THE COMPASS

July 2015

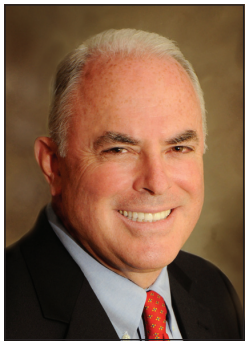
A Quarterly Newsletter of Martin Capital Advisors, LLP

INVESTMENT PERSPECTIVE by Paul Martin, Managing Partner

Stocks Hold on to Small Year-to-Date Gains in Sideways Market

July 23, 2015

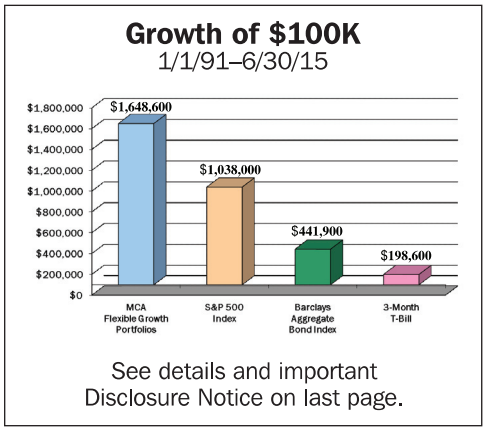
The second quarter saw the S&P 500 maintain the slightly positive sideways performance of the first quarter as large gains at the end of last year continued to be digested. The Barclays Aggregate Bond Index was down a few percent in the last quarter, resulting in a slightly negative year-to-date performance. Oil prices rebounded at the beginning of the second quarter, but have since rolled over and are now down again significantly this year and appear to be in route to break below the lows set in the first quarter. After a counter-trend rally at the beginning of the year, gold has resumed its downward trend and is now down about eight percent year-to-date.



As we enter the third quarter, stocks have managed to move somewhat higher after brushing off concerns about a Greek debt default, a Chinese stock market bubble collapse, another oil price plunge, and a three hour shutdown of the New York Stock Exchange due to a software glitch. Stocks have been resilient in the face of numerous uncertainties because the economy remains on track for sustainable long-term growth and valuations are still attractive relative to interest rates and inflation. At some point, interest rates and inflation will return to historical norms, which will hurt fixed income investments, but stock prices in the past have benefited from the initial stages of reflation, which is driven by above average economic growth that contributes to stronger corporate earnings.

There is a fifty percent chance that the Fed will raise the Fed Funds rate in September. If they do, it should be more of a positive than a negative for the stock market because the raise will be based on improving economic data. Although there may be a knee-jerk selloff, my guess is that there will be a rebound fairly quickly as sentiment shifts from a concern about less monetary stimulus to the expectation of stronger economic growth.

In any event, going back for at least sixty years the economy has always managed to expand until the Fed has raised rates so many times that short rates are higher than long rates, which is called a yield curve inversion. This is the only indicator that I am aware of that has been 100% accurate in predicting recessions. So, even if the Fed begins to regularly raise rates, it probably would take at least a few years for the yield curve to invert, at which point it would make sense to begin taking defensive actions to minimize the impact of an impending recession and consequent bear market. Until then, however, economic expansion should stay on track and the stock market will likely continue to work its way higher.



See details and important Disclosure Notice on last page.

COMPARISON OF INVESTMENT RESULTS

January 1, 1991 to June 30, 2015

	Martin Capital Advisors[1]	S&P 500	Wilshire 5000	Barclays Aggregate Bond Index	3 Month T-Bill	Consumer Price Index
Total[2]	1548.6%	938.0%	1014.4%	341.9%	98.6%	77.7%
Avg.[3]	12.1%	10.0%	10.3%	6.3%	2.8%	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]1991-2015 annualized return.

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

Real annualized gross domestic product contracted at a rate of 0.2% in the first quarter of 2015. Like last year, the decline was largely caused by the harsh winter, but there were also effects from the West Coast port slowdown. Economists expect the contraction to be one-time in nature with estimates for growth in the second quarter hovering most recently around 3.7%. Recent economic data has shown steady strength across multiple sectors, including the labor market, housing, and consumer spending. Even areas of relative weakness, like manufacturing, are showing signs of improvement. **(Figure 1)**

The labor market continues to strengthen, adding 223,000 jobs in June and bringing the first half of the year's job growth total to 1.25 million. The unemployment rate fell from 5.5% to 5.3% in June. The drop is largely attributed to a fall in the labor participation rate, which now is 62.66% – the lowest level since 1977. While job growth has been steady, wage growth has yet to materialize and was flat in June. The lack of wage growth, and subsequent weak inflation, is what is causing the Fed to continue to delay raising interest rates. Additionally, recent job growth has been uneven across sectors of the economy. Due to relatively weak energy prices, and a strong dollar that has hurt exporters, job growth is primarily occurring in industries that rely on the domestic economy, like healthcare and financial services. **(Figure 2)**

