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# The Kaufman Report

Trade what you see, not what you think.

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Monday October 26, 2009

Closing prices of October 23, 2009

**Editor's Note:** Many of our readers have asked why The Kaufman Report has not published issues during the week recently. The reason for this is the time constraints caused by the tremendous growth we have had at John Thomas Financial. This weekend we moved our corporate headquarters into the entire 23<sup>rd</sup> floor in our current building at 14 Wall Street, more than tripling our office space. The new offices comprise 42,000 square feet and facilitate further plans for expansion. Once we are fully settled in we will be back to more regular publishing schedule.

Last Sunday (10/18) we expressed short-term concerns regarding increasing selectivity, negative divergences, and excess bullishness on the part of options buyers. Major indexes rallied in the first half of the week to new 52-week highs before succumbing to these conditions and having a key reversal day Wednesday. Even good news from MSFT and AMZN couldn't keep the Nasdaq 100 trading higher after causing it to gap up at the open on Friday, only to see it reverse and finish down on the session.

Third quarter earnings continue to surprise to the upside, with a phenomenal 80.1% of companies doing just that. Still, there is a lot of noise in the market as we are approaching the end of October, which is the fiscal year end for many financial institutions. In addition, there remain some indications that certain intermarket elements of our analysis, such as gold and the U.S. Dollar Index, may be pausing as far as their recent trends, or even approaching short-term reversals. We don't think this noise will abate and a more easily readable trend direction will declare itself until early November.

**Therefore, investors still need to be cautious regarding entry points, and positions they don't have a good reason to hold onto should be considered as a source of funds for what we hope will be another leg up for equities. 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.**

We have stressed three characteristics of this bull market. Those are huge global liquidity, the belief held by investors that companies have become lean and mean with operating leverage that will lead to upside earnings surprises, and the reticence of investors to sell their stocks. **So far these remain intact.** We have been in a good news cycle, although we are now in third quarter earnings season, the period where the upside surprise thesis and the good news cycle will be tested.

It's a simple story. Bad economic news or disappointing earnings could certainly change investor's desire to hang onto stocks. All market participants need to be on their toes as earnings reports continue to stream in. The key issues on the minds of investors relative to earnings are top line growth versus cost cutting benefits, and whether there is improving demand versus inventory re-stocking.

We will remain on guard for any signs of a change in trend. We have been saying there is the potential for a deep correction at some point. **However, we have also been saying since June 1<sup>st</sup>, 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.

## IMPORTANT DISCLOSURES

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The S&P 1500 (246.49) was down 1.254% Friday. Average price per share was down 1.43%. Volume was 6% lower than Thursday, 102% of its 10-day average and 99% of its 30-day average. 11.17% of the S&P 1500 stocks were up, with up volume at 17.85% and up points at 14.24%. Up Dollars was 1.86% of total dollars, and was 6% of its 10-day moving average. Down Dollars was 294% of its 10-day moving average.

For the week the index was down 0.817% on increasing and about average weekly volume.

The S&P 1500 is up 2.00% in October, up 2.00 quarter-to-date, up 20.28% year-to-date, and down 30.84% from the peak of 356.38 on 10/11/07. Average price per share is \$31.00, down 28.29% from the peak of \$43.23 on 6/4/07.

Percent over 10-sma: 28.47%. 13-Week Closing Highs: 48. 13-Week Closing Lows: 76. 52-week closing highs: 37.

Kaufman Options Indicator: 1.04 Put/Call Ratio: 0.856

P/E Ratios: **141.69 (before charges)**, 20.88 (continuing operations), 18.02 (analyst estimates).

P/E Yield 10-year Bond Yield Spreads: **-80% (earnings bef. charges)**, 38% (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 \$1.74, a drop of 90.93%. Aggregate earnings from continuing operations peaked at \$19.95 in September 2007 and are now \$11.80, down 40.85%. Estimated aggregate earnings peaked at \$21.95 in February 2008 and are now \$13.68, a drop of 37.68%.

