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

Tuesday September 2, 2008 **Closing prices of August 29, 2008**

Summer has unofficially come to an end, and the very low volume of the last few weeks may be ending also. As we enter September, the media is full of comments about it being the worst month of the year historically. This is true, but interestingly the last down September came in 2003. We are currently on a streak of four positive Septembers, with the 2006 and 2007 Septembers being surprisingly strong, up 2.5% and 3.5%, respectively.

The recent low volume sideways action has done nothing to clarify a confusing market picture. The concerns we have had for weeks are still intact, while at the same time equities have shown surprising resilience. The negative seasonality of September – October does concern us, along with the relentless move lower for reported and projected earnings. However, the negative effect of these factors may be mitigated by the recent weakness in energy and commodities prices.

We remain concerned about the P/E ratio of the S&P 1500, which on Thursday hit the highest level since January 2004. The difference is now it is rising, while at that time it was coming down. <u>The spread between the 10-year bond yield and the earnings yield based on the current P/E ratio is 2.3%, meaning the 10-year bond yield is almost the same as the S&P 1500 earnings yield. That spread is below levels seen at May 2006, July 2007, and June 2008. Each of those occurrences was followed by a sharp drop in equities.</u> The spread based on the forward P/E ratio is still at levels where stocks would usually be attractive, but that spread has been narrowing also and is in the area it was in during the May to July stock plunge. The problem is that aggregate reported earnings dropped precipitously during the recent earnings season, while projected earnings continue moving inexorably lower. With earnings season essentially 99% over reported earnings and projections may level off for a while, but if interest rates move higher in the near-term these spreads will only worsen.

Valuations are at levels where equities have been vulnerable in the past, short-term sentiment is getting bullish, buyers have been reluctant, and we are in the seasonally weak months of September and October. *<u>Therefore, investors should be on high alert for the possibility that equities may be about to make another leg down.</u>* The factors that could help keep a floor under stocks would be continued weakness in the price of crude oil and commodities, continued strength in the U.S. Dollar, and an extremely active Fed.

<u>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.</u>

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

Tuesday September 2, 2008 **Closing prices of August 29, 2008**

So far 493 companies in the S&P 500 have reported second quarter earnings. According to Bloomberg, 67.8% have had positive surprises, 6.9% 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 90.0% probability that the Fed will *leave rates at 2.00%,* and a 10.0% probability of *raising 25 basis points to 2.25* when they meet on September 16th.

The S&P 1500 (292.72) was down 1.338% Friday. Average price per share was down 1.10%. Volume was 92% of its 10-day average and 73% of its 30-day average. 19.65% of the S&P 1500 stocks were up on the day. Up Dollars was 4% of its 10-day moving average and Down Dollars was 161% of its 10-day moving average. For the week the index was down 0.63% on decreasing and well below average weekly volume.

Options expire September 19th.

