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The Kaufman Report

Trade what you see, not what you think.

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Tuesday September 8, 2009 **Closing prices of September 4, 2009**

Last Sunday we discussed the increase in negative divergences and new high reversals, and the increase in pessimism shown by options buyers. We said it appeared investors were gearing up for the widely broadcast weakness in September and October. The divergences kicked in as stocks gapped down and stayed down Monday, followed on Tuesday by a 90% down day. By Wednesday the percent over 10-sma was oversold at 13.13%, and stocks bounced Thursday and Friday with back-to-back days of strong market breadth with buying statistics over 80% of the total for both days. Normally we would be very optimistic from two strong days like that, but they came on low pre-holiday volume which tempers our enthusiasm.

The recent weakness seems to be more from reluctance on the part of buyers than from an increase in selling. In the short-term stocks can go either way, but we don't expect any further pullback to be too deep due to the muted levels of selling and the increased pessimism still showing up in our options indicator.

The next three weeks promise to be very interesting as we have a quadruple witching options expiration on September 18th, an FOMC meeting on September 23rd, and the end of the third quarter which brings with it earnings pre-announcements. We think there is a strong possibility of a period of consolidation with possibly a downward drift as investors watch for further developments on the economy.

For months we have said the most important factors in this tremendous rally have been huge global liquidity and the reluctance of investors to sell equities. Those factors remain intact and in spite of demand statistics for stocks not being impressive, selling statistics remain even more muted. As long as sellers remain unmotivated the path of least resistance is up, and with earnings season now out of the way it will probably take some very negative economic news to create more than minor pullbacks.

Seasonality could be a catalyst for sellers. September is known as the worst month of the year, and October is famous for market crashes. Many market watchers have been calling for a major plunge to occur during this period, although we do not see that happening. A sharp correction is certainly a possibility we will watch for, but as always, the more market participants there are expecting a certain outcome the less likely it is to occur. We do expect volatility to increase in this period, especially around the time of September options expiration, which is a quadruple-witch.

We will remain on guard for any signs of a change in trend. We think there is the potential for a deep correction at some point. <u>However, as we have been saying for some time, we accept the possibility that huge global government intervention along with a possibly healing economy and companies that have become very lean and mean could create a scenario where profits will start to surprise to the upside and the deteriorating earnings trend will start to change.</u> If so, we will be more than happy to delay or even cancel our expected bearishness.

<u>Based on the S&P 500 the short-term, intermediate-term and long-term trends are up. Traders should not hesitate to rotate out of lagging sectors and stocks and into leaders. Caution is advised regarding entry points and stop losses should be used to keep losses manageable. Very aggressive traders can enter short keeping in mind shorting is counter-trend at this time and they may have to cover quickly.</u>

IMPORTANT DISCLOSURES

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Tuesday September 8, 2009 **Closing prices of September 4, 2009**

The S&P 1500 (231.92) was up 1.302% Friday. Average price per share was up 1.14%. Volume was 75% of its 10-day average and 71% of its 30-day average. 86.63% of the S&P 1500 stocks were up, with up volume at 89.04% and up points at 93.75%. Up Dollars was 99.29% of total dollars, and was 308% of its 10-day moving average. Down Dollars was 2% of its 10-day moving average.

For the week the index was down 1.26% on decreasing and well below average weekly volume.

The S&P 1500 is down 0.395% in September, up 10.81% quarter-to-date, up 13.17% year-to-date, and down 34.92% from the peak of 356.38 on 10/11/07. Average price per share is $28.92, down 33.10% from the peak of $43.23 on 6/4/07.

Percent over 10-sma: 41.80%. 13-Week Closing Highs: 110. 13-Week Closing Lows: 3.

Put/Call Ratio: 0.892. Kaufman Options Indicator: 0.92.

P/E Ratios: **109.50 (before charges)**, 19.04 (continuing operations), 17.62 (analyst estimates).

*P/E Yield 10-year Bond Yield Spreads: **-73% (earnings bef. charges),** 54% (earnings continuing ops), and 68% (projected earnings).*

Aggregate earnings before charges for the S&P 1500 peaked in August 2007 at $19.18 and are now at $2.15, a drop of 88.79%. Aggregate earnings from continuing operations peaked at $19.95 in September 2007 and are now $12.33, down 38.20%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $13.40, a drop of 38.95%.

