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The Kaufman Report

Trade what you see, not what you think.

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Monday July 14, 2008 **Closing prices of July 11, 2008**

"Nothin' lasts forever, even cold November rain" – Guns N' Roses

The down trend continues, and last week the S&P 1500 fell 1.607% as it also recorded its lowest weekly close since July 2006. This was the sixth consecutive down week. With options expiring this week we expect continued volatility in equities.

Indicators are almost universally at levels where oversold bottoms have been made in the past. The exception seems to be the VIX, the Volatility Index, which did spike up Friday although not to levels seen in March and January. Since the June 11th 90% down day, which followed closely the June 6th 90% down day, <u>we have been warning that a market that does not respond to oversold conditions is dangerous.</u> The S&P 1500 is down 9.5% since then.

Investors are braced for a very important earnings season. The rising price of crude oil is like a boa constrictor slowly squeezing the life out of some sectors of the economy. The effect on corporate profits and forecasts is about to be quantified in the upcoming earnings reports.

The spread based on projected earnings versus bond yields reached the widest level since March last week, and remains at levels where stocks should be very attractive. The March numbers were the widest levels seen in decades. If earnings numbers are brought down, the question will be how much of that is already built into stock prices. <u>However, if current quarter numbers are met, and forecasts are not ratcheted down dramatically, in hindsight stocks at current levels will appear to have been very undervalued</u>.

<u>The current short, intermediate, and long-term trends are down, and we reiterate that this continues to be a bifurcated, opportunistic trader's market, with adept traders able to take advantage long or short. Investors need to be alert to sector rotation and should not hesitate to move out of lagging sectors and stocks and into leaders.</u>

Federal Funds futures are pricing in an 88.5% probability that the Fed will *<u>leave rates at 2.00%,</u>* and a 11.5% probability of *<u>raising 25 basis points to 2.25</u>* when they meet on August 5th.

The S&P 1500 (282.24) was down 1.00% Friday. Average price per share was down 0.53%. Volume was 123% of its 10-day average and 137% of its 30-day average. 41.95% of the S&P 1500 stocks were up on the day. Up Dollars was 38% of its 10-day moving average and Down Dollars was 94% of its 10-day moving average. For the week the index was down 1.607% on increasing and above average weekly volume.

Options expire July 18th.

IMPORTANT DISCLOSURES

The S&P 1500 retraced the entire rally from the March low to the May high, and then fell below the March low. It printed a hammer-like candle on the daily chart after a panicky open Friday.

The S&P 1500 is below all the major moving averages, which are all lined up negatively. This is the lowest weekly close since July 2006.

