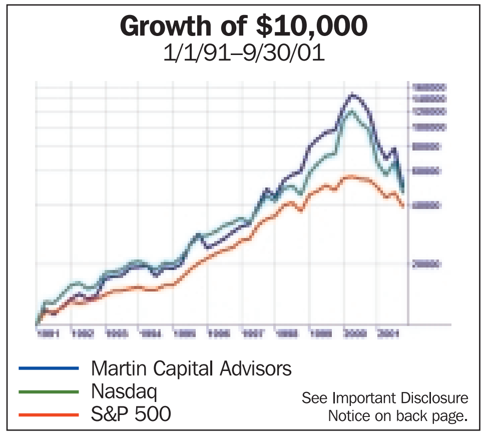
THE COMPASS

Fourth Quarter, 2001 | **A Quarterly Newsletter of Martin Capital Advisors, LLP**

INVESTMENT PERSPECTIVE by Paul Martin, Managing Partner

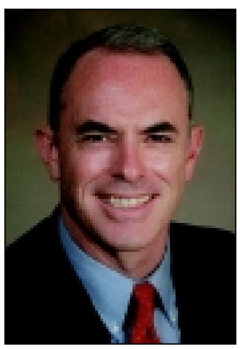
Worst quarterly decline since 1987 most likely marks end of bear market



October 8, 2001

The third quarter proved to be much worse than anticipated. July and August saw declines as the stock market chose to see the economic glass as half empty when, in fact, economic conditions were improving in many areas. For example, the National Association of Purchasing Managers August report showed expansion in production and new orders for the first time in over a year. However, the Federal Reserve Board's negative statements and the media's preoccupation with unemployment, a lagging indicator which often has its worst numbers more than a year after a recession is over, influenced the stock market more than nascent signs of economic improvement. As September began, the stock market appeared to be testing the April lows and showed signs of starting to look at the economic glass as half full in anticipation of improving economic growth by the end of the year. Then the September 11 terrorist attacks precipitated the worst week for the stock market in more than sixty years.

MCA Flexible Portfolios
12-month Tax Efficiency: 96.6%
(After Tax Return divided by Before Tax Return)

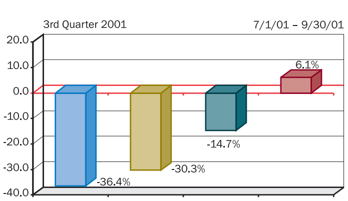


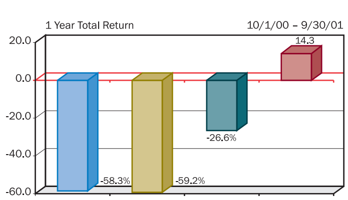
Although the post-September 11 decline was gut wrenching, the extreme technical conditions it produced, along with much greater economic stimulus than previously planned, may actually result in a stronger economy and stock market next year than may have occurred otherwise. As the stock market begins to look beyond the short-term negative impact of the terrorist attacks it should rally in anticipation of better economic conditions next year. Our investment portfolios remain positioned to take advantage of better economic performance through high growth companies, especially in the beaten down high-tech sector, which appear to be coming out of the past year's economic malaise better positioned against their competition than they were a year ago.

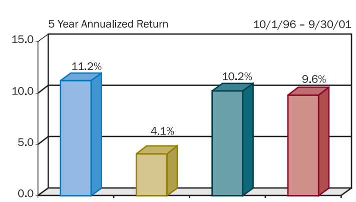
Different investment styles will normally go through cycles of out-performance and under-performance. The last several years have been very unusual in the extreme variations of performance. From 1998 to 2000, growth stocks ran up great returns while value stocks languished. Just how poorly value stocks performed is shown in the June 1998 to March 2000 52% drop in the price of Berkshire Hathaway, managed by one of the greatest value managers, Warren Buffet. During the same period, growth portfolios had exceptional performance. The performance statistics have been reversed for the past year and a half, due largely to the severe slowdown in economic growth. Fortunately, the positive underlying fundamentals for above average economic growth, such as, the high productivity and investment potential of U.S. baby-boomer demographics, global business competition and opportunity, and the infrastructure for productivity enhancing technological advances, are still in place. As economic activity rebounds, the high growth companies in our investment portfolios should rebound as well.

