

MLK CAPITAL
MANAGEMENT, INC.

ADVICE ON THE MARKET



March 1, 2007

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

Re: Headlines Sell Newspapers
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Headlines Sell Newspapers

William Randolph Hurst built a fortune and a media empire with sensational headlines and stories. They didn't necessarily have to be true – but if they made a good story – people seemed to want to read them like the rats following the Pied Piper.

You have to be careful about getting too wrapped up in headlines such as **“Stocks Have Worst Day Since 9/11 Attacks: Dow Down 416, Nasdaq Drops 97 on Global Market Plunge.** All of this is true but is it of any significance? In our opinion, it would have been significant if it had not happened.

Since July 14th of last year the Dow went straight up for a gain of almost 21% leading up to Tuesday's measly 3.28% decline. There was not a single day during that period when there was as much as a 1% decline. Now that's abnormal! Just give us one of those runs every year and we will be happy.

Yes, we took a hit on Tuesday like everyone else but all of our models are up for the year, unlike the Dow which is down 1.26% and the S&P 500 which is down 0.58% year-to-date. All our non-401(k) equity models have beaten all of the major indexes (Dow, S&P 500, Nasdaq and Russell 2000) YTD and for the last 3 months, 5 months, 3 years and 5 years. Since we are intentionally not closely correlated with the US markets, we don't win every month – but our clients are way ahead of index investing over the last several years.

US Media and Investors Have a Myopic View of Things.

I find it interesting that the US investment publishing industry finds it so hard to look beyond our own market for the reasons things are happening in (and to) our markets. What am I talking about?

If you have read the US financial papers and watched CNBC for the last few months, there are at least 15 reasons stated as to why the market should continue going up or down – virtually all of them focused on US housing, interest rates, inflation, budget deficit, negative balance of payments, and what's happening at Walmart. Like the old saying, “we are becoming our parents”, we have begun to act like the Europeans used to act.

We act like we are the center of the universe and if you sail too far out, you will drop off the edge of our known world. Just like the Europeans used to think that we were of no financial significance, we are now acting like the rest of the world has no relevance to our personal finances. That could not be farther from the truth!

US housing, interest rates, inflation, budget deficit, negative balance of payments and what's happening at Walmart are important but they are not the primary cause of what primary cause of what has happened in our markets over the last year. The major selloff last May and the one this week were caused by factors outside of the United States. I am

amazed that the major newsletter writers, the media and most professional investors still look only at US fundamentals to make investment decisions.

What is Really Driving Market Actions ?

The cause of Tuesday's market decline was and continues to be a global liquidity squeeze. Money is coming out of world markets and it is coming out fast. The money being sucked out of the world markets is money that has been borrowed at rates so cheap that it could be invested at a higher rate in other parts of the world for a profit. Two of the primary sources of this money have been Japan and Switzerland. This is called the "Carry Trade" and I have been talking for months about it.

Unlike the US media, the foreign media has had the Carry Trade on their radar screens for months.

In our November 1st newsletter I talked about this in great length. The following is a quote from that newsletter,

"... the Japanese have provided the cheap money to fund investments, help keep world interest rates low and stimulate growth worldwide. Their cheap money loans are showing up in unexpected places – like mortgage loans in the US. If that money were to suddenly dry up – because of a surprising rebound by Japan, or a sharp increase in the value of the Japanese Yen currency, world economies would suffer. A rise in the Yen is more likely to happen than a surprise rebound in the Japanese economy. This would create problems for the "carry trade" (those people borrowing cheap money in Japan to invest elsewhere). The reason is that if the Yen rises, it costs more for foreigners to pay back those Japanese loans and "carry-trade" investing will become unprofitable. Even if you are borrowing money at ¼%, if the currency appreciates 10%, you are now paying 10 ¼% for your loan."

"Watch for the strong move up in the Yen against major currencies worldwide. If and when that happens, look out for falling worldwide markets. Or, as Ross Perot once said "you will hear a large sucking sound" as the borrowing stops and money is withdrawn from world markets."

Did anyone notice that on Tuesday, the yen appreciated 2% against the US dollar?! That is a huge move in the value of a country's currency, and it happened in one day! Yesterday's Financial Times carried this quote – "A sharp rise in the yen signaled the beginnings of an unwinding of the global carry trade, in which investors borrow in currencies with low interest rates and buy higher yielding assets elsewhere."

So Where Should My Money be Invested?

In defense of anyone who watched the portfolios they manage go down this week, Tuesday's decline was very unusual, not so much due to its magnitude or breadth as to the fact that it came with so little technical warning. The market had weakened a little in the preceding days, but there was nothing to indicate trouble was brewing. The good news is that it was a relatively small hit in the bigger scheme of things.

