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The Kaufman Report

Trade what you see, not what you think.

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Friday November 14, 2008 — Closing prices of November 13, 2008

Stocks rallied strongly Thursday in a panic-buying 90% up day, the day after a panic-selling 90% down day. An early morning sell off took the S&P 1500 to the lowest level since March 2003, then stocks reversed into a big gain as the S&P 1500 rallied 11.38% from the intra-day lows. In doing so a key reversal day, one in which an important low is made intra-day but the session finishes higher, was printed on the daily chart.

All ten S&P sectors were up strongly led by Energy, +11.1%, Telecom, +8.7%, and Materials, +8.3%.

On Tuesday night we said we were due for a bounce, which of course was just before Wednesday's sharp sell off. Wednesday night we repeated our comments about positive divergences in momentum indicators and new lows, about extremely stretched valuations, and we said a short-covering rally could take place at any time. These factors finally kicked in and we had Thursday's strong rally on expanding and higher than average volume.

Another positive divergence occurred Thursday, which was in the number of intra-day lows. That number was 490, much fewer than the 1,187 which we saw on October 10th. Of these 490 intra-day lows, 437, or 89.2% of them, finished higher on the day. On October 28th, the prior intraday low for the S&P 1500, there were 447 intra-day lows, of which only 366, or 81.9%, reversed to finish higher on the day. It would appear that at least for the short-term, most stocks just don't want to go much lower. They may not have many reasons to do so since earnings season is now 93% over and reported aggregate reported earnings have stopped ratcheting down.

In the very short-term, major indexes have bounced up to levels just under resistance. The next few sessions should tell us if this was just another short covering rally caused by extreme oversold conditions, or if longer-term investors are coming back to the market. Next week is November options expiration, so it doesn't seem like an end to the extreme volatility is in sight.

The short, intermediate and long-term trends are down. We reiterate that this continues to be an 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.

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The S&P 1500 (206.00) was up 7.046% Thursday. Average price per share was up 7.5%. Volume was 142% of its 10-day average and 120% of its 30-day average. 94.52% of the S&P 1500 stocks were up on the day, with up volume at 90.65% and up points at 98.2%. Up Dollars was 99.9% of total dollars, and was 435% of its 10-day moving average while Down Dollars was 1/4% of its 10-day moving average. The index is down 6.16% month-to-date, down 37.84% year-to-date, and down 42.2% from the peak of 356.38 on 10/11/07. Average price per share is down 45.14% from the peak of $43.23 on 6/4/2007.

The Put/Call Ratio was 0.99. The Kaufman Options Indicator was 0.98.

The spread between the reported earnings yield and 10-year bond yield is 34.8% and 120.84% based on projected earnings.

Reported aggregate earnings for the S&P 1500 peaked in August 2007 at $19.18 and are now at $10.61, a drop of 44.68%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $17.37, a drop of only 20.87%. 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.*

465 companies in the S&P 500 have reported third quarter earnings. According to Bloomberg, 57.4 % have had positive surprises, 9.7% have been in line, and 32.8% have been negative. The year-over-year change has been -18.6% on a share-weighted basis, +5.4% market cap-weighted, and -1.5% non-weighted. Ex-financial stocks these numbers are 11.5%, 24.8%, and 18.2%, respectively.

