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The Kaufman Report

Trade what you see, not what you think.

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Monday May 18, 2009

Closing prices of May 15, 2009

We wrote last week that we thought the terrific rally off the March lows had ended, at least for the time being. We are sticking with that opinion, as our proprietary options indicator is still at high levels after too much optimism recently on the part of call buyers. Therefore, it will be difficult to see new rally highs without some consolidation or pullback. Also, sellers, who have been on the sidelines, are getting more aggressive as buyers get more reticent.

We have been saying a pull back or consolidation was likely at any time, but that equities would take any pullback in stride and follow the average first year of the Presidential cycle pattern and trade higher afterwards. We are sticking with that opinion also, but our trading strategies keep us from being rigid and if we need to become bearish we will do so quickly.

We are now 93% through earnings season and during the recent rally investors have been giving stocks the benefit of the doubt by ignoring bad news and focusing on data points and forecasts that give hope that things are turning for the better. Unfortunately, valuations based on reported earnings (before charges) are terrible, while valuations based on earnings from continuing operations (after charges) and analyst forecasts make stocks very attractive.

This disconnect can't last much longer. The P/E based on reported earnings for the S&P 1500 is 64.57, creating an earnings yield of 1.55%. Ten year bond yields are currently 3.123%, making bonds look far more attractive than stocks. The P/Es based on earnings from continuing operations and projected earnings are 14.38 and 15.75, respectively. Their earnings yields of 6.95% and 6.35% are attractive versus bond yields. The problem is the trend of all three of these earnings metrics is inexorably lower. Investors may be giving stocks the benefit of the doubt at this time, but if reported earnings don't eventually start to move towards the continuing operations numbers and the analyst estimates, stocks will look very overvalued and investors may lose their recent optimism.

This is a bifurcated, opportunistic trader's market, with adept traders able to enter long or short. The short-term and intermediate-term trends are up, while the long-term trend remains down. Traders should not hesitate to rotate out of lagging sectors and stocks and into leaders.

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The S&P 1500 (200.59) was down 1.12% Friday. Average price per share was down 0.93% as small-caps outperformed. Volume was 76% of its 10-day average and 80% of its 30-day average. 30.61% of the S&P 1500 stocks were up, with up volume at 21.24% and up points at 2.68%. Up Dollars was 7.65% of total dollars, and was 9% of its 10-day moving average. Down Dollars was 100% of its 10-day moving average. For the week the index was down 5.248% on decreasing and below average weekly volume.

All ten S&P sectors were down Friday led by Financials which were down 2.5%. All ten sectors were also down for the week, led by Financials, down 12.08%, Industrials down 7.55%, and Consumer Discretionary down 7.25%.

The S&P 1500 is up 0.68% in May, up 10.83% quarter-to-date, down 2.12% year-to-date, and down 43.71% from the peak of 356.38 on 10/11/07. Average price per share is \$24.39, down 43.58% from the peak of \$43.23 on 6/4/07.

Percent over 10-sma: 15.6%. 13-Week Closing Highs: 18. 13-Week Closing Lows: 13.

Put/Call Ratio: 0.800. Kaufman Options Indicator: 1.06.

P/E Ratios: 64.57 (before charges), 14.38 (continuing operations), 15.75 (analyst estimates).

P/E Yield 10-year Bond Yield Spreads: -50% (earnings bef. charges), 122% (earnings continuing ops), and 103% (projected earnings).

Aggregate earnings before charges for the S&P 1500 peaked in August 2007 at \$19.18 and are now at \$3.11, a drop of 83.79%. Aggregate earnings from continuing operations peaked at \$19.95 in September 2007 and are now \$13.95, down 30.01%. Estimated aggregate earnings peaked at \$21.95 in February 2008 and are now \$12.74, a drop of 41.96%.

466 of the S&P 500 have reported 1st quarter earnings. According to Bloomberg, 67.1% had positive surprises, 7.1% were in line, and 25.8% have been negative. The year-over-year change has been -34.6% on a share-weighted basis, -23.8% market cap-weighted and -36.0% non-weighted. Ex-financial stocks these numbers are -34.2%, -23.2%, and -32.5%, respectively.