496 of the S&P 500 have reported 2nd quarter earnings. According to Bloomberg, 72.2% had positive surprises, 8.8% were in line, and 19.0% have been negative. The year-over-year change has been -28.9% on a share-weighted basis, -21.3% market cap-weighted and -25.5% non-weighted. Ex-financial stocks these numbers are -27.9%, -23.0%, and -27.4 %, respectively.

Federal Funds futures are pricing in a probability of 70.0% that the Fed will leave rates unchanged and a probability of 30.0% of cutting rates 25 basis points to 0.00% when they meet on September 23rd. They are pricing in a probability of 70.0% of no change, 30.0% of cutting 25 basis points to 0.00%, and 0.0% of raising 25 basis points to 0.50% when they meet on November 4th.

IMPORTANT DISCLOSURES

	Daily	WTD	MTD	QTD	YTD
Nasdaq 100	2.00%	-0.31%	0.79%	10.89%	35.19%
Nasdaq Composite	1.79%	-0.49%	0.48%	10.01%	28.01%
Bank of New York Mellon ADR	1.66%	-0.57%	0.63%	14.27%	23.05%
NYSE Composite	1.38%	-1.07%	-0.09%	12.40%	15.29%
S&P 500	1.31%	-1.22%	-0.41%	10.56%	12.53%
S&P 1500	1.30%	-1.26%	-0.40%	10.81%	13.17%
S&P Midcap 400	1.25%	-1.48%	-0.18%	13.01%	21.38%
S&P Smallcap 600	1.22%	-1.88%	-0.45%	12.13%	11.96%
Dow Jones Industrials	1.03%	-1.08%	-0.58%	11.77%	7.58%

	Daily	WTD	MTD	QTD	YTD
Industrials	1.99%	-0.15%	1.02%	14.92%	6.10%
Information Technology	1.68%	-0.71%	0.19%	11.92%	38.87%
Telecom Services	1.56%	-1.92%	-1.32%	-0.24%	-6.96%
Energy	1.52%	-2.00%	-0.17%	4.49%	1.11%
Consumer Discretionary	1.46%	-1.43%	0.21%	13.25%	21.77%
Materials	1.41%	-0.57%	0.87%	16.53%	30.84%
Health Care	1.26%	-0.45%	-0.21%	7.71%	6.68%
Financials	0.83%	-3.61%	-3.24%	18.79%	13.14%
Consumer Staples	0.71%	0.56%	0.22%	7.26%	3.57%
Utilities	0.34%	-1.94%	-0.92%	2.91%	-1.28%

	Daily	WTD	MTD	QTD	YTD
Media	2.97%	-1.08%	0.99%	13.45%	15.58%
Transportation	2.21%	1.19%	2.63%	16.65%	9.10%
Capital Goods	2.03%	-0.50%	0.67%	15.14%	5.66%
Semiconductors & Equipment	1.88%	-1.46%	-0.80%	18.74%	42.74%
Software & Services	1.67%	-0.66%	0.15%	6.83%	30.17%
Technology Hardware & Equipment	1.63%	-0.52%	0.51%	14.13%	45.07%
Telecom Services	1.56%	-1.92%	-1.32%	-0.24%	-6.96%
Energy	1.52%	-2.00%	-0.17%	4.49%	1.11%
Consumer Durables & Apparel	1.51%	-2.44%	-0.63%	20.34%	18.97%
Materials	1.41%	-0.57%	0.87%	16.53%	30.84%
Real Estate	1.35%	-5.39%	-4.02%	17.85%	-1.63%
Pharmaceuticals, Biotech & Life Sciences	1.32%	-1.01%	-0.85%	6.02%	1.57%
Health Care Equip & Services	1.15%	0.80%	1.21%	11.59%	19.33%
Consumer Services	1.06%	-1.58%	-0.29%	6.06%	7.14%
Commercial & Professional Services	1.03%	-0.51%	-0.10%	7.75%	2.02%
Automobiles & Components	0.99%	-2.34%	-1.58%	23.23%	79.30%
Food, Beverage & Tobacco	0.97%	1.05%	0.89%	6.68%	8.89%
Diversified Financials	0.91%	-3.26%	-2.81%	18.81%	30.82%
Banks	0.86%	-3.63%	-3.92%	14.29%	-11.09%
Food & Staples Retailing	0.66%	1.38%	1.39%	10.91%	4.77%
Retailing	0.54%	-1.17%	0.40%	13.47%	31.06%
Utilities	0.34%	-1.94%	-0.92%	2.91%	-1.28%
Insurance	0.32%	-3.97%	-3.51%	24.48%	9.27%
Household & Personal Products	0.22%	-1.38%	-2.46%	4.58%	-7.36%

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The S&P 500 had its second day strong day in a row Friday after Tuesday's 90% down day. It reclaimed the 20-sma and is at resistance. Near-term support is at the 992 and 979 areas. Last week we said the recent action was looking like the period of early June. The sideways action was shorter, but the result was the same, a sharp move lower.