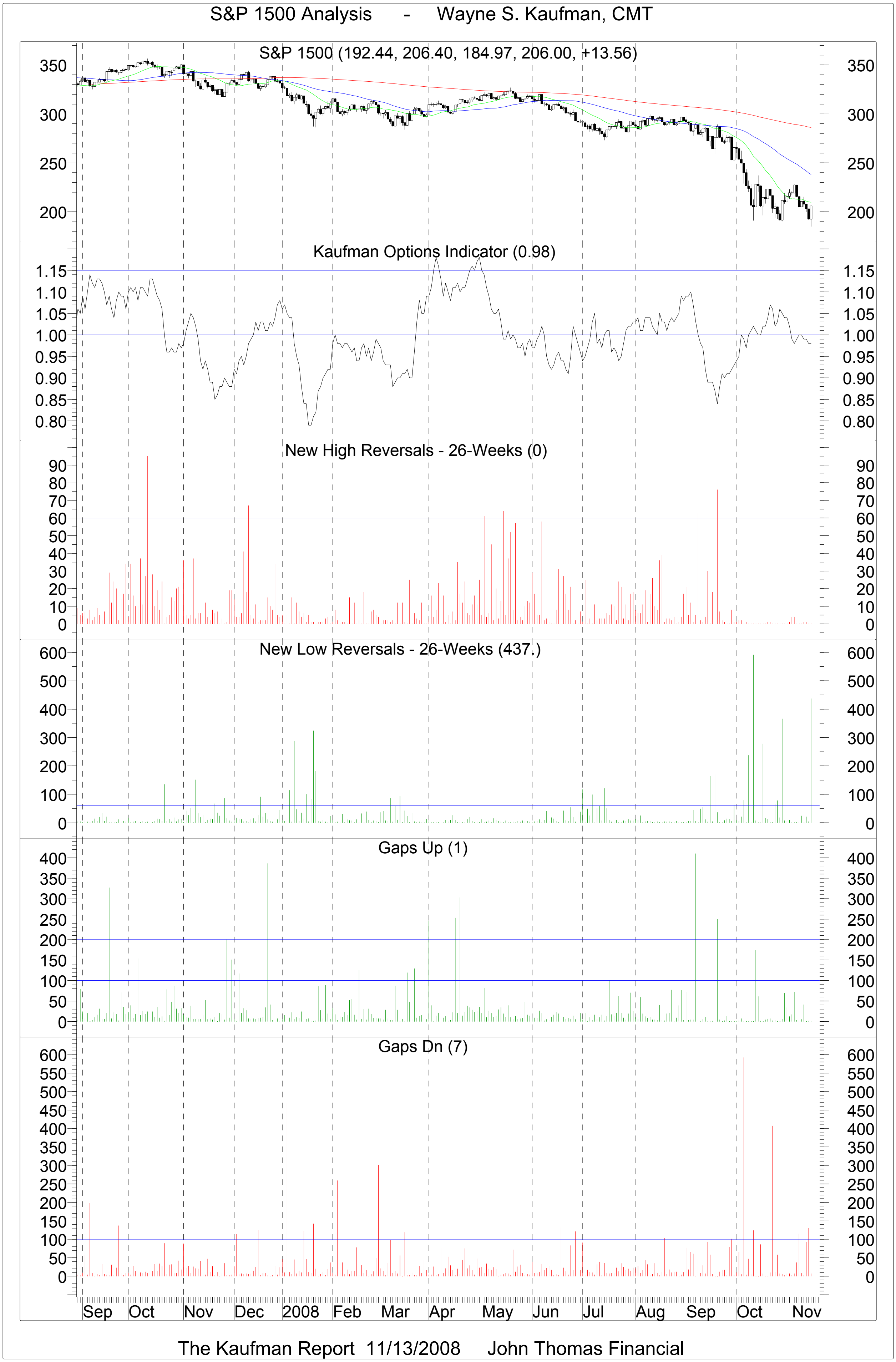
Federal Funds futures are pricing in an 82.0% probability that the Fed will *cut rates 50 basis points to 0.50%,* and an 18.0% probability of *cutting25 basis points to 0.75%* when they meet on December 16th. They are pricing in a 59.1% probability that the Fed will *cut rates 50 basis points to 0.50%* on January 28th, and a 35.9% probability of *cutting 25 basis points to 0.75%.*

