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The Kaufman Report

Trade what you see, not what you think.

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Friday September 5, 2008 **Closing prices of September 4, 2008**

Bad news in the form of higher than expected jobless claims and warnings from various companies including Corning, Terex, Altera, MEMC, and Ciena caused stocks to break down out of the narrow trading range they have been in for a month. The S&P 1500 has dropped for four straight days for the first time since January 18th.

It was a panic-selling day as more than 90% of stocks, points, and dollars were down.

We have been warning investors to be on high alert for the possibility that equities may be about to make another leg down, and that leg has started. The odds strongly favor a retest of the July low. The factors that could help put 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.

<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>

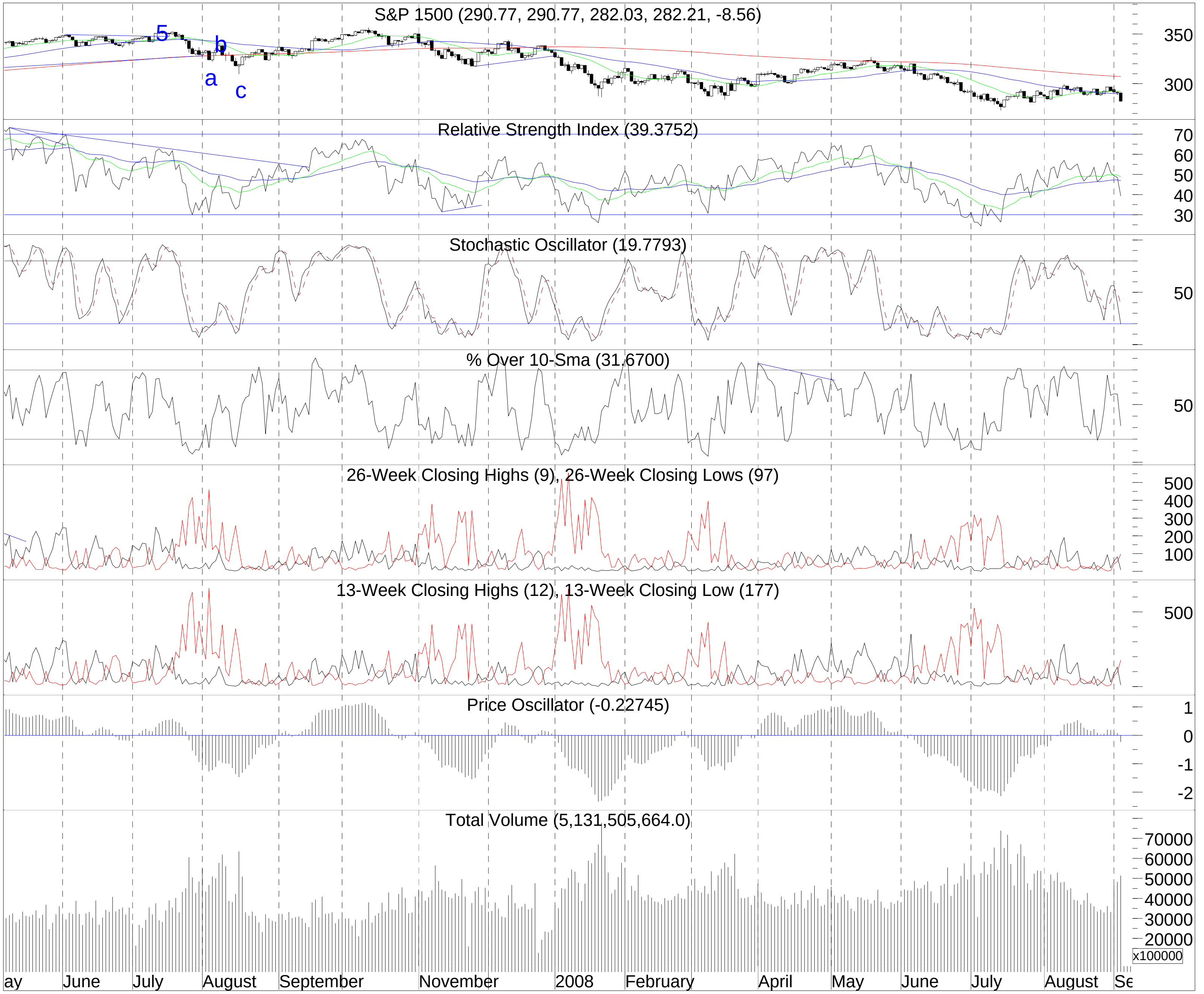
So far 496 companies in the S&P 500 have reported second quarter earnings. According to Bloomberg, 67.4% have had positive surprises, 7.3% have been in line, and 25.3% have been negative. The year-over-year change has been -23.4% on a share-weighted basis, -23.4% market cap-weighted, and -12.4% non-weighted.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

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

The S&P 1500 (282.21) was down 2.944% Thursday. Average price per share was down 2.87%. Volume was 132% of its 10-day average and 116% of its 30-day average. 7.04% of the S&P 1500 stocks were up on the day. Up Dollars was less than 1% of its 10-day moving average and Down Dollars was 367% of its 10-day moving average.
Options expire September 19th.

