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The Kaufman Report

Trade what you see, not what you think.

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Monday October 19, 2009 **Closing prices of October 16, 2009**

Stocks rallied again last week seemingly in a celebration of the 2-year anniversary of the market top in October 2007, with major indices posting not just post-March rally highs, but 52-week highs as well. Third quarter earnings season is off to a good start, with 79% of companies reporting having upside surprises.

As we enter a week with an enormous amount of companies reporting, we do have some short-term concerns. Some negative divergences have shown up indicating a higher degree of selectivity on the part of investors, and our options indicator is showing excess bullishness on the part of options buyers. In addition, there are some indications that some of the intermarket elements of our analysis, such as gold and the U.S. Dollar Index, may be pausing as far as their recent trends, or even approaching short-term reversals.

Therefore, with short-term indicators still at overbought levels and over bullishness creeping in, investors need to be cautious regarding entry points.

We have stressed three characteristics of this bull market. Those are huge global liquidity, the belief held by investors that companies have become lean and mean with operating leverage that will lead to upside earnings surprises, and the reticence of investors to sell their stocks. We have been in a good news cycle, although we are now in third quarter earnings season, the period where the upside surprise thesis and the good news cycle will be tested.

It's a simple story. Bad economic news or disappointing earnings could certainly change investor's desire to hang onto stocks. All market participants need to be on their toes as earnings reports continue to stream in. The key issues on the minds of investors relative to earnings are top line growth versus cost cutting benefits, and whether there is improving demand versus inventory re-stocking.

We will remain on guard for any signs of a change in trend. We have been saying there is the potential for a deep correction at some point. However, we have also been saying since June 1st, we accept the possibility that huge global government intervention along with a possibly healing economy and companies that have become very lean and mean could create a scenario where profits will start to surprise to the upside and the deteriorating earnings trend will start to change. If so, we will be more than happy to delay or even cancel our expected bearishness.

Based on the S&P 500 the short-term, intermediate-term and long-term trends are up. Traders should not hesitate to rotate out of lagging sectors and stocks and into leaders.

Editor's Note: Many of our readers have asked why The Kaufman Report has not published issues during the week recently. The reason for this is the time constraints caused by the tremendous growth we have had at John Thomas Financial. Next week we will be more than tripling the size of our corporate headquarters as we move into the entire 23rd floor in our current building at 14 Wall Street. The new offices comprise 42,000 square feet and facilitate further plans for expansion. Once this move is complete we will be back to more regular schedule.

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The S&P 1500 (248.52) was down 0.834% Friday. Average price per share was down 0.54%. Volume was 4.85% lower than Thursday, 110% of its 10-day average and 100% of its 30-day average. 22.12% of the S&P 1500 stocks were up, with up volume at 20.08% and up points at 23.25%. Up Dollars was 9.46% of total dollars, and was 12% of its 10-day moving average. Down Dollars was 429% of its 10-day moving average.

For the week the index was up 1.42% on increasing and about average weekly volume.

The S&P 1500 is up 2.84% in October, up 2.84 quarter-to-date, up 21.27% year-to-date, and down 30.27% from the peak of 356.38 on 10/11/07. Average price per share is $31.32, down 27.55% from the peak of $43.23 on 6/4/07.

Percent over 10-sma: 67.07%. 13-Week Closing Highs: 119. 13-Week Closing Lows: 21.
52-week closing highs: 75. 316 on October 14the the highest in years.

Kaufman Options Indicator: 1.11 Put/Call Ratio: 0.765

P/E Ratios: **124.19 (before charges)**, 20.39 (continuing operations), 18.29 (analyst estimates).

*P/E Yield 10-year Bond Yield Spreads: **-76% (earnings bef. charges),** 43% (earnings continuing ops), and 60% (projected earnings).*

Aggregate earnings before charges for the S&P 1500 peaked in August 2007 at $19.18 and are now at $2.00, a drop of 89.57%. Aggregate earnings from continuing operations peaked at $19.95 in September 2007 and are now $12.19, down 38.90%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $13.58, a drop of 38.13%.

