

MARTIN CAPITAL ADVISORS

QUARTERLY ECONOMIC REVIEW

by Alston Boyd, Economic Director

July 7, 2003

Market and Economic Statistics

as of Market Close
June 30, 2003

	1st Qtr '03, Final	3m ch	12m ch
GDP-Bil\$	9552	1.4% apr	2.0%
GDP Deflator	111.9	2.4% apr	1.6%
Empl Cost Index	164.5	1.3%	4.0%
NF Productivity	124.8	1.9% apr	2.4%

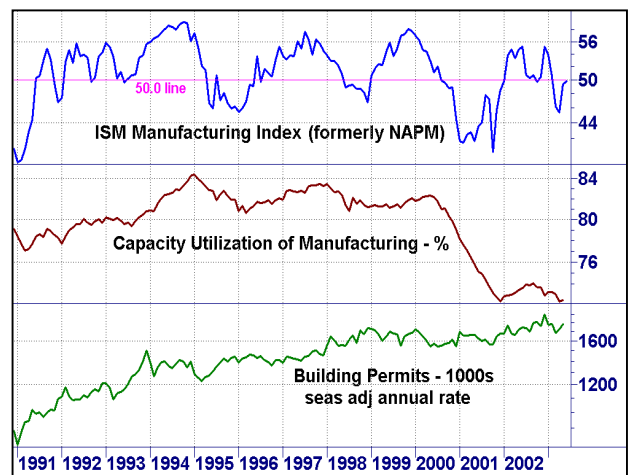
Stock Indexes*	3m ch	12m ch	Interest Rates	3m ch	12m ch	Prices, Inflation	3m ch	12m ch	
Dow Industrials	8985	12.4%	91-day T-Bill DR	0.86%	-23.2%	CPI, May	183.3	0.0%	2.1%
S&P 500	975	14.9%	30-yr T-Bond Yld	4.55%	-5.8%	PPI, May	141.9	-0.8%	2.5%
NASDAQ Comp	1623	21.0%	FNMA 30yr mortg	5.03%	-7.5%	Gold, cash \$/tr oz	346.4	2.7%	8.8%
NASDAQ 100	1202	18.0%	Prime Rate	4.00%	-5.9%	W Tx Int Cr Oil \$/bbl	30.18	-2.7%	12.3%
NYSE Comp	5505	16.4%	Fed Funds Trgt	1.00%	-20.0%	Copper cents/lb	0.75	5.0%	-2.5%
Wilshire 5000	9343	16.0%	Fed Disc Rate	0.50%	-33.3%	CRB Futures Ind	233.8	0.7%	11.7%
Russell 2000	448	23.0%	S/L Long T-Bnd Ind	12374	5.0%	CRB Raw Indust	259.5	0.6%	4.9%

* excluding dividends

Money	Industry	Labor - Jun'03
M2, Bil Curr\$, May	ISM Index, Jun	Unemployment Rate
Free Reserves	Indust Prod Ind, May	New Non-Farm Jobs
Money Mkts - Bil\$	Capacity Utiliz, May	Avg Hourly Wages
US Dollar Index	Bldg Permits - May	Avg Init Unempl Clms

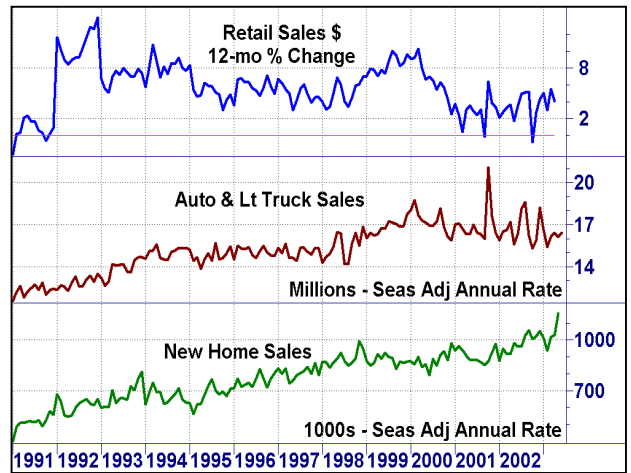
The final figure for GDP growth in the first quarter of 2003 was revised down to an annualized 1.4%, and the second quarter's growth rate will probably be 1.5% to 2.0%, not much stronger. The stock market, however, put on a great show in the second quarter, with major stock indexes rising 12% to 23%. Interest rates have declined across the yield curve, as the Fed has cut rates on the short end and the market has pulled them down on the long end. Inflation is minimal, so low in fact that that deflation has become a concern. Industry, with the exception of housing, has remained weak and shows few signs of gaining much strength. The labor market is an important part of our economy and also was showing few signs of strength by the end of the second quarter.

