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The Kaufman Report

Trade what you see, not what you think.

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Monday November 24, 2008 **Closing prices of November 21, 2008**

It was another amazing week in this historic year. Stocks rallied Friday afternoon on news that New York Fed chief Tim Geithner would be the new Treasury Secretary. The rally came at the end of a dismal options expiration week and still left the S&P 1500 down 8.7% for the week.

We said on October 10th that the breaking of certain price levels at that time "greatly increased the possibility of a 100% retracement of the entire bull market of 2002 – 2007." That incredible move was accomplished Thursday as the S&P 1500 plunged over 6% for the second session in a row, breaking the 2002 lows and reaching levels last seen in May 1997.

We have warned repeatedly that markets that do not respond to oversold conditions are dangerous, and that the last stages of waterfall declines can be very painful. Many trusted indicators have been rendered useless in this historic bear market, and many analysts calling the bottom have been humbled. The problem is that in spite of extreme, sometimes historic oversold conditions and indicators, and many measures of valuation having reached extreme levels, buyers have been staying away and sellers remain very aggressive. Unfortunately, in spite of the recent devastating losses, many technical techniques project even lower prices to come.

The next week should tell us if Friday's rally is just another short covering trader's rally or if longer-term buyers are coming back into the market. Stocks had gotten so oversold that there is still room for them to rally before hitting resistance levels. Also, the Thanksgiving holiday is usually a bullish period, so a continuance of Friday's rally would not surprise us. However, until we see signs of increased demand for stocks, any rallies should be considered the bear market variety.

Liquidations by hedge funds and mutual funds may continue through the end of the year. If so, that source of supply will continue to be a drag on equities. However, if that selling abates, and if investors become excited about the new Obama administration and its stimulus plans, it is possible stocks could enter a multi-week end of year rally. Therefore, investors need to be on their toes for continued volatility and the possibility of sharp moves in either direction.

Regarding Tim Geithner, we don't want to rain on the parade, but does he represent new leadership? Wasn't he involved in the original bailout plan, and going further back was he totally uninvolved in the entire financial crisis and the problems at Lehman, Merrill, Bear Stearns, Citigroup, AIG, etc? Also, wasn't he considered the frontrunner recently even as stocks melted down in what amounts to a bear market just since Election Day? Even after Friday's 6.27% rally, the S&P 1500 is down 20.86% since Election Day.

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.

IMPORTANT DISCLOSURES

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The S&P 1500 (179.99) was up 6.27% Friday. Average price per share was up 5.68% as Large Caps led. Volume was 147% of its 10-day average and 151% of its 30-day average. 85.18% of the S&P 1500 stocks were up on the day, with up volume at 75.2% and up points at 93.5%. Up Dollars was 99.1% of total dollars, and was 367% of its 10-day moving average while Down Dollars was 1.3% of its 10-day moving average. The index is down 18.1% month-to-date, down 32.33% quarter-to-date, down 45.68% year-to-date, and down 49.49% from the peak of 356.38 on 10/11/07. Average price per share is $20.19, down 53.29% from the peak of $43.23 on 6/4/2007. For the week the index was down 8.667% on increasing and above average weekly volume.

The Put/Call Ratio was 1.12, the fourth day in a row over 1.00. The Kaufman Options Indicator was 0.97.

***The spread between the reported earnings yield and 10-year bond yield is 85% and 201% based on projected earnings. These are unheard of levels*.**

Reported aggregate earnings for the S&P 1500 peaked in August 2007 at $19.18 and are now at $10.55, a drop of 44.99%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $17.18, a drop of only 21.73%. 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.*

