

MLK CAPITAL
MANAGEMENT, INC.

ADVICE ON THE MARKET



December 30, 2003

To: Friends and Clients of MLK Capital Management

From: Lane Kerns

Re: **Recent Performance**
Current Market Conditions and 2004 Outlook
Risk versus Return?
Our Current Holdings

Recent Performance

Conservative, Moderate and Aggressive accounts are all up between 3% and 4% for the month through 12/29/03.

Over the last 36 months, a \$1,000,000 investment in one of our accounts would have made a profit of \$110,000 to \$128,400 while the S&P 500 and the NASDAQ have lost \$120,500 and \$187,600 respectively!

Current Market Conditions and 2004 Outlook

The market has continued to show good resistance to anything that would drag it lower. I think that bodes well for 2004, or at least for the start of the new year. Even though this BULL market is more than a year old, there are still those who have completely missed out. Either they don't believe it is real or are still afraid because of what happened in the three prior years. Most investors expected 2003 to be an extrapolation of the bear market of 2001 and 2002, but it turned out to be a very positive year.

There is still plenty of cash on the sidelines to drive prices higher and the market's resistance to selling indicates that investors are buying on the dips. Un-invested cash is a necessary ingredient because if everyone was fully invested, there would be no one left to buy - and the market would be completely comprised of investors who could only sell.

As we come to the end of 2003, it is obvious that this was a year in which a worldwide economic recovery gained traction. Stock markets around the world responded as they typically do **at this point in the business cycle**. If the cycle progresses normally, growth will eventually accelerate to the point that inflation starts to pick up and the Fed will respond by raising rates to curb growth. **Until then, however, the outlook for additional gains in stocks is very good.** That does not preclude a significant market correction, but the odds of a bear market starting while interest rates are low and the economy is growing robustly are very small. In the event of a market correction, our proven risk management strategies will again come into play to protect our clients' portfolios.

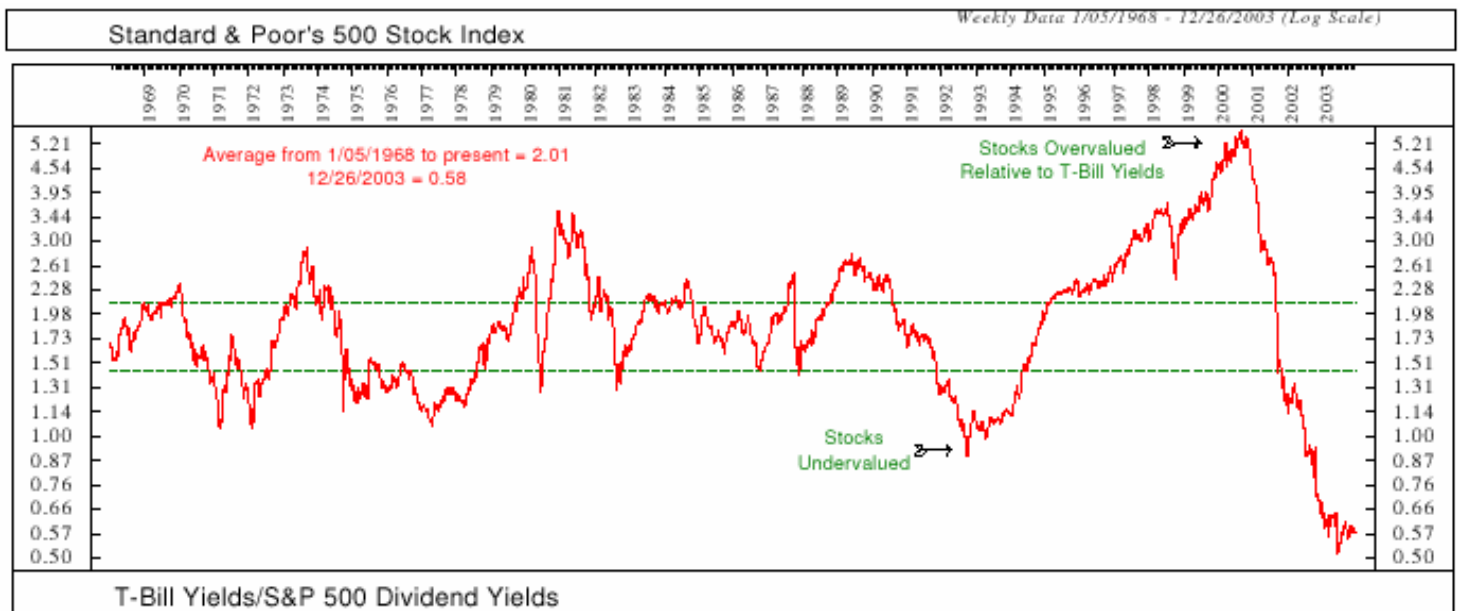
The outlook for 2004 is very bright in my opinion, but the reality is that no one knows what the future will bring. Our task is to deal effectively with whatever the market gives us and I think we have the tools to do that. Over the next few years, I expect the economy to do better than it did in the '90s; however, I am not so bold as to suggest that the stock market will do as well - but I do expect it to do well relative to any other alternative.

