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

Thursday September 4, 2008 **Closing prices of September 3, 2008**

September has started off with the expected increase in volume along with weakness in the major indexes, but so far the sideways range equities have been locked in for the past month is intact. A brutal sector rotation continues as former leaders energy and basic materials are getting flogged and former laggards financials, homebuilders, and even airlines are performing well.

Small-caps are outperforming. Quarter-to-date they are up 6.42% versus mid-caps and large-caps, which are down 2.06% and 0.39% respectively. Foreign stocks are getting walloped due to the strong U.S. Dollar, with the ADR Index down 9.42%.

The concerns we have had for weeks are still intact, while at the same time equities have shown surprising resilience. Spreads between aggregate earnings yields and the 10-year bond yield have improved the last few days as stocks and yields have moved lower in tandem, but valuations remain near levels where equities have been vulnerable in the past. 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 worsen again.

Short-term sentiment has been getting bullish, buyers have been reluctant, and we are in the seasonally weak months of September and October. *Therefore, investors should be on high alert for the possibility that equities may be about to make another leg down.* 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 bonds and the U.S. Dollar, and an extremely active Fed.

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.

So far 495 companies in the S&P 500 have reported second quarter earnings. According to Bloomberg, 67.5% have had positive surprises, 7.1% have been in line, and 25.4% 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 4.8%, respectively.

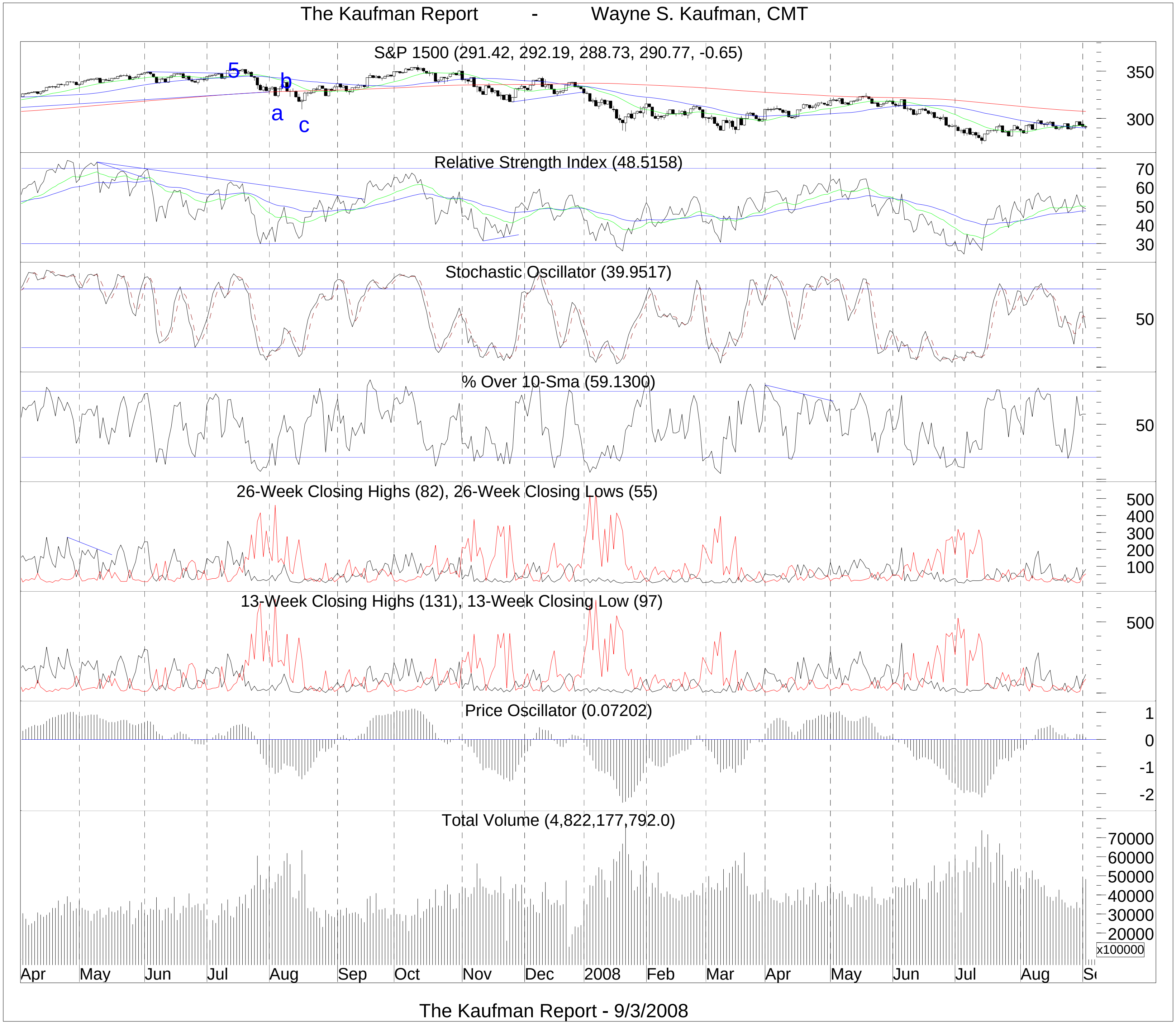
Federal Funds futures are pricing in an 92.0% probability that the Fed will *leave rates at 2.00%,* and an 8.0% probability of *raising 25 basis points to 2.25* when they meet on September 16th.

