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The Kaufman Report

Trade what you see, not what you think.

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Monday March 2, 2009 **Closing prices of February 27, 2009**

Stocks recorded their worst February since 1933 as the S&P 1500 was down 10.94% on the month. End of month window dressing failed to prevent a broad selloff Friday as every S&P sector closed down on the day, led lower by Financials -7.39% and Health Care -4.16%. Consumer Discretionary was the best performer -0.19%. There are positive divergences showing up in short-term momentum indicators and in breadth statistics, so a bounce is possible at any time. However, we continue to think any rally will be of the bear market variety, and that conservative investors should be very defensive at this time. This is a market for aggressive traders only, and conservative investors should not worry about missing the bottom when it comes. There may be another strong leg down coming soon, and avoiding devastating losses is more important for some investors than participating in the first bounce of a new bull market.

The lack of any type of oversold bounce causes us to reiterate our frequent warning from last October that a market that doesn't respond to oversold conditions is dangerous. The short-term, intermediate-term, and the long-term trends remain down. This continues to be an opportunistic trader's market, with adept traders able to take advantage long or short.

"Study after study over the past several decades has shown how countries that spend more produce less, while nations that tax less produce more. Obama is doing it wrong on both counts". - Lawrence Kudlow

The S&P 1500 (166.75) was down 2.181% Friday. Average price per share was down 1.28%. Volume was 134% of its 10-day average and 146% of its 30-day average. 34.68% of the S&P 1500 stocks were up, with up volume at 18.77% and up points at 25.20%. Up Dollars was 10.65% of total dollars, and was 32% of its 10-day moving average. Down Dollars was 79% of its 10-day moving average. The index is down 10.943% in February, down 18.63% quarter-to-date and year-to-date, and down 53.21% from the peak of 356.38 on 10/11/07. Average price per share is $19.94, down 53.87% from the peak of $43.23 on 6/4/07.

Put/Call Ratio: 0.976. Kaufman Options Indicator: 1.03.
The spread between the reported earnings yield and 10-year bond yield is 44%, and 176% based on projected earnings.
Reported aggregate earnings for the S&P 1500 peaked in August 2007 at $19.18 and are now at $7.29, a drop of 61.99%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $14.01, a drop of 36.17%. The spread between reported and projected earnings is the widest the level in years. If investors believed the estimates stocks would be much higher.

478 of the S&P 500 have reported 4th quarter earnings. According to Bloomberg, 60.6% had positive surprises, 8.4% were line, and 31.0 % have been negative, a high number. The year-over-year change has been -37.5% on a share-weighted basis, -17.8% market cap-weighted and -25.1% non-weighted. Ex-financial stocks these numbers are -18.7%, -6.1%, and -12.1 %, respectively.

Federal Funds futures are pricing in a probability of 98.0% that the Fed will *leave rates unchanged*, and a probability of 2.0% of *raising 25 basis points to 0.50%* when they meet on March 18th. They are pricing in a probability of 90.3% that the Fed will *leave rates unchanged* on April 29th and a probability of 7.9% of *raising 25 basis points*.

IMPORTANT DISCLOSURES

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Economic News

2/27/09 – GDP for the fourth quarter shrank at a 6.2% annualized pace, the most since 1982 and worse than the estimate of -5.4%.

2/26/09 – Initial Jobless Claims for w/e 2/21 rose to 667,000, the highest since 1982. Durable Goods orders for January fell for a record 6th straight month, down 5.2% versus the estimate of -2.5%. Silver lining: inventories were down 0.8% from December. Singapore's economy shrank the most in 33 years last quarter, as GDP declined at an annualized 16.4% from the prior three months.

2/25/09 – Existing Home Sales for January fell 5.3% to 4.49 million annualized from 4.74 million in December. This was the lowest rate since 1997. Median price dropped 15% Y-o-Y. Distressed properties were 45% of sales.

2/24/09 – The Conference Board's reading of U.S. Consumer Confidence for February dropped to 25, the lowest ever and well below the estimate of 25. The S&P/Case-Shiller index of home prices in 20 U.S. cities plunged 18.5% in December Y-o-Y, the fastest drop on record. The MSCI World index is off to its worst ever yearly start. German business confidence was reported at a 26-year low. Eurozone Industrial Orders fell 5.2% in December versus November and -23.3% year-over-year.

2/23/09 – Dallas Fed Manufacturing Activity came in at -57.3% versus the estimate of -50.0%.

