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 May 19, 2008 **Closing prices of May 16, 2008**

We have discussed many of the bullish developments in the stock market for the last few weeks, most notably the Dow Theory buy signal, the bullish breakout from the inverse head & shoulders pattern, and the big improvements in many statistics of market breadth.

We would be remiss not to point out some potential negatives which should keep investors on their toes. The one that concerns us the most is the narrowing of the spread between the 10-year bond yield and the earnings yield of the S&P 1500 based on the current P/E. That spread is now at the same level it was at on July 23, 2007, which was the beginning of a very sharp correction. In June 2007 the spread was even lower than where it was on July 23rd, so the condition can persist even as stocks go higher as they did then. However, at some point the attractiveness of stocks versus bonds begins to diminish, and sellers step in.

The spread based on the forward P/E is still at levels where stocks should be attractive versus bonds. This should put a floor under stock prices when we have the inevitable periods of short-term weakness, and may allow the rally to continue in spite of a further narrowing of the spread based on the current P/E. The key point here is that current and forecast earnings cannot continue to move lower without jeopardizing the current rally.

From a purely technical standpoint there is concern based on the ability of the major indexes to move decisively through their 200-day moving averages which have come into play. The Nasdaq 100 is well above its 200-day moving average, but the Dow Industrials and the S&P 500 are still fighting with theirs. Also, the S&P 1500 is nearing the apex of the bearish rising wedge it is in, and that pattern will be resolving soon.

Due to the factors stated above, we advise caution in the near-term, specifically meaning care when selecting 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 consolidation or 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 90% probability that the Fed will *leave rates at 2.00%,* and a 10% probability of *cutting another 25 basis points to 1.75* when they meet again on June 25th.

The S&P 1500 (323.44) was up 0.127% Friday. Average price per share was down 0.08%. Volume was 102% of its 10-day average and 100% of its 30-day average. 40.07% of the S&P 1500 stocks were up on the day. Up Dollars was 50% of its 10-day moving average and Down Dollars was 102% of its 10-day moving average. For the week the index was up 2.76% on decreasing and below average weekly volume.

Options expire June 20th. The FOMC meets June 25th.