IMPORTANT DISCLOSURES

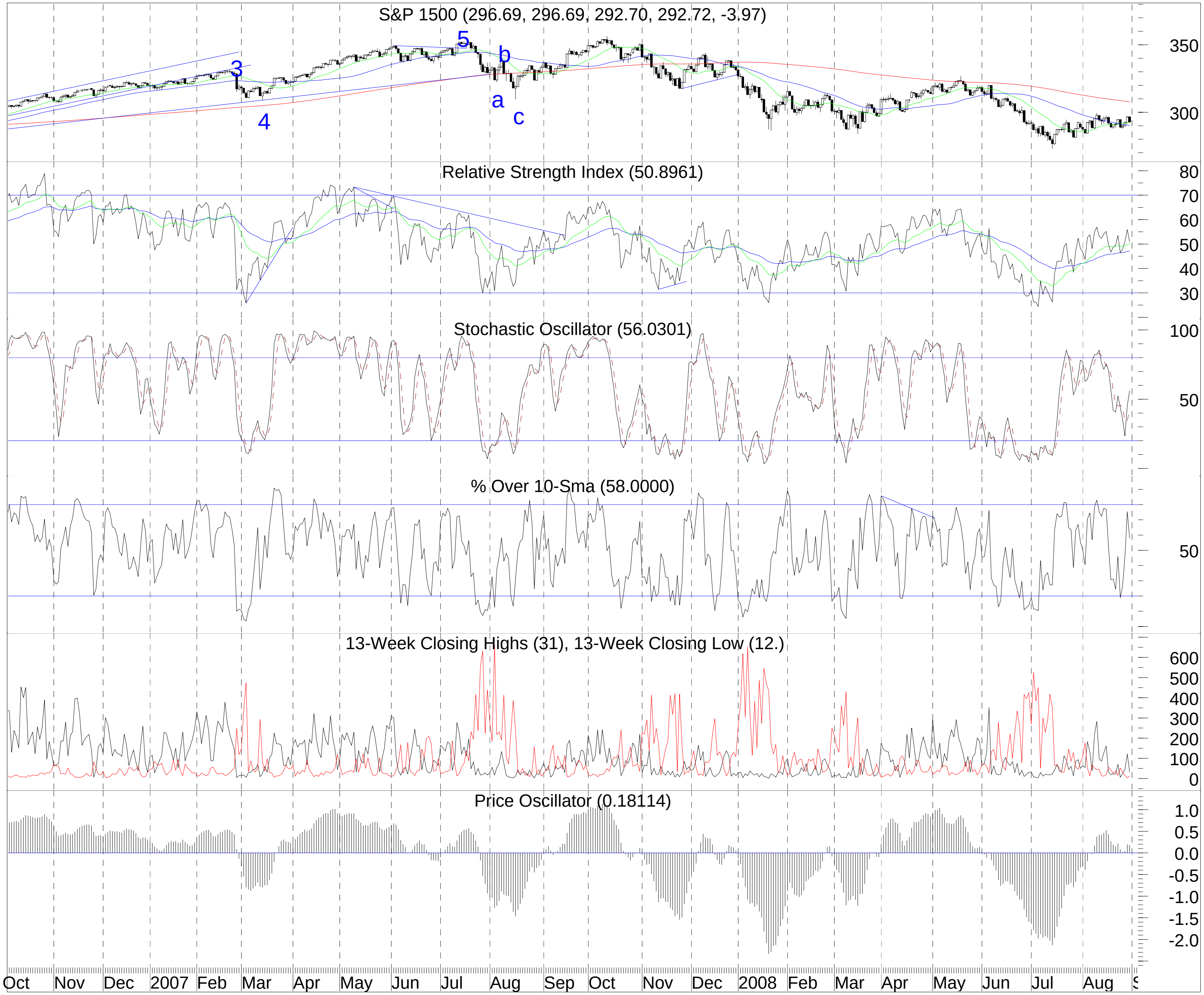
Friday's action left the S&P 1500 just above its 20 and 50-sma.

The monthly chart of the S&P 500 shows a hammer was printed in July. Hammers are bottoming candles. This was followed by a bullish engulfing candle in August.

Combined with the hammer printed on the weekly chart in mid-July, there is a good case to be made for the July bottom holding at least for a while longer, although the weekly stochastic indicates the strong possibility of a retest of the July lows.