2/20/09 – The Consumer Price Index for January rose for the first time in six months by +0.3%, hitting the estimate. It was unchanged on an annual basis for the first time since 1955. Energy expense rose 1.7%, led by a 6% increase in gasoline prices.

2/19/09 – Initial Jobless Claims for the week ending 2/14 hit 627,000 versus the 620,000 estimate. The prior week was also 627,000. Continuing Claims were 4.99 million and set another record. The Producer Price Index for January was +0.8% versus a +0.3% estimate. Leading Indicators rose 0.4% versus the estimate of 0.1%. Some economists said this was a temporary jump.

2/18/09 – Housing Starts for January were the lowest on record at 466,000 annualized, missing the forecast of 529,000 and falling 17% from December. Building permits dropped 4.8% to 521,000 annualized.

2/17/2009 – Empire Manufacturing Index, which shows NY manufacturing, was -34.65 in February versus the -23.75 estimate. It dropped from -22.2 in January for the fastest drop ever. Net long-term TIC inflows, which shows international demand for U.S. financial assets, was $34.8 billion in December, up from -$21.7 billion in November and above the $20 billion estimate.

2/16/09 – Japanese GDP dropped 3.3% from the prior quarter, or 12.7% annualized, the biggest drop since 1974. Exports dropped at an 45% annualized rate as the synchronized global contraction hurts countries where global trade is extremely important.

2/12/09 – Jobless claims for w/e 2/7 were 623k versus 610k estimated. The 4-week moving average of 607,500 is the most since November 1982. Continuing claims w/e 1/30 were 4,810k versus estimated 4,800k, and rose the 4th week in a row to another record. Business Inventories for December -1.3% versus -0.09% estimate, biggest drop since 2001. Sales -3.2% after -5.7% in November. 1.4 months of inventory highest since April 2001. January Retail Sales +1% versus -0.8% estimate rose for the first time since July. Gasoline sales +2.6%, sales at auto dealers and parts stores up 1.6% for the first gain since August.

2/11/09 – China exports fell 17.5% year-over-year in January, the most in 13 years. Imports plunged by a record 43.1%. The $39.1 billion trade surplus was China's 2nd biggest ever. Numbers may be skewed by the Chinese New Year.

2/11/09 – The U.S. December trade deficit was $39.9 billion, wider than the $35.7 billion estimate. It was the lowest in almost six years. Exports and imports each declined for the 5th straight month, highlighting the effects of the synchronized global contraction. This is causing rumblings of protectionism worldwide, which would not be a good thing for the global economy.

2/10/09 – Wholesale inventories in December fell 1.4% versus a projected drop of 0.7%. Inventories have dropped four straight months, the longest streak in almost seven years. At current demand levels there is a 1.27 month supply of inventory, the highest since 2002. This points to further reductions in production. Factory inventories fell 1.4% in January. Retail inventories will be reported 2/12.

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Economic News

2/6/09 – The Unemployment Rate in January hit 7.6%, slightly above the 7.5% estimate. This was up from 7.2% in December and the highest since 1992. Payrolls fell by 598,000 (estimate 540,000), the biggest decline since December 1974. This is the first time since the beginning of payroll records in 1939 that job losses exceeded 500,000 for three consecutive months. Average Hourly Earnings increased 3.9% year-over-year.

2/5/09 – Initial Jobless Claims increased by 35,000 for the week ending 1/31 to 626,000, the highest number since October 1982. Continuing Claims hit a record 4.788 million for the week ending 1/24. Silver lining: Productivity rose 3.2% in the fourth quarter versus a 1.6% forecast. U.S. December Factory Orders dropped 3.9% versus a -3.1% estimate. Excluding transportation equipment (cars and aircraft) orders fell 4.4%.

2/4/09 – ADP Employer Services report showed a loss of 522,000 jobs in January, less than the 535,000 forecast and much lower than the December loss of 659,000. The Institute of Supply Management index of non-manufacturing businesses rose to 42.9 in January from 40.6 in December, and was above the estimate of 39.0.

2/3/09 – U.S Pending Home Sales rose for the first time in four months. The December increase of 6.3% beat the estimate of 0.0%. November showed a drop of 4%. According to the U.S. Census Bureau, a record 19 million U.S. houses were vacant at the end of 2008 for a 2.9% vacancy rate (vacant for sale), the highest ever. Purchases of New Homes in December, reported last week, dropped 14.7% versus November.

