THE COMPASS

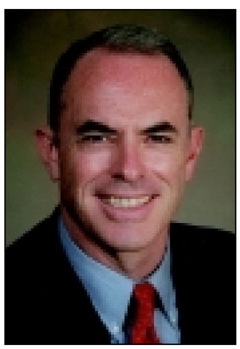
First Quarter, 2000

A Quarterly Newsletter of Martin Capital Advisors, LLP

INVESTMENT PERSPECTIVE by Paul Martin, Managing Partner

1st quarter pullback may follow rally

Fourth-quarter stock market returns surpassed expectations. As the quarter began, conflicting forces had the potential to drive prices up or down. Fortunately, these forces resolved with a positive bias as the quarter progressed. Investors correctly perceived that the Y2K bug would not bite, and chose to focus on positive earnings forecasts over inflation concerns, resulting in an impressive year-end rally. The bond market, however, could not ignore inflation fears, and continued the downward trend established at the beginning of the year.

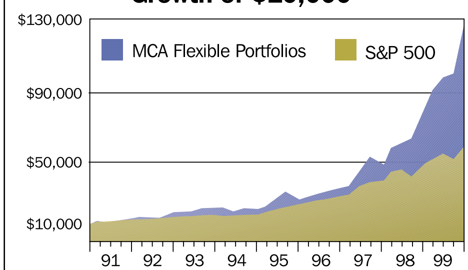


The first quarter should see some weakness hit the stock market as liquidity dries up in the face of realized-gain selling and the normal beginning of the year delay in retirement plan contributions. By the middle of January liquidity should turn positive, setting off the perennial "January effect" stock market rally. By the middle of the quarter liquidity conditions may deteriorate again to the point of creating substantial short-term risk to the stock market. Bonds may perform inversely to stocks, beginning the quarter with further weakness, then finishing the quarter with strength as stocks pull back. We will hedge equity positions by the middle of the quarter if the stock market advances as anticipated.

Whatever happens during the first quarter, the great bull market will not lose its footing for the long run. The triad of the expanding global economy, high technology advances and positive baby boom demographics will benignly influence corporate earnings and inflation over time.

The key to doing well in the financial markets for the next ten years will be to keep in mind that market performance is ultimately driven by economic conditions. As long as sound arguments can be made for above average growth with low inflation, the stock market will continue to achieve above average performance. The only extended periods of time in which stocks have performed poorly against other asset classes in the past century were during extremes of severe deflation or inflation. It would be difficult to make a case for either of these extremes to occur in the near future. Therefore, the best approach to investing is to stay on track with what has worked with only two exceptions over the past one hundred years – riding the stock market's long-term upward trend.

Growth of $10,000



Martin Capital Advisors vs. S&P 500
1/1/91–12/31/99

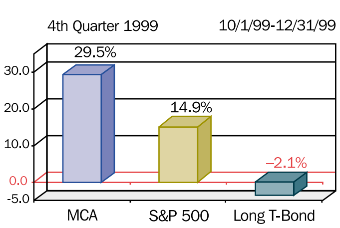
See Important Disclosure Notice on back page.

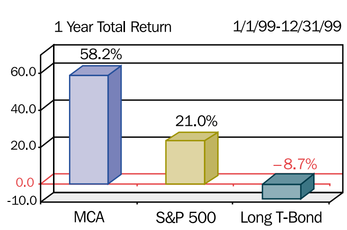
The Martin Capital Marathon Fund, LP, a hedge fund for accredited investors, began operations at the end of the year. This fund will focus on core equity exposure coupled with increased use of options and leverage for periodic market timing. Please contact us for further information.

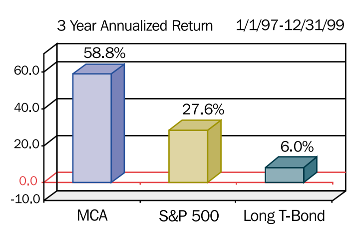
MCA Flexible Portfolios
12-month Tax Efficiency: 98.4%
(After Tax Return divided by Before Tax Return)

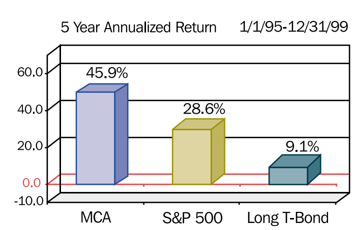
INVESTMENT RESULTS

Martin Capital Advisors Flexible Portfolios vs. the S&P 500 Index and the Lehman Brothers Long Treasury Bond Index









See Important Disclosure Notice on back page

MARTIN CAPITAL
ADVISORS

QUARTERLY ECONOMIC REVIEW by Alston Boyd, Economic Director

Market and Economic Statistics
as of Market Close on Dec. 31, 1999,
with 3-month and 12-month changes

3RD QUARTER

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
Dow Industrials	11497	11.2%	25.2%
S&P 500	1469	14.5%	19.5%
NASDAQ Comp	4069	48.2%	85.6%
NASDAQ 100	3708	54.0%	102.0%
NYSE Comp	650	9.7%	9.1%
Wilshire 5000	13813	17.9%	22.0%
Russell 2000	505	18.1%	19.6%

*excluding dividends

INTEREST RATES		3 mo	12 mo
91-day T-Bill DR	5.19%	7.5%	18.8%
30-yr T-Bond Yld	6.48%	7.3%	27.3%
FNMA 30yr mortg	8.08%	2.8%	21.3%
Prime Rate	8.50%	3.0%	9.7%
Fed Funds Trgt	5.50%	4.8%	15.8%
Fed Disc Rate	5.00%	5.3%	11.1%
S/L Long T-Bnd Ind	7921	–2.1%	–8.7%