Federal Funds futures are pricing in a probability of 82.0% that the Fed will leave rates unchanged, and a probability of 18.0% of cutting 25 basis points to 0.0% when they meet on June 24th. They are pricing in a probability of 74.0% that the Fed will leave rates unchanged on August 12th, a probability of 15.8% of cutting 25 basis points to 0.0%, and a probability of 10.2% of raising 25 basis points.

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S&P 500 Cash (892.76, 896.97, 878.94, 882.88, -10.19)



The daily chart of the S&P 500 shows it is on the 20-sma and just above a support level at the 878 area. With the stochastic and the percent over 10-sma at oversold levels it would probably take some bad news to push it below support at this time. Still, sellers have come off the sidelines and buyers have become reluctant, so lower prices could be seen shortly.



The 40-week moving average (roughly 200-days) is pushing the S&P 500 down on the weekly chart. With the stochastic showing a negative crossover from the overbought zone it seems consolidation or pullback is necessary for the index to push through the 200-day. There is also no guarantee that it will do so.

NASDAQ 100 (1,355.55, 1,374.10, 1,351.13, 1,355.11, -4.56)



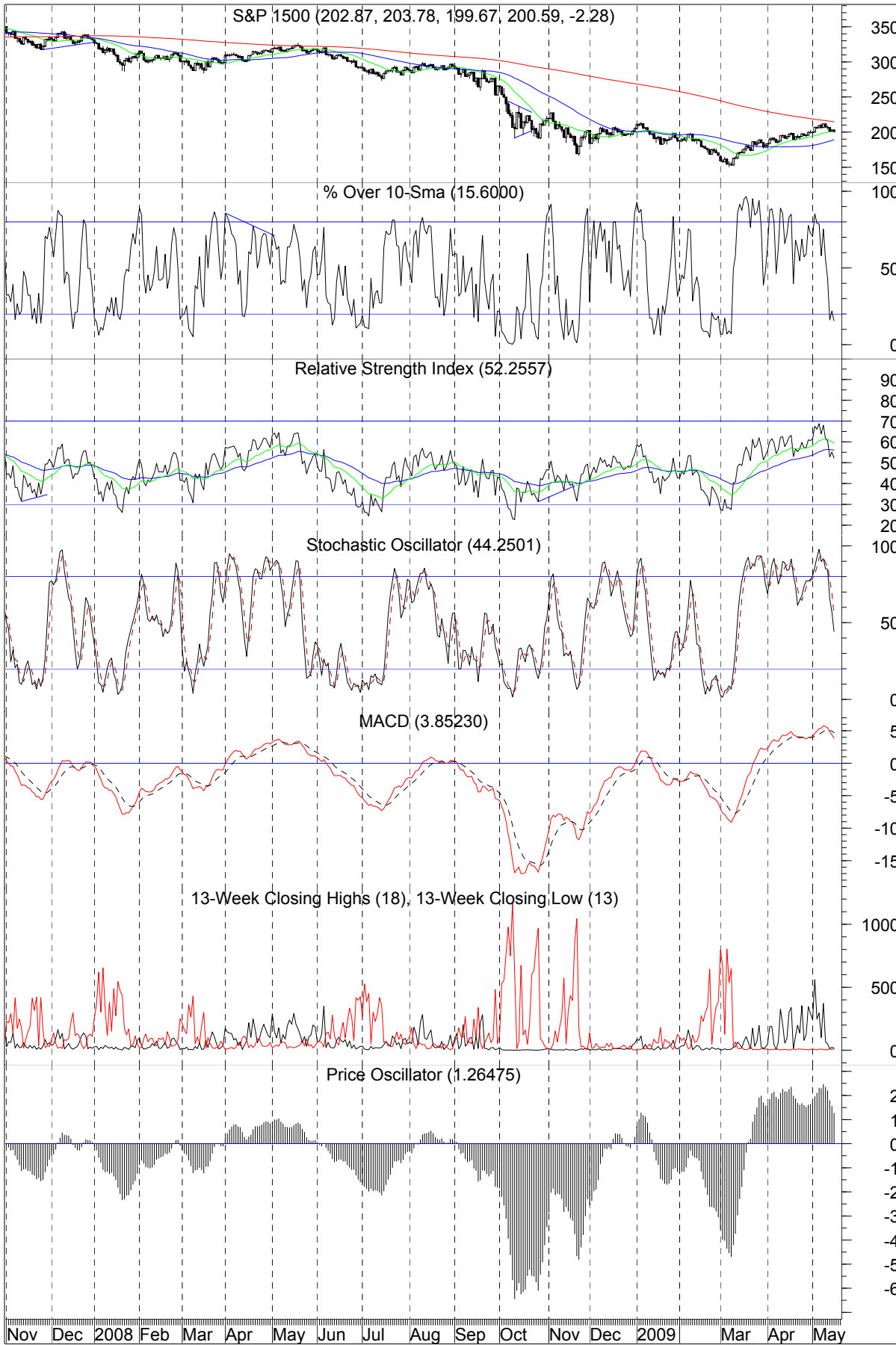
The Nasdaq 100 has fallen below its 20-sma and 200-sma. The stochastic is in the oversold zone but not yet turning up.

