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The Kaufman Report

Trade what you see, not what you think.

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Wednesday September 10, 2008 **Closing prices of September 9, 2008**

On September 1st we warned that investors should be on high alert for the possibility that equities could be about to make another leg down. The S&P 1500 is down 4.65% in the six sessions since, with no letup to the selling in sight.

On Tuesday stocks plunged again in the second 90% panic-selling day in the last four sessions. The S&P 1500 (279.11) is now just above the July 15th closing low of 276.67, which was the lowest close since June 2006.

We have been highlighting the spreads between 10-year bond yields and the earnings yields of the P/E and forward P/E of the S&P 1500. Stocks bottomed Friday when the earnings yield of the forward P/E became 90% higher than the 10-year bond yield. *This was the exact level of the spread when stocks bottomed on July 15th.* It is currently 88.28% above the 10-year bond yield, so obviously we would like this to be a support level. *However, valuations may be meaningless if much of this selling is the result of forced liquidations of assets.* The spread based on current reported earnings is 13.83%, still well below the 29.62% level of July 15th. This shows the discrepancy in the way reported earnings have plunged versus the slower descent of earnings estimates.

Reported aggregate earnings for the S&P 1500 peaked in August 2007 at $19.18 and are now at $11.42, a drop of 40.45%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $18.91, a drop of only 13.86%. 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.*

Time will tell how much lower earnings projections will actually go, but for the time being it is one of many variables where there is a lack of visibility for investors. Some of the other variables with little or no visibility are the slowing global economy, the political landscape, energy and commodities prices, real estate valuations, the ongoing lack of liquidity in the credit markets, even whether or not there is the threat of inflation or deflation.

In the very near-term, with earnings season essentially over, reported and projected earnings could flat line for a little while, which may prevent stocks from plunging too much lower as long as interest rates, which are oversold, don't move up too much. However, we are in a seasonally weak time of the year, there is a triple-witching options expiration coming shortly, bad news continues to dominate, and the last stages of waterfall declines can be extremely damaging. Therefore, investors still need to be on high alert for further deterioration in equities.

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.