PRICES, INFLATION		3 mo	12 mo
CPI, Nov	168.4	0.7% apr	2.6%
PPI, Nov	135.0	1.3% apr	3.3%
Gold, cash	288.5	–3.1%	–0.1%
W Tx Int Cr Oil	25.60	4.6%	113%
Copper, cash	0.85	4.0%	29.2%
CRB Futures Ind	205.1	0.0%	7.3%
CRB Raw Indust	268.9	–1.5%	1.3%

MONEY			
M2, Bil Curr$, Nov	4267	1.3%	6.0%
Free Reserves	832	–3.1%	–43.2%
Money Mkts - Bil$	1621	8.4%	16.3%
US $$$ Index	101.9	3.4%	8.3%

INDUSTRY			
Indust Prod Ind, Nov	139.5	1.3%	4.3%
NAPM Index	55.5	–2.3	10.2
Cap Utiliz, Nov	81.0%	0.3%	0.1%
Bldg Permits, Nov	1614	–0.3%	–2.4%

LABOR			
Unemployment Rate	4.1%	–0.1%	–0.2%
New Non-Farm Jobs	315K	212K	+1K
Avg Hourly Wages	13.46	0.8%	3.7%
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, hirable 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 sector is 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 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 25 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.

MARKET TIMING VIEWPOINT

Recommended Tactical Asset Allocation

Stocks 90%	∆ Unchanged
Bonds 10%	∆ Unchanged
Cash 0%	∆ Unchanged

Performance Expectation

	January 1, 2001		*January 1, 2005*	
	Target	% Change	Target	% Change
S&P 500	1700	+15.0%	3000	+110.0%
30-Year T-Bond Yield	5.85%	+10.0%	4.25%	+ 35.0%

MARTIN CAPITAL

OPPORTUNITY FUNDS

PERFORMANCE

(Net Asset Value per Share as of 12/31/99)

	12/31/99	Since Inception
Austin Opportunity Fund*	$13.21	+32.1%
U.S. Opportunity Fund**	$14.36	+43.6%

*Austin Opportunity Fund Inception Date 9/1/99

**U.S. Opportunity Fund Inception Date 4/1/99

FLEXIBLE PORTFOLIO TOP 20 HOLDINGS

1	Dell Computer	51.00	6	Microsoft	116.75	11	Enzon	43.38	16	Whole Foods Mkt.	46.38
2	Cisco Systems	107.13	7	Oracle Systems	112.06	12	Tiffany	89.25	17	LSI Logic	67.50
3	Charles Schwab	38.25	8	Intel	82.31	13	Hewlett-Packard	113.75	18	LAM Research	111.56
4	Applied Materials	126.69	9	Sun Microsystems	77.44	14	Motorola	147.25	19	Electronic Arts	84.00
5	Texas Instruments	96.63	10	Home Depot	68.75	15	Williams Sonoma	46.00	20	CitiGroup	55.69

COMPARISON OF INVESTMENT RESULTS

Performance of Relevant Indexes

	Martin Capital Advisors*	Dow Jones Industrial Avg.	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	+ 58.2%	+ 27.2%	+ 21.0%	+ 23.6%	- 8.7%	+ 4.9%	+ 2.6%
Total**	+1,155.7%	+458.2%	+450.4%	+438.6%	+115.9%	+ 48.4%	+ 25.5%
Avg.***	+ 32.5%	+ 21.1%	+ 20.9%	+ 20.6%	+ 8.9%	+ 4.5%	+ 2.6%

*Total Annual Performance, net of commissions, fees, and expenses, of all Martin Capital Management flexible investment portfolios. Audited 1991-98 by Jeff D. Heard, Jr., P.C., Certified Public Accountants. **Total compounded return, including reinvestment of dividends and interest. ***1991-1999 annualized return.

IMPORTANT DISCLOSURE NOTICE: Past performance does not guarantee future results. Figures include the reinvestment of all dividends received and reflect cash and cash equivalents. Our Flexible Portfolios tend to be more volatile than the S&P 500. From time to time, portfolio performance may reflect the use of margin investing as well as material investments in bonds or cash. The manager will utilize stocks, bonds and cash in an attempt to enhance returns. The Flexible Portfolio average represents 62 individual portfolios and 67.2% of all funds under management by MCA on 12/31/99. Clients explicitly elect this management style on their personal data form. The Flexible Portfolio contains primarily equity stocks that are managed with a view toward capital appreciation.

INVESTMENT PHILOSOPHY

Our investment approach recognizes that to achieve long-term, superior performance, there must be an acceptance of some short-term risk. We pursue an investment allocation strategy that emphasizes diversification to manage short-term volatility in pursuit of long-term performance.

We then consider fundamental and technical factors in determining a prospective investment's risk-reward ratio. We also evaluate social issues, such as environmental policies and employee relations, as part of our investment assessment.

Overall market risk is considered in the timing of investments and implementation of hedging strategies. We seek to maximize portfolio performance and manage volatility by reducing investment exposure during high market risk, while increasing investment commitment during periods of lower risk.

THE COMPASS

A Quarterly Publication of

MARTIN CAPITAL ADVISORS, LLP
816 Congress Avenue, Suite 1540
Austin, Texas 78701
512-477-7036 • Fax 512-477-7096
www.martincapital.com

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