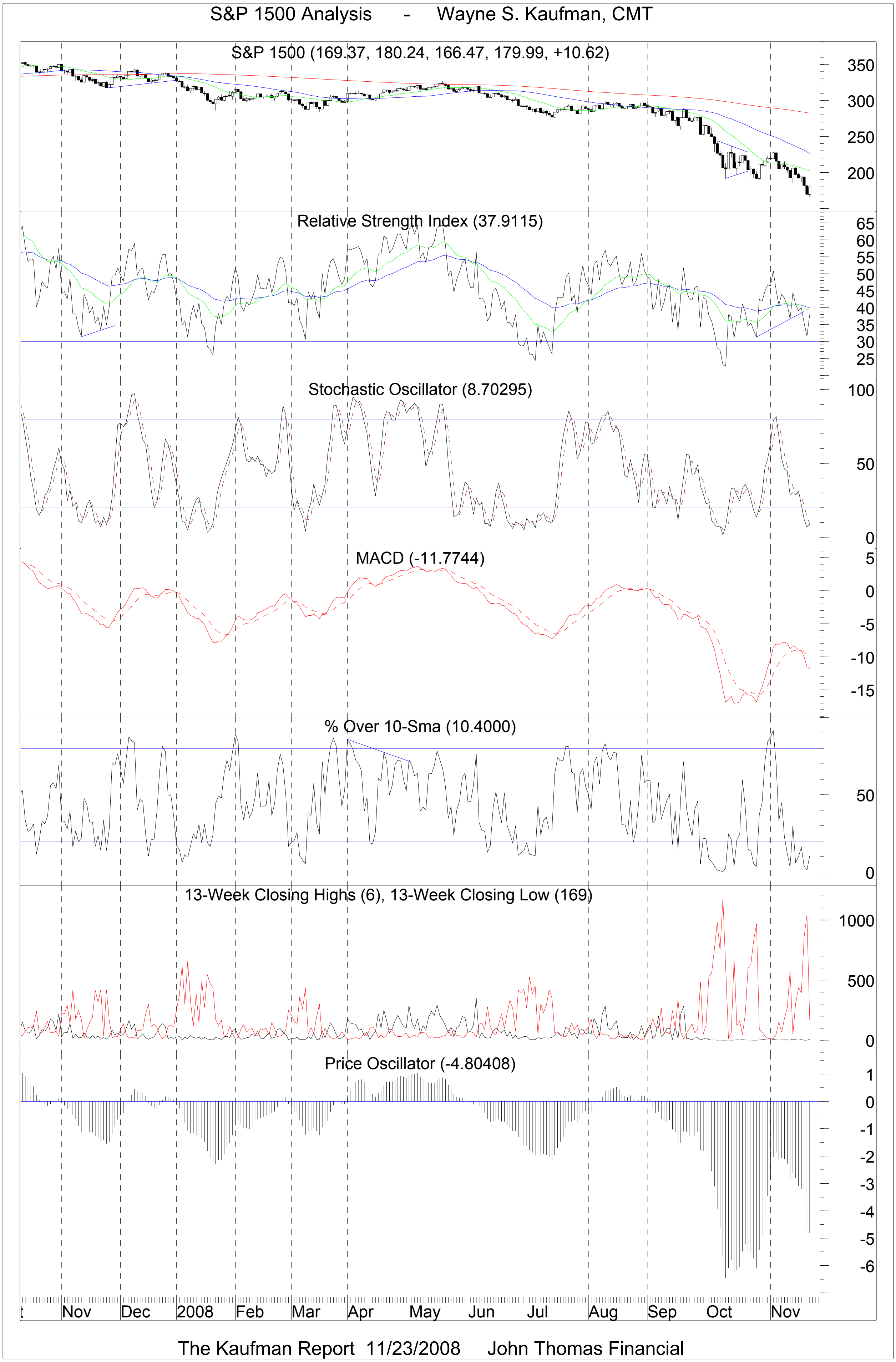
479 companies in the S&P 500 have reported third quarter earnings. According to Bloomberg, 58.1% have had positive surprises, 9.4% have been in line, and 32.5% have been negative. The year-over-year change has been -18.4% on a share-weighted basis, +5.3% market cap-weighted, and -1.7% non-weighted. Ex-financial stocks these numbers are 10.7%, 24.0%, and 17.4%, 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 *cutting75 basis points to 0.25%* when they meet on December 16th. They are pricing in an 82.0% probability that the Fed will *cut rates 50 basis points to 0.50%* on January 28th, and an 18.0% probability of *cutting 75 basis points to 0.25%.*

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.

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

The S&P 1500 rallied Friday afternoon on the announcement Tim Geithner will be the new Treasury Secretary. Stocks were due for a bounce after hitting extreme oversold levels on many indicators. There is room for stocks to move higher before running into resistance. On Thursday the S&P 1500 fell low enough to completely retrace the entire bull market of 2002 - 2007.



