John Thomas Financial
14 Wall Street, 5th Floor
New York, New York 10005
wskaufman@johnthomasbd.com
www.kaufmanreport.com

The Kaufman Report

Trade what you see, not what you think.

Wayne S. Kaufman, CMT
Chief Market Analyst
(800) 257-1537 Toll Free
(212) 299-7838 Direct

Monday January 12, 2009 **Closing prices of January 9, 2009**

Tuesday night we discussed the bearish shooting star candle on the daily chart, the overbought short-term indicators, and our proprietary options indicator which had reached levels where stocks were vulnerable to a sharp drop. The S&P 1500 dropped 4.85% over the next three sessions, alleviating the overbought condition. The rally off the November lows is still intact, but further consolidation or pull backs in the near-term is still possible as we enter an options expiration week and investors brace for a flood of fourth quarter earnings reports. We expect this market to continue to exhibit infuriating whipsaw action with multiple false starts. As we have stated since the November bottom, until proven otherwise this remains a bear market rally.

The S&P 1500 (201.75) was down 2.243% Friday. Average price per share was down 2.84%. Volume was 115% of its 10-day average and 94% of its 30-day average. 8.44% of the S&P 1500 stocks were up on the day, with up volume at 13.89% and up points at 7.13%. Up Dollars was 8/10 of 1% of total dollars, and was 2% of its 10-day moving average while Down Dollars was 329% of its 10-day moving average. The index is down 1.552% month-to-date, down 1.552% quarter-to-date, down 1.552% year-to-date, and down 43.39% from the peak of 356.38 on 10/11/07. Average price per share is $23.80, down 44.95% from the peak of $43.23 on 6/4/2007. For the week the index was down 2.243%

The Put/Call Ratio was 1.027. The Kaufman Options Indicator is 1.03 after hitting 1.21 on 12/30, indicating too much bullishness.

The spread between the reported earnings yield and 10-year bond yield is 113% and 244% based on projected earnings, still very wide levels. The dividend yield on the S&P 500 recently moved higher than the 10-year bond yield for the first time since 1958.

Reported aggregate earnings for the S&P 1500 peaked in August 2007 at $19.18 and are now at $10.36, a drop of 45.98%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $16.84, a drop of only 23.28%. *If investors had confidence in earnings estimates stocks would be much higher than they currently are.*

498 companies in the S&P 500 have reported third quarter earnings. According to Bloomberg, 58.1% have had positive surprises, 9.7% have been in line, and 32.3% have been negative. The year-over-year change has been -18.3% on a share-weighted basis, +5.3% market cap-weighted and -2.7% non-weighted. Ex-financial stocks these numbers are 10.1%, 23.7%, and 15.8%, respectively.

Federal Funds futures are pricing in a probability of 72% that the Fed will *leave rates unchanged,* and a probability of 28.0% of *cutting 25 basis points to 0.00%* when they meet on January 28th. They are pricing in a probability of 65.0% that the Fed will *leave rates unchanged* on March 17th, and a probability 23.5% of *cutting 25 basis points to 0.00%.*

The short-term trend is still up, while the intermediate-term and long-term trends remain down. This continues to be an opportunistic trader's market, prone to whipsaws, with adept traders able to take advantage long or short. The long-term downtrend must still be respected. Investors should not hesitate to take profits when they get them as market direction changes rapidly and short-term profits can quickly become losses.