196 of the S&P 500 have reported 3<sup>rd</sup> quarter earnings. According to Bloomberg, 80.1% had positive surprises, 7.7% were in line, and 12.2% have been negative. The year-over-year change has been -10.3% on a share-weighted basis, +5.1% market cap-weighted and -13.2% non-weighted. Ex-financial stocks these numbers are -14.0%, -3.9%, and -13.9%, respectively.

Federal Funds futures are pricing in a probability of 61.2% that the Fed will leave rates unchanged and a probability of 38.8% of cutting rates 25 basis points to 0.00% when they meet on November 4<sup>th</sup>. They are pricing in a probability of 58.9% of no change, 34.7% of cutting 25 basis points to 0.00%, and 6.4% of raising 25 basis points to 0.50% when they meet on December 16<sup>th</sup>.

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	Daily	WTD	MTD	QTD	YTD
Nasdaq Composite	-0.50%	-0.11%	1.51%	1.51%	36.62%
Nasdaq 100	-0.54%	0.82%	2.02%	2.02%	44.73%
Dow Jones Industrials	-1.08%	-0.24%	2.68%	2.68%	13.63%
S&P 500	-1.22%	-0.74%	2.13%	2.13%	19.52%
S&P 1500	-1.25%	-0.82%	2.00%	2.00%	20.28%
S&P Midcap 400	-1.33%	-0.92%	1.49%	1.49%	30.29%
NYSE Composite	-1.62%	-0.94%	2.26%	2.26%	22.75%
Bank of New York Mellon ADR	-1.65%	-0.14%	3.36%	3.36%	32.77%
S&P Smallcap 600	-1.94%	-2.38%	0.07%	0.07%	18.20%

	Daily	WTD	MTD	QTD	YTD
Information Technology	-0.31%	1.04%	3.24%	3.24%	49.48%
Consumer Discretionary	-0.73%	-0.26%	2.58%	2.58%	31.08%
Health Care	-1.06%	-1.66%	-0.01%	-0.01%	7.85%
Consumer Staples	-1.09%	-1.41%	2.04%	2.04%	8.88%
Telecom Services	-1.30%	-0.52%	-4.77%	-4.77%	-7.68%
Financials	-1.56%	-0.83%	0.93%	0.93%	20.30%
Utilities	-1.66%	-0.87%	0.42%	0.42%	1.10%
Industrials	-1.70%	-1.62%	0.57%	0.57%	12.57%
Energy	-2.01%	-1.13%	7.91%	7.91%	14.32%
Materials	-2.05%	-1.76%	1.88%	1.88%	38.40%

	Daily	WTD	MTD	QTD	YTD
Retailing	1.38%	0.51%	4.65%	4.65%	41.46%
Software & Services	0.87%	1.54%	6.12%	6.12%	44.55%
Health Care Equip & Services	-0.55%	0.22%	-0.41%	-0.41%	17.05%
Technology Hardware & Equipment	-0.70%	1.49%	2.34%	2.34%	55.96%
Food & Staples Retailing	-0.78%	-1.84%	4.70%	4.70%	7.82%
Diversified Financials	-0.99%	-1.31%	0.39%	0.39%	37.30%
Consumer Durables & Apparel	-1.00%	-0.48%	2.05%	2.05%	30.87%
Capital Goods	-1.13%	-0.65%	0.50%	0.50%	14.07%
Food, Beverage & Tobacco	-1.16%	-2.09%	1.37%	1.37%	13.90%
Consumer Services	-1.21%	-1.23%	0.82%	0.82%	14.60%
Household & Personal Products	-1.26%	0.59%	0.79%	0.79%	0.91%
Pharmaceuticals, Biotech & Life Sciences	-1.30%	-2.50%	0.11%	0.11%	4.04%
Telecom Services	-1.30%	-0.52%	-4.77%	-4.77%	-7.68%
Real Estate	-1.36%	0.86%	-0.22%	-0.22%	9.70%
Utilities	-1.66%	-0.87%	0.42%	0.42%	1.10%
Automobiles & Components	-1.72%	1.51%	6.60%	6.60%	90.67%
Commercial & Professional Services	-1.73%	-0.88%	2.16%	2.16%	7.98%
Energy	-2.01%	-1.13%	7.91%	7.91%	14.32%
Banks	-2.02%	0.29%	3.78%	3.78%	-2.55%
Materials	-2.05%	-1.76%	1.88%	1.88%	38.40%
Semiconductors & Equipment	-2.29%	-1.91%	-1.53%	-1.53%	41.50%
Media	-2.69%	-0.87%	0.59%	0.59%	23.72%
Insurance	-2.88%	-1.31%	-0.06%	-0.06%	14.63%
Transportation	-3.80%	-5.32%	0.26%	0.26%	8.90%