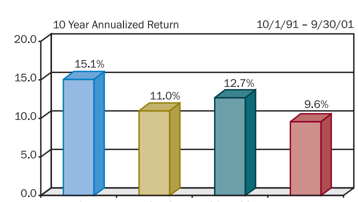
INVESTMENT RESULTS

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.

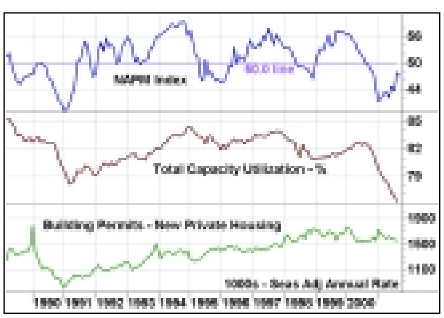
QUARTERLY ECONOMIC REVIEW by Alston Boyd, Economic Director

The table of Market and Economic Statistics shows big changes over three and 12 months. Economic growth has been slow and the stock market has performed poorly. The 59.2% drop in the NASDAQ is the worst for a major stock index in several generations. Interest rates are down sharply. The 61.8% drop in the 91-day T-bill rate is the biggest such drop since 1958. The other remarkable figures in the table are those showing the huge increase in free reserves in the banking system. The figures above are tied together in this way: slower economic growth has been the primary cause of the decline in the stock market. The slow economic growth and bear market in stocks has led the Fed toward a loose monetary policy, evidenced by the declines in short interest rates and the increase in free reserves.

The terrorist attacks of September 11 created a watershed in the direction of the US economy. Prior to that date, we had been experiencing an economic slowdown that was largely confined to the manufacturing sector and cuts in business spending. Consumer spending, which makes up two-thirds of our economy, had remained relatively strong and had kept us out of a recession. After September 11, we have been faced with declines in the service sector, particularly related to travel. Airlines, hotels, rental car companies, etc. have been hit in the aftermath of the attacks, resulting in large numbers of job cuts.

INDUSTRY

The North American Purchasing Managers Index started showing slower growth in February 2000 and has shown outright contraction in manufacturing since August 2000. The NAPM Index low of 41.2 was reached in January 2001, slightly above the cyclical low of 39.2 reached exactly 10 years before. The other important indicator of manufacturing activity is the Industrial Production Index, which fell 4.8% in 12 months through August 2001. That is the largest such decline since early 1983. Total capacity utilization of industry (middle chart at right) was 76.2% in August and capacity utilization in manufacturing was 74.6%, the lowest such figures since 1983. The slowdown in manufacturing indicated by these declines has occurred primarily because of big cuts in capital spending. Some evidence points to the beginning of a turnaround in August. The new orders component of the NAPM Index was up for the second month in a row, following 13 straight declines. Business inventories have dropped every month since January, and the rate of inventory liquidation has remained strong.



The NAPM Non-Manufacturing Survey for September rose to 50.2, showing a welcome bit of expansion. The strongest component in the survey was related to sentiment that inventories were not too high. As the economic slowdown has been largely related to working off inventories, this was good news.

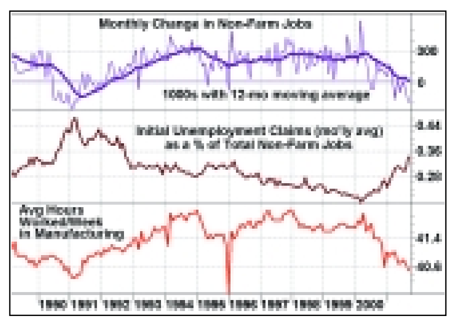
Homebuilding has been a bright spot in our economy. Mortgage rates have remained at or below 7% for a year, stimulating the industry by keeping mortgage payments low and making housing affordable for many people. Until lately, the consumer confidence index has remained high, indicating that consumers felt secure about their situations. Mortgage rates have fallen even further since September 11, which should help overcome some of the decline in consumer confidence and keep that industry relatively strong.

SALES

As consumer spending makes up two-thirds of our economy, sales are an important gauge of the strength of our economy. Retail sales have not decreased during any month since last March, and are up 3.6% in 12 months. While not especially strong today, they were far weaker during the last recession. Auto and truck sales declined only slightly from a high plateau until September, when they fell 3.6%. This is no surprise, as most of the country stayed glued to their TVs during the last half of September. Lower interest rates will help maintain sales in the months ahead. Existing home sales hit an all-time high in August, pumped up by low mortgage rates. The terrorist attacks will have an impact on September's figures, but hopefully it will be a short-term phenomenon and consumer spending will not suffer for more than a few months.