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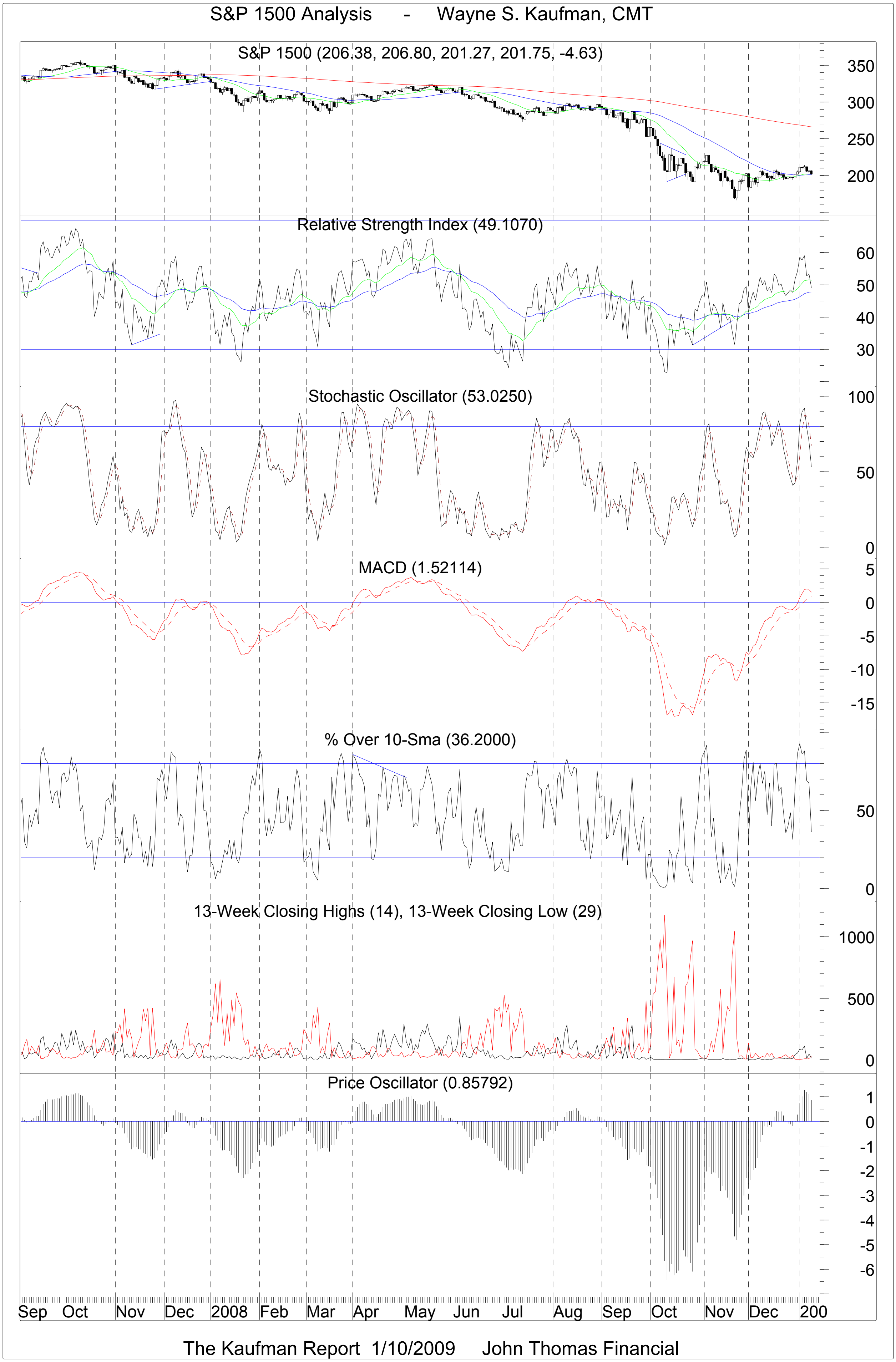
Tuesday night we discussed the bearish shooting star candle, the over bullishness of options buyers, and short-term indicators being at overbought levels. Stocks have pulled back sharply since then and are no longer overbought. With indicators not yet oversold stocks may go lower, but they are nearing levels where support has been found during the recent rally. Still, with a flood of earnings reports just ahead, we don't see any catalyst for a big pickup in demand for stocks ahead of those reports.

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

The weekly stochastic has a negative crossover from a high level, so more weakness in equities is to be expected. It is possible to see a sideways consolidation, but investors need to be alert.



Our momentum indicators are no longer overbought, but they are not yet oversold. They are nearing levels where they have bottomed during the current rally. Movement below those levels will be a red flag.