Momentum indicators are no longer at high levels, and the stochastic is showing a positive crossover from the oversold zone.

After entering a resistance zone on the weekly chart the S&P 500 stalled out. The 80-week moving average is just above the zone at 1053 and moving down 4 to 5 points per week.

Weekly momentum indicators remain at high levels and the stochastic is showing a negative crossover in the overbought zone.

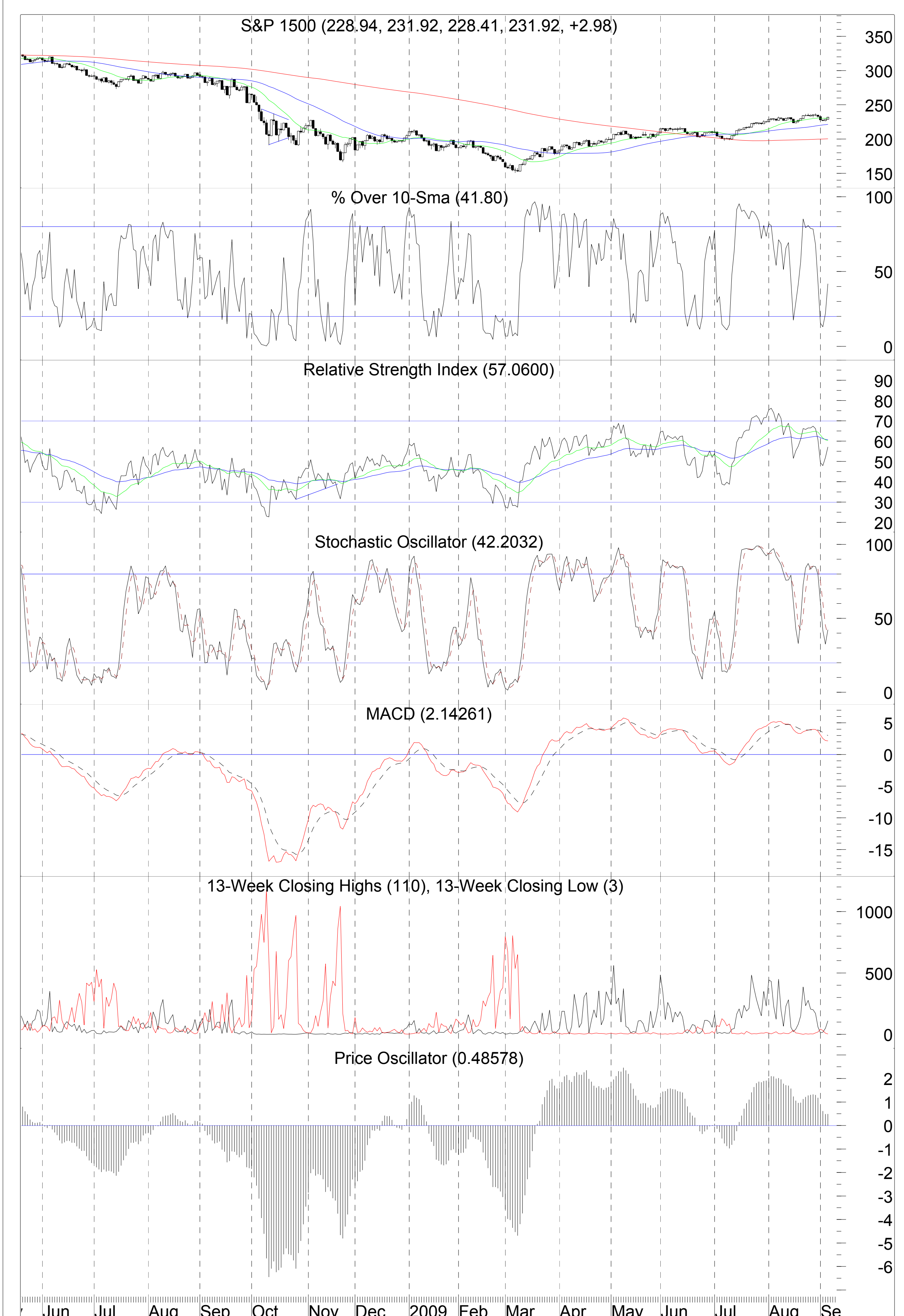
The Kaufman Report - Wayne S. Kaufman, CMT

