

MARTIN CAPITAL ADVISORS QUARTERLY ECONOMIC REVIEW

by Alston Boyd, Economic Director

Market and Economic Statistics

as of Market Close
December 31, 1999

	3rd Quarter	3 mo	12 mo
GDP-Bil\$, 3rd Qtr	8901	5.7% apr	4.1%
GDP Deflator	104.5	1.1% apr	1.3%
Empl Cost Index	142.9	0.8%	3.0%
NF Productivity	113.8	4.9% apr	3.1%

Stock Indices*	3 mo		12 mo		Interest Rates	3 mo		12 mo		Prices, Inflation	3 mo		12 mo	
	Value	%	Value	%		Value	%	Value	%		Value	%	Value	%
Dow Industrials	11497	11.2%	25.2%	91-day T-Bill DR	5.19%	7.5%	18.8%	CPI, Nov	168.4	0.7% apr	2.6%			
S&P 500	1469	14.5%	19.5%	30-yr T-Bond Yld	6.48%	7.3%	27.3%	PPI, Nov	135.0	1.3% apr	3.3%			
NASDAQ Comp	4069	48.2%	85.6%	FNMA 30yr mortg	8.08%	2.8%	21.3%	Gold, cash	288.5	-3.1%	-0.1%			
NASDAQ 100	3708	54.0%	102%	Prime Rate	8.50%	3.0%	9.7%	W Tx Int Cr Oil	25.60	4.6%	113%			
NYSE Comp	650	9.7%	9.1%	Fed Funds Trgt	5.50%	4.8%	15.8%	Copper, cash	0.85	4.0%	29.2%			
Wilshire 5000	13813	17.9%	22.0%	Fed Disc Rate	5.00%	5.3%	11.1%	CRB Futures Ind	205.1	0.0%	7.3%			
Russell 2000	505	18.1%	19.6%	S/L Long T-Bnd Ind	7921	-2.1%	-8.7%	CRB Raw Indust	268.9	-1.5%	1.3%			

* excluding dividends

Money				Industry				Labor - Dec'99			
M2, Bil Curr\$, Nov	4627	1.3%	6.0%	Indust Prod Ind, Nov	139.5	1.3%	4.3%	Unemployment Rate	4.1%	-0.1%	-0.2%
Free Reserves	832	-3.1%	-43.2%	NAPM Index	55.5	-2.3	10.2	New Non-Farm Jobs	315K	212K	+1K
Money Mkts - Bil\$	1621	8.4%	16.3%	Cap Utiliz, Nov	81.0%	0.3%	0.1%	Avg Hourly Wages	13.46	0.8%	3.7%
US \$\$\$ Index	101.9	3.4%	8.3%	Bldg Permits, Nov	1614	-0.3%	-2.4%	Avg Init Unempl Clms	279.8	0.0%	-14.9%

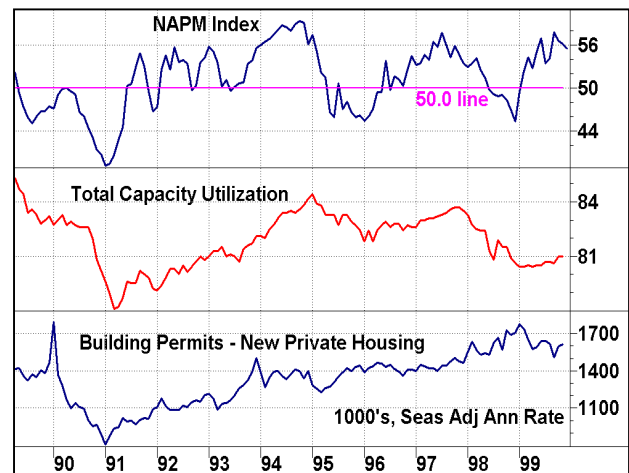
The quarterly data and the monthly data on the labor market in the tables above are essential for an understanding of what's going on in our economy today. Our GDP grew at a rapid 5.7% annual rate in the third quarter and 4.1% over 12 months. In spite of this rapid growth, the GDP Deflator, a broad measure of inflation in our economy, rose by only a 1.1% annualized rate in the third quarter and by 1.3% over the entire year. Big increases in non-farm productivity have helped hold down the rate of inflation. The strong economy has created many new jobs, bringing down the unemployment rate to a 30-year low of 4.1%. The low rate of unemployment and the shrinking pool of unemployed, hireable workers have raised the possibility of wage inflation, prompting the Fed to raise interest rates.

