THE COMPASS

April 2010

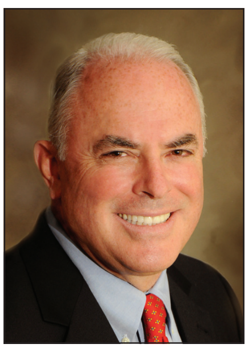
A Quarterly Newsletter of Martin Capital Advisors, LLP

INVESTMENT PERSPECTIVE by Paul Martin, Managing Partner

Economic Expansion Now Driven By Virtuous Cycle of Self-Reinforcing Growth

April 22, 2010

After an almost ten percent correction half way through the first quarter, stocks rebounded to finish with strong gains by the end of March (e.g., the S&P 500 gained 5.4%). The long anticipated correction that began in mid-January and bottomed in mid-February set up the next leg of the bull market from the February low to significantly higher prices in April. Bonds again underperformed, but generally achieved slightly positive returns (e.g., the Barclays Aggregate Bond Index gained 1.8%).



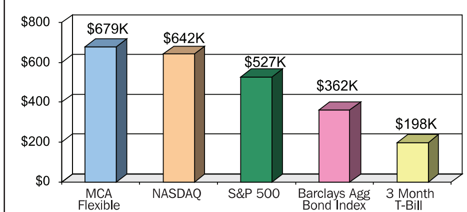
As we enter the second quarter, the stock market rally is still intact, but getting long in the tooth. I would not be surprised to see a pull back in the near future, which would allow stocks to consolidate recent gains and regroup for the next stage of the bull market. That said, as I have pointed out previously, investors have to be careful not to miss the forest for the trees by focusing too much on avoiding corrections and consequently missing a large part of the bull market. Just as bear markets often decline much further than expected, bull markets tend to climb much higher and faster than expected, and don't give many opportunities to get in at lower levels.

Bonds have begun the quarter with mixed results, with Treasury prices down slightly and corporate prices up a little. Although inflation has remained tame, signs of economic improvement have begun to proliferate, suggesting somewhat higher inflation may be just down the road. Even after declining fifteen percent last year, Treasury bond prices appear to still have a lot more downside risk than most investors realize.

As I wrote in the last edition of *The Compass*, the economy has entered "a virtuous cycle of higher corporate profits and improving economic conditions." Essentially, the economy is now at a point at which better economic numbers have become self-reinforcing, creating a symbiotic counterbalancing of supply and demand, where inventory rebuilding stimulates economic activity, which spurs more demand, which then precipitates production of additional inventory. This is how economies normally shift from recession to expansion, and our economy is clearly well into the virtuous cycle, or positive feedback loop, of a sustained multi-year growth phase. From an investment standpoint, this makes the prospects for bonds doubtful, at best, and the prospects for stocks quite positive.

Growth of $100K

1/1/91–3/31/10



See details and important Disclosure Notice on last page.

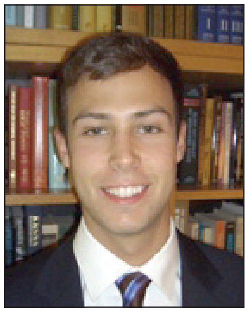
COMPARISON OF INVESTMENT RESULTS

January 1, 1991 to March 31, 2010

	Martin Capital Advisors[1]	NASDAQ	S&P 500	Dow Jones Industrial Avg.	Dow Jones Wilshire 5000	Barclays Aggregate Bond Index	3 Month T-Bill	Consumer Price Index
Total[2]	578.8%	541.5%	426.7%	546.6%	462.7%	262.3%	97.8%	62.7%
Avg.[3]	10.5%	10.1%	9.1%	10.2%	9.4%	6.9%	3.6%	2.6%

[1]Total annual performance, net of commissions, fees, and expenses of all Martin Capital Advisors' *Flexible Portfolios*.
[2]Total compounded return, including reinvestment of dividends and interest. [3]1991-2009 annualized return.

