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# The Kaufman Report

Trade what you see, not what you think.

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Monday July 20, 2009

Closing prices of July 17, 2009

It's been an exciting time in the financial markets since our last, pre-vacation report, which was dated June 29<sup>th</sup>. To recap, we had been saying since April that stocks could rally into June or early July. Multiple times we disagreed with the "sell in May and go away" crowd. On June 14<sup>th</sup> we said aggressive traders could enter short based on negative divergences we identified, that a pull back at that point fit our previously expressed roadmap, but we didn't expect a pull back to be deep based on our proprietary options indicator. As we approached the end of June we suggested selling into pre-holiday seasonal strength, and to get rid of stocks investors didn't have a very good reason for holding onto. We also said that due to the enormous liquidity created by governments around the globe we hoped to see another rally leg beginning in the second half of July or in August. Our roadmap seems to have worked out, as weakness persisted to July 10<sup>th</sup>. Then with stocks in an oversold condition, a number of positive catalysts (Meredith Whitney, Goldman Sachs, Intel, Nouriel Roubini, a good start to Q2 earnings season) caused equities to have a terrific rally last week.

Last week's rally created a number of positive technical elements. The Nasdaq 100 broke out to a new rally high. The 20-week moving average of the S&P 500 crossed above the 40-week moving average for the first time since November 2007. **On July 16<sup>th</sup> the percentage of stocks in the S&P 1500 that are over their own 200-day moving averages hit 71.93%, the highest number since 6/5/2007.** Statistically three out of four stocks follow the primary trend, so with almost that amount trading above the moving average used by so many to define the long-term trend, this is certainly fodder for the bull market bear market debate.

In the short-term stocks are overbought so caution is advised regarding entry points. We continue to believe we will see another rally leg, with the odds saying last week was the initiation of that leg. We also think there is the potential for a deep correction as the year unfolds. 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. If so, we will be more than happy to delay or even cancel our expected bearishness.

**This is a bifurcated, opportunistic trader's market, with adept traders able to enter long or short. 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.**

## IMPORTANT DISCLOSURES

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The S&P 1500 (224.09) was down 0.072% Friday. Average price per share was down 0.24%. Volume was 108% of its 10-day average and 108% of its 30-day average. 41.11% of the S&P 1500 stocks were up, with up volume at 43.46% and up points at 38.89%. Up Dollars was 32.15% of total dollars, and was 26% of its 10-day moving average. Down Dollars was 117% of its 10-day moving average. For the week the index was up 7.056% on increasing but below average weekly volume.

The S&P 1500 is up 2.29% in July, up 2.29% quarter-to-date, up 4.47% year-to-date, and down 37.12% from the peak of 356.38 on 10/11/07. Average price per share is \$26.36, down 39.02% from the peak of \$43.23 on 6/4/07.

Percent over 10-sma: 90.27%. 13-Week Closing Highs: 133. 13-Week Closing Lows: 12.

Put/Call Ratio: 0.739. Kaufman Options Indicator: 0.97.

P/E Ratios: 59.12 (before charges), 15.16 (continuing operations), 16.11 (analyst estimates).

P/E Yield 10-year Bond Yield Spreads: -53% (earnings bef. charges), 81% (earnings continuing ops), and 70% (projected earnings).

Aggregate earnings before charges for the S&P 1500 peaked in August 2007 at \$19.18 and are now at \$3.62, a drop of 81.12%. Aggregate earnings from continuing operations peaked at \$19.95 in September 2007 and are now \$14.12, down 29.22%. Estimated aggregate earnings peaked at \$21.95 in February 2008 and are now \$13.29, a drop of 39.45%.

61 of the S&P 500 have reported 2<sup>nd</sup> quarter earnings. According to Bloomberg, 70.5% had positive surprises, 9.8% were in line, and 19.7% have been negative. The year-over-year change has been -23.9% on a share-weighted basis, -0.5% market cap-weighted and -10.5% non-weighted. Ex-financial stocks these numbers are -19.9%, +3.5%, and -7.8 %, respectively.

