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 November 10, 2008 **Closing prices of November 7, 2008**

The stock market of 2008 continues to make history. It is on pace to be the worst year since the 1930s. October was one of the worst months ever, and near the end of the month had one of the best weeks ever. The Election Day rally was the best ever, followed immediately by the worst post-election day ever. The two-day post-election stock plunge was the worst since 1987.

Opinions regarding the Presidential election were very polarized, and opinions about the direction of stocks seem to share a similar dichotomy. One group feels that the drop in stocks has been so extreme that anyone with a reasonable time horizon should be buying stocks. They point out the common knowledge that stocks bottom six to nine months before the economy picks up, and they also back up their position with statistics such as historical valuations, the average length of bear markets, the average drop of stocks during bears, and they point out the carpet bombing of liquidity into the financial markets by governments around the globe.

The other side maintains that the trend in earnings is down and valuations based on projections can't be trusted, the economy is in a severe recession and is likely to get worse before it gets better, there is still no transparency regarding the value of the toxic assets which are owned around the globe, and the optimism created by huge government bailouts and infusions of liquidity is unjustified.

We find it difficult to disagree with the second group. We have expressed many times our lack of confidence in Paulson and Bernanke. In the first paragraph we listed some of the noteworthy aspects of 2008. We can add to that the list of names of once great companies that are no longer around or are trading under $5: Lehman, Merrill Lynch, Bear Stearns, Fannie Mae, Freddie Mac, Washington Mutual, AIG, etc. We have said many times we are waiting for GM to be kicked out of the Dow Jones Industrials, and now the survival of GM is up in the air. Our question is should investors rely on averages of bear markets when we are experiencing a financial and economic collapse of historical proportions?

Stocks have been in a trading range since early October. We had been hopeful of seeing a multi-week bear market rally, but that rally is in jeopardy as stocks have fallen below the 20-day moving average and the mid-way point of the trading range. This greatly increases the odds of a retest of the October lows. The recent rally was helped by sellers stepping back, not by a big increase in buyers. Sellers reappeared dramatically Wednesday and continued with no letup through Thursday. Friday's rally was on decreasing volume. Investors now need to be on high alert for signs of further deterioration which could lead to another retest of the lows of October 10th, or even a move below it. Stocks may be ready to make another leg down, and the last stages of waterfall declines can be very painful.

The short, intermediate and long-term trends are down. We reiterate that this continues to be an opportunistic trader's market, with adept traders able to take advantage long or short, but the primary downtrend must be respected. Investors need to be alert to sector rotation and should not hesitate to move out of lagging sectors and stocks and into leaders.

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The S&P 1500 (210.59) was up 2.805% Friday. Average price per share was up 2.19%. Volume was 85% of its 10-day average and 75% of its 30-day average. 77.53% of the S&P 1500 stocks were up on the day, with up volume at 80.6% and up points at 86.7%. Up Dollars was 97.8% of total dollars, and was 108% of its 10-day moving average while Down Dollars was 3% of its 10-day moving average. The index is down 4.07% month-to-date, down 36.45% year-to-date, and down 42.52% from the peak of 356.38 on 10/11/07. Average price per share is down 43.51% from the peak of $43.23 on 6/4/2007. For the week the index was down 4.07% on decreasing and below average weekly volume.

The Put/Call Ratio was 0.97. The Kaufman Options Indicator was 1.00.

The spread between the reported earnings yield and 10-year bond yield is 31.22% and 121.38% based on projected earnings.

Reported aggregate earnings for the S&P 1500 peaked in August 2007 at $19.18 and are now at $10.45, a drop of 45.52%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $17.69, a drop of only 19.41%. Analysts have obviously been very late in lowering estimates, and have also been way too optimistic. *If investors had any confidence in current earnings estimates stocks would be much higher than they currently are.*

442 companies in the S&P 500 have reported third quarter earnings. According to Bloomberg, 57.4 % have had positive surprises, 10.2% have been in line, and 32.4% have been negative. The year-over-year change has been -12.5% on a share-weighted basis, +6.2% market cap-weighted, and +0.2% non-weighted. Ex-financial stocks these numbers are 11.9%, 25.1%, and 19.1%, respectively.

