MARTIN CAPITAL ADVISORS
QUARTERLY ECONOMIC REVIEW

by Alston Boyd, Economic Director   January 11, 2009

Market and Economic Statistics

As of Market Close
End of 4th Quarter
December 31, 2008

3rd Qtr '08, Final		3m ch	12m ch
GDP-Bil Chained$	524	-0.5% apr	0.7%
GDP Deflator	123.1	3.9% apr	2.5%
Empl Cost Index	109.1	0.7%	3.0%
NF Productivity	142.3	1.3% apr	3.2%

Stock Indexes*		3m ch	12m ch
Dow Industrials	8776	-19.1%	-33.8%
S&P 500	903	-22.5%	-38.5%
NASDAQ Comp	1577	-24.3%	-40.5%
NASDAQ 100	1212	-23.5%	-41.9%
NYSE Comp	5757	-23.6%	-40.9%
Wilshire 5000	9087	-23.5%	-38.7%
Russell 2000	499	-26.5%	-34.8%

* stock index % changes exclude dividends

Interest Rates		3m ch	12m ch
10-yr T-Note Yld	2.24%	-1.60%	-1.79%
3-mo T-Bill Rate	0.08%	-0.81%	-3.15%
Treas Spread 10y-3m	2.16%	-0.79%	1.36%
Fed Funds Target	0.13%	-1.88%	-4.13%
Prime Rate	3.25%	-1.75%	-4.00%
FNMA 30-yr mortg	4.53%	-1.38%	-1.58%
S-L Long T-Bnd Ind	19043	17.11%	25.06%

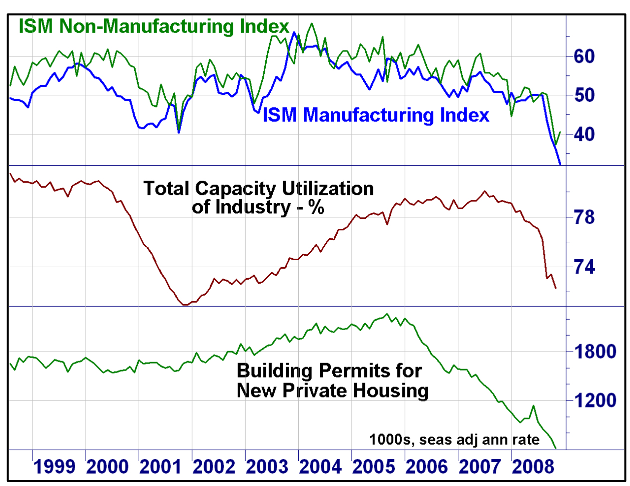
Prices, Inflation		3m ch	12m ch
CPI-U, Nov	213.1	-2.7%	1.0%
CPI Core, Nov	216.8	0.1%	2.0%
PCE Core Defl, Nov	117.6	0.1%	1.9%
Gold, cash $/tr oz	881.7	1.2%	5.8%
W Tx Int Cr Oil $/bbl	44.60	-55.7%	-53.5%
Copper, $/lb	1.40	-51.7%	-54.0%
CRB Futures Ind	229.5	-33.6%	-36.0%

Industry			
ISM Manuf Ind, Dec	32.4	-11.1	-15.3
ISM Services, Dec	40.6	-9.6	-13.3
Capacity Utiliz, Nov	75.4%	-2.9%	-5.7%
Bldg Permits, Nov	616K	-28.1%	-48.1%

Sales			
Total Retail-$B, Nov	352.6	-7.0%	-7.5%
Ttl ex Autos-$B, Nov	293.2	-5.9%	-3.8%
Autos-Mil Units, Dec	10.3	-17.5%	-35.6%
New Homes, Nov	407K	-9.2%	-35.3%

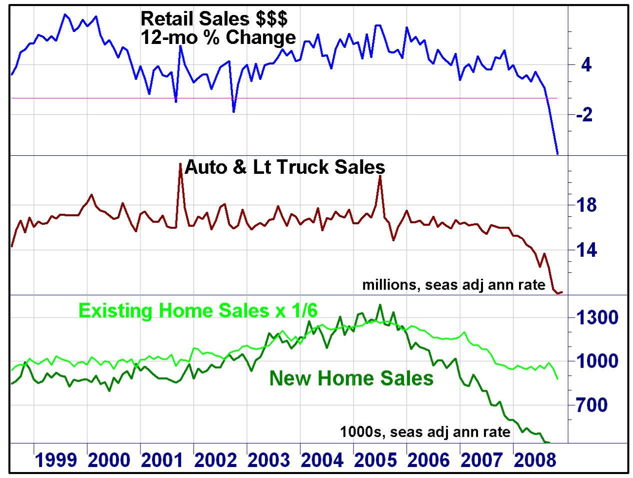
Labor - Dec'08			
Unemployment Rate	7.2%	1.1%	2.2%
Non-Farm Jobs Chg	-524K	-1531K	-2589K
Avg Init Unempl Clms	552K	375K	346K
Avg Hourly Wages	18.36	1.0%	3.7%