**INTERNATIONAL ETFs**

	<b>Daily</b>	<b>WTD</b>	<b>MTD</b>	<b>QTD</b>	<b>YTD</b>
China 25 FXI	0.09%	2.68%	8.41%	8.41%	52.49%
South Korea EWY	-0.09%	-1.43%	-4.12%	-4.12%	62.42%
Sweden EWD	-0.29%	2.12%	5.70%	5.70%	57.39%
Malaysia EWM	-0.46%	-0.09%	7.40%	7.40%	49.38%
BRIC EEB	-0.50%	0.00%	7.96%	7.96%	82.03%
Austria EWO	-0.65%	-1.93%	4.15%	4.15%	75.50%
Singapore EWS	-0.73%	-0.55%	1.67%	1.67%	55.04%
Taiwan EWT	-0.73%	-1.55%	-0.73%	-0.73%	61.13%
Germany EWG	-0.77%	1.08%	4.19%	4.19%	20.29%
MSCI Emerging Markets EEM	-0.83%	0.02%	4.75%	4.75%	63.24%
Australia EWA	-1.07%	0.46%	6.86%	6.86%	72.38%
Brazil EWZ	-1.08%	-1.55%	9.91%	9.91%	112.46%
Hong Kong EWH	-1.10%	2.90%	4.38%	4.38%	56.22%
Switzerland EWL	-1.28%	1.12%	2.95%	2.95%	20.60%
Netherlands EWN	-1.31%	-0.28%	5.19%	5.19%	41.29%
Latin America ILF	-1.31%	-0.60%	8.48%	8.48%	82.76%
France EWQ	-1.34%	-0.23%	2.23%	2.23%	26.85%
Spain EWP	-1.42%	1.07%	2.80%	2.80%	35.95%
Canada EWC	-1.64%	-2.55%	1.41%	1.41%	48.25%
Belgium EWK	-1.66%	-0.44%	5.08%	5.08%	56.36%
United Kingdom EWU	-1.83%	-0.19%	3.61%	3.61%	31.18%
Mexico EWW	-1.92%	-1.02%	7.65%	7.65%	45.71%
Italy EWI	-2.28%	-2.23%	3.04%	3.04%	28.31%
Japan EWJ	-2.32%	-1.14%	-2.52%	-2.52%	1.15%
Vietnam VNM	-3.43%	-0.55%	7.72%		

S&P 500 Cash (1,095.62, 1,095.83, 1,075.49, 1,079.60, -13.31)



On Wednesday the S&P 500 made an intra-day post-March rally high which was also a 52-week high. Unfortunately it closed lower on the day in a key reversal.

Momentum indicators are not yet oversold and the MACD is just now showing a negative crossover.



The weekly chart of the S&P 500 shows it remains above its 80-week moving average. The last pieces of the bullish puzzle will be the 80-week changing its slope from down to up and the shorter-term moving averages crossing above the longer-term.

Momentum indicators are still at high levels, but there are negative divergences on the RSI and the stochastic.

NASDAQ 100 (1,774.05, 1,777.57, 1,749.03, 1,753.63, -9.52)



The Nasdaq 100 also made a 52-week high Wednesday and also closed lower on the day printing a gravestone doji-like candle. As the name implies these aren't happy candles, and they are seen at tops. Friday's action printed a dark cloud cover, another bearish candle, in spite of good news from MSFT and AMZN.

