THE COMPASS

A QUARTERLY NEWSLETTER FROM MARTIN CAPITAL ADVISORS, LLP

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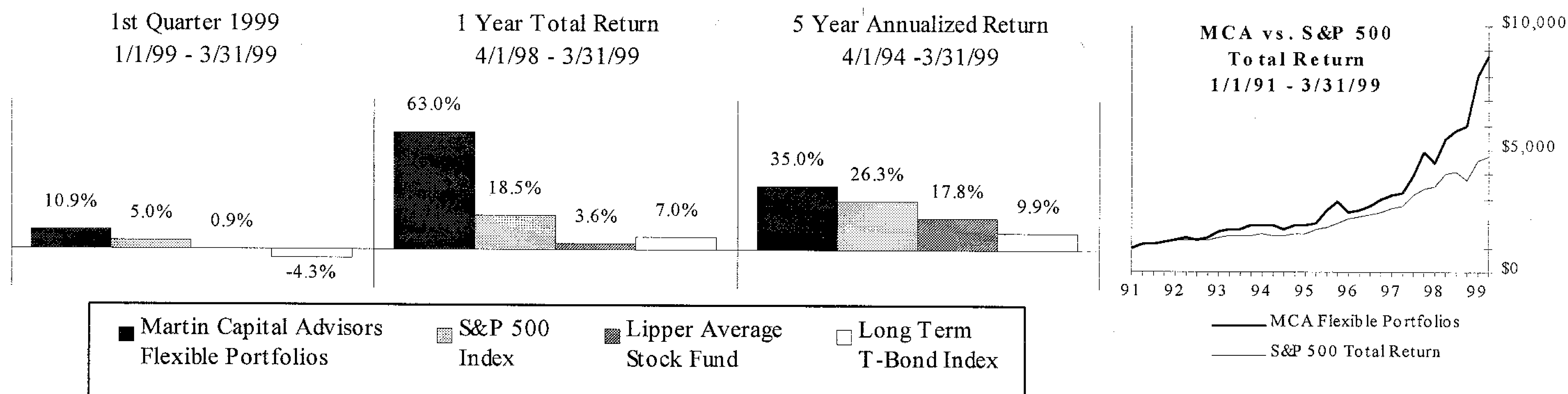
April 1, 1999

Investment Results



MCA Flexible Portfolio 12 Month Tax Efficiency: 97.1% (After Tax Return divided by Before Tax Return)

Investment Perspective

The stock market held up better than expected during the first quarter. Some consolidation of recent gains had been anticipated, but the resiliency of the bull market continues to make it very difficult to time corrections. Fortunately, we did not react to the possibility of a pull-back and were able to capitalize on the market advance. Conversely, the bond market did not fare as well as expected, despite persistent benign inflation statistics. Inflation paranoia continues to keep interest rates well above historical norms relative to inflation.

The beginning of the second quarter may see more of the same for stocks and bonds. As the quarter progresses, however, there is a good chance that the stock market may give back some of its gains. Interest rates are more difficult to predict, but barring further significant increases in oil prices, there is a fair chance that rates will be somewhat lower by the end of quarter. Once again, as discussed in the last newsletter, we plan to remain fully invested throughout the second quarter, despite greater short-term risks of a stock market sell-off. As the stock market moves higher, however, we will consider using incremental hedging strategies. We continue to be much more afraid of missing out on the long-term upside potential of the stock market than worried about potential short-term setbacks.

The *Martin Capital U.S. Opportunity Fund* began operations at the end of March. The fund is managed the same as our flexible portfolios. The minimum investment is one thousand dollars. A prospectus is available on request. The *Austin* and *Texas Opportunity Funds* should be available for purchase by the end of the summer.

Once again, Nelson's *World's Best Money Managers* (http://www.nelnet.com) has rated *Martin Capital Advisors* #1 in U.S. Tactical Asset Allocation and U.S. Balanced/Multi-Asset classes for one, three, and five year periods ending December 31, 1998. An independent performance review for 1991 through 1998 by the certified public accounting firm *Jeff D. Heard, Jr., P.C.* is available on request.