Some stocks have shown remarkable strength, with the greatest price increases occurring in the high-tech sector. That is the sector primarily responsible for big increases in productivity. For instance, the NASDAQ 100 Index increased at more than 10 times the rate of the NYSE Composite Index during 1999. The Russell 2000 Small Cap Index played catch-up, with almost all its gain for the past year coming in the last quarter. Interest rates have climbed for most of the year, as the world economy gained strength along with our own. While the overall rate of inflation has remained low, oil prices have more than doubled.

MANUFACTURING The manufacturing sector recovered and then remained strong during 1999. The North American Purchasing Managers Index began to show strong expansion after January. This Index stood at 55.5 in December, off slightly from the peak of 57.8 in September, but still considerably above the 50.0 value that separates expansion from contraction. The Industrial Production Index was up 4.3% in the 12 months ending in November. Capacity utilization bottomed at 80.4% in February and April of 1999, and has risen only slightly to 81.0%. The economic recovery in Asia that began in late 1998 has been a great help to manufacturing, increasing exports to the Far East.

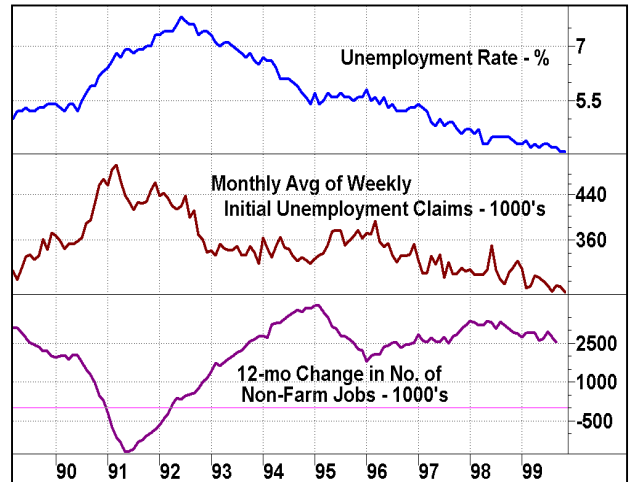
The construction industry has been hampered since early 1999 by rising long interest rates. The 21% jump in Fannie Mae mortgage rates over the year has brought similar increases in monthly payments. Commercial construction has been more severely impacted than residential construction, but seems to be coming back. The bottom chart shows building permits for new private housing. They are still at a very high level historically after dropping slightly since the beginning of the year. It is surprising that more buyers have not been priced out of the single-family home market by such a large increase – the strength must be attributed to our strong economy providing enough secure, well-heeled buyers who can handle the higher costs.

SALES Consumer spending has been extremely strong, with the just-finished holiday season being one of the best for retailers in the past 10 years. Many people have jobs with good pay, few are losing them and few are unemployed. This translates into high consumer confidence, an indication that many feel secure about spending the money they have earned rather than saving much of it. Retail sales

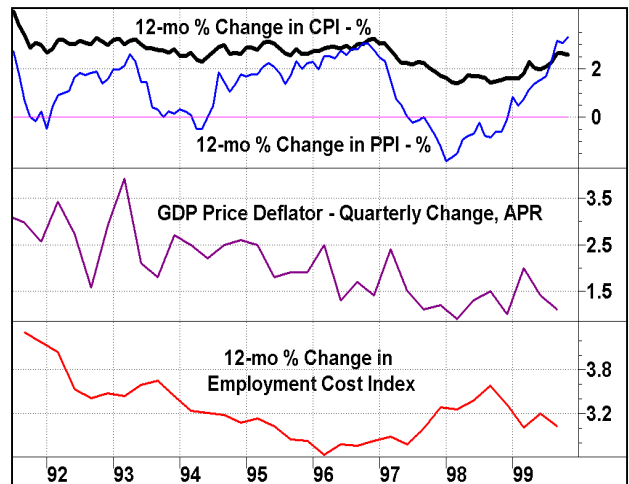


are up 9.1% in the 12 months ending in November. Auto and light truck sales over the past six months have hit an average annual rate of about 17 million units, the highest in history for this average. New home sales hit an all-time high in November 1998, and have dropped only about 12% over the year in spite of much higher mortgage rates. For sales, it doesn't get much better than this.

