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The Kaufman Report

Trade what you see, not what you think.

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Monday June 30, 2008 **Closing prices of June 27, 2008**

In poker they say that "if you don't know who the sucker at the table is, it's probably you." We think this expression is applicable to the current stock market, and it's obvious who the suckers at the table are. They would be investors who bought into the buy and hold theory, the diversified mutual fund investors, and the managers of funds that must remain fully invested at all times using a strategic allocation strategy. These players are unable to react to rapidly changing market conditions and are unable to generate profits in a bear market the way tactical traders can. Therefore, while the media reports major indexes entering bear market territory, and politicians search for the next scapegoat for supply and demand imbalances and economic woes, tactical traders are able to steer their assets into ongoing bull markets in energy, commodities, and basic materials.

As we entered June we said we expected weakness for equities due to the breakdown of the bearish rising wedge on May 21st, negative seasonality, and a lack of fundamental news flow. We also said it would be a good test of how aggressive sellers would become. Once stocks retraced more than 50% of the March to May rally, we said the selling had become even more intense than we expected. The S&P 1500 is now down 8.712% for the month. So far June 2008 is the tenth worst month in the history of the S&P 500, and the Dow Jones Industrial Average is on its way to having the worst June since the Great Depression. The Dow also had its lowest weekly close since August 2006.

Bad news in the form of record oil prices, projections of more writedowns in the credit markets, and weaker than expected earnings forecasts by tech leader Research In Motion and others were the catalysts for another panic-selling 90% down day for stocks on Thursday. This was the third 90% down day recently, the others being June 6th and June 11th. <u>We have stressed numerous times since that second 90% down day that a market that does not respond to oversold conditions is dangerous</u>.

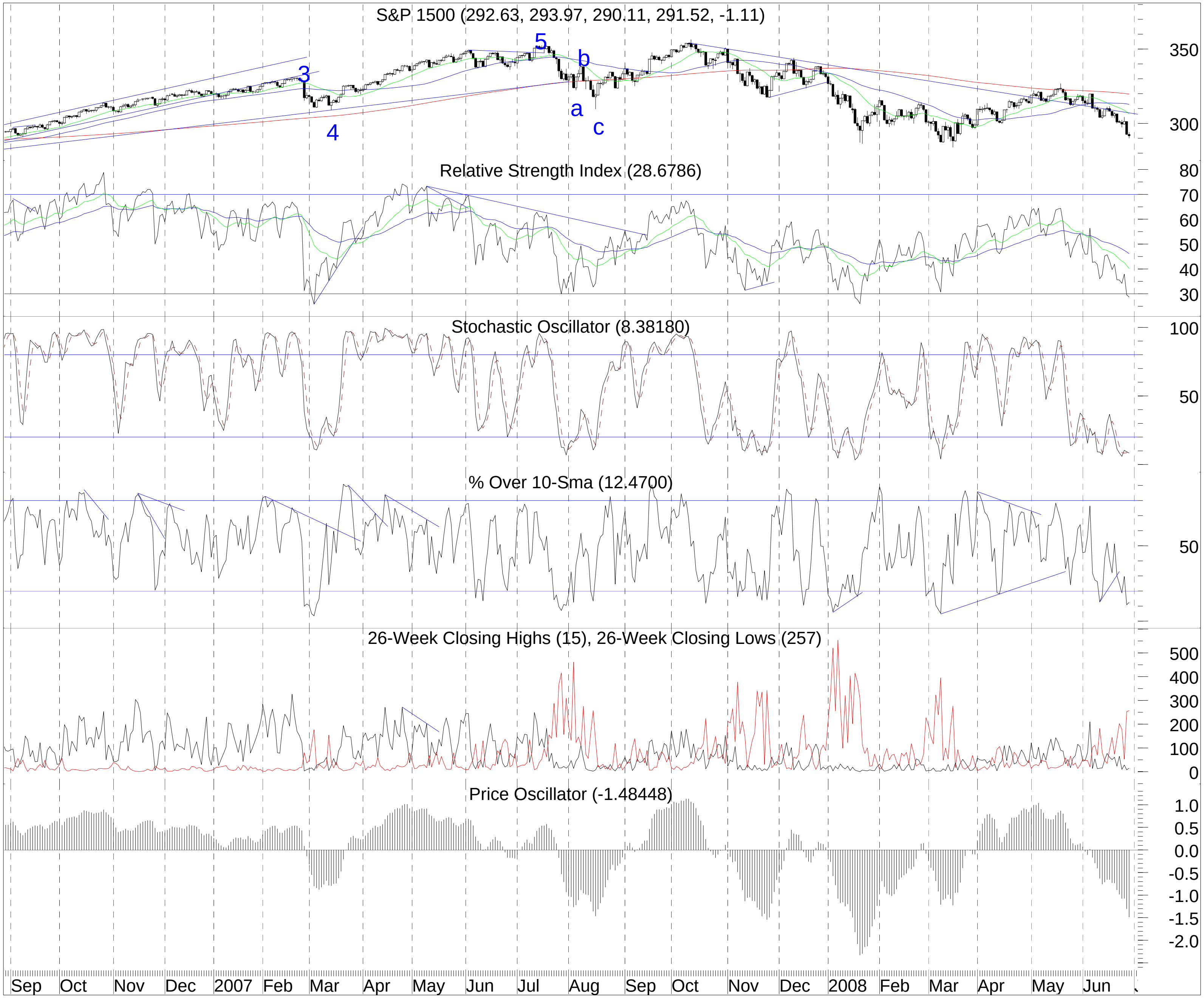
In the short-term, our oscillators are all at oversold levels. Spreads between bond and earnings yields have widened to the best levels seen in over two months. <u>The spread based on forecast earnings is the widest since April 23rd, and is at a level where historically stocks have been extremely attractive versus bonds</u>. If earnings estimates are met in the coming earnings season, and projections are not ratcheted down, in hindsight stocks will appear to have been undervalued at current levels.

