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The Kaufman Report

Trade what you see, not what you think.

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Wednesday October 8, 2008 **Closing prices of October 7, 2008**

On 9/28 we said there was the possibility of a market crash. Since then, only seven trading sessions later, the S&P 1500 is down 18.13% to the lowest level since October 2003. Year-to-date the index is down 31.7%, and since the peak last October 11th it is down 36.49%.

Stocks are at very extreme oversold levels. Valuations based on spreads between equity and earnings yields are at ridiculous levels. <u>A sharp rebound relief rally is due at any time</u>. When it takes place we will be skeptical of it being "the" bottom as long as our options indicator, which we said on Sunday was at a surprising neutral level, is not showing the kind of bearishness seen at prior important bottoms. The only exception to that would be if we see extreme demand for stocks resurface.

<u>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.</u>

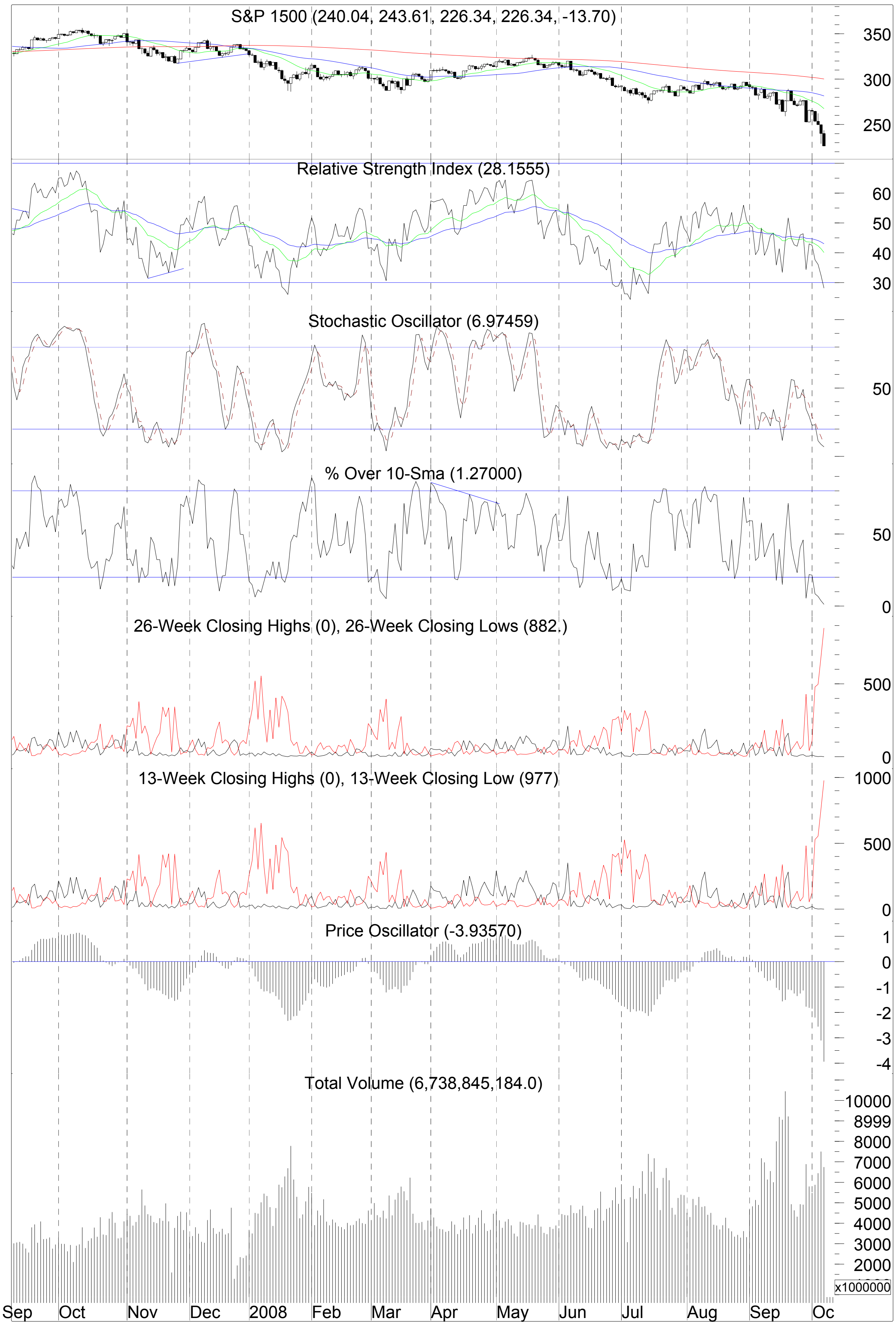
Reported aggregate earnings for the S&P 1500 peaked in August 2007 at $19.18 and are now at $11.934, a drop of 37.78%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $18.803, a drop of only 14.34%. Analysts have obviously been very late in lowering estimates, and have also been way too optimistic. *<u>If investors had any confidence in current earnings estimates stocks would be much higher than they currently are.</u>* 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.

