THE COMPASS

January 2015

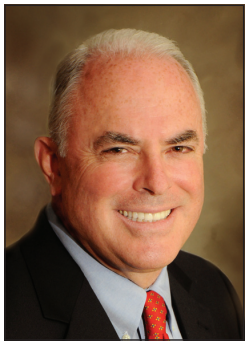
A Quarterly Newsletter of Martin Capital Advisors, LLP

INVESTMENT PERSPECTIVE by Paul Martin, Managing Partner

Oil Price Collapse Augurs Well for Global Economy

January 28, 2015

Fourth quarter equity returns were quite strong as corporate earnings and economic conditions continued to improve. Bonds also fared well with continuing signs of low inflation – including a virtual collapse in oil prices – increasing the likelihood that the Fed may delay raising rates longer than previously expected. Gold managed a slightly positive return for the quarter as the turmoil in the energy markets caused some investors to seek safety in precious metals and U.S. Treasury securities.

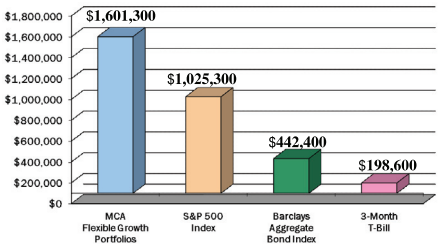


For 2014, many equity indexes achieved above average returns; however, indexes weighted toward small caps and consumer discretionary stocks lagged the broader market and contributed to a wide dispersion in performance, resulting in a very large percentage of equity portfolio managers performing poorly against major benchmarks, such as the S&P 500. Most fixed income securities achieved respectable returns as inflation remained tame and oil prices collapsed in the face of surging supply in the U.S. and policy discord within OPEC. The bear market in gold moderated in 2014 with just a slightly negative return for the year.

So far, 2015 has kicked off with a modest bias to the downside for the stock market as fourth quarter gains are being assimilated and all possible negative ramifications of the steep drop in oil prices are being taken into account. Interestingly, lower energy prices will be most beneficial to many of the sectors that underperformed last year, such as consumer discretionary and small caps, as they stand to realize lower costs and more money in the pockets of their customers. Lower energy costs are also disinflationary and are supportive of lower interest rates and higher bond prices. Strangely, gold prices have rallied as inflation expectations have diminished over the past few months. As mentioned earlier, my guess is that the short-term uncertainty associated with the severe decline in energy prices has resulted in a safe harbor flight to the precious metal. Once energy prices begin to stabilize, then the bear market in gold will probably resume.

For the rest of the year, stock prices will most likely start to advance again when the volatility in energy prices subsides and investors can focus on the fact that less than 10% of the S&P 500 consists of energy companies and that most of the other 90% will profit from lower energy costs. The resulting pickup in economic activity will at some point begin to stimulate inflation, which could be the catalyst for the initial stage of a secular bear market in bonds that could last for decades. Stocks, however, have historically performed very well at the beginning of the reflation phase in the economic cycle, and so above average long-term returns have a high probability of persisting for an extended period of time.

Growth of $100K
1/1/91–12/31/14



See details and important Disclosure Notice on last page.

COMPARISON OF INVESTMENT RESULTS

January 1, 1991 to December 31, 2014

	Martin Capital Advisors[1]	S&P 500	Wilshire 5000	Barclays Aggregate Bond Index	3 Month T-Bill	Consumer Price Index
Total[2]	1501.3%	925.3%	995.1%	342.4%	98.6%	76.5%
Avg.[3]	12.2%	10.2%	10.5%	6.4%	2.9%	2.4%

[1]Total performance, net of commissions, fees, and expenses of all Martin Capital Advisors' *Flexible Growth Portfolios.*
[2]Total compounded return, including reinvestment of dividends and interest. [3]1991-2014 annualized return.

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

Real annualized gross domestic product grew at a rate of 5.0 percent in third quarter of 2014. This marked the strongest single quarter since 2003 and was 1.1 percentage points better than expected. Personal consumption and business investment were particularly strong and were revised up 0.7 and 0.2 percent respectively. Estimates for fourth quarter GDP growth are over 3 percent, which is the annual growth rate most economists forecast for 2015. **(Figure 1)**

GDP is being bolstered by a rapidly improving labor market. In December's employment report, the unemployment rate dropped to 5.6 percent and 252,000 jobs were added. For the year, unemployment fell from 6.7 percent and 2.8M jobs were created, making it the best year of job growth in 15 years. Despite the strong growth, there has yet to be upward pressure on wages. For the year, wages are up 1.7 percent, and are only slightly outpacing core inflation. **(Figure 2)**

U.S. manufacturing had its best year since 2010, despite a strengthening dollar and a slowing global economy. Recently, manufacturing growth has slowed, but nevertheless is still expanding. In December the ISM Manufacturing Index fell from 58.7 to 55.5 and the Non-Manufacturing Index fell from 59.3 to 56.2. The declines in both indexes can be attributed to weak global demand. Falling commodity prices have hurt some manufacturers, especially those that are tied to or service oil companies, however, falling prices should have a net benefit to manufacturing, due to lower input costs.