The U.S. economy grew at an annualized rate of 5.6 percent during the fourth quarter 2009, which was the fastest pace in six years. The market expected GDP growth to be 4.7 percent, but the numbers came in much higher, providing strong evidence that the U.S. economic recovery has begun. Gross domestic product is expected to rise more than three percent in the first quarter of 2010, marking the third consecutive quarter of GDP growth. (Figure 1)



Unemployment remains at its highest level in decades, but is steadily declining. The March unemployment rate was 9.7 percent, which is 0.4 percent less than the peak reached in October 2009. The recent nonfarm payrolls report showed that the economy added 162,000 jobs during the month of March; however, some of the increase was due to jobs created for the 2010 census. (Figures 2, 3, 4)

Other economic indicators confirm that the unemployment rate will likely stay on a downward trend. In both the services and manufacturing indexes from the Institute for Supply Management, there is a component on employment that provides an indication of the employment conditions in the sector. The employment component of the ISM manufacturing index is now above 50, and the employment component of the ISM services index for March has been trending higher and is now just below 50, at 49.8 (readings above 50 indicate employment expansion). (Figure 5)

Household's balance sheets are improving. The Federal Reserve reported that consumer net worth was $54.2 trillion at the end of 2009, which was $5.5 trillion higher than the low reached in March 2009. Consumer net worth includes the value of household's homes and investments, less consumer debt.

Despite improvements in many sectors of the economy, the recovery still faces strong headwinds in the view of consumers. High unemployment continues to weigh on consumer confidence; however, confidence is up somewhat over the past year, though still well below its historical average. (Figure 6)

Consumer spending is improving – retail sales grew 0.8 percent over the quarter and April's retail sales report beat market expectations by 0.5 percent. Most importantly, the report found that same store sales were up over 9 percent. Stronger sales have caused businesses to restock their inventories. The increase in inventories is expected to add two percentage points to GDP for the first quarter 2010. Overall, the retail sector has improved significantly as sales are 7.6 percent higher than last year. (Figure 7)

The housing market is showing signs of a slow recovery, but remains weak despite historically low interest rates and government incentives. The first-time homebuyer program that was enacted last fall helped increase home sales last year, but may have caused sales to wane this year. The housing market is showing signs of stabilization, but home foreclosures continue to trend upward. (Figure 8)

Low inflation and a strong demand for bonds have continued to keep bond yields below their historical averages. For the first quarter, the yield on the 10-year Treasury note remained unchanged and there was very little change in the steepness of the yield curve. (Figure 9)

Deflationary pressures still persist in the economy due to slack in capacity utilization and high unemployment. This has allowed the Federal Reserve to keep the federal funds rate at historically low levels. The core consumer price index remained largely unchanged over the quarter, and has only increased 1.2 percent in the past twelve months, which is at the lower end of the Fed's target range. (Figure 10)

Figure 1

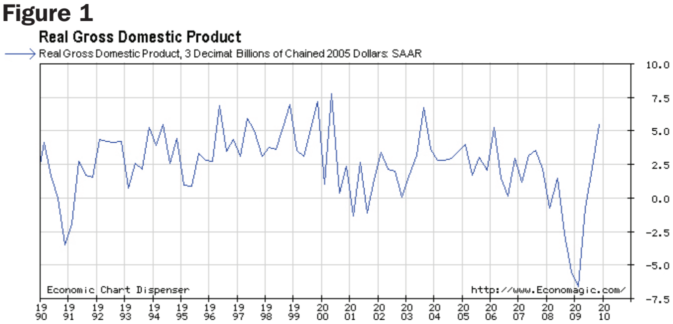
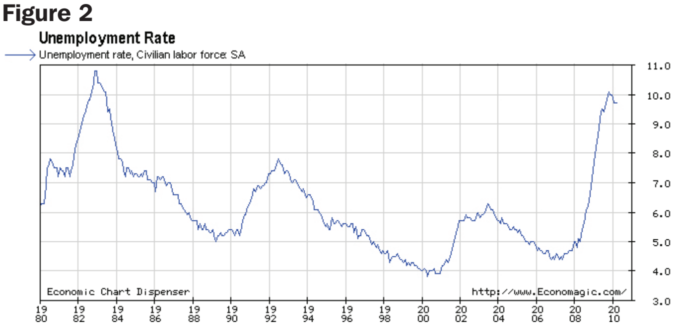


