



MLK Capital Management, Inc. Mid-Month Market Report

Monday - July 17, 2006

What is Happening in the Market?

The markets are having a tough month but we are having a great month!

World markets have been hit this month by a confluence of negative factors, including rising interest rates and doubts over second quarter earnings in the US. The geopolitical concerns in the form of war or potential war in five different hot spots "overlaid" the more fundamental factors. All together, these could create a difficult summer.

Additionally, it has been more than three years since the beginning of the March 17, 2003 bull market. Historically, bull runs rarely last longer than three or four years.

The Nasdaq is down 6.2% for the month & the Dow is down 3.61% through July 14th. One of our typical Aggressive accounts is up 1.53% after fees & expenses. A representative Conservative account is only down 0.13%.

Our out-performance of the markets can be partially attributed to implementation earlier this month of our new Portfolio Builder system. More on that later.

Trading Activity Up!

For those in the money management business there has been a very visible and obvious trend over the last three years. In an attempt to add investment returns and reduce risk - there has been a proliferation of new investment products and derivatives. The material character of the market has changed. I do not mean an economic cycle change - I mean a structural change.

The speed at which money moves is increasing. Therefore, the speed at which we must react must increase with it. According to the Financial Times - Average velocity, the value of shares traded divided by market capitalization - at the New York, Tokyo and London exchanges has risen from 35% in 1995 to 109% last year.

This implies that the average holding period is about 11 months. The average holding period on the Nasdaq is just 5 months. The average trading time that hedge funds are utilizing now has reduced from 30 milliseconds to 2 milliseconds.

Falling trading costs have allowed investors to trade more vigorously and that should improve liquidity for all of us. However, this has created problems for many mutual funds that want you to give them your money and never ask to get it back. A high percentage of funds have added early redemption fees. We have been fairly successful at avoiding these fees in the past, but the divergence of the reality of the market place and the self interest of the mutual funds is forcing us to make a decision.

Our Preferred Method of Investing is Changing

Long time clients know that we have limited ourselves to using mutual funds with no transaction fees (NTF funds). However, even a NTF with a holding fee may not be a great deal, and holding through a major market downturn just because there is a selling penalty clearly does not make sense.

We are beginning a move to use exclusively funds with no short holding penalties and (ETF) Exchange Traded Funds. Later this year, we will begin using individual stocks.

Our new Portfolio Builder system will allow us to react to changes in the markets to capture its direction more quickly. It incorporates econometrics more effectively and soon will incorporate a sophisticated probability based technique.

Moving away from the exclusive use of NTF mutual funds will mean that we will begin to incur more trading fees. We have weighed this move carefully and have determined that the cost to our clients should actually go down because, in the case of ETFs, the management fees are a fraction of the typical mutual fund. In the case of individual stocks, we completely avoid mutual fund management fees which would be a savings of between 0.70% and 1.5% per year.

Our Near-term Outlook

I said last month "At some point the selling will stop - when values become so attractive as to be irresistible. At that same point, there will be a shortage of sellers and an abundance of buyers. . . . Till then we are protecting cash." Since then, the US has increased interest rates again and commodity prices have resumed their upwards march. Japan, the world's second largest economy and the last major economy to do so has started raising interest rates. Some feel that when we look back a year from now, this may

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have been the exact peak in the global growth cycle. Although I am not that pessimistic, caution is in order.

Oil prices are not going to come down! According to energy experts, oil import prices last month were still 16.5% below market prices, largely due to forward purchase contracts signed months or even years ago. When this discount disappears, costs will only go up. The only thing that will cause prices to go down will be a major worldwide recession. Frankly, I'd rather pay the higher oil prices.

I concluded several months ago that in addition to our Global-Macro Economic and technical approach - we needed to add a quantitative element that included Econometrics and Probability Theory. For the last four months Ted Cackowski has been tailoring modern econometric techniques to the rapidly evolving market paradigm and Mark Ellender has been programming them into a new system we call Portfolio Builder. Ted is a PhD and a mathematician with years of experience in the quantitative investment arena. Mark - in addition to being the most gifted programmer Ted and I have worked with - has a masters degree in applied mathematics.

Our Current Holdings

All models are hedged to a market-neutral position which is what has allowed us to make money during a very difficult period in the market.

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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