Be careful not to take a short view of where you want your money invested. If you want to maintain its purchasing power and build or maintain a respectable retirement portfolio you have to stick to two basic things.

First, we must keep ourselves exposed to opportunity for reasonable growth in our portfolios. In our opinion, that growth is not achieved anywhere but equities.

Secondly, we must manage risk so that we do not suffer a loss bigger than we can reasonable recover from in a short period of time. Remember that just to break even after a 50% loss, you have to earn 100% on your remaining portfolio. We have received very little criticism over the years from clients but when we do, it is not because we have lost big money – it is because we have been too conservative and for short periods of time (not long-term) we have underperformed.

We will not know whether this week's market decline was just a minor correction or the beginning of a major downtrend until we see a few more days of how the market reacts. That will take five to ten trading days – but I think we will know by the end of that time. If this is a correction, a buying opportunity will develop very quickly. If it is a market top, we may have the opportunity to short the market and make money while it is going down.

Managed Account Performance Verses Market Indices

PERIOD ENDING 2/28/07	PERFORMANCE							RISK ²	
	One Month	YTD	Last 3 Months	Last 5 Months	3 Years Annualized	5 Years Annualized	Since 12/31/00 Annualized	3 Yr. Standard	5 Yr. Deviation
Equity									
Dow Jones Industrials	-2.62%	-1.26%	0.86%	5.94%	7.44%	7.32%	4.92%	7.51%	12.64%
NASDAQ	-1.94%	0.03%	-0.65%	6.97%	6.26%	5.13%	0.09%	13.05%	18.22%
S & P 500	-2.06%	-0.58%	0.81%	6.01%	9.12%	6.86%	3.23%	7.05%	12.35%
MLK Conservative - 401(k) Plans	-0.99%	-2.28%	-0.62%	5.64%	10.60%	12.89%	9.90%	9.06%	8.31%
MLK Conservative Growth	-1.63%	1.29%	2.60%	5.83%	9.87%	12.43%	9.54%	9.28%	8.38%
MLK Cons. Growth Margin	-1.70%	1.25%	1.81%	5.05%	7.18%	N/A	N/A	12.27%	N/A
MLK Moderate - 401(k) Plans	-1.48%	0.71%	1.89%	8.08%	11.50%	12.82%	9.28%	10.65%	9.98%
MLK Moderate Growth	-2.06%	1.96%	3.13%	7.68%	10.27%	12.08%	8.68%	11.56%	10.57%
MLK Moderate Growth Margin	-2.10%	1.99%	2.86%	7.34%	10.76%	N/A	N/A	13.96%	N/A
MLK Aggressive - 401(k) Plans	-2.24%	2.98%	3.85%	12.33%	16.35%	14.98%	11.50%	11.15%	10.56%
MLK Aggressive Growth	-2.66%	2.03%	3.38%	10.20%	12.69%	12.80%	9.74%	11.87%	11.01%
MLK Aggressive Growth Margin	-2.69%	1.79%	1.53%	8.20%	10.49%	N/A	N/A	14.57%	N/A
INCOME									
LB 1-3 Yr. Govt. Bond	0.40%	0.62%	-0.03%	0.10%	1.38%	2.44%	3.00%	1.20%	1.52%
3 Month T-bill	0.38%	0.81%	1.29%	2.09%	3.49%	2.56%	2.55%	0.42%	0.45%
MLK Stable Value (Non-401(k))	0.18%	-0.17%	0.80%	4.02%	6.46%	5.43%	5.08%	3.37%	2.99%
MLK Stable Value 401(k)	0.48%	0.78%	0.73%	2.56%	6.10%	5.22%	4.90%	3.21%	2.88%

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

One of the brokers down the hall from our office asked me yesterday, "Do you invest for the long-term?" I said "Absolutely - but the long-term is made up of a lot of short-term market conditions. We try to treat each of them appropriately so that we get to the end of the long-term with less risk and more money."

We are currently 64% to 76% in cash until we get a clear market direction. Again, this may be a move that is to conservative, but we would rather err on the safe side rather than present you with a big draw down in your account. In DXMTX, where it is easier to hedge, we are slightly hedged with significant cash holdings.

Dr. Ted Cackowski and his wife Sherron are on a cruise this week. I think he looked at the charts and decided this would be a good week to be gone. Billie and I hope to do the same thing soon.

Unless you believe in reincarnation, be sure you take time to enjoy this life. If not now, when?

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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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