THE COMPASS

April 2011

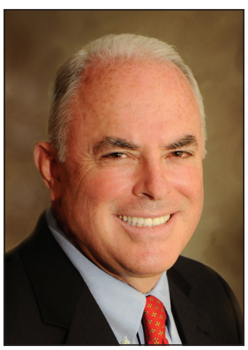
A Quarterly Newsletter of Martin Capital Advisors, LLP

INVESTMENT PERSPECTIVE by Paul Martin, Managing Partner

Bull Market Climbs "Wall of Worry" as Stocks Advance Strongly in First Quarter

April 27, 2011

The first quarter proved to be quite good for stocks, despite a number of crises – from federal budget brinksmanship to expanding strife in the Middle East and devastating earthquakes, tsunamis, and nuclear meltdowns in Japan. Bond prices were fairly flat in the face of rising inflation concerns, which were driven primarily by higher food and energy prices.

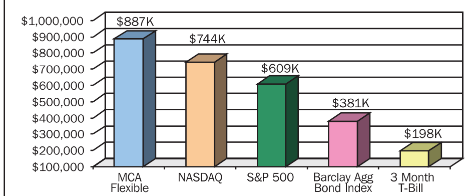


The stock market advance in the first quarter is now continuing into the second quarter; however, the odds of a near-term correction are now somewhat above average. In the last newsletter in January, I also said that odds of a correction in the near-term were higher than average, but noted that "investors should stay with stocks through periodic corrections in order to fully participate in the resumption of the bull market after the corrections have run their course." The one month correction from mid-February to mid-March proved the value of that statement, since stocks have now rebounded significantly from the March lows.

As it has been for the last two years, the Federal Reserve's accommodative monetary policy should continue to be beneficial for stocks and the economy for at least a few more years. The majority of Fed governors and the chairman have made it clear that they will err on the side of stimulating the economy to create jobs rather than fighting inflation for the foreseeable future. Although this bodes well for stocks and commodities, it is a problem for bonds, which could see prices drop as the economy continues to recover and inflation rises.

The "wall of worry" that the stock market climbed in the first quarter confirms the strength of the bull market. Solid corporate balance sheets and strong earnings most likely will continue to be catalysts for higher stock prices over the next several years.

Growth of $100K
1/1/91–3/31/11



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COMPARISON OF INVESTMENT RESULTS

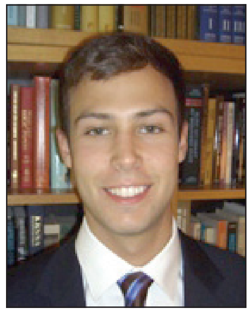
January 1, 1991 to March 31, 2011

	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]	787.2%	644.0%	509.2%	649.7%	551.5%	280.9%	98.0%	64.2%
Avg.[3]	11.4%	10.4%	9.4%	10.5%	9.8%	6.8%	3.4%	2.5%

[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]1991-2011 annualized return.

—— See Important Disclosure Notice on back page. ——

The economic recovery continues to proceed at a moderate pace – U.S. GDP grew at an annualized rate of 3.1 percent in the fourth quarter 2010, driven by strong consumer spending and net exports. This growth rate was stronger than the previous two quarters, which were 1.7 percent and 2.6 percent; however, the preliminary GDP number for the first quarter will probably be weaker than the previous quarter, so it appears that the economy has settled into a pattern of moderate growth between 2 and 3 percent. **(Figure 1)**



Since November the unemployment rate has dropped 1 percent and is down to 8.8 percent – the lowest rate since March 2009. A total of 216,000 jobs were created in March, which beat most economists' forecasts. In the past three months, the monthly increases in nonfarm jobs have averaged 160,000 per month and private sector job gains have averaged 200,000 per month. Although local governments continue to shed jobs to meet tight budgets, private sector job growth is projected to continue to improve. **(Figures 2, 3, & 4)**

Manufacturing, which has led the economic recovery, posted its 20th consecutive month of expansion in March, expanding to a very high reading of 61.2, well above the 50 level that separates expansion from contraction. The non-manufacturing sector expanded for the 16th straight month in March to 57.3, which is also a very strong report. **(Figure 5)**

Consumer confidence fell 8.6 points in March to 63.4, matching December's index level. This sharp decline erased the index's previous five months of consecutive gains and was the largest single month drop since February 2010. While the decline is troubling for the economy, it actually was not as bad as economists' expected, especially in light of rising oil prices and food costs, unrest in the Middle East, and the catastrophe in Japan. Surprisingly, the preliminary report for April's Consumer Sentiment Index was better than expected, showing once again that consumer's reactions are often volatile and can very quickly change direction. **(Figure 6)**

