

January 10, 1998

Dear Client:

Happy New Year! I am pleased 1997 was another successful year for our clients and Noesis, although certainly one full of challenges. We are enthusiastic going into 1998 and look forward to continued growth together.

### REVIEW OF THE STOCK MARKET

1997 was a prosperous year for investors, at least for those who were not overweighted in the Asian markets. The U.S. has enjoyed strong economic growth, robust corporate profit margin expansion, low inflation, and the lowest interest rates in many years. 1997 was the third consecutive year that overall equity returns in terms of both the S&P 500 and Dow Jones Industrial Average exceeded 20% (see table below), for the first time in history.

	1995	1996	1997
DJIA	33.5%	26.0%	22.6%
SP500	34.1%	20.3%	31.0%
NASDAQ	39.9%	22.7%	21.6%
Russell 2000	26.2%	14.8%	20.5%

Monday, October 27, 1997 was a day most investors will long remember. As stock markets around the world experienced severe sell-offs, triggered by a sudden drop in the Hong Kong market, the DJIA plunged 554 points, or 7.2%, its biggest one-day point-drop ever and the largest in percentage terms since Black Monday 1987. While uncertainty remained, market volatility returned to historical trends, after years of notably below-average volatility.

### U.S. ECONOMY & MARKETS

Thirty-year Treasury bond yields breaking below the 6% level is nearly as notable as a third consecutive year of 20%-plus returns in the equity market. Several factors have driven this strong financial-market performance. First, the economy continued to enjoy moderate growth with decelerating inflation. This is highly unusual considering we are entering the seventh consecutive year of economic expansion. Second, corporate profit growth benefited from profit margin expansion, which mainly was driven by corporate restructuring and significant technological changes. Third, U.S. financial markets have benefited from a flight to quality. While rising volatility in global financial markets occur, the U.S. is viewed as a safe haven and attracts investment flows.

As we mentioned before, the recent economic trends rank among the best in our history. Even more exciting is that these nearly ideal conditions could prove to be sustainable.



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Economic growth has benefited from strong domestic demand. Although it has slowed down a bit, it remains solid. Inflation continues to be low, helped by a strong dollar and rapid improvement in productivity. The strong dollar in relation to weak Asian currencies intensifies the already fierce global competition which limits companies' ability to raise prices. Rapid growth in productivity has held down unit labor costs.

### ASIAN FINANCIAL CRISIS

Asian financial woes started in July when Thailand abandoned its long-time foreign exchange policy of pegging its currency to the U.S. dollar. Currency devaluation, in turn, makes a country's exports cheaper. Thailand's decision forced other competing nations also to devalue in order to remain competitive. This created a domino effect that eventually knocked down the currencies of almost the whole region.

"Three-feet-high ice could not be frozen in one day." The Asian financial crisis occurred as a result of some long-term policy mistakes including, 1) using high debt to grow their economies and 2) adopting stern foreign exchange control policy to peg currencies to the U.S. dollar. To peg to the U.S. dollar, a country must keep interest rates high to attract foreign buying into local currencies. When an economy turns sour, high interest rates plus high debt create a heavy burden. The situation may become worse after devaluation, because paying back in dollars then becomes even more expensive.

### OUTLOOK

The Asian currency crisis is not over yet and will continue to put pressure on global financial markets. However, recent policy developments in the region have generally been in the right direction, which should help restore investors' confidence and stabilize exchange rates. We believe equity prices and currencies are now discounted to such a degree that if Asia stabilizes in the next few months, the outlook for equities could be positive.

On the U.S. side, we believe that the economy will continue to grow, but probably at a slower, more sustainable rate. Rising inflation should not be a concern. Depreciated Asian currencies should result in very low-priced exports to the U.S. While we remain optimistic about the longer term outlook for the U.S. equity markets, we believe short-term uncertainty could continue to affect volatility, which might create investment opportunities.

NEW PURCHASES IN FOURTH QUARTER OF 1997

As a reminder, you may find some or none of these positions in your accounts depending on your cash position, investment suitability, or some other portfolio management techniques implemented by your portfolio manager.

AlliedSignal, Inc.

AlliedSignal is an advanced technology conglomerate engaged in the auto parts, aerospace equipment and chemicals industries. Since 1991, when CEO Lawrence Bossidy took charge of an ailing AlliedSignal, it has been transformed from a cyclical company to a more consistent growth company. The company has since created a strong track record of 23 consecutive quarters of 14%-plus earnings growth. The recent market overreaction to the company falling \$0.01 per share short of the street estimate, in addition to general market volatility, created an attractive buying opportunity.

Citicorp

With assets over \$300 billion, a staff of 90,000, and offices in over 100 countries, Citicorp is one of the largest and best performing companies in the global financial services industry. While shares of Citicorp declined 15% in reaction to the Asian financial crisis, we believe this weakness was overdone. The management is very experienced in operating in Latin America, Asia, and other developing regions, and we believe it has the capability of controlling risks under difficult conditions.

Kimberly-Clark Corp.

Kimberly-Clark is in the midst of a transition from a paper company to a global household products company. This will translate into less volatile earnings growth compared with its past cyclical nature. The company has operations in 35 countries and over 150 products with strong brand names such as Huggies, Kotex, Depend, Kleenex, and Scott. With management's commitment and strong cashflow, Kimberly-Clark could become a consistent growth company and would deserve a much higher valuation.

Xilinx, Inc.

Xilinx is the world's leading supplier of high-end programmable logic devices (PLD), which is a fast growing segment of the semiconductor industry. PLDs are attractive to electronic systems designers because they offer design flexibility and short time-to-market. In our opinion, the decline of the stock due to an inventory correction and the effect of the Asian market uncertainty on the semiconductor industry was overdone. Although some difficulties remain in the near future, the long-term prospect for the industry is positive. With a seasoned management team in place, Xilinx is well positioned to take advantage of the positive long-term outlook.

# NOESIS CAPITAL MANAGEMENT

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In conclusion, I sincerely hope that you are pleased with our management style, services, and performance. Remember, Noesis is a long-term investor. We are looking for long-term relationships and want to make sure we are in a position to achieve your financial goals. Should you have any concerns or comments or any change in your financial situation, please feel free to call your financial advisor or call me directly.

Sincerely,



Joseph T. Lai  
Vice President - Money Management

PS An updated copy of our Form ADV is available upon request.