



# MLK Capital Management, Inc.

## Mid-Month Market Report

*Monday - October 15, 2007*

### A Good Month

A growing sense of optimism about the global economic outlook helped drive the equity markets around the world to record highs last week even as the price of oil (which would normally depress the markets) hit a new all time high. Our energy holdings are up substantially.

Both the MSCI World and Emerging Market indices achieved life-time peaks, and the US markets also set records.

Asian markets enjoyed the lion's share of the gains as investors remained confident that strong growth in Asia would offset any weakness in the US. We participated in these gains with our holdings in China and Emerging Markets. These holdings are up substantially.

Exactly one month ago today, and before the Fed rate cut, I said in this newsletter, "Eventually, the market will find a firm bottom, then it will be harvest time. We are already seeing some real buying opportunities. We are intentionally staying away from any big commitments until we have a tailwind rather than a headwind and cross-currents. We will probably get a nice rally before the end of the year, and if so, will try to benefit from it. But for now, we are not willing to bet the ranch on anything."

Since September 19th, the first day we had a chance to react to the surprise 1/2% Fed rate cut, our equity models are up from 3.69% (Conservative) to 5.4% (Aggressive). The S&P 500 with dividends is up 2.26%.

### Why We Are Positive on China

According to the Financial Times, "China's ICBC is the largest bank in the world. China Airline is the world's largest airline. The world's largest insurer is China Life and the world's largest telecoms company is China Mobile."

Hong Kong was among the month's strongest performers. It will be the chief beneficiary of funds from mainland Chinese investors after the relaxation of investment rules by the Chinese government.

When a new rule allowing Chinese to invest in Hong Kong listed shares goes into effect, it will be the only market through which they can buy shares of foreign companies listed on the Hong Kong exchange.

The new rule was announced August 20 and will take effect later this year. But in anticipation of the new rule, money has poured into Hong Kong and Chinese Stocks on the Hong Kong exchange are up over 60%.

Normally, we would be cautious about buying into this kind of a run-up. It smacks of a bubble. But the interesting thing is that price-earnings ratios of Chinese stocks, while higher than US stocks, are only 20 times earnings. Considering the amazing rate of earnings growth in Chinese companies, that is not high!

We hold 16% of our Aggressive portfolio in ICHKX, a fund that invests exclusively in Hong Kong. That holding is up almost 19% since we bought it a month ago. I have no doubt there will be some volatility in this market, but we have a very good cushion with gains of that size.

The government is allowing investment outside of China for a very selfish reason. It has an increasing problem with inflation. It is estimated that the Chinese have personal savings of over two trillion dollars!

China's inflation rate is running at 6% annually and growing. This is a result of too much money chasing too few goods. If Chinese savers and investors can get some of the money outside the country, it will reduce buying pressure and therefore help their inflation problem.

### Emerging Markets Are Part of The World Growth Story

We currently hold approximately 9% of our Aggressive portfolio in Emerging markets. This fund is up 27.8% since we added it on September 19th. Even though we only have 9% of the portfolio invested in it, it is a 2 Beta fund which is the equivalent of owning about 18%.

For those now saying to themselves, "Why are we talking Greek?", let me explain Beta as it pertains to an investment. If an investment moves up or down 1% when the market moves up or down 1%, it has a Beta of one. Therefore, if a fund has a Beta of two, it moves 2% when the market only moves 1%.

This is a good opportunity to talk about why we sometimes use mutual funds that have a Beta greater than one. We like to trade actively to take advantage of changing market conditions. Not all mutual funds welcome active traders. They want you to give them your money and never ask for it back.

Therefore, we limit our trading to fund companies with no trading fees and no penalties for not holding long periods of time who welcome active traders. In order to cover their extra trading costs, most of these funds have slightly higher management fees. For example, they may have a management fee of 1.5% rather than the more average 1%. If we buy a two Beta fund with a 1.5% management fee, it is the equivalent of getting a one Beta fund with a .75% management fee. Even though the volatility is

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magnified, they are a better buy. We can leave the rest of the money in cash to reduce the volatility. We believe it makes good sense.

### **Market Outlook**

While a number of companies have reported third quarter earnings, this week begins the heavy reporting. Expectations are very low so surprises to the upside should be very positive for the market. It is anticipated that, on average, S&P 500 companies in the last quarter will show minimal growth over last year. However, it is anticipated that 4th quarter earnings will show growth back up over 10%. In other words, while the economy has slowed, we are still not near a recession.

Employment numbers released earlier this month were not only much higher than expected but the prior month's numbers were raised substantially. We have seen a significant run-up since the Fed announcement and a pullback would not be a surprise nor a bad thing. However, we think the market will finish the year higher and we have positioned ourselves in the strongest performing segments. As always, we will react to whatever comes along. In the meantime, it has been a good month for our clients!

### **Our Other Current Holdings**

When I talk about our percentage of holdings, I am referring to our Aggressive model. The other equity models will mostly hold the same things but in lower percentages and with more cash, bonds or less volatile companions. In addition to the China and Emerging Market holdings mentioned above, we hold Oil & Gas, Nasdaq 100, Biotechnology, Healthcare & Emerging Market Debt.

Lane Kerns

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