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The Kaufman Report

Trade what you see, not what you think.

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Friday October 31, 2008

Closing prices of October 30, 2008

Stocks rallied again Thursday as the S&P 1500 rose 2.76%. There was broad participation as all of the S&P sectors advanced, led by Utilities +4.3% and Energy +4.04%. Small and mid-caps led large-caps once again.

The next few days promise to be very exciting. We could see end-of-month window dressing and profit taking before the election. Earnings season is nearing an end as more than 2/3 of the S&P 500 have reported. Unfortunately earnings and projections keep moving down, and the P/E ratio is almost back to 21. Spreads between equity and bond yields are narrowing sharply. Options buyers are becoming bullish again, with Thursday's Put/Call ratio hitting 0.80. We are watching these numbers carefully.

We continue to be hopeful that the recent price action proves to be a successful retest of the lows of October 10th, giving us at least a multi-week rally. It is possible that most of the bad news regarding the current earnings season and the upcoming election are already in stock prices, and that forced liquidations are subsiding for the time being. We noted Sunday that sellers were becoming less aggressive, and that some positive divergences had emerged. Therefore, we are trying to trade what may become a good rally, while keeping alert for signs of weakness and distribution which could mean the resumption of the downtrend.

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The S&P 1500 (215.77) was up 2.757% Thursday. Average price per share was up 3.68% as small-caps lagged the major indexes. Volume was 98% of its 10-day average and 91% of its 30-day average. 86.64% of the S&P 1500 stocks were up on the day, with up volume at 78% and up points at 91%. Up Dollars was 97.8% of total dollars, and was 198% of its 10-day moving average while Down Dollars was 4% of its 10-day moving average. The index down 18.87% in October, 34.87% year-to-date, and 39.46% from the peak of 356.38 on 10/11/07. Average price per share is down 42.45% from the peak of \$43.23 on 6/4/2007.

The Put/Call Ratio was 0.801. The Kaufman Options Indicator was 1.04.

The spread between the reported earnings yield and 10-year bond yield is 21.76% and 109.98% based on projected earnings.

Reported aggregate earnings for the S&P 1500 peaked in August 2007 at \$19.18 and are now at \$10.35, a drop of 46.04%. Estimated aggregate earnings peaked at \$21.95 in February 2008 and are now \$17.85, a drop of only 18.68%. Analysts have obviously been very late in lowering estimates, and have also been way too optimistic. *If investors had any confidence in current earnings estimates stocks would be much higher than they currently are.* The earnings numbers jumped up recently as Lehman, Fannie and Freddie were unceremoniously kicked out of the S&P indexes, highlighting the old expression that sometimes less is more. *We are waiting for GM to be kicked out of the Dow.*

346 companies in the S&P 500 have reported third quarter earnings. According to Bloomberg, 60.6 % have had positive surprises, 11.0% have been in line, and 28.4% have been negative. The year-over-year change has been -13.6% on a share-weighted basis, +1.9% market cap-weighted, and +4.1% non-weighted. Ex-financial stocks these numbers are 13.4%, 22.4%, and 24.1%, respectively.

Federal Funds futures are pricing in a 55.3% probability that the Fed will *cut rates 50 basis points to 0.50%*, and a 44.7% probability of *cutting 25 basis points to 0.75%* when they meet on October 29th. They are pricing in a 48.2% probability that the Fed will *cut rates 25 basis points to 0.75%* on December 16th, and a 36.9% probability of *cutting 50 basis points to 0.50%*.

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

Options expire November 21st. December options expire the 19th.