2/2/09 – Personal Income fell 0.2% in December, better than the -4% estimate, the third straight decline. The last three-month decline was January 1954. Personal spending in December fell 1% versus the .9% estimate, for a record sixth consecutive month. Consumer spending rose 3.6% for 2008, the smallest gain since 1961. Consumer Spending dropped at a 3.5% annual pace in Q4 versus 3.8% in Q3, the first ever declines above 3% in consecutive quarters. Silver lining: the decrease in spending pushed the savings rate up to 3.6% in December from 2.8% in November.

Not much new here on the S&P 500 daily chart with another new low as the index continues to follow through after breaking the lower boundary of the triangle. While oversold bounces will occur, we expect lower prices in the future.

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

On the intra-day chart there is resistance at the 752 area, and important resistance at 780.

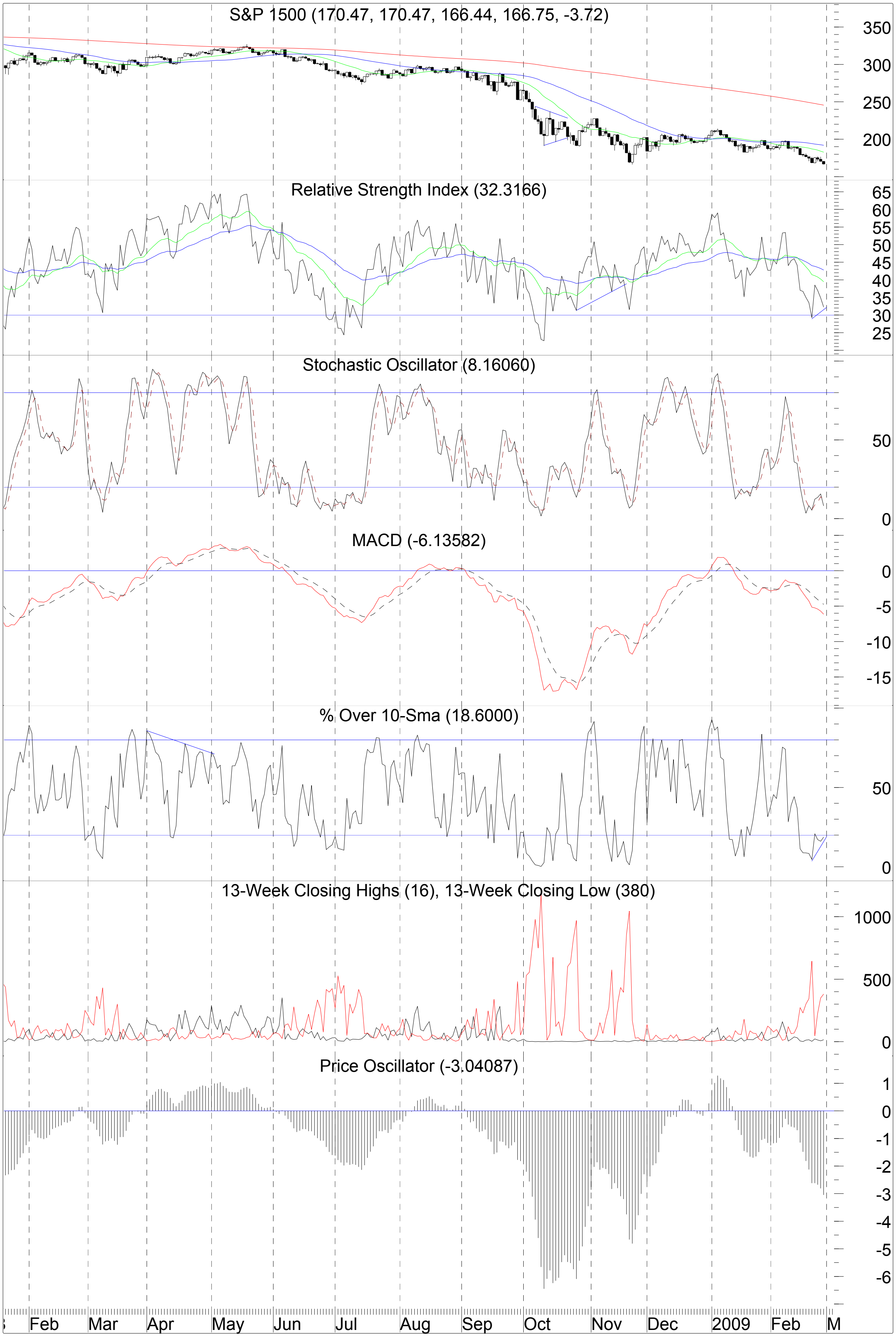
The stochastic is in the oversold zone.

