

MLK CAPITAL
MANAGEMENT, INC.

ADVICE ON THE MARKET



July 2, 2007

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

Re: A Choppy Month but a Good Quarter
Economic and Market Outlook
Current Portfolio Holdings

A Choppy Month but a Good Quarter

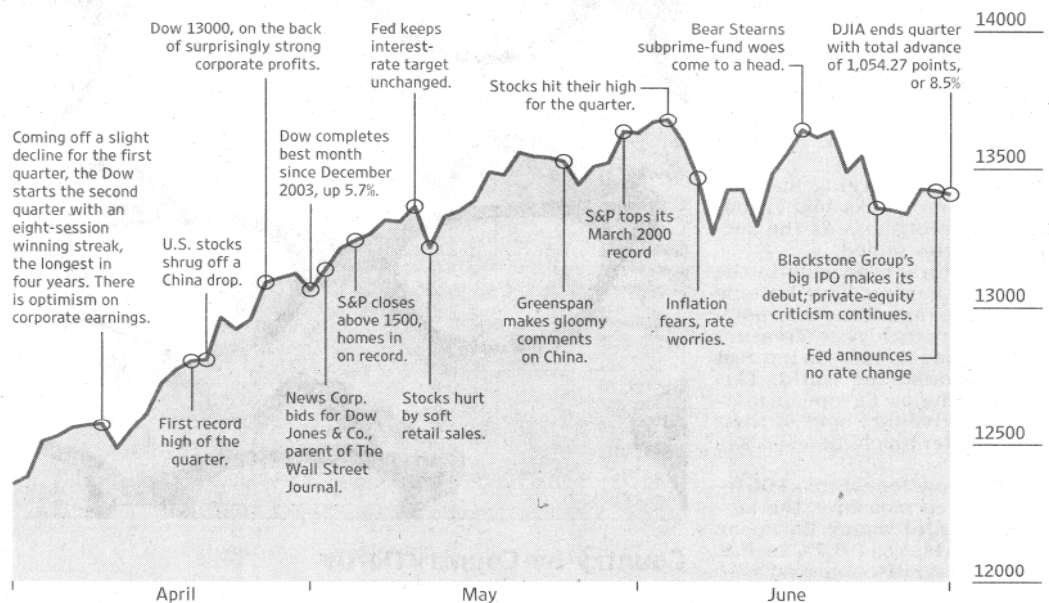
The quarter ending 6/30/07 was very strong with the Dow having its largest returns since 2003. Even though the quarter was strong, June proved to be somewhat choppy. For the month, all our models performed better than the DOW and the S&P 500. Last week oil prices rose to a ten month high that propelled our energy holdings to strong returns. We also held Energy Services and Basic Materials which are highly correlated with Energy.

Joining Energy as a strong performer for the month was Technology. Holdings in Semiconductors and Technology contributed to our performance there.

The following chart from this morning's Wall Street Journal shows what a terrific quarter it was – even with many people focusing on isolated concerns.

Dow Rewind: The Industrials' Second-Quarter Performance

The Dow Jones Industrial Average in the April-May-June quarter



Economic and Market Outlook

Let me start this section by saying that when it comes to the Market, I do not consider myself either a Bear or a Bull on. Some people are always overly optimistic or overly pessimistic about things in general and the market in particular. I try to avoid being either a Bull or a Bear and just look at the facts and understand them. Right now, that puts me more in the optimistic Bull camp. If anything, we have probably been too conservative over the last twelve to eighteen months – but this year, we seem to have it about right.

So, let's look at the facts. Until conditions change materially, we will continue to update the factors that seem to be having the most influence on the stock markets. We will add and drop as conditions dictate. This month I will add an additional influence - housing. In the May 1st newsletter I started with the original nine factors and thought it would just be a one-time occurrence. However, these combined factors have proven to be a good yardstick for how investors should view market opportunity and risk. Let's restate and comment on each of these reasons.