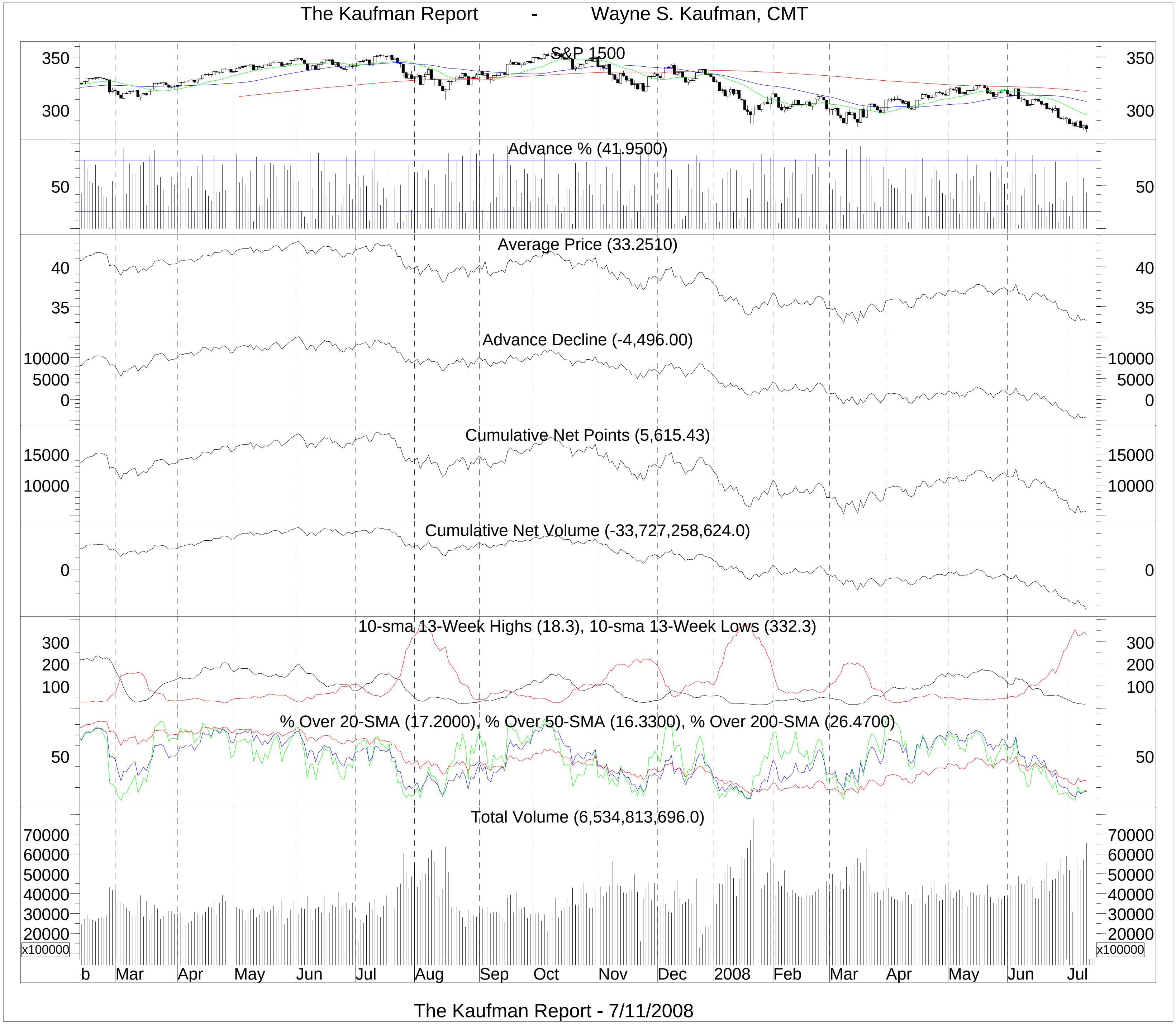
This indicator is derived from 13-week highs and 13-week lows. It is in an area where important bottoms have been made, although it has not yet turned up.

The media is trumpeting the bear market based on major indices being down 20%, but the S&P 1500 falling below the 80-week moving average (400-day approximately) which we highlighted in January told the story much earlier.

The RSI and percent over 10-sma are showing positive divergences. The RSI recently hit levels where important bottoms have been made.

Closing lows are also showing a positive divergence.

Our price oscillator is deeply oversold.

