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Second Quarter, 2001 — **A Quarterly Newsletter of Martin Capital Advisors, LLP**

INVESTMENT PERSPECTIVE by Paul Martin, Managing Partner

'Blood in the streets' NASDAQ bear market builds base for next bull market cycle

April 7, 2001

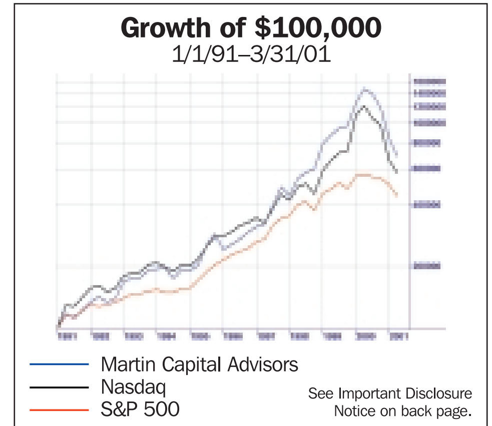
The first quarter began with a bang as the Federal Reserve started off on the right foot with a much needed half-percent fed funds rate cut. Yet despite two additional half-percent cuts by March 20, corporate earnings expectations continued to deteriorate as the perception grew that the fed was doing too little, too late to stimulate the economy. Pressure on the tech sector increased as corporations further delayed technology spending because of ongoing economic uncertainty; however, some tech stocks, such as Dell Computer, did manage to post impressive gains. Short-term fixed income rates dropped significantly in anticipation of more fed funds cuts, but long-term rates held steady as bonds began to discount an economic rebound later in the year.

As we begin the second quarter, I remain extremely bullish about the prospects for the stock market in general, and technology in particular, for the intermediate-term (six to twelve months) and the long-term. For the short-term, I am optimistic that the second quarter will be the first positive quarter in a year, but that hinges on how soon and how much the Federal Reserve cuts rates over the next few months. Bonds will also be affected by how quickly the Fed lowers rates and may perform well, but the risk/reward potential is now much more attractive for stocks than for bonds.

Although many factors contributed to the present S&P 500 bear market and the worst NASDAQ performance since the index was created in 1971, the biggest factor has been the Federal Reserve's tight monetary policy. Fortunately, this is an easy problem to fix, since macro-economic fundamentals remain quite positive. Now that the Fed has finally lowered the fed funds rate to 5%, the economy should begin to stabilize. With further rate cuts the stock market should start to discount the present negative economic conditions in favor of better conditions later this year.

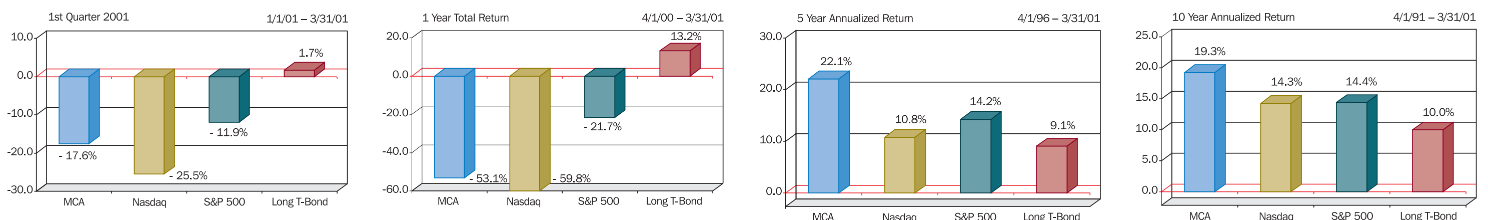
The final stage of a bear market is always the most frustrating. Just as the euphoria at market tops is contagious, the disappointment and despair at market bottoms is demoralizing. There is a tendency to focus on how the loss of capital could have been avoided and a desire to take action to prevent further losses. My experience in achieving high long-term returns, however, is that investment consistency based on macro-economic expectations is the best course. Today, favorable macro-economic conditions, such as the expanding global economy and technological advances enhancing productivity and communications, will bring back the secular bull market once there is a general consensus that the Fed has lowered rates enough to accommodate higher economic growth. Accordingly, rather than taking a defensive approach, now is the time to be most aggressive.

MCA Flexible Portfolios
12-month Tax Efficiency: 96.7%
(After Tax Return divided by Before Tax Return)



INVESTMENT RESULTS

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



See Important Disclosure Notice on back page.