Those who miss the impending growth in the economy and the continued explosion in technology (leading to huge productivity gains) will miss an incredible opportunity. Again, I believe that the coming economic period will be unparalleled in our history and will be a period of growth and prosperity previously unmatched in this country.

Of the hundreds of charts and dozens of articles and research reports I read every week, I thought the following chart might be of interest. It deals with a thought process I find very useful. That is – if you do not invest in the stock market, what are your alternatives? I have said in previous newsletters that I do not think bonds will be a good alternative in the next few years. When interest rates start going up to counteract future inflation, the value of your bonds will go down. But don't worry about the future – just look at right now. The following chart compares the yield (income paid) by Treasury Bills to the current average dividends being paid by the 500 companies that make up the S&P 500. What it shows is the dividends being paid on stocks are a much better source of income than T-Bills – and – **therefore, stocks are undervalued!**

S&P 500 Gain/Annum When: (1/05/1968-12/26/2003)		
T-Bill Yield to S&P 500 Dividend Yield Ratio is:	Gain/ Annum	% of Time
Above 2.12	-0.5	32.9
Between 1.45 and 2.12	6.2	37.1
1.45 and Below	16.2	29.9

Based only on their ability to generate more income (compared to the alternatives) stocks are the best buy they have been in the last thirty years! And, in addition to their income potential, their value will go up as more income seeking capital is attracted to the stock market. Over the last 30 years, when the ratio of T-Bill yields to S&P 500 dividend yields has been at 1.45 and below, the stock market has grown at a 16.2% annual rate.



Risk versus Return?

Bottom Line – However you measure it, our portfolios have captured more investment gains than the market – while taking substantially less risk. Isn't that what you want? If we do not manage your money, are you or your broker accomplishing this? **For the five year period ending 12/29/03, our Moderate and Aggressive accounts out-performed the S&P 500 from 38.69% to 41.77% and the NASDAQ from 43.91% to 46.99% respectively!** **Our equity accounts have only half the volatility of the S&P 500 and only 1/3 the risk of the NASDAQ.** All the above numbers are net after deducting all fees and expenses and represent the composite performance of all client accounts we manage – not just a few selected ones. Also, www.401k-Investment-Advice.com shows you how to protect and grow your retirement investments.

Our Current Holdings

Our **Conservative**, **Moderate** and **Aggressive** accounts are mostly 75-100% invested and un-hedged. With the market rotation that started taking place in November, most of the sectors that have been the strongest all year (small cap international funds, technology funds and small cap funds in general) came under some selling pressure. This could have been a market change or just the effect of year end portfolio adjustments and tax selling. Since we never know until it is over, combined with the fact that we did not want to sell holdings with large taxable short-term gains, we put on a partial hedge. The hedge has been removed as of today.

