

THE COMPASS

January 2017

A Quarterly Newsletter of Martin Capital Advisors, LLP

INVESTMENT PERSPECTIVE by Paul Martin, Managing Partner

Stocks Finish 2016 Near New Highs As Corporate Earnings Rebound

January 23, 2017

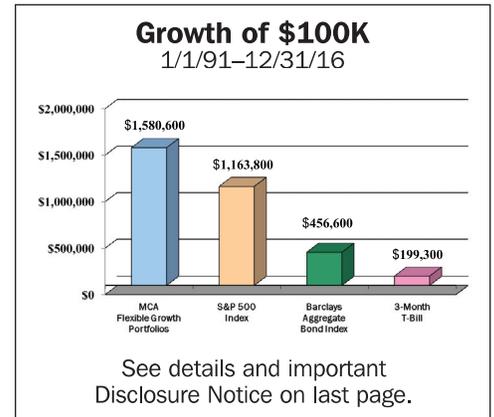
Corporate earnings continued to rebound in the fourth quarter, contributing to further advances in stock prices on the heels of solid third quarter returns. Some of the fourth quarter's positive performance also may be attributed to higher expectations of infrastructure stimulus and corporate tax cuts in 2017, which could result in significant increases in corporate earnings over the next few years. Fixed income returns, as represented by the Barclays Aggregate Bond Index, were negative in response to the same factors that buoyed stocks. In the face of a strengthening U.S. dollar, gold prices declined further from their first half of the year counter-trend rally, but still managed to achieve a



modest gain for 2016. Oil prices continued to stabilize at the end of the year in the \$50 per barrel range as supply and demand balances persisted despite OPEC finally agreeing to production cuts.

Contrary to the stock market correction at the start of the year last year, stock prices have advanced slightly as the first quarter of 2017 has begun. This is in stark contrast to the beginning of 2016, when the S&P 500 had its worst performance for the month of January going back to 2009, which was another time that the S&P 500 saw a reversal to much higher prices by the end of the year. (So much for the January indicator: "As goes the market in January, so goes the market for the year"!)

Fixed income returns are flat so far in 2017 as the markets digest the potential for economic stimulus



and further Fed Funds rate increases this year.

Stock prices are fundamentally based on corporate earnings, which are picking up as we enter the reporting season for 2016 fourth quarter earnings. At this point, the economy appears to be poised for at least moderate growth in 2017 and the potential for higher earnings as the year unfolds. Although the Federal Reserve raised rates in December and may do so again several times in 2017, as long as the Fed remains data dependent, which I think will be the case, then chances are good that stronger earnings and higher stock prices will continue in 2017.

COMPARISON OF INVESTMENT RESULTS

January 1, 1991 to December 31, 2016

	Martin Capital Advisors ¹	S&P 500	Russell 3000	Barclays Aggregate Bond Index	3 Month T-Bill	Consumer Price Index
Total ²	1480.6%	1063.8%	1130.7%	356.6%	99.3%	80.4%
Avg. ³	11.2%	9.9%	10.1%	6.0%	2.7%	2.3%

¹Total performance, net of commissions, fees, and expenses of all Martin Capital Advisors' Flexible Growth Portfolios.

²Total compounded return, including reinvestment of dividends and interest. ³1991-2016 annualized return.

— See Important Disclosure Notice on last page. —

Real annualized gross domestic product expanded at a rate of 3.5% in the third quarter, accelerating dramatically from the 1.2% rate recorded in the first half of 2016. The strong result was caused by continued support from consumers and finally a pick-up in business investment. The strong growth recorded in the third quarter is projected to be short-lived, with GDP estimates for the fourth quarter currently hovering just above 2%. The slowdown was due to some pre-election anxiety, however, the economic data released for December has shown a reacceleration. **(Figure 1)**



The labor market recorded its 75th month of consecutive job gains, adding 156,000 jobs in December and 204,000 jobs in November. Job growth is slowing, but this is to be expected as the economy reaches full employment. The unemployment rate ticked up 0.1% to 4.7% due to an increase in the labor participation rate. As the economy reaches full employment, there should continue to be upward pressure on wages. Average hourly earnings increased 0.4% and are up 2.9% in last year, pacing ahead of inflation. **(Figure 2)**

Despite the continued strengthening of the dollar, manufacturing has turned a corner. After contracting in 2015, the ISM purchasing managers index finished the year at 54.7, its strongest reading since December 2014. This improvement in the second half of the year was due to the stabilization of oil prices, which has encouraged equipment spending, as well as a surge in factory activity aided by an increase in consumer demand. The ISM services index continues to be strong, recording 57.2 in December – the highest level since October 2015.

