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The Kaufman Report

Trade what you see, not what you think.

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Monday November 17, 2008 **Closing prices of November 14, 2008**

Last Sunday we warned that "stocks may be ready to make another leg down, and the last stages of waterfall declines can be very painful." This proved accurate as the S&P 1500 dropped 6.42% for the week.

Thursday was the most noteworthy day as the major indexes broke below the bottoms of the trading range that has been in place since October 10th. Stocks then staged a terrific rally where the S&P 1500 closed 11.38% off the lows of the day. In doing so the index printed a bullish engulfing candle on a key reversal day. 437 of the S&P 1500 stocks made new intra-day lows but reversed to finish higher on the day. This was a very high number, and usually would be a very bullish sign.

Our problem is that we do not yet see the signs that buyers are rushing back in to grab stocks. In an environment where demand is slack, increases in supply caused by forced liquidations of hedge funds and mutual funds will drive prices lower, even if valuations, as some would maintain, have become reasonable.

In the very short-term, major indexes bounced up to levels just under resistance and were repelled in a harsh close to Friday's session. The next few sessions should tell us if Thursday's dramatic turnaround was just another short covering rally caused by extreme oversold conditions, or if longer-term investors started coming back to the market. This week is November options expiration, so it doesn't seem like an end to the extreme volatility is in sight.

In the meantime our warning about the last stages of waterfall declines is still in effect, and we still believe there is a good chance at some point of a retest of the lows of 2002.

We wrote essays a while back that were very critical of Paulson and Bernanke, and also questioning the original bailout plan. The shift in strategy by Paulson & Co. regarding the TARP, the need for more funding by AIG, and the mind numbing $25 billion third quarter loss announced on Friday by Fannie Mae highlight the lack of understanding and planning on the part of our public servants regarding the financial crisis.

We also have expressed our disdain for the three stooges Nancy Pelosi, Barney Frank, and Harry Reid. We will spare everyone another rant here, but we hope they do not make a bad situation even worse regarding the automobile companies. These entities have bad business models, and pumping money into them without big changes being made will only delay the inevitable and waste more taxpayer money.

<u>**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.**</u>

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The S&P 1500 (197.07) was down 4.335% Friday. Average price per share was down 5.11%. Volume was 106% of its 10-day average and 86% of its 30-day average. 5.88% of the S&P 1500 stocks were up on the day, with up volume at 15.0% and up points at 1.9%. Up Dollars was 1/6% of total dollars, and was 6/10% of its 10-day moving average while Down Dollars was 191% of its 10-day moving average. The index is down 10.23% month-to-date, down 25.90% quarter-to-date, down 40.53% year-to-date, and down 44.7% from the peak of 356.38 on 10/11/07. Average price per share is down 47.94% from the peak of $43.23 on 6/4/2007. <u>For the week the index was down 6.418% on increasing and just above average weekly volume</u>.

The Put/Call Ratio was 1.014. The Kaufman Options Indicator was 0.99.

The spread between the reported earnings yield and 10-year bond yield is 44.30% and 133.92% based on projected earnings.

Reported aggregate earnings for the S&P 1500 peaked in August 2007 at $19.18 and are now at $10.66, a drop of 44.42%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $17.29, a drop of only 21.23%. Analysts have obviously been very late in lowering estimates, and have also been way too optimistic. <u>*If investors had any confidence in current earnings estimates stocks would be much higher than they currently are.*</u>

468 companies in the S&P 500 have reported third quarter earnings. According to Bloomberg, 57.7 % have had positive surprises, 9.7% have been in line, and 32.6% have been negative. The year-over-year change has been -18.6% on a share-weighted basis, +5.4% market cap-weighted, and -1.8% non-weighted. <u>Ex-financial stocks these numbers are 11.2%, 24.5%, and 17.7%, respectively.</u>

Federal Funds futures are pricing in an 84.0% probability that the Fed will <u>*cut rates 50 basis points to 0.50%,*</u> and an 16.0% probability of <u>*cutting25 basis points to 0.75%*</u> when they meet on December 16th. They are pricing in a 60.5% probability that the Fed will <u>*cut rates 50 basis points to 0.50%*</u> on January 28th, and a 35.0% probability of <u>*cutting 25 basis points to 0.75%.*</u>