LABOR

Conditions in the labor market are becoming softer. The unemployment rate has risen from 3.9% a year ago to 4.9% in August and September. While this is a substantial rise, it's important to remember that the NAIRU, Non-Accelerating Inflationary Rate of Unemployment, was regarded as being 6% for many years. Thus, today's rate is still low by historical standards. The net change in the number of non-farm jobs in September was minus

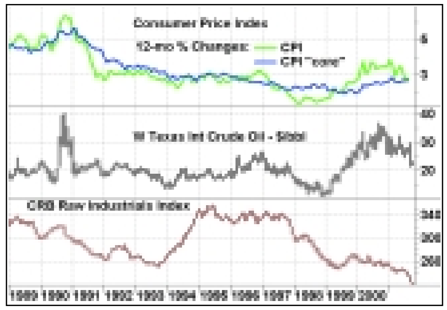


199,000, the largest drop for any month since February 1991, near the bottom of the last recession. Though the Labor Department says that the figures weren't affected by the attacks, the survey was taken during the week of September 12. Airlines started cutting jobs by the tens of thousands within a day or two after the attacks, so some of these cuts may have been included. Job losses amounted to

93,000 in manufacturing and 85,000 in services and retail trade. The monthly average of weekly initial unemployment claims, one of the Conference Board's Leading Indicators, jumped from 398,000 to 453,000 in September, and these figures do include the last half of the month. Prior to the last weeks of September, it appeared likely that initial claims had peaked in June and were flat to down. Seen as a percentage of the number of jobs in our economy (middle chart above), they still are below the two-year period surrounding the last recession. The average number of hours worked in manufacturing (bottom chart above), another Leading Indicator, is down, but the average weekly number of hours worked in the whole economy was up a tenth. With the exceptions of the two leading indicators above, most labor market data lags the economy. The data depicted in the charts above show the hit we've taken because of the attacks. October figures may be as bad or worse, but after that, we should see a marked improvement.

INFLATION

The overall rate of inflation in our economy was 2.8% in August, measured by the 12-month change in the Consumer Price Index. This rate is near an 18-month low, and the CPI shows no inflation at all over the past three months. The "core" rate, which



excludes the volatile food and energy components, was 2.7%. Oil prices are now at a two-year low, brought down by the softening of the world economy and by the sudden drop in the demand for jet fuel. This makes a further decline in our inflation rate a near certainty. Industrial raw materials prices are also dropping, with the CRB Raw Materials Sub-Index at the lowest point since 1986. With inflationary pressures diminishing, the Fed has more room to lower interest rates without creating future inflationary pressures.

SUMMARY AND OUTLOOK

The course of the economy is now more subject to politics than at any time since the Vietnam War. I include within "politics", not only actions by governments, but also actions by the terrorists. These are far less predictable than economic policy, making the direction of our economy harder to predict. It is clear that the economy will suffer a more severe slowdown because of the terrorist attacks. At the same time, the Federal Government plans to pump more than a hundred billion dollars into the economy for rebuilding and in an effort to avoid a deep recession. With the lowest short interest rates in nearly 40 years and the injection of huge amounts of liquidity into the banking system, the Fed's loose monetary policy will have a big positive impact on the economy. We may well see the government's fiscal policy help even more with a tax cut. Added together, these positive forces all point to a "V-shaped" recovery next year. What remains uncertain is how bad the economic contraction will be before the recovery begins. As it appeared that the manufacturing sector was at the bottom or starting to recover at the time of the attack, the recovery will largely depend on the answers to a number of difficult questions. For example, will we experience more attacks? The people of this Unites States will adjust to the threat over time and as the adjustment in attitude and patterns of living take place, the economy will return to an even keel. Though the efforts to root out terrorism around the world will take years to complete, stability will return to our economy and society within a far shorter span of time. This country has fought wars in the past against far more daunting enemies and emerged with a strong spirit and economy.

