

MLK CAPITAL
MANAGEMENT, INC.

ADVICE ON THE MARKET



December 1, 2006

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

Re: Everything is Relative
What is Going to Happen
A New Service
Managed Account Performance vs. Market Indices
Current Portfolio Holdings

Everything is Relative

Every day I read several financial newspapers, white papers and commentaries. I mark relevant points for possible newsletter topics. I throw everything on a stack and when newsletter day (today) rolls around, I pull them out and see what topics have been getting the most attention in the market and why.

Two topics have consumed the financials since this letter was last written – The decline of the dollar and the potential weakness creeping into the economic outlook. **Let me explain why these are important to your personal financial well-being. Incidentally, we had a very good month!**

First the dollar: Christmas shopping in New York is usually thought of as an excessive indulgence rather than a bargain hunter's dream. But this year, there are savings to be had if one is spending euros, sterling or yen.

“With the dollar suddenly sliding against all the main currencies, shoppers from Europe and Asia are being told they can get their iPods, Nintendo Wiis and Armani suits cheaply if they buy them in the US. The dollar has fallen 11.5% against the Euro and 14% against the English Pound this year.” FT

Before I explain why it is falling and its significance to your investments let me say that a falling dollar has some good aspects. Just as people from Europe and Asia want to buy iPods & Nintendos, they also want to buy Boeing Airplanes and Caterpillar tractors. This country has been spending much more in other parts of the world than we have been selling to them. We have been doing that by creating debt to those other countries. We now owe China alone over one Trillion dollars!

A weaker dollar makes American products more competitive in the world market by allowing the rest of the world to buy things here cheaper than they may be able to get anywhere else. That keeps our people working, our wages increasing and our standard of living increasing – all good things. Eventually, we need to start selling more to the rest of the world than we are buying in order to start paying off what we owe.

Another good side effect is that any US dollars invested overseas will get not only the appreciation of the investments but also the appreciation of the currency of the country in which they are invested. Since commodities, precious metals and basic materials are priced in dollars, they will be a good investment while the decline continues.

There are also potential bad side effects to a falling dollar. Since our dollar is worth less, that means that other currencies are worth more and consequently their products cost more. Eventually all increased costs for the purchase of foreign goods that America has become addicted to will have to increase in price. Many already have. We will begin to import more inflation as this process accelerates.

These new inflation pressures could (notice I don't say will) force the Fed to increase not decrease interest rates as the market has been anticipating. That could put the brakes on the economy. So, as you can see, it is a balancing act between competing financial pressures. Many readers of this letter are very sophisticated students of the market and may find these explanations a bit simple. If you do, you already know the pressures created by a falling dollar can have dramatic affects on investment portfolios and I feel it is important to put it in terms that make sense to those who don't spend their days immersed in the markets.

"Never since the birth of the Euro in 1999 have we seen an environment where the European Central Bank and the Bank of England are in the midst of an interest rate tightening cycle while the US Federal Reserve is approaching an easing cycle. It is this unprecedented contrast in monetary policies that is behind the accelerating flows that are emerging against the dollar." FT It is being driven by fundamental factors that aren't going away soon.

If the dollar starts falling as much against the Yen as it is against the Euro, we will see an accelerated unwinding of the "Carry-Trade" which has been the source of much of the world liquidity. This liquidity has been pushing world stock markets higher! Refer to our last couple of letters for a fuller explanation of how severe that could be for the markets. There has been some speculation over the last few days that the unwinding is starting already and is causing some of the weakness that started last Friday.

A Potentially Slowing Economy: For the last couple of months there has been a disagreement between the bond markets and the Fed. The Bond markets have interest rates significantly different than the Fed. The lower interest rates that investors are willing to accept for their investment in bonds indicates that they think there is no inflation, the economy is slowing at a rate that will wring out any inflationary pressures. The current rate as recent as last week predicted that the Fed would not increase rates (less than a 20% chance) and that we could be looking at a rate decrease at the March meeting.

This view by the market that the economy is slowing at a rate that will not be a hard landing – but will still be enough to remove any need for the Fed to keep interest rates at their current level has been dubbed the "Goldilocks Economy". Not too hot and not too cold. That consensus by market forces was the reason for the big selloff on Monday of this week. That is when we went to a high cash position. On Wednesday, Fed chairman Bernanke gave a speech indicating the economy was much stronger than that. The market bounced back and as it always does, it makes one question why we are in the investment business.

But that bounce was short lived! Now we feel smart again. Yesterday (Thursday), the Chicago PMI (Purchasing Managers Institute) index fell when it was expected to rise. The market showed indecision and lost momentum. When the ISM report was released this morning, it showed a decrease rather than the expected increase. Both of these indexes came in just under 50. Less than 50 indicates a shrinking manufacturing sector rather than a growing one. The market sold off. Another day when we feel smart again because, fortunately we are mostly cash and the holdings we do have are remaining strong during this weakness.

These PMI & ISM declines seem inconsistent with the stimulation they should be receiving from the falling dollar. But dollar declines always have a lagging effect since contracts for today's orders were signed months or weeks ago.

What is Going to Happen?

As usual our crystal ball is a bit cloudy. Our sense of things is that there is probably going to be slightly more slowdown than we expected a couple of months ago but not enough to force us into recession. A slowing economy could mean slower corporate earnings which are always followed by a declining stock market. Walmart reported its first year over year decline in years. Since they represent almost 10% of the entire Gross National Product, that news depressed the market also. The odds that the Fed will cut rates have climbed substantially. That would stimulate both the economy and the market. All this spells a bit more uncertainty than we had a few weeks ago. The market could still finish the year strong but I feel good about where we are invested.

