

MLK CAPITAL
MANAGEMENT, INC.

ADVICE ON THE MARKET



September 1, 2006

To: Friends and Clients of MLK Capital Management

From: Lane Kerns

Re: **The Economy and The Market**
Our View
Managed Account Performance vs. Market Indices
Current Portfolio Holdings

The Economy and The Market

At certain points in the economic cycle the market leads the economy. At other times, when we are at or near the end of the economic cycle, the economy tends to lead the market and that is what is happening now.

From May 8th this year until July 21st, there was great uncertainty about the direction of the economy. The market reflected that uncertainty and the major indexes all declined and the Nasdaq lead the way with a 13.84% decline. Since that time, the indexes have generally trended up. Why?

Last month I said: "The market is in a decision box. If the economy continues to slow enough to convince the Fed to stop raising rates, stocks could break out to the upside. But, if inflation remains stubbornly high, the Fed may have to continue raising rates even at the risk of a recession. That would send stocks sharply lower."

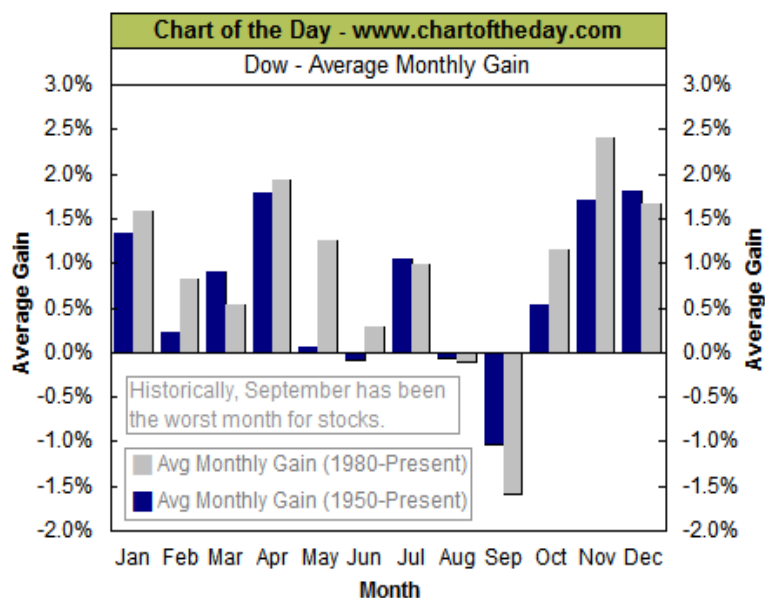
With all of the economic reports released this week/month, it now appears that we have a potential direction – and that direction is up. One additional piece of good information is that not only does the Fed seem to think that inflation is under control – but it is under control with the economy appearing to be strong enough for corporate profits to continue growing! It takes growing profits for the market to continue rising.

This is a rather bold statement on our part so let me give you the reasons we sense that we may be in for better times over the next few months :

1. As I said above, inflation appears to be under control so the chances of Fed tightening have diminished. Germany, Japan, China, the US and elsewhere have all shown softer inflation gains. Whether this is from improving productivity or slowing economies, it is good news for the markets.
2. Although housing starts have declined dramatically over the last year, and construction has been estimated to be as high as 30% of our GDP, I feel that lower interest rates could put a cushion under housing preventing a complete collapse in residential real estate activity and prices.
3. Whereas a few months ago, Japan appeared to be recovering from two decades of declining economic activity which caused them to stop their policy of flooding the world financial markets with easy money. Over the last few months, there has been an economic slowing in Japan that is causing them to attempt to re-inflate. In other words, they are back to an easy money policy which is making money cheap and plentiful. This is re-energizing the "carry trade". This, combined with other factors, will keep our interest rates low and perhaps push them even lower.
4. Interest rates in the US, Europe and Japan have topped and are trending down. European economic activity was unusually strong in the 2nd quarter and they

may have one more rate hike left – but with the increased worldwide liquidity, it is possible we have seen a top in interest rates for the near term.

5. Because Asian economies have cooled off from the Red Hot pace they had been maintaining, the pressure on commodity prices is easing. Notice that there has been no shortage of oil and its prices have declined from about \$80.00 per barrel to the \$70.00 vicinity.
6. The mild economic slowing worldwide is taking some of the pressure off commodity prices – therefore giving major central banks room to pause in their rate increases and decreasing pressure on corporate profits.
7. The Nasdaq has recovered the most since its July low. This is a positive thing because no major bull market has ever started without the Nasdaq leading the way.



8. Corporate America is awash in cash they either need to invest in new technology, pay out in dividends or use to repurchase their stock. All of these are good for economic growth and do not directly feed inflation.

9. Whereas, August has historically been a weak month for the market and September the weakest of all, the combination of the above factors have conspired to make August of this year above average. We are entering September with a great deal of bullish momentum. If we have a decent September with no shocks regarding increasing inflation – we will then be entering the historically strongest part of the year.

