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The Kaufman Report

Trade what you see, not what you think.

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Monday September 15, 2008 **Closing prices of September 12, 2008**

Stocks rallied three sessions in a row after the September 9th 90% panic-selling day. That 90% down day was the second in four sessions and so far we haven't seen either the strong buying or the fearful capitulation which would indicate a bottom. The good news is our proprietary options indicator has plunged into negative territory due to the put/call ratio moving over 1.0 for four sessions in a row ant six out of seven. Our indicator is not at the extreme bearish levels which mark important bottoms yet, and the highest reading of the put/call ratio in those six sessions was on September 9th at 1.11 which is not that high, but increasing pessimism is what is needed in order to put in a meaningful bottom.

This will be a very important week. There is triple-witching options expiration (quadruple if you prefer), Goldman Sachs and Morgan Stanley report earnings, the Fed meets on September 16th, and there should be some major news regarding Lehman Brothers. This combination could create some short-term trading opportunities.

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 September 5th 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 hit 88.28% on September 9th, with stocks rallying thereafter, so that 90% area is an important support level. The reading is currently 78.73%, which obviously allows room for stocks to drop.

The spread based on current reported earnings is only 9.88%, well below the 29.62% level of July 15th, so here too there is room for stocks to drop. *Valuations may be meaningless if much of the recent selling is the result of forced liquidations of assets, and that liquidation continues.*

Reported and projected earnings for the S&P 1500 jumped up last week as Fannie and Freddie were unceremoniously kicked out of the S&P indexes, highlighting the old expression that sometimes less is more. Prior to that bump up earnings and forecasts had been moving inexorably lower. 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 don't move up too much. However, we are in a seasonally weak time of the year, there is a triple-witching options expiration this week, 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.*

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Reported aggregate earnings for the S&P 1500 peaked in August 2007 at $19.18 and are now at $11.70, a drop of 39.0%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $19.03, a drop of only 13.30%. 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>* The earnings numbers jumped up last week as Fannie and Freddie were unceremoniously kicked out of the S&P indexes, highlighting the old expression that sometimes less is more.

So far 497 companies in the S&P 500 have reported second quarter earnings. According to Bloomberg, 67.5% 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 -12.3% non-weighted. Ex-financial stocks these numbers are 3.9%, 7.2%, and 4.8%, respectively.

Federal Funds futures are pricing in an 88.0% probability that the Fed will *<u>leave rates at 2.00%,</u>* and an 12.0% probability of *<u>decreasng 25 basis points to 1.75%</u>* when they meet on September 16th. They are pricing in a 75.7% probability that the Fed will *<u>leave rates at 2.00%</u>* at the meeting on October 29th, and a 22.6% probability of *<u>decreasing 25 basis points to 1.75%.</u>* They are pricing in a 63.9% probability that the Fed will *<u>leave rates at 2.00%</u>* at the meeting on December 16th, and a 30.9% probability of *<u>decreasing 25 basis points to 1.75%.</u>*