A strong labor market and falling gas prices have contributed to rising consumer sentiment. In December the consumer sentiment index reached 93.6, which was the highest reading since January 2007 and marked five consecutive months of increases. However, improving consumer attitudes and lower gas prices have yet to cause a large uptick in retail sales. Sales for December dropped 0.9 percent, which was the largest drop in 11 months. One reading does not make a trend and the macro trends favor a boost in future consumer spending.

Housing continues to trend upwards, albeit unevenly. Housing permits and starts declined in November, falling 5.2 percent and 1.6 percent respectively. Home prices also continue to rise, increasing 4.5 percent year over year, although the rate of price increases has slowed considerably since 2013. After two consecutive months of growth, existing home sales dropped 6.1 percent in November in large part due to low inventories. The National Association of Home Builders is forecasting a 25 percent increase in single-family construction in 2015, which will increase the supply of housing and improve inventories.

Inflationary pressures remain weak. The consumer price index dropped 0.4 percent last month. This was the largest one-month decrease since December 2008. The decline was in large part due to falling energy prices, which included a 9.4 percent drop in gasoline prices. Core consumer prices were flat for the month. For the year, CPI increased 0.8 percent and core prices increased 1.6 percent. Weak inflation and slow growth in wages could delay the interest rate hike that has been expected to happen in June this year. **(Figure 3)**

Long-term yields on U.S. Treasuries continue to fall as investors flee to safety and higher yields from weaker economies around the world. This past week the 30-year Treasury fell to an all-time low and the 10-year fell well below 2.0 percent to the lowest level since May 2013. As long-term rates fall, short-term rates have continued to climb as the market prepares for the interest rate hike. This has caused a significant flattening of the yield curve in the last six months. On June 30, 2014 the difference between the 10-year and 2-year Treasury note was 2.06 basis points, as of January 16, 2015 the difference is 1.34 basis points. **(Figure 4)**

The recent weakness in the global currencies and falling energy prices provides opportunity for the US economy. As the labor market continues to improve, the market will become more competitive, which will put upward pressure on wages. The wage effect coupled with low inflation and historically low interest rates should boost consumer purchasing power and provide a strong tailwind to economic growth.