62 of the S&P 500 have reported 3rd quarter earnings. According to Bloomberg, 79.0% had positive surprises, 9.7% were in line, and 11.3% have been negative. The year-over-year change has been +6.6% on a share-weighted basis, +29.8% market cap-weighted and +7.6% non-weighted. Ex-financial stocks these numbers are -9.2%, -7.4%, and -4.5%, respectively.

Federal Funds futures are pricing in a probability of 63.1% that the Fed will leave rates unchanged and a probability of 36.9% of cutting rates 25 basis points to 0.00% when they meet on November 4th. They are pricing in a probability of 60.4% of no change, 33.0% of cutting 25 basis points to 0.00%, and 6.6% of raising 25 basis points to 0.50% when they meet on December 16th.

IMPORTANT DISCLOSURES

	Daily	WTD	MTD	QTD	YTD
Dow Jones Industrials	-0.67%	1.33%	2.92%	2.92%	13.90%
Nasdaq Composite	-0.76%	0.82%	1.62%	1.62%	36.76%
Nasdaq 100	-0.80%	0.67%	1.18%	1.18%	43.55%
S&P 500	-0.81%	1.51%	2.89%	2.89%	20.42%
S&P 1500	-0.83%	1.42%	2.84%	2.84%	21.27%
S&P Midcap 400	-0.95%	0.81%	2.44%	2.44%	31.51%
NYSE Composite	-0.97%	1.69%	3.23%	3.23%	23.92%
S&P Smallcap 600	-1.12%	0.63%	2.50%	2.50%	21.08%
Bank of New York Mellon ADR	-1.23%	2.18%	3.51%	3.51%	32.96%

	Daily	WTD	MTD	QTD	YTD
Consumer Staples	0.39%	1.67%	3.50%	3.50%	10.44%
Utilities	0.25%	1.42%	1.31%	1.31%	1.99%
Energy	-0.05%	5.08%	9.14%	9.14%	15.63%
Health Care	-0.39%	1.12%	1.67%	1.67%	9.67%
Consumer Discretionary	-0.56%	1.61%	2.85%	2.85%	31.42%
Telecom Services	-0.87%	0.08%	-4.28%	-4.28%	-7.20%
Industrials	-0.89%	1.91%	2.22%	2.22%	14.42%
Information Technology	-0.99%	0.72%	2.17%	2.17%	47.94%
Materials	-1.38%	1.78%	3.70%	3.70%	40.88%
Financials	-2.63%	-0.17%	1.77%	1.77%	21.30%

	Daily	WTD	MTD	QTD	YTD
Food & Staples Retailing	0.55%	3.53%	6.66%	6.66%	9.84%
Software & Services	0.51%	3.48%	4.52%	4.52%	42.36%
Household & Personal Products	0.33%	-0.03%	0.20%	0.20%	0.32%
Food, Beverage & Tobacco	0.33%	1.56%	3.53%	3.53%	16.33%
Utilities	0.25%	1.42%	1.31%	1.31%	1.99%
Consumer Services	0.11%	2.24%	2.07%	2.07%	16.03%
Energy	-0.05%	5.08%	9.14%	9.14%	15.63%
Health Care Equip & Services	-0.08%	-0.25%	-0.63%	-0.63%	16.79%
Transportation	-0.19%	4.01%	5.90%	5.90%	15.02%
Consumer Durables & Apparel	-0.40%	2.38%	2.55%	2.55%	31.50%
Media	-0.44%	0.90%	1.48%	1.48%	24.81%
Pharmaceuticals, Biotech & Life Sciences	-0.53%	1.70%	2.68%	2.68%	6.71%
Commercial & Professional Services	-0.53%	3.02%	3.07%	3.07%	8.93%
Retailing	-0.75%	1.34%	4.11%	4.11%	40.74%
Telecom Services	-0.87%	0.08%	-4.28%	-4.28%	-7.20%
Capital Goods	-1.12%	1.24%	1.16%	1.16%	14.82%
Materials	-1.38%	1.78%	3.70%	3.70%	40.88%
Technology Hardware & Equipment	-1.82%	-0.96%	0.84%	0.84%	53.67%
Insurance	-1.88%	-0.51%	1.27%	1.27%	16.16%
Automobiles & Components	-2.27%	3.43%	5.01%	5.01%	87.83%
Semiconductors & Equipment	-2.28%	-0.89%	0.39%	0.39%	44.25%
Diversified Financials	-2.56%	-0.65%	1.73%	1.73%	39.13%
Real Estate	-3.00%	-0.97%	-1.07%	-1.07%	8.76%
Banks	-3.35%	1.80%	3.48%	3.48%	-2.84%