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S&P 500 Cash (940.56, 941.89, 934.65, 940.38, -0.36)



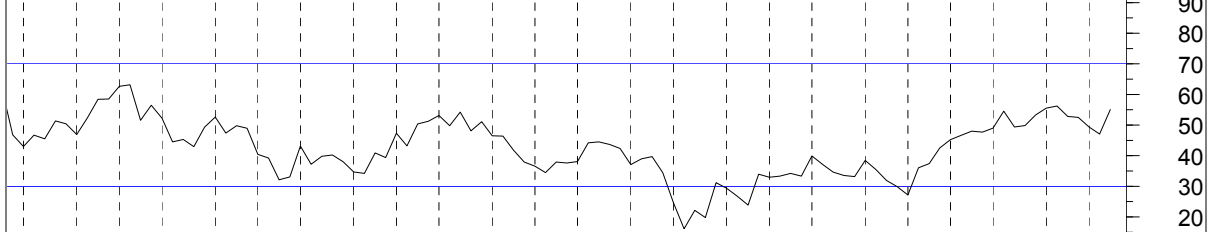
The S&P 500 is overbought at resistance. It will take some very positive news to punch it through.

S&P 500 Cash (879.57, 943.96, 875.32, 940.38, +61.25)



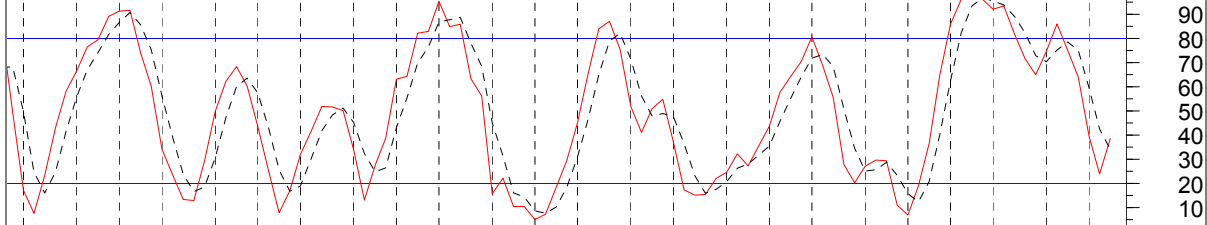
The weekly chart of the S&P 500 shows the index bounced off its 40-week moving average. Then 20-week average is crossing over the 40-week for the first time since November 2007.

Relative Strength Index (55.0794)

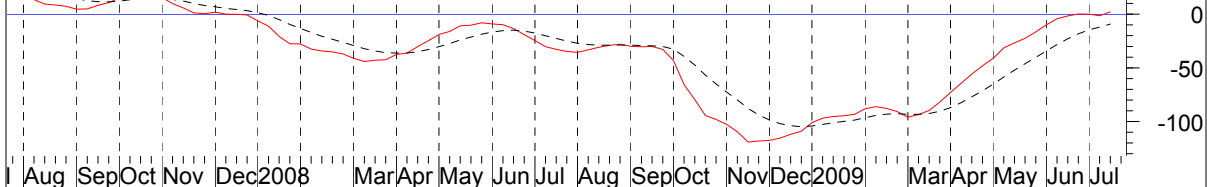


Our weekly momentum indicators have room to move higher.

Stochastic Oscillator (38.6292)



MACD (2.10249)



NASDAQ 100 (1,516.77, 1,527.26, 1,511.61, 1,527.26, +8.39)



The Nasdaq 100 broke out to new rally highs last week. The Nasdaq Composite advance decline line (not shown) is showing a negative divergence, so some short-term weakness may be coming.

November December 2009 February March April May June July

NASDAQ 100 (1,423.20, 1,527.26, 1,402.19, 1,527.26, +107.42)