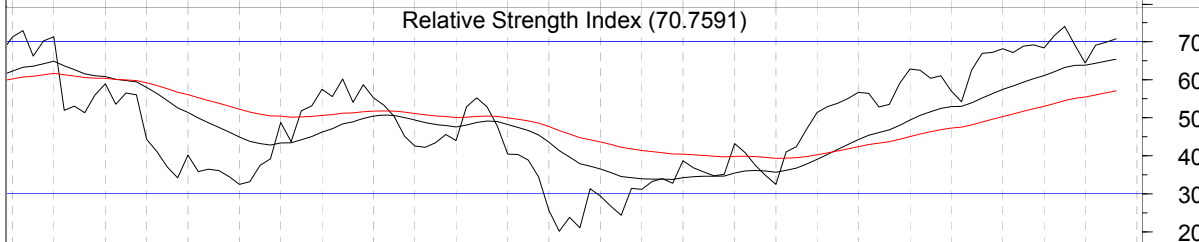
There is a negative divergence on the RSI and the stochastic and the MACD are showing negative crossovers.

NASDAQ 100 (1,741.43, 1,780.83, 1,732.02, 1,753.63, +14.31)



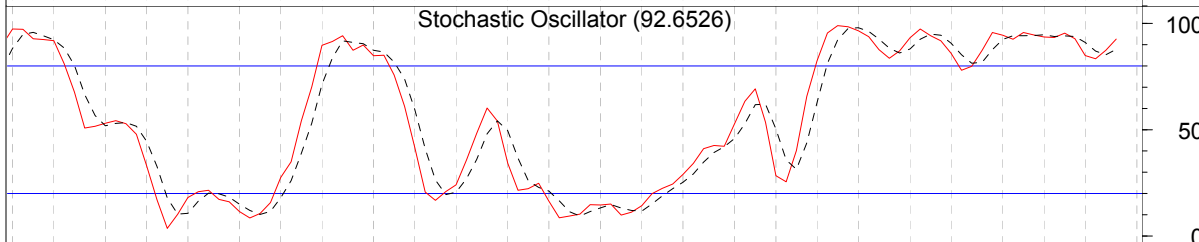
The weekly chart of the Nasdaq 100 printed a shooting star candle which closed just under a resistance level. Shooting stars are bearish candles seen at tops.

Relative Strength Index (70.7591)

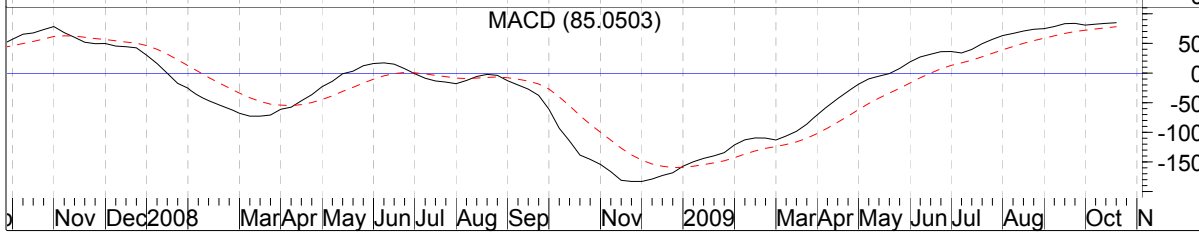


There is a negative divergence on the RSI, while the other momentum indicators remain at high levels.