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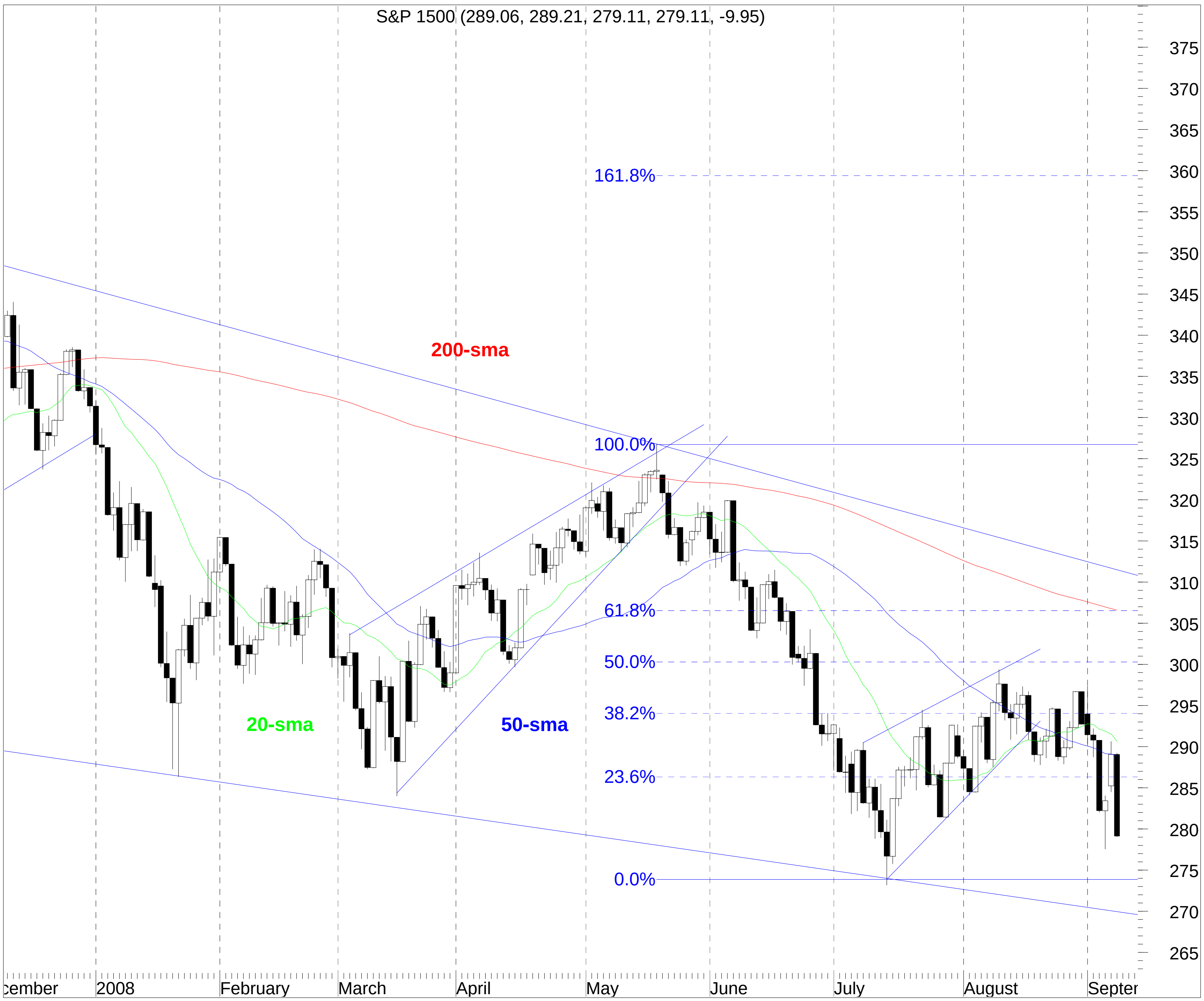
So far 496 companies in the S&P 500 have reported second quarter earnings. According to Bloomberg, 67.4% have had positive surprises, 7.3% have been in line, and 25.3% have been negative. The year-over-year change has been -23.4% on a share-weighted basis, -23.4% market cap-weighted, and -12.4% non-weighted. Ex-financial stocks these numbers are 3.9%, 7.2%, and 4.7%, respectively.

