THE COMPASS

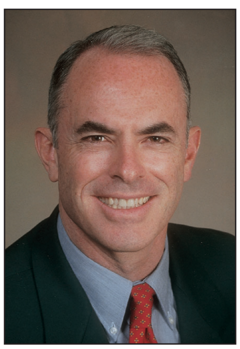
April 2006

A Quarterly Newsletter of Martin Capital Advisors, LLP

Higher Interest Rates and Energy Prices Warrant Caution, but Stock Market Prospects Remain Positive

April 18, 2006

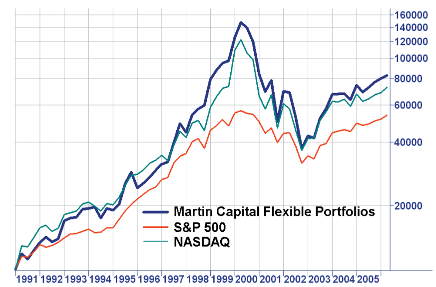
First quarter stock market returns were buoyed by strong earnings. Bonds were hurt, however, by the uncertainty of how high interest rates will have to go to curb inflation. So far in the second quarter stocks have continued to do well while bond prices have declined. For the time being it seems that the stock market is focusing more on strong earnings and economic activity, and less on the implications of higher interest rates and energy prices. The bond market, on the other hand, is looking at these same factors and beginning to show some concern about the prospects for higher inflation.



MCA Flexible Portfolios
12-month Tax Efficiency: 100.1%
(After Tax Return divided by Before Tax Return)

My sense is that stocks have the potential to do well this quarter and for the rest of the year, but that higher interest rates and energy prices create greater economic uncertainty and warrant some caution. At this point, the Federal Reserve Board will determine the prospects for the financial markets and the economy by how high they raise short-term interest rates. The economy can probably weather Fed Funds at or slightly above 5%. As long as the uncertainty persists as to how high rates will go, it is less likely that stocks will do well; however, once it becomes clear, or at least likely, that the Fed has finished raising rates before going too far, then the stock market could have a significant rally. The impact of monetary policy on bonds is more difficult to gauge, but I would guess that until there are definite signs of an economic slowdown or lower inflation, yields will probably go somewhat higher.

Growth of $10,000
1/1/91–3/31/06



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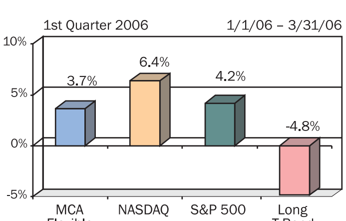
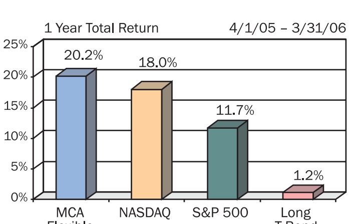
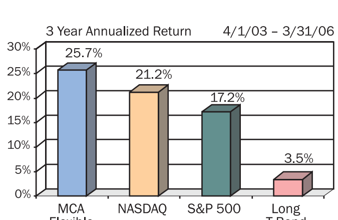
Although global economic strength has been largely responsible for huge increases in energy prices, these price increases have only partially filtered down to core consumer prices (i.e., excluding food and energy) because of global competition and the efficiencies of global markets. At the same time, access to global markets has provided additional growth opportunities to U.S. companies. This disinflationary growth aspect of globalization bodes well for the U.S. economy and financial markets, and mitigates the possibility of a recession, even in the event of monetary policy becoming restrictive.