Figure 2



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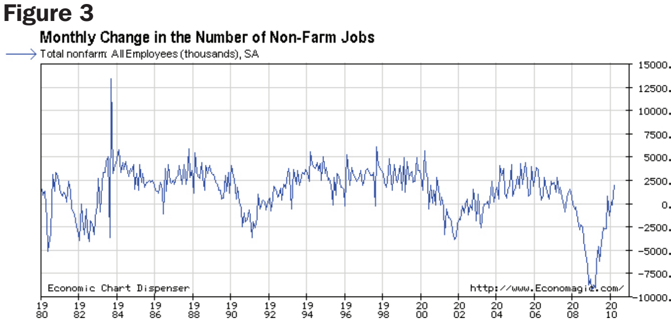
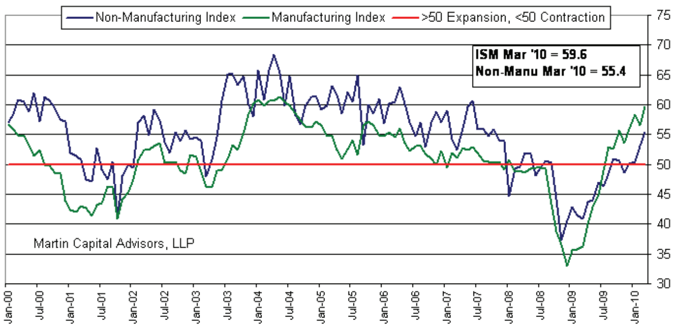


Figure 4

Figure 5



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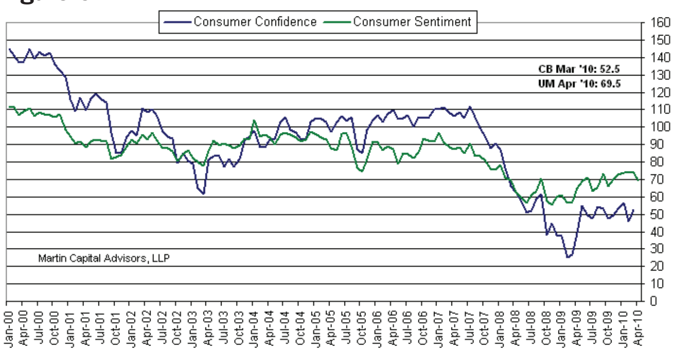


Figure 7

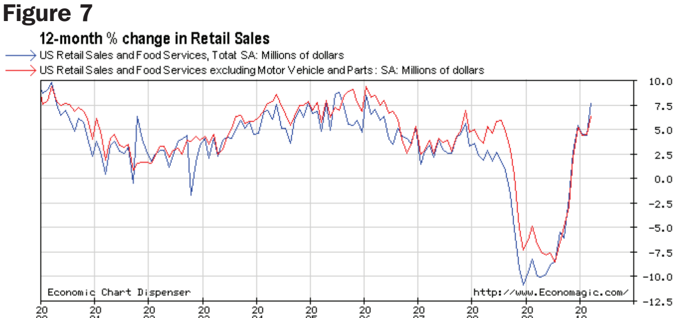


Figure 8

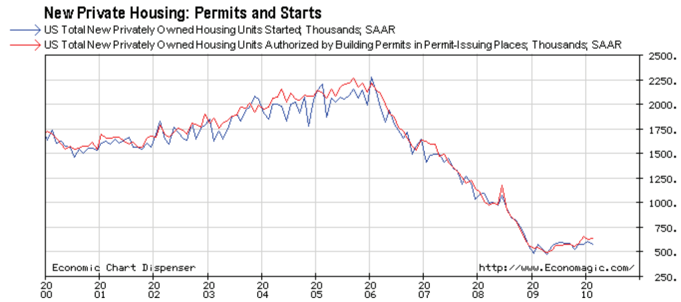


Figure 9

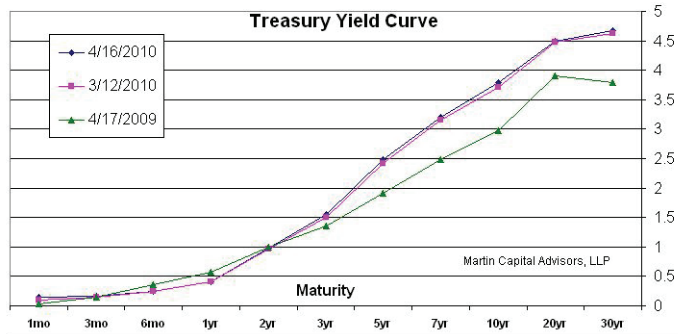
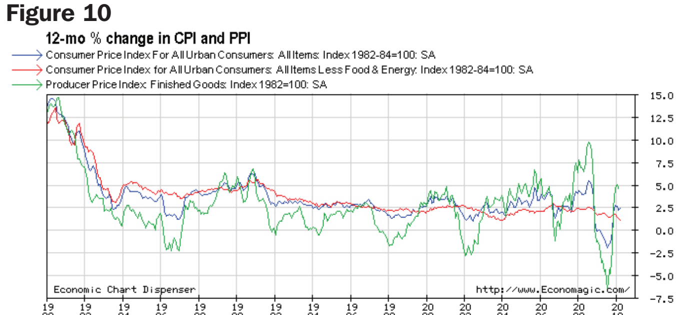