July August September November 2009 February March April May

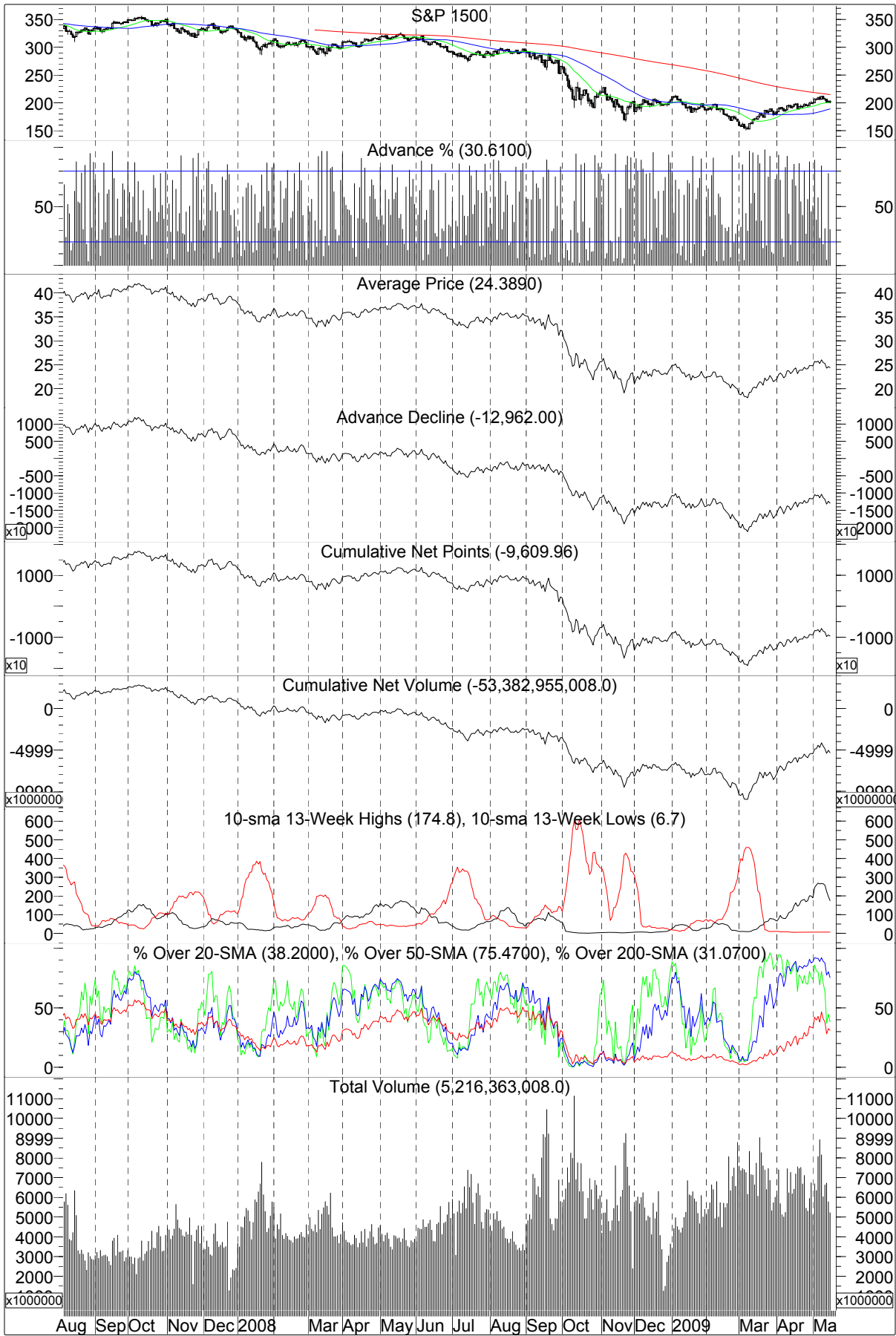
NASDAQ 100 (1,375.05, 1,410.43, 1,339.82, 1,355.11, -39.05)



The Nasdaq 100 is now down two weeks in a row.