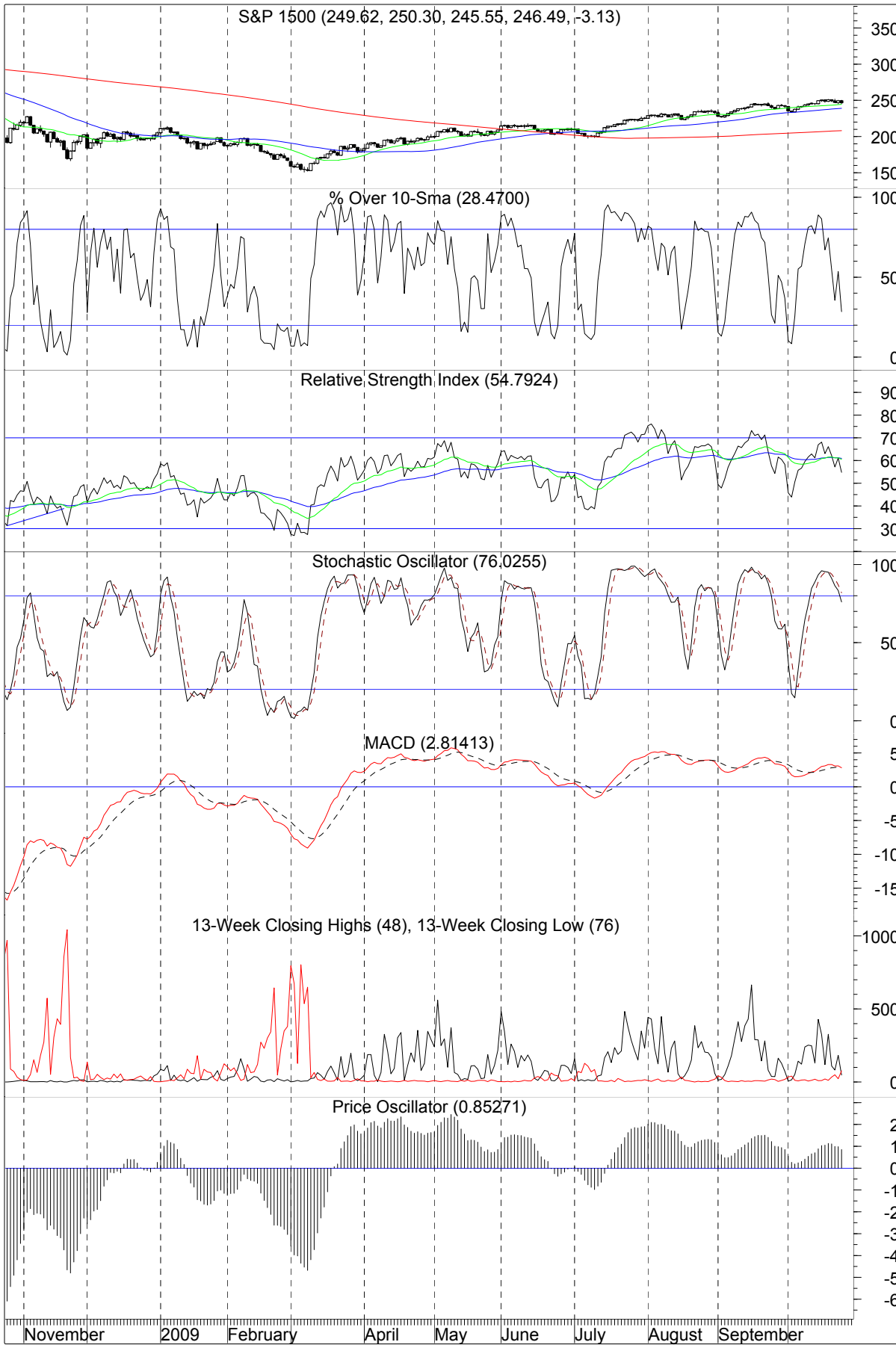
Stochastic Oscillator (92.6526)



MACD (85.0503)