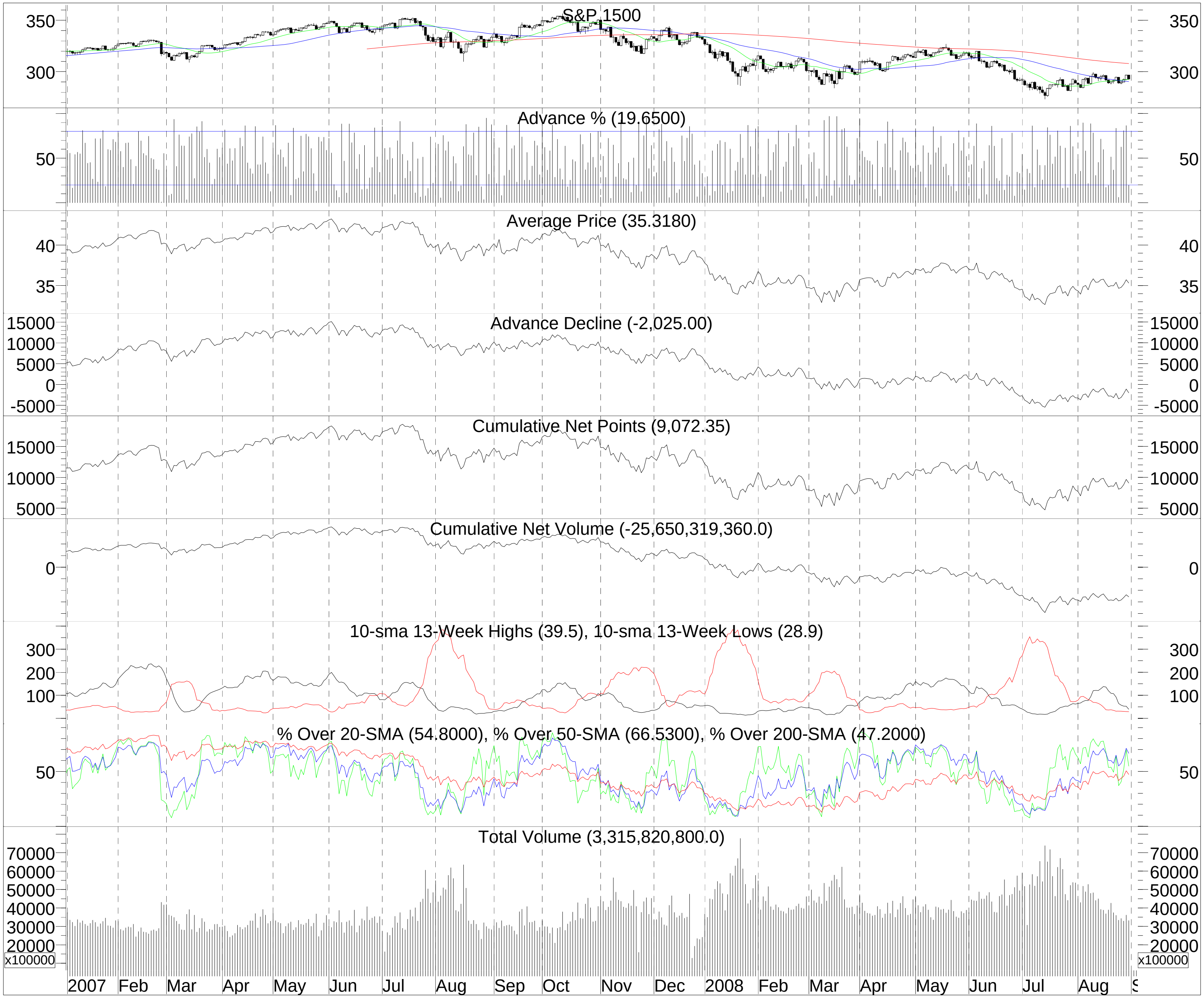
These moving averages show the S&P 500 is in a confirmed downtrend.

The stochastic is giving a sell signal from the overbought zone, so some weakness is to be expected. However, the other oscillators are already at low levels, so a move lower should not be too extreme, and could create a terrific oversold entry point.



Our oscillators are at neutral levels.

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



19.65% of the S&P 1500 traded higher Friday.