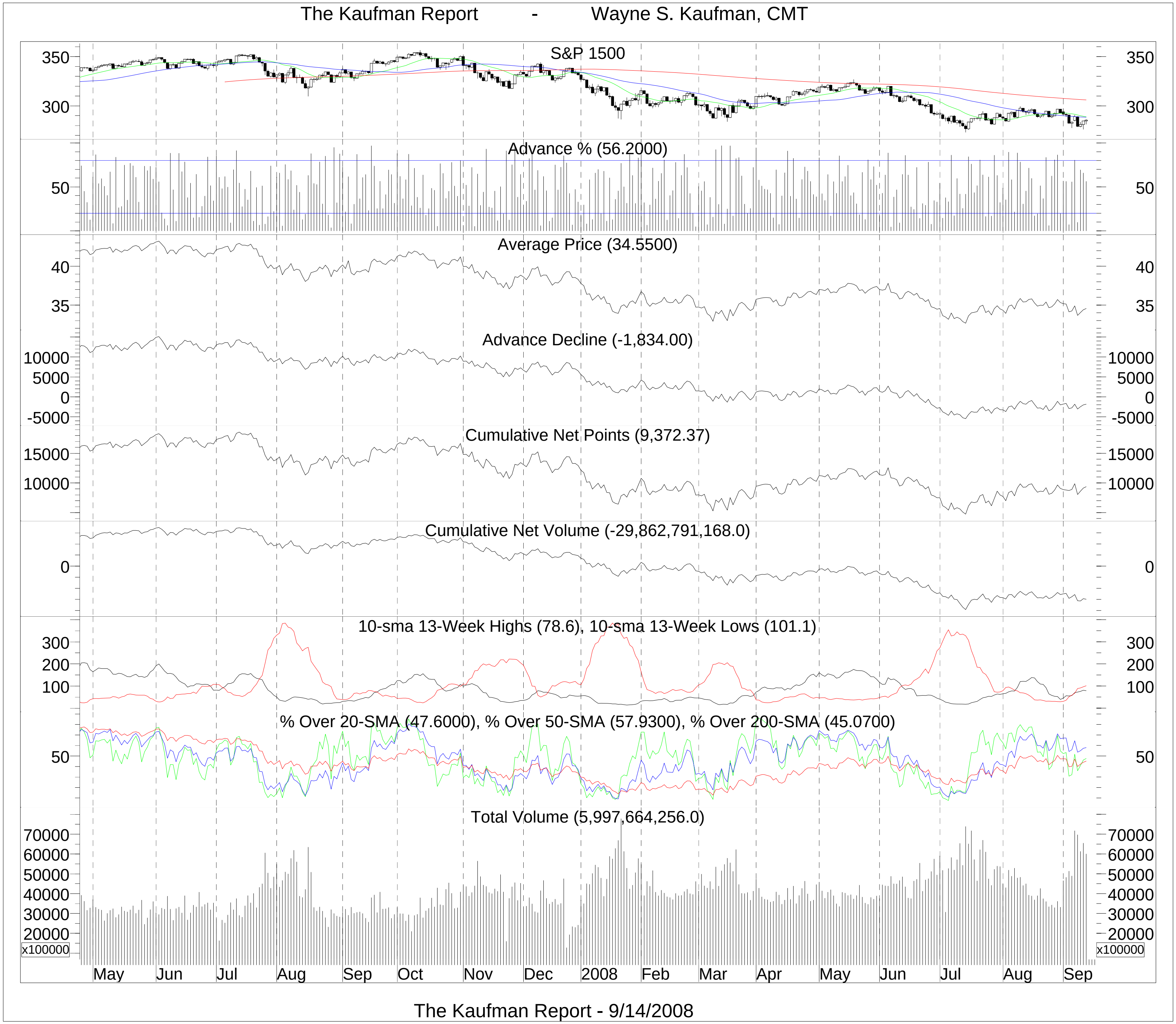
The S&P 1500 (285.49) was up 0.288% Friday. Average price per share was up 0.48%. Volume was 108% of its 10-day average and 129% of its 30-day average. 56.2% of the S&P 1500 stocks were up on the day. Up Dollars was 104% of its 10-day moving average and Down Dollars was 29% of its 10-day moving average. For the week the index was up 0.73% on increasing and above average weekly volume.

Options expire September 19th. October options expire October 17th.

The S&P 1500 traded higher the last three sessions after Tuesday's panic-selling 90% down day. Multiple hammers have been printed on the daily chart as the index attempts to form a bottom. Resistance is just above at 287 and all the way to 296.

Our oscillators are in neutral territory. So far the RSI is holding the 40 level, which is support during up trends.

Our price oscillator, a good indicator of trends, is in negative territory.