Market Timing Viewpoint

Recommended Tactical Asset Allocation

Stocks 90% (Δ UNCH) Bonds 10% (Δ UNCH) Cash 0% (Δ UNCH)

Performance Expectation

	June 30, 1999		December 31, 1999		December 31, 2003	
	Target	% Change	Target	% Change	Target	% Change
DJIA/S&P 500	10050/1320	+ 02.5%	10750/1410	+ 10.0%	20500/2750	+ 110.0%
Nasdaq Comp.	2585	+ 05.0%	2830	+ 15.0%	6000	+ 150.0%
30 Year T-Bond	5.30%	+ 05.0%	5.00%	+ 10.0%	4.00%	+ 40.0%

20 Largest Common Stock Positions

(Prices as of March 31, 1998)

1 Dell Computer	40.88	6 Applied Materials	61.69	11 Hewlett-Packard	67.81	16 Sprint	98.13
2 Charles Schwab	96.13	7 Texas Instruments	99.25	12 Tiffany	74.75	17 Motorola	73.25
3 Microsoft	89.63	8 Home Depot	62.25	13 Williams-Sonoma	28.25	18 Citigroup	63.88
4 Cisco Systems	109.56	9 Southwest Airlines	30.25	14 Whole Foods Mkt	34.38	19 Enzon	14.75
5 Intel	118.88	10 Sun Microsystems	125.06	15 Oracle	26.38	20 Starbuck's	28.06

Investment Philosophy

Our investment approach focuses on the reality that in order to achieve long-term superior performance there must be an acceptance of some amount of short-term risk. With this in mind, we pursue an investment allocation strategy emphasizing a diversified mix of stocks and bonds - structuring our clients' portfolios according to their ability to withstand short-term volatility in the pursuit of long-term investment returns.

Both fundamental and technical factors are taken into account in determining a prospective investment's risk-reward ratio. Socially responsible issues, such as environmental policies and employee relations, are evaluated as part of our investment risk assessment.

Overall market risk is considered in the timing of investment decisions and the implementation of hedging strategies. The reduction of investment exposure during periods of high market risk, and the complementary increase of investment commitment during periods of low risk, should normally reduce volatility and enhance portfolio performance.

Our general goal, which will vary depending on market conditions and individual client risk tolerance, is a 15% to 20% average annual return over the course of a five year period or market cycle. We expect this goal can be achieved with minimized volatility through our combination of risk-reward analysis and market timing strategies.

Comparison of Investment Results

		Performance of Relevant Indexes					
	Martin Capital Management*	Dow Jones Industrial Average	S&P 500 Index	Wilshire 5000 Index	Long-Term T-Bond Index	Money Market Avg. Yld.	Consumer Price Index
1991	+ 33.9%	+ 24.5%	+ 30.6%	+ 34.2%	+ 18.5%	+ 5.2%	+ 3.1%
1992	+ 26.8%	+ 8.0%	+ 7.7%	+ 9.0%	+ 8.0%	+ 3.3%	+ 2.9%
1993	+ 14.5%	+ 18.1%	+ 10.0%	+ 11.3%	+ 17.3%	+ 2.7%	+ 2.7%
1994	- 2.1%	+ 5.9%	+ 1.3%	- 0.1%	- 6.9%	+ 3.8%	+ 2.7%
1995	+ 27.5%	+ 36.9%	+ 37.6%	+ 36.5%	+ 30.7%	+ 5.5%	+ 2.5%
1996	+ 29.4%	+ 29.1%	+ 23.0%	+ 21.2%	- 0.8%	+ 5.0%	+ 3.3%
1997	+ 41.4%	+ 24.9%	+ 33.4%	+ 31.3%	+ 15.1%	+ 5.1%	+ 1.7%
1998	+ 78.8%	+ 18.1%	+ 28.7%	+ 23.4%	+ 13.5%	+ 5.0%	+ 1.5%
1999 YTD	+ 10.9%	+ 7.0%	+ 5.0%	+ 3.8%	- 4.3%	+ 1.1%	+ 0.4%
Total**	+780.2%	+369.7%	+377.4%	+352.3%	+126.3%	+ 43.1%	+ 22.8%
Avg.***	+ 30.2%	+ 20.6%	+ 20.9%	+ 20.1%	+ 10.4%	+ 4.4%	+ 2.5%

* Total Annual Performance, net of commissions, fees, and expenses, of all Martin Capital Management flexible investment portfolios.
Audited 1991 through 1998 by Jeff D. Heard, Jr., P.C., Certified Public Accountants.