INDUSTRY Conditions in the manufacturing sector were better in the second quarter, though the improvement was from weak to less weak. The ISM Manufacturing Index rose from 45.4 in April to 49.8 in June, still below the 50.0 level separating growth from contraction. New orders and inventory increased in June, while employment declined. Total capacity utilization was 74.3% in April and May, the lowest since 1983. Capacity utilization of manufacturing was even lower, 72.5% and 72.6% in those two months, also representing 20-year lows. Historically, 80% to 82% has been regarded as being a good level of capacity utilization where not much equipment or too many facilities are idle and at the same time no inflationary bottlenecks are occurring. The auto industry in the US Midwest is reporting unutilized capacity of over 20%, unusually high for that type of manufacturing.

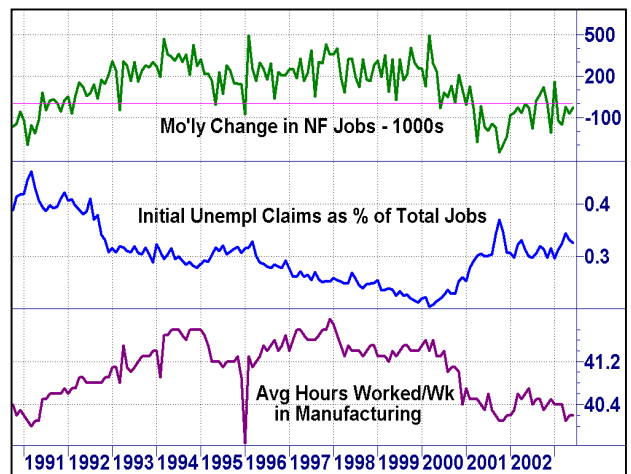


The homebuilding industry continued to lead the rest of the economy, buttressed by low mortgage rates. Building permits and housing starts remained strong through May with no signs of any slowing. As long as mortgage rates remain near 40-year lows this industry will continue its strong performance.

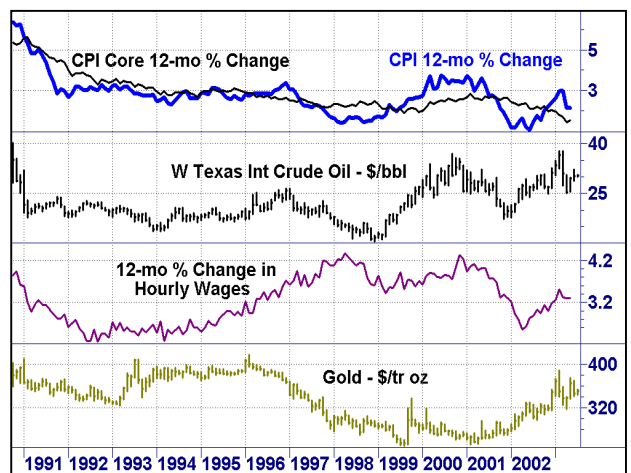
SALES Consumer spending has continued to be the driving force behind our economy, while business spending has hardly picked up from recession levels. Retail sales have remained relatively strong, up only 0.1% in May, but showing a respectable 5.1% gain in 12 months. Though volatile, retail sales have been generally improving since early 2002. Auto and light truck sales have put in a strong, though volatile performance for the past two years. June's sales at an annual rate of 16.4 million were better than any months between 1987 and 1998. Car manufacturers have been offering strong incentives like zero-interest financing to potential buyers for the past 20 months, so it remains to be seen how sales will hold up when these giveaways are no longer available. New home sales hit an all-time high of an annualized 1.157 million units in May. Mortgage rates have fallen lower and lower, making homes more and more affordable, so more buyers continue to come forward to take advantage of the situation. As long as rates stay low, these sales will continue at near-record levels. Unfortunately, business spending is what is not happening today; pessimism about the direction of the overall economy has caused many businesses to cut spending to the bone. That pessimism must be altered before we begin to see the expansion and job creation that our economy sorely needs.



