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The Kaufman Report

Trade what you see, not what you think.

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Wednesday May 21, 2008 **Closing prices of May 20, 2008**

In Sunday's report we advised caution in the near-term when selecting entry points. We said we were concerned with 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 was at the same level it was at on July 23, 2007, which was the beginning of a very sharp correction.

We were also concerned about the ability of the major indexes to move decisively through their 200-day moving averages which had come into play, and that the S&P 1500 was nearing the apex of the bearish rising wedge it is in, and that pattern would be resolving soon.

Those conditions still exist, although the current P/E spread has widened a little the last two sessions. 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 as long as earnings forecasts do not continue their recent inexorable march lower.

The bearish rising wedge pattern is nearing some resolution as price is near the apex of the wedge. On Monday the rally reversed when the S&P 1500 hit the top line of the wedge, and on Tuesday there was a bounce when it approached the bottom support line. A break one way or the other is imminent.

We still advise caution in the near-term, but we do not believe any pullbacks will be deep.

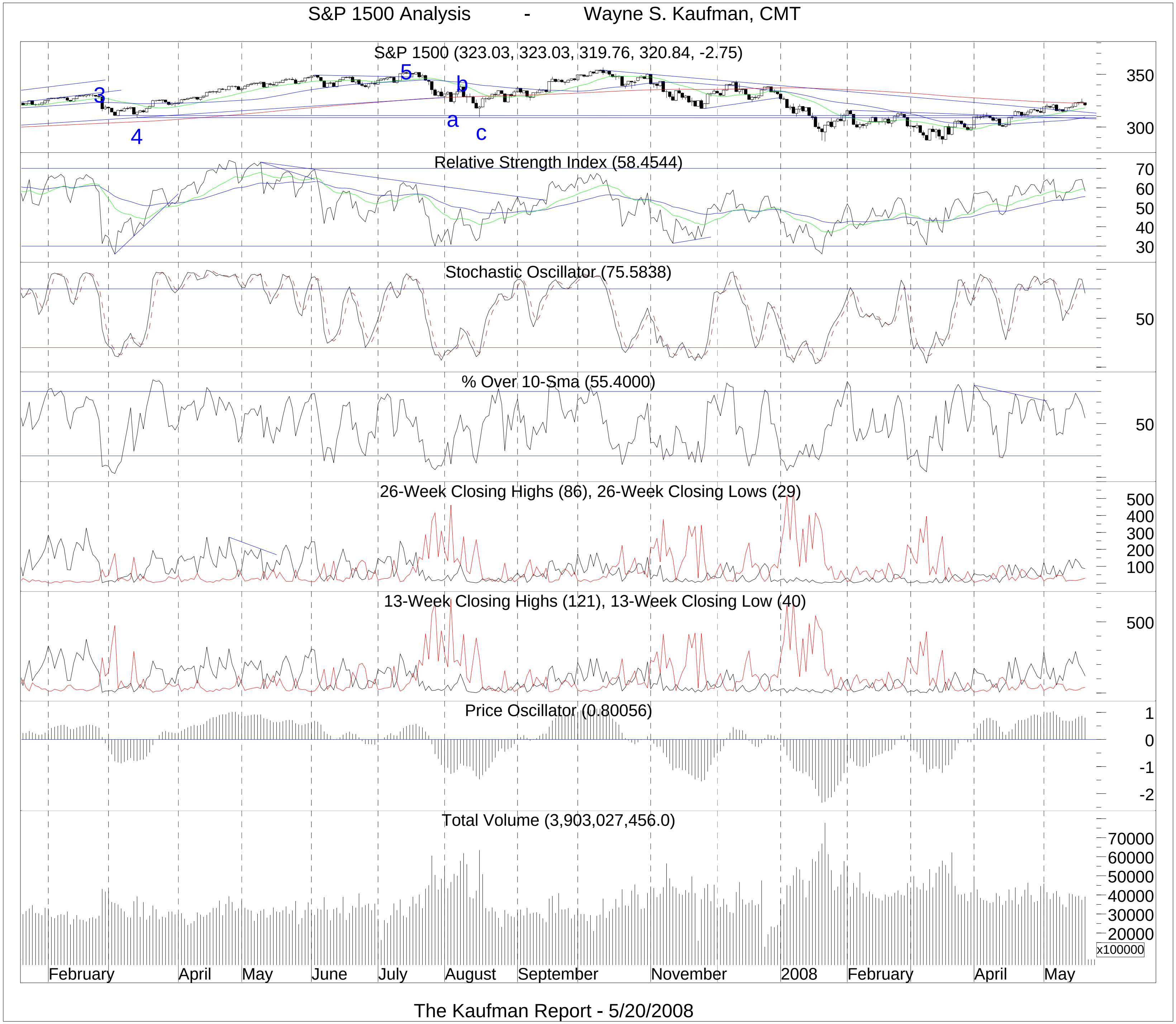
Our strategy for some time has been to buy leading stocks while watching for sector rotation and being prepared for the down trend to resume. We continue to follow that course of action while hoping that after a brief consolidation or pull back stocks will strengthen and successfully challenge the last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

Federal Funds futures are pricing in an 88% probability that the Fed will *leave rates at 2.00%,* and a 12% probability of *cutting another 25 basis points to 1.75* when they meet again on June 25th.