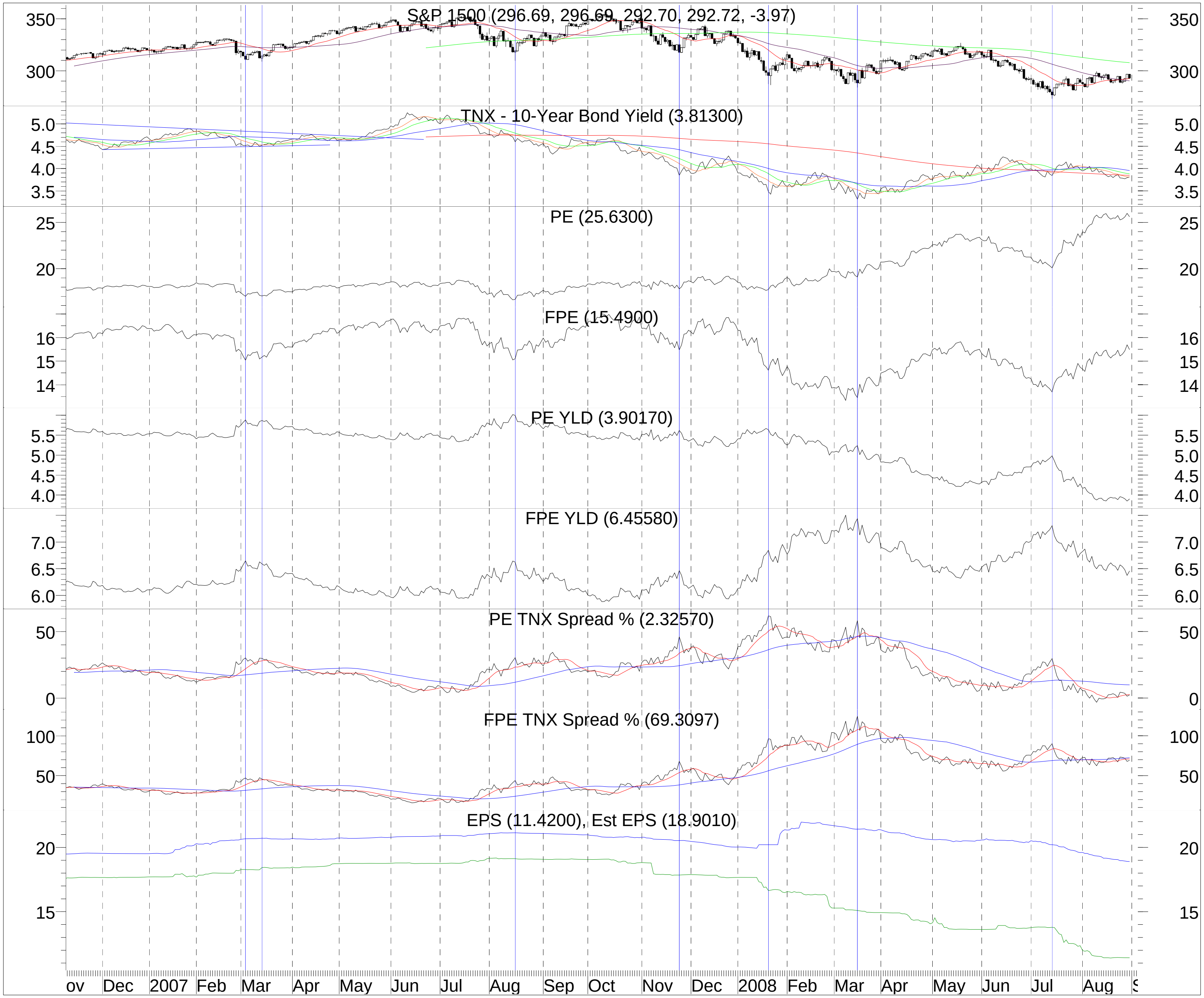
The average of 13-week highs is still above the average of 13-week lows.

Market breadth has improved lately, with almost half of stocks above their 200-sma.

Volume has been very low the last few weeks.

Our proprietary options indicator is showing bullishness among options buyers, but not yet the extreme levels seen at important tops. Still, it can leave stocks vulnerable at these levels and at the least will prevent any significant move higher from here.

