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The Kaufman Report

Trade what you see, not what you think.

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Monday June 8, 2009 **Closing prices of June 5, 2009**

We said on May 14th that the terrific rally off the March lows had ended, and we expected to see a pullback or period of consolidation, which we got. Last Sunday we said "we think the consolidation is ending and that stocks will proceed higher shortly." That is precisely what happened as the major indexes broke out to new rally highs Monday and held on for another week of nice gains. There was some selling into Friday's gap open after the much better than expected May Non-farm Payrolls Report, but that is not unusual.

We also said last Sunday we still had concerns and we would be watching for false breakouts and more aggressive selling than we saw during the period of consolidation. Even if this new rally leg is not truncated, we repeated our expectations of it ending in June or July, which follows the road map we had previously laid out. **Therefore, we continue our strategy of playing the long side of the market while relying on basic trading strategies to protect us when the market does make a turn that could be painful. In other words, we remain long with an eye on the exit.**

The short-term picture is getting more difficult as volume remains light due to a lack of conviction by both bulls and bears. Also, some negative divergences are starting to show up, such as Monday's 484 closing highs in the S&P 1500 versus May 4th's 560. This shows market leadership becoming more selective. Still, the bottom of the market is firming up as evidenced by the percentage of stocks over their own 200-day moving averages, which on Friday hit 58.13%, the best since 7/23/2007.

The balance of the month promises to keep investors on their toes. June 19th is a quadruple witching options expiration, followed shortly thereafter by the end of the second quarter. The end of this quarter promises to be particularly interesting as it combines earnings warning season with window dressing and some nail biting by money managers who are under-performing the market. What will these poor souls do if stocks don't sell off soon, or if there is another round of better than expected economic news?

Our perfect scenario (what are the odds of that happening?) would be another period of sideways drift to work off short-term overbought conditions followed by a nice rally to end the quarter which would make client statements look beautiful. Our inclination, based on our road map, would be to fade that rally. Of course, we are flexible and we are trend followers. 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 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.

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The S&P 1500 (214.32) was down 0.247% Friday. Average price per share was down 0.10%. Volume was 94% of its 10-day average and 84% of its 30-day average. 43.50% of the S&P 1500 stocks were up, with up volume at 35.95% and up points at 42.62%. Up Dollars was 31.56% of total dollars, and was 21.81% of its 10-day moving average. Down Dollars was 109% of its 10-day moving average. For the week the index was up 2.50% on below average volume.

Six of the ten S&P sectors were down on the day, led by Financials -1.45% and Materials -1.14%. Industrials were up 0.79% and Info Tech was up 0.42%.

For the week eight of the ten sectors traded higher, led by Industrials +5.70%, Info Tech +4.3%, and Consumer Discretionary +3.98%. The laggards were Telecom -0.77% and Health Care -0.41%.

The S&P 1500 is up 2.50% in June, up 18.42% quarter-to-date, up 4.58% year-to-date, and down 39.86% from the peak of 356.38 on 10/11/07. Average price per share is $26.61, down 38.45% from the peak of $43.23 on 6/4/07.

Percent over 10-sma: 80.07%. 13-Week Closing Highs: 210. 13-Week Closing Lows: 6.

Put/Call Ratio: 0.807. Kaufman Options Indicator: 1.02.

P/E Ratios: 57.21 (before charges), 14.86 (continuing operations), 16.23 (analyst estimates).
P/E Yield 10-year Bond Yield Spreads: ***-55% (earnings bef. charges),*** *74% (earnings continuing ops), and 60% (projected earnings)*.

Aggregate earnings before charges for the S&P 1500 peaked in August 2007 at $19.18 and are now at $3.75, a drop of 80.45%. Aggregate earnings from continuing operations peaked at $19.95 in September 2007 and are now $14.42, down 27.72%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $13.20, a drop of 39.86%.