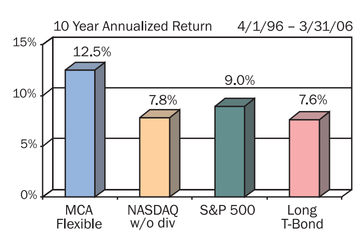
INVESTMENT RESULTS

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









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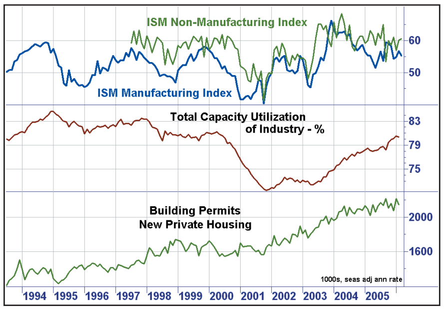
QUARTERLY ECONOMIC REVIEW by Alston Boyd, Economic Director

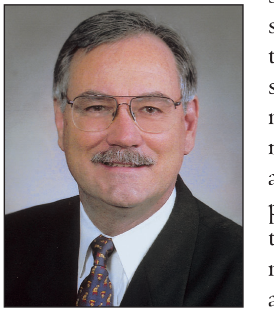
April 9, 2006

Economic growth in the last quarter of 2005 fell to an annualized 1.7%, but growth probably re-accelerated in the first quarter of 2006 to a rate perhaps exceeding 5%. Stocks performed reasonably well in the first quarter, with most major indexes up 3% to 7% and the Russell 2000 leading the pack at 13.7%. Interest rates rose moderately, both long and short, marked by the Fed's 15th quarter-point increase in the Fed Funds target. Inflation rose moderately, though core rate increases, excluding food and energy, were flat to down. Consumers continued to spend and support our economy, though large vehicle sales were off somewhat due to much higher gasoline prices. Crude oil and its products were the primary sources of the uptick in inflation, though other commodity prices were also up sharply. Industrial growth has remained strong, which has in turn supported an equally strong labor market.

INDUSTRY

Manufacturing remained strong during the first quarter, with the ISM Manufacturing Index at 55.2 in March, and an average pace of 55.6 for the last three months, well above the 50.0 that separates expansion from contraction. The three strongest of 10 components making up the index were prices, new orders and backlog of orders. The ISM Non-Manufacturing Index for March stood at 60.5. As this encompasses the services sector of the economy, which is about six times as large as manufacturing, it's a more important indicator of our economy. The strongest component was export orders. All these new orders point to increasing industrial activity over the next few months. Total capacity utilization of industry hit 81.2% in December and February, the highest since September 2000. By comparison, the average of the past 25 years was 80.2%. Capacity utilization of manufacturing was only slightly lower than that for total industry at 80.4%, and it has been catching up over the past couple of years. This is a healthy level of capacity utilization – high, but not high enough to precipitate bottlenecks, which could lead to supply related price increases. From a positive perspective, capacity utilization is reaching levels where we are likely to see the construction of new facilities, implying an increase in durable goods orders for factories and equipment.

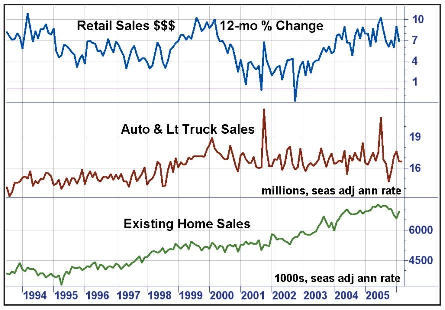




Building permits and housing starts for new private housing appear to have leveled off, though volatility from month to month makes it difficult to tell for sure. February's annualized, seasonally adjusted figures were 2.145M and 2.120M, respectively. If a flattening out has occurred, it's likely due to the expectation that rising mortgage rates, which have just hit a four-year high at over 6.25%, will dampen consumers' eagerness and ability to buy homes.