A brutal three week period would seem to call for some sort of rally. So, where are the buyers?

The monthly chart of the S&P 500 shows the lowest close since October 1996. Unfortunately, even though indicators are at oversold levels, there is nothing on this chart that shows signs of a long-term bottom.

The Nasdaq 100 followed through lower after the break of its trend line. We said at the time a break of the line would be bad for the market as a whole. The doji candle printed on Friday shows indecision, and may lead to a bounce. Still, there is nothing on the weekly chart (not shown) that indicates a bottom is in.

The Dow Industrial Average continues to make new lows and is on a confirmed Dow Theory sell signal.



The RSI is showing a positive divergence.

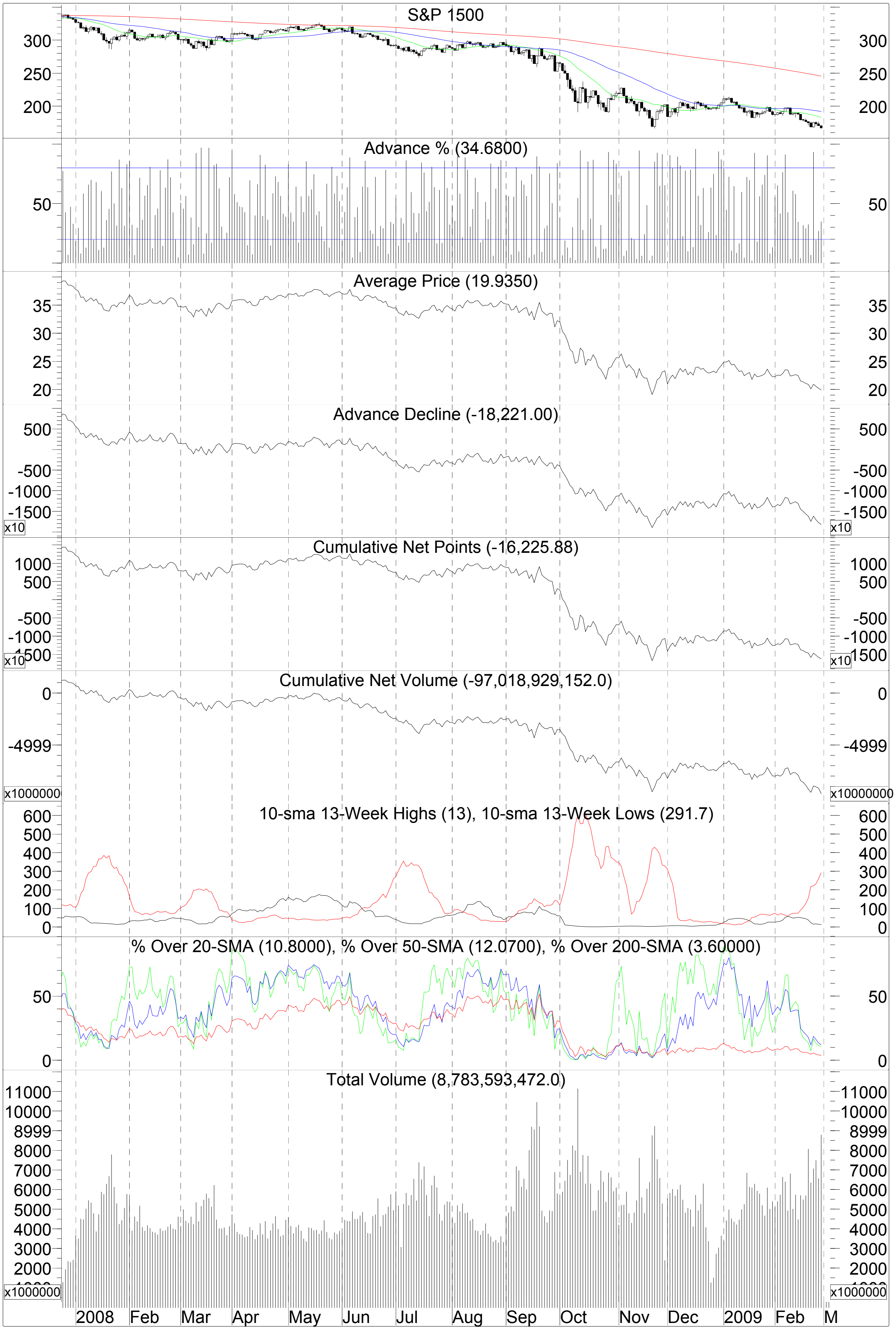
The stochastic is very oversold.