The Nasdaq 100 also reclaimed its 20-sma on Friday. It has short-term support at the 1585 area, and the trend line from the March lows is also coming into play.

Momentum indicators are no longer at high levels and the stochastic is showing a positive crossover.

The weekly chart of the Nasdaq 100 shows it fell back after hitting a resistance level two weeks ago.

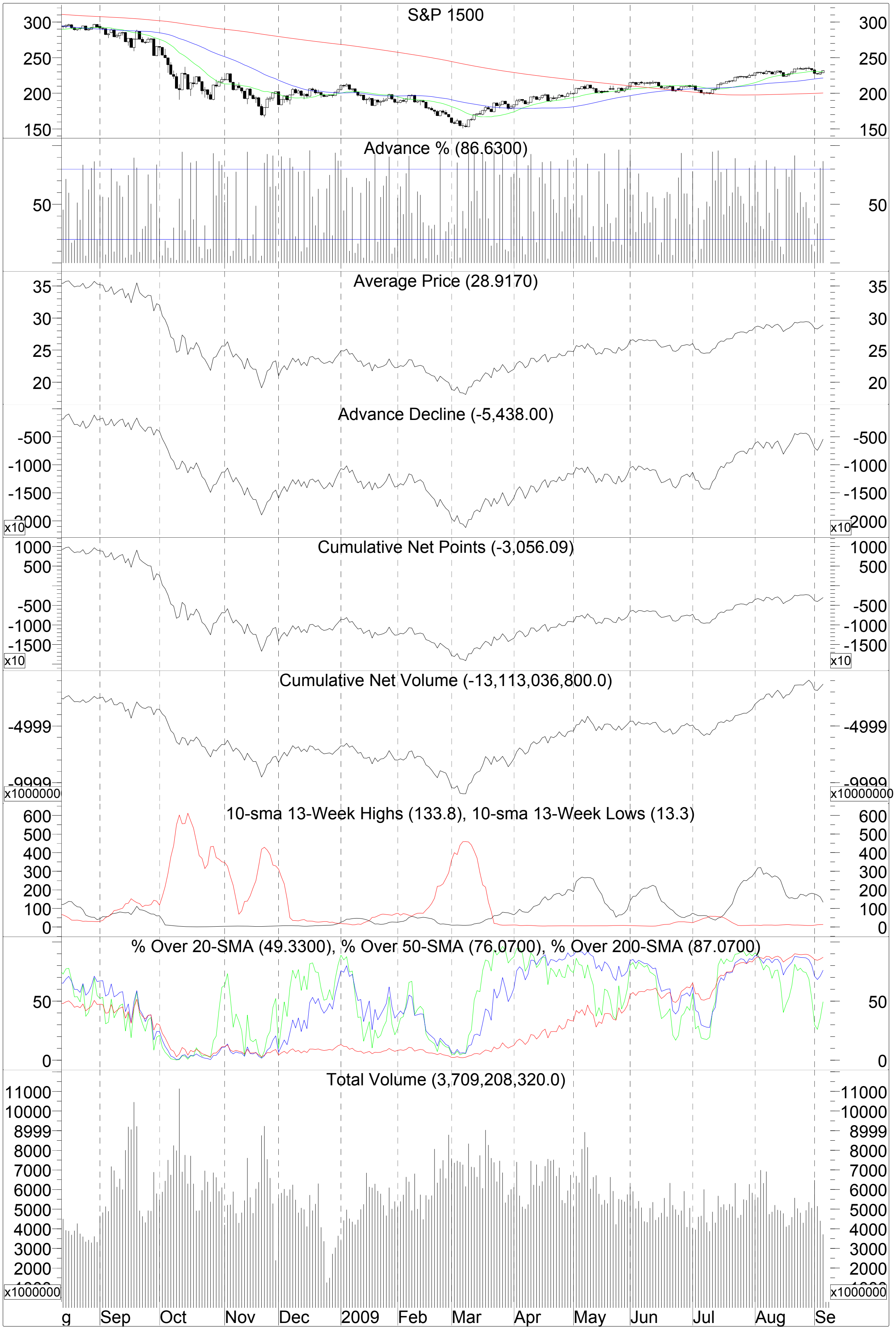
Momentum indicators remain at high levels.