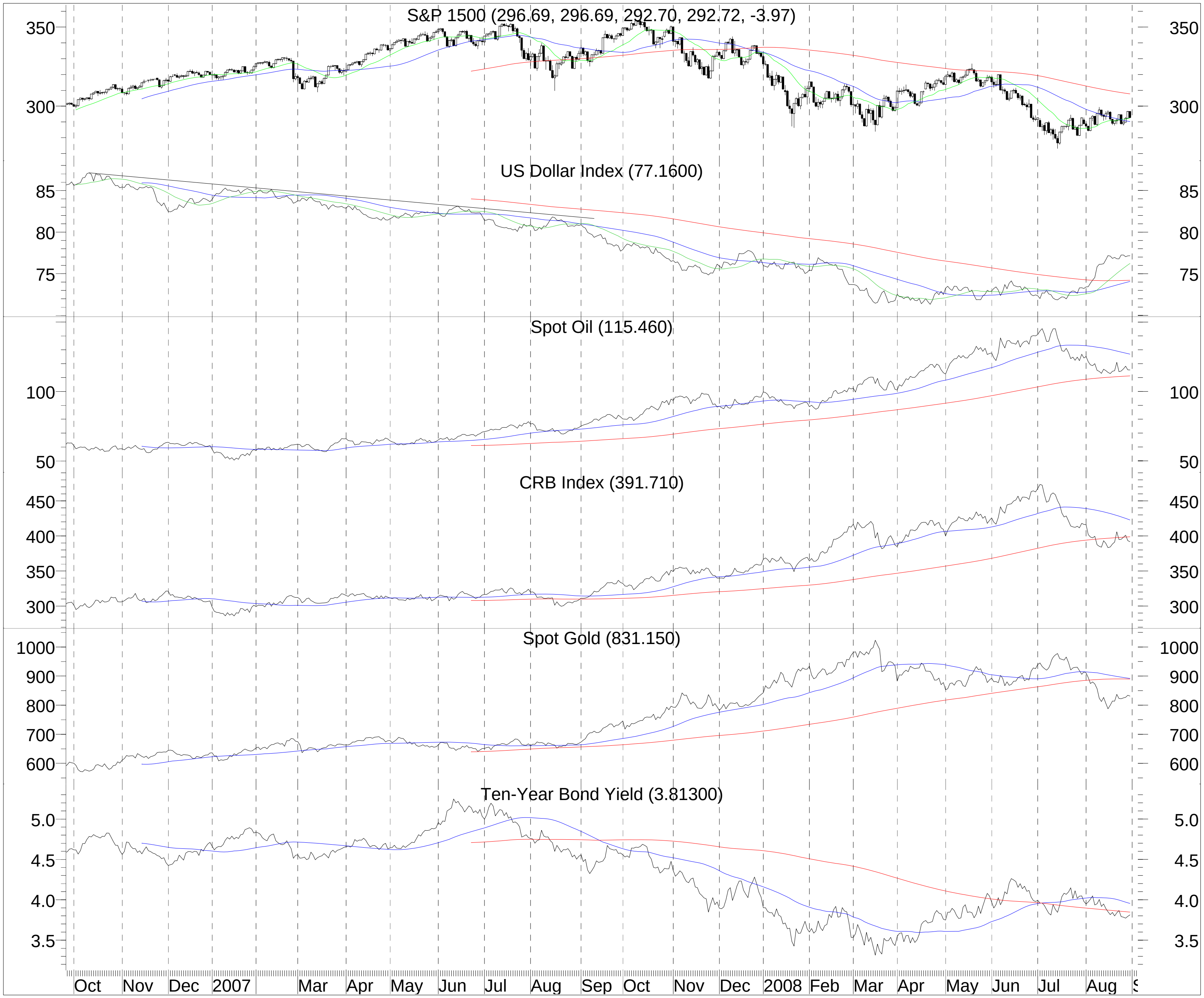
Our 10-day statistics of supply (red lines) are greater than our stats of demand (green lines). However, with recent volume levels so low the data may not be so meaningful



On Thursday the P/E ratio hit the highest level since January 2004. At that time it was coming down, versus today's which is moving higher.

The forward P/E is just under the level it was at when stocks topped in May.

The spread between the P/E yield and the 10-year bond yield remains at a very low level. The spread based on the forward P/E is at a level where stocks should be attractive, but earnings and projections continue to move inexorably lower.



The U.S. Dollar Index is overbought and showing a negative RSI divergence. However, it is in an uptrend.

Crude oil is still above support in the 111 - 112 area. A break below this would target the 100 area.

The commodity index is below the 200-sma and is in a confirmed downtrend.

Gold has bounced up to a resistance level. If it can break through it should make its way back to the high 800s.