The percent over 10-sma is also showing a positive divergence.

New lows are much less than October, November, or even recently. This is another positive divergence.

Our price oscillator is at an extreme level.

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



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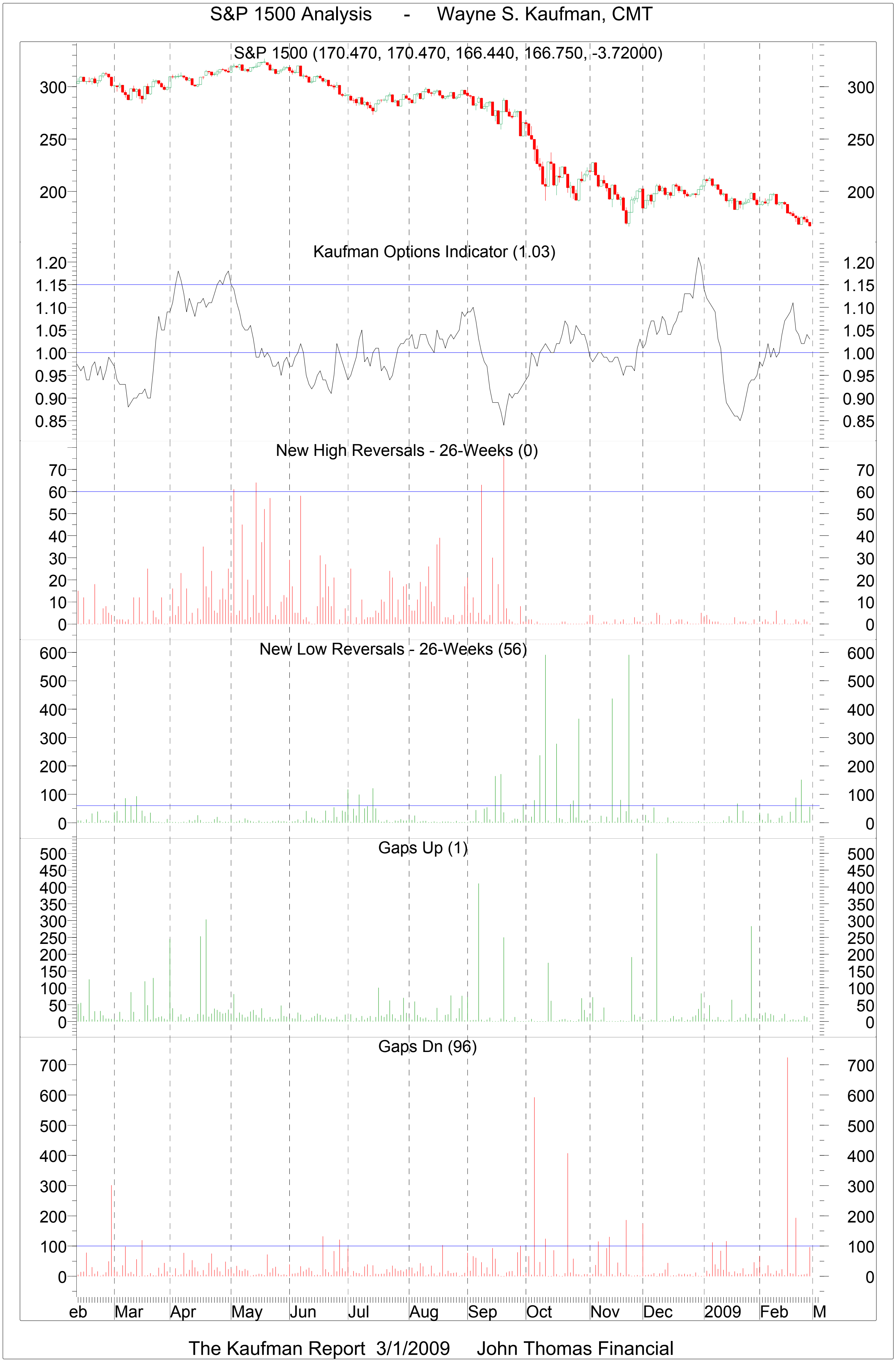
34.68% of stocks traded higher Friday.