** Total compounded return, including reinvestment of dividends and interest.

*** 1991 – 1999 annualized return.

(AIMR performance presentation is available on request. / Past performance does not guarantee future results.)

Martin Capital Management is a registered investment advisor, managing discretionary investment portfolios for individuals, trusts, and pension plans.

MARTIN CAPITAL ADVISORS
QUARTERLY ECONOMIC REVIEW

by Alston Boyd, Economic Director

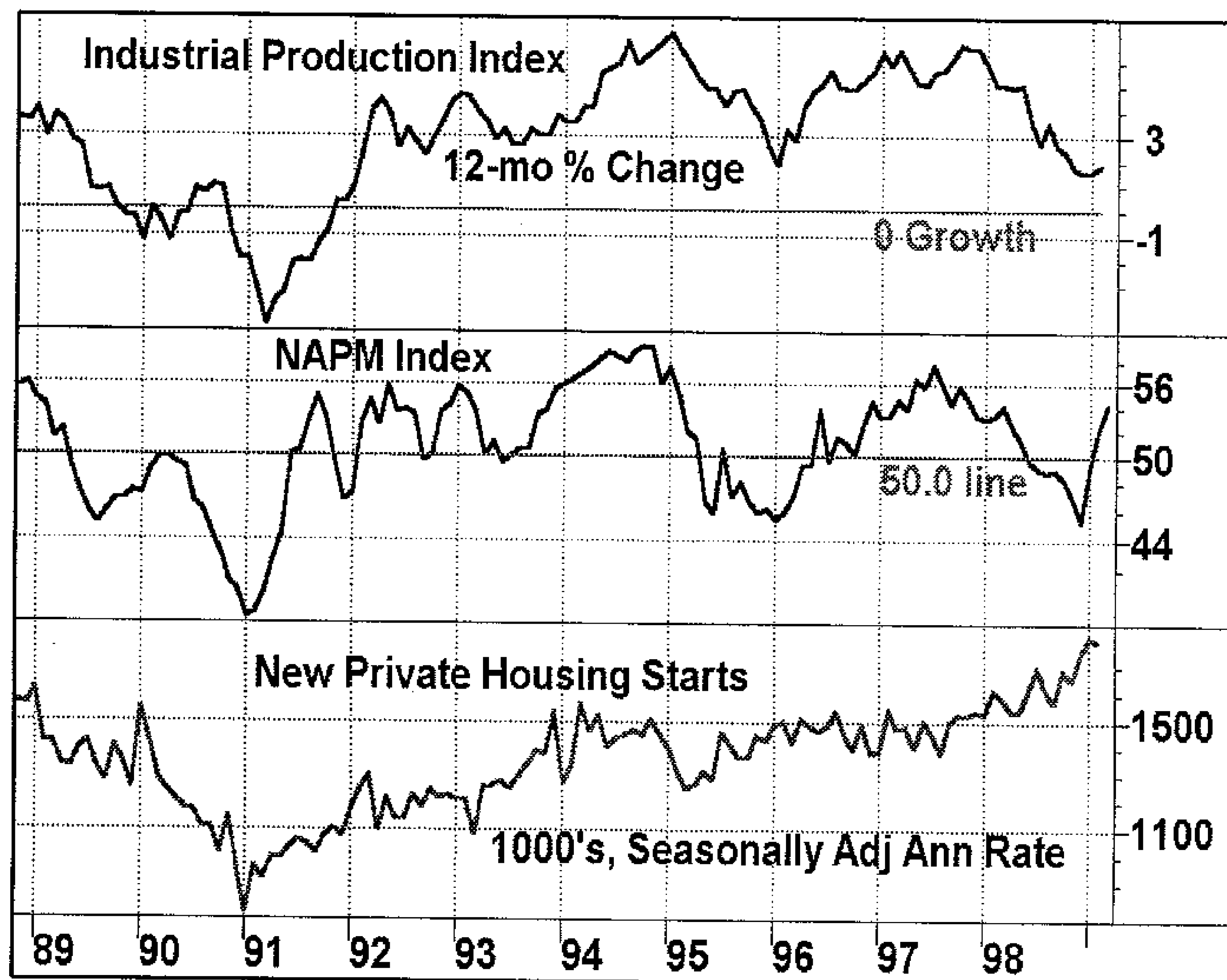
Market and Economic Statistics as of Market Close on March 31, 1991, with 3-month & 12-month Changes