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

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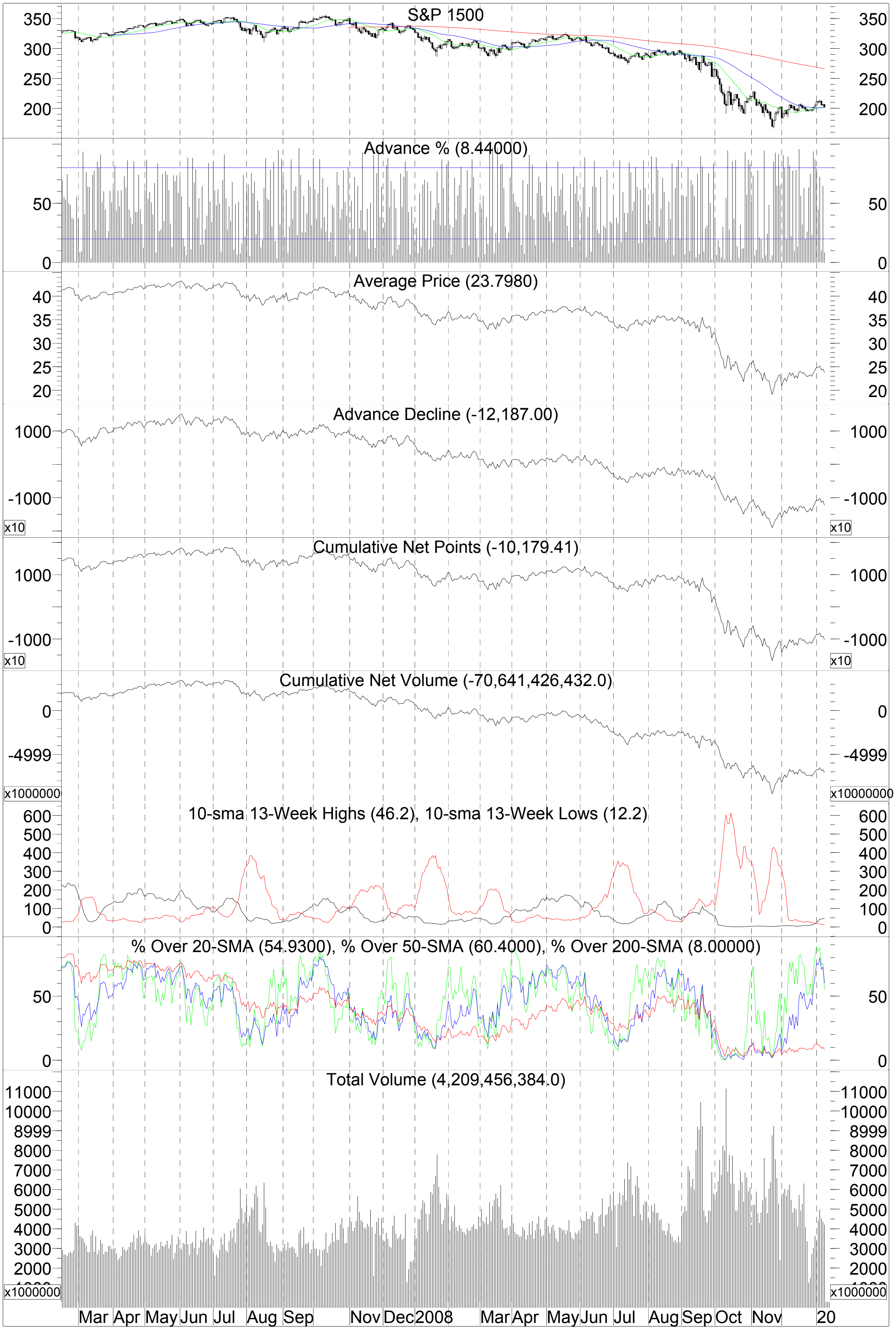
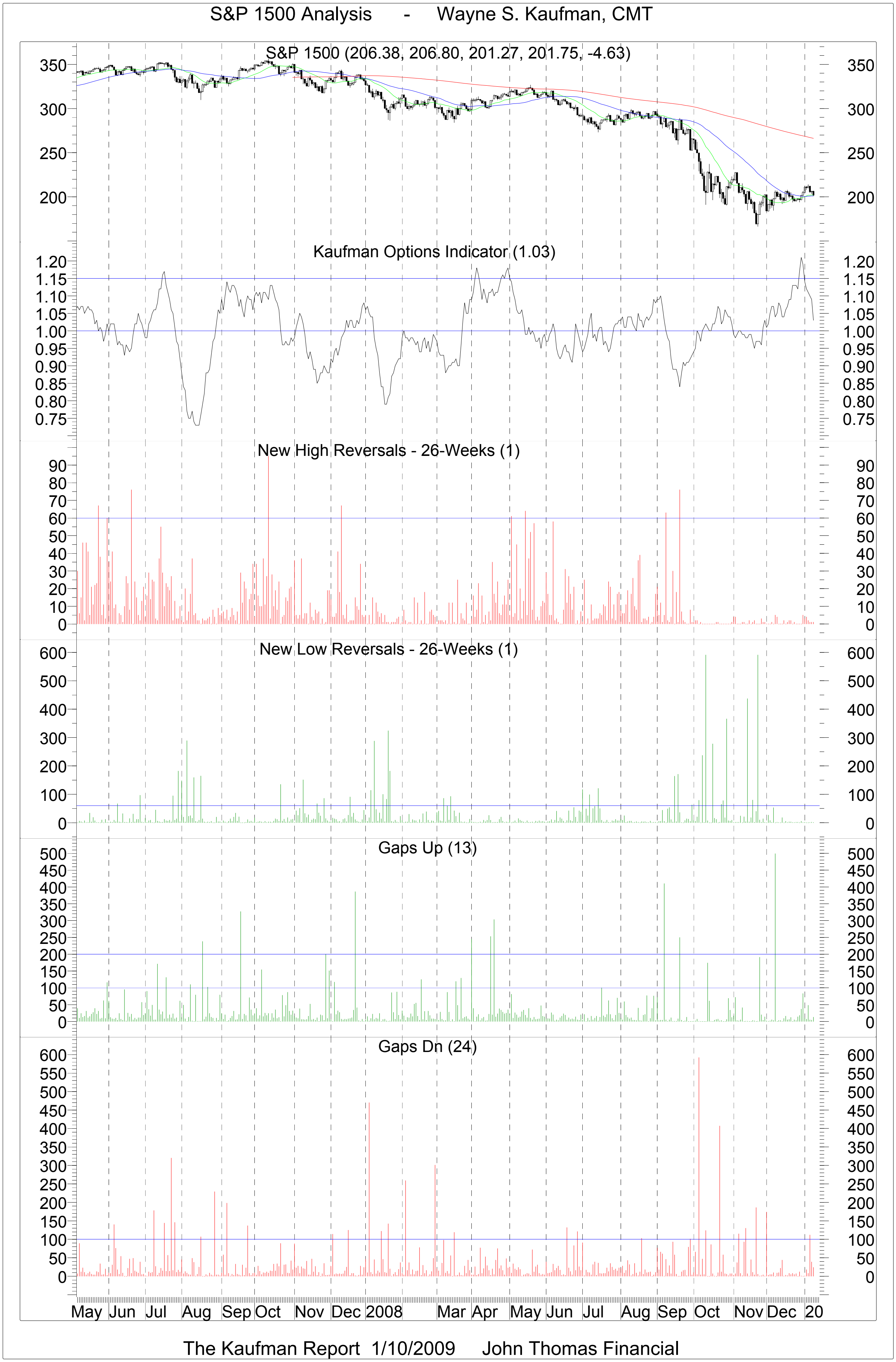