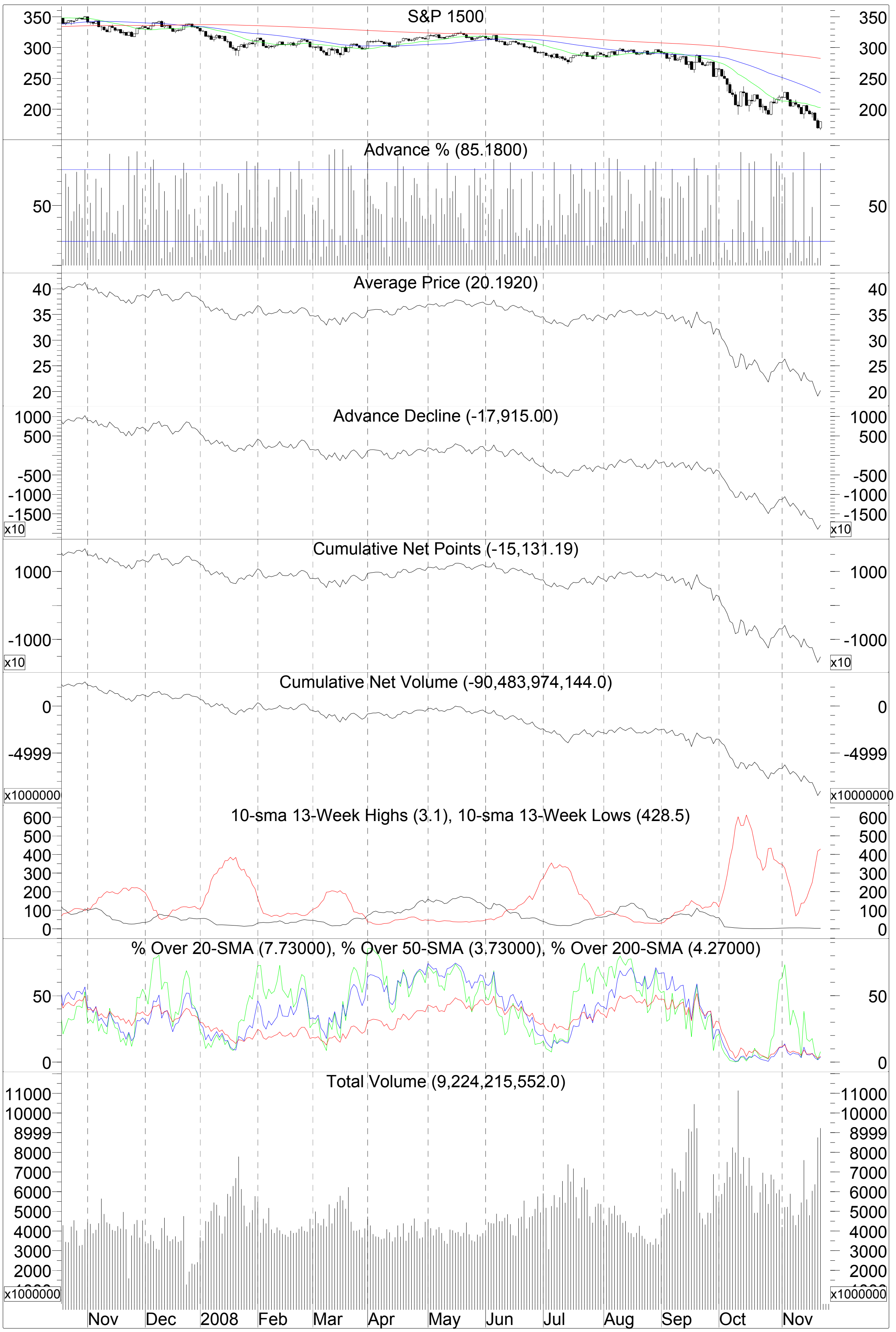
Our momentum indicators remain at low levels.

The percent over 10-sma is still well in the oversold zone.

The lack of new highs Friday doesn't tell us anything regarding very short-term trading.

Our price oscillator is in extremely oversold territory.