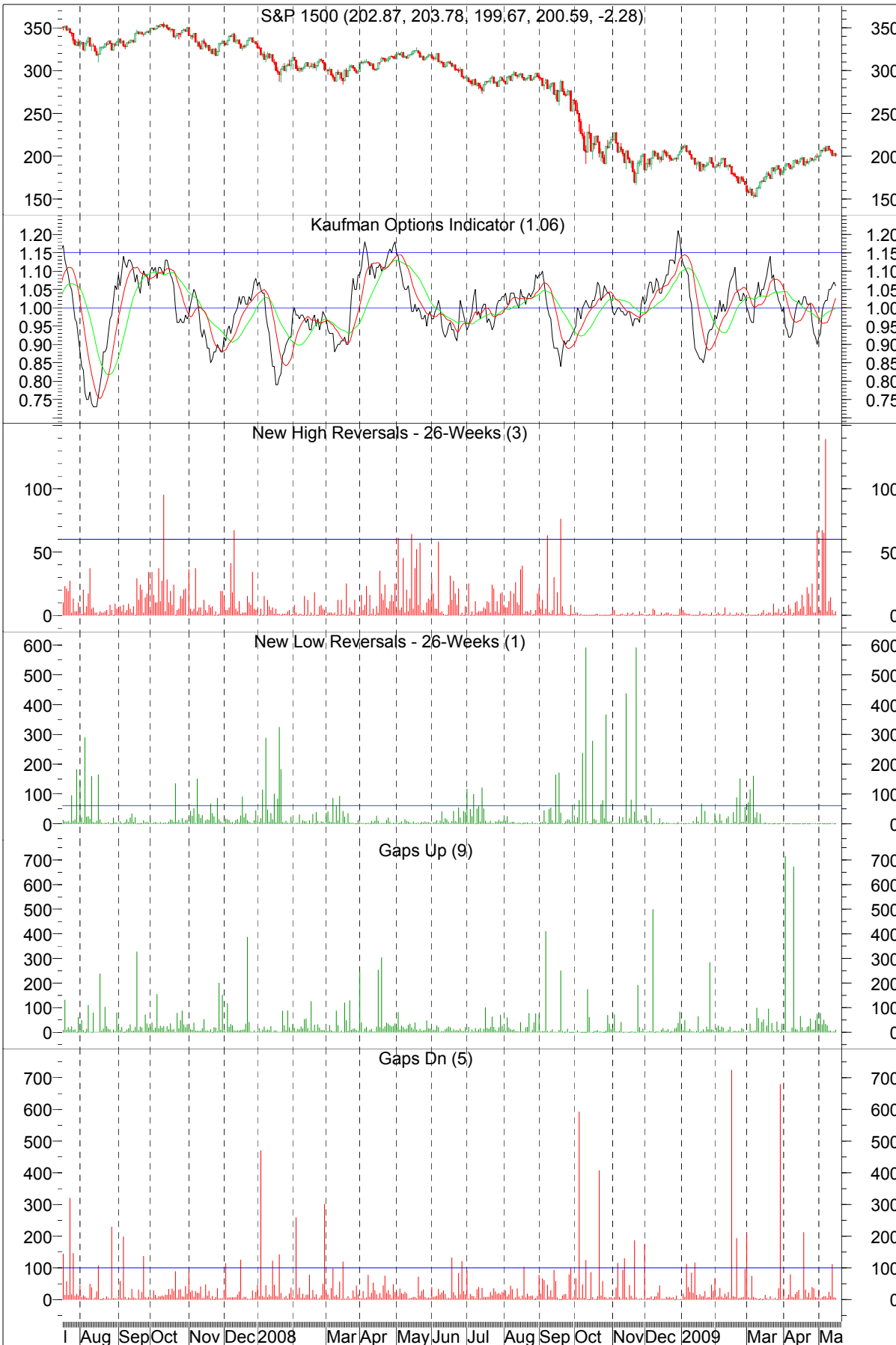


With the percent over 10-sma in the oversold zone we wouldn't expect a plunge lower. However, with our other momentum indicators still above oversold levels, stocks still need to consolidate or move lower.