Stocks bounced after the percent over 10-sma hit the oversold zone.

Momentum indicators are neutral.

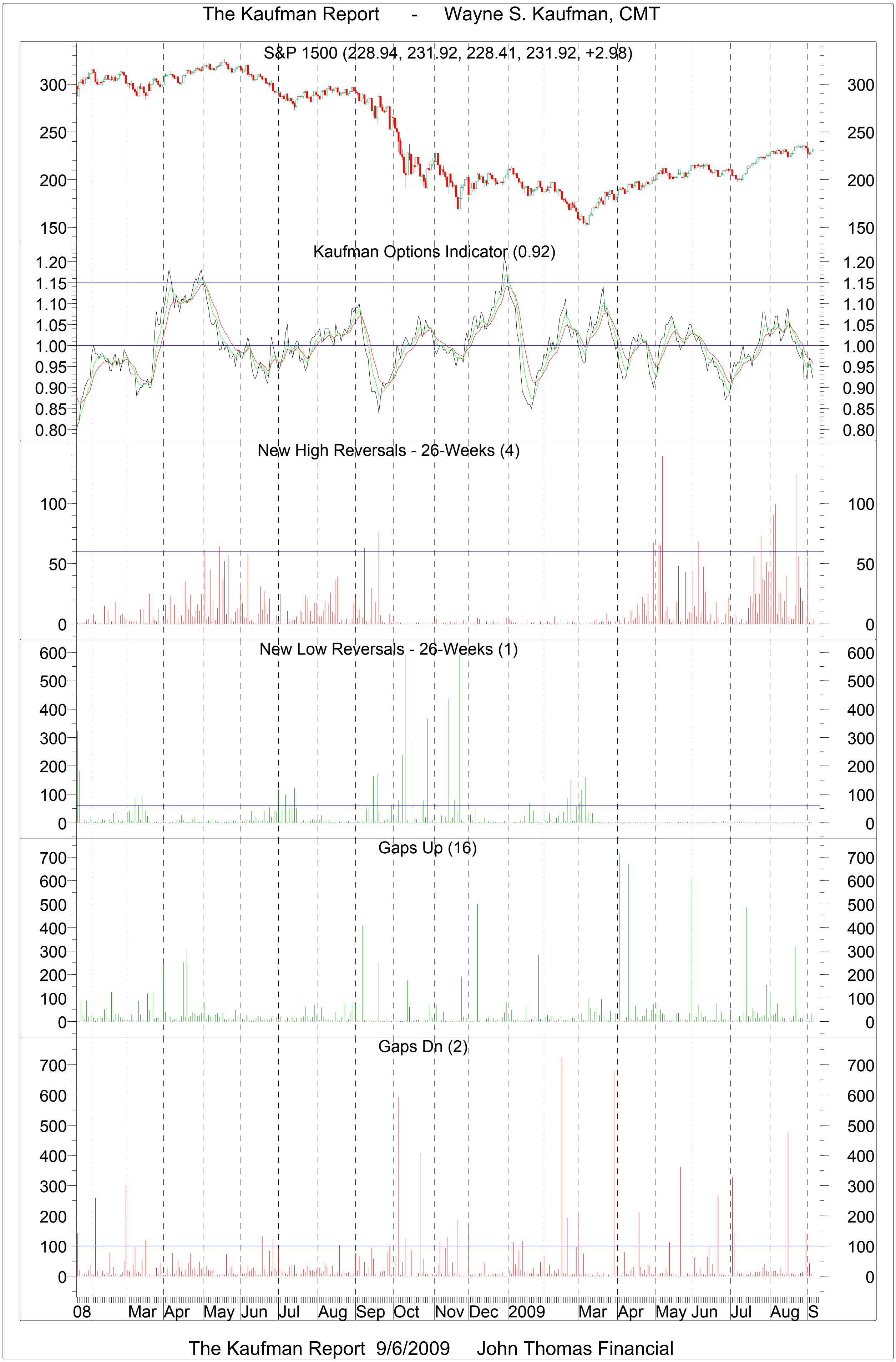
Our price oscillator, a good indicator of trends, remains in positive territory.