Consumers continue to be more optimistic about the economy. Consumer confidence rose to 113.7 in December, which was the highest level since 2001. This confidence is continuing to translate into consumer spending. Retail sales in December increased 0.6% and for the year increased 3.3%. Auto sales also were strong in December and posted the highest seasonally adjusted sales rate since July 2005.

The housing market continues its virtuous cycle in which rising prices prompt buyers to act, home prices then rise further, and this then draws in more buyers.

Sales of existing homes increased 0.7% in November to the highest level since 2007. New home sales, which have the biggest effect on the economy, have increased 16.5% over last year. Average home prices are 5.6% higher than a year ago and inventory continues to be scarce.

Inflation is showing signs of firming and finally hovering around the 2% threshold that the Fed targets. The Consumer Price Index increased 0.3% in December and is 2.1% higher compared to a year ago. The Core Index increased 0.2% and is 2.2% higher for the year. The Producer Price Index, which measures the prices U.S. companies receive for their goods and services, increased 0.3% in December and is 1.6% higher than a year ago. **(Figure 3)**

Long-term rates have increased dramatically in the past six months as investors are anticipating higher growth rates for the economy. Since July there has been a little over a 100 basis point increase in the 10-year Treasury rate to where it currently stands at about 2.40%. This has caused the yield curve to steepen, which is a welcome sign, since the curve had been flattening for the previous two and half years. Last quarter the spread between the 10-year and 2-year Treasury rate was less than 100 basis points, and today the spread has increased to 1.20 basis points, despite the Fed increasing short-term rates by a quarter point in December. **(Figure 4)**

After uneven growth in 2016, recent economic data points to an acceleration in the economy in the last month of the year. While consumers and the markets are optimistic, there remain a number of uncertainties regarding both fiscal and monetary policies that could have an impact next year. However, changes in policies aside, what has been steady and entrenched in the economy are gains in the labor market and the strong housing market. These are two powerful forces that can weather exogenous shocks and should continue to bolster the economy into 2017. As we saw towards the end of 2016, companies have finally begun spending, and this should continue into 2017, especially given the some of the initiatives being proposed by the new administration. Altogether, the economy should have tailwinds from both consumer and business spending to achieve higher growth rates in 2017.

