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The Kaufman Report

Trade what you see, not what you think.

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Monday August 11, 2008 **Closing prices of August 8, 2008**

Stocks staged a broad based rally Friday breaking through a resistance level and helping the S&P 1500 post its best week since April. The market picture has changed dramatically over the past month as crude oil and commodities prices have dropped dramatically, the U.S. Dollar has rallied strongly, and the stock rally off the July 15th bottom is still intact.

We remain concerned about the P/E ratio of the S&P 1500, which is at the highest level since January 2004. The difference is now it is rising, while at that time it was coming down. The spread between the 10-year bond yield and the earnings yield based on the current P/E ratio is now negative, with the 10-year bond yield above the earnings yield. It is below levels seen at May 2006, July 2007, and June 2008. Each of those occurrences was followed by a sharp drop in equities. 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 have been dropping precipitously, while projected earnings are also moving inexorably lower, although at a slower rate.

The current rally could lead one to believe that investors have confidence in forecast earnings, along with the expectation that reported earnings will bottom soon. We find that scenario difficult to except, considering poor forecasts given of late by major companies, a slowing economy, and the fact that many recently leading sectors still have profit margins well above their historical averages. Therefore, we expect forecast earnings to continue to move lower and narrow the extremely wide spread between current and forecast earnings, which is at the widest level seen in years.

In spite of so many negative developments, options buyers, based on our proprietary options indicator, are moderately bullish. This optimism is not at the extreme levels seen at tops, but it will probably prevent any rally from going too much higher, and could set the stage for another sharp drop.

The current rally is still intact, so investors should continue to trade the long side. Valuations are at levels where equities have been vulnerable in the past, short-term sentiment is getting bullish, and we have entered the seasonally weak months of August and September. *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 the current rally going would be a continued drop in interest rates and/or the price of crude oil, and an extremely active Fed.

The short-term trend is up, the intermediate and long-term trends are down, and we reiterate that this continues to be a bifurcated, opportunistic trader's market, with adept traders able to take advantage long or short. Investors need to be alert to sector rotation and should not hesitate to move out of lagging sectors and stocks and into leaders.