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S&P 1500 Analysis - Wayne S. Kaufman, CMT

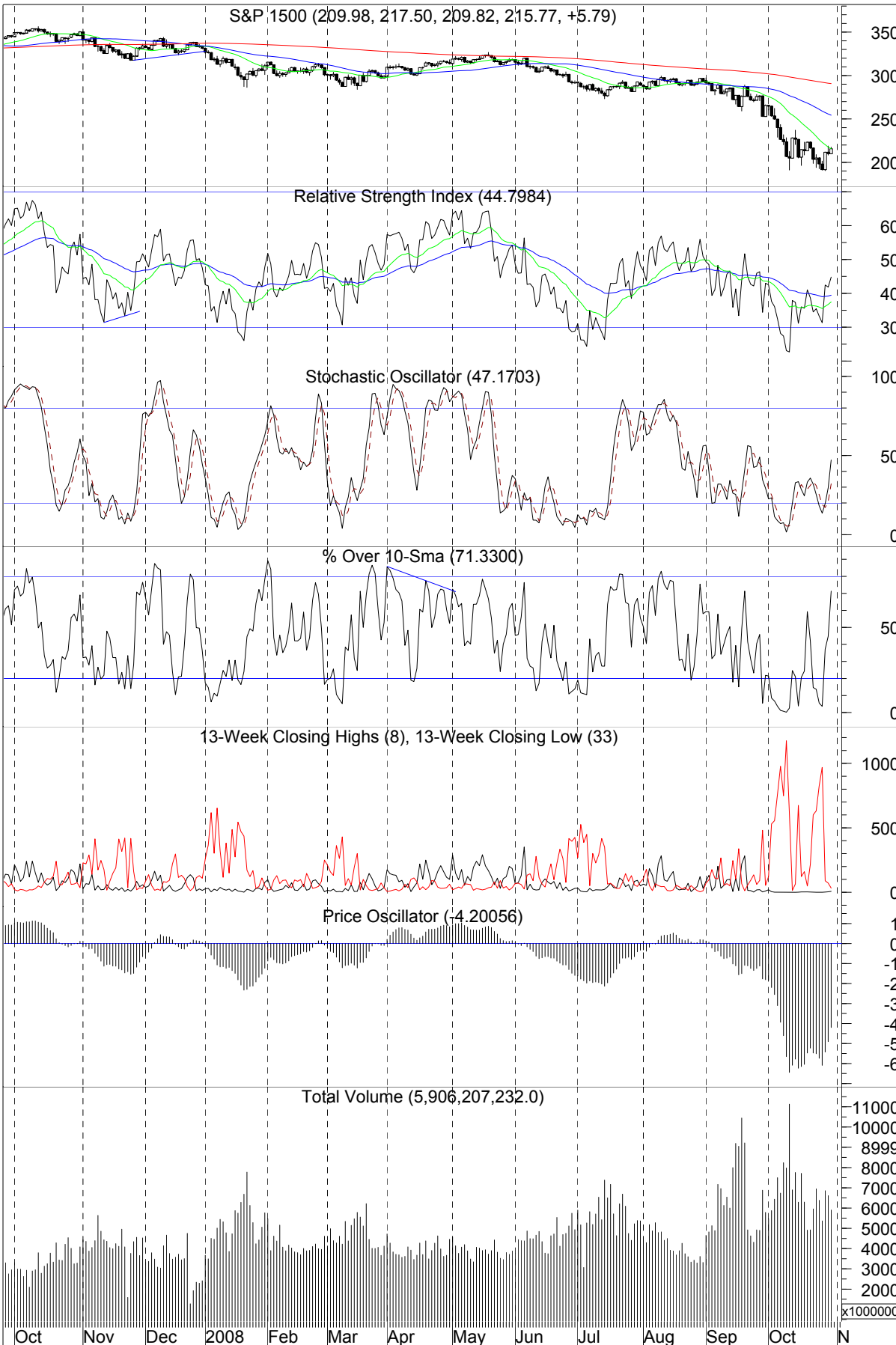
S&P 1500 (209.98, 217.50, 209.82, 215.77, +5.79)



The S&P 1500 rallied Thursday to resistance in the form of the 20-day moving average.