INTERNATIONAL ETFs

	Daily	WTD	MTD	QTD	YTD
United Kingdom EWU	0.44%	4.04%	3.80%	3.80%	31.43%
Malaysia EWM	0.18%	2.39%	7.50%	7.50%	49.52%
Canada EWC	-0.23%	1.47%	4.00%	4.00%	52.04%
Sweden EWD	-0.50%	3.75%	3.45%	3.45%	54.05%
Switzerland EWL	-0.58%	2.08%	1.80%	1.80%	19.26%
Belgium EWK	-0.65%	3.06%	5.54%	5.54%	57.04%
Brazil EWZ	-0.72%	4.46%	11.61%	11.61%	115.75%
Taiwan EWT	-0.88%	0.64%	0.81%	0.81%	63.64%
Latin America ILF	-0.91%	3.80%	9.14%	9.14%	83.86%
Mexico EWW	-0.98%	3.41%	8.75%	8.75%	47.20%
BRIC EEB	-1.04%	3.12%	7.96%	7.96%	82.03%
Australia EWA	-1.15%	2.79%	6.37%	6.37%	71.59%
Italy EWI	-1.19%	3.35%	5.34%	5.34%	31.18%
Singapore EWS	-1.26%	1.64%	2.23%	2.23%	55.89%
Austria EWO	-1.27%	3.05%	6.15%	6.15%	78.88%
MSCI Emerging Markets EEM	-1.38%	2.21%	4.73%	4.73%	63.20%
Spain EWP	-1.57%	1.30%	1.70%	1.70%	34.50%
Hong Kong EWH	-1.63%	-0.06%	1.35%	1.35%	51.69%
Netherlands EWN	-1.72%	2.74%	5.49%	5.49%	41.69%
Japan EWJ	-1.80%	-1.53%	-1.41%	-1.41%	2.30%
France EWQ	-1.92%	2.03%	2.46%	2.46%	27.14%
Germany EWG	-2.06%	1.75%	3.06%	3.06%	18.99%
Vietnam VNM	-2.23%	4.85%	8.31%		
China 25 FXI	-2.24%	0.65%	5.50%	5.50%	48.40%
South Korea EWY	-3.32%	-1.17%	-2.74%	-2.74%	64.75%

The S&P 500 posted new post-March highs Thursday before selling off Friday. It remains within the boundaries of the bearish rising wedge pattern. It is also within striking distance of the 50% retracement of the entire bear market, which is at 1121.

Momentum indicators are at high levels. The inability of the RSI to reach the overbought zone in spite of making new highs is a short-term sign of the rally weakening.

The weekly chart of the S&P 500 shows it remains above its 80-sma, a very important long-term moving average.

There is a negative divergence on the weekly RSI.

The Nasdaq 100 also made new highs last week.

Here too new index highs couldn't get the RSI into the overbought zone.

The weekly chart of the Nasdaq 100 shows it is at a resistance level. It has surpassed its 50% retracement of the bear market (1629) with the 61.8% level not far above at 1773.

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The Kaufman Report 10/17/2009 John Thomas Financial

Our statistics of supply (red) versus demand (green) shows that sellers remain very passive. Even though buyers are also not aggressive, as we have said many times, unless sellers become more motivated the path of least resistance will be up.