SALES

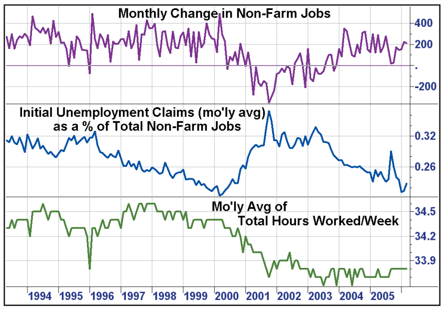
Total retail sales fell 1.3% in the month of February, but were up 6.9% over 12 months. The recent drop follows



January's increase of 2.9%, the biggest monthly gain since October 2001, so some of February's sales may well have been pulled forward into January. February's total was also depressed by weaker auto sales. Those typically make up roughly 25% of total sales and were down 5.7% for the month. Excluding autos, February's total sales were down 0.4% and up 8.9% in 12 months. Auto sales have been pulled down since September because of a drop in SUV sales after gasoline prices soared last fall. Furthermore, the big incentives offered by auto makers last summer may have pulled sales forward for several months. The last six months showed an average of 16.3 million autos and light trucks sold on an annualized and seasonally adjusted basis, while the previous six months showed an average of 17.6 million sold, a 9% drop. Both new and existing home sales appear to have flattened out or perhaps even to have started to turn down over the past eight months. Rising mortgage rates are the likely culprit. As rates go up, monthly mortgage payments increase and price more buyers out of the market.

LABOR

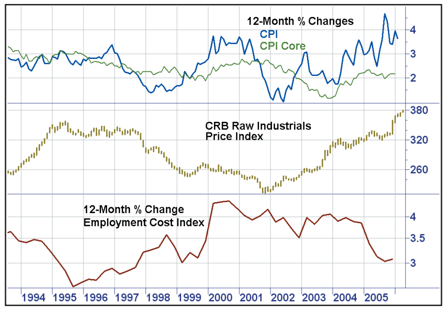
As growth continues in both the manufacturing and service sectors, more workers are being hired. The average number of net new jobs added per month in the first quarter was 199,000, with a 211,000 gain in March. The biggest job gains for the quarter were in the education & health sector and the leisure sector. Construction was not far behind. The average of weekly initial unemployment claims for the quarter was 294,000, down 10,100, from the previous quarter. March's figure was up somewhat at 306,400. The chart of labor market data shows unemployment claims as a percentage of total jobs in order to remove the effects of our labor market growing over time. With that bias removed, current levels are near the lowest in history. The monthly average of total hours worked has flattened out at a low level of 33.8, while hours worked in manufacturing increased slightly over the past few months to



41.0. Both weekly unemployment claims and average hours worked in manufacturing are components of the Conference Board's Index of Leading Indicators.

INFLATION

The 12-month change in the Consumer Price Index, the most often quoted inflation rate, was 3.6% in February, while the CPI core rate was 2.1%, considerably less. As the core rate excludes food and energy, the difference can be seen as the result of much higher prices for crude oil and associated products. China has had a dual effect on inflation in the past several years. Commodity prices, particularly industrial raw materials, have surged as China has used monumental amounts of these materials in expanding its industrial base. In the last 12 months through March, copper was up 67%, aluminum 22% and zinc up 57%. Other materials, such as scrap steel and nickel, experienced big price increases the year before. China also consumed 40% of the world's supply of concrete last year and it has gone from being a net exporter of oil to being one of the world's largest importers as oil consumption there has risen dramatically over the past several years. Not all of China's influences have been inflationary, however, as competition from cheap labor there and in other Asian countries has had the effect of holding down



labor costs around the world. The bottom chart shows the 12-month change in the US Employment Cost Index, which by including both wages and benefits, reflects total labor costs. The trend over the past six years has been downward, with the past year showing the biggest drop. Hourly wages in the US have gone up 3.4% over the last 12 months, but benefits have been cut drastically, causing a deceleration in total labor costs. In the tightening labor market of today in the US, this decline in costs could only come about as a result of outside competition. As two-thirds of inflation is said to come from labor costs, we would undoubtedly be experiencing much higher inflation without that competition.