Stock Indices*		3 mo	12 mo	Interest Rates		3 mo	12 mo	Prices, Inflation		3 mo	12 mo
Dow Industrials	9786	6.6%	11.2%	91-day T-Bill DR	4.35%	-0.5%	-13.0%	CPI, Feb	164.5	1.2% ap	1.6%
S&P 500	1286	4.6%	16.8%	30-yr T-Bond Yld	5.62%	10.4%	-5.5%	PPI, Feb	130.9	0.3% ap	0.5%
NASDAQ Comp	2461	12.3%	34.1%	FNMA 30yr mortg	7.00%	5.1%	-1.0%	Gold, cash - H&H	279.8	-3.1%	-7.0%
NASDAQ 100	2106	14.7%	72.5%	Prime Rate	7.75%	0.0%	-8.8%	W Tx Int Cr Oil	16.79	39.9%	5.9%
NYSE Comp	605	1.5%	5.6%	Fed Funds Trgt	4.75%	0.0%	-13.6%	Copper. cash	0.62	-6.1%	-21.5%
Wilshire 5000	11708	3.4%	11.6%	Fed Disc Rate	4.50%	0.0%	-10.0%	CRB Futures Ind	191.3	0.0%	-16.4%
Russell 2000	398	-5.8%	-17.3%	S/L Long T-Bnd Ind	8303.8	-4.3%	7.0%	CRB Raw Indust	256.8	-3.2%	-14.5%

* excluding dividends

Money				Industry				Economy			
M2, Bil Curr$, Feb	4447	1.9%	8.4%	Indust Prod Ind, Feb	132.6	0.3%	1.9%	GDP-Bil$, 4th Qtr	7678	6.0% ap	4.3%
Free Reserves	1122	-32.9%	-8.4%	NAPM Ind, Mar	54.3	9.0	0.1	Unemplmnt %, Mar	4.2	-0.1	-0.5
Money Mkts - Bil$	1459	4.7%	26.8%	Cap Util, Feb - %	80.3	-0.6%	-2.8%	Empl Cst Ind, 4th Qtr	140	2.8% ap	3.3%
US $$$ Index	100.10	6.4%	-1.4%	Bldg Permits - Feb	1745	5.4%	6.7%	Leading Indic, Feb	107.1	3.4% ap	1.8%

