NOESIS CAPITAL MANAGEMENT
A REGISTERED INVESTMENT ADVISOR

October 15, 2004

Dear Client,

The major U.S. stock indices were all lower in the third quarter, reversing small gains in the second quarter, while year-to-date changes were mixed (see table below). On the fixed-income side, although short-term rates have risen steadily during the past eighteen months, longer-term rates have been relatively stable and flat.

Index	**3rd Quarter**	**Year to Date**
Dow Jones Industrial Average	-3.40%	-3.57%
Standard & Poor's 500	-2.30%	+0.24%
NASDAQ Composite	-7.37%	-5.32%
Russell 2000	-3.14%	+2.88%
Morgan Stanley EAFE	-0.75%	+2.27%
Merrill Bond/Preferred/Convertible Composite	+2.57%	+2.73%

Current economic conditions and the outlook for the fourth quarter and 2005 remain consistent with the views we expressed recently in our letter to clients dated August 17, 2004. As we indicated then, it had become evident that the pace of economic activity is unlikely to meet previous consensus expectations, which had proved to be overly ambitious. However, momentum in the economy remains positive with prospects for a moderate rate of sustainable growth continuing through 2005.

Second quarter real GDP growth was 3.3%, an upward revision from the preliminary 2.8% gain. Increases of 3.5% are anticipated for the third and fourth quarters of 2004, resulting in full year growth of 4.3%. Maintaining our cautiously optimistic view of 2005 prospects, we anticipate real GDP growth of 3.0% for the full year, with a slightly smaller gain in the first quarter due to the possible effect of higher winter-heating costs.

Consumer spending advanced at an annual rate of 1.6% in the second quarter, somewhat above our previous expectation. Based on preliminary indications, the third quarter gain may be at an annual rate of about 3.5%. Recent data are actually a very impressive indication of the underlying strength of the economy, or at least a perspective on its potential, when the impact of higher energy prices is factored in. The sharp rise in the price of oil is comparable to a tax increase that siphons off purchasing power and it is encouraging to see how well the economy is absorbing this impediment to growth. It should also be noted that in inflation-adjusted terms, oil prices are not as high as in the early 1980s. Moreover, with the strength of global economies, the current spike is not as dangerous as in the 1970s.

Corporate outlays for capital goods and inventories have been rising, clearly a positive sign, but not at as vigorous a rate as many economists and corporate leaders had anticipated. Similarly, employment statistics are showing only moderate improvement. As discussed before, sluggish job growth is attributable to a significant extent to productivity gains combined with

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intense global competition relating to establishment of offshore facilities and job outsourcing. The job outsourcing trends, which are likely to be more secular than cyclical, compound the normal difficulty of short term economic analysis.

The war in Iraq, concerns about terrorism, other geopolitical risks in the Middle East and Asia, and domestic budget deficits also influence the confidence level. Under these circumstances, the current positive economic data, despite being more moderate than previously anticipated, can be interpreted as a sign of underlying strength, in our opinion.

The consensus S&P 500 operating earnings estimate for 2005 is currently in the $68-$70 per share range, with a P/E multiple of about 16.3 times earnings. By historical standards this valuation is low compared with previous periods of low interest rates and low inflation, and reflects many of the present uncertainties. The average valuation of our core holdings is at a P/E multiple equal to that of the S&P 500, while the average projected growth rate for the next five years is approximately double that of the S&P 500. Accordingly, we remain confident of our holdings and believe they could have significant appreciation potential under more favorable market conditions.

SPECIAL NOTES

During the past quarter, there were some notable events at Noesis. Greg Reynolds has been promoted to a full time assignment in Fixed Income Research, working with Barry Berkeley. We are confident that Greg will be an asset to our Fixed Income Department.

Shihfang Chuang has joined the firm as an Analyst in our Equity Department. Shihfang holds a Master of Science degree in Management of Information Systems from Louisiana State University and a B.A. degree in Economics from National Taiwan University, Taiwan. Shihfang has strong prior work experience in technology and will also serve as Noesis' Director of Information Systems.

Finally, we congratulate both Jason Whitby and Greg Reynolds for passing their CFA examinations. Jason is now a CFA, Pending Charter, and Greg is a CFA, Level III Candidate.

We are always available to discuss your portfolios and look forward to hearing from you if any questions arise.

Sincerely,

Richard M. Brown, CFA
Vice President-Research

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