Figure 10



MARKET AND ECONOMIC STATISTICS

as of Market Close March 31, 2010
with 3-month and 12-month percentage changes

4th Qtr. '09	Final	3 mo	12 mo
GDP-Bil Chained$	13149	5.6% apr	0.0%
GDP Deflator	109.9	.5% apr	0.6%
Empl Cost Index	111.2	0.5%	1.5%
NF Productivity	152.3	6.9% apr	5.8%

STOCK INDICES*		3 mo	12 mo
Dow Industrials	10907	4.6%	45.0%
S&P 500	1171	5.0%	48.2%
NASDAQ Comp	2402	5.8%	58.2%
NASDAQ 100	1962	5.5%	59.2%
NYSE Comp	7447	3.6%	52.0%
Wilshire 5000	12205	6.1%	52.5%
Russell 2000	681	9.0%	62.5%

*excluding dividends

INTEREST RATES		3 mo	12 mo
10-yr T-Note Yld	3.84%	–0.01%	+1.13%
3-mo T-Bill Rate	0.16%	+0.10%	–0.05%
Trea Spd 10y-3mo	3.63%	–0.16%	+1.13%
Fed Funds Trgt	0.09%	+0.04%	–0.07%
Prime Rate	3.25%	0.00%	0.00%
FNMA 30yr mortg	4.50%	–0.03%	+0.16%
Barclays Agg Bond	3.47%	–0.20%	–0.34%

PRICES, INFLATION		3 mo	12 mo
CPI-U, Feb	217.6	0.3%	2.2%
CPI Core, Feb	220.6	0.0%	1.3%
PCE Core Defl, Feb	110.5	0.2%	1.8%
Gold, cash $/tr oz	1112.5	1.5%	24.8%
W Tx Int Cr Oil $/bbl	83.38	4.7%	58.9%
Copper	353.55	6.2%	77.7%
CRB Futures Ind	273.3	–3.5%	24.3%

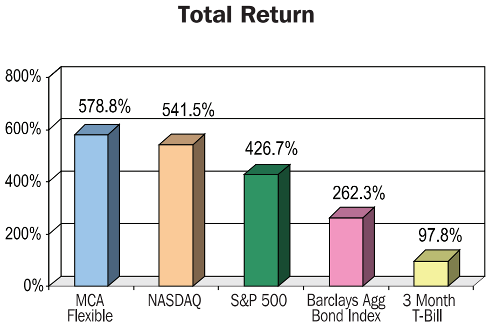
INDUSTRY		3 mo	12 mo
ISM Manuf Ind, Feb	56.5	2.9	20.7
ISM Services, Feb	53.0	4.6	10.9
Cap Utiliz, Feb	72.6%	1.2%	2.0%
Bldg Permits, Feb	637K	8.1%	15.8%

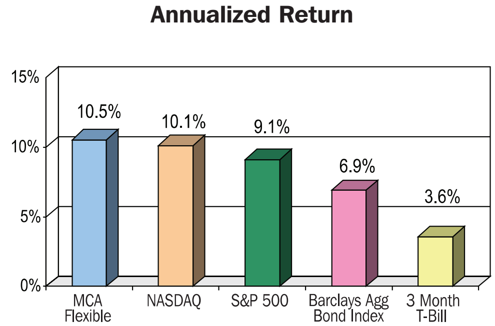
SALES		3 mo	12 mo
Total Retail-$B, Feb	355.5	0.0%	3.8%
Ttl ex Autos-$B, Feb	297.6	1.2%	4.2%
Autos-M Units, Mar	11.7	4.9%	21.3%
New Homes, Feb	308K	–14.9%	–13.0%

LABOR – Mar '10		3 mo	12 mo
Unemployment Rate	9.7%	–0.3%	+1.1%
Non-Farm Jobs Chg.	+162K	+162K	–2320K
Avg Init Unempl Clms	455K	–5.7K	–195.7K
Avg Hourly Wages	18.90	0.2%	2.0%

RELATIVE LONG-TERM PERFORMANCE

January 1, 1991 to March 31, 2010





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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.

