



MLK Capital Management, Inc.

Mid-Month Market Report

January 15, 2008

Smiling During an Air Raid

Have you ever seen someone smiling during an air-raid? Fortunately, most of us have never experienced an air-raid so our answer has to be no. But think about it - if you were in a bomb attack and you saw someone smiling you would have to think that either they don't know what is happening - or - they know something we don't know.

The markets are experiencing an air-raid and we are smiling! So, do we know something the market doesn't know? Apparently the answer is yes. The technical picture ranges from bad for the S&P 500 (which is down 3.48% for 2008 through last night) to terrible, for the Russell 2000 Small Company Index (which was down 6.99% for 2008 through last night). Even worse, it appears both will be down at least another 2.00% when the market closes today!

Before anyone panics, let me say that all our models are up nicely for the month from 1.10% to 1.75%!

What is Troubling the Markets and How are We Profiting From It?

Last month I wrote, "...TWO major themes have started a "Battle of the Titans" that is overriding all of the minor influences on the markets. Those two themes are Fear of Recession and the Emergence of Inflation."

Those two themes are revealing themselves in greater detail and the markets don't know what to do about it. Plus there are some new and complicating factors. *(This is one of those times when I could write much more than most of our readers could endure but you have been saved by the two page space limitation of our mid-month letter.)*

If you look at your portfolios, you will see a significant holding in commodities. Our commodities holdings have gained nicely because, due to a weakening dollar and shortages in some commodities, the following has happened:

1. Gold and other precious metals are hitting new highs in price. This week Gold hit \$914.00 per ounce while platinum hit a twenty-seven year high. Other metals are rising also. While there is no doubt there is speculation in these markets and that will contribute to volatility, demand is truly high due to a still-strong world economy. The London Bullion Market Association forecasts \$1,000 per ounce for gold at some point.
2. Grain commodities are skyrocketing and it is not because of speculators. There truly is a shortage of available acres for

planting crops. Friday, the USDA revealed that there is very little increase in acreage being planted this year and wheat storage is at its lowest level since 1947 and there has been a 20% reduction in corn inventories! *(Does that ethanol sign on gas pump give you a hint as to why?)* Last week, wheat prices hit an all time high of \$10.09 per bushel which is more than double the \$4.50 a bushel one year ago.

3. With the dollar falling and the price of producing things around the world going up, Import Prices last month were 10.3% higher than one year earlier. We are going to be paying more for things even though we have not seen much of a rise in prices in the stores.
4. Oil prices finally hit \$100.00 per barrel last week and are expected to average somewhere between \$80.00 and \$120.00 per barrel during 2008.

All of the above are making you money because our holdings benefit from these higher prices.

Another Theme

While the world economies are slowing, some are stronger than others and they are not slowing at the same rate. The institute of International Finance predicted that world growth will slow to 3.6% this year, with developed economies (that's the US, Europe, Japan, etc.) growing at 2.1% and emerging markets (Brazil, Russia, India & China) growing at 6.9%. This presents an opportunity.

Since we don't know for sure if the US is going into a recession, one way to work both sides of the street is to bet against the weakest economies and bet for the strongest economies! The great thing about this approach is that even if the US and other developed markets go down, we can make money because the strong (emerging) economies don't go down as much - so our losses there are not as great as our gains from our bets against the weakest economies.

You will see in your portfolio holdings which Short (bet against) Japan and Developed Markets. You will also see a fund that is a BRIC fund which is Long (bets for) Brazil, China, Russia & India. This combination has made us money this year!

Formation of Our New Mutual Fund is Under Way

About the time of our last newsletter, we started the lawyers working on the formation of our own proprietary mutual fund. It is estimated that with the legal work and the SEC approval process, this will take four to five months.

The new fund will allow us the ability to cut costs and take advantage of better investment choices. I want to point out that we are forming the new fund exclusively for the use of our current

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and new clients. It is our intention that initially, and perhaps permanently, it will not be available to the general public. Many of the strategies that would have helped us navigate last year more effectively can be utilized in the new fund while reducing overall costs to our clients.

Until the fund is formed, we have started this year by retrieving a process that worked so well for us during the down markets of 2001 to 2003. The mutual fund market place has changed dramatically since that time and with the exception of a few hundred mutual funds, we are limited in our ability to trade. This relatively short list of “easily-tradable” funds caused us to rotate among them very actively over 2006 and 2007. We were not satisfied with the 2006 and 2007 results after substantially beating the market in all other years since 2000.

Therefore, we have selected some core holdings in the areas where we feel that certain themes will persist for months or years and have selected funds managed by the very best managers we could find in those theme areas. These will be our core holdings and we plan to hold them for a long time. The problem with this approach is that if we only had these core holdings and never traded, our clients would have some very big roller-coaster rides. To supplement these core “Theme Holdings” by outstanding managers, we will trade around them by hedging in bad market environments (like now) and adding additional strong growth positions when the market rallies. This approach should reduce our trading while allowing us to benefit from outstanding managers.

May your New Year be rewarded with good health, good family life, good investment returns and the joy of helping those less fortunate.

Lane Kerns

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