

MLK CAPITAL
MANAGEMENT, INC.

ADVICE ON THE MARKET



March 3, 2008

To: Friends and Clients of MLK Capital Management
From: Lane Kerns

Re: Compassion and Excitement
Economic and Market Outlook
Current Portfolio Holdings

Compassion and Excitement

February ended on a down note with steep losses in all the major US indexes dragged lower by a lot of bad news on many fronts. The economic environment is not good and appears to be getting worse. Unlike a year ago when I could see mostly positives for the market, there are many negative influences on the market that are yet to be resolved. I will discuss why I have compassion for any "Buy-and Hold" investor who can do nothing but watch himself lose money and why we are excited that we are making money in this environment.

NOV, DEC, JAN and now FEB have all been down months in the market. In a chat room of one of the Technical Analysis organizations we belong to, the following question was asked – "When have NOV, DEC and JAN, usually strong months, all had negative returns before?" The answer was 1931-32, 1941-42 and 1969-70. Each of these periods went on to lower lows in the market.

The difference in those three prior instances of three consecutive down months during a normally strong part of the year was that those markets were already in primary bear markets before those three months arrived. In the current case, the market just topped out in October after a five year Bull market. Bear markets average about a year in length, and this one has just begun. The one that began in 2000 lasted three years. In other words, it is unlikely that this downturn will end soon.

Many of you have heard of the market's Presidential Cycle. Traditionally an election year is almost always a positive year. Why then not this year? Aside from who might get elected and how negative their affect on the stock market might be, I do not think the market is going down solely for political reasons. Things are really bad in the world financial market place or the markets would not be falling during what is normally a strong period in the Presidential Cycle.

First, how have we weathered the market decline so far?

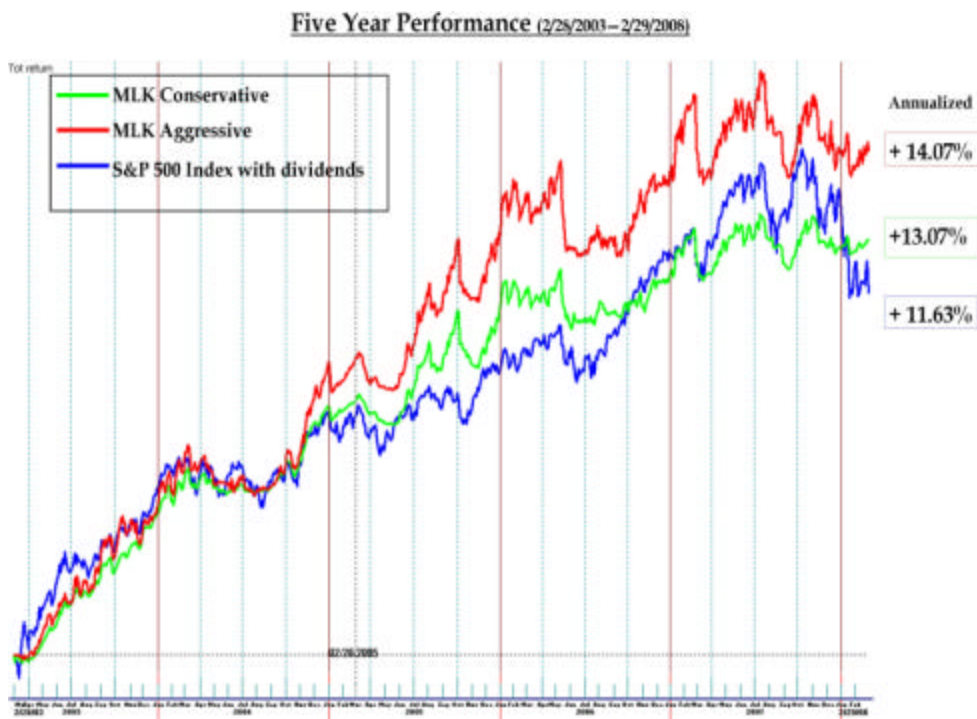


The above chart shows our Conservative and Aggressive models over the last six months. All our equity models were up while all major US indexes were down by a significant amount! Our

goal is to protect our client's money during down markets so that when the bottom arrives we still have your assets to reinvest in the rally that will follow. Our conservatism sometimes costs us some performance but it has clearly paid off over the last few months.

The 10-year track record for our Aggressive model (which includes one of the worse bear markets in history) is more than double that of the S&P 500!

The following chart is our five year performance (which happens to begin at the start of the last bull market and ended last October). I point out these two periods because they show both a period of very bad market conditions and a period of good market conditions and our ability to conserve and grow your money during both.



How to avoid damage to your wealth and your family's future lifestyle?

While I think it is important to acquaint our readers with reality, whether that is in the form of good news or bad news, some people don't handle the bad news very well. With that in mind, I want to direct our clients and readers through what we feel is the most cautious course for investors to take.

The Nasdaq (not pictured on charts) has declined 20.55% since its top on 10/31/07. Remember, we don't think the bottom is here yet. An investor in the Nasdaq that started with \$1 million dollars would now be down to \$794,500. Just to get back to breakeven, that \$794,500 will have to grow 25.87%! If a

portfolio declines by 50%, the balance that remains must grow 100% just to get back to \$1 million dollars.