IMPORTANT DISCLOSURES

I, Wayne S. Kaufman, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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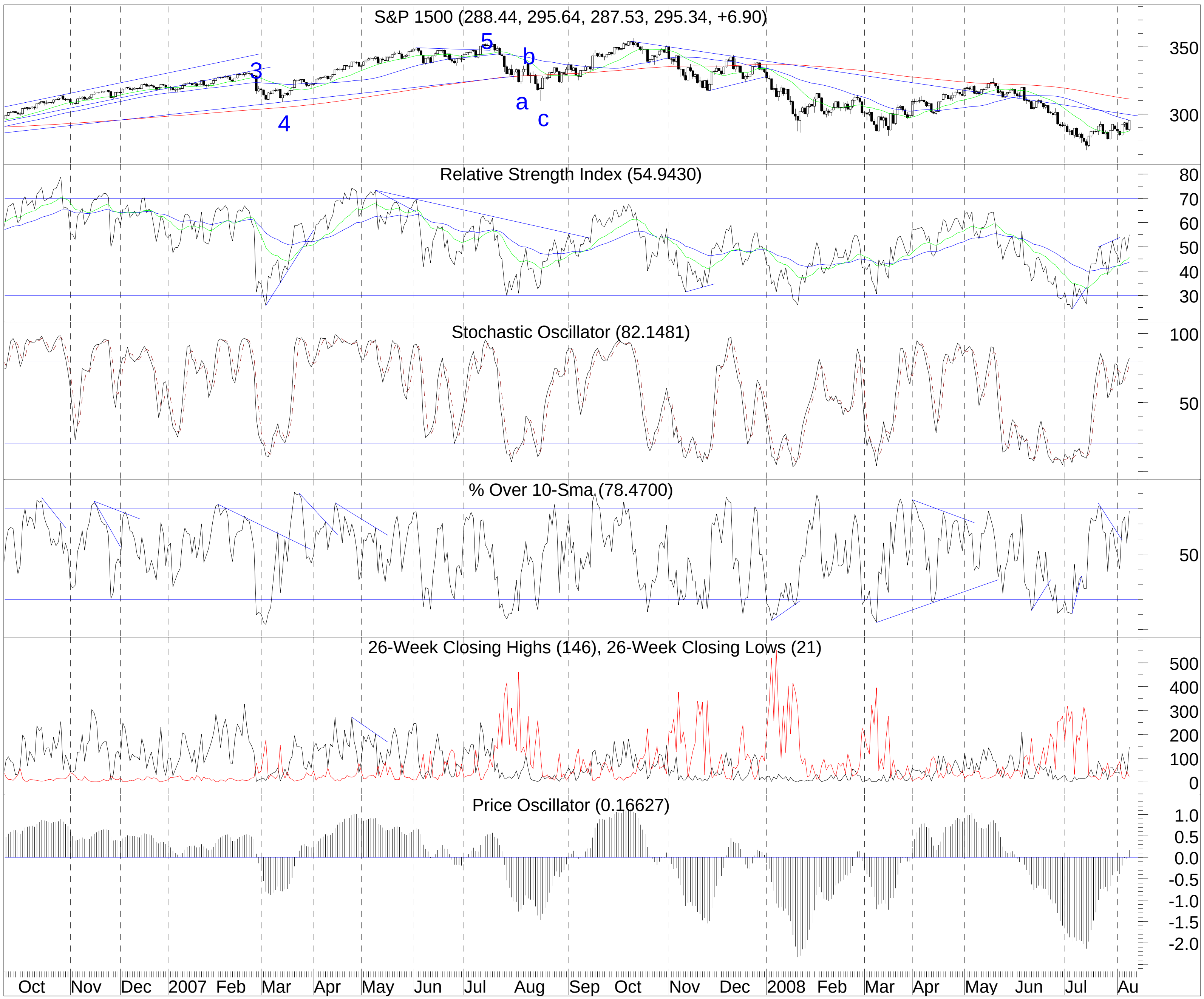
So far 453 companies in the S&P 500 have reported second quarter earnings. According to Bloomberg, 68.1% have had positive surprises, 6.4 % have been in line, and 25.5% have been negative. The year-over-year change has been -23.6% on a share-weighted basis, -23.6% market cap-weighted, and -11.7% non-weighted. Ex-financial stocks these numbers are 4.3%, 7.4%, and 5.1%, respectively.

Federal Funds futures are pricing in a 82.0% probability that the Fed will *leave rates at 2.00%,* and a 18.0% probability of *raising 25 basis points to 2.25* when they meet on September 16th.

The S&P 1500 (295.34) was up 2.392% Friday. Average price per share was up 2.57%. Volume was 97% of its 10-day average and 88% of its 30-day average. 88.68% of the S&P 1500 stocks were up on the day. Up Dollars was 260% of its 10-day moving average and Down Dollars was 4% of its 10-day moving average. For the week the index was up 2.78% on decreasing and lower than average weekly volume.