Figure 1

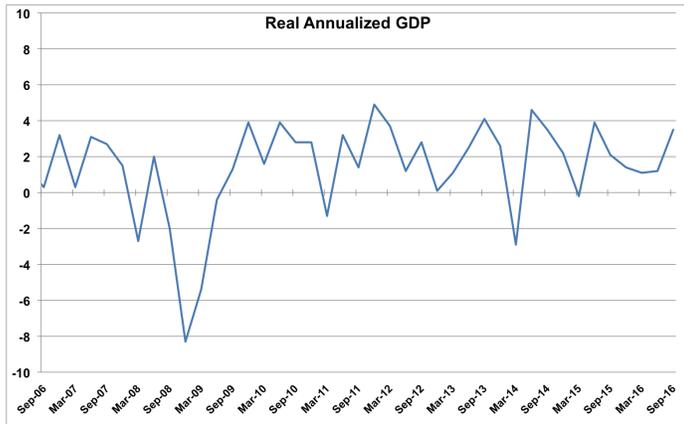


Figure 2

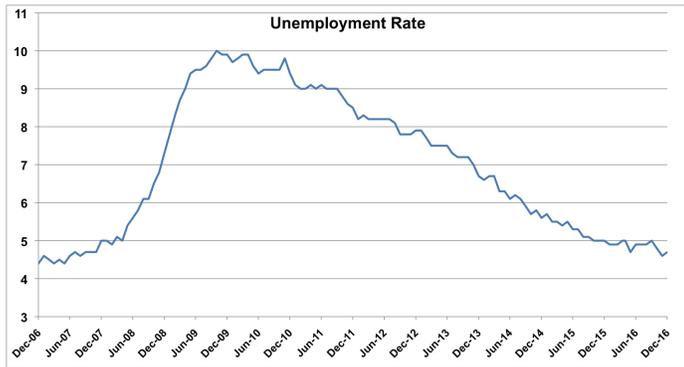


Figure 3

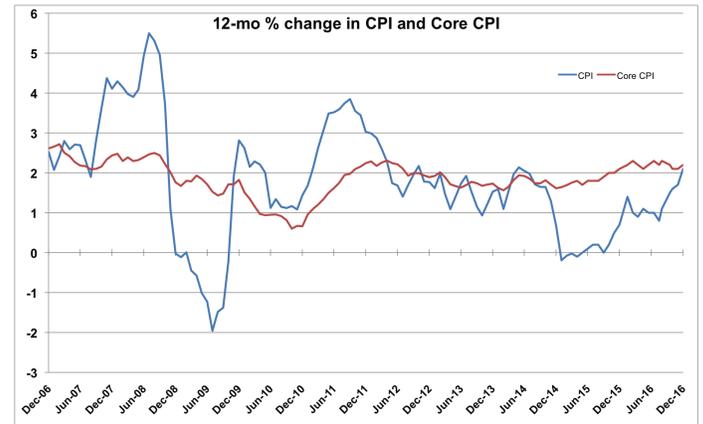
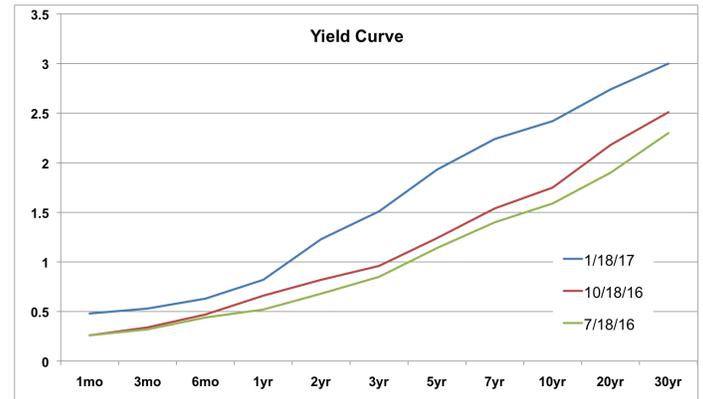


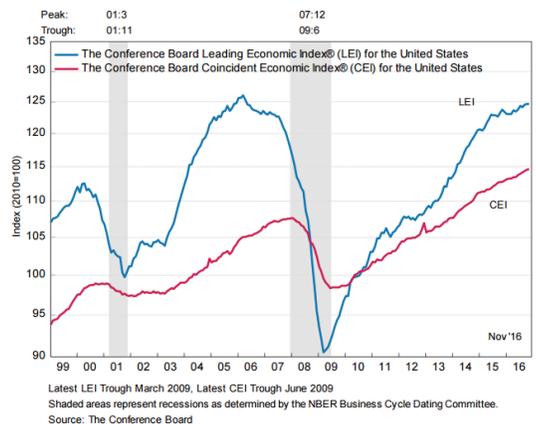
Figure 4



LEADING ECONOMIC INDICATORS

	Current Reading	1-month change	6-month change
Conference Board Leading Economic Index	124.6	Unch	+1.0%
S&P 500	2165	+1.0%	+4.8%
Average weekly hours, manufacturing	41.7	-0.2	-0.1
Initial Jobless Claims	252.5K	-5.7K	-24.4K
Manufacturers' new orders, capital goods ex. aircraft	37.3B	+0.6%	+1.5%
Manufacturers' new orders, consumer goods and materials	138.8B	+0.1%	+0.2%
ISM New Orders	53.0	+0.9	-2.7
Building Permits	1201K	-4.7%	+5.7%
Spread between 10-yr Treasury Note and Federal Funds Rate	1.73	-0.37	-0.29
Avg. Consumer Expectations for Business Conditions	0.11	+0.41	+0.21
Leading Credit Index (negative readings are positive for the LEI)	-0.48	-0.71	-0.30

The Conference Board Leading Economic Index® (LEI) for the U.S. was Unchanged in November



RELATIVE LONG-TERM PERFORMANCE

January 1, 1991 to December 31, 2016



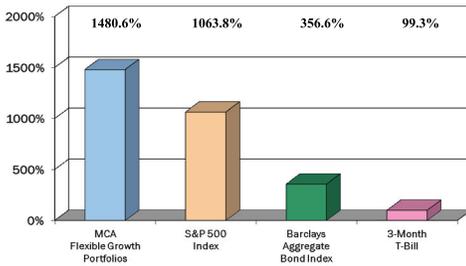
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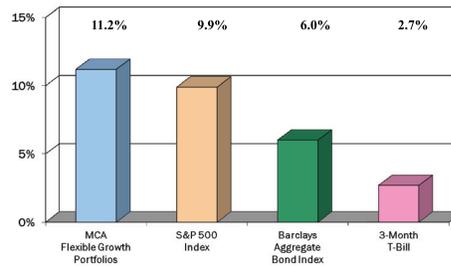
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Martin Capital Advisors, LLP, is a registered investment advisor managing private and institutional investment portfolios.