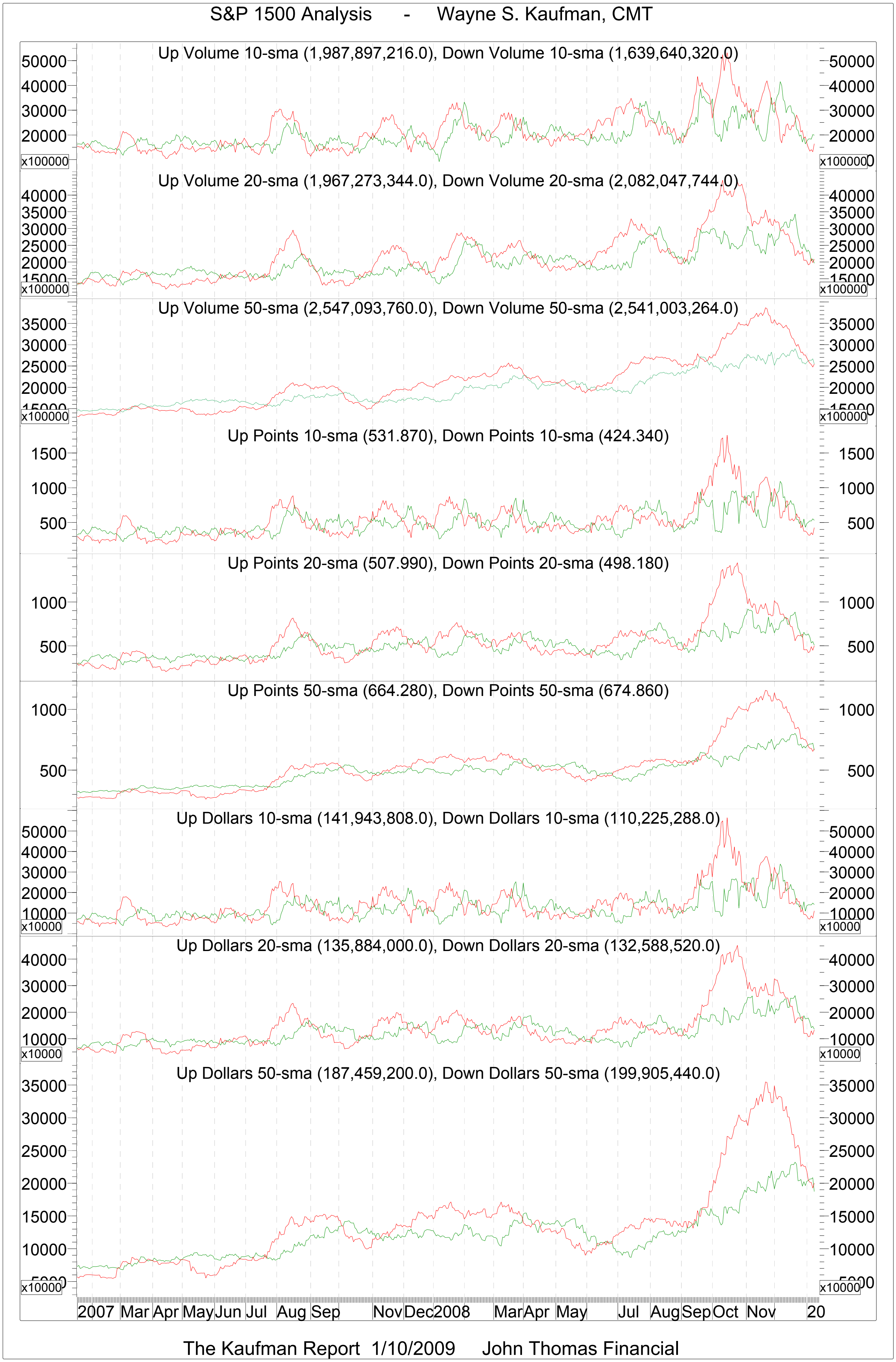
8.44% of the S&P 1500 traded higher Friday. This follows Wednesday's 10.19% advancing stocks, showing broad based selling for the three day period.