<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 a 75.3% probability that the Fed will *<u>leave rates at 2.00%,</u>* and a 24.7% probability of *<u>raising 25 basis points to 2.25</u>* when they meet on August 5th.

The S&P 1500 (291.52) was down 0.379% Friday. Average price per share was down 0.33%. Volume was 123% of its 10-day average and 133% of its 30-day average. 34.41% of the S&P 1500 stocks were up on the day. Up Dollars was 61% of its 10-day moving average and Down Dollars was 71% of its 10-day moving average. For the week the index was down 3.095% on increasing and above average weekly volume. Options expire July 18th.

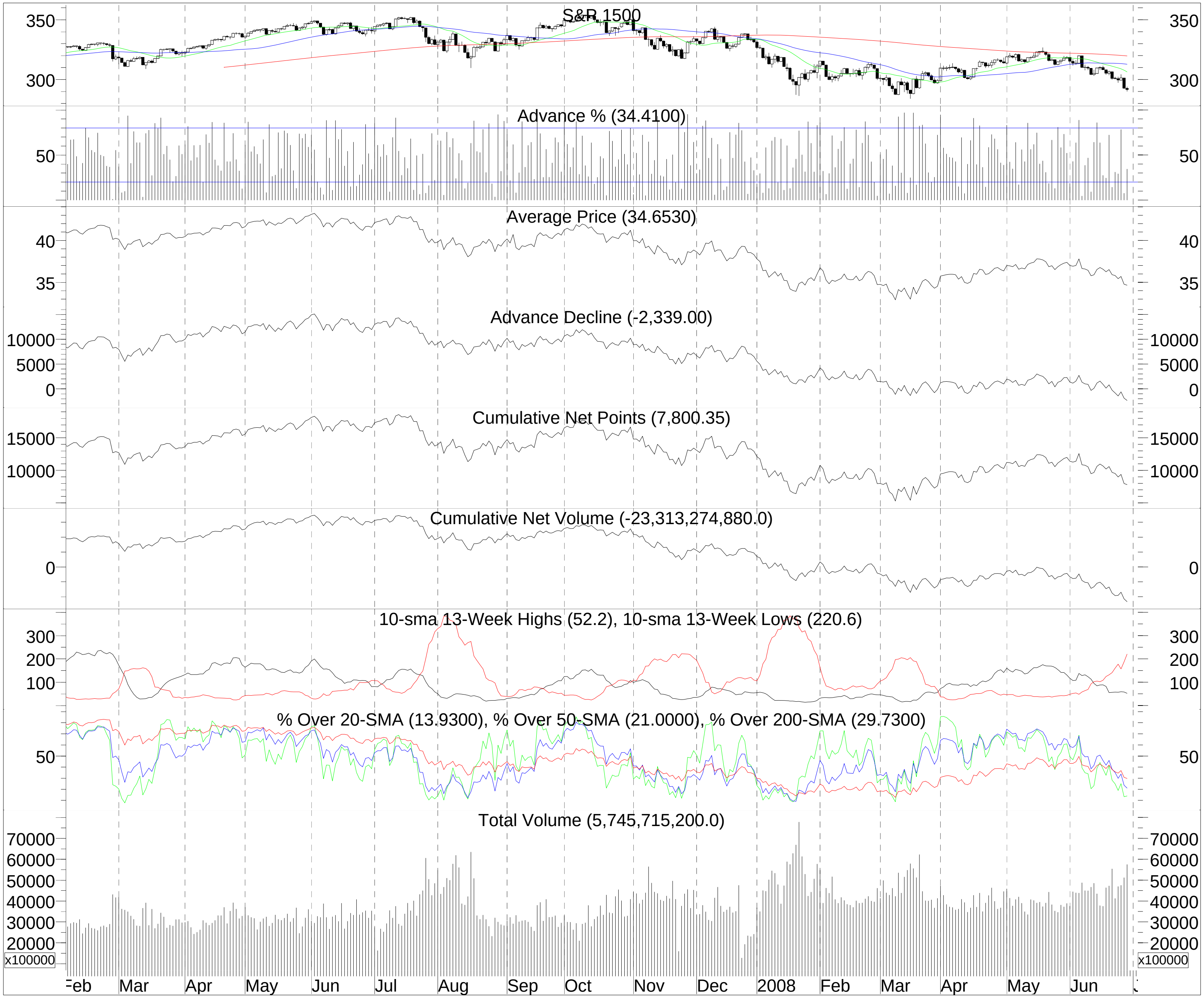
We knew the S&P 1500 would break out of the falling wedge soon, and it did on Thursday. Unfortunately, the break was down instead of up, taking it closer to a full retest of the March lows. On Friday the index printed a high volume spinning top, showing indecision on the part of investors. Since we are near the March support, and with short-term indicators oversold, sellers may be letting up to see if buyers start to come back into the market.



All of our oscillators are now in the oversold zone. This is setting up great entry points for long trades.

New lows continue to expand, but are still lower than March and January.

Our price oscillator, a good indicator of trends, turned negative on June 3rd. Since then the S&P 1500 is down 7.03%. It is at or near levels where oversold bounces occurred in the past.

