



# MLK Capital Management, Inc.

## Mid-Month Market Report

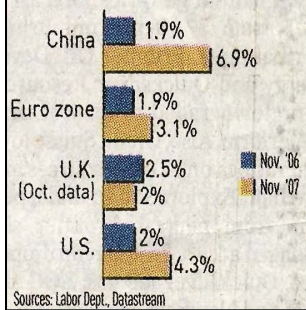
December 17, 2007

### Uncertainty Creates Opportunity

There is usually a single major theme running through the markets that determines their direction. The volatility that circles around that theme presents the challenges as well as the opportunities of the moment.

### **Global Inflation Returns**

Consumer prices, year-over-year changes



However, things seem a bit more complex than we have seen in recent years because, this year, 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.

As you can see from the chart at the left, inflation is clearly heating up. The Fed has said its stated goal is to keep inflation between 1% and 2%. Over the last twelve months it is running at double that rate.

### **Why does this make any difference to you?**

I began to write several months ago about something called Stagflation. Most of the working class today are unfamiliar with that term because they have never experienced it. Unless you are over age 55, your adult experience does not include what happened in the 1970's.

What happened in the 70's was a massive run-up in inflation that caused the average working person to experience a decrease in their standard of living. They kept getting raises - but the rise in their income was less than the rise in prices for everything they had to buy! The result was a lower standard of living.

Unfortunately, some were not even that fortunate because what accompanied the inflation was a stagnant economy - a recession, or an economy growing so slow that it did not create jobs for its growing population. So, if you were employed, there was a good chance your standard of living was decreasing and if you were not employed - well, you know the answer.

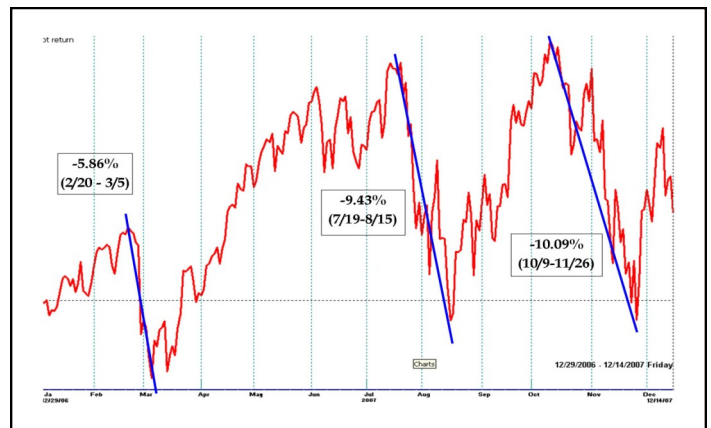
Stagflation occurs when prices start rising because there is easy credit or too much money circulating in the economy. Both of those things are present today. Too much money chasing too few goods (like oil and food) causes the price to go up.

Stagflation is the Fed's worst nightmare! The way you fix a slowing economy is to create easy credit and flood the economy with

easy money. The way you fix inflation is to slowdown the economy by restricting credit and taking money out of the economy. These are not compatible goals! The awareness that this “Battle of the Titans” was emerging has been obvious for many months and it has presented challenges to any investor who doesn't want to get caught in the downdraft that almost always accompanies stagflation.

### Why Has it Been so Hard to Grow Investments in 2007?

The following chart shows the S&P 500 index year-to-date for 2007. Note that there have been three major corrections during the year. Those three corrections have been 5.86%, 9.43% and 10.09%! For the entire year of 2006, there was a single correction amounting to 7.7%.



Notice the corrections are getting larger. I don't know if that is of any significance, but I do know that as a money manager like ourselves that does not want our clients to lose any big money on the way to growing their accounts, it creates problems. If we were a buy-and-hold investor, we would just let the chips fall where they may. But what if the next correction is more than just a correction?

### Market Outlook - Longer Term

It appears that the world is not going to escape escalating inflation. The Central banks of the major economies will bring it under control. They can not afford to fail. The question is, can they do it without sending their economies into a major recession. Until that answer becomes more clear, it is our feeling that the increasingly volatile nature of the markets will continue. This will create opportunities. I made a lot of money during the stagflation of the 70's and retired when I was age 39. It is possible to make money this time once the picture becomes more clear. Our challenge now however, is to hold our money together until it does become clear. The market may rally over the next few weeks. That would be typical for this time of year, but I think the risk is that any rally will not hold.

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## DATED MATERIAL - CURRENT MARKET REPORT

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For the month of December through Friday night, the S&P 500 and the Nasdaq are down a net of 0.82% and 0.95% respectively. Our Aggressive and Conservative models are pretty much neutral at down 0.79% and 0.25% respectively over the same period.

### **Our Current Holdings**

As of today, we have switched to a hedged Long-Short portfolio. We are Long the Large-Cap Dow Jones 30 (These stocks should hold up better if the US goes into a recession), a small holding of a BRIC fund (One that invests in the four strongest economies in the world - Brazil, India, Russia & China) and Utilities (which is very defensive). We have a significant short position in a developed markets fund. These are the more developed countries of the world and have not done as well as the BRIC countries. The combination should protect us from any major falls while giving us an opportunity to make a little money.

For those that know what it means, we are not yet “net short”.

The next letter will come out after Christmas and the New Year and we will have news about our new Mutual fund which will allow us to reduce client expenses and give us more opportunity to invest in things other than mutual funds. Exciting times.

May you have a wonderful Holiday!

Lane Kerns

For copies of prior newsletters go to our home page at <http://www.MLKerns.com> and click on ‘Market Outlook’.

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