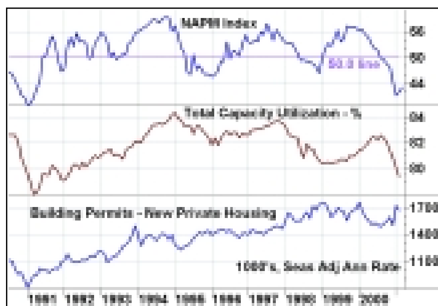
MARTIN CAPITAL
ADVISORS

QUARTERLY ECONOMIC REVIEW by Alston Boyd, Economic Director

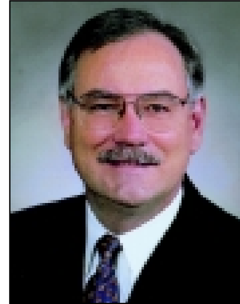
Our economy continued to grow slowly in the first quarter of 2001, probably at an annualized rate of less than 1.0%. The final figure for the previous quarter was an annualized 1.0%, the slowest since 1995. The economic downturn has hit the high-tech sector the hardest, as sales and then manufacturing slumped. In response, the NASDAQ 100 Stock Index took the biggest hit, falling 64.2% in 12 months, while the Dow was only down 9.6% in a year. In response to the downturn, short interest rates have plummeted over the last three months as the Fed has cut rates a half-percent three times for a total of 1.5%. Inflation in our economy today has been almost entirely confined to the energy sector.

MANUFACTURING

The manufacturing sector has been the hardest hit in the current slowdown as an inventory correction is under way. The North American Purchasing Managers Index fell precipitously throughout 2000. The January 2001 reading of 41.3 was the lowest since 1991, near the low of 39.2 in the 1990-91 recession. The Index recovered slightly in March to 43.1, still far below the 50.0 line dividing expansion from contraction. Capacity utilization has fallen to 79.4%, the lowest since 1992. Within the manufacturing sector, high-tech has suffered most. Overinvestment in areas such as fiber optic communications systems during the past few years has led to a glut of capacity that will have to be worked off over time. Many non-tech companies reacted to the possibility of an economic slowdown by instantly cutting capital expenditures, and many high-tech items were on the list of things to be cut. The collapse of many dot coms also meant that less communications hardware and software would be needed.



Housing has remained strong, as low mortgage rates are attracting buyers. Apartment dwellers, particularly in areas with high rents, have found that monthly payments on starter homes are less than their rents. The choice between paying rent and paying a mortgage on a home that can increase in value is an easy one to make. Consequently, building permits and housing starts, which dipped in 2000, have come back up to about the average of 1999. Total construction spending has grown only 2.2% over 12 months, slower than the average of the past 18 months, as declining need for office space slowed commercial construction.

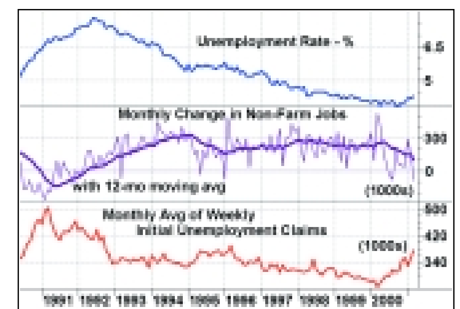


SALES

Retail sales growth over 12 months sagged from a high of 10.8% in March 2000 to 2.7% in February 2001, the second lowest for any month since 1992. Surprisingly, consumers have been as willing to buy new vehicles and homes as they have smaller items. Car and light truck sales held steady at an annualized rate of 17.4 million units in February, close to the average of the past two years, and initial reports for March appear to have dropped only slightly. Low interest rate loans and cash discounts have been used as incentives to maintain car sales. New home sales at an annual rate of 911,000, and existing home sales at a 5.18 million annual rate have also been steady over the past two years, helped by falling mortgage rates. The decline in Consumer Confidence from 142.5 in September 2000 to 109.2 in February did not bring a cutoff in consumer spending, though many, including Alan Greenspan, have been worried about that possibility. Retail sales began declining months before Consumer Confidence, so the connection between confidence and sales has not been a particularly close one either this time or previously.