Federal Funds futures are pricing in an 97.0% probability that the Fed will *cut rates 50 basis points to 0.50%,* and a 3.0% probability of *cutting75 basis points to 0.25%* when they meet on December 16th. They are pricing in a 62.2% probability that the Fed will *cut rates 25 basis points to 0.75%* on January 28th, and a 35.9% probability of *cutting 50 basis points to 0.50%.*

The short, intermediate and long-term trends are down. We reiterate that this continues to be a bifurcated, opportunistic trader's market, with adept traders able to take advantage long or short, but the primary downtrend must be respected. Investors need to be alert to sector rotation and should not hesitate to move out of lagging sectors and stocks and into leaders.

Options expire November 21st. December options expire the 19th.

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

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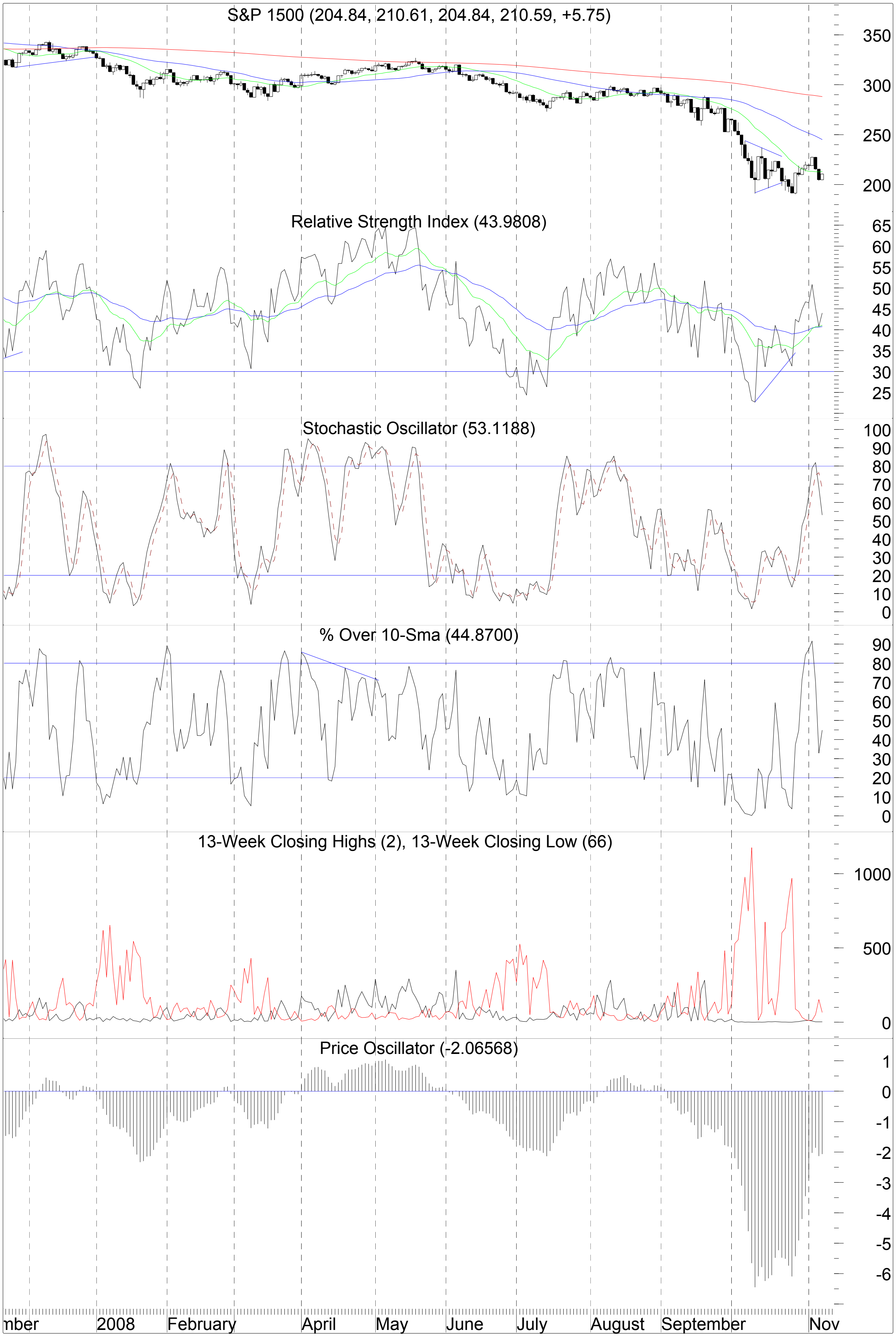
The S&P 1500 fell back below its 20-sma (green) Thursday and has fallen below the 50% level of the sideways trading range it has formed since early October. This increases the odds of another retest of the October lows.