After recording several months of weak growth, the ISM Manufacturing Index is beginning to show signs of strength, increasing to 53.5 from 52.8 in May. This is the highest reading since December 2014. The export component of the index remains tepid, but the new orders component is strong, which bodes well for future growth. The U.S. service sector continues to expand at a solid pace. The ISM Non-Manufacturing report registered 56.0% in June, up 0.3% from May. This reading marked the sixty-fifth month of expansion. Once again, the new orders component showed the strongest growth, indicating that the economy is continuing to pick up steam.

The improving labor market and elevated personal savings rates has consumers feeling much more optimistic about the economy. In June, Consumer Confidence jumped to 101.4 from 96.4 in May and the Consumer Sentiment Index increased to 96.1, a five-month high. Initially, the fall in gasoline prices earlier this year did not translate into sales, instead consumers saved, causing the personal savings rate to jump to 5.4% in the first quarter of 2015 from 4.7% in the fourth quarter of 2014. More recently, consumers are beginning to spend. Retail sales surged 1.2% in May, recording their third straight increase.

The housing market has been very strong. Sales of existing homes rose 5.1% in May, increasing at the highest pace in six years. Nearly a third of homebuyers were first-time purchasers. This is an important demographic that has largely been absent from the housing recovery until recently. The demand from first-time buyers remains high and this trend will likely continue to be a tailwind to the housing market. Building permits increased 12% in May to the highest rate since 2007. The rise in permits along with the looming Fed interest rate hike point to a strong summer season for home sales.

Inflationary pressures remain weak, although they are showing nascent signs of rising. In May the consumer price index jumped 0.4%, which was the largest increase since 2013. The cause for the increase was due to a 10.4% rise in gasoline prices. Core inflation, which excludes food and energy costs, rose 0.1%. Year over year, the CPI is flat and core inflation is up 1.7%. Until there is sustained inflation above an annualized rate of 2%, the Fed is unlikely to raise interest rates. **(Figure 3)**

During the quarter, yields on long-term interest rates began to widen after narrowing significantly in the first quarter. In the beginning of the second quarter, the spread between 2-year and 10-year Treasuries was 138 basis points and by the end of the quarter the spread increased to 171 basis points. The steepening of the yield curve is a welcome sign and is reflective of the string of positive economic data observed during the second quarter. Very recently, yields have tightened due to the Greek debt crisis; however, this is likely only a temporary aberration. Yields should resume their upward trend, especially if GDP for the second quarter proves to be above 3%. **(Figure 4)**

As we enter the second half of the year, the economy continues to have significant tailwinds propelling it forward. The labor market has recorded a year of very strong growth and the housing market continues its multi-year upward trend. These two forces create a halo for consumer confidence and consumer spending, which drive GDP growth. There are still pockets of weakness, particularly in wage growth, inflation, and in world economies. However, given continued improvement in the labor market and signs that Europe and Asia are strengthening, these negative headwinds should subside, and the US and world economies should experience a favorable GDP growth trend.

