

THE COMPASS



First Quarter, 2001

A Quarterly Newsletter of Martin Capital Advisors, LLP

INVESTMENT PERSPECTIVE by Paul Martin, Managing Partner

After unprecedented decline in 2000, prospects for 2001 are extremely bullish

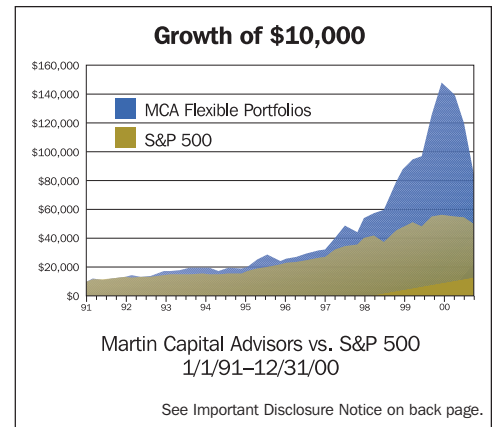
January 5, 2001

At the beginning of last October short-term prospects for the stock market in general and the technology sector in particular appeared to be quite favorable. The stock market bottomed in mid-October and rebounded through the end of the month and into the beginning of November. Then, unfortunately, the presidential election on November 7 was too close to call. The ensuing five weeks of uncertainty created a vicious cycle of stock market declines, which led to reductions in consumer spending during the holiday season, resulting in corporate earnings warnings and further stock market declines. Tech stocks were hardest hit because of their higher growth expectations and subsequent concerns about unforeseen earnings deterioration. An indication of the extremely unpredictable nature of



the fourth quarter economic slowdown came from Microsoft issuing its first earnings warning in ten years. The net result was that the high hopes for the fourth quarter were wiped out by five weeks of election uncertainty, disintegrating into the worst NASDAQ year since the index was created in 1971.

Now for the good news – many high tech stocks are trading at the most attractive valuation levels seen in years. For example, Dell Computer is trading at a 25% discount to the S&P 500, but Dell's earnings should grow twice as fast as the S&P 500 over the next five years. On January 2nd, the CEO and largest shareholder, Michael Dell, bought almost twelve million shares of his company's stock. He hasn't been a net buyer of Dell stock for many years. I mentioned in the October *Compass* that no one rings a bell at the bottom, but the CEO and largest shareholder buying a significant amount of additional shares of his company is a very good sign.

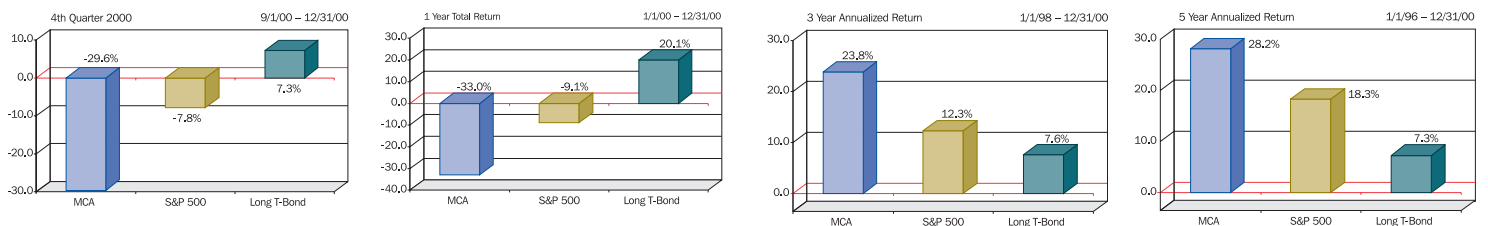


Another good sign is the Federal Reserve beginning to cut interest rates, which happened on January 3. Although corporate earnings may continue to slide and the economy may continue to slow for the next several months, the positive underlying macro-economic conditions of the greatest bull market since the 1950's remain intact and will contribute to the economy responding quickly to monetary stimulus. Once the stock market begins to look past earnings warnings to a resumption of strong economic growth with low inflation, the next phase of the long-term bull market will begin to unfold. Notwithstanding additional short-term volatility, 2001 should be a very good year.