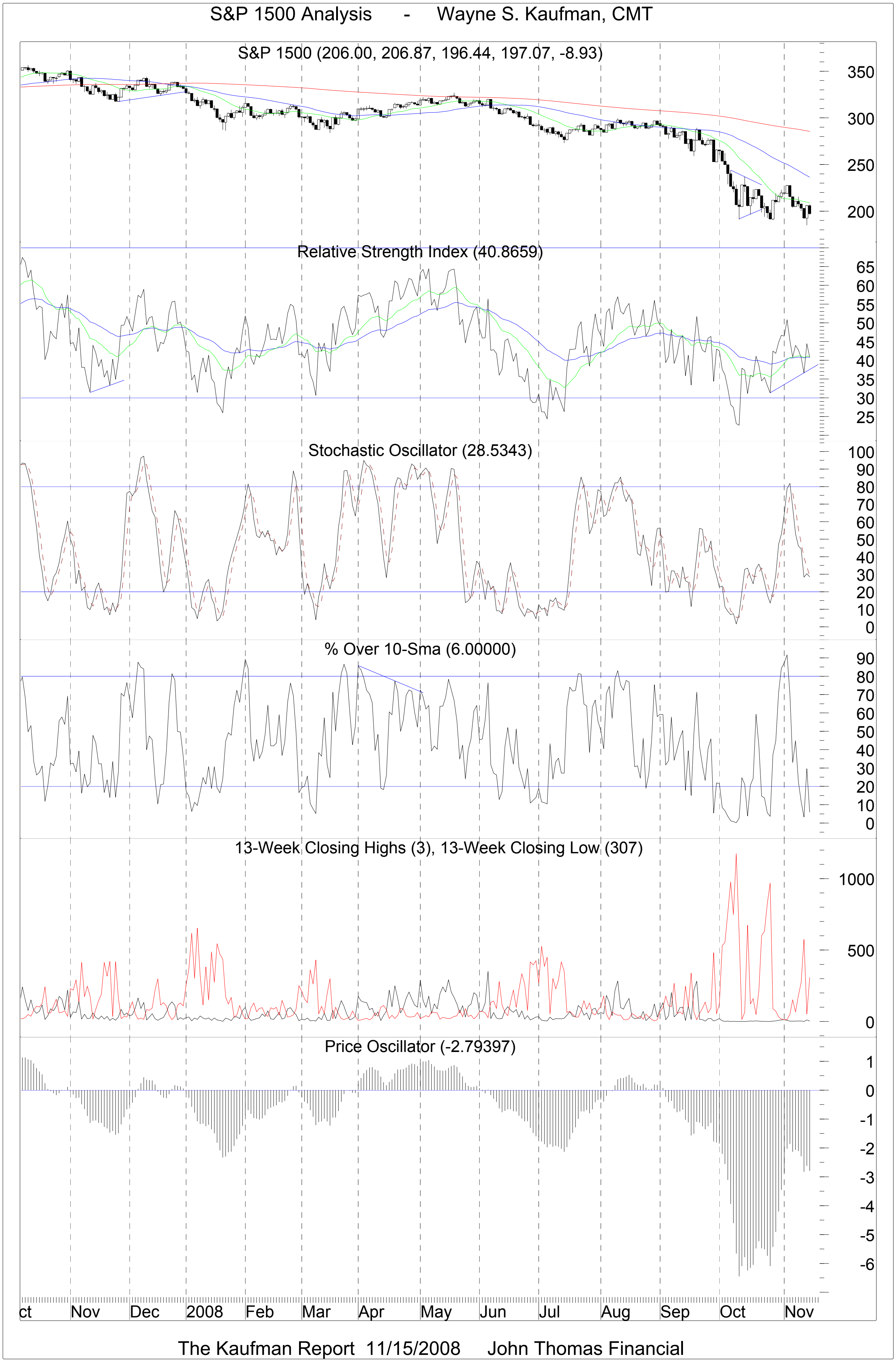
Options expire November 21st. December options expire the 19th.

IMPORTANT DISCLOSURES

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

The S&P 1500 sold off in the last hour Friday after rallying up to Thursday's high. We don't know yet if Thursday's key reversal bullish engulfing day is a bottom or just another sharp short-covering rally. The coming week has an options expiration, and hopefully the action this week will give us a better idea.