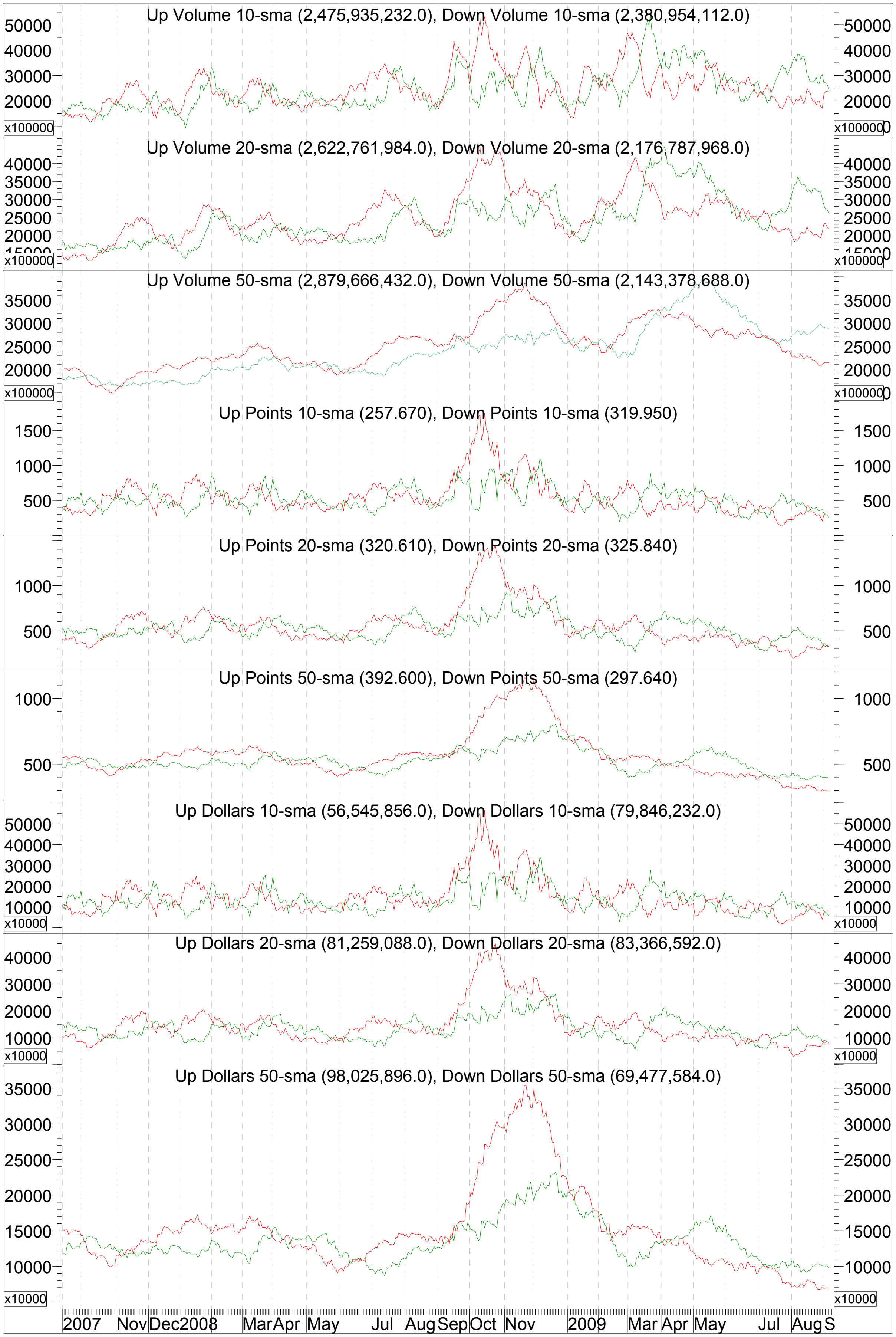
Back-to-back days of over 80% advancing stocks is a good sign.

New highs and market breadth have weakened in September.