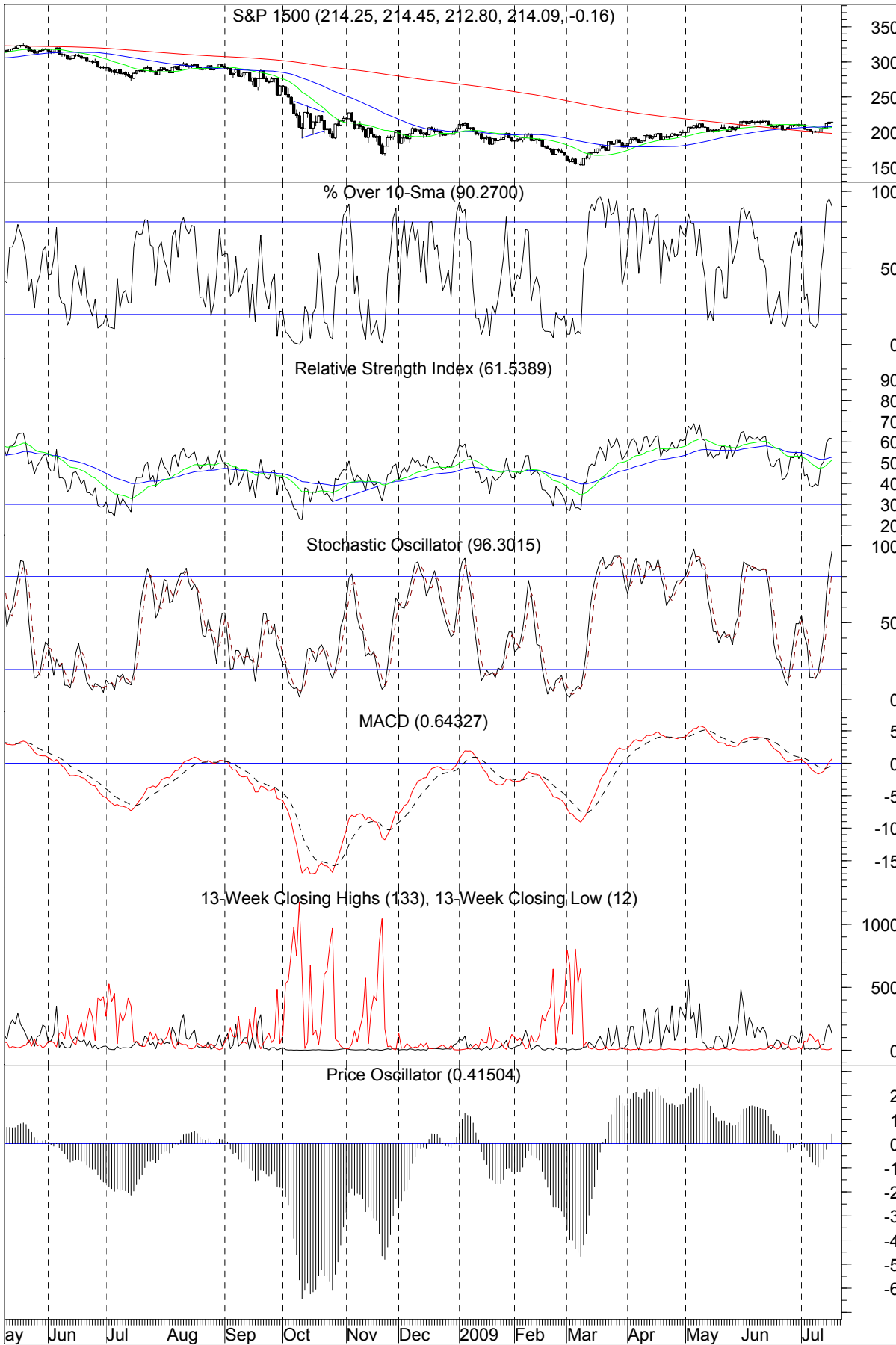


Weekly momentum indicators look ok, but the stochastic is still on a sell signal. A positive crossover would obviously help the picture, and the indicator may be about to have one.

Bank of New York ADR (113.68, 113.91, 112.75, 113.59, -0.09)