ECONOMIC CHARTS

as of December 31, 2014

Figure 1

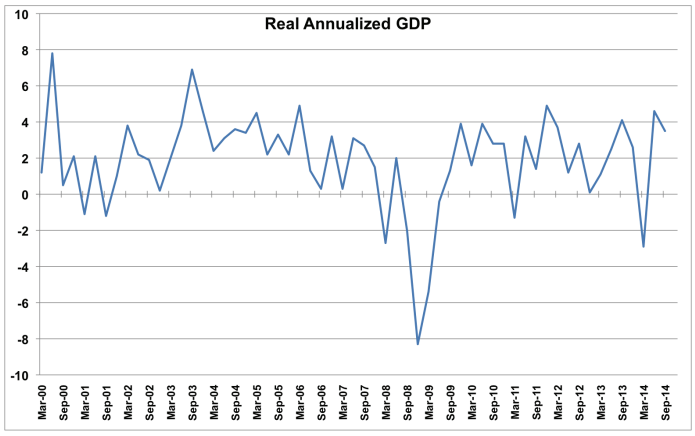


Figure 2

Figure 3

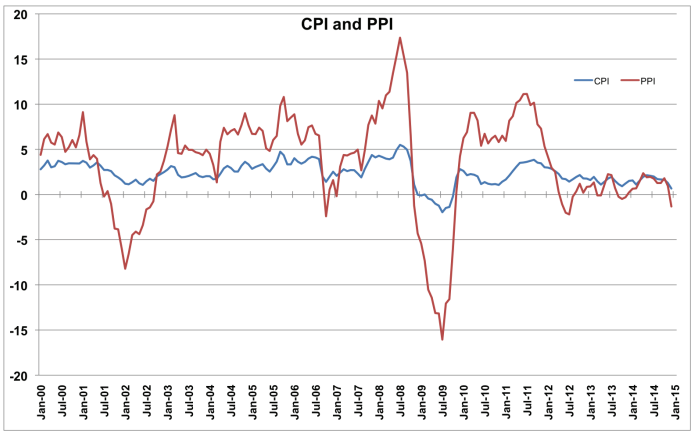
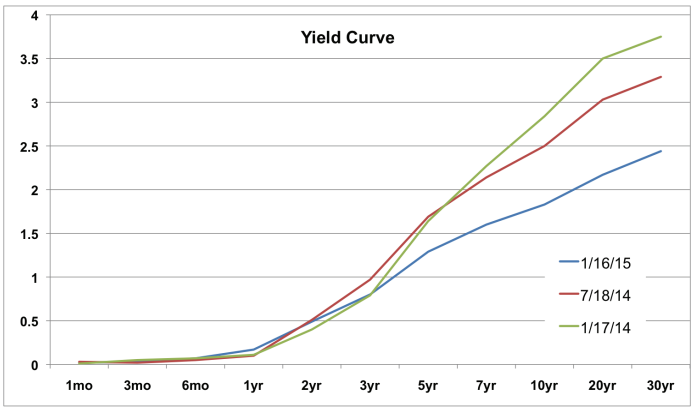


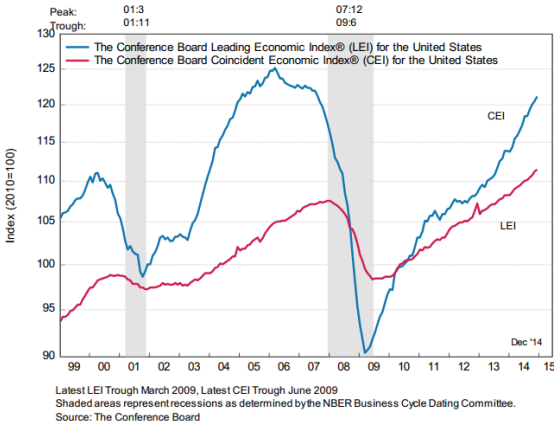
Figure 4



LEADING ECONOMIC INDICATORS

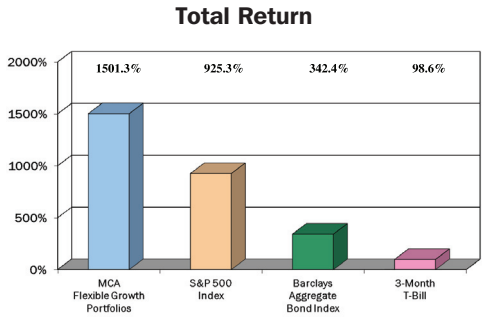
as of January 23, 2015

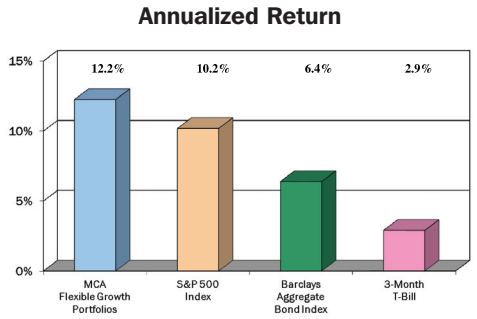
	Current Reading	1-month change	6-month change
Conference Board Leading Economic Index	121.1	+0.5%	+3.3%
S&P 500	2054	+0.5%	+5.5%
Average weekly hours, manufacturing	42.2	0.0	+0.1
Initial Jobless Claims	290.8K	-8.1K	-24.2K
Manufacturers' new orders, capital goods ex. aircraft	42.7B	+0.2%	-0.2%
Manufacturers' new orders, consumer goods and materials	134.0B	+0.2%	-0.2%
ISM New Orders	57.3	-8.7	-1.6
Building Permits	1032K	-1.9%	+6.1%
Spread between 10-yr Treasury Note and Federal Funds Rate	2.09	-0.15	-0.41
Avg. Consumer Expectations for Business Conditions	0.37	+0.22	+0.43
Leading Credit Index (negative readings are positive for the LEI)	-1.64	-0.07	+0.17



RELATIVE LONG-TERM PERFORMANCE

January 1, 1991 to December 31, 2014





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A Quarterly Publication of
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Martin Capital Advisors, LLP, is a registered investment advisor managing private and institutional investment portfolios.