Total Return



Annualized Return



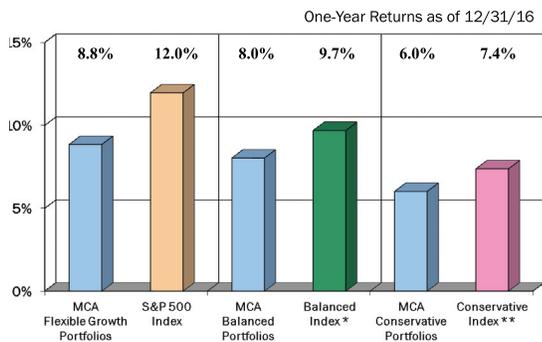
MCA FLEXIBLE GROWTH PORTFOLIOS TOP 20 STOCKS

as of December 31, 2016

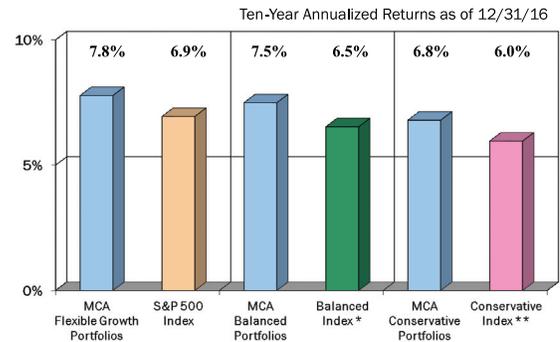
1 Apple	115.82	6 Charles Schwab	39.47	11 Blackrock	380.54	16 IDEXX Laboratories	117.27
2 Starbucks	55.52	7 MasterCard	103.25	12 Tractor Supply	75.81	17 Oracle	38.45
3 Intuitive Surgical	634.17	8 Edwards Lifesciences	93.70	13 Costco Wholesale	160.11	18 Diamond Hill Inv. Group	210.38
4 Whole Foods Market	30.76	9 DaVita	64.20	14 Visa	78.02	19 Toll Brothers	31.00
5 US Physical Therapy	70.20	10 Texas Instruments	72.97	15 IPG Photonics	98.71	20 Williams-Sonoma	48.39

INVESTMENT RESULTS

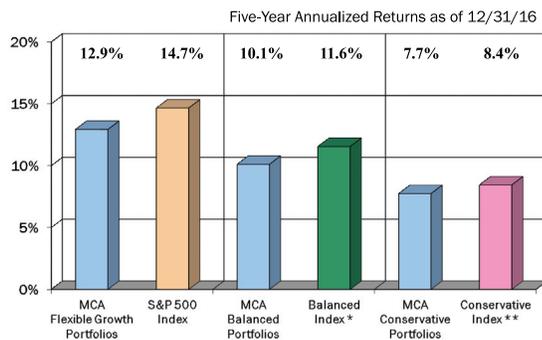
Martin Capital Advisors' Investment Portfolios vs. S&P 500 and Barclays Aggregate Bond Indexes



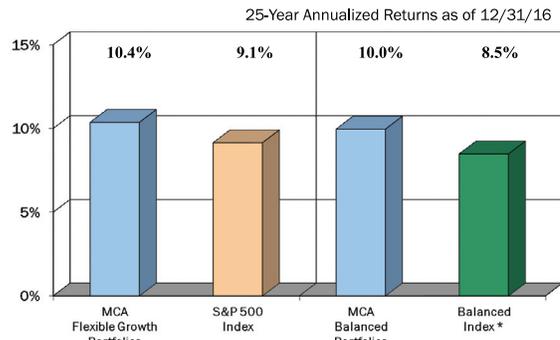
* 75% S&P 500 Index + 25% Barclays US Aggregate Bond Index
** 50% S&P 500 Index + 50% Barclays US Aggregate Bond Index



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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 12/31/2016, the MCA Flexible Growth/Balanced/Conservative portfolios' returns represent, respectively, 36/6/1 individual portfolios and 69%/23%/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). MCA has been independently verified for the periods January 1, 1991 to December 31, 2016 by Dabney Investment Consulting Associates, Inc. The verification reports are available upon request. 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 Paul Martin at (210) 694-2100, ext. 1, or paul@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®).

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.

Martin Capital Advisors, LLP has been independently verified for the periods January 1, 1991 to December 31, 2016 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.

MCA Flexible Growth Portfolios are invested in publicly 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 Paul Martin at (210) 694-2100, ext. 1, or paul@martincapital.com.