IMPORTANT DISCLOSURES

We said Wednesday night that the Bollinger Bands had narrowed to the point where a sharp move was probably coming, and on Thursday the S&P 1500 broke down out of the recent narrow range. This is the second bearish rising wedge to break down recently, and the odds strongly favor a retest of the July low.



Our oscillators are not yet oversold.

New lows are starting to break out.

Our price oscillator, a good indicator of trends, has turned negative.

Volume has expanded as stocks sold off.

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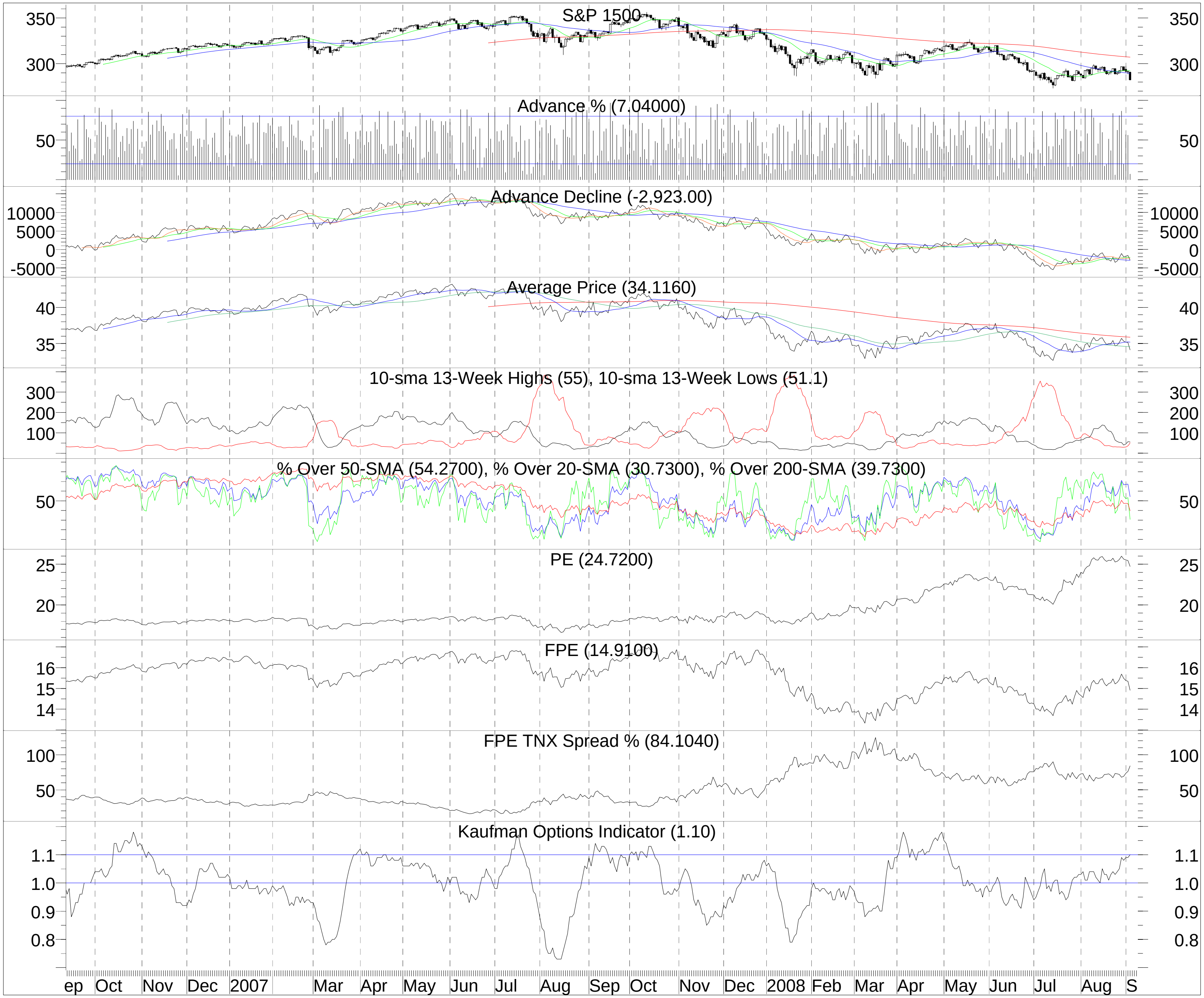

7.04% of stocks traded higher Thursday.

Our proprietary options indicator has been showing bullishness, which we have said leaves stocks vulnerable to sharp drops.