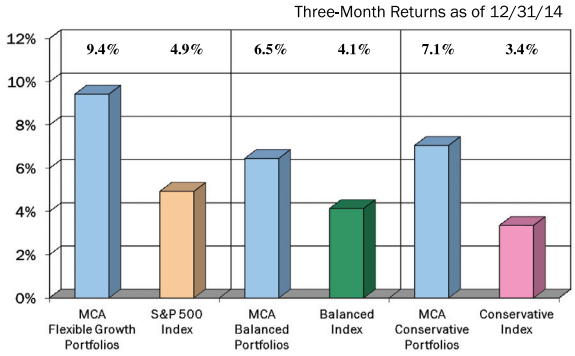
MCA FLEXIBLE GROWTH PORTFOLIOS TOP 20 STOCKS

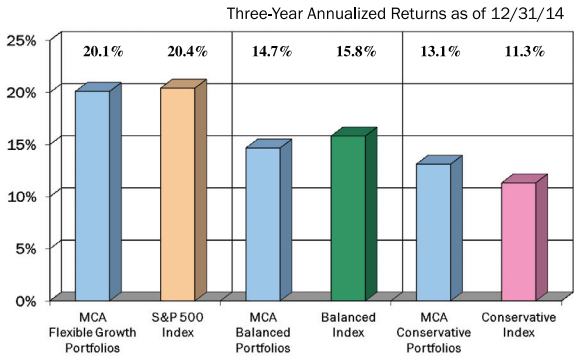
as of December 31, 2014

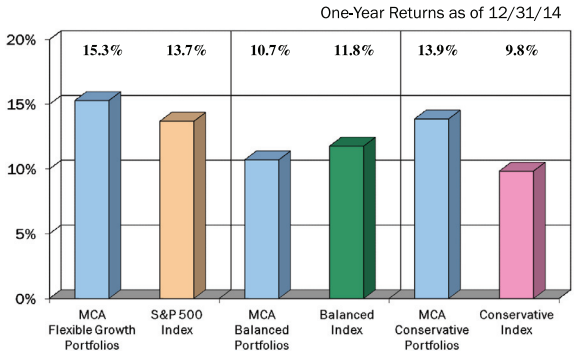
1	Apple	110.38	6	SanDisk	97.98	11	Texas Instruments	53.47	16	Sotheby's	43.18
2	Whole Foods Market	50.42	7	Oracle	44.97	12	MasterCard	86.16	17	Cisco Systems	27.82
3	Starbucks	82.05	8	Tiffany	106.86	13	OmniVision	26.00	18	Tractor Supply	78.82
4	Williams-Sonoma	75.68	9	Charles Schwab	30.19	14	Intel	36.29	19	Costco Wholesale	141.75
5	Intuitive Surgical	528.94	10	DaVita	75.74	15	Visa	262.20	20	IDEXX Laboratories	148.27

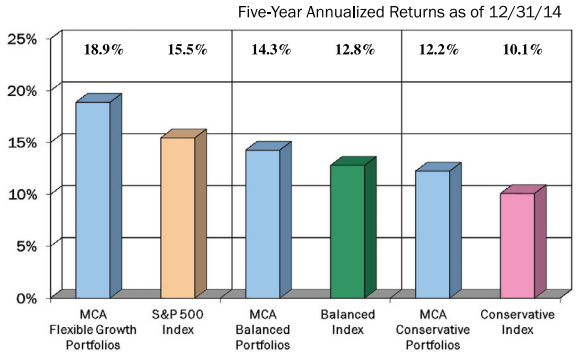
INVESTMENT RESULTS

Martin Capital Advisors' Investment Portfolios vs. 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. Martin Capital Advisors, LLP (MCA) composite returns are net of all fees and expenses. From time to time composite performance may reflect the use of margin investing and options, as well as material investments in bonds and cash, and volatility may differ from that of the benchmark. As of 12/31/2014, the MCA Flexible Growth/Balanced/Conservative Portfolios' returns represent, respectively, 34/6/1 individual portfolios and 69%/27%/2% of all funds under management by MCA. Clients explicitly elect these management styles on their Personal Data Form. The MCA Flexible Growth Portfolios are managed for capital appreciation, and the MCA Balanced and Conservative Portfolios are managed for capital appreciation and income. Independent performance reporting is provided by CGM Investment Management.