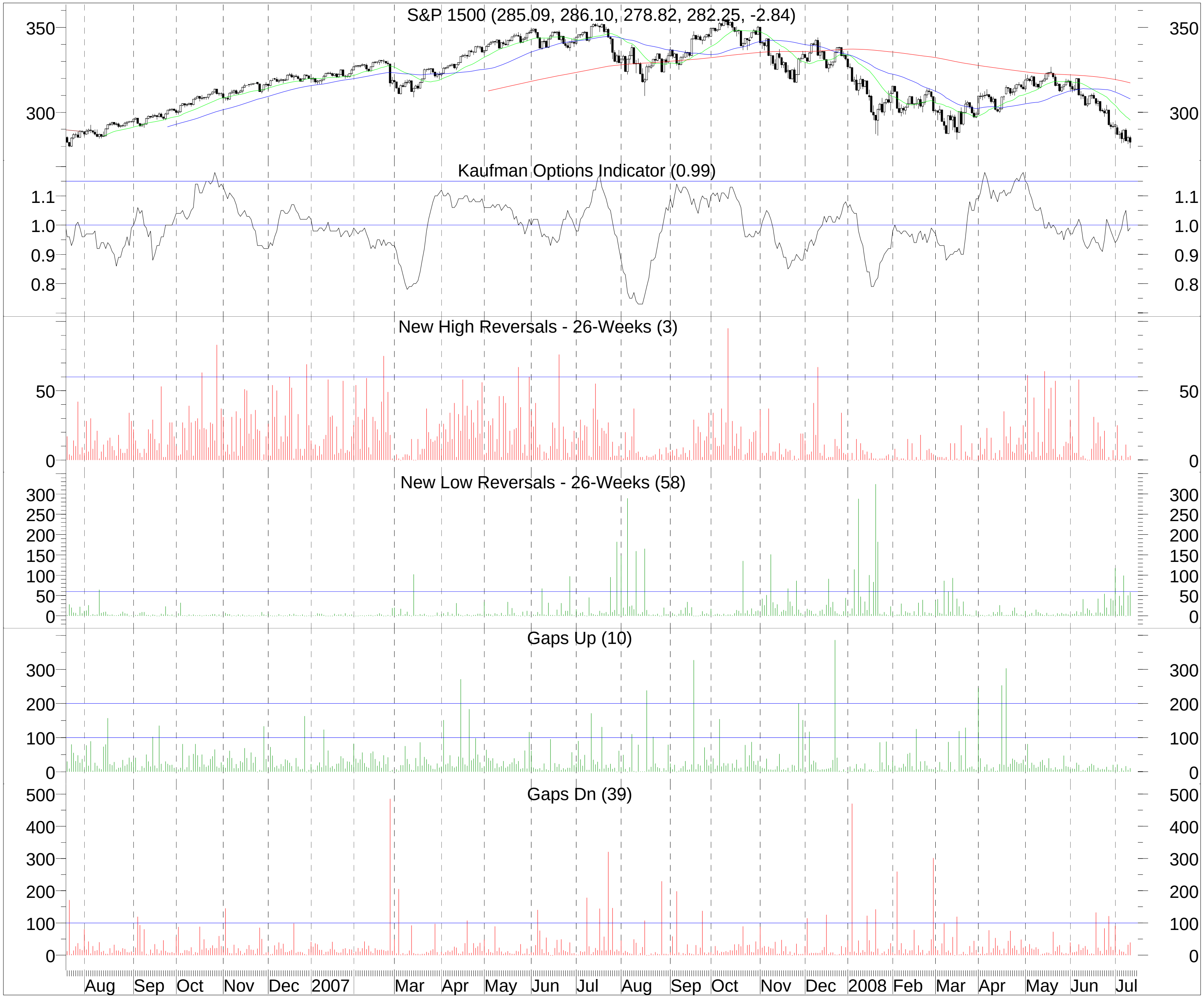


only 41.95% of stocks traded higher Friday.

In spite of a new closing low for the S&P 1500 Average Price Per Share is slightly higher than its low. This is also true for the Advance Decline line.

The 10-sma of 13-week lows is in the area where we have seen prior bottoms.

Volume expanded on Friday but certain issues traded huge volume.