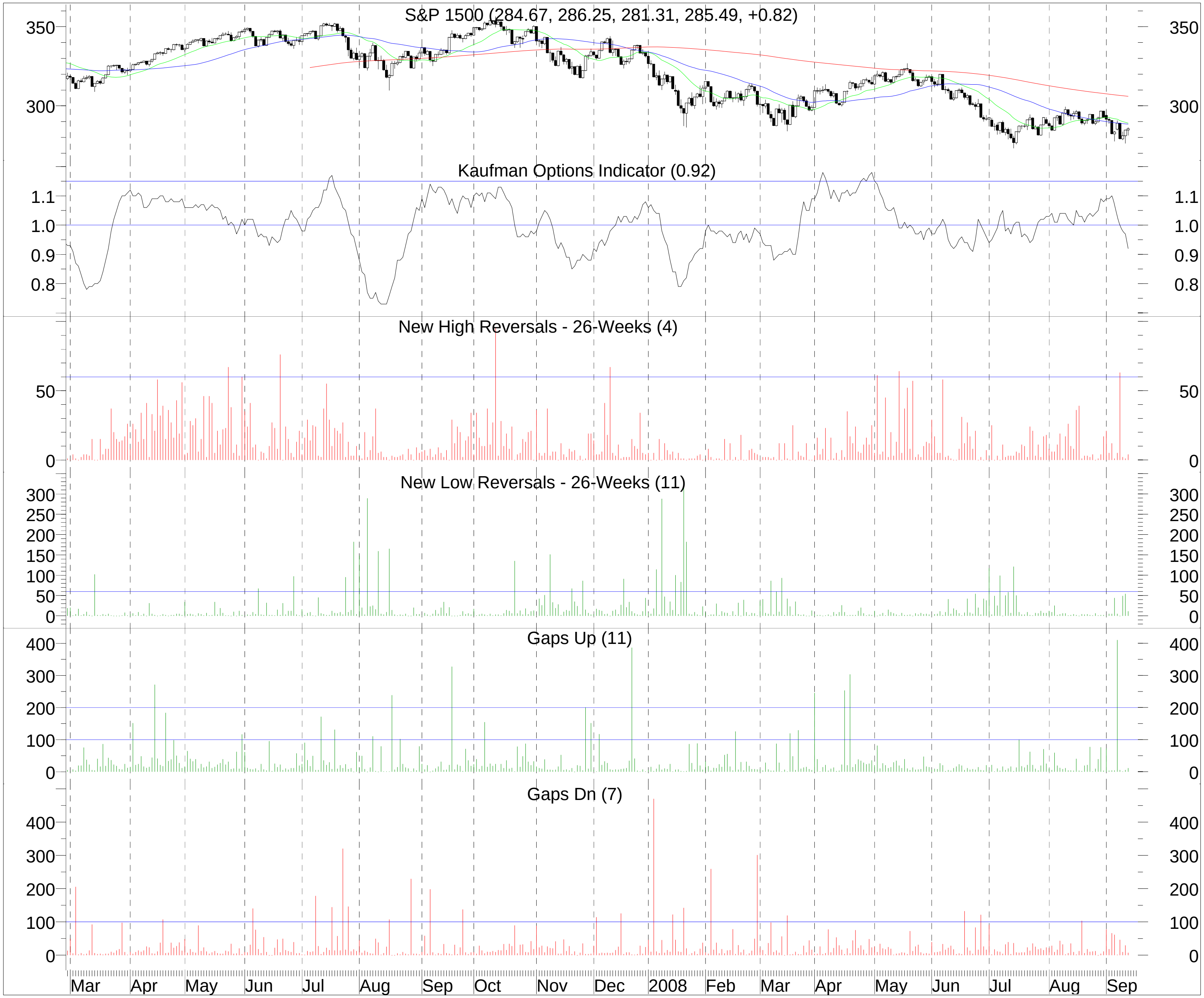


56.2% of the S&P 1500 traded higher Friday.

Our statistics of market internals are not giving many clues about the future.