494 of the S&P 500 have reported 1st quarter earnings. According to Bloomberg, 67.5% had positive surprises, 7.9% were in line, and 24.5 % have been negative. The year-over-year change has been -33.5% on a share-weighted basis, -23.2% market cap-weighted and -34.7% non-weighted. Ex-financial stocks these numbers are -33.0%, -22.6%, and -31.1 %, respectively.

Federal Funds futures are pricing in a probability of 88.0% that the Fed will *leave rates unchanged*, and a probability of 12.0% of cutting *25 basis points to 0.0%* when they meet on June 24th. They are pricing in a probability of 64.4% that the Fed will *leave rates unchanged* on August 12th, a probability of 27.3% of raising 25 basis points to 0.50%, and a probability of 8.3% of *cutting 25 basis points*.

IMPORTANT DISCLOSURES

On Monday the S&P 500 jumped out of its sideways consolidation to make new rally highs and a new high for 2009. It also moved over the 200-sma and had a weekly close above it for the first time since 11/2007.

Our momentum indicators are at high levels, with the stochastic showing a negative crossover from the overbought zone.

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The S&P 500 printed its highest weekly close since 11/2008. Unfortunately volume remains light.

Our weekly momentum indicators are pointed higher.

The Nasdaq 100 hit the highest level since 10/3/2008 on Friday. It is looking extended as it is well above its 20-sma. The 20, 50, and 200-sma are bullishly aligned with the short-term averages above the long-term averages for the first time since 11/2007.

Our momentum indicators are at high levels.

The Nasdaq 100 printed its highest weekly close since 9/26/2008. We won't be surprised to see the gap in the chart filled.

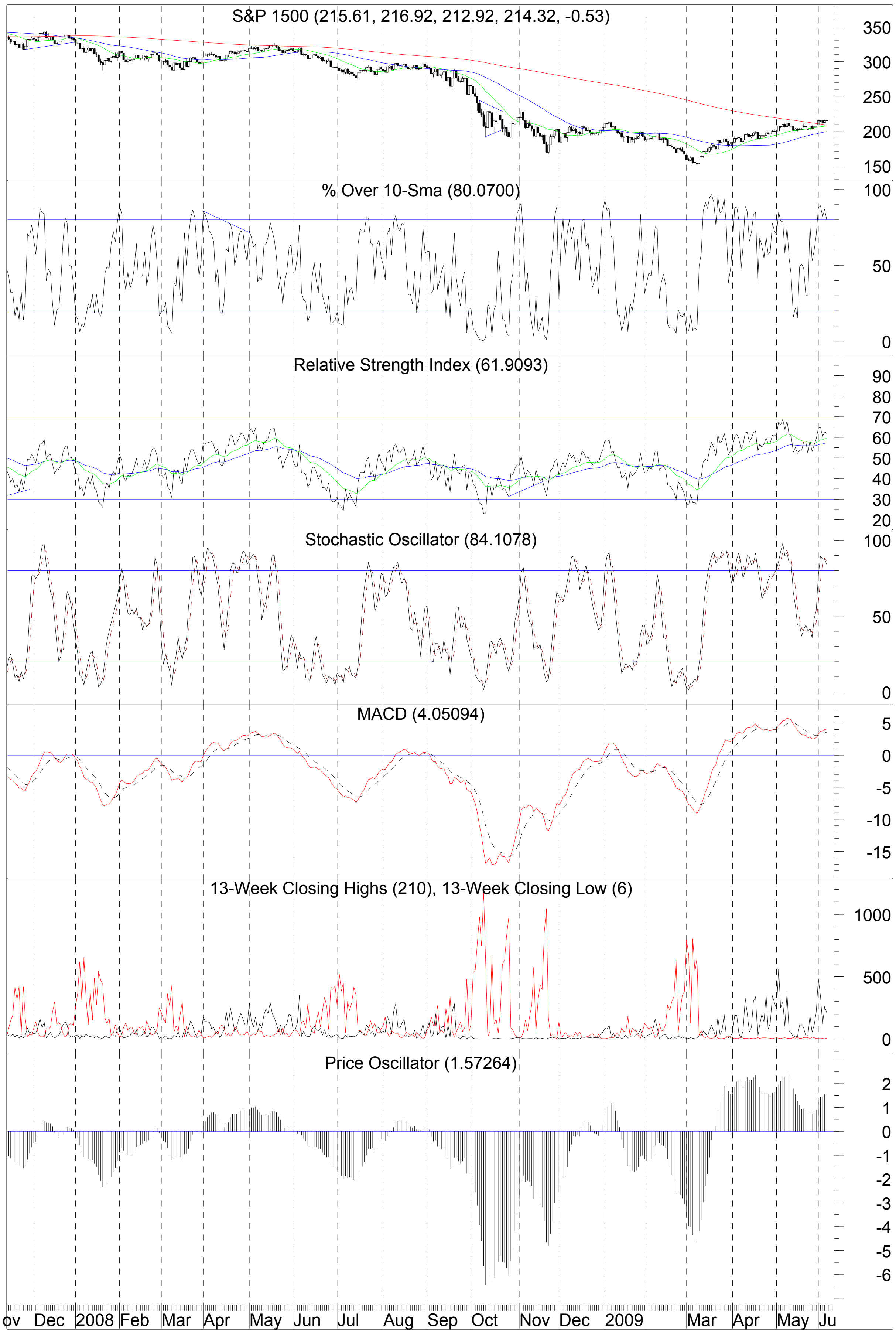
Our weekly momentum indicators are at high levels but seem pointed higher.