Despite all the negative world news and fear over the effect of high gasoline prices on consumer's pocketbooks, retail sales have been quite resilient. In March, retail sales rose 0.4 percent to $389.3 billion, which marked an all-time high for this metric; however, most of the gain was attributed to rising sales of gasoline and food – excluding these from the calculation, retail sales would have been roughly flat. Auto sales continue to be strong and have posted huge gains over the quarter. In February, they were 27 percent higher compared to the year before, and March's numbers were also strong. **(Figure 7)**

The housing sector continues to be a dark spot in the economy, but there has been some good news recently. After hitting a two-year low of 534,000 in February, building permits rebounded strongly in March to 599,000, much better than most economists had predicted. Housing starts were also better than expected in March, reaching 549,000, after they too had posted a near two-year low of 512,000 in February. **(Figure 8)**

Rising oil and food prices have created fears that inflation is on the horizon, but the evidence from the Consumer Price Index (CPI) and the Produce Price Index (PPI) shows that these fears do not yet reflect reality and that inflation for now remains tame. In March, the PPI for finished goods rose 0.7 percent, which was the smallest monthly increase since November. The increase was largely due to higher energy costs; core PPI for March rose 0.3 percent, which was in line with the 12-month trend. CPI rose 0.5 percent in March, making the yearly gain 2.7 percent. Core CPI rose 0.1 percent and is up 1.2 percent for the year. Gasoline and food prices caused three quarters of the 0.5 percent increase in CPI. **(Figure 9)**

Yields on Treasuries rose over the quarter, but were very volatile. The 10-year Treasury went as high as 3.74 percent, but fell as low as 3.14 percent days after the earthquake in Japan. The yield curve continues to be very steep as the Fed maintains an extremely accommodative monetary policy. In fact, the spread between the yields on the two and the 30-year Treasuries hit a record of 401 basis points at the beginning of February, but spreads have since narrowed slightly. **(Figure 10)**

The economy and the financial markets have shown tremendous resiliency in the face of all of the negative news that has unfolded in 2011. This provides powerful evidence that the recovery is on strong footing.

Figure 1

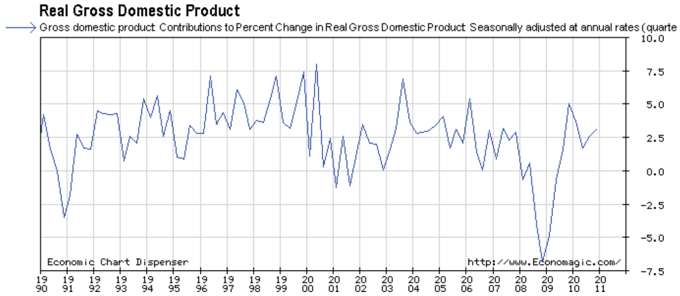
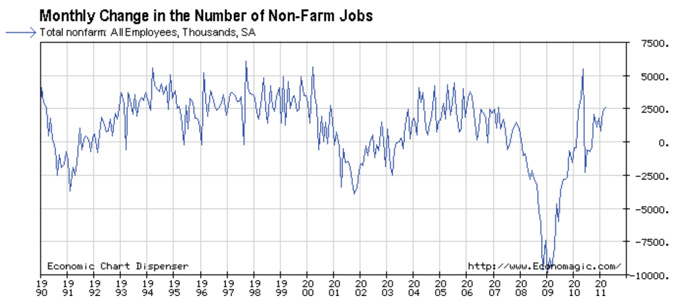


Figure 2

Figure 3



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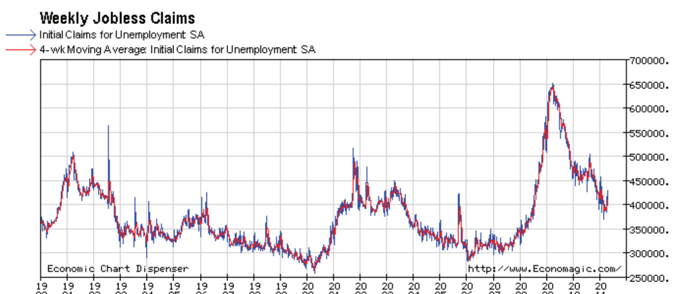
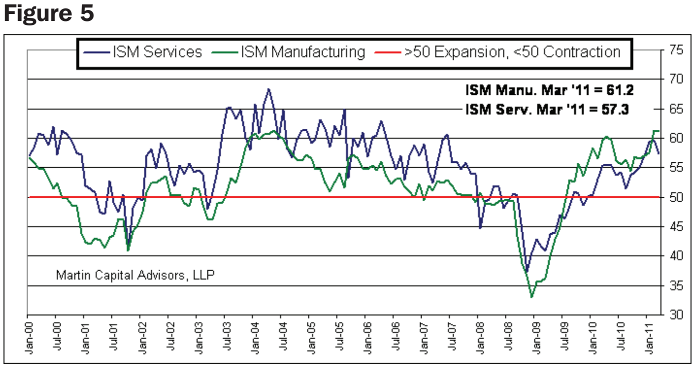