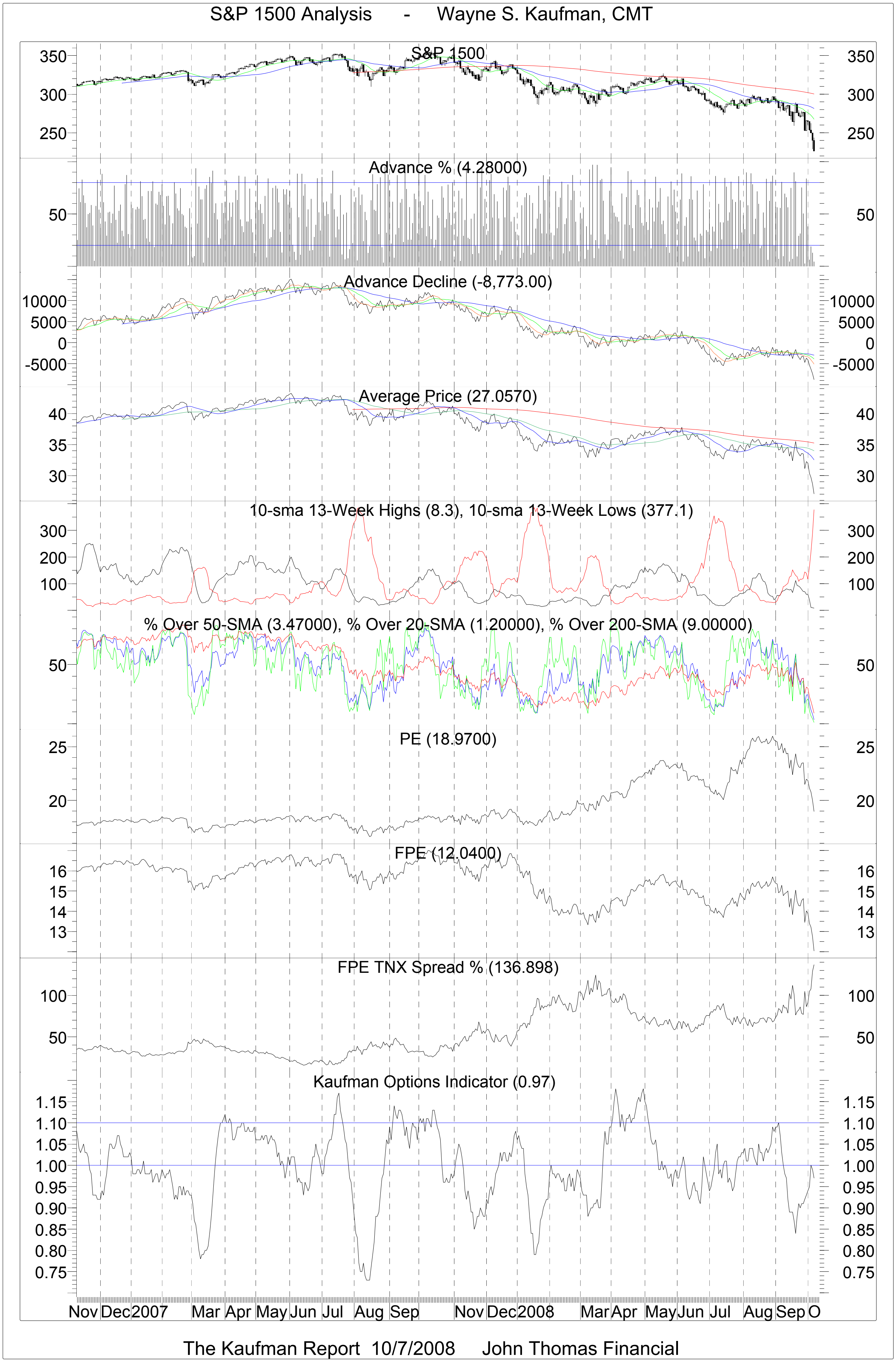
Federal Funds futures are pricing in an 68.0% probability that the Fed will *<u>cut rates 50 basis points to 1.50%,</u>* and a 32.0% probability of *<u>cutting 75 basis points to 1.25%</u>* when they meet on October 29th. They are pricing in a 47.4% probability that the Fed will *<u>cut rates 75 basis points to 1.25%</u>* at the meeting on December 16th, and a 39.0% probability of *<u>of cutting 50 basis points to 1.50%.</u>* They are pricing in a 47.1% probability that the Fed will *<u>cut rates 75 basis points to 1.25%</u>* at the meeting on January 28th, and a 37.7% probability of *<u>decreasing 50 basis points to 1.50%.</u>*

The S&P 1500 (226.34) was down 5.707% Tuesday. Average price per share was down 5.51%. Volume was 115% of its 10-day average and 112% of its 30-day average. 4.28% of the S&P 1500 stocks were up on the day. Up Dollars was 1/5 of 1% of its 10-day moving average and Down Dollars was 195% of its 10-day moving average.

Options expire October 17th. November options expire November 21st.

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





4.28% of the S&P 1500 traded higher Tuesday.

New lows have exploded.

Amazing numbers. 9% of stocks over their 200-sma, 3.47% over their 50-sma, 1.2% over their 20-sma.

P/Es are making multi-year lows.

Spreads between equity and bond yields are at very extreme levels.

We said Sunday it was very surprising to see our proprietary options indicator at neutral. It still is not at the level where prior important bottoms have been made.