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The Kaufman Report

Trade what you see, not what you think.

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Monday May 12, 2008 **Closing prices of May 9, 2008**

Last week we said we were expecting a pullback in equities. We explained that our proprietary options indicator was showing too much bullishness on the part of options buyers, that there were negative divergences on some breadth indicators, and that the down sloping 200-day moving averages were coming into play on major indexes. We also explained that there had been 61 new high reversals on May 2nd and that in the past a number over 60 had preceded weakness in stocks.

We got the expected pullback as the S&P 1500 dropped 1.62% on the week. In the very short-term a bounce is possible due to an oversold condition on intra-day charts and some price support levels. However, we think more weakness is probable over the next one to two weeks. We don't think this pullback will be a resumption of the down trend for reasons outlined in our May 5th "Climbing a Wall of Worry?" essay, and we believe that the huge amount of cash on the sidelines is looking for entry points.

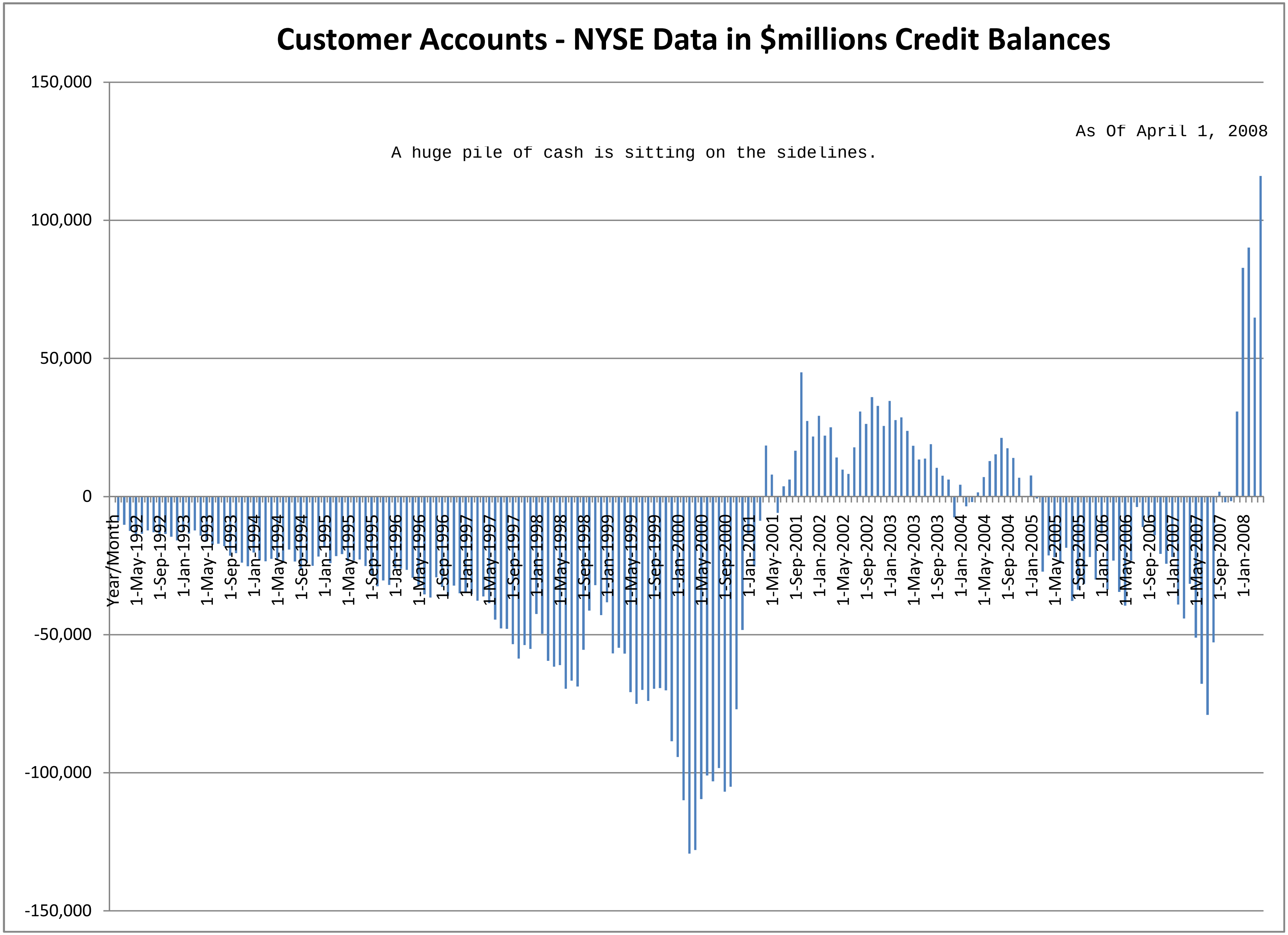
Our strategy for some time has been to buy leading stocks while watching for sector rotation and being prepared for the down trend to resume. We continue to follow that course of action while hoping that after a brief pull back stocks will strengthen and successfully challenge the last barriers that prevent us from calling the long-term trend up instead of down.