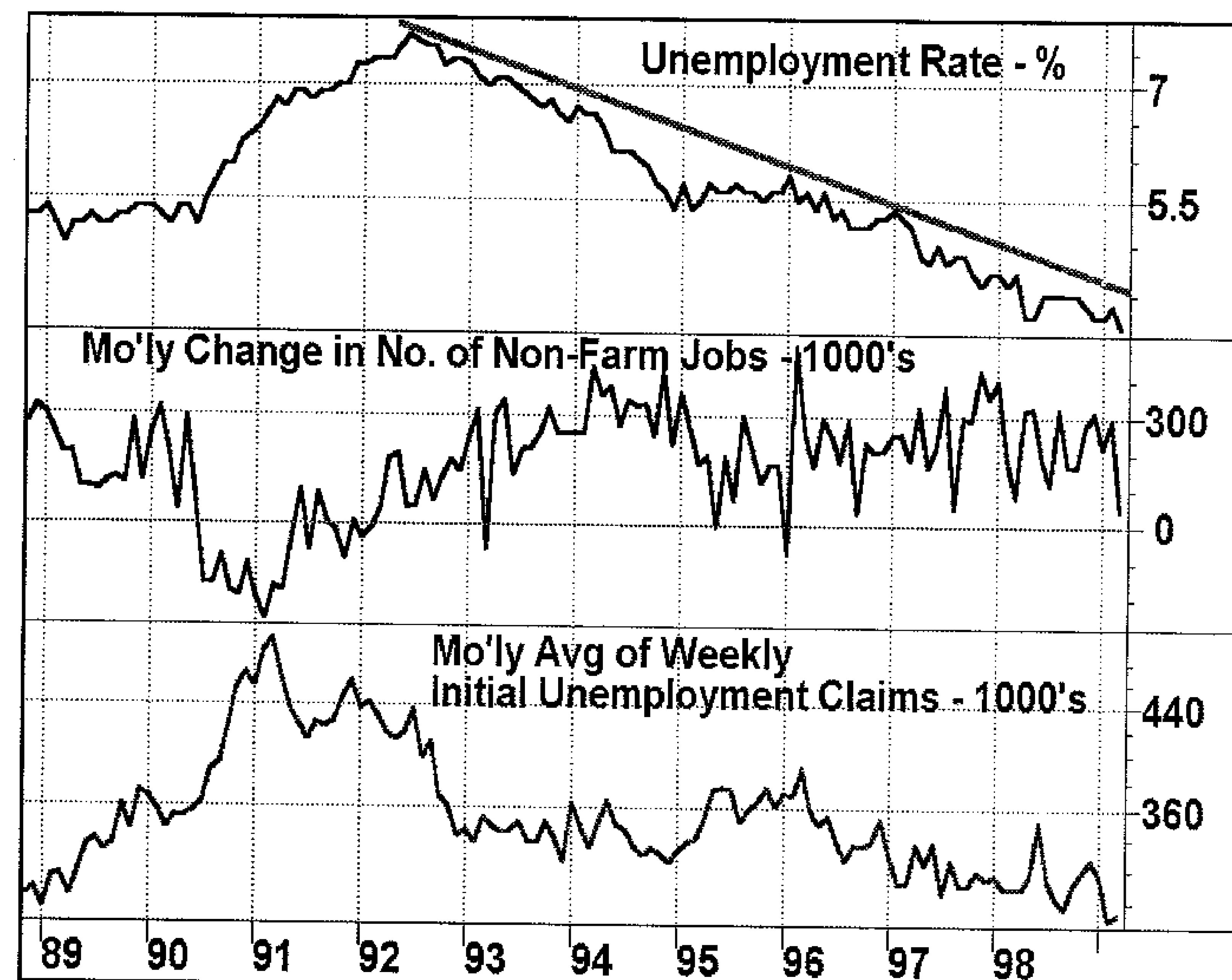
The difference in performance between the NASDAQ 100 and Russell 2000 stock indices has been extreme, illustrating an extraordinarily uneven equity market. The former index represents mostly high-tech stocks, and the latter small cap issues. Short interest rates have remained very stable over the past three months after having dropped last year. Long interest rates have risen sharply during the past quarter, a fact that masks the even larger decrease that took place in the first nine months of last year. The inflation rate has remained very low over the past 12 months, both on the wholesale and retail levels. The CRB commodity price indices show a strong decline over the past 12 months, which is strikingly different from the nearly 40% increase in the price of oil.