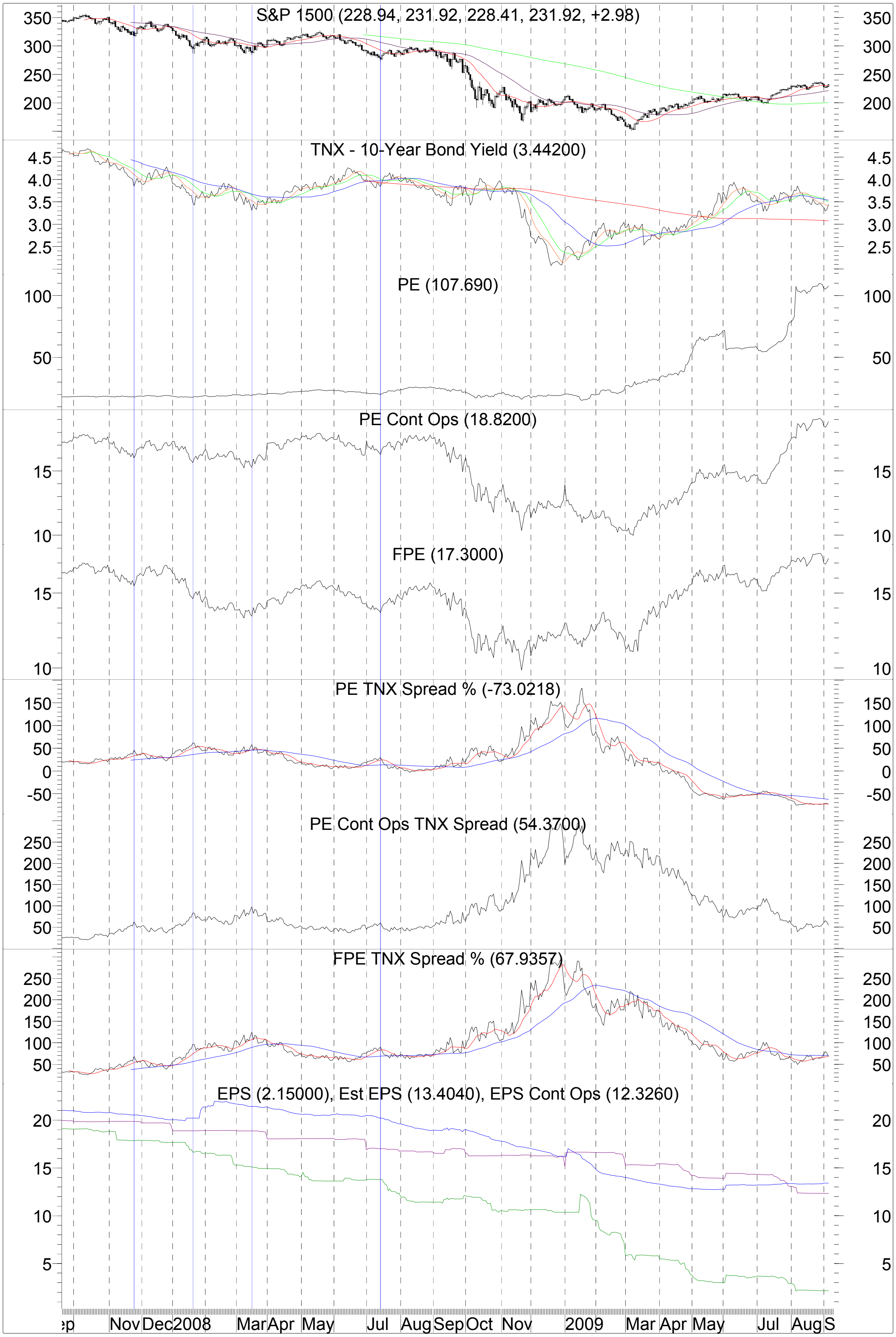
Unfortunately volume was light last week, leaving the strong days suspect.



Our proprietary options indicator is showing pessimism on the part of options buyers. Based on this we don't believe near-term pullbacks will be too deep, and rallies certainly can take place from these levels.