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

IMPORTANT DISCLOSURES

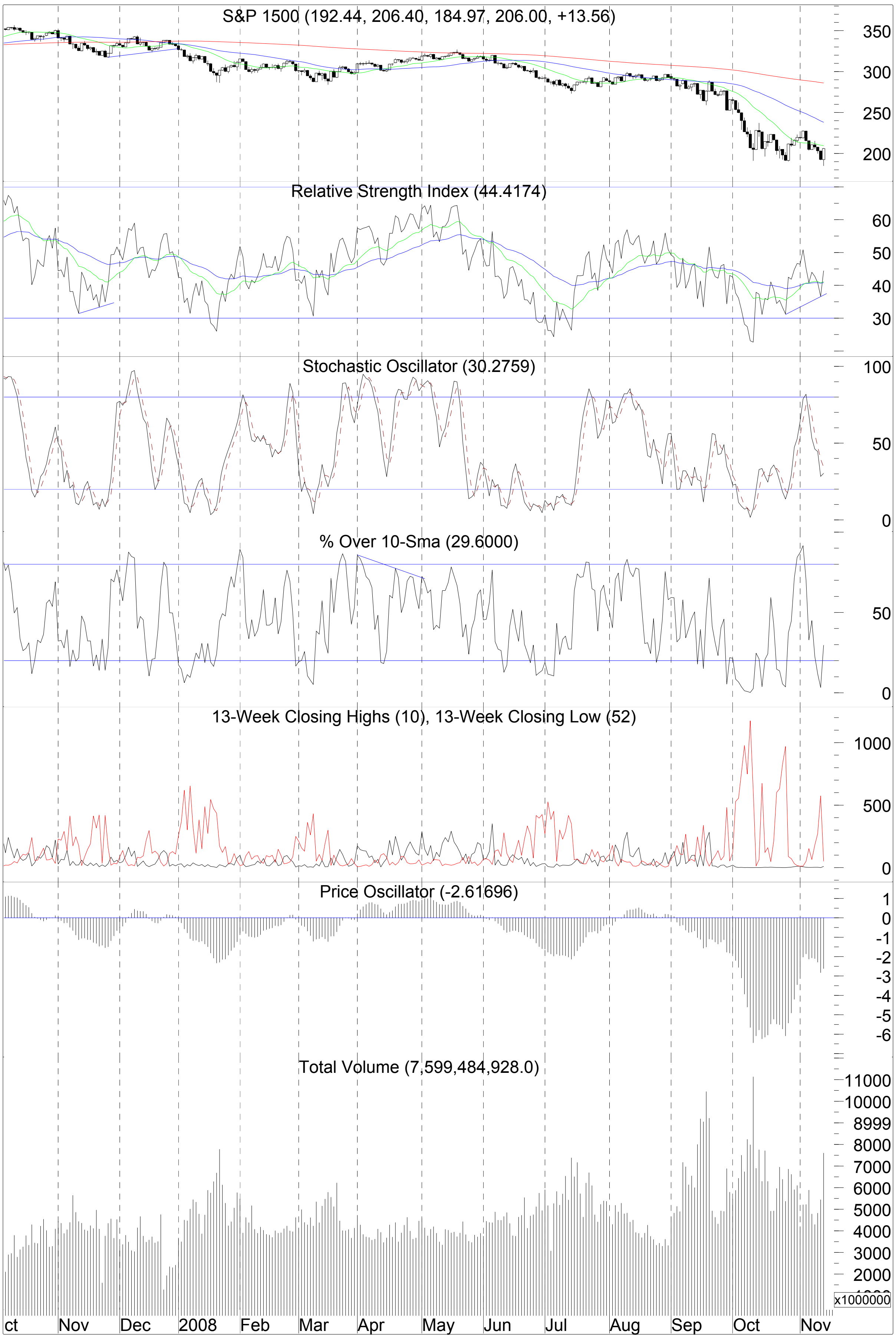
S&P 1500 Analysis - Wayne S. Kaufman, CMT

The S&P 1500 rebounded from the lowest intra-day level since March of 2003 to print a bullish engulfing key reversal day. From the low to the close the index rebounded 11.38% as it successfully retested the closing lows of October and November.



437 new low reversals out of 490 intra-day lows. This compares to 591 reversals out of 1187 intra-day lows on 10/10. The lower number of intra-day lows is a positive divergence.