The S&P 1500 (320.84) was down 0.85% Tuesday. Average price per share was down 0.56%. Volume was 101% of its 10-day average and 99% of its 30-day average. 30.77% of the S&P 1500 stocks were up on the day. Up Dollars was 16% of its 10-day moving average and Down Dollars was 180% of its 10-day moving average.

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

IMPORTANT DISCLOSURES



The S&P 1500 has fallen back below the 200-sma (red) but is still above the 20-sma (green). It hit resistance Monday at the top of the bearish rising wedge and found support Tuesday at the bottom line of the wedge.

Our oscillators are still at high levels, although not overbought.

In spite of Tuesday being a down day there were more new highs than lows.

Our price oscillator is in positive territory.

Volume was average Tuesday.

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

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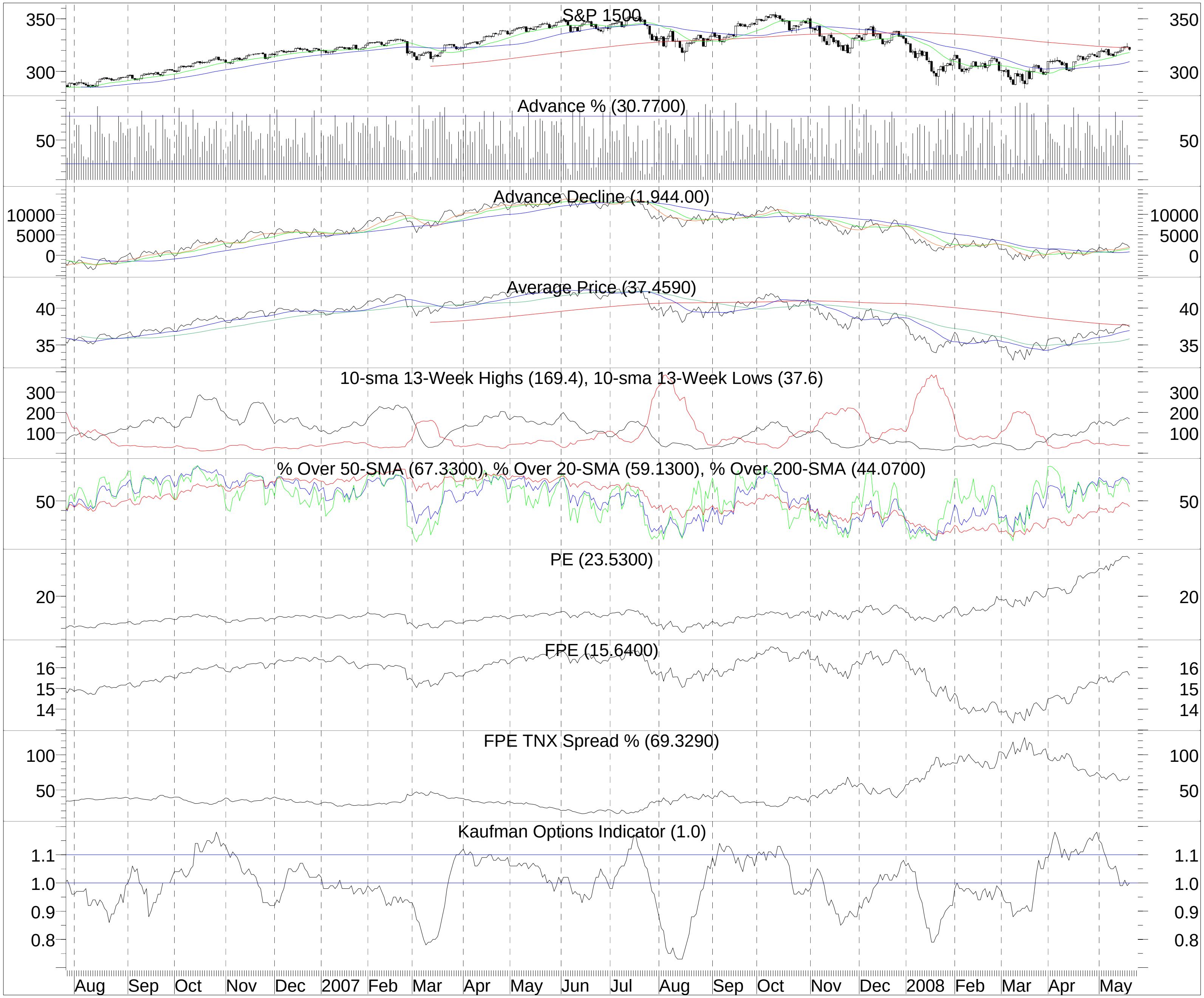
The S&P 1500 hit resistance at the top of the bearish rising wedge, then bounced as it got near the support line of the wedge. It has to break out of the pattern soon with the apex not far away.

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



Only 30.77% of the S&P 1500 traded higher Tuesday.

The spread between the 10-year bond yield and the forward P/E earnings yield is still at a level where stocks are attractive versus bonds.

Our proprietary options indicator is neutral, so we don't think this pullback will be deep.