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The Kaufman Report

Trade what you see, not what you think.

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Tuesday September 16, 2008 **Closing prices of September 15, 2008**

The three session winning streak for the S&P 1500 came to an end Monday with the third panic-selling 90% down day in the last eight sessions. It was the worst day for stocks since the World Trade Center attack in 2001, and the S&P 1500 made new 52-week intra-day and closing lows.

We said Sunday this would be a very important week. There is triple-witching options expiration (quadruple if you prefer), Goldman Sachs and Morgan Stanley report earnings, the Fed meets on September 16th, and we did get major news regarding Lehman Brothers. This combination should create some short-term trading opportunities, with an extreme oversold entry point being set up. <u>A key number could be 1172 on the S&P 500, which is the 50% retracement level of the bull market of 2003 – 2008</u>.

Our proprietary options indicator has plunged into negative territory and is at the lowest level since March 11th. The put/call ratio hit 1.469 Monday, the highest level since 1.483 on March 17th. It has been over 1.00 for seven of the last eight sessions. Fear and bearishness are what is needed to create a meaningful bottom.

We have been highlighting the spreads between 10-year bond yields and the earnings yields of the P/E and forward P/E of the S&P 1500. The reading spread between the forward P/E and the 10-year bond yield is currently 102.19%, the widest since March 31st. The spread based on current reported earnings is 24.88%, the widest since July 15th. <u>*Valuations may be meaningless if much of the recent selling is the result of forced liquidations of assets, and that liquidation continues.*</u>

Reported and projected earnings for the S&P 1500 jumped up last week as Fannie and Freddie were unceremoniously kicked out of the S&P indexes, highlighting the old expression that sometimes less is more. Prior to that bump up earnings and forecasts had been moving inexorably lower. Time will tell how much lower earnings projections will actually go, but for the time being it is one of many variables where there is a lack of visibility for investors. Some of the other variables with little or no visibility are the slowing global economy, the political landscape, energy and commodities prices, real estate valuations, the ongoing lack of liquidity in the credit markets, even whether or not there is the threat of inflation or deflation.

In the very near-term, with earnings season essentially over, reported and projected earnings could flat line for a little while, which may prevent stocks from plunging too much lower. However, we are in a seasonally weak time of the year, there is a triple-witching options expiration this week, bad news continues to dominate, and the <u>*last stages of waterfall declines can be extremely damaging. Therefore, investors still need to be on high alert for further deterioration in equities.*</u>

<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>

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Tuesday September 16, 2008 **Closing prices of September 15, 2008**

Reported aggregate earnings for the S&P 1500 peaked in August 2007 at $19.18 and are now at $11.84, a drop of 38.26%. Estimated aggregate earnings peaked at $21.95 in February 2008 and are now $19.18, a drop of only 12.62%. 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 last week as Fannie and Freddie were unceremoniously kicked out of the S&P indexes, highlighting the old expression that sometimes less is more.

So far 497 companies in the S&P 500 have reported second quarter earnings. According to Bloomberg, 67.5% have had positive surprises, 7.3% have been in line, and 25.3% have been negative. The year-over-year change has been -23.4% on a share-weighted basis, -23.4% market cap-weighted, and -12.3% non-weighted. Ex-financial stocks these numbers are 3.9%, 7.2%, and 4.8%, respectively.

Federal Funds futures are pricing in a 32.0% probability that the Fed will *<u>leave rates at 2.00%,</u>* and a 68.0% probability of *<u>decreasng 25 basis points to 1.75%</u>* when they meet on September 16th. They are pricing in a 25.6% probability that the Fed will *<u>leave rates at 2.00%</u>* at the meeting on October 29th, and a 60.8% probability of *<u>decreasing 25 basis points to 1.75%.</u>* They are pricing in a 11.7% probability that the Fed will *<u>leave rates at 2.00%</u>* at the meeting on December 16th, and a 41.7% probability of *<u>decreasing 25 basis points to 1.75%.</u>*

The S&P 1500 (272.21) was down 4.653% Monday. Average price per share was down 4.09%. Volume was 133% of its 10-day average and 168% of its 30-day average. 4.41% of the S&P 1500 stocks were up on the day. Up Dollars was less than 1% of its 10-day moving average and Down Dollars was 334% of its 10-day moving average.