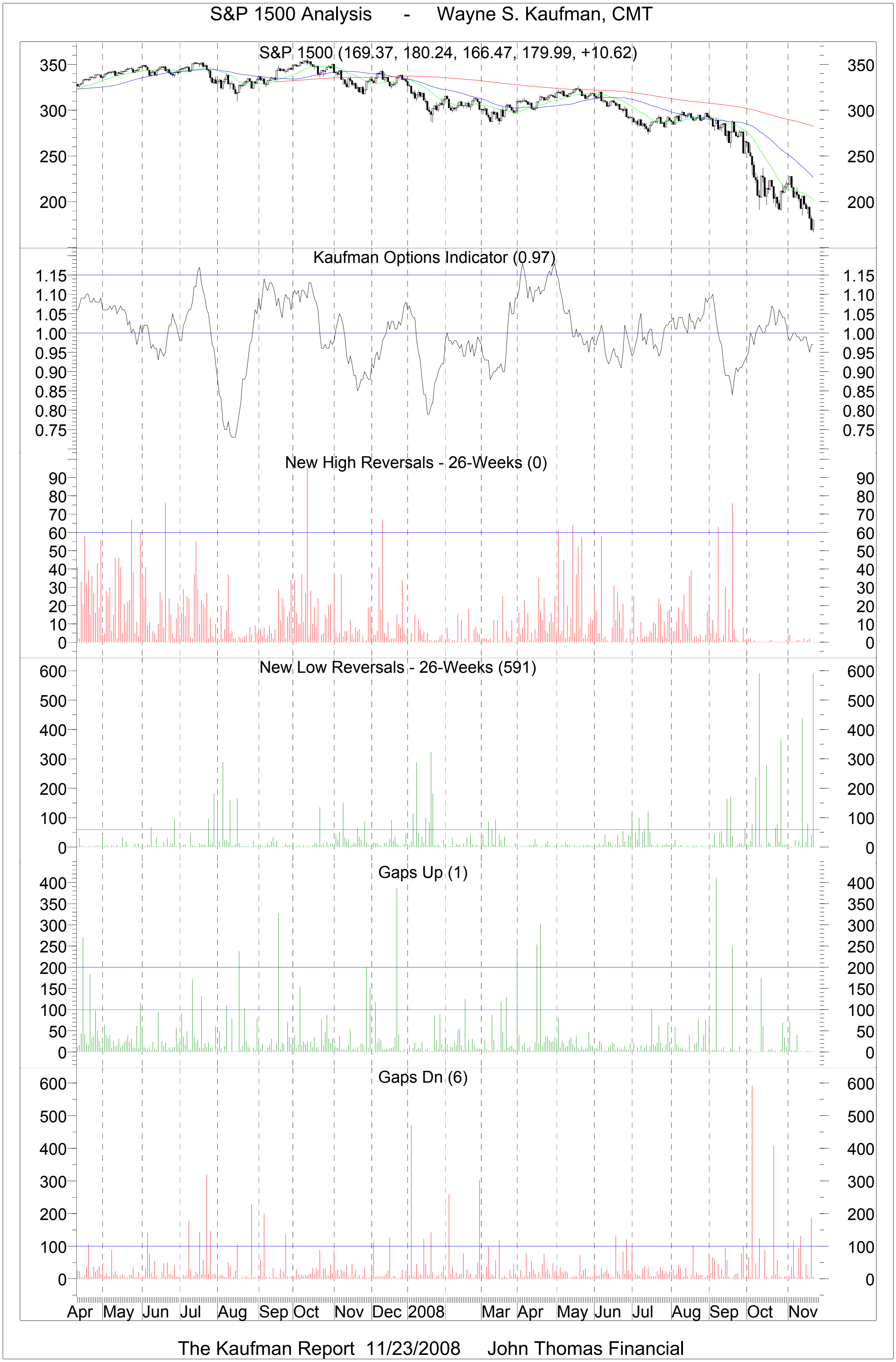
S&P 1500 Analysis - Wayne S. Kaufman, CMT



85.18% of stocks traded higher Friday.

On Thursday all of our statistics of market breadth hit new lows, confirming the new low in the S&P 1500 and pointing to lower prices in the future.