ECONOMIC CHARTS

as of June 30, 2015

Figure 1

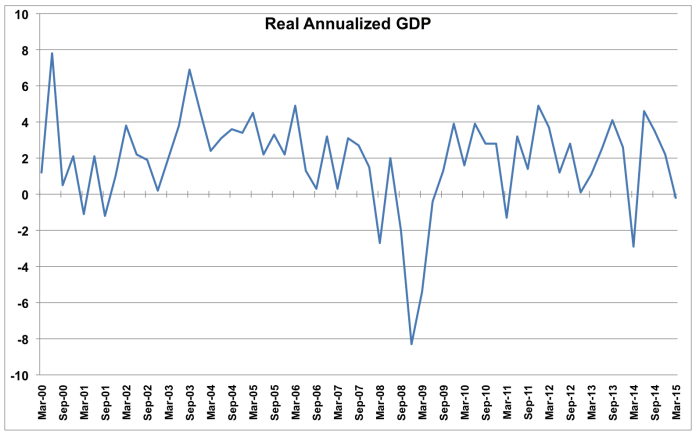


Figure 2

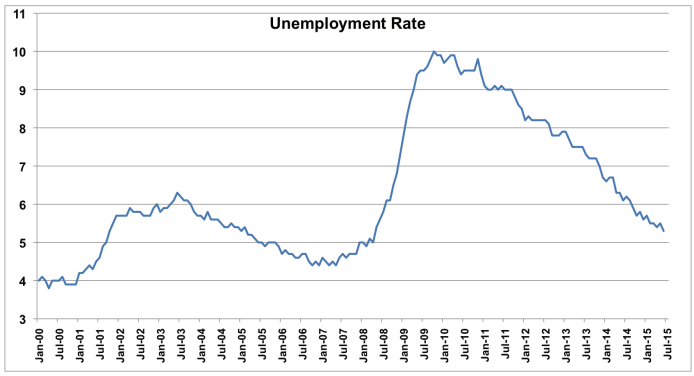


Figure 3

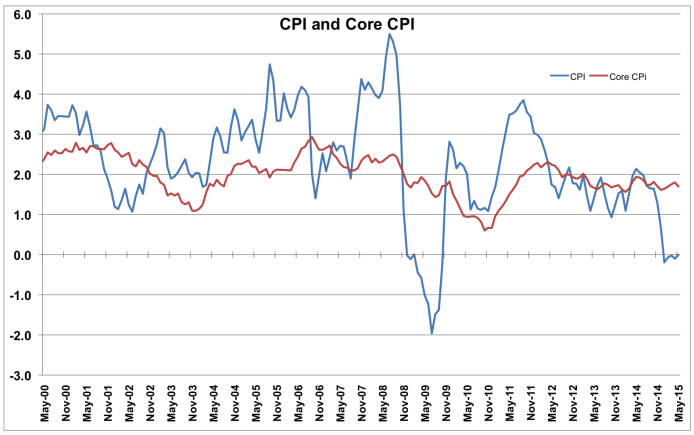
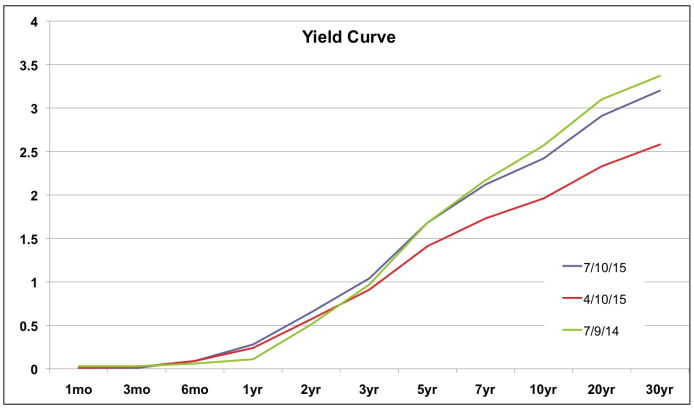


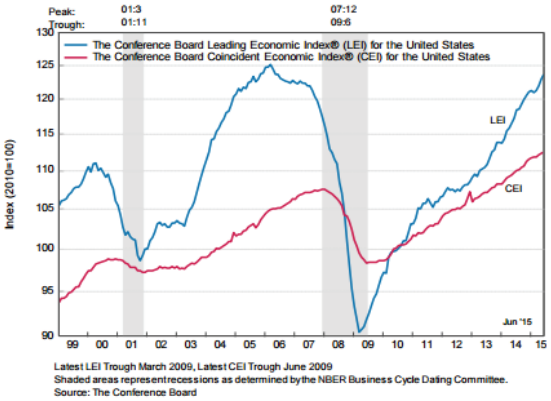
Figure 4



LEADING ECONOMIC INDICATORS

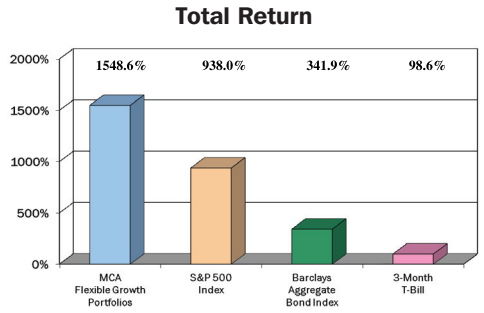
as of June 2015

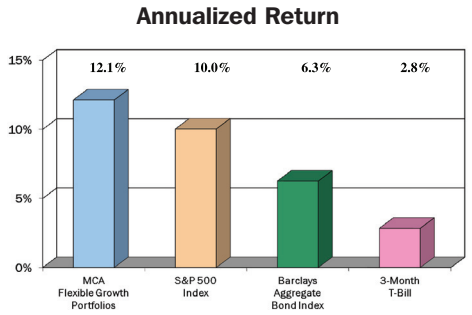
	Current Reading	1-month change	6-month change
Conference Board Leading Economic Index	123.6	+0.6%	+2.2%
S&P 500	2099	-0.5%	+2.2%
Average weekly hours, manufacturing	41.8	unch	-0.3
Initial Jobless Claims	275.0K	unch	-12.7K
Manufacturers' new orders, capital goods ex. aircraft	40.5B	+0.7%	+5.1%
Manufacturers' new orders, consumer goods and materials	135.4B	unch	-0.1%
ISM New Orders	56.0	+0.2	-1.8
Building Permits	1343K	+7.4%	+24.7%
Spread between 10-yr Treasury Note and Federal Funds Rate	2.23	+0.15	+0.14
Avg. Consumer Expectations for Business Conditions	0.57	+0.47	+0.20
Leading Credit Index (negative readings are positive for the LEI)	-0.96	-0.19	+0.34