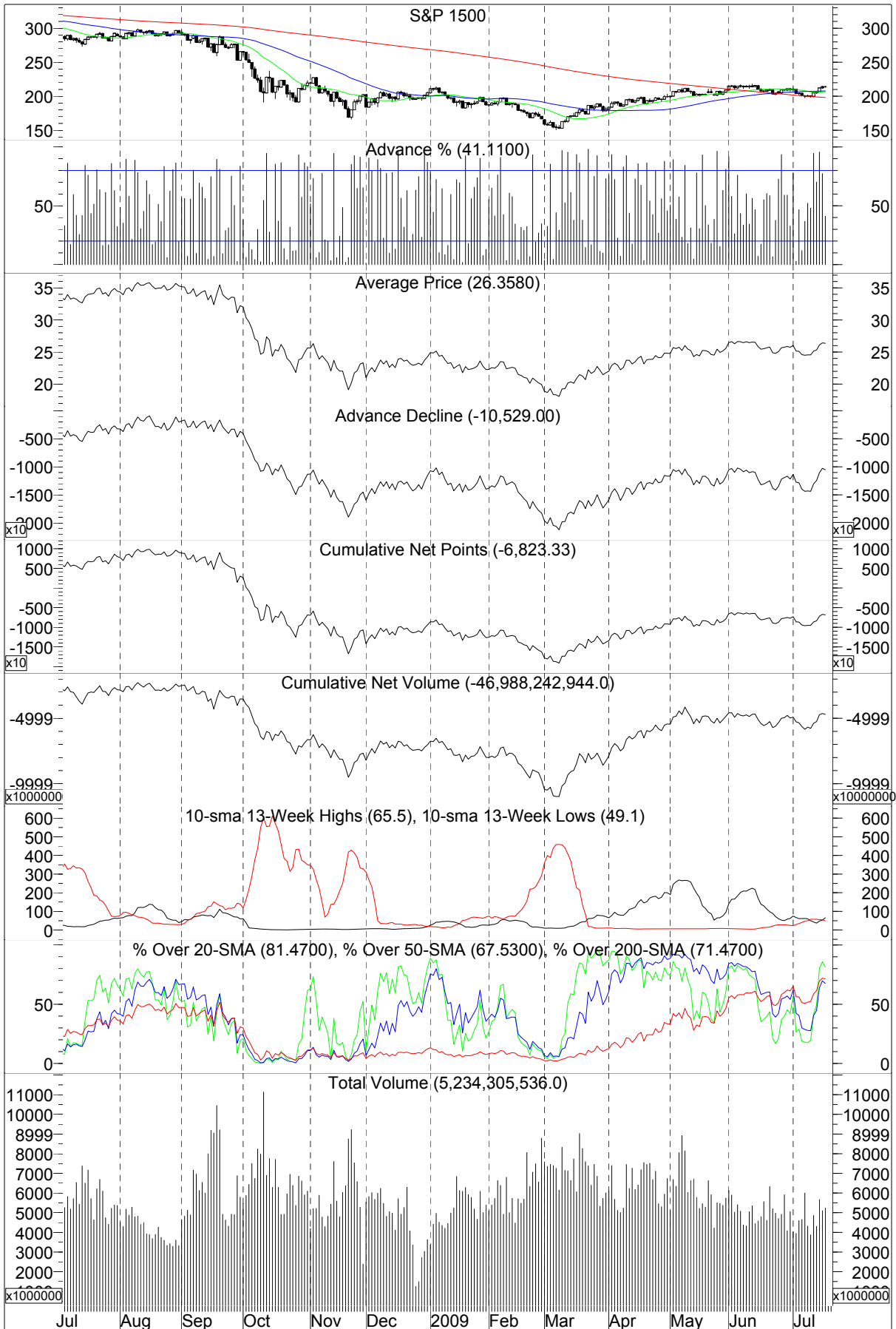
The Nasdaq Composite is outperforming the ADR Index.



After hitting oversold levels, the percent over 10-sma bounced strongly into the overbought zone. In a sign of strength on Thursday it hit 95.27%, the highest reading since March 18th.