The Internet Index remains a leader and is up 45% year-to-date. It is not only above its 200-sma (green) it is also above its 400-sma (not shown) for the first time since June 2008.

Our momentum indicators are at high levels.

The MS High Tech Index, a leader which is up 32.8% year-to-date, has gotten short-term overbought. It printed a doji candle Friday. Doji are signs of indecision frequently seen at turning points.

Our momentum indicators are at high levels.

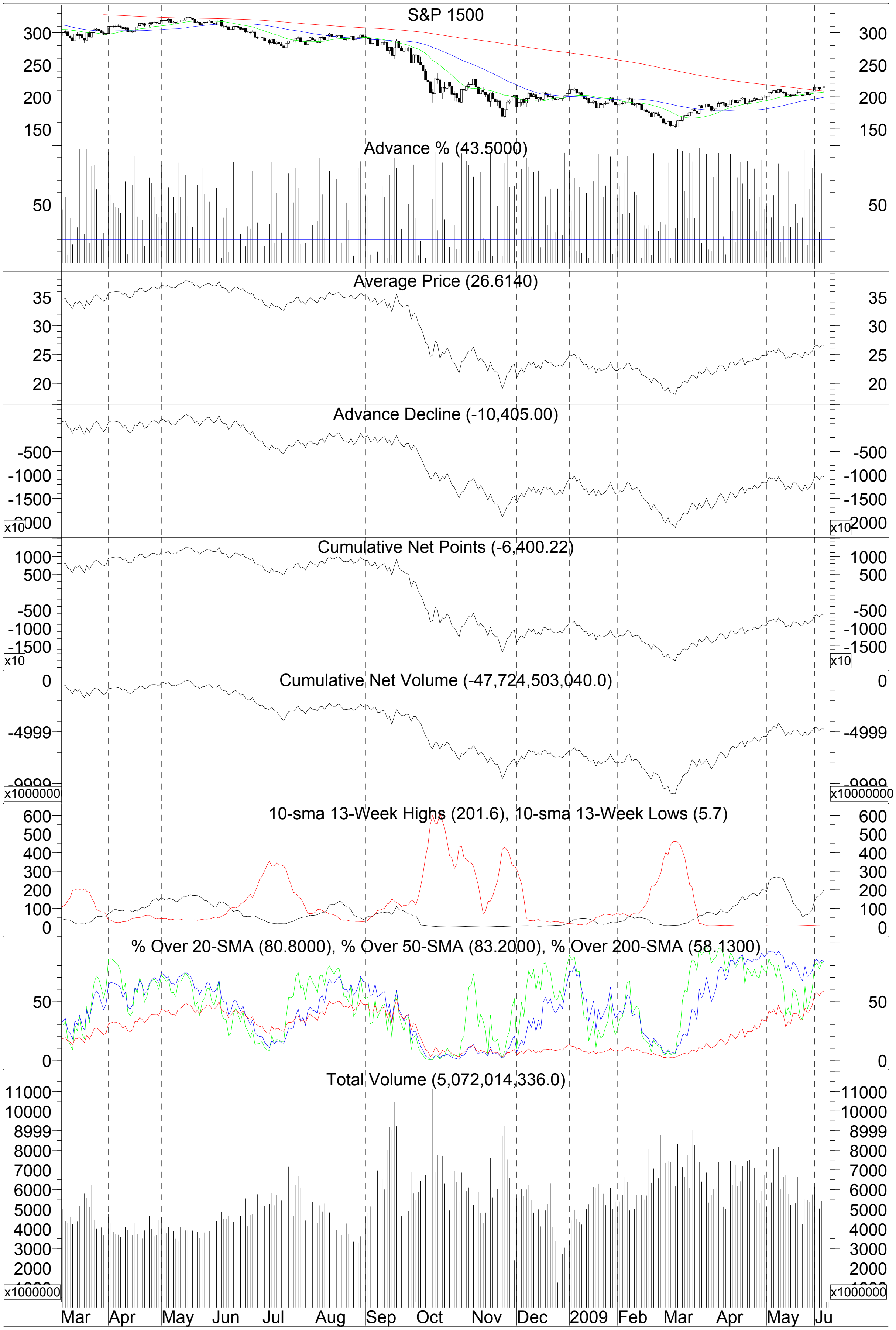


80.07% of the S&P 1500 are above their own 10-sma.

Our momentum indicators are at high levels, leaving stocks vulnerable to a pull back at some point.

Monday's 484 13-week closing highs is a negative divergence with May 4th's 560 and shows leadership becoming more selective.