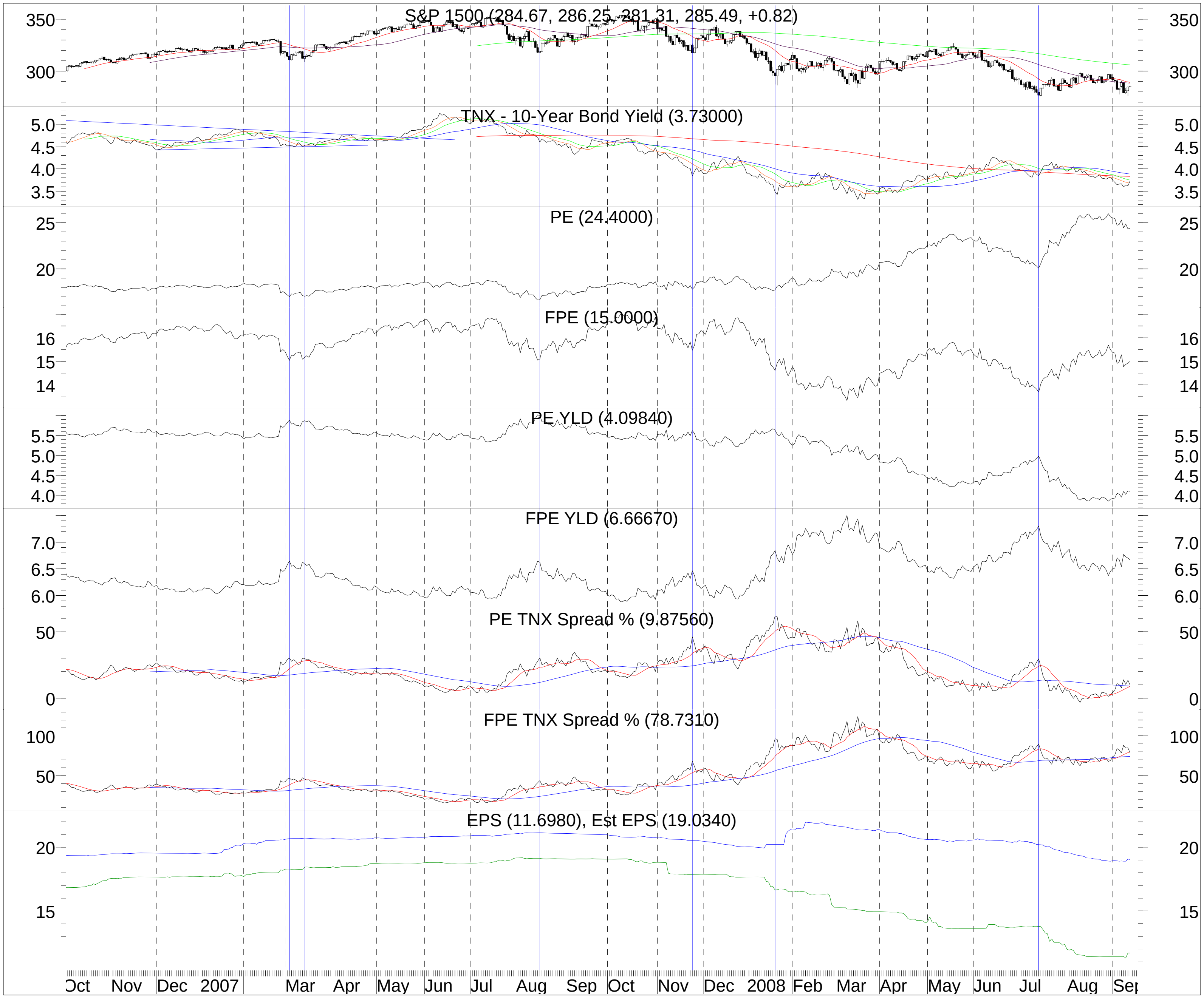
The 10-sma of 26-week closing lows is above the 10-sma of 26-week highs.

The percent over 50-sma is 57.93% even though the index is below its 50-sma. This is because small-caps have been outperforming.



Our proprietary options indicator has plunged as options buyers have gone from optimistic to pessimistic very quickly. The put/call ratio has been above 1.00 four sessions in a row and six out of seven. We are not yet at the negative levels that have marked important bottoms, although rallies are possible from here.