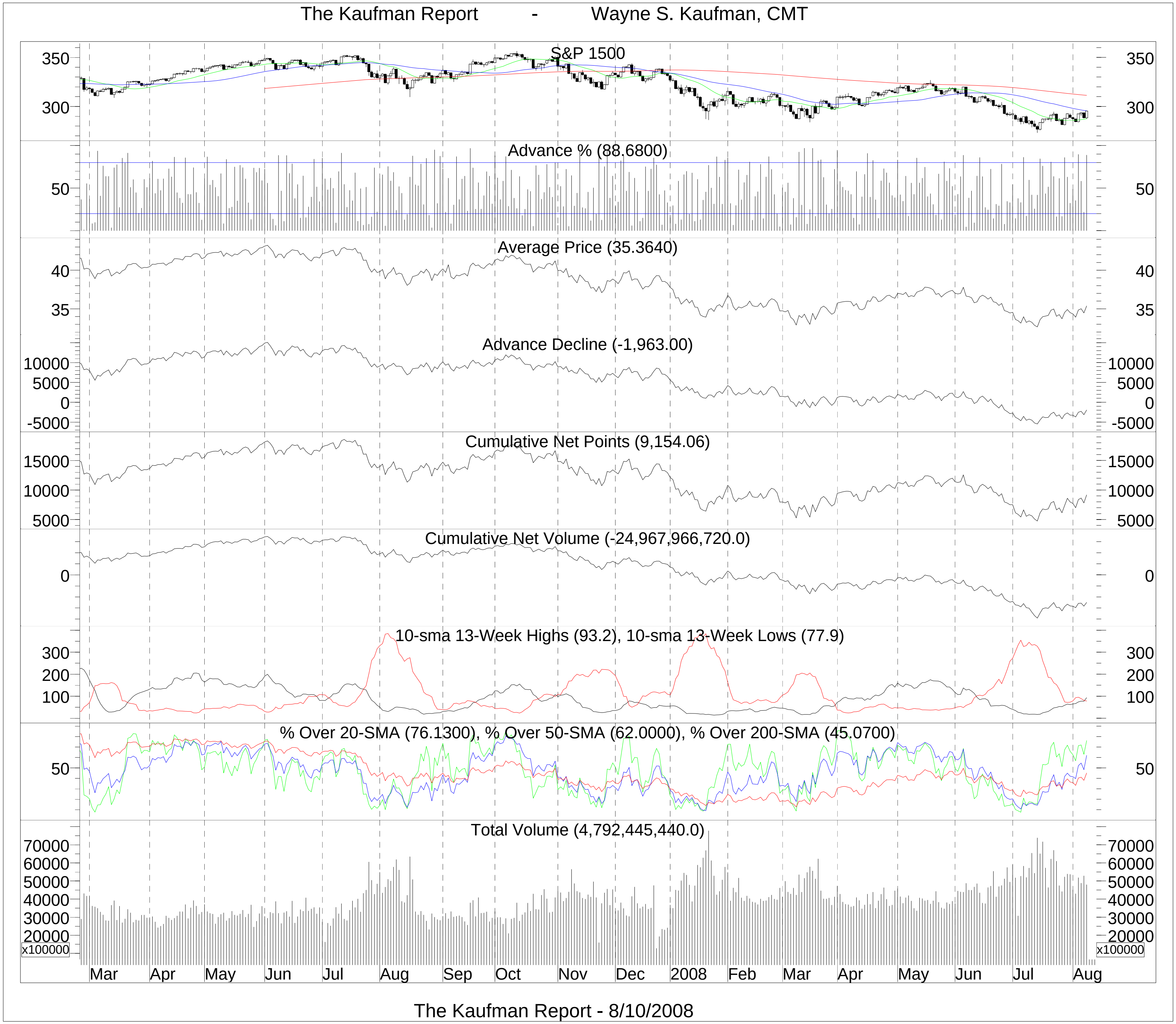
Options expire August 15th.



Our oscillators are at high levels, although not yet extremely overbought.

New highs Friday were the most since early June.

Our price oscillator, a good indicator of trends, turned positive Friday.