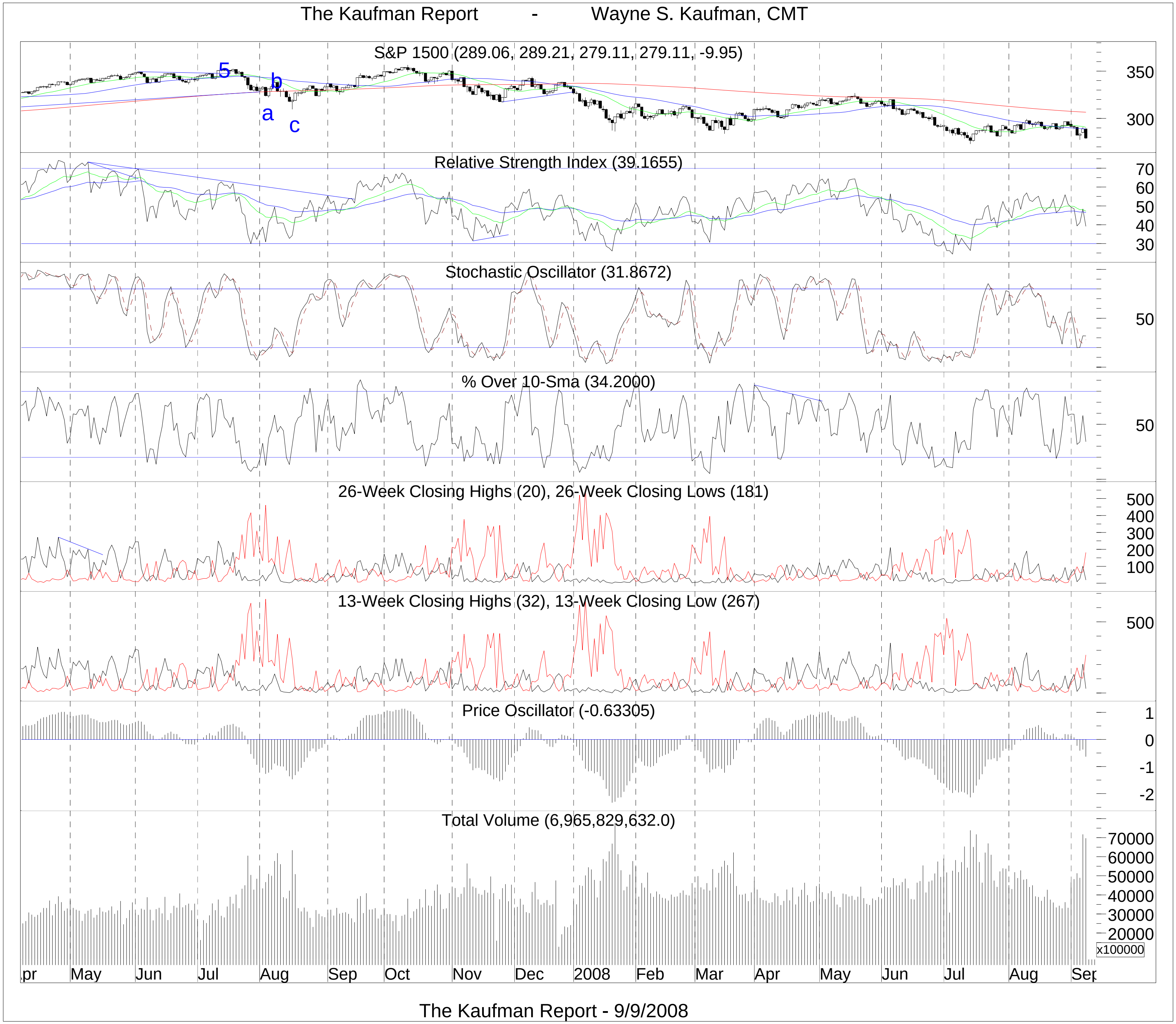
Federal Funds futures are pricing in an 98.0% probability that the Fed will *leave rates at 2.00%,* and an 2.0% probability of *decreasng 25 basis points to 1.75%* when they meet on September 16th. They are pricing in a 94.1% probability that the Fed will *leave rates at 2.00%* at the meeting on October 29th, and a 5.8% probability of *decreasing 25 basis points to 1.75%.*

The S&P 1500 (279.11) was down 3.442% Tuesday. Average price per share was down 3.50%. Volume was 147% of its 10-day average and 153% of its 30-day average. 9.58% of the S&P 1500 stocks were up on the day. Up Dollars was 1% of its 10-day moving average and Down Dollars was 370% of its 10-day moving average.

Options expire September 19th.



