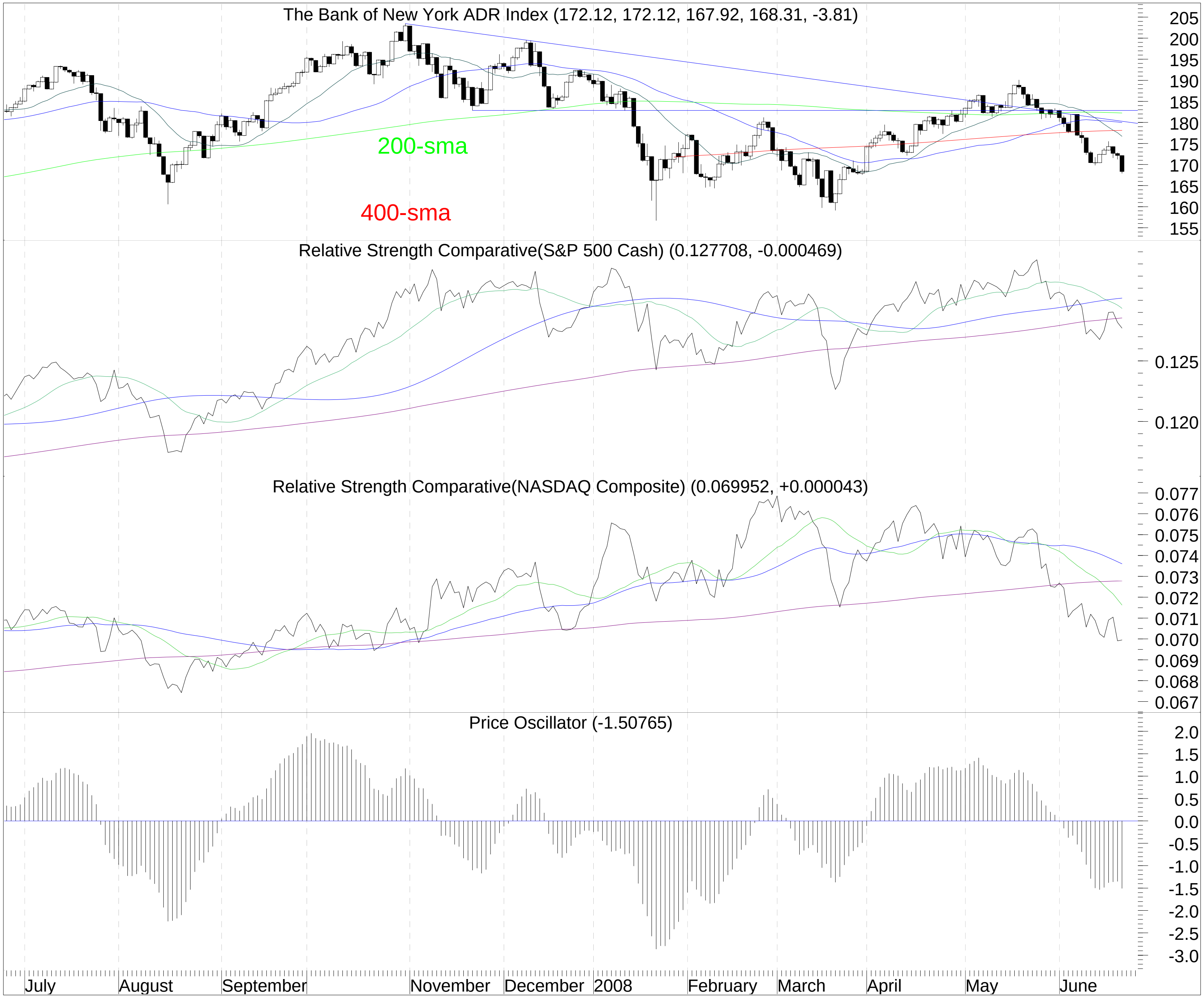

The Kaufman Report - 6/22/2008

Foreign stocks, represented by the ADR Index, have been underperforming the S&P 500 and the Nasdaq Composite. This is due to the stronger U.S. Dollar, and the belief that overseas economies will see slower growth.

This is the weekly chart of the S&P 500, showing that it is at the same level as in March 1999. On a nominal basis it is flat, but in real terms it has greatly under-performed other asset classes. This is why we recommend a tactical allocation strategy versus a strategic one. It is also obvious from this chart we are in a bear market. The moving averages on this chart are the 20-week (blue), 40-week (red), and 80-week, (purple). The 80-week (approximately 400-day) has been far more important as an indicator of long-term trends than the more commonly used 40-week (approximately 200-day) moving average. In a bear market a more active trading strategy is required as opposed to a bull market where the rising tide lifts most boats.