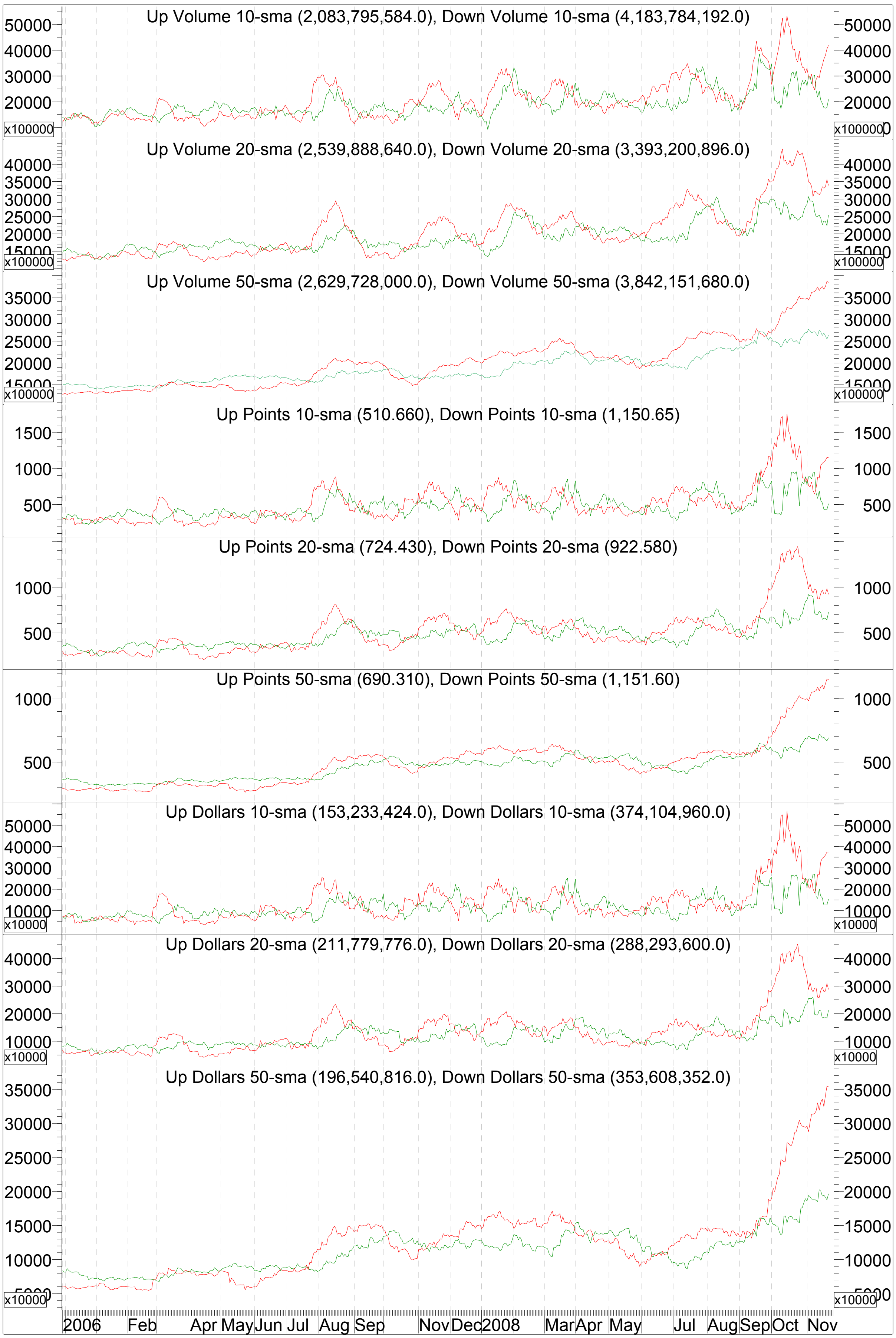
Volume increased dramatically Thursday and Friday.



Our proprietary options indicator is showing some pessimism, although not the extreme amount seen at previous important bottoms.

591 new low reversals were recorded Friday. Numbers over 100 have usually been bullish, but in this bear market this has not been meaningful.