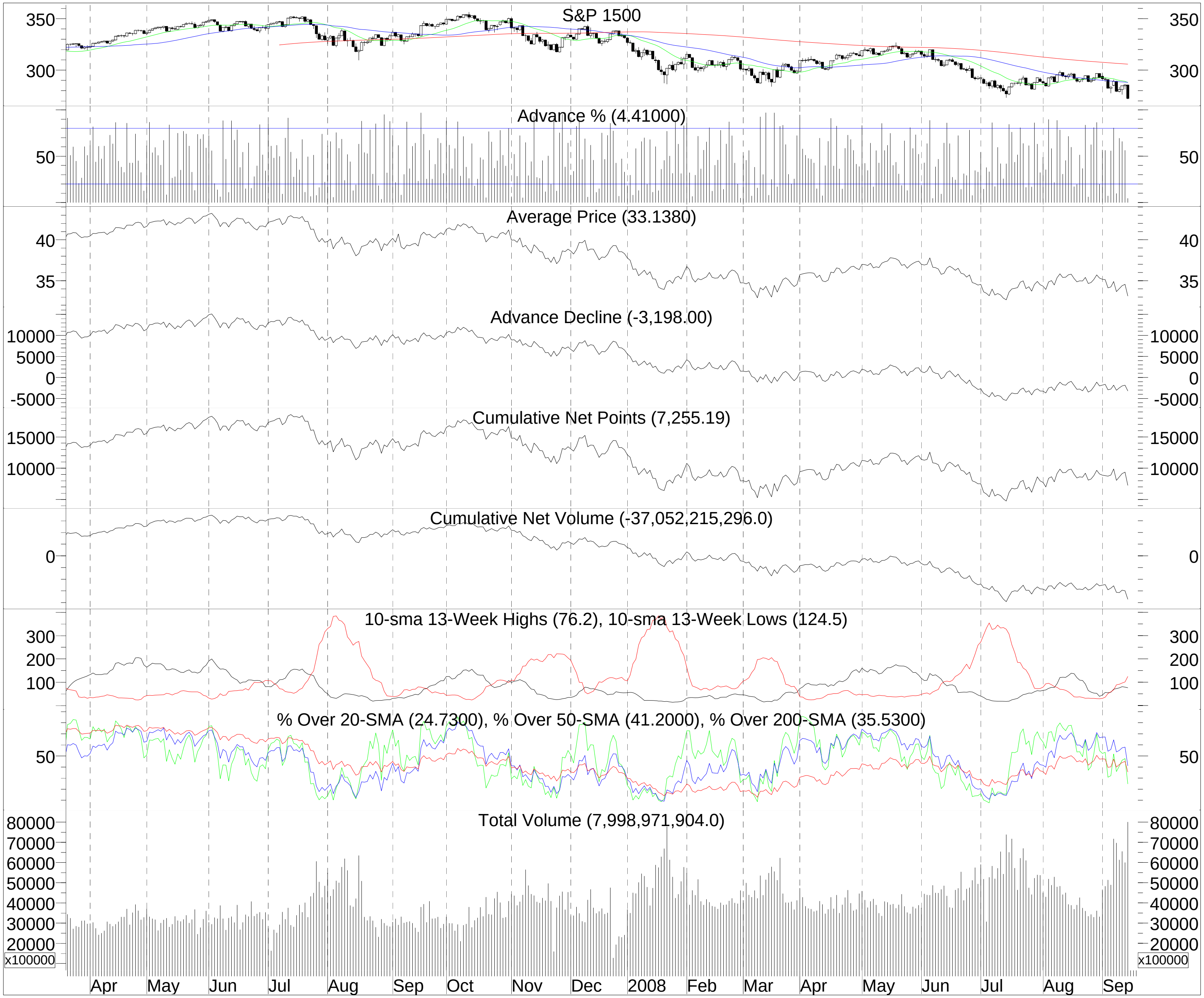
Options expire September 19th. October options expire October 17th.

The S&P 1500 had the third panic-selling 90% down day in eight sessions as it plunged to new 52-week intra-day and closing lows.

The percent over 10-sma is getting oversold, but overall our oscillators can still move lower.