LABOR The labor market is the most important weak spot in our economy today. The unemployment rate rose to 6.4% in June, the highest since 1994, when we were experiencing a slow recovery from a previous recession. Two things need to be mentioned about this: the unemployment rate is a lagging indicator that shows where we've been, not where we're going and 6.4% is not a high rate by historical standards prior to about 1994. Nevertheless, it's a negative indicator of current conditions. Our economy experienced a net loss of 122,000 jobs in the second quarter, more than the 114,000 lost in the first, though the monthly trend appears to be improving, with smaller losses each month than early in the year. The average of weekly initial unemployment claims was 435,000 in the second quarter compared to 406,000 in the first, marking deterioration in a leading indicator. The monthly average in June was 424,000, well above the 400,000 figure marking stability. The middle chart shows claims as a percent of total jobs, as the labor force is larger today than it was at the beginning of the period shown. The average numbers of hours worked slipped to 33.7 for the entire second quarter, equal to the lowest in over 40-years. The average weekly hours worked in manufacturing, another leading indicator, was 40.2 in June, low, but not so extreme in historical terms. Only one indicator of labor conditions shows improving conditions: the Challenger Report of large corporate layoffs fell to 59,715 in June, the lowest such number since November 2000. By comparison, the worst such number was 248,332 in September 2001. Taken all together, the numbers show weak labor market conditions with few signs of improvement.



INFLATION Inflation is not a problem in our economy today, while its opposite, deflation, is considered to be a threat. Our inflation rate measured by the 12-month change in the Consumer Price Index, is 2.5%, while the core rate, which excludes food and energy, is 2.1%. The rate based on the CPI is down from 3.0% in February and March, while the core rate is up from a 38-year low of 1.4% in April. Fears of deflation have arisen from an extended slowdown in the world economy and the lack of a strong recovery by the US economy from the last recession. Just as economic growth that is too fast will eventually create inflation, growth that is too slow has a tendency to be deflationary. Ironically, some of the factors that were beneficial in helping subdue inflation in the past like gains in productivity and globalization are now potentially harmful as they push in the direction of deflation. Another deflationary factor cited above is low capacity utilization. Looking at some of the most important individual factors and



prices, the connection between our CPI-derived inflation rate and the price of oil on the top two charts is striking. The price of oil is projected to decline, as Iraqi oil comes back on line, along with increased production in Nigeria and Venezuela. Hourly wages are important because two-thirds of inflation is said to be due to labor costs. That trend was down until early 2002, when it reversed. Gold is both an indicator of the valuation of the dollar and of inflation. Today, the weaker dollar is more responsible for higher gold prices than the expectation of inflation.

SUMMARY AND OUTLOOK Two key questions are being asked today. Will economic growth accelerate in the last half of 2003? And will the prospects for deflation diminish? The answers are tied together because faster growth will push back the danger of deflation. Some compare our situation today with the early days of the depression of the 1930s, but there is a big difference. After the stock market crash of 1929, the Fed continued with a tight monetary policy, essentially strangling our economy. Today, the Fed has made it clear that it intends to fight deflation with loose monetary policy, using all the tools at its disposal. It has already cut short rates to near zero and it can also buy US bonds on the open market and drive down long interest rates, something it has not done before. Furthermore, the Fed has made it clear that it will not take away the punch bowl immediately when the economy picks up and the party starts to get lively. Some indications in the financial markets point to improved growth: the continuing stock market rally and the increase in long interest rates over the past two weeks. The stock market tends to look out something like six months in the future, so if that indication is correct about the future, we should see the economy much stronger by the end of the year. Bond yields tend to rise mainly from two expectations: an increase in inflation, which is not bad news at this point, and an increase in economic activity and demand for loans, which is good news. Though these indications are not always right, at least they are pointing in a good direction. Geopolitical events have calmed down and now it is business confidence rather than consumer confidence that must improve. What is needed more than anything else to get our economy moving is for businesses to get past the prevailing pessimism and be willing to spend for expansion and hiring.