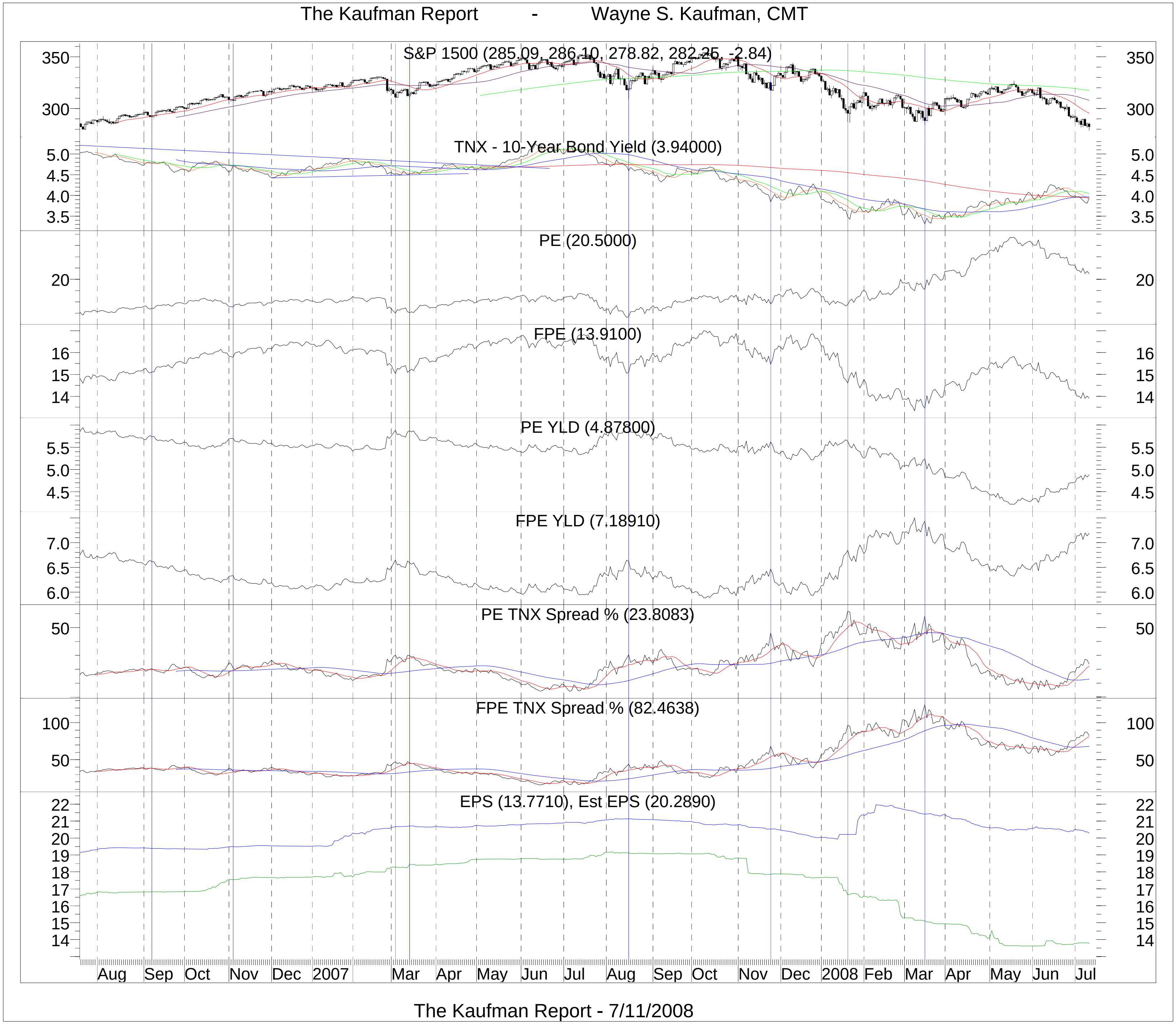


Our proprietary options indicator is barely in negative territory. We would like to have seen more fear at this point.