A glance at the weekly chart of the S&P 500 shows why we called this a bear market back in January.

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

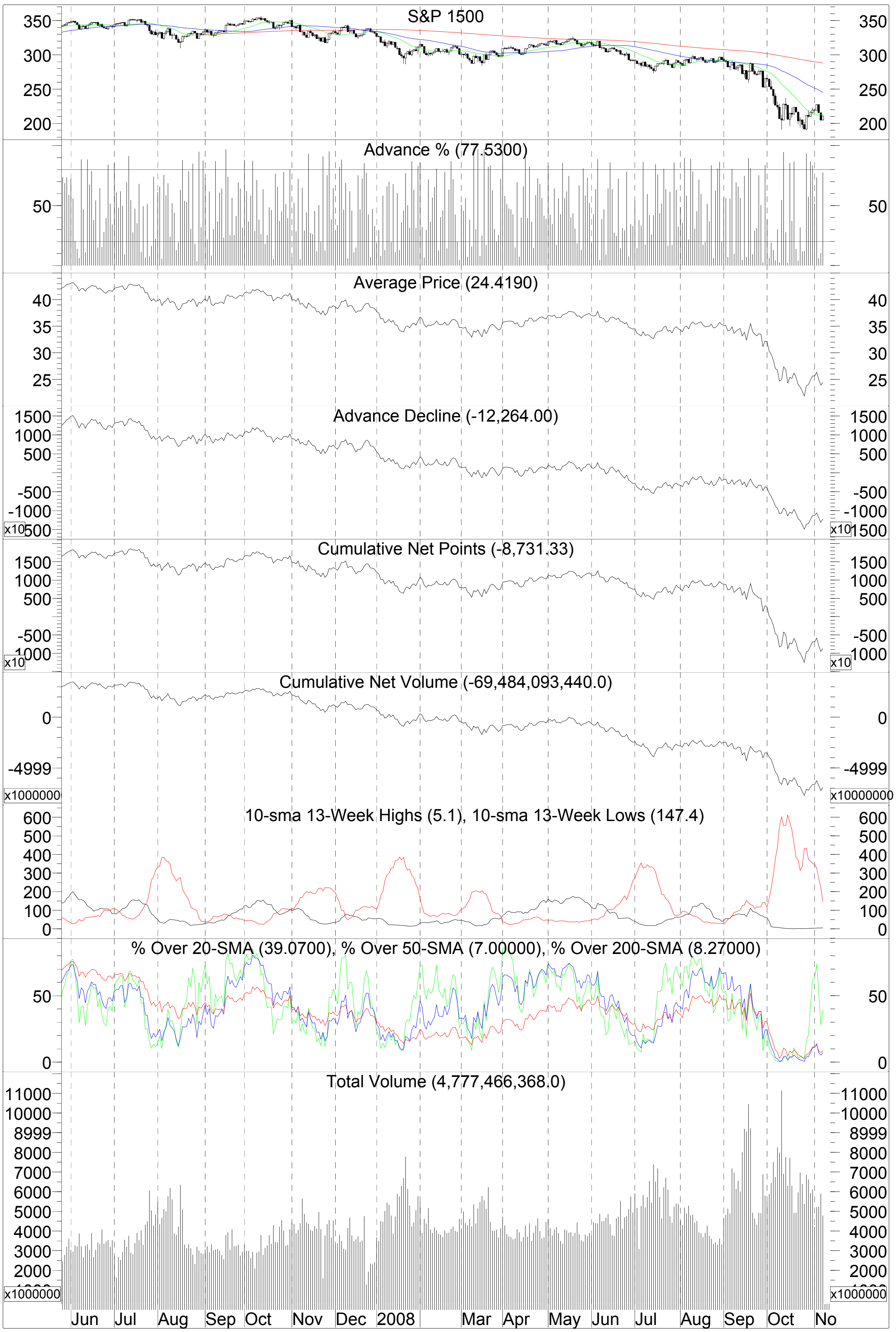


The RSI and percent over 10-sma are neutral, but the stochastic is just under the overbought zone, so more sideways or lower for stocks is indicated.