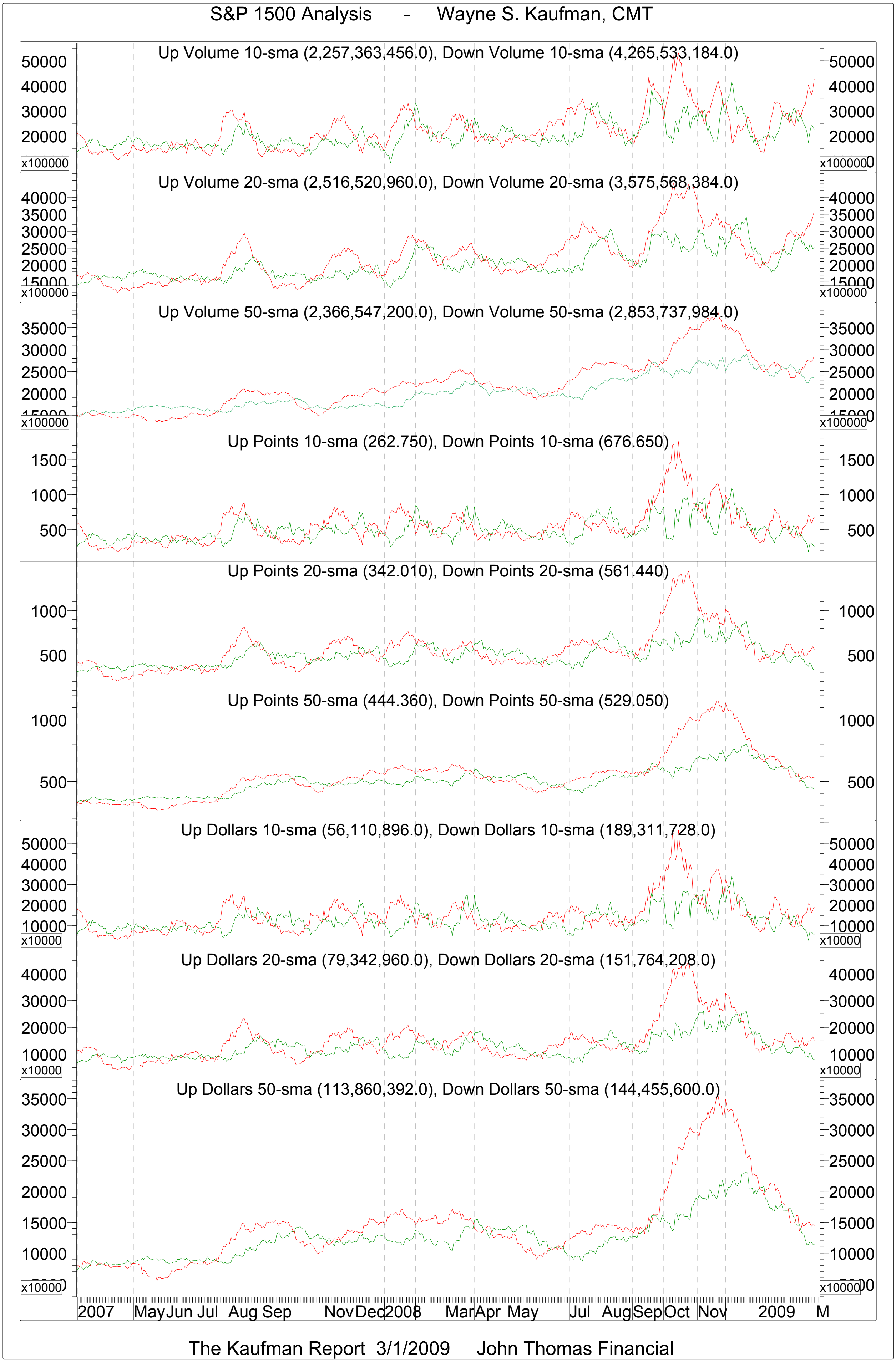
Average price per share has not made a new low like the S&P 1500 index has, and other breadth statistics are still above their November lows, another positive divergence.

These percentages remain at bear market levels.