Final GDP figures for the 3rd quarter of 2008 showed an annualized contraction of 0.5%, with growth of just 0.7% in 4 quarters. The 4th quarter just completed likely saw annualized contraction between 2.5% and 4.0%, with the total change for 2008 right around zero. GDP in the 1st quarter of 2009 is projected to shrink at an annualized rate of about 2.5%. The equity market has suffered tremendously in this situation, with the largest declines over 12 months in major stock indexes since 1931. Interest rates have plummeted as the Fed cut rates and prospects for growth in most of 2009 simply have been blown away. The brightest spot to be seen is the market for Treasury-backed securities, as investors fled to that safe haven. Industry has been devastated as demand for most products has fallen sharply. Sales of homes and autos have hit lows not seen for over 20 years. Employment figures reflect huge job losses and a rapidly rising unemployment rate. Many of the statistics represent extremes not seen for decades.



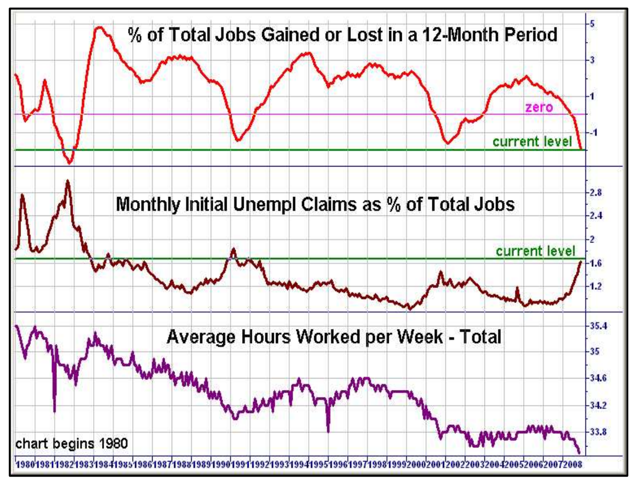
INDUSTRY The manufacturing sector has been hit particularly hard by the recession. The ISM Manufacturing Index fell to 32.4 in December, a 28-year low, with 10 components showing contraction and only one showing expansion. The price component fell to 18.0 on a scale of 100. More importantly, since services make up a much larger part of our economy, the ISM Services Index rose 3.3 to 40.6, but with nine of ten components showing contraction. Total capacity utilization of all industries fell to 75.4% in November, down 5.7% in 12 months in the sharpest, though not the deepest, drop since 1981. Orders for durable goods were down 13.7% in 12 months, while durables excluding transportation were down only 6.2%, reflecting in part weakness in the auto industry. As the recession continues to worsen, consumers have been less inclined to buy expensive items, which partially explains why sales of autos and homes have slowed dramatically. Other reasons for the huge drop in home construction are the lack of home mortgages and the big inventory of existing homes for sale. Housing starts are now less than a third of the peak in 2006.

SALES Total retail sales started a drastic decline in June, and are now down 6.7% through November on a year-over-year basis, the largest such negative change in at least 40 years. While a large part of this drop in sales dollars was due to the fall in gasoline prices, the main cause was consumers preferring to hold onto their cash rather than spend it in the uncertain times we face now. Holiday sales were weak, putting pressure on prices of virtually all items from clothes to electronics. Auto and light truck sales have been very weak, mostly due to consumers not wanting to spend, but also due to a lack of available financing. While numbers of sales have declined, the mix of vehicles being sold has also changed toward fewer large, expensive models and more less expensive, high-mileage cars. The large, expensive models tend to have higher profit margins and vice-versa for smaller, cheaper models, so vehicles sold and profit margin per vehicle have both come down. Home sales have suffered the most in the downturn. Our current economic problems began as the housing bubble popped and huge numbers of home loans that had been packaged and sold turned out to be nearly worthless. Not surprisingly, home sales suffered even more when loans became hard to get and home prices dropped.