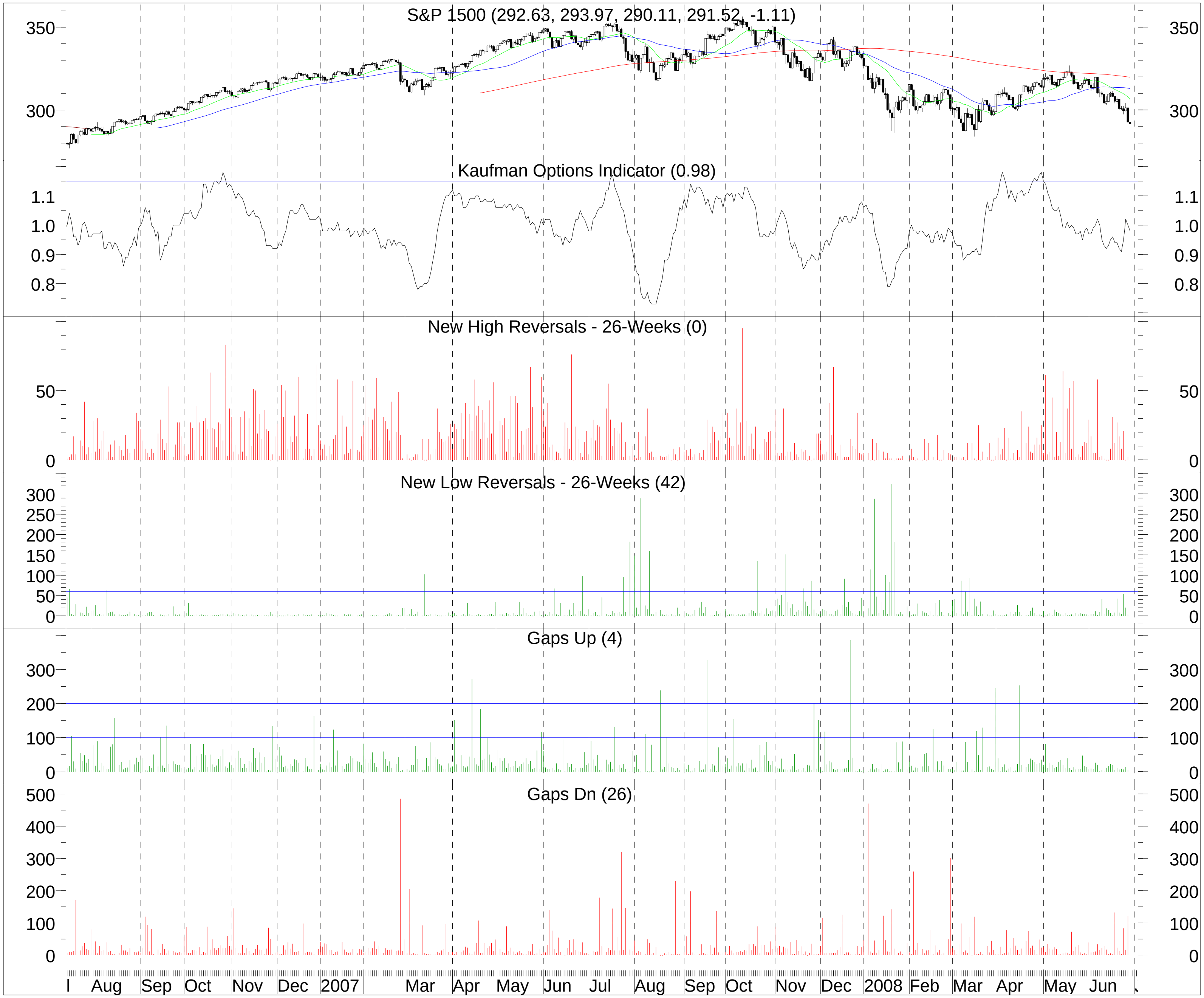


34.41% of the S&P 1500 traded higher Friday.

The Advance Decline line and Net Cumulative Volume have made new correction lows, and point to lower prices in the future. Average Price Per Share and Cumulative Net Points are still well above their March lows, highlighting the selective nature of this market.