The weekly chart of the S&P 500 shows how extended it is from its major moving averages.



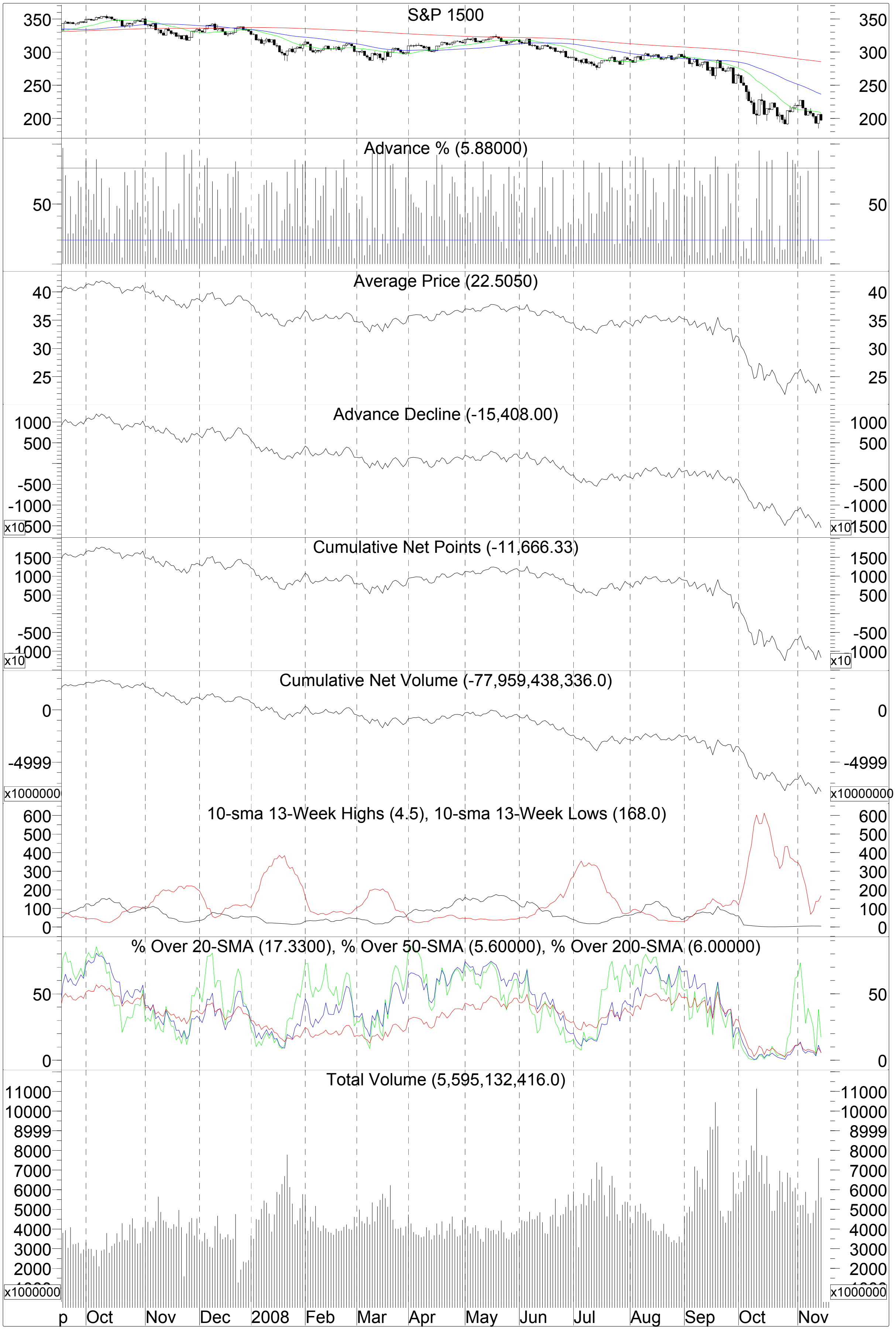
Our momentum indicators are still at low levels. There is still a positive divergence on the RSI.

The percent over 10-sma is still extremely oversold.

New lows has been showing a positive divergence.

Volume expanded Friday.

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



5.88% of stocks traded higher Friday.