Whenever we hedge, I always hope it turns out to be a wrong decision. If we hedge and the market does not go down we still make money – just not as much. If the market does go down, we protect your holdings and in some cases still make money. We just never know in advance what the market is going to do so I look at the cost of hedging (the trading fee and the slightly lower performance) as an insurance premium. If we all knew that our houses and cars would never suffer damage we would never insure them – but we just can't be sure – so we buy insurance. Applying a hedge is our way of providing some insurance against losses in your portfolio. It is not an exact science and requires us to make judgments based on our interpretation of many market and economic factors. We manage portfolios for many of you far in excess of the value of your home and cars – and since your future source of income is your portfolio it probably makes more sense to protect it at least as much as your home and cars.

We continue to hold in those sectors with strong, low volatility uptrends – US Small and Micro Cap, International Small-Cap and Emerging Markets. When we get through the year end and the first week in January, it will be clearer whether the market rotation was for real or just due to year-end factors. At that point, we may be making some changes to set up our portfolios for a different set of conditions than we have had for the last several months. We have eliminated our natural resources fund holdings. It seemed strange that the price of gold and other metals continued to climb while the share prices of funds investing in them started falling sharply. It appears the share prices just got overbought. In any event, they fell below our stop loss and since there is no way to hedge gold effectively, we sold them. We will not willingly lose money.

Some people have asked what we mean by the term Stop-Loss. As the name implies, it is something we do to stop the losses. In addition to other risk controls, such as trying to buy the right thing to begin with and hedging, we generally pick some point below which we are unwilling to take a loss. In most cases, that is around 7%. If one of our holdings drops 7% **and** it does not appear to be a market sector that will come back soon **and** it can't be easily hedged – then we sell it. If we think we are in a basically strong investment and it is just down because the market is down we will first try to hedge out the market risk – thereby avoiding the sale of the investment.

If we take a 7% loss on something, and move that money to a better performing investment, we only have to earn 7.5% on the new investment to break even. If we held the investment and the market turned really bad and it dropped 25%, we would have to earn back 33% just to break even. A 33% loss would require a 50% gain and a 50% loss would require a 100% return just to get back to even. You get the point.

Between March 10, 2000 and October 9, 2002 the NASDAQ dropped from 5048 to 1114 – a drop of 78%! It would require a gain of 312% from the bottom just to get back to even at the top. Even though the NASDAQ has had a strong run since the bottom, it is still down 60% from the top. Doesn't it make sense to use risk management?

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401(k) Investment Advice

If you are managing your own money, www.401k-Investment-Advice.com would have told you that it was time to become more aggressive or when to go to more conservative holdings - also what funds to buy. It gives you a view of Current Market conditions by going to "Current Market Conditions". It gives users the tools that we use in managing client portfolios. Check it out. Once you log in, go to Investment Advice – Actively Manage. Or, if you prefer not to do it yourself, we can manage your account for you. If your company does not sponsor it, or you are not a member, contact us at MLKCM@MLKerns.com. If we do not already do so, we can manage your 401(k) account – as well as your personal and IRA investments.

MLK Capital Management, Inc. is a fee based investment advisor. Our income can not grow unless our assets under management grow. We do not make money by trading client's accounts. When we make a trade, it is to keep the account from losing money or to put it in a position to grow more. The success of our firm is tied to the success of our client's investment accounts.

This letter is published periodically with my views on the market, investing and things that seem important to me at the time. Remember, all of this is filtered through 40 plus years of experience including a fair amount of both "Good Judgment" and "Bad Judgment". Or, as a friend of mine says, we may not be right - but this is our opinion. Please feel free to share this with anyone you think might be interested. If someone would like to be put on the list just send me an email with his or her email address. You can reach me at: Lane Kerns - MLK Capital Management, Inc. - (713) 993-0949 - (800) 945-2125 - LaneK@MLKerns.com

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