SUMMARY AND OUTLOOK

We're late in the economic cycle now, with sharply rising commodity prices, the Fed's 15th rate hike in place, a flat yield curve and capacity utilization above 81% and rising. Some conditions in the economy don't seem to fit the late-cycle situation, however. Those particular conditions are being heavily influenced by factors originating outside the country and result from our participation in the global economy. Bond yields haven't risen as much as we might have expected in current conditions because of foreign banks and individuals making big purchases of our government debt instruments. Fortunately for us, our government debt is the safest and most liquid in the world. Labor costs are increasing more slowly than one might expect at this point in the economic cycle because cheap competition from Asian workers is keeping the lid on. There's already a considerable amount of pressure on the economy from the Fed's rate increases to date. The effects of rate hikes typically aren't seen for as much as a year, so we won't see the full impact right away. High oil prices so far have not leaked into the rest of the economy, which we hope will continue to be the case and allow the Fed to raise rates only another ½% or ¾% before they call a halt. Long rates will probably continue creeping upward, maintaining a flat rather than an inverted yield curve. With luck, inflation will remain contained and the Fed will be right about when to stop raising rates. That being the case, our vibrant and robust economy will continue to grow apace.

MARKET AND ECONOMIC STATISTICS

as of Market Close March 31, 2006, with 3-month and 12-month changes

4th Qtr. '05	Final	3 mo	12 mo
GDP-Bil$	11248	1.7% apr	3.6%
GDP Deflator	113.5	3.5% apr	3.1%
Empl Cost Index	180.9	0.8%	3.1%
NF Productivity	136.7	–0.5% apr	2.5%

STOCK INDICES*		3 mo	12 mo
Dow Industrials	11109	3.7%	5.8%
S&P 500	1295	3.7%	9.7%
NASDAQ Comp	2340	6.1%	17.0%
NASDAQ 100	1704	3.6%	14.9%
NYSE Comp	8233	6.2%	14.9%
Wilshire 5000	13155	5.1%	13.0%
Russell 2000	765	13.7%	24.4%

*excluding dividends

INTEREST RATES		3 mo	12 mo
91-day T-Bill DR	4.61%	13.3%	65.8%
30-yr T-Bond Yld	4.89%	6.1%	2.7%
FNMA 30yr mortg	6.35%	4.3%	9.5%
Prime Rate	7.75%	6.9%	34.8%
Fed Funds Trgt	4.75%	11.8%	72.7%
Fed Disc Rate	4.25%	13.3%	88.9%
S/L Long T-Bnd Ind	13048	–4.8%	1.2%

PRICES, INFLATION		3 mo	12 mo
CPI, Feb	199.1	0.7%	3.6%
PPI, Feb	158.2	–0.5%	3.8%
PCE Core Defl, Feb	110.6	0.1%	1.8%
Gold, cash $/tr oz	583.0	12.7%	36.0%
W Tx Int Cr Oil $/bbl	66.66	9.2%	20.3%
Copper, $/lb	2.49	15.1%	64.7%
CRB Futures Ind	333.2	0.4%	6.3%

MONEY		3 mo	12 mo
M2, Bil Curr$, Feb	6758	1.7%	4.7%
Free Reserves	0.911	–38.7%	–23.8%
Money Mkts-Bil$	2056	0.0%	8.5%
US $$$ Index	91.2	–1.5%	6.8%

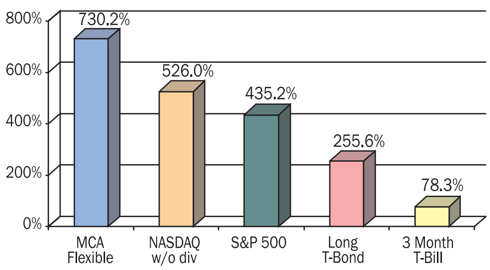
INDUSTRY		3 mo	12 mo
ISM Manuf, Mar	55.2	1.0	0.0
ISM Non-Manuf, Mar	60.5	–0.5	–2.6
Cap Utiliz, Feb	81.2%	0.7%	1.2%
Bldg Permits, Feb	2145K	–0.8%	2.5%