Average Price Per Share did not make a new low Wednesday.

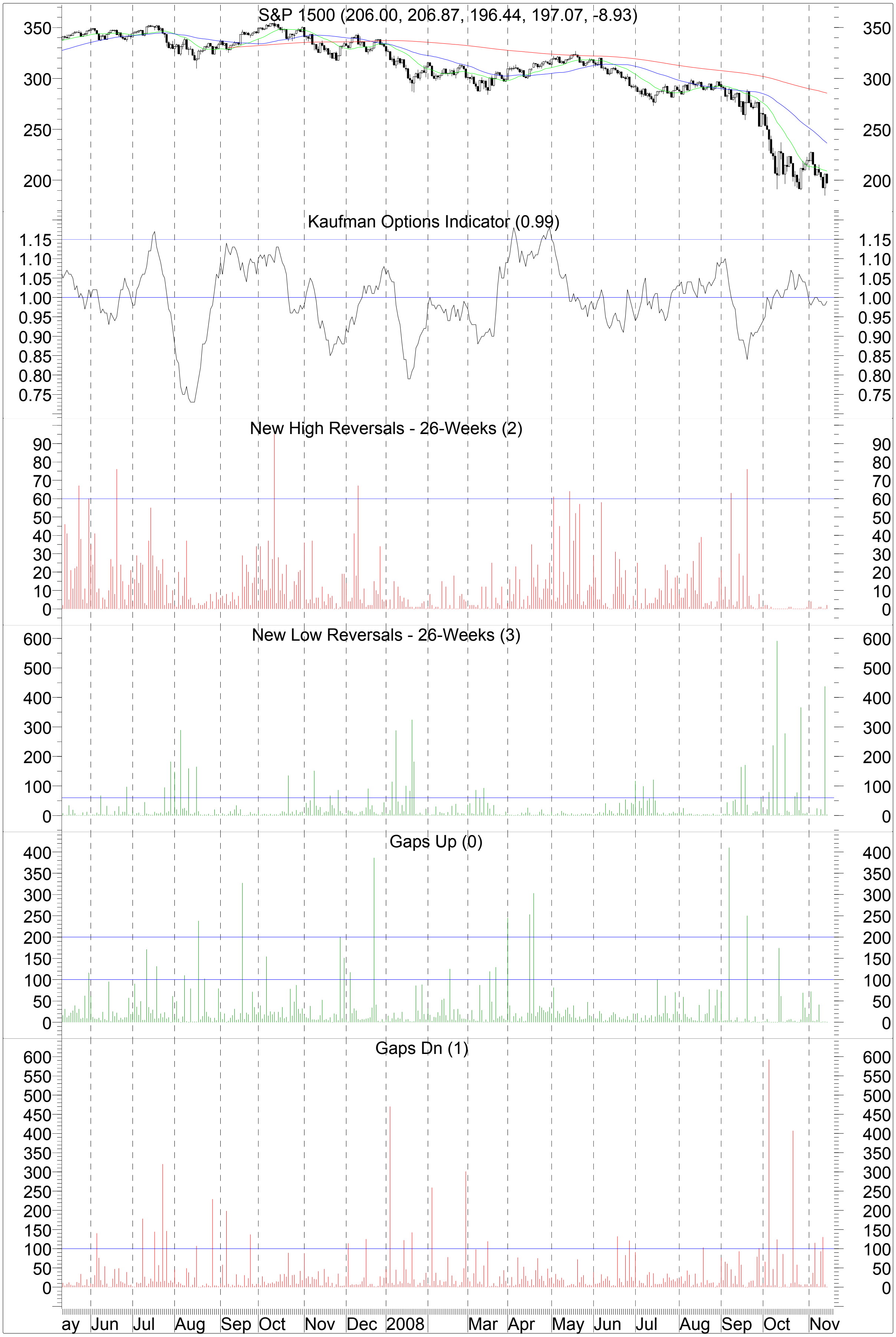
The AD line made a new low Wednesday.

Like Average Price, Cumulative Net Points did not make a new low Wednesday, showing a positive divergence.

Net Volume made a new low Wednesday.

Volume decreased Friday.