The S&P 1500 (290.77) was down 0.223% Wednesday. Average price per share was down 0.15%. Volume was 127% of its 10-day average and 108% of its 30-day average. 56.2% of the S&P 1500 stocks were up on the day. Up Dollars was 71% of its 10-day moving average and Down Dollars was 87% of its 10-day moving average, as neither the bulls nor the bears could create a decisive advantage.

Options expire September 19th.

The S&P 1500 continues to trade in a narrow range. It is below the 20-sma, but is hanging onto the 50-sma (blue).

Bollinger Bands (not shown) have narrowed, so we do not expect this trading range to last much longer.

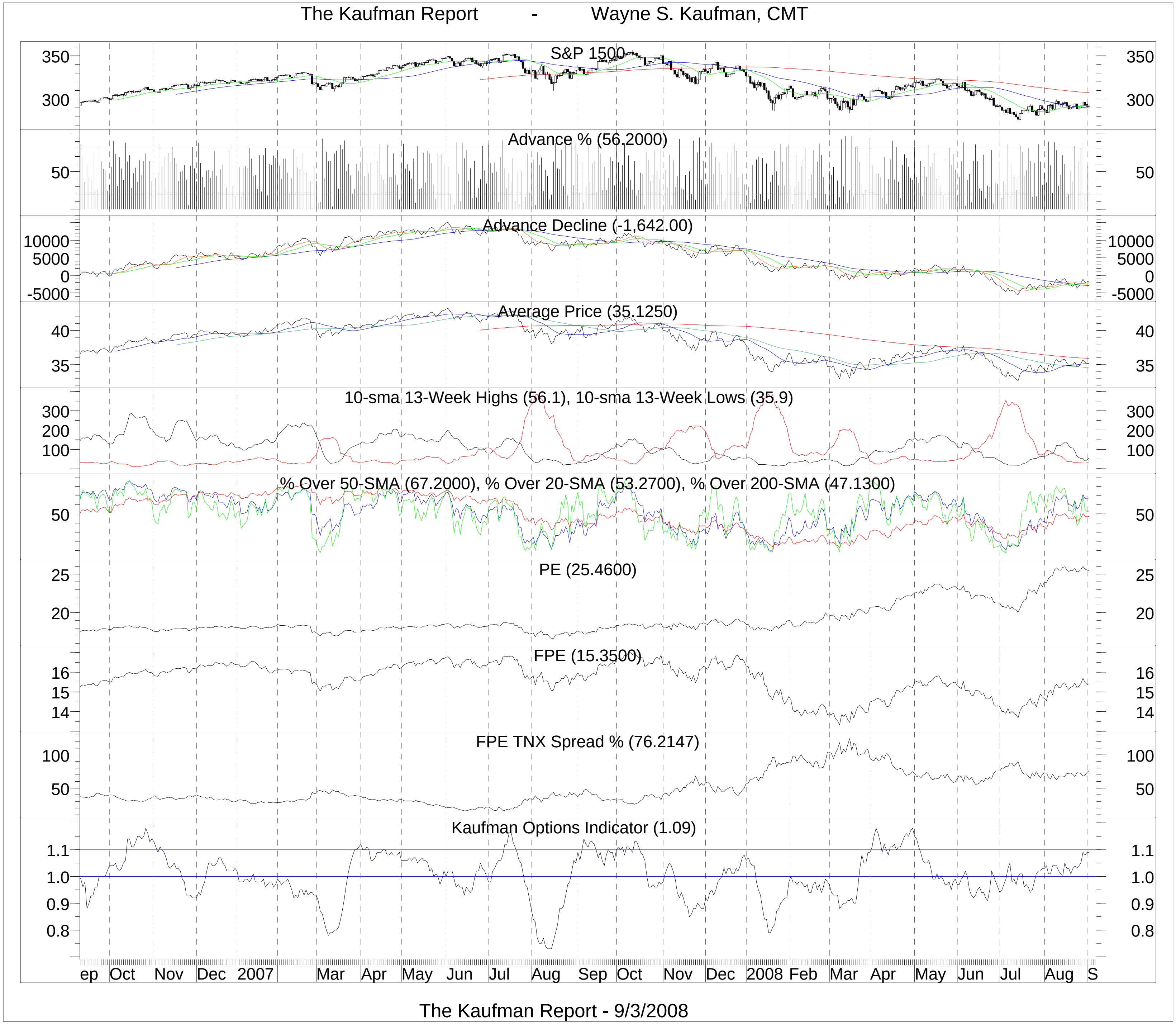


Our oscillators are in neutral territory.

New highs were greater than new lows Wednesday.

Our price oscillator remains in positive territory.

Volume has jumped as September has stasrted.



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

Average price per share is up 7.56% since 7/15 versus 6.17% for the S&P 1500, showing the outperformance of small-caps.

The average of new highs is still greater than the average of new lows, but both are rising the last few days. This can be a red flag.

Spreads between the 10-year bond yield and earnings yields are rising again and are at the best levels since July.

Our proprietary options indicator is showing bullishness, but not yet at the extremes that have marked important tops. However, it does leave stocks vulnerable to sharp drops.