IMPORTANT DISCLOSURES

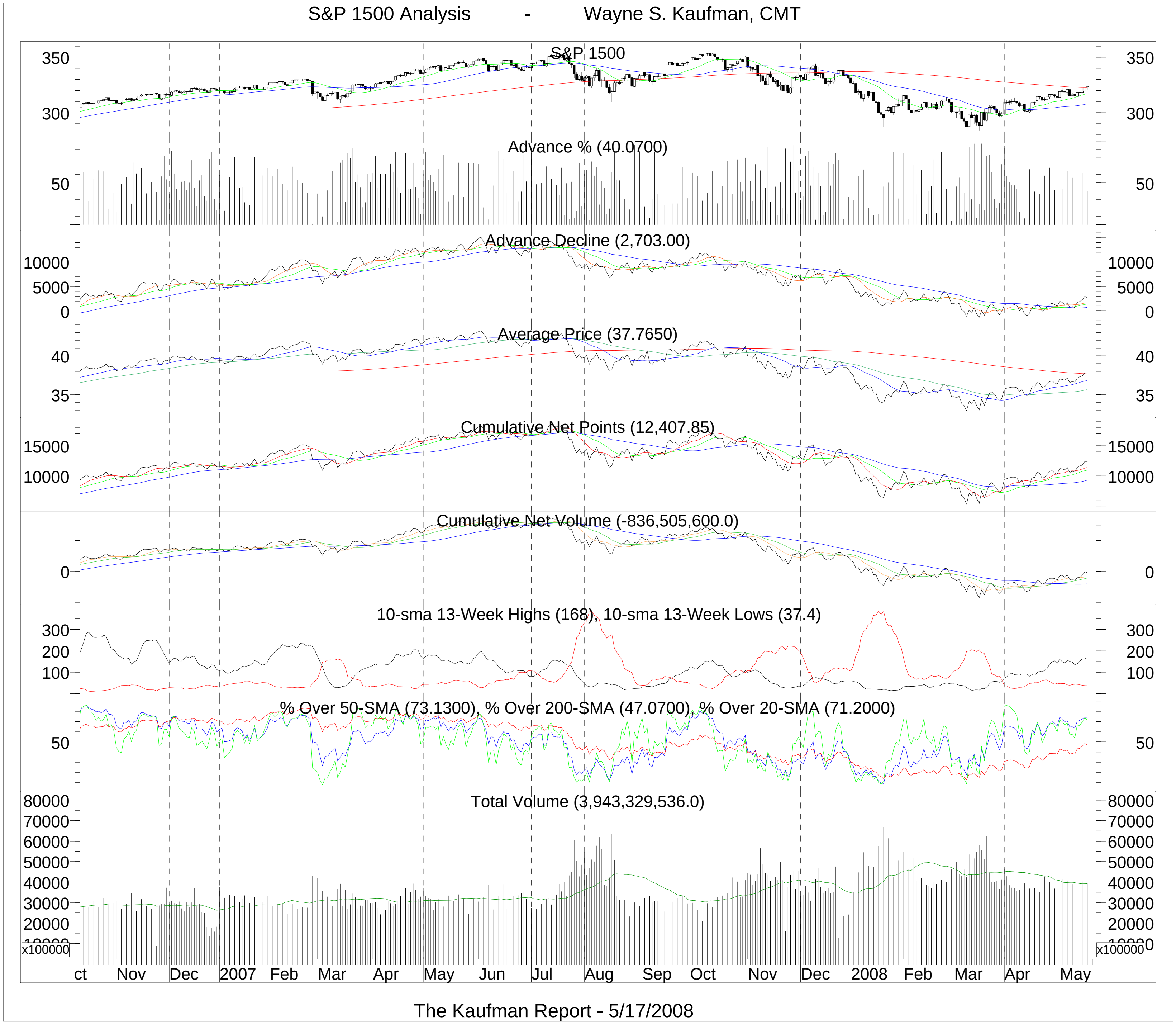
The S&P 1500 closed above the 200-sma (red) for the second day in a row.

Our oscillators are at high levels.

New highs have been expanding to the highest levels of 2008.

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

The S&P 1500 continues to move higher within the bearish rising wedge pattern. The resolution of this pattern will be arriving shortly. The other important pattern on the chart is the inverse head & shoulders pattern which has a target of the 339 area.



