



MLK Capital Management, Inc. Mid-Month Market Report

Tuesday - May 15, 2007

What is Happening in the Market?

Another great month. All our Schwab equity models are up nicely from about 1.75% to 2.13% for the month!

I am amazed at the number of people in my business that still only look at a few headlines to make their investment decisions. To hear them talk, housing, bad loans and a slowing economy are going to bring Armageddon.

I, on the other hand, while acknowledging the weakness in the above areas, see incredible strength from both inside and outside the United States - so much so that it would take a much longer letter to cover them. A list of nine positive factors were discussed in the May 1st newsletter available on our websites.

Let me give you an update on three of the factors that have added major support since the first of the month:

(1) The influence of surging foreign economies on the world stock markets.

Anyone who disregards the effect of massive amounts of cash and profits flowing into the world's stock markets is missing the big picture.

I attended a conference of 150 investment advisors in Orlando last week and one of the speakers pointed out an interesting development in the effect the US has on world markets.

He pointed out that since the end of WWII, a rise or fall in the US markets would be followed the next day by a similar rise or fall in other world markets. That was because, at one point, the US markets represented roughly 80% of the value of the world's stock markets combined. That is no longer the case. We now represent less than 50%. Now, if Asian markets go up or down, the US follows the next day. A complete reversal of the old scheme of things.

That process is accelerating. Yesterday, Asian stocks were lifted by the prospect of a deluge of funds from China after the Beijing authorities relaxed their rules on overseas investing. Chinese shares listed on the Hong Kong exchange gained 5.4% for the day! That market is up over 50% so far this year. I keep saying that it just can't keep going and have refused to chase the performance. Time will tell.

It has been estimated that at least \$10 billion dollars of invest-

ment money will flow out of China into foreign markets by the end of the year, with much more to follow in coming years. This fits nicely with one of the points to follow. This will further fuel the "Carry Trade" I have talked about for months.

On the same point, last Wednesday, the value of shares traded on China's stock markets exceeded that for the rest of Asia - including Japan - combined!

(2) Corporate earnings have been phenomenal.

Back in March, there was universal belief that corporate America was slowing down drastically. After 14 straight successive quarters of year-on-year growth in earnings per share in excess of 10%, analysts polled at the beginning of the quarter by Thompson Financial said profit growth would slow to 3.7% for the first quarter.

With earnings season more than half over, S&P 500 companies are on track for growth of 8.1%. This helps explain the dizzying rally of the past few weeks.

(3) Supply and demand - there just aren't enough stocks to go around.

Warren Buffet - the world's most successful investor who has \$46 billion in cash - said last week he is as ready as he has "ever been" to buy a "big business outright". That would probably be a company valued at more than \$50 billion.

He says that the current equities rally has strong foundations. It has been driven by a wall of cash.

New cash takeovers of businesses came to \$90 billion last month - a record. These type of purchases are 73% ahead of last year and the net result is that \$90 billion of stock for you and me to purchase was taken off the market last month!

More cash chasing fewer shares of stock is pushing prices up. Money needs a home - and stocks are being bid up.

Corporations with large amounts of cash are also buying back their own stock (taking it out of the market). This makes sense when they can't find a good place to expand their own business because it raises the earnings per share for the remaining shareholders of their company. Example: A company has one billion shares of its stock outstanding and \$1 billion of annual earnings. That equals \$1.00 of earnings per share. If they repurchase half of their shares with cash they have accumulated, they

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still have the same annual earnings of \$1 billion but only 500,000 shares of stock outstanding. They just raised their earnings per share from \$1.00 to \$2.00. The stock price will go up.

Risk

Having said how much support there is for the market, nothing goes straight up. We will (and should) have periodic corrections. Small ones throughout the year prevent the “Big One”. They give people a chance to take profits and get comfortable. Fortunately, in the market environment of the last few months, most of the corrections have only lasted a few days - in some cases only a day. The US market could very well have a correction of as much as 5-10% this year. My feeling is that the probability of anything larger than that is not high. In any event, it would be very costly to not be invested this year. I think we have the potential to finish the year much higher.

A Personal Thought

Even as optimistic as my crystal ball looks, we are only investing in those segments of the market that show strong strength compared to the overall market - in both up and down markets. Although the markets have risen nicely, not all sectors have kept up with the major indexes. Our system has kept us out of those weaker sectors and in the stronger ones. We do not want to be over concentrated in any one sector. This has led us to have some money un-invested and setting in cash. In spite of that we have kept up with the overall US markets. Because of trading restrictions and fees, we have not been able to take full advantage of foreign opportunities. That will change when we get our own mutual funds opened up and running.

Lane Kerns

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