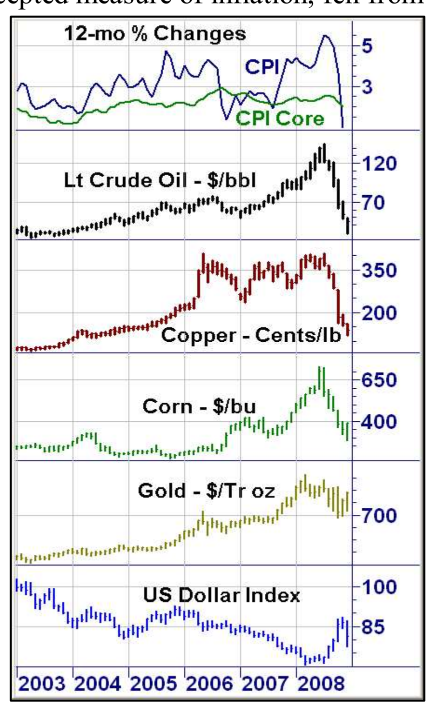


It appeared that existing home sales numbers had stabilized between October 2007 and October 2008 at a rate of about 5 million per year, roughly the same as 1998 through 2000, but November showed a drop of 10% from that level. New home sales have fared much worse than existing home sales, down 71% from the peak in 2005, while existing home sales are down "only" 38%. With big inventories of existing homes on the market and loans hard to get, many homebuilders have completely shut down. Though usually with only about 1/6th the number of sales, new homes have a bigger impact on the economy because of the materials used and jobs dedicated to building them.

LABOR The loss of 2.59 million non-farm jobs in 2008 represents the largest portion of total jobs lost since 1983, 1.9%, and more than half of those were lost in the 4th quarter. This puts the gravity of the current situation in perspective. Weekly initial unemployment claims averaged 551,500 in December, which as a percentage of total non-farm jobs was the worst since 1991. Average hours worked per week have been in decline for many years, but December marked a historic new low of 33.3, down a half an hour in 12 months. Average hours worked in manufacturing fell to 39.9, down 1.2 hours in 12 months, an even larger drop. The national unemployment rate jumped 0.5% to 7.2% in December, up 2.2% in a year. Virtually all labor statistics point to a weaker economy with none pointing in a positive direction yet.



INFLATION The 12-month change in the Consumer Price Index, the most widely accepted measure of inflation, fell from 5.5% in June to 1.0% in December, the steepest 6-month drop for that indicator since 1950. The chart shows the drop in prices of oil, copper and grain, which helped cause the change in the overall inflation rate. The sudden decline in inflation resulted from the economic slowdown, in turn caused by the financial meltdown that began with the sub-prime loan crisis. As major banks and other financial institutions became shaky and were taken over or failed, lenders virtually quit lending, either to each other, to businesses or to individuals. With lending essentially shut down, the world economy went into a tailspin that has not ended yet. The exception to the rule of falling commodity price declines is gold, which is being bought for purposes of financial security, just as US Treasury securities are being bought for the same reason.



SUMMARY AND OUTLOOK We're faced today with a deep recession, already as bad as any we've seen for several decades, involving contraction in industry, sales, labor and price inflation. In other words, virtually all parts of the US economy and the world economy, as well, are affected. Conditions will likely get worse before they get better, particularly with regard to jobs.

However, the present financial and economic picture is complex and is changing rapidly. Banks, which were afraid to lend to each other a few months ago, are now lending relatively easily, thanks to injections of cash by the Fed. The Fed has cut rates to almost zero, which makes loans advantageous to borrowers, and is in the process of reliquifying the economy as fast as it can. With Congressional approval, the Treasury is making available more than $700 billion to fix banks and other major financial institutions and pushing to make funds available for buying homes through Fannie Mae and Freddie Mac. Mortgage rates on new homes are now down to historic lows below 5%. In addition, Congress is likely to pass tax cuts for individuals and businesses. The total amount of liquidity injected into our economy in various ways will probably top $2 trillion. These actions by the government are without precedent in size and variety and the economic pump is being primed like never before in history. On top of all that, the decrease in the price of gasoline has acted like a tax cut, leaving more money in consumers' pockets. It typically takes between 12 and 18 months for Fed's actions to have a noticeable effect on the economy and, consequently, the current weak economic conditions will most likely begin to improve by late 2009.

The massive flow of funds to banks (at least those helped by the government) and low interest rates will help most banks' balance sheets and restore lending to credit-parched businesses and individuals. First among recoveries will likely be the banking and housing industries and perhaps auto sales. The housing industry was the first to turn down and is so depressed now that the demand created by low mortgage rates could create a big turnaround. There's a huge inventory of existing homes and foreclosures continue at a rapid rate, but lenders are more in a position to sell assets cheaply and low mortgage rates will bring in buyers to take advantage of the bargains. A lot of our nation's wealth is in real estate, so this is a key factor.

What happens after the recovery? If the unprecedented amount of fiscal and monetary stimulation brings about an economic recovery quickly, it could also bring extraordinarily rapid growth, and with it a potential new round of inflation. The Fed tends to react late to such things and we must keep a sharp eye out for this in 2010 and beyond.