A New Service

We have a free retirement planning service for our clients and 401(k) participants. After a couple of clients had asked us time and time again to go over their "retirement picture," we decided to begin offering this service. We will analyze your current assets and future contributions towards retirement and help you determine your probability of enjoying the retirement you are hoping for. Keyla and James in our office would be delighted to meet with any clients who wish to

take advantage of this free service. Contact either of them at our office to setup an appointment. On a personal note, I have found this process to be invaluable and very eye-opening to your chances for a comfortable retirement. I strongly suggest you go through the process.

Managed Account Performance Verses Market Indices

Since 12/31/2000, the Nasdaq is finally in positive territory being up a total of 6.10 % which works out to be an annualized return of 1.01% through November 30, 2006. By contrast our models over the same period are up from 61% to 81%! Risk Management! The S&P 500 with dividends is up a total of 20.55% and the Shearson Treasury Bond Index is only up 46.28%.

PERIOD ENDING 11/30/2006	PERFORMANCE					RISK	
	One Month	Last 12 Months	Since 12/31/03 Annualized	3 Years Annualized	5 Years Annualized	3 Yr. Standard	5 Yr. Deviation
Equity (Non-401(k))							
Dow Jones Industrials	1.35%	15.79%	9.32%	10.17%	6.76%	8.09%	12.58%
NASDAQ	2.75%	9.75%	8.40%	7.73%	4.89%	13.10%	18.85%
S & P 500	1.79%	14.58%	12.11%	11.88%	6.11%	7.32%	12.37%
MLK Conservative Growth	2.15%	8.31%	13.14%	12.08%	12.08%	9.33%	8.36%
MLK Cons. Growth Margin	2.15%	5.13%	13.04%	N/A	N/A	N/A	N/A
MLK Moderate Growth	1.54%	10.43%	13.69%	12.76%	11.46%	11.55%	10.43%
MLK Moderate Growth Margin	1.55%	8.92%	14.13%	N/A	N/A	N/A	N/A
MLK Aggressive Growth	1.53%	10.85%	16.77%	15.28%	11.84%	11.80%	10.83%
MLK Aggressive Growth Margin	1.51%	6.57%	15.68%	N/A	N/A	N/A	N/A
Equity (401(k))							
MLK Conservative Growth	4.69%	14.08%	15.51%	14.03%	13.25%	8.98%	8.11%
MLK Moderate Growth	2.61%	15.54%	15.77%	14.47%	12.47%	10.91%	10.01%
MLK Aggressive Growth	2.75%	21.43%	21.11%	18.83%	13.90%	11.13%	10.44%
INCOME							
LB 1-3 Yr. Govt. Bond	0.14%	2.30%	1.98%	1.85%	2.59%	1.16%	1.47%
3 Month T-bill	0.41%	4.92%	3.74%	3.13%	2.44%	0.44%	0.42%
MLK Stable Value (Non-401(k))	1.01%	6.39%	7.51%	6.61%	5.43%	3.27%	2.93%
MLK Stable Value 401(k)	2.56%	7.40%	7.92%	6.95%	5.63%	2.87%	2.87%

The above fund performance information is historical in nature and is not a guarantee of future performance. Actual performance will be different and may be less. Losses could occur in all funds. Time periods may reflect a trend in rising or falling stock prices which may not be sustained in the future. MLK Capital Management, Inc. ("MLK") performance figures are after the deduction of MLK's actual management fee and include reinvestment of dividends and earnings on accounts held at Charles Schwab & Co., Inc. MLK performance figures represent a composite of all individual portfolios managed in accordance with each investment category. ¹ Standard Deviation is a measurement of risk and smaller numbers indicate less volatility or risk.

Current Portfolio Holdings

We have significantly reduced our equity holdings and are taking a much more conservative stance in all models until our indicators indicate strength again. Depending upon the model, we currently are 65% to 73% in cash with 27% to 35% equity holdings in Europe, Utilities and Basic Materials. Since we have significant short-term gains in all those holdings we intend to hold them at least through the end of the year to avoid taxation in 2006. To avoid buying additional 2006 tax liabilities we will not be reinvesting our cash in any Fund until after it has made its capital gains distributions for the year. Happy Holidays!

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401(k) Investment Advice

If you are managing your own money, www.401k-Investment-Advice.com would have told you that it was time to become more aggressive or when to go to more conservative holdings - also what funds to buy. It gives you a view of Current Market conditions by going to “Current Market Conditions”. It gives users the tools that we use in managing client portfolios. Check it out. Once you log in, go to Investment Advice – Actively Manage. Or, if you prefer not to do it yourself, we can manage your account for you. If your company does not sponsor it, or you are not a member, contact us at MLKCM@MLKerns.com. If we do not already do so, we can manage your 401(k) account – as well as your personal and IRA investments.

MLK Capital Management, Inc. is a fee based investment advisor. Our income can not grow unless our assets under management grow. We do not make money by trading client’s accounts. When we make a trade, it is to keep the account from losing money or to put it in a position to grow more. The success of our firm is tied to the success of our client’s investment accounts.

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 40 plus years of experience including a fair amount of both “Good Judgment” and “Bad Judgment”. Or, as a friend of mine says, we may not be right - but this is our opinion. 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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