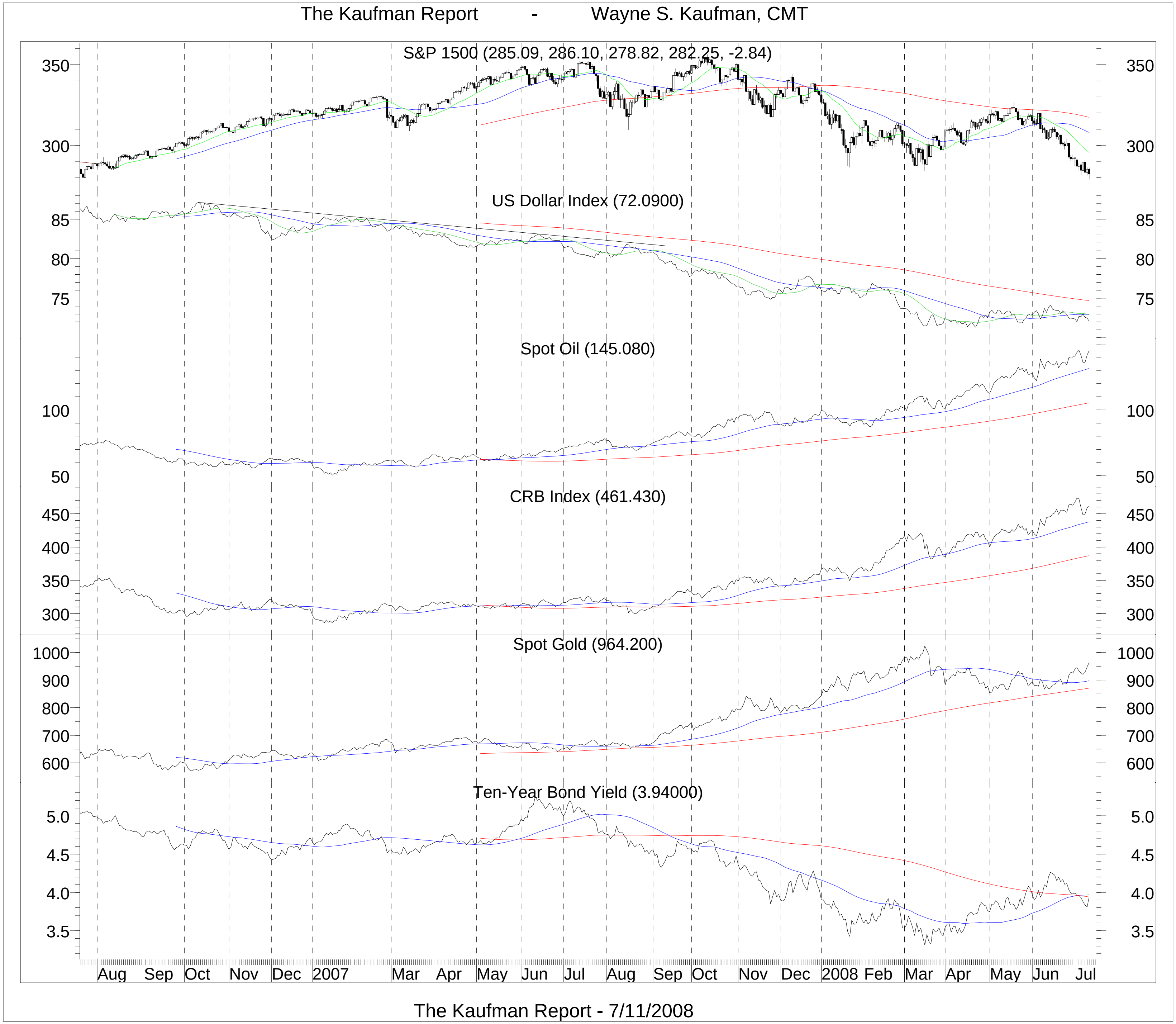
New low reversals have been picking up, showing that bottom fishers are out there.

All of our statistics of supply (red lines) are greater than the stats of demand (green lines) for all time periods.

The 10-sma of Down Dollars is lower than during prior sell offs, while Up Dollars have been low. Any catalyst for buyers could start a good rally.