RELATIVE LONG-TERM PERFORMANCE

January 1, 1991 to June 30, 2015





THE COMPASS

A Quarterly Publication of
MARTIN CAPITAL ADVISORS, LLP

559 E. Huisache Avenue
San Antonio, Texas 78212

100 Congress Avenue, Suite 2000
Austin, Texas 78701

210-694-2100 • 512-477-7036

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

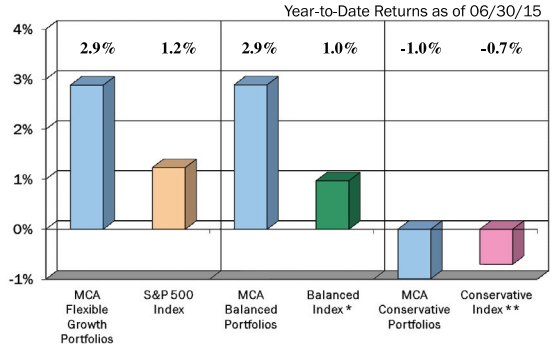
MCA FLEXIBLE GROWTH PORTFOLIOS TOP 20 STOCKS

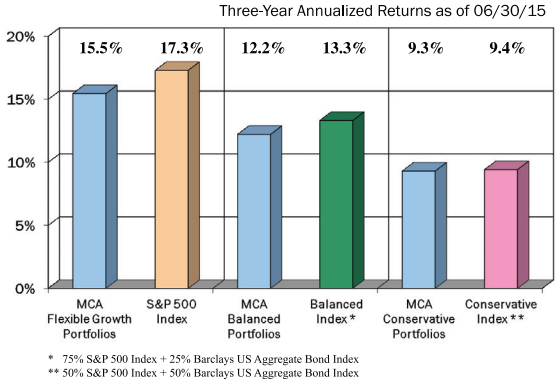
as of June 30, 2015

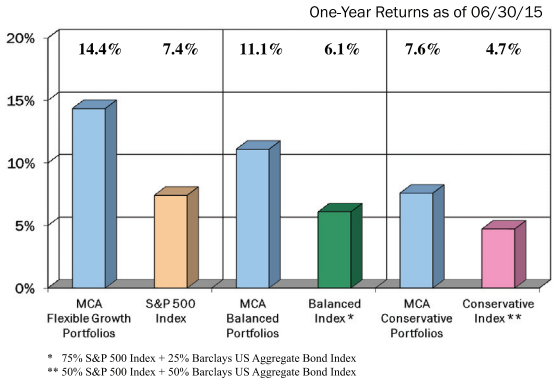
1	Apple	125.43	6	Charles Schwab	32.65	11	Diamond Hill Inv. Group	199.66	16	Blackstone Group	40.87
2	Starbucks	53.62	7	DaVita	79.47	12	Tractor Supply	89.94	17	Visa	67.15
3	Whole Foods Market	39.44	8	Tiffany	91.80	13	Texas Instruments	51.51	18	SanDisk	58.22
4	Williams-Sonoma	82.27	9	Oracle	40.30	14	OmniVision	26.20	19	ARM Holdings	49.27
5	Intuitive Surgical	484.50	10	MasterCard	93.48	15	Sotheby's	45.24	20	IPG Photonics	85.18

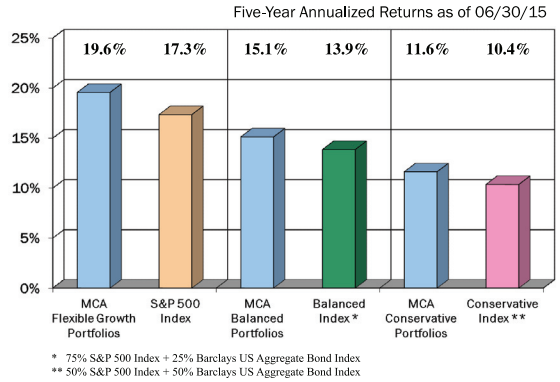
INVESTMENT RESULTS

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 6/30/2015, the MCA Flexible Growth/Balanced/Conservative Portfolios' returns represent, respectively, 38/7/1 individual portfolios and 70%/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. 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 March 31, 2015 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.