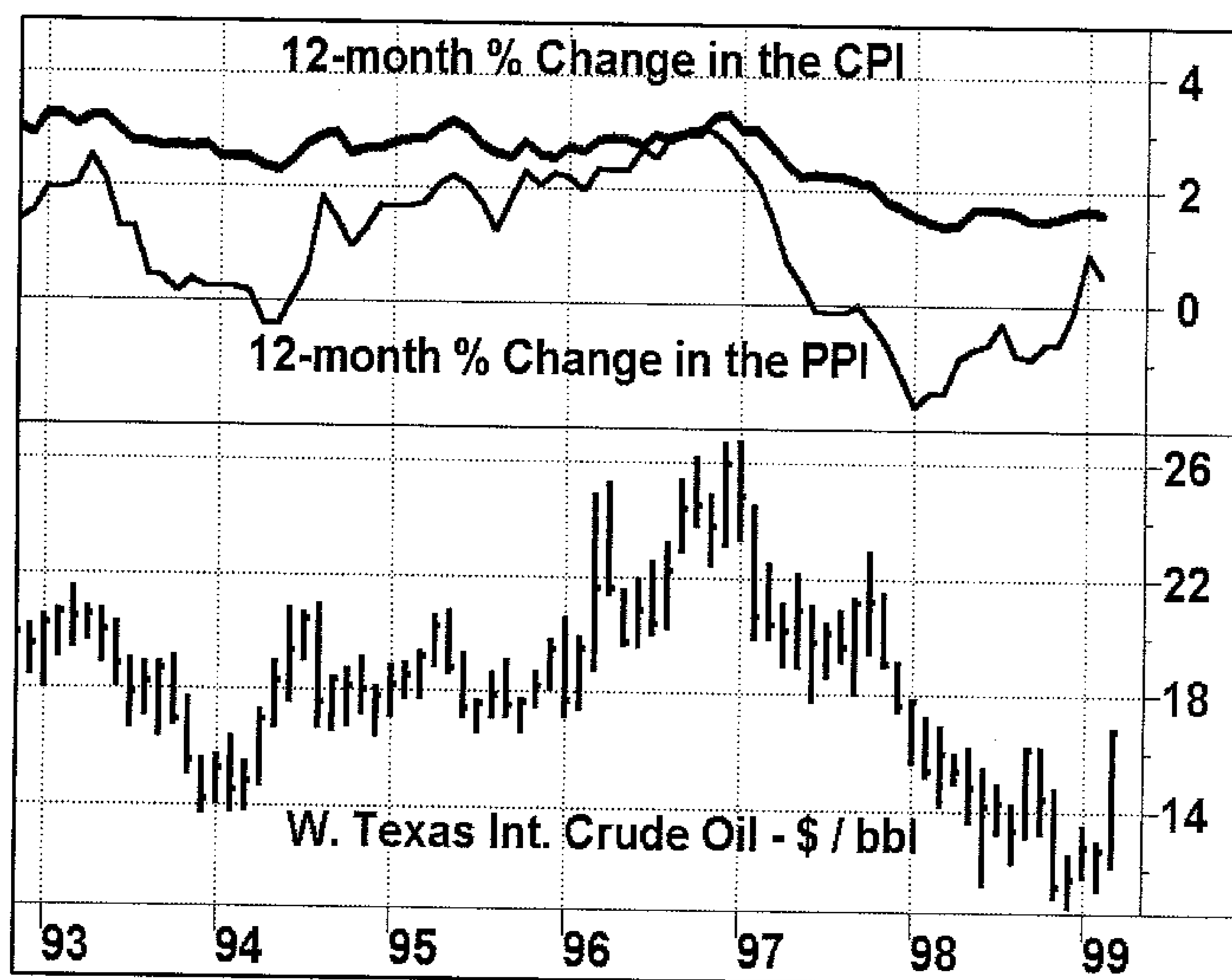
INDUSTRY The manufacturing sector of our economy appears to have gained considerable strength in the first quarter, at least according to one important indicator. The North American Purchasing Managers Index has risen nine points during the first three months of this year to 54.3. This three-month change brought it from well below the 50.0 line dividing contraction from expansion to well above it in one of the biggest jumps since the end of the last recession. The 12-month change in the Industrial Production Index through February, however, only shows a slight upturn. The March figures will probably show more of a change when they come out in mid-April. In February, capacity utilization for manufacturing alone and for all of industry stood at 79.5% and 80.3%, respectively. These are the lowest levels since 1992, when the economy was still recovering from a recession. Trends of both capacity utilization measures remain downward with no sign yet of any reversal. The bright spot in the industrial sector over the past year has been construction, led by single family homes. Building permits and starts of new single family homes have reached the highest levels since 1986. The extremely low rate of inflation has brought interest rates down to lows not seen in decades, helping buyers to afford monthly mortgage payments for new homes. At the same time, a low unemployment rate helped bring job security and a high level of consumer confidence. This confidence in having a bright future has encouraged many individuals to step out and make the biggest purchase of their lives: a new home.

SALES Sales figures have been consistently strong across the board recently. Total retail sales were up 7.1% over the 12 months ending in February, close to the highest rate of increase in the past four years. In addition, the average annual rate of auto and light truck sales over the past six months is 16.1 million units, the highest in 12 years. Sales of new single-family homes have been the strongest of all relative to historical performance: the six-month average has reached an all-time high annual rate of 918,000. The numbers fell slightly to 881,000 in February after setting a record last November with an annual rate of 1,002,000. Consumers have been the driving force behind our economy during the past year, as Asian problems have held back manufacturing and exports. The purchasing power of consumers has been provided by lots of good-paying jobs with security, the result of our strong labor market.