New highs and lows won't change much until stocks move out of the current trading range.

The price oscillator remains in negative territory.

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



77.53% of stocks traded higher Friday.

Our statistics of market internals confirmed the closing low of the index on October 27th. That same day we had the Dow Industrials and Transports also make new closing lows, which confirms the bear market based on Dow Theory.

Volume receded during Friday's rally.

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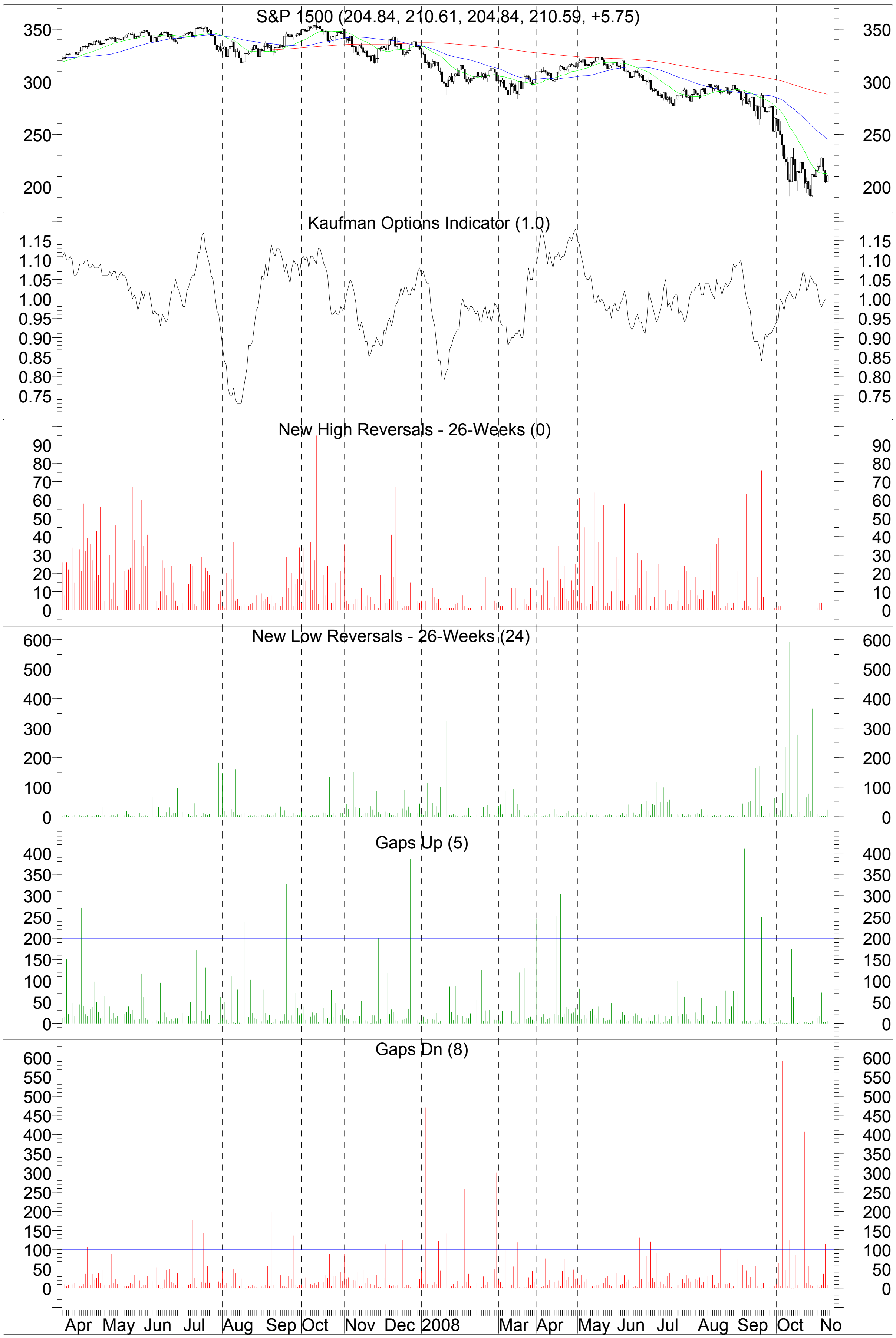
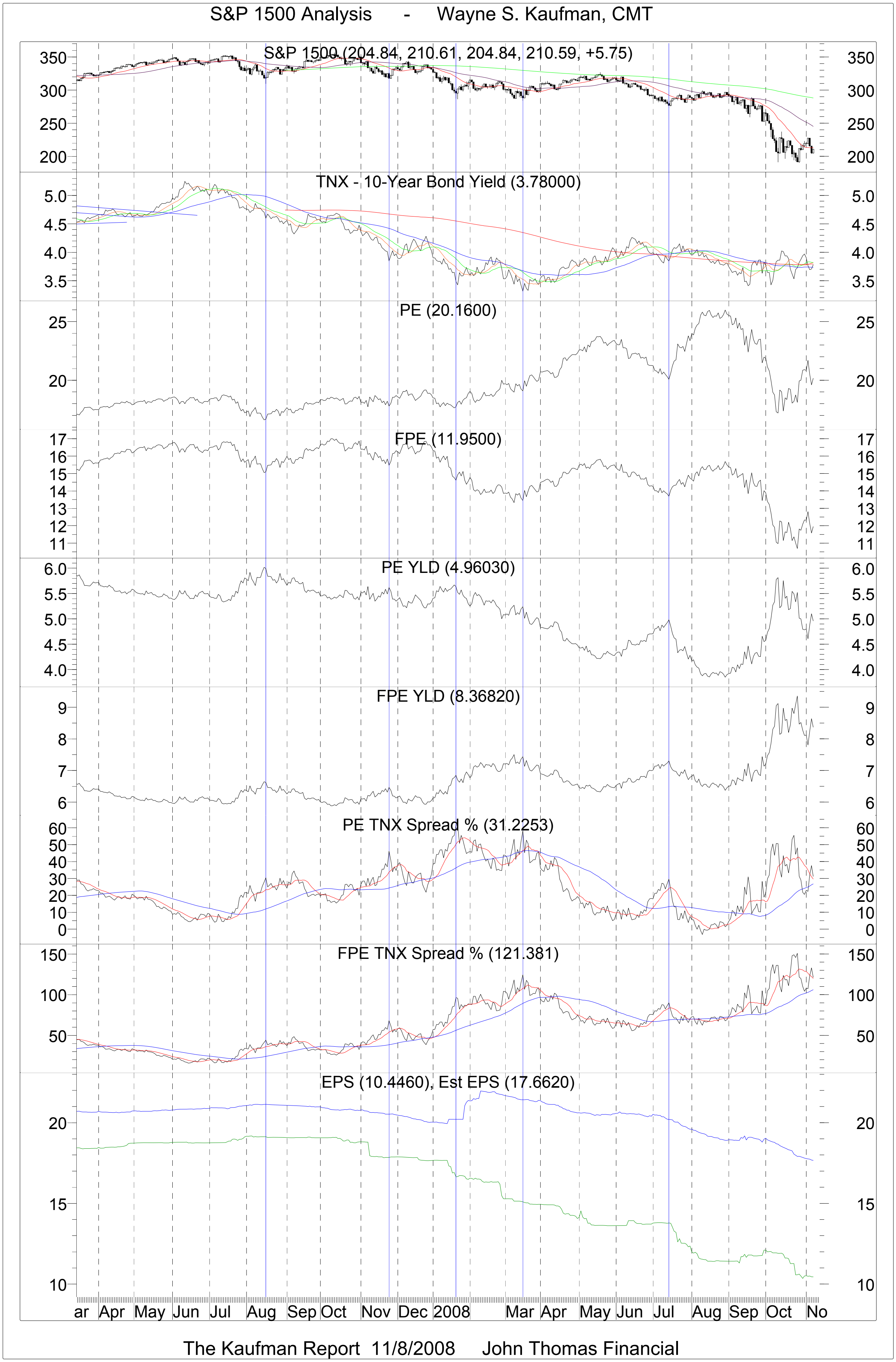


Our proprietary options indicator is neutral.

Over 100 gaps down on Thursday is a negative. Days like this have frequently been followed by weakness.