The 10-sma of 13-week highs is well above the 10-sma of 13-week lows. The averages of 26-week highs and lows (not shown) is are still negative.

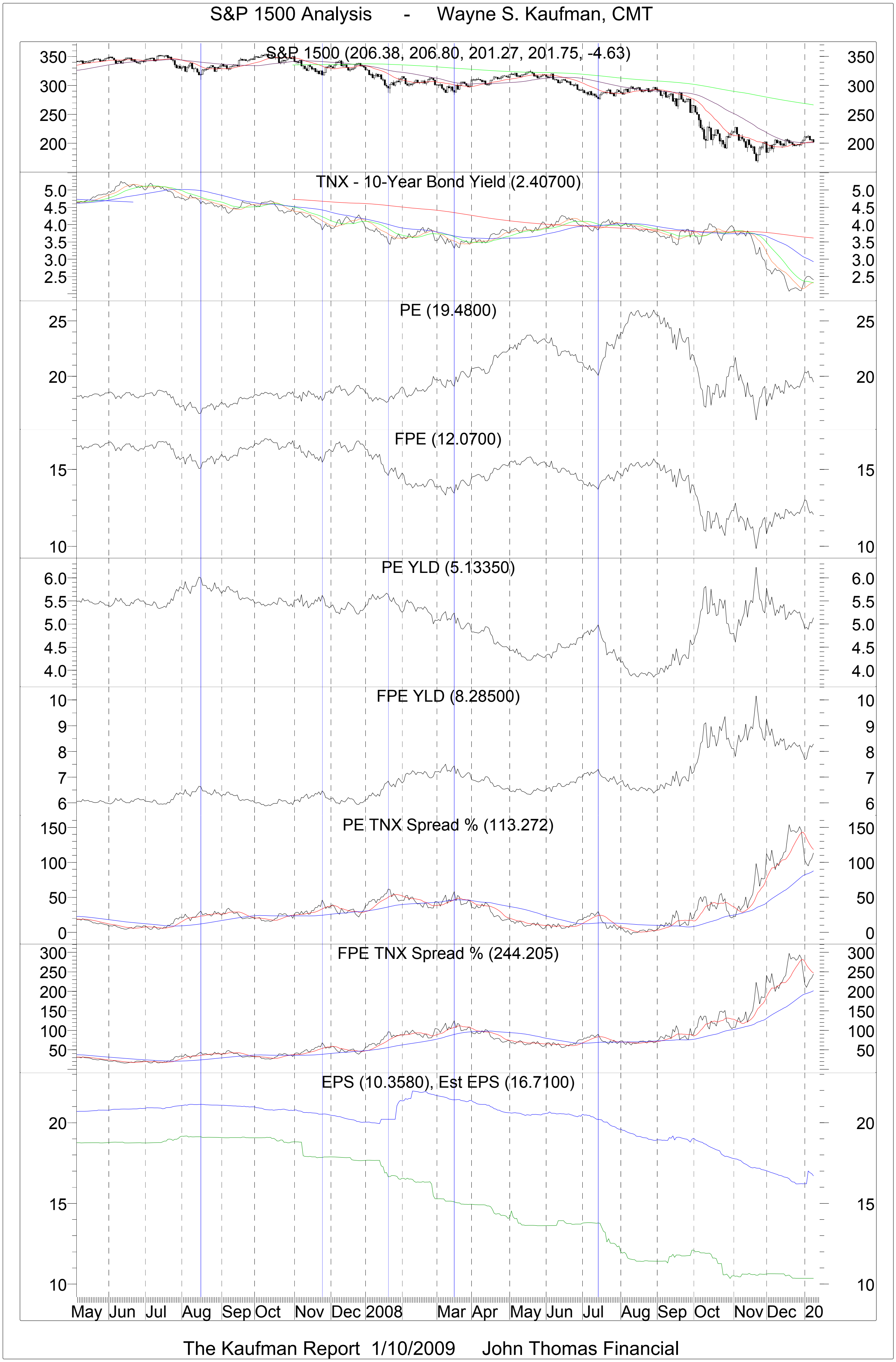
Volume was about average Friday, and slightly lower than on Thursday.



After reaching extreme over-bullish levels our proprietary options indicator has plunged. Moves below the neutral level can sometimes precede lower prices for stocks.



A quick glance at our statistics of demand (green) versus supply (red) shows that the recent rally has not shown enthusiastic buying. At the same time, sellers have stepped to the sidelines until the last few days. The upcoming earnings season will change this picture. With total volume being low stocks will move sharply if either bulls or bears become very aggressive.

