



MLK Capital Management, Inc.

Mid-Month Market Report

Tuesday - August 15, 2006

What is Happening in the Market?

The market tried to rally yesterday and is trying again today, but the fact is that it still appears to be in a downtrend. For the month through last night - the Nasdaq is down 1.07%, the Dow is down 0.70%, the Russell 2000 is down 2.67% and the S&P is down 0.59%. Shearson Treasury Bond Index is down 0.10%

To quote a hedge fund manager I have great respect for - "Rather than become overly concerned if stocks do decline significantly from current levels, we should welcome the decline. Steep declines in stock prices make strong advances possible. We need a good cyclical bear market to set up the next bull market." I agree with him as long as our portfolios do not take the steep decline with the market.

All our portfolios are in a very defensive position - a balance of long and short positions that have the potential for some growth but with much less risk of loss than the general market. Month-to-date through last night, representative accounts after management fees and any expenses are as follows: Conservative +0.20%, Moderate +0.08% and Aggressive -0.87%.

Our Near-term Outlook

I look for the market to find a bottom sometime in the next six to eight weeks. If it is significantly lower than its current level when it bottoms, we could have an explosive rally into the end of the year. The stage is being set for a great buying opportunity. Until then, we are holding our money together and trying to understand the big picture.

What Should Be Happening?

It appears that the U.S. economy as well as Global Economies are slowing. This is a good thing. Why is it a good thing, you ask? Both Stock and Bond markets hate rising interest rates. Rates have been rising worldwide to slow inflation caused by overheated economic activity. This is why the stock market has been in a sideways pattern for the last year.

Everything from oil to copper has been rapidly rising in price for the last couple of years because of strong worldwide demand caused by growth that is in excess of what the world

can support without inflation.

The Trick Is

The trick is to slow growth in the U.S. and worldwide enough to slow inflation without killing the job market! This is the so-called "soft-landing" we all want. It appears that - at least in the U.S. - we may be getting it right.

Our economy needs to slow just a bit to allow the cost of everything to stabilize. That appears to be happening. If it is happening, the Fed will stop raising interest rates and perhaps start lowering them. Even the anticipation that this is about to happen will cause an explosive rally in both the stock and bond markets!

What If We Get It Wrong?

If our Fed and other central banks worldwide continue to raise rates to the point that they slow economic growth until unemployment starts increasing - we could go into a recession.

Stock markets hate recessions. They love coming out of recessions but that could be months away if one occurs. High Quality (not high yield) bonds generally do better than stocks in a recession because interest rates are falling and that causes the value of the bond to increase.

I feel that the risk of a severe recession is very limited. The U.S. and Japan (the world's two largest economies) both passed up the opportunity to raise rates earlier this month. The markets took that as a positive sign.

Personally, I am optimistic that over the last fifty years the world's central bankers have become much more astute at engineering a "soft landing". They never seem to get it quite right - but history shows that they are getting better.

Location - Location - Location

Like real estate, making money in the stock market is a lot about being in the right place. We do not want to expose ourselves to the risk of a recessionary Bear Market. At the same time, we want to be ready to move to bonds if one occurs or aggressively to stocks if we get a soft landing.

Our current positioning allows us to move with the market. It looks to me like the Japanese and European markets will

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probably offer more opportunity than the U.S.

Our Current Holdings

All models are hedged to a market-neutral position.

All That Paper

We have received some comments about the amount of paper Schwab sends out. In order to keep you informed, trade confirmations are sent every time trades are made. If mutual funds are involved, you will always get a new prospectus. In addition to these, the normal account statements and notices are sent.

IF YOU ARE STILL GETTING PAPER FROM SCHWAB - YOU DO NOT NEED TO BE! You can have everything sent to you electronically! We have sent out several notices explaining that you should elect to receive electronic notices. Schwab will even lower trading fees if you do. Call Keyla or James in our office for help on getting the paper flow stopped. Save our trees. Save your mailboxes. Be kind to your post-person!

Lane Kerns

MLK Capital Management, Inc.

For copies of prior newsletters and a good overview of our approach to successful money management, go to our home page at <http://www.MLKerns.com> and click on the 'Market Outlook' link.

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