Federal Funds futures are pricing in an 82% probability that the Fed will *leave rates at 2.00%,* and a 18% probability of *cutting another 25 basis points to 1.75* when they meet again on June 25th.

So far 450 companies have reported first quarter earnings. According to Bloomberg 61.1 % have had positive surprises, 10.7% have been in line, and 28.2% have been negative. The year-over-year average change has been -16.7% on a share-weighted basis, -0.8% market cap-weighted, and -11.4% non-weighted.

The S&P 1500 (314.75) was down 0.591% Friday. Average price per share was down 0.25%, showing more selling in large-caps. Volume was 87% of its 10-day average and 88% of its 30-day average. 42.64% of the S&P 1500 stocks were up on the day. Up Dollars was 26% of its 10-day moving average and Down Dollars was 95% of its 10-day moving average. For the weak the index was down 1.616% on declining and below average weekly volume.

Options expire May 16th. The FOMC meets June 25th.



Customer Accounts - NYSE Data in $millions Credit Balances
As Of April 1, 2008
A huge pile of cash is sitting on the sidelines.
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-Sep-2006
1-Jan-2007
1-May-2007
1-Sep-2007
1-Jan-2008

The S&P 1500 has pulled back to just above the 20-sma and the bottom line of the bearish rising wedge (see next chart on next page).