LABOR

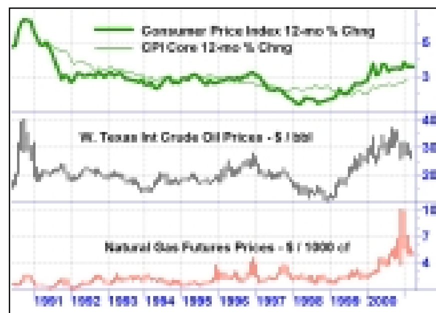
As economic growth has slowed, the labor market has become softer, though it still remains relatively tight by historical standards. The unemployment rate is 4.3%, lowest in 20 months, but still close to a 30-year low of 3.9% seen last year. The number of new jobs created each month is volatile from month to month, so it's useful to look at a 12-month average. The average in April 2000 was 270,000, while the March 2001 average was 101,000, a drop of well over half. Weekly initial unemployment claims, a measure of the number of people losing their jobs, began rising sharply in early 2000 as economic growth slowed. The average for the month of March 2000 was 263,000, compared to the March 2001 average of over 370,000. An early warning of softening in the labor market was the number of hours worked, which started to decline in mid-2000. The latest numbers for total hours worked are up slightly except for the manufacturing sector and may be indicating that the worst has passed for the economy as a whole.



INFLATION

The rate of inflation in our economy, as measured by the Consumer Price Index, rose to 3.8% during the past year. Energy is the main culprit. By the end of 1999, oil prices had risen 120% in 12 months. The oil price rise slowed in 2000, then flattened out at the end of the year, just as natural gas and other energy prices increased

sharply. The "core" rate, which excludes the volatile food and energy sectors, is up 2.8% in 12 months. Even though the "core" rate excludes energy itself, higher energy prices still have an impact, as the cost of electricity affects housing and fuel costs affect transportation. The upturn in energy prices has two primary sources. A growing world economy has been consuming more oil and increasing demand. OPEC and other oil producing nations have cut production in order to maintain prices as the world economy slows. Thus, the supply of oil has been altered from what would be produced in an entirely free market and as a result, prices are higher than they would otherwise be. On the other hand, natural gas prices rose dramatically in December and January, as increased demand caused a shortage because not enough could be produced and delivered. This type of late-cycle commodity price inflation appears to be isolated, as prices of most industrial raw materials have been slumping for a year. For example, scrap steel is at a 15-year low without adjustment for inflation. Gold, the oldest traditional indicator of inflation, is just a few dollars above a 21-year low. In summary, we are in an environment of very low inflation around the world with certain specific and important exceptions, which are mostly related to energy.



Our long economic expansion and need for more workers has brought a tight labor market. Wages and benefits are now rising at an annual rate of close to 4%. The economic slowdown and associated slower job formation should soon ease pressures on wages and benefits. Also, increases in productivity over the past few years have been greater than the increases in wages, which has left the net inflationary effect of labor costs at or below zero.

SUMMARY AND OUTLOOK

Our economy's growth has been slowing since the first quarter of last year. The biggest surprise was the speed at which the downturn accelerated last December. Modern communications, helping management to keep up with developments, warned of the coming downturn and companies quickly responded by cutting or postponing capital spending. As a result, the high-tech sector was immediately and selectively hit hard. Earnings and earnings projections fell precipitously, pulling down stock prices. The Fed started cutting interest rates between Open Market Committee meetings in early January in an effort to stimulate the economy and avoid a recession. The Fed Funds target is down 1.5% so far. This will eventually have a positive effect, though it usually takes between six and nine months for results of rate cuts to become apparent. Therefore, we will most likely begin to see the economy accelerate in the third quarter after Fed rate cuts begin to have an effect and when capital spending that has been postponed will begin to flow again.

Looking ahead, the high-tech/information revolution we have been experiencing will eventually be as extensive as the industrial revolution and continue for decades. Computer hardware, software and communications equipment are today's tools in this revolution and the need for these products will not decrease except on a temporary basis such as we are now experiencing. The shock lately has been that there could be a decrease in demand for these products at all. The forms and adaptations of equipment and software will continually change. The fastest growth will occur in the sectors that deliver products for the mainstream of this revolution.