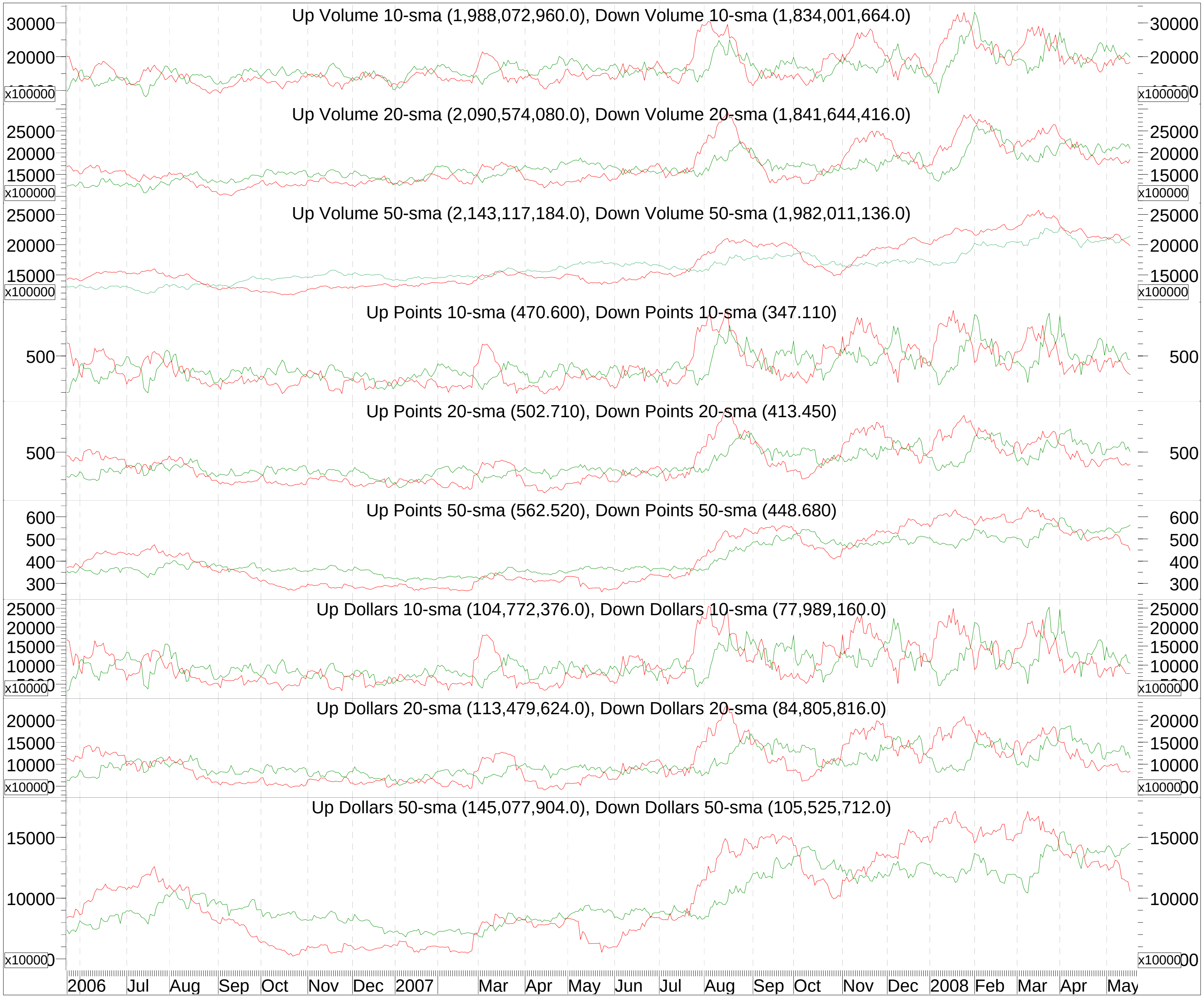
Our statistics of market internals are not showing divergences at this time.

The 10-day moving average of 13-week closing highs is at the best level since June 5, 2007.

Our proprietary options indicator is neutral, which is good. As can be seen on the chart, too much bullishness always leads to drops in stock prices.