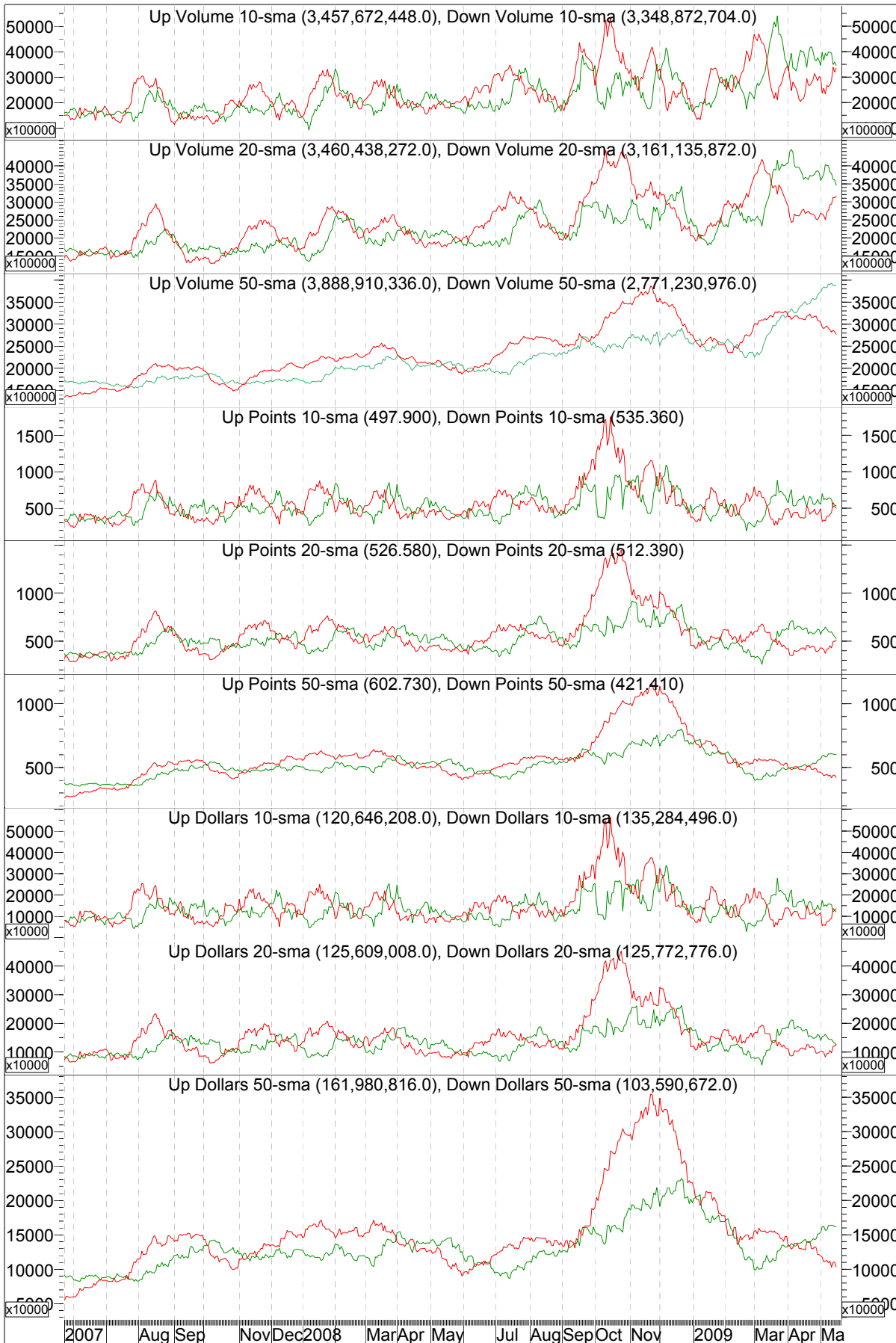
30.61% of stocks traded higher Friday.

Volume has been decreasing lately as bulls and bears search for direction.