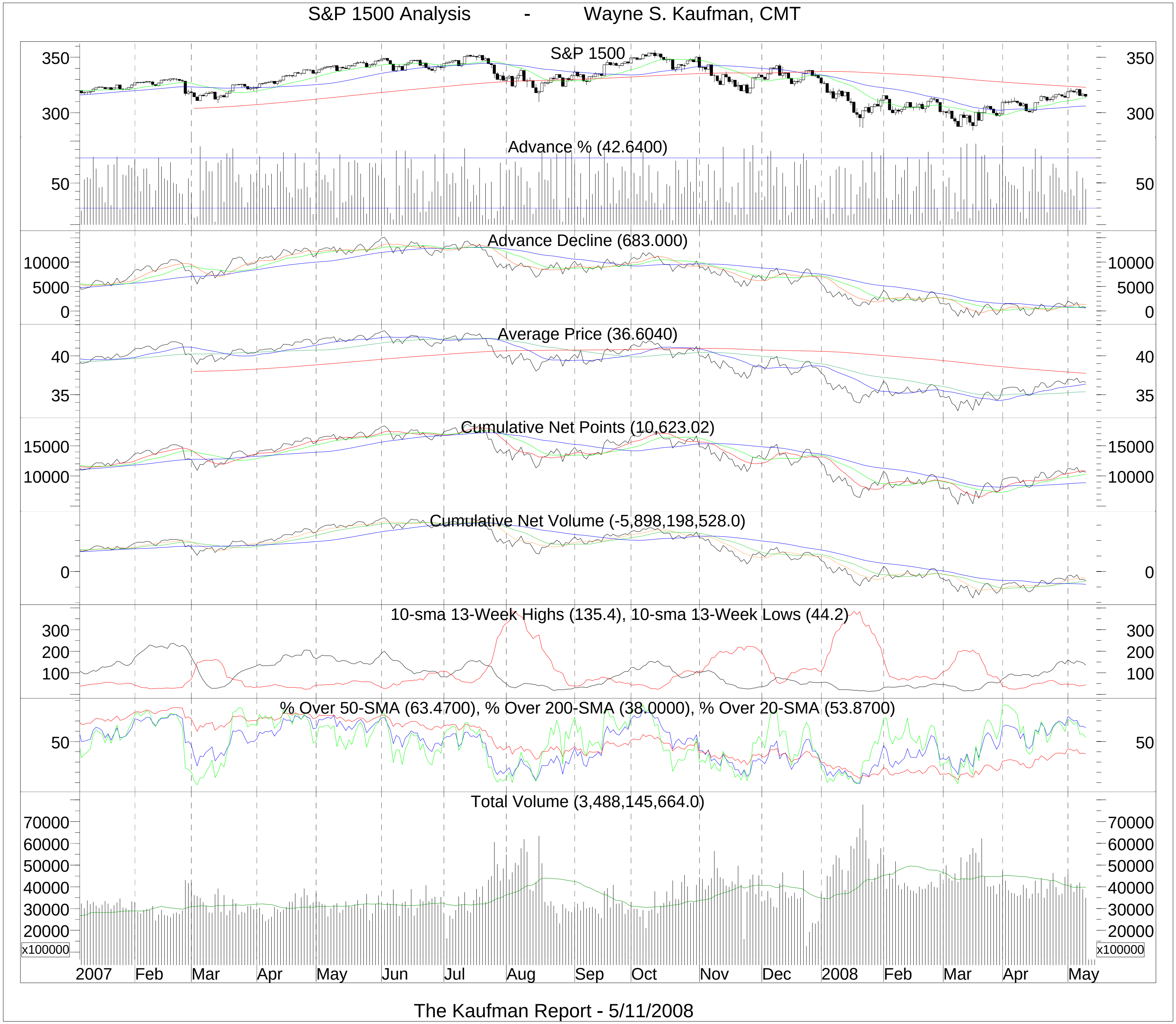
Our oscillators are not yet oversold.

Our price oscillator is still in positive territory after reaching overbought levels.