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

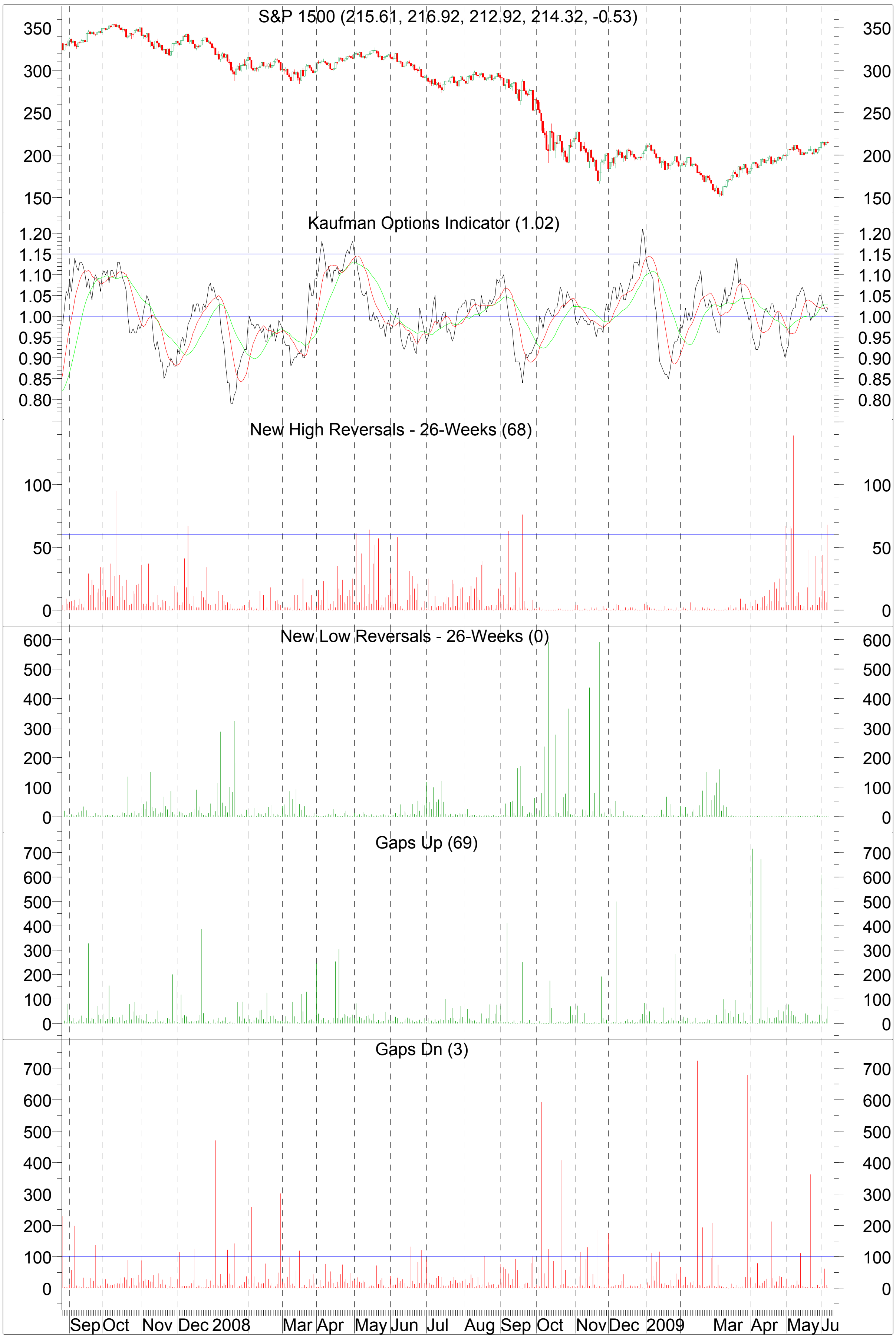


43.5% of stocks traded higher Friday in spite of the big gap up open.

The 10-sma of 13-week highs continues to move up, although here too it negatively diverges from early May.

The percentages over various moving averages are bullish, with 58.13% over their 200-sma. That is the best number since 7/23/2007.