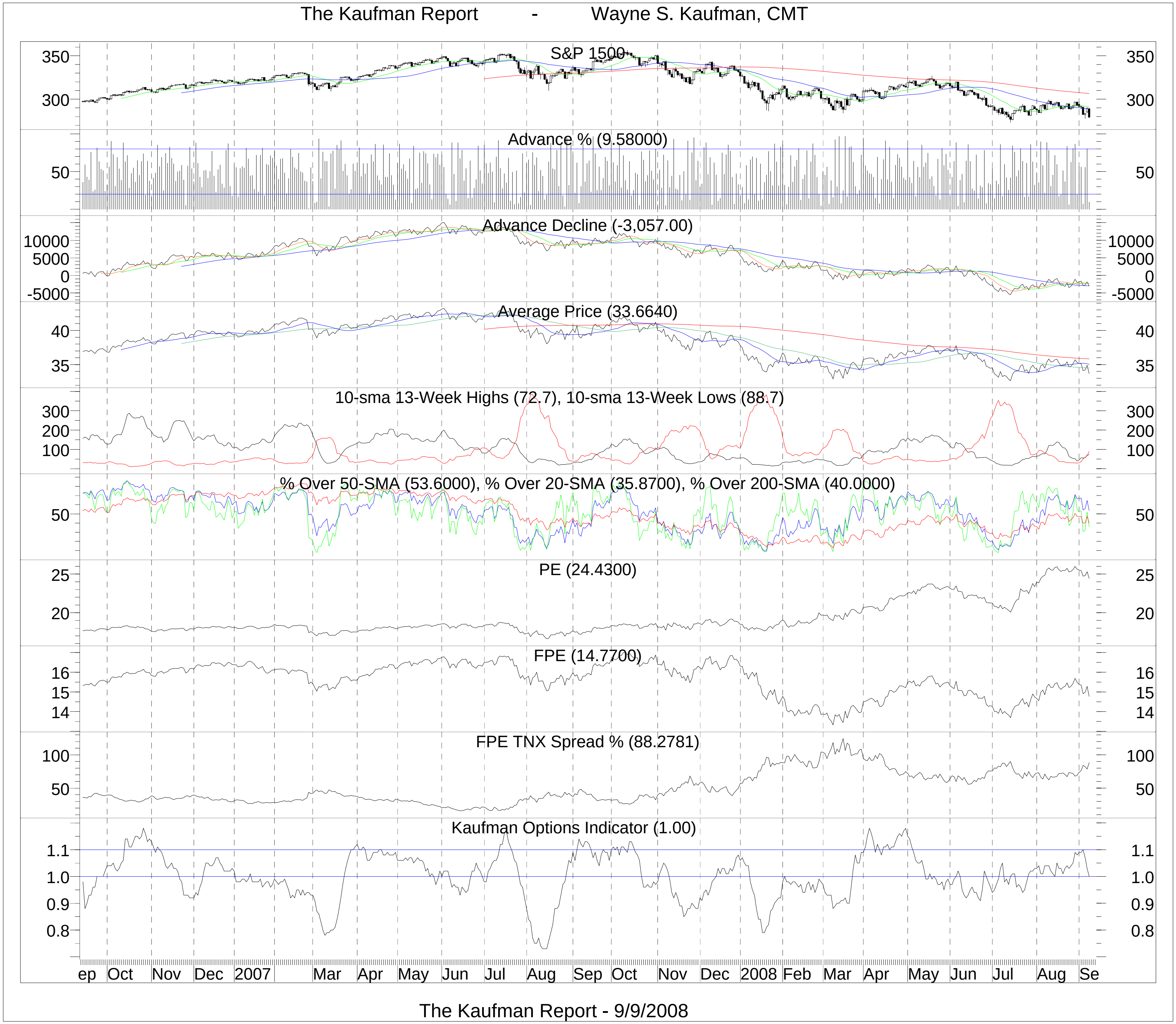
The S&P 1500 plunged again Tuesday in the second panic-selling 90% down day in four sessions. It is just above the July 15th closing low of of 276.67, which was the lowest close since November 2005.



Our oscillators are at low, but not oversold, levels.

New lows continue to expand dramatically.

Our price oscillator, a good indicator of trends, is becoming more negative.



9.58% of the S&P 1500 traded higher Tuesday.

The 10-sma of 13-week lows is greater than the 10-sma of 13-week lows.

More than 50% of the S&P 1500 are above their 50-sma, due to strength in small-caps.

The earnings yield of the forward P/E is 88.28% higher than the 10-year bond yield. 90% is the level of the July 15th and September 5th lows.

Our proprietary options indicator has dropped to the neutral level, which is still above levels where stocks have bottomed in the past.