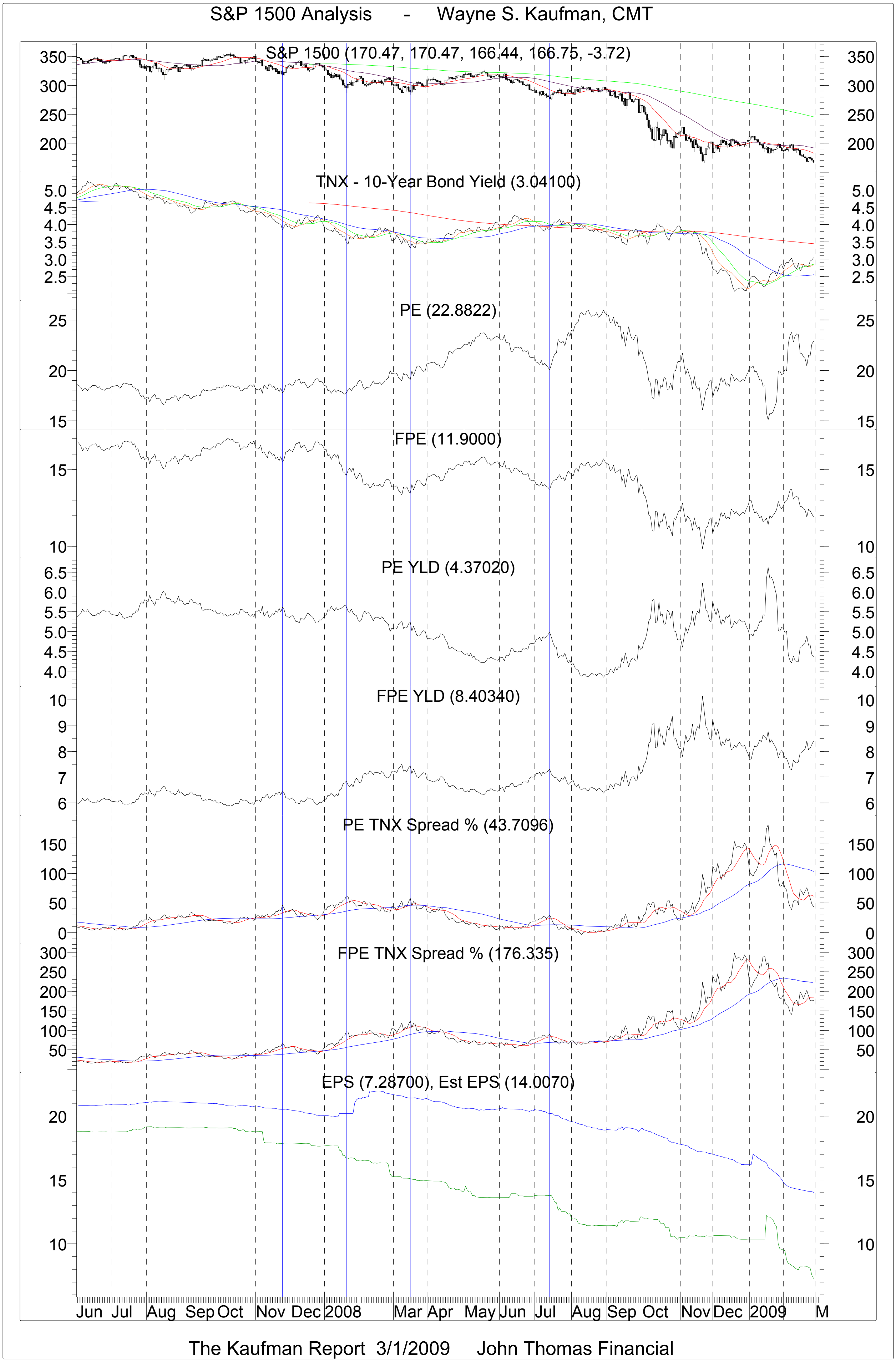
Volume expanded Friday.



Our proprietary options indicator is just above neutral. This is not an area where important bottoms have been made in the past, but rallies can start from here.



Our statistics of supply (red lines) versus demand (green) are showing negative crossovers for all statistics and time frames. Simply put, supply continues to overpower demand. Even though selling has not been intense recently, buyers are nowhere to be found.