S&P 1500 Analysis - Wayne S. Kaufman, CMT

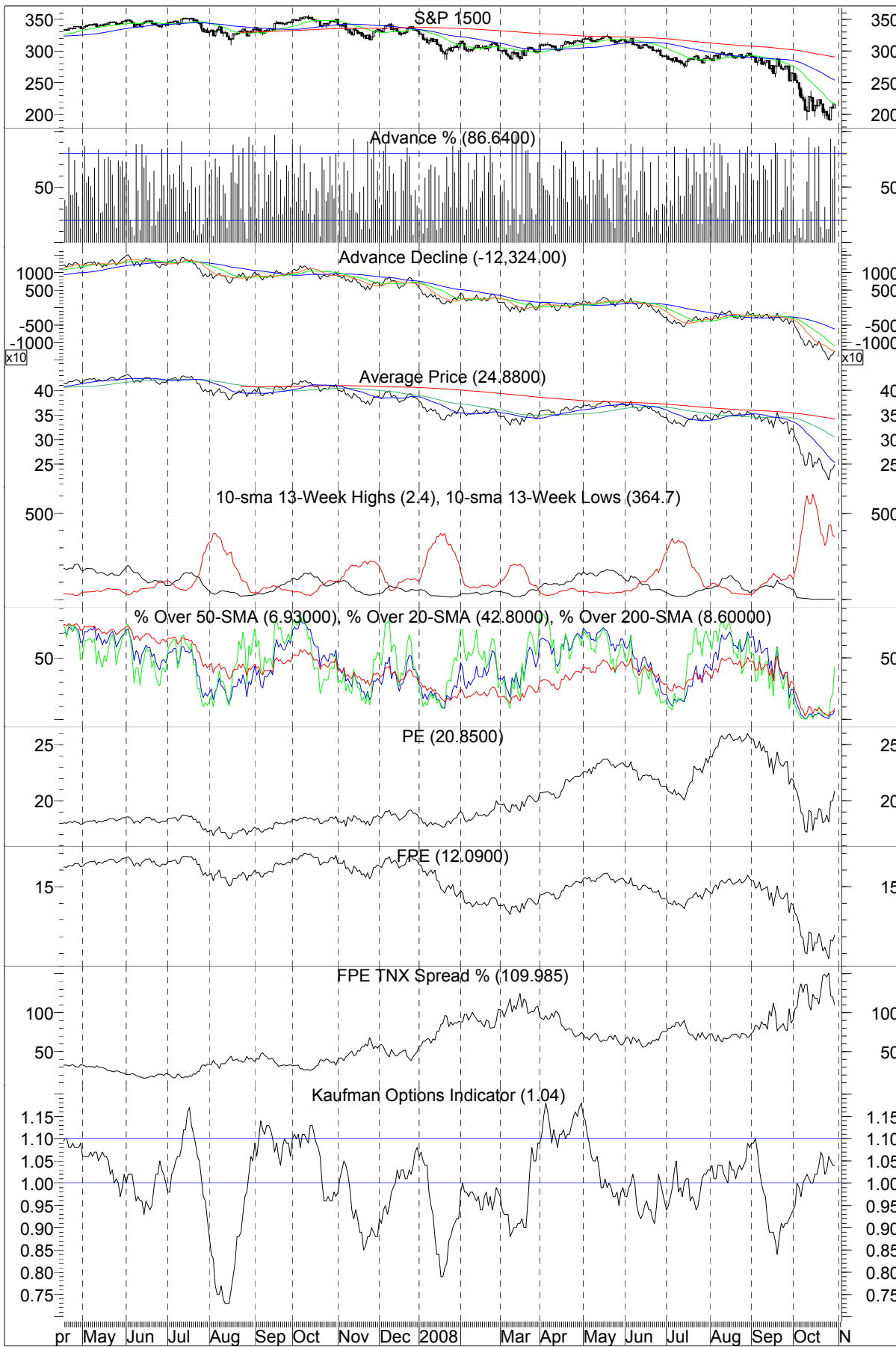
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Our oscillators are at neutral levels. The percent over 10-sma is nearing the overbought zone.

Volume receded Thursday.

S&P 1500 Analysis - Wayne S. Kaufman, CMT



86.64% of stocks traded higher Thursday.

Finally some movement here as the percent over 20-sma jumped.

The P/E ratio is moving higher.

The forward P/E is still low, but the difference between current and forecast earnings is widening as current numbers drop faster.

Our options indicator still shows bullishness among options buyers.