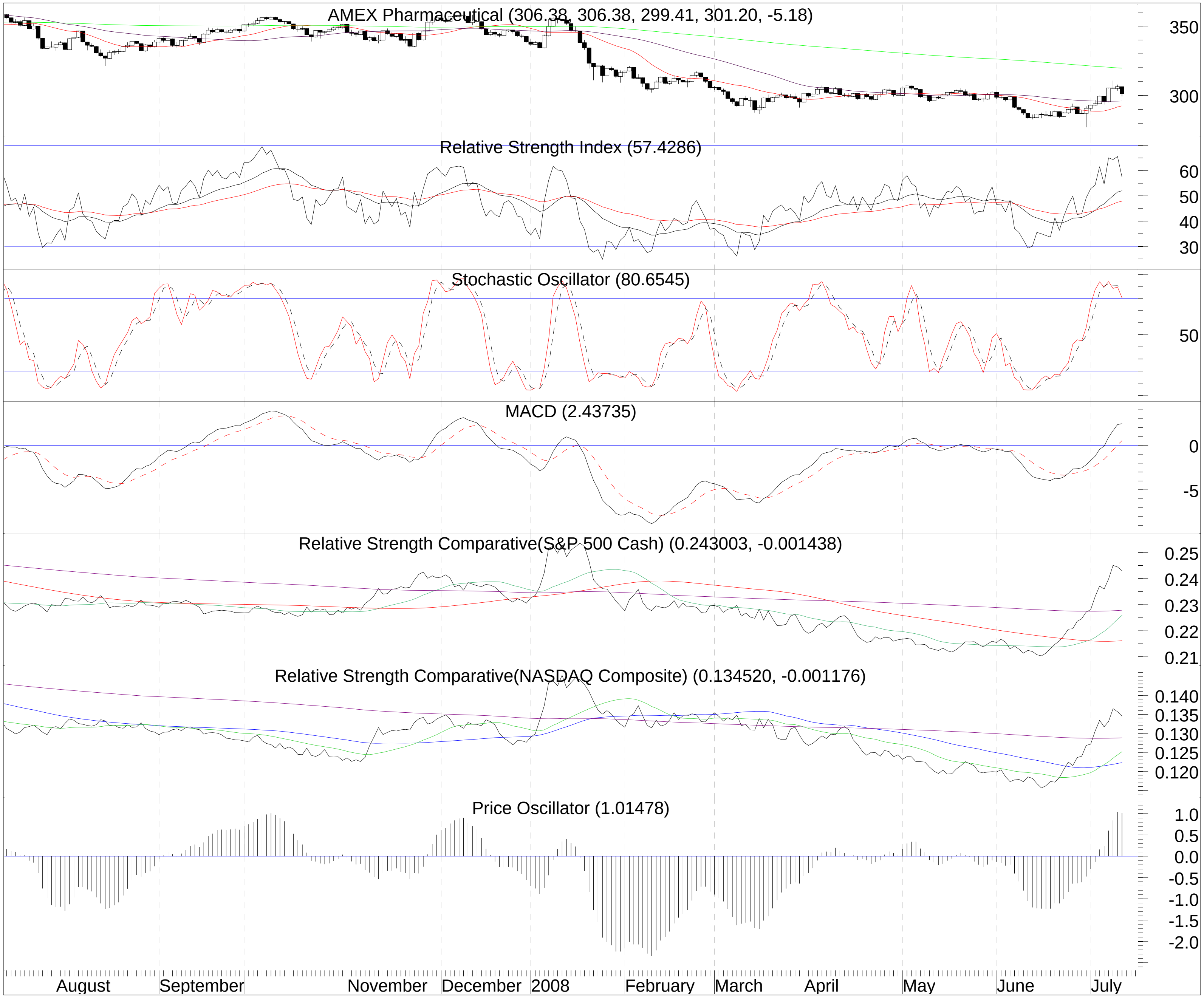


The 10-year bond yield is at the 200-sma (red).



The U.S. Dollar Index has weakened again and looks like it will make new lows. This could push crude oil higher as crude faces a potential double top. If the dollar makes new lows but crude can't move higher, it would mark current levels as very strong resistance for crude. There is a negative RSI divergence on the crude oil chart.

We said last week gold looked ready to break out and move to our prior target of the high 900s. It looks like it will go north of 1000, and may challenge its old highs.



The AMEX Pharmaceutical Index shows that big drug companies have been outperforming the S&P 500 and the Nasdaq Compositie.