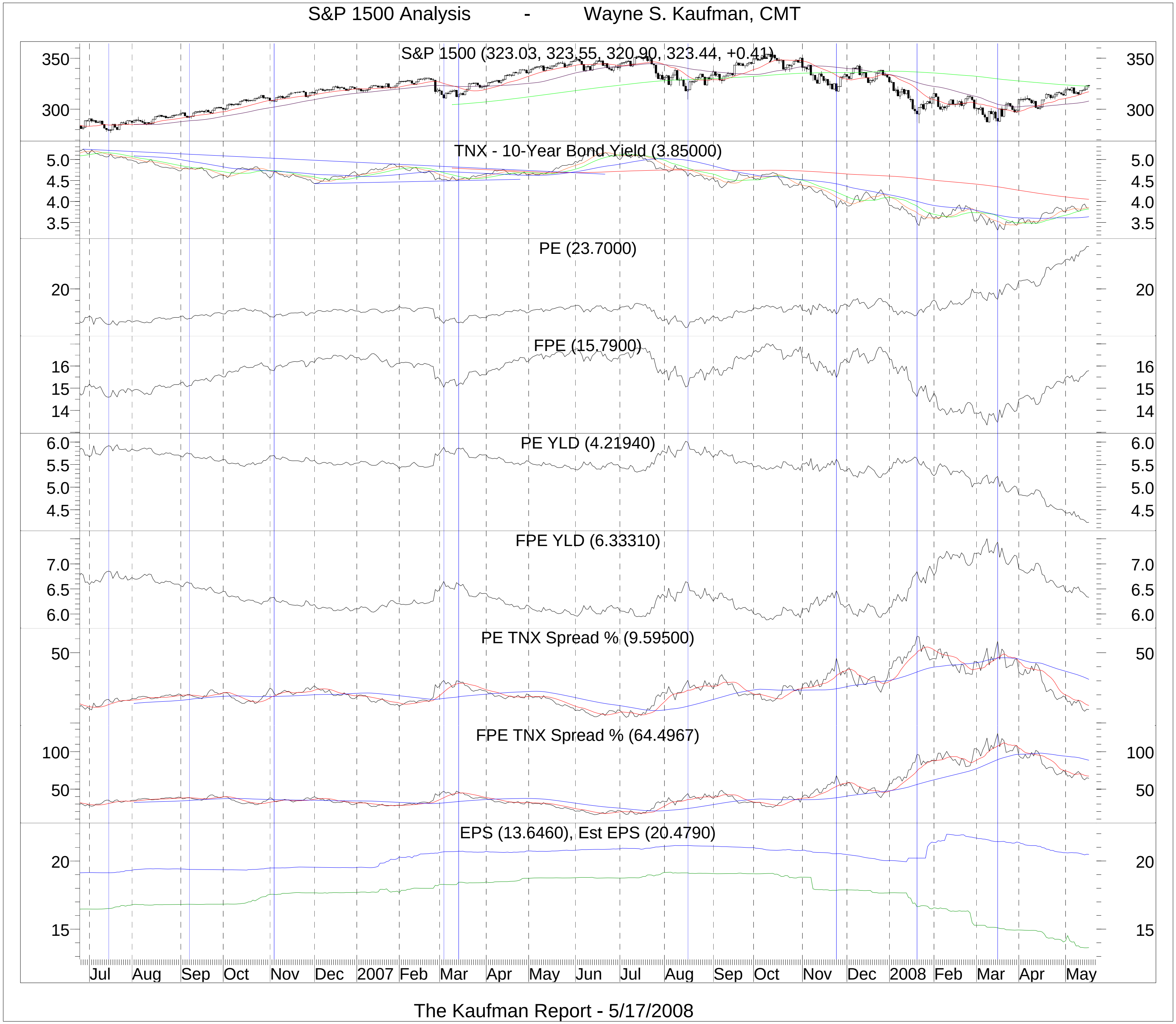
New high reversals have increased lately, showing an increased desire to take profits as the 200-sma has come into play.

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



Our statistics of demand (green) are positive versus our statistics of supply (red).

Unfortunately, buying enthusiasm has been diminishing recently. It is easily seen that the 10-day statistics of demand (green) are less than their 20 and 50-day counterparts. This is also true for the supply statistics, but unless this changes and buying pressure increases, the rally will be vulnerable to short-term pickups in selling.