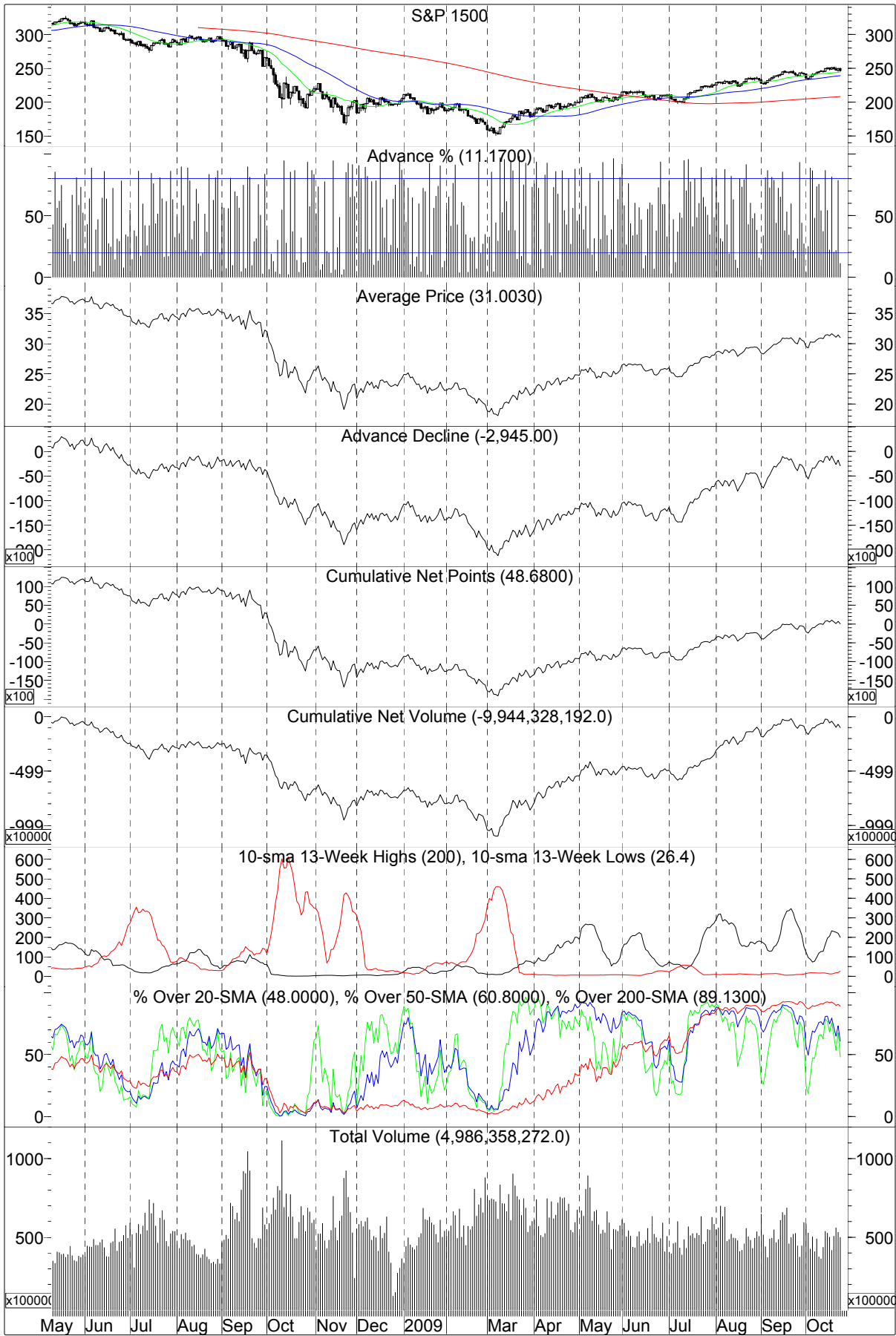


The percent over 10-sma is 28.47.