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

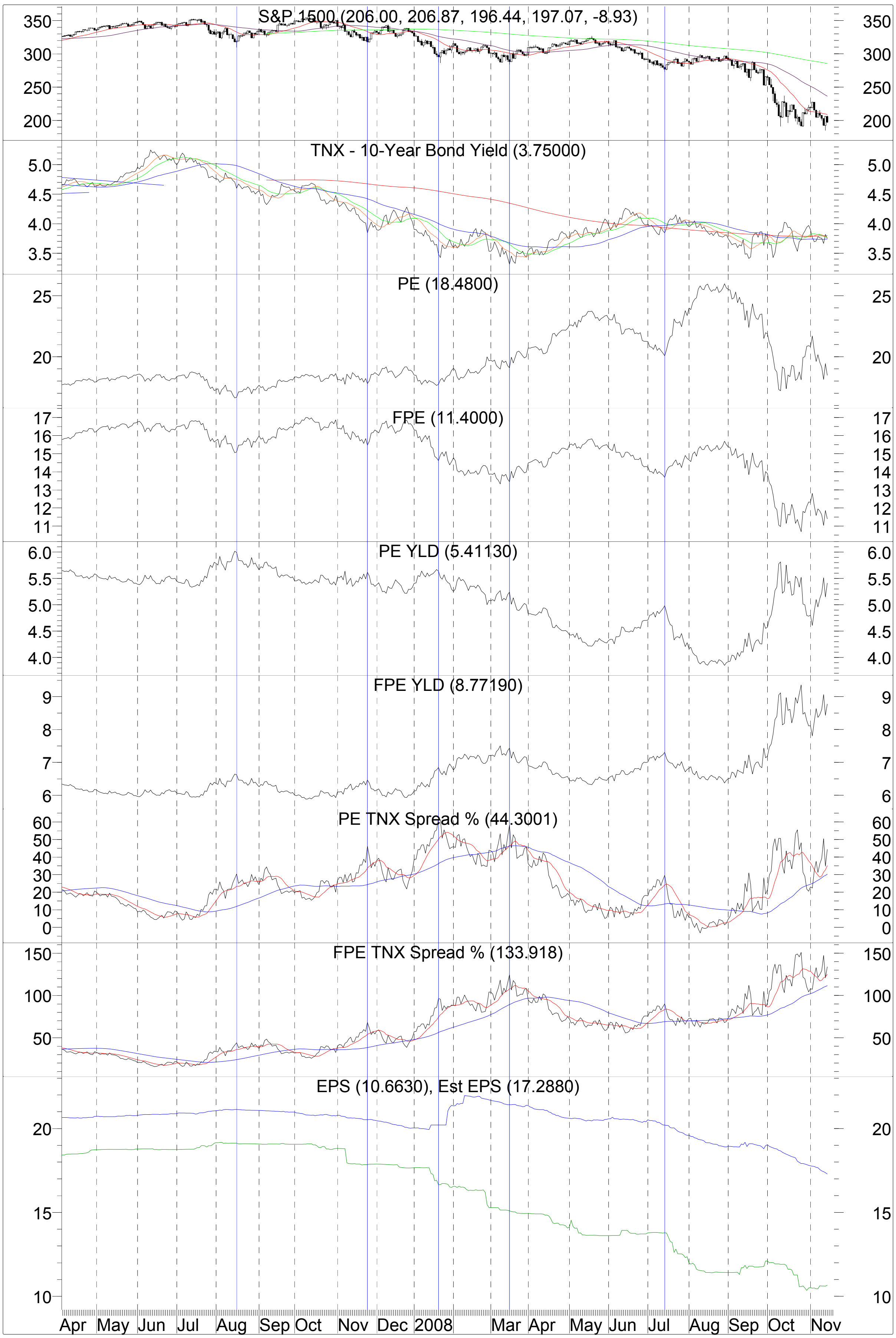


Our proprietary options indicator is just under the neutral line.

437 new low reversals on Thursday was a very high number. Over 100 is usually short-term bullish.

Our statistics of supply (red lines) versus demand (green lines) show that supply remains firmly in control. Sellers had stepped to the sidelines briefly, but the 10-day statistics show they have come back while buyers are reticent again.