MCA Flexible Portfolios
12-month Tax Efficiency: 97.1%
(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



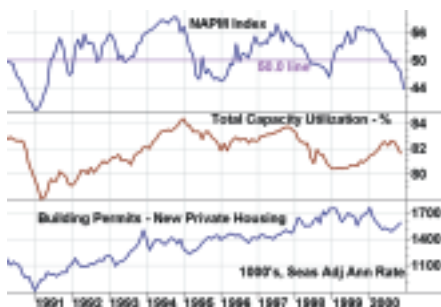
— See Important Disclosure Notice on back page —

QUARTERLY ECONOMIC REVIEW by Alston Boyd, Economic Director

Our economy has been growing more slowly, with the annualized rate in the third quarter of 2000, now months behind us, down sharply to 2.2% from 5.6% in the previous quarter. Growth in the last quarter of 2000 will probably come out at between 1.0% and 2.0% when the advance figures are released next January 26th. This is a long way down from the 8.3% rate in the last quarter of 1999. Fed rate hikes, assisted by higher energy costs, finally put the brakes on the economy. The last rate hikes were in April 2000, and six months afterward the economy and the stock market really hit the skids. While stocks had been weak through the third quarter, the fourth quarter was a disaster for many stocks, particularly those in the tech sector. The table at the end of this report shows percent changes of stock indexes for the last quarter and the whole year, which in most cases are close to the same. Now that the Fed has reversed course and cut rates, we may expect the economy to react six months from now by beginning to grow more quickly.

MANUFACTURING

Higher interest rates and higher energy costs have left potential buyers of products with less cash to spend. A strong dollar has also weakened the market for US products as it has made our products more expensive for foreign buyers. As a result, the manufacturing sector has taken the biggest hit in the current economic slowdown. The North American Purchasing Managers Index fell in December to 43.7, the lowest level since April 1991, when we were emerging from a recession. An Index value below 50.0 implies



contraction. Almost all components of the index presented a negative outlook, particularly inventories, production and new orders. The other major indicator of manufacturing activity is the Industrial Production Index (not shown here), which points to a decline in the rate of growth less severe than the NAPM. Total capacity utilization turned down sharply after September 2000 as output slowed and use of production facilities declined.

Construction in general and housing in particular have managed to hold their own. As evidence of a slower economy has become more abundant, long interest rates have fallen. The drop in mortgage rates has been primarily responsible for the recent gains in housing. The bottom chart above shows the drop in building permits for new private housing that began early in 2000 and reversed after last September. Evidently the pull of lower mortgage rates has overcome worsening economic conditions and decreasing consumer confidence.

SALES

Two-thirds of our economy is directly related to consumer spending. It is therefore disturbing to see sales, the other side of the consumer spending coin, experiencing much slower growth. The 12-month change in retail sales has gone from a red-hot 10.8% in March 2000 down to 5.5% in November. Although the December figures have not yet been released, they have been categorized as being disappointing. Therefore, we may expect to see the 12-month change decline still further. Auto and light truck sales have dropped from a peak annualized rate of 18.8 million units in February to 15.4 million in December. In contrast, both new and existing home sales have remained essentially flat. After a steady rise from 1995 through 1998, home sales reached a plateau. Mortgage rates began a long climb in late 1998 that peaked in May 2000, and these higher

rates held back the growth of home sales in that period. Since last May, as mortgage rates have dropped, home sales have picked up a little. The differing rates of sales of autos and trucks vs. homes may be attributed to differences between the behavior of short and long interest rates. Autos and trucks, as well as retail sales, are more affected by short rates, while home sales are more closely tied to long rates.

LABOR

April 2000 appears to have marked the peak in labor market tightness for at least the past decade. The unemployment rate was 3.9%, the lowest in 30 years, and the average numbers of hours worked per week were at or equal to the highest in several years. The numbers of hours worked tend to be leading indicators of the labor market because employers will tend to cut the number of hours that employees work before making the final decision to let them go. After last April, the average numbers of hours worked began to decline and the numbers of new non-farm jobs in our economy also began to decline. Initial unemployment claims, a measure of the number of



people losing their jobs, began to climb. The combined picture of fewer hours worked, fewer new jobs being created and more people losing their jobs every week paints a clear and unmistakable picture of a softer labor market. Although the unemployment rate has remained almost the same, there has been a sea change in underlying condi-

tions since April. The conditions cited above lead toward a slower economy because they mean smaller and fewer paychecks. Less money in consumers' wallets means slower sales, which backs up into slower production. Nevertheless, we still have a huge, well-paid workforce in this country. This fundamental strength should keep us out of a recession in the next six months.