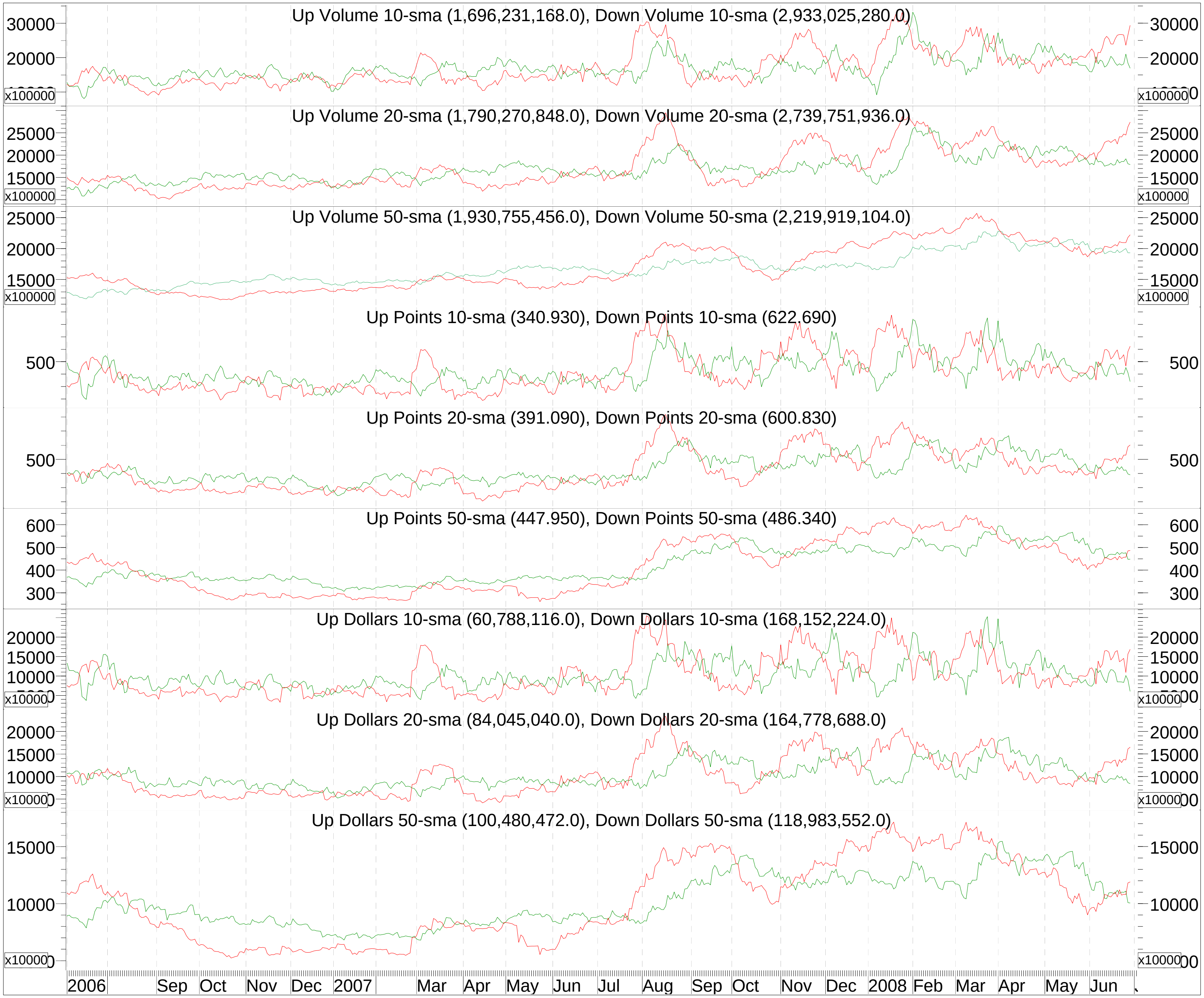
Although it can go into single digits, the percent of stocks over their 20-day moving average is in the area where bottoms are made.

Volume expanded during Friday's sell off.



Our proprietary options indicator is just under the neutral level. We would prefer to see greater negativity.