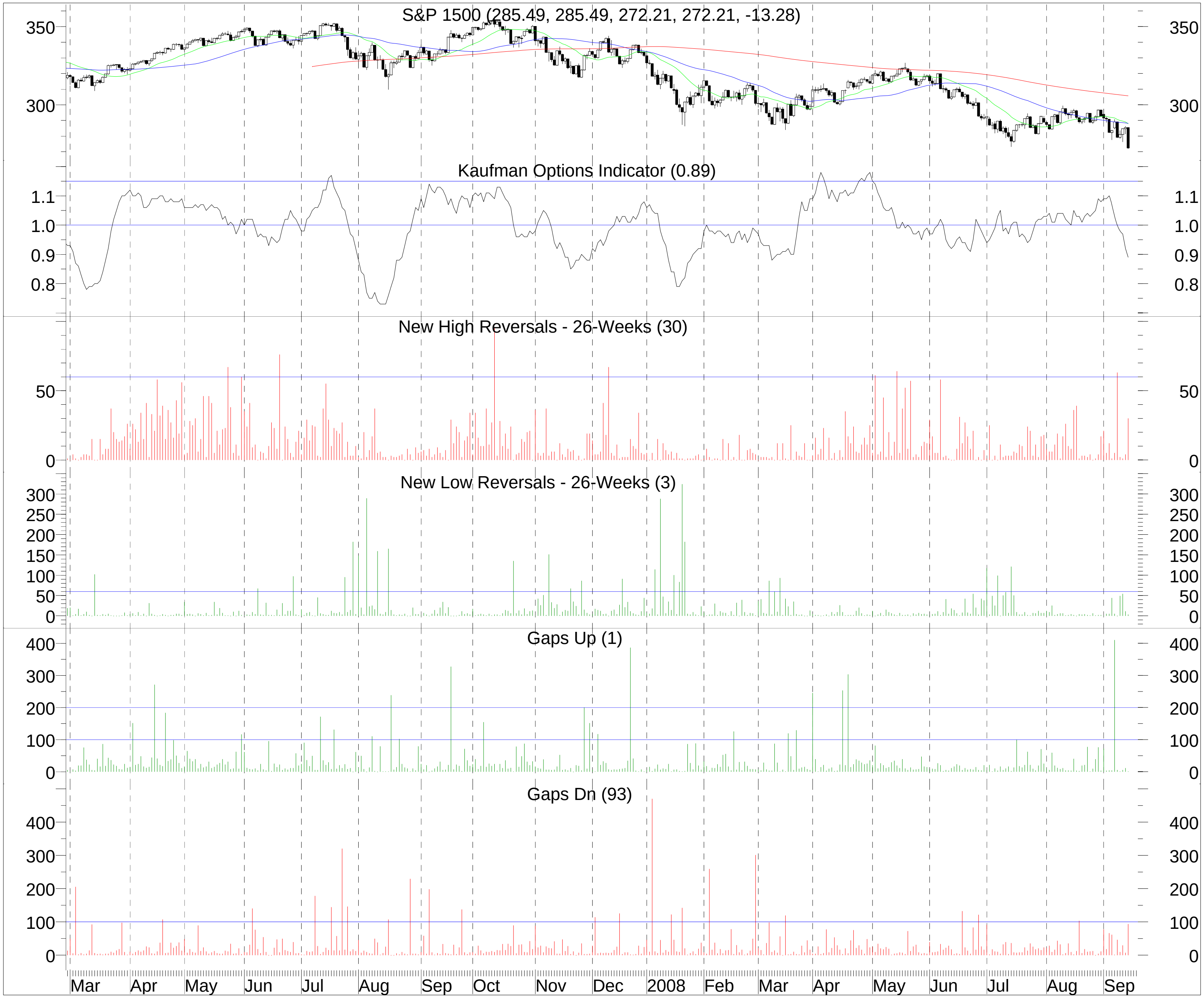
New lows are not nearly as high as during prior legs down for stocks.

Our price oscillator, a good indicator of trends, is moving deeper into negative territory.



Only 4.41% of the S&P 1500 traded higher Monday.

The 10-sma of new lows is rising but not anywhere near prior levels.



Our proprietary options indicator has plunged into negative territory and the lowest level since March 11th. Still, we have seen lower levels at important bottoms.