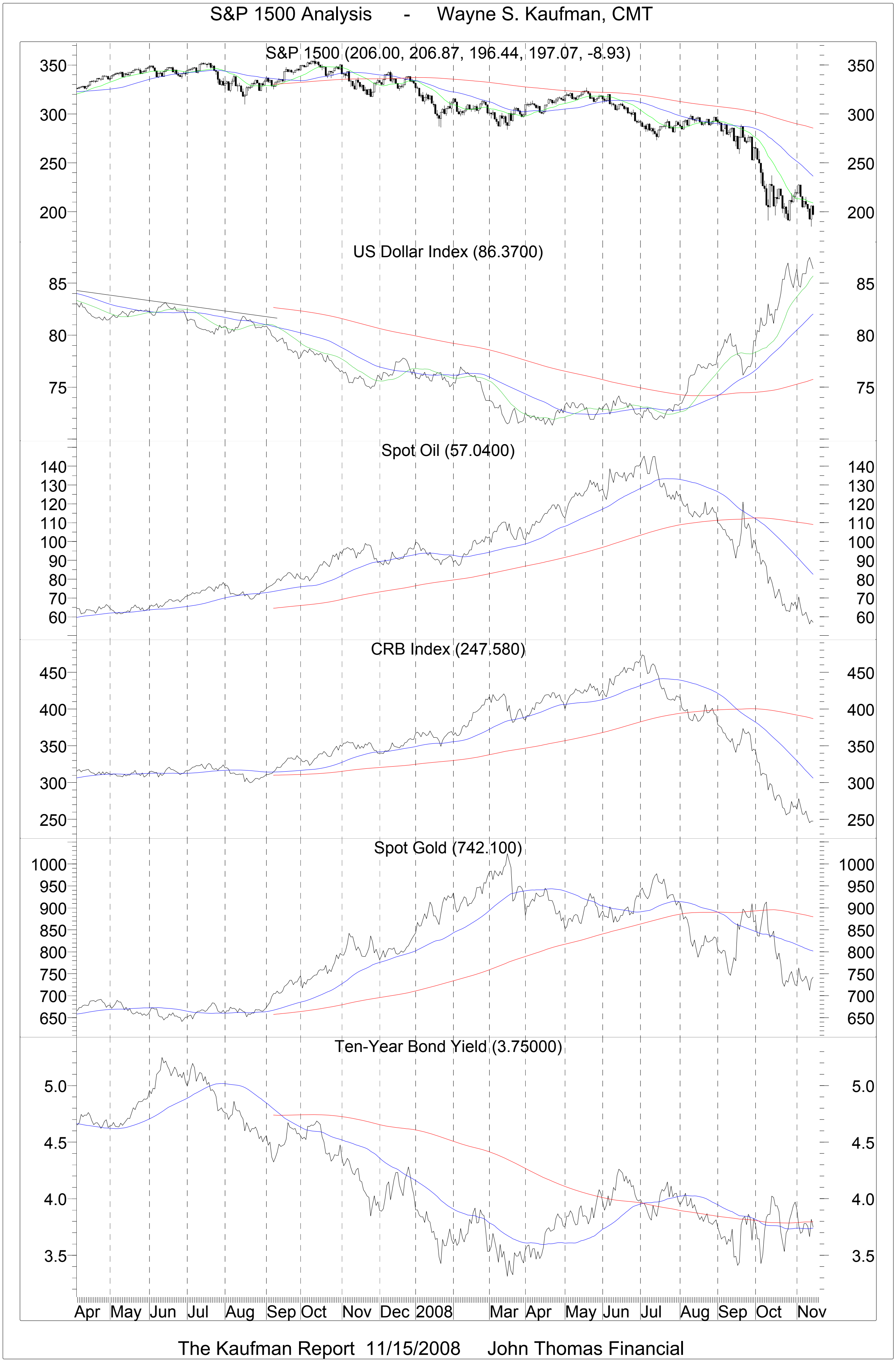
S&P 1500 Analysis - Wayne S. Kaufman, CMT



Bond yields are trading in a sideways pattern. There is a series of higher bottoms.

Spreads between bond and earnings yields have entered a trading range, just like stocks.

As earnings season ends reported earnings (green) are flattening while projected earnings (blue) continue their inexorable move lower.



The U.S. Dollar Index is still in an uptrend but has a potential double top on the daily candlestick chart (not shown).

Crude oil has a positive RSI divergence on the daily chart.