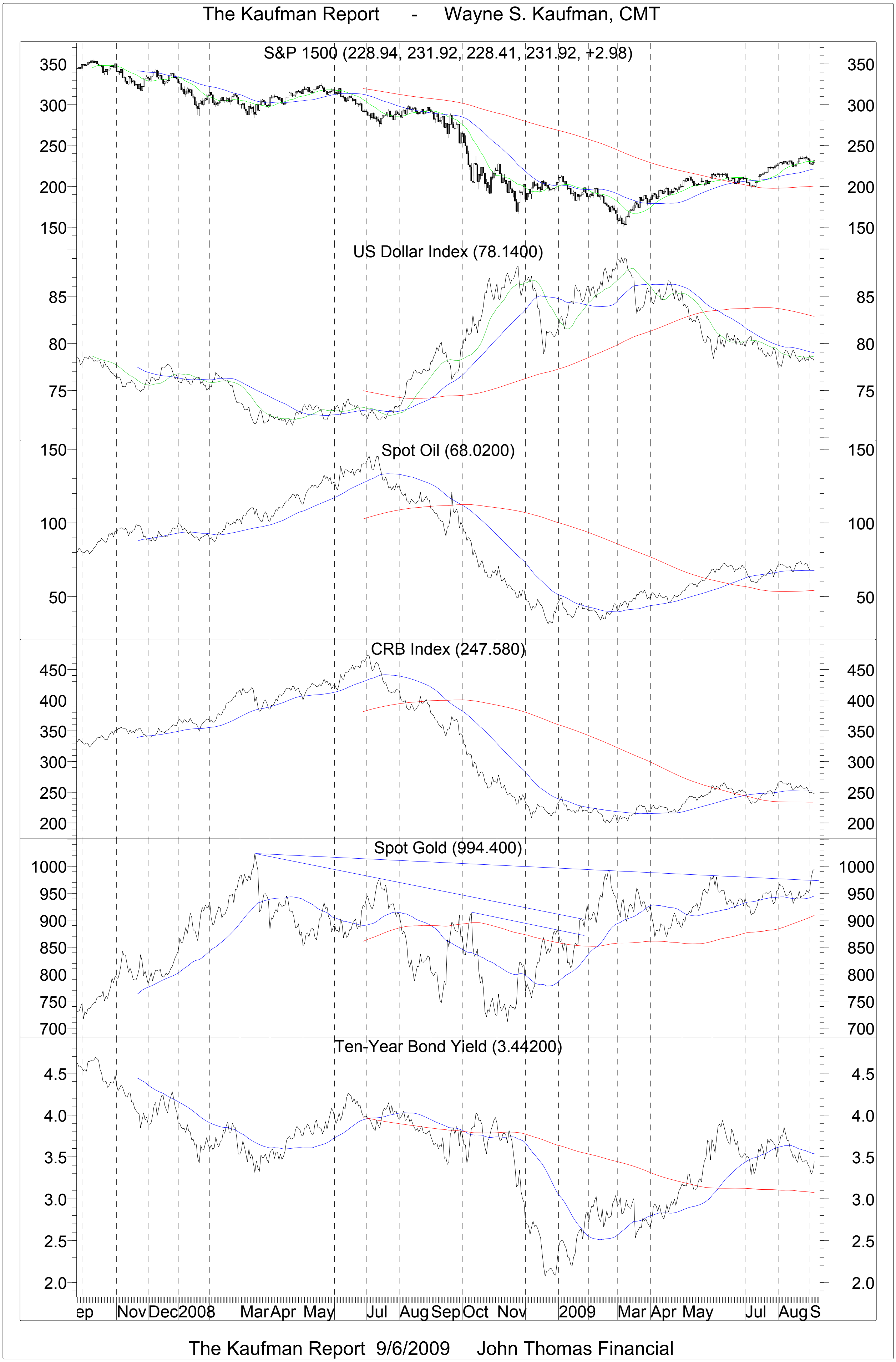
Our statistics of supply (red) versus demand (green) are showing some negative crossovers. However, these are more from a reticence on the part of buyers than from a big increase in selling. Selling statistics remain at relatively low levels, another sign that pullbacks should not be too deep.



After hitting high levels P/E ratios are moving sideways.

Spreads between bond and equity yields are also moving sideways.

With earnings season now over our earnings metrics are all flat lining. They need to start improving, especially earnings before charges, or equities will run into trouble.



The U.S. Dollar Index is trying to make up its mind and it remains just under important moving averages. It is in a tight range that won't last for long.

Gold finally broke out of the triangle we have been discussing. Our one concern here is the near-unanimous bullishness for gold.