INFLATION

The Consumer Price Index has risen 3.4% over the last 12 months, while the core rate that excludes food and energy has risen only 2.6%. The 12-month rise in the CPI is slightly above the average of the past nine years, while the change in the core rate is below the nine-year average. The bulge in inflation that we have recently experienced has been due to the sharp rise in oil prices that began in early 1999. The bottom chart at right shows the 12-month change in oil prices rising more than 120% in late 1999 and early 2000. The 12-month change has fallen until it is now slightly negative. While this price shock will reverberate through our economy for a while, it has not managed to spread widely through the rest of the economy. Inflationary effects of higher oil prices should diminish over the next six to 12



months and our overall inflation rate should come down. The labor market has been the other source of concern over inflation, but this has been held in check by huge increases in productivity. Although the future increases may be uneven, the continuation of the high-tech revolution will assure that productivity will continue to grow rapidly over at least the next ten years.

SUMMARY AND OUTLOOK

We have recently been experiencing the effects of normal economic and market cycles. As we have not seen such a pronounced cycle since 1990, it has come as a surprise to many people who have not recognized it. In a typical late-cycle sequence, the economy began to grow too fast, causing the Fed to begin a succession of rate hikes in June 1999. Higher oil prices added to the drag of higher rates until it became clear late

last summer that the economy was finally slowing. As is normal for this part of the cycle, stock prices began to decline on the expectation that earnings growth would slow along with the economy. Few people if any, however, anticipated the extent of the stock price decline. Along with the expectation of a slower economy came falling interest rates, which accelerated downward around the end of the year. Finally, the Fed capitulated and cut the Fed funds target rate on January 3rd.

The rapid fall in long interest rates and the short rates cut by the Fed will give the economy a badly needed shot in the arm, but it takes at least six months before these lower rates have any measurable impact on the economy. We can expect a slow economy in the next two quarters with an annualized growth rate of perhaps 1% to 2%. A recession with two consecutive quarters of negative growth is unlikely. As the stock market looks ahead six months and more, it will anticipate the positive effects of lower interest rates and stock prices will begin to benefit. Stability in the financial markets will eventually help consumers regain some of their lost confidence, shoring up retail sales. By the third quarter, our economy should be returning to a more rapid and more normal rate of growth.

MARKET AND ECONOMIC STATISTICS

as of Market Close December 29, 2000,
with 3-month and 12-month changes

3rd Quarter '00	Final	3 mo	12 mo
GDP-Bil\$	9370	2.2% apr	5.2%
GDP Deflator	107.3	1.6% apr	2.3%
Empl Cost Index	149.2	0.9%	4.4%
NF Productivity	119.2	3.8% apr	5.0%

STOCK INDICES*		3 mo	12 mo	INTEREST RATES		3 mo	12 mo	PRICES, INFLATION		3 mo	12 mo
Dow Industrials	10787	1.3%	-6.2%	91-day T-Bill DR	5.91%	-4.7%	13.9%	CPI, Nov	174.2	0.9% apr	3.4%
S&P 500	1320	-8.1%	-10.1%	30-yr T-Bond Yld	5.46%	-7.1%	-15.7%	PPI, Nov	139.7	1.4% apr	3.7%
NASDAQ Comp	2471	-32.7%	-39.3%	FNMA 30yr mortg	7.31%	-10.1%	-9.5%	Gold, cash	270.8	-1.0%	-6.1%
NASDAQ 100	2342	-34.4%	-36.8%	Prime Rate	9.50%	0.0%	11.8%	W Tx Int Cr Oil	25.76	-16.4%	0.6%
NYSE Comp	657	-0.9%	1.0%	Fed Funds Trgt	6.50%	0.0%	18.2%	Copper, cash	0.85	-6.9%	0.0%
Wilshire 5000	12176	-10.6%	-11.9%	Fed Disc Rate	6.00%	0.0%	20.0%	CRB Futures Ind	227.8	0.6%	11.1%
Russell 2000	484	-7.3%	-4.2%	S/L Long T-Bnd Ind	9514	7.3%	20.1%	CRB Raw Indust	256.5	-1.2%	-4.6%

*excluding dividends

MONEY

M2, Bil Curr\$, Nov	4887	1.4%	5.9%
Free Reserves	1182	118%	19.8%
Money Mkts - Bil\$	1861	6.5%	14.8%
US \$\$\$ Index	109.3	-3.4%	7.3%

INDUSTRY

Indust Prod Ind, Nov	148.6	0.0%	4.7%
NAPM Index, Dec	43.7	-6.2	-11.8
Cap Utiliz, Nov	81.6%	-1.0%	0.7%
Bldg Permits, Nov	1586K	-6.7%	-5.5%

LABOR - Dec. '00

Unemployment Rate	4.0%	0.1%	-0.1%
New Non-Farm Jobs	105K	230K	1915K
Avg Hourly Wages	14.01	1.3%	4.2%
Avg Init Unempl Clms	352K	+45K	+69K