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

The Kaufman Report - 5/11/2008

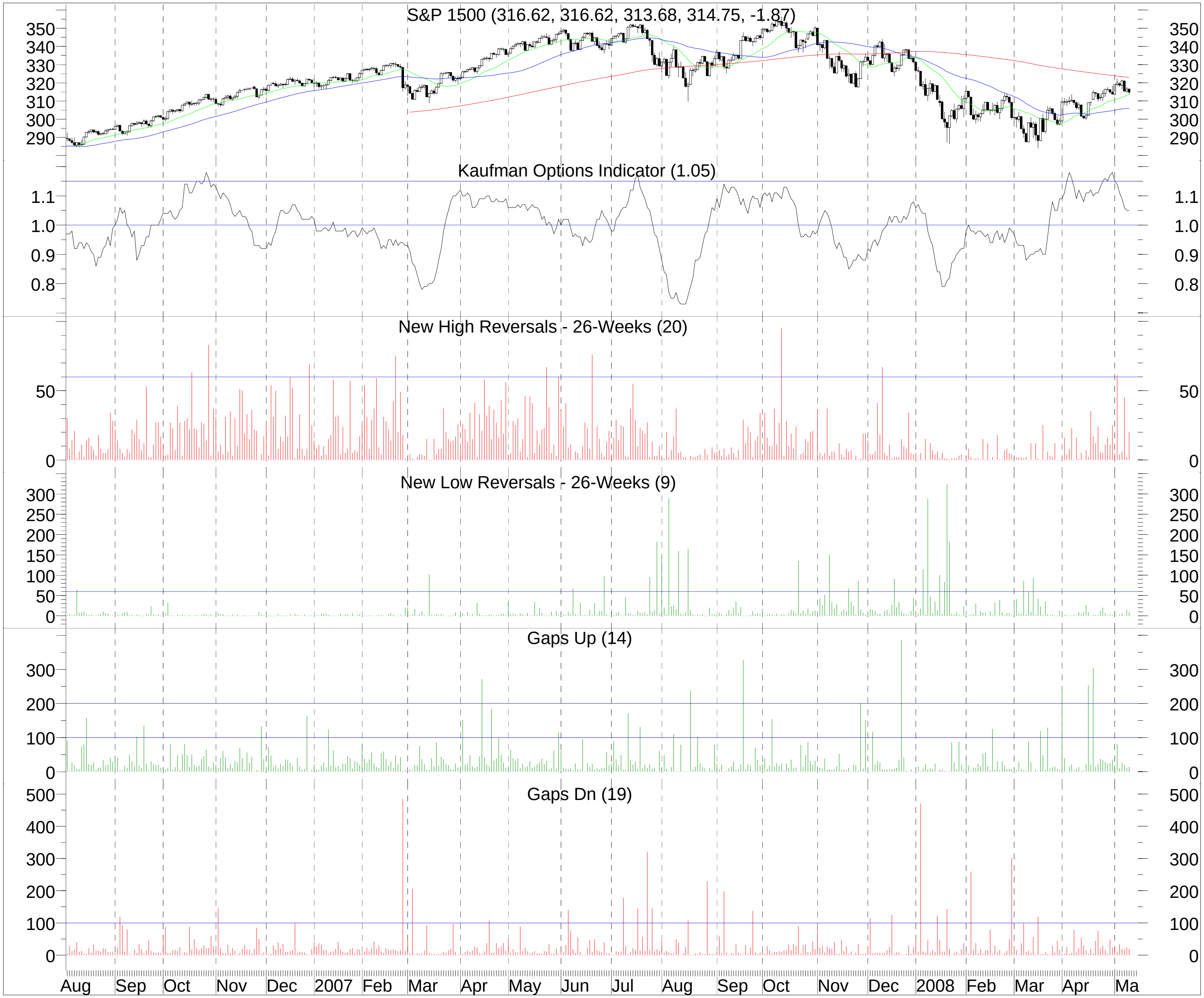
The S&P 1500 recently broke out of a reverse head & shoulders pattern with a target of the 339 area. There is another pattern on the chart, a bearish rising wedge. The index was repelled by the top line of the wedge on May 2nd, and on Friday the index bounced off the 20-sma and the bottom line of the rising wedge. A break through the bottom could lead to a sharp drop.



The 10-sma of 13-week closing highs is still much higher than the 10-sma of lows.

Volume was light during last week's pullback.