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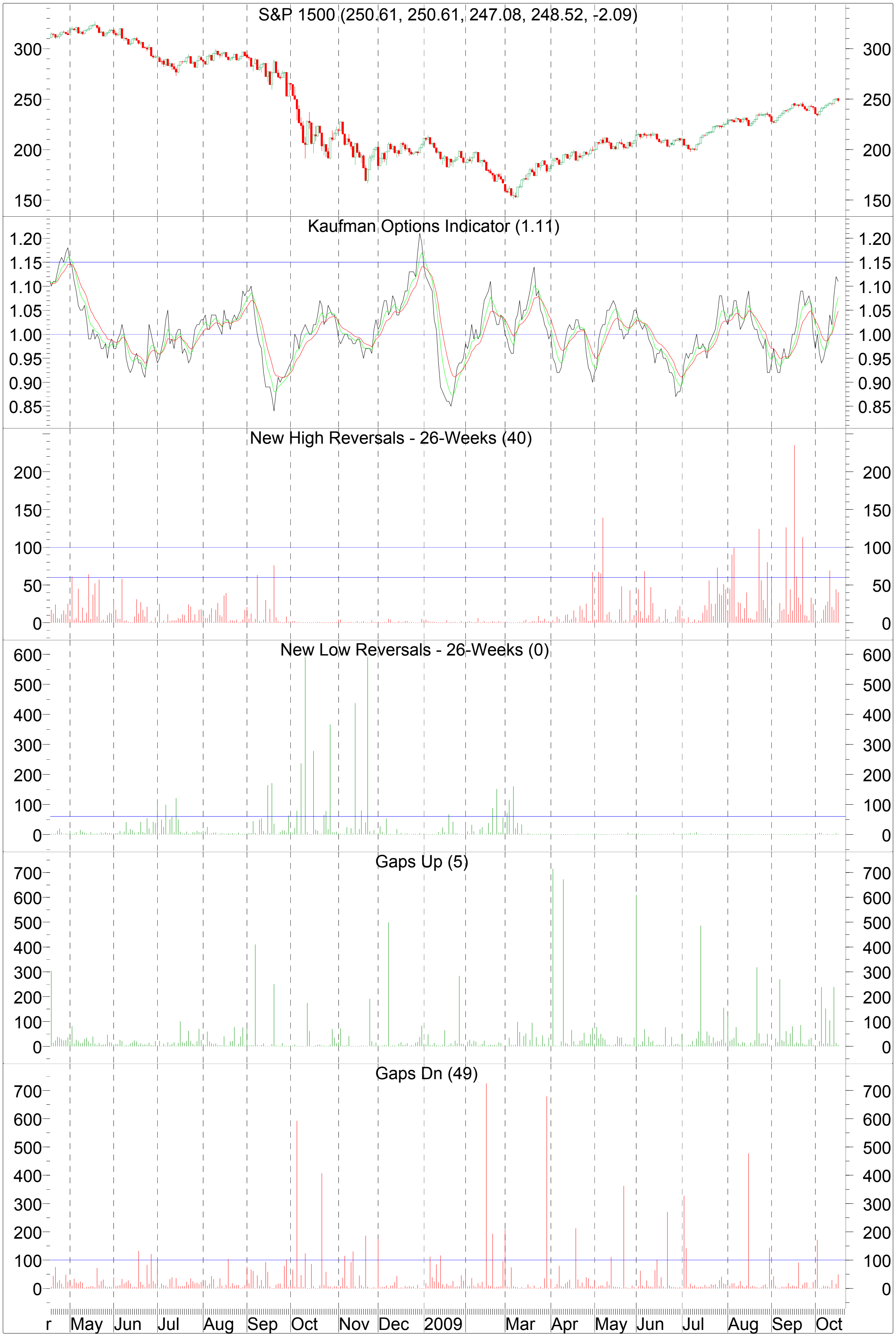
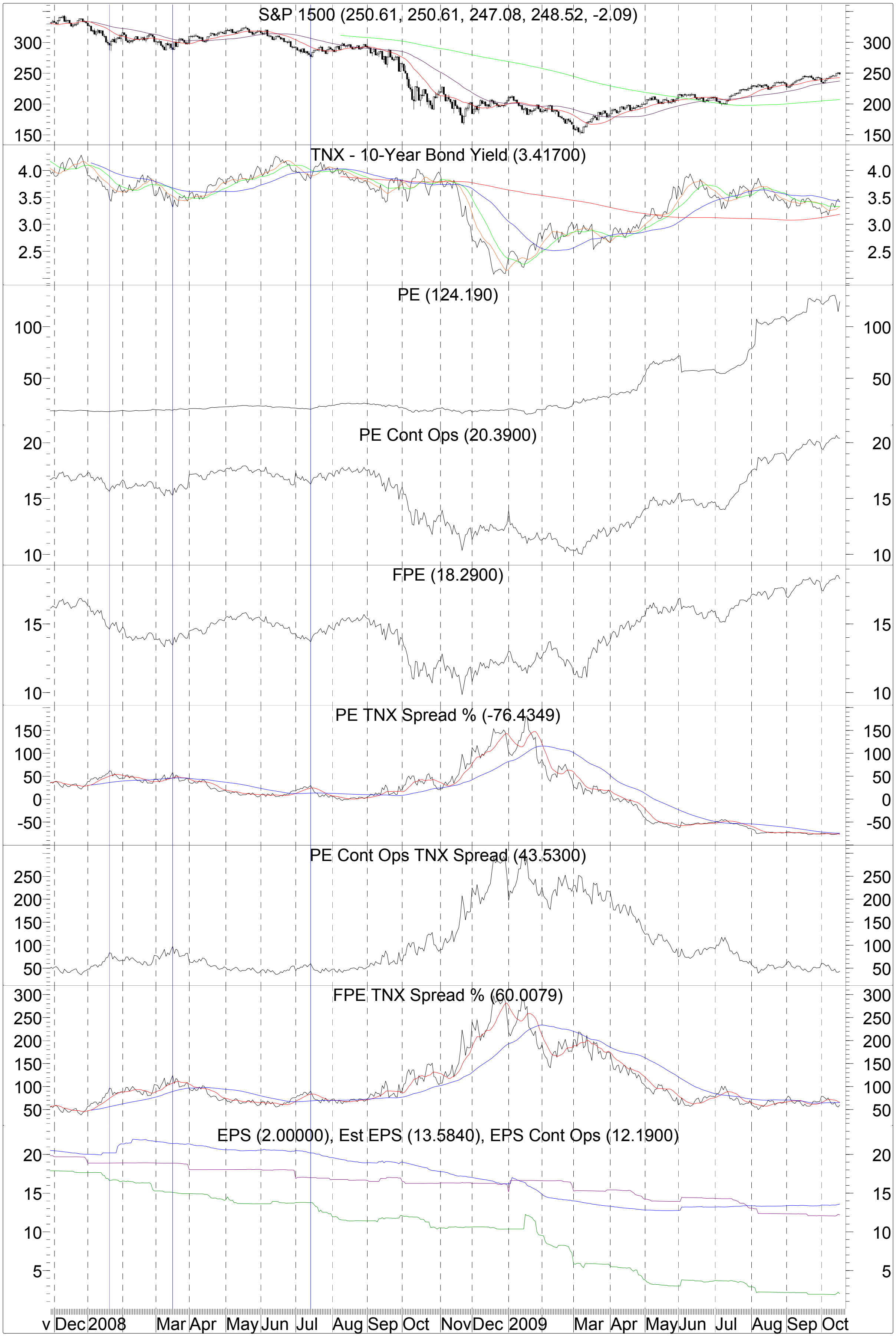