MCA claims compliance with the Global Investment Performance Standards (GIPS) and has prepared and presented this report in compliance with the GIPS standards. The listed composites contain all fee-paying accounts with an investment strategy as indicated by the composite title. Non-fee paying or nondiscretionary portfolios are excluded from the composites, but are included in the definition of total firm assets. Performance results are expressed in U.S. dollars. Performance returns are considered PRELIMINARY numbers until examined according to GIPS for the reporting period. To receive a complete list and description of Martin Capital composites and a presentation that adheres to the GIPS standards, contact Robert Godines at (210) 694-2100, ext. 2, or robert@martincapital.com.

ADDITIONAL DISCLOSURE NOTICE

MARTIN CAPITAL ADVISORS, LLP (MCA) is a registered investment advisor based in Austin and San Antonio, Texas, founded in 1989. MCA specializes in managing customized equity and balanced investment portfolios with an all-cap equity strategy to grow capital, as well as balanced strategies to grow capital with less volatility.

MCA claims compliance with the Global Investment Performance Standards (GIPS®). Martin Capital Advisors, LLP has been independently verified for the periods January 1, 2000 to December 31, 2014 by Dabney Investment Consulting Associates, Inc. The verification reports are available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

Returns are shown in U.S. dollars net of fees.

Leverage (margin) is not normally used except temporarily or at client request. Derivatives such as options may be used occasionally as a risk reduction measure.

The GIPS standards allow firms to link non-GIPS-compliant performance to their compliant history provided that no non-compliant performance is shown for periods beginning on or after 1 January 2000. Performance for periods prior to 1/1/2000 is not GIPS-compliant, but has been linked to the subsequent GIPS-compliant performance for cumulative periods.

MCA Flexible Growth Portfolios are invested in publically traded companies with the goal of maximizing long-term returns. These portfolios are classified as an all-cap core strategy, but predominately invest in large and mid-cap stocks, blending the characteristics of both growth and value investing. Each portfolio typically invests in 30 to 40 stocks that are rigorously selected to meet our core philosophy of investing in companies with an enduring competitive advantage that offer growth at a reasonable price. These portfolios are for investors who are willing to accept significant short-term volatility in the pursuit of superior long-term returns. The benchmark for this composite is the S&P 500 Index, which is an index of the 500 leading companies in the U.S. and is designed to reflect the risk and return characteristics of the large-cap U.S. equities universe.

MCA Balanced Portfolios are invested in equities and fixed income securities with a target asset allocation of 75% equities and 25% fixed income. These portfolios are for investors with a long-term investment horizon who seek to grow capital, but want to do so with less short-term volatility than the MCA Flexible Growth Portfolios. The equity investments in the portfolios are classified as an all-cap core strategy and are managed in the same way as the MCA Flexible Growth Portfolios. Fixed income investments include both individual and ETF fixed income securities. The benchmark for this composite is a blend of 75% S&P 500 Index and 25% Barclays U.S. Aggregate Bond Index, rebalanced monthly. The S&P 500 is an index of the 500 leading companies in the U.S. and is designed to reflect the risk and return characteristics of the large-cap U.S. equities universe. The Barclays U.S. Aggregate Bond index is made up of the Barclays U.S. Government/Corporate Bond Index, Mortgage-Back Securities Index, and Asset-Backed Securities Index, and only includes securities that are investment grade quality or better, have at least one year to maturity, and have an outstanding par value of at least $100 million.

MCA Conservative Portfolios are invested in equities and fixed income securities with a target asset allocation of 50% equities and 50% fixed income. These portfolios are for investors who prefer to significantly reduce short-term volatility in their investments rather than maximize long-term returns. The equity investments in the portfolios are classified as an all-cap core strategy and are managed in the same way as the MCA Flexible Growth Portfolios. Fixed income investments include both individual and ETF fixed income securities. The benchmark for this composite is a blend of 50% S&P 500 Index and 50% Barclays U.S. Aggregate Bond Index, rebalanced monthly. The S&P 500 is an index of the 500 leading companies in the U.S. and is designed to reflect the risk and return characteristics of the large-cap U.S. equities universe. The Barclays U.S. Aggregate Bond index is made up of the Barclays U.S. Government/Corporate Bond Index, Mortgage-Back Securities Index, and Asset-Backed Securities Index, and only includes securities that are investment grade quality or better, have at least one year to maturity, and have an outstanding par value of at least $100 million.

To receive a list of composite descriptions of MCA and/or a compliant presentation, contact Robert Godines at (210) 694-2100, ext. 2, or robert@martincapital.com.