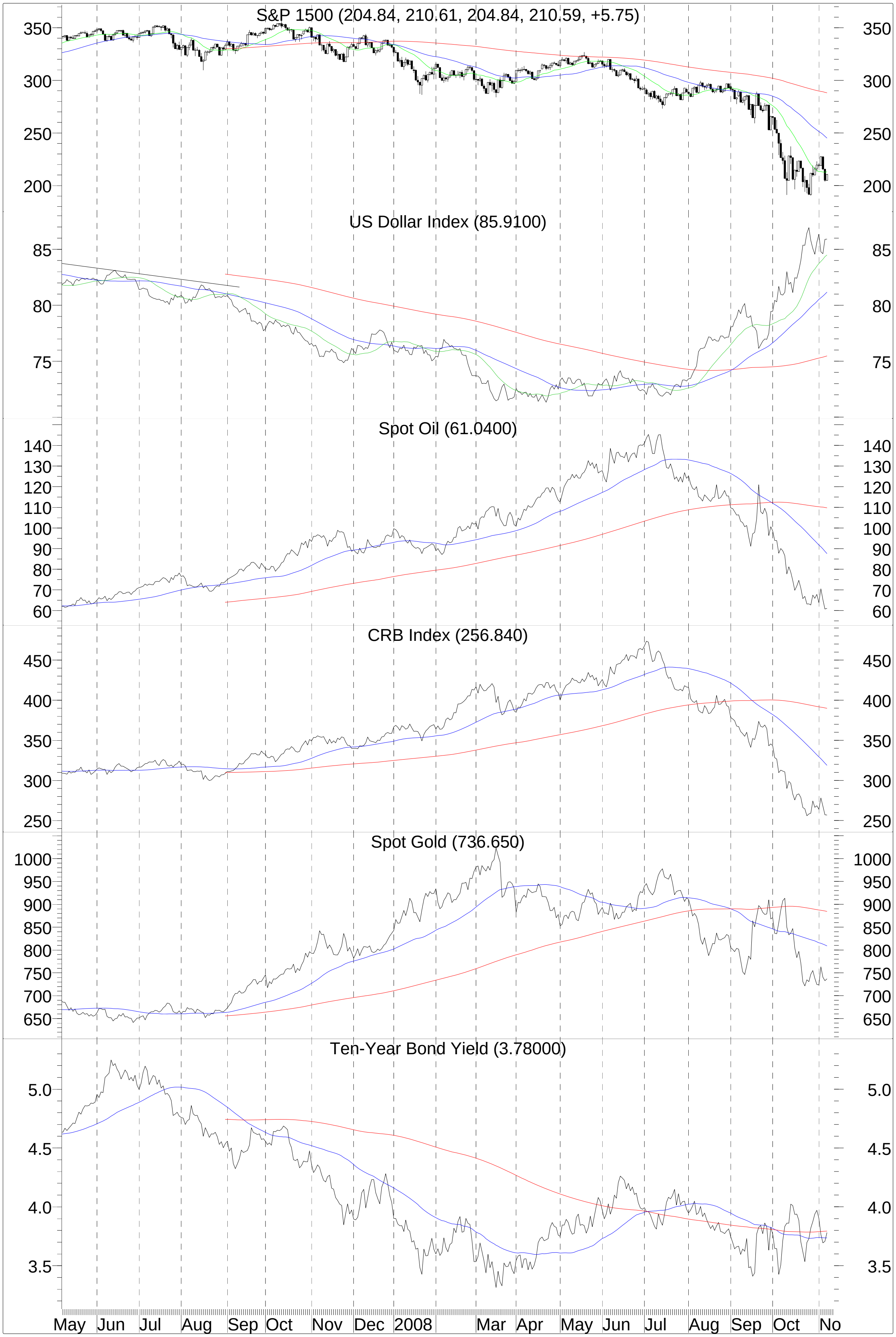
A glance at our 10-day statistics of supply (red lines) versus demand (green lines) shows that sellers have stepped back while buyers have been steady. However, the 5-day numbers (not shown) showed an increase in sellers, so the next week or so is very important.



The P/E ratio is much higher than it was at the recent bottom for stocks.

Reported and projected earnings continue to move inexorably lower, but with earnings season coming to an end they should level off soon, at least for a couple of weeks.

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



The U.S. Dollar Index has formed a triangle (not shown) and may be ready for a final move higher.

The picture on crude oil is mixed, but the down trend is still intact until proven otherwise.

Commodities look like they are trying to bottom in the short-term, but here too the picture is mixed in the longer-term.

Gold also looks like it is trying to bottom.