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



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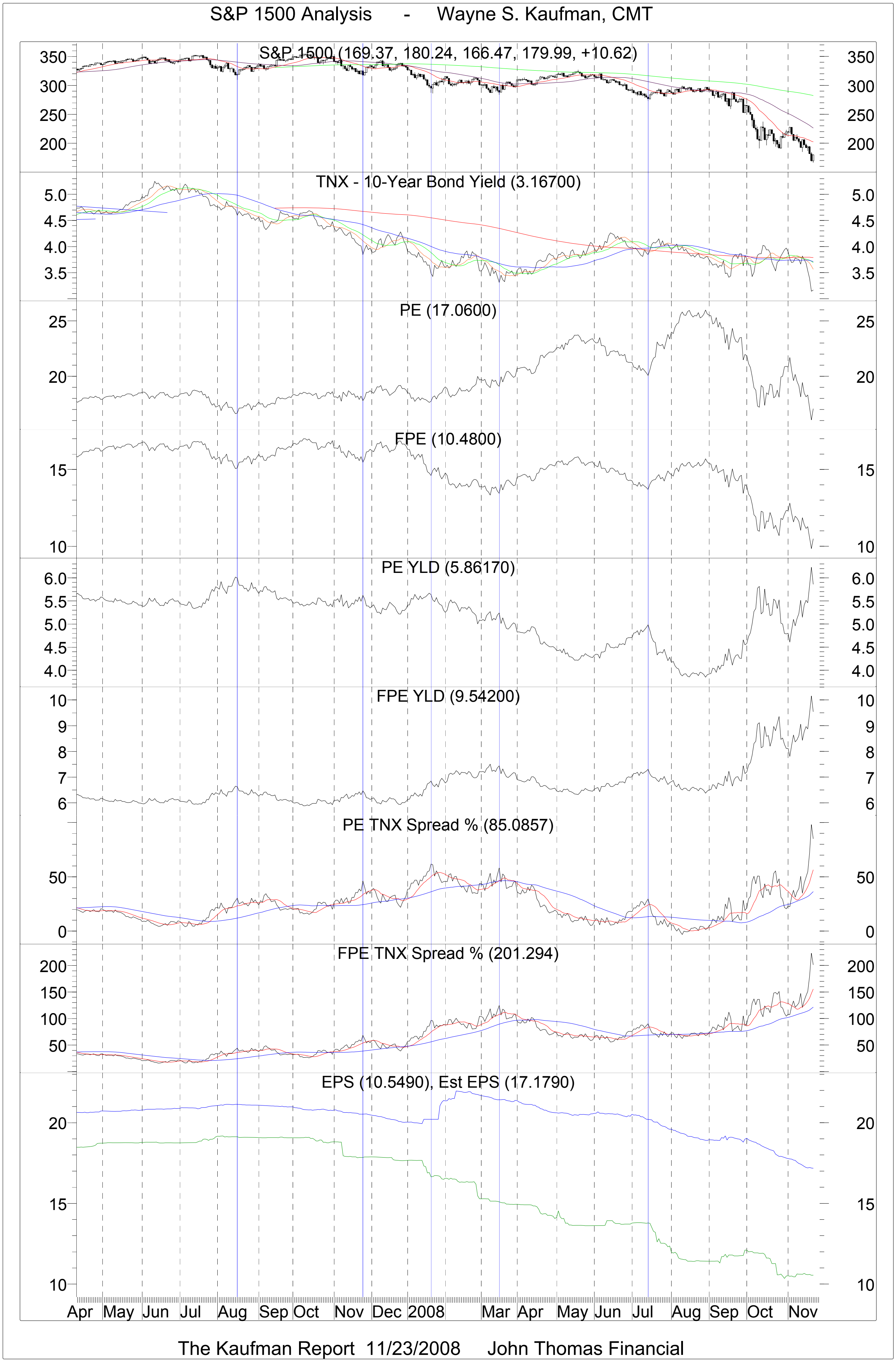
Our statistics of supply (red lines) versus demand (green lines) show that buyers were nowhere to be found until Friday afternoon while sellers had become very aggressive again. The next few days should tell us if Friday was just another one day wonder of short covering, or if buyers are coming back to pick up bargains.

