



MLK Capital Management, Inc.

Mid-Month Market Report

Thursday - February 15, 2007

Strong Performance Year To Date!

Our models are all up for the month and year and substantially ahead of all the major indexes!

The S&P 500 was up 2.82% year-to-date as of last night's market close and our non-401(k) equity models are up more than the S&P. Aggressive and Moderate are more than double the S&P 500 YTD.

For the period of time since 9/30/06, our equity models are up from 8.90% to 15.64%. The S&P 500 is up only 9.64% including dividends. We are trading more actively and able to capture market moves more accurately.

What is Happening in the Market?

There are two themes running through the market at the Macro (flying at 30,000 feet looking down) level. One theme says everything is coming up roses and it is a Goldilocks economy worldwide. The other theme is a dark cloud - or perhaps I should say - an ominous dark front on the horizon.

First the good news - According to the WSJ yesterday, "This has been a period of unparalleled calm across a broad sweep of financial assets. It has been 143 days since the Dow Jones Industrial Average posted a 2% decline - the longest such stretch in nearly 50 years." "The... volatility index remains extremely low."

Normally, as now, that puts investors on edge that the other shoe is going to fall. In reality there are sound economic reasons why this is happening and the market may continue to extend upwards.

Fed Chairman Bernanke has been testifying before Congress for the last two days and his comments yesterday set off a strong market rally. "Current (monetary policy) is likely to foster sustainable economic growth and a gradual ebbing of core inflation," Bernanke told Congress. Additionally, December sales growth was revised up. January sales excluding autos and gasoline climbed a solid 0.5%, furniture and building material store sales were strong, suggesting housing's worst days may be over.

Things are not just good in the US. The world's economies

are strong. The Euro zone's four biggest economies are producing strong performances. Fourth quarter growth of 3.6% on an annualized basis topped the great 3.5% quarter the US experienced.

According to the communiqué issued at the close of the Group of Seven meeting of finance ministers and central bankers this weekend, they acknowledged solid growth in the US, UK and Canada with broad based growth in the Eurozone and noted that Japan's recovery was on track and expected to continue. China, Korea and India continue to outpace all the western economies.

The thing that is unusual about all this is that so many economies are strong at the same time. This coupled with unparalleled liquidity and low volatility in the markets gives us a picture not seen in my investing career - and I'm an old guy.

The Black Cloud on the Horizon - A few months ago, I began writing about something most people had never heard of - the "Carry Trade." The Carry Trade is the practice of borrowing in a country with low interest rates and investing in the securities or bonds of a country that has higher interest rates or growth opportunities and pocketing the difference in profits.

This has now risen to the consciousness of the investing world. It has grown so large that it can not be ignored. Because it has become so large - to quote this morning's Financial Times - "... fears are growing that if investors suddenly decide to unwind this carry trade for any reason, the reverberations could be painful."

Painful to whom? The world of institutional and private investors and the world's economies - that's who. There were no less than four articles in the financial journals I read this morning focusing on this problem. The Financial Times devoted a full page to one of the articles.

Since the greatest amount of borrowing is from Japan, which has interest rates of less than 1%, we need to focus on what would cause this to unwind. Very simply, it will unwind when it becomes more expensive to borrow from Japan and these trades become unprofitable. That will happen when Japanese interest rates start climbing, which will

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not happen until Japan's economy gains more steam. It will probably happen slowly but when it occurs, there will be a major draining of capital from the world markets as these loans are paid off and the investments they funded are sold and dumped onto the markets. Interest rates will go up around the world and it will cost you and the corporations you are invested in more to borrow money.

Our Outlook?

Things are good and other than the day-to-day news items that create the small (less than 5%) market fluctuations - the foreseeable future looks good. A minor correction (less than 10%) could (probably will and should) occur, but nothing looms that appears to be capable of creating a larger pullback other than some type of nuclear terrorist related event or the carry-trade issue mentioned above. We think any major pullback in the future will come with warnings that our system of investing can react to without big losses. Remember, like insurance, risk management in the market is to protect against the big hits but it comes with a deductible - that being the ride through the small corrections.

We are reminded frequently by calls from clients and friends just how short and precious good health and time with family are. Be sure you don't let it speed by without spending time with those you love and care for. Wealth is a tool not a burden.

Lane Kerns

Ted Cackowski, J.D., PhD

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