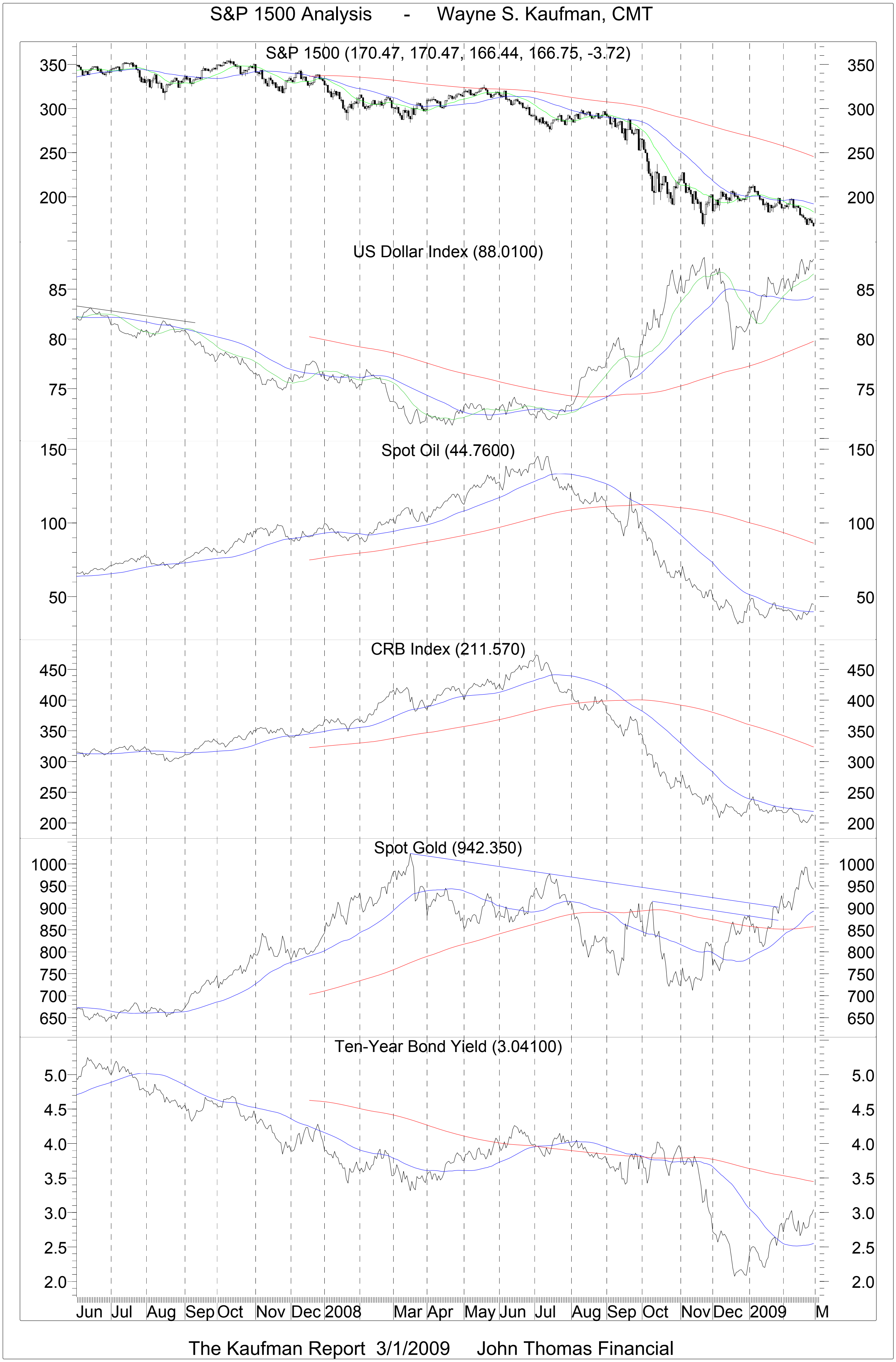


10-year bond yields have been rising a seem poised to go higher. That won't be great for equity prices.

The P/E ratio remains at high levels. The forward P/E has been moving lower. This is due to analyst estimates not coming down nearly as fast as reported earnings.

Spreads between bond and earnings yields have been coming down, with the spread based on the current P/E at levels where stocks have had trouble moving higher recently. During normal markets stocks would still be attractive with this spread.

Earnings (green) and estimates (blue) continue their inexorable march lower, with reported earnings moving down much faster than estimates.



The U.S. Dollar Index is challenging resistance levels but should be topping soon based on longer-term charts.

Crude oil is back above its 50-sma (blue). There is a potential double bottom at the 34 area.

Gold pulled back as it got overbought near resistance. There may be more downside to go.