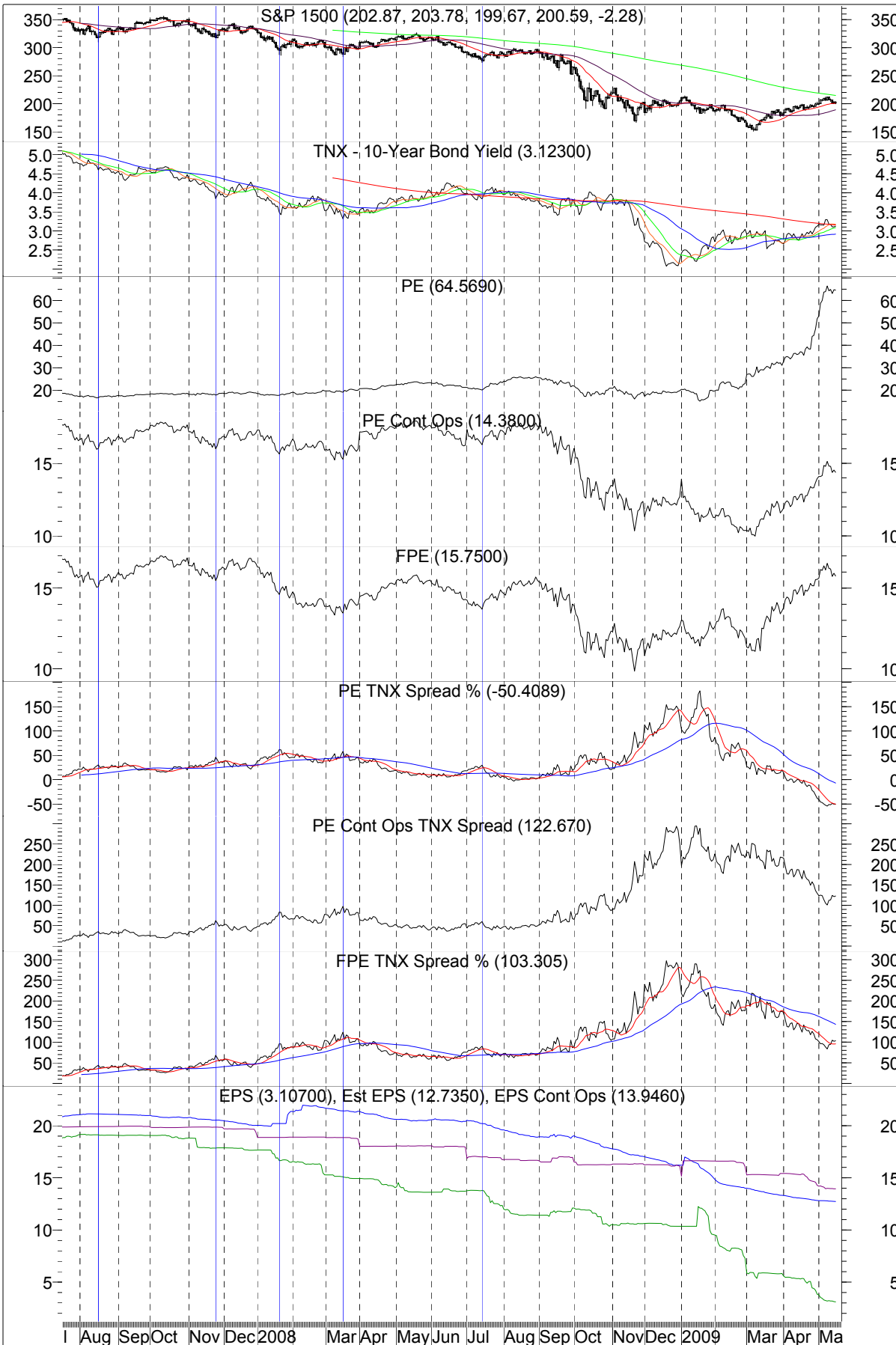


Our proprietary options indicator shows optimism on the part of call buyers. We have been saying this would put a cap on the upside, but it doesn't have to cause a plunge. Still, it does leave stocks vulnerable in the near-term.