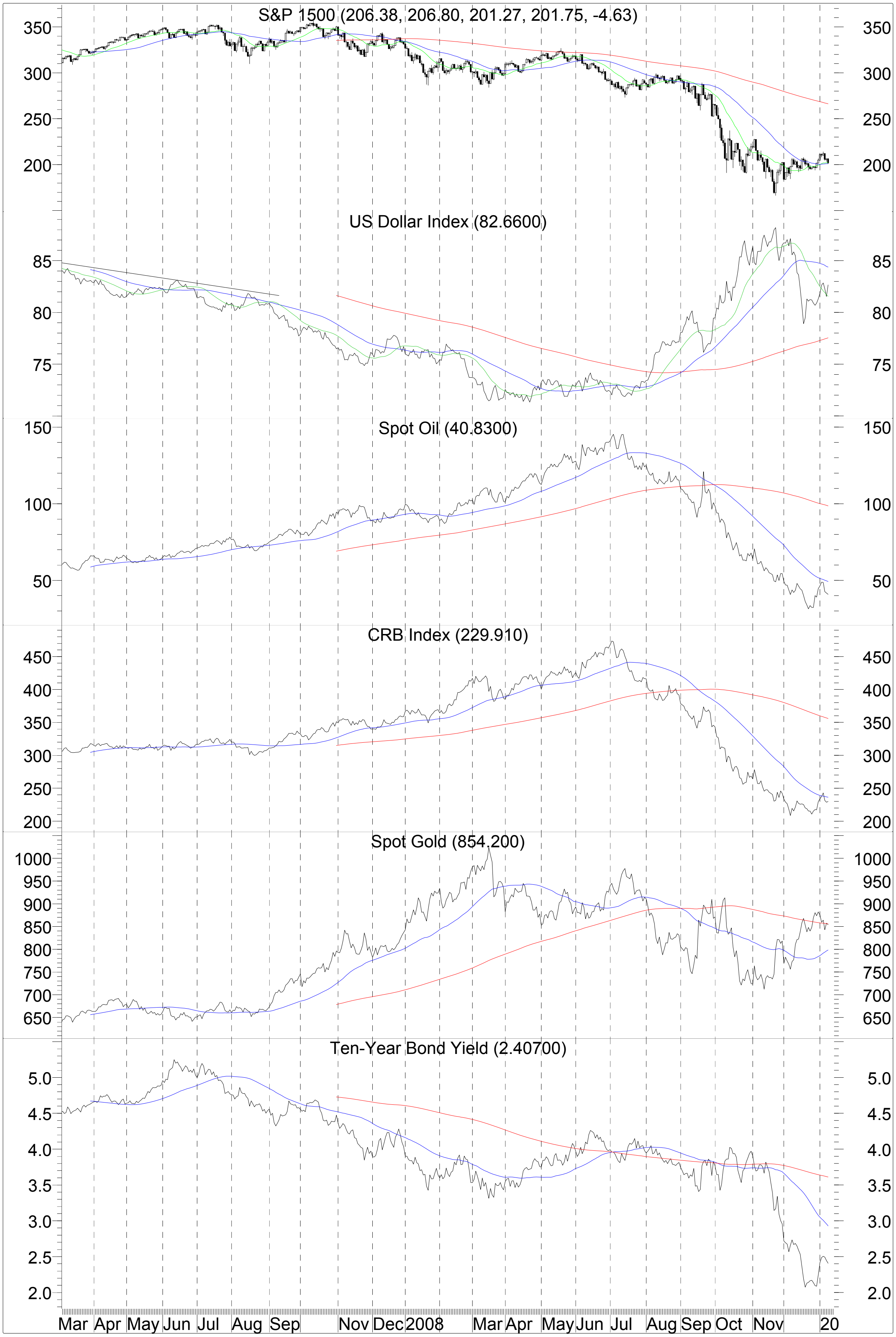


P/E ratios continue to be range bound.

Spreads between earnings yields and bond yields have dropped from amazing levels, but are still at levels where stocks should be very attractive versus bonds.

Reported and forecast earnings are in long-term down trends, and this earnings season will tell us if the recent rally is justified. If numbers are terrible but stocks don't make new lows, a case for trough valuations can be made.

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



The U.S. Dollar Index has been strong after a sharp drop. The way governments around the world are printing money at some point commodity prices have to move higher.

Crude oil got up to its 50-sma before dropping below its 20-sma (not shown) and back into a down trend.

Gold is getting pinched between support and resistance levels. There is support at the 830 area.