Figure 5



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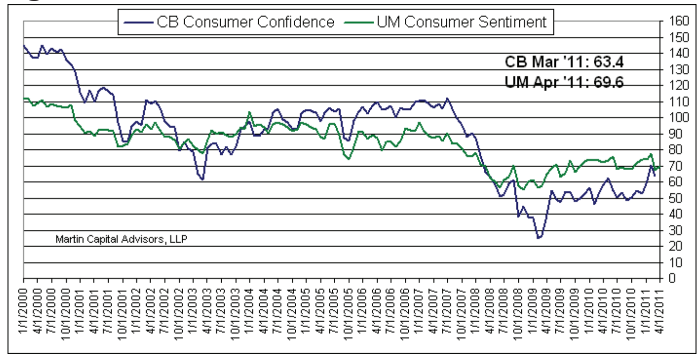


Figure 7

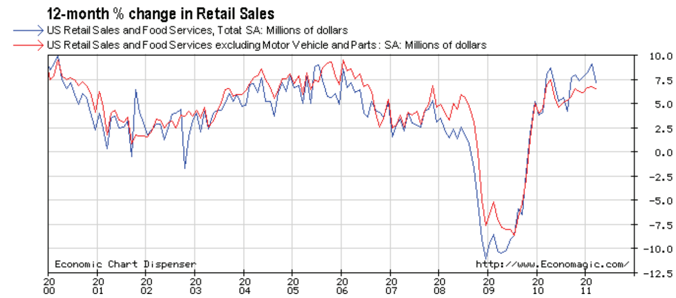


Figure 8

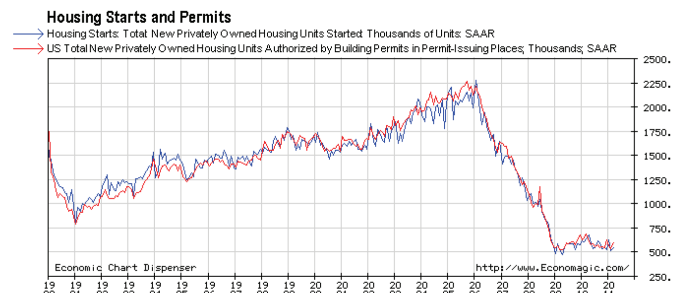


Figure 9

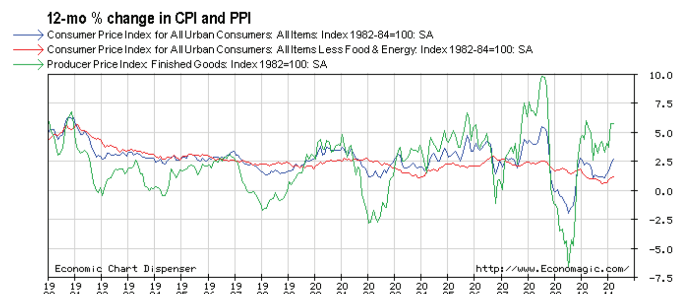
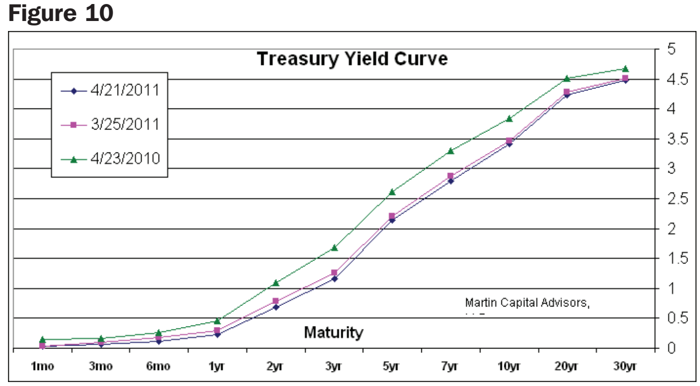
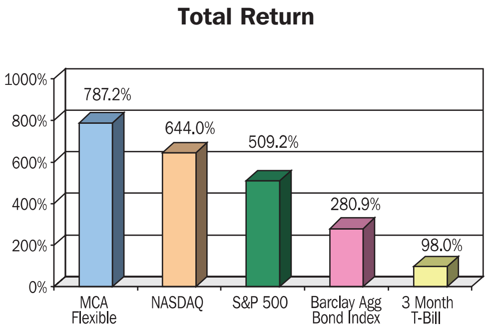