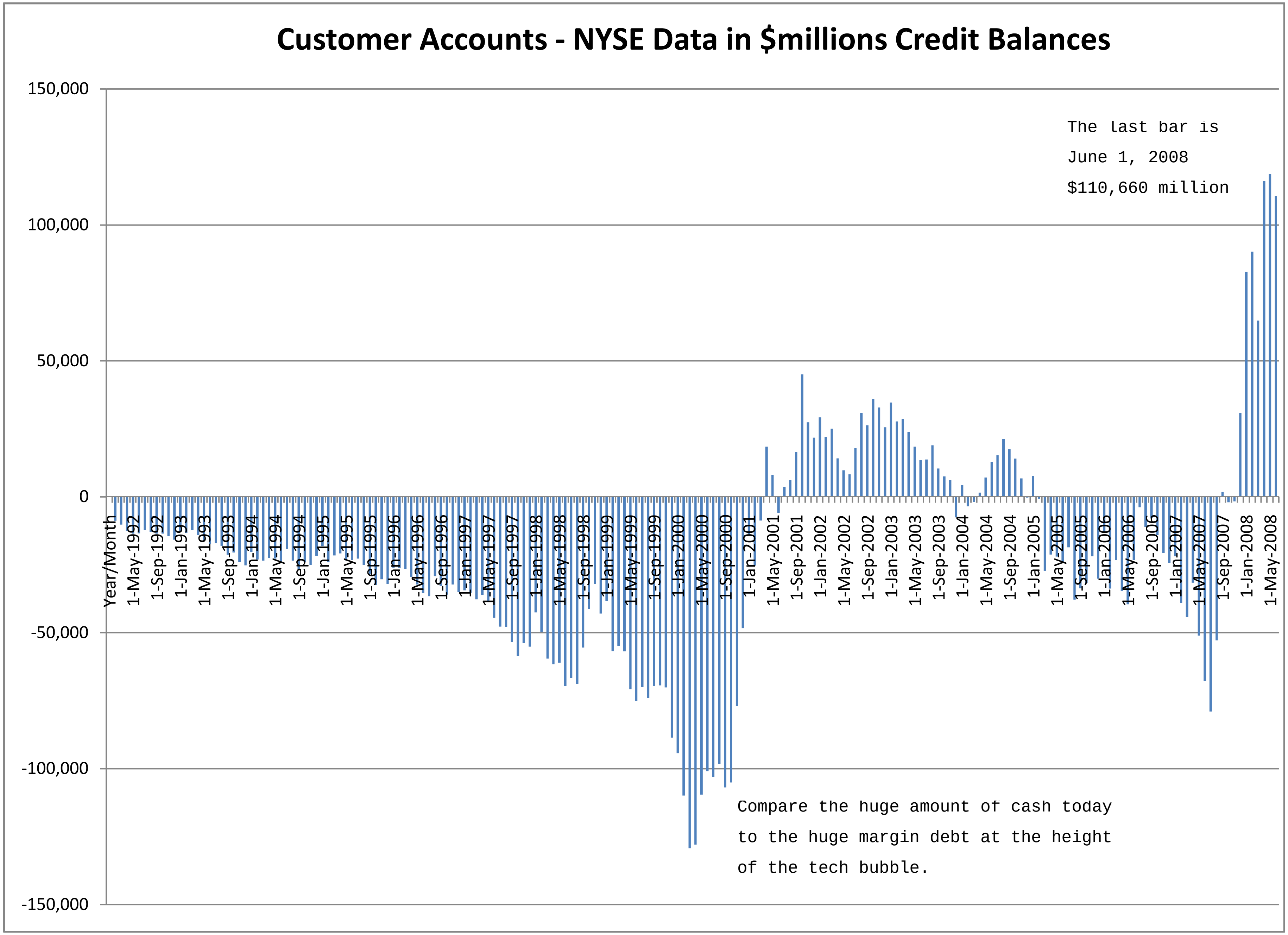
New low reversals are starting to increase, but are still not at levels seen at bottoms. This could change in one day. All that is needed is a big sell off followed by buyers rushing in.



All of our statistics of supply (red lines) are greater than our stats of demand. Simply put, supply has been overpowering demand.

Our 10-day statistics of Down Points and Down Dollars are not showing the intensity of selling seen in the past. This means that if buyers get a reason to move off of the sidelines, a sharp price move higher could take place.

The chart on the next page shows the mountain of cash sitting in the accounts of NYSE customers.