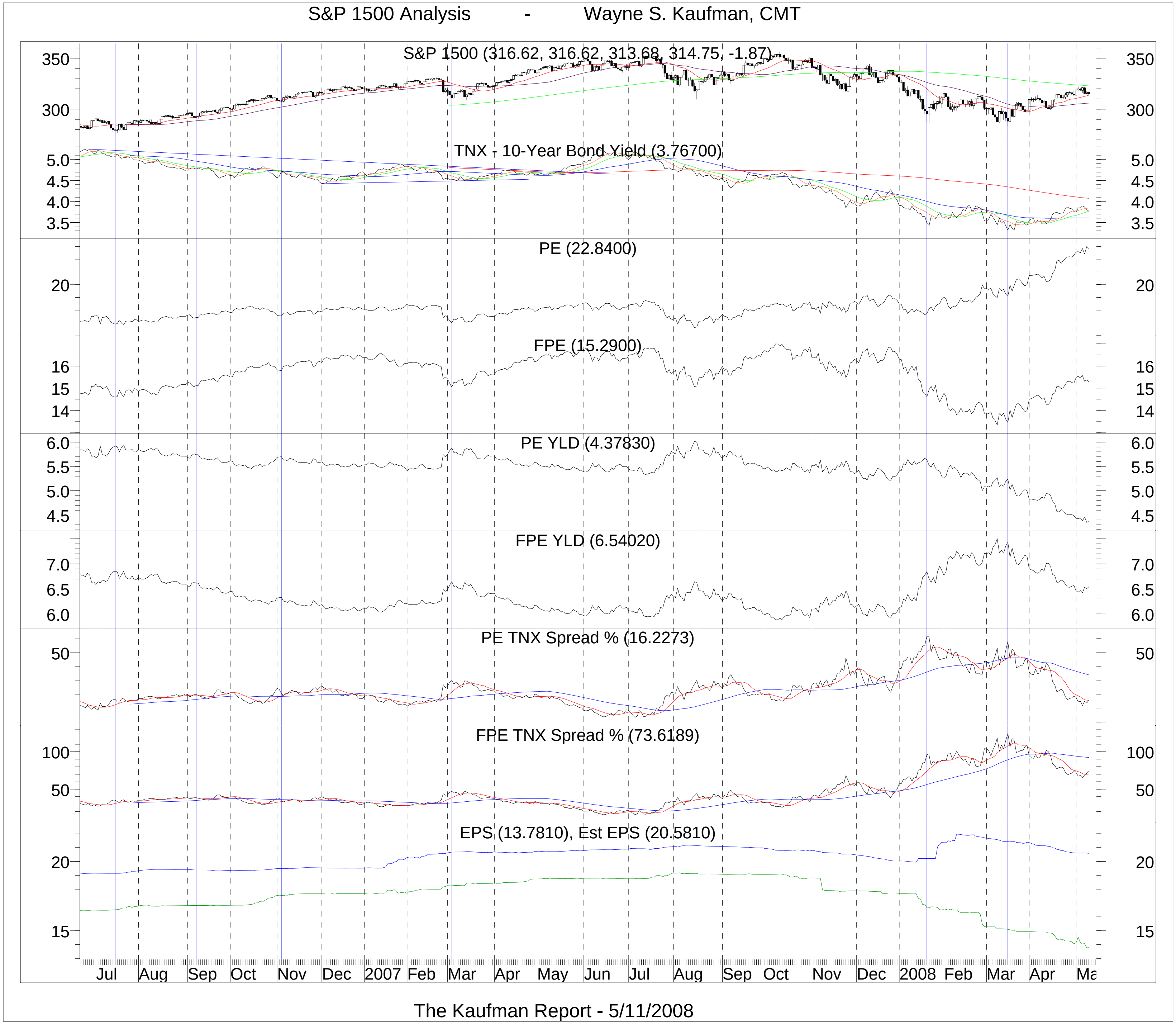
S&P 1500 Analysis - Wayne S. Kaufman, CMT



Our proprietary options indicator has dropped after reaching levels of extreme bullishness where stocks have always pulled back. Current levels show some bullishness on the part of options buyers

Last week we pointed out that the 61 new high reversals on May 2nd was a number that usually preceded weakness in stocks, and that held true once again.

Our 10-day statistics of supply (red lines) have crossed above the 10-day statistics of demand (green). However, so far there has been no big increase in selling pressure.