LABOR Our labor market remains tight with an unemployment rate of 4.2% for March, the lowest since February of 1970. While the net gain in the number of non-farm jobs only rose by 46,000 in March, weather was largely the culprit. February's good weather in effect stole jobs from a March with terrible weather in many areas. As a result, construction suffered the loss of 47,000 jobs in March, compared to the previous month's gain of 79,000 in that sector. While a remote possibility exists that higher interest rates have had some impact on housing, bad weather undoubtedly had far more. Many analysts have looked at the small number of jobs added in March and concluded that it represents a change in the long trend toward a tighter labor market. More important, I believe, is the evidence supporting the continued strength of the labor market found in the low numbers of weekly initial unemployment claims. The February and March monthly averages of 291,000 and 293,000 per week are the lowest such numbers in ten years. In spite of the tremendous amount of corporate restructuring going on these days, fewer workers are losing their jobs without being able to find new ones. It is largely this security of being able to find a new job if one loses the present one that has raised consumer confidence to near-record levels. With an annual rate of new job creation holding close to 3,000,000, lots of new paychecks are pouring into our economy, further stimulating consumer spending. If this trend continues, our economy should continue to be boosted by more free-spending consumers. While shortages of trained workers are appearing in a few sectors and causing wages to go up here and there, no overall upward surge in labor costs has yet occurred. Productivity has increased at a rapid rate so that the wage increases that have occurred so far have had any inflationary effects largely cancelled out by more efficient use of labor. The high-tech revolution is largely responsible for this increase in productivity.



INFLATION The overall rate of inflation in our economy has remained very low over the past year. As economic problems in Asia led to a drastic slowing of demand for raw materials and finished products, prices slid across the board, continuing a trend that had already begun. Those broad price declines have helped keep our rate of inflation considerably lower than otherwise might have been the case. Wholesale prices, which are closely related to raw materials prices, are rising only 0.5% a year according to the Producer Price Index. The overall rate of inflation in our economy indicated by the 12-month change in the Consumer Price Index is 1.6%. The GDP Deflator, a broader indicator calculated quarterly, showed an inflation rate of only 0.8% for the fourth quarter of last year. The moderation in the rise of wholesale prices and of prices at the retail level has been partly the result of the steady drop in oil prices that has taken place since early 1997. The steepest part of the decline came after the economic debacle in Asia. In response to oil prices falling to lows not seen since 1977, OPEC has agreed to cut oil production by 2 million barrels per day. In anticipation of curtailed oil supplies, the price has run up about 60% off its lows last February of $10.80/bbl to nearly $17.00/bbl. It is doubtful that OPEC will entirely hold to their agreed production cuts, judging from past performance. Nevertheless, such a large and sudden increase in oil prices will inevitably have an inflationary impact, provided that OPEC manages to cut back on production to a significant degree.



SUMMARY AND OUTLOOK The U.S. economy grew at the rapid annual rate of 6.0% in the last quarter and at a 4.3% rate over all of 1998. Growth rate in the first quarter of 1999 appears to have been hardly any slower, although figures are not yet available to confirm this. Consumer purchasing seems to have remained as strong as before, while manufacturing probably gained momentum. Construction remained as strong as in late 1998. The future appears to hold conflicting forces, some promoting weakness and some promoting strength in the economy. Higher oil prices will take money away from other consumer purchases, as will higher interest rates. Higher interest rates will also have at least some negative impact on the construction industry. The growth rate of the money supply seems to be coming down, another factor that will tend to slow the economy. Free reserves in the banking system have dropped, another kind of reduction in liquidity. On the other hand, the beginning of an Asian recovery could add strength to our economy. If I am right about continued strength in the job market, consumer purchases will not be cut back enough to have a serious, negative impact. If the job market contracts instead and consumer spending is therefore cut back, the economy will slow some more, although with little to no chance of slipping into a recession. Under either scenario of a stronger or weaker labor market, the outlook for the U.S. economy is good, with the expectation of moderate to strong growth.