



MLK Capital Management, Inc.

Mid-Month Market Report

Friday - December 15, 2006

What is Happening in the Market?

Until yesterday, the market had consolidated for the last week and a half. Just as stocks will often pull back before spurting higher, the broad market did the same. Then yesterday, the Dow Jones Industrial average bounced to another record finish - its first in nearly a month. The S&P 500 is still about a hundred points below its high set in March of 2000.

Our models are all up for the month!

The euphoria of the market seems to be continuing today because of a very favorable inflation report. Inflation for November, as reported in the November Consumer-price report was almost non-existent.

Low inflation is important to your portfolio for a number of reasons:

1. Obviously, with low or no inflation, the price of things does not increase.
2. If the Fed is not fighting inflation, they can go back to lowering interest rates to keep the economic expansion going.
3. Housing and real estate prices will not climb much, if at all.
4. The value of the dollar will probably continue to slide .

How the falling dollar will affect your investments.

1. A falling dollar makes US investments less attractive to foreign investors. Decreased money flow into our markets from foreign investors will reduce returns. Less money competing for the same stocks means the values will not go as high.

An example of why this can happen is the fact that even though the S&P 500 is actually up 13% for the year, in dollar terms, if you were a British investor, your investment in the US would actually be down for the year. In Euro terms US investments are nearly flat, and in gold, the hardest currency of all, the S&P has dropped 6.5% for the year.

2. The good side of the falling dollar for US investors is that

when we invest outside the US, we not only get the return of what we have invested in - we also get the return on the others country's appreciating currency.

3. With a falling dollar things we buy from overseas will cost more. If the dollar falls 10% against the Euro, things from Europe have to cost 10% more. China has allowed their currency to appreciate about 3.5% against the dollar over the last year and a half. It has been estimated that 80% of the Christmas gifts purchased this year will be made in China. Those gifts are costing you 3.5% more.
4. Even though slowing cash flows from foreign investors into our stock and bond markets creates downward pressure on those markets, the falling dollar, on the other hand, may actually help stimulate the stock market (though not the bond market). Let me explain.

According to Richard Bernstein, investment strategist at Merrill Lynch "The markets are rallying largely because the dollar is depreciating. If the underlying corporate assets maintain their values, then the stock market will accordingly rise as the dollar falls. Meanwhile the standard of living of dollar based investors slowly depreciates."

It seems to me that those who invest in bonds and CD's get caught either way. If we have inflation and a stable dollar, their bond income will not keep up with inflation. If we have a falling dollar and foreign goods cost more, their standard of living falls. Investing in equities solves both problems!

5. One thing is certain. The only way that we are going to solve the huge deficit in the balance of payments with the rest of the world is for them to buy more from us than we buy from them. That can't happen until the cost of buying American becomes so low that it is the best place for foreigners to buy products.

Our Outlook?

As we have been predicting for a number of newsletters, the US economy is too strong to fall into recession. We are going to have a "soft landing". That means that the risk of a major market pullback (I mean 20% to 30%) is unlikely

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as we complete this market cycle and start into the next one.

When we cut through all the noise and opinions in the market there are three things that really matter: corporate earnings, interest rates and inflation. Earnings remain stronger than expected, interest rates have stabilized at a low level and may go lower over the next year and inflation is moderating. Employment remains strong. Times are good. The market always seems to know in advance what is going to happen and the rally that started in June has been telling us that. See **‘A Cloud on the Horizon’** in our November 15th letter for what could stop the market in its tracks.

Retirement Planning

What is the right age to do retirement planning? You are never too young to make sure you are on a good path to guarantee you will have enough money for the quality of life you want. You are never too old to make sure that your investment plan and your standard of living won't create a situation where you last longer than your money does. We now offer a simple yet extensive retirement planning process - free of charge - to clients and non-clients. Contact James Salter in our office at (713) 993-0949 ext. 101 or at James@MLKerns.com.

May you have a blessed holiday season from all of us at MLK Capital Management.

Lane Kerns

Ted Cackowski, J.D., PhD

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