The Kaufman Report - Wayne S. Kaufman, CMT



The Kaufman Report - 9/14/2008

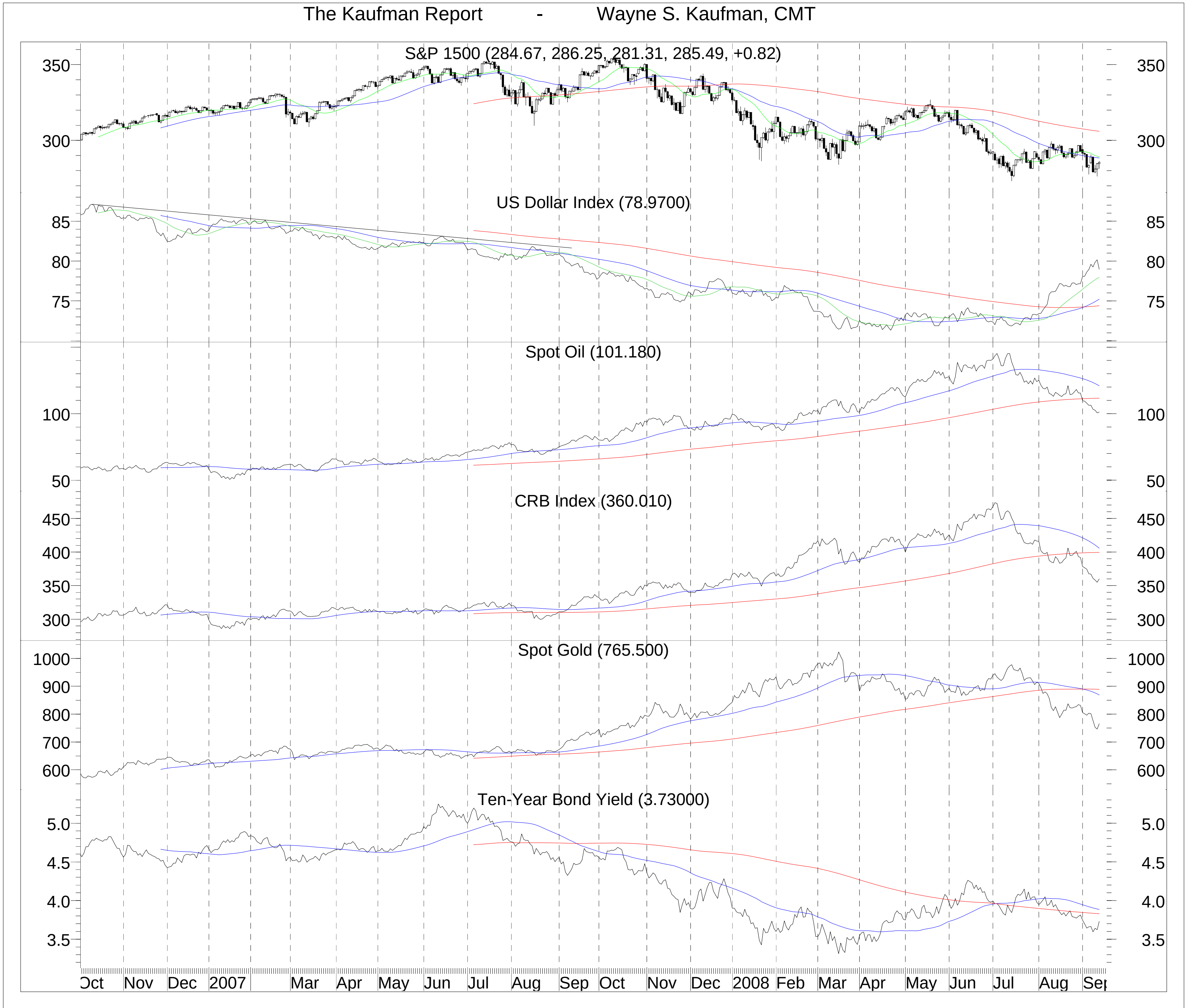
10-year bond yields bounced from oversold levels. There is resistance at the 3.8% area.

The P/E is coming down after hitting the highest level in years.

The forward P/E is at an attractive level if you believe the estimates.

Spreads between earnings yields and 10-year bond yields have widened, but the spread based on the current P/E is too narrow for equities to rally much. The 90% area on the forward spread has been support.

Current and forecast earnings jumped up as FNM and FRE were kicked out of S&P indexes.



The Kaufman Report - 9/14/2008

The U.S. Dollar index is pulling back from an overbought condition.

Crude oil is at important support at the $100 area and almost oversold. It is now in a down trend.

Gold is bouncing from an extreme oversold condition and printed a bullish engulfing candle on the daily chart.