NOESIS CAPITAL MANAGEMENT

A REGISTERED INVESTMENT ADVISOR

October 15, 2006

Dear Clients:

Entering the final months of the year, we continue to review our near and longer term portfolio strategy with a focus on the prospects for 2007.

The recent and fairly widespread anticipation of a broad economic slowdown appears to have been scaled back to some extent based on stronger than expected data reported in several important sectors. This was clearly described last month by a Federal Reserve official who suggested that inflation would be dampened by a slowing economy and added that "while the housing and auto sectors are economic weak points, the rest of the U.S. economy is doing extremely well." Fed Chairman Ben Bernanke affirmed and expanded on these comments on October 4th, reiterating that "a substantial correction in the housing market will likely shave about a percentage point off growth in the second half of the year from what it would otherwise have been and probably something going into next year as well." While Bernanke remains concerned about inflation, which bears careful monitoring, he did say that the Fed expects inflationary pressure to ease as the economy slows. Based on these remarks from Fed officials, the odds of another rate increase are slim. In recent months, market expectations have increasingly reflected stable or possibly lower interest rates.

Real Gross Domestic Product (GDP) growth weakened to 2.6% in the second quarter versus very rapid first quarter growth of 5.6%. Full year expectations are generally in the area of 3.5%, with consensus forecasts of 2.5% to 3.0% in 2007. In contrast to perceptions of a sluggish economy, second quarter corporate profits grew 16% with consensus expectations for double-digit profit growth through year-end.

Reduced expectations for U.S. economic growth are not a valid reason for a significant cutback in projections for global growth which, in 2007, are expected to decline much more moderately. Furthermore, growth in the Rest of the World (ROW) excluding the U.S. will probably slip less than overall global growth due to strong domestic demand in Europe, Japan and major emerging markets. Significantly, since the U.S. economic softening is primarily the result of the housing slowdown, it has little effect on international trade. Accordingly, there are valid reasons to believe that a decoupling is taking place between U.S. and global economic growth during the current cycle.

As we mentioned in our July 15, 2006 letter to clients, global economic expansion appears to have sustainability. It is fueled largely by the momentum in China, India, Mexico, Brazil and other developing countries. While the actual pace can be subject to fluctuation, sustainability of vigorous growth is unlikely to become an issue.

With this in mind, we are continuing to increase the global orientation of our portfolios. As mentioned in the past, many of our companies, such as Wal-Mart, Citigroup, UPS and others, have very substantial international exposure and this trend will no doubt continue.

As discussed last quarter, we were interested in adding another major international banking company, in addition to our Citigroup position, to broaden our participation in global trade. Last month we purchased HSBC Holdings PLC (Hong Kong and Shanghai Banking Corporation), which is one of the largest banking and financial services organizations in the world. HSBC has a strong worldwide presence and has a leading position among international banks operating in mainland China, where it is currently pursuing an aggressive expansion program.

In order to more fully participate in the rapidly expanding global shipping business, as an addition to UPS, we mentioned last quarter that we were interested in finding a suitable publicly traded operator of containerships since the bulk of international cargo traffic travels by sea. While we were able to identify a number of large publicly owned companies in this line of business, we became aware of an unexpected problem. Evidently, the strong growth in cargo volume triggered substantial increases in the number of containerships in operation. This created industry overcapacity, resulting in serious downward pressure on rates and severely depressed earnings. We will continue to watch and perhaps there will be an attractive buying opportunity during some future cycle.

Meanwhile, there are a number of large, far less cyclical companies with impressive operating records in businesses closely related to shipping. We are actively looking for other investment vehicles that could enable us to participate in this rapidly growing aspect of global trade.

Harman International is another recent portfolio addition that fits in with our international theme. Harman is a worldwide leader in the manufacture of premium quality audio and infotainment/navigational systems that are widely used in luxury automobiles. Major customers for these products are Mercedes, BMW and Audi, which account for 43% of Harman's sales.