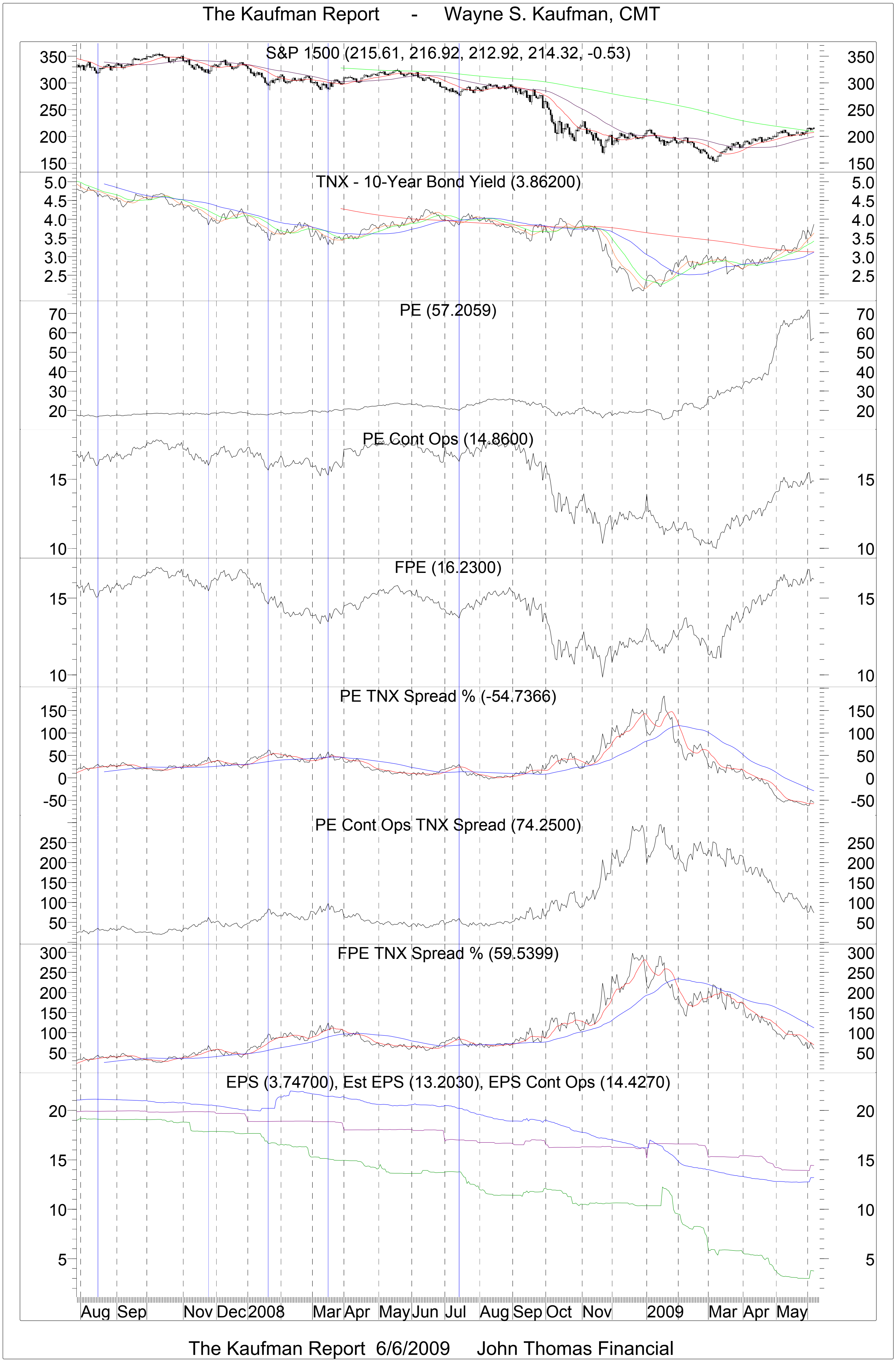
Volume remains low, showing not much conviction by bulls or bears.



Our proprietary options indicator is slightly above neutral.

68 new high reversals on Friday shows an increased desire to take profits.

Our statistics of supply (red) versus demand (green) continue to show that the recent rally is characterized by a lack of sellers more so than by strong demand.



Bond yields are in an up trend and are the highest since November 2008. They are short-term overbought and nearing intermediate-term overbought.

PE ratios dropped last week as aggregate earnings numbers jumped up. Before we get too excited, this was due to GM being removed from the indexes.

Spreads between bond and earnings yields have narrowed dramatically.

As discussed above, earnings jumped up due to the removal of GM from the indexes.

We said last week the US Dollar was short-term oversold. During the week it bounced up to its 20-sma. It could move a little higher, but there is tough resistance up to the 83 area.

Crude oil is above its 200-sma for the first time since September. It remains short-term overbought, so a pull back is likely at any time. We think it goes higher longer-term.

We said last week gold was overbought and it traded lower during the week. It is just above its 20-sma (not shown). We expect some more weakness, especially if the US Dollar shows a little more strength. A move over 1000 could be the start of a sharp move higher with a huge inverse head and shoulders pattern having formed.