On the other hand, our most aggressive model is down only 5.28% to \$944,430 during that period. We only have to grow by 5.57% to get back to \$1,000,000. If we grow by the 25.87% the Nasdaq will have to, we will have \$1,188,754 – not \$1,000,000. This is why it is so important to protect your money. During that same period, our Conservative model was down only 2.68% - a little more than 1/10th the decline of the Nasdaq.

According to the rule of 72 (divide your long-term growth rate into 72), money growing at 15% per year will double every five years. Money growing at 5% takes fourteen years to double. To build wealth, you must give yourself the opportunity to win while not reducing long-term growth with big market losses in times like these.

Why not just go to cash or bonds?

Many people have retreated to government bonds. That is one potential solution. However it presents three problems:

1. With so many people joining the panic by selling stocks and rushing to Treasury bonds, the yield on two year Treasuries was down to 1.65% (that's per year) as of Friday night. That is not a long-term solution because the inflation rate is higher than that. In other words, the cost of buying things is going up faster than your money is growing. The yield on money market funds is following the decline of the Treasury yield.
2. While short-term government bond yield rates are declining because of investors' flight to their relative safety, yields on long-term bonds are climbing. You might say what's wrong with that. If you buy bonds and interest yields start climbing because of current and anticipated inflation, your bonds decline in value! The Shearson Treasury Bond Index has declined 5% in the last five weeks!

3. Unless you are a very good market timer, you will miss the strongest part of the Bull market that follows a downturn like we are experiencing. The more the market is beaten down, it is like a large spring that is being compressed. When the selling pressure is finally relieved, there will be quite a bounce. The bottom of the market will be evidenced by panic selling (called capitulation in the investment business). The mini-capitulation we saw on Friday was not big enough and it is too early in the Bear cycle to be the bottom.

Economic and Market Outlook

While I could write a small book about what is happening in world economics, I am going to focus on the topic of inflation. Inflation now consumes an increasing portion of the financial news. Readers that are investment professionals will realize that I am only touching the surface of this issue and its many potential ramifications but our limited space forces a condensation to a few facts.

1. The *Producer Price Index* rose faster than expected, up 1% for the month and 7.4% year on year. This is the price manufacturers pay for things they sell us. They are starting to raise our prices.
2. *Chinese inflation* is running at 7% annually. That combined with the expected 10% weakening of our Dollar against their currency means we will probably pay 15-20% more for anything imported from China.
3. Last month the price of contracts for delivery of May wheat rose by more than 25%, the biggest increase since 1973 according to Bloomberg news.
4. The *U.N.'s food price index* in December rose 37% according to a report by the agency's Food and Agricultural Organization. The average for the year was 23%, compared with 9% in 2006.
5. The *price of oil* appears to have taken a firm foothold above the \$100 per barrel level Over \$103 last week.
6. Gold continues to climb toward the \$1,000 per ounce mark. It hit a record \$975.90 this week.
7. So far this year, natural-gas prices are up 26%, coal is up 56%, platinum is up 41%, wheat is up 31% and cocoa is up 38% according to the Wall Street Journal.

In our opinion, the economy has a negative bias. Higher prices for everything will have to filter down to us, the consumer. Things will probably get worse before they get better – but that will present great opportunities for growth investors! Therefore, the way to make money is to invest in those things that benefit from an inflationary environment. Those things are commodities, which include oil and materials and the countries that produce them. An additional dynamic is the falling dollar which is reducing our purchasing power and causing us to pay more dollars for anything imported but makes foreign investments more valuable.

I have mentioned in the past a book called *The All-Season Investor*. In that book the author divides the economic and market cycles into six parts and matches them up. During one of those six cycles, stocks bonds and commodities all rise. In another part all three go down. The other four parts are combinations of up and down. It is not always easy to determine which part of the cycle we are in. In our opinion, we are in the part of the cycle where both bonds and stocks will decline more while commodities continue to rise. They will eventually get so high they will slow the world economies and will also begin to decline. At that time things start over which will lead us to the phase where everything should go up. *The fun times!*

Current Portfolio Holdings

I have said in the past that it is much easier to make money in an up-market or a down-market than it is in a market that just bounces sideways. We are now in a down-market. Remember, as bad as the markets are, we have continued to make money! We continue to hold long positions in Commodities, Emerging markets, a BRIC fund (Brazil, Russia, India and China) and have moved a significant portion of our holdings to a fund that we expect to hold long-term. Because we are in a strong down-market we have hedged these long holdings with counter balancing short positions (things that go up when the market goes down). That combination reduces volatility, holds your money together and has been profitable while the markets are going down.

The legal process of forming our own mutual fund is still progressing nicely. Our fund should be available sometime during the second quarter of the year. We think it will be a win-win arrangement for our clients.

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This letter is published periodically with my views on the market, investing and things that seem important to me at the time. Remember, all of this is filtered through 45 plus years of experience including a fair amount of both “Good Judgment” and “Bad Judgment”. Please feel free to share this with anyone you think might be interested. If someone would like to be put on the list just send me an email with his or her email address. You can reach me at:

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