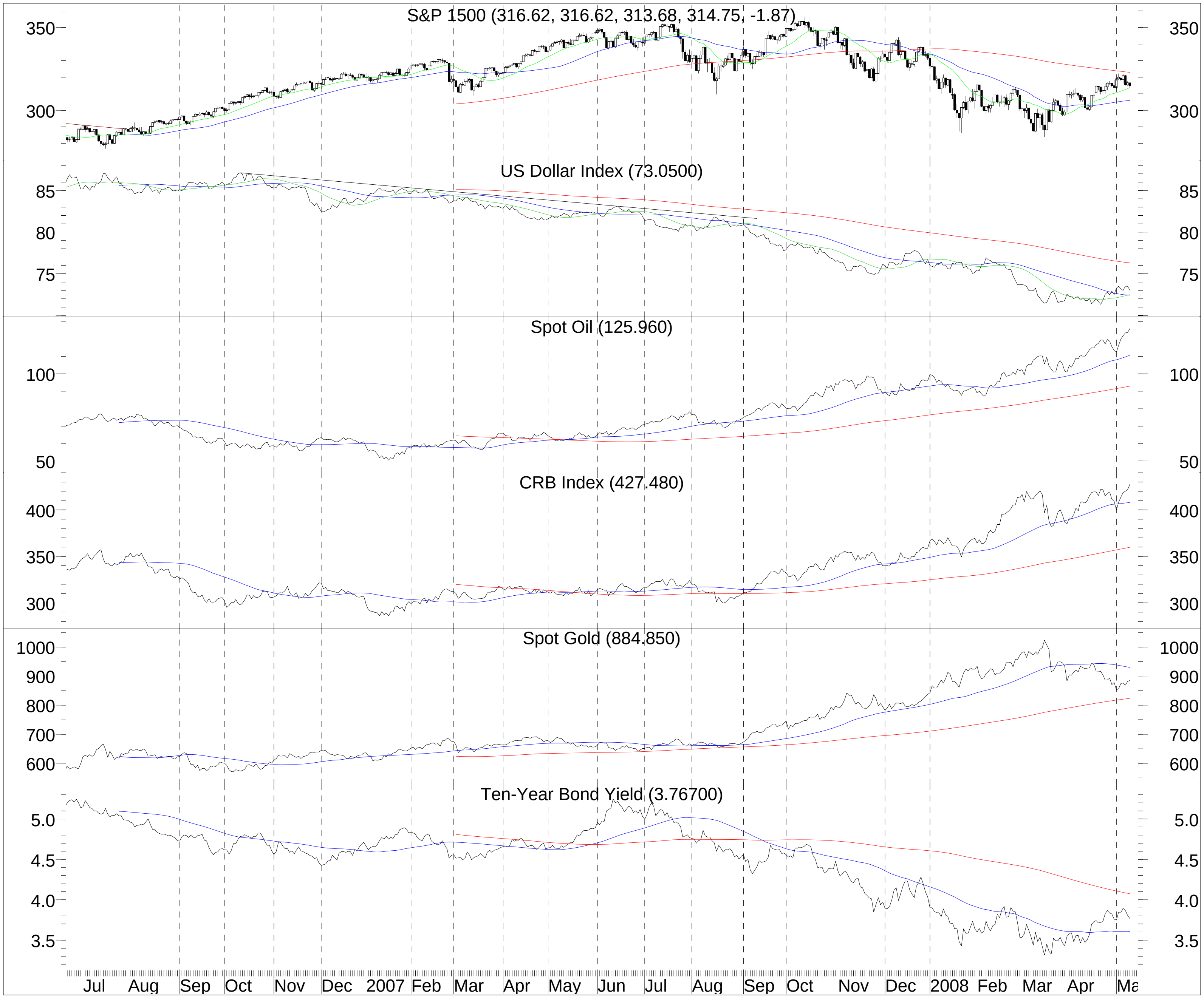


10-year bond yields have moved higher since bottoming in mid-March, but they have resistance at the 3.9 - 3.96 area and they have moved back below the 20-sma.

The P/E ratio hit the highest level since early 2004 last week.

Current earnings (green) continue to move lower, while projections may be leveling off. The spread between the two is very extreme and can't last at such a wide level much longer.

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



The U.S. Dollar Index has been showing strength since bottoming mid-March.

Oil continues to make new highs in spite of strength in the U.S. Dollar. This shows strong demand.

The commodities index is also making new highs.

Gold has been weak, which is in line with its classic inverse relation-ship to the U.S. Dollar. Last week we said it may be ready to rebound, and it did move higher. It looks like there is still upside even though it is just under the 20-sma (not shown).