The put/call ratio has been over 1.0 for five sessions in a row and seven of eight. Monday's reading was 1.469, the highest since March 17th.

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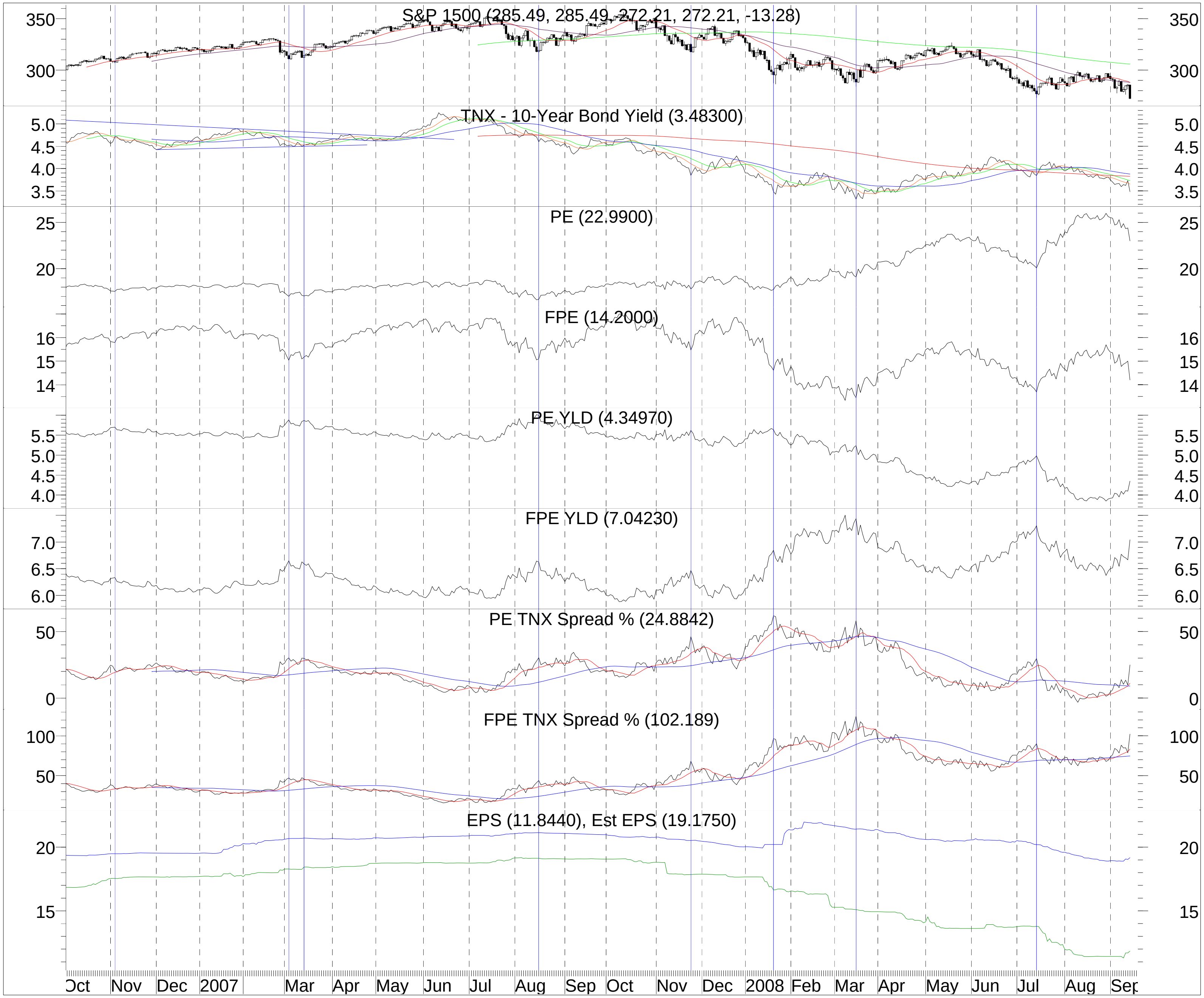

Bond yields plunged Monday after hitting resistance.

P/Es are plunging with stocks.

Spreads between earnings yields and bond yields are widening dramatically as equities and bond yields plunge in tandem.

Current and forecast earnings seem to have bottomed for the time being.