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
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1-May-2007
1-Sep-2007
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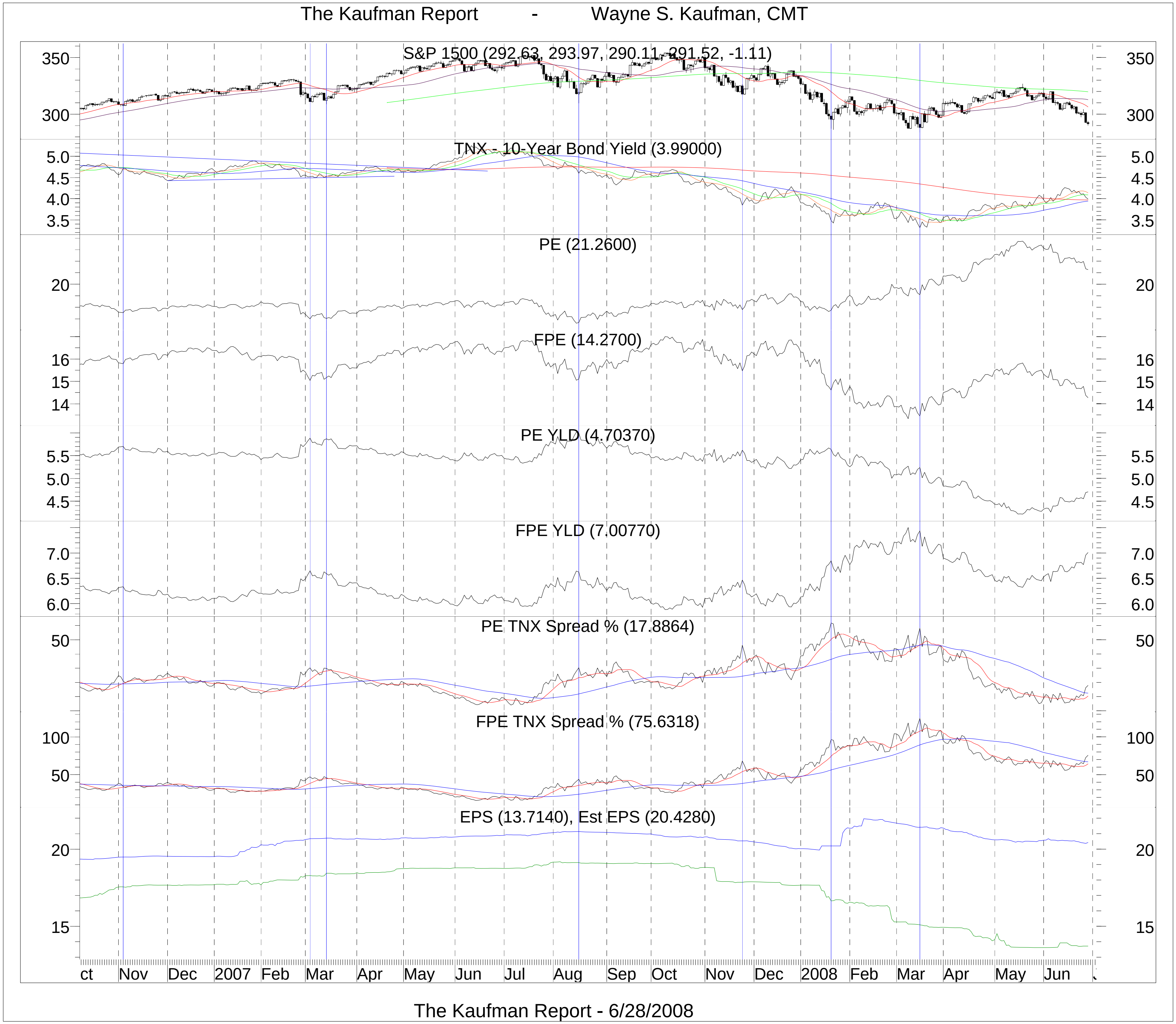
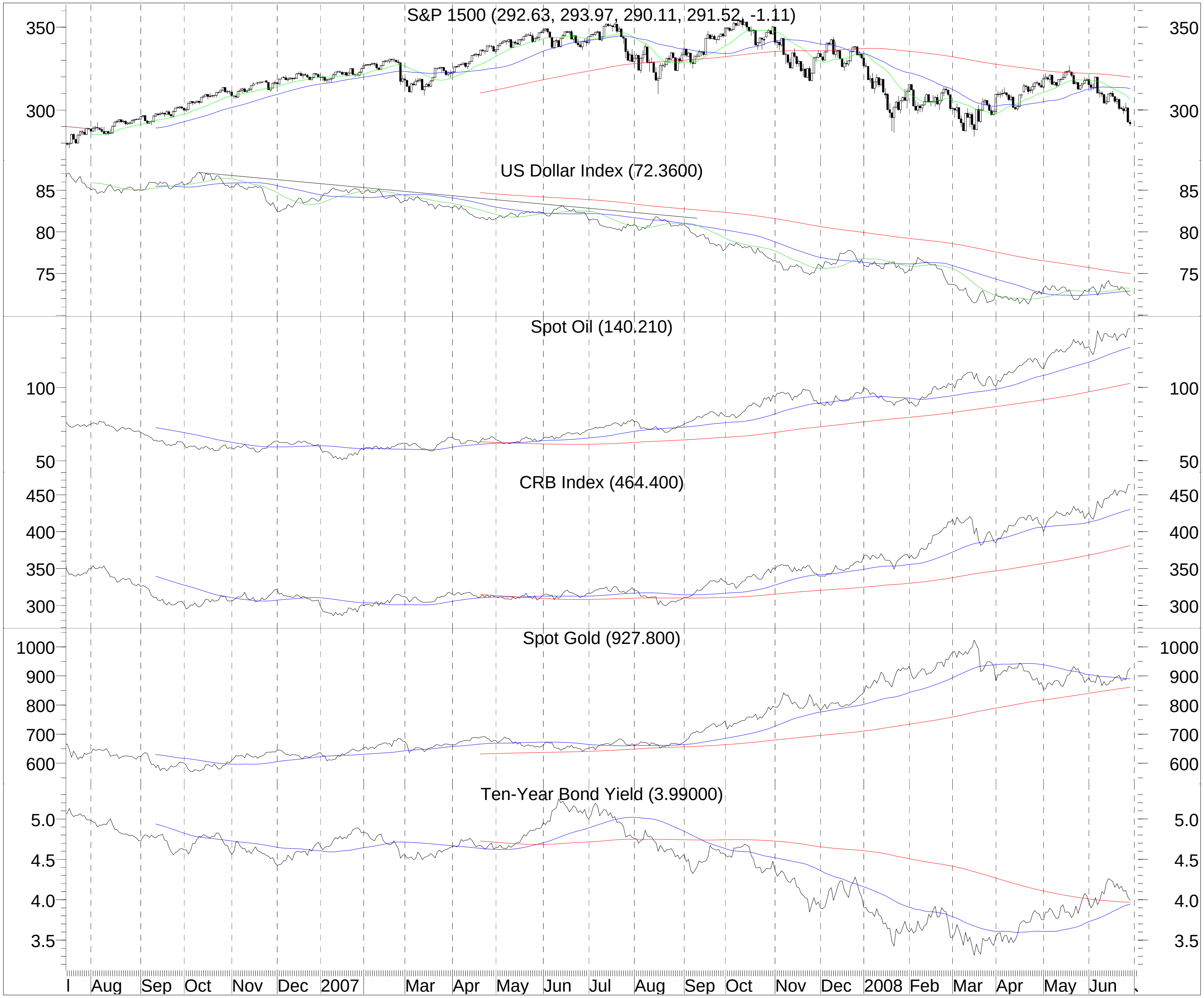
1-May-2008
The last bar is
June 1, 2008
$110,660 million
Compare the huge amount of cash today
to the huge margin debt at the height
of the tech bubble.



After reaching short-term overbought levels, 10-year bond yields have retreated to the 50 and 20-sma, which have converged.

Spreads between earnings and bond yields have widened as bond yields and equities have plunged in tandem. The spread based on the forward P/E is at the widest level since April 23rd. Historically, a spread this wide makes stocks very attractive versus bonds. Current and projected earnings have been relatively flat for a while. If estimates are met in the coming earnings season and projections are not ratcheted down, in hindsight stocks will appear to have been undervalued at current levels.



After a period of strength the U.S. Dollar Index has weakened and fallen back below the 20 and 50-sma. There are multiple areas of support just below.

We have been commenting that crude oil and commodities have been strong in spit of Dollar weakness, showing real demand. With the Dollar now showing weakness again oil and commodities have broken out to new highs.

Last week we said gold was trying to make a bottom, and during the week it rose $25. It is probably going back into the high 900s.