LABOR Our strong labor market is both a major source of strength in our economy and a potential source of inflation that might trigger even higher interest rates. The unemployment rate has come down to 4.1%, the lowest since January of 1970. The number of initial unemployment claims filed each week is a measure of the number of people losing their jobs. The average number of these claims for the four weeks ending December 25th was 279,000, the lowest since 1973, when the total labor force was 60% of what it is today. The bottom chart shows the change in the number of non-farm jobs over each 12 month period. The rate of new job formation has been over 2.5 million in 12 months for most of the past six years with the exception of a short period in late 1995 and early 1996. Looking back at the past 40 years, when job growth in 12 months was greater than 2.5 million, the unemployment rate almost invariably fell steeply. The past six years is the longest period of job growth at this rate in the past 40 years. Consequently, the number of jobs has grown faster than the number of new workers entering the labor force. At this rate of job creation, we will use up the relatively small pool of available workers that remains. The Fed's greatest fear with regard to inflation today is that all of these remaining workers will be hired and then employers will be forced to cannibalize from each other, raising wages in competition for those already at work. Such a condition would result in an upward wage spiral that would quickly spread inflation throughout the economy. Two things are counteracting this tendency: the U.S. is part of a world economy where wages in many places overseas are much cheaper than here. The second factor holding down wage inflation is our increasing productivity. Technology has increased efficiency and productivity throughout our economy, allowing higher pay for workers without the inflationary penalty. Additionally, it is possible to pull yet more people into the work force by providing services such as day care and improved transportation.



INFLATION The overall inflation rate in our economy as measured by the Consumer Price Index is 2.6%, near a two-year high, but lower than the steady rate that prevailed from 1992 through 1996. The Producer Price Index of wholesale prices rose 3.3% in the past 12 months, pushed upward primarily by higher oil prices, which also had a strong effect on consumer prices. Additionally, industrial raw materials like copper, nickel, aluminum and scrap steel have seen prices rise from 25% to 120% off the lows of the Asian economic crisis. The GDP Price Deflator takes into account everything in the economy and is our broadest measure of inflation. This indicator shows only a 1.1% annual rate of increase in the third quarter and a 1.3% increase in 12 months. The Employment Cost Index, which includes both wages and benefits, rose 3.1% in the 12 months ending September 30, 1999. As non-farm productivity is increasing at about the same 3% rate, it offsets the labor cost increase. Thus, inflationary pressures coming from labor appear to have been virtually nonexistent.



SUMMARY AND OUTLOOK Growth over the past several quarters has been stronger than expected, as very strong consumer spending overcame the restraining effects of higher oil prices and higher interest rates. A small part of the growth in the last quarter came from inventory buildup in anticipation of problems with Y2K. Now we can expect those inventories to be worked off, as the problem is behind us. Nevertheless, we have an extremely strong economy fueled by a large, well-paid, confident work force. Well-heeled consumers will continue to spend until they no longer feel so comfortable about their prospects. Strong consumer spending carried us through the Asian crisis two years ago and now that strength is becoming excessive, creating somewhat of a problem. Another factor adding to our economic strength is the recovery of the world economy, which grew twice as fast as expected in the past year. Europe, Asia and Latin America are all doing better now than a year ago, and the favorable economic trends there are expected to continue. Demand for goods from those regions will increase, adding to the activity in our manufacturing sector.

The outlook for the coming year is one of continued economic growth at an annualized rate of 3.5% to 5% in the first two quarters. Future economic performance depends on job growth and labor costs. The Fed will probably start the year with a rate hike of ½%, probably in two steps. It will do this in order to slow the economy, and more specifically to rein in the rate of job creation. Further rate increases will follow if the economy continues to grow faster than an annualized rate of about 4% and if the pool of unemployed workers continues to shrink.