MARKET AND ECONOMIC STATISTICS

as of Market Close September 28, 2001, with 3-month and 12-month changes

2nd Quarter '01	Final	3 mo	12 mo
GDP-Bil$	9338	0.2% apr	1.2%
GDP Deflator	109.2	2.2% apr	2.3%
Empl Cost Index	153.7	0.9%	4.0%
NF Productivity	118.0	2.1% apr	1.5%

STOCK INDICES*		3 mo	12 mo
Dow Industrials	8848	–15.8%	–16.9%
S&P 500	1041	–15.0%	–27.5%
NASDAQ Comp	1499	–30.6%	–59.2%
NASDAQ 100	1168	–36.3%	–67.3%
NYSE Comp	544	–12.5%	–18.0%
Wilshire 5000	9563	–16.2%	–29.8%
Russell 2000	405	–21.1%	–22.3%

*excluding dividends

INTEREST RATES		3 mo	12 mo
91-day T-Bill DR	2.37%	–31.3%	–61.8%
30-yr T-Bond Yld	5.43%	– 5.7%	– 7.7%
FNMA 30yr mortg	6.42%	–11.2%	–21.0%
Prime Rate	6.00%	–11.1%	–36.8%
Fed Funds Trgt	3.00%	–20.0%	–53.8%
Fed Disc Rate	2.50%	–23.1%	–58.3%
S/L Long T-Bnd Ind	10142	6.6%	14.3%

PRICES, INFLATION		3 mo	12 mo
CPI, Aug	177.5	0.0%	2.8%
PPI, Aug	140.9	– 0.9%	2.1%
Gold, cash	292.4	8.1%	6.9%
W Tx Int Cr Oil	23.43	–10.7%	–24.0%
Copper, cash	0.65	– 8.8%	–29.4%
CRB Futures Ind	190.5	– 7.3%	–15.9%
CRB Raw Indust	224.5	– 8.8%	–13.5%

MONEY			
M2, Bil Curr$, Aug	5285	2.6%	8.5%
Free Reserves	32315	2986%	4933%
Money Mkts-Bil$	2229.1	15.9%	27.5%
US $$$ Index	118.2	–1.0%	4.4%

INDUSTRY			
NAPM Index, Sept	47.0	2.3	–2.6
Indus Prod Ind, Aug	141.5	–1.9%	–4.8%
Cap Utiliz, Aug	76.2%	–1.8%	–6.4%
Bldg Permits, Aug	1560K	–3.8%	1.0%

LABOR – Sept. '01			
Unemployment Rate	4.5%	0.4%	1.0%
New Non-Farm Jobs	–199K	–265K	+120K
Avg Hourly Wages	14.44	0.9%	4.3%
Avg Init Unempl Clms	453K	+45K	+147K

MARKET TIMING VIEWPOINT

Recommended Tactical Asset Allocation

Stocks	145%	Δ	+10%
Bonds	0%	Δ	0%
Cash	–45%	Δ	–10%

Performance Expectation

	October 2002		*October 2006*	
	Target	Total Return	Target	Total Return
S&P 500	1500	+45%	2500	+240%
NASDAQ	2500	+70%	4900	+325%
30-Yr. T-Bond	5.5%	+ 5%	5.0%	+ 35%

MARTIN CAPITAL

U.S. OPPORTUNITY FUND

	NAV	YTD	Annual-ized	Since Inception
U.S. Opportunity Fund-MCUSX*	$4.70	–50.94%	–25.62%	–52.66%

*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 9/28/01

FLEXIBLE PORTFOLIO TOP 20 POSITIONS

1	Dell Computer	18.53	6	Texas Instruments	24.98	11	Intel	20.44	16	Electronic Arts	45.67
2	SPDR Trust	104.44	7	Applied Materials	28.44	12	Advent Software	37.65	17	Citigroup	40.50
3	Enzon	51.00	8	Oracle Systems	12.58	13	Home Depot	38.37	18	Medtronic	43.50
4	Nasdaq 100	28.98	9	Whole Foods Market	31.41	14	Tiffany	21.65	19	Honeywell	26.40
5	Charles Schwab	11.50	10	Microsoft	51.17	15	Cisco Systems	12.18	20	Bear Stearns	50.01

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	–40.7%	–16.9%	–20.4%	–39.3%	–20.8%	+6.6%	+2.0%	+2.0%
Total[3]	+398.7%	+341.3%	+303.8%	+301.0%	+280.3%	+176.4%	+60.2%	+32.4%
Avg.[4]	+16.1%	+14.8%	+13.9%	+13.8%	+13.2%	+9.9%	+4.5%	+2.6%

[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 62 individual portfolios and 45.3% of all funds under management by MCA on 9/28/00. 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 periods of apparent high market risk, while increasing investment commitment during periods of apparent lower risk.

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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.