NOESIS CAPITAL MANAGEMENT

A REGISTERED INVESTMENT ADVISOR

January 15, 2007

Dear Clients:

Looking at 2006 in retrospect, it is clear that the bulls were right; the economy slowed but made a soft landing, interest rates remained relatively low, inflation remains moderate and both corporate profits and equity markets are strong.

Despite the soft housing market and the severe contractions of American auto manufacturers, most other sectors of the U.S. economy appear to be experiencing healthy growth. Moreover, global economic activity remains strong, evidently not significantly impaired by the moderating growth in the U.S., which primarily has resulted from a weakness in homebuilding, principally a domestic industry.

The strength in the U.S. equity markets that began in mid-2006 continued throughout the year with only minor interruptions. Large-cap growth stocks, which underperformed over the past few years, have now been among the market leaders. Since this asset class is heavily represented in most of our clients' portfolios, we are very pleased with the strong results since last July.

Will this all continue in 2007, and to what degree, remains to be seen. As always, there are some uncertainties in the near term outlook but we believe that most of the indicators are encouraging and the environment for equities should be favorable this year.

Real GDP growth decelerated to about a 2% rate in 2006, due mainly to softness in the housing and auto industries, which represent about 9% of total real GDP. The remaining 91% of the economy grew by more than 4% last year, an acceleration from 3.2% in 2005. Continuation of growth at about a 2% rate appears likely for the first half of 2007, barring a pickup in housing, and current data suggests that weakness in this area may be bottoming out. A recent *Wall Street Journal* semiannual survey of 60 economists provided an optimistic view of 2007, with real GDP growth of 2.3% in the first half and 2.8% in the second half.

Recent increases in new home sales and firmness in mortgage applications are indications that the housing softness may be nearly over, reducing the risk of broader damage to the economy. According to the Mortgage Bankers Association, the four-week moving average for its purchase index rose 12% since August. Also, the Commerce Department reported on December 27th that new home sales rose 3.4% in November and, while down over 15% from a year earlier, they have been up since July and have held fairly steady in recent months.

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

The fourth quarter of 2006 was the 13th consecutive quarter of double-digit profit growth for the S&P 500 companies, a post-World War II record. Adjusted for inflation, total U.S. corporate profits since 2000 have grown at a 7% annual rate. This has been the most rapid growth in any decade since WWII and is well above the 5.3% rate achieved in the 1990s, which had been considered outstanding. Similarly, other G-7 countries including Japan, Germany and the United Kingdom are also experiencing strong profit growth as are less developed countries such as China, India, Mexico and Indonesia. We believe inflation-adjusted profit growth well above the current sub-5% long term bond yields strongly illustrates the favorable outlook for the equity markets.

The impressive performance of U.S. corporations in recent years resulted from factors that may well continue to stimulate strong growth in the future. Rising revenue stems from solid growth in domestic demand, greatly enhanced by interaction with strong expansion of global economies. Many developing countries are expanding dramatically but are still at early stages in relation to their long term potential. Therefore, the impact of their internal consumption growth on both their domestic economies and global trade could be a very strong stimulant for many years to come, notwithstanding the possibility of cyclical interruptions. Combined with this favorable outlook for revenue growth, it is important to note that companies are not relaxing the intense focus on cost control that became so evident in the1990s and this is a very good omen for profit growth.

Much has been written about the world being "awash in cash" and the positive effect this has had on equity markets and merger activity, as well as boosting the prices of lower grade domestic and foreign bonds. This rise in liquidity to a large extent results from the monetary policies of central banks which, in the past, mainly reflected the Federal Reserve, the Bank of Japan and the European Central Bank. However, the Peoples' Bank of China and other Asian central banks now contribute to this abundance of cash. In addition, large cash reserves in oil producing countries add to worldwide liquidity. According to the *Wall Street Journal*, "even the most pessimistic economists and central bankers see little sign that the liquidity boom will end anytime soon barring a major shock to the system."

Our research analysts have identified and analyzed a number of domestic and foreign companies that meet most of our criteria and have the potential for becoming attractive additions to our clients' portfolios. A drawback, however, is that the current market has taken them to price levels inconsistent with our valuation standards. We will continue to closely monitor these companies and will be able to act quickly if market fluctuations bring them down to more attractive price levels.

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

NEW PURCHASES IN THIRD QUARTER OF 2006

We recently added to our position of iShares MSCI Japan Index Fund (EWJ). We initially purchased a half position of EWJ due to short term concerns about the Japanese market at the time, with the NIKKEI 225 having risen 40% in 2005. Although the fundamentals are gaining momentum, the NIKKEI 225 Index significantly underperformed most global markets in 2006. In contrast, domestic demand is picking up in Japan for the first time in fifteen years without much help from government spending. The economy is strong with continued strength in employment, corporate profits and business confidence. Accordingly, we have become increasingly optimistic about Japan since our initial purchase.

FIXED-INCOME UPDATE

During 2006, short term interest rates, measured by the 3-month Treasury Bill, went from 4.08% to 5.02% and long term interest rates, measured by the 10-year Treasury Note, went from 4.39% to 4.71%. The Federal Reserve stopped raising the federal funds rate in June but has kept an "inflation risk" bias since May. In their opinion, core inflation measures are still above "price stability" levels. They stopped raising interest rates because they are forecasting inflation to move lower. In addition, they are forecasting GDP growth to move lower, but not substantially so.

Because short term rates moved higher than long term rates during the year, the yield curve is inverted by 31 basis points. As we have noted in the past, the inversion is in part due to an unusually strong demand for U.S. fixed income securities by foreign investors and central banks. The forward interest rate markets have priced in a federal funds rate cut by June of 2007. We may see interest rate cuts in 2007 but it would seem unlikely to see a large bond rally unless the economy suddenly enters a recession, which we believe to be unlikely. Consequently, finding acceptable yields to maturity without excessive reinvestment risk is a challenge. We are focused on doing specific credit and duration research in order to find income securities with the best risk adjusted returns. For example, we recently purchased an attractive preferred stock issued by an insurance company that has a fixed coupon of 7.4% until 2017, at which time, the coupon will float above 3-month Libor by 328 basis points. So if interest rates rise in the coming years, causing prices of many fixed income securities to slide, the price of this security should not decline as much because the cash flows will eventually float above the market rate and adjust quarterly.

Finally, we thank our clients for their continued loyalty during the past year and appreciate the many referrals that have been made. We wish everyone a happy, healthy and prosperous 2007 and, as always, we are always available to discuss your portfolio in detail.

Sincerely,

Richard M. Brown, CFA
Chief Investment Strategist

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

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