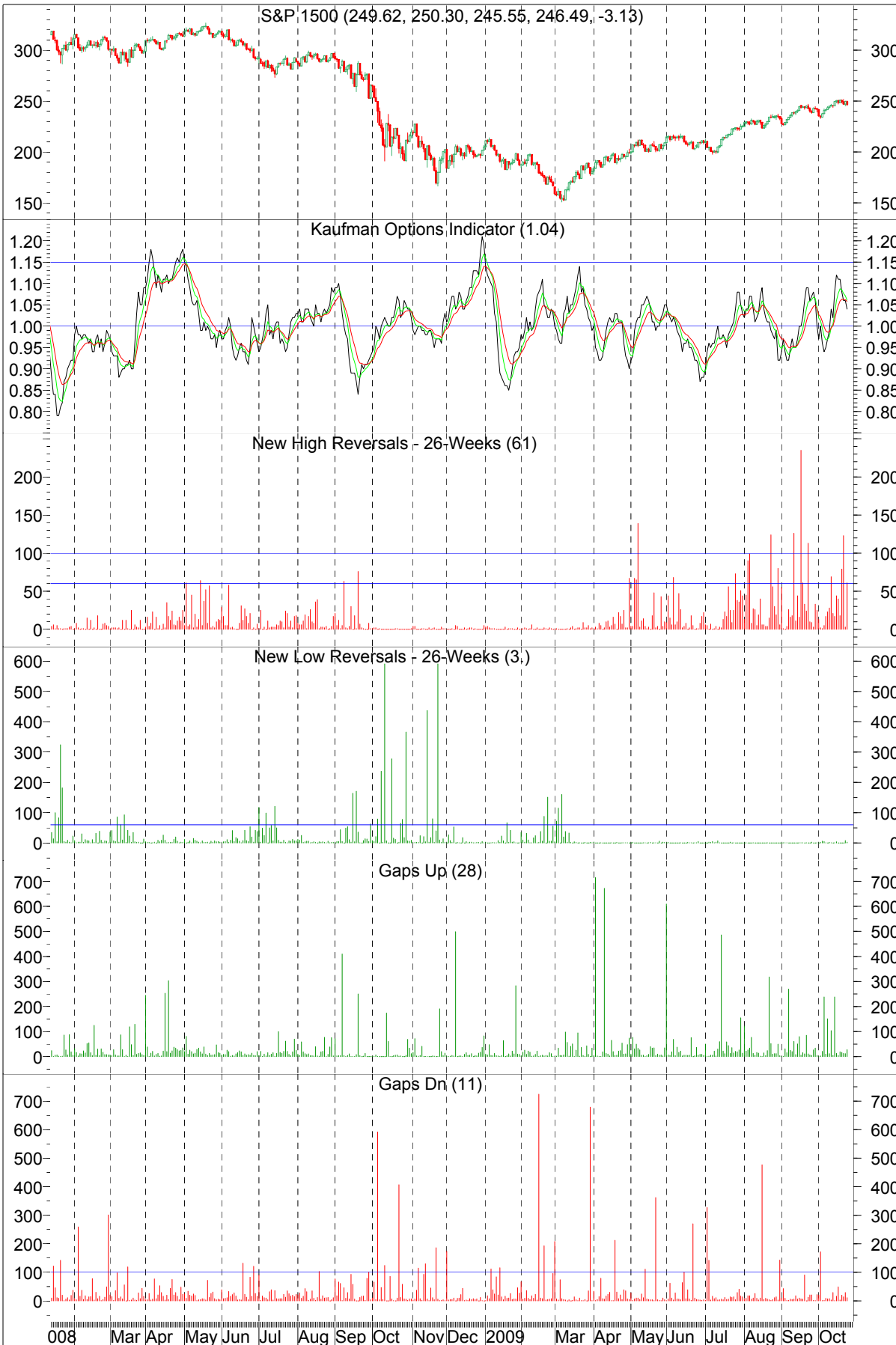
Our momentum indicators are not yet oversold. In fact, the stochastic is just turning down from the overbought zone.

13-week closing lows were greater than 13-week highs Friday, and are starting to increase. So far they are still lower than the number seen in July.

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



11.17 percent of  
stocks advanced  
Friday.