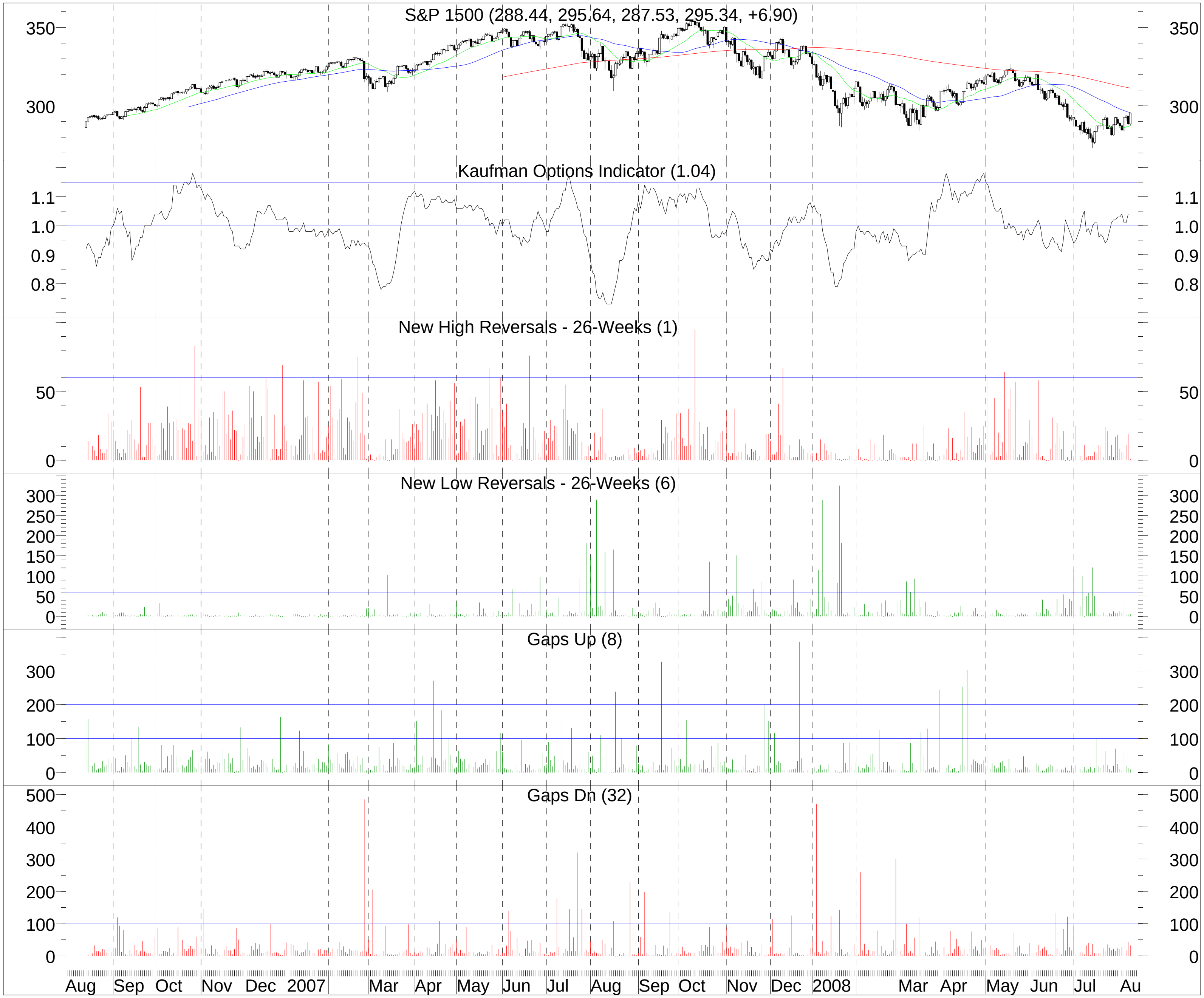


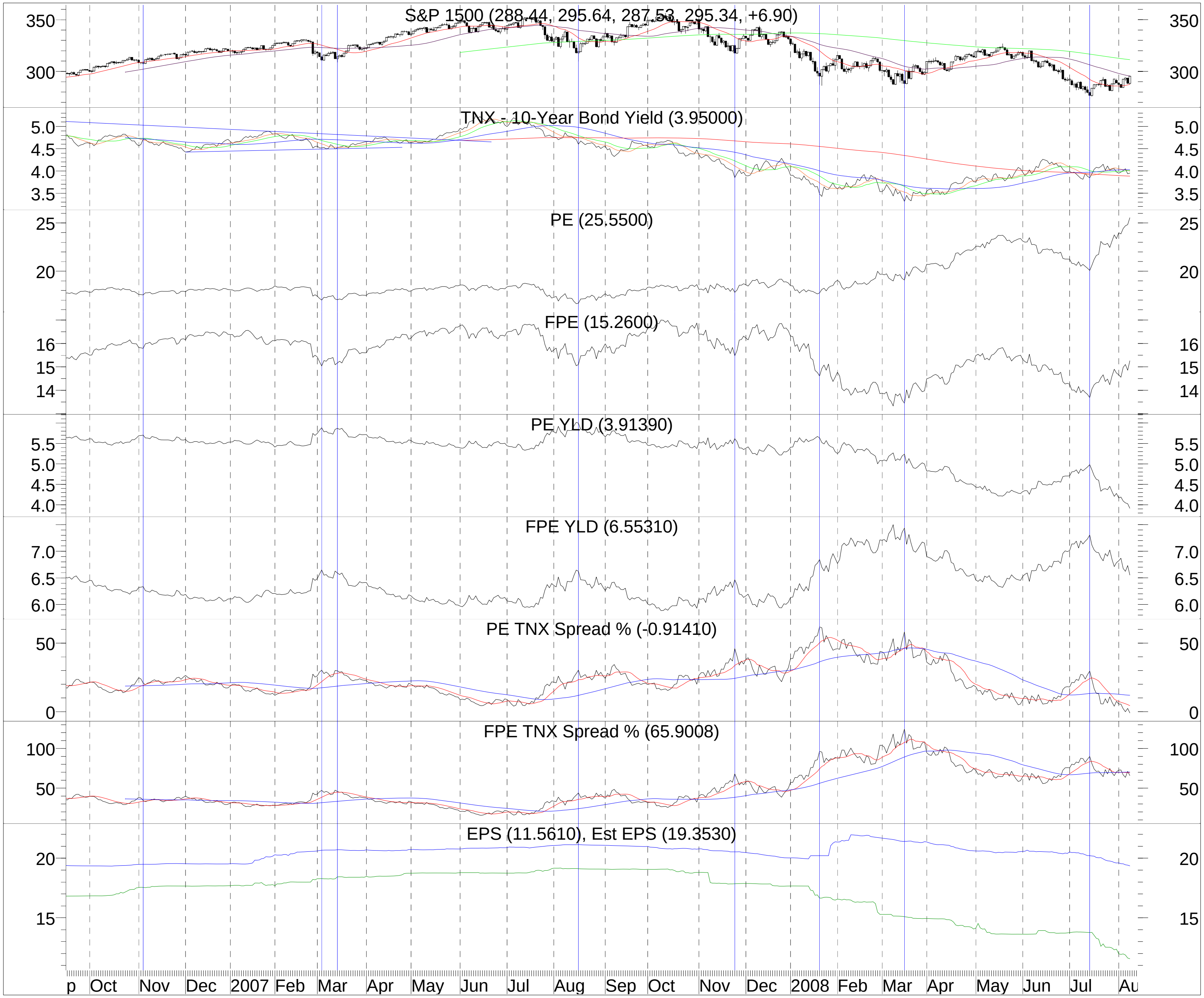
88.68% of stocks traded higher Friday.

The Advance Decline line remains strong.

The percent of stocks over various moving averages has improved dramatically.

Volume was decreasing during Friday's rally. Weekly volume was also decreasing and below average.


S&P 1500 (288.44, 295.64, 287.53, 295.34, +6.90)
Kaufman Options Indicator (1.04)
New High Reversals - 26-Weeks (1)
New Low Reversals - 26-Weeks (6)
Gaps Up (8)
Gaps Dn (32)
Aug Sep Oct Nov Dec 2007 Mar Apr May Jun Jul Aug Sep Oct Nov Dec 2008 Mar Apr May Jun Jul Au



The P/E ratio is the highest since January 2004 and still rising. At that time it was declining.

The 10-year bond yield is higher than the S&P 1500 earnings yield.

The spread between the 10-year bond yield and the forward P/E earnings yield is about at the level it was at during the May to July plunge.

Reported (green) and projected (blue) earnings continue to move lower.