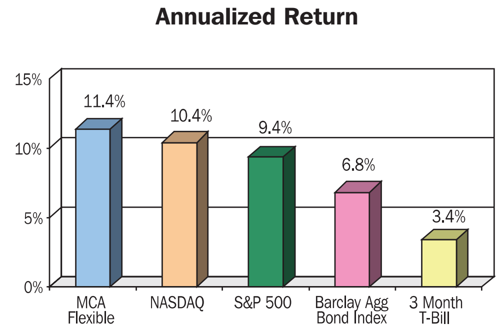
Figure 10



RELATIVE LONG-TERM PERFORMANCE

January 1, 1991 to March 31, 2011





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Martin Capital Advisors, LLP, is a registered investment advisor managing private and institutional investment portfolios. Independent performance reporting provided by Robert Harrell, Inc.

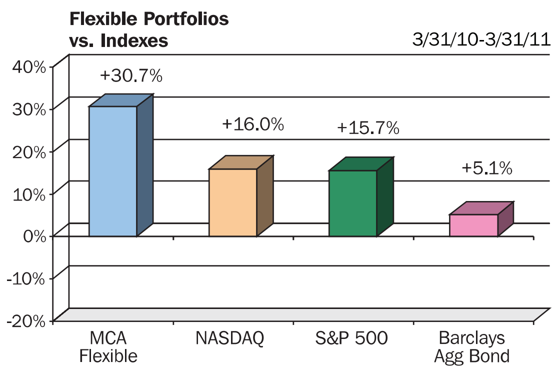
FLEXIBLE PORTFOLIO TOP 20 POSITIONS

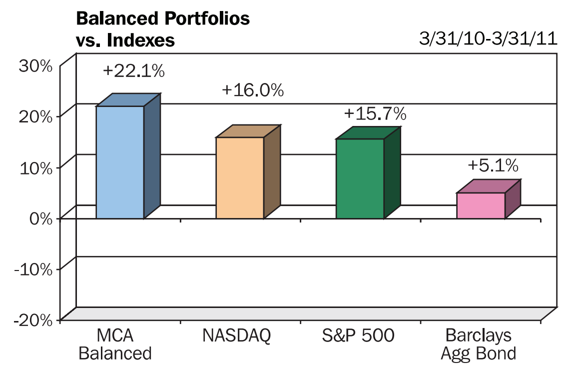
as of March 31, 2011

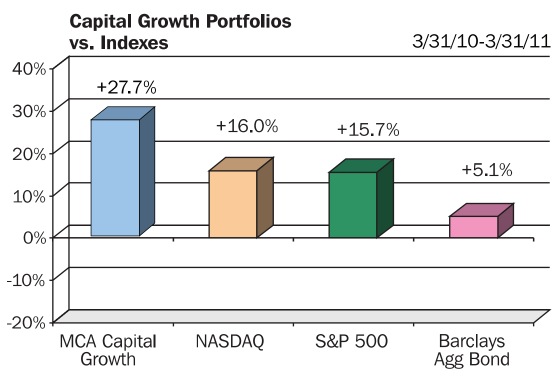
1	Apple	348.51	6	Intuitive Surgical	333.46	11	Davita	85.51	16	Sotheby's	52.60
2	Whole Foods Market	65.90	7	Charles Schwab	18.03	12	Tiffany	61.44	17	Blackrock, Inc.	201.01
3	Oracle	33.43	8	Williams Sonoma	40.50	13	SanDisk	46.09	18	Intel	20.18
4	Omnivision Tech	35.53	9	Texas Instruments	34.56	14	Cisco Systems	17.15	19	Peet's Coffee & Tea	48.09
5	Starbucks	36.95	10	Caterpillar	111.35	15	iShares Russell 3000	79.26	20	NASDAQ Biotech	100.16

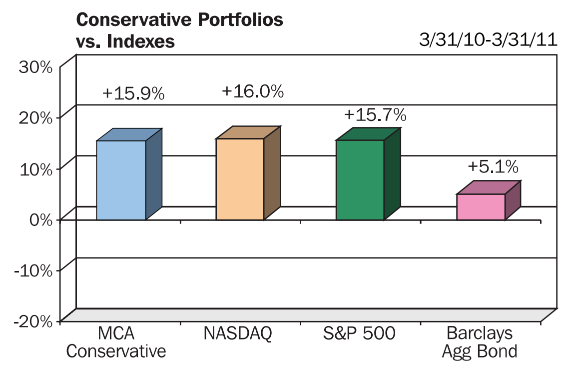
INVESTMENT RESULTS

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 and are net of all fees and expenses; 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 22 individual portfolios and 32% of all funds under management by MCA on 3/31/11. 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.