1. Corporate earnings: This week starts the reporting period for second quarter corporate earnings. The current estimate for S&P 500 companies is for earnings growth somewhat in excess of 4.4%. That is higher than the estimate at the beginning of the first quarter. Remember that first quarter earnings ended up greatly exceeding the estimates at the beginning of that quarter and that momentum carried into the second quarter. I do not know if we will have the same number of "positive surprises" this quarter but as you will see below - business is strong.
 2. Personal income: While Personal Income growth was not as strong in April and May as it was earlier in the year, it was still very strong.
 3. Inflation: The Core PCE Deflator (the Fed's favorite inflation gauge) slowed to 2% year over year from 2.1% in March. That is within the Fed's comfort range of 1% to 2% for the first time in a couple of years. That announcement has added momentum to the markets. As I said last month, "If we have another month or two at these levels, the Fed could start reducing interest rates to re-stimulate the economy. That would set off the first up leg of the next economic cycle in the US. Lower rates would be extremely bullish for the stock market and would set up the opportunity for strong gains." We are one step closer to lower interest rates.
 4. Manufacturing Activity: The Institute of Supply Management report (for the entire nation) showed significantly stronger US growth than anticipated. Growth seems to have rebounded due to strong business investment, factory output and consumer spending. Additionally, the weak dollar has made products manufactured in the US more competitive to other nations and they are buying more from us. The economy continues to surprise and delight investors.
 5. The world economies are very strong! A quote from the Wall Street Journal – "Global expansion continues to be driven by healthy economies and strong corporate earnings. Corporate profits continue to be strong in European countries, like Germany, and have beaten analysts expectations in major Asian countries. Inflation – which is usually a big worry in emerging markets – has remained under control. Globally, economic statistics continue to surprise to the upside."
 6. Europe is the strongest it has been in many years. See #5 above. Germany's DAX index ended the quarter up 16%.
 7. Dollar Strength: One reason the Dow 30 Industrials have been so hot this year, after underperforming for several years, is the weak US dollar. A weak dollar makes it cheaper for foreigners to purchase from the US. Large US companies that do business worldwide earn profits in appreciated foreign currency and then convert them back to an increased number of US dollars. This has increased the earnings of the large multi-national US companies significantly this year. Exports and export orders have gained momentum and this is being reflected in stronger US manufacturing profits and employment.
 8. World Liquidity: As I have said many times over the last few months, the world is awash with liquidity. This creates tremendous buying pressure as this money is invested around the world. While we do not see anything in the short run to make this liquidity disappear, we had two things happen during June that have taken this from a "10" to a "9" in our books. First, while the US Fed is no longer raising interest rates, other central banks around the world still are. Additionally, we had a little scare during June when the Yen got stronger several days in a row. If the Yen gets as strong as 115 to the dollar, the "carry trade" will dry up and liquidity will begin to disappear from the market. It only got to 123 this month, so we are a long way from that happening. No change here. Cash is still abundant.
 9. Supply of Stocks to Invest In: Even though the US has enjoyed strong economic growth and high employment (thus creating increasing spendable income) there are less opportunities in the US in which to invest it. That may sound strange, but there are actually less shares of stock in which to invest, this year than there were a year ago.
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That is due to the number of shares being created by new companies going public has been exceeded by shares being taken off the market because of corporate stock buybacks and companies being taken private. While this is continuing, there are signs of a slowdown due to less willingness of large banks to finance these multi-billion dollar buyouts. They are becoming more risk conscious. For now, however, buyouts are continuing though not at an increasing rate!

When a company goes private, that means that someone bought the entire company and its shares are no longer available for the public to purchase for investment. That means that we have more and more dollars chasing fewer shares – a sure recipe for increasing stock prices. There is a lot of money looking for a home.

10. Housing and Subprime Mortgages and Mortgage Defaults: Housing is probably the biggest risk to the economy at this point but I would not say that there is any high degree of possibility that the drain it is creating on the economy can overcome the momentum of all the other positive forces. For example, in spite of the severe slowdown in home building, US unemployment is lower than our historical average – even lower than in good times. Jobs being lost in housing construction are being replaced by other jobs. There is concern about a shortage of qualified workers so the slowdown in housing, while tough on home builders and those trying to sell an existing home, is not negatively affecting the overall economy.

Subprime mortgages have caused the failure of two very large hedge funds and may spread to more. However, this sector of the mortgage market is a relatively small percentage of the overall mortgage market and does not stand a chance of stopping home financing for qualified buyers. The biggest damage being done is that mortgage companies are tightening up lending standards. Many people feel this is not a bad thing. It will help keep people from buying over their heads with the wrong kind of home financing.

In our opinion, all of the original nine reasons for optimism remain valid. Additionally, while the housing slowdown is not over, it appears close to a bottom and the markets always look six to twelve months ahead. Mortgage defaults do not appear to be having any affect on the credit markets except to tighten credit slightly. That obviously is not slowing down the economy.

Current Portfolio Holdings

We are currently just over 100% invested in all our equity models. We remained fully invested throughout the last month.

We have refined our process for being in the right place at the right time and we are having a higher percentage of days when we out-perform the market. This will benefit us greatly on strong up days, much like today. As I write this letter, the S&P 500 is up .68% (a great day) and the sectors we are invested in are up as follows: (We won't get actual fund prices until later tonight.)

Telecom	+1.87%	Oil Services	+2.03%
Emerging Markets	+2.01%	Semiconductors	+1.32%
Technology	+0.86%	Small Cap Growth	+1.44%
Basic Materials	+1.60%	A Blend Fund	+0.61%
Energy	+1.77%		

I think it is good sometimes to rethink our investment objectives and how we hope to obtain them. We hope to miss 75% of major market downtrends and capture 75% of market uptrends. If we can do that, we will double the market's performance over the long run. Over the last 10 years, that is what we have been able to do. We don't always get it right but over the long run our process is working and I think it is getting stronger for all types of markets.

Have a great July 4th holiday and remember that as Americans we have less problems and more opportunities than the citizens of any other country in the world – and with greater safety.

Give a helping hand to those down on their luck. Most of us have needed it at some time during our lives.

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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 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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