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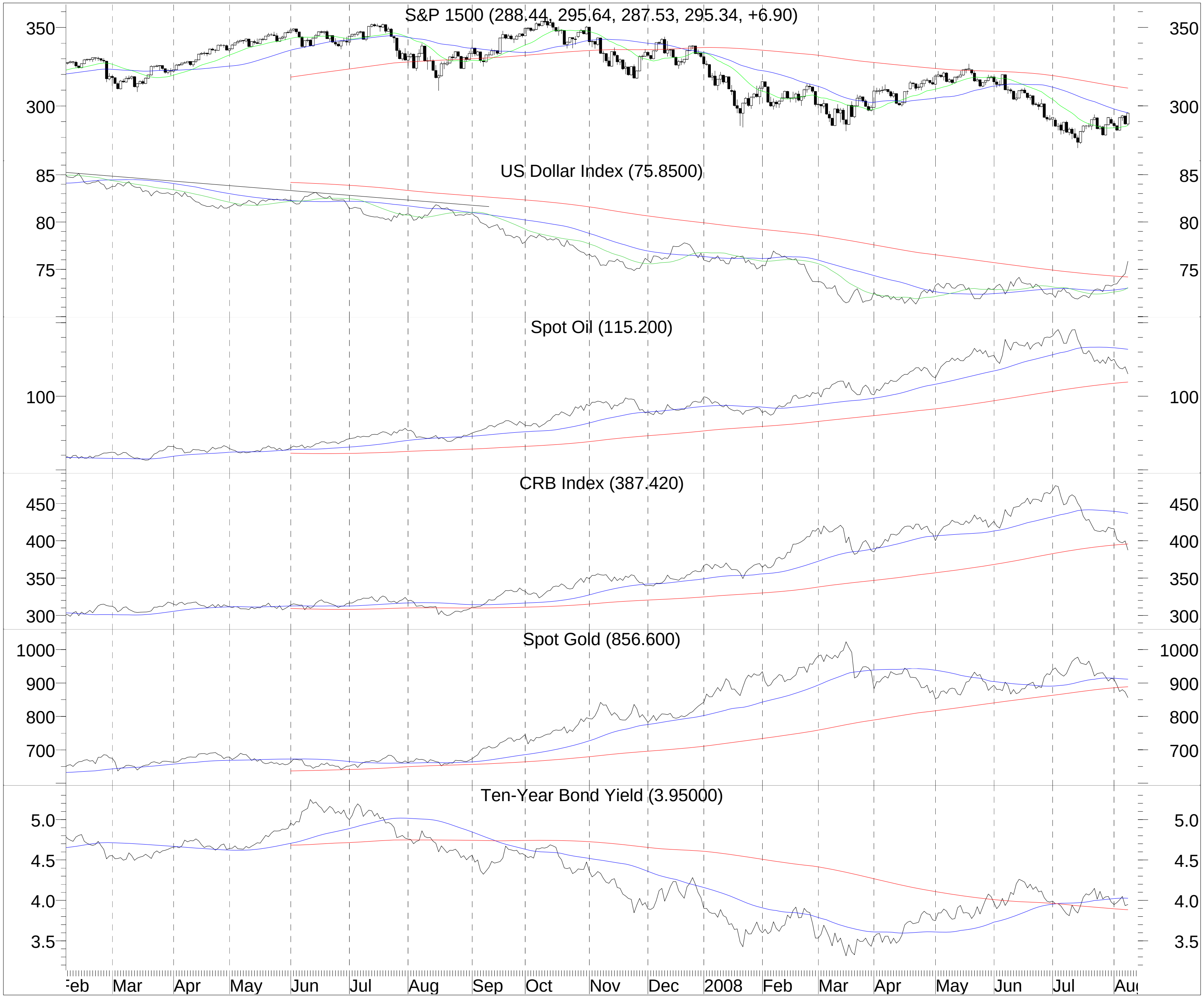

The U.S. Dollar Index has broken through and closed above the 200-sma (red) for the first time since October 2006. It is short-term overbought.

Crude oil seems on its way to testing the 200-sma (red).

The commodities index has broken through the 200-sma.

Gold has fallen through its 200-sma (red). There is important support at the 850 area. It is shot-term oversold.