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



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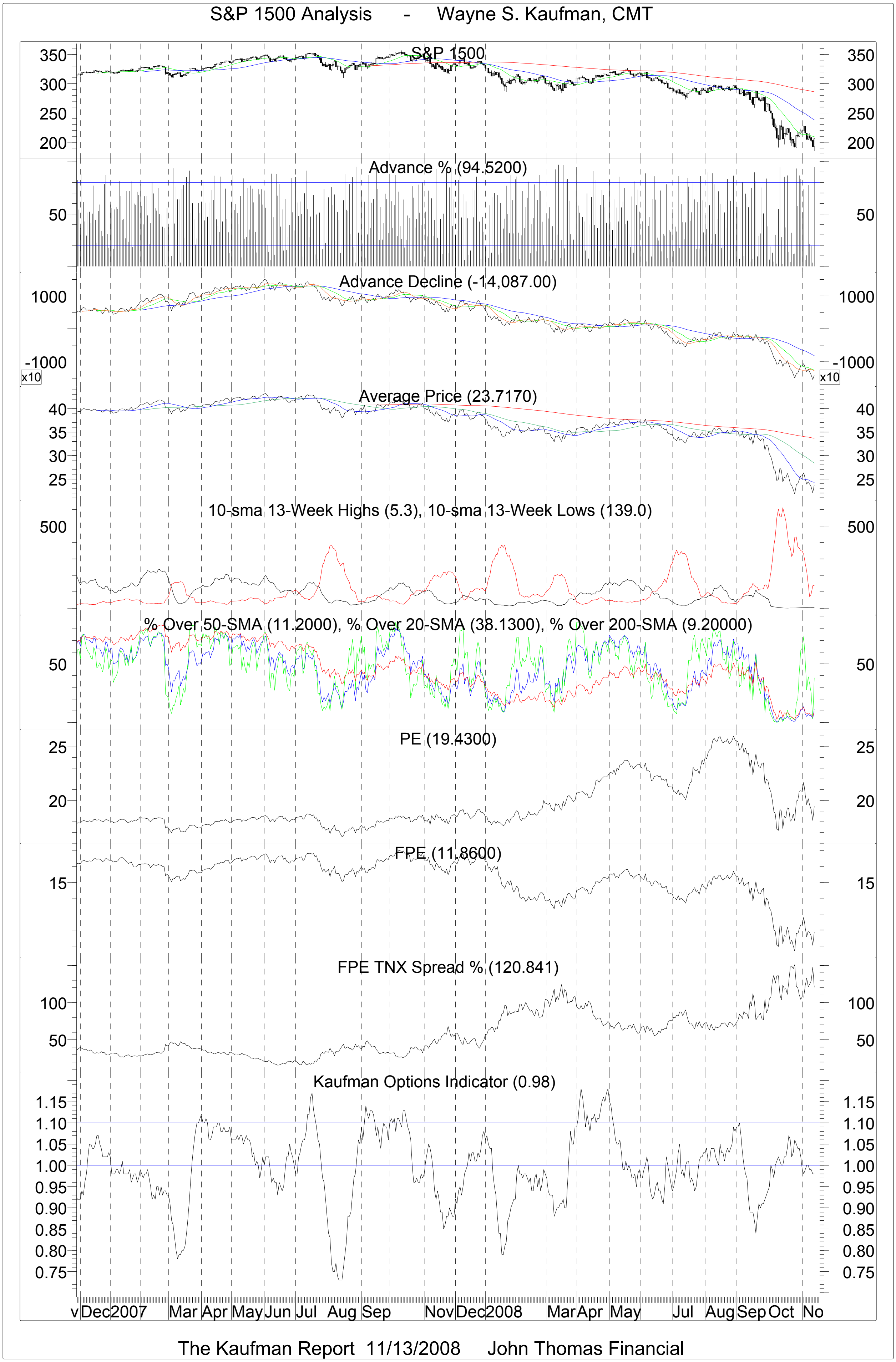
Our momentum indicators are still at low levels.

In spite of the strong rally there were still more new lows than highs.

Volume expanded dramatically during Thursday's rally.



94.52% of stocks traded higher Thursday.

Our options indicator is slightly negative.