NOESIS CAPITAL MANAGEMENT

A REGISTERED INVESTMENT ADVISOR

July 15, 2003

Dear Client,

Stock markets around the world enjoyed a robust rebound during the past quarter, as shown by Morgan Stanley EAFE (Europe, Australasia, and the Far East) Index (see table below). The bond markets also enjoyed an above-average gain.

| **Index** | **2nd Quarter** | **Year to Date** |
|---|---|---|
| Dow Jones Industrial Average | 12.43% | 7.72% |
| Standard & Poor's 500 | 14.89% | 10.76% |
| NASDAQ | 21.00% | 21.51% |
| Russell 2000 | 22.99% | 17.04% |
| Morgan Stanley EAFE | 18.10% | 7.67% |
| Merrill Lynch Corporate/Government Bond | 3.39% | 5.02% |

<u>We believe the outlook for the U.S. economy and stock market is encouraging, although we have some concern over the short term. There is, however, a growing consensus regarding the prospects for improvement over at least the next four quarters.</u>

In our opinion, the likelihood of near-term price deflation remains remote, although we have experienced disinflation in recent years. Looking ahead, the prospective inflation rate is likely to be very moderate even with stronger economic conditions. This is due largely to increased global competition from countries with much lower labor costs, technology-led productivity growth, and much greater manufacturing capacity. In addition, increased worldwide supplies of some raw materials can also help control costs.

Consumer spending has been stronger than generally expected in view of conditions in the general economy and the financial markets, in part stimulated by the use of proceeds from mortgage refinancing. Continuation of very accommodative fiscal policy and the stimulus of a tax cut should provide for further upward momentum in the near term, but without causing serious inflationary effects.

Recent events regarding Freddie Mac warrant comment. This past January Freddie Mac announced that its new auditors, Price Waterhouse Coopers, would require a restatement of its earnings for the period 2000-2002 due to improper accounting on certain hedges relating to FASB 133. Interestingly, its prior auditors, Andersen, had previously approved these items. This in turn led to the company replacing its top three executives on June 9th. The company mentioned that its Chief Operating Officer had failed to fully cooperate with an internal audit. The company's new management team hosted a conference call on June 25th, during which time they reiterated that the restatement is accounting in nature, and that economic earnings (defined as creation of equity on a fair value basis) will be largely unchanged.

Although the market reacted strongly to these events, we believe the recent decline likely already discounts most possible negatives. It is our understanding that the accounting changes are attributable to accounting methods, rather than fraud. The company has been conservative in its recognition of earnings over the last few years, as its core earnings power has been very strong due to the favorable interest rate environment. The restatement is expected to increase retained earnings by $1.5 to $4.5 billion. As Freddie Mac plays an important role in he mortgage market, we believe possible changes in government regulation could be restrictive in some ways but not likely to seriously

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damage the outlook. While we will remain cautious until the completion of the restatement, we lean toward believing the company's business model will be unaffected and the outlook should remain strong.

NEW PURCHASES IN SECOND QUARTER OF 2003

~~MBNA(KRB)~~

Headquartered in Wilmington, Delaware, MBNA is the second largest credit card issuer in the U.S. The company has subsidiaries in Canada, the U.K., and Ireland, and recently announced it would launch operations in Spain. MBNA's approach to the business is unique: sell to affinity groups who share common interests. MBNA targets customers who have strong credit history and works hard to retain them.

MBNA has been one of our favorites for years. The company has an excellent long-term track record and has been very consistent. During the first quarter there was a sell-off primarily due to an unexpected addition to loss reserves and higher-than-expected charge-offs. MBNA's loss reserve was increased to cover twelve months as compared to nine months in the past. The increase in charge-offs was mainly due to general economic weakness. We believe these two events created an attractive buying opportunity.

United Parcel Service Inc. (UPS)

UPS is the world's largest package delivery company. Founded in 1907, the company completed its IPO in November 1999. UPS operates over 149,000 delivery vehicles and 500 aircraft to deliver an average of 12.5 million packages daily.

UPS' market share of the U.S. ground parcel market is estimated to be 58%, compared with 28% for the U.S. Postal Service. With 1,700 hubs through out the U.S., UPS is able to serve virtually every business and residence in the country. In addition to its dominant ground delivery market share in the U.S., UPS has aggressively been moving into air express and continues to expand overseas.

We hope everyone has an enjoyable summer.

Sincerely,

Joseph T. Lai, CFA
Chief Portfolio Manager

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