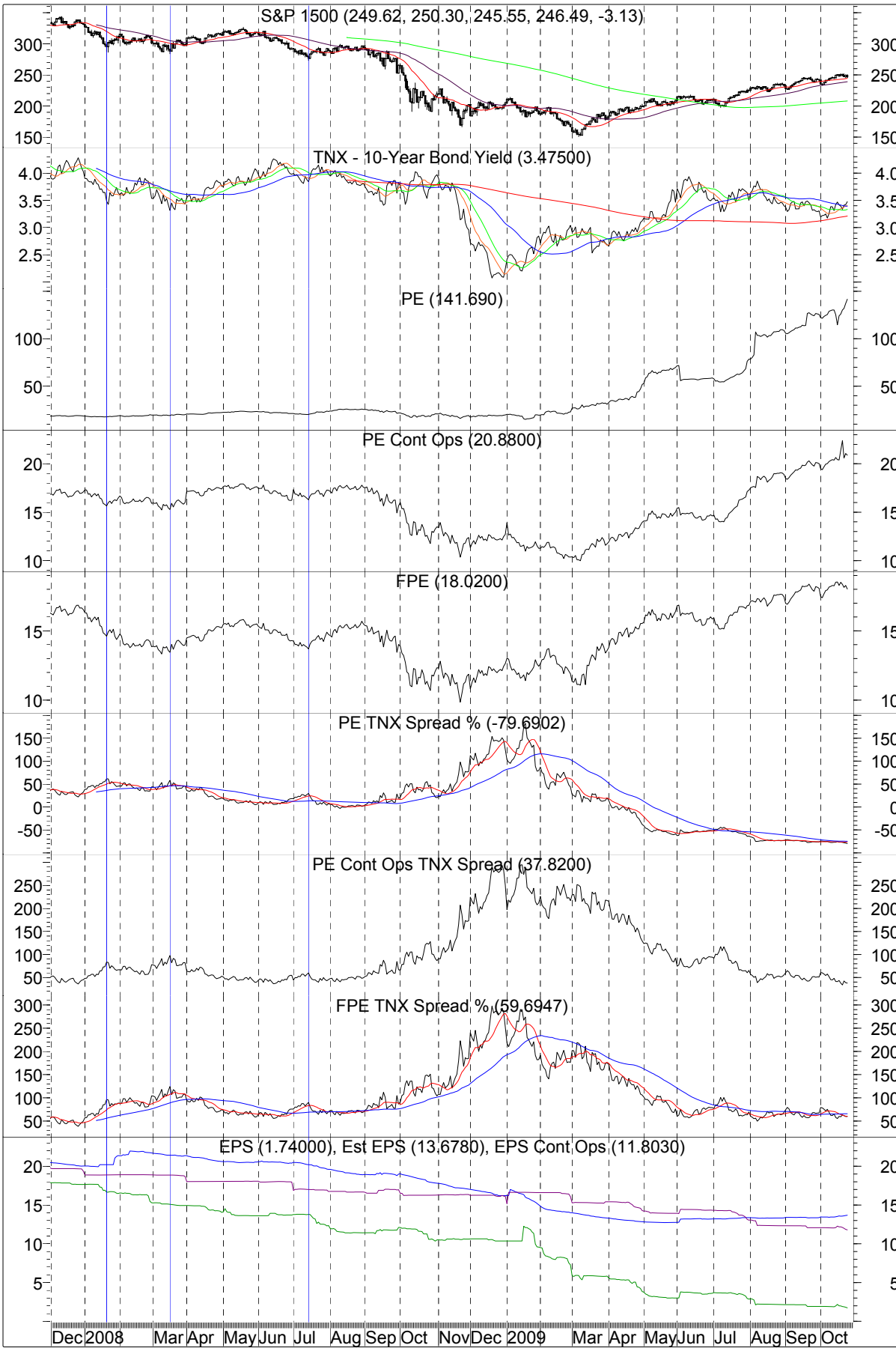


Our proprietary options indicator warned us of over bullishness when it hit 1.12 on 10/15. It has dropped, but is still showing optimism on the part of options buyers at 1.04

Wednesday's 123 new high reversals is a number seen ahead of periods of weakness or consolidation.



Our statistics of supply (red lines) versus demand (green lines) show that recent weakness is more due to a pullback by buyers than an increase in selling. While this is good, it leave equities vulnerable to bad news which could act as a catalyst for increased selling. With buyers becoming reticent an increase in selling pressure could cause a sharp drop in stocks.



P/E ratios remain very high.

Spreads between bond and equity yields have been moving sideways.

Aggregate earnings estimates bottomed in May and are slowly moving higher. Unfortunately aggregate earnings before charges and aggregate earnings from continuing operations continue to move lower.



The astonishing inverse relationship between the U.S. Dollar Index and equities remains intact.

The Dollar Index has a positive divergence on the daily RSI and is getting oversold on a weekly basis.

Crude oil followed through on its recent breakout and is starting to get short-term overbought. It is not nearing overbought longer-term.

Gold is consolidating after its recent breakout and could be getting ready for another leg up.