LABOR – Dec '05		3 mo	12 mo
Unemployment Rate	4.7%	–0.2%	–0.5%
New Non-Farm Jobs	+211K	+484K	+1971K
Avg Hourly Wages	16.35	0.9%	3.4%
Avg Init Unempl Clms	306.4K	–10.5K	–26.1K

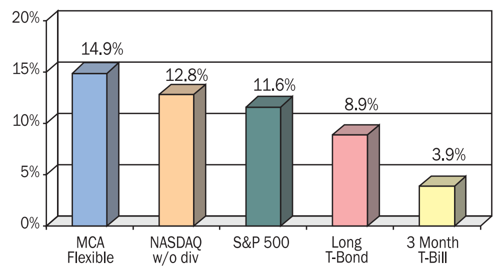
RELATIVE LONG-TERM PERFORMANCE

January 1, 1991 to March 31, 2006

Total Return



Annualized Return



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

FLEXIBLE PORTFOLIO TOP 20 POSITIONS

1	Dell Inc	29.76	6	Charles Schwab	17.21	11	LAM Research	43.00	16	Centex	61.99
2	Whole Foods Mkt	66.44	7	Tiffany	37.54	12	Cisco Systems	21.67	17	Oracle Systems	13.69
3	Starbucks	37.63	8	Electronic Arts	17.51	13	Advanced Micro Dev	33.16	18	CitiGroup	47.23
4	Williams-Sonoma	42.40	9	Applied Materials	17.51	14	Bear Stearns	138.70	19	Intel	19.46
5	Texas Instruments	32.47	10	Sandisk	57.52	15	Red Hat	27.98	20	Caterpillar	71.81

COMPARISON OF INVESTMENT RESULTS

Performance of Relevant Indexes

	Martin Capital Advisors[1]	Dow Jones Industrial Avg.	S&P 500	NASDAQ[2]	Dow Jones Wilshire 5000	Long-Term T-Bond	3 Month T-Bill	Consumer Price Index
1991	33.9%	24.5%	30.6%	56.9%	34.2%	18.5%	5.6%	3.1%
1992	26.8%	7.3%	7.7%	15.5%	9.0%	8.0%	3.5%	2.9%
1993	14.5%	17.0%	10.0%	14.8%	11.3%	17.3%	2.9%	2.8%
1994	-2.1%	5.0%	1.3%	-3.2%	-0.1%	-6.9%	3.9%	2.7%
1995	27.5%	36.9%	37.4%	40.0%	36.5%	30.7%	5.6%	2.5%
1996	29.4%	28.7%	23.1%	22.7%	21.2%	-0.8%	5.2%	3.3%
1997	41.4%	24.9%	33.4%	21.6%	31.3%	15.1%	5.3%	1.7%
1998	78.8%	18.1%	28.6%	39.6%	23.4%	13.5%	4.9%	1.6%
1999	58.2%	27.2%	21.0%	85.6%	23.6%	-8.7%	4.7%	2.7%
2000	-33.0%	-4.9%	-9.1%	-39.3%	-10.9%	20.1%	5.9%	3.4%
2001	-17.4%	-5.4%	-11.9%	-21.1%	-11.0%	4.6%	3.8%	1.6%
2002	-38.3%	-15.0%	-22.1%	-31.5%	-20.9%	17.2%	1.7%	2.4%
2003	56.8%	28.3%	28.7%	50.0%	31.63%	2.1%	1.0%	1.9%
2004	10.7%	5.3%	10.9%	8.6%	12.6%	8.0%	1.4%	3.6%
2005	7.6%	1.7%	4.9%	1.4%	6.3%	6.7%	3.0%	3.5%
2006	3.7%	4.3%	4.2%	6.1%	5.5%	-4.8%	1.1%	0.6%
Total[3]	730.2%	510.8%	435.2%	526.0%	462.5%	255.6%	78.3%	48.5%
Avg.[4]	14.9%	12.6%	11.6%	12.8%	12.0%	8.9%	3.9%	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]1991-2006 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 33 individual portfolios and 34.4% of all funds under management by MCA on 3/31/06. 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 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.