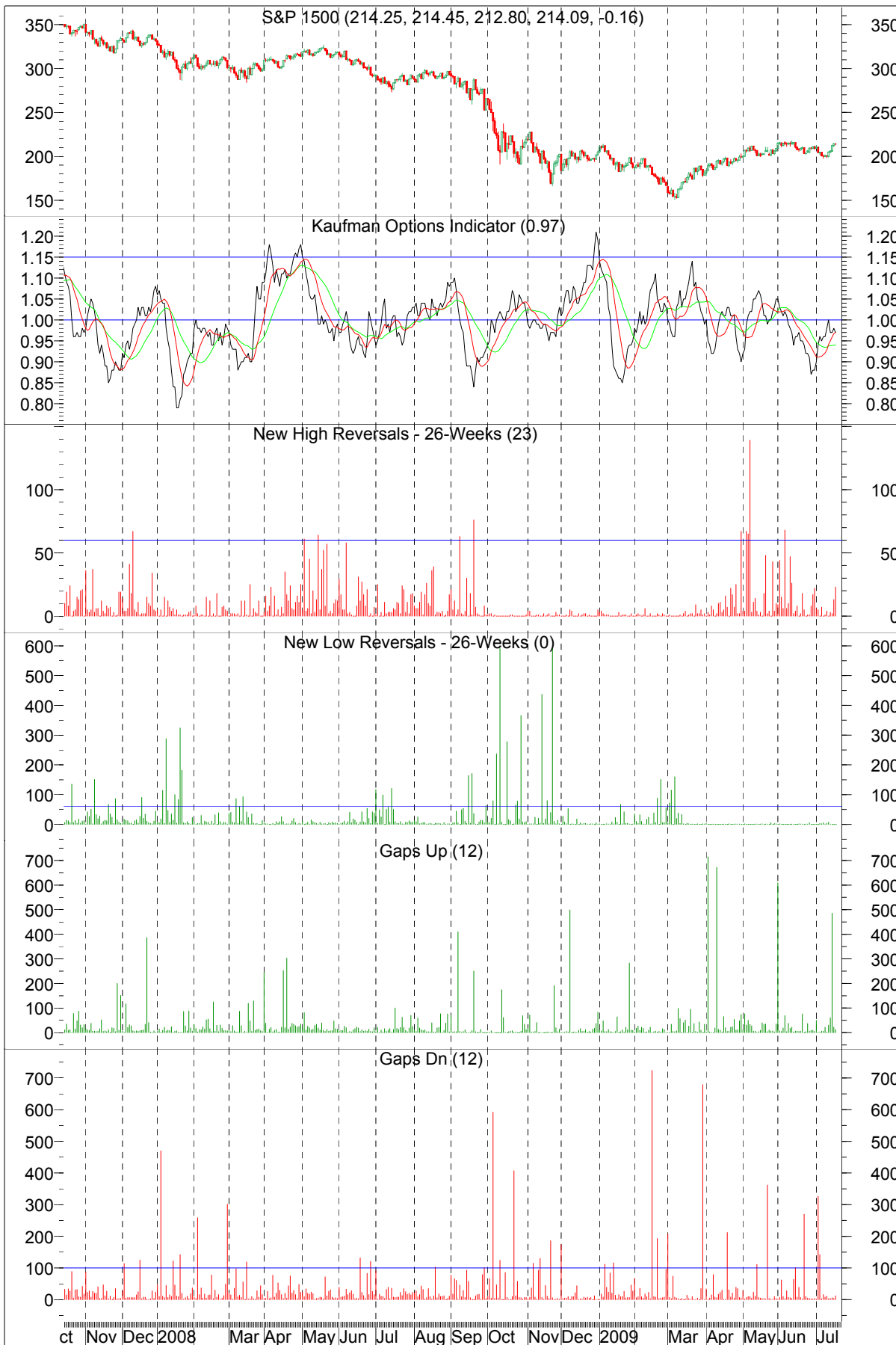
After a brief move into negative territory, our price oscillator, a good indicator of trends, has moved back into positive territory.





These percents over various moving averages are close to bull market numbers. On Thursday the percent over 200-sma hit 71.47%, the highest since 6/5/2007.

