NOESIS CAPITAL MANAGEMENT

A REGISTERED INVESTMENT ADVISOR

October 11, 1997

Dear Client:

Except for a minor hiccup, the third quarter was a continuation of the current bull cycle. While blue-chip multinationals, investors' favorites in this prolonged bull market, stumbled in the third quarter, long-ignored small and mid-cap stocks started to show strong momentum. During this past quarter the Dow Jones Industrial Average rose 3.6%, to within 4.7% of its high; the S&P 500 index was ahead 7%, and the small-cap Russell 2000 index soared 14.5%.

As we mentioned in our last quarterly report, we believe that many investment opportunities exist in smaller-capitalization stocks. In today's market, stocks with market capitalizations of $1 billion or less are generally considered small-cap. History has shown that small-caps have outperformed large-caps in the long run, primarily due to higher rates of growth and lower initial institutional ownership. Small-cap stocks, however, have underperformed relative to large-cap stocks by a high margin in the past few years. Although small-cap stocks strongly outperformed large-caps during the second quarter, we continue to believe that many investment opportunities exist in this sector of the market.

At Noesis, we focus on high-return companies with track records of consistent growth and highly predictable future prospects. Based upon this philosophy, our selections very often are market leaders with large capitalizations. In order to take advantage of the high growth potential that small-caps can provide, while at the same time maintaining a moderate level of diversification, we may utilize open or closed-end small-cap funds instead of individual stocks. Remember that investment in small-cap stocks involves higher risk, including high volatility, lower liquidity, and less predictability, and may not be suitable for every investment portfolio. Diversification is a major key to successful investment in stocks with these characteristics.

NEW PURCHASES

Adaptec Inc.

Adaptec is the innovator of SCSI (Small Computer System Interface) technology with approximately an 80% market share. SCSI is used to move data flows among computers and peripherals at higher speeds. This technology becomes critical as demand for servers rises and the usage of multitasking software increases. We believe that Adaptec can sustain a 20% or higher growth rate for the next five years.

Meditrust

Meditrust is the largest healthcare Real Estate Investment Trust (REIT) in the US, specializing in nursing homes and other long-term care facilities, and is nearly twice the size of its closest competitor. Meditrust has excellent access to capital at favorable rates due to its impressive record and the quality of the properties in which it invests. The stock currently has a dividend yield of 7.2%. Dividends have increased consistently, with 44 consecutive quarterly dividend increases since the company was formed in 1985.

1801 Clint Moore Rd., Suite 100, Boca Raton, Florida 33487
561-999-9888 • Fax 561-994-2893 • E-Mail: info@noesis-capital.com
www.noesis-capital.com

Safeway Inc.

With approximately 1,370 stores, Safeway is one of the largest supermarket operations in North America. Safeway is in the midst of a remarkable turnaround, which has shown strong improvement in operations and balance sheets during the past three years. With the benefit of strong management, strategy and execution in food retailing, the company should continue to be a strong performer going forward.

In addition to these three new positions, we increased our holding in Freddie Mac.

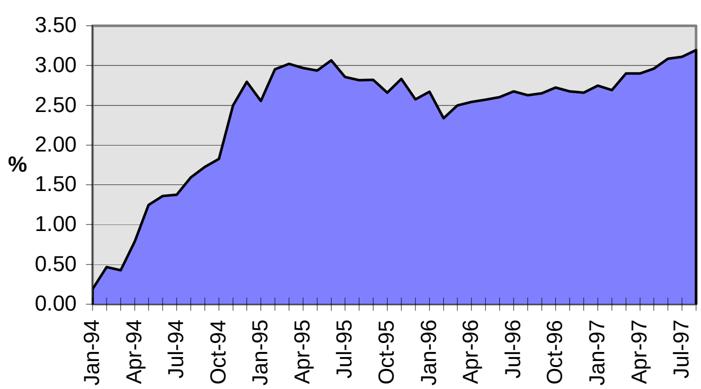
Freddie Mac

Freddie Mac is a shareholder-owned, government-sponsored enterprise established by the U.S. Congress. Its purpose is to provide a continuous flow of funds for residential mortgages to help more Americans achieve the dream of home ownership. As a government-sponsored enterprise, Freddie Mac enjoys favorable interest rates on the U.S. Treasury loans used to finance its purchases. It has been profitable for 25 consecutive years and remains competitively positioned.

OUTLOOK

As widely expected, the Federal Reserve left interest rates unchanged at its September 30th meeting. Based upon declining inflation and slower-than-expected Gross Domestic Product (GDP) growth, we do not foresee any urgency for the Federal Reserve to tighten its current policy. This year's surprising decline in inflation has pushed up real interest rates resulting in de facto tightening (see chart below)--another tightening without the Fed taking any action. With the relatively high real rate in mind, the nominal rate may continue to stay low.

Real Federal Funds Rate



Note: The real federal funds rate is the Fed's short-term rate minus core inflation.

While we remain highly confident about overall Asian long term economic prospects, Southeast Asia may continue to suffer the negative effects of past government policy mistakes and the related currency devaluations for a few more quarters. Since the combined GDP of

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Southeast Asia is only a relatively small portion of the global economy, we do not expect the slowdown to have a material impact outside the region, at least in the short term.

In view of current conditions, we remain optimistic about the U.S. and global economies in general, and feel comfortable overall with the current holdings in our clients' accounts. We do, however, anticipate continued volatility in the market.

After reviewing the enclosed quarterly account statement, we encourage you to contact us with any questions you may have.

Sincerely,

Joseph T. Lai
Vice President - Money Management

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www.noesis-capital.com