10. Although there are many reasons for the US dollar to decline in value, it has surprised everyone with its resilience. To quote the Financial Times, “There is no sign yet of the great dollar crises that those most concerned about the US deficit have been forecasting. Perhaps this is because none of the alternative currencies is sufficiently attractive to trigger a stampede out of US assets”. This is supporting our lower interest rates and our stock market. America’s economic might is just very hard to bet against.

Our View

If as we suspect, September does produce a strong rally, we will be reducing or removing our hedges. We will move more to sectors which are showing strength and momentum.

Our Portfolio Builder system follows a process whereby we can dial-in acceptable risk based on current market conditions as we see them. We then focus on the areas of the market that are trending up while at the same time reducing volatility with Linear Program risk smoothing. This dramatically reduced our volatility over the last two months.

Dr. Ted Cackowski and Mark Ellender are putting the finishing touches on another powerful part of the quantitative system we are building that will add more science to the way we react to market changes. We feel that these tools, combined with our Global Macro-Economic overview will allow us to capture more of the up markets and avoid surprises. There is no crystal ball, but we are devoting a great deal of resources and time to systems development and being students of the market.

Our performance over the last few years has been pretty spectacular, but the last few months have not been what we would have liked. We have had occasional periods like this in the past and have always rewarded patience with above market performance without taking big risks. We feel confident we will continue to do so. All our family’s money is invested in the same models as that of our clients.

Managed Account Performance versus Market Indices

PERIOD ENDING 8/31/2006	PERFORMANCE					RISK	
	One Month	Last 12 Months	Since 12/31/03 Annualized	3 Years Annualized	5 Years Annualized	3 Yr. Standard	5 Yr. Deviation
Equity							
Dow Jones Industrials	1.96%	11.25%	6.01%	8.98%	5.03%	8.47%	14.05%
NASDAQ	4.41%	2.26%	3.84%	6.73%	4.05%	13.51%	21.91%
S & P 500	2.30%	9.14%	8.75%	11.03%	4.70%	7.70%	13.27%
MLK Conservative Growth	0.10%	6.02%	11.76%	13.54%	11.06%	9.57%	8.43%
MLK Cons. Growth Margin	0.06%	1.52%	11.66%	N/a	N/a	N/a	N/a
MLK Moderate Growth	0.60%	5.77%	11.50%	13.56%	10.37%	11.69%	10.50%
MLK Moderate Growth Margin	0.54%	3.44%	11.23%	N/a	N/a	N/a	N/a
MLK Aggressive Growth	-0.88%	6.04%	13.85%	15.40%	10.72%	11.97%	10.99%
MLK Aggressive Growth Margin	-0.88%	1.31%	10.63%	N/a	N/a	N/a	N/a
INCOME							
LB 1-3 Yr. Govt. Bond	0.34%	2.04%	1.86%	1.94%	3.02%	1.30%	1.66%
3 Month T-bill	0.41%	4.59%	3.21%	2.78%	2.30%	0.43%	0.38%
MLK Stable Value	0.57%	4.87%	6.53%	6.40%	4.94%	3.13%	2.85%

The above fund performance information is historical in nature and is not a guarantee of future performance. Actual performance will be different and may be less. Losses could occur in all funds. Time periods may reflect a trend in rising or falling stock prices which may not be sustained in the future. MLK Capital Management, Inc. ("MLK") performance figures are after the deduction of MLK's actual management fee and include reinvestment of dividends and earnings on accounts held at Charles Schwab & Co., Inc. MLK performance figures represent a composite of all individual portfolios managed in accordance with each investment category. ¹ Standard Deviation is a measurement of risk and smaller numbers indicate less volatility or risk.

Current Portfolio Holdings

All our models have been hedged close to a market neutral position. Whereas a month ago the trend was down, the short-term trend is now up. If next week does not suffer any significant market decline, we could be entering the explosive rally I mentioned in the last letter. We did some repositioning yesterday in the Aggressive models and will probably be making some moves in the other models as the picture unfolds over the first few days of September.

A New Associate – I would like to introduce James Salter who joined MLK Capital Management a few weeks ago. James came to us from Atlanta where he worked for another Investment Advisory firm. He is a graduate of Sewanee (The University of the South) and an all around good guy. His wife is in the Doctoral program at Rice University. He is working with Keyla Villarreal in investor relations servicing client needs and opening new accounts. As our assets under management have grown to almost a quarter of a billion dollars and our client list to several hundred, we continue to build good staff and systems.

Billie and I spent time early this week at a Schwab meeting in San Francisco and tacked on a few extra days prior to the meeting in Carmel, CA and then Yosemite National Park. (Always in touch with the market via computer on wireless broadband!) It is nice to be getting to the size where we have great staff to cover any contingency. If you have never been to Yosemite, we highly recommend it. Absolutely spectacular!

Have a great Labor Day Holiday.
Lane Kerns and the MLK Capital Team

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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:

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