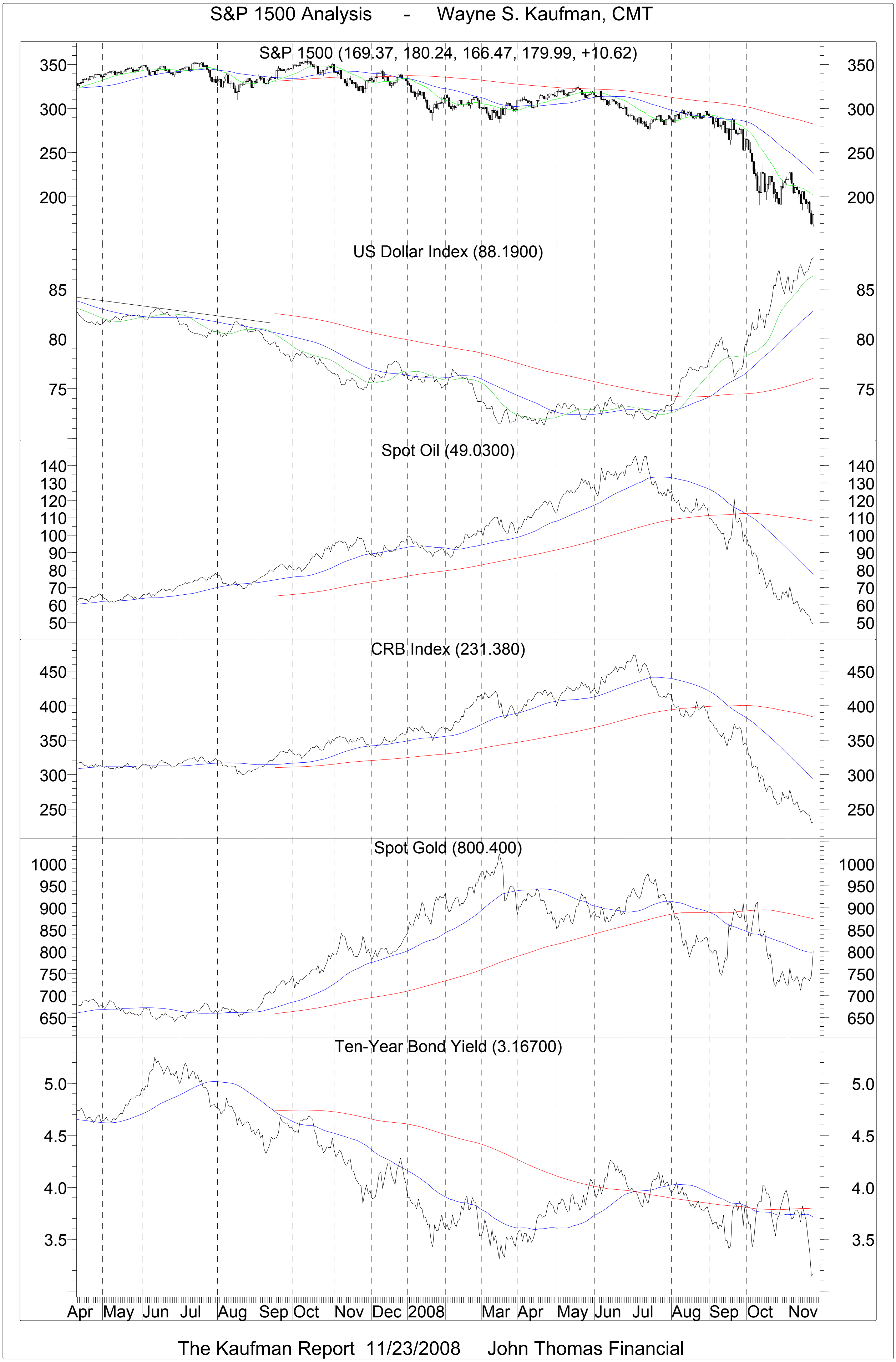


Bond yields are very oversold (bond prices overbought).

P/E ratios have broken through the bottom of their recent ranges.

Spreads between bond yields and equity yields are at amazing levels where stocks would normally be considered extremely undervalued.

Forecast earnings continue to move lower, but reported earnings are moving sideways as 96% of third quarter earnings are in.



The U.S. Dollar Index is in a fifth wave after breaking out of a triangle. It may go a little higher, possibly 90 - 92, but a pull back seems to be coming.

Crude oil is not yet oversold and may need a reversal in the U.S. Dollar to find a bottom.

Commodities look like oil, but there is a positive divergence on the RSI.

Gold has bounced up to the 50-sma.