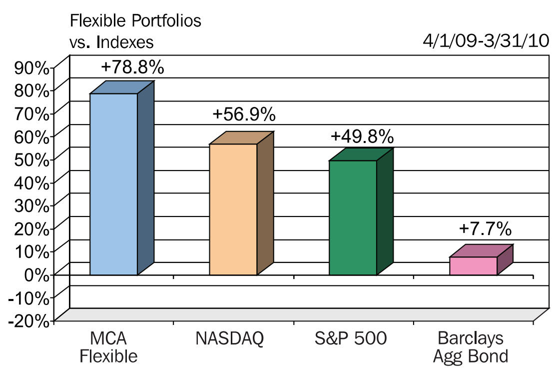
FLEXIBLE PORTFOLIO TOP 20 POSITIONS

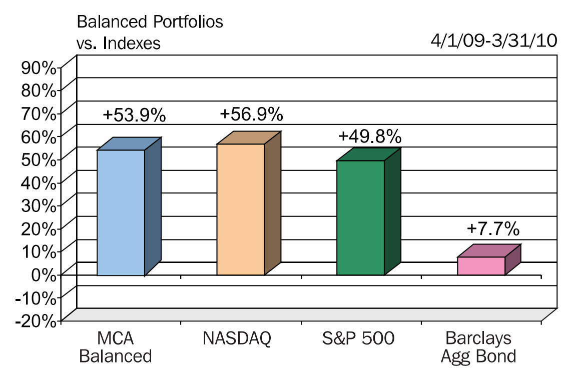
as of March 31, 2010

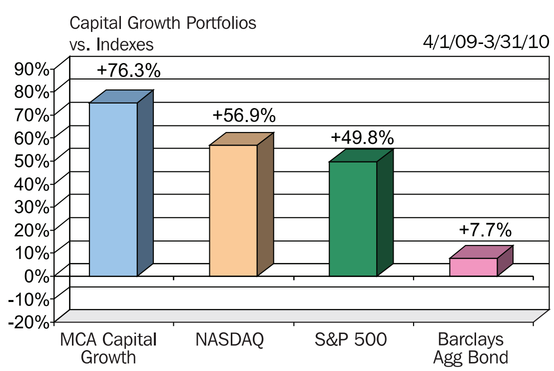
1	Apple	235.00	6	Texas Instruments	24.47	11	Intuitive Surgical	348.13	16	NASDAQ Biotech Index	90.94
2	Whole Foods Market	36.15	7	Intel	22.29	12	Tiffany	47.49	17	LAM Research	37.32
3	Oracle	25.71	8	Starbucks	24.27	13	Omnivision Tech	17.18	18	Advent Software	37.32
4	Charles Schwab	18.69	9	SanDisk	34.63	14	Applied Materials	13.47	19	Caterpillar	62.85
5	Cisco Systems	26.03	10	Williams-Sonoma	26.29	15	Davita	63.40	20	Dell, Inc.	15.02

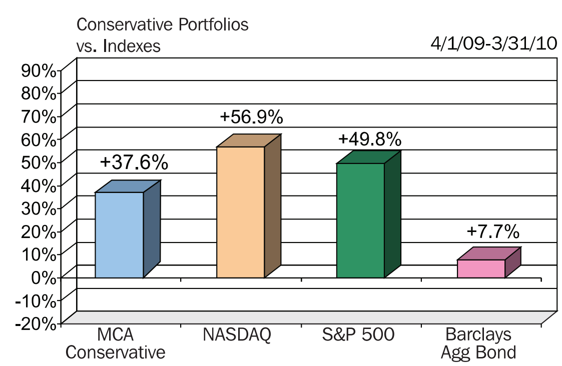
INVESTMENT RESULTS

Martin Capital Advisors' Investment Portfolios vs. NASDAQ Composite, S&P 500 and Barclays Aggregate Bond Indexes









IMPORTANT DISCLOSURE NOTICE: Past performance does not guarantee future results. Figures include the reinvestment of all dividends received and reflect cash and cash equivalents; however, NASDAQ returns are without dividends. 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 24 individual portfolios and 32% of all funds under management by MCA on 3/31/10. 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.