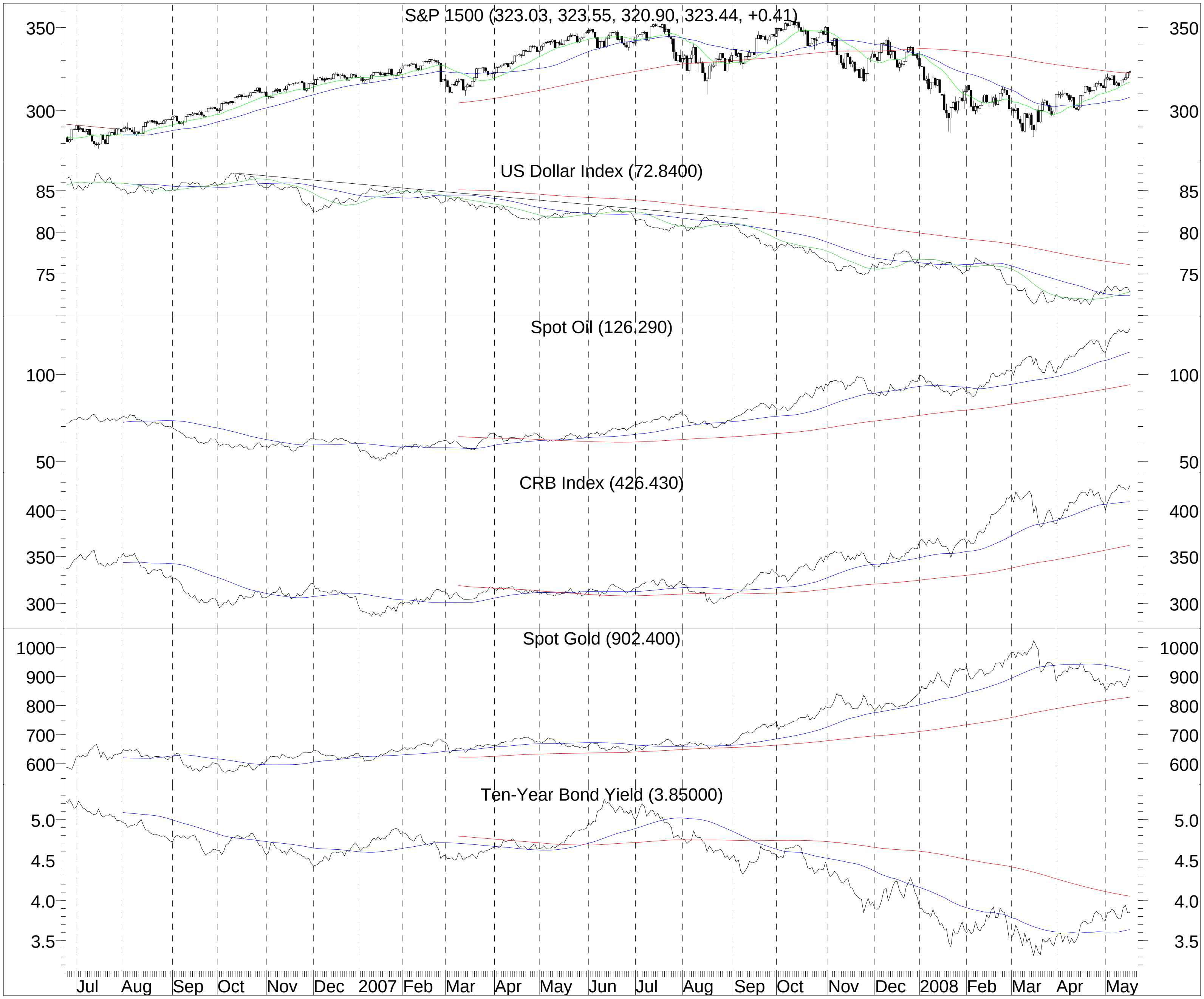


The P/E ratio is still moving higher, and is at the highest level since late 2003.

The forward P/E is at average levels, but forecasts need to be met and not continue to be lowered.

The spread between the 10-year bond yield and the current earnings yield does not make stocks attractive. The spread based on the forward earnings yield still makes stocks look attractive versus bonds. Again, current and forecast earnings need to stop moving lower.

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



Oil traded at a record high last week, but there is a negative divergence on the daily RSI and the weekly RSI is in the overbought zone.

Two weeks ago we said gold was attempting to find a bottom. It did and now is back above its 20-sma (not shown). The 50-sma is above at 916.