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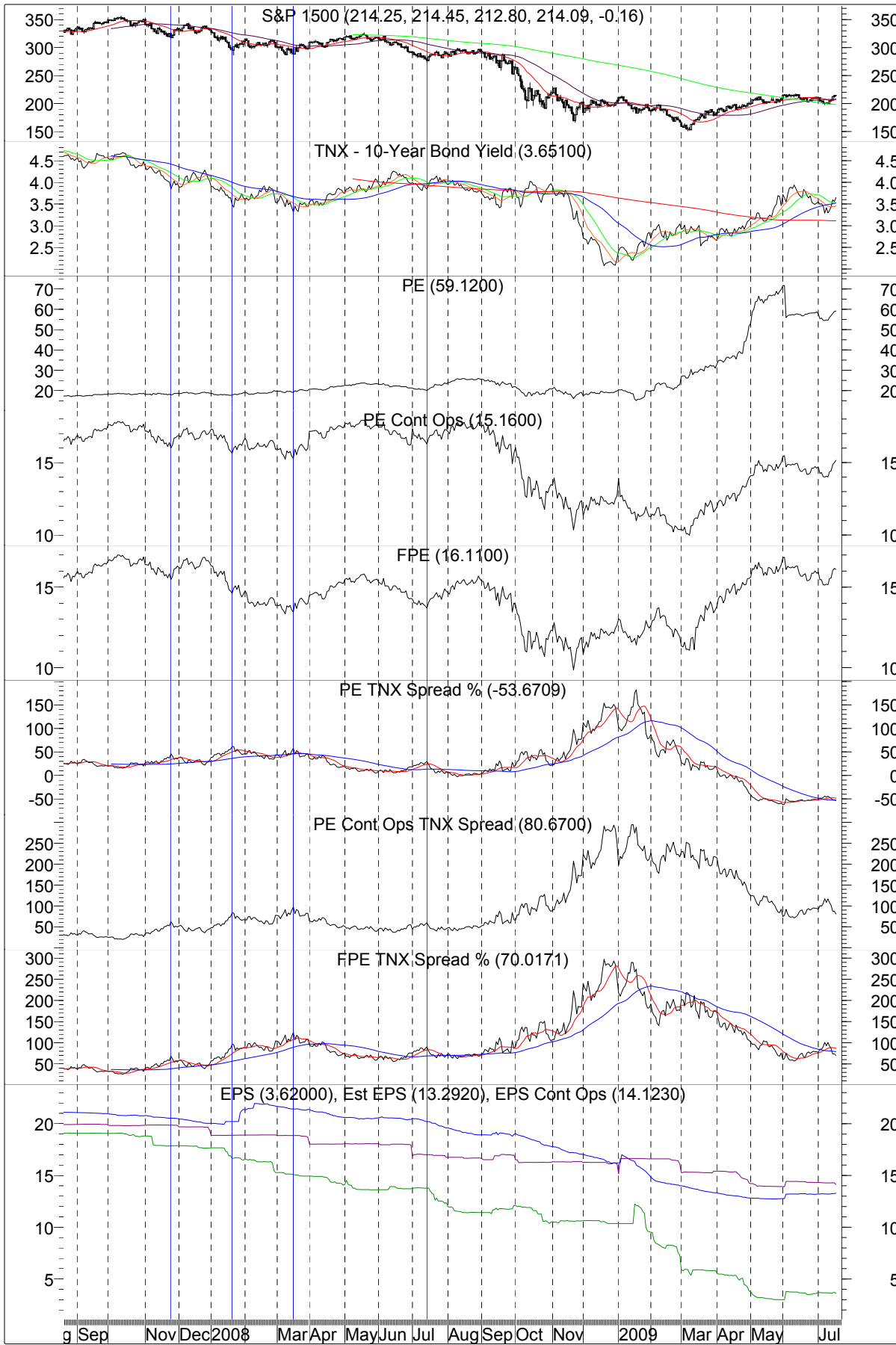


In June our proprietary options indicator helped us forecast that the recent pull back would not be too deep. It has moved up a lot, but still shows some pessimism, which is good.

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Our statistics of supply (red) versus demand (green) are showing positive crossovers for all time frames. Everyone knows that demand for stocks has been light, and that is easily seen on these charts. Still, if sellers have stepped to the sidelines again, the path of least resistance is up.



P/Es are rising, and earnings need to justify them.

Our earnings metrics have been flat lining since the end of Q1 earnings season. Will Q2 numbers begin to reverse the declining trend which has been in place since the end of 2008?



The U.S. Dollar Index has resumed its down trend and is being pressured by its 20 (green) and 50-sma. There are multiple support levels just below, so a short-term plunge seems unlikely. Also, the weekly stochastics seem to be bottoming.

Crude oil has bounced up to its 50-sma which is at a resistance zone. Weekly charts are looking topy.

The commodities index is also below its 50-sma. Maybe a better indicator is the Journal of Commerce Index of Industrial Materials (not shown) which is above all its moving averages.

Gold has bounced up to resistance. A move to 950 should target the high 900s. With all the U.S. Dollar bashing and talk of inflation one wonders why gold isn't much higher. Maybe because there is near universal bullishness.