Noesis continues to broaden its horizons geographically because, as we have mentioned in the past, it is becoming increasingly apparent that the dynamics of globalization are generating a growing number of appealing investment opportunities throughout the world. It is important to note that our interest in domestic companies is undiminished and that we expect them to remain dominant in the portfolios we manage. Moreover, our investment policy and quality standards remain the same whether the companies are foreign or domestic.

During the third quarter we saw continuing improvement in the performance of many of the largest and most respected blue-chip stocks with strong earnings trends and which are heavily represented in our Model Portfolio. Over the past two years, many of these stocks had been outperformed by segments such as small caps, emerging markets and cyclical stocks despite the fact that they were selling at valuations well below their peak P/E ratios. This pattern has reversed in recent months, with the performance of large cap stocks improving steadily, while other market sectors, particularly commodity oriented and energy stock, have continued to weaken. In view of their relatively reasonable valuations, combined with a favorable economic outlook, it appears that this trend should continue. While we were confident that this turnaround would occur, we are pleased that our investment discipline and patience are once again starting to show results.

NEW PURCHASES IN THIRD QUARTER OF 2006

HSBC Holdings (HBC)

HSBC, headquartered in London, was founded in Hong Kong in 1865 and, not surprisingly, has a dominant position among international banks in mainland China. Through acquisitions in Europe and the Americas, HSBC has become a geographically well diversified company, generating roughly a third of its profits from each of its Asia-Pacific, European and North American operations. HSBC also has a substantial presence in emerging markets, such as Mexico, Middle East, Brazil and India. HSBC's aggressive ramp-up of its investment banking division is nearing completion. As a result, HSBC is showing its strongest operational performance since the 1997/98 Asian financial crisis with accelerating revenue and operating profit growth trends.

Harman International (HAR)

Harman, based in Washington, DC, is a world-leading manufacturer of high-fidelity audio and integrated infotainment systems for automotive (70% of FY '05 sales), consumer (14%) and professional (16%) use. Its well recognized brand names include JBL, Infinity, Harman Kardon, Mark Levinson, and AKG. As a dominant supplier, Harman has a strong $13 billion backlog of infotainment offerings through fiscal 2013, which provides high visibility of earnings and growth prospect. Additionally, Harmon's consumer segment could be the next fastest growing business as it continues to benefit from selling peripheral accessories for MP3-players/iPods, as well as the emergence of music-enabled mobile phones.

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FIXED-INCOME UPDATE

At the end of the third quarter, the annualized yield of the 3-month Treasury Bill was 4.88% vs. 4.63% for the 10-year Treasury Note. The net effect is an inverted yield curve which, historically, suggests a slow down in future economic growth, usually leading to a recessionary environment. However, this current inversion is likely influenced by substantial purchases of Treasury bonds by foreign investors and central banks. Consequently, the growth rate of the economy is slowing, but we do not expect the slow-down to be of the same degree following yield curve inversions in the past.

The Fed has stated that the growth rate of core inflation is above their comfort level. Even though the Fed has forecasted it to slow over the coming quarters, they have noted that the largest risk to this forecast is for inflation to remain too high. The forward interest rate markets have priced in federal funds rate cuts starting in the spring of 2007. So the bond market believes that inflation will come down as the Fed's forecast suggests.

Given the current state of the fixed income market, we are particularly sensitive to reinvestment risk. While many investors perceive short-term CDs to be very attractive in the current environment, we believe that over-concentration increases reinvestment risk. Instead, we are using a strategy for our income portfolios that keeps our maturities laddered using a broad range of different income securities. For example, we may use income securities that are more/less sensitive to interest rate risk, or securities that are more/less sensitive to credit or equity risk. Using this strategy, in addition to focusing on good trade execution, has helped us achieve good overall returns for our income clients.

As we move into the last quarter of the year, we encourage our clients to communicate with us regarding any year-end planning and, as always, we are available to discuss your portfolio.

Sincerely,

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Our most recent Form ADV, Part II is available upon request

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