MARKET TIMING VIEWPOINT

Recommended Tactical Asset Allocation

Stocks	120%	Δ	+15%
Bonds	5%	Δ	Unchanged
Cash	-25%	Δ	-15%

Performance Expectation

	December 2001		December 2005	
	Target	Total Return	Target	Total Return
S&P 500	1590	+20%	3300	+150%
NASDAQ	4250	+70%	10100	+310%
30-Yr. T-Bond	5.1%	+10%	4.1%	+ 45%

MARTIN CAPITAL

U.S. OPPORTUNITY FUND

	NAV	YTD	Annual-ized	Since Inception
U.S. Opportunity Fund-MCUSX*	\$9.58	-34.03%	-2.00%	-3.49%

*Inception Date was 4/1/99. Obtain a prospectus and read carefully before investing. Call 1-877-477-7036 for a copy. Mutual funds are subject to investment risks, including possible loss of the principle amount invested. Distributed by AmeriPrime Financial Services, Inc. Past performance is no guarantee of future results.

DUE TO LACK OF INVESTOR INTEREST, THE AUSTIN AND TEXAS OPPORTUNITY FUNDS WILL CLOSE JANUARY 31, 2001.

FLEXIBLE PORTFOLIO TOP 20 POSITIONS

1	SPDR Trust	131.19	6	Cisco Systems	38.25	11	Tiffany	31.63	16	Citigroup	51.06
2	Dell Computer	17.44	7	Enzon	62.06	12	Whole Foods Market	61.13	17	Starbucks	44.25
3	Charles Schwab	28.38	8	Applied Materials	38.19	13	Home Depot	45.69	18	Medtronic	60.38
4	Oracle Systems	29.06	9	Intel	30.06	14	Advent Software	40.06	19	Hewlett-Packard	31.56
5	Texas Instruments	47.38	10	Sun Microsystems	27.88	15	Microsoft	43.38	20	Electronic Arts	42.63

COMPARISON OF INVESTMENT RESULTS

Performance of Relevant Indexes

	Martin Capital Advisors ¹	Dow Jones Industrial Avg.	S&P 500 Index	NASDAQ ²	Wilshire 5000 Index	Long-Term T-Bond Index	Money Market Avg. Yld.	Consumer Price Index
1991	+33.9%	+24.5%	+30.6%	+56.9%	+34.2%	+18.5%	+5.2%	+3.1%
1992	+26.8%	+8.0%	+7.7%	+15.5%	+9.0%	+8.0%	+3.3%	+2.9%
1993	+14.5%	+18.1%	+10.0%	+14.8%	+11.3%	+17.3%	+2.7%	+2.7%
1994	-2.1%	+5.9%	+1.3%	-3.2%	-0.1%	-6.9%	+3.8%	+2.7%
1995	+27.5%	+36.9%	+37.6%	+40.0%	+36.5%	+30.7%	+5.5%	+2.5%
1996	+29.4%	+29.1%	+23.0%	+22.7%	+21.2%	-0.8%	+5.0%	+3.3%
1997	+41.4%	+24.9%	+33.4%	+21.6%	+31.3%	+15.1%	+5.1%	+1.7%
1998	+78.8%	+18.1%	+28.7%	+39.6%	+23.4%	+13.5%	+5.0%	+1.5%
1999	+58.2%	+27.2%	+21.0%	+85.6%	+23.6%	-8.7%	+4.9%	+2.6%
2000	-33.0%	-4.9%	-9.1%	-39.3%	-10.9%	+20.1%	+5.8%	+3.2%
Total ³	+741.2%	+431.1%	+407.3%	+560.9%	+379.9%	+159.3%	+57.0%	+29.8%
Avg. ⁴	+23.7%	+18.2%	+17.6%	+20.8%	+17.0%	+10.0%	+4.6%	+2.6%

¹Total Annual Performance, net of commissions, fees, and expenses, of all Martin Capital Advisors flexible investment portfolios. Audited 1991-99 by Carpenter & Langford, P.C., Certified Public Accountants. ²Without dividends. ³Total compounded return, including reinvestment of dividends and interest. ⁴1991-2000 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. The volatility of the Flexible Portfolios may differ from that of the benchmark. 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 66 individual portfolios and 43.9% of all funds under management by MCA on 12/31/00. Clients explicitly elect this management style on their personal data form. The Flexible Portfolios are tactical asset allocation investment accounts containing stocks and bonds 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

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Martin Capital Advisors, LLP, is a registered investment advisor managing private and institutional investment portfolios, mutual funds and hedge funds. Independent CPA performance review available on request.