Our proprietary options indicator is showing excessive bullishness among options buyers. On Thursday it hit the highest level since march 20th. This can leave stocks vulnerable to a pullback, or at least a period of consolidation.

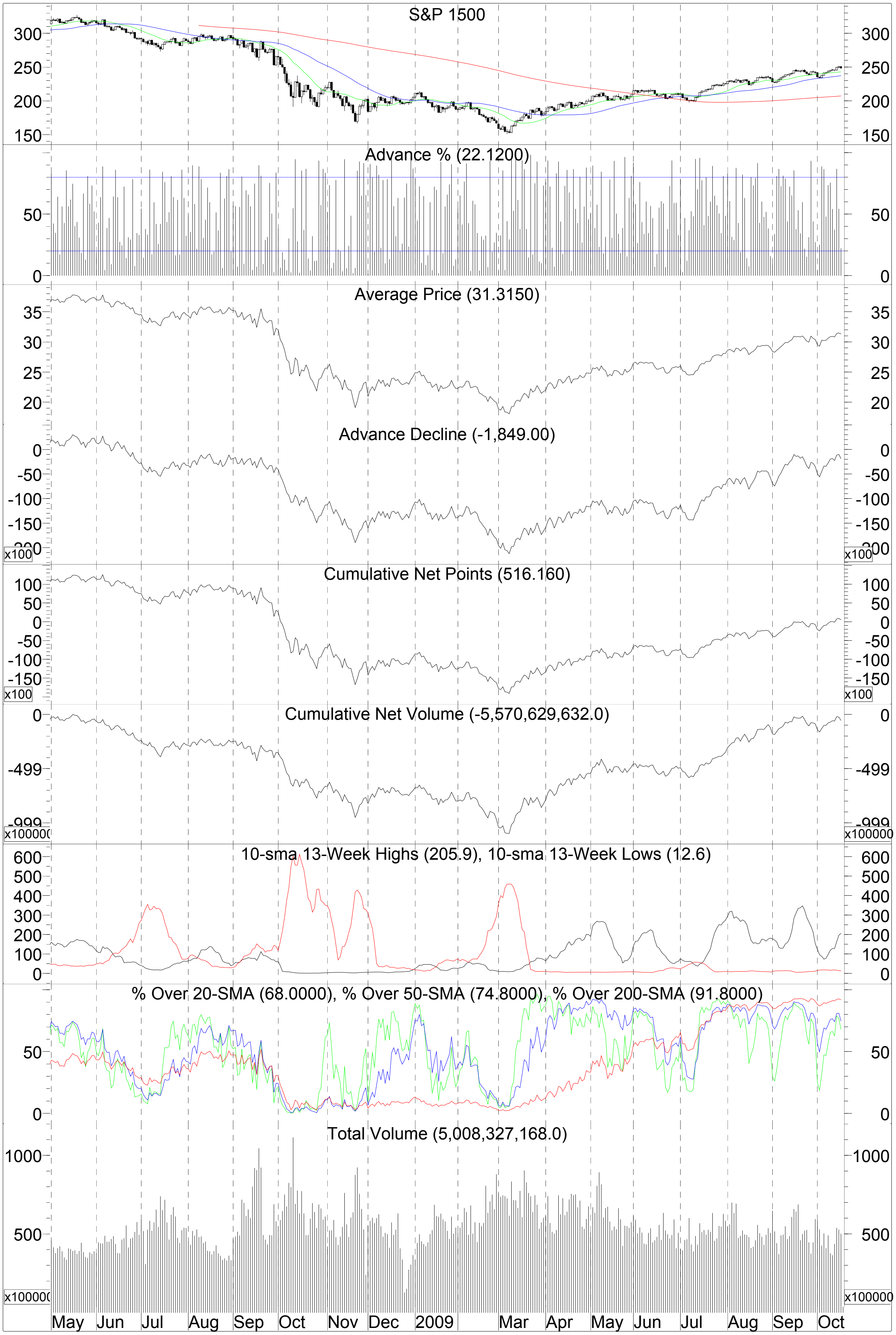


The 10-year bond yield has bounced up to its 50-sma. Resistance is up to 3.535%.