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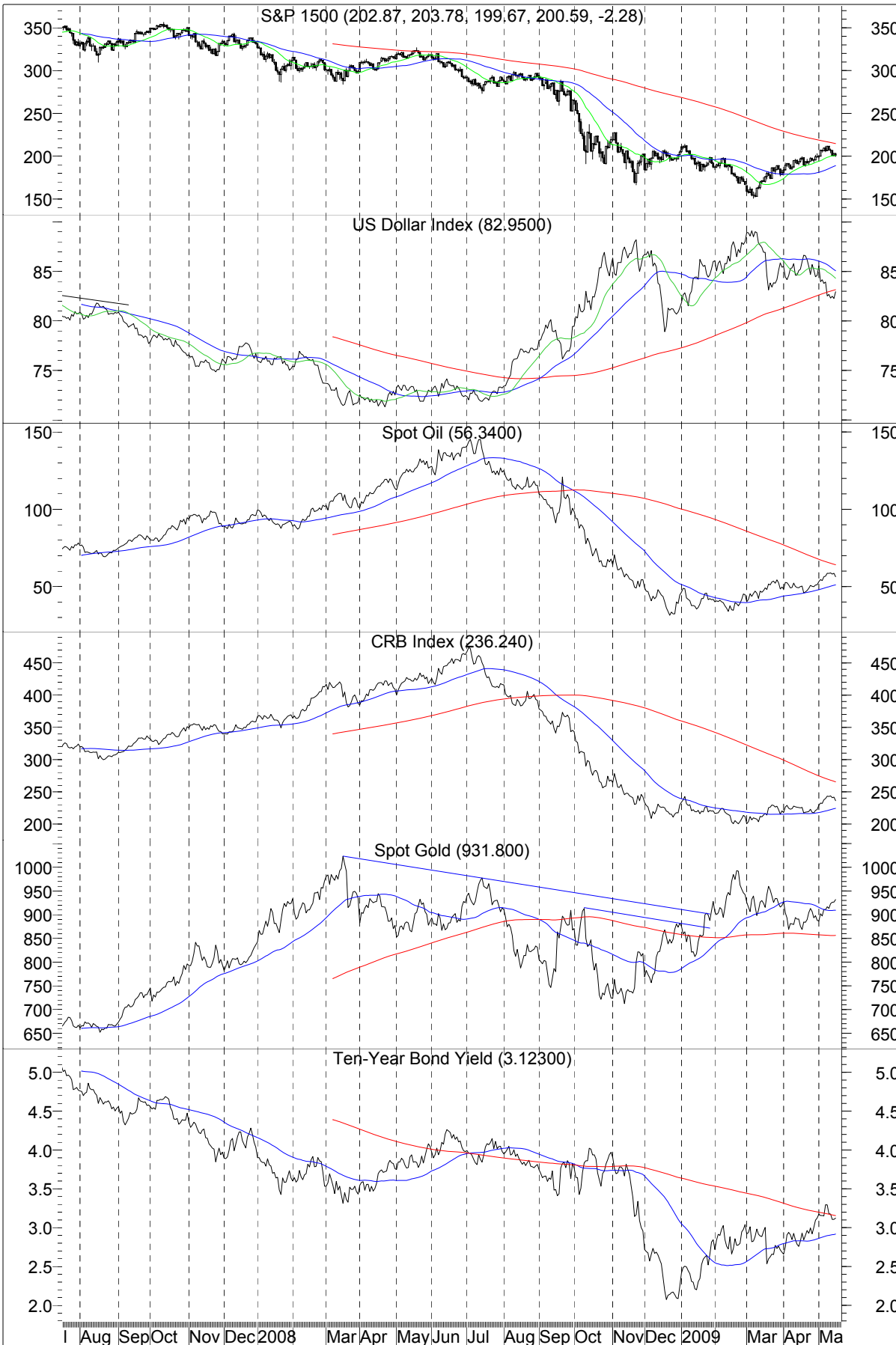


Our statistics of supply (red) versus demand (green) show some negative crossovers for the first time in a while. We have said that buying hasn't been that enthusiastic and that sellers had stepped to the sidelines. Now we are seeing a pickup in selling. Obviously something has emboldened the sellers, and with no increase in buying to counteract increased selling this is a prescription for lower prices.



The P/E based on reported earnings remains at very high levels, while the other P/Es seem reasonable.

With earnings season essentially over our metrics of aggregate earnings should pause in their inexorable move lower.



The U.S. Dollar Index has been weak but is due for a bounce.

Oil is pulling back from short-term overbought, with the 200-sma not far above at 64.54. Weekly charts show plenty of room to move higher.

We have been calling for a move up in gold, and that move doesn't seem finished quite yet.