MARKET AND ECONOMIC STATISTICS

as of Market Close March 30, 2001, with 3-month and 12-month changes

4th Quarter '00	Final	3 mo	12 mo
GDP-Bil$	9934	1.0% apr	3.4%
GDP Deflator	107.7	2.0% apr	2.3%
Empl Cost Index	150.4	0.8%	4.1%
NF Productivity	119.5	2.4% apr	3.4%

STOCK INDICES*		3 mo	12 mo
Dow Industrials	9879	– 8.4%	– 9.6%
S&P 500	1160	–12.1%	–22.6%
NASDAQ Comp	1840	–25.5%	–59.8%
NASDAQ 100	1573	–32.8%	–64.2%
NYSE Comp	596	– 9.3%	– 8.0%
Wilshire 5000	10646	–12.6%	–25.5%
Russell 2000	451	– 6.8%	–16.4%

*excluding dividends

INTEREST RATES		3 mo	12 mo
91-day T-Bill DR	4.19%	–29.1%	–28.6%
30-yr T-Bond Yld	5.45%	– 0.2%	– 6.5%
FNMA 30yr mortg	6.99%	– 4.4%	–16.0%
Prime Rate	8.00%	–15.8%	–11.1%
Fed Funds Trgt	5.00%	–23.1%	–16.7%
Fed Disc Rate	4.50%	–25.0%	–18.2%
S/L Long T-Bnd Ind	9673	1.7%	13.2%

PRICES, INFLATION		3 mo	12 mo
CPI, Feb	176.2	1.1%	3.6%
PPI, Feb	141.8	1.5%	3.9%
Gold, cash	257.7	–4.8%	–7.4%
W Tx Int Cr Oil	26.46	2.7%	–1.3%
Copper, cash	0.76	–11.0%	–5.2%
CRB Futures Ind	210.3	–7.7%	–1.9%
CRB Raw Indust	242.0	–5.7%	–6.4%

MONEY			
M2, Bil Curr$, Feb	5043	2.7%	7.6%
Free Reserves	1030	–13.0%	0.4%
Money Mkts - Bil$	2078	11.7%	22.0%
US $$$ Index	117.4	7.4%	11.4%

INDUSTRY			
Indust Prod Ind, Feb	146.0	–1.5%	1.2%
NAPM Index, Mar	43.1	–1.2	–12.2
Cap Utiliz, Feb	79.4%	–2.5%	–2.6%
Bldg Permits, Feb	1670K	4.5%	0.5%

LABOR – Mar. '01			
Unemployment Rate	4.3%	0.3%	0.2%
New Non-Farm Jobs	–86K	343K	1212K
Avg Hourly Wages	14.17	1.1%	4.3%
Avg Init Unempl Clms	372K	+21K	+113K

MARKET TIMING VIEWPOINT

Recommended Tactical Asset Allocation

		Δ	
Stocks	135%	Δ	+15%
Bonds	0%	Δ	– 5%
Cash	–35%	Δ	– 10%

Performance Expectation

	April 2002		April 2006	
	Target	Total Return	Target	Total Return
S&P 500	1625	+40%	3800	+225%
NASDAQ	3400	+85%	8800	+380%
30-Yr. T-Bond	5.3%	+ 8%	4.6%	+ 45%

MARTIN CAPITAL

U.S. OPPORTUNITY FUND

	NAV	YTD	Annual-ized	Since Inception
U.S. Opportunity Fund-MCUSX*	$7.25	–23.10%	–14.53%	–26.98%

*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 Unified Financial Services, Inc. Past performance is no guarantee of future results.

Net Asset Value per Share as of 3/31/01

FLEXIBLE PORTFOLIO TOP 20 POSITIONS

1	Dell Computer	25.69	6	Enzon	47.50	11	Tiffany	27.25	16	Electronic Arts	54.25
2	SPDR Trust	116.69	7	Texas Instruments	30.98	12	Advent Software	44.31	17	Starbucks	42.44
3	Nasdaq 100	39.15	8	Oracle Systems	14.98	13	Home Depot	43.10	18	Whole Foods Market	42.13
4	Charles Schwab	15.42	9	Intel	26.31	14	Cisco Systems	15.81	19	Citigroup	44.98
5	Applied Materials	43.50	10	Microsoft	54.69	15	Advanced Micro Dev.	26.54	20	Micron Technology	41.53

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%
2001 YTD	–17.6%	–8.0%	–11.9%	–25.5%	–12.3%	+1.7%	+1.2%	+1.1%
Total[3]	+593.3%	+388.5%	+347.2%	+392.3%	+320.7%	+163.7%	+59.7%	+31.2%
Avg.[4]	+20.8%	+16.7%	+15.7%	+16.8%	+15.1%	+9.9%	+4.7%	+2.7%

[1]Total 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. [2]Without dividends. [3]Total compounded return, including reinvestment of dividends and interest. [4]1991-2001 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 64 individual portfolios and 44.3% of all funds under management by MCA on 3/31/00. 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.

A Quarterly Publication of
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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.