



MLK Capital Management, Inc. Mid-Month Market Report

April 15, 2008

Just When You Thought it Was Safe What Stopped the Market Rally? The US is in Recession

Just When You Thought it Was Safe To Re-enter the Water

After all of the turmoil in the financial markets that started last August, it appeared that things were starting to settle down. With the Fed's rescue of the banking system last month, the market stopped falling and started to climb.

I doubt if most Americans have any idea just how close our banking system came to a complete meltdown. Banks had virtually stopped lending money—even to each other. The crises came to a head when Bear Stearns, the fifth largest investment bank in the United States, began having a run on the bank.

Investors and other investment banks began withdrawing money and had the Fed not stepped in on a Sunday night and arranged for it to be taken over by J.P Morgan Bank, Bear could not have opened on Monday morning. It was bankrupt. If they had not opened, other investment firms that traded with them could not have completed their trades or withdrawn money from Bear. This would/could have caused a ripple effect throughout the world.

But that is all past us. Or is it?

When there is fear in the banking system, the kind of fear that causes banks not to want to loan even to each other, you can bet they are not loaning to individuals or businesses either. When that

happens economies go into recessions and people start losing jobs.

That fear can be measured by something called the “TED Spread.” Without trying to make things too complicated it measures the cost, or interest rate, that banks charge each other to borrow from each other. That rate is called LIBOR. LIBOR stands for the London Interbank Overnight Rate.

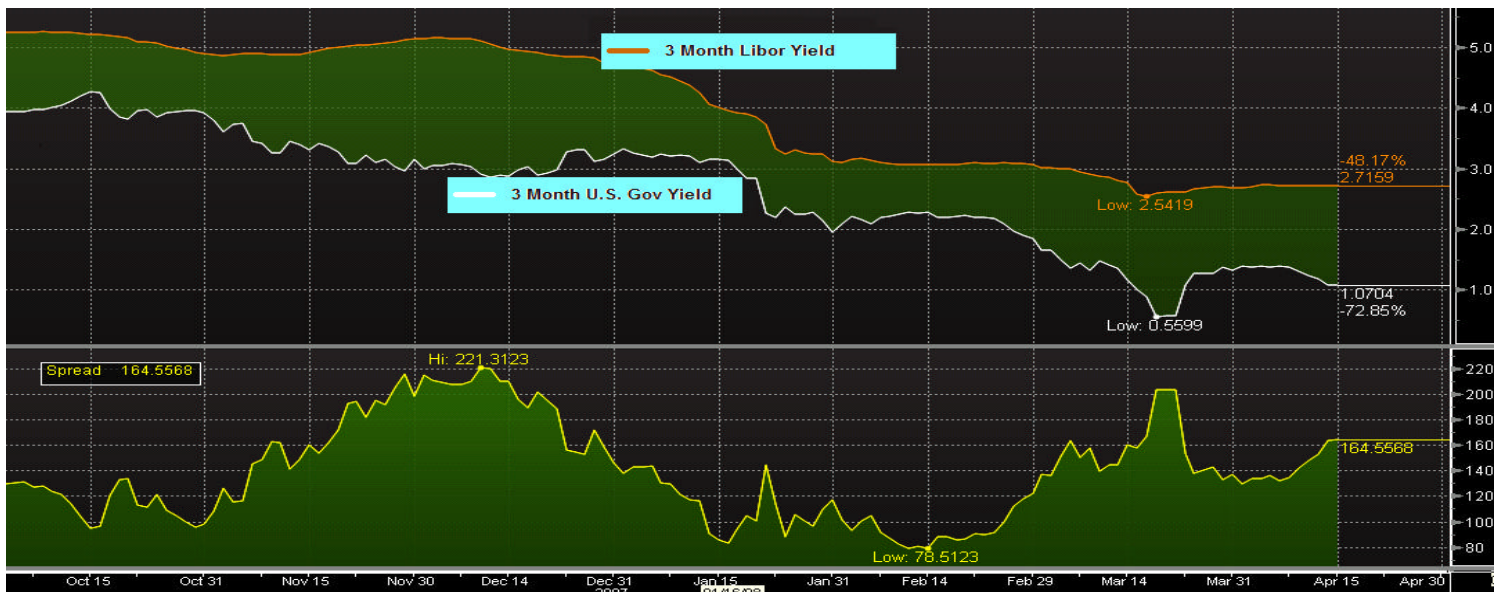
If banks are financially sound, LIBOR is very low and close to the rate of interest paid on US government Treasury funds. The difference this rate and LIBOR in normal times will be 12 to 25 bases points or .12% to .25%.

Look at the chart below. The top part of the chart shows the two rates or yields. The bottom part shows the spread or difference between the two. This is the TED Spread.

Notice that last December the spread got as high as 221 basis points. At those rates, banks couldn't afford to borrow and loan it to their customers. So, credit began to freeze up. Then as the initial crisis seemed to be easing, the spread got as low as 78 basis points on February 14th. Last night it was back up to 164 basis points and climbing!

What stopped the Market Rally?

The accepted wisdom among many investment advisors was that the safe way to invest was to purchase the stocks of large companies that do a large portion of their business overseas, so that they can profit from our falling dollar.



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That was the accepted wisdom until last Friday when General Electric, the second largest company in the US reported its earnings. Without warning it reported disappointing earnings and a disappointing outlook for the future. GE is the poster child for large multinational companies and which was generally thought to be so diversified as to be “Bullet Proof” from negative earnings surprises. The price of GE stock declined 13.61% on that day. That was also the day the TED Spread started rising again. Since October 2nd, GE’s stock price has declined over 23% and our US market index is down almost 15%.

Our models are down somewhat but we have escaped the majority of the market decline and have held our money together for the inevitable Bull market that will follow. While we are not excited about having our accounts decline at all, we feel that a prudent amount of exposure will position us to at least outgrow inflation.

We joined into the rally that started in late March, only to be hit with the GE surprise. We have since reduced most of our market exposure and our current holdings consist of mostly energy, natural resources and high yield bonds. For the month, all our equity models are up. By comparison, GE is down 17.38% since April Fools day.

The US is in a Recession.

Quarterly earnings reporting season has just gotten under way and this is a volatile time in the markets. Bad earnings surprises (like GE) can rapidly spike the market down while positive surprises can do the opposite. As of today, 244 companies have reported earnings with 110 showing some growth in earnings and 83 showing a decline in earnings. There have been exactly 45 negative and 45 positive surprises. We will stay conservatively invested in all our models until the picture develops and the TED Spread declines.

Lane Kerns

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