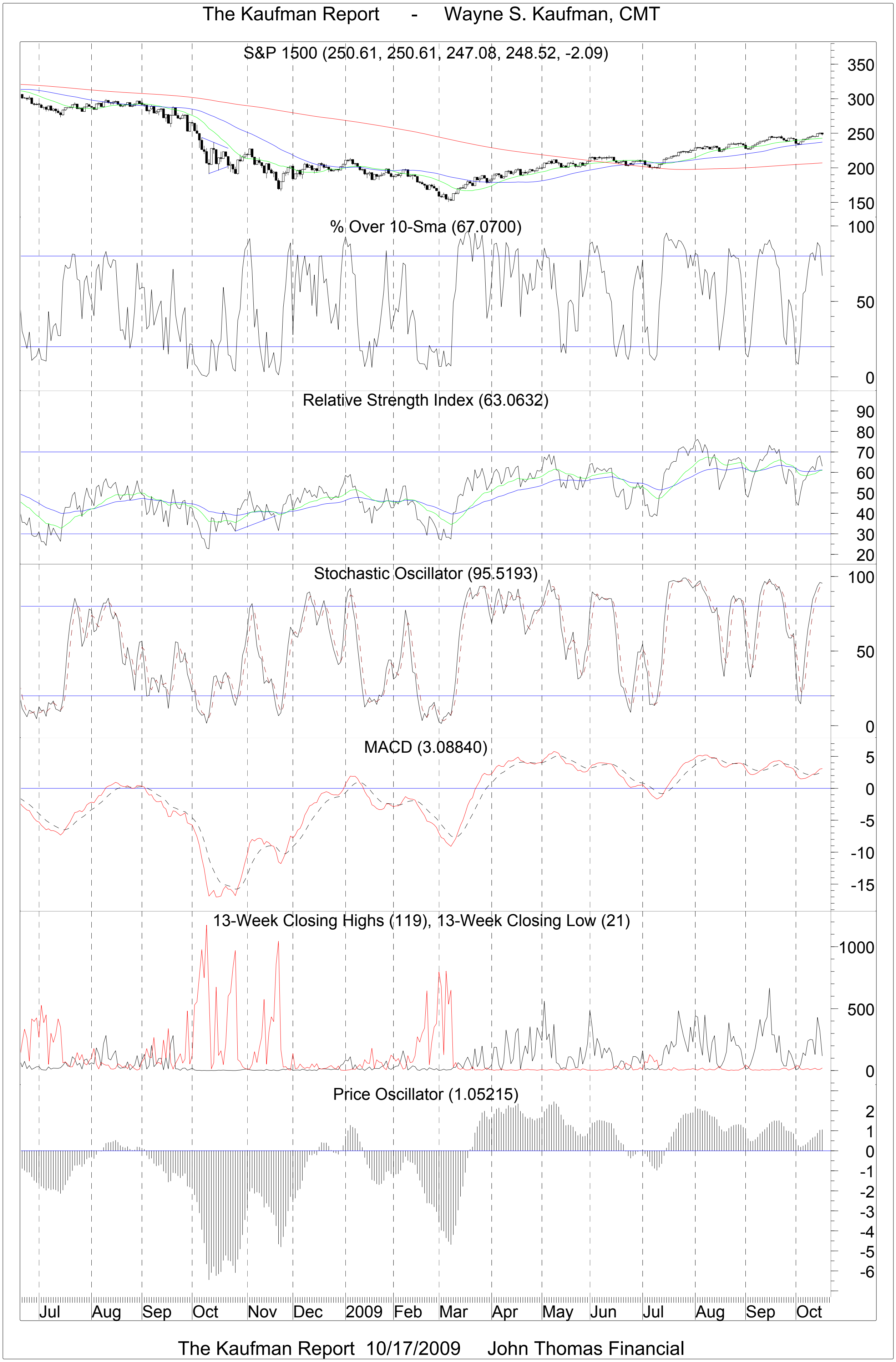
P/E ratios remain at high levels.

Spreads between bond and equity yields have been going sideways for quite a while.

Earnings have been flat lining, but as we get further into earnings season these numbers need to start moving higher to justify valuations.



The percent over 20-sma is showing a negative divergence.



The percent over 10-sma has turned down from the overbought zone.

13-week closing highs is showing a negative divergence.

Our price oscillator, a good indicator of trends, remains in positive territory.

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The U.S. Dollar Index remains in a down trend, but there is a positive RSI divergence on the daily and weekly charts. This means the descent may be pausing, or even reversing soon. There is an inverted hammer on the daily chart. Hammers are bottoming candles.

Crude oil has broken out of its 4-month range but is getting overbought. If the dollar stabilizes it will take real increased demand to push oil higher.

